

THE MALDIVES

Sustaining Growth &
Improving the Investment Climate

April, 2006



Finance and Private Sector Development Unit
South Asia Region
The World Bank

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AG	Attorney General
ATMs	Automated Teller Machines
BML	Bank of Maldives
CICFA	Foreign Investment I-WB
CPI	Consumer Price Index
DBI	Doing Business Indicators
EEZ	Exclusive Economic Zones
ESOPS	Employee Stock Options
FAD	Fish Aggregating Devices
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investment
FET	Faculty of Engineering Technology
GDP	Gross Domestic Product
GEF	Global Environment Fund
HDFC	Housing Development Finance Corporation
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immunodeficiency Syndrome
HRD	Human Resource Development
ICA	Investment Climate Assessment
IDA	International Development Association
IFC	International Finance Corporation
ISBS	Integrated Standard Banking System
ISIC	International Standard Industrial Classification
ITQ	Individual Transferable Quotas
ITR	International Tourism Receipts
LDC	Less Developed Country
MACI	Maldives Association of Construction Industry
MATI	Maldives Association
MCHE	Maldives College of Higher Education
MCS	Marine Control and Supervision
MDGs	Millennium Development Goals
MFA	Multi Fibre Agreement
MFLC	Maldives Finance Leasing Company
MIFCO	Maldives Industrial Fisheries Company
MIGA	Multilateral Investment Guarantee Agency
MMA	Maldives Monetary Authority
MoFAMR	Ministry of Fishing, Agriculture, and Marine Resources
MRC	Marine Research Council
MRfs	Maldives Rufiyaas
MTCA	Ministry of Tourism and Civil Aviation
NDB	National Development Bank

NGOs	Non-Governmental Organizations
OECD	Organization for Economic Cooperation and Development
PE	Public Enterprises
SARS	Severe Acute Respiratory Syndrome
SASAR	South Asia Agriculture and Rural Development
SASFP	South Asia Finance and Private Sector Development
SIDS	Small Island Developing States
SIE	Small Island Economy
SME	Small and Medium Enterprise
SOEs	State Owned Enterprises
STELCO	State Electricity Company
STO	State Trading Organization
SWIFT	Society for Worldwide Inter-bank Financial Telecommunications
SWOT	Strength, Weaknesses, Opportunities, Threats
UNDP	United Nations Development Program
UNEP	United Nations Environment Program
VA	Value Added
VAT	Value Added Tax
VPA	Vulnerability and Poverty Assessment
WTO	World Trade Organization
WTTC	World Travel and Tourism Competitive

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EXECUTIVE SUMMARY

The Maldives has recorded remarkable economic growth over the past two decades, especially compared with the rest of the South Asian countries, and is on the threshold of graduating from Less Developed Country (LDC) status to the middle-income group. It reached an impressive per capita income of \$2,514 in 2004 — from \$771 in 1984 — and has sustained an annual GDP growth of 7.9 percent in the past 15 years. A country that was not even on the economic radar in the 1980s has become a phenomenal success due to a continued stable political environment and strong leadership and commitment to liberalization policies, all of which have attracted a significant level of foreign direct investments (FDI). The homogeneity of race and religion have also partly contributed to the country's long-term social stability. However, due to the combination of the adverse impact of the Tsunami and the expansionary expenditure policies of the government, for the first time in its history, the country has recorded a negative growth rate — 5.5 percent in 2005.

Ironically, although the Maldives lacks the resource endowments, the scale of economies, and the geographical diversity enjoyed by its South Asian neighbors, it has surpassed all of them to achieve the highest per capita GDP levels in the region. What is more remarkable in this island state is the achievement of economic upsurge without compromising human development. *The economic achievements were complemented by high literacy, low maternal and child mortality, declining poverty levels, and improvements in service delivery during the past decade.* Poverty levels have dramatically declined in the Maldives from 23 percent to 8 percent during the period 1997-2004. This has been further reinforced by the significant achievement of the Millennium Development Goals (MDGs) as reflected in box E.1. However, it has also been revealed that income inequality has not undergone much change between 1997 and 2004, reflecting that the economic gains achieved during this period have been more beneficial for the upper echelons of the population. An increasing regional disparity in poverty has also been observed. It is notable that the economic development and poverty reduction were accompanied by rising unemployment (14 percent in 2004) especially among youth (33 percent). This is mainly due to the mismatch in the labor market and the existing skills profile.

The Maldives belongs to a special category of countries called "Small Island Economies," of which a large number are dependent primarily on tourism and or on a narrow product or service range. These countries are characterized by major economic disadvantages, including restricted comparative advantages; diseconomies of scale; dysfunctional market structures; high transport costs; high levels of openness to international trade; tendencies to be price takers not price makers; limited natural resources; and small labor markets with deficiencies in professional and institutional knowledge and experience. Like all countries in this category, the Maldives is also vulnerable to external events, including natural disasters that cause high volatility in national incomes. Many of them are currently facing an uncertain and difficult economic transition to a changing world-trade regime, exacerbated by their limited capacity in the public and private sectors.

Despite the Maldives' phenomenon achievements in economic and social spheres, the extent of their vulnerability was recently brought home with the devastating destruction caused by the Tsunami tidal waves. The combined impact of recent international incidents and natural disasters has temporarily forestalled the upward economic trends enjoyed by the country.

Box E.1 : Achievement of Millennium Development Goals (MDGS)											
Goal	Target	Status									
1. Eradicate extreme poverty and hunger	1. Halve, between 1990 and 2015, the proportion of the population whose income is less than one dollar a day.	Under two levels of income, poverty levels have been more than halved: <table border="1"> <tr> <td></td> <td>1997</td> <td>2004</td> </tr> <tr> <td>Rf 10</td> <td>23%</td> <td>8%</td> </tr> <tr> <td>Rf 15</td> <td>44%</td> <td>21%</td> </tr> </table>		1997	2004	Rf 10	23%	8%	Rf 15	44%	21%
		1997	2004								
Rf 10	23%	8%									
Rf 15	44%	21%									
	2. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.	The proportion of underweight children was reduced from 46-52% in 1990 to 27% in 2004 and can achieve the target of 23-26% by 2015.									
2. Achieve universal primary education	3. Ensure that by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.	100% net enrollment for both girls and boys. Literary rate of 15-24 age cohorts was 98% in 2000.									
3. Promote gender equality and empower women	4. Eliminate gender disparity in primary and secondary education, preferably by 2015, and at all levels of education no later than 2015.	No gender disparity in primary and lower secondary education, but still there is a disparity in the upper secondary levels.									
4. Reduce child mortality	5. Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.	Under-five mortality rate, which was 48 per 1000 live births in 1990, has been reduced to 18 per 1000 in 2003, and can reach 16 per 1000 in 2015. No gender difference.									
5. Improve maternal health	6. Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.	The maternal mortality rate has declined from 500 per 100,000 live births in 1990 to 78 per 100,000 in 2003.									
6. Combat HIV/AIDS, malaria, and other diseases	7. Have halted by 2015, and begun to reverse, the spread of HIV/AIDS.	Only 13 local cases of HIV have been reported since 1991-2003, while 100 foreign cases have been reported during that time. Malaria had been completely eradicated by 1984.									
	8. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.	Malaria is eradicated and all communicable diseases are under control.									
7. Ensure environmental sustainability	9. Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources.	Government of Maldives has mainstreamed environmental sustainability as a priority.									
	10. Halve by 2016 the proportion of people without sustainable access to safe drinking water and basic sanitation.	90% of the people have access to rainwater in the atolls. In Male, 100% of the population has access to high-quality desalinated pipe-borne water.									
	11. Have achieved by 2020 a significant improvement in the lives of at least 100 million slum dwellers.	Not applicable.									

Source : Millennium Development Goals - Maldives Country Report, 2005

What are the most severe obstacles in the Maldives's investment climate? To answer this query, in 2005, an enterprise survey was conducted in three major sectors-tourism, transport-logistics, and manufacturing-covering 148 enterprises. The three sectors jointly accounted for about 50 percent of the GDP and 60 percent of the labor force.

The industrial base is very small and narrow in the Maldives and the enterprises varied in character and size. In addition, neither the government nor industry associations had a comprehensive database of enterprises, only lists of names. There was lack of enterprise data on employment, output, turnover, etc. at the disaggregate level. At the outset of the Investment Climate Assessment (ICA) Survey, the World Bank team worked closely with both the government agencies and the industry associations, but the quality of data shared was relatively poor compared to the rest of the South Asian countries. Given these inadequacies, the ICA team also carried out selected interviews with a large number of public and private enterprises and drew extensively on a plethora of studies conducted in related areas by various international and local agencies. It was interesting to note that

the preliminary findings were corroborated by the enterprise survey data. The survey was supplemented by two major sector studies on tourism and fisheries. In addition, a few case studies were carried out in areas that the government and the ICA team considered important, namely, the construction industry, the handicraft industry, and agriculture (see annexes 2-4).

Most of the enterprises covered were in *Male* Atoll. As is the case of most of the resorts, the head offices are located in *Male*. Given that Maldives does not require an annual registration fee or has a corporate taxation system, the culture of providing data especially on financial performance is relatively new for the enterprises and they were hesitant to engage in this activity.

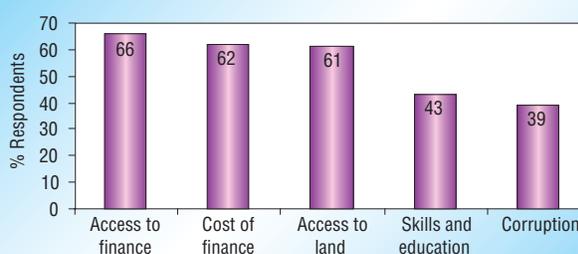
The ICA revealed that, given the poor resource endowments in the country, most of the material inputs —over 50 percent— are imported from abroad, thus limiting linkages to the rest of the economy. However, the capacity utilization of the enterprises was more than 75 percent and they expect that it will reach 100 percent in 2006. The majority of the enterprises are private limited companies and more than 90 percent of them are owned by Maldivian nationals. The enterprises surveyed have been in business for a relatively long period of time—the majority more than 10 years—reflecting stability in the industries. In order to overcome the size and diseconomies of scale, there is a tendency for the entrepreneurs to move into horizontal integration, thus making the industrialists less vulnerable to external shocks and capable of achieving efficiency gains.

Irrespective of intersectoral differences in investor perceptions, there are a number of areas that represent major obstacles to all three sectors, including: (i) access to finance; (ii) the cost of finance; (iii) access to land; (iv) skilled labor; and (v) corruption (see figures E.1- E.4). The entrepreneurs in all three sectors have identified access to finance as one of the most important and most severe constraints affecting enterprise performance. There is, however, a high degree of diversity across the three sectors with respect to the

relative significance and severity of other constraints affecting enterprise performance. For example, entrepreneurs in tourism and transport-logistics have identified the cost of finance as the second major problem, while their counterparts in manufacturing ranked it at third. Similarly, the transport-logistics sector identified access to land as the most severe constraint, while their counterparts in manufacturing and tourism ranked it second and sixth, respectively. Interestingly, entrepreneurs in the tourism sectors identified the relative significance of the lack of skilled labor as the third-highest constraint on investment decisions, while their counterparts in manufacturing and transport-logistics ranked it at the fourth-highest position.

The Maldives is strong in tax administration and has fewer entry barriers. Registering a business is simple, efficient, and not costly, according to the 2006 Doing Business Indicators (DBI-2006). In terms of tax administration, Maldives features a simple and administratively efficient tax system and the country has no corporate taxation system. Even the industries that are subject to some form of taxation, such as tourism and banking, are required to pay taxes only once a year. The Maldives has

Figure E.1
Overall Top Five Constraints



Source: World Bank, Maldives, ICA, 2005

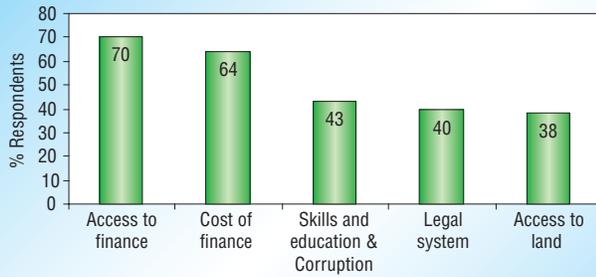
been rated "global best" in terms of taxation, along with Hong Kong.

Telecommunications also does not appear to be a major constraint to the Maldives entrepreneurs. In the recent past, with the increasing educational achievements telecommunications has emerged as an industry with high growth potential. It has also opened up new avenues for the industrialists and has contributed to the growth and expansion of industries. The penetration of the telecommunications industry in the Maldives is very high compared to other South Asian countries. The use of modern communications technology is significantly high among the business community and is expected to pave the way for mobile phone banking, a modern concept that has been found cost effective and important for improving access to financial services in the recent past in countries like Brazil and Philippines.

The perception of corruption in the Maldives is better than in other South Asian countries. The Maldives has scored 4.2 according to the Corruption Index of the Transparency International 2005,¹ but there is significant scope for improvement compared with Singapore (9.2). In the World Bank Governance Indicators (GI) of 2005, the Maldives ranked second best in control of corruption in South Asia, just behind Bhutan and ahead of all others. However, the overall Governance Indicators for 2004 for Maldives have deteriorated compared with those of 2002 (refer to chapter 3). This perception has been supported by increasing print and electronic media exposure on perceived conflict of interest, which will affect the business environment in the medium term. In addition, in the ICA enterprise survey, corruption featured as a relatively important obstacle to business; the informal payment for obtaining licenses was reported as high as 6 percent of sales, much higher than in other South Asian countries (2%). It also revealed that investor confidence in the judicial system is low at 38 percent, compared with Sri Lanka (69%) and India (71%). Another concern raised by investors is the unclear demarcation between the roles of the public and private sectors. This is an emerging concern for most of the small countries, including Bhutan and Sri Lanka. The Maldives was rated 31 out of 155 countries in DBI 2006 for ease of doing business, ahead of all South Asian countries; however, to consolidate its position, it should continue to improve public disclosure, transparency, and accountability in its public policy matters and better manage conflict of interest (refer to annex 1).

Access to finance emerged as the major obstacle to business in the ICA survey. In all major sectors, as well as the construction, handicraft, and agriculture sectors, access to and cost of finance featured high

Figure E.2
Top 5 Constraints in Tourism Compared with Other Sectors



	Access to finance	Cost of finance	Skills and education & Corruption	Legal system	Access to land
Tourism	1	2	3	4	5
Manufacturing	1	3	4 & 5	6	2
T&L	3	2	4 & 6	9	1

Source: World Bank, Maldives ICA, 2005

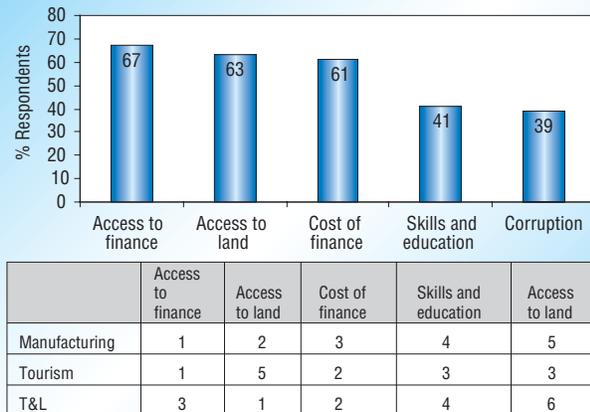
1 Transparency International 2005 and University of Passau. Since the Maldives' CPI is based on one survey, it is not listed in the general CPI ranking list but available in the extended list.

on the list, with a leading margin. The financial sector is shallow and the banks have been following a very conservative approach — a far cry from the modern and competitive banking that is emerging elsewhere in the region. The minimum reserve requirement is 30 percent, which restrains the ability of the banks to lend. There is high sector exposure to tourism and, except for the only domestic bank in the Maldives, others have been serving primarily the corporate sector. The commercial banks are still focused on collateral rather than on cash-based lending and there are no venture capital companies in the country to support the emerging industrialists in the nontraditional and SME sectors. In addition, there is no credit information system and the government and the Maldivian Monetary Authority should consider promoting the establishment of a private Credit Information Bureau that would facilitate lending, especially to new investors.

The entry of new players such as Maldivian Leasing Company and the Housing Development Finance Corporation (HDFC) into the financial market has spurred some level of competition in the minds of the traditional bankers. The leasing company has been quite active in equipment financing, especially in the tourism sector and the fisheries. In addition, the development role played by the Bank of Maldives also has instigated the other banks to look beyond the Male Island, thus reflecting a deepening of the market. The geophysical structure of the archipelago imposes a high cost of operations, which discourages the banks from lending outside of Male. This has been overcome in other countries like the Philippines and Brazil by introducing mobile-phone banking, especially for micro-enterprises. This strategy provides great potential, given the high penetration of telecommunications. Unlike the rest of the region, Maldives lacks an entrenched culture of savings, which also poses a problem for banks in mobilizing long-term domestic resources in the country. The negative rate of return on savings due to increasing inflationary trends and the attractive investment opportunities for the Maldivian Diaspora in the region also discourage domestic savings. The Maldivian companies could also consider listing in emerging stock markets like Colombo and Mumbai.

The reluctance of the bankers to be more proactive to the market demand is also restrained by the absence of a strong legal framework and weak enforcement capacity. The Maldivian judicial system is based on a combination of Islamic Shari'ah law and common law in the commercial sector. The exit barriers are quite prohibitive since there are no insolvency or bankruptcy laws and the average time taken to close a business is 6.7 years compared to the regional average of 4.2 years. The banks complained that the recovery of bad debt, despite court orders, has been quite time consuming and costly, thus leading to relatively high nonperforming levels in the past. This situation has improved in the recent past, with the banks currently recording less than 10 percent

Figure E.3
Top 5 Constraints in Manufacturing Compared with Other Sectors



Source: World Bank, Maldives ICA, 2005

nonperforming loans. The banks also complain of a mismatch of maturities between deposits and lending portfolios. There is adequate empirical evidence to reflect that the micro and small enterprises have difficulty in access to finance and that the cost is also a major concern for them.

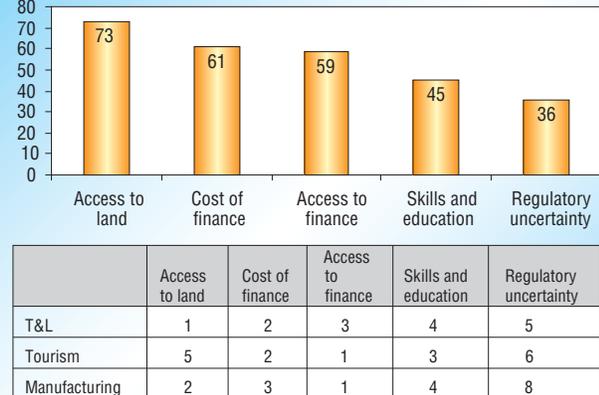
Relating to the financial constraint, access to land is also a major obstacle identified by a large number of the enterprises interviewed during the ICA survey. Most of the enterprises (between 48 and 75 percent) carry out their businesses in rented or leased land. Given the traditional allocation of land by government at request, there is no proper land market in the Maldives. However, with the commencement of the Hulhumale Development Project, adjacent to the Male Capital Island, there is an emerging land market. There is also a need for a paradigm shift for the government from being a provider to a facilitator and a regulator. One of the major bottlenecks in recent years has been eliminated with the entry of the new housing finance company, the HDFC. However, at the initial stages, financial assistance from external sources may be needed. This need is more pronounced at present, given the fiscal constraints faced by the Maldivian economy due to the Tsunami and to some of the expansionary policies adopted by the government to contain rising social and political tensions. The absence of a vibrant private land market aggravates the access-to-finance issue, especially since banks are still focused on collateral-based lending rather than cash flows. The government should promote the establishment of a modern movable assets registry to encourage using such assets as collateral. This exercise could be combined with a Credit Information Bureau.

Another major obstacle that has been highlighted is the emerging skills mismatch in the Maldivian labor force and the high proportion of foreign labor. As indicated by the achievement of MDGs given in box E-1, the Maldives has been able to achieve high educational attainments in terms of literacy, enrollment, etc. However, the quality of education and work ethics demanded by the market have not been adequately developed. This has led to a dysfunctional labor market that creates high reliance on migrant labor. There is no easy and immediate solution to this emerging problem, given the Maldives' proximity to a large, cheap labor market in India, Sri Lanka, and Bangladesh. From the perspective of the industrialists, it is a positive development, but from a long-term economic and social perspective, it poses a major threat that needs to be addressed without affecting industry performance.

Tourism Sector

The Maldives has been very successful in developing its tourism industry and enjoys an enviable image in the marketplace. The Maldivians' entrepreneurial flair and the liberal investment climate have resulted in 30 years of continuous growth. While the Tsunami was a major setback, the country has shown great resilience. The Maldives enjoys the support of the travel industry, for it offers a superior

Figure E.4
Top 5 Constraints in T&L Compared with Other Sectors



Source: World Bank, Maldives ICA, 2005

beach product, and tour operators have continued to treat the country as a favored destination. The country has 87 resorts with about 30 more planned and a fleet of more than 100 sailing safari vessels, all contributing to a capacity of about 20,000 beds. In 2004, the country hosted 618,000 tourists, a record number. Its hotel occupancy (more than 80%), average length of stay (more than 8 days), and daily expenditures (approaching \$200/day) are all high by international standards.

Issues are emerging on the horizon and it is time for the growth strategy to be reviewed. It is a long-haul destination, more than ten hours from originating markets with only one major airport, which is likely to be a severe constraint to market expansion. Newer investments seem to be pitched at nontraditional markets without adjustment to the new realities in other parts of the supply chain. Although there is still great scope for market development, the country's product line appears vulnerable if there is no differentiation and segmentation. Tourists are looking for more active pursuits. While the country has adopted a sound environmental stance, some aspects-like coastal zone management-need attention. There is also a need for increased linkage with the local communities.

Maldives has long relied on a public sector role limited to creating the environment for sound investment in tourism and managing the leasing process, with private sector companies bidding on individual islands. The decision to increase the speed of issuing new resort leases represents a fundamental change in Maldives' policy of expanding the sector gradually. A number of current operators are known to be very concerned at this change in policy. As part of the proposed expansion, the government has decided to create a public enterprise that would hold leases at low, preferential rates in a number of islands, and sell these to new operators. It would also sell some shares to the Maldivians on the stock market. This concept is still evolving, but advantages it would have for the country are not clear. The public enterprise would have a fixed stream of income (a share of island rents) that would not increase over time unless indexed to the rise in profits of the resorts themselves; a public sector company might in fact discourage investments in a sector so long dominated by the private sector. It might be possible to structure a public company to buy shares in approved resorts, which it would then hold and sell on the open market to Maldivians —with a clear timetable and exit strategy. A more market-oriented way of encouraging broader Maldivian participation would be to promote employee stock option plans (ESOPs), encourage tourism companies to list on the stock market, and provide incentives for senior managers in the industry and young entrepreneurs to become investors.

A public company could play a useful role, provided it has autonomy of action. One weakness in the Maldivian tourism system is regulation and inspection. A public company could become a regulatory agency with a small earmarked tax to fund its operations. Although most firms in Maldives are conscious of regulatory issues, such an agency could strengthen the emphasis on quality and address licensing and standards issues (including physical and human resources), an essential part of improving the islands' image in international markets.

Fisheries

The fishing sector is a fundamental pillar of the national economy in terms of GDP, employment, and exports. Growth in the fishing industry has increased since 2002 based mainly on increased catches and

firming up of export prices. The Tsunami had only a moderate and short-term impact on fishing efforts. The primary Maldives fish product is frozen skipjack tuna, exported mainly to large markets in Thailand and Japan. Commercial "pole and line fishing" methods for tuna in Maldives are unique and offer a niche marketing advantage for environmentally friendly tuna.

The sector is in transition, with a shift to larger mechanized vessels having greater capacity within a rapidly changing global trading environment and structural changes in the domestic market. Further private investment is needed for modernization to remain competitive in global markets. The positive side of the investment climate includes large skipjack tuna stocks, a highly educated labor force, expeditious procedures in importing and exporting goods, and excellent communications systems. The negative side of the investment climate is led by poor access to finance. In addition, significant public investment is needed in selected activities of public infrastructure; MIFCO (Maldives Industrial Fisheries Company Limited); monitoring, control, and surveillance systems; and research, training, and quality control.

Despite a reasonably positive business outlook, this sector still faces difficult challenges. In a nutshell, growth can continue to be based on rapidly expanding production and exports in markets in which Maldives' fishing industry has traditionally operated, facing high risks of strong future pressures on prices and margins while remaining a modest producer in global markets. Or it can target fresh fish markets with new products, optimizing net national benefits rather than production. Future sector development will require a very different public role, focused on enabling and supporting private sector initiatives and investments.

A long-term strategy is urgently required to guide longer-term sector development, including a more aggressive approach to actively pursuing foreign and local investment. In this regard, the World Bank and the Food and Agriculture Organization (FAO) are currently assisting the Government of Maldives to prepare comprehensive analytical work and policy studies to underpin the development of a long-term Fisheries Master Plan.

The policy recommendations for critical and short term reforms are presented in Box E.2.

Box E.2 : Recommendations for Critical and Short Term Reforms (Details in Chapter 7)		
Sector	Issues	Recommendations
Finance	<ul style="list-style-type: none"> o High cost of finance o Lack of a credit information system o Inadequate SME financing o Lack of collateral o Lack of long-term finance 	<ul style="list-style-type: none"> o Introduce new products for equity and guarantee funds and provide training for bank staff on development finance o Access external finance for SME, housing finance with external help o Establish a modern Credit Information Bureau and a Movable Asset Registry o Introduce a contributory pension fund for new recruits and separate the retirement savings from the redistributive function o Conduct a financial sector study to develop a sector strategy focusing on development
Land and Housing	<ul style="list-style-type: none"> o Role of the government o Lack of a housing finance policy o Land law land administration o Lack of capacity 	<ul style="list-style-type: none"> o Change the role from being a provider to a facilitator and build public-private partnerships o Divest shares in HDFC to improve mortgage financing o Develop Hulhumale of mixed land uses and public agencies to pay market rates o Conduct local research and training, possibly with international funding
Skill Development	<ul style="list-style-type: none"> o Inadequate training and skills development o Mismatch in skills mix 	<ul style="list-style-type: none"> o Increase intake at graduate level for relevant subjects o Encourage in-house and external training at firm level o Further strengthen public-private partnerships in the delivery of training services o Explore the possibility of conducting joint programs with neighboring countries o Establish close linkages and partnerships with private sector industry/organizations for mutual benefit and for the improvement of the quality and relevance of training programs o Design labor-market policies to promote private sector development while increasing opportunities for youth
Legal and Regulatory Framework	<ul style="list-style-type: none"> o Lack of more advanced legal and regulatory framework o Weak law enforcement capacity 	<ul style="list-style-type: none"> o Enhance human-resource development for legal and judicial services in commercial law o Draft new laws in the areas of commercial law o Introduce Alternate Dispute Resolution mechanisms through mediation o Set up a high-level steering committee with all stakeholders-legal finance, and judicial-to better coordinate for proposed reforms
Good Governance	<ul style="list-style-type: none"> o Weak regulatory framework o Insufficient transparency in public policy 	<ul style="list-style-type: none"> o Improve and build a strong and independent judiciary and audit agency with enhanced capacity o Establish and enhance a Public Procurement Bureau with Web-based information disclosure on tender procedures, contract awards o Delineate public and private sector roles to avoid conflict of interest o Increase participation of business associations, including small-scale businesses, in the policy dialogue
Tourism	<ul style="list-style-type: none"> o Increasing rent on land leases o Employment and training o Lack of a culture-based tourism o Lack of a comprehensive taxation system 	<ul style="list-style-type: none"> o Separate technical and financial proposals o Establish land indices to be applied across the board o Possibly introduce a second price auction o Better supervise construction standards o Carry out a needs assessment on training requirements o Continue to respect cultural diversity and create awareness among the communities o Carry out a tourism taxation study
Fisheries	<ul style="list-style-type: none"> o Absence of a comprehensive sector strategy to guide policy development, investment, and management o Requirement for stronger and more effective institutions within the sector o Need to increase private investment in the sector o Defining the role of Maldives' fisheries sector in a rapidly changing global market o Improving offshore and inshore fisheries management systems 	<ul style="list-style-type: none"> o Prepare a comprehensive, long-term Fisheries Master Plan that encompasses evaluation of policy options, identifies investment and development strategies, and sets out new approaches for fisheries management o Complete revised regulatory framework to help implement new fisheries legislation o Conduct strategic planning for MoFAMR [Ministry of Fisheries, Agriculture and Marine Resources] to facilitate restructuring and focus on key business functions o Strengthen local institutions involving key stakeholders o Actively promote foreign and local investment in the sector through information dissemination o Engage IFC and multilateral agencies and local financial institutions in sector dialogue and information sharing on how to improve access to capital o Clarify the future role of the MIFCO and prepare a timeframe for the remaining privatization process o Strengthen information programs to position Maldives' tuna as ecologically friendly in western markets o Involve local communities in tuna long-line fishing for fresh fish exports o Develop logistics models and information systems to rationalize fish harvesting, processing, and marketing o Test new technologies to strengthen monitoring effectiveness in Exclusive Economic Zones (EEZ) o Pilot programs to test co-management of inshore resources with local communities o Develop a strategic plan for fisheries-sector research and options for new partnerships with external institutions

Chapter One

MACRO-ECONOMIC OVERVIEW

"Small states like the Maldives happen to be in the front line of most of the crises that afflict or threaten the world. From environmental degradation through international lawlessness to energy crises, it is the small states who are often the first victims."

*His Excellency Mr. Maumoon Abdul Gayoom, President of the Republic of Maldives
at the 2005 World Summit - United Nations*

1.1 What is the Investment Climate and Why does it Matter?

There is an increasing awareness of the need for a better investment climate in countries, in order to stimulate higher growth and reduce levels of poverty. The term investment climate broadly encompasses the policy, regulatory, institutional, and governance environment that supports entrepreneurship and efficient markets. A favorable investment climate creates opportunities for firms and entrepreneurs of all types. More governments are recognizing that their policies and behavior play a vital role in shaping the investment climates of their societies and they are consciously making changes. The most compelling examples are China and India. Many other governments are introducing reforms, but the progress is somewhat slow and uneven.

World Bank studies have been conducted in more than 53 countries surveying more than 30,000 firms in all parts of the world.² In South Asia, investment climate assessments have been conducted in all seven countries. The recent research has highlighted four main issues that need attention: (i) the investment climate should benefit the society as a whole, not just firms; (ii) efforts to improve the investment climate should go beyond reducing business costs; (iii) progress requires more than changes in formal policies; and finally, (iv) governments need to address major constraints to build up investor confidence and, most importantly, sustain the reform process in the long run.

1.2 Why Conduct an Investment Climate Assessment (ICA) in the Maldives?

The main objective of the investment climate study in the Maldives is to develop a better understanding of the constraints to support more rapid expansion and growth of investments in the formal enterprises in the Maldives, provide input to the Seventh National Development Plan, and identify priority areas for funding for the country's development partners, including the World Bank. Compared to the rest of the region, the Maldives has been able to provide a relatively better policy environment for investors. However, the results of the study will be useful for the government and the private sector in the Maldives and donor organizations for creating an even more conducive policy environment to further improve the investment climate over time.

2 World Development Report 2005-World Bank.

ICAs generally use a rigorous and a standardized approach to measure investment climate conditions in countries. These assessments also provide cross country-comparisons wherever possible while at the same time allowing the flexibility to address the specific needs of the country. ICAs cover factor markets, product markets, infrastructure services, and firm performance measures to the extent possible. In addition, they also use the available literature extensively to place the survey results in a broader macroeconomic context. The survey findings reflect the perceptions of investors in major sectors, which will be a useful input for the governments in their policy formulation process.

1.3 Facing the Special Challenges of being a Small Island Economy (SIE)

Small islands are defined as those with a total population below 1.5 million.³ Since the 1940s, more than 80 small states have become independent or have secured increased autonomy from their former colonial rulers. Of these, a large number are dependent to some degree on tourism and have tropical or subtropical climates. SIEs are characterized by profound economic disadvantages, including restricted comparative advantages; diseconomies of scale; dysfunctional market structures; high transport costs; high levels of openness to international trade; tendencies to be price takers not price makers; limited natural resources; and small labor markets with deficiencies in professional and institutional knowledge and experience.

Developing small states share a number of characteristics that pose special development challenges. They are especially vulnerable to external events, including natural disasters, which cause high volatility in national incomes; many of them are currently facing an uncertain and difficult economic transition to a changing world-trade regime; and they suffer from limited capacity in the public and private sectors. Box 1.1 reflects the special development challenges and vulnerabilities that many small states face.

Box 1.1 : Special Development Challenges and Vulnerabilities for Small Island Economies

- o **Remoteness and isolation.** Of the developing small states, the majority are islands, some are widely dispersed multi-island states, and most are located far from major markets. High transport costs make it harder for them to turn to world markets to compensate for the drawbacks of the small size of their domestic markets. Small domestic markets, combined with greater distances from other markets, reduce competition and lessen opportunities to improve efficiency and innovation.
- o **Openness.** Usually a high degree of openness to the rest of the world brings benefits. But it also means that small economies are heavily exposed to events in global markets, and developments in the global trade regime, over which they have very little influence. They also tend to rely more heavily on taxing imports as a source of revenue, leading to difficulties when tariffs are reduced.
- o **Susceptibility to natural disasters and environmental change.** Most small states are in regions that are susceptible to natural disasters such as hurricanes, cyclones, drought, and volcanic eruptions, which typically affect the entire population and economy. Some are threatened by global environmental developments. Since most of such adverse events affect the entire population, risk pooling at the national level is not feasible.
- o **Limited diversification.** Because of their limited domestic markets, many small states are relatively undiversified in their production and exports. Where one dominant activity declines, it is replaced with another. This adds to vulnerability to changes in the external environment.
- o **Poverty.** There is some evidence that poverty levels tend to be higher, and income distribution more uneven, in smaller states than in larger ones. Where this is so, income volatility can create additional hardship as the poor are less able to weather negative shocks to their incomes.
- o **Limited capacity.** While weaknesses in both public and private sector capacity are a key problem for most developing countries, small size adds a further dimension to the challenge. This is further compounded in states, where the internal distances are large and the population is scattered. In the public sector, small states face diseconomies in providing public services and in carrying out the business of government, and tend to have relatively larger public sectors than other developing countries. As they face the challenges and opportunities of globalization, small states find that they do not have sufficient institutional capacity to participate fully in international finance and trade negotiations-the outcomes that can profoundly affect their economies. In the private sector, as already noted, the lack of diversification and domestic competition can hold back successful development.

Source: Small States Meeting Challenges in the Global Economy-Report of the Commonwealth Secretariat/World Bank Joint Taskforce on Small Economies-April 2000.

3 Commonwealth Secretariat, 1997.

Many of these factors combine to make small states' economies especially vulnerable, and in particular, they affect income volatility and access to external capital. The Maldives belongs to the category of highly vulnerable SIEs and therefore one needs to take this into consideration in the investment climate assessment. Compared to the other economies in the region, the Maldives' economy is small in size. For instance, Maldives is but a fraction of Sri Lanka, one of the smallest countries in the region. The Maldives' population is only 1.5 percent of the Sri Lankan population, the Gross National Income is only 3.6 percent, and exports are only 8.9 percent of exports in Sri Lanka.

1.4 Macroeconomic Environment

The Maldives, known as "Divehi Rajje," is a small island economy comprising a chain of Indian Ocean islands spread over a distance of 900 kilometers. The total land area is less than 300 square kilometers and covers about 26 geographic atolls. The estimated population in the Maldives is about 300,000 and the country has 1,190 islands, of which 198 are inhabited. Of these islands, only 33 have a land area greater than one square kilometer. One-third of the inhabited islands have a population of less than 500, and 70 percent of the inhabited islands have a population of less than 1,000.⁴ However, the population density is 977 per square kilometer; one of the highest in the world.⁵

	1996	1997	2002	2003	2004 estimate	2005 estimate
GDP growth	9.10%	10.40%	6.50%	8.50%	8.80%	-5.50%
Inflation - CPI	6.20%	7.60%	0.90%	-2.90%	6.50%	8.00%
Employment - Government	15,862	18,022	26,363	28,651	-	-
Employment - Expatriate	21,169	16,744	30,664	33,765	-	-
Exchange Rate (Rf per US\$)	11.77	11.77	12.8	12.8	12.8	12.8
Total external debt (% GDP)	38.50%	35.60%	40.40%	40.70%	42.00%	48.90%

Source: Maldives - Ministry of Planning and National Development, Ministry of Education and World Development Indicators.

The Maldives has recorded remarkable economic growth over the past two decades, especially compared with the rest of the South Asian countries, and is on the threshold of graduating from Less Developing Country (LDC) status to the middle-income group (Table 1.1). In 2004, it reached an impressive per capita income of \$2,514, up from \$771 in 1984; this reflects more than a threefold increase during the past two

decades. The Maldives has enjoyed strong economic performance over a sustained period of time, with real GDP growth averaging more than 7.9 percent in the past 15 years.⁶ A country that was not even on the economic radar in the 1980s has become a phenomenal success due to continued stable political environment and strong leadership and commitment to liberalization policies, all of which have attracted foreign direct investments.

4 Maldives Tsunami: Impact and Recovery. Joint Needs Assessment by World Bank-ADB-UN Systems, February 2005.

5 World Development Report, 2006.

6 World Bank-Maldives Economic Update- December 15, 2004.

Ironically, the Maldives lacks the resource endowments, the scale of economies, and the geographical diversity enjoyed by its South Asian neighbors, but it has surpassed all of them to achieve the highest per capita GDP levels in the region. What is more remarkable in this island state is the achievement of economic upsurge without compromising human development. The economic achievements were complemented by high literacy, low maternal and child mortality, declining poverty levels, and improvement in service delivery during the past decade, as shown in table 1.2.

	1996	1997	2002	2003	2004 estimate
Infant Mortality (per 1000 live births - under 1 year)	28	27	18	14	-
Child Mortality (per 1000 live births - under 5 years)	39	39	23	18	-
Life expectancy	-	70	73	70	-
Adult Literacy Rate (% of people ages 15 and over)	96.1	96.4	97.2	-	-
Public Education Expenditure (% GDP)	4.6	5.4	7.8	8.1	-
Poverty - Male (% below Rf 10)	-	8	-	-	0
Poverty - Atolls (% below Rf 10)	-	28	-	-	11
Source: Maldives - Ministry of Planning and National Development, Ministry of Education and World Development Indicators.					

However, despite the Maldives' phenomenal achievements in the economic and social spheres, the Tsunami tidal waves also washed ashore the message of the country's high vulnerability to natural disasters. The high level of global integration brings with it the vulnerability to external shocks such as the downturn in tourism after the terrorist attack on the World Trade Center in 2001, the outbreak of SARS in East Asia in 2003, and the escalating fuel prices since 2004. The combined impact of these international incidents has temporarily forestalled the upward economic trends enjoyed by the country that, for the first time in its recent history, had a negative growth rate of 5.5 percent in 2005.

In addition, the Maldives is facing the challenges of increasing unemployment and underemployment of the educated Maldivian youth and increasing inflationary trends. Continuation of such adverse trends could bring in social unrest, as demonstrated by the recent incidents in *Male*, which will have social and economic implications in the long run. The loss of assets due to the Tsunami has been estimated at 62 percent of the Maldives' GDP and the government is expected to face budgetary constraints requiring significant levels of budgetary support from foreign sources. This might result in severe pressure on the exchange rates.

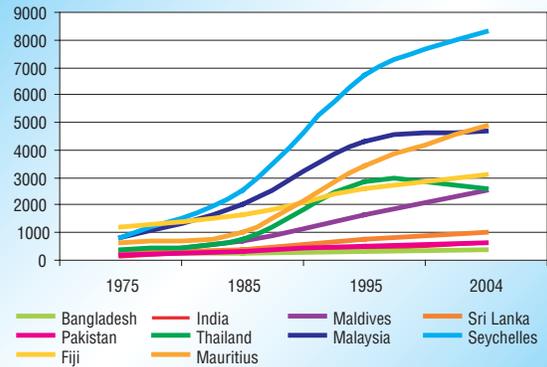
1.5 Economic Upsurge in the Region with a Trickle-down Effect on Social Development

Economic growth in the Maldives has been spectacular from an Asian context, with per capita income escalating from \$192 in 1975 to \$2,514 in 2004; this reflects a 13-fold growth compared to other South Asian countries, who have recorded only marginal growth ranging from 2 times in Bangladesh to 4 times in India during the same time period. As can be seen in figure 1.1, Maldivian per capita growth had even exceeded the East Asian countries: Malaysia (6 times), Thailand (7 times), and Singapore (10 times). Some of the comparable smaller island economies, who were at a higher base than the Maldives even in 1975, have also grown at a lower pace, as is the case for Seychelles (10 times), Fiji (3 times), and Mauritius (8 times). However, the Maldives' economic growth had a setback in 2005 and more prudent government expenditure policies will be required to ensure that this is a temporary phenomenon.

