Trade Policy Making in a Small Island Economy: The WTO Review of the Maldives

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1. INTRODUCTION

THE *Trade Policy Review of Maldives 2003* (henceforth referred to as TPRM03) is the first review of the country under the Trade Policy Review Mechanism of the World Trade Organisation (WTO). It will be valued by the trade policy analysts not only for the purpose of assessing the Maldives' performance in meeting multilateral rules and disciplines as a WTO member, but also as a valuable contribution to the literature on the characteristic and development issues of small developing economies. It is a highly timely study given the emphasis placed in the current policy debate in the WTO and other international fora on 'especial' problems faced by small economies in the world trading system. In March 2002, the WTO inaugurated a Work Programme on Small Economies (WPSE) in pursuance of a decision made at the fourth Ministerial Meeting held in Doha. The objective of WPSE is to frame policies to address trade-related issues relating to successful integration of small economies into the multilateral trading system. Reconsideration of 'special and differential treatments' (SDTs) for small economies in the light of the recommendations arising from the WPSE is likely to figure prominently on the agenda of the Doha Round trade negotiations. Following the Doha Ministerial Declaration, a number of multilateral and regional financial institutions and international agencies also have launched various work programmes to deal with special problems believed to be characteristic of small-state economies (Commonwealth Secretariat/World Bank, 2000). Insights gained from in-depth country case studies like TPRM03 are vital for assessing these programmes and informing the related policy dialogue.

The purpose of this paper is to examine the trade policy regime and trade-related development issues in the Maldives based on the TPRM03. Section 2 provides a stage-setting overview of the salient economic characteristics of the

Maldivian economy and its performance over the past two decades. Section 3 examines main facets of current trade policy regime, with emphasis on differences between reform commitments and actual implementation. Section 4 provides a critical evaluation of some selected issues central to the future course of the preform process and growth prospects of the Maldivian economy. The final section presents some concluding remarks. Throughout the paper, an attempt is made to place the Maldivian experience in the context of the existing body of knowledge on structural features and trade-related developmental issues in small developing economies.[1]

2. TRADE AND DEVELOPMENT IN THE MALDIVES: AN OVERVIEW

The Republic of Maldives is an archipelago of 1,192 small coral islands covering a land area of 115 square miles, located about 300 miles south of the Indian subcontinent (Table 1).[2] With a population of 277,000 (in 2002), it is the eighth smallest among the 147 member countries of the WTO.[3] The Maldives became an original member of the WTO on 31 May, 1995, having been a contracting party to the General Agreement on Tariffs and Trade (GATT) since 19 April, 1983. From 1990, the GDP per capita of the Maldives has persistently exceeded the minimum cut-off point (US$1,035) used by the World Bank in demarcating lower-middle income countries. However, according to the United Nations' country classification, which forms *inter alia*, the basis for according 'special and differential treatments' under various WTO agreements, it is still considered a least developed country (LDC), on the grounds of economic disadvantages arising from the small economic size and narrow domestic production base.

From 1970, the earliest year from which national account statistics are available, up to about mid-1985, the Moldivian economy remained sluggish with GDP per capita hovering around US$250. From then on, the economy has expanded rapidly, lifting GDP per capita beyond the US$1,000 mark in 1990 and doubling that level by 1997 (Table 2). Over the past two decades, the Maldives' per capita income has been the highest among all countries in South Asia. Rapid growth has been accompanied by low inflation and rapid reduction in unemployment. There

[1] The key recent works on this subject include Alesina and Spoalare (2003), Armstrong and Read (1998), Easterly and Kraay (2000) and Srinivasan (1986). For a useful survey see WTO (2002a). The term 'small economy' and 'microstate economy' are used interchangeably in this paper.

[2] The Maldives, formerly a sultanate under the British protection, became a republic briefly in 1953 and a monarchy again until a republican government returned in 1968.

[3] The other seven countries in descending order (with population (thousands) circa 2000 in brackets) are Belize (240), St Lucia (156), Vanuatu (197), St Vincent and Grenadine (115), Grenada (98), Antigua and Barbuda (68), St Kitts and Nevis (41). (Source: World Bank, *World Development Indicators 2002*.)

