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TRADE POLICY REVIEW

Report by

MALDIVES

Pursuant to the Agreement Establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), the policy statement by the Maldives is attached.

Note: This report is subject to restricted circulation and press embargo until the end of the first session of the meeting of the Trade Policy Review Body on the Maldives.

CONTENTS

	<i>Page</i>
I. INTRODUCTION	5
II. OVERVIEW OF THE ECONOMY	7
(1) PRODUCTION, PRICES AND EMPLOYMENT	7
(2) PUBLIC FINANCE/FISCAL POLICY	7
(3) FINANCIAL SECTOR AND MONETARY DEVELOPMENT	11
(4) BALANCE OF PAYMENTS AND EXTERNAL SECTOR	13
III. TRADE POLICY AND PERFORMANCE	14
(1) TRADE POLICY OBJECTIVES AND FRAMEWORK	14
(2) LAW ON EXPORT AND IMPORT AND LAW ON PROHIBITED IMPORTS	15
(3) CUSTOMS VALUATION	16
(4) SANITARY AND PHYTOSANITARY (SPS) MEASURES	16
(5) ENVIRONMENTAL MEASURES	17
(6) SERVICES	17
(7) TRADE RELATED INTELLECTUAL PROPERTY RIGHTS	18
(8) BILATERAL TRADE ARRANGEMENTS	18
(9) REGIONAL TRADE AGREEMENTS	19
(10) EXTERNAL TRADE PERFORMANCE	20
IV. INDUSTRIAL DEVELOPMENT AND DIVERSIFICATION	22
(1) INDUSTRIAL DEVELOPMENT	22
(2) MEASURES FOR INDUSTRIAL DEVELOPMENT	23
(3) INDUSTRY DIVERSIFICATION	23
V. FOREIGN DIRECT INVESTMENT AND PRIVATISATION	24
(1) PRIVATIZATION AND PUBLIC PRIVATE PARTNERSHIP	27
(2) INCREASING FLOWS OF FOREIGN DIRECT INVESTMENT	27
(3) PROVIDING INVESTMENTS OPPORTUNITIES TO SMEs	27
VI. GRADUATION	28
(1) GRADUATION OF THE MALDIVES FROM LDC STATUS	28
(2) TRADE IMPACT OF LDC GRADUATION	29
(3) IMPLICATIONS FOR TRADE RELATED TECHNICAL AND FINANCIAL ASSISTANCE	29
(4) ACTIONS TOWARDS ACHIEVING A SMOOTH TRANSITION	29
(5) CONTINUED ACCESS FOR TRADE RELATED TECHNICAL AND FINANCIAL ASSISTANCE	30
(6) FUTURE OUTLOOK	30

I. INTRODUCTION

1. Maldives has experienced uninterrupted economic growth along with political stability and social harmony for the last three decades. Since gaining independence from Britain after 78 years as a protectorate, the country has continued on a path of development and building self-confidence in many aspects of economic and social development.

2. Over the last six years since its first trade policy review in 2003, Maldives has continued to achieve excellent levels of economic development relative to its neighbours, despite the devastating tsunami of 26th December 2004. It has pursued these developments within the context of a liberalized economy with much improved and transparent trade policies.

3. In June 2004 the former government announced a political reform programme, instituting a new process of reform and modernisation of democratic institutions, with the introduction of the "Roadmap for Reform". This reform agenda envisaged fully-functional democratic governance and fuller participation of the people in national development. The most distinct elements of the reform programme included the amendment of the Constitution, allowing the formation of political parties for the first time in the country's history, accession to international human rights treaties and the tabling of a modern penal code in line with international legal norms, as well as the establishment of independent institutions vital for ensuring good governance and accountability.

4. With the introduction of these changes the country has emerged strong and with more than 12 registered political parties, which provided the citizens with a robust democratic arena to express their aspirations and at the same time made it possible to build political consensus on issues of national significance. The international community welcomed the institution-building efforts of the government, and provided sustained support to these efforts.

5. The presidential election in October 2008 ushered in a new era of participative democracy and the first democratic, multiparty presidential election in the history of the Maldives. This election also brought to an end a regime which had been in power for 30-years. A new President was elected by majority of Maldivians with a strong mandate to continue the process of governance reform, while preserving, protecting and promoting the national character of Maldives in the great task of development and modernization. The first pluralist, multiparty Parliamentary election was held on 9th May 2009, with a total of 455 candidates completing for 77 seats in the new Majlis.

6. This nascent democracy requires a broad-based government policy and strong engagement from the international community to support the pro-democracy efforts of Maldivians. In addition, continued support from the international community to address the income inequality between Male' and atoll is needed.

7. The Asian tsunami of 26 December 2004, which had a devastating impact on the socio-economic environment, was another major event that took place during the review period. This event suddenly disrupted the steady growth of the economy, bringing tourism, the most dynamic industry of the country, to a halt while badly damaging physical and social infrastructure. The losses from the disaster account over US\$470 million or 62% of Gross Domestic Product (GDP).¹ However, the losses would be much higher if costs such as environment costs and the value of the top-soil and reclaimed land that was washed away by the tidal wave, are included.

8. Although loss of life was limited, the tsunami virtually eliminated 14 inhabited islands, and more than 15,000 people became homeless. Immediately after the tsunami Maldivians, especially

¹ A Joint Need Assessment carried out early in 2005 by the World Bank, ADB and UN.

those in island communities, experienced serious psychological stress, health threats, and loss of property as well as threats to their livelihoods.

9. At the same time the tsunami severely damaged the mainstays of the economy, namely the tourism and fisheries sectors, by causing the closure of a quarter of the resorts and almost completely destroying 8% of fishing vessels. Even six months after the devastation, the resorts were running at half the rate of 2004 and employees working in these resorts were badly affected through reductions in their net income.² Damages to equipment for traditional fish processes reduced the output in this sector in the year 2005.

10. Government made swift efforts of providing temporary accommodation to those internally displaced persons (IDP) as the first and most immediate concern after the tsunami. And as early as February 2005, the international community such as International Federation of Red Cross and Red Crescent Societies (IFRC) agreed to help the Government meet demand by financing the construction of additional temporary shelter.

11. As agreed 855 temporary apartments and 396 individual rooms and relief to the IDP in twenty two islands in eight atolls were delivered and completed by end of 2006.³ Provision of temporary or upgraded schools, health posts, sports grounds, community health centres and safe-play areas in displacement locations and community projects are also part of the assistance programs which are been regarded as important aspect of livelihoods recovery for people of different communities to live together peacefully.

12. The National Recovery and Reconstruction Plan (NRRP) outlines the objectives and strategies for meeting urgent needs in housing and infrastructure development, reviving livelihoods, and creating the conditions for sustained economic recovery. The plan contains projects and programs proposed by different sectors to restore key industries and provide social and economic services and facilities⁴.

13. Four years since the tsunami, the country made considerable progress in rebuilding the country especially in the economic sector recovery. All the tsunami affected resorts are open again for business, most of the homes are being rebuilt and livelihoods restarted. However, the recovery process remains under funded in certain key sectors such as transport, housing, livelihood, power and energy and the recovery program still requires considerable sum of external funds to bridge the funding gap.⁵

14. The country experienced mixed economic effects. Islands which acted as hosts and received people who were displaced saw substantial rises in income through increases in their economic activity, while the people who were forced to move to these islands suffered economic losses. The main business hub of the country, the capital city Male', experienced a fall in trade as well as disturbances in the property markets.

15. The United Nations Millennium Declaration in 2000 set 2015 as the target date to achieve the eight goals. In 2007, an assessment was made in order to tracks the progress of Maldives on

² Monthly salary, service charges and tips.

³ Report – "The Maldives: Two years after the tsunami" by the Department of National Planning (formerly known as Ministry of Planning & National Development).

⁴ Report: *National Recovery and Reconstruction Plan: Programs and Project, 2005. Ministry of Planning and National Development.*

⁵ Report: *National Recovery and Reconstruction Plan: Programs and Project, 2005. Ministry of Planning and National Development.*

13 Millennium Development Goal (MDG) targets and assess whether the Maldives will achieve the targets by 2015 using the latest data from 2006 Census. Based on this assessment, rapid progress was made on poverty, education and health targets. Significant improvement is seen on empowerment of women as well. However, considerable efforts are needed to achieve nutrition and environmental targets.

II. OVERVIEW OF THE ECONOMY

(1) PRODUCTION, PRICES AND EMPLOYMENT

16. Maldives has achieved robust growth during the period under review. Both per capita income and per capita GDP have risen substantially, accompanied by a marked improvement in social indicators during this period. Real GDP grew at an average rate of more than 7% for the review period, stimulated by a strong rebound of the tourism sector following the Asian tsunami and the boom in construction industry. But with the current global turmoil, the economy is expected to grow at a modest rate of around 1.3%.

17. The absence of land based mineral resources, the limited scope for expansion of the agriculture sector, vulnerability to natural disasters and dispersed population have all contributed to the country's continued reliance on the tourism and fisheries sectors. They are also the major sources of foreign earnings, accounting for 31% of the GDP at the end of 2008. The construction and real estate sectors have become one of the most dynamic sectors in the economy, contributing to a considerable extent to the sustained high growth rate of the economy during the review period. At the end of 2008, these sectors taken together contributed 12% to GDP.

18. As Maldives is a highly open economy, domestic price movements are very much influenced by price developments in the international market. Price movements in the domestic economy during 2008 were largely influenced by soaring global food and oil prices coupled with high domestic fish prices, which reached peak levels during the first half of the year. However, it should be noted that the direct impact on the domestic consumer price index (CPI) of high oil prices, which rose to a record high in July 2008, remained limited, given that oil-related products such as petrol account for a relatively small share in the CPI basket, and also that the administered price of local electricity tariffs remained unchanged throughout.