The increase in per capita has been coupled with great strides in human indicators, with Maldivians achieving a life expectancy of 70 years, infant mortality dipping down to 14 per thousand live births, maternal mortality declining to 1 in one thousand live births, the adult literacy rate reaching 97 percent, and the poverty levels declining to 8 percent.

These changes were mainly due to the government's policy of improving access to health and education not only in *Male* but also addressing these issues in the outer Atolls. However, regional disparities still exist and the government's policy on regional development is expected to ameliorate these disparities. Though regional development was a priority area identified in the Sixth National Development Plan, progress seems to have been rather slow. The development of Hulhumale Island adjacent to the main island of *Male* to address emerging issues of high urbanization, increasing unemployment in *Male*, the inward migration to *Male*, and the lack of land for expansion need to be resolved when the fiscal pressure on the government budget eases off. In addition, the government needs to increase public-private partnerships in development work, as in the case of *Male* water treatment project.

Figure 1.1
GDP per capita (current US\$)

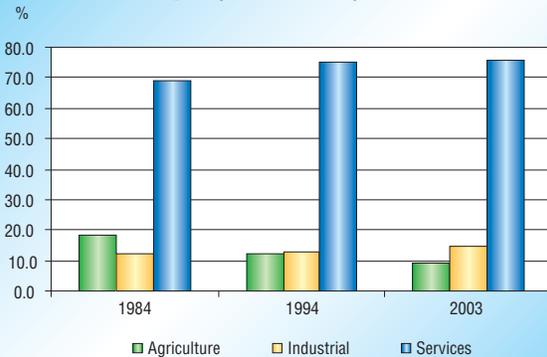


Source: WDI and UN statistics

1.6 Continued Narrow Economic Base

Over the past two decades, the structural change in the economy is only marginally visible as experienced in many a small island economies. The agricultural sector, including fishing, accounted for 18.6 percent of the GDP in 1984 but declined to 9.4 percent in 2003, while the industrial sector accounted for 12.3 percent in 1984, increasing to 14.9 percent in 2003 (figure 1.2). The decline in agriculture was offset by the services sector, which accounted for 69.1 percent in 1984, expanding to 75.7 percent in 2003. Within the agricultural sector, the decline mainly came from fishing, which accounted for 11.8 percent in 1984, dipping down to 6.6 percent by 2003.

Figure 1.2
Structural Changes (1984 - 2003)



Source: Maldives - Ministry of Planning and National Development

The industry sector that includes the construction industry increased its contribution to GDP from 2.7 percent to 3.6 percent between 1984 and 2003. In the services sector, tourism accounted for 32.7 percent, transport and communication 14.2 percent. In the recent past, the transport and construction sub-sectors have shown significant growth potential. With the increase in tourism, development projects such as Hulhumale, and reconstruction efforts in Tsunami-affected areas, the construction sector would have further enhanced its potential for growth. However, in 2005

the manufacturing industries recorded much less growth since the garment factories in the Maldives closed down after the phasing out of the Multi Fibre Agreement (MFA). The narrow economic base poses a major threat to the country and demonstrates the need for further diversification to the extent possible, given the limited resource base.

1.7 A High Level of Global Integration and Excessive Reliance on Imports

The Maldives has a very low level of natural resources other than "sun and sand," which the country has exploited to a great extent through tourism. However, all food products, fuel, raw material, and intermediate goods need to be imported. Unlike all of the other countries in South Asia, the Maldives does not have any hydro potential for electricity and also needs to desalinate sea water for consumption and other uses. The export base is very narrow, with only fish products accounting for 16 percent of the GDP. Since 2004, with the exit of garment exporters, fish has become the only export product. Conversely, all of the essential food products, such as rice, flour, and vegetables, are imported, bringing the share of imports as a percentage of GDP up to 68 percent in 2003. The flourishing tourism industry is highly reliant on imports, with all food products, fruits, and vegetables being imported from neighboring countries. Thus, the tourism industry has not created adequate direct linkages with the rest of the economy; however, it has provided an indirect impetus to other sectors such as transport, construction, and import trade.

The openness indicator⁷ in the Maldives has increased from 64 percent in 1984 to 85 percent in 2003, reflecting a high level of integration with the international economy. While this is a barometer of the country's open economic policies, it also demonstrates the nation's vulnerability to changes in the external environment.

The Maldives follows a more *laissez faire* trade policy⁸ than other countries in the region: the average tariff is about 23 percent and some quotas are in effect. Duty exemptions amounted to 36 percent of the total import duty collected and loss of revenue had been \$32.0 million in 2004, of which 50 percent was in lieu of foreign investments.⁹ Taxes on imports are relatively nondiscriminatory. Since there are virtually no import-competing domestic industries other than handicrafts, differences in tariff rates are commonly imposed on certain goods or activities for the same reasons as is the case in the rest of the world. Tariffs are in place mainly in order to raise revenue at low administrative cost compared to implementing a sales tax or Value Added Tax accounting, and account for more than 60 percent of the tax revenue and almost 25 percent of the total revenues and grants. Except for few exceptions,¹⁰ no duties are levied on exports or re-exports. However, the government needs to consider reviewing trade policy, eliminating quotas to further induce the private sector, and developing alternate sources of revenue. The government also plans to develop technology-intensive, knowledge-based, and environmentally sustainable light industries while some of the import-substituting heavy industries such as cement, gas, and

7 Openness indicator = exports of goods and services)/GDP.

8 Trade Policy Review-World Trade Organization, 2002 and World Bank, Maldives: Country Economic Update, December 2004.

9 Maldives Customs-2004 (internal data base).

10 Refer to chapter 4 for details.

boat building are based in the reclaimed island of Thilafushi (which is only assigned for industrial use). In addition, the Laamu Gan and Seenu Gan islands have been declared industrial zones due to the availability of physical infrastructure and large populations, but are yet to take off as main growth centers.

While the legal and regulatory environment for foreign direct investment (FDI) in the Maldives is very liberal, the leasing of resort islands still has a differential for local and foreign investors. This has been further liberalized by issuing new FDI guidelines. However, more discretionary powers still seem to be vested with institutions and the selection criteria need to be made more transparent in order to improve the credibility of the policy makers and the overall governance structure.

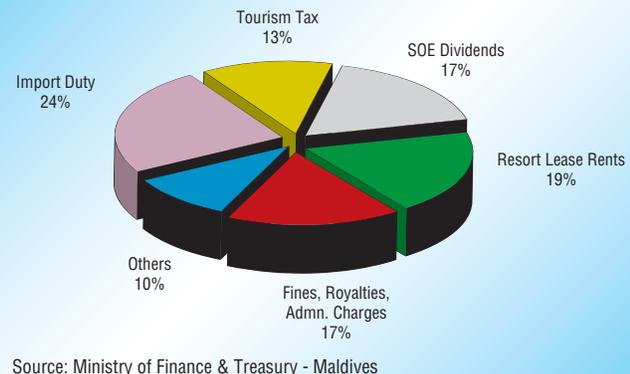
1.8 Need to Sustain Prudent Macroeconomic Policies

Generally, the Maldives has followed a prudent macroeconomic policy, which resulted in the spectacular growth recorded in the past. However, the government has been following a more expansionary fiscal policy regime, and since 1999 the overall deficit, including grants, had been between 4 and 5 percent of the GDP,¹¹ increasing up to 11 percent in 2005, mainly due to the Tsunami. Despite the strong revenue growth recorded until 2004, the government had not been able to bring additional revenue measures to offset the increasing government expenditure due to public investment programs for Tsunami reconstruction. Given that the major growth sectors—the tourism and fisheries sectors—are vulnerable to external shocks, maintaining a low level of government deficit is essential, as was seen with the downturn in the economic environment after the Tsunami.

However, according to the 2006 budget, the overall fiscal deficit, including grants, is expected to increase up to \$165 million, of which more than 50 percent is expected to be financed by foreign loans. At present, the ability of the government to raise domestic debt is highly constrained, which raises concerns about the feasibility of any proposed higher public expenditure.

The main sources of revenue are import duties, tourism taxes, resort lease rents, dividends from state-owned enterprises and royalties, fines, and other administrative charges, accounting for 91 percent of the total revenue in 2004 (figure 1.3). In 2005, the revenue sources were affected mainly by the contraction in the tourism industry. This would have been slightly offset by an increase in imports of construction material for reconstruction in Tsunami-affected areas but would not have been adequate to compensate for the revenue losses. The revenue flows were less

Figure 1.3
Government Revenue - 2004 budget (Rf mn)



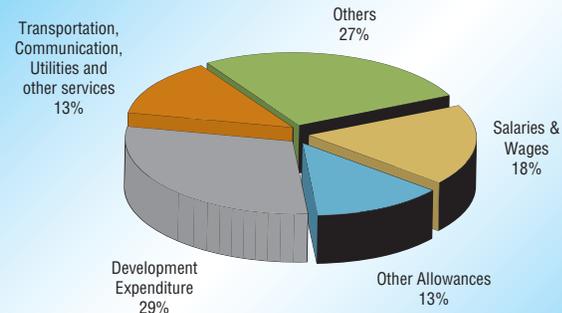
11 World Bank, Maldives: Country Economic Update, December 2004.

than budgeted, since the implementation of Tsunami activities was slow. The 2006 budget has proposed the removal of waivers for Tsunami-related imports. Higher revenue is also expected from lease rent and land rent from proposed new resorts, cost recovery from health and education services, and Tsunami-related grants.

On the expenditure side, the main areas of expenditure are government salaries and allowances (31 percent); transport, communications, and other utilities (13 percent); and development expenditure (29 percent) (figure 1.4). Escalating fuel prices, which have not been adequately adjusted, would put further pressure on government expenditures since they would require either direct subsidies from the budget or lower dividends from the state-owned enterprises such as State Trading Organization and State Telecom Company. Higher-

expenditure measures have been proposed in the 2006 budget in the form of additional hiring and promotion in the public sector, an increase in public investment programs, and higher expenditure for public health and educational services. Some of these public investment programs may need further prioritization, given the emerging fiscal constraints.

Figure 1.4
Government Expenditure - 2004 budget (Rf mn)



Source: Ministry of Finance & Treasury - Maldives

1.9 High Reliance on Foreign Labor and Maintaining a Large Public Sector

The Maldives has been following a liberal labor policy, unlike in the rest of South Asia. According to the 2000 census, the total labor force¹² (economically active over 15 years) and the total employed were estimated to be about 87,442 and 85,722, respectively. Of the total employed, about 33 percent were women. Of the labor force, foreign labor accounted for more than 30 percent. The total employment in the government sector (government and public enterprises) was about 28,651, of which 37 percent were females. In terms of the industry origin, the tourism, manufacturing, and fisheries sectors accounted for about 16, 13, and 11 percent, respectively. Within the tourism sector, about 47 percent were foreign workers. The estimated unemployed were about 1,720, of whom about 68 percent were in the age group of 15-29.

The government controls majority shares of about 21 state enterprises covering transport, aviation, real estate, telecom, water supply, hospitality, and banking. During 2004, the net profits of these institutions amounted to \$144 million. However, given the emphasis on private sector development, the government should expedite the divestment process of some of the state enterprises where the private sector can provide services more efficiently. During 2004, the state owned enterprises' (SOEs) value-added contribution to the economy was 36 percent; SOEs are by far the largest employer, accounting for about 30 percent of the total employment. Given the size

12 Statistical Yearbook of the Maldives, 2004.

and the geophysical nature of the country, a relatively large public sector is unavoidable. However, investors have raised concerns about the public and private sector roles. There is an urgent need for an increase in public disclosure, transparency, and accountability to improve investor confidence.

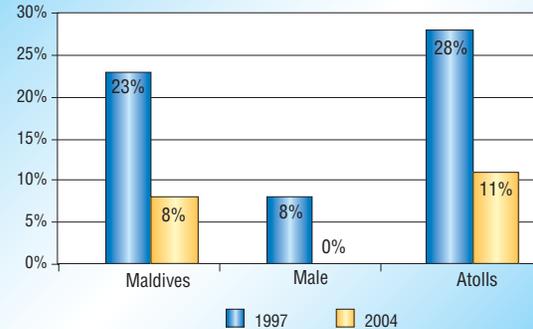
1.10 Declining Poverty and Increasing Regional Disparity

As is the case for most other countries in the region, the economic growth has resulted in a reduction of poverty in the country. The rate of growth in population has declined from 2.1 percent in 1997 to 1.6 percent in 2003. The geophysical nature of the country makes it difficult to have a trickle-down effect of the economic gains unless proper strategies are adopted by the government to ensure equity. Given the increasing economic opportunities in and around Male, there had been an increase in urbanization. It has increased from 25 percent in 1997 to 30 percent in 2004 (figure 1.5). The poverty levels have dramatically declined in the Maldives, from 23 percent to 8 percent between 1997 and 2004.

The poverty levels in Male have declined from 8 percent to zero, while in the Atolls it has declined from 28 to 11 percent. However, there is regional disparity, with the poverty levels ranging from 19 percent in the North to 3 percent in the South, according to the recent poverty assessment carried out by the government with assistance from the UNDP (United Nations Development Program) and the World Bank (2005) (figure 1.6).¹³ It has also been revealed that income inequality has not undergone much change during the period 1997-2004, reflecting that the economic gains achieved during this period have been more for upper echelons of the population.

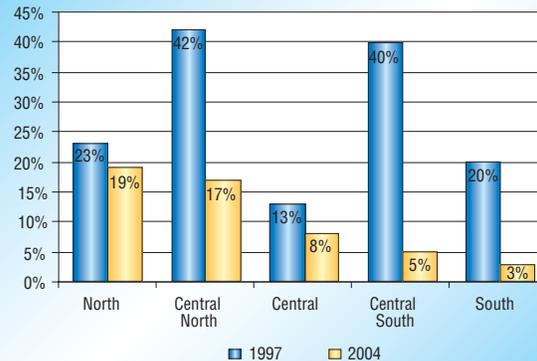
It has also been noted that the Gini Coefficient in the Maldives (0.41), which reflects the inequality, is much closer to the United States (0.41) and Singapore (0.43) than it is to its neighbors such as Sri Lanka (0.34), India (0.33), Pakistan (0.33), and Bangladesh (0.32).

Figure 1.5
Headcount Ratios: Maldives, Male and the Atolls - 1997 & 2004



Source: Maldives - Vulnerability and Poverty Assessment, 2004

Figure 1.6
Headcount Ratios by Region, 1997 & 2004



Source: Maldives - Vulnerability and Poverty Assessment, 2004

13 Vulnerability and Poverty Assessment-2004-Ministry of Planning and National Development in cooperation with the UNDP and World Bank

Chapter Two

PROFILES OF THE TOURISM, MANUFACTURING, AND TRANSPORT-LOGISTICS SECTORS

2.1 A Snapshot of the Business Environment in Maldives

The enterprise landscape of the island economy of Maldives is rather narrow and limited to a few economic sectors: tourism, fisheries, manufacturing, transport, and related services. It is estimated that there are about 2,500 registered small and medium enterprises (SMEs) in the Maldives and most of them are quite small, with an average turnover of less than \$80,000 per annum.¹⁴ Most of them are located in *Male*, which accounts for about 27 percent of the total population.¹⁵ The sample frame details compiled by the ICA team comprised 1,003 business establishments operating in the manufacturing, tourism, and transport-logistics subsectors. However, the aggregate summary table prepared by the Statistical Division of the Ministry of Planning and National

Indicator	Manufacturing	Tourism	Transport-Logistics	Overall
Private limited liability (%)	78	73	66	68
Firms owned by private domestic (%)	97	87	89	91
Average age - years	12.5	11	14	12.4
Firms affected by tsunami (%)	35	36	50	41
Average number of workers - permanent	60	115	66	82
% of managers with university degree or above	36	52	41	42
Land ownership (%)	17	10	21	13
Establishments having more than one holding/factory/service outlet in Maldives (%)	88	66	91	87
Firms with a bank loan (%)	28	36	32	33
Firms willing to increase regular fulltime employees if there are no restrictions (%)	63	43	45	
Source: World Bank, Maldives ICA Survey, 2005				

Development for the Establishment Survey of 2004 had a total of only 520 establishments representing 11 ISIC subsectors at the 2-digit level and their database covered only 136 establishments.

The Maldives investment climate survey covered three major economic sectors: manufacturing, tourism, and transport-logistics (table 2.1). These sectors jointly account for about 50 percent of the GDP and 60 percent¹⁶ of the total employment. The growth performance of manufacturing, tourism, and transport-logistics over the past three years has been 8.3, 6.1, and 6.3 percent, respectively.

14 IFC, 2003. SME Sector Review and IFC Linkages Identification Assignment. Republic of Maldives. Public Enterprise Development Facility. December, 2003.

15 This is based on the estimate of 74,000 Maldivians living in Male. According to some estimates, this number is as high as 120,000, including expatriates.

16 Based on the 2000 census, manufacturing was 11,081; construction, 3,691; hotels and restaurants, 9,748; and transport 7,873, out of a total of 86,245. (Our industry categories are different than those of the census). The total of 33,765 foreign employees was added on.

Given the small size of the country, sectors were broadly defined. In the sample survey, the manufacturing sector activities include boat building, commercial fishing, fish processing, food and beverages, printing, furniture, and handicrafts, while the tourism sector covers six subsectors: guest houses, safari vessels, tour operators, travel agents, resorts, and hotels. The transport-logistics sector includes sea transport, ferry services, land transport, air travel, taxi services, retail trade, shipping, cargo handling, and freight and logistics services. Among these three major sectors, tourism demonstrates a high degree of diversity in terms of service mix, price strategy, and location-specific factors. The transport-logistics sector is considered a potential source of economic diversification, as well as providing transport services to both producer and consumer groups (refer to technical appendix 1).

Indicator	Manufacturing	Tourism	Transport & Logistics
Value added per worker- MRfs (000)	314 (31)	211 (29)	277 (16)
Average price-cost margin - (%)	32 (28)	49 (30)	47 (16)
Investment rate - (%)	74 (42)	53 (38)	66 (42)
Fixed assets per worker- MRfs (000)	153 (32)	245 (32)	220 (28)
Labor cost per worker- MRfs (000)	45 (31)	36 (35)	50 (33)
Source: World Bank, Maldives ICA Survey, 2005* Percentage of profits (after tax) reinvested in the establishment.			

The value added per worker in manufacturing, tourism, and transport-logistics ranged from MRf. 314,000 to MRf. 211,000.¹⁷ (table 2.2) The manufacturing and transport-logistics sectors purchase more than 37 percent of their material inputs and supplies from domestic sources, while for tourism, domestic sources account for only 30 percent of their material inputs and supplies. The enterprises engaged in commercial fishery and fish processing are highly export-oriented, accounting for more than 97 percent of the total sales. More than 65 percent of the firms in all three sectors reported having holdings/factories or service outlets in Maldives. About 17 percent of firms in the transport-logistics sector also reported having holdings/factories or service outlets in other countries. In 2004, the capacity utilization of business enterprises in Maldives was about 76 percent. Interestingly, only about one-third of business enterprises use bank loans as a source of finance. The status of land ownership clearly indicates the presence of a serious constraint to growth and development in the business sector enterprises. Only 10 percent of entrepreneurs in tourism claim to have land ownership, while that figure was about 18 and 25 percent in manufacturing and transport-logistics sectors.

The tourism sector represents a much larger segment of business enterprises than its counterparts in manufacturing and transport-logistics. The business activities in all three sectors are highly concentrated in *Male* Atoll. Only in the case of tourism does it expand into other atolls, as can be seen in table 2.3.

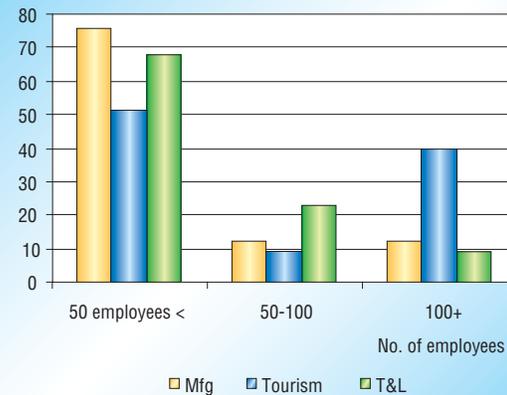
The value added per worker in manufacturing, tourism, and transport-logistics ranged from MRf. 314,000 to MRf. 211,000.¹⁷ (table 2.2) The manufacturing and transport-logistics sectors purchase more than 37 percent of their material inputs and supplies from domestic sources, while for tourism, domestic sources account for only 30 percent of their material inputs and supplies. The enterprises engaged in commercial fishery and fish processing are highly export-oriented, accounting for more than 97 percent of the total sales. More than 65 percent of the firms in all three sectors reported having holdings/factories or service outlets in Maldives. About 17 percent of firms in the transport-logistics sector also reported having holdings/factories or service outlets in other countries. In 2004, the capacity utilization of business enterprises in Maldives was about 76 percent. Interestingly, only about one-third of business enterprises use bank loans as a source of finance. The status of land ownership clearly indicates the presence of a serious constraint to growth and development in the business sector enterprises. Only 10 percent of entrepreneurs in tourism claim to have land ownership, while that figure was about 18 and 25 percent in manufacturing and transport-logistics sectors.

Location	Manufacturing	Tourism	Transport & Logistics
Male'	(53) 100	(30) 60	(43) 98
Male Atoll	0	(8) 15	(1) 2
Other Atolls	0	(13) 25	0
Total	(53) 100	(51) 100	(44) 100
Source: World Bank, Maldives ICA Survey, 2005			

17 It is important to note, however, the estimated value-added figures are based on a small number of responses with high degree of variation. As an alternative measure, median value added per worker was also computed and the figures stand at Rfs. 114,750, MRf. 180,000 and MRfs. 175,833 for the manufacturing, tourism and transport, and logistics subsectors, respectively.

The majority of business enterprises in the Maldives are private limited liability companies and, in the case of tourism, that figure is about 81 percent, and the majority are owned by the Maldivians. In tourism the share of foreign ownership was about 13 percent, while it was as low as 8 percent in the other two sectors. The age profile of the business enterprises is quite mature. About 44 percent of business enterprises report more than 10 years of business experience, while another 22 percent report 5 to 10 years, indicating the stability of business sector activities in the country. The presence of oligopolistic and monopolistic competitive market conditions can also be observed in several industry groups.

Figure 2.1
Size Distribution of Firms

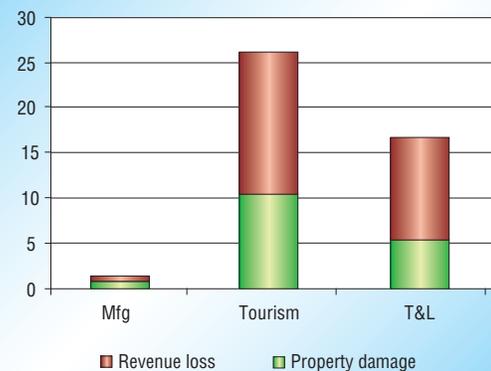


Source: World Bank, Maldives, ICA, 2005

The median number of workers employed in manufacturing enterprises was approximately 63 (figure 2.1). This was much higher in tourism and transport-logistics, indicating an average employment of 117 and 72 workers per enterprise, respectively. The tourism sector tends to operate with relatively smaller number of temporary workers. It was observed that the majority of firms in the manufacturing and transport-logistics sectors employ less than 50 employees, respectively. In tourism only about 40 percent of entrepreneurs employ more than 100 workers. Females account for about 11 percent of permanent employees, while they represent about 2 percent among temporary employees.

A significant number of firms had been affected by the Tsunami. The proportion of firms affected was about 35 percent in manufacturing and 36 and 50 percent in tourism and transport-logistics sectors, respectively. On average, the estimated property damage was in the region of MRfs. 5.8 million per firm and the estimated revenue loss was in the region of MRfs. 11.3 million per enterprise. As shown in figure 2.2, tourism sector enterprises appear to have incurred heavy losses compared with their counterparts in the manufacturing and transport-logistics sectors. About 62 percent of respondents expect a slow recovery of business activities during the post-Tsunami period.

Figure 2.2
Impact of Tsunami on Business Activities per Enterprise (Rf millions)



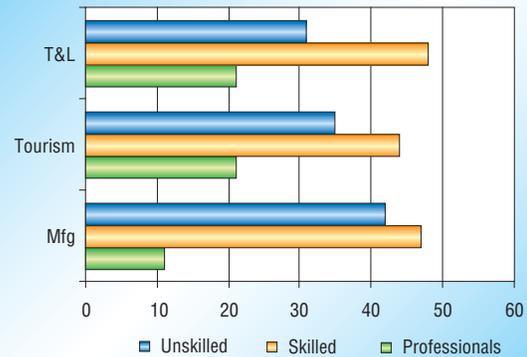
Source: World Bank, Maldives, ICA, 2005

2.2 Skills Mix of Workers

In Maldives, the enterprises have acquired professional and skilled workers and also have focused on the continued enhancement of skills. About one-fifth of the employees in the tourism and transport-logistics sectors are professionals, while they account for about 11 percent in the manufacturing sector (figure 2.3). Skilled workers in all three sectors comprise more than 44 percent of the

employees. In overall terms, about 5 percent of employees in manufacturing have acquired a degree or higher-level qualifications, while that figure was 9 and 15 percent in tourism and transport and logistics, respectively. More than 43 percent of the employees in all three sectors have completed secondary level education and the proportion of employees with incomplete secondary education was about 25, 17, and 25 percent in the manufacturing, tourism, and transport-logistics sectors, respectively. Among the top managers, more than 50 percent had acquired a university degree or higher-level training, but only the tourism sector has provided overseas training for its employees (22%). Given the competitive nature of business, Maldivian enterprises have focused on capacity building. More than 50 percent of the permanent employees in manufacturing and transport-logistics have received internal training, while that number was about 44 percent in tourism. This empirical evidence clearly indicates the potential to improve labor productivity and competitiveness through further increases in human resource development and the introduction of new technology.

Figure 2.3
Skills Mix of Employees (%)

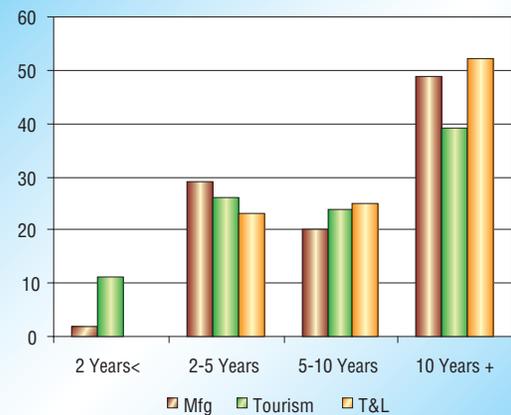


Source: World Bank, Maldives, ICA, 2005

2.3 Stability and Longevity

The majority of the enterprises in the major economic sectors have been in operation for more than 10 years, demonstrating the favorable business environment (figure 2.4). Transport-logistics-sector enterprises tend to be older than tourism and manufacturing enterprises, given the early origin of that sector. The average age of transport-logistics sector firms is 14 years, compared with 11 and 12 years in the tourism and manufacturing sectors, respectively. Within manufacturing, enterprises in the fisheries subsector recorded on average 8 years of business experience, whereas enterprises in boat building display an older profile-ranging from 10 to 12 years-since this was a traditional industry in Maldives. Within the transport-logistics sector, transport-service providers tend to be older, ranging from 5 to 40 years, while the enterprises operating in the logistics and distribution subsector were in the range of 5 to 30 years.

Figure 2.4
Age Profile of Firms



Source: World Bank, Maldives, ICA, 2005

2.4 Ease of Entry and Barriers to Exit

The Maldives has made progress in reducing the administrative burden for startups. Fewer than 2 percent of manufacturing firms, 6 percent of tourism enterprises, and 9 percent of transport-

logistics enterprises reported that business licensing and operating permits are major or severe obstacles. According to DBI 2006, entrepreneurs wishing to register a limited-liability company in the Maldives had to go through 6 different procedures taking a total of at least 12 days and incurring a cost of \$331, equivalent to 12.4 percent of per capita GNI. This is on par with many of the developed countries, which provide an enabling environment conducive for promoting businesses. In terms of closing a business, the Maldives is far behind relative to its counterparts in the South and East Asian economies and there is certainly room for further efficiency gains. The bankruptcy process takes on average 6.7 years.

Business registration in the Maldives is simple and straightforward. The owners are simply required to register the name of the business with the Ministry of Trade, a procedure that only needs to be complied with once in a lifetime of the enterprise. In the absence of a corporate tax system, business registration is only a formality and registration fees have been linked to authorized capital of an enterprise. Once a business is registered, the owners are required to obtain licenses for employing foreign labor, imports, etc. Licensing agencies vary in each case, e.g., the Ministry of Employment grants permits for employing expatriate labor, the Department of Customs for import licenses, and the Ministry of Tourism for operating permits for the hotels subsector.

2.5 Weak Supply-side Linkages with the Domestic Sector

% of firms that purchase their material inputs & supplies from:	Manufacturing	Tourism	Transport & Logistics
Domestic sources	37	30	41
Purchased through direct imports	51	27	53
Purchased through indirect imports	13	43	7

Source: World Bank, Maldives ICA Survey, 2005

Empirical evidence from the ICA survey indicates that linkages between industry and the domestic economy are relatively weak. For example, tourism sector enterprises purchase only 30 percent of their material inputs and supplies from domestic sources, while that figure was slightly higher in manufacturing (37%)

and transport-logistics (41%) (table 2.4). More than 50 percent of the enterprises in manufacturing and transport-logistics purchase their material inputs and supplies directly from foreign sources without depending on domestic firms engaged in importing and distribution.

2.6 Dependence on Public Utilities

Sources	Manufacturing	Tourism
Public	55	19
Private	3	3
Own well/ desalination	33	77
Rain water	9	1
Total	100	100

Source: World Bank, Maldives ICA Survey, 2005

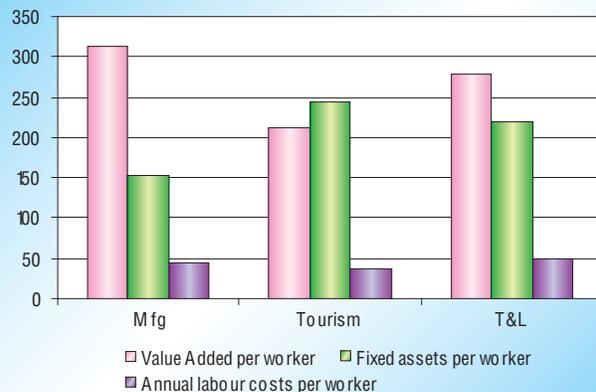
Dependence on public utilities is an important factor in analyzing the investment-climate conditions of an island economy. The majority of the business enterprises in manufacturing (80 percent) and transport-logistics (96 percent) rely on the state-run State Electricity Company (STELCO) for power. In tourism, this number is about 55 percent, as many of the business enterprises outside *Male* use their own generators for power supply. Contrary to the experience of some other countries, many of

the business enterprises in Maldives prefer to have their own generators to ensure reliable supply. In fact, the Water and Sewerage Company maintains its own power generator and intends to sell the excess supply to the national grid, while the Airports Authority provides electricity to Hulhumale Island.

Heavy dependence on public provision of the water supply can also be noticed in the manufacturing (76%), tourism (65%), and transport-logistics (84%) sectors, since access to other sources such as groundwater and rainwater is limited or nonexistent in some locations.¹⁸ In overall terms however, the tourism sector depends more on private sources for its supply of water (table 2.5) since the island resorts need to have their own desalination plants. With respect to telecommunications, almost one hundred percent of the service requirements are met by the state-run telecommunications company, Dhiraagu. The new entrant to the market, Wataniya, is yet to penetrate into different business segments of the Maldivian market.

2.7 Asset Base, Labor Productivity, and Profitability

Figure 2.5
Relatively High Productivity in Manufacturing Sector



Source: World Bank, Maldives, ICA, 2005

Evidence on industry performance indicates that Maldivian manufacturing firms are more productive than their counterparts in the tourism and transport-logistics sectors (refer to technical appendix 2 for details). Similarly, the rate of investment in manufacturing is much higher than it is for the other two sectors. Value added per worker in manufacturing is 50 percent and 13 percent higher than that in the tourism and transport-logistics sectors, respectively (figure 2.5). In terms of profitability, however, the enterprises in the tourism and transport-logistics sectors appear to be more profitable than the manufacturing

sector enterprises. The low profitability in manufacturing may be due to the presence of competition, particularly from foreign sources.

In the manufacturing sector, the fish-processing industry appears to be at the high end of labor productivity (Rfs. 638,485 VA per worker), while boat-building industries appear to be at the lower end (Rfs. 178,630 VA per worker). The former could be attributed to the resource endowments and export orientation of the sector while the latter could be attributed to the suboptimal nature of the boat-building industry. During field visits, it became evident that, in addition to a small market, high costs and the non-availability of land were major constraints affecting growth and expansion in the boat-building industry in Maldives.

18 Malé's drinking water is supplied almost entirely by desalination. Groundwater is present on Malé but is no longer used for drinking. The desalination plants are professionally managed and render 25 liters of water for 100 liters processed, but somewhat less efficient than smaller installations on resorts, which can reach 35 liters per 100 processed.

Chapter Three

INVESTMENT CLIMATE AND ITS IMPACT ON ENTERPRISE PERFORMANCE

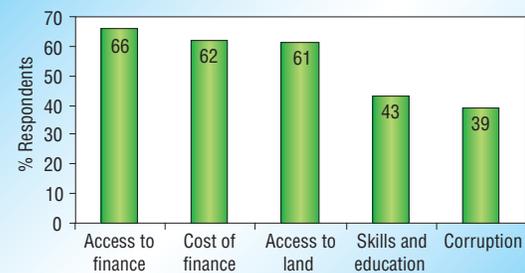
3.1 Introduction

The assessment of the business climate and its impact on enterprise performance in Maldives is based on standard ICA methodology comprising both subjective and objective variables. The subjective measures provide a first step in understanding the preferences and perspectives of firms on constraints that affect the growth and expansion of business sector activities, while the objective measures provide additional information for carrying out the analysis, paying particular attention to industry-specific and country-specific factors. A proper blend of these two aspects allows us to assess the burden imposed by these constraints on enterprise performance.

3.2 An Efficient Taxation System; Weaknesses in Access to Finance, Land, and Skilled Labor

The empirical evidence from the ICA survey¹⁹ reveals that there are significant differences in the perceptions of opportunities and barriers for investment and growth among Maldivian entrepreneurs, depending on sector-specific issues (figure 3.1). Irrespective of the intersectoral differences among investor perceptions, there are a number of areas that represent major obstacles to all three sectors. These include: (i) access to finance; (ii) cost of finance; (iii) access to land; (iv) skilled labor; (v) corruption; and (vi) legal framework. A detailed assessment of these issues based on a sector-specific approach would be more interesting and policy relevant (figure 3.2).

Figure 3.1
Overall Top Five Constraints



Source: World Bank, Maldives, ICA, 2005

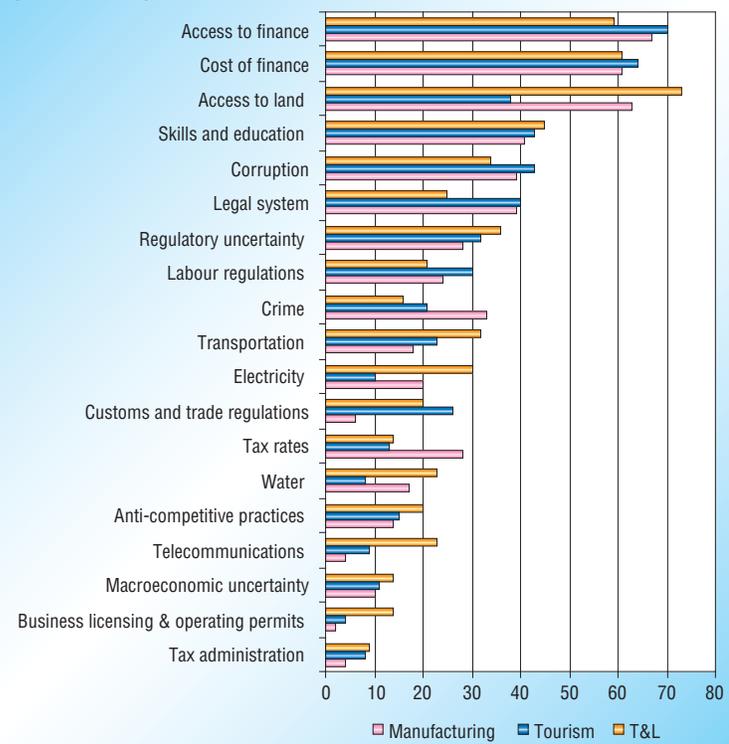
Entrepreneurs in all three sectors identified access to finance as the most important and most severe constraint affecting enterprise performance. There is, however, a high degree of diversity across the three sectors with respect to the relative significance and severity of other constraints affecting enterprise performance. For example, entrepreneurs in tourism and transport-logistics identified the cost of finance as the second-most severe problem, while their counterparts in manufacturing ranked it as third. Similarly, entrepreneurs in the transport-logistics sector identified access to land as the most severe constraint, while their counterparts in manufacturing and tourism

¹⁹ Using the standard ICA methodology, manufacturing, tourism, and transport and logistics sector enterprises were asked to rate 19 predetermined factors and any other factor that may affect their business performance on a 0 to 4 scale.

ranked it second and sixth, respectively. Interestingly, entrepreneurs in the tourism sector identified the relative significance of a lack of skilled labor as the third-highest constraint on investment decisions, while their counterparts in manufacturing and transport-logistics ranked it at the fourth-highest position.

The explanatory factors underlying these findings are discussed in the remainder of this chapter. The next section describes the overall success story of reducing bureaucratic obstacles to doing business and identifies specific factors leading to barriers to entry. This is followed by sections on the legal system, governance structure, finance, land, labor, and infrastructure, and an analysis of the impact of the prevailing investment climate on firm performance.

Figure 3.2
Different Constraints in the Investment Climate in Maldives
(% of firms)



Source: World Bank, Maldives ICA Survey, 2005

3.3 Minimum Administrative Obstacles to Business Startup

Maldivian businesses do not appear to suffer from entry barriers as so many other South Asian countries do, and DBI 2006 ranked it 31 among 155 countries. Official procedures required to do business, such as registering a new business, obtaining licenses, paying taxes, etc., are often viewed as negative factors affecting the investment climate. These procedures can slow down the growth and expansion of business activities and retard the graduation of the informal economy into the formal sector. The existing body of empirical evidence on the business climate in South Asian countries—except for Maldives—points to heavy government regulation and unpredictability as key constraints to private sector development.

As noted in chapter 2, Maldives' performance is better than South Asia's overall performance and also relative to that of comparable small-island economies. In dealing with licenses, Maldives records the lowest cost relative to some of the island economies of similar income levels. Only 9 steps of licensing procedures need to be followed and the time required is about 131 days, while the regional average is much higher. Maldivian performance is better with respect to payment of taxes in terms of frequency of payments, time to comply, and tax rates. In the ICA survey, less than 10 percent of the firms cited licensing and operating permits and tax administration as constraints to doing business. As reported in DBI 2006, the Maldives and Hong Kong are the only two countries who collect taxes once a year. In Hong Kong, however, it takes 80 hours per year

to collect taxes and the total tax payable is 14.3 of gross profits, as against 5.5 percent of gross profits in Maldives with no extra time taken.

3.4 Weak Legal Framework and Enforcement Capacity

According to the ICA survey findings, confidence in the rule of law also varies among entrepreneurs across sectors. Only about 41 percent of the entrepreneurs in manufacturing and tourism were confident that the judicial system would enforce contractual rights in business disputes and that figure was about 27 percent among transport and logistics sector entrepreneurs. Similarly, only 43 percent of entrepreneurs in tourism were confident that "government officials' interpretations of regulations affecting establishments are predictable," while it was 39 and 20 percent among entrepreneurs in the manufacturing and transport-logistics sectors.

Major problems still remain with respect to enforcing contracts and closing a business, creating severe exit barriers. According to the DBI 2006, the procedures for starting a business is relatively better in Maldives, with only 6 stages, compared to a regional average of 7.9; the time required is 12 days, compared to the regional average of 35.3 days. The cost is much less also, at 12.4 percent of income per capita, while the South Asian regional average was 39.7 percent. To enforce a contract, it takes 434 days, compared to a regional average of 385 days, even though the cost-at 8 percent of the debt-was much less than the regional average of 36.7 percent. Since there is no insolvency or bankruptcy law, the time taken for closing a business can be as long as 6.7 years, compared to a regional average of 4.2 years; the cost is about 4 percent of the estate. (Refer Box 3.1)

The perception of corruption in the Maldives is better than the South Asian average (Star Graph 3.1). The score was 4.2 according to the Corruption Index of Transparency International, but lags behind Singapore (9.2). In the World Bank Governance Indicators 2005, Maldives ranked second in South Asia and is only behind Bhutan in control of corruption. However, the performance under overall governance indicators deteriorated in the Maldives in 2004 compared to the ranking of 2002, as can be seen in the Star Graph 3.2. This perception has been supported by increasing print and electronic media exposure on perceived conflict of interest, which will affect the business environment in the medium term. More attention needs to be given to this aspect to ensure that the situation does not deteriorate further, despite the fact that Maldives' performance relative to the other countries in the region may still be better. This perception was further supported by the empirical evidence of the ICA. Fifty-two percent of the firms surveyed reported making informal payments to conduct typical business activities; this amounted to 6 percent of the share of sales.