TABLE 1
Maldives: Key Economic and Social Development Indicators

Land area, sq. km	300	Trade dependence (2000/1), per cent	
Population, thousand; as of July 2002	281	Total trade/GDP	164.3
Labour force, thousand in 2001	88	Export/GDP	79.8
Annual population growth (1900–2002), per cent	1.9	Imports/GDP	84.5
Urban population, per cent of total population	27.5		
		Composition of Government revenue (2000), per cent	
GDP per capita (2002)	US$2274	Tax revenue	45.0
GNP per capita annual growth (1995–2002), per cent	7.5	Import duties	28.0
		Tourism tax[a]	13.0
Composition of GDP (2001–02 average), per cent	100.0	Non-tax revenue (excluding grants)	55.0
Primary production	16.4	Profit transfers from SOEs	16.0
Agriculture	9.4	Land-lease rent on tourist resorts	31.0
Fishing	6.4		
Industry	15.3	Life expectancy at birth (2000), years	71
Manufacturing	8.4	Infant mortality rate, per 1,000 (2000)	21
Services	74.7	Adult literacy (per cent) (2000)	99
Tourism	32.9	UN *Human Development Index* (HDI) (2000)	
		Ranking:	
Composition of exports (goods + services), per cent		Overall	77th
2000/1		Among medium-HD countries	29th
Services (predominantly tourism)	82.7	School Enrolment ratio (per cent) (2000)	
Merchandise exports	17.3	Pre-school	85
Marine products	9.6	Primary	99
Clothing	6.8	Secondary	36

Note:
[a] Revenue from the bed tax on foreign tourists (US$6 per bed-night).

Source: Compiled from WTO (2003), Table 1.1; ADB, *Key Indicators of Developing Asian Pacific Countries* (www.adb.org), and World Bank, *World Development Indicators* (www.worldbank.org).

TABLE 2
Maldives: Economic Performance

	1990–95	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
GDP per capita at current market price (US$)	1,323	1,848	2,005	2,069	2,215	2,304	2,272	2,279
Real GDP growth, per cent	8.3	7.9	9.1	9.6	7.2	4.8	3.4	6.0
Inflation (CPI), per cent	7.3	6.2	7.6	–1.4	3	–1.2	0.7	0.9
Broad money (M2) growth, per cent	6.5	26	23.1	22.8	3.6	4.1	9.1	19.3
Fiscal operation (per cent of GDP)								
Government revenue (including grants)	22.25	28.9	31	31.8	34.1	34.8	35.5	38
Government expenditure	31.95	31.4	32.3	37.4	41.2	43.2	44.4	47.7
Overall budgetary surplus/deficit	–8.3	–2.5	–1.4	–5.1	–7.3	–7.7	–8.5	–9.2
Government domestic debt (per cent of GDP)	15.3	17.7	14.9	16.2	16.7	20	21.4	18.7
Current account balance (per cent of GDP)	–1.1	–1.6	–6.8	–4.5	–15.3	–9.5	–11.2	–8.6
International reserves, US$ million	36.15	77.6	99.7	119	127	123	93	133
Months of imports (c.i.f.)	3.4	3.2	3.4	4.1	3.8	3.8	2.9	4.6
External debt (per cent of GDP)	34.4	35.6	33	35.8	33.2	31.8	31.9	29.3
External debt service ratio, per cent	4.1	3.2	6.9	3.5	3.9	4.2	4.4	4.2
FDI inflows (US$ million)	5	11	11	12	12	13	12	12
Per cent of gross domestic fixed investment	7.9	6.5	6.5	6.6	5.8	8.9	7.2	7.3
Exchange rate, rufiyaa per US$ (monthly average)	10.8	11.7	11.7	11.8	11.8	11.8	12.2	12.8

Source: Compiled from WTO (2003), various tables; ADB, *Key Indicators of Developing Asian Pacific Countries* (www.adb.org), and World Bank, *World Development Indicators* (www.worldbank.org).

has also been a notable improvement in social development indicators (Table 1). With a literacy rate of 99 per cent, an infant mortality rate of 21 per 1,000 and an average life expectancy of 71 years, by 2000 the Maldives was in the top one-third of the UN ranked 'medium human development' countries.

Fishing is the traditional mainstay of the Maldivian economy. With only 3,000 hectares of arable land, most agriculture is subsistence farming of mainly native crops, mostly coconuts, yam and fruits. The only significant traditional manufacturing activities are fish processing and shipbuilding. Other manufacturing activities include small-scale production of soft drinks and foodstuffs, building material and some light manufactured goods. Over the past one-and-a-half decades, tourism has gained importance as the most dynamic line of economic activity. There has also been a notable diversification of the fishing industry away from traditional dry fish production and towards fish processing for developed-country markets. More recently, the clothing industry has become a major source of export earning and employment generation with the entry of 'quota hoping' investors from other countries in the region.

Annual tourist arrivals reached 461,000 in 2001, almost a five-fold increase from the levels in the mid-1980s.[4] By 2001/2, tourism directly accounted for over 34 per cent of GDP (up from 18 per cent in 1990) and provided employment for over one-fifth of the labour force. Tourism also has substantial links to other sectors of the economy, such as construction, transportation, telecommunication and distribution, which together accounts for over 50 per cent of GDP. The relative importance of fishing declined substantially from 30 per cent of GDP in the mid-1980s to 6 per cent in 2001/2, but this sector still accounted for 25 per cent of total employment. The share of manufacturing in GDP increased from about 6 per cent in 1990 to 9 per cent in 2001/2, due predominantly to the expansion of the export-oriented garment industry. Manufacturing accounted for over 18 per cent of total employment in 2000.