19. Another major factor, perhaps, the most significant factor, which contributed to higher inflation, was the rise in demand for goods and services due to the increase in money supply. This increase is due to the monetization of the government budget deficit via the Central Bank (the Maldives Monetary Authority - MMA). At the end of 2008, inflation in the economy was recorded at 12.3%, approximately a 20% increase compared to 2006.

(2) PUBLIC FINANCE/FISCAL POLICY

20. Government involvement in the commercial activities is still strong, with around 20 state-owned enterprises (SOEs) dominating the delivery of a wide variety of services and goods. Most of these enterprises operate on the basis of monopoly concessions granted by the regulatory and policy ministries.

21. The new government, sworn in on 11th November 2008, is committed to reduce government involvement in commercial activities. It has already listed some of these SOEs for privatization. Maldives Airports Company Ltd is first of many such businesses that are going to be privatized under the new government policy. The main reasons for this policy change are to increase efficiency,

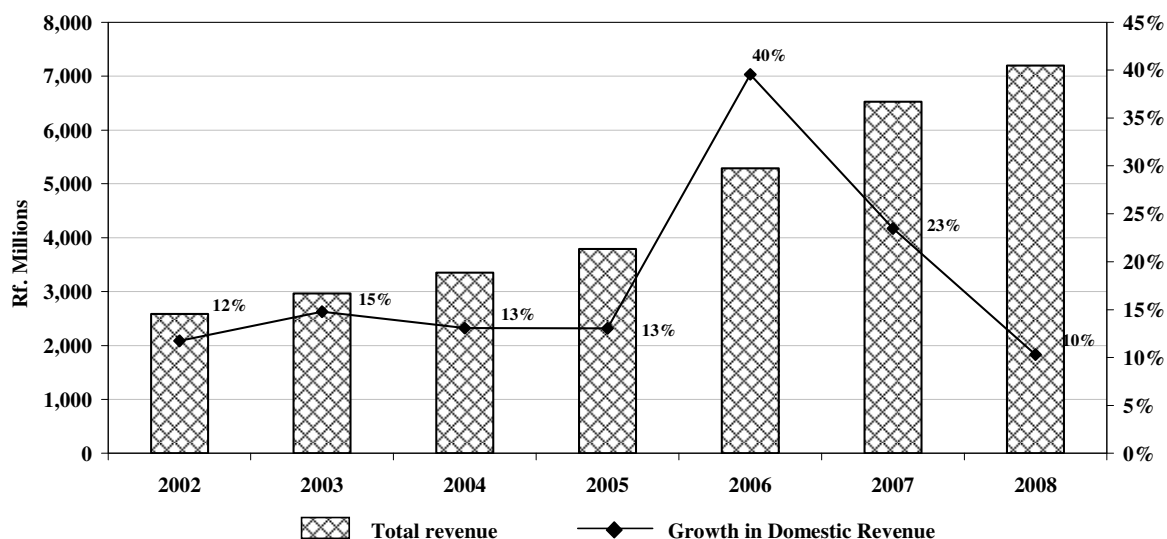
transparency and accountability of the enterprises, and also to create and distribute wealth among the people of the country on a more even basis.

22. The government's fiscal policy aims to reduce the level of government expenditure, while increasing revenues through sustainable measures, and thereby to reduce the large deficits that have accrued over past years. The budget for the year 2009 had to be presented to Parliament by the end of November 2008, leaving the new government without enough time to re-evaluate the budget in terms of its new priorities. The budget was therefore presented to Parliament as it stood with only minor changes, and with the request that the government be allowed to submit a new revised budget, based on a medium term fiscal framework (MTFF) within three months. The new budget for 2009 was presented to the Parliament in early April 2009, and was passed just before the Parliamentary Election in May 2009.

23. Domestic revenue growth for the period 2003 to 2005 was on average 12%. However revenues increased by 40% in 2006, largely due to ad-hoc measures such as advance lease rent payments on the islands which were leased in 2006 for development of new resorts. Growth in 2007 was again fuelled by such advance payments, as well as by increased import duty receipts resulting from higher imports of building materials due to the boom in construction, especially in the tourism sector.

24. Growth in domestic revenues declined in 2008, as the advance lease rent payments levelled off. For 2009, according to the initial budget that was passed, revenues are estimated to decline by 9% for the year.

Figure II.1: Domestic Revenue, and Growth in Domestic Revenue, 2002-2008

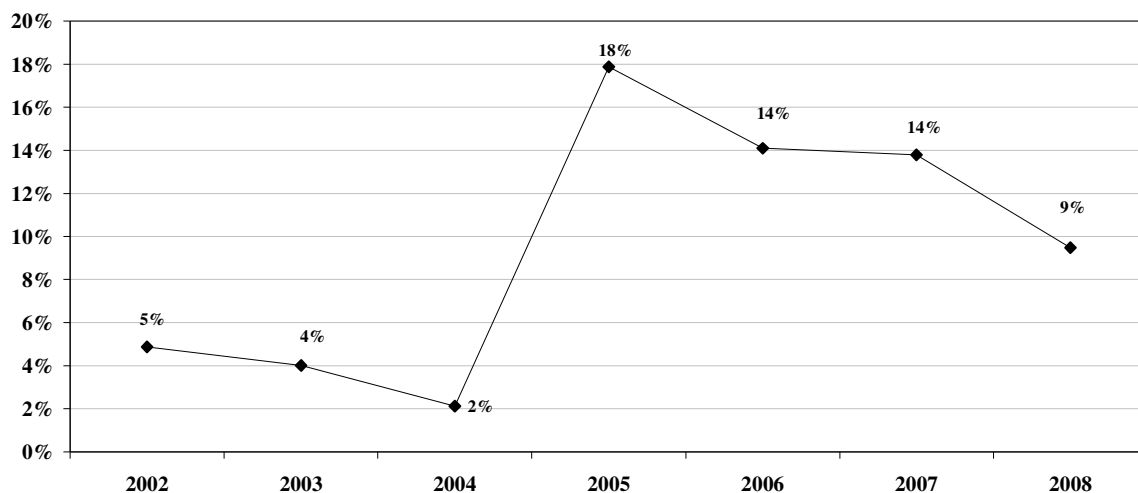


25. Due to the absence of a broad based tax system, the main sources of government revenue are import duties, tourism taxes, resort lease rents and dividend payments from state owned enterprises. These account for 31%, 10%, 20%, and 16% respectively. Tourism-related sources and import duties account for about 30% of domestic revenue each. As such, 60% of total domestic revenue is generated from only two main sources, increasing the vulnerability of government revenue and the economy, especially since tourism-related revenues are very vulnerable to external shocks.

26. Historically, project grants made up a considerable proportion of government revenue, averaging around 3% of total revenue during 2003 and 2004. It should however be noted that the

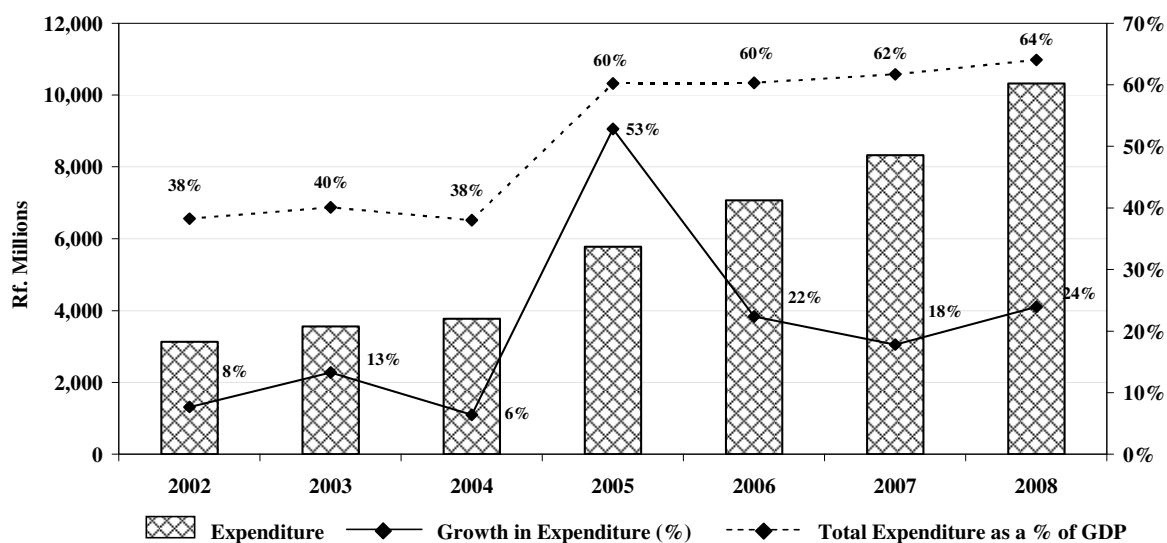
trend in grants received during the last three years was declining at a faster rate, with grants as a percentage of revenue in 1995 at 14%. In 2005, however, in the aftermath of the tsunami disaster, the amount of grants received was recorded at 18% of total revenue. This trend is expected to decline in the coming years, as reconstruction following the tsunami disaster is completed, and due to aid flows to developing countries drying up as a result of the current global financial crisis and most importantly when Maldives graduates from Least Developed Country (LDC) status.

Figure II.2: Grants as a Percentage of Total Revenue and Grants, 2002-2008



27. Government expenditure grew in both 2003 and 2004 at an average rate of 10% per annum, while revenue growth was on average 12% per annum for the same period. In 2005, however, total expenditures increased by 53% compared to 2004, as the country struggled to recover from the effects of the tsunami. The years 2006 to 2008 saw expenditure increase by 21% per annum on average, due mainly to an increase in salaries of civil servants. The current policy direction is to reverse this adverse trend, and to ensure that expenditures are at a more sustainable level.