Box 3.1 : Legal and Judicial System in the Maldives

The Maldivian judicial system is based on Islamic Shari'ah law. The Urf or customary law in the community is accepted, as the conventions do not contradict the Shari'ah or the legislative framework. In 1997, reforms brought four categories into the court system: civil, criminal, family, and juvenile law. All of the island courts come under the Ministry of Justice, while the high court is independent of the lower courts. However, there is also a right of appeal to the president if the litigants are dissatisfied with the decision of the High Court. The Maldives is already a member of the Multilateral Investment Guarantee Agency (MIGA).

Civil courts handle cases relating to property, commercial, and summary matters. Unlike the other countries in South Asia, where the legal system has been well developed over the past three centuries, the legal and judicial system in Maldives is still at a very preliminary stage. The members of the Bar are drawn from graduates of Common law, Islamic law as well as from qualified graduates who follow the diploma course in Shari'ah law in Maldives. The government has recognized the need to introduce major reforms in the legal and judicial system especially in the commercial law to provide a better legal framework to further induce investors.

Source: Year Book 2003

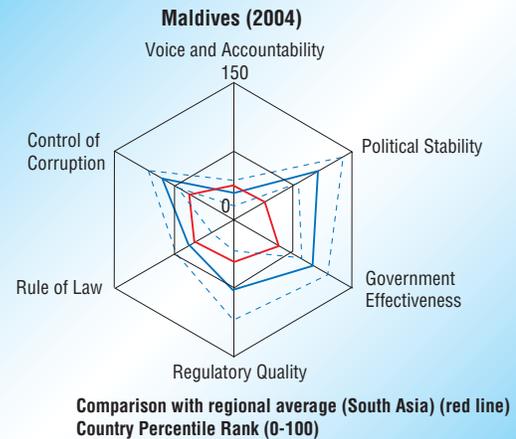
Confidence in the legal system that contracts will be honored and disputes will be handled fairly and efficiently is important for attracting investments. The ICA study revealed that investor confidence in the judicial system is low at 38 percent, compared to Sri Lanka (69%) and India (71%). Another concern raised by investors is the unclear demarcation between public and private sector roles. This is an emerging concern for most of the small countries, including Bhutan and Sri Lanka. The Maldives was rated 31 out of 155 countries in DBI 2006 for ease of doing business, ahead of all South Asian countries; however, to consolidate its position, it needs to improve public disclosure, transparency, and accountability in its public policy matters and better manage conflict of interest. Having recognized that a more modern legal and judicial system needs to be introduced, the government has already initiated reform efforts in the legal and regulatory framework to facilitate investment

and private sector development. However, these efforts need to be expedited.

During 2005, the government introduced several reforms, including the setting up of a separate body for monitoring compliance with enforcement of court decisions in the Attorney General's department. The government also announced that it would introduce an examination for practicing lawyers and that it plans to establish a Bar Association and draft a Code of Ethics for judges. The Attorney General's department is in the process of preparing a three-year civil-justice action plan. Training has been provided to the staff in Malaysia and Singapore. Currently civil court procedures, banking law, labor tribunal law, and arbitration acts are being drafted. The AG's

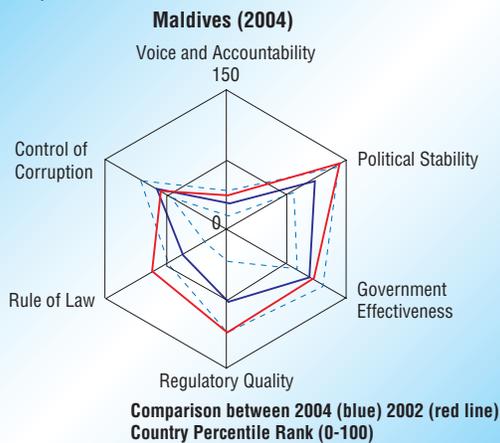
department is in the process of amending the foreign investment law, which will be presented to the parliament shortly. A treasury bills law and an audit law are also being drafted. The government also has initiated efforts to strengthen the Public Procurement Bureau with assistance from the World Bank (see annex 1).

Star Graph 3.1



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2005: Governance Matters IV: Governance Indicators for 1996-2004 (<http://www.worldbank.org/wbi/governance/pubs/govmatters4.html>)

Star Graph 3.2



Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2005: Governance Matters IV: Governance Indicators for 1996-2004 (<http://www.worldbank.org/wbi/governance/pubs/govmatters4.html>)

3.5 Access to Finance, a Growing Concern

Access to finance is the most serious constraint affecting the investment climate in the Maldives. As noted in chapter 2, only one-third of the business community uses bank loans for business activities. Survey data also reveal that firms in the Maldives heavily depend on internal funds for

meeting their working capital and investment capital requirements (Table 3.1). On average, the contribution of domestic commercial banks and international commercial banks to working capital requirements is as low as 11 and 3 percent, respectively. The contribution to new investments, however, is 17 and 5 percent by domestic and foreign banks, respectively. Use of credit cards, equity, family and friends, and leasing as alternative sources of financing are also relatively less significant in Maldives. Further investigations into low dependency on bank loans by business sector enterprises revealed that more than 75 percent of the respondents in all three sectors have not applied for a bank loan. Twenty-five percent in tourism, 19 in manufacturing, and 17 percent in transport stated that their last application was turned down by a bank.

Working capital - %	Manufacturing	Tourism	Transport & Logistics
1. Internal funds	73	67	56
2. Domestic commercial banks	13	10	13
3. International commercial banks	2	4	2
4. Trade credit	5	8	12
5. Other	7	11	17
Total	100	100	100
New investments - %	Manufacturing	Tourism	Transport & Logistics
1. Internal funds	48	65	44
2. Domestic commercial banks	13	16	13
3. International commercial banks	1	10	7
4. Leasing arrangement	6	1	3
5. Other	32	8	13
Total	100	100	100
Source: World Bank, Maldives ICA Survey, 2005			

The financial sector of the Maldives is very narrow and is dominated by the banking sector, which consists of one locally owned commercial bank, branches of three South Asian state-owned commercial banks, and a branch of a widely known international bank. The nonbank financial sector in the country consists of a government provident fund, a finance leasing company, a housing bank, two insurance companies registered in the country, and some agents for overseas insurance companies. The government recognizes the importance of a well-functioning financial sector to making further progress on the path of development and has taken measures to increase competition in the financial sector, including facilitating the expansion of the banking sector, and supporting the creation of a leasing finance and a housing finance institution, which have somewhat deepened the market.

Of the commercial banks, Bank of Maldives (BML), the only domestic bank, is jointly owned by the government (51%), island communities (25%), and other government agencies. The BML has 18 branches (three of which are located in Male) and 5 mobile branches (dhonis). It is undertaking development-banking activities whereby credit is extended to the private sector for various income-generating activities. Of the foreign commercial banks, all of which are based in *Male*, three are South Asian banks. These banks provide credit especially for the tourism sector. Although they continue to mobilize deposits and provide foreign exchange to the private sector, they cater primarily to the corporate sector.

Banks hold a substantial part of their assets in the form of reserves (the minimum reserve requirement is a high 30 percent), which constrains their ability to increase lending. Commercial banks invest in Certificates of Deposits of the MMA (Maldives Monetary Authority); residents are

Table 3.2 : Loans and Advances in Commercial Banks, 2002-2004 (%)

Sectors	2002	2003	2004
Fishing	5.50	6.80	6.30
Tourism	55.60	56.00	58.20
Agriculture	0.50	0.50	0.30
Construction	6.50	7.60	6.80
Manufacturing	0.70	1.80	1.40
Commerce	25.40	22.00	20.70
Others	5.70	5.40	6.30
	100.00	100.00	100.00

Source: Maldives Monetary Authority - (2002 - 2004)

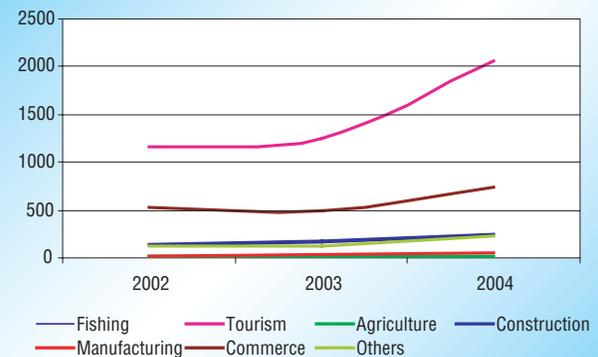
allowed to maintain foreign currency accounts and both current and capital accounts have been liberalized. Banks are generally reluctant to extend loans with longer-term maturities (more than 3-5 years) and the spreads remain high. Bank-to-bank credit ceilings were removed in 2001. Prior to July 2001, there were aggregate credit limits on commercial banks, which served as a cap on the growth of credit to the private sector.

Total assets in the commercial banking sector as of 2004²⁰ were MRf 7.1 billion. Total credit to the private sector increased from MRf 2.2 billion to MRf. 3.5 billion in 2004. As reflected

in table 3.2, almost 60 percent of the credit is for the tourism sector. It was followed by the commerce and fisheries sectors, with all three sectors accounting for more than 85 percent (figure 3.3). The expansion of credit in 2003 was significant and 70 percent of the credit was for the private sector in that year. This trend was endorsed in discussions with the individual banks. The deposits amounted to MRf 5.7 billion in 2004 and there is an increasing tendency for the foreign currency deposits to grow. However, it was notable that 69 percent of the deposits were short-term deposits.

Deposit rates vary from 1.5 percent to 3.0 percent for savings deposits, while time deposits range from 1.5 percent to 6.5 percent for maturities of 6 months to over 5 years. The lending rates vary from 8-13 percent for domestic currency and 7.75-13.0 percent for foreign currency; the same rates apply for the government. The rates of return on deposits had been negative, given the high inflationary trends in the past two years (6.5 and 8.0 percent, respectively). In addition, Maldivians enjoy other attractive investment opportunities in neighboring countries, which require the banks in Maldives to be more competitive and innovative.

From the analysis given in table 3.3, it is evident that large-scale entrepreneurs are dominant in the utilization of bank loans in tourism. In contrast, small-scale entrepreneurs in manufacturing and transport and logistics account for more than 50 percent of the bank loans utilized for business development. However, it is evident from the supplier side as well as the demand side that access

Figure 3.3 Commercial Bank Credit (Rf millions)

Source: Maldives Monetary Authority, 2005

to credit is a major constraint, especially for the medium and small enterprises, given that more than 50 percent²¹ of bank credit is for the tourism sector. In addition, the banks rely on collateral more than cash-based lending and, given the limited availability of land ownership in the country, the SMEs find it difficult to raise funds for new business ventures.

Table 3.3 : Use of Bank Loans by Firm Size (%)

Size	Manufacturing	Tourism	T & L
Small (50< employees)	61.5	37	57
Medium (51-100 employees)	30.5	5	21
Large (employees 100 +)	8	58	21
	100	100	100

Source: World Bank, Maldives, ICA Survey, 2005

With the entry of the Maldives Finance Leasing Company (MFLC) in 2002, enterprises have access to medium- and long-term capital-equipment financing for various economic sectors. This was one of the government's initiatives to strengthen and introduce more sophistication and depth into the financial sector. The company was established with assistance from International Finance Corporation (IFC), with the National Development Bank (NDB) of Sri Lanka as the technical partner. It has provided leasing finance for capital equipment, of which 79 percent is for the tourism sector—speed boats, live-aboard safari and fishing vessels, dhonis, computers, and excavators. The lease periods range from 12-60 months, with the majority being at the upper end. Given the proactive role played by the leasing company, greater expansion in leasing facilities can be expected.

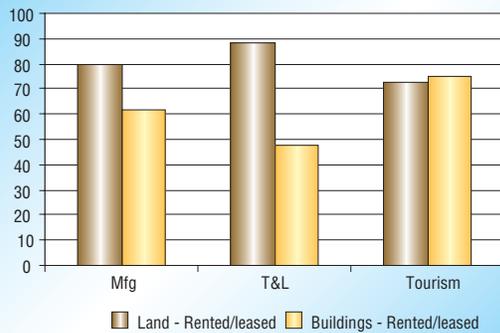
Another positive initiative was the commencement of capital market operations in April 2002, with the opening of securities trading; this remains, however, at a very nascent stage. Only three state enterprises that have been quoted on the stock exchange—the BML, State Trading Organization (STO), and the Maldivian Transport and Construction Company—and have limited secondary market activities. Total market capitalization was MRf 662 million in 2002 with only three state-owned enterprises listed, but there is potential for high growth with government plans to list more enterprises on the stock exchange. That will encourage corporate governance as well as more transparency for the state-owned enterprises. Currently, the investment instruments are extremely limited, and if other private sector companies—especially in tourism, trading, and commerce—are also encouraged to list on the stock exchange, the economic linkage with the rest of the economy can be strengthened. The government may also explore the feasibility of Maldivian companies listing on emerging stock markets in the region, including those of Colombo and Mumbai.

3.6 Access to Land, a Critical Constraint to Further Expansion

Access to land has emerged as one of the biggest obstacles to business growth. In fact, the majority of business operations are being carried out in rented/leased out land and buildings (figure 3.4). The average contract length for land varies from 7 years in transport and logistics to 10 and 14 years in manufacturing and tourism, respectively. Similarly, the average contract length for buildings varies from 7 years in transport and logistics to 8 and 11 years in manufacturing and tourism. The financial terms of the lease are primarily (90 percent) based on the rental value.

21 Maldives Monetary Authority, Economic Statistics, June 2005.

Figure 3.4
Rented/Leased out Land and Buildings (% of firms)



Source: World Bank, Maldives ICA Survey, 2005

According to the survey evidence, more than one-third of the firms in tourism and transport-logistics and about 26 percent in manufacturing have made an attempt to acquire rights to new land or buildings. However, as reported by the respondents, such efforts have been unsuccessful (62% in manufacturing, 44% in tourism, and 47% in transport-logistics). The entrepreneurs believe that this is primarily due to high prices and a lack of interest on the part of the government. The other reasons include failure to get zoning approval, lack of infrastructure facilities, and absence of clear titles.

One of the major challenges for the government is how to attract investments within the structure of an increasingly competitive market economy while protecting the vulnerable groups, particularly women, the poor, and the elderly. This is endorsed by the government's Vision 2020. Land and housing markets are an integral component of a dynamic market economy, which was recognized in the Sixth National Development Plan. This will require a paradigm shift in the role of the government from being a direct provider to being a facilitator and a regulator by allowing the development of housing, land, and property markets in the private sector and local communities.

Until about 2002, there was no housing and urban development strategy in the Maldives and development took place within an ad-hoc regulatory framework. Residential densities in *Male* Island are extremely high. A survey in 2002 revealed an average net density of 913 persons per hectare, with some areas even higher. Estimates of demand for housing indicated that between 2003 and 2020, additional dwellings would be needed for about 600 households annually for the next few years. More would be required in order to reduce existing levels of overcrowding and replacement of obsolete or substandard housing on *Male*. Since there is no prospect of increasing the area of land available on *Male*, the only significant option for meeting future housing and urban development needs exists through the development of Hulhumale, which has already begun. According to the 2002 study, even that may not be adequate in the long term, so policymakers need to be efficient and sensitive in allocations.

A regulatory audit carried out in 2002 concluded that existing planning standards and regulations, together with land-use planning and zoning regulations, are generally flexible and accommodate needs within the available resources. For example, although government authorities have proposed land-use zoning for major land uses, their application has not inhibited the development of small-scale economic activities within residential areas or housing within institutional areas. However, there is considerable inconsistency and duplication in the application of the regulatory framework by government departments, most of which lack the capability to enforce the regulations and standards for which they are responsible. In addition, administrative procedures are complicated and there is a lack of transparency in providing information in a coordinated, comprehensive manner. This makes it extremely difficult for private developers or individuals to conform to these regulations, standards, and procedures.

According to the available studies, no comprehensive and transparent regulatory framework for housing and urban management currently exists in the Maldives. Planning and building standards and regulations have been developed in an ad-hoc manner in response to individual needs and circumstances. According to the 2002 study, neither the *Male* Municipality nor Ministry of Housing possesses a single list of regulations or standards to which individuals or developers must conform in order to obtain planning or building permission. This lack of a clear framework does not appear to have inhibited a substantial increase in building activity during the last two decades. A large number of multistory buildings have been developed in *Male*, even though regulations concerning set-backs from adjacent properties for window openings and ventilation were not formally introduced until May 2002.

Procedures for obtaining building permits in the *Male* urban region are perceived as lengthy, but are in fact extremely quick compared to most countries. For example, it took only 17 days in 2002 to obtain building permits for private buildings of one or two stories; 24 days for private buildings over two stories, and 40 days for government buildings. However, the procedures in the atolls were much lengthier, since many more institutions are involved.

Several agencies are developing regulations on similar issues, which has led to duplication in some cases and gaps in others. In many cases, the regulations that do exist are not readily available to the general public or potential developers. This inhibits the development of a formal property market. Finally, the lack of a condominium or strata title system, together with the regulation permitting plots to be subdivided into separate buildings, has resulted in excessive subdivision and inefficient plot use.

Land Use and Urban Form. Land use in the reclaimed area of *Male* is less efficient than in the older parts of the city. This is partly due to the segregation of land uses and the lack of residential uses in the reclaimed area, which is less than 7 percent of the total area reclaimed. This is ironic, since the stated objective of reclaiming this area was to increase space for residential use. The layout of blocks in the reclaimed area does not achieve the flexibility or efficiency of the traditional layouts. The allocation of large blocks to single government users has also resulted in the inefficient development of block frontages onto roads, raising the unit costs of infrastructure provision and resulting in an urban environment that lacks the social vitality, economic efficiency, and visual interest found throughout the older areas of *Male*.

Management of Public Non-residential Property. In 2002, government departments paid only a nominal monthly rent of MRf 0.5 per square foot for land they occupied. Public enterprises (PEs) paid a fixed monthly rent of MRf 1.0 per square foot (MRf 10 square meter) compared to notional market rates of MRf 5.0-8.0 per square foot, which represented an opportunity cost of between MRf 4 and MRf 7 for every square foot of such land every month. There is no regular land market in *Male*, since all land has been developed and the tradition by which government allocates land free to selected applicants makes estimates of market rates difficult to obtain. However, the recent policy discourages public sector agencies from realizing the full value of their property portfolios. It also encourages them to claim larger areas of land than may be strictly required to fulfill their mandates, and in several cases has enabled public enterprises to generate considerable income from renting out surplus space to private sector companies, thereby further inhibiting the development of a transparent land market.

The development of Hulhumale' provides an opportunity for the spatial decentralization of economic activity and population as part of a national housing and urban development strategy. While the government of Maldives has identified Hulhumale as the means of achieving this objective, the key issue is the nature and extent of incentives that may be required to achieve it. This also raises the possibility of relocating inappropriate land uses on *Male* to Hulhumale' or Thilafushi and releasing land for additional residential development and social facilities to reduce densities and improve the urban environment in *Male*.

3.7 Inadequacies in the Skills Mix

Award	Male	Female
Certificate	61	13
Advanced Certificate	138	128
Diploma	93	152
Degree	14	18
Foundation Studies	80	165
Sub Total	386	476
Grand Total	862	
Source: Maldives College of Higher Education, 2004		

Educational attainment in Maldives has improved over the past several years, but other elements for a strong human capital base are missing. In 2004, the graduate output of Maldives College of Higher Education was 862, representing certificate, diploma, degree, and foundation study programs (table 3.4). Although most workers (67 percent) are involved in some on-the-job training, it is often not enough to enable them to adjust to major changes in technology or to move across different jobs (table 3.5). Despite certain improvements, the lack of local skilled labor continues to be a major problem in Maldives. Moreover, the quality of education has not kept pace with enrollment. This has led to a dysfunctional labor market and creates reliance on migrant labor from neighboring countries. Since there is no statutory minimum wage, cheap labor in the region, especially from India, Sri Lanka, and Bangladesh, further depresses the market.

Type of training	Manufacturing	Tourism	Transport & Logistics
Internal	57	63	57
External	28	43	36
Source: World Bank, Maldives ICA Survey, 2005			

According to the 2000 Population Census, the country's domestic labor force stands at about 87,442. The labor force participation rate is 47.7 percent. The local labor force is supplemented by the employment of a significant expatriate labor force. In 2004, 38,413 expatriates were employed in the Maldives, up from 33,765 employed at the end of 2003. Youth is the largest cohort among the Maldivian population (35 percent)²² and the extent of nonparticipation by youth in national development is disturbing. Unemployment rates have risen significantly in the Maldives, especially in the Atolls and among youth. As shown in the figure 3.5, access to employment opportunities is much lower for young women than for youngmen. This trend is attributable to cultural issues and the restricted mobility of women in the atolls, as well as to increasing income and education levels, which result in high expectations among youth for professional and remunerative jobs.

22 Based on 2000 Census data, age group 15-35 years.

With the growth and expansion of business activities, however, expatriate labor has recorded a steady increase over time. As can be seen from table 3.6, the presence of expatriates is very high at the unskilled level. Some surmise that the immigration of "guest workers" and the concomitant decline in the birth rate might lead to non-Maldivians being a majority in 50 years.

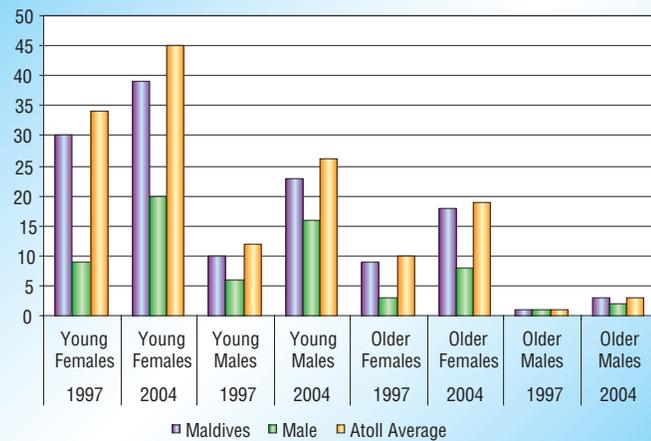
Survey data indicated that existing labor regulations act as a constraint affecting enterprise performance, particularly in employing foreign

labor. As argued in the literature, liberalizing temporary contracts while leaving in place strict regulations on regular contracts reinforces the inequity in the labor market. It also creates distortions in the labor market. According to industry sources, an unskilled worker from a foreign country collects an average monthly pay of MRfs 2,000 while a local person needs to be paid at least MRfs 2,500 per month. Hence, firms will have greater incentive to hire foreign workers at an entry level and employ them for a limited period, without giving them a regular position thereafter. This does not necessarily increase overall employment or productivity because at the end of the contract, there will be little or no development of human capital.

The survey also highlighted the lack of availability of the right skills. Most schools only offer commerce subjects and the average pass rate is 25 percent. The pass rate for English was 6 percent. However, the pass rate for chemistry, physics, commerce, fisheries, and science ranges from 25-45 percent. Difficulty in access to gainful employment increases the incidence of drug use, pessimism, and delinquency. An investment climate that benefits all members of society confronts the challenges of creating opportunities for the unemployed and young people joining the workforce for the first time. Labor market policies that meet this test play a vital role in the investment climate by helping to connect people to opportunities.

Maldives has no labor law in place, and issues relating to labor are governed by the labor regulations and numerous procedures set out by the Ministry of Labor and Employment. According to the current labor regulations, those intending to work in the Maldives must acquire a work permit issued by the Ministry of Employment and Labor. Employers intending to employ foreign nationals in the Maldives are required to apply for work permit numbers prior to the prospective employees' arrival in the Maldives. A completed work permit application is processed within one to three working days.²³ Wages and working hours in the private sector are largely determined by negotiations between the employer and prospective employees. However, the public

Figure 3.5
Unemployment by Broad Age Group and Gender (1997 & 2004)



Source: World Bank, Maldives ICA Survey, 2005

Table 3.6 : Employment - Local and Foreign

Occupation	Employed - Local*	Employed - Foreign"	Total
Legislators, Senior Officials & Managers	3,815	801	4,616
Professionals	7,604	4,072	11,676
Technicians & Associate Professionals	6,363	1,941	8,304
Clerks	4,611	258	4,869
Service workers and shop and market sales workers	10,554	4,717	15,271
Skilled Agricultural & Fisheries Workers	11,565	107	11,672
Craft & related Trade Workers	14,518	5,329	19,847
Plant, Machine Operators Assemblers	5,079	2,422	7,501
Elementary Occupations	6,158	14,118	20,276
Armed forces	1,433		1,433
Not stated	14,545		14,545
Totals	86,245	33,765	120,010

Source: * Census 2000 - Ministry of Planning and National Development
" 2003 data - Ministry of Employment and Labor

sector has standardized working hours and salary scales. Labor strikes and other work disruptions are nonexistent in the Maldives, which is a positive sign compared to the unhealthy trends in the rest of South Asia.

There seems to be a lack of relevant training, which leads to a mismatch in demand and supply. The demand is primarily in the "blue collar" category while the supply is more for "white collar" jobs (Box 3.2). According to a study conducted in 2003, every year about 10,000 non secondary-qualified youth join the labor force. The employment age is specified as 18 years, but there is no mandatory schooling age as in the case of some of the other South Asian countries (e.g., Sri Lanka). It has also been revealed that 56 percent of the youth join the labor force unprepared for the demands of the labor market.²⁴

Box 3.2 : Higher Education in the Maldives

The Maldives College of Higher Education consists of the Faculty of Health Sciences (established in 1973, caters to nursing, pharmacy, and paramedics), the Faculty of Engineering Technology (1975, caters to engineering and other technical courses); the Faculty of Education (1977, caters to teacher training); the Faculty of Hospitality and Tourism (1987), the Faculty of Management and Computing (1991) caters primarily to the lower administrative services such as clerical, accounting, and business studies); the Centre for Maritime Studies (1987), the Centre for Open Learning (1999, distance learning), and the Faculty of Shari'ah and Law.

According to a tracer study of the Faculty of Engineering Sciences, 75 percent of the students were employed, of which 70 percent in the private sector; 92 percent in the field of training had found jobs within 41 days at an average. One-third of the enrollments of the 5,584 in 2003 were females, and 32 percent in Law, 80 percent in Education, 67 percent in Health, 64 percent in Accounting, and 26 percent in Hoteliering were female students. Ten percent of the courses are degree courses, 10 percent diplomas, 13 percent advanced certificate courses, and 65 percent are certificate courses. Most of the students qualify in health, maritime, and tourism, compared to the other sectors. In 2004, the completion rate was 25 percent. Annual budget for MCHC was MRF 61 million.

Source: Profile - MCHC 2005.

3.8 Among Infrastructure Facilities, Sea Transport appears to be the only Major Constraint

Transportation

In stark contrast to the above, the provision of infrastructure services does not appear to be a serious constraint from the perspective of the Maldivian entrepreneurs. Transportation problems seem to be a bottleneck only for tourism (23 percent) and transport-logistics (32 percent) sector businesses. In fact, this could be viewed as an important factor affecting the growth of business

24 Memo on Youth Employment: Real Issues by Dr. H. Hamid, May 2003.

activities in other atolls. In an island economy, transportation involves land, air, and maritime transport. As shown in table 3.4, only a small percentage of firms have their own transport and the majority of them are dependent on the services provided by public and private sector service providers. In manufacturing, about 55 percent of the transport requirements are met by maritime transport, while the rest is shared by land (29 percent) and air transport (16 percent) facilities.

The high cost of transportation in Maldives has major implications for business progress. Improvement of the transportation facilities will promote business activities in all sectors of the economy. It will also facilitate the decentralization initiative of the government and allow economic activities to develop outside *Male*. During field visits entrepreneurs complained strongly about the high cost of transport between atolls. Transport has also been identified as a major factor affecting poverty.

Road transport is important in *Male* and the large islands have paved roads and easy accessibility. Motorcycle (14,200 in 2002) is the popular vehicle in *Male* and the island and motor car is more of a status symbol, with about 1,950 (2002) in *Male*; a very efficient taxi service for reasonable rates is also available in *Male*. Sea transport is crucial for the Maldives and visible growth in domestic aviation is evident, with the setting up of domestic airports and the establishment of floating platforms for sea planes (30 in 2002).

Indicator	Atoll Average
More than 100 people per vessel	43
Dhoni traveling 3 time or less a month to Atoll capital	26
Dhoni traveling 3 time or less a month to <i>Male</i>	36
Island not always accessible	40
Source: World Bank, Maldives ICA Survey, 2005	

Sea transport is the largest mode of transport, especially between *Male* and the islands. With the exception of a few ferry services among the islands of the greater *Male* region and very few in the atolls, the Maldives is without regular interatoll and interisland boat services (table 3.7). In the islands, people are required to arrange dhonis for themselves for travel and the cost of hire is very high. Fishing dhoni is the all-purpose

vessel in Maldives in addition to the ferries; they are primarily owned by the tourist resorts or by ferry companies who provide transport to islands on individual requests. Problems include a lack of harbors and jetties, sometimes due to shallow waters and coral reef, weather conditions, and visibility at night (markers are not available). The problem of sea transport is assessed based on: (i) the number of people per vessel; (ii) the frequency of transport to the atoll capital; and (iii) the accessibility of the island.

According to the recent VPA,²⁵ during the past seven years, from 1997 to 2004, limited changes have taken place in interatoll and interisland transport. With the exception of the ward islands of *Male*, a limited number of islands and primary atolls, a large number of islands are without regular ferry or boat services. One reason is the increased size of a typical dhoni. The same can be seen with transport to *Male*. In 1997, 29 percent of the population had a dhoni traveling less than three times a month; in 2004, however, the percentage had increased to 36 percent.

25 Vulnerability and Poverty Assessment, 2005.

Accessibility has also improved significantly during the period 1997-2004. By now, there are no islands without accessibility due to coral reefs. The number of people who live without a harbor or jetty are half the number they were in 1997. The population who live on islands that are always accessible has risen from 30 percent to 60 percent.

Electricity

Similar to the findings for transportation, only about 20 percent of the firms in manufacturing thought that electricity represented a major constraint, while it was 23 and 10 percent in transport-logistics and tourism sectors. State Electric Company Ltd. is generating and distributing electricity to commercial and residential customers, government departments, and mosques in *Male* and 23 other inhabited islands in the Maldives. The commercial and industrial sector accounts for about 31 percent of its revenue, while the rest is generated by residential (48%) and public and government institutions (21%). The tariff rates for business sector enterprises vary from MRf. 3.15 to MRf. 3.75 per unit depending on the level of power consumption. On average, the frequency of power outages was 2.8 days as against 6 days in the Philippines and 14.5 days in Pakistan. The delay in obtaining an electricity connection was 5.5 days in Maldives in comparison to 8.2 days in the Philippines and 81.6 days in India.

Similar to India, 64 percent of business enterprises in Maldives reported having their own generators. However, contrary to international experience, the use of generators in the island economy of Maldives appears to be a low-cost operation in carrying out business activities. As noted during field visits, having their own generators is more advantageous to business enterprises in *Male* as the unit cost of electricity is less relative to STELCO (the STELCO cost per unit for business-purpose customers varies from MRfs. 3.15 to 3.75, while they incur a much lower cost per unit with the use of a generator). On average, the cost of a generator varies from MRf. 0.61 million among businesses in the manufacturing sector to MRf. 1.75 million for those in tourism. This is equivalent to 5 percent and 7 percent of the total fixed assets of the manufacturing and tourism enterprises. These resources could be employed more productively in the core business areas of firms.

STELCO²⁶ is the only company that supplies electricity. Due to the geographical structure, supplying electricity from one island to another is more expensive than installing individual power stations in the islands. *Male* was the first island to have a 24-hour power supply, but this has now increased to more than 20 islands. In addition, the government has provided financial assistance for developing both private and community-based power stations in the remaining islands. Fifty islands have community power and another 6 islands have private providers for 24-hour power supply. The remaining 119 islands have at least 5-12 hours' power supply (table 3.8).

There are about 5.7 MW of privately owned standby power systems in *Male* alone. A standby power system is used by the Maldives Water and Sanitation Authority for production of water. There are more than 20 private providers in the outer islands, primarily small private companies and family-run businesses.

26 Vulnerability and Poverty Assessment, 2005.

Even in 1997, only 7 percent did not have access to electricity, with 7 islands not having access to electricity at all. Two-thirds of the islands' supply was less than six hours. According to the VPA 2005, all have access to electricity, and only three islands, with populations of less than 150 people, had less than six hours of power supply. On the other islands, a very small number of the people had less than six hours, not due to supply but due to unaffordability.

Table 3.8 : Access to Electricity (% of population)

	1997	2004	1997	2004
	Access to electricity	Access to electricity	More than 6 hours	More than 6 hours
Maldives	93	100	80	99
Male	100	100	100	100
Atolls	91	100	72	98
Source: VPA, 2005				

3.9 Growth in Telecommunications Leads to Greater Connectivity

Telecommunications do not appear to be a serious constraint to Maldivian entrepreneurs. Only 27 percent of the firms in transport and logistics thought that it represented a major constraint, while it was 18 and 4 percent in tourism and manufacturing. The telecom sector in Maldives appears to be one of the high-growth sectors in the economy. To a large extent, Maldives has performed well in terms of telecommunications, particularly during the recent past, as in the case of all South Asian countries. In fact, improved telecommunications has opened up new economic opportunities and contributed to growth and expansion of business activities in the Maldives. While the combined fixed and mobile phone penetration rate in Maldives is higher than that of its South Asian counterparts, it remains low compared to other countries in East Asia (e.g., Singapore), indicating significant scope for improvement. Similarly, with respect to use of the Internet, Maldives ranks far behind Singapore, in spite of its better performance by South Asian standards. As noted earlier, use of e-mails and Web sites for business purposes is high in tourism relative to manufacturing and transport and logistic (table 3.9).

Table 3.9 : Use of Telecommunications Facilities in Business Activities (%)

	Manufac-turing	Tourism	T & L
Regular use of e-mails interacting with clients/suppliers	96	98	84
Regular use of Websites interacting with clients/suppliers	45	93	59
Source: World Bank, Maldives ICA Survey, 2005			

The rapid progress of communication has proved to be a backbone for socioeconomic development in the Maldives and it lessens the insular nature of the islands.²⁷ Further developments are envisaged. Traditionally, communication services were provided solely by Dhiraguu Private Limited, a joint venture between the government and a United Kingdom-based company. Creating more competition, the sector has been opened to a second player recently, with Wataniya, a Kuwait-based company commencing operations in 2004. Postal services are provided by the government. With the introduction of mobile telephones in 1997, the accessibility of the outer islands has improved significantly. About 150,000 mobile phones are available, while the fixed lines total up to about 60,000.

In *Male*, two-thirds of the population have a fixed-line phone at home and more than three-fourths have a mobile phone. In the atolls where fixed lines have been installed, one in six has a telephone in the house. Mobile phones have spread wider, and 50 percent of the population in the atolls have at least one mobile phone. Radio and television are quite widely used, with five-sixths of the

population having both these items. Regular newspapers are not available for more than 40 percent of the population.

The phenomenal progress seen in the telecommunications sector also widens the horizons for mobile banking, providing connectivity with the island communities and especially promoting income-generating economic activities that were not feasible earlier.

Water Supplies

Maldives Water & Sewerage Company Pvt. Ltd. (MWSC) is primarily responsible for providing water supply and sewerage services to the islands of *Male*, Hulhumale, Villingili, and Maafushi (in *Male* atoll). Its tariff rates for the institutional and commercial sectors have remained unchanged over the past three years, while the tariff rates for domestic customers have marked a declining trend during the same period. Interestingly, water service is the only sector addressed in the survey for which there are no complaints about service interruptions and resulting hours of productive time lost. Out of a total of 59 percent of enterprises in manufacturing, only 17 percent complained about the quality of water used in production.

3.10 Impact of the Investment Climate on Enterprise Performance and Investments

This section presents the results of our empirical analysis of the effect of various investment-climate indicators on enterprise performance: labor productivity, profitability, sales growth, employment growth, and investment rate. Our findings confirm that the investment-climate constraints discussed in the preceding sections affect firm performance. However, we are not in a position to highlight intersectoral differences of investment climates due to the small size of the sample. The methodological approaches used in the analysis are described in detail in technical appendix 2.

An assessment of investment climate- and industry- and firm-specific factors on enterprise performance brings out some interesting policy insights. First, foreign competition (as measured subjectively by entrepreneurs) is positive and significant as a determinant of productivity, profitability, and employment growth. It also indicates the negative impact of unskilled labor on profitability and productivity. Use of e-mail and Web sites in business activities is positive and significant as a key determinant of productivity. Similarly, the impact of training is positive and significant in promoting employment growth and the rate of investment.

Second, the impact of unskilled labor on productivity and profitability indicates the significance of human resource development in improving the investment climate in the Maldives. In addition, labor relations are also perceived to be negatively associated with value added and profitability. The negative impact of bank loans on value added, profitability, and sales growth confirms the relatively low utilization of bank loans by the firms. The evidence on investment climate and enterprise performance clearly confirm the negative impact of access to finance over labor

productivity. The cost of finance is also negative and significant as a determinant of labor productivity and investment rates.

Among governance and administration variables, total waiting days for import licenses appear to be negatively associated with labor productivity. The impact of the regulatory burden measured in terms of the number of government visits (inspections) per employee revealed a significant negative correlation with labor productivity, profitability, and investment rates. The impact of other investment climate constraints on business performance cannot be assessed due to the lack of robustness and the small sample size of the study.

Chapter Four

INTERNATIONAL COMPETITIVENESS OF THE MALDIVIAN ECONOMY

The international competitiveness of the Maldivian economy is crucial, given its high degree of openness. In light of the integration of the economy with international markets and the increased cost of being an SIE (refer to chapter 1), obstacles in the investment climate become pivotal to a country's international competitiveness. An investment climate conducive to entrepreneurship and well-functioning markets can offset some of the costs associated with being an SIE. Compared to the rest of South Asia, Maldives already has made headway in creating a better investment climate. However, experiences from other countries demonstrate more scope for improvement in the investment climate.

4.1 Benchmarking the Investment Climate in the Maldives

The investment climate falls into three broad categories: macroeconomic framework, governance, and infrastructure. It is important to question whether the institutional framework and the provision of infrastructure are efficiently designed, aligning incentives to avoid adverse selection and moral hazard and serve the public interest, and whether they are implemented expeditiously, without delays and corruption, to facilitate efficient outcomes.

Table 4.1 : Top Five Perceived Investment Climate Constraints²⁸

Rank	Maldives	Pakistan	India	Bangladesh	Sri Lanka	South Asia
1	Access to finance	Tax administration	Corruption	Corruption	Electricity	Electricity
2	Cost of finance	Cost of finance	Electricity	Cost of finance	Policy uncertainty	Economic & reg. uncertainty
3	Access to land	Corruption	Tax rates	Tax administration	Macro Economic Stability	Cost of finance
4	Lack of Skills	Electricity	Tax administration	Economic & reg. uncertainty	Cost of finance	Tax rates
5	Corruption	Access to finance	Economic & reg. uncertainty	Customs & trade regulations	Labor regulations	Corruption

Source: World Bank Enterprise Surveys database 2005, Maldives and Sri Lanka ICA surveys.

In chapter 3, the microeconomic foundations of Maldives' investment climate was analyzed based on the ICA survey. Based on responses from the Maldivian firms, the top constraints to new investment were identified as access to and cost of finance, access to land, lack of skilled labor, and corruption. Table 4.1 presents the major constraints in the investment climate in South Asia.

28 The sample of Maldivian firms includes both the manufacturing and services sectors, whereas the samples for most other countries exclusively comprise firms in the manufacturing sector. The perception of the IC constraints in these other countries may accordingly be biased and not representative of the true ranking of constraints.

The cost of finance and corruption are perceived as constraints in Maldives as well as in most economies in South Asia. Conversely, the perception of access to land as an investment constraint is unique to the Maldives.

This chapter provides a comparative analysis of the investment climate in Maldives with other economies in the region and the rest of the world to assess the competitiveness of the country. Four groups of economies have been chosen as benchmarks: (i) groups of peers in South Asia; (ii) small island economies; (iii) lower-middle-income economies; and (iv) a group presenting a reference point of high-income economies (a group of countries in the OECD).

4.2 The Competitiveness of the Maldives

The Maldives has set a clear course of market-based integration with international markets harnessing its natural endowment of marine-based assets in fisheries and tourism. Given the challenges of being an SIE, the investment climate becomes doubly important in offsetting the added logistics and inefficiency costs. In the following sections, the effect of the investment climate on the international competitiveness of the Maldives is assessed in terms of the ease of access, and the transaction costs of dealing with finance, commodities, and labor.

