SUMMARY

1. Since its previous Trade Policy Review in 2009, Maldives' economic growth has been sustained, although at an irregular and relatively slower pace. Its ability to attract tourism from new and emerging markets (e.g. China) has helped the recovery from the global economic crisis. After a peak of 8.7% in 2011, real GDP growth decelerated to 2.5% in 2012 largely due to the impact of weak economic conditions in Europe on the tourism sector, but increased demand in tourism and related sectors made it rebound progressively to 6.5% in 2014. Inflation dropped progressively to 2.4% in 2014 (from a peak of 11.3% in 2011) and remained subdued in 2015; the unemployment rate also declined slightly from 12.2% in 2009 to 11.6% in 2014 owing mainly to the recovery in the tourism sector.

2. During the review period, the trade and trade-related structural reforms included the introduction of the goods and services tax (GST) and the business profit tax (BPT), new investment incentives for activities in special economic zones (SEZs), legislative measures for the formalization of informal enterprises, and a new pension system. Monetary policy accommodated fiscal indiscipline at times but with the enactment of the Fiscal Responsibility Act in 2013, strict limits on monetary accommodation were imposed, and the financing of the fiscal deficit was halted; furthermore, the 2015 Budget contained a mix of revenue raising and expenditure restraint measures as well as a large increase in capital expenditures financed by bilateral official loans.

3. Following a sharp decline in foreign exchange earnings, on 11 April 2011 Maldives, a highly-dollarized economy, switched from a *de facto* fixed exchange rate to a stabilized exchange rate regime with the rufiyaa allowed to fluctuate within a band of 20%. The nominal exchange rate moved quickly towards the upper limit of the band where it remains, while the real exchange rate appreciated by around 20% owing to rapid inflation pass-through. With low level of reserves, the Maldives Monetary Authority (MMA) is able to supply only a small fraction of foreign exchange demand with the rest satisfied in the parallel market; consequently, non-discriminatory exchange restrictions and a multiple currency practice (MCP) remain in place. Between 2009 and 2011 the current account deficit grew, due, *inter alia*, to a substantial increase in the value of imports reflecting, among other things, higher global oil prices, whereas between 2012 and 2014 it narrowed progressively owing mainly to the recovery in the tourism sector, and subdued global food and fuel inflation. In 2015 the deficit peaked due to a reduction in the trade surplus reflecting stronger domestic import demand and a fall in fish exports and re-exports. Maldives' gross official reserves rose in 2014 due to an increased supply of dollars in the market. Total public debt increased to 74.6% of GDP in 2014 while gross external debt decreased.

4. The high degree of openness of the Maldivian economy to international trade, and its integration into the world economy continued to be reflected by the ratio of its trade (exports plus imports) in goods and services-to-GDP, which rose to 198.6% in 2014 largely due to increased tourism receipts and goods imports. International trade and foreign direct investment (FDI) developments reflect the continuous importance of Asia as Maldives' main regional market and supplier, while the European Union remains its major individual merchandise market followed by Thailand. Marine food (mainly fish, crustaceans, and preparations thereof) remain Maldives' main exports. The foreign investment regime remains liberal; 100% foreign ownership is permitted in all sectors except for longline fisheries (since 2010) and retail trade. As of 2014 the positive list of foreign investment activities was replaced by a case-by-case review of each application. In addition to the 2015 constitutional changes opening land ownership to foreign investors, SEZs incentives applicable to both domestic and foreign investors, an equitable BPT (replacing the disadvantageous royalty regime), and dispute settlement guarantees were introduced recently.

5. During the review period, Maldives has been through a complex political transition period. Some changes were made in its legal and institutional framework for trade and investment, including new legislation or amendments, *inter alia*, on customs valuation, public health, taxation, copyright and related rights, tourism, land lease and financial services as well as the establishment of a Trade Facilitation Committee to advise on issues in facilitating trade and ease of doing business in the country.

6. The graduation of Maldives from least-developed-country (LDC) status in 2011 and/or its classification as an upper-middle-income country by the World Bank have had some implications for preferential market access to certain major markets (i.e. Canada, China and the EU), some WTO commitments/benefits (e.g. TRIPS), and possibly the level of official development assistance

and technical assistance. Its involvement in regional trade agreements remains limited and unchanged; it is a party only to the South Asian Free Trade Agreement (SAFTA) and is about to launch negotiations for a free trade agreement with China. Despite a seemingly transparent legislative process and being a longstanding beneficiary of trade-related technical assistance (TRTA), Maldives' poor record of WTO notifications and observance of tariff binding commitments remains virtually unchanged.