Figure II.3: Expenditure, Expenditure Growth and Expenditures as a Percentage of GDP, 2002-2008

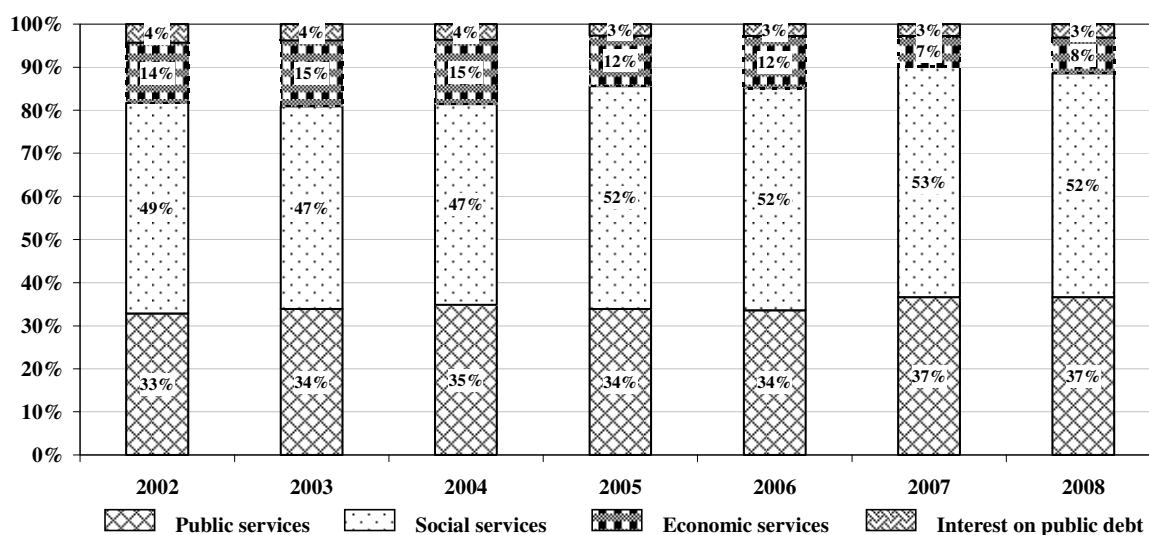


28. Expenditures on public services and social services together accounted for approximately 85% of total expenditure over the review period. Economic services⁶ accounted for an average of 12% per annum over the same period, while interest on public debt accounted for 4% per annum.

29. Public services include expenditure on general administration, defence, public order and internal security, and environmental protection. General administration and public order taken together accounted for 40% of the total expenditure on public services in 2008. In 2005, the Maldives National Defence Force (MNDF) and the Maldives Police Services (MPS) were divided into separate entities, thereby increasing expenditure on each entity.

30. Expenditures on social services include health, education, welfare and community programmes. The latter includes all expenditures related to the tsunami disaster, and hence this category increased by 178% in 2005. The government focus on economic services has been on the regulatory and administrative aspects, and as a result, this sector receives a smaller portion of the total expenditure package.

Figure II.4: Functional Classification of Government Expenditure, 2002-2008



31. The declining and highly vulnerable sources of domestic revenue, combined with sharp increases in expenditures over the past two to three years, have led to unsustainable deficits which have been largely financed through domestic sources, mainly through borrowing from Central Bank. The option of borrowing from the public has not been possible, owing to the absence of a well-developed financial market, and of government debt instruments. The new government is seeking to develop the financial market in the short-to-medium term, and to introduce debt instruments which could be purchased by the public.

32. The MTFE is based on reducing the fiscal deficit over the medium term, while ensuring that basic levels of services are not affected. Under the MTFE, expenditure for 2009 is estimated at around Rf11.3 billion, and regular domestic revenue is estimated at around Rf5.5 billion. This domestic revenue envelope will be augmented by additional revenue from the proceeds of privatization of SOEs, and from the extension of resort lease periods, increasing total revenue to Rf9.6 billion. The resulting deficit in 2009 is now estimated to be 7.4% of GDP. These forecasts are based on public sector employment reform, and on the assumption that proceeds from privatization of SOEs and from extension of resort lease periods will be realized in 2009.

⁶ Include regulatory and administrative aspects.

33. The fiscal deficit for 2010 is estimated to be around 3% of GDP, for which the government will seek external financing. This reduction in the deficit compared to 2009 is based on new revenue to be realized from the privatization initiative, as well as on structural tax measures such as the introduction of an environmental tax to be levied on visitors to the Maldives, changing the current bed tax of US\$8 per night to an *ad valorem* tax, and implementation of a business profit tax in 2010. With the addition of a goods and services tax to be introduced in 2011, it is estimated that the fiscal position will be in surplus in 2011. The government is supported by the International Monetary Fund (IMF), the World Bank and the Asian Development Bank (ADB), as well as by the United Nation (UN) system, in its objectives of achieving the above targets and introducing much needed reforms in public finance.

(3) FINANCIAL SECTOR AND MONETARY DEVELOPMENT

34. The financial sector in Maldives is very narrow and is dominated by the banking sector. The banking sector consists of one locally owned commercial bank⁷ and branches of five foreign owned commercial banks.⁸ In addition to commercial banks, the sector consists of many non-bank financial institutions. These include insurance companies, a finance leasing company, a specialized housing finance institution, money services businesses and securities market intermediaries. All banks and non-bank financial institutions except for the security market intermediaries operate under the supervision of the MMA.

35. The MMA is also endowed with the regular powers and obligations of a central bank under MMA Act (1981). Under this mandate it is responsible for the issuing of Maldivian currency (the Rufiyaa), regulating money supply, and promoting price stability. Apart from this, the MMA regulates and supervises the operations of all commercial banks and the non-bank financial institutions except for the securities market intermediaries. It formulates and implements monetary policy and advises the Government on issues relating to the economy and financial system in order to foster an environment conducive to the orderly and balanced economic development of the country.

36. The total deposits of the commercial banks stood at 76% of GDP at the end of 2008, while the stock of credit extended by the banks to the private sector accounted for 101% of GDP. Total private sector credit has been rising, reflecting an annual growth of 33% at the end of 2008 as opposed to 7% annual growth at the end of 2003. Meanwhile monetary aggregates of the past few years indicate that broad money growth increased in annual terms by 15% in 2003 and by 24% in 2008. Net government borrowing increased significantly during 2008 and was 275% higher than in 2007, due mainly to the rapid increase in government expenditure which caused a huge budget deficit. In the meantime, Net Foreign Assets of the banking system, after a growth of 58% in 2003, witnessed a decline over the past few years and since July 2007 has recorded a net foreign liabilities position. In 2008, net foreign liabilities of the banking sector increased by Rf2,114.1 million and reached Rf2,572.4 million at the end of 2008.

37. With effect from April 2007, as provided under the amended MMA Act, the post of the Governor of the MMA was separated from the post of Minister of Finance. The Governor and the Deputy Governor are appointed by the President with the approval of the Parliament. Other members of the Board of Directors are appointed by the President on the recommendation of the Governor. The Board of Directors of the MMA is responsible for the policy and affairs of the Authority.

⁷ Bank of Maldives established in 1982. Since 1993 it is owned by government of Maldives.

⁸ State Bank of India (SBI), established in 1974; Habib Bank Ltd (HBL), established in 1976; Bank of Ceylon (BOC), established in 1981; the Hong Kong and Shanghai Banking Corporation (HSBC), established in 2002; and Mauritius Commercial Bank Ltd (MCB) which was granted a banking licence in 2007 and commenced its operations in 2008.

38. The main purpose of this change in the administration of monetary policy was to ensure macroeconomic stability through price stability and to maintain an adequate level of external reserves. To achieve these objectives the MMA uses the exchange rate peg of the Rufiyaa to the United States (U.S.) dollar as the intermediate target. The Minimum Reserve Requirement (MRR) for commercial banks was reduced from 30% to 25% in June 2006, while with effect from September 2006 MMA also started issuing Treasury Bills (T-Bills) on behalf of the Government, replacing the former MMA Certificates of Depositories (CDs). The T-Bills, which are open to commercial banks and public enterprises, are issued at maturities of 28 days and 91 days with interest rates respectively of 5% and 5.25%. With effect from July 2007, the interest rates on T-Bills were raised to 6% for 28 days and 6.25% for 91 days. At the same time, starting from November 2006, MMA introduced a Repurchase facility to replace the Lombard facility and Rediscount facility, in order to develop the secondary market in T-Bills.

39. Capital market activities in Maldives have grown rapidly within the past few years. The Maldives Security Act (MSA) 2006 set up the Capital Market Development Authority (CMDA), which acts as a specialized agency regulating the securities market intermediaries and also has statutory powers to license these intermediaries including brokers, dealers and investment advisers, as well as stock exchange and central depositories. Prior to this Act, the regulation and supervision of securities market was carried out by MMA.

40. In 2008, the Security Trading Floor and the Maldives Security Depository, both regulated by the CMDA, were licensed as a private sector Stock Exchange and Securities Institution respectively. At present five companies are listed on the Maldives Stock Exchange (MSE).⁹ Meanwhile, there are three licensed dealing companies, which include Stockbrokers Maldives Pvt Ltd, First Option Pvt. Ltd., and Aariya Securities Pvt. Ltd.

41. A Bill concerning Collective Investment Schemes (CIS), a Trust Bill and a Securities Depository Bill have been sent to authorities to be presented to the Parliament. These Bills will strengthen the existing regulatory regime for the capital market and will facilitate more investment/financing opportunities. CMDA has been encouraging private sectors to raise finance through the stock market and also to open the door for foreign investments through the capital market.

42. Non-banking financial institutions in the country include insurance companies and intermediaries, a finance leasing company, a specialized housing finance company and money transfer businesses.

