

**Trade Policy Review Body**

**TRADE POLICY REVIEW**

**MALDIVES**

**Report by the Secretariat**

This report, prepared for the first Trade Policy Review of the Maldives, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from the Government of the Maldives on its trade policies and practices.

Any technical questions arising from this report may be addressed to Mr. S. Stamnas (tel. 022-739 5382).

Document WT/TPR/G/110 contains the policy statement submitted by the Government of the Maldives.

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



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## SUMMARY OBSERVATIONS

1. *The Maldives, a trade-dependent least developed country (LDC), with per capita income of over US\$2,000, relies heavily on tourism (one third of GDP, 70% of exports in 2001) and its related services (e.g. construction); traditional fishing (6% of GDP), is still important for many Maldivians. Given its smallness and narrow economic base, the possibility of graduation from LDC status (deferred until 2003 at the earliest) particularly concerns the authorities.*

### (1) ECONOMIC ENVIRONMENT

2. *The Maldives' impressive growth rates have been reduced as a result of the recent slowdown in tourism-related expenditure (after a major expansionary phase), a deterioration in the terms of trade from falling world fish prices and rising oil prices, and fewer visitors after the 11 September 2001 events.*

3. *Poor economic management also weakened performance. Escalating fiscal deficits were accommodated by credit expansion from the non-independent Maldives Monetary Authority (MMA). Currency pressures led to the devaluation of the rufiyaa in July 2001, which due to its peg to the U.S. dollar had appreciated considerably, thereby helping to undermine Maldivian international competitiveness.*

4. *External deficits remain substantial; they can no longer be financed by official and private capital inflows. However, foreign exchange reserves remain at almost three months of imports and the debt service ratio is low (2001).*

5. *Although trade and investment have been liberalized, deep-rooted structural weaknesses remain, including the State's prominent role in commercial activities, a narrow tax base, and constraints on economic governance. Tax receipts rely heavily on tourism (a bed levy and rentals on leased island resorts), tariffs, and profits transferred*

*from state-owned enterprises (SOEs). The introduction of a business profits tax on all sectors (not just banking) and a property rental tax on income from leasing is under consideration. It is envisaged that expenditure reforms will include enhanced government controls and better prioritization.*

6. *A privatization programme launched in 1999 is a longer-term priority. Some SOEs have already been partially divested. The main policy focus is to restructure and corporatize SOEs, including rescheduling public debt, with a view to the potential privatization of some of them. The Public Enterprise Monitoring and Evaluation Board oversees SOE performance, and implicit subsidies are being reduced.*

7. *The main markets for Maldives' exports are developed countries, especially the EU (processed fish) and increasingly the United States (garments). Imports are primarily sourced from East Asian economies, especially Singapore, and the EU. Sri Lanka and India are the main trading partners within the South Asian Association for Regional Cooperation (SAARC) Preferential Trading Arrangement (SAPTA).*

8. *The investment regime lacks transparency in parts. Moreover, the Maldives has not been particularly successful in attracting foreign direct investment (FDI), except in especially tourism, but also fisheries and garments. About half of tourist resorts are foreign or jointly run and around two thirds of the stock of non-tourism foreign direct investment is seemingly with two SOEs (telecoms and water/sewerage).*

### (2) TRADE POLICY FRAMEWORK

9. *Trade reforms have been undertaken to foster economic development and private-sector participation in the economy, though trade liberalization is not specifically included in the Sixth National Development Plan, 2001-2005. The Plan calls for making the Maldives a "hub for regional free trade"*

and for developing "a more diversified economy with export-oriented services trade."

10. The Maldives grants at least MFN treatment to all trading partners. It benefits from "special and differential treatment" afforded to LDCs in the form of exemptions or delayed implementation of certain WTO provisions.

11. The Maldives maintains preferential trading arrangements within the SAARC/SAPTA framework, and supports the formation of the South Asian Free Trade Area (SAFTA) and the vision for a South Asian Economic Union.