As in most other small economies, a critical structural feature of the Maldivian economy is its heavy trade dependence. The 'trade coefficient' (total trade (including services) as a percentage of GDP) stood at 164 by 2002. Over half of the total catches of fish and over 90 per cent of clothing production are exported. Such a high degree of trade dependence generally implies a high degree of exposure of the economy to exogenous shocks and high sensitivity to developments in the global trading environment (Armstrong and Read, 1998; and World Bank/Commonwealth Secretariat, 2000). However, the level of economic activity in the Maldivian economy has been much less volatile compared to many other microstates (WTO, 2002b, Table 5A). This is presumably because the fortune of tourism, the prime source of economic expansion since the mid-1980s, is

[4] Unless otherwise stated, data reported in the text come from WTO (2003).

remarkably less affected by the world business cycle. Given its geography, the Maldives has also been less susceptible to vagaries of the weather and natural disasters compared to other microstates.

Services exports (predominantly earnings from tourism) accounts for over 80 per cent of total foreign exchange earnings. Total merchandise exports (17 per cent of total foreign exchange earnings) come from marine products (9.6 per cent) and clothing (6.8 per cent). The current account in the balance of payments has been in deficit for the past ten years, despite the widening net surplus in the services account resulting from rapid expansion in tourism. The current account deficit is mostly financed through foreign aid and concessionary borrowing from international development finance agencies, and private capital flows, mostly foreign direct investment.

The narrow population base, coupled with the low educational level of the domestic labour force, has led to a high proportion of expatriates in the workforce of the country. Expatriate workers account for over 20 per cent of the workforce and they a play a key role in various high- and middle-level occupational categories as well as in semi-skilled and unskilled occupations such as domestic helpers and construction workers. Total unrequited outward transfers, which reflect predominantly outward remittances by migrant workers, increased persistently from around US$5 million (1 per cent of GDP) in the early 1990s to over US$30 million in 2001 (5 per cent of GDP).

The government revenue structure of the Maldives is much in line with that of the other microstates. Taxes on foreign trade (including tourism) are the predominant source of government revenue. In 2000, import duties accounted for 28 per cent of total government revenue. Tourism-related (the bed tax on foreign tourists (13 per cent) and rentals on leased island resorts (31 per cent)) accounted for over 45 per cent. The balance consisted largely of profit transfers from public enterprises whose activities are also closely related to foreign trade. There are no taxes on personal income, capital gains, business profits (other than a bank profit tax), wealth or real estate. Given the narrow domestic tax base, rapid expansion in government development expenditure in recent years[5] has resulted in a widening budget deficit. The budget deficits in the Maldives have been historically financed through recourse to foreign concessionary borrowing. But, recent years have seen an increased reliance on borrowing from the Maldives Monetary Authority (the central bank). This has reflected in a sharp increase in money supply, but domestic inflation remains rather low because of the national currency, rufiyaa (Rf.), remain in virtual fixed parity against the US dollar (see below on exchange rate policy).

[5] The major contributing factor to the jump in expenditure was the government's Hulhumale project, a large-scale infrastructure initiative to create a land mass and develop a new town on an island near the capital city of Male.

Foreign direct investment (FDI), mostly in tourism, fisheries and the garment industry, has played an important role in recent economic expansion. Average annual FDI inflows increased from US$5 million during 1985–1995 to $12 million during 1997–2000. The total stock of FDI as at March 2002 was US$65 million, 30 per cent of which was in manufacturing and the balance in hotels, utilities and services. About half of tourist resorts are fully foreign-owned or run as joint ventures with foreign firms. Over 84 per cent of manufacturing investment was in garments, with cement (7 per cent) and boat building (8 per cent) accounting for the balance (WTO, 2003, Table 1.5). About two-thirds of the stock of non-tourism FDI is in joint ventures with SOEs involved in public utilities (mainly in telecommunication and water/sewerage).

3. TRADE POLICIES AND PRACTICES

Given the small domestic market and the narrow domestic resource base, there is little room in the Maldives for using tariffs and other trade restrictions as a means of promoting import substitution and infant industry. However, substantially high tariffs maintained for revenue reasons and direct import restrictions that favour state trading corporations have continued to remain important features of the economic landscape of the country, notwithstanding the emphasis placed on outward-oriented, private-sector-led growth strategy since 1989. This section discusses the key elements of the current trade and investment policy regime.

a. Import Policy Regime

Tariffs are the main instrument of border protection in the Maldives. Except in the case of cigarettes, on which a specific duty of Rf.0.30 per stick (introduced in 2000 in place of a 50 per cent *ad valorem* tariff), all other duties are *ad valorem* tariffs levied on CIF (cost, insurance and freight) import value (Table 3). The present structure of applied *ad valorem* tariffs (in 2002) has ten bands: duty fee, 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 35 per cent, 50 per cent, 100 per cent and 200 per cent. The simple average tariff is 20.8 per cent,[6] with a simple average degree of dispersion (measured by the coefficient of variation) of 60 per cent. The three main staple foods – flour, rice and sugar – and all imports intended for commercial re-export (including inputs used in export production) enter the country free of duty. Only 3 per cent of the total tariff lines have rates exceeding three times the simple average tariff rate (domestic tariff peaks). These high tariffs apply, *inter alia*, to automobiles, beverages, textiles

[6] This is the second lowest average tariff rate in South Asia after Sri Lanka (World Bank, 2003).