43. The Allied Insurance Company of Maldives, incorporated in 1984 and owned by the State Trading Organization Plc Ltd (STO) is the only local insurance company in the country and the only composite insurance company. The Sri Lanka Insurance Corporation Ltd, being the oldest insurance service provider, established its branch office in the country in 1976. Several other insurance companies and market intermediaries from Sri Lanka operate in the country through their appointed local agents. Ceylinco Insurance, Company Limited (Sri Lanka) is represented in the country through its local agent, RSH Financial Service Pvt Ltd while Amana Takaful (Sri Lanka) has been providing general insurance business in Maldives since 2005 through an agent; HMS private limited.

44. The insurance market has been virtually unregulated until September 2004, when a new set of regulations was introduced with the objective of facilitating the orderly development of the insurance sector. As an interim measure under the regulations, insurance undertakings and market

⁹ These five companies are Maldives Transport and Contracting Company Plc (MTCC), Bank of Maldives Plc (BML), State Trading Organization Plc (STO), Maldives Tourism Development Corporation (MTDC) and Dhivehi Ekuveri Kunfuni (DEK).

intermediaries operating in the country as at September 2004 have been granted a temporary registration for a period of one financial year during which all such parties are required to meet all necessary conditions to qualify for full-fledged licenses in their respective categories. Reinsurance businesses relating to the activities of these companies are currently being provided by overseas reinsurers.

45. Under the assistance from the World Bank's FIRST initiative, MMA initiated a project to establish a supervisory regime for the Insurance sector. This is a comprehensive project which includes drafting an Insurance Act, other subsidiary regulations and standard templates and procedure for collecting reporting returns. The first mission under the project took place during May 2008. During this mission, the first draft of the proposed Insurance Act was produced.

46. The Maldives Finance Leasing Company Pvt. Ltd. (MFLC), established in May 2002, is the only player in the finance leasing market. The company was setup as a collaborative venture between five domestic public and private sector entities and two international parties, in order to address the demand for medium to long-term equipment financing from all sectors of the economy.

47. The Housing Development Finance Corporation Ltd (HDFC), setup in March 2004, is an initiative of the Government of Maldives to provide the much needed financing in the residential and commercial housing sector to address the pressing demand for housing. HDFC Plc was registered as a public company on the 9th of February 2006. The shareholders' agreement for privatization between the Government of the Maldives, ADB, International Finance Corporation (IFC), and Housing Development Finance Corporation – India (HDFC-I) was signed on 23 July 2008. The initiative to restructure the capital and restart the business of HDFC Plc became effective in February 2009 with the first equity disbursement by the international shareholders whose commitment also comprises of a multi-lateral loan component by IFC and ADB. The structure of new shareholding is 49% by the Government of the Maldives, with the balance 51% being shared as IFC (18%), ADB (18%), by HDFC-I of (15%). After having re-structured its capital and with new lines of long-term credit HDFC Plc has re-entered the market for mortgage loans for housing needs of individuals and families.

48. Money transfer services businesses in the country include three local companies operating as agents of international money transfer companies. The services of these companies are largely targeted towards the expatriates in the country who utilize their services for outward remittances from Malé.

(4) BALANCE OF PAYMENTS AND EXTERNAL SECTOR

49. As Maldives depends mainly on imports for consumption, the lack of import substituting industries and of manufacturing capacity for exports results in a current account deficit. The current account continued to be in deficit over the review period and the deficit for 2008 stood at US\$651.3 million. This is a 139% increase when compared to the current account deficit in 2005, which stood at US\$273.0 million. This huge increase in the deficit is due to the ever widening trade balance over the years, which recorded a deficit of US\$890.9 million. The current account deficit averaged around 40% of GDP between 2004 and 2008. In 2008, more than 98% of Maldives commodity exports consisted of fish and related products, amounting to US\$125.9 million, a 29% increase when compared to 2005.

50. As a result of the December 2004 tsunami which resulted in a devastated Maldivian economy with huge infrastructure losses, large amounts of foreign aid and insurance compensation were received, increasing the transfers received which peaked in 2005 at a total of US\$211.5 million. The balance on current transfers in the year 2005 stood a surplus of US\$142.0 million, which declined to a

deficit of US\$52.2 million at the end of 2008. The greater part of the deteriorating balance was decline in transfers' credit (grants).

51. The official medium and long-term flows of loan capital for direct investment dominate the financial account of the balance of payments. A modern capital market, which is at present only at the infant stage, needs to be developed in order to attract portfolio investment. The lack of a statistical framework for collecting data on external debt means that only public sector and commercial bank debt is captured. Up to now data on private debt are not available. The total recorded external debt stock of the economy averaged 76.9% of GDP during the review period. The total debt stock of the economy at the end of 2008 was US\$969.2 million.

52. There is no exchange control legislation in the Maldives. Both residents and non-residents may freely import and export capital through the foreign exchange market and residents do not require permission to maintain foreign currency accounts either at home or abroad. There is no distinction made between foreign nationals residing in Maldives and Maldivians in terms of accounts held with the banks operating in the Maldives. Inward direct investment requires prior government approval. However, once permission is granted there are no restrictions on the repatriation of profits.

53. The Maldives has a pegged exchange rate system, whereby the Rufiyaa is pegged to the U.S. dollar at a market reflective rate. As per IMF Staff report of 2008, the real effective exchange rate has depreciated by 27% including 1.9% depreciation since the end of 2006. At present the buying and selling rates of the Rufiyaa in terms of US dollar are Rf12.75 and Rf12.85 respectively.

III. TRADE POLICY AND PERFORMANCE

(1) TRADE POLICY OBJECTIVES AND FRAMEWORK

54. Maldives, a country strategically situated in the middle of the Indian Ocean has always been closely intertwined with international commerce since 10th century when Arab and Persian traders began visiting the country. Apart from pearls, spices, coconuts, dried fish, their attractiveness was very much on the abundance of cowry shells which were accepted as currency from Africa to China until the 16th century. Soon after Arabs, East-African and European began to make the Maldives a transit point before they reached Far East.

55. The central objective of Maldives trade policy is to establish conducive environments for brisk commerce and economic activity focusing on diversifying the economy with export-oriented trade in services and industrial development focusing to achieve the main objectives – poverty alleviation and improvement in the standard of living – of Maldives.

56. Over the years, Maldives maintains a relatively open trade policy, with no major direct trade measures, low tariffs and keeping non-tariff measures to an absolute minimum. The free trade policy will be maintained and improved in accordance with government development policies and priorities. Further bilateral, regional and multilateral approach to free trade will be pursued.

57. Maldives imports virtually everything which is consumed in the economy. As a result, imports accounted for more than 75% of total trade in goods during the review period. Trade in goods typically accounts roughly 20% of the country's GDP. Trade in goods and services taken together accounts for approximately 150% of GDP. However, this large shortfall in foreign exchange earnings is to a large extent made up for by revenues from the export of services especially via the tourism sector.

58. Maldives' economy comprises a very limited range of productive activities. Tourism and related services such as transport and communication accounts as much as 70% of GDP. However, fisheries sector, the main productive sector continues to play a vital role in the economy.

(2) LAW ON EXPORT AND IMPORT AND LAW ON PROHIBITED IMPORTS

59. The main law governing international trade is the law on export and import of 1979¹⁰, which stipulates the conditions and procedures for the imports and exports of goods and entrusts the Ministry of Economic Development (MED) as the authority to regulate export and import.

60. The Law mandates the authority to determine the customs tariffs on the products imported into the country. The tariff remains the main trade policy measure, and is mainly used as a revenue instrument accounting for nearly two third of tax receipts. Some tariffs are levied on environmental, health and religious grounds.

61. The basic MFN tariff structure remains the same over the review period with all duties being levied on *ad valorem* basis except a specific duty of Rf. 0.30 per stick on cigarette. Maldives customs Services (MCS) as the implementing agency charges 11 different rates¹¹ as stipulated by Law, using the 2007 version of World Customs Organization's Harmonised System (HS-2007). With effect from 1st of January 2006, a separate set of duties is being applied to goods importing from South Asian Association of Regional Cooperation (SAARC) member countries under the South Asian Free Trade Area (SAFTA)'s Tariff Liberalization Program (TLP).

62. Government has the discretion to exempt duty, especially if these imports are use for industrial purposes and development of infrastructure and tourist resorts. However, Government stopped duty exemption on imported items that are to be used for resort development since 2006.

63. Government aims to reduce the dependence on import revenue as an income source for government expenditure and recently proposed much wider tax reforms. In this background, in June 2009, government proposed amendments to the export-import law to eliminate import duties on foods items and lower it for other commodities. This proposal is part of a much wider amendments government will bring to the export-import law in the next two-three years, where government intends to bring down all applied rates to a level which have a positive impact on the economic development needs of the country and in accordance with international obligations including World Trade Organization (WTO).

64. The proposed amendments to the import and export law intend to address three broad policy considerations which include economic development objectives, environmental objectives and WTO obligations during its formulation.

65. The government foresees that the proposed amendments will be initially costly. Therefore, in order to compensate the loss of revenue government has also submitted a corporate tax bill in parallel to parliament as a part of new broader tax regime which includes income tax and goods and services tax.

66. There are no changes to the Law¹² on Prohibited Imports since last trade policy review. Under this, goods are prohibited on the basis of national security and religious grounds.

¹⁰ Law No: 31/79.

¹¹ 10 *ad valorem* and one specific duty.

¹² Law No: 4/75.

(3) CUSTOMS VALUATION

67. Since 2003, various efforts are being made towards the implementation of the provisions of the WTO Customs Valuation Agreement. One of the milestones achieved during the review period includes setting up of valuation database. One of the major impediments to implementing the agreement is the passage of the Customs Act (CA) through the Parliament, due to numerous bills of the more urgent political reform agendas. Draft CA to adopt the WTO valuation provisions has been prepared and the Bill is currently under review by the Attorney General Office.

68. Currently custom valuation done by MCS is based on their valuation database compiled from the rates generally declared to customs by importer.