7. The tariff remains one of Maldives' main trade policy instruments but its predominance as a source for government revenue has declined substantially with the introduction of new taxes. As a consequence of a 2011 unilateral MFN tariff liberalization initiative eliminating tariffs on about 31.5% of tariff lines, the average applied MFN tariff rate dropped from 21.4% in 2008 to 13.9% in 2015. Agricultural products continue to face lower tariff rates (averaging 11.3%) than non-agricultural items (WTO definition) (14.3%). The peak *ad valorem* rate was doubled to 400% (plastic bags and polythene film and sheets). The introduction of the HS2012 tariff nomenclature resulted in 7% less tariff lines. The tariff structure has become slightly more complex owing to the increase in the number of applied MFN rates, which in 2015 stood at 13 (zero, 5%, 10%, 15%, 20%, 25%, 35%, 50%, 100%, 150%, 200%, 400%, one specific duty) compared to 11 in 2009. For most activities, the tariff is characterized by some level of de-escalation between unprocessed and semi-processed products, and escalation to fully processed goods, which means that effective rates of tariff protection for final products can be considerably higher than nominal rates. The Maldives Customs maintains an online Customs Tariff containing only 6,422 "active" tariff lines for customs declaration purposes that could provide scope for administrative discretion. The fact that 94.9% of tariff lines are bound imparts a degree of predictability to the tariff. However, the simple average of bound MFN rates could considerably exceed the average applied MFN rate (possibly by about 24 percentage points), providing the authorities with extensive scope for increasing applied tariffs within bindings. Furthermore, similar to the time of its past TPR, applied MFN tariff rates appear to exceed bound rates on some 323 tariff lines of which 271 were on manufactured products. As Maldives' Tariff Schedule of Concessions is based on the HS2007 it is difficult to accurately compare its bindings' status with the currently applied HS2012 tariff schedule, thus, making the transposition of binding commitments to HS2012 another pressing task.

8. During the review period, trade facilitation improvements included the introduction of a fast clearance channel for imports as well as the launching of the internal process to ratify the WTO Agreement on Trade Facilitation. New customs legislation in 2011 allowed for the implementation of provisions of the WTO Agreement on Customs Valuation; the transaction value is now used in a large majority of cases as the valuation basis.

9. Import licensing continues to apply to all imports, and an *ad valorem* fee is collected for the issuance of licences. Import restrictions and prohibitions on various items for, *inter alia*, religious, health, safety, security, and environmental reasons have remained generally unchanged during the review period. There has been no major change in the area of standards and other technical requirements. Labelling requirements for pre-packaged food, food imports, tobacco products and breast-milk substitutes have been updated.

10. Export duties levied on fish products (royalties) were replaced by the BPT indirect tax as from 2012, whereas a 50% duty on the f.o.b. value of ambergris exports was retained for revenue purposes. No changes were made to export prohibitions, restrictions, or the licensing regime. As from 2014 incentives, *inter alia,* involving temporary BPT exemption, have been provided for the establishment of SEZs, including for export processing, but no such zone has been set yet.

11. Domestic support is provided mainly through tax and non-tax incentives (e.g. direct payments) some of which are available to sector-specific activities, e.g. fisheries, agriculture and energy sectors. State involvement in the economy, including in trading activities, remains prevalent in numerous sectors (e.g. fishing, public utilities, finance, telecoms, transport, and tourism). Despite the absence of privatization action during the review period, the authorities promoted joint ventures between government-owned companies and private sector stakeholders and in 2013 they passed legislation on the procedures for the privatization, corporatization, monitoring, evaluation and introduction of shares of state-owned properties to the stock exchange. No major changes were made in the government procurement framework of Maldives, a non-signatory to the WTO Plurilateral Agreement on Government Procurement; in addition to the possibility of restricting bids to domestic suppliers, local firms may be granted a margin of preference of up to 7.5% in the evaluation of bids.

12. The passing of a Copyright and Related Rights Act in 2010 has been a major development in the protection of intellectual property rights (IPRs) while the preparation of draft legislation on patents, industrial designs, trademarks and geographical indications is under way. Maldives remains a non-signatory to any of the treaties administered by the World Intellectual Property Organization and protection enforcement is weak. Competition and bankruptcy and insolvency legislation remains at a drafting stage, although sector-specific legislation is in place for telecommunications.

13. Despite its declining share of GDP (1.4% in 2015) the fisheries sector continues to be of major importance to the Maldivian economy as it accounts for nearly all (97.4%, 2014) merchandise exports; following the loss of preferential treatment in the EU market some fish exports were partly diverted into other markets. During the review period, tariff protection for the activity was reduced significantly, although most tariff lines relating to fish and fish products remain unbound. Fisheries subsidies are in the form of direct payments are granted to support fuel costs (2009-14), a minimum income level during the low season (2014 onwards) and installation of equipment for on-board ice making facilities and for conversion of bigger fishing vessels to engage in longline fishing. The longline fishing policy and regime were changed to reflect illegal fishing and overfishing developments as well as domestic fishermen's interests/concerns; foreign participation in this type of fishery was ceased in 2010 and a catch allocation-based individual transferable quota (ITQ) scheme was established in 2014. The state-owned Maldives Industrial Fisheries Company (MIFCO) continues to enjoy considerable monopsony power as it holds exclusive rights in purchasing and processing skipjack tuna in two of four zones.