12. Maldivian exports enjoy unilateral preferences from many developed countries, especially under the Generalized System of Preferences. Preferential access for the Maldives' few export items (mainly canned tuna to the EU) is crucial and depends largely upon its LDC status. Additional SAARC LDC preferences also apply.

13. Executive power is with the President who is in charge of several portfolios in sensitive areas. The Constitution prohibits foreign ownership of land.

14. Trade policy is formulated primarily by the Ministry of Trade and Industries in coordination (on an ad hoc basis) with other ministries. To better coordinate trade policy, a National WTO Committee comprising relevant officials was established in May 2002. More structured dialogue between the private sector and policy makers may be required in order to meet policy objectives.

15. Apart from revised trade legislation, few major changes have been made in recent years to the Maldives' trade and investment legal framework. Nevertheless, several important legislative changes are under way (customs valuation) or envisaged (investment, intellectual property rights). The Maldives, a GATT Contracting Party before becoming an original member of the WTO, seems to have begun the process of ratifying the WTO

Agreements, which are believed to be de facto law. National legislation implementing WTO requirements will make the foreign trade regime more transparent, rules-based, and predictable, thereby increasing confidence of traders and investors.

### (3) **TRADE POLICY INSTRUMENTS**

16. The customs tariff is the main trade policy instrument, and a major source of tax revenue (accounting for some two thirds of total tax receipts). All tariffs are bound, mainly at a rate of 30%, but some (3% of tariff lines) are bound at 300%. Major changes to duties and customs commodity classifications in May 2000 seemingly lowered average rates, although this could not be verified. The average applied MFN tariff (unweighted) is 20.8%. Almost all duties range from 5% to 25%, the most common rate, and well over half of the rates exceed 15%. Tariff peaks of 200% on plastic bags and 100% on motor vehicles, as well as a specific duty of Rf 0.30 per stick on cigarettes, are justified by the authorities mainly on environmental and health grounds. There is a substantial gap between applied and bound tariff rates, currently of 18 percentage points, on average, thus leaving considerable scope for the authorities to raise applied duties; so far it would appear that they have not taken advantage of this scope. Applied tariffs on 149 tariff lines exceed WTO-bound levels; some are almost double; the authorities have indicated their intention to take corrective action.

17. The widespread granting of duty concessions has accentuated the use of the tariff as an industrial policy tool, and undermined its transparency. These incentives may distort producer decisions, accentuate escalation, and intensify budgetary pressures. In 2001, over one third of tariff revenue was forgone through duty concessions,

18. Trade is being facilitated by greater computerization in import procedures. Despite a seemingly adequate preparation of the Customs Service; the Maldives has yet to



fully implement the WTO Customs Valuation Agreement as relevant legislation remains to be passed. Minimum prices are currently used for valuation purposes.

19. Few formal non-tariff barriers are in place. Import restrictions and prohibitions apply for health, safety, security, environmental or religious reasons. All imports require an Open General Licence, which is granted automatically. Import quotas were eliminated in 1998, except on rice, sugar, and wheat flour. In the absence of domestic legislation, no contingency measures have been used. Foreign standards (e.g. Australian, United Kingdom, United States) have been required.

20. State involvement persists in many important sectors (e.g. fisheries, distribution, banking, construction, insurance, utilities). SOEs are major suppliers to the Government as well as traders (accounting for one third of total imports and one quarter of total exports in 2001); a few SOEs (e.g. the State Trading Organization (STO) and Maldives Industrial Fisheries Company (MIFCO)) have diversified into various activities. No SOE seems to have a *de juris* import monopoly; nevertheless, certain statutory or *de facto* monopolies (e.g. electricity, basic telecoms, water/sewerage, airport/seaports management) are in place and SOEs benefit from government assistance (nominal rent on state land, loan guarantees). The STO is allocated 70% (down from 85% in 1998) of import entitlements for rice, sugar, and wheat flour; the retail prices of these items are controlled at near STO levels to ensure supplies at affordable prices. Government procurement seems to have become more transparent through the introduction of open competitive tendering and transparency procedures. The STO was until recently the central purchasing entity for public procurement.