(4) SANITARY AND PHYTOSANITARY (SPS) MEASURES

69. Importers are required to submit state veterinary certificate when they import live animals, birds and plants. Ministry of Fisheries and Agriculture (MOFA), implements the regulation on the importation of live animals into the country. The regulation states the required standards of health requirement of the non-prohibited imported live animal, along with the health standards of importing vessels. The Plant and Animal Quarantine Unit of MOFA monitors plant and animal quarantine in coordination with the MCS. Ministry of Health and Family (MOHF) regulates food safety and human quarantine.

70. In addition to the import license, importers are still required to obtain specific license from the MOHF when importing pharmaceutical drugs and traditional or herbal medicine. Importers are required to seek approval of the suppliers of those medicines mentioned prior to importation.

71. Maldives Foods and Drug Authority (MFDA) under the MOHF in close collaboration with MOFA, MED and MCS randomly inspect food and beverage products imported and also issues health related certificates required for exports. It is important to note, that all these functions are carried out with a very limited trained personnel. MED may suspend or prohibit imports of a good based on public health, religious, environmental or other grounds, upon recommendations by the relevant ministry, department or agency.

72. There is no National Standard applied to any product which is imported and exported. Export standards for fish and fishery products follow the exporting countries standards such as following European Union (EU) regulations/Council's Directives when exporting to EU. Nevertheless, efforts are undertaken by MED to strengthen the national standards regime through United Nations Industrial Development Organization (UNIDO) – SAARC Market Access and Trade Facilitation Support or Asian LDCs through strengthening Institutional and National Capacities Related to Standards, Metrology, Testing and Quality (SMTQ) project funded by Norwegian Agency for Development Cooperation (NORAD).

73. In order to strengthen phytosanitary and quarantine procedures, MOFA set-up a Plant and Animal Quarantine Unit at the International Airport in Hulhulhe. However, much needs to be done to fully implement the SPS agreement. Government plans to set-up similar Plant and Animal Quarantine Units at its main ports and also establish legal framework required for such establishments. Government is also considering the development of a national phytosanitary certificate based on the Food and Agriculture Organization (FAO) – International Plant Protection Convention (IPPC) model and good manufacturing practices and national standards for fish and fish products based on Codex standards.

74. Maldives is a member of World Health Organization (WHO)/FAO Codex Alimentarius from March 2008, International Office Epizootics from November 2007, and IPPC from October 2006.

(5) ENVIRONMENTAL MEASURES

75. The Environment Protection and Preservation Act (Law 4/93) is the key legal instrument guiding formulation of environmental policies, rules and regulations that are deemed necessary for environmental protection and preservation.

76. Government believes that the lack of full scientific evidence shall not be an excuse to postpone actions when there is a threat of serious or irreversible damage.

77. The regulation¹³ that requires a special license which are need for the importation of vehicles such as cars, lorries, vans, cranes, excavators, forklifts, and dumpers were abolished from January 2006. Ministry of Housing, Transport and Environment (MOHTE) levies restrictions on environmental grounds in registering of the above vehicles if only items are imported after five years from the date of manufacture.

78. In March 2009, the President unveiled a plan¹⁴ to make Maldives, the first carbon-neutral country by virtually eliminating the use of fossil fuel by the year 2020. The plan include a new renewable electricity generation and transmission infrastructure with large wind turbines, half a square kilometre of rooftop solar panels, and a biomass plant burning coconut husks. The experts believe, this would not only power the homes and businesses, but also be able to run vehicles, and marine vessels which now use petrol and diesel gradually been replaced with electric versions.

79. This plan is more ambitious than any other¹⁵, not just in terms of its shorter time period but also it aims to totally decarbonize the local economy. This ten year plan is estimated to be about \$110 million a year. And it is expecting that this plan should pay for itself quite quickly since Maldives will no longer need to import oil products for electricity generation, transport and other functions.

(6) SERVICES

80. Since early 1970s, with the introduction of tourism to the country, services contribution to the economy has been increasing. According to best estimates¹⁶, commercial services account more than 65% of GDP, in addition to 16% of Government services and 72% of employment. Apart from marine resources, Maldives lacks the natural resources needed for further development in agriculture, manufacturing and mining. With all this background and tourism dominating the service sector (and with its limited capacity for development), further development of the economy must take place predominantly in services beyond tourism sector.

81. Maldives is currently engaged in negotiations for the further liberalization of international trade in services with South Asian Association of Regional Cooperation (SAARC) and within the WTO.

82. Government is currently working on a National Strategy, in which Government is intending to identify the services sectors that are essential for the development of domestic economy; identify

¹³ Public Announcement N: A-34/2000, of 26 September 2000, of the Ministry of Trade and Industries.

¹⁴ Prepared by British climate change experts Chris Goodall and Mark Lynas.

¹⁵ Norway is aiming to be zero-carbon by 2030.

¹⁶ Sufficient data of the sector limits the real contribution of services to the economy.

those sectors which have the best potential for development and growth; identify the sectors which are already engaged in, or have future potential for selling services internationally; and determine the priority for Maldives in the negotiation for liberalization of trade in services both with SAARC¹⁷ and WTO.

83. This strategy constitutes the nationally agreed basis for further development of the services sectors in Maldives. The Government does not intend to select or control the sectors, within which development shall take place, nor to direct or restrict the processes of development including development financing, other than through the conformation of internationally agreed standards. The Government will be guided by the current policies on corporatization and privatization; and principles and priorities set out in this National Strategy in order to create a favourable environment for services development, including a framework of laws and regulation which is conducive to development of priority services in Maldives.

(7) TRADE RELATED INTELLECTUAL PROPERTY RIGHTS

84. Maldives became a member of World Intellectual Property Organization (WIPO) in 2004. There are currently no Intellectual Property (IP) laws in Maldives. The Government is working with WIPO to set up an IP regime before graduation. An IP law together with an action plan has been drafted.

85. The Government set up an IP function in the MED in 2007. Currently its main function is to work towards the establishment of a modern IP regime in Maldives and be ready for the time when the country graduates out of LDC status.

86. Copyright law is drafted while laws on Trademarks, Patents and Geographical Indications are also in the drafting process. The copy right legislation is expected to come into force in 2010, while the rest are expected to come into force in 2013.

87. At present Copyrights are registered by the National Bureau of Classification (NBC). Prior to the registration, the work needs to be verified by a Committee to confirm its originality. The works eligible for such protection are: stories, computer programs, speech, drama, audiovisual work, artistic creations, illustration, photographic works, sketch work, songs, lyrics, musical drama, stage shows etc.

88. Though International Trademarks are not registered or protected in Maldives, foreign advertisers print advertisements in local newspapers through local agents to give Cautionary Notices on protection of their Trademarks.

(8) BILATERAL TRADE ARRANGEMENTS

89. The oldest bilateral arrangement, as identified in the first Trade Policy Review report, is the agreement in force since 31 March 1981 which is known as "*Trade Agreement between the Government of the Republic of Maldives and the Government of the Republic of India*".

90. A preferential *Zero Tariff Agreement* was signed between Maldives and China on 23rd July 2006. After having several discussions between Maldives and China regarding rules of origin, the Agreement is now in effect as of 1st February 2009.

¹⁷ Currently Maldives is participating in the finalization of draft Agreement on South Asian Trade in Services (SATIS).

91. The Agreement promotes the economic development of Maldives and strengthens the economic and trade relationship between the two countries. Under this Agreement, non-reciprocal preferential tariff treatment is given by the Government of China to 278 products exported from Maldives.

92. Maldives currently enjoys tariff-free entry to the EU for canned¹⁸ and fresh fish¹⁹ under the Everything But Arms (EBA). The EU market is the second most important market for Maldives' exports, accounting for more than 30% of total exports. Maldives will continue to receive this preference until it graduates out of LDC status.

(9) REGIONAL TRADE AGREEMENTS

93. The SAARC was founded in 1985. Started as a political association, SAARC took up economic cooperation on its agenda in the early 1990s. Prior to SAFTA, a preferential arrangement known as the SAARC Preferential Trading Agreement (SAPTA) was signed on 11th April 1993. This followed a positive list approach to tariff liberalization. Its narrow product coverage, narrow margins of preferences and the inability to address non-tariff barriers lead to the broader SAFTA Agreement.

94. Maldives is also one of the seven original signatories of a more recent trade integration initiative of SAARC, namely the SAFTA²⁰ signed at the 13th SAARC Head of States Meeting held in Islamabad on January 2004. The objective was to strengthen intra-SAARC economic cooperation and to realize to the maximum possible the region's potential for trade and development for the benefit of the member states, in a spirit of mutual accommodation and with full respect for the principles of sovereign equality, independence and territorial integrity of all member states, *inter alia*:

- a) eliminating barriers to trade in, and facilitating the cross-border movement of goods between the territories of the contacting states;
- b) promoting conditions of fair competition in the free trade area, and ensuring equitable benefits to all member states, taking into account their respective levels and patterns of economic development;
- c) creating effective mechanisms for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
- d) establishing a framework for further regional cooperation to expand and enhance the mutual benefits of this agreement.

95. SAFTA entered into force on 1 January 2006. Following the commencement of the TLP in July 2006, trading started under SAFTA provisions. The relevant SAARC mechanisms are also pursuing the implementation of trade facilitation measures including harmonization of standards²¹, and Customs rules, procedures, and documentation.

96. SAFTA only covers trade in goods. However, subsequent SAARC Summits noted the importance of liberalization and regional integration in the area of trade in services under SAFTA.

¹⁸ Normally 24.3% import duty

¹⁹ Normally 12% import duty

²⁰ Afghanistan became the 8th Contracting Member States of SAFTA after the Heads of signed the Protocol on Afghanistan for Accession to SAFTA at the 15th Summit in Colombo, August 3rd 2008.