TABLE 3
Tariff Structure of Maldives (MFN Tariff)[a], 2002

1	Number of tariff lines					5,321
2	Bound tariff (per cent of lines)					100
3	Simple average bound rate					39
	Agricultural, mining and quarrying					41
	Manufacturing					39
4	Distribution of applied rates by tariff bands				*Tariff (Band)*	*Per Cent of Total Tariff Lines*
					0	0.1
					5	3.9
					10	14.6
					15	21.5
					20	11.7
					25	43.1
					35	3.4
					50	0.2
					100	1.3
					200	0.1
5	Applied tariff rate by major economic sectors					
		Simple Average	*Range*	*CV*	*Domestic Tariff Peak*[b]	*International Tariff Peaks*[c]
	Agriculture	18.0	0–50	33.3	0	
	Fishing	18.8	15–25	26.1	0	
	Mining and quarrying	24.4	10–25	12.3	0	
	Manufacturing	20.8	0–200	62.0	1.5	65.0
	All sectors	20.8	0–200	60.1	1.4	59.9

Notes:
[a] At the eight-digit level of the harmonised system (HS).
[b] Domestic tariff peaks are defined as those exceeding three times the overall simple average NFN rate.
[c] International tariff peaks are defined as those exceeding 15 per cent.

Source: WTO (2003), Table III.1, Chart III.2 and Table AIV.

and clothing. Peak/prohibitive rates (50 per cent, 100 per cent, 200 per cent) are used largely for environmental and/or human safety purposes (such as on imported plastic bags and motor vehicles).

As part of its WTO commitments, the Maldives notified bound rates on all tariff lines in 1995. Some 3 per cent of tariff lines (mainly meat, alcoholic beverages, tobacco products, plastic bags, passenger motor vehicles, buses, motorcycles and their components) were bound at 300 per cent, and the rest mostly at 30 per cent. The simple average bound rate is 39 per cent, with rates for agricultural products and manufactured goods averaging, respectively, to 41 per cent and 39 per cent. The Maldivian bound tariff rates are on average much lower than the overall South Asian levels, with the sole exception of those in Sri Lanka (World Bank, 2003). However, the Maldives has so far failed to keep applied rates within bound levels. Applied rates for 149 tariff lines exceed the bound rate of 30 per cent by between 5 and 170 percentage points, with the majority of differences clustering at the upper end (TPRM03, p. 36). In other cases, bound rates are much higher (on average by 18 percentage points) than the applied rates. This gap imparts a degree of uncertainty to the tariff by giving policy makers ample room for arbitrary changes.

The Government of the Maldives makes extensive use of import duty concessions as part of the government policy to promote domestic and foreign investment in export-oriented manufacturing and tourism. Under the Maldivian Customs legislations, the President may grant duty-free import concession for any 'economically productive activity' for a period of up to ten years. He may also allow items to be imported duty free under 'special circumstances' when it would benefit the nation. There are no precise estimates, but it is believed that these concessions amount to well over one-third of potential tariff revenue (WTO, 2003, pp. 36–37). Fishing and tourism sectors have been the major beneficiaries of import duty concessions. Apart from the revenue losses involved, these concessions seriously undermine the transparency of the tariff structure.

As regards the sectoral distribution of tariffs, there are no significant differences in tariff rates applicable to agriculture, other primary production and manufacturing (Table 3). Moreover, data on simple average tariffs by stage of processing at the two-digit level of the International Standards Industry Classification (ISIC) (WTO, 2003, Table III.2) do not reveal a clear pattern of tariff escalation (that is, a tendency to tax inputs to the production process at lower rates and final goods at higher rates). Only in two of the nine ISIC industries is the tariff on fully processed products somewhat higher (by about 2 to 5 percentage points) than first-stage processed or semi-processed products. In the remaining cases tariff rates are remarkably similar or indicate the reverse pattern.[7] Both these features

[7] Thus the inference made in TPRM03 that '[T]he Maldives's tariff structure has a degree of built-in escalation' is not consistent with the data reported therein.

of the tariff structure – the absence of significant difference in tariff rates across sectors/industries and the absence of clear evidence of tariff escalation – are consistent with the fact that tariffs in the Maldives are determined primarily, if not solely, by revenue considerations, not by considerations of industry protection.