Access and Cost of Finance

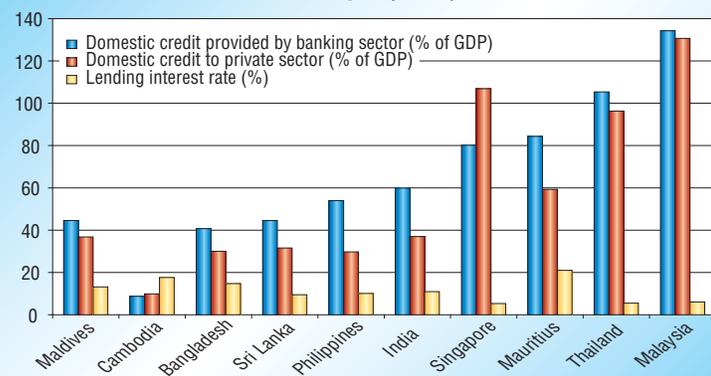
Capital is an essential resource for all firms, and the ability to access finance at competitive costs is integral to firms' achieving their growth potential rather than the potential set by their current stock of capital. Finance was highlighted as the main constraint across the board in the Maldives. Both access to and the cost of finance were ranked quite high on the list of obstacles by the interviewed firms.

Benchmarking the financial sector reveals that the availability of finance in the Maldives is limited. (figure 4.1) Compared to other economies in South and East Asia - most having lower GDP per capita - the financial markets in the Maldives are relatively shallow. Private credit in Maldives is 37 percent of GDP, more comparable to Sri Lanka (32 percent) than to Thailand (96 percent). The lending rate (13.2 percent) is also less competitive than the rate in comparable economies

like Thailand (5.5 percent), Seychelles (10.1 percent), and Fiji (7.2 percent), reflecting the high cost of funds. Given the low level of inflation, the real interest rate is even less competitive than the real interest rate of comparable economies, which might change with the increasing inflationary trends that have been observed.

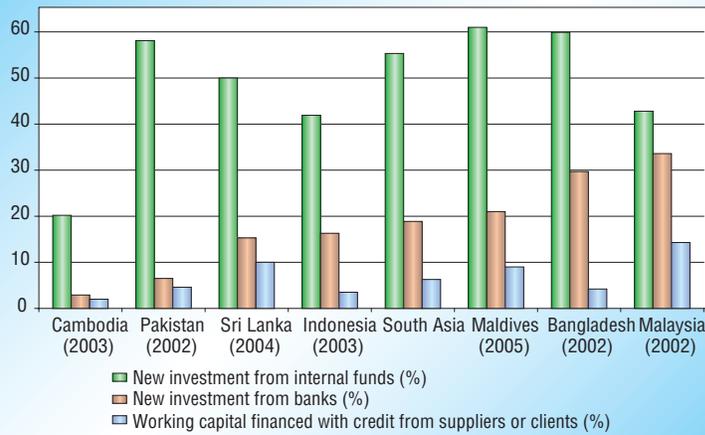
The limited availability of options for finances curbs the growth of the Maldives economy. Most companies are financing investment out of their own funds such as retained earnings (figure 4.2).

Figure 4.1
Maldives' Financial Markets' Depth (2004)



Source: World Bank World Development Indicators, 2005

Figure 4.2
Financing of Investment and Working Capital in Maldives



Source: World Bank ICS database

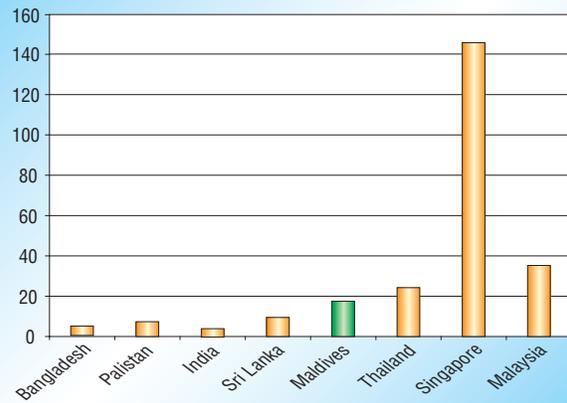
The Maldives firms are getting more bank financing than the average South Asian firm. Approximately 20 percent of new investments in Maldives are being financed from commercial banks, while the bulk has to be financed through the entrepreneurs' own funds and alternate sources.

The bank financing of new investment in the Maldives is 35 percent less than in Bangladesh. There is financing through trade credit, but in this category, the Maldives falls behind Sri Lanka and

Malaysia. With the current size and depth of the Maldives' financial sector, it invariably will need to look toward international financial markets for the financing of investments.

Despite the limitation of being a small island economy, Maldives has been able to attract foreign investment to the tune of \$12-14 million annually during the period 2002-2004.²⁹ FDI has made up for the lack of liquidity in the Maldives economy (Figure 4.3). The stock of foreign investment has risen from \$25 million in 1990 to \$169 million in 2004 and represents 22.5 percent of GDP. Compared with South Asian countries like Sri Lanka, Pakistan, and Bangladesh, Maldives has performed well as a recipient of FDI, but compared to other East Asian countries like Singapore, Malaysia and Thailand, it still lags behind.

Figure 4.3
FDI Stock (% GDP) - 2004



Source: World Bank, 2004

Legal Framework and Conflict Resolution

The lack of financial depth reinforces the need for a better investment climate and a low cost of doing business to access international markets. To create an enabling environment for financing for businesses, it is important to have an efficient legal framework and the institutional capacity for the enforcement of contracts. This puts emphasis on the efficacy and transparency of property rights, disclosure, investor protection, dispute resolution through arbitration, mediation and adjudication (such as bankruptcy), and contract enforcement in a predictable and speedy manner.

29 World Investment Report, 2005-United Nations, New York and Geneva.

The Doing Business Indicators in table 4.2 indicate that the legal framework for facilitating market-based transactions is a mixed picture. It is fairly efficient in terms of time and cost to register property rights, and Maldives is among the top-performing economies in South Asia and across the world in that aspect. However, in Thailand and Singapore, the process of property registration is quicker, albeit at a higher cost.

In Maldives, the rules of disclosure covering financial and transactional information provided to investors and the public are poor and lag behind most other countries in the world. Conversely, the rules

regarding the legal liability of the director and the strength of shareholder lawsuits is favorable for investors with a ranking of 8, which is well above the South Asia average as well as the OECD group average. The combination of high ranking of director liability and high ranking of shareholders' powers in lawsuits gives investors relatively good protection in terms of the legal framework, but a poor capacity for getting information pertinent to business transactions.

The legal framework for getting credit is only slightly better than the South Asia average but well below the high-income group, which means that the ability to supply collateral and the value of collateral are comparatively circumscribed. Not all assets can be used as collateral and, in contrast to most other countries in the region, Maldives has no record of personal or business credit information, which makes it difficult for lenders to assess the risks.

The other part of the equation of a business transaction is the

Region or Economy	Registering Property		Protecting Investors		Getting Credit	
	Time (days)	Cost (% of property value)	Disclosure Index	Director Liability Index	Legal Rights Index	Credit Information Index
Maldives	20	0	0	8	4	0
Thailand	2	6.3	10	2	5	4
Singapore	9	2.8	10	9	10	4
Fiji	48	12	5	5	8	4
Pakistan	49	3.2	6	6	4	4
Sri Lanka	63	5.1	4	5	3	3
India	67	7.9	7	4	5	2
Malaysia	143	2.3	10	9	8	6
Mauritius	210	16.5	6	8	7	0
High income	32.2	4.8	6.1	5.1	6.3	5
South Asia	124	6.3	4.1	4.6	3.8	1.8

Source: Doing Business Indicators 2005. Note: The disclosure and director liability indexes vary from 1-10, where higher values indicate more disclosure and higher liability. The credit information and the legal rights indexes varies respectively from 1-6 and 1-10, where higher values mean more information and better legal rights facilitating lending.

Region or Economy	Enforcing Contracts		Closing a Business	
	Time (days)	Cost (% of debt)	Time (years)	Recovery rate (cents on the dollar)
Maldives	434	8.7	6.7	18
Thailand	390	13.4	2.7	44
Singapore	69	9	0.8	91.4
Fiji	420	53.8	1.8	20.6
Sri Lanka	440	21.3	2.2	33.9
India	425	43.1	10	12.8
Malaysia	300	20.2	2.2	38.8
Mauritius	367	8.6	2	31.1
High income OECD	225.7	10.6	1.5	73.8
South Asia	385.5	36.7	4.2	19.7

Source: World Bank, Doing Business Indicators, 2005

economy's ability to enforce contracts through a transparent, efficient, and speedy dispute-resolution process. The dispute-resolution process, which is directly affected by the clarity and transparency of the legal framework, is comparatively poor. The dispute-resolution process is no better than the framework on which it is based.

The Doing Business Indicators in table 4.3 show that the dispute-resolution processes in the Maldives are less efficient compared to those in the rest of South Asia and much more efficient compared to those of the OECD group. Enforcing contracts costs less than the South Asia average. However, this is outweighed by the time taken for the process –434 days—which is 10 percent above the South Asia average and almost 100 percent more than the high-income group average. For bankruptcy the delay is even more pronounced, with a 6.7 year process time and a recovery rate of only 18 percent, which is well below South Asia averages of 4.2 years and a recovery rate of almost 20 percent. The Fiji and Mauritius averages are 1.8-2 years, and for OECD, the number is 1.5 years, which reflects those countries' efficiency in the legal system.

Figure 4.4
Rule of Law, 2004

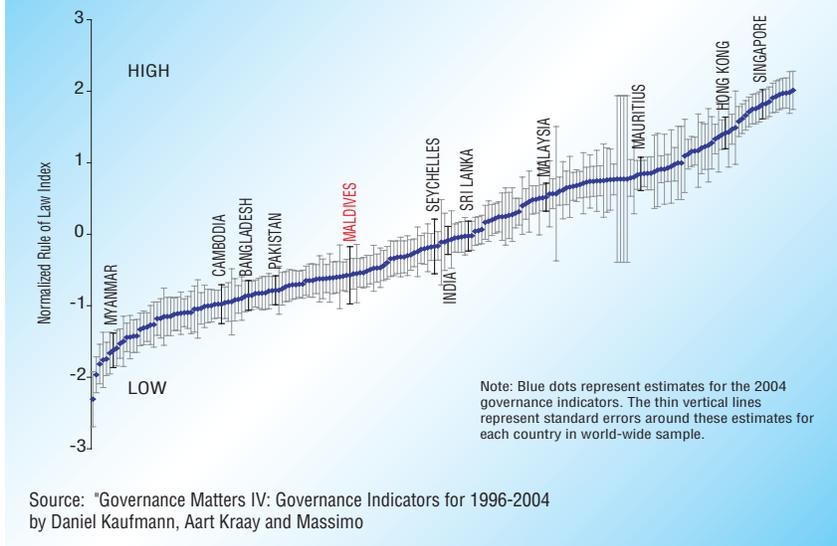


Table 4.4 : Confidence in the Judicial System and Predictability of Interpretation of Regulation in Maldives, 2005

%	Maldives	Bangladesh	Pakistan	Sri Lanka	India	China
Confidence in the judiciary system	38%	17%	38%	69%	71%	83%
Consistency of interpretations of regulations	37%	79%	35%	71%	64%	66%

Source:: World Bank Enterprise Survey Database, 2005

The legal and regulatory framework is only one aspect of the investment climate. The implementation of the rules and the complementary institutions in conjunction with the legal and regulatory framework ultimately determines the efficacy of the investment climate, and how it

may facilitate entrepreneurship and economic growth through the efficient allocation of finance and improve the international competitiveness of the Maldives. The investment climate survey in fact examined these aspects of the economy: the ranking of corruption, and legal system and conflict resolution were respectively fifth and sixth on the list of major obstacles in the Maldives, as referred to in table 4.1.

The governance-rule of law indicator measures among other things the quality of contract enforcement and the efficiency of the court system in enforcing the laws. In figure 4.4, Maldives

is located around the 37th percentile rank, which is above Bangladesh but below Sri Lanka and the Seychelles. The figure indicates that the legal institutional framework is inadequate compared to most of the South Asian neighbors and small island economies.

Approximately 40 percent of the firms surveyed in the ICA indicated that they lacked confidence in the judicial system to enforce their property rights in business disputes. In table 4.4, confidence in the judiciary is better in most of the other economies, e.g., 69 percent in Sri Lanka, 71 percent in India, and 83 percent in China. Only 37 percent in Maldives indicated that the interpretations of the rules were predictable or consistent. Also, table 4.4 shows that Maldives compares poorly with most of the economies in the region with regard to consistency of interpretation of regulations.³⁰

From the data, it appears that Maldives is less competitive relative to its peers when it comes to the adequacy of the legal system and conflict resolution; this perception requires serious attention from the policymakers.

The perception of corruption in the Maldives is better than in most countries in South Asia and the South Asian average. A score of 4.2 in the index, however, still leaves room for improvement compared to Singapore with a score of 9.2 (figure 4.5).

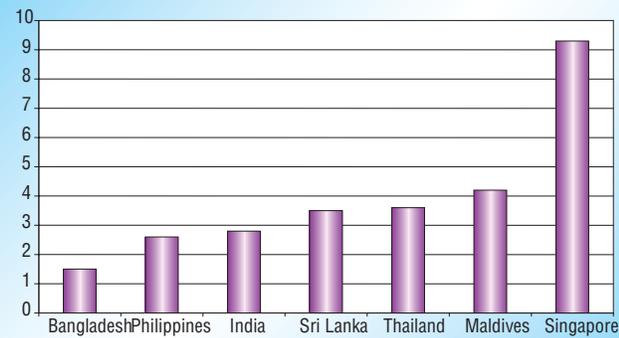
Table 4.5 : The Corruption Tax in the Maldives, 2005³¹

	Maldives	South Asia	Bangladesh	Pakistan	Sri Lanka	India
Share of management time spent with compliance requirements (%)	6%	8.15%	4.20%	10.10%	3.80%	14.40%
Value share of sales (%)	6%	1.60%	2.50%	2.00%	0.20%	-

Source : World Bank Enterprise Survey Database 2005

However, the ICA survey data also reveals that more than 50 percent of the firms have made informal payments totaling a value of approximately 6 percent of sales; this is three times higher than the South Asian average of 2 percent of sales and the highest in the region (table 4.5). In terms of the time spent by management complying with rules and regulations, the Maldives is faring better than the South Asian average. It is, however, slightly worse off than Bangladesh and Sri Lanka.

Figure 4.5 Perception of Corruption Index, 2005



Source: Transparency International 2005. The index varies from 1-10 where lower values mean the perception of corruption is more prevalent.

30 The sectoral composition of the data used in table 4.4 varies: for the Maldives, it includes the services sector, while for most other countries it exclusively covers parts of the manufacturing sector.

31 The different composition of the survey sample across countries primarily regarding the lack of coverage of the services sector elsewhere in South Asia implies that the representation of the corruption and time tax is less true (and potentially biased) for these countries.

Labor

The Maldives workforce is well-educated in comparison to other low-middle income countries. Unfortunately, the demand for technical skills, management, and computer skills still outpaces supply. In table 4.6, indicators of education and skill levels are presented. With regard to attainment of education, Maldives seems to be lagging slightly behind the lower-middle-income reference point, although it is higher than the average for South Asia.

Indicator	Maldives	South Asia	Lower-middle Income	OECD Countries
Adult literacy rate (%)	97.2	59.3
Gross enrollment ratio (%), secondary	66.7	48.5	73.9	107.2
Gross enrollment ratio (%), tertiary	16.0[1]	10	19.8	69.4

Source : World Bank World Development Indicators 2005 and UNESCO
[1] Tertiary enrollment/(15-24 age group)

In addition, the regulations appear to be conducive to an efficient labor market in terms of ability and costs of hiring and firing workers. In table 4.7, a number of indicators illustrating the regulations of the labor market are presented.

Region or Economy	Difficulty of Hiring Index	Hiring cost (% of salary)	Difficulty of Firing Index	Firing costs (weeks of wages)
Singapore	0	13	0	4
Maldives	0	0	0	20
Fiji	22	8	0	27.8
Bangladesh	11	0	20	47
OECD: High income	30.1	20.7	27.4	35.1
Pakistan	67	12	30	90
South Asia	41.9	5.1	42.5	75
Mauritius	0	7	50	15.2
Sri Lanka	0	16.3	80	175.7
India	56	12.3	90	79

Source : Doing Business database 2005. The firing and hiring indexes vary from 1-100, with higher values meaning more difficulty of hiring and firing respectively.

Compared to South Asia and indeed most countries in the world, in the Maldives hiring and firing are most flexible. The hiring costs are at the very low end of the spectrum, while the costs of firing are less than one-third of the South Asian average. Therefore, on the labor rigidity index Maldives fares well internationally and provides a competitive edge.

The attainment of skills of the Maldivian labor force appears to be circumscribed compared to international benchmarks. Firms in all sectors surveyed ranked the availability of skills and education as one of their biggest constraints. However, training can help enhance skill levels, increase labor productivity, and facilitate the adaptation or introduction of new technologies. Training in Maldives is indeed very high, almost on par with China, which is exceptional at 71 percent (table 4.8). It would appear that the Maldives firms are investing significantly in upgrading the labor force to compensate for the relatively low availability of skills.

	Maldives	Sri Lanka	India	China	South Asia	Lower - middle income
Share of firms offering formal training (%)	69%	33%	28%	71%	29%	56%

Source : World Bank Enterprise Survey Database, 2005

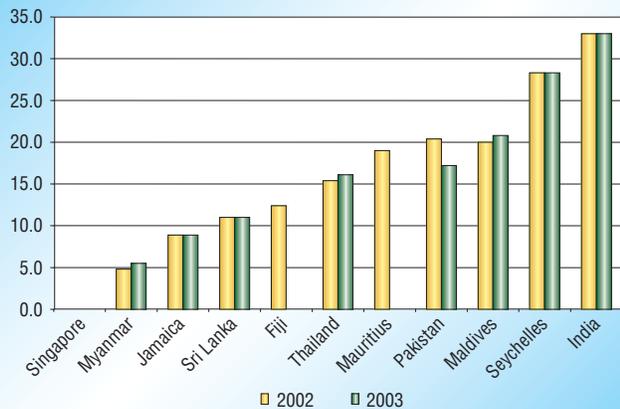
Intermediate Inputs

To compete efficiently in international markets, Maldives firms need to source intermediate inputs efficiently without intervention and the added cost of waiting for customs clearance. Also, it has to be able to export without having to deal with lengthy procedures and red tape.

Maldives is well integrated into international markets and is keeping government intervention in product markets in relative check. The indicator for tariffs, however, is relatively high compared to the rest of South Asia, with the exception of India (figure 4.6). The average tariff rate of approximately 21 percent is almost 50 percent higher than the average for all developing countries. The tariffs, however, vary considerably, from more than one hundred percent on certain goods to zero for others. Also, the indicator fails to capture the effect of other fees, levies, and surcharges that are levied in addition to the tariff in other countries.

The Maldives follows a more outward-oriented and open trade policy³² than other countries in the region. Generally the tariffs on imports in the Maldives are nondiscriminatory, since there are virtually no import-competing domestic industries. However, differences in tariff rates are imposed on certain goods and activities. No duties are levied on exports or re-exports.³³ The possible graduation of Maldives from LDC status will have important trade-related implications, especially for tuna exports to the European Union.³⁴ If the Maldives intends to become a hub for regional free trade, this option needs to be further studied, since both Sri Lanka and South India are planning extensive port-expansion projects.

Figure 4.6
Average Tariff Rates, 2002 and 2003



Source: World Bank Trade database, 2005

Figure 4.7
Payable Corporate Taxes (LH axis) and Compliance Costs (RH axis), 2004



Source: Doing Business 2005 database

32 WTO Report, 2002 and Maldives Economic Update-World Bank, December 2004.

33 There are export controls (on timber), taxes (on ambergris), royalties charged on fish exports (5 percent CIF), and required licenses for fish exports.

34 Maldives Economic Update-World Bank, December 2004.

Economy or Region	Documents for export (number)	Signatures for export (number)	Time for export (days)	Documents for import (number)	Signatures for import (number)	Time for import (days)	Cost of a 20 foot container to Singapore (US \$)
Maldives	7	4	24	12	4	29	2,816
Bangladesh	7	15	35	16	38	57	1,569
Malaysia	6	3	20	12	5	22	-
Thailand	9	10	23	14	10	25	800
Singapore	5	2	6	6	2	8	-
India	10	22	36	15	27	43	1,615
Sri Lanka	8	10	25	13	15	27	1,150
Fiji	6	5	22	13	2	22	2,441
Mauritius	5	4	16	7	4	16	2,316
Philippines	6	5	19	8	7	22	1,005
Samoa	6	4	12	8	6	13	-
South Asia	8.1	12.1	33.7	12.8	24	46.5	-
OECD: High income	5.3	3.2	12.6	6.9	3.3	14	-

Source : Doing Business, Trading across Borders and own data, 2004

Although the tariff structure is relatively high, it has to be evaluated against the backdrop of no corporate taxes. Tariffs are in place mainly in order to raise revenue at low administrative cost. In fact, in terms of the Doing Business Indicators, the Maldives is a world leader in taxes and tax administration. Figure 4.7 shows the privileged position of the Maldives in terms of tax competition.

The Doing Business case study, however, does not consider the rental fees for resorts, which are quite significant and equivalent to a tax for the tourism sector. Collecting taxes through bed-night taxes and lease-rental fees is less costly than a corporate tax system. Internationally, no economy matches the low compliance costs of the Maldives tax system and very few economies require less than one week's worth of administration.

Revisions of the trade or tax policies should at least consider the collective impact on the private sector. Specifically, the government should consider reviewing existing trade policy to ensure a nondiscriminatory tariff structure, and to eliminate quotas and develop alternative sources of revenue.

The logistics also add extra cost for exporters. Table 4.9 illustrates the challenges of logistics for a small island economy and the impact of the regulatory barriers by benchmarking the Maldives with South Asia, OECD, and other small island economies.

Compared to South Asia, the Maldives is competitive when it comes to logistics indicators. Maldives requires fewer documents, fewer signatures, and shorter processing time for both exporting and importing than do most countries in South Asia and in comparison to other small island economies and the OECD countries. It is clear that the Maldives has the opportunity to better its administrative procedures. Compared with good practices, there is still scope for improvement.

The case of logistics illustrates the challenges of small open economies and the opportunities for reforming the investment climate to increase their competitiveness. In fact, it shows that there are considerable gains to be made through investment-climate reforms. Also, it shows the considerable costs of operating in an SIE, which needs to be offset somehow in order to compete internationally.

In addition to the formal barriers to trade discussed above, informal barriers to trade may also be important: firms need to acquire import licenses and they pay a time tax waiting for goods to clear customs; sometimes they also have to make informal payments to clear customs. Table 4.10 shows that Maldives is fairly competitive when it comes to clearing goods through customs.

	Maldives	India	Pakistan	Bangladesh	Sri Lanka	South Asia
Days to clear customs	5	6.6	17.1	10.6	3.6	8.51
Source : World Bank, Maldives ICA Survey, 2005						

35 The representation of days to clear customs may be biased for the countries in the rest of South Asia because the samples only include the manufacturing sector for these countries.

Chapter Five

TOURISM SECTOR AND ITS POTENTIAL

"Maldives is the Number-One Destination for Our Clients" - Kuoni Annual Report 2004

5.1 Background

Maldives belongs to a group of countries known as the Small Island Developing States (SIDS), some 50 island economies in the Caribbean Islands and the Indian and Pacific Oceans, which is quite active in working together on common problems (refer to chapter 1). They share similar problems, such as vulnerability due to their small size and high costs of doing business. They often have few economic opportunities, but tourism is certainly one of them. Tourism is often the only sector that offers potential for export development. Among the SIDS, Maldives has the highest ratio of international tourism receipts to GDP (49.8 percent) (see table 1 in the statistical annex).

Although Maldives' per capita income (\$ 2,514) is not as high as Seychelles (\$6,000), it clearly has achieved more than any of its South Asian neighbors in improving the welfare of its citizens, and compares favorably with countries like the Dominican Republic in the Caribbean (\$2,130 per capita) or Fiji (\$2,240) in the Pacific.

5.2 Tourism Leads Growth in the Maldives

The Maldivians have shown a remarkable capacity to adapt since tourism began in the 1970s, perhaps reflecting their exposure to trade routes for millennia. Although the contribution of tourism to GDP is estimated at 33 percent, it is commonly believed that much of the activity in the islands –as much as 70 percent– is linked to tourism. Maldives receives about 600,000 tourists a year, double its total population.

It currently has almost no corporate tax revenues from tourism; taxation is based on long-term land leases negotiated on a per-bed basis for each individual resort island. In fact, the leases amount to taxes paid in advance. In addition, each tourist pays a bednight tax of \$8 and a one-time airport tax (or user charge) of \$10. The other major source of taxation is duty on all imports (except for initial construction, which is exempt as an incentive); the impact of the import taxes is estimated at about 30 percent of sales. On this basis, the impact of the tourism industry is estimated as: (i) 44.4 percent of total taxes (land leases and bednight taxes); (ii) 33.0 percent of the GDP; (iii) 1 percent of total government expenditure; (iv) about 85 percent of total foreign exchange earnings³⁶ (2004): \$415.4 million (net of payments on service account); and (v) direct employment in resorts of 14,182, of whom half are foreign.

36 Tourist receipts as percentage of exports plus net services (2004).

5.3 Tourism Landscape in the Maldives

Natural and Cultural Assets. The Maldives represents a unique geological formation in the Indian Ocean about 500 kilometers to the west/southwest of India and Sri Lanka, the latter being the closest major landmass. Its coral reefs host the densest mass of tropical fish anywhere in the world. Annual rainfall was 2,473 millimeters in 2003; wind speeds are about 7 miles per hour, and the country is on the fringe of the two annual Indian Ocean monsoons (Southwest and Northeast). The temperature ranges between 26 and 31° C and humidity between 78 and 82 percent. Officially, the months of May to October are "sunny/rainy" and November to April are "sunny/dry"; even in the rainy season, there are long spells of sunshine.

The Maldives has 25 officially designated marine protected areas, with one combining marine and terrestrial measures for biodiversity protection. Lagoons and reefs make up 21,300 square kilometers of the Maldives and the reefs contain more than 200 coral species. Bleaching killed as much as 90 percent of the coral in 1998 as a result of *El Niño*. The coral was showing signs of recovery when the Tsunami hit in 2004; much of it is now covered with sand, which retards its growth. The overriding environmental issue that claims attention is that of global warming, as the islands are often no more than one or two meters above sea level. Many face the danger of rising seas that could submerge some of the islands. A considerable effort has been expended in *Male*, for example, to protect its coastline and there has been significant land reclamation.

Tourism has been developed on uninhabited islands, for the most part, one resort per island. Maldives is trying to nurture an environmental image, with a number of resorts having "green" endorsements.³⁷

Structure of the Industry. Maldives' accommodation capacity has grown rapidly in recent years to 87 island resorts; 8 hotels and 28 guest inns primarily in *Male*; and 113 safari vessels, with a total of about 20,000 beds. (see table 2 in the statistical annex). Many resorts are quite small (20-60 units); about 30 have 100 or more rooms, and there are a few large operations of between 200 and 400 rooms. Eleven new resorts (1,600 beds) were approved early in 2004, which will push the total number of beds over 21,000. Permission to build resorts is given by the Ministry of Tourism through a leasing system. Most lessee/owners are Maldivians and the industry remains largely in Maldivian hands, although well-known foreign hotels (e.g., Four Seasons, Hilton) are beginning to open up in

Table 5.1 : Ownership of Lodging and Travel Related Businesses		
	Lodging (%)	Tour Operators & Travel Agents (%)
Ownership		
Private- Domestic	86	91
Private -Foreign	14	9
Government	0	0
	100	100
Legal status		
Publicly listed	0	0
Limited liability	83	73
Partnership	5	27
Sole proprietorship	12	0
	100	100
Age profile of firms		
Less than 2 years	2	18
2-5 years	21	45
5-10 years	29	0
More than 10 years	48	36
Total	100	100
Source: World Bank, Maldives ICA Survey, 2005		

37 Green Globe or ISO 14001

Maldives (see table 3 in the statistical annex). Some groups have sprung up with multiple operations (e.g., trading, import/export, etc.), leading to horizontal integration to achieve scale and cost efficiency. Recently, operating companies, a number of them foreign, have become prevalent.

The ICA survey reviewed the ownership patterns and structure of the lodging and travel-related businesses in some detail, as shown in table 5.1. The survey covered more than 40 per cent of lodging capacity. The industry remains predominantly locally owned, and confirms a trend seen in many countries where ownership is often local but management (or leasehold) is in the hands of foreigners (see table 3 in the statistical annex). No resort, resort company, or travel company is publicly listed in the Maldives and, except for one hotel, government ownership is nonexistent.³⁸ There is separation of ownership and management, but only in the resort sector.

Maldives usually Offers Additional Services and Recreation Facilities. The resorts in the Maldives offer their own excursions for snorkeling, fishing, and speedboating. They also tend to outsource such services (e.g., submarine reef trips). The larger hotels outsource them to their main tour operators by permitting them to offer excursions for pre-sale in their brochures and set up desks in resort lobbies for on-the-spot sales. In fact, these constitute a significant aspect of their business for many resorts. They would include arrival/departure from the airport (\$75-200 per trip); a day or half-day trip to *Male* for sightseeing and shopping; fishing, snorkeling, scuba diving, surfing trips, picnics to uninhabited islands, island-hopping tours, and other tours by water. Spa operations are also offered by concessions, affiliated companies, and independent concessionaires (e.g., Clarins). There is a fair range of handicrafts available in *Male*, much of it imported from India, Indonesia, and Sri Lanka, but there is an emerging Maldivian industry in handicrafts and painting.

Channels of Distribution. Maldives has developed an impressive supply chain over the past 30 years. There are about 100 intermediaries operating in the Maldives. Most of the world's key tour operators and travel agents offer Maldives in their brochures, and they have their own offices or agents locally providing ground handling and transfer services. There are also well-established Maldivian tour operators and travel agents handling both inbound and outbound travel. There are more than 100 travel service organizations in the Maldives, including international tour operators, travel agents, and ground handling services. About 40 of the well-known international tour operators (Kuoni, Elegant Resorts, etc.) have offices in the country; they usually contract with one of the 60 local companies to handle passengers on arrival, from planeside to the ferry jetties or air taxi services. There is a large fleet of 140 local ferries (*dhonis*), but these are relatively slow. About 80 percent of visitors arrive via a tour operator on a package tour on a charter flight.

Air Transport. The main entry point for tourists is the international airport on Hulhulé Island,³⁹ a 10-minute ferry ride away from the capital of *Male*. It has a runway of 3,200 meters, which can accept all planes with the exception of the largest Boeing 747s. It is constrained, since the main

38 The government owns interest in the Nasundara Hotel in *Male*.

39 The main international air port is run by the Maldives Airport Company, a public enterprise that derives its revenues from sale of jet fuel, concessional fees in the airport, landing and navigation fees, and a passenger tax or user charge of \$14 per tourist. It is profitable and transfers 75 percent of its profits as a "dividend" to government. A key issue is whether the airport tax is a tax or a user fee-and hence revenue for MAC or a tax to government.

runway is also used for taxiing and apron space is very tight. The airport also has a water runway in the airport, handling transfers to the resorts. While adequate for the most part, the terminal facilities are stretched beyond capacity at peak times. The ferry jetty adjoins the air terminal.

The country is expected to open an international airport in Gan, in the southern part of the country, with a runway of 2,600 meters, and there are plans for six regional airports to improve commuting between the atolls and the capital. There are about 30 carriers serving the Maldives. Access to all islands is tightly controlled through transfers to resorts (by speedboats owned by the resorts themselves or under contract with the two seaplane taxi services). For domestic flights, there are two sea-taxi services (Transmaldivian and Maldives Air Taxi), with a total of 31 Twin Otters and an airline serving the country's network of airports (Island Airways). Total international arrivals at Maldives airports reached 630,000 in 2004 and show a significant growth trend for the past ten years.

Environment.⁴⁰ The relationship between tourism and the environment is important, both for conservation and for sustaining the quality of tourism. The harsher forms of degradation due to coral and sand mining, dragnet fishing, and poisoning and dynamiting fish have all been outlawed in the Maldives and protection measures are in place for the resort islands. The main areas of concern are marine biodiversity and coastal-zone management, including natural barriers (fringing coral reefs); shoreline and beach planning; coastal land forms; coastal vegetation, such as sea grass (important for green turtles); forests; and the extent to which exotics are invasive. While the government is aware of all these areas, more needs to be done to better understand these environmental issues and to develop indicators for benchmarking.⁴¹

5.4 Impact of the Tsunami

The Tsunami (2004) did not affect the country badly regarding the loss of life, as in other countries, and was protected by both India and Sri Lanka. However, the economic impact has been tremendous. According to the survey findings (table 5.2) half of the resorts and almost all of the travel companies expect the recovery from the Tsunami to be slow. However, indications are that for the current winter (Europe) season, resort reservations are very strong.

	Lodging	Tour Operators & Travel Agents
1. Firms interviewed affected by Tsunami:		
Lodging %	36	
Tour Operators %		36
2. Estimated Total Cost per firm (MRF/firm)	13.3	0.37
3. Average estimated revenue loss (MRF/firm)	20.0	0.22
4. Recovery predictions:		
Quick recovery %	36	9
Slow recovery %	55	91
Don't know %	10	0
Total sample	100	100
Source: World Bank, Maldives ICA Survey, 2005		

40 The environment is the responsibility of the Ministry of Environment and, in the case of tourism, the Ministry of Tourism. Physical planning has focused on housing but there is a case for better physical planning for tourism-the government's new land use plan is to include tourism. The mission acknowledges the following information sources: UNEP: Maldives Post Tsunami Environmental Assessment, June 2005, www.unep.org/tsunami/ and UNDP/WTO Social, Economic, and Environmental Impacts of Tourism, Madrid, 2000. www.world-tourism.org.

41 For information on benchmarking, contact www.UNEP.org or the Global Environment Fund, www.GEF.org.

5.5 Growth of Tourism in the Maldives

Maldives has an impressive record of growth, while at the same time rapidly expanding its lodging capacity. There are major factors that have clearly contributed to this phenomenal growth. The remote island nature of the Maldives has been nurtured, even if guests fly in Boeing Triple Sevens and other large aircraft. The expansion of capacity has been handled quite judiciously through the leasing of islands on a periodic basis. Many countries (e.g., Mallorca in the past or Bulgaria currently) flounder on growth and get into a series of boom-and-bust scenarios. Growth is seductive and has to be managed in terms of quantity, quality, and location. The Maldives has the advantage of a land structure that lends itself to incremental expansion but there are also bottlenecks, notably access, both international and domestic. It is to the country's credit that the process has been handled effectively to date, though problems are emerging.

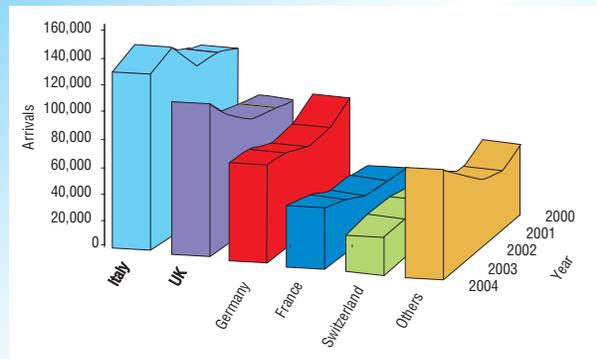
Tourism grew at a rate of 11.6 percent between 1972 and 2005; 26.5 percent between 1972 and 1982; and 6.7 percent since 1982. These rates are well above regional or global growth rates, as might be expected for a successful emerging market. Total bednights exceeded 5 million for the first time in 2004 and the Maldives has shown steady growth since the late 1980s (see table 4 in the statistical annex). The three key original markets were Germany, Italy, and the United Kingdom and these continue to be the core of the Maldives travel industry. However, new markets are also emerging regularly, as shown

in figure 5.2. While recent growth has been noted in markets such as Russia, China, Japan, and Australia, Europe still accounts for 80 percent of Maldivian tourism and Asia for 10 percent.

Maldives' tourism is growing at an average of 7 percent, in excess of the current global rate of 5 percent. The public sector has confidence in the future of tourism; this is also reinforced by tourist operators. Almost all banks have more than half of their lending portfolios in tourism. Many of the big companies in Maldives are diversified and resorts represent only a fraction of their total business, thus hedging the risks. Kuoni, a leading international tour operator, reports that its clients rated Maldives as their number-one destination in the world.

Tourists to the Maldives have tended to be couples in recent years. The honeymoon market has been strong, but there are signs that family travel, in spite of the cost, is becoming more frequent. Originally, Maldives was a diving destination –and still is– but now many travel simply for the "sea and sand" and the opportunity to unwind. In response, many resorts now have spas offering a broad range of services. The main activity is scuba diving and the country has some of the best diving sites in the world, although 90 percent of its coral was blanched due to *El Niño* in 1998. Other popular sports are snorkeling and game fishing in the open sea. Surfing has caught on and the Maldives is currently a stop on the professional surfing circuit. Most resorts also offer excursions to *Male*, island hopping, picnicking, and night fishing, and there is a submarine service that attracts a significant number of tourists.

Figure 5.1
Maldives: Growth of Six Main Markets



Source: Ministry of Tourism - Maldives 2004

Historically, the Maldives' market has been 80 percent tour-operator driven and 20 percent individual clients, and this has served the country well. However, the newer resorts seem to be more and more geared to the individual client at a very upscale level, and international chain operators are entering the market, with their own inhouse marketing capability. This could change the mix of resorts and the demand for the country and will require improvement in some services, notably international access via scheduled service.

Occupancy and Capacity. Occupancy has continued to rise in the face of expanding capacity, showing the strength of the market and Maldives' image in the marketplace (figure 5.3). In 2004, the national annual occupancy rate was about 84 percent, up from 77 percent in 2003 and rates in the 60s following 9/11. This is very high compared to competitor countries like Seychelles (54 percent), Jamaica (55.5 percent), or Bali (47.8 percent) (see table 5 in the statistical annex). Typically, the Maldives is a winter destination with a peak market from November through March/April. In recent years, however, it has also developed as a summer market from June to September. In fact, in 2004, there was little marked seasonality, with resorts busy year-round.

Length of Stay and Daily Expenditure. While occupancies and capacity have continued to grow, the average length of stay has remained relatively stable at just over 8 days-reflecting a blend of one-, two-, and three-week stays that are typical for Europeans in the Maldives. Asians typically stay 3-5 days. Tables 6-12 in the statistical annex show tourist expenditure and arrival data. The average daily expenditure was estimated at \$156 in surveys in 2001 and 2002. With inflation in the Maldives close to zero or negative until recent times, these prices are still fairly good estimates for 2005.⁴² However, with the economic setback in 2005, there can be an adverse impact with high inflation.

5.6 Maldivian Competitiveness in the Tourism Sector

To assess the Maldivian tourism sector with other comparable countries, three sets of data were assembled based on SID countries in different parts of the world (the Pacific and Indian Oceans and the Caribbean Islands). Bali (Indonesia) was also included, as it is an island, albeit in a far larger country, and it shares many of the characteristics of a SID country.

In terms of international arrivals, most of the islands cited have larger markets than Maldives (see table 5 in the statistical annex). This is the case in the Caribbean, in particular, which is close to the North American market and competes with Maldives for the European market. Bali attracts a large part of the Australian and Asian markets, which are also competitors for the Maldives. Japan is a significant player in all of these markets. The only island with smaller demand than Maldives is Seychelles, but its propinquity to Maldives makes it a direct competitor. All of the comparators except Jamaica have growth rates in excess of the world rates (approximately 5 percent per annum). In terms of tourist expenditures, Maldives (\$166 per day) fares better than any of the comparators, except for Seychelles (estimated at \$200 per day). Room capacities are much higher in the Dominican Republic, Jamaica, and Bali but room occupancies are much more robust in Maldives.

42 Evidently there are some contradictions in the data, reflecting the different sample sizes and timing of the surveys. However, as noted below, there is a healthy debate on tourist expenditures in Maldives and a sense that overall tourist expenditures are being systematically underestimated.

All, save Bali, have average lengths of stay of more than a week (8 to 10 days). Overall, the countries earn between \$0.4 and \$2.0 billion (Seychelles is an exception, with about \$40 million).

According to the World Travel and Tourism Competitive (WTTC) Index,⁴³ while a number of the sources are directly related to tourism, many reflect a country's general competitiveness as much as its tourism sector (table 5.3). One of the main indicators is a blend of incoming and outgoing tourism designed to show participation rates for both residents and foreigners: both Maldives and Seychelles score higher than the other comparators and are first and second in the world. All islands in the sample score in the midrange for infrastructure, and all save Bali are in the top 25 percent of the 212 countries. None scores well on the environment,⁴⁴ all being in the lower half.

Factor	Maldives	Seychelles	Jamaica
Price	n/a	n/a	109
Human tourism	1	2	n/a
Infrastructure	53	n/a	39
Environment	153	133	164
Technology	99	47	64
Human resources	43	50	90
Openness	61	9	17
Social	99	81	53

Source: World Travel and Tourism Council (www.wttc.org) in cooperation with Christel DeHaan Tourism and Travel Research Institute at the University of Nottingham, England)

Seychelles scores relatively well on technology (ranking in the top 25 percent), while the others all fall in the middle range. Maldives and Seychelles both score better than the other countries on human resource development, ranking 43rd and 50th, respectively. Only Seychelles and Jamaica are in the top half of the distribution on social issues (UN Human Development Index) and access to media and computers.