²¹ The Heads of State signed the text of the Agreement on the Establishment of the South Asian Regional Standards Organization at the 15th Summit held in Colombo, August 3rd 2008.

97. The SAFTA Agreement is being implemented through six instruments, namely:

- a) trade liberalization program (TLP)
- b) rules of origin
- c) institutional arrangements
- d) consultations and dispute settlement procedures
- e) safeguard measures, and
- f) any other instruments that may be agreed upon.

98. Tariff reductions under the TLP are divided into two phases. Under phase one, Non-LDCs must reduce existing tariff rates (except for items included in national sensitive lists) by at least 20% within the first-two years from the date of coming into force of the Agreement, while for LDCs, tariff rates (for items not in the sensitive lists) have to be brought down to 30% over the same period.

99. Under the second phase of the TLP all Non-LDCs have to bring down all tariffs to a range of 0 - 5% at the beginning of 2013. For LDCs, the same reduction has to be achieved at the beginning of 2016.

100. The Agreement puts special emphasis on special and differential treatment for LDC member states, specifically:

- a) giving special regard to the situation of the LDCs when considering the application of anti-dumping and/or countervailing measures.
- b) greater flexibility in continuation of quantitative or other restrictions provisionally and without discrimination in critical circumstances by the LDC member states on imports from other Contracting States.
- c) considering, where practical, taking direct trade measures with a view to enhancing sustainable exports from LDC States,
- d) establishing an appropriate mechanism to compensate the loss of customs revenue of LDCs arising from the implementation of TLP, until an alternative domestic arrangements are formulated to address this situation.

101. A separate article on special and differential treatment for Maldives is also included in the Agreement stating that after graduation, Maldives will receive no less favourable treatment than that accorded to LDC member states.

102. Maldives is a party to the Trade Negotiation Committee (TNC), a committee that is negotiating to establish a Trade Preference system specific to Organization of Islamic Countries (OIC) member states. Maldives joined organization of Islamic Countries on August 1974.

(10) EXTERNAL TRADE PERFORMANCE

103. The country's total export in 2008 grew by Rf1,384 million to Rf 1,617 million, a growth of 16.8% over the year 2007 (Table III.1). Average growth rate for the past years is 18.8%. With 98%, marine products are the main exports. Figure III.1 represents an upward trend in exports from 2002 to 2008. However, due to tsunami disaster, there was a slight downturn in the exports in year 2005. Starting from 2006, there is a fluctuation trend until 2008, with an estimate of 16.8% increase by the end.

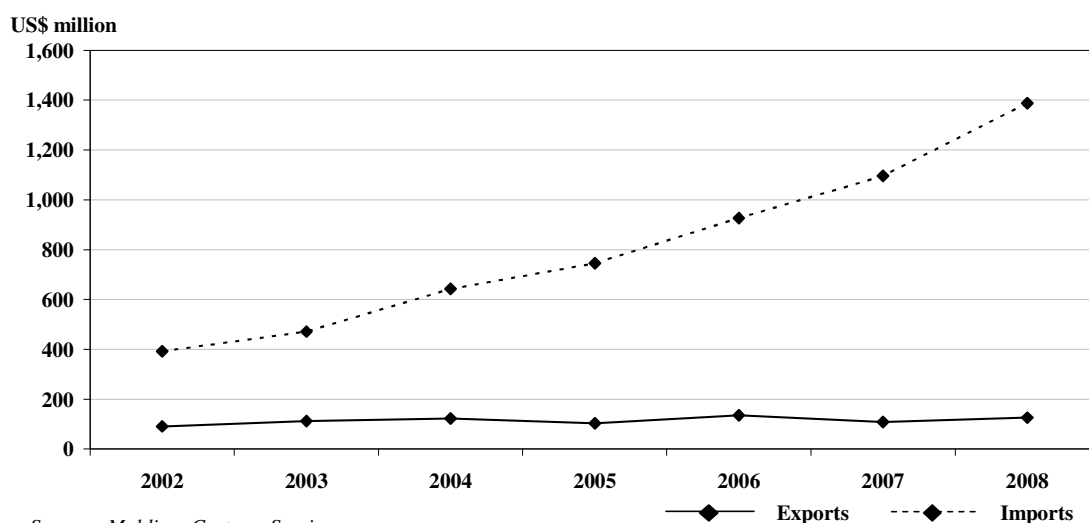
104. The biggest single shares in the marine products category were attributable to fresh, chilled or frozen tuna (80.6%), salted fish (7.8%), dried fish (5.5%) and canned fish (1.3%).

105. Imports grew at an average rate of 15% for the last ten years, as presented in Table III.1 and Figure III.1.

Table III.1
Export, import and balance of payment

	2002	2003	2004	2005	2006	2007	2008
EXPORTS							
Total (f.o.b. in RF '000)	1,161,415	1,445,922	1,572,277	1,329,830	1,735,722	1,384,589	1,617,306
Total (f.o.b. in U.S. '000)	90,382	112,523	122,356	103,489	135,076	107,750	125,860
Marine Products							
(f.o.b. in RF '000)	716,429	978,733	1,155,306	1,308,330	1,709,989	1,357,190	1,591,794
Clothing Products							
(f.o.b. in RF '000)	443,664	462,439	408,955	7,731	-	-	-
Other Products							
(f.o.b. in RF '000)	1,321	4,750	8,016	13,769	25,733	27,399	25,512
% Marine Products	62	68	73	98	99	98	98
% Other products	38	32	27	2	1	2	2
IMPORTS							
Total (c.i.f. in RF '000)	5,014,062	6,026,026	8,215,256	9,534,267	11,859,521	14,032,513	17,760,114
Total (c.i.f. in U.S. '000)	391,724	470,783	641,817	744,865	926,525	1,096,290	1,387,509
BALANCE OF PAYMENTS (in millions of US\$)							
Trade Balance	(212.3)	(262.3)	(383.8)	(493.8)	(590.1)	(736.8)	(890.8)
Current account balance	(35.6)	(31.3)	(122.3)	(273.0)	(302.0)	(437.8)	(651.3)
Overall balance	40.2	26.5	44.2	(17.3)	45.1	76.9	(67.8)
Services (net)	251.7	311.7	350.2	109.8	320.7	379.8	355.7
Current transfers (net)	(39.6)	(42.3)	(53.6)	142.0	8.2	(13.7)	(52.2)
Capital and financial account	73.9	50.7	153.2	263.8	290.6	442.0	499.2

Figure III.1: Import and Export Trends, 2002-2008



Source: Maldives Customs Service.

IV. INDUSTRIAL DEVELOPMENT AND DIVERSIFICATION

(1) INDUSTRIAL DEVELOPMENT

106. The manufacturing sector is small and limited by the low level of domestic demand and the shortage of skilled domestic labor. The sector's contribution to the overall GDP continues to decline over the review period from 8.8% in 2002 to 6.9% in 2008. Though the sector employs 19,259²² people in 2006 compared to 12,082²³ people in 2001, its contribution to the overall employment fell from 18.05% in 2001 to 17.47% in 2006.

Table IV.1
Manufacturing contribution to GDP, 2002 -2008

	Manufacturing contribution to GDP, 2002 -2008						
	2002	2003	2004	2005	2006	2007	2008
Percentage of GDP	8.8	8.5	7.9	7.5	7.3	7.0	6.9

Source: MMA.

107. Most of the traditional home based industries such as manufacturing of coir (a rope made from dried coconut fibres) and lace-making (handmade pillow lace), mat weaving, weaving on hand-operated looms were no longer regarded as major economic activities in the country since they have lost demand in the domestic market for cheaper substitutes. And, though products such as coconuts, copra, shells, and handicrafts are made locally, they do not reach the export markets simply because apart from handicraft, there is no export market for these products and handicrafts are targeted for the local tourism market.

108. Fish processing, boat building, handicrafts, furniture, food and beverage products, brick-making, PVC pipes, and soap are the main industries in Maldives. Fish processing, which is the main industry, is geared towards exports and is dominated by small and medium enterprises. Maldives Industrial Fishing Company (MIFCO), a SOE, plays a vital role in the sector.

109. Garment industry played a major role in diversifying the country production and also contributed favourably in the country's export. Maldives enjoyed the special preference accorded under from USA and EU Multi-Fibre Agreement (MFA) till 2005. In the aftermath of MFA, all the garment factories were closed in 2005.

110. Since the use of nets is illegal, Maldivian fishermen use the traditional line and pole in their fishing. The mechanization of the traditional sailing boat – *dhoani* – in 1974 revolutionized the fishing fleet of the country from sails to outboard motors. The new generation of *dhoanis*, designed especially now target for fishing beyond the coastal zone.

(2) MEASURES FOR INDUSTRIAL DEVELOPMENT

111. In March 2009, the Government decides to review the guidelines for fishing in the Exclusive Economic Zone (EEZ) by ceasing granting of additional license to do fishing within EEZ. Licenses for fishing in the EEZ of the country are issued under Article 6 of the Fisheries Act of the Maldives.

112. Government export promotion policy envisages as core strategies the introduction of a quality assurance system for Maldivian goods and services, and alleviation of supply and market bottlenecks

²² Census 2006, Department of National Planning (former Ministry of Planning and National Development).

²³ Department of National Planning (Former Ministry of Planning and National Development).

in the export of goods and services. Monitoring of markets and prices in order to maintain competitiveness is also identified as a strategy for promoting fair trading and healthy competition.

113. The Export Promotion Section (EPS) within the Invest Maldives Division of the MED together with the MOFA, provide institutional support to the promotion of export competitiveness. Participation in international trade fairs is facilitated by these ministries and financial assistance is also provided to some extent.

114. In addition to the EPS, the Maldives Standards and Metrology Unit (MSMU) has also been established within the MED with the aim of building the export capacity of the country. The national metrology laboratory, covering calibration, certification, metrology standards and regulation, exists within the MSMU so as to guide and facilitate exporters.