b. Non-tariff Barriers

Importation of a small number of items (alcoholic beverages, pork, used cars and motorcycles) are prohibited or restricted for security, environmental or religious reasons. Import quotas apply to the three major staple foods (rice, flour and sugar) which together account for around 20 per cent of the total import value. Around 70 per cent of these imports are reserved for the state-owned State Trading Organisation (STO). The (officially declared) objective of this policy is to ensure adequate supply of these products at affordable prices. Importation of all other goods requires an Open General Licence (OGL). However, OGLs are issued automatically for a certain value, and permission for additional amounts is normally granted.

c. Export Policy Regime

Since 1996, there have been no export taxes other than a 50 per cent duty on exports of ambergris[8] and export controls on timber. However, garment manufacturers pay a royalty on exports which is akin to an export tax (as it does not apply for domestic sales). Until recently, the royalty rate was 3 per cent of export turnover. It was replaced in August 1999 with specific rates ranging from US$0.025 to US$0.10 per piece, depending upon the clothing category, and in a few cases depending on the market destination and the material used (i.e. cotton or nylon) (WTO, 2003, Table II.3). The foreign firms, which dominate the garment industry, have established production plants in the Maldives with a view to exploiting 'quota rents' in developed-country markets arising from import restrictions under the Multifibre Arrangement (MFA). The quota rents are believed to be very high compared to the minute royalty charged by the Maldivian authorities. Thus the existing royalty presumably has only a marginal effect on export profitability. But, complexity of the royalty rate schedule, which has 30 different rates applicable to exports to different markets and clothing produced using different material in an overlapping fashion, seems to impose unnecessary transaction costs to exporters.

A royalty of 2 per cent is charged on the sales turnover of both local and foreign companies involved in fishing within the 200-mile exclusive economic

[8] A wax-like substance present in the intestines of whales, used as a fixative in perfume.

zone (EEZ) of the country. This is a resource rent rather than an export tax (which applies to both exports and local sales). A fixed tax of US$6 per bed-night is levied on foreign tourists. As discussed, this has become an important source of government revenue in recent years.

d. Trade in Services

Relating to trade in services, the Maldives' sectoral commitments under the GATS cover very few sub-sectors in business services (i.e. certain professional services, computer and related services). There is no specific market access or national treatment commitments affecting services such as accountancy, auditing, bookkeeping, data processing, database, software implementation and consultancy services relating to hardware installation. The Maldives did not participate in the WTO negotiations on basic telecommunication service (Fourth Protocol) or the extended WTO negotiations on financial services (Fifth Protocol).

e. Other Measures Affecting Production and Trade

(i) Exchange rate and the external payments regime

The Maldives became a member of the International Monetry Fund (IMF) in 1978. Since then its national currency, rufiyaa, has been pegged to the US dollar. The peg has been adjusted marginally from time to time to avert major misalignments,[9] but overall the Maldivian exchange rate regime can be described as a *de facto* fixed rate regime. Given the high degree of openness of the economy and the 'thin' currency markets, which constrain smooth economic adjustment under a flexible exchange rate, the current exchange rate regime appears to be the optimal choice for the Maldives (Corden, 2002).

The rufiyaa is convertible on both current and capital account transactions. Both residents and non-residents can freely hold foreign currency accounts. Foreign investors are permitted to repatriate profits and investment proceeds freely. There are no restrictions on offshore borrowings by both local and foreign firms.

(ii) The FDI regime

The policy regime for FDI in the Maldives is very liberal. The Law Governing Foreign Investment (No. 25/79), promulgated in 1979, covers foreign investment in business enterprises. The Law on Doing Business in the Maldives by Foreign Nationals, 1979 (No. 4/79), also promulgated in 1979, covers foreign investment in trade (imports and exports) and related services. The Ministry of Trade and Industry, through its Foreign Investment Services Bureau (FISB) handles

[9] The latest adjustment was in July 2001 when the rufiyaa was devalued by 8.5 per cent against the US dollar.

registration of foreign investment in all sectors, except tourism, which is the responsibility of the Ministry of Tourism.

Full foreign ownership of investment projects is allowed in all sectors and activities. As already noted, foreign investors are permitted to repatriate capital and profits in full. Employment of foreign workers in approved projects is permitted when workers with required skills are not locally available. Most investment incentives apply equally to foreign and domestic investors. The incentives include duty-free imports of machinery, construction material and capital goods for the first year, and for two years on large projects (above US$200,000), duty-free access to raw material used in export production (over half the total tariff revenue forgone from duty concessions accrues to foreign investors (US$11.8 million in 2001)). The Maldives became a member of the World Bank's Multilateral Investment Guarantee Agency (MIGA) on 26 March, 2002, and is aiming to ratify the Convention for the Settlement of Investment Disputes.

(iii) Privatisation policy

State involvement is pervasive in the Maldivian economy. Twenty state-owned enterprises (SOEs) (twelve of which are fully state owned and the others have minority private sector participation) operate in many important sectors of the economy, including trade, banking, construction, insurance, fishing and utilities. They employ around 8 per cent of the total labour force.