21. Export controls affect live aquarium fish, and timber; exports of a few marine species are banned for environmental reasons. A 50% export tax is levied on ambergris. Some royalties paid by foreign investors under

investment agreements act effectively like export taxes as they apply to only exports; those on garments vary depending on the destination. MIFCO's export monopoly at the national level on canned and frozen tuna no longer operates. Export assistance is virtually non-existent.

22. The Maldives adopted consumer protection legislation in 1996, but has no competition policy. It has specific regulators of electricity and water utilities. It has no intellectual property legislation, but intends to comply with the provisions of the TRIPS Agreement by end 2005; it is preparing copyright legislation..

#### (4) **SECTORAL POLICY DEVELOPMENTS**

23. Scarce and infertile land has made the Maldives a net food-importing LDC; most agricultural activity entails subsistence farming. Government intervention largely involves the use of tariffs and state trading.

24. Fisheries development has been dominated by the state-owned MIFCO but efforts to introduce competition are under way. Under the 2000 Skipjack Industry Development Programme, which has divided coastal fisheries into four geographical zones, the Government licensed two private processors/exporters to operate in one of these zones. MIFCO retains the exclusive right to export processed fish from the other two zones. A floor price scheme, which sets minimum prices for fresh fish, was retained. The Government has stated its intent to privatize MIFCO.

25. The successful expansion of tourism has reduced the Maldives' traditional dependence on fishing. New legislation increased the maximum lease period for islands from 21 to 25 years on investments below US\$10 million, and retained the maximum period of 35 years for larger investments; it also introduced a 50-year lease under certain conditions. Government compensation was introduced for leaseholders transferring facilities at the end of the lease.

*The Maldives Tourism Promotion Board was formed in 1998. A flat-rate bed tax of US\$6 per night is levied on foreign tourists.*

26. *Other services are also receiving increased attention to improve efficiency. A legal and regulatory framework for telecommunications is intended to facilitate the sector's opening when Dhiraagu's monopoly expires in 2008; new internet and mobile phone operators are also envisaged by the end of 2005.*

27. *No restrictions apply to foreign bank subsidiaries or branches, provided that prudential licensing requirements are met. No specific licensing requirements apply to insurance companies, and foreign agents and brokers are allowed to operate. Bank supervision is being strengthened following international (BIS) norms.*

28. *GATS commitments are limited to certain business services; the Maldives did not participate in the extended basic telecommunications or financial services negotiations.*

#### **(5) PROSPECTS**

29. *The authorities believe that the implementation of its multilateral commitments will aid the Maldives' economic recovery. However, without appropriate technical assistance, it will be very difficult to implement WTO-consistent policies. The Maldives assessed its many assistance needs in trade-related areas within the Integrated Framework (IF), and has formally requested coverage by the IF exercise. It is seeking bilateral and multilateral support to meet its WTO commitments.*

30. *Continued structural reforms, including trade and investment liberalization,*

*and the pursuit of privatization could strengthen competition, thereby improving the economy's efficiency. Tariff rationalization, including lower and more uniform rates with fewer exemptions, should facilitate better resource allocation and reduce distortions caused by this tax. Revenue losses associated with such reforms are of critical importance given the narrow tax base.*

31. *The economy remains vulnerable to external factors affecting tourism and fishing. Current fiscal deficits, if not corrected, may weaken the Government's intention for reforms (including privatization, a source of Government revenue), thereby undermining economic diversification. Reform of key services, such as telecommunications, transportation, and financial services, would facilitate such diversification, by reducing costs of doing business, and improve international competitiveness. Improved service (GATS) commitments would raise investor confidence and help attract needed foreign investment.*

32. *A major challenge for the Maldives will be LDC graduation. While the loss of EU and SAARC (special) preferences will require more re-structuring of fish processing, graduation represents a necessary first step in the country's economic transition. Continued over-dependence on unilateral preferences may retard the economy's export diversification, and encourage inefficient industries, like tuna canning, whose products are only competitive in the EU with large tariff preferences.*

33. *Trading partners can contribute substantially to the Maldives' economic development by ensuring reliable, increased, and non-discriminatory access to their markets.*