115. MED with technical assistance from UNIDO aims to develop national capacity related to trade and market access requirements and to identify manufacturing sub-sectors which have the greatest export potential for development in the country.

116. Nevertheless, Maldivian exporters face a number of difficulties when exporting products. Some of these constraints are specific to the key export sector, fisheries, and some are general constraints. Some of these difficulties include; financing; limited export promotion services, transport and logistics issues.

117. The on-going infrastructure and institutional developments initiated by the new Government will address these supply side constraints to a considerable extent. In particular, the proposed Integrated Transport Network will facilitate market linkages, trade facilitation and industrial development and diversification activities.

(3) INDUSTRY DIVERSIFICATION

118. The new administration, under its economic diversification strategies will implement policy measures to reduce the country's dependency on two major economic activities. As such, the following policy measures will be put in place to achieve industry diversification in the medium to long term.

(i) Tourism

119. As the pivotal sector, the Government plans to expand eco-friendly sustainable tourism further based on available resources in a manner that will increase the local value added by encouraging greater local participation. In particular measures will be put in place to introduce new products such as cultural and health tourism, private islands and international hotel schools to provide world class hospitality training. The existing regressive tax regime and financing constraints will be addressed to encourage local SME Investments and participation in the tourism sector.

(ii) Fisheries

120. As a major employment generating sector, measures will be put in place to expand the scope of the fisheries sector in the country's economy and to address its declining trend in GDP share. Towards this end, the market would be further liberalized to enable local fishermen benefit more directly with less intermediaries in the market. While the policy of sustainable fisheries would be continued and promoted to prevent over exploitation, new measures such as introduction of mariculture, research and training facilities are considered to further diversify the sector. In addition, participation of SME in value addition activities within the sector will be promoted. Surveillance of

the Exclusive Economic Zone will be strengthened in order to address existing impediments to the effective management of fishery industry.

(iii) Agriculture

121. Agriculture in Maldives is limited due to the salinity of the soil and due to smallness of land available for arable production. Nevertheless, as a net food importing country, small scale farming practices will be promoted and encouraged to increase food security and livelihood opportunities for locals. New technology, such as hydroponics and auto-pot cultivation systems, and new crop varieties conducive to the climate and geography will be introduced to further diversify the sector. Incentives will be provided to increase production of locally marketable crop varieties and small scale value addition activities will be encouraged in support of SME development activities. Recognizing the importance of the sector for domestic food security, the government is considering formulation of comprehensive agribusiness development policies in the immediate future to encourage small scale industrial development.

(iv) Energy

122. Increasing energy security and diversification is an important policy measure pursued by the new administration. Dependency on imported fuel products is aimed to be reduced through encouraging use and investment in alternative fuels and renewable source of energy. In addition, the fuel market will be opened up for competition and decentralized service delivery models will be introduced to enhance sector competitiveness.

V. FOREIGN DIRECT INVESTMENT AND PRIVATISATION

123. The legal and regulatory framework for Foreign Direct Investments (FDI) in the Maldives is simple and transparent. The Law²⁴ on FDI governs foreign investments in the country, which requires both the investor and the government to enter into an agreement. The foreign investment law guarantees security for foreign²⁵ investments.

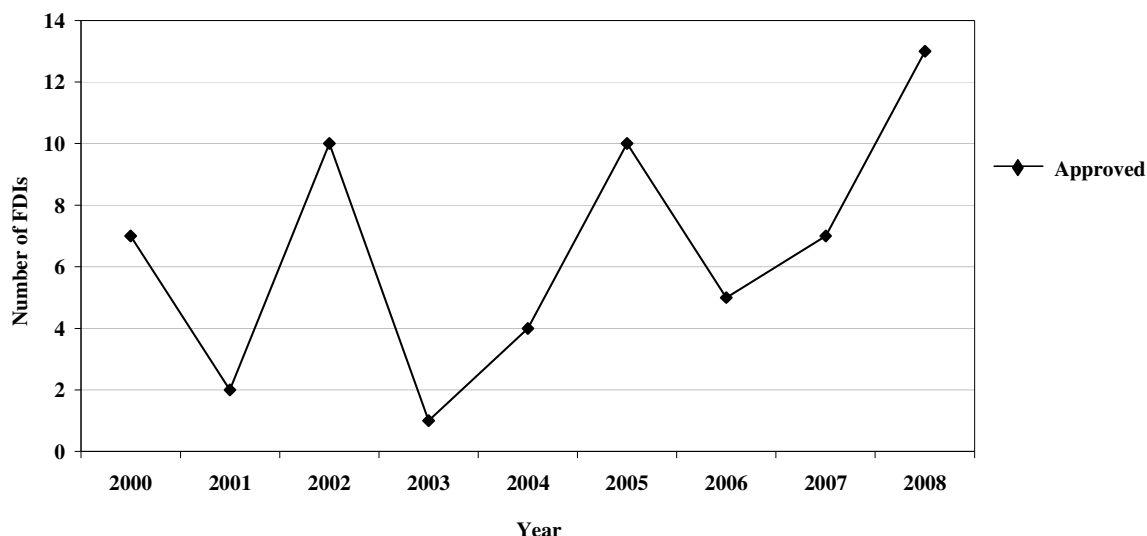
124. The new Administration's legislative agenda for the coming two to three years will address the existing legal and regulatory gaps for improving investment and business climate. Legislations under consideration include Company's Act, Import-Export Bills, Corporate Taxation, Property Rights, Intellectual Property Rights, Banking and Consumer Protection.

125. The Maldives' liberal trade environment, dynamic private sector and development-oriented legal structure all contribute to a climate conducive to trade and investment. Since 2000, a total of 59 foreign investments were approved. However, all the approved investments are not in operation currently.

²⁴ Law No: 25/79, Law on Foreign Investments in all areas except foreign investments in tourism sector, and there has not been any change or amendments brought to the law since then.

²⁵ Both 100% foreign and joint venture investments.

Figure V.1: Approved Foreign Investment in the Maldives, 2002-2008



126. Right to 100% foreign ownership, legally backed investment guarantee, overseas arbitration of disputes, freedom of repatriation of profits and capital, long term lease of land for large scale projects, freedom to use foreign managerial, technical and unskilled workers and no exchange controls are some of the attractive incentives offered by Maldives.

127. The process of registering a foreign investment, as required by Law, is simple and straight forward. The new administration encourages foreign investments in all commercial areas except that are prohibited by the constitution. Foreign investments will get their approval within ten days if that area is included in the Positive list. The company has to be registered and an Agreement has to be signed before starting the operation.

Box V.1 Options for registering foreign investments		
Option I Proposal for registering Joint Venture investments whose proposed activity(s) is in the "positive list"	Option II Proposal for registering Joint Venture investments whose proposed activity(s) is NOT in the "positive list"	Option III Proposal for registering Wholly owned by foreigners or legal Entities incorporated outside of the Maldives

128. A decision on all inward investment proposals, which meet the conditions, stated in Option I, are made and communicated to the investor within ten working days, while all foreign investments, which meet the conditions stated in either in Option II or Option III are made and communicated to the investor within 30 working days, upon submission of all the relevant documentations.

Box V.2

List of investments approved by the Government

Positive List – List of investments approved by the Government

1. Financial consultancy
2. Auditing services
3. Insurance services
4. Water sports services
5. Commercial diving (salvage)
6. Domestic air transport services
7. Catering services for airlines
8. Big game fishing
9. Technical support services i.e. photocopies, elevators, ATM machines, etc
10. Manufacturing of garments
11. Water production, bottling and distribution
12. Consultancy in public relation, editorial, advertising and translation services
13. Packing and distribution of cement
14. General Sales Agency, Passenger Sales Agency and Cargo Sales Agency for airlines and shipping lines
15. Spa operations and management
16. Water treatment plants
17. Boat building
18. Software development and related support services
19. Domestic maritime ferry services
20. Financial leasing services
21. Fish processing activities
22. Traditional medical services
23. Production of underwater photography, video-graphy and post cards
24. Block ice making
25. Speciality restaurants
26. Professional business valuation services
27. Flying school
28. IT system integration and implementation services

129. Current government is committed to pursue a vigorous investment policy by opening up the economy for more private sector participation through three-pronged approach of:

(1) PRIVATIZATION AND PUBLIC PRIVATE PARTNERSHIP

130. The new wave of privatization process of the government began at the end of 2008. As part of an extensive privatization program, a privatization committee composing of high level state and private sector representative has been established by the government under the direct supervision of the President. The key components of the privatization strategy of the government involve privatization of the state-owned enterprises and seeking public-private partnership.

131. The first phase of privatization involves approximately 20 projects involving different models of privatization from outright sales of shares in SOEs, management contracts, joint venture partnerships and service agreements.

132. Clear guidelines on procurement are being followed with high level participation of both the private sector and civil society. The government strongly believes in raising awareness for public private partnership initiative and holds regular stakeholder meetings to stress the positive consequences of the initiative as well as how to mitigate the associated risk of the initiative.

133. Key expertise from multilateral agencies is also an important aspect of this program. Agencies such as the International Finance Corporation of the World Bank Group are acting as transaction advisors for the government in the privatization of vital SOEs.

(2) INCREASING FLOWS OF FOREIGN DIRECT INVESTMENT

134. The key government agency in charge of promoting investment into the country is Invest Maldives²⁶, an agency operating under the MED. The functions undertaken by former Foreign Investment Services Bureau (FISB) was overtaken by Invest Maldives with its own corporate logo, website, rules and organization structure.

135. The overall task in the short-to-medium term is to conduct targeted investment promotions efforts, particularly concentrating on South-South FDI inflows from within the region and Asia. Greater emphasis is now placed on not just promoting investment, but also on servicing investments in the Maldives. Non-traditional and cost-effective avenues for advertising and marketing, such as marketing investment opportunities to high-net worth individuals that visit the country are being evaluated. Greater use will be made of Maldivian embassies abroad, and more will be done to harness the attractiveness of Maldives as a tourist destination to bring potential investors to our doorsteps.