Privatisation of SOEs is a key element of the new private-sector-oriented development strategy in the Maldives. A major privatisation programme was launched in 1999. The programme aims to restructure and corporatise SOEs under the Companies Act of 1996, with a view to eventual privatisation. Some SOEs have already been partially divested and implicit subsidies to some SOEs have been reduced. Seven state-owned enterprises, including Air Maldives, have been opened to minority private participation. There is a plan to abolish the telecommunication monopoly in 2008. Exclusive trading rights of the State Trading Organisation (STO), the largest SOE in terms of sales turnover and also by far the largest importer in the country, were abolished in the late 1990s. As a further step to reduce STO trading monopoly, government procurement of goods and services above Rf.5,000 are now made through open competitive tender. The fish processing and exporting monopoly of the Maldives Industrial Fisheries Company (MIFCO) monopoly was abolished at successive stages starting in 2000.[10] Greater competition following privatisation has resulted in an increase in export volume and diversification of exports into fresh/chilled tuna, including

[10] Until 1990, fish exports remained under the exclusive monopoly of MIFCO. In that year private sector firms were allowed to trade in dried/salted tuna. This was followed by liberalising trade in yellow-fin tuna in 1996 and trade in skipjack in 2000.

exports to the Japanese and East Asian sashimi markets. Some SOEs, including MIFCO and Air Maldives, have been a drain on the government budget.

Despite these notable initiatives, the implementation of the privatisation programme has fallen short of the original expectations. For instance, over 30 per cent of total import trade is still handled by the STO. As already noted, 70 per cent of import quotas of rice, wheat flour and sugar is reserved for the STO. The government purchases over 80 per cent of its goods and services requirements from the STO and other SOEs. Despite recent attempts to deregulate fish processing and export trade, the Maldives Industrial Fisheries Company (MIFCO) is still the dominant player in this sector.

The delayed and cautious approach to privatisation reflects resistance arising from concern about the possible anti-competitive effects of privatised firms in key activities, which would dominate the small domestic market. It also reflects the need to strengthen the judiciary and the legal system as well as to broaden the tax base (WTO, 2003, pp. 40–41). Another, and perhaps the most important, explanation (which is not discussed in TPRM03) is the importance of SOEs as a vehicle for dispensing political patronage. In particular, most SOEs provide employment to those whom the government wants to reward on political grounds.

(iv) BTAs, FTAs and GSP

The Maldives has a bilateral trading agreement (BTA) with India. This BTA, signed on 31 March, 1981, is basically a ‘Most Favoured Nation’ (MFN) agreement, which has so far had little impact on trade between the two countries. The Maldives is a founding member of the South Asian Association for Regional Cooperation (SAARC) Preferential Trading Agreement, signed in April 1993 and came into effect in December 1995. SAPTA was notified to the WTO in 1997 under the Enabling Clause. In principle, it covers all products – manufacturers and commodities – in their raw, semi-processed and processed forms. Tariff preferences under SAPTA apply to 390 tariff lines, covering mainly vegetable oils, leather or textile products, timber and timber products, footwear, headwear and umbrellas. The overwhelming majority of these tariff lines have preference margins of 7.5 per cent and the balance of 10 per cent and 15 per cent, of the MFN related rates. Most of these 390 products have MFN rates of 25 per cent in the Maldivian tariff schedule. TPRM03 has not undertaken any analysis of the impact of these trade preferences on the Maldives’ trade performance, but the actual impact is unlikely to be substantial because most of the significant preferential rates relate to commodities which are rarely traded between the Maldives and the other South Asian countries.

The EU and Japan provide the Maldives with trade preferences under the Generalised System of Preferences (GSP). The USA, the major export market, does not extend GSP privileges to the Maldives. Owing to rules of origin and product exclusions, the main export from the Maldives that benefits from GSP is processed (canned) fish exports. The other major export product, clothing, does not qualify because of the low domestic input content (less than 30 per cent in most cases). The current average tariff on fish product imports to the EU is 4.5 per cent. Fish products from the Maldives are allowed at the preferential rate of 1.6 per cent.

4. PROBLEMS OF GLOBAL INTEGRATION

As we have seen in the previous section, the trade and investment policy regimes in the Maldives have undergone noteworthy reforms, but much remains to be done to set the stage for economic expansion through global economic integration. What are the constraints faced by the Maldivian authorities in translating the promised reforms into action? Is there any need for reconsidering reform priorities in the light of recent changes in the international economic scene? How can the international development community assist the Maldives in the reform process? A full treatment of these issues was beyond the terms of reference of the TPRM03, but it has drawn attention to a number of related themes.

a. Budgetary Implications of Tariff Reforms

As in many other developing countries, in the Maldives government revenue implications are a major concern often voiced as an argument against further reduction/rationalisation of import duties. It is argued that import duties are an important source of government revenue, and the speed with which customs duties are reduced needs to be determined in accordance with the speed and effectiveness of domestic tax reforms aimed at overhauling the revenue structure to compensate for the lost revenue. Otherwise the anticipated economic gains from tariff reforms could well be erased by adverse budgetary implications arising from revenue shortfall.