The third comparator is the Doing Business Indicator, which has been discussed in detail in chapters 3 and 4.

5.7 Linkages with the Rest of the Economy

Several factors militate against greater inclusion of the population in the benefits of tourism. Access between atolls and islands is quite limited. Access to land requires considerable financial and administrative skills. Employment in tourism, especially by women, is still viewed with some

43 **Description of assumptions in WTTC Competitiveness Index: Price competitiveness** is based on Hotel Price index (HPI) <http://www.placestostay.com>. **Purchasing power parity:** WB World Development Indicators, 2004. **Taxes on goods and services:** WB World Development Indicators, 2004. **Human tourism** is based on Tourism Participation Index, Tourism Impact Index, arrivals/departures, employment, etc. and others (WB Development Indicators, 2004; WTTC studies). **Infrastructure** is based on WB Development Indicators (2004) for roads, drinking water, sanitation, and railways. **Environment** is based on population densities, CO2 emissions from WB Development Indicators (2004), and ratification of environmental treaties (UN). **Technology** is based on WB Development Indicators (2004) for Internet use, telephone connections, high tech exports, etc. **Human resources** is based on WB Development Indicators (2004) for life expectancy, various school enrollment indicators, employment and unemployment and gender indicators, and WTTC studies on employment. **Openness** is based on WB Development Indicators (2004) for visa requirements, tourism openness, trade openness, and trade taxes. **Social** is based on UN data on Human Development Index and Crime and WB Development Indicators (2004) on access to newspapers, radio, television, and computers.

44 The index is based on population densities, CO2 emissions, and adherence to environmental treaties—a matter of some concern for many countries.

skepticism by Maldivians. The construction industry is made up of many small firms who act independently and do not have common working conditions and practices, and linkages between agricultural production and tourism is yet to be developed.

Difficulty in Domestic Mobility. The first tourism master plan suggested a national system of local transportation by boat; however, this proved difficult at the implementation stage. The main mode of commuting between airports and *Male* and the resorts is by launches owned by the resorts themselves, who restrict their use to clients and staff. There is a fleet of *dhonis* that transports both passengers and goods, but they are slow and infrequent. While *Male* remains the indubitable center of the nation, Gan (with a new international airport) is proposed as a center for the south. There are plans for a transshipment center in the North that could also become another center. If the proposed regional development proceeds as planned –with two major centers in North and South– a national high-speed connection (by hovercraft or hydrofoil) might be feasible, with a network of feeder lines using more traditional craft.

Leasing of Islands. The land-lease process is perceived as less transparent and has led to a major debate between government and the private sector. Nonetheless, the government has tried to make the process more transparent and objective. Extension of the leases to 50 years or more would mitigate private sector complaints. However, the long-term land lease is an important instrument for government revenue, especially in the absence of a corporate tax system (refer to annex 5).

Tourism generates about 30 percent of total government revenues and land rents are equivalent to about 66 percent of tourism revenue (see tables 13 and 14 in the statistical annex). Land leases therefore generate roughly 19 percent of total government revenue –a significant amount. The government rightly wishes to optimize its revenue over time and the private sector also has to see the opportunity for making reasonable profits, given the high risks. Although the system of leasing islands for tourism has been an effective way of expanding tourism in a reasonable regulatory context, it would be advisable to revisit this policy.

The leasing model consists of auctioning off uninhabited islands in a bidding process with criteria published in advance and evaluated by independent persons who have no vested interest in the proceedings. The land leases currently vary from 25-50 years depending on the ownership and listing on the stock market. However, the long-term leases (up to 99 years) would allow better business planning.

The survey showed that most lodging facilities are in fact leased, as shown in table 5.4. There are a few hotel properties (as distinct from resorts), primarily on *Male*, where the land and buildings are private. Beyond that, resort properties are on land leased from the government on long-term leases, based on the terms shown above. Similarly, most travel companies operate in leased buildings.

In the 2004-5 bidding process, 11 were islands approved (out of more than 200 applications); very high land rents were proposed, with land rent weighted at 50 percent. Although this does not seem surprising, it is likely to result in a bubble and push up room rates or result in bankruptcy. Some accepted rents were as high as \$45,000 per bed per year *after 10 years*. This translates into ground rent of \$150-200 per occupied bed (\$300-400 per room). This condemns the property to the highest strata of room rents, for which the market may be rarified; it will certainly change the profile of the Maldives over time. Typically, hoteliers suggest that resorts are unlikely to be

profitable if land rents are above \$3-5,000 per bed- or \$18-20 per occupied bed.⁴⁵

The government wishes to refine the process to ensure a more efficient and equitable system that protects the rights of all parties. This report would propose the following: first, ways should be found to delink the rent from bid evaluations. In addition, the emphasis on land rent imposed by the system forces more attention to lease payments than to the rest of the investment proposals, such as concept drawings, business plans, and proposed physical works. More attention needs to be paid to these elements. Recently constructed resorts have increased the level of engineering going into landscaping and beautification not directly related to the resort. Some have construction costs estimated as high as \$1 million per room.

Several additional elements that might contribute to a solution in the short term include: (i) separating the technical and financial proposals; (ii) establishing an index for land rent to be applied across the board; (iii) seeking bids by resort category;⁴⁶ (iv) reducing the weighting of rent if it stays part of the equation; (v) extending the same leasing options to all bidders, foreign and domestic; and (vi) considering the introduction of a "second price auction."⁴⁷

In the longer term, more modest land rents and introduction of a corporate tax and/or a property tax would likely be more efficient. The property tax would reflect the value of the business as a going concern, and the corporate tax would reflect efficiency and profitability, not estimates of future results as the land rent now does. The survey confirmed that there is already a small, active market in the resale of leases and the vacating lessee can participate in the new bid. The current evaluation process is a deterrent to long-term investment, as shown in table 5.4. This is especially true at a time when many of the original leases (1975-85) are coming to term and have to be renegotiated.

	Lodging (%)	Tour Operators & Travel Agents (%)
Land ownership		
Land owned	10	5
Under management	0	9
Rented/leased	90	77
Building ownership		
Buildings owned	35	5
Under management	2	9
Rented/leased	63	86
Average length of lease (years)		
Land	17	3.6
Buildings	14	3.3
Renewable		
Land	82	89
Buildings	79	91
Frequency of review (months)	51	16
Rent (number of firms)		
Based on rental value	85	91
Other	12	0
Source : World Bank, Maldives ICA Survey, 2005		

45 Thinking of this payment as a tax, or government revenue, it is equivalent to 10 percent of a tourist's daily expenditure (@ \$200/day), or 20 percent (@\$100/day).

46 Whereas Maldives does not rate hotels, tour operators do, and there appears to be a common understanding of different categories.

47 See Vickrey quoted in John Kay, Culture and Prosperity, Harper Collins, New York, 2005, p. 101. Under this technique, the two highest bidders are retained. The contract is given to the highest bidder but at the price offered by the second-highest bidder-this in an attempt to reduce if not eliminate gamesmanship. Bidders have an incentive to offer a price reflecting their best judgment of the proposed contract's value.

Late in 2005 and early in 2006, the government offered an additional batch of 35 islands for leasing. This amounts to a fundamental change in policy and one that has made many operators concerned. They have done 98 (87 plus 11) resorts in 30 years and now propose to add an additional third over the next couple of years. Some likely impacts are that access capacity will be strained, and the basic model will undergo modification. While these impacts are not necessarily for the worse, there does seem to be little research information available on the impact of accelerating growth. A new public-management enterprise is proposed to manage at least 50 percent of the new resorts and it is not clear how it will achieve its stated objective of encouraging wider Maldivian participation in resort ownership (see annex 5).

High Contribution to Employment. Overall, direct employment in resorts and hotels is reported by government at 14,182, compared to total beds of 16,858 (2004), or a ratio of 0.72 employees per bed or 1.44 per room (see table 5 for comparators, and table 17 in the statistical annex for similar island economies in the Pacific and Indian Oceans, as well as the Caribbean). For example, the Dominican Republic (a Caribbean competitor with more mass market) has 0.8 employees per room. These numbers do not include the overall "tourism" sector, for example, which employs more than 9,200 foreign employees alone.⁴⁸ Assuming that there is one foreigner per national in tourism (the government target ratio is 50/50), then close to 20,000 people would work in tourism alone in addition to plus hotel and resort staff. It seems safe to suggest that resorts and transport together employ about 35,000 employees, half of them foreign.

The survey highlighted some interesting features of the workforce in the Maldives, as shown in table 5.5. The average workforce size for the sample is 137 staff⁴⁹ for resorts and 34 in tourism-related businesses, with a profile of 20 professional staff and the balance in skilled or semiskilled positions in a single enterprise. Forty percent work in enterprises with 50 or fewer employees, 10 percent in enterprises with 50-100 employees, and the other half work in enterprises with more

	Lodging	Tour operators & Travel Agents
Average no. of permanent workers	137	34
Professionals	20	4
Skilled	56	8
Unskilled	61	1
Average no. of temporary workers	2	1
Percentage employees by enterprise size:		
Less than 5	41 %	91 %
0 employees		
50 -100 employees	10 %	0
More than 100 employees	49 %	9
Percentage employees by education level:		
University or higher	9 %	15 %
Completed secondary	56 %	45 %
Incomplete secondary	17 %	25 %
Completed primary	16 %	10 %
Did not complete primary	2 %	5 %
Turnover in staff		
Number dismissed or laid off	3	0
Sickness or death	2	0
Other reasons	16	1
Absenteeism		
Average days lost	0	0
Source : World Bank, Maldives ICA Survey, 2005		

48 Maldives: Summary Statistics, 2004

49 The size of resorts varies greatly in Maldives but the overall (national) average is 96 rooms; if the average (ICA sample) staffing is 137, then staffing for the survey (1.42) is about the same as the national average of 1.44.

than 100 employees. More than half have a secondary education and another third have at least completed primary education. This is probably a higher level of education than in many developing countries, although comparative data is hard to find. Turnover is about 12 percent initiated by staff and a further 3 percent due to dismissal or for health reasons. This is in direct contrast to many countries, where staff turnover can be a multiple of these levels. In Tanzania, for example, most employees leave after eight months and find work in other hotels or industries (That is linked to social security and other benefits which accrue to permanent employees).

Despite Maldivians' reported reluctance to work in tourism, Maldivian workers follow extensive training programs, since there is a perception that quality of service is important. The industry is addressing quality in several ways. First, the Faculty of Hospitality and Tourism Studies in the Maldives College of Higher Education, in partnership with the Birmingham College of Food, Tourism and Creative Studies, is working hard to improve training for the industry (on a limited budget). In turn, standards are approved by the EdExcel Foundation in the United Kingdom. In addition, as noted above, the industry can employ up to 50 percent of their staff, presumably highly trained, from overseas.⁵⁰

The resort chains in Maldives are also sponsoring training at the Faculty as well as overseas. Human-resource development is considered critical by the companies. The survey gives some indication of the levels of training in the tourism industry, as shown in table 5.6. There is a high level of training, with more than half of the staff having received training on the job. External training is particularly high and, indeed, many firms do send their employees overseas for training (often to Singapore). Unskilled employees, however, receive less training and this is probably where more emphasis should be given. More than half of senior managers have a university or postgraduate degree in both the lodging and travel-related sectors.

Utilities and Infrastructure. The main issues for the tourism infrastructure are water supply, sanitation, solid waste, and telecommunications, as shown in table 5.7. In fact, Maldives has had to accept some relatively high-cost solutions for infrastructure. Electricity is almost all generated by onsite generators, except on *Male* and Hulhulé islands. The water supply is almost all provided by desalination (reverse osmosis process), certainly in *Male* and the resort islands, and is well

	Lodging (%)	Tour Operators & Travel Agents (%)
Employees receiving training:		
Overall		
Internal training	63	46
External training	43	55
Overseas training	31	27
Per firm:		
Skilled	56	37
Unskilled	29	2
Highest level of education of senior managers:		
Did not complete secondary school	2	0
Secondary school	14	27
Vocational training	12	9
Some university training	19	9
Graduate degree	38	27
Post graduate degree	14	27
Source : World Bank, Maldives ICA Survey, 2005		

50 There has been talk of a new hotel school for about ten years but in spite of a little discussion recently, it has not yet appeared. This is a critical problem but the industry can provide career paths for individuals.

managed for the most part. Groundwater has been contaminated by fecal material and the intrusion of saltwater. In the early days of Maldives' tourism, planes carrying tourists also carried out solid wastes generated by the tourists. Now Maldives has allocated three islands (Thilafushi, Kalhufahalafushi, and Hurasdoo) as solid waste dumps, but management of the landfills is quite poor. Resorts often incinerate solid wastes, which can release noxious gases. Little sorting is taking place and biodegradables are either composted (for conditioning soils) or dumped far offshore in the ocean. Sewage treatment is now mandated to be via sanitation treatment plants for resorts (depending on the size of the island), but some of the older resorts still rely on septic tanks with soak pits or ocean outfalls-and are only as safe as the quality of the effluents. The government is well aware of these

practices and progress is being made in improving the situation, but such systems are clearly part of the quality of the Maldivian experience and need to be addressed as a matter of urgency.

Nonetheless, interruption of utility service occurs for many firms in the sample, as shown in table 5.7. All of the tour operators and travel agents experience interrupted service, located as they are on *Male* or Hulhulé; interestingly, telecommunications is also a problem for all of the resorts in the sample. Table 5.8 provides some

comparative data from East Africa. By and large, firms on the mainland have access to power from the national grid, but it does not seem to reduce dependency on stand-by generators.

The lesson from the Maldives experience with utilities is that they have found ways to provide water, sanitation, and electricity using alternative technologies. While these may have higher overall (capital and operating) costs, they have shown that it is possible to run profitable operations using these sophisticated technologies (such as large desalinization plants from Japan; turnkey sanitary treatment plants from Italy and elsewhere).

Construction Industry. The construction industry in Maldives has grown, primarily due to tourism. It is unique in the sense that practically all building materials have to be imported in bulk, broken down into lots, and shipped from the port to the islands. There is little storage space available and construction is a hostage to importation. Earlier, the construction industry used coral rock for building. Coral dredging is now outlawed, as is mining of sand. Sand and aggregates for construction are imported from India. Construction costs have become exorbitant in the past few

	Lodging	Tour Operators & Travel Agents
Firms reporting service interruption (% of firms):		
Power	43	100
Water	43	100
Telecommunications	100	100
Frequency of interruption (times per year):		
Power	3	1
Water	0	0
Telecommunications	2	1
Service interruptions (hours lost):		
Power	143	16
Water	0	0
Telecommunications	119	27
Source : World Bank, Maldives ICA Survey, 2005		

	Kenya	Tanzania	Uganda	Maldives
Outages (days)	82.9	91.85	-	3
Duration of Outages (hours)	31	4.55	-	143
Firms with Generator (%)	88.89	74.24	60.71	83
Share of Electricity from Generator (%)	17.54	35.33	3.26	96
Source : World Bank, Maldives ICA Survey, 2005				

years, with some recent resorts reputedly costing as much as \$800,000-\$1,000,000 per room; one resort's cost of upgrading is estimated at \$300,000-400,000 per room. While these are private decisions, such levels of construction impact the environment in terms of soil and beach engineering, land reclamation, and landscaping. There is scope for recycling building and demolition waste. There do not appear to be construction-industry indices against which to benchmark. Nor do construction/building inspection and control seem to be exercised sufficiently. The following are measures recommended to address these issues: (i) development of indices of construction, such as costs per square meter or per room; and, (ii) better supervision of construction, possibly using specialized firms (refer to annex 2 of the construction industry profile).

Food and Beverages. Many of the hotel companies grew out of other activities. The large hotel chains primarily started business as importers of various commodities. Tourism appeared as a natural extension of their other activities, notably shipping and commerce. Most of the food for the tourism industry is imported from Colombo and Dubai primarily, but also from India. At the same time, most resorts have gardens and produce many of their fresh foods and vegetables on site, some in very sophisticated environments, including hothouses, hydroponics, etc. Additionally, there is some trade between the islands in tropical fruits and poultry, but shipping remains the weak link between islands. The farmers complain that they cannot get their produce to market (refer annex 4 for details about the agricultural sector).

5.8 Other Important Policy Issues

Tourism is not really a sector but rather an agglomeration of cross-cutting sectors. One of its appealing factors is its linkages to other sectors and activities. In Maldives, tourism presents a number of priority issues: institutions and regulation; private partnership; finance, incentives and taxation; small- and medium-sized enterprises; culture and sustainable development; statistics and information technology; and monitoring and evaluation. These have the possibility of creating synergy, building bridges, and, more important, producing value added and wealth. Performing public institutions are at the heart of a modern economy; key policies determine whether the private sector can expand in creative areas or must languish in traditional ones, and there must be measurement and monitoring criteria as benchmarks for success.

Institutions. The Ministry of Tourism and Civil Aviation (MTCA) is responsible for planning, developing policy, and implementing certain functions, such as marketing.⁵¹ The ministry has grown in stature and has used international advice effectively under two tourism master plans. The First Tourism Master Plan covered the period 1983-1990 and set a ceiling of 12,000 beds. The plan was successful in that it recognized Maldivians' entrepreneurial spirit and built on that while at the same time channeling growth away from a *laissez faire* model that threatened the future of tourism.⁵² It also developed the concept of *Male* as the center of an industry with growth poles to be selected where they were needed regionally, as described above. Some failures were recorded, notably the

51 Through the Maldives Tourism Promotion Board and the Government Tourism Information Office in Germany, both dependent agencies of the Ministry.

52 Much of the information in this section is derived from "Strategic Directions for the Maldives Tourism Industry," Maldives Association of Tourism Industry, January 2005. See page 11.

attempt to provide a local transport system between the atolls. The Second Tourism Master Plan covers the period 1995-2005; it recognizes the preeminent role of the private sector in resort development and underscores the government's role "of facilitating the business environment whereby the private sector can operate efficiently," rather than providing infrastructure. In a nutshell, while the first tourism plan focused on growth, the second emphasizes the quality of growth, especially its distribution, human resource development, the environment, institutions, and finally marketing and promotion. The government is now recruiting consultants to work on a third tourism development plan.

Tourism Regulation. The Maldivian Government has been quite efficient in leaving the private sector to proceed with business. Control over the sector is exercised through a deliberate regulatory process. Tourism has been developed on uninhabited islands, for the most part as one resort per island. Access to the islands in the atolls is controlled through the land-leasing process in the first place and through tight control of air and maritime access on the other, as noted above. Each island has to be autonomous in terms of provision of water and sanitation, garbage treatment and disposal, and electricity and telecoms, with clear development standards. The government has developed standards for carrying capacity and construction on the islands. New projects must have an environmental impact assessment and mitigation plan and certain standards (such as 40-meter setbacks from the high-water mark; maximum ground coverage ratios of 20 percent; building heights limited to treetop level) are prescribed. Last, developers have the right to pierce the coral protecting the island if necessary, to build a small harbor for transfers/excursions/and supplies and to combat the effects of sand erosion and accretion.⁵³ Maldives is trying to nurture an environmental image, with a number of resorts having "green" endorsements (from Green Globe, for example). There are weaknesses in the area of inspections on the part of the Ministry of Tourism but, by and large, resorts respect the regulatory framework.

Beyond that, the government has tried to be a catalyst for investment. It also has an inspection department in place. The private sector, for its part, has been responsible in building attractive properties. Together, they have built a modern tourism sector that is the envy of many countries. One useful idea for the proposed new public enterprise would be to focus on regulation and quality enhancement-physical and human resource standards-provided it has a stature of autonomy (see annex 5).

Public-private Partnership. The private sector is represented by the Maldives Association of Tourism Industry (MATI), representing the resort industry (it also has a few members from travel intermediaries, transporters, and linked services such as shopping). Much of its agenda has been focused on the process of leasing islands, particularly the length of the leases and the process of awarding leases.

Views on the relationship between government and industry are mixed. Many in the travel industry (tour operators and travel agents) do not see the need for a trade association. On the other hand, there is fairly strong discontent with (some) government policies (including leasing, quality of marketing, human-resource development, the business environment), all of which would benefit from a space for frank, professional discussion.

53 This was certainly one factor leading to damage during the Tsunami, but it is a question of finding better solutions rather than prohibiting marine access.

A partnership arrangement between the stakeholders (government, industry, and civil society, including local communities and NGOs) could be effective in moving the agenda along, and securing action. It might include the Ministry of Tourism and those ministries directly involved in tourism; MATI; the resort operators; as well as the tour operators and travel agents not currently have formal representation. Ideally, such a program could be channelled to the highest levels through a business council or a committee working on the National Development Plan.

Finance, Incentives, and Taxation. Financial markets are quite shallow in the Maldives (as discussed in chapter 3.) Tourism features importantly in the loan portfolios of several banks –as high as 75 percent in one case. This lack of diversification could pose a problem in terms of risk sharing were the tourism industry to show signs of strain. Most banks appear optimistic that the industry will absorb the shock of the Tsunami and that recovery will be quick, in spite of a very poor first-half performance. Some banks postponed payment of principal on loans following the Tsunami to mitigate the impact on the resorts' finances (occupancies dropped to about 20 percent in many cases at that time). From a tourist's point of view, the banks offer good transfer and payments systems service (SWIFT and ISBS), and easy access to cash via ATMs.

With the 11 new resorts approved in March 2005, there is a debt-financing requirement of \$400 million or more-50 percent of that as debt. This seems beyond the banks' current funding capacity and in fact forces investors to finance offshore. If some of the financing could be raised on local markets –equity and bond– tourism could contribute to deepening the financial sector and at the same time opening up investment to a broader range of Maldivians.

A typical financing plan for a resort is likely to be 30 percent equity for well-established customers and as much as 50 percent for others. In the past, the tour operators also provided some of the equity financing, but established entrepreneurs now use retained earnings and profits from non-tourism activities. Typically, several entrepreneurs become partners in a single deal-thus, there are many cross-holdings in tourism. For the 70 percent debt, loans are usually 5-7 years (plus a grace period up to 18 months) but can be stretched to 10 years for good customers. They can be denominated in dollars or rufiyaa –with most tourism business being conducted in dollars, loans are often tied to LIBOR.

It is difficult to establish the profitability of hotels in Maldives and there are no tax records to simplify the task. Most companies are private and do not publish annual reports. The following is some "impressionistic" feedback on resort operations: hotels have payback periods of 4-7 years. Some hotels break even at occupancies as low as 30 percent. Several operators reported gross operating profits in the order of 30-40 percent, and one investor suggested returns on equity in the order to 25-35 percent. While this fragmentary data suggest that the resort business is still quite profitable, it would be more useful to carry out a detailed study of the sector (see also the section below on statistics and estimation of tourism revenues and impacts). The government needs to encourage firms to list on the stock market as the country develops its capital markets, and to adopt employee stock-option plans as a way of increasing participation in ownership and broadening the stakeholder base.

Taxation. Maldives has a simplified tax system that has no income tax, property tax, sales tax or VAT, and no taxes on exports-with the exception of tourism, an invisible export, which is quite highly taxed. There are four taxes that affect tourism: (i) the \$8 bednight tax, representing 14

percent of total current government revenue; (ii) the \$10 airport tax, 2.4 percent of revenue; (iii) resort land leases, representing 20 percent of revenue; and (iv) import duties, estimated at 16 percent of total revenues from tourism. Core tourism revenues account for about half of total government revenue. Tourism taxes are therefore an important pillar of government revenue mobilization. For 2004, the total government revenue budget was MRf 3.2 billion; of this, tourism-related revenue accounted for about MRf 1.8 billion, or 56 percent.⁵⁴ (See tables 13-16 in the statistical annex).

On the other hand, public expenditure on tourism is about 1 percent of total revenues, and this was a conscious decision when it was decided that resorts would provide their own infrastructure. However, a case could be made for development of transportation, in partnership with the private sector. This could be used for opening up new areas, developing poles in the north and south, and training and destination marketing in tourism, for example. It could also be used to achieve the government's redistribution objectives, including public transport, northern and southern development poles, creating SMEs, and enhancing linkages.

Culture and Sustainable Development.⁵⁵ The Maldives has a rich historical and cultural past, some of which is inevitably being lost in the modern world. To date, the Maldives has lost its skilled masons who carved coral stone, among other trades. However, cultural activities can also include aesthetic activities, the living arts, art, theater, dance, and music, all capable of bringing social and economic benefits. To date, Maldivians have not been very active in researching their cultural past; rather, they have been active in traditional activities that lead to jobs and wealth creation. Many more cultural activities have intrinsic value for tourism, via interpretation of the traditional skills and crafts and through sale of the crafts (e.g., grass mats, coir rope, drumming and dance, and of course boat-making boats). Interpretation of these activities can create interest for tourists and at the same time preserve traditional skills. Saudi Arabia is doing this for its traditional construction industry. In Dhangethi, local people give demonstrations of traditional village activities and school children dance; however, in general there is little of this in Maldives.

With migration to urban areas, it is also important to dealing with the issues of preserving the Maldives' historical and cultural past. The next national development plan could perhaps address these issues. If so, cultural and historical activities to be included in tourism would require: (i) mutual respect for cultural diversity (certainly evident in Maldives today); (ii) a grass-roots approach; (iii) policies that are understood by the population; (iv) education and awareness programs to increase understanding and appreciation; (v) employment generation through culture-based activities and sustainable tourism; and (vi) promotion of cultural enterprises.

54 Evidently, some of these categories are not denominated as "taxes," but all may be attributed to tourism; some designated as nontax revenue could easily be considered taxes in other settings (e.g., the \$10 airport tax currently treated as Maldives Airport Company revenues).

55 Neville, Adrian, *Dhivehi Raajje: A Portrait of Maldives*, Seven Holidays Publishing for Maldives Tourism Promotion Board.

5.9 Social Impact⁵⁶

Tourism has affected individuals, families, and society in general. The vast majority of workers in tourism are male. Families have been impacted by tourism largely through employment and higher incomes. Most welcome tourism but complain that they have difficulty in marketing their produce to tourists. Lifestyle changes have included the stress of working in tourism itself, a nontraditional employment sector. Workers also feel isolated due to separation from friends and family-and this is not limited to tourism, for most of those living in *Male* are far from their home atolls.

In addition, no consultation on resort development has taken place with the adjacent islanders and the issues of reef accessibility and harvesting being lost without compensation have not been addressed. Although the participation of women is limited, they like to start small businesses for the visitors; however, they often lack access to finance. Also, there is still reluctance, particularly from their families, to have girls work in resorts. Women do not like to live in the resorts and wish to return home in the evenings. Their inability to speak English also has restricted their interactions with the tourists. In *Male*, some women work in cafes and restaurants but they are much more prevalent in government positions. Several countries face this problem and to date there is no really satisfactory answer, other than to improve working conditions and to offer careers and entrepreneurship, rather than mere jobs, as the future for young workers. Now that there are several chains with multiple outlets, career planning should be more feasible.

Since Maldivian tourism is organized on a "separate resort island" basis, adverse social impact on lifestyles seems less. The Maldives employs a large proportion of foreigners; about 50 percent of the workers in resorts are from South Asia. This practice is not sustainable, however, as Maldives needs to generate job opportunities for its young. Direct local participation in tourism is diminished due to the dominance of the foreign nationals employed in the sector. However, this could lead to resentment toward the foreign employees. Growth in employment opportunities in resorts has resulted in outmigration from outer atolls to *Male* Atoll and it has put pressure on the resources of the capital. Unlike in other countries, the social carrying capacity⁵⁷ has not been exceeded; however, the outmigration raises sustainability issues, as for example in Addu Atoll.

In addition to outmigration from atolls, an increase in use of drugs and alcohol seems to be an emerging social problem. Furthermore, the local employees believe that there is discrimination against local staff in resorts.

56 Based on Social Economic and Environmental Impacts of Tourism-Republic of Maldives-UNDP and WTO-Madrid, 2000.

57 Threshold of exposure (direct or indirect), after which the community life styles and structure change, which is unacceptable to the community. UNDP-WTO Report, 2000.

Chapter Six

FISHERIES SECTOR AND ITS POTENTIAL

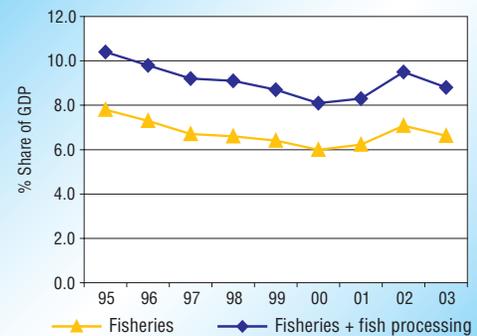
6.1 Introduction

This chapter provides a brief overview of the Maldivian fishing sector based on various World Bank studies and missions.⁵⁸ In addition, the chapter also incorporates findings of the investment climate survey, which included a small number of firms in primary fishing, fish processing, and boat building. Tourism and fishing⁵⁹ are key industries in the economy and account for approximately 40 percent of the GDP.

Growth in the fishing industry is variable but has increased since 2002. After relatively slow growth in the fishing industry in the 1990s, including a major decline from 1995, annual growth⁶⁰ in the fishing sector has picked up, although it still exhibits high variance in response to global market trends for tuna (figure 6.1). From 1996 to 2003, real growth in the sector was 10.3 percent, but the variance is quite pronounced: 7.2 percent in 2001; 28.4 percent in 2002; and a decline of 0.6 percent in 2003. This increase in net output in the fishing industry in 2002 appears to be primarily generated by increased catches and the firming up of export prices.

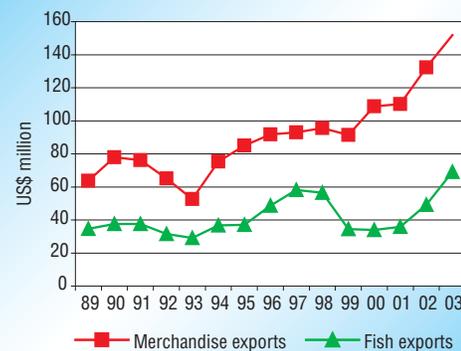
The fisheries sector continues to be an important contributor of foreign exchange. Fish-product exports currently generate about \$60 million annually, which corresponds to more than \$200 per capita (figure 6.2). Although about a third of the annual catch is consumed in the domestic market, fish exports currently account for almost half of the country's merchandise exports, including re-exports (World Bank 1999-2004).⁶¹

Figure 6.1
Contribution of Fisheries to Maldivian GDP



Source: Government of Maldives 1999 - 2001; World Bank 2004

Figure 6.2
Maldivian Fish and Merchandise Exports



Source: World Bank, 1999 - 2004

58 It is based on the findings of a major study of the fisheries sector (World Bank 2002), an update mission and consultant report in 2004, and additional information gathered by Bank missions in September and November 2005 related to a proposed program of economic sector work in fisheries. Contributing material to this report came from consultant papers prepared for the World Bank by Ragnar Arnason (2004) and Gert van Santen (2005).

59 Including fish processing.

60 Based on real value added 1995=100.

61 Where re-exports are included in the merchandise exports.

Maldives' development status is a critical factor for exports. The Maldives currently enjoys Least Developed Country (LDC) status. This secures preferential treatment with regard to development assistance and access to markets. However, with macroeconomic growth, the Maldives is in the process of graduating to the Middle Income Country Status. Although this transition has been delayed by three years to January 2011, when this occurs, the fishing industry's preferential access to certain foreign export markets, especially the European Union, may be adversely affected. Since the European Union is a major (possibly 25 percent in terms of value) and a growing market for Maldives' fish products, and the general import tax is quite high (24 percent), a shift from LDC status would constitute a substantial threat to the fishing industry.

6.2 Current Status and Outlook

The Resource Base

The fisheries sector comprises two quite distinct fishing activities: (a) inshore fisheries consisting of lagoon, reef, aquarium, and recreational (tourist) fisheries; and (b) offshore tuna fisheries focusing mainly on skipjack and, to a lesser extent, yellowfin.

India, Maldives, and Sri Lanka share common boundaries with their Exclusive Economic Zones (EEZ) for fishing. As a result of these common seas, they lack any significant area of international waters.⁶² As the EEZs⁶³ have been established by each country, foreign fishing has subsequently declined. Research from the 1950s indicates that the tuna resources in these common waters consist of yellowfin tuna, bigeye tuna, long-tail tuna, skipjack tuna, eastern little tuna, frigate tuna, bullet tuna, dog-tooth tuna, and the oriental bonito. The last five species are insular, with highly localized migratory habits. The other species are widely distributed throughout the Indian Ocean.

The primary commercial fish species inhabiting Maldivian waters and being exploited is skipjack tuna, which is common to all the warm waters of the Pacific, Indian, and Atlantic Oceans. Skipjack fisheries and exploitation vary across each ocean. The Eastern Pacific and Atlantic Oceans have been heavily fished for the past three decades, while the Indian and Western Pacific Oceans have seen commercial fishing steadily increase over the last two decades (figure 6.3).⁶⁴ The Indian Ocean's commercial harvest of skipjack (0.4 million tons) is one-third the harvest level of the Western Pacific Ocean (1.2 million tons). Skipjack is a warm-water species found in equatorial ecosystems. Tagging programs in different oceans indicate that the species tend to have a migratory range of less than 1,500 nautical miles. Skipjack⁶⁵ tuna populations in any region are quite sedentary and isolated in terms of their low mixing rates with other skipjack fractions. For Indian Ocean stocks, given the large distances (over 1,000 nautical miles) between different skipjack fisheries, there is a high probability that various fractions of the population such as those found in Maldivian waters could represent isolated fractions of stocks. As a result, the stock

62 Sivasubramaniam, 1985.

63 The Maldives EEZ extends 200 miles, with an inner zone (within 75 miles) exclusively for Maldivian fishermen, and an outer zone (75-200 miles) for both local and foreign boats.

64 This section draws heavily on work by Fonteneau (2003).

65 MacCall (1990).

assessment analysis for skipjack tuna and its management recommendations could be done at a regional scale (for example Maldives EEZ), rather than for the entire Indian Ocean.⁶⁶ This suggestion is confirmed by various researchers in studies of Indian Ocean tuna stocks.

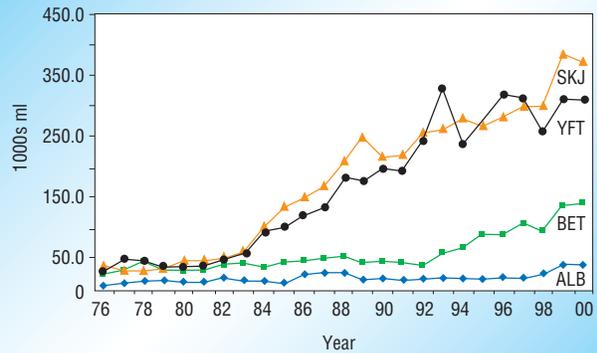
A general conclusion concerning skipjack stocks is that the species is difficult to severely overfish because of its habitat, biology, and behavioral characteristics. According to researchers,⁶⁷ skipjack tuna is a species with a short life span and very high rates of natural mortality that lead to high turnover of population. Combined with the species' wide distribution, the result is a huge biomass of fish, and very high levels of potential production.

Since commercial exploitation began in the early 1970s, researchers generally agree that the stock of skipjack across all oceans was not overly exploited and was capable of sustaining much higher harvest levels. However, because of the limited movement of skipjack, there is potential for local overfishing when local fishing efforts and catches are excessive. This local overfishing tends to be restricted to small geographic areas and is not likely harmful for the larger spawning stock. There are few signs of biological overfishing of skipjack tuna stocks within the Maldives EEZ. Efforts are being made by the Government of Maldives to improve biological data on fish stocks and information on fishing efforts in order to develop growth models and subsequent estimates of maximum sustained yield and economic yield for main tuna species. On the other hand, yellowfin tuna, the second most important tuna species in Maldives, does appear to show some signs of overfishing. This is probably more a consequence of the high seas fishery and foreign fishing within the Maldivian EEZ than of overexploitation by Maldivians.

Maldives pole-and-line fishery critically depends on baitfish. Estimates are that at present some 25,000 tons of various baitfish species are being caught throughout the country. In the past several years, fishermen have claimed that baitfish resources were in short supply. Since baitfish requirements have grown substantially in line with pole-and-line catches, it is likely that, while local shortages may have existed and may still exist in locations where many boats fish for bait, the overall status of the stocks remains uncertain. Extensive studies by the Marine Research Council (MRC) suggest that, given the very high fecundity of baitfish and very short life span, the resource is quite resilient.

Reef fishery, another main fishery in the Maldives, shows some characteristics of overfishing. The last major assessment of reef fisheries⁶⁸ indicated a sustainable reef fishery of 1,800 metric tons

Figure 6.3
Trends in the catch of Tuna in the Indian Ocean



Source: Joseph 2003

Note: SKJ (skipjack), YFT (yellowfin), BET (bigeye), ALB (albacore)

66 For example Hilborn and Sibert, 1986; Anganuzzi, Stobberup, and Webb, 1996.

67 See Joseph, 2003; Stequert and Ramacharrun, 1996 for example

68 Shakeel and Ahmed, 1996

(+/- 700 tons) per annum. Estimated reef-fish export levels in 1999 were more than 1,300 tons, suggesting that biological harvesting levels may soon be reached. The grouper harvest and the sea cucumber harvest have drastically declined in recent years. Giant clam fishery was banned in 1990 and black coral collection was banned in 1995 due to fears of overfishing. Very little information is available on the third important fishery in the Maldives, aquarium fishery (live tropical fish being collected and sold overseas) and its sustainability.

Sustainability of the Resource Base

Understanding sustainable yields for the main tuna fishery in Maldives is critical for long-term sector development. The most common view for skipjack tuna is based on the previous scientific assumptions about stock biology and behavior.⁶⁹ With efficient property rights, the maximum economic harvest is generally less than the biological maximum. Owners of fishing rights are expected to behave rationally and maximize their net returns where marginal cost and marginal revenue are equated. The Maldivian fisheries have been and still are common property fisheries open to all Maldivian citizens. As is well known,⁷⁰ this arrangement can lead to an excessive fishing fleet and fishing effort, undue reduction in fish stock levels and, most importantly, complete or near-complete loss of potential economic rents. This theoretical prediction is verified by numerous empirical studies. When the fish stocks are biologically productive and have a reasonably high unit value, as in the Maldivian case, this loss of potential economic rents can easily constitute a substantial fraction (30-50 percent) of the total value of landings.

A slightly diverging view of stock management⁷¹ is that species such as skipjack may have higher migratory ranges than previously thought. In this case, the maximum sustained yield of key tuna species within the Maldivian fishery might depend to a greater degree on fish inflow from the surrounding ocean. The implication is that sustainability in the Maldivian fishery is not primarily determined by the fishing effort within the Maldivian EEZ but by the tuna-fishing effort in the Indian Ocean as a whole. This suggests that in order to preserve the Maldivian fishery, the government must make a determined effort to curtail high-seas fishing for tuna in the Indian Ocean.

The Institutional Structure

Fisheries development in Maldives has been historically handled by three organizations: the Ministry of Fishing, Agriculture, and Marine Resources (MoFAMR) and the affiliated Marine Research Council (MRC); the state-owned Maldives Industrial Fisheries Company (MIFCO); and the Fisheries Advisory Board. Although there is growing private sector participation in the fishing-sector organizations representing firms and/or workers, they are nonfunctional. Current and future sector development could assign new and different roles to each of these organizations. As an example, only a pro-forma fishermen's organization currently exists. In the future, effective management of the sector will not be possible without a regular dialogue between representatives

69 Refer to annex 2 for more detailed material on fisheries management and economics.

70 Gordon, 1954.

71 Arnason, 2004.

of various stakeholder groups and the government. This requires the creation of organizations that can truly and effectively represent the interests of the fishermen (boat owners and crew), processors and exporters, and producers of Maldivian fish. Such organizations may not only represent their members in discussions with the government, they may also play a critical role in coordinating marketing (Maldivian fish, fresh tuna), market development (fresh skipjack products), and joint transport.

MoFAMR currently combines traditional sector planning, policy design, regulatory, economic analysis and monitoring, control and supervision (MCS), quality control, and developmental functions. It may need to focus more resources on core planning, policy, and regulatory functions in the future. This might mean transferring responsibility for such activities as training, extension, product development, vessel design, project implementation, monitoring, control and supervision, and investment regulation to new or existing institutions.

MIFCO has been partly privatized; its main operations involving canning, freezing, and processing of fresh fish will be further privatized over time, although the schedule and approach have not been finalized.

The Fisheries Advisory Board has long been the main advisory arm at the ministerial level. Some coordination between ministries has been achieved through the Board, although most coordination in areas such as quality control, MCS, vessel licensing, etc., takes place directly between ministries. The emergence of a substantial private sector in fish catching and processing will fundamentally change the nature of high-level policy discussions and ministerial coordination in the future. The need for coordination between ministries must be augmented by a dialogue between the public and private sectors on key policy and strategy issues. Hence, the nature of the Board and its membership may require adjustment, or it may be replaced by a new institution with more representative membership from the public and private sectors, including fishermen, traders, and processors.

Fisheries Management

World-wide experience over the past 25 years⁷² shows quite conclusively that rights-based regimes are by far the most effective in promoting good fisheries management and overcoming inefficiencies caused by open-access management systems.