14. Notwithstanding its land limitations and climatic risks, agriculture remains a crucial sector in terms of employment and therefore poverty reduction. Domestic producers receive support in the form of direct payments mainly distributed to compensate for loss of income due to natural disasters; as from 2014 the direct payments were replaced with insurance schemes for farmers as well as concessional loans to support agricultural development. While average tariff protection to agriculture was reduced, tariffs on tobacco and alcohol products were increased for health, religious and revenue purposes. Staple foods (i.e. ordinary rice, flour and sugar) continue to be imported mainly through the majority government-owned enterprise State Trading Organization (STO) and sold at government-controlled prices involving a subsidy.

15. Development of manufacturing remains limited and state involvement seems to persist in a few key areas through, *inter alia,* STO's and MIFCO's activities. Although tariff protection of manufacturing was reduced – except for some chemicals, cosmetics, soaps, tyres, textiles, motor vehicles, buses, and motor vehicle parts where it was increased – it remained slightly higher than the overall average applied MFN tariff and much higher than rates levied on agricultural items.

16. Maldives remains fully import dependent on petroleum-based fuels with key activities like tourism and fishery being the main energy consumers. Action is being taken both at the border and investment level to promote renewable energy and address several constraints. State involvement in the energy sector was strengthened with the establishment of a second state-owned electricity company to achieve operational efficiency and ensure 24-hour electricity access to island communities. As electricity tariffs remain expensive by international standards, two types of subsidies equivalent to 0.7% of GDP (2014) are paid directly to households, some of which also benefit from cross-subsidization at the expense of businesses subject to much higher tariffs.

17. Services remain by far the largest sector of the economy (accounting for more than 80% of GDP and over 90% of total goods and services exports) with tourism being the largest activity and the largest generator of government revenue. The limited commitments of Maldives under the GATS remain unchanged. Tourism-related taxes and revenue were increased during the review period. Although tourism facilities are predominantly locally-owned, state involvement was apparently increased, and the lease period for islands or land was extended under certain conditions. New legislation in the financial sector covered Islamic banking, prudential requirements and prevention of money laundering and terrorism financing. Consequently, to capture a part of the market, a new Islamic bank was established and the offer of Shariah type financial products was expanded. The banks' capital adequacy ratio rose, but their minimum reserve requirement was reduced. Despite a recent drop, the relatively high level of non-performing loans (NPLs) remains a concern. State involvement in fixed-line communications was somewhat reduced in recent years with the state firm's (Dhiraagu) opening to public investment in late 2011; efforts were made to reduce its dominance in other telecoms segments. Other major developments

include a new National Broadband Policy aimed, *inter alia,* at extending broadband Internet access to all the inhabited islands as well as the introduction of mobile number portability and the extension of the existing broad-based GST tax to telecommunications. Cabotage restrictions persist in both maritime and air transport activities. During the review period, the supply of international airline services was increased with the arrival of new operators and the expansion of airport capacity whereas a lower GST rate has benefited the domestic air transport of locals. On the other hand, state involvement in port and airport ownership and handling remained relatively unchanged.

18. Despite a favourable economic outlook Maldives' economic growth is expected to slow further in 2016 with the implementation of fiscal adjustments contained in the 2015 Budget. Downside risks to the economic outlook are posed by, *inter alia*, possible fiscal slippages, the timely implementation of proposals to diversify into new and tourism-support activities, and political volatility. With limited policy buffers, Maldives' economy also remains vulnerable to exogenous risks including a surge in oil prices, protracted slow growth in its major markets (mainly Europe, and increasingly China), as well as a strengthening of the U.S. dollar. International competitiveness is crucial to the sustainable development of Maldives' tourism-dependent economy given its high degree of openness and regional competition. A major economic challenge confronting Maldives, with potential trade policy implications, is to formulate appropriate macroeconomic policies and undertake productivity-enhancing structural reforms to address, *inter alia*, skill mismatch in the labour market, the high dependence on fishing, tourism and oil imports, and government expenditure-related distortions (e.g. subsidies) as well as improving the efficiency of public service provision across the country. These and related reforms would increase the flexibility of the Maldivian economy and its ability to respond to external shocks, thus enabling it to continue meeting its economic and welfare objectives.