The discussion on the future direction of tariff reforms in the TPRM03 is much in line with this conventional view. It simply emphasises the need for broadening the internal tax base to reduce the government's heavy reliance on border taxes which would facilitate further tariff reductions, without examining (at least analytically) revenue effects of tariff reduction. Broadening the internal tax base to reduce the government's heavy reliance on border taxes would, of course, facilitate further tariff reductions. In that sense, tariff and domestic tax reforms are intertwined. Moreover, as has been argued in the TPRM03, unlike tariff on foreign products, a true consumption tax, such as the conventional value-added tax would be non-discriminatory and tax both imports and domestically produced goods equally. In particular, a broad-based consumption tax or a value-added tax (VAT) with the usual adjustments to exclude exports would ensure neutrality with regard to exports, and the potential economic benefit in improved efficiency from such a switch may be substantial.

However, the argument that tariff reforms need to wait for domestic tax reforms ignores the important point that higher tariffs do not necessarily imply higher revenue (Pritchett and Sethi, 1994). There are strong reasons to believe that tariff reduction could result in less than one-to-one reduction in revenue collected, and in some instances even in an increase in revenue. First, high tariff levels are usually prohibitive and inhibit imports, so that bringing them down into the range where imports materialise has the potential to increase revenue. Second, the tariff rates being reduced are subject to exemptions that make the reductions effectively less than what they appear to be. We have already noted that the revenue loss resulting from various duty concessions could be as high as one-third of the realised revenue. Third, higher tariffs generally encourage attempts by importers to get their imports classified under lower duty slabs within the given commodity category through various means in order to minimise duty payments. This has become a lucrative practice because of the ongoing process of 'product fragmentation' (splitting of manufactured goods, in particular electronic and electrical goods, into separate components) which enables importers to import certain final products as separate components (which are generally subject to lower duty compared to the whole product). Fourth, tariff cuts also have the potential to increase revenue collection through reducing incentives to smuggling.

b. Institutional and Financial Constraints on Meeting Reform Commitments

The TPRM03 contains an informative discussion on the problems encountered by the Maldives in the reform process, particularly in the implementation of its reform commitments as a WTO member. The Maldives has not yet fully implemented the provisions of the WTO Customs Valuation Agreement. It invoked the five-year transitional period available to developing countries until 31 May, 2000, and subsequently obtained an extension until 31 May, 2002. But the implementation process had not yet been completed (at the time of writing the TPRM03 in mid-2003). There is no competition law or other laws that regulate the activities of enterprises and protect consumer interest which are needed to provide the necessary setting for speedy implementation of the privatisation programme. Intellectual property legislations are yet to be promulgated. As many other small developing countries, the Maldives does not have permanent representation at the WTO in Geneva. Consequently, it has not been able to participate effectively in the rule-making process and to promote and defend its interests in the WTO in accordance with its national policy priorities.

The key inference arising from this discussion is that, in most cases, lack of human and institutional capabilities and the financial constraint, rather than lack of reform commitments on the part of the authorities, are the main reason for delays in the implementation process. This inference corroborates the emerging consensus in related policy debate that technical assistance and the capacity-building initiative to assist small developing countries in the implementation of reform commitments should be a core element of the development dimensions of the multilateral trading system (Finger and Schuler, 2002; and Hoekman, Michalopoulos and Winters, 2004). It is important to note that, as part of the economic transition through global integration in the post-war era, most developed countries have already put in place institutions and policies to participate effectively in a rule-based world trading system. There is, therefore, a strong case for a well-coordinated international initiative (involving the WTO, international aid agencies such as the World Bank, the IMF, regional development banks and individual donor countries) to assist developing countries in putting in place similar institutions and policies, if we expect them to become equal partners in the process of removing impediments to global economic integration (Bhagwati, 2003).

An important limitation of the otherwise comprehensive treatment in TPRM03 of constraints of the implementation of reforms is the absence of any discussion on the implementation issues relating to the WTO agreement on Sanitary and Phytosanitary Standards (SPS Agreement). This should be a pivotal theme of any discussion on the Maldives' participation in the multilateral trading system, given the heavy reliance of the economy on fish product exports.

The Maldives' success in the expansion of fish product exports depends critically on its ability to meet increasingly more stringent food safety standards imposed in developed countries. Not only are these standards typically much higher and costly to meet than those required for selling on the domestic market, but they are also subject to frequent changes. Moreover, and perhaps more importantly, as traditional trade barriers such as tariff and quantitative restrictions continue to decline, protectionist interests are likely to make increasing use of food safety regulations and other technical barriers to block trade. Meeting international safety standards is far more complicated and costly in the case of processed food than in primary agricultural products. Thus, these standards can retard exports by developing-country producers even when they are imposed on genuine health and safety considerations because of the limited availability of compliance resources. The purpose of the Sanitary and Phytosanitary (SPS) Agreement and the related dispute settlement procedures of the WTO are to strengthen multilateral discipline in the implementation of food-safety standards (SPS standards) in agricultural trade, with a view to achieving the objective of protecting consumers while regulating the use of these standards as a means of non-border trade protection.