The MoFAMR is taking important steps to develop new systems of fishing rights through promulgation of new fisheries legislation.⁷³ The fisheries within 75 nautical miles are still essentially open-access fisheries to Maldivian citizens. According to this new legislation, access to the fisheries will be closed and a system of new permits introduced. Thus, all fishing vessels must be registered and all fishing except subsistence fishing will require a fishing license. The new legislation provides a basis for the adoption of effective fisheries management systems by first requiring the Minister of Fisheries to formulate fisheries management plans and second by vesting in him substantial powers to impose necessary fisheries management.

72 Neher et al., 1988, Shotton, 2000.

73 Government of Maldives, 2004b.

Since the 1970s, a number of nations have adopted new systems for fisheries property rights called individual transferable quotas (ITQ). With reasonably robust and transferable fish quotas, the rights holders have an incentive to conserve fish stocks.⁷⁴ In the offshore fisheries, rights in the form of ITQs appear to have good potential for application in Maldives. The reason is that the Maldives is characterized by medium- to large-scale commercial fisheries. There are relatively few landings places, thus the landings enter relatively few processing and distributional channels. Much of the catch is exported. Therefore, enforcement of ITQs is feasible at a relatively low cost. Moreover, the fishery is from a shared stock.

At present, however, the government and MoFAMR lack sufficient capacity for implementing new fisheries management regimes such as ITQs. These would require careful monitoring of the volume of offshore catches or landings. A quota registry to keep track of current quota holdings (initial quota less landings) of individual fishing vessels is also needed. Biological data and information about the operating conditions of the fishing industry would also need to be strengthened in order to set the appropriate total allowable catch based on either biological or economic measures of optimal harvest levels. Finally, an improved fisheries judicial system would be needed to process allegedly illegal activities and to sanction violators.

With inshore fisheries, centralized management and enforcement has proven difficult, given capacity issues and the wide geographic distribution of the atolls. Management on the basis of community fishing rights appears to have good potential. In this approach, the state allocates certain fishing rights to individual communities, which then manage these rights with minimal interference from the state. There are several reasons why this arrangement may be appropriate in the inshore fisheries. The inshore fisheries are spread over numerous lagoons and reefs across atolls. They are generally small and localized. Many of the inshore fisheries are based on local stocks that are separate from those in other atolls and sometimes other lagoons. Thus, the management of these stocks can largely be carried out independently by communities on each island. Even in the case where stocks may be shared, allocation of quota shares to communities would allow them to carry out their own internal fisheries management. Many of the communities in question have good experience utilizing their marine resources. They also have a political and decision-making structure that can form the basis for effective local fisheries management. To overcome the technical and sociopolitical obstacles and introduce these rights-based fisheries-management regimes could take two years or more and require significant internal capacity building and investment.

The Harvesting Sector

Harvests of skipjack are increasing and supporting general expansion in primary fishing. The annual fish harvest has increased from 118,115 metric tons in 1998 to 155,415 metric tons in 2003 (figure 6.4). Close to 90 percent of the total marine harvest in Maldives is tuna, of which skipjack is the most important species, increasing its share of the catch from 66 percent in 1998 to 70 percent by 2003. Local tuna consumption accounts for approximately 40,000 metric tons

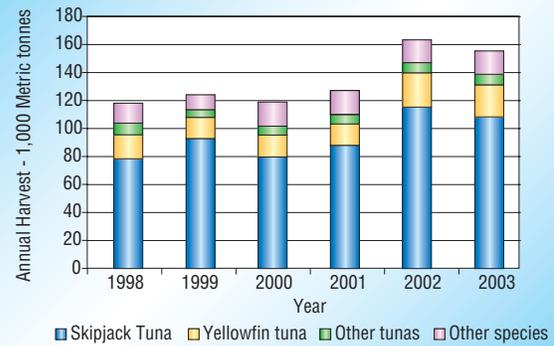
74 Arnason, 2002.

(approximately 137 kilograms per capita per year), with the balance being processed and exported. The expansion of harvests is largely due to strengthening global prices for tuna from 2001. More recently, projected fish landings for 2005 are estimated to increase from 158,000 metric tons in 2004 to 192,000 metric tons (22 percent growth) based on expanded processing and freezing capacity. As indicated earlier in the chapter, few concerns exist about the sustainability of this level of skipjack harvest. On the other hand, yellowfin tuna and other local fisheries such as reef or aquarium fish may not be in a biological position to sustain higher harvesting levels at this time.

Even though skipjack harvests are increasing, fishing employment is continuing to decline. The fisheries sector is a major provider of employment in the Maldivian economy. Moreover, in many of the outlying atolls, fishing constitutes the main source of formal and informal employment. On a national scale, however, employment in the fishing industry has seen significant contraction (figure 6.5). The number of fishermen, which was remarkably steady at just over 20,000 for most of the 1990s, declined by 25 percent to about 15,000 participants by 2003. Although primary fishing employment represents 10 percent of the labor force, employment is unlikely to return to pre-2000 levels. Principal causes of the employment decline include a reduction in the number the smaller fishing boats and a shift by some fishermen to fewer but larger mechanized vessels, increasing employment opportunities in other sectors such as tourism, and a growing aversion by young, educated men to seek work in the fisheries sector. A high proportion of workers in processing and freezing plants in atolls outside of the main island of Male are foreign, mainly from India, Bangladesh, and Sri Lanka. The recent investment climate survey by the World Bank shows that nearly half of the workers in the fishing, boatbuilding, and processing subsectors had completed secondary school, but these include both local and foreign workers.

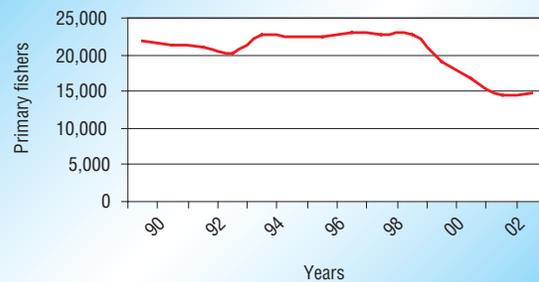
The fishing fleet is shifting to larger mechanized vessels with greater capacity. From government records, the number of vessels operating in the fishery industry has remained relatively stable from 2000 to 2003 (table 6.1). The mechanized boats represent more than 80 percent of all inshore vessels. These vessels and the small fleet operating in the outer EEZ currently account for 98 percent of registered fish landings. So, for the purposes of describing fishing activity, it is sufficient to concentrate on this fleet. According to the results in table 6.1, the number of mechanized

Figure 6.4
Annual Marine Harvest, Maldives 1998 - 2003



Source: MoFAMR, various years

Figure 6.5
Reported Number of Fishermen



Source: MoFAMR, various years

masdhonis operating in the sector has steadily declined since 1995. This tells a limited story however, as the profile of the skipjack fleet is changing rapidly from the traditional wooden vessels of approximately 15 meters, to fewer but larger vessels of 30 meters or more, often fitted with means of preserving fish on ice or with refrigerated sea water, more powerful engines, and modern fish-locating equipment.

It is unclear whether the trend to larger vessels has positive or negative impacts in terms of aggregate net benefits and distribution of benefits to the primary producers (fishermen) and communities (e.g., artisanal processors) [figure 6.6]. Thus, although the number of mechanized inshore fishing vessels has declined, the fishing capacity of this fleet has substantially increased. Fisheries research in Western countries suggests a rule of thumb that the increase in efficiency of a typical fishing vessel of a given size is generally 3-5 percent annually. In Maldives, output volume has increased substantially; primary fishing labor as measured by the reported number of fishermen has been decreased by about a quarter, and capital use appears to have increased by up to 20 percent.

Thus, labor productivity⁷⁵ has likely increased due to capital investments in boat capacities and power, increased human capital in the crews as general education levels rise, and subsequent improvement in knowledge about fishing, and fishing conditions, supported by better location gear and the use of Fish Aggregating Devices (FAD).

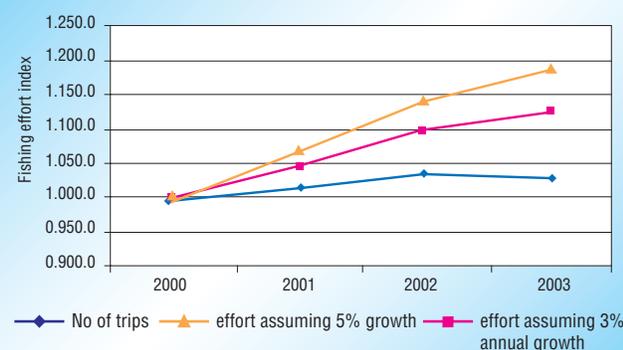
The magnitude of the fishing capacity increase, however, depends on how much vessel fishing power has actually increased. If fishing power has increased by 5 percent annually since 2000, as could be likely, then the increase in total fishing effort since 2000 can easily be 20 percent or more. These estimates are based on data for the number of fishing trips by vessel classes, which have been collected for some time. But these data do not capture information on

Table 6.1 : Number of vessels Applied to Fishing

Year	Masdohani		Vadhu			Outer EEZ
	Engine	Sailing	Engine	Others	Total	Vessels
1995	1406	8	52	Na	Na	Na
1996	1397	13	63	Na	Na	Na
1997	1328	9	102	Na	Na	48
1998	1271	30	61	Na	Na	46
1999	1206	52	70	Na	Na	32
2000	1137	41	58	91	1327	49
2001	1128	66	49	53	1296	20
2002	1102	90	59	25	1276	43
2003	1104	115	46	22	1287	31

Source : Government of Maldives 2004a, MoFAMR, various years

Figure 6.6
Evolution of fishing effort: mechanized masdhonis



Source: MoFAMR, various years

75 Measured as value of output divided by value of labor used.

the estimated fishing power of the vessels making these trips, or on the length of the trips and the distance traveled.

The Tsunami had a moderate impact on the fishing effort. When the Tsunami hit the Maldives, most of the fishing vessels were at sea.⁷⁶ As a result, many boats did not get lost or damaged and many lives were not threatened. However, an estimated 76 vessels (17 meters in size) were fully damaged, 25 vessels (of 17 meters) were completely lost, and another 19 (row boats of 2.5 to 3.5 meters) were completely damaged. Approximately 147 boats lost fishing gear and another 123 suffered damage to electronic equipment.

Commercial fishing methods for tuna in Maldives are unique and offer a niche marketing advantage. About 90 percent of all fish harvested in Maldives is with the traditional pole and line method; this allows much better species targeting compared to other approaches such as trawling or purse seining, which can lead to high by-catch of other species, like dolphins. The Maldives commercial fishery is quite unique with the pole and line method, which is emerging as a significant marketing advantage for "green" tuna by processing companies seeking higher penetration into European markets.

The financial health of the primary fishing sector is difficult to quantify. There are few systematic data on profitability in the harvesting sector in Maldives. The MoFARM is building cost and earnings models based on recent surveys of fishermen, which account for fixed and variable costs, fish landings, and estimated revenues. These models are in the early stages of development and further work is needed to improve survey instruments, interview approaches, and methodologies. As these models and underlying data collection are strengthened, more robust estimates of primary fishery profitability may be possible by boat class as well as aggregated for the sector as a whole.

The Processing and Marketing Sector

The sector is based largely on frozen tuna exports. The primary Maldives fish product is frozen skipjack tuna exported mainly to large markets in Thailand and Japan. Frozen tuna sold in Thailand is primarily used for canning, while in Japan it is mainly converted into traditional smoked fish products. In Maldives, freezing facilities are located in Felivaru in the northern regions, and Maandhoo and Khoodoo in the South. Maandhoo has a freezing capacity of 100 metric tons of fish in two twelve-hour shifts, with a total storage capacity of 1,000 metric tons. The Khoodoo facility has a freezing capacity of 240 metric tons of tuna in two twelve-hour shifts, with a cold-storage capacity of 1,900 metric tons.

Production of canned tuna began in 1977 as a joint venture between the government and a Japanese company. In 1986, a new facility was built by the government with a production capacity of 50 metric tons per day. Given the normal yield in canning operations of 30 to 35 percent of total fish input, a significant volume of waste is generated. The Felivaru cannery converts this residual output into fishmeal, with the primary market in Sri Lanka as poultry feed.

76 Nagy, 2005.

An emerging market for fresh tuna for Sashimi is developing in Japan. This market is based on large, high-quality yellowfin or bigeye tuna, individually boxed and iced, and then flown directly to Japan for sale in auction markets. Katsoubishi, a higher-value dried fish product, is now being produced in Khoodoo for the Japanese market. Fresh frozen tuna loins are also being produced as a high-quality, high-value export into the European market, primarily the United Kingdom.

The volume and composition of fish exports has increased greatly since 2000. This is a reflection of both higher catches and export prices since 2002 (table 6.2). At the same time, there has been a certain shift in production toward higher-valued products such as cooked tuna loins. Somewhat surprisingly, this has not been reflected in a significantly higher unit value of exports, at least as reported by the customs statistics.

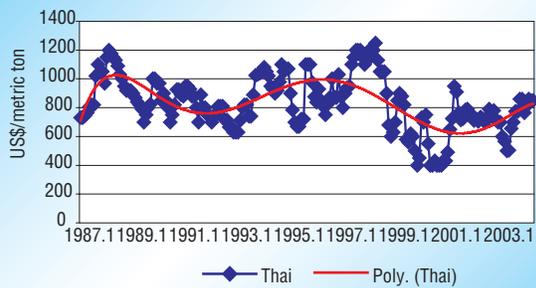
Table 6.2 : Export Volumes and Values, 2000 to 2003

Year	Volume	Value	Price	Value	Price
	1000 mt	1000 Rf	Rf/kg.	1000 US\$	US\$/kg
2000	57.3	481915	8.41	40944	0.71
2001	64.8	538337	8.31	43981	0.68
2002	79.3	716706	9.04	55992	0.71
2003	112	978778	8.74	76467	0.68

Source : Government of Maldives and MoFAMR, various years

World market prices for tuna are cyclical and have been increasing since 2000. Frozen tuna is a commodity that is marketed globally. Since 1987, average prices on the Thailand market for frozen tuna have fluctuated in cycles of approximately 7 years (figure 6.7). Similar trends have occurred in other frozen tuna markets around the world. The last trough in market prices for frozen tuna was around

Figure 6.7
Frozen tuna prices: Thailand market



Note: Prices are for landed price in Thailand. Poly.(Thai) represents a polynomial trendline. Prices are averages for January each year.

the year 2000. Average prices have climbed through 2003 to the present, although they are still about \$200 per ton lower than some of the peak prices recorded in 1997-98. The current market price for frozen skipjack whole tuna in Europe is about \$820 per metric ton. By contrast, fresh frozen skipjack loins are selling for approximately \$3,150 per metric ton.⁷⁷ The short-term market outlook for tuna is mixed. Although prices have been rising in the past few years, high fuel prices are reducing profit margins to a minimum in the tuna-harvesting sector.⁷⁸

The structure of the tuna processing and the follow-on marketing sector in Maldives is changing. Processing and marketing activities are still dominated by MIFCO, established in 1993 to meet a perceived need for more advanced domestic processing of tuna in the face of declining sales of traditional smoked and dried tuna products sold in Sri Lanka. MIFCO was established as a state-owned fishing company, acquiring existing facilities run by the then State Trading Organization. MIFCO was granted exclusive rights to processing and exporting frozen and canned skipjack in Maldivian waters. The company was provided with government loan guarantees but did not receive direct government finance. MIFCO soon established a canning factory in Felivaru and later freezing

77 FAQ, 2005a.

78 FAQ, 2005b.

plants and cold storage facilities in Koodhoo and Maandhoo. In addition, it invested in collector vessels and mother vessels to gather fish from the various atolls and islands. MIFCO operated by setting fixed floor prices for the fish it received. These prices were uniform across the Maldives, representing regional equalization through cross-subsidies to the more remote islands (relative to MIFCO's plants) and an indirect tax on fishermen operating from the better located islands.

For the first few years, MIFCO was close to breaking even. However, with falling (skipjack) tuna prices in 1998, and rising fuel prices and increased rates of interest in 2000-2001, the company suffered very heavy financial losses (figure 6.8). As a result, the company defaulted on its debt, which then had to be served by the government, as the guarantor. The losses continued in 2002 but at a declining rate as MIFCO management took defensive actions by reducing floor prices for fish and trying to rationalize fish collection and processing.

In 2001, the government embarked on the financial restructuring of MIFCO. This process was completed in January 2003. The financial restructuring consisted of the following main items:⁷⁹

- Infusion of cash (MRf 20 million or \$1.5 million).
- Nominal interest on MIFCO's long-term debt owed to the government, amounting to approximately MRf 260 million (\$20 million), was reduced from 12-13 percent to 6 percent.⁸⁰
- MIFCO's short-term debt of between MRf 65 million and MRf 100 million (\$5 million and \$7.7 million) at high interest rates was converted to long-term debt at 6 percent nominal rate of interest.
- Government took over the loss-making Mandaloo freezing plant⁸¹ with liabilities of approximately MRf 166 (\$13 million). This plant was subsequently resold to a private operator for about MRf157 million (\$12 million).

At the same time, the company undertook further rationalization, especially in its canning factory at Felivaru (whose efficiency was reportedly increased by 25 percent). The company also improved its quality control in all its operations. The result was that the company was profitable in 2003 (without debt servicing), the first time since 1997. Aside from the debt burden, the future outlook is reportedly good, although the recent increases in world fuel prices may alter this view.

Figure 6.8
MIFCO: Sales, Profits and Liabilities



Source: Government of Maldives, Ministry of Finance

79 Note that these are rough figures.

80 This is debt initially taken by the government and then re-lent to MIFCO. This debt was in arrears and interest had accumulated.

81 Located in Zone III, which, as a part of opening up the processing and export sector, had been vacated by MIFCO.

Privatization has also accompanied these structural changes. The major change in the institutional framework since 2000 has been liberalization in the processing and export sector. The processing (canning, freezing) and export monopoly of MIFCO, which used to cover the whole archipelago, was withdrawn from the northernmost region, referred to as Zone I and the southern middle region, Zone III. The remaining zones (II and IV) remain unchanged at this point, although the government is committed to further privatization. Following MIFCO's withdrawal from Zones I and III, licenses to operate in these areas were opened to bids from the private sector and eventually granted to four private companies, two in each zone. These companies, all with 100 percent local shareholding, are: Island Enterprises and Jausa Fisheries operating in Zone I, which received their licenses in 2002; and Horizon Fisheries and Funadoo Tuna Products in Zone III, which received their licenses in 2003. As a result, competition for fish to process and/or export has increased, and fish prices have become more flexible and favorable to fishermen. Field visits in September 2005 revealed that prices paid to fishermen by the private companies were usually higher than the floor prices set by MIFCO.

Investment Climate for the Fishing Sector

The government needs further private investment if the sector is to continue modernizing and remain competitive in global markets. Current private ownership is limited to the four small processing companies, several boat builders, independent fishermen, and small producers of smoked fish. The recent investment climate survey confirmed the small structure of existing operations: the majority of firms (79 percent) have less than 50 employees. The median number of permanent workers is 15.5 persons. The average asset base per firm is about \$1.7 million. The sector is also characterized by high gender imbalance, with only 9.2 percent of the workers being female. This reflects religious and cultural factors, as women do not wish to work away from home for extended periods of time (for example, on distant islands with processing facilities).

The positive side of the investment climate includes large skipjack tuna stocks, a highly educated labor force, few delays in importing or exporting goods, and use of e-mail for communications. As discussed earlier, there are few concerns at the moment in light of the sustainability of skipjack tuna stocks and the ability of these stocks to support increased fishing effort. Workers and managers in the sector are fairly well educated. As alluded to earlier in this chapter, almost half of the general labor force among firms responding in the recent investment climate survey had completed secondary education. This also is reflected by 66 percent of the labor force being classified as "skilled." Fourteen percent are classified as "professional" and the remaining 20 percent as "unskilled." Among top managers, 35 percent either had some university training, or had completed a degree, including a postgraduate degree (7.1 percent). While this is a positive attribute for investment, in the Maldives cultural environment as mentioned earlier, many educated young men no longer find work in the fishing sector an attractive career option. Another positive aspect of the investment climate is that the average number of days to clear imports or exports is 2.5 and 2.6 days, respectively; this is one of the lowest rates in the world. At the same time, 92 percent of the firms use e-mail for communications, reflecting the high-quality communication system in the country. It is possible for people on even fairly remote atolls to have access to mobile phone networks and e-mail/Internet services.

The negative side of the investment climate is led by poor access to finance. Of 20 potential factors identified as major or severe constraints for operations in the investment climate survey, the top-ranking

issue, cited by 57 percent of fishing sector firms surveyed, was access to finance. Tied for second place (cited by 50 percent of firms surveyed) were access to land, regulatory uncertainty, the cost of finance, and legal systems. This is corroborated by the fact that 42 percent of firms also highlighted access to finance as their biggest single obstacle. The Maldives has only six commercial banks. The banks have high liquidity but also carry strict regulatory requirements and offer few options for people and firms to invest savings. There is still a mismatch between bank deposits (which generally earn nominal returns of only 1-2 percent) and the term lending for resorts and fishing boats, which attracts real interest rates of between 7.5 and 8.5 percent. Loans are normally financed on the basis of collateral rather than cash flow, which inhibits small businesses or private owner-operators (for example, boat builders) from obtaining commercial finance. For the new large boats being constructed, financing is usually from personal savings or informal loans from friends and families.

Taking account of these investment climate pluses and minuses, the four existing private processing companies are investing in infrastructure and building up their operations. Projected fish landings for 2005 were estimated to increase from 158,000 metric tons in 2004 to 192,000 metric tons (22 percent growth) based on expanded capacity in collector vessels (173 metric tons per day) and land-based freezing facilities (120 metric tons per day). Private capital investments to finance these recent developments are more than \$42 million. Diversification of product lines is under way as investors plan for construction of additional canning and tuna loining plants.

Investment plans also extend to fishing activities in the outer EEZ. Private investors, through local associates, have been licensed to operate tuna long-liners in Maldives "outer" EEZ for some time; currently some 40 vessels have been issued annual fishing licenses. At least one investor, who currently is licensed to operate foreign vessels, is planning to create shore-based facilities on a yet-to-be identified atoll to handle and forward the outer EEZ catch.

Another potential investment area is tuna transshipments, but it is not clear if Maldives would have a competitive advantage. Virtually all long-line- and purse-seine-caught tuna in the Indian Ocean is transshipped at sea or in ports outside Maldives. Given its location, Maldives may have some comparative advantage to develop transshipment facilities for foreign and locally caught frozen tuna. However, in order to be successful, such a facility should be able to compete with existing transshipment facilities in countries such as Seychelles. In the future, local licensing agreements for foreign and local tuna long-lining vessels may stipulate that a percentage of the catch be landed and processed locally. All of these factors suggest the need for a careful review of investments in tuna transshipment facilities and facilities at major airports to handle and temporarily store fresh tuna for export.

Aquaculture (mariculture) is another area with investment potential. The Maldives, with their numerous and sparsely populated islands, sheltered lagoons, and extensive reef areas, are well suited for warm water mariculture. This could support incomes in the outlying atolls in accordance with the Maldives' social policy. However, economically successful mariculture is not a simple undertaking, even when the environmental conditions are good. Among the critical factors are the selection of species to be cultured, the market potential, and the potential environmental impacts of its development in fragile tropical environments, including coral reefs and seagrass beds. Noting this, the government, with the support of the Kuwait fund, has embarked on an extensive feasibility study of mariculture in Maldivian waters. A draft report by the main consultants, Canadian Fishery

Consultants Ltd. from Nova Scotia, contains encouraging results concerning options for mariculture and the associated social benefits. However, the report does not contain a reasonably complete study of the commercial viability of such projects. Neither does it contain a satisfactory risk analysis that takes into account the possible external effects of mariculture in the Maldivian environment. Finally, it does not take adequate account of alternative uses of the marine resources in question (e.g., for tourism and fishing) and the implied opportunity costs of mariculture. Thus, at this stage it would be premature to herald mariculture as an ideal development opportunity for the Maldivian economy. Nevertheless, the evidence to date is sufficiently encouraging to warrant a degree of guarded optimism.

As indicated earlier, MIFCO has already been partly privatized; its remaining operations involving canning, freezing, and processing of fresh fish will be further privatized over time. The government has committed to privatizing the remaining assets of MIFCO in the future. Although no date has been set, the nature of this privatization will have a major impact on the company's future effectiveness, and the process needs to proceed with caution. While various privatization scenarios are possible, to be effective in the future the company will need to strengthen its relationship with its main suppliers, the fishermen. Hence a dilution of public ownership combined with an increase of direct stakeholder ownership may in the future be a favorable option. This will require changes in the structure of the company, developing a process of educating fishermen, and issuing new shares to specific target groups such as active and retired fishermen, populations of specific fishermen villages, people involved in Maldivian fish production, etc. Obviously the privatization of MIFCO could be done in very many different ways (box 6.1).

Any combination of these alternatives and others represents possible options for privatization. Different options may have quite varying short-term and long-term implications. The economic solution should be based on efficiency. On the other hand, the social problem is to select the option that is most in accordance with the Maldivian social objectives identified by government, recognizing the income-equalization role that MIFCO has played with floor prices for fish across all atolls. Therefore, to proceed in a sensible way, it is crucial that government set down explicitly its vision for the industry of the future and the objectives it would like the privatization to achieve. Given these objectives, it is then essentially a technical matter to select the optimal combination of privatization alternatives.

The fisheries fiscal framework is closely linked to investment decisions by the private sector. According to Maldivian law, no taxes can be raised on fishing and the export of fish products, except those produced by foreign parties. Since the government in the more distant past was totally dependent on the fishing sector to generate the revenues needed to pay for food imports, this legal requirement has historically been dealt with through a variety of financial constructions such as an export levy on processed fish. As the sector moves more into a commercial and privatized model, the government needs to identify options for tapping a fair share of rents from a public resource that can be used to support monitoring and management, as well as other national development requirements.

At present, no official investment policy is applicable to these kinds of sector investments except for those contracted with the government for skipjack processing and export. All other applications are reviewed on an ad-hoc basis. Maldives needs a consolidated and coherent investment policy for offshore and onshore

investments in all major fisheries that is transparent and clearly defines the rights and obligations of investors, while fully reflecting the long-term policies and development strategies of the government.

Box 6.1 : Options for further privatization of MIFCO

- (1) Should MIFCO be privatized as a one entity or should it be broken up?
 - a. If MIFCO is sold in parts, how big should the individual parts be?
- (2) Should current market or competitive restrictions continue to apply after privatization?
 - a. Should the current restricted licensing (limited number of companies in each zone) continue or should there be free access?
 - b. Should there be geographical restrictions on company operations (fully/partially/not at all)?
 - c. Should there be restrictions on subsequent consolidation or, for that matter, breaking up of companies?
 - d. How should these restrictions, if any, evolve over time (i.e., be unchanged, diminish, and so on)?
- (3) Should the privatization be accompanied with social-industrial obligations?
 - a. How should social-industrial obligations such as collecting fish, the geographical coverage of the fish collection, offering a uniform price, fuel supply, and so on be handled?
 - b. How should these obligations evolve over time (i.e., be unchanged, diminish, and so on)?
- (4) Should the privatization be by sale or allocation (e.g., of shares) or a combination of the two?
- (5) If allocation:
 - a. Allocation to whom (e.g., individuals, islands, atolls, associations of fishermen, regions)?
 - b. What method of allocation (e.g., equal, lottery, need, other considerations)?
 - c. Should subsequent sales of shares be restricted?
- (6) If sale:
 - a. How important is the selling price?
 - b. What method of sale (auction, closed bids, prebids and negotiation, piecemeal selling of shares, and so on)?
 - c. Should islands, atolls, regions, fishermen's association have any special buying rights (e.g., right of first refusal)?
- (7) Should foreign ownership (direct and indirect) be allowed?

SECTORAL OUTLOOK: KEY CHALLENGES AHEAD

What is the Sectoral Outlook?

The fisheries sector in Maldives still faces difficult challenges despite having a reasonably positive business outlook and investment climate. As indicated earlier in the report, concerns have been raised by government and other stakeholders about possible declining fish stocks in some species such as yellowfin tuna, and temporary pressure on local fish aggregations. Further, the outlook for increased GDP contributions is uncertain, and capital/labor substitutions may lead to more reductions in primary fishing employment. Several factors that appear to be affecting fisheries sector development include: (i) continued public sector involvement in the tuna industry; (ii) impediments to private sector investment, such as access to capital; (iii) inadequate physical infrastructure for fisheries; and (iv) limited institutional and human resource capacity, particularly in MoFAMR. Possibly most important is the sector's continued vulnerability to external shocks from fluctuating tuna prices in the world market. The current export-product mix is not well diversified and, as a result, is overly dependent on products facing highly mature and monopsonistic markets. Although prices for the main tuna products have firmed up in the past 3-4 years, demand is relatively stable, with prices determined largely by supply forces. Markets are therefore highly cyclical. Coupled with rising world fuel prices, a major decline in global tuna prices would leave the fisheries sector in Maldives again very exposed.

What are the Policy and Investment Priorities?

To sustain future fishing sector growth, the country will need to balance two fundamental risks. On the one hand, it can continue to rapidly expand production and exports in markets in which it has traditionally operated, facing high risks of strong future pressures on prices and margins while remaining a modest producer in global markets. Or it can aim at targeting fresh fish markets with new products, optimizing net national benefits rather than production. The fishing sector, both through MIFCO and private firms, has already proven its ability to export fresh and frozen yellowfin. It can experiment with exporting high-quality fresh and frozen skipjack products for direct human consumption. In the short term, the country has no choice but to expand output of commodity product; however, the rapid expansion of the local fishing effort in the past few years necessitates a review of the economic aspects of fleet expansion, and of the current imbalance between catching and processing capacity. Maldives would aim to keep its key comparative advantage of maintaining an economically efficient, low-cost fishing fleet. In the longer term, the ultimate choice will be how to reduce the country's relative dependence on low-value commodity production.

Any move from producing processed tuna to fresh tuna will require the country to quickly adjust its shore-based infrastructure, rapidly expand the use of fish cold storage on boats, develop new airports and other transport facilities on more remote atolls, and formulate new strategies to attract local and foreign investment. Necessary adjustment of the fleet, processing plants, airport infrastructure, and internal logistics can be made relatively quickly; adjustment of the regulatory and incentive framework will require careful study and implementation. Coordinated industry efforts to test new products and develop new markets will require carefully organized public support.

The sector strategies outlined above will also require special efforts to ensure that fishing communities benefit from the development of new products and new markets and, for those that cannot, to provide viable alternatives. Traditional production of Maldivian dried/smoked fish also requires a new approach; the dependence on a monopsonistic single market such as Sri Lanka has limited Maldivian benefits. Higher-quality products are needed and new markets must be identified, while marketing strategies in traditional markets require adjustment. In areas with limited alternative economic options, government policies will need to balance support for maintaining viable production of traditional products with the need to enhance fishing sector efficiency, taking into account the high social and economic costs of migration to Male.

Past efforts at expanding coastal and reef fisheries without effective management measures in place led to quick depletion of the targeted resources. Since most of these products are more valuable for the tourist industry in the water than on consumer plates and since development of a management regime will take considerable time, practical measures are needed to quickly halt exploitation of these species. These measures include more stringent export controls on live tropical fish and closer cooperation with the tourist industry to share management responsibilities around commercial tourism atolls.

Efforts to develop mariculture as an alternative source of fisheries income have had some technical successes, but the commercial viability of new techniques in Maldives remains to be proven. Ongoing efforts to test mariculture production and establish the regulatory and support structures

needed for future commercial development should be completed; new mariculture initiatives should focus only on commercial development.

Sector development in the past depended on and was directed by action and investment dominated by the public sector. Future sector development will require a very different public role, enabling and supporting private sector initiatives and investments, encouraging new developments, mitigating imbalances, and effectively providing critical public services in areas like human resources development, MCS, extension, quality control, and research. Future sector development will also include strengthening the public capacity to design and implement sector policies and enforce a business-friendly regulatory environment aimed at developing a highly competitive and quality-oriented export industry. Adjustment of the character of public interventions, more effective coordination of sector-related public interventions, and adjustment of the capabilities of MoFAMR should receive high priority from the government.

Chapter Seven

CONCLUSIONS AND POLICY RECOMMENDATIONS

The Maldives has achieved remarkable economic growth without compromising its social development. It has set a clear course of market-based integration with international markets, harnessing its natural endowment of marine-based assets in fisheries and tourism. Compared to the rest of South Asia, the Maldives already has made headway in creating a better investment climate. However, experiences from other countries demonstrate more scope for improvement.

Domestic-resource mobilization capacity is limited, but foreign direct investment has made up for the scarcity of liquidity in the Maldives economy. In addition, the Maldives is ahead of other countries in terms of flexibility in labor regulation, and allows foreign labor to fill the skills gap. Recognizing the need for enhancement of local skills, the Maldivian enterprises' emphasis on training of their staff is exceptionally high and is on a par with China's. Business start-up costs are very competitive and process is comparatively efficient. However, disclosure and credit information policies are lagging behind even the South Asian countries and there is great scope for improvement. The governance structure, especially the rule of law and contract-enforcement capacity, need strengthening, since investor confidence in the current judicial system is perceived to be low compared to other comparable countries in Asia.

The Maldives has a simple and administratively efficient taxation system that is considered global best according to the Doing Business Indicators 2006. However, the emerging issues in land leases for tourist resorts-especially their role as a major revenue source for the government-urgently need to be reviewed. The DBI 2006 ranks the Maldives at 31st place in respect of ease of doing business, ahead of all South Asian countries and even ahead of Fiji, Samoa, and the Philippines.

In terms of severity however, (i) access to finance, (ii) cost of finance, (iii) access to land, (iv) lack of skilled labor, and (v) corruption appear to be the five most severe obstacles to growth and expansion of business activities in the Maldives. The lack of a strong legal framework also appears to be a severe obstacle relative to several others.

Financial Sector Issues

High Cost of Funds. As referred to in chapter 3, there is a mismatch in the maturities of loans and deposits. Reportedly, the banks had a relatively high level of nonperforming loans in the past, in the region of 15-20 percent, but these have declined to below 10 percent at present. The legal framework is weak, which creates additional difficulties as mortgages are registered in courts. This becomes a special challenge when in a small island economy as described in chapter 1. Bank transaction costs can be very high in the atolls, and to achieve breakeven, a bank branch takes about two years. In addition, the dispersed nature of the islands requires cash to be transferred physically by sea, adding to the operational costs.

High Exposure to the Tourism Sector. Analysis of the sectoral breakdown of credit at the aggregate level as well as the individual bank level reveals that the exposure to tourism ranges from 50-75 percent. However, except for the domestic bank, the other banks are confined to Male and are focusing on the corporate sector. These are regional state banks that are not very innovative: they have been having their own share of inefficiencies, and they have not been very progressive in their own countries. Given the size of the market, the regional banks may not have given much attention to developing appropriate products for the Maldivian market; especially for SMEs. With the entry of new financial intuitions in the recent past, especially in leasing, housing, and international banking, the banking sector has made better progress. The BML is the only bank that has been engaged in development banking and financing of SMEs; it is also expanding banking outside of Male.

Lack of a Credit Information System. Despite the fact that the informal bankers' association has a regular information-sharing system on bad loans, the lack of a proper credit information system makes it difficult for the banks to extend credit to new businesses, especially in the SME sector. The Maldives will be able to learn from the experiences of countries in the region and in South Africa to establish a credit information bureau that includes the SME sector. This will improve access to credit; there is also the potential for the International Finance Corporation (IFC) or the International Development Association (IDA) to provide technical assistance, especially to bring in the private sector at the outset.

Absence of a Strong Savings Culture. Maldives developed very rapidly from a subsistence economy to a more modern economy during a very short time. However, a savings culture is nonexistent and, given that more than 70 percent of the population is below 35 years of age, the propensity to save is relatively low. Given the paucity of data on savings, it is difficult to analyze the existing situation. Most of the businesses do reinvest their profits in their own enterprises but, reportedly, savings is not a priority in the Maldivian society. The prevailing low negative rates of return on savings deposits limit its capacity for domestic mobilization of long-term capital. This is quite contrary to the trends observed in the other neighboring countries, where credit and savings societies, especially in the rural sector, have a very long history. The development of investment instruments was relatively slow compared to the rapid growth seen in the levels of income. Housing and real estate were the areas where domestic savings had been diverted in the neighboring countries like India, Bangladesh, and Sri Lanka. If investments and saving opportunities are not created in the short term, there is a danger of capital flight, since the other South and East Asian countries tend to offer attractive investment opportunities for the Maldivians.

Lack of Collateral. Given the underdeveloped land and housing markets, most of the entrepreneurs lack collateral for obtaining credit from the banking sector. Most of the banks' lending is based on securities, and cash-flow-based lending is rather limited. Most of the regional banks take a very traditional approach to lending in the Maldives. Therefore, as the survey findings reveal, access to finance is very limited in all sectors and it creates a major problem in the SME sector.

Lack of Long-Term Finance. With a short-term deposit base, nonavailability of large contractual savings in the country, and lack of access to concessionary funding from multilaterals

because of the high per capita levels, investors have limited access to long-term capital. The capital market is still at a nascent stage and the private sector has not listed any of its companies on the stock exchange. Therefore, there is high potential for developing retirement savings schemes like provident and pension funds, an insurance industry, a debt market, and development finance capacity in the country.

Lack of Legal and Regulatory Framework. The government recognizes the need for a better legal environment to develop the private sector and also to attract investments in the country as well as from external sources. Since the Maldives had been practicing Shari'ah law for a long time, unlike in the rest of the region, there is no tradition of commercial law. The delays in the legal system and the weak enforcement capacity contribute to access to finance being severely constrained and lead to a high cost of finance.

Recommendations for Financial Sector Development

- o Introduce new products in the financial sector, especially for the SME sector, and provide training for bank staff on development financing on a cost-sharing basis
- o Enhance credit programs for SME lending assisted by external finance and the introduction of mobile phone banking
- o Divest government shares in the HDFC and enhance the credit program for housing finance with external help
- o Establish a modern, private credit information bureau and movable asset registry
- o Initiate a financial sector study to develop a sector strategy focusing on development
- o Improve legal and enforcement capacity (refer the legal reform section).

Good Governance Issues

Governance and corruption remain controversial and misunderstood topics. The harmful effects of corruption are especially severe on the poor, who are hard hit by economic decline, are the most reliant on the provision of public services, and are least capable of paying the extra costs associated with bribery, fraud, and the misappropriation of economic privileges. Corruption becomes a regressive tax and undermines the government's efforts to redistribute income. It undermines policies and programs that aim to reduce poverty. Therefore, addressing corruption is critical to achievement of the overarching mission of poverty reduction. In the short term, the government needs to improve the regulatory framework and introduce enhanced transparency into public policy.

Other factors hindering good governance include:

- o Perceived conflict of interest
- o A high level of informal payments for business transactions
- o An unclear demarcation between the public and the private sectors
- o Underdeveloped legal and judicial systems with inadequate enforcement capacity.

Recommendations for Improving Good Governance

- o Build a strong and independent judiciary and audit agency with enhanced capacity
- o Establish a Public Procurement Bureau with Web-based information disclosure on tender procedures, contract awards, etc.
- o Delineate public and private sector roles
- o Increase participation of the business associations, including small-scale businesses, in the policy dialogue.

Tourism Sector Issues

Lack of a Comprehensive Taxation system. Currently, the incentive framework for tourism⁸² is quite liberal, if a resort license can be obtained via the lease-bidding process. However, the revenue-generating efforts through the leasing arrangements have been repressive, driving the market to unsustainable levels. Experience with the taxation system is marginal, but such a system is inevitable for the Maldives if the country is to sustain the social development it has achieved so far.

Limited Domestic Access. Interisland transportation remains a problem in Maldives. The dispersed nature of the country and the high cost of transportation adversely affect the private sector. Even labor mobility is restricted because of this factor.

Increasing Rent on Land leases. Tourism policy is based on "one resort per island," which has been a successful policy for decades. Given that there are no corporate taxes, and also to minimize administrative inefficiencies, the government had been charging lease rent. However, this has become a major source of revenue for the government and there is a tendency to maximize rental income. This has become a critical problem that will define the future of the industry, since the bidders have been offering unsustainable lease rentals in the recent bidding.

Employment and Training. The tourism sector is dominated by foreign labor: more than 50 percent of the labor force in the tourism sector is non-Maldivian. Although the government has set up an institution of higher learning, many Maldivians lack the necessary work experience to apply for the jobs available. Given that the tourism sector accounts for more than 30 percent of GDP, this is an area that needs greater attention from industry and the government.

Lack of Standards in the Construction Industry. The growth of the construction industry in Maldives has been primarily spurred by tourism. It is unique in that practically all construction material is imported in bulk and shipped to the islands. There is little storage space available and construction is a hostage to importation. However, there is scope for recycling building and demolition waste. There appear to be no construction industry indices against which to benchmark.

Lack of a Significant SME Sector. The economy is based on the tourism industry, fishing, and trade. While there are good social and infrastructure services, support for SMEs within the country is inadequate.

82 They include no income tax; no foreign exchange limitations; 100 percent foreign ownership is permitted (with a 25-year limit on the land lease period); employment of foreign workers; overseas arbitration; and import duty exemptions, 100 percent for new construction.