136. In support of these strategies, the new Administration is considering a move away from a Positive-List approach and to adopt a Negative-List approach to facilitate a more transparent investment environment and increase inflow of FDIs.

(3) PROVIDING INVESTMENTS OPPORTUNITIES TO SMES

137. Small and medium enterprises (Sees) sector is one that has been very much ignored in the economic history of the Maldives. However, Sees are viewed as a source of flexibility and innovation, and make a significant contribution to the country's economic development. In Maldives, Sees play an important role in the development and acceleration of the economic growth through employment creation, resource utilization, income generation and sustainability of economy through building up a middle income population. The lack of adequate information on Sees makes it difficult to measure the exact contribution they play in both social and economic development of the country.

138. As evidenced by research conducted by various authorities and institutions including the ADB, some of the obstacles impeding the development of Sees in Maldives include skill deficiencies, costs, asymmetric market information, the inadequate level of business development services especially in the atolls, and the exorbitant costs of inter-island transportation and generation of power. In addition to these noted challenges, structural issues related to both tourism and financial sectors act as major impediments to SME development.

139. In the absence of a proper tax regime, a significant proportion of government revenue has come from a direct lease payment or rent per bed. Demand for resort permits are heavily oversubscribed, with competitive bidding pushing up the rental value per bed. With the upward trend in rent payments, the required returns from the tourism sector has become profitable only to large investments at the expense of crowding out small and medium size participation in the tourism sector.

140. Furthermore, the financial system of the country is characterized by a lack of any centralized credit rating system – one of the crucial reasons that force the commercial banks to rely on high levels of collateral for each loan given. Factors such as high MRR, limited competition and legal limitation

²⁶ www.investmaldives.org.

in using land as collateral limit the lending ability of the service providers. As a result, the financial sector is very shallow and the financial products available to public are limited, in particular for Sees.

141. To address the structural challenges facing Sees, the Government will focus on policies such as creation of more opportunities for SME participation in the three main industries, tourism, fisheries and agriculture, through the formulation of relevant policies. Such include development of human resources in SME sector, provision of business support services and making access to finance more readily available to Sees. Towards this end, the government, with technical assistance from United Nations Development Program (UNDP) and ADB, is exploring the feasibility of establishing an SME Development Bank to operate as a one-stop facility to render SME financing and support services across the country by middle of 2010.

142. The key distinction of an SME bank would be to provide greater support mechanism to borrowers through business advisory services as well as different modes of credit, including both traditional and Islamic financing scheme.

143. The SME Advisory Committee formed under the direction of the Minister of Economic Development with close coordination by the National Planning Council of the Ministry of Finance and Treasury is responsible for coordinating SME policy.

144. Furthermore, the MMA is in the process of setting up a country-wide credit rating system with the assistance of the World Bank and the UNDP. This is expected to ease credit constraints for the SME borrowers, and restrict upward movements in interest rates. It is expected that once the system is operational, greater participation by the private sector in the both the provision of finance and borrowing will take place.

VI. GRADUATION

(1) GRADUATION OF THE MALDIVES FROM LDC STATUS

145. The United Nations General Assembly decided in December 2004 to graduate Maldives and to remove it officially from the list of LDCs. Maldives was to be granted a three year pre-graduation transition period so that the country could work with its development partners on modalities for a smooth transition. However, the decision was revisited in the aftermath of the devastation caused by the Indian Ocean tsunami, which temporarily destroyed two thirds of the country's GDP and destroyed key infrastructure. The new arrangement agreed by the UN is for the three year transitional period to run from 2007 to 2010, whereby Maldives would graduate from LDCs list in 2011.

146. Maldives by virtue of being an LDC enjoys preferential market access and receives technical and financial support and assistance from multilateral and regional as well as bilateral sources. Graduation in 2011 means that the country will face a range of new challenges caused by removal of trade preferences and the loss of several types of technical and financial assistance.

(2) TRADE IMPACT OF LDC GRADUATION

147. Graduation will inevitably lead to loss of benefits from preferential market access to the EU under the EBA Scheme, resulting in the loss of margin of preference, and an immediate imposition of the EU's 24.3% MFN tariff on canned tuna and 12% for fresh tuna. At present, roughly 30% of Maldives exports of tuna goes to EU which is the second largest single export market following Thailand (41%). Clearly this could be a detrimental to tuna exporters as market share would be lost to more competitive MFN exporters, but also to LDCs such as the Solomon Islands and non-LDC

African Caribbean Pacific countries such as Papua New Guinea and Fiji which can continue to export fish products on a duty free basis to the EU under the Cotonou Agreement.

(3) IMPLICATIONS FOR TRADE RELATED TECHNICAL AND FINANCIAL ASSISTANCE

148. After graduation, the Maldives will no longer benefit from most of the forms of Special and Differential treatment such as the participation cost in major events. At the same time, graduation will also increase its level of obligations in the WTO in terms of both commitments and time. Further, Maldives will also see substantial reduction of financial assistance provided by the WTO for participation in different events organized by WTO such as Ministerial Conferences, seminars, workshops and training courses.

149. There will also be implications for the Integrated Framework (IF) and Enhanced Integrated Framework (EIF) programmes for trade related technical assistance, which are only available for LDCs. At present the Maldives benefits from a number of Technical Assistance (TA) projects from the IF participating agencies. Apart from the IF, the Maldives also benefits from a range of TA programmes that could be subject to payment when the country graduates from LDC status.

(4) ACTIONS TOWARDS ACHIEVING A SMOOTH TRANSITION

150. The Government fully understands the importance of ensuring a smooth transition from LDC status and realizes that 2011 is now approaching fast, and that it is vital for an effective transition strategy be put in place. With this in mind, the Government of Maldives has established an inter-ministry "Working Group on Smooth Transition from LDC Status" with the main task of preparing a transition strategy in partnership with international partners such as UNCTAD and UNESCAP.

151. In order to provide a platform for discussion and dialogue between the Government and its development partners on key development objectives, Maldives began in 2006 to host an annual Partnership Forum with bilateral donors and multilateral aid agencies. The 2009 Forum was focused specifically on the issue of graduation and on formulating economic policies and strategies geared to tackle the challenges of middle income country status. At the same time, the government is also making other arrangements and plans to increase domestic resource mobilization and to gear up to attracting more foreign investment.

152. The Government is also working to comply with the eligibility criteria for the EU's GSP+ scheme (special incentive arrangement for sustainable development and good governance) especially for vulnerable countries with special development needs. The Maldives has already acceded to many of the requisite international conventions and is in the process of ratifying the remaining conventions including the conventions of International Labour Organization (ILO), to fulfil this requirement.

153. As part of the smooth transition strategy, Maldives has taken the leadership and tabled a resolution requesting UN ECOSOC to assess the structure and effectiveness of UN support for Small Island Developing States (SIDS). In this regard, the resolution called on the Committee for Development Policy to submit its independent views and perspectives on UN support for SIDS, and for the independent assessment to be considered by ECOSOC in its substantive session in 2010. The resolution was passed and the Committee for Development Policy will conduct a review on aid framework for SIDS.

154. The Government of Maldives is also in the final stages of signing the Trade and Investment Framework Agreement (TIFA) with the United States. TIFA will open doors for entering into the US Generalised System of Preferences. Simultaneously linked with TIFA and GSP, Maldives will also be

eligible for assistance from Overseas Private Investment Corporation and the Millennium Challenge Corporation.

(5) CONTINUED ACCESS FOR TRADE RELATED TECHNICAL AND FINANCIAL ASSISTANCE

155. Securing a smooth transition for Maldives requires continued and sustained assistance from the international community, particularly from the development and trading partners in the form of technical assistance and access to predictable financing. It is imperative that support be continued to address major gaps in supply side and productive capacities, in particular enhancing trade related infrastructure, trade and investment financing, improving national competitiveness, building human capital and technological know-how and capacity. The country need extensive support in diversifying the economy, industries and its export-base, to upgrade and strengthen the legal and regulatory framework to facilitate trade and investment activities and to develop support services for enterprise and SME development.

156. It is in this context and in light of the Government's new economic reform program that continued access to EIF funding is pertinent for Maldives in order to support implementation of priority trade capacity building activities identified in the IF Action Matrix. Extension of EIF benefits post graduation for a 'reasonable timeframe' is pertinent to ensure that the efforts initiated belatedly is not adversely affected. To this effect, Maldives is working closely with the IF Board to explore possibilities to secure EIF benefits post graduation.

(6) FUTURE OUTLOOK

157. The trade policies of the new Government with respect to each major economic activity are stated in the Government manifesto. The document is succinctly in specifying policy targets for short term and medium term for major economic sectors such as fisheries, agriculture, energy, tourism and other essential services.

158. The new Government's policy shifts intend to address the country's existing structural and economic challenges. The manifesto explicitly specifies the continuation of the open and liberal approach that new Government wishes to make as the hallmark of its economic policies. The openness pledged however, is within the context of sustainability, good governance and targeted towards boosting the long term productive supply capacity of the country. The policies also put a particular emphasis on diversifying the productive and tradable sectors as well as the broader social objectives.

159. The proposed policy changes will contribute towards more private sector development, involvement and participation in the local economy and thereby contribute to increase flow of investments.

160. Further, the policy changes will encourage industry diversification, value addition and employment generation potential of tourism, fisheries and agriculture sectors.

161. In addition to strengthening the open economic regime, the policies will in parallel develop the internal market, thereby allowing Maldives to take advantage of, and to integrate better into the global economy.

162. The policies will address the existing distributional inequalities in wealth and income and involvement of SMEs in the local economy.