The developing countries have so far failed to effectively participate in the implementation of the Agreement as equal partners (Finger and Schuler, 2002;

and Athukorala and Jayasuriya, 2003). Unlike conventional trade policy reforms, SPS regulations cannot be implemented simply through legislative declaration. There is a need for a global framework to support national capacity building and improve the design of international standards. Quite apart from helping countries when they confront a dispute, there seems to be a great need for international initiatives to educate developing-country exporters and policy makers about the new legislation and on how to comply with internationally adopted food standards. This is certainly an area where there is ample room for fruitful 'aid for trade' initiatives by the international development community. The SPS Agreement itself tries to facilitate effective participation of the developing countries in its implementation by encouraging developed-country members to provide technical assistance and accord special and differential treatment to developing countries (Articles 9 and 8). But so far developed countries have failed to take any serious steps in this direction. International organisations, such as the UNCTAD, the ITC and the World Bank have to begin to provide this kind of technical assistance. But, these initiatives are still in their early stages and the technical and financial support provided so far falls below what is required.

c. Graduation from LDC Status

With the sustained increase in GDP per capita passing beyond the LDC threshold, the Maldivian authorities have become seriously concerned about the implications of losing preferential access to developed-country markets and other 'special and differential treatment' associated with the LDC status. The TPRD recognises the imminent graduation from LDC status as a 'major challenge for the Maldives', but it stops well short of assessing the potential adverse impact. However, based on the information provided in the report relating to trade patterns and the actual coverage of existing trade preferences one could argue that the fear of losing trade preferences is vastly exaggerated.

Trade preferences enjoyed by the Maldives have been by and large limited only to fish (mostly canned and preserved tuna) exports to the EU. However, the share of exports to the EU in total fish product exports from the country has declined sharply in recent years (from 21 per cent in 1997 to 12 per cent in 2001). This suggests that sheltering exports from world competition through preferential tariffs *per se* is unlikely to ensure export success. What is important is to focus on redressing supply-side constraints on export performance. The exclusive monopoly enjoyed until recently by MIFCO is considered a major factor behind the Maldives' poor export performance in fish products. Until recently MIFCO's long-standing monopoly in fish processing and exporting depressed raw fish processing below the levels in world markets, penalising local fishermen and acting as a disincentive for expanding fish catch (WTO, 2003, p. 45). There are indications that gradual relaxation (since 1996) and the final abolition (in 2000) of MIFCO's monopoly has begun to boost production and improve efficiency in the industry.

d. Trade and Environment

Given its fragile ecology and peculiar bio-diversity, and the heavy dependence on two environmentally sensitive industries (fishing and tourism), environmental issues are central to the national development policy of the Maldives. Rapid expansion of reef fisheries has already led to over-fishing of certain species, such as grouper, snapper and sea cucumbers. There is anxiety about the long-term sustainability of tourism, particularly given the effects of pollution on the coral on which the island stands (Farmer, 1993, p. 169; and Armstrong and Read, 1998, p. 570). In both areas, trade and foreign investment policy needs to be appropriately linked with national resource management policy and an enhanced regulatory framework for greater surveillance and control of environmental degradation. Unfortunately, the environmental dimension of trade and investment policy is entirely missing in the TPRM03.

4. CONCLUSION

Given the narrow resource base and small domestic market, openness to foreign trade and investment remains the 'natural' policy choice for the Maldives. Since the late 1980s the Maldivian authorities have made considerable progress in implementing policy reforms driven by this conviction. The reform process is far from complete, however. High import tariffs maintained predominantly on revenue considerations, a large direct role played by the public sector in foreign trade and some key sectors of the economy, the lack of transparency in duty concessions and other investment incentives, failure to incorporate environmental concerns as part of the national development policy, and delays in the implementation of multilateral reform commitments under the WTO are among the key items of the unfinished reform agenda.

The TPRM03 provides a useful framework for examining these and related issues, and designing appropriate policies and strategies by the international development community for helping microstate economies like the Maldives in global economic integration in an orderly fashion. The report is particularly commendable given the severe staffing and financial constraints under which the Trade Policy Review mechanism of the WTO operate. There are, however, many areas in which further work is needed in order to inform the policy debate. These include the political economy of SOE reforms – in particular, the relative importance of genuine economic reasons versus political patronage in determining the nature and speed of the reform process; revenue implications of tariff reforms;

the implications for Maldivian fish exports of the SPS agreement and the related institutional mechanisms for monitoring international food safety standards, and the impact of graduation from LDC status for export performance.

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