Lack of Culture-based Tourism. The Maldives has a rich historical and cultural past, some of which is being lost in the modern world (although this may be inevitable). To date, for example, the Maldives has lost its trade of skilled masons who carved coral stone.

Good Tourism Statistical Base. Both government and the private sector recognize the need for better data collection and management.

Recommendations for Development of the Tourism Sector

Taxation

- Carry out a tourism taxation study (addressing all of the points in this section) to look at resource mobilization from tourism; revisit the issue or resource use (with stakeholders) and review incentive policy
- Review these options as well: a corporate income tax; a property tax; replacing the bednight tax with a sales tax or VAT; in addition, review import duties on tourism, Maldives' leading export.

Domestic Access

- Explore the possibility of a national high-speed connection (by hovercraft or hydrofoil) with a network of feeder lines, using (modernized) traditional craft.

Land Leases

- Separate technical and financial proposals, with financial proposals opened only upon acceptance of technical proposals
- Establish land indices to be applied across the board (this would focus attention on the quality of proposals)
- Seek bids by resort category, with land leases established by category
- If rent remains part of the equation, reduce its weighting
- Consider introducing a "second price auction"
- Modify leasing conditions by:
 - Basing the residual payment on the business as a going concern, unless there is evidence to the contrary
 - Introducing an option for an additional 5-10 years in the lease, unless there is evidence of poor performance
- Providing foreign and local investors the same lease conditions and
- Reinforcing the market system and institutions managing the resale of resort properties.

Employment and Training

- Prepare a needs assessment for a staff development program.

Construction Industry

- Develop indices for construction, such as costs per square meter or per room
- Apply better supervision to construction, possibly through the use of specialized firms.

Public-private Partnership

- Develop a partnership arrangement between the stakeholders (government, industry, and civil society, including local communities and NGOs) to be effective in moving along the agenda and securing action. (This partnership might include the Ministry of Tourism and the other ministries directly involved in tourism; MATI, the resort operators, and the tour operators and travel agents not currently represented formally.) Ideally, such a program would be channelled to the highest levels through a business council or a committee working on the National Development Plan.

Financial Sector

- Encourage tourism firms to list on the stock market as the country develops its capital markets, and to adopt employee stock-option plans as a way of increasing participation in ownership and broadening the stakeholder base.

SMEs

- Seek additional support for SMEs from the donor community
- Carry out supply-chain analyses for the linked sectors cited above
- Consider instruments such as equity and guarantee funds and incubation services to facilitate the entry of a new generation of entrepreneurs and
- Consider introducing stock-option plans for Maldivian employees as a means of distributing the benefits of tourism to local communities.

Culture

- Continue to respect cultural diversity
- Adopt a top-down approach
- Create awareness of the policies, to increase understanding and appreciation
- Generate employment through culture-based activities and sustainable tourism
- Promote of cultural enterprises.

Tourism Statistics

- Further develop the current statistical base to ensure better information for public and private decision making by:
- Establishing a user group, including the Ministry of Tourism, the Customs and

Immigration Service, the Maldives Monetary Authority, the Ministry of Planning Economic Research Department, and the private sector, to supervise this activity

- Exploring options for better information management. In this context, the government might wish to introduce a Tourism Satellite Account, a unit of the 1993 UN System of National Accounts, in a phased manner. This would be complemented by supply and visitor surveys on a sample basis.

Fisheries Sector Issues

Absence of a Comprehensive Sector Strategy. The fisheries sector is in transition to meet both a rapidly changing global trading environment, and structural changes in the domestic market (including rising fuel prices, labor issues, privatization, poor access to commercial credit, etc.). The need for a long-term sector strategy is urgently felt.

Private Sector Investment. Rapid expansion and development of fresh and frozen skipjack and yellowfin tuna exports are only feasible if the private sector (i) plays a key role in developing and test-marketing new products; (ii) invests in local collection and handling, processing and export of these products; and (iii) gains access into new export markets. While some local private investment in the sector has been forthcoming, foreign investment in the sector has been limited, except through joint-venture arrangements for long-lining in the outer zone of the EEZ. Substantial additional investment is needed, and product development, quality standards, and test marketing will require coordination and support. Finally, as in the case of other sectors, access to credit needs substantial improvement and expansion.

Public Sector Investment. At the same time, however, significant public investment will be needed in selected activities of public infrastructure; MIFCO; monitoring, control, and surveillance systems; and research, training, and quality control.

Global Markets and the Role of Maldives. The conservation of tuna stocks is an important objective and requires cooperation among all countries whose fleets exploit these stocks. The abundance of the skipjack tuna resources resident or moving through Maldivian waters is subject to interannual variations. Current scientific knowledge is insufficient to predict future abundance with any precision or to establish precisely the size of the tuna stocks in past years.

Resource Stock Management. The information and analysis needed to manage the fishing sector and fish resources on a sustained basis increasingly requires multidisciplinary and international cooperation to effectively combine biological, technical, economic, and market research. There is an urgent need to strengthen local research capabilities in these areas, and develop better linkages with research institutes, information services, and international commissions abroad. Research products in Maldives should increasingly satisfy public and private demands for analysis and information, and be funded jointly by research users and the public sector. Joint public-private efforts to develop new products, manage selected fisheries, and define future development strategies should have access to long-term cooperative research relationships with a flexible network of research and private institutions.

Reef Management. Management of reef areas can be achieved by reducing access to reef areas or by managing reef exploitation. This is increasingly combined with management of the entire

coastal area. The feasibility of the latter approach is being tested through a Global Environment Facility (GEF)-funded pilot project in Baa Atoll. However, whatever form reef management takes, it is expensive and takes time-often decades-to properly organize. With its very large reef areas, Maldives faces critical decisions on how to effectively manage reefs in the short and longer term. The population declines of selected coral reef species as a result of past heavy exploitation requires urgent attention. Less-traditional solutions are immediately needed to specifically ensure sustainable management of reef and bait fisheries around the country, within the capacity of local island communities.

Mariculture. Past efforts at identifying mariculture activities have particularly focused on promising technical developments. Since mariculture was to play a key role in the diversification strategy of the fisheries sector, substantial financial and research resources were allocated. While the technical viability of the culture and reproduction of selected species have been established, greater attention is required to testing the commercial viability of these technologies, to supporting private investment, and to establishing an appropriate regulatory framework for investment in mariculture.

Recommendations for the Fisheries Sector Development

Building a Comprehensive Sector Strategy

- o Over the next 12-15 months, complete a comprehensive long-term Fisheries Master Plan to set government policy priorities for the development of the Maldivian fisheries sector. The plan would consolidate existing information on the resources, industry, markets, and fisheries management. It would evaluate the entire regulatory framework of the sector, including the business climate, investment code, incentive and tax systems, and implementation of regulations and procedures. The plan would address knowledge gaps, evaluate policy options, and set out a 10-15 year sector investment and development program.
- o Strengthen the supportive knowledge base with assistance from the World Bank.

The following actions should be considered as input to the development of the Fisheries Master Plan:

Institutional Development

- o Initiate a strategic planning process for MoFAMR to define the critical functions of the organization and how these can be rationalized to improve service delivery.
- o Develop and implement an action plan to revise the regulatory framework in support of the new legal framework and lay out a road map for implementation.
- o Conduct an assessment of how the ministries involved in sector governance can better cooperate and coordinate policies and regulations with respect to the investment code, incentive framework, regulatory framework, fishing, transport, processing, and exports.
- o Strengthen MoFAMR's capabilities to manage the fisheries sector, including its

ability to collect and analyze the relevant fishing-industry data, for the design and development of the appropriate fisheries-management regime; set the appropriate management measures (e.g., total allowable catches) within that regime.

- o Strengthen local community and industrial fishing institutions to facilitate broader stakeholder input into sector strategy and development.

Investment and Finance

- o Adopt a more aggressive approach to actively pursuing foreign and local investors as a means of attracting investment in the sector; for example, conduct local investment seminars, engage with stakeholders such as the IFC, train local bank officials, and participate in offshore-fisheries investment fairs.
- o Evaluate options for government incentives to support private investment in the sector, including: developing and testing new skipjack products and markets through more favorable tax and licensing arrangements; reviewing the current pricing system; offering temporary incentives for immediate investments that address current imbalances between catching and processing tuna and make investments in fresh yellow-fin and skipjack exports more attractive; and increasing commercial investment in mariculture.
- o Develop a strategy for further MIFCO privatization, detailing the timing of individual privatization actions, the nature of the privatization, and the longer-term involvement of the government through debt or minority shareholding.

Market Development

- o Develop and rapidly expand fresh skipjack exports and enhance the effectiveness of traditional processing, and efforts to balance fleet and processing capacity will mitigate against financial risks in the longer-term.
- o Strengthen information programs to further position Maldivian's tuna as ecologically friendly in western markets.
- o Involve local communities in tuna long-lining and engage them in supplying fish for fresh fish export; also assist them in improving processing and value-addition methods, transport, and marketing of Maldivian fish through cooperative efforts.
- o Set minimum standards for on-board fish preservation as a condition of all new fishing-vessel licenses to create a future fleet capable of producing the raw material for high-quality export products.

Fisheries Management

- o Initiate regional agreements on the restriction of capacity and the allocation of capacity/fishing effort and/or harvesting shares for key species such as yellowfin tuna among cooperating members and cooperating nonmembers of the Indian Ocean Tuna Commission.
- o Take steps to ensure better viability of the Maldivian fishing fleet by:

- o Developing a transport logistics model for key tuna species to help rationalize fishing, transport, and processing operations
- o Defining a range of vessels with optimal design characteristics and safety standards, reviewing all new vessel designs, and monitoring building performance with design and building standards, to be enforced in cooperation with the Ministry of Transport
- o Providing credit facilities to support the installation of suitable fish -reservation equipment in new and existing vessels
- o Developing policy measures and tools to temporarily limit fleet expansion until sufficient investment in infrastructure and processing capacity has materialized.
- o Initiate pilot programs to test co-management of inshore fish resources with local communities.
- o Complete a strategic plan for fisheries research and development that describes how research can be effectively executed, funded, and directed; how the private sector can participate in research execution, design, and funding; and how the Marine Research Council can build stronger links with external research institutions.
- o Create awareness of the dangers of excessive exploitation and involve communities in designing local actions to protect specific coral reef areas (for example, (i) certain spawning areas can be identified and designated as local marine-protected areas; (ii) quotas can be established for exports of some species, for which exporters can bid; and (iii) exports should be prohibited for the most threatened species).

Land and Housing Finance Issues

In keeping with international experience and the Habitat Agenda, it is likely that the role of government will need to change from that of a provider to a facilitator and regulator of land, housing, and urban development.

Lack of Capacity. The agencies related to land and housing lack the capacity and the required skills to play their new role of facilitator.

Housing and Urban Development. The key issue is how government can stimulate private sector investment while protecting vulnerable groups, especially the poor and women.

Lack of a Housing Policy. Housing conditions in Male and several islands are seriously inadequate, especially because of severe overcrowding; this also contributes to low productivity and social tensions. The current housing market cannot satisfy the demand for new housing because there is no land market, the laws are not appropriate for contemporary conditions, no long-term capital is available for housing loans, and public agencies have overlapping roles and responsibilities.

Land Law. There is a gap between the development of the economy and the development of the legal system. The economy has made more rapid progress in the direction of a market economy than has the legal system, which needs to underpin such a development. The Land Law Act of the Maldives is a significant step forward in the direction of closing the gap between land law and

economic development, providing the fundamentals on which to construct a more detailed land law for an effective and equitable land market.

Land Administration. There is no comprehensive database on the land landholdings and the public has no access to such information.

Recommendations for Land and Housing Finance

- o Government needs to facilitate and regulate a range of supply options for the benefit of the private sector and local communities.
- o Priority must be given to developing Hulhumale as the major commercial and industrial center for the country, with Thilafushi serving as the secondary industrial center. Male can then be developed concurrently as the main administrative and cultural capital at a lower density and with an improved urban environment.

Land Use and Urban Form

- o Develop Hulhumale with the proposed mixed land uses to provide maximum flexibility for future changes in land-use needs.

Property Taxes and the Management of Public Nonresidential Property

- o Public agencies and enterprises should be required to pay rent at market rates, as well as property taxes.
- o Prior to introducing a property tax for other land users, a study should be carried out to assess the impact and levels of taxation.

Establish a Financially Sustainable National Housing Finance System

- o Strengthen and support the HDFC with their mortgage financing.
- o Set up contractual savings funds to mobilize long-term capital like insurance and savings products.

Legal and Regulatory Framework Issues

The Lack of a More Advanced Legal and Regulatory Framework. Given the legacy of a more traditional legal and judicial environment, the Maldives is far behind the other South Asian countries. This also significantly contributes to access to finance, which is the major constraint that has been identified by the private sector.

Low Enforcement Capacity. Due to lack of capacity and the nature of the small island economies, the private and the public sectors recognize this as a major issue. However, the government has already taken several positive steps (see chapter 3) to improve the legal framework.

The government is in the process of conceptualizing a reform program that resembles the reform program currently taking place in Sri Lanka under the Legal and Judicial Reforms Project financed by the World Bank.

Recommendations for Legal and Regulatory Framework

The report strongly supports the following major reforms:

- o Development of the human resources needed for a modern legal and judicial service
- o Drafting of new laws in the areas of commercial law
- o Provision of legal aid
- o Introduction of Alternate Dispute Resolution mechanisms
- o Automation of court procedures, including court management and case management
- o Establishment of a high-level steering committee with all stakeholders-legal, financial, and judicial-for better coordination of efforts.

Similar reforms are being introduced in other, neighboring countries such as Sri Lanka, India, and Bangladesh, which have a long history of strong legal and judicial systems. It is recommended that they be studied and used to design a system that is appropriate to the Maldives. Some of the other systems that might be useful would be Malaysia, Singapore, Australia, and Hong Kong which have similar but more modern systems. Capacity building needs to be an integral part of the reform process.

Given the daunting challenges of being a small island economy and having limited resource endowments, the Maldives needs to continue improving the investment climate to sustain its current achievements in the economic, social, and political spheres.

Annex 1

GOVERNANCE INITIATIVES⁸³

Governance and corruption remain controversial and misunderstood topics. A recent report of Africa Commission stated, "Good governance is the key.... Unless there are improvements in capacity, accountability, and reducing corruption...other reforms will have limited impact."⁸⁵ World Bank research has identified corruption as one of the major obstacles to economic and social development. It undermines development by distorting the rule of law and weakening the institutional foundation on which economic growth depends.

The harmful effects of corruption are especially severe on the poor, who are hard hit by economic decline, are most reliant on the provision of public services, and are least capable of paying the extra costs associated with bribery, fraud, and the misappropriation of economic privileges. Corruption becomes a regressive tax and undermines the government's efforts of redistribution of income. It undermines policies and programs that aim to reduce poverty. Therefore, addressing corruption is critical to the achievement of the overarching mission of poverty reduction. The effective anticorruption strategy builds on five key elements:

- o Increasing political accountability
- o Strengthening civil society participation
- o Creating a competitive private sector
- o Institutional restraints on power
- o Improving public sector management.

Political Accountability refers to the constraints placed on the behavior of public officials by organizations and constituencies with the power to apply sanctions on them. As political accountability increases, the costs to public officials of making decisions that benefit their private interests at the expense of the broader public interest also increase, thus working as a deterrent to corrupt practices.

Strengthening Civil Society Participation. As stakeholders in good governance and institutions mediating between the state and the public, the organizations that comprise "civil society"-citizen groups, nongovernmental organizations, trade unions, business associations, think tanks, academia, religious organizations, and last but not the least, the media-can have an important role to play in constraining corruption. This is true at the country level as well as internationally. Civil society as a third sector in a new governance structure can play a vital role in limiting

83 Based on a World Bank Intranet Web site-Public Sector and Governance.

84 "Myths and Realities of Governance and Corruption," Daniel Kaufmann, The World Bank Economic Forum Global Competitiveness Report, 2005-6, chapter 2.1.

corruption but it also has its limits: without being elected democratically, civil society groups lack the formal legitimacy of political parties as well as accountability measures—a potential entry point for various civil society groups with questionable motives. A high degree of public scrutiny is thus important to hold civil society groups to the same accountability standards as people in public office or private companies.

Competitive Private Sector. The degree to which powerful elites influence the decisions and policy making of the state constrains the implementation of a fair, competitive, honest, and transparent private sector and thus hinders broad-based economic development. The ability of powerful economic interests to capture the state can be minimized through liberalization of economic policy, enhancing greater competition, regulatory reform, good corporate governance, and promotion of business associations.

Institutional Restraints on Power. The institutional design of the state can be an important mechanism in checking corruption, especially through the separation of powers and establishment of cross-cutting oversight responsibilities among state institutions. Restraint on power requires an independent and effective judiciary, anticorruption legislation, independent prosecution enforcement, audit organizations, and legislative oversight.

Improve Public Sector Management. The fifth block of an anticorruption strategy consists of reforms in the internal management of public resources and administration to reduce opportunities and incentives for corruption. Therefore, reforming the public sector requires: meritoric civil service with monetized, adequate pay, enhancing transparency and accountability in budget management; enhancing transparency and accountability in tax and customs; policy reforms in sectoral service delivery; and decentralization of accountability. In most cases, greater public oversight can play a key role in the reform process. Transparency has been an underemphasized pillar of institutional reform and is associated with better socioeconomic and human development indicators, as well as with higher competitiveness and lower corruption.

The research generally shows that countries can derive a very large *development dividend* from better governance since it plays a significant role in country's competitiveness.

Annex 2

POTENTIAL FOR AGRICULTURAL PRODUCTS IN THE MALDIVES⁸⁵

The contribution from agriculture to the GDP is low-2.7 percent in 2003-but it is often underestimated since the production is of a subsistence nature and may not be accurately captured in the national accounts. Agriculture provides formal and informal employment facilities, reduces poverty, provides work for women, and provides safety nets for the population, especially in terms of food security. Agriculture is also affected by the nature and the size of the domestic market, the nonavailability of arable land, and the dispersed nature of the archipelago. The geographical nature of the islands and its limited natural resources for supporting commercially viable agriculture have established that Maldives does not have a comparative advantage in traditional methods of producing agricultural products. The soil in Maldives is very poor and tends to be porous and highly alkaline.

Agriculture will have potential once the Tsunami-related reconstruction is completed. Damage to the agricultural sector is estimated to be \$11 million in terms of the Tsunami's effect on crops, timber, and agricultural infrastructure. The groundwater systems in about 26 islands have been affected, while seawater intrusion has affected 112 inhabited islands. The cultivable land was estimated in 1974 by a Food and Agricultural Organization (FAO) survey as 2,800 hectares in 172 islands, of which 63 percent were in inhabited islands. In 1996, 60 islands were classified as agricultural islands and 32 had been leased (21 years) to individuals or companies.

The Sixth National Development Plan recognized the importance of agriculture to the country's economy as well as its role in generating employment opportunities and providing food security.

	Qty (KG 000)	CIF Value (MRf in millions)
Eggplants	273	3.1
Bananas	323	2.7
Chilies	316	9.3
Cucumbers	334	5.2
Mangoes	232	6.3
Papayas	94	1.4
Pumpkins	162	1.1
Tomatoes	1,051	15.7
Watermelon	540	2.2
Source : Maldives Customs, 2003		

85 Based on "Commercialization of Agriculture," Asian Development Bank and Government of Maldives, 2005.

Table A2.2 : Estimated Resort Fruits and Vegetables - Annual Requirements		
	Qty in millions (KG /year)	Total value at local prices (MRf in millions)
Bananas	1.6	32
Tomatoes	1.1	21.7
Watermelons	1.2	7.4
Cucumbers	0.3	4.5
Papayas	0.6	4.5
Green Chillies	0.1	3.4
Eggplants	0.3	3.3
Cucumbers	0.2	2.6
Mangoes	0.07	2.1
Red Chillies	0.004	0.1
Coconuts- Dry	0.007	0.1
Total		81.9
Source : Maldives Customs Estimates		

Issues relating to Production

Land allocation. No clear guidelines have been issued to island offices on the allocation of land; it varies from one island to the other. There is lack of clarity on land allocation procedures, which leads to conflict between the farmers and the officers. E.g Feevah island, Foahmulah island.

Labor. A labor shortage and the lack of skilled labor hinder commercial cultivation. The younger generation prefers other occupations and the average age of the farmers is more than 45 years. The increasing level of education invariably leads to a declining level of the farming community; also, there is no formal training for agriculture. Hired labor is exclusively for commercial activities and is never used for subsistence agriculture, as in the case of other South Asian countries. Hiring labor is not a practice that would improve the productivity and profitability of subsistence agriculture.

Lack of technical know-how. The farmers have very little knowledge of pest control, plant diseases, and role of herbicides and pesticides.

Lack of access to credit. A field assessment by the Asian Development Bank (ADB) has revealed that attitudes toward credit varied according to region. Northern farmers did not favor debt, while the Southern farmers did. Reportedly, farmers have easy access to credit with simple procedures and without delays, but only a small proportion of farmers seem to have availed of this resource. The ICA survey findings contradict this assessment and highlight that access to finance is the major issue and obstacle to economic development.

Role of women. Women have a limited role in general and especially in the financial management of farms-their role is limited to farm labor.

Market Access

Tourist Resorts. Tourist resorts provide potential for agricultural products. Most of the established hotels import their required produce and have contracts with the importers. However, to capture such markets, the agricultural sector needs to ensure high quality, timely delivery, and low cost compared to imports. The opportunity is there, especially as the Maldives will be able to provide fresh vegetable and fruits grown in an environmentally friendly manner. However, it will have to be well organized, since the Maldives' transport cost is prohibitive and might not be cost effective unless the islands situated in close proximity to the resorts provide such agricultural products.

Domestic Market. Distribution to commercial markets has been established. Intermediaries and wholesalers are already operating in Male. However, the scale of economies required for low-cost agricultural production does not exist in the country. Given the limited land resources, high cost of labor, cost of transport and proximity to large agricultural neighbors like India, Bangladesh, Pakistan, Sri Lanka and would not permit the Maldives to access international markets.

Support Services

There is a lack of agricultural extension services. The Maldivians may need to learn from their neighboring countries rather than look toward the Western hemisphere. Most of the farmers lack basic knowledge of agriculture. It was noted that some of the vegetables grown by expatriate labor, such as green leaves and varieties of pumpkin, were not known to the Maldivians. Transport and distribution systems may need to be introduced on a cooperative basis and training should be provided for use of fertilizer and other inputs. Members of the Women's Development Committees are reported to have knowledge in basic agriculture but they are not actively involved; government involvement might be required as a facilitator. The lack of market information also can be addressed through support services.

In the ADB report, six fruits and seven vegetables which will have high commercial value have been identified. Those are dry and green coconuts, bananas, papayas, watermelons, mangoes, medicinal plants, chilies, pumpkins, eggplant, cucumbers, tomatoes, and cut flowers. The selection criteria for those were: the perennial nature of the plants; technology; transport; storage and production costs; market potential (domestic, resort, and international markets); and value-adding capacity.

Proposed Actions

- o Improvements of forestry and water resources; importation of planting material; provision of extension services.
- o Development of market-distinctive crop types and agribusiness activities for the domestic, resort, and foreign markets.
- o Provision of a high-value added processing industry.
- o Adoption of a cluster approach to the integration of production, marketing, and distribution activities for targeted geographical areas.

- o Enhancement of the "catalytic role" of the public sector; design of a legal and regulatory mechanism.
- o Targeting of the Tsunami-affected areas that will combine both subsistence and commercial production and ensure an increased role for women in agriculture.
- o Ensure close coordination between public and private sector.
- o Provision of access to credit facilities/crop insurance.

Annex 3

CASE STUDY ON CONSTRUCTION INDUSTRY

The construction industry has contributed 10 percent of the GDP and accounts for five percent of the national employment data. With the growth in tourism, government development programs in Hulhumale, and the Tsunami-reconstruction efforts, tourism will continue to play a critical role in the development process. Of the total labor force of the construction industry, more than 70 percent is provided by expatriate labor; particularly at the skilled and unskilled levels.

This annex presents a brief account of the construction industry in the Maldives based on interviews with a representative sample of the construction firms owned by the Maldivians. The interviews covered small-, medium-, and large-scale industrialists and also the construction industry as a whole, represented by the Maldives Association of Construction Industry (MACI). In terms of business experience, the industrialists account for 19 years of average work experience and vary within a range of 8 to 30 years. The usage of information technology in business operations is widespread and almost all of the managers at the top level have a university degree or diploma-level training in addition to work experience in the industry. Of the total employment, about 10 percent are professionals, while the rest comprises skilled (34 percent) and unskilled (56 percent) workers.

In terms of the structure, it consists of 40 to 50 industrialists covering small-, medium-, and large-scale enterprises. Some of the players are highly specialized and cater to specific segments of construction industry, i.e., tourist resorts. The industrialists believe that the industry is yet to reach a maturity stage and, therefore, foreign competition should be limited to areas where new technology and skills, i.e., construction of bridges, are needed.

The key players in the industry import the bulk of the material requirements directly, in addition to using imported material from large-scale importers. On an average, about 45 percent of the material requirements are directly imported by the industrialists. Imported materials are subject to a 15 percent import duty; some of the items however, i.e., parts used in air conditioners, are subject to a 200 percent duty. The market comprises both public and private sector construction activities; the former accounts for about 55 percent of the market. In 2005, capacity utilization was about 92 percent and the majority of the respondents expected the capacity levels to reach 100 percent in 2006.

The industry is organized under the Maldives Association of Construction Industries in order to voice the issues of the industry with policy-making bodies. There is evidence of an increasing level of public-private partnership and also more consultation of the private sector by the government on policy formulation.

An assessment of key issues affecting growth and expansion based on standard ICA methodology revealed transport (particularly interisland transport), access to land, labor regulations, access to and cost of finance, electricity, and skills and education of available workers as major constraints

to the industry. Price fluctuations in imported material inputs have also been identified as a factor affecting the profitability of the construction industry as well as a difficulty in planning for the future. In addition, the cost of the regulatory system was cited as an important factor for the high transaction costs of the industry. The regulatory system involves a substantial amount of the top managers' time and in some cases (i.e., large-scale operators) it requires at least two additional staff to handle paperwork relating to procedural matters.

In overall terms, access to finance was identified as the biggest obstacle to the operation and growth of the enterprises. Detailed investigations into this issue revealed that the commercial banking sector accounts for about 10 percent of working capital requirements, while the rest is met by internal funds (58%), family and friends (12%), trade credit (10%), equity (6%), and leasing (3%). In the case of new investments, however, domestic commercial banks provide 40 percent, while foreign commercial banks account for 20 percent of the investment requirements.

One of the key issues emphasized by the respondents in the construction industry was the heavy transaction costs involved in the various payments associated with the bidding process, including the bid security to be paid at the pre-proposal stage; the 90 days bid security (MRf. 40,000) performance guarantee; and at the post-bid stage, payment of 15 percent is obtained as an advance payment. In addition, the reduction of letter of credit margins by commercial banks has also been cited as a contributory factor to the high cost of finance. The industry also raised the lack of venture capital companies.

The skills and education of available workers is an important problem that needs to be addressed at national level. In fact, the construction industry in the Maldives is known as the training center for both skilled and unskilled workers, particularly from the neighboring countries. A high proportion of expatriate labor at both the skilled and unskilled levels has led to several distortions in the labor market. On the one hand, the existing practice of project wise foreign employment quota allocation has led to additional transaction costs due to procedural delays and on the other, lower wages and poor working conditions have led to a dual wage system (i.e., relatively low wages are being paid for foreign labor especially at semi-skilled and unskilled levels). The minimum wage levels expected by the Maldivian labor is about MRf. 2,000 per month while the prevalent minimum wage for foreign labor is MRf. 1,000.

Recently the government introduced a policy to encourage recruitment of local labor. As in other industries, the investors commented on the "anti-blue collar" attitude among the Maldivians. Despite the high level of literacy, there is a lack of professional and technical expertise. Most of the training provided in the higher learning centers is supply driven. The industrialists, however, are making every effort to maintain the foreign/local share of employment on an equal basis. They are also willing to participate in skills-development programs on a cost-sharing basis. This is an issue directly linked with the technical and vocational education sector and its capacity limitations. With regard to the former, it reflects the limited output of the technical and vocational education sector, i.e., the capacity to offer diploma-level courses in the Faculty of Engineering Technology (FET).

The remedial measures to overcome these constraints rest primarily with the institutional and policy support system of the Maldives. For example, the high cost of electricity could easily be avoided by encouraging the use of private generators, especially in Male. But this requires the

approval of the STELCO. Similarly, development of technical and vocational skills needs to be demand driven and initiated with the joint participation of private sector enterprises. The competitive practices of the industry need to be promoted by discouraging unfair trade practices. The high cost of water-mainly due to the high cost of desalination-raises the issue of whether the prevalent quality is needed for construction purposes. This is being discussed even at the policy levels. Another issue raised was the high cost of electricity. The government and private sector might consider exploring the possibility of using alternate energy such as solar power and wind power, which have been the subjects of successful experiments in other countries in the region, including as India and Sri Lanka.

Interisland transport costs are very high: for example, while transporting a 20-foot container from Singapore to Male costs about \$1,200, the cost for transporting building materials to an island would be about the same (\$1,000-\$1,100). Additional costs are incurred due to lack of jetty facilities in some of the islands. The industry also emphasized the lack of suitable means of transport (vessels/boats) for construction material, which might be another private sector service that could be encouraged. There are also increasing costs due to thefts, which means engaging 24-hour security at the construction sites. This is reportedly linked to drug addiction and increasing unemployment among educated youth.

The industrialists also feel that the government does not pay adequate recognition to the sector, and also that they "listen but not hear us!" However, the government is making concerted efforts to encourage consultation with the industry, and this needs to be further strengthened.

Policy Recommendations

Improve Access to Finance. Explore the possibility of venture capital companies. Increase the expertise of bank staff in development banking. The current threshold for SME loans without collateral is low, at MRf 15,000; this should be raised.

Alternate means of cheaper utility services. Explore the possibility of allowing the use of generators, and solar and wind power.

Development of a Land Policy. Land policy needs to be more market oriented, and there needs to be greater clarity and transparency. The government needs to shift from being a developer to a facilitator and a regulator, and it needs to expedite the Hulhumalle development program.

Governance. Law and order need to be stepped up to curb the increasing crime rate linked to drug abuse; clarity and transparency in regulations needs to be improved.

Role of Government. The bureaucracy simultaneously holding public and private sector positions is a major conflict of interest. The government should conduct a study showing how to delineate these functions between the two sectors.

Labor Laws. Minimum wage rates, regulated working hours, labor standards, modern electronic-surveillance systems, and drug control measures all need to be introduced.

Legal Framework. More training on commercial law, the introduction of modern commercial law, and improved enforcement of decisions are all needed.

Improve Infrastructure. Improved transport services using better transport modes and vessels for transport of construction material are needed. Develop the international airport and expedite the Hulhumale Development program.

Training and Capacity Building. Introduce better, more demand-driven skill development programs. Use training to improve the work ethics of the labor force. Commence cost sharing-programs with the private sector.

Set better standards. Develop a system for grading construction companies. Adopt clear guide lines, and register foreign contractors. Require local participation for small contracts.

Further improve private-public partnership and dialogue. Provide better recognition for the industry.

Annex 4

CASE STUDY OF HANDICRAFT INDUSTRY IN MALDIVES

In the Maldives, microenterprise industry is very marginal in terms of providing employment opportunities. With the rapid development of a modern economy, traditional crafts-except for a few-are in danger of extinction. Boats have been an essential part of the life of the Maldivians for centuries, for fishing and commuting from one atoll to another or one island to another. Ribadhoo Island has been well known in Maldives for its jewelry making. In addition, the traditional Liye'laa jehun or craft of making lacquer products has also been mastered through generations. Another craft in the olden days was kunaa or mat weaving from the screw pines or cadjans.

These traditional products, which had a utility value in the past, have lost their place to the substitutes that can easily be imported from other countries and that are cheaper than the Maldivian products. Weaving feyli, the heavy cotton sarongs with brown and black borders that were traditionally worn by both the men and women, had also been a craft practiced in some of the Atolls. Currently, there is hardly any demand for these, which are only worn on ceremonial occasions. Maldives was also known for stone carving, another form of art that involves hard manual labor and is not financially viable anymore. In the past, Maldivians had produced some of the finest Muslim tombstones, with almost calligraphy-like inscriptions and intricate carvings, but today it would be hard to find stone carvers. Coir rope from coconut husks was once an export of the Maldives, but the demand has declined for coir rope and this craft is also fading away.

A random survey in Male revealed that the handicraft shops or gift shops for tourists contained primarily imported products from Indonesia, Thailand, India, and Sri Lanka. Reportedly, there are about 20 retailers and about 10 wholesalers of imported handicrafts. Some products are imported directly by the shop owners, but most of the products are purchased from wholesalers. Discussions also revealed that the average annual income of these shops is about \$40-50,000. The profit margins are reported to be about 25-35 percent, but are probably more, depending on the tourist arrivals. The discussions also revealed that, given the cheap labor costs in the neighboring countries in South and East Asia, it is more profitable to manufacture and import these products. The cost of operations is very low, with a monthly import license fee of MRf. 200 and a monthly rental cost. The shops typically have about 3 or 4 workers, primarily family and friends. Labor costs in Maldives are relatively high, and it appears that the minimum wage for an unskilled worker would be about MRf. 2,000 per month. Therefore, most of the resorts and Maldives handicraft shops prefer imported products. This is another example of the absence of linkages between the tourist industry with the rest of the economy. Ironically, "Maldivian" tea (a product that requires a very high elevation and cooler climate for cultivation) was displayed at one of the Male gift shops: further inquiries revealed it to be from Sri Lanka.

A visit to Thulusdhoo Island, the Capital of Male Atoll, revealed that such craftsmanship is in danger of extinction if not supported. Due to the Tsunami, about 250 of the islanders (about 56

families) of Ribudhoo Island (famous for jewelry) have migrated to Thulusdhoo and another 200 have expressed their intention to migrate. Even though they had been traditionally making gold, silver, and marine jewelry, they lost their equipment and the stocks of gold and silver to the Tsunami tidal waves. Prior to the Tsunami, they had been manufacturing these products for the resorts as well as for Male shops. Now they require financial assistance as start-up capital, since they are at present living in temporary shelters provided by the Government of Maldives. The discussions with the women folk revealed that they are continuing with the manufacturing at a lower scale but would like to receive financial assistance from any bank or another financial institution to scale up their manufacturing. According to them there is a substantial demand for their products; this has also been confirmed in the Official Year Book of the Republic of Maldives 2003. Another suggestion was assistance to construct a center for group work so that the women would be able to improve their efficiency. In addition, due to the close proximity of this island to Male, this could also be used as a training centre to promote this skill to other islands as well. In this island there is a population of about 1,200, and some of the inhabitants of Thulusdhoo would also be able to learn this craft.

Despite many claims of the poor work ethics of the Maldivian work force that require the importation of labor from neighboring countries, an interesting experiment was conducted by the owner of the Creative Center in Villingili, the fifth ward of Male. In addition to traditional lacquer work, this center has also introduced the manufacture of creative wooden products unique to Maldives. Some of the products displayed at HERITAGE are reasonably priced from Rf 50-100 to \$50. The craftsmanship of the products displayed is of very high quality and demonstrates the



Source: Heritage - Creative Arts and Crafts Training Centre (CACTC)

creative talents of the Maldivian youth, both girls and boys. If this kind of venture is promoted, it will provide employment for a larger number of youth in the country, especially in the outer Atolls. In addition, unlike other industries, the handicraft industry needs to be more indigenous. The Maldives has successfully created a brand name for its tourist industry in the past and it also caters to up-market clients. Therefore, the relatively high cost of handicrafts would not affect the market for such products.

There may be a need to introduce a certification system for authentic products from Maldives. In addition, the government may need to improve market access. A handicraft display center at the airport and or Male to display the variety of Maldivian handicrafts available would be another possibility. The Tourist Promotion Board also might be able to support such promotional activities and, since very little space is required for handicrafts, the resort owners would also be able to promote more Maldivian handicrafts as an act of corporate social responsibility.

Annex 5

TOURISM-LEASING OF RESORT ISLANDS

Leasing of islands. The land-lease process has become controversial and the way it is priced is a matter of hot debate in the Maldives in government and private circles; nonetheless the government has tried to make the process transparent and objective. Only its extension to 50 more years (or uniform application to all investors, as suggested below) would pacify private sector complaints; however, this is unlikely to occur in the short term, as the long-term land lease is an important instrument of government revenue policy.

Tourism generates about 30 percent of total government revenues and land rents are equivalent to about 60 percent of tourism revenue (see table 14 - annex 7). Land leases therefore generate roughly 19 percent of total government revenue, a heady figure. Clearly, interests differ. The government rightly wishes to optimize its revenue over time and the private sector also has to see the opportunity for making reasonable profits in line with the risks it runs. Although the system of leasing islands for tourism has been an effective way of expanding tourism in a reasonable regulatory context, it is perhaps now distorting the market.

The leasing model consists of auctioning off uninhabited islands in a bidding process with criteria published in advance and evaluated by independent and disinterested persons—those who have nothing to gain whatever from the results. The most recent set of bids were evaluated on the following basis:

- | | | |
|---|---------------|------------|
| ■ | Concept | 20 percent |
| ■ | Business plan | 10 percent |
| ■ | HRD | 10 percent |
| ■ | Environmental | 10 percent |
| ■ | Lease value | 50 percent |

Last, the terms of the lease are standardized as follows:

- 25 years is the norm
- 35 years if the investment is more than \$10 million
- 50 years if some shares are sold on the Maldives stock market.

Additionally, foreign investors cannot be awarded a lease of more than 25 years under the present rules. While this favors local investors, it discourages foreign private investment at a time when Maldives is promoting FDI. Twenty-five years appears to be a long enough period to generate a profitable investment (in the absence of the restrictive residual value clause). On the other hand, many countries use 99 year long-term leases.

The survey showed that most lodging facilities are in fact leased, as shown in table A5.1, below, along with some other leasing data. There are a few hotel properties (as distinct from resorts), primarily on Male, where the land and buildings are private; beyond that, resort properties are on land leased from the government on long-term leases, based on the terms shown above. Similarly, most travel companies operate in leased buildings.

In the 2004-5 round of bidding, with 11 islands approved (out of more than 200 applications), very high land rents were proposed. With land rent weighted at 50 percent, this does not seem surprising, but is likely to result in a bubble and push up room rates or result in bankruptcy. Some rents proposed (and accepted) were as high as \$45,000/bed/year after 10 years. This translates into ground rent of \$150-200 per occupied bed (\$300-400 per room). This consigns the property to the highest strata of room rents, for which the market may be rarified-and will certainly change the profile of the Maldives over time. Typically, hoteliers suggest that resorts are unlikely be profitable if land rents are above US\$3-5,000 per bed-or \$18-20 per occupied bed⁸⁶-and it would seem that this could be pushed a bit further.

The government wishes to refine the process to ensure a more efficient and equitable system that protects the rights of all parties and we would propose the following ideas. First, ways should be found to unlink the rent from bid evaluations. In a more typical environment, land rents often represent a small fraction of investment costs, say, 5-10 percent of investment. Moreover, in the absence of a corporate income tax, the land rent may operate more as a tax paid in advance than as a land rent. In addition, the emphasis on land rent imposed by the system forces more attention to lease payments than the rest of the investment proposals, such as concept drawings, business plan, and physical works proposed. More attention needs to be paid to these elements: recent resorts have increased the level of engineering going into landscaping and beautification not directly related to the resort (some have construction costs estimated as high as \$1 million per

	Lodging		Tour Operators and Travel Agents	
	Mean (%)	Count	Mean (%)	Count
Land ownership				
Land owned	10	42	5	11
Under management	0	42	9	11
Rented/leased	90	42	77	11
Building ownership				
Buildings owned	35	42	5	11
Under management	2	42	9	11
Rented/leased	63	42	86	11
Average length of lease (years)				
Land	17	38	3.6	9
Buildings	14	28	3.3	10
Renewable				
Land		31 (82%)		8 (89%)
Buildings		22 (79%)		10 (91%)
Frequency of review				
		51 months		16 months
Rent (number of firms)				
Based on rental value		36 (85%)		10 (91%)
Percentage sales/profits		1 (3%)		1 (9%)
Other		5 (12%)		0
Source : World Bank, Maldives ICA Survey, 2005				

86 Thinking of this payment as a tax, or government revenue, it is equivalent to 10 percent of a tourist's daily expenditure (@ \$200/day), or 20 percent (@\$100/day).

room (see below)). Several additional elements that might contribute to a solution in the short term include:

- Separate technical and financial proposals, with financial proposals opened only upon acceptance of technical proposals
- Establish land indices to be applied across the board (this would focus attention on the quality of proposals)
- Seek bids by resort category, with land leases established by category. (Whereas Maldives does not rate hotels, tour operators do, and there appears to be a common understanding of different categories)
- If rent stays part of the equation, reduce its weighting
- Extend the same leasing options to all bidders, foreign and domestic, and
- Consider the introduction of a "second price auction."⁸⁷

In the longer-term, a process of more modest land rents and introduction of a corporate tax and/or a property tax would seem to be more efficient solutions. The property tax would reflect the value of the business as a going concern and the corporate tax its efficiency and profitability, based on results, not estimates of future results as the land rent now does.

Currently, at the end of the lease period, the property is handed back to the state to be re-bid. At that point, an audit is made of the physical assets and a payment (which can take two years to effect) is made to the lessee based on book value, rather than as a going concern. This may encourage lessees to "milk" their properties in the later years of the lease, and dilutes the idea of the resort as a long-term "going concern;" it could also ultimately affect the Maldives' image in the market place, if it goes to extremes. The survey confirmed that there is already a small, active market in the resale of leases and the vacating lessee can participate in the new bid; the current evaluation process is a deterrent to long-term investment, as shown in table A5.2.

	Lodging		Tour Operators and Travel Agents	
	Frequency	%	Frequency	%
Percentage of firms seeking new land or buildings	15	36	5	46
Percentage of firms unsuccessful	7	47 ^a	1	20
Reasons for lack of success:				
1. Government unwilling to release	4	57 ^b	1	100
2. No zoning approval	2	29 ^b	0	0
3. Could not get clear title	1	14 ^b	0	0
4. Failure to agree on price	4	57 ^b	0	0
Source: World Bank, Maldives ICA Survey, 2005				
a/ Of unsuccessful firms				
b/ Multiple answers				

87 See Vickrey quoted in John Kay, "Culture and Prosperity," Harper Collins, New York, 2005, p.101. Under this technique the two highest bidders are retained. The contract is given to the highest bidder but at the price offered by the second highest bidder-this in an attempt to reduce if not eliminate gamesmanship. Bidders have an incentive to offer a price reflecting their best judgment of the proposed contract's value.

This is especially true at a time when many of the original leases (1975-85) are coming to term and have to be renegotiated.

The private sector would like to see leases extended to 35 or 50 years. Extension to 35 year, or even 99 years, seems unlikely in the near future but we recommend the following, which should respond to hoteliers' concerns:

- The residual payment should be based on the business as a going concern, unless there is evidence to the contrary
- Introduction of an option for an additional 5-10 years in the lease, unless there is evidence of poor performance
- Give foreign and local investors the same lease conditions
- Reinforce the market system and institutions managing the resale of resort properties.

Recent Developments. Late in 2005/early 2006, the government initiated an additional batch of 35 islands for leasing. This amounts to a fundamental change in policy and one that has made many resort and tour operators concerned. Maldives has done 87 resorts in 30 years and it now proposes to add an additional third over the next couple of years. Some likely impacts are that access capacity will be strained and the basic model will undergo modification-not necessarily for the worse, but there seems to be little research information available on the impact of accelerating growth. A new public enterprise is proposed to manage at least 50 percent of the new resorts and it is not clear how it will achieve its stated objective of encouraging wider Maldivian participation in resort ownership.

Maldives has long relied on a public sector role limited to creating the environment for sound investment in tourism and managing the leasing process-with private sector firms bidding on individual islands. The decision to increase the speed of issuing new resort leases represents a fundamental change in Maldives' policy of expanding the sector gradually-a number of current operators are known to be very concerned at this change in policy. As part of that expansion, it was decided to create a public enterprise that would hold leases at low, preferential rates in a number of islands, and sell these to new operators. It is expected to sell some of the shares on the stock market to Maldivians. This concept is still evolving but it is not clear what its advantages would be for the country. The public enterprise would have a fixed stream of income (a share of island rents) that would not increase over time unless indexed to the rise in profits of the resorts themselves; a public sector company may in fact discourage private investment in a sector so long dominated by the private sector. It may be possible to structure a public company to buy shares in approved resorts, which it would then hold and sell on the open market to Maldivians-with a clear timetable and exit strategy. A more market oriented way of encouraging broader Maldivian participation could be adopted, such as employee stock option plans (ESOPS), encouraging tourism firms to list on the stock market, and providing incentives for senior managers in the industry and young entrepreneurs to become investors.

A public company could play a useful role, provided it has autonomy of action. One weakness in the Maldivian tourism system is regulation and inspection-a public company could become a regulatory agency with a small earmarked tax to fund its operations. Although most companies in Maldives are conscious of regulatory issues, such an agency could strengthen the emphasis on quality, and address licensing and standards issues (physical and human resources)-an essential part of improving the islands' image in international markets.

Annex 6

TOURISM - SWOT ANALYSIS

<p>Strengths</p> <ul style="list-style-type: none"> ● Unique model of island development ● Natural resource base: tropical atolls and islands ● Excellent resort facilities with ocean-based activities (coral beaches, diving, and fishing) ● Envidable brand image in marketplace ● 30-years of progressive growth ● Liberal investment climate ● Entrepreneurial drive 	<p>Weaknesses</p> <ul style="list-style-type: none"> ● Reliance on foreign personnel and Maldivians' coolness (reluctance) to working in tourism ● Long-haul destination for current market segments ● Dependence on imports of capital and operating goods and products ● Interisland transport ● Absence of forward linkages and poor integration of local inputs ● Destination marketing ● Poor information base for mature market
<p>Opportunities</p> <ul style="list-style-type: none"> ● Productive public-private dialog and action planning-by including all stakeholders, including tour operators, in future planning ● Product differentiation and segmentation: ecotourism, island themes ● New markets (China?) ● Human resource development ● Supply chains for local products, including coir rope, thatch, grass mats, fishing, fruit and vegetable production ● Enhanced SME and microenterprise development ● Improve government resource mobilization/use framework for tourism 	<p>Threats</p> <ul style="list-style-type: none"> ● Monochromatic product line ● Losing traditional market base ● Progressive commercialization ● Environmental degradation and weak coastal zone management (e.g., sanitation) ● Shallow financial sector and lack of savings and investment vehicles ● Limited prospects for emerging entrepreneurs to enter the field

Annex 7

TOURISM - STATISTICAL ANNEX

Table 1:	Small Island Developing States (SIDS) and International Tourism Receipts (ITR)
Table 2:	Bed Capacity and Number of Accommodation Establishments, 2000-2004
Table 3:	Tourist Resorts by Type of Lease Holdings and Management Operators (end-December 2004)
Table 4:	Tourist Bed nights, Occupancy Rate, and Average Duration of Stay, 2000-2004
Table 5:	Selected Tourism Data for Island Economies, 2004 (unless noted)
Table 6:	Maldives Monthly Tourist Arrivals, 2000-2004
Table 7:	Index of Monthly Arrivals (November/December 2000=100)
Table 8:	Arrivals and Market Shares for Selected Countries, 2000-2004
Table 9:	Maldives: Growth Rates, Selected European Markets, 2000-2004
Table 10:	Tourist Arrivals and Market Share from Asia, 2000-2004
Table 11:	Airline Schedules: Summer 2004/2005
Table 12:	Tourism Contribution to GDP (Rf. Millions -1995 Constant Price)
Table 13:	Tourism Revenue and Tax, 2000-2004 (Rf. millions)
Table 14:	Government Revenue by Category (Rf. millions)
Table 15:	Government Expenditure on Tourism
Table 16:	Foreign Exchange Earnings from Tourism (\$ millions) and Growth Rates, 2000-2004
Table 17:	Direct Employment in Tourism (Resorts and Hotels), 2003

Table 1 : Small Island Developing States (SIDS) and International Tourism Receipts (ITR)

Country	Population (thousands 2004)	ITR/GDP (percent)	GDP (\$ millions - 2004)
Maldives	293	49.8	96
Antigua	79	38	719
Bahamas	317	34.9	295
Saint Lucia	161	31	650
Barbados	271	26.5	2507
St.Vincent and Grenadines	109	23	361
Grenada	105	22	388
Sao Tome and Príncipe	157	18.5	48
Seychelles	84	18.5	626
Dominica	71	18.1	643
Samoa	178	17	257
Jamaica	3000	15.7	7882
St.Kitts and Nevis	47	15.7	309
Fiji	835	14.3	1200
Mauritius	1000	13.4	5009
Dominican Republic	9000	12.9	19000
Cape Verde	470	10.2	675

Source: SIDS - World Bank, 2004

Table 2 : Bed Capacity and Number of Accommodation Establishments, 2000-2004

Category	2000		2001		2002		2003		2004	
	No	Beds								
Tourist Resorts	86	15,914	87	16,318	67	16,400	87	16,444	87	16,858
Hotels	9	744	9	688	8	670	8	670	8	636
Guest Houses	22	356	20	367	17	282	24	360	28	425
Safari Vessels	112	1,716	92	1,392	96	1,475	113	1,636	113	1,676
Total	229	18,730	208	18,765	208	18,827	232	19,110	236	19,595

Source: Ministry of Tourism

Table 3 : Tourist Resorts by Type of Lease Holdings and Management Operators (end-December 2004)

	Local	Foreign	Joint Venture	Other	Total
Lease Holders					
No. of Resorts	68	5	11	3	87
No. of Beds	13,282	548	2,412	616	16,858
Operators					
No. of Resorts	49	25	13	-	87
No. of Beds	10,344	3,774	2,740	-	16,858

Source: Ministry of Tourism

Table 4 : Tourist Bednights, Occupancy Rate, and Average Duration of Stay, 2000-2004

Year	Tourist Bed nights	Bed night growth (%)	Occupancy Rate (%)	Average Duration of Stay (days)
2000	3,936,741	5.9	68.2	8.4
2001	3,932,748	-0.1	65.6	8.5
2002	4,066,640	3.4	69.0	8.4
2003	4,704,601*	15.7	77.2	8.3
2004	5,109,977	8.6	83.9	8.3

Source: Ministry of Tourism
Note: * Revise

Table 5 : Selected Tourism Data for Island Economies, 2004 (unless noted)

	Maldives	Seychelles	Indonesia (Proxy for Bali)	Dominican Republic	Jamaica
International arrivals (000s)	617	179 ^a	1,457	2,748	1,350
Domestic tourists (000s)	n/a	n/a	n/a	521	n/a
Growth rate for tourism (arrivals)	9.4	0	18.6	17	4.8
Cruise passengers (000s)	n/a	n/a	n/a	400	1,132
Contribution to GDP (percent)	33	20 ^b	2 ^b	7.3	6
Foreign exchange earnings (\$ millions)	415	46.4 ^a	2,000 ^b	3,180	800
Number of room equivalents	8,429	3,975 ^a	19,522 ^c	58,932	24,625
Room occupancy (percent)	83.9	54 ^a	47.8 ^f	74.2	55.5 ^{a,e}
Average daily expenditure (\$)	166.82 ^a	200 ^b	95.17	103.68	92 ^a
Length of stay (days)	8.3	10 ^a	4.1 ^d	9.1	9.7
Employment (hotel sector)	14,182	5,000 ^b	n/a	48,994	32,856
Employment per room	1.7	1.3	n/a	0.8	1.3

a: Overall; all-inclusive hotels had a rate of 69 percent
b: Staff estimates
c: Classified rooms only; there is an equivalent number of unclassified rooms
d: 9.47 days for Indonesia as a whole
e. 2002 figures
f. 2003 figures
Sources: Caribbean Tourism Organization, Jamaica Tourist Board, Maldives Ministry of Tourism, DR Central Bank, Seychelles Ministry of Tourism, Statistics Indonesia, World Bank estimates

Table 6 : Maldives Monthly Tourist Arrivals, 2000-2004

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2000	45,297	48,974	45,393	43,458	27,019	24,033	33,027	40,563	36,878	39,078	38,985	44,449	467,154
2001	50,459	48,987	50,466	48,100	29,450	25,593	35,461	38,744	31,726	31,209	30,341	40,426	460,984
2002	36,211	47,024	49,260	42,647	31,529	23,641	34,341	41,243	39,760	42,579	42,310	54,115	484,680
2003	54,503	56,706	56,441	48,742	31,119	26,915	38,076	48,431	44,951	48,357	51,087	58,265	563,593
2004	61,861	59,692	63,855	55,396	42,197	33,835	43,527	55,843	46,838	52,511	56,656	44,505	616,716

Source Data: Department of immigration and Emigration

Table 7 : Index of Monthly Arrivals (November/December 2000=100)

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Seasonality Ratio
2000	116	126	117	112	69	62	85	104	95	100	100	114	1.3
2001	131	128	131	125	77	67	92	101	83	81	79	105	1.3
2002	90	116	122	106	78	59	85	102	98	105	105	134	1.3
2003	116	121	120	104	66	57	81	103	96	103	109	124	1.2
2004	120	116	124	108	82	66	85	109	91	102	110	87	1.2

Source Data: Department of immigration and Emigration

Table 8 : Arrivals and Market Shares for Selected Countries, 2000-2004

	2000		2001		2002		2003		2004	
Europe	362,196	(84.3)	364,105	(79.0)	373,428	(77.0)	443,093	(78.6)	475,707	(77.1)
Austria	11,725	(2.7)	10,494	(2.3)	10,480	(2.2)	12,391	(2.2)	13,059	(2.1)
Belgium	5,071	(1.2)	3,719	(0.8)	2,606	(0.5)	2,795	(0.5)	3,085	(0.5)
Denmark	772	(0.2)	891	(0.2)	938	(0.2)	1,073	(0.2)	1,256	(0.2)
Finland	350	(0.1)	304	(0.1)	388	(0.1)	614	(0.1)	788	(0.1)
France	27,517	(6.4)	30,542	(6.6)	31,228	(6.4)	41,055	(7.3)	46,156	(7.5)
Germany	77,642	(18.1)	66,149	(14.3)	63,212	(13.0)	70,762	(12.6)	72,967	(11.8)
Greece	1,776	(0.4)	1,775	(0.4)	2,446	(0.5)	2,287	(0.4)	2,949	(0.5)
Italy	106,451	(24.8)	115,740	(25.1)	114,955	(23.7)	140,304	(24.9)	131,044	(21.2)
Netherlands	7,275	(1.7)	4,097	(0.9)	4,662	(1.0)	5,047	(0.9)	6,639	(1.1)
Norway	945	(0.2)	577	(0.1)	772	(0.2)	987	(0.2)	1,331	(0.2)
Portugal	4,276	(1.0)	3,526	(0.8)	2,785	(0.6)	3,379	(0.6)	3,608	(0.6)
Russia	3,608	(0.8)	3,983	(0.9)	7,550	(1.6)	12,108	(2.1)	18,075	(2.9)
Spain	5,322	(1.2)	4,203	(0.9)	5,160	(1.1)	6,323	(1.1)	7,561	(1.2)
Sweden	2,236	(0.5)	2,112	(0.5)	1,749	(0.4)	1,940	(0.3)	2,482	(0.4)
Switzerland	24,528	(5.7)	28,313	(6.1)	31,707	(6.5)	30,787	(5.5)	29,252	(4.7)
United Kingdom	71,440	(16.6)	77,151	(16.7)	80,377	(16.6)	93,989	(16.7)	113,991	(18.5)
Other countries	11,262	(2.8)	10,529	(2.3)	12,413	(2.6)	17,252	(3.1)	21,464	(3.5)
Global Total	467,154		460,984		484,680		563,593		676,716	

Source Data: Department of immigration and Emigration

	2000	2001	2002	2003	2004
Europe	6.4	0.5	2.6	18.7	7.4
Austria	-13.5	-10.5	-0.1	18.2	5.4
Belgium	62.8	-26.7	-29.9	7.3	10.4
Denmark	8.0	15.4	5.3	14.4	17.1
Finland	-33.5	-13.1	27.6	58.2	28.3
France	15.5	11.0	2.2	31.5	12.4
Germany	-10.2	-14.8	-4.4	11.9	3.1
Greece	-16.5	-0.1	37.8	-6.5	28.9
Italy	20.0	8.7	-0.7	22.1	-6.6
Netherlands	-21.9	-43.7	13.8	8.3	31.5
Norway	26.0	-38.9	33.8	27.8	34.9
Portugal	3.9	-17.5	-21.0	21.3	6.8
Russia	5.3	10.4	89.6	60.4	49.3
Spain	-5.5	-21.0	22.8	22.5	19.6
Sweden	0.4	-5.5	-17.2	10.9	27.9
Switzerland	7.3	15.4	12.0	-2.9	-5.0
United Kingdom	11.8	8.0	4.2	16.9	21.3
Other countries	22.9	-6.5	17.9	39.0	24.4
Global Total	8.7	-1.3	5.1	16.3	9.4

Source Data : Department of immigration and Emigration

	2000	2001	2002	2003	2004
Asia	86,524 (20.1)	80,825 (17.5)	94,986 (19.6)	101,806 (18.1)	117,008 (19.0)
Bangladesh	321 (0.1)	321 (0.1)	241 (0.0)	313 (0.1)	667 (0.1)
China	5,380 (1.2)	7,342 (1.6)	12,092 (2.5)	15,021 (2.7)	20,599 (3.3)
India	10,616 (2.5)	8,511 (1.8)	11,377 (2.3)	11,502 (2.0)	10,999 (1.8)
Japan	47,180 (11.0)	41,895 (9.1)	43,705 (9.0)	42,081 (7.5)	46,939 (7.6)
Korea	5,771 (1.3)	6,708 (1.5)	7,696 (1.6)	8,417 (1.5)	9,672 (1.6)
Malaysia	1,829 (0.4)	1,478 (0.3)	2,240 (0.5)	2,251 (0.4)	2,908 (0.5)
Pakistan	1,049 (0.2)	1,017 (0.2)	1,329 (0.3)	1,942 (0.3)	1,529 (0.2)
Philippines	317 (0.1)	346 (0.1)	405 (0.1)	376 (0.1)	499 (0.1)
Singapore	2,530 (0.6)	2,227 (0.5)	2,520 (0.5)	4,653 (0.8)	3,016 (0.5)
Sri Lanka	8,413 (2.0)	6,902 (1.5)	6,909 (1.4)	7,296 (1.3)	8,351 (1.4)
Thailand	1,007 (0.2)	1,350 (0.3)	2,002 (0.4)	3,009 (0.5)	3,289 (0.5)
Other countries	2,111 (0.5)	2,728 (0.6)	4,470 (0.9)	4,945 (0.9)	8,540 (1.4)
Global Total	467,154	460,984	484,680	563,593	616,716

Source Data: Department of immigration and Emigration

Table 11 : Airline Schedules: Summer 2004/2005

	Name Of Airline	Originating Sector	Aircraft Type	Capacity Seats	Summer 2004		Summer 2005		Remarks
					Frequency Per Week	Capacity Per Week Seats	Frequency Per Week	Capacity Per Week Seats	
Scheduled Flight Operators									
1	Srilankan Airlines	CMB	A330	294	2	588	0	0	
		CMB	A320	144	13	1872	10	1440	
		CMB	A340	375	3	1125	5	1875	
		NRT	A340	375	2	750	2	750	
		CDG	A340	375	1	375	0	0	
		LHR	A340	375	3	1125	3	1125	
		ZRH	A340	375	2	750	0	0	
2	Austrian	VIE	B767	258	1	258	1	258	
3	Qatar Airways	DOH	A330	294	7	2058	7	2058	
4	Lauda Air Italy	MKP/CMB	B767	258	2	516	2	516	
5	Condor	FRA/MLE	B767	258	1	258	1	258	
		MUC/MLE	B767	258	1	258	1	258	
6	Emirates	CMB	A330	294	4	1176	4	1176	
		DXB/CMB	A330	294	7	2058	2	588	
		DXB	A 330	294	6	1764	6	1764	
7	Indian Air Lines	TRV	A 320	150	7	1050	7	1050	
8	LTU International Airways	DUS	A330	323	1	323	1	323	
		MUC	A330	323	1	323	1	323	
		FRA	A330	323	1	323	1	323	
9	Malaysia	KUL	A 330	294	2	588	3	882	
10	Singapore	SIN	B777	323	5	1615	5	1615	
11	Eurofly	MXP	A330	288	6	1728	2	576	
		MXP/FCO	A330	288	1	288	1	288	
		MXP/CMB	A330	288	1	288	1	288	
12	Air Seychelles	SEY/BOM	B737	126	1	126	0	0	
		BOM/SEY	B737	126	1	126	0	0	
13	Aeroflot	SVO	IL96	298	2	596	0	0	
Total Schedule Flights					84	22305	66	17734	
Charter (Passenger) Flight Operators									
1	Monarch Airlines	LGW	A330	374	3	1122	3	1122	
2	Edelweiss	ZRH/CMB	A330	310	1	310		0	From 29 Sep 04 - 29 Oct 04 Only
		ZRH	A330	310	1	310	1	310	
3	Transaero	SVO	B767	276	2	552	1	276	
4	Star Airlines	CDG	A330	364	0	0	1	364	Effective 05
5	Air Europe (Charter)	MXP	A330	298	4	1192	0	0	Air Europe Ceased Operation To Maldives During December 2004
		MXP/FCO	A330	298	2	596	0	0	
		MXP/CMB	A330	298	1	298	0	0	
		VRN/FCO	A330	295	1	295	0	0	
Total Charter Flights					15	4,675	6	2,072	
Grand Total					99	26,980	72	19,806	
* Winter 2004/2005 Continuations (Ending During Apr/May 05) Are Not Included.									

Table 12 : Tourism Contribution to GDP (Rf. millions - 1995 Constant Price)

Year	GDP	GDP Growth %	Tourism Contribution	% Share of Tourism Contribution
2000	6,345.50	4.8	2,094.00	33.0
2001	6,564.40	3.4	2,093.50	31.9
2002	6,849.90	4.3	2,162.40	31.6
2003	7,581.10*	4.2	2,479.02*	32.7*
2004	8,248.80	8.8	2,763.35	33.5

Note: * Revised
Source: Ministry of Planning & National Development

Table 13 : Tourism Revenue and Tax, 2000-2004 (Rf. millions)

Year	Government Revenue	Tourism Revenue	% Share of Tourism Revenue	Tourism Tax	% Share of Tourism Tax Tourism Revenue
2000	2,206.80	693.28	31.4	276.60	39.9
2001	2,310.90	715.85	31.0	292.70	40.9
2002	2,714.90	892.10	32.9	305.25	34.2
2003	3,061.80	899.65	29.4	359.80	40.0
2004	3,185.20	921.47	28.9	409.50	44.4

Note: Budget Estimates
Source: Ministry of Finance & Treasury Department of Inland Revenue

Table 14 : Government Revenue by Category (Rf. millions)

Category	2002	2003 (provisional)	2004 (budget estimates)
Total revenue *	2582.4	2939.4	3185.2
Current revenue	2577.9	2912.2	3168.6
Tax revenue	1091.7	1233.3	1365.7
Import duty **	692.1	783.8	822.3
Tourism tax	305.2	356.9	430.4
Bank profit tax	50.9	46.2	55.1
Other	43.5	46.45	57.9
Non tax revenue, Including tourism related	1486.2	1678.9	1802.9
Maldives Airport Company ***	75.2	125.5	123.1
Government hotels	1.5	1.4	2.2
Maldives in-flight catering	14.3	16.3	16.3
Island aviation	4.5	10	15.7
Resort lease rent	577.9	539.3	614.5
Other ****			
Capital revenue	4.5	122.4	74.7

Source : Ministry of Finance and Treasury

* Plus grants of roughly Rf. 100 million

** There are no export duties

*** Airport tax estimated as Rf. 74.2 million in 2004 (618,000 tourists x \$10)

**** Includes fines, confiscated property, penalties, and administrative charges. Also royalties.

Year	Government Expenditure	Tourism Expenditure	% share of Tourism Expenditure
2000	2,739.90	27.70	1.0
2001	2,912.10	31.40	1.1
2002	3,117.30	35.90	1.2
2003	3,428.40	37.50	1.1
2004	3,785.90*	52.50*	1.4

Note: * Budget Estimates
Source : Ministry of Finance & Treasury

Year	Tourism Receipts	Growth Rate (%)
2000	320.70	2.3
2001	327.10	2.0
2002	318.40	-2.7
2003	401.60 _/	26.1
2004	478.50 *	19.1

Note : _/ Revised Estimates (15/7/04)
* Estimated (13/12/04)
Source : Maldives Monetary Authority

Occupation	Total	Male	Female	Local	Foreign
Total	14,182	13,637	545	7,568	6,614
Front office	2,144	1,982	162	1,166	978
Public relations	352	262	90	141	211
Food and beverages	3,913	3,865	48	1,715	2,196
Staff mess	695	694	1	13	552
Housekeeping	2,124	2,023	101	1,536	588
Maintenance	2,129	2,129	0	665	1,464
Transport	1,608	1,604	4	1,558	50
Powerhouse	417	417	0	237	180
Sports and Diving	448	355	93	162	286
Malé office	352	306	46	245	107

Source: Statistical Pocket Book of Maldives

Technical Appendix 1

SAMPLING METHODOLOGY

This technical appendix will give an overview of the distribution of firms in the survey, focusing on sectoral coverage and its relative significance. It also makes an attempt to compare the sample with the entire population of business enterprises with a view to assess its degree of representation. In view of the narrow industry base and poor quality of industrial statistics for the small island economy of Maldives, it was decided to conduct the ICA with a sample of 140 establishments representing three major economic sectors: manufacturing (50), tourism (50), and transport and logistics (40). These three sectors jointly account for about 50 percent of the GDP and 60 percent of employment. In deciding the number of observations for each sector, it was also decided to give extra weight to manufacturing at the expense of tourism in order to make the results more comparable to other ICAs and also to maintain statistical rigor.

The coverage and quality of industrial statistics in Maldives is rather poor. The existing body of information on business sector enterprises maintained by government and business promotion organizations does not provide enterprise-specific details (i.e., ownership, employment, turnover, or capital investment) that could be used to develop a proper sample frame. In fact, there is no consolidated institutional effort to generate a comprehensive and periodic database on industry. In the absence of a reliable and updated universe, the ICA team—working jointly with the survey firm—had to develop its own sample frame. The first step was to develop one unique sample frame based on establishment lists obtained from different institutions, e.g., the Ministry of Finance; the Statistical Division of the Ministry of Planning and National Development; the Ministry of Trade; the Maldives National Chamber of Commerce and Industry; the Tourism Association; and the Maldives Yellow Pages—2004 Commercial Directory. It should be noted, however, that none of these lists provide complete coverage of business sector enterprises, as business registration is not mandatory in the Maldives. At the second stage, the list of business enterprises collected from the above sources was updated in consultation with relevant government officials and representatives from business associations. The population and the sample frame developed along these lines are given in table TA.1.1.

The third step was to identify strata to include in the sample, and it was agreed that the strata would be determined on the basis of firms' activity, level of employment, and location. The strata to be included in the survey were selected mainly on the basis of their importance as measured by employment, contribution to GDP, and growth trends. Accordingly, the sample frame of the three major sectors was designed to cover several subsectors.

The **manufacturing sector** was defined to include five subsectors: (i) boat building/repairs; (ii) commercial fishery; (iii) fish processing and canning; (iv) printing, wood, and products of wood; and (v) other manufacturing (cement, food and beverages, etc.). The sample frame of manufacturing was built from the lists furnished by the Ministry of Trade, the Statistics Section of

the Ministry of Planning and National Development (Establishment Survey– 2004), and the Maldives Yellow Pages– 2004 Commercial Directory.

The sample frame of tourism was more comprehensive than the other two sectors. It was defined to include six main subsectors: (i) resorts; (ii) hotels; (iii) safari vessels; (iv) guest houses; (v) tour operators; and (vi) travel agents. Of these subsectors, the sample frame for the resorts, hotels, safari vessels, and guest houses was developed using the Resort/Hotel Guide 2005/6 published by the Maldives Tourism Promotion Board, while the sample frame for tour operators and travel agents was developed using the lists provided by the Maldives Association of Tourism Industry and the Maldives Tourism Promotion Board.

The sample frame for the **transport-logistics** (T&L) sector consists of seven main subsectors: (i) ferry services; (ii) air transport; (iii) taxi services; (iv) importers; (v) freight forwarders; (vi) distributors; and (vii) others (supermarkets). The sample frame for air transport, taxi services, importers, freight forwarders, distributors, and others (supermarkets) was built using the Maldives Yellow Pages– 2004 Commercial Directory, while the sample frame for ferry services was developed using detailed lists provided by the Maldives National Chamber of Commerce and Industry.

Data limitations and time constraints led to a decision to administer a predetermined sample of 140 establishments drawn through a disproportionate stratified random sampling. During the sample design stage, it was also decided to select enterprises operating outside the *Male* area. In determining the probability of selection of units across subsectors, different sampling fractions were used within the strata to oversample small groups, considering their relative magnitude within a key sector, i.e., resorts, guest houses, and hotels in tourism, and air transport and distributors in T&L. The complete distribution of the sample is given in table TA.1.2.

As noted at the outset, none of the lists produced information on the size of employment, turnover, or capital investment. In fact, most of the lists simply provide business addresses, and only a few of them give details on the type of business and ownership. As noted earlier, none of them provide complete coverage of all enterprises operating in a given sector. This ruled out the chances of performing any sampling with a predetermined sampling level of error. It also ruled out the possibility of determining weights for different sectors, and therefore the overall values for the total sample are based on weighted statistical averages of the three sectors covered in the survey.

Table TA1.1 : Sample Frame and Population			
Sector	Subsectors	Population	Sampling Frame
Manufacturing	1.1 Boat building/repairs	23	<ul style="list-style-type: none"> List of Local Investments 2005 Maldives Commercial Directory Statistical Division, Ministry of Planning and National Development
	1.2 Commercial fishery	26	<ul style="list-style-type: none"> List of Foreign Investors in Maldives List of Local Investments 2005 Maldives Commercial Directory
	1.3 Fish processing and canning	43	<ul style="list-style-type: none"> List of Local Investments 2005 Maldives Commercial Directory
	1.4 Printing	46	<ul style="list-style-type: none"> List of Local Investments 2005 Maldives Commercial Directory List from Statistical Division, Ministry of Planning and National Development
	1.5 Wood and products of wood	22	<ul style="list-style-type: none"> List of Local Investments 2005 Maldives Commercial Directory
	1.6 Other manufacturing (cement, fiber, food and beverages, etc.)	42	<ul style="list-style-type: none"> List of Local Investments 2005 Maldives Commercial Directory
	Total	202	
Tourism	2.1 Resorts	87	The Resort/Hotel Guide 2005/2006, published by the Maldives Tourism Promotion Board
	2.2 Hotels	12	The Resort/Hotel Guide 2005/2006, published by the Maldives Tourism Promotion Board and 2005 Maldives Commercial Directory (www.yellowpages.com.mv)
	2.3 Safari vessels	87	The Resort/Hotel Guide 2005/2006, published by the Maldives Tourism Promotion Board
	2.4 Guest houses	8	2005 Maldives Commercial Directory (www.yellowpages.com.mv) and The Resort/Hotel Guide 2005/2006, published by the Maldives Tourism Promotion Board
	2.5 Tour operators	25	Ministry of Tourism
	2.6 Travel agents	325	Ministry of Tourism
	Total	544	
Transport and Logistics	3.1 Ferry services	63	<ul style="list-style-type: none"> Maldives National Chamber of Commerce and Industry
	3.2 Air transport	6	<ul style="list-style-type: none"> 2005 Maldives Commercial Directory
	3.3 Taxi services	25	<ul style="list-style-type: none"> 2005 Maldives Commercial Directory
	3.4 Importers	106	<ul style="list-style-type: none"> 2005 Maldives Commercial Directory
	3.5 Freight forwarders	32	<ul style="list-style-type: none"> 2005 Maldives Commercial Directory
	3.6 Distributors	10	<ul style="list-style-type: none"> 2005 Maldives Commercial Directory and Verification from Expert Interviews
	3.7 Others (supermarkets)	15	<ul style="list-style-type: none"> 2005 Maldives Commercial Directory
	Total	257	
	Grand Total	1003	

Source : World Bank, Maldives ICA Survey, 2005

Table TA1.2 : Complete Sample Distribution by Sector

Sector	Subsectors	Sample Distribution (No. of establishments)	Sample share (as a percent of population)
Manufacturing	1.1 Boat building/repairs	10	44
	1.2 Commercial fishery	4	15
	1.3 Fish processing and canning	10	23
	1.4 Printing	10	22
	1.5 Wood and products of wood	4	18
	1.10 Other manufacturing (cement, fiber, food and beverages, etc.)	13	31
	Total	53	26
Tourism	2.1 Resorts	23	26
	2.2 Hotels	4	33
	2.3 Safari vessels	11	13
	2.4 Guest houses	4	50
	2.5 Tour operators	3	12
	2.6 Travel agents	8	2
	Total	51	9
Transport and Logistics	3.1 Ferry services	10	16
	3.2 Air transport	6	100
	3.3 Taxi services	4	16
	3.4 Importers	10	9
	3.5 Freight forwarders	7	22
	3.6 Distributors	4	40
	3.7 Others (supermarkets)	3	20
	Total	44	17
	Grand Total	148	16

Source : World Bank, Maldives ICA Survey, 2005

Technical Appendix 2

INVESTMENT CLIMATE AND FIRM PERFORMANCE

a. Methodology

The impact of the IC on firm performance on the small island economy of Maldives was examined using the standard regression analysis. Different functional forms of the following reduced-form regression equation were estimated:

$$Y_i = \alpha_0 + \alpha_1 IC_i + \alpha_2 X_i + \alpha_3 Z_i + \varepsilon_i \quad (1)$$

The dependent variable, Y, represents a measure of firm performance defined in terms of four different criteria: (i) labor productivity, (ii) profitability, (iii) sales growth, and (iv) the average investment rate. Table TA2.1 below provides details on how each of these measures was constructed. IC represents a measure of the investment climate while X and Z denote a vector of firm-level control and industry control variables, respectively. The main problem encountered in estimating the equation was the limited number of observations due to the high nonresponse rate, particularly with respect to the financial performance of business enterprises. In fact, the number of observations reduced significantly when several variables were included in the regression, even after pooling the three sets (manufacturing, tourism, and transport and logistics). This is to be expected in a country where the quality of industrial statistics is very poor both at the national and the firm level.

Table TA2.1 : Firm Performance Variables	
Variable	Definition
Labor productivity	Value added (Sales - cost of intermediate inputs) divided by total employment
Profitability (PCM)	Profitability (Price-cost margin = PCM) is estimated using the following formula: $PCM = \frac{VA - (Salaries \& Wages + Rent + Interest)}{Sales}$
Sales growth	Average annual growth in sales for the past two years (2002-04)
Investment rate	Percentage of net profits (after tax) reinvested in the establishment.
Source : World Bank, Maldives ICA Survey, 2005	

The impact of investment climate (IC) over firm performance is captured using four different set of variables: a) presence of competition, b) functioning of labor markets, c) finance, and d) measures of governance, including administrative and regulatory functioning. In addition, IC perception variables were also employed as a part of the analysis. The basic estimation procedure involved the following steps. First, each equation was estimated using IC perception variables along

with industry dummies and industry-specific variables. This procedure enabled us to avoid the risk of reducing the number of observations and also to avoid the problem of multicollinearity. Second, each equation is estimated with several IC variables simultaneously mainly to ensure robustness of the regressions. In order to avoid the problem of endogeneity each equation is estimated using control variables, e.g., industry dummies to control for industry-specific and firm-specific factors. The estimates were carried out for a pooled sample representing the manufacturing, tourism, and transport and logistics subsectors.

b. The Investment Climate Regression Results

The analysis of IC data suggests that the presence of competitive pressure, formal-in-house training, and the use of e-mail and Web sites enhance enterprise performance. There is evidence suggesting that the presence of unskilled labor, access to finance, usage of bank loans, government visits, and waiting time for import license are factors negatively associated with enterprise performance. The key regression results are summarized in tables TA 2.2 and TA 2.3).

Finance: As noted in chapter 3, access to finance is the biggest constraint affecting business progress in Maldives. It was also found to be the most severe constraint affecting growth and expansion of business sector activities. The impact of access to and cost of finance were also found to be negatively correlated with productivity. The survey data point to a poor participation of the banking sector in promoting productivity.

Labor market issues: The quality of labor inputs plays a major role in determining the performance of an enterprise, especially in a small island economy. In the case of Maldives, the presence of unskilled labor appears to be a major constraint on the profitability of business enterprises. The positive and significant impact of training on investment rate further confirms this evidence. Labor relations were also perceived to be negative factors affecting productivity and profitability of enterprises.

Competition: Presence of competition both from foreign and domestic sources leads to high efficiency and improved performance at the enterprise level. Maldivian IC survey evidence further confirms this view based on the experience of a small island economy. The presence of foreign competition (measured in terms of an important factor leading to reduction of cost of existing products and/or to develop new products) was found to be a key determinant of productivity and profitability. Two variables on foreign ownership and purchase of imported material and supplies did not perform well in any of the performance measures.

Technology: Technology is yet another important factor affecting firm-level performance, especially in the present context of highly globalized and knowledge-based systems of production. This is of special relevance to Maldives in promoting the tourism and transport and logistics subsectors. The proxy measure employed for technology, regular use of e-mails and Web sites in business operations, was positive and significant as a determinant of productivity and sales growth.

Regression Results Using All IC Measures Simultaneously (table TA2.2): This section deals with the regression estimates of all the key IC variables employed on a simultaneous basis. Despite the fact that there is a large reduction in sample size-about 65-75 observations-due to missing observations, the results confirm key findings discussed above. On the positive side, foreign

competition and use of e-mails and Web sites for business activities emerge as key determinants of enterprise performance. On the negative side, use of bank loans, government visits, and total waiting days for import licenses emerge as priority areas for improving investment climate conditions in the Maldives.

Table TA2.2 : Perception on IC Variables					
IC Variables	Employment Growth	Sales Growth	Productivity	Profitability	Investment Rate
Land-PED	-2.72	0.37	0.38	-0.23	0.19
	-0.48	-0.04	-1.31	-1.18	-1.21
Regulatory policy uncertainty	-17.77***	1.86	0.84	0.23	0.13
	-2.71	-0.17	-2.51	-1.11	-0.76
Labor relations	3.51	6.87	-.92**	-.62***	0.03
	-0.55	-0.7	-2.53	-2.7	-0.16
Skills and education of workforce	1.23*	-3.65	0.77	0.61	-0.07
	-0.23	-0.44	-2.68	-3.75	-0.49
Business licensing and operating permits		-24.33*	-1.41**	-.66*	
		1.7	-2.39	-1.67	
Access to finance	-4.21	-9.24	-.55*	-0.19	0.18
	-0.62	-0.86	-1.67	-0.84	-1.09
Cost of finance	0.25	0.2	-.74**	-0.34	.29*
	-0.04	-0.02	-2.14	-1.43	-1.75
Macroeconomic uncertainty	10.77	-11.83*	-0.43	-0.31	-0.25
	-1.21	-1.71	-1.15	-1.12	-1.14
Corruption	-2.72	17.19	0.21	0.33	0.08
	-0.48	-0.04	-0.61	-1.11	-0.45
Legal system	-7.38	-11.98	1	0.61	0.08
	-1.18	-1.15	-2.75	-2.62	-0.45
N	100	50	87	83	113
R-squared	0.21	0.42	0.42	0.34	0.16
F		(14,35) = 2.91	(13,73) = 4.12	(14,68) = 2.48	(13,48) = 2.28
Absolute value of t statistics in parentheses					
* significant at 10 percent; ** significant at 5 percent; *** significant at 1 percent					
Note : Controls included but not shown here are: firm size, firm age, capital/labor ratio and sector dummies.					

Determinants	Sales Growth	Productivity	Profitability	Investment Rate
Unskilled labor	0.07	-.004*	-0.004	0.002
	-0.61	-1.69	-1.11	-0.9
Formal in-house training	4.4	0.25	0.12	.26*
	-0.44	-0.85	-0.58	-1.99
Bank loans	-.30*	-.02**	0.003	0.003
	-1.68	-2.28	-0.6	-0.12
Government visits per employee	0.14	-0.008	-0.005	-.008***
	-1.69	-1.39	-1.25	-3.35
Use of e-mails and Web sites	18.92	.78*	0.11	-0.24
	-1.52	-1.94	-0.35	-1.34
Foreign competition	8.26	.72**	.51*	0.22
	-0.85	-2.15	-1.65	-1.19
No. of competitors	-.04*	0.001	0.001	.002*
	-0.88	-0.79	-0.74	-1.64
Total waiting days for import licenses (X100)	0.19	-.11**	-0.02	0.01
	-0.19	-2.72	-0.91	-0.6
Small firms	-7.17	0.55	0.25	
	-0.44	-1.16	-0.66	
Medium firms	6.96	-0.24	-0.09	0.06
	-0.48	-0.49	-0.23	-0.32
Large firms				-0.16
				-0.8
Manufacturing dummy		-0.55	-0.35	.34*
		-1.35	-1.08	-1.85
Tourism dummy	39.00***	0.18	-0.42	0.007
	-3.07	-0.38	-1.13	-0.03
Transport and logistics dummy	19			
	-1.07			
Capital-labor ratio	-0.45	0.14	0.05	-0.02
	-1.07	-0.4	-1.1	-0.33
Multi-plant operations	-0.55	0.11	0.03	-0.01
	-0.27	-1.17	-0.43	-0.42
N	50	87	83	113
R-squared	0.53	0.34	0.19	0.33
F	(12,37) = 2.61	913, 73) = 3.17	(13,70) = 2.53	(11, 50) = 2.05
Absolute value of t statistics in parentheses * significant at 10 percent; ** significant at 5 percent; *** significant at 1 percent				

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