

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

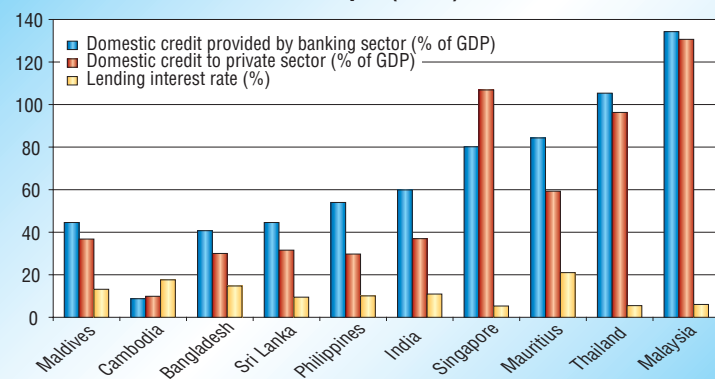
Capital is an essential resource for all firms, and the ability to access finance at competitive costs is integral to firms' achieving their growth potential rather than the potential set by their current stock of capital. Finance was highlighted as the main constraint across the board in the Maldives.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

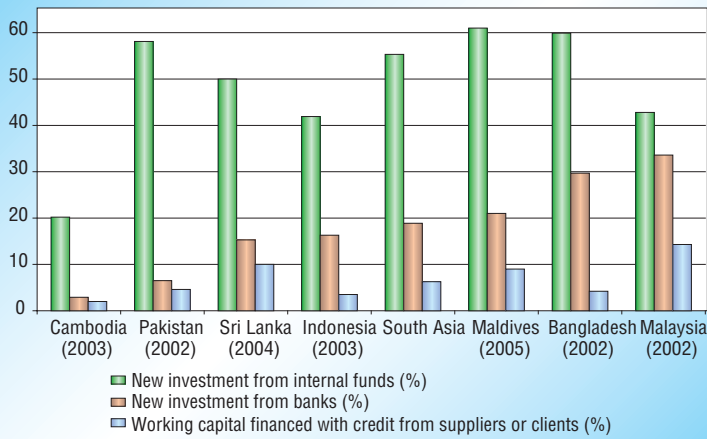
The limited availability of options for finances curbs the growth of the Maldives economy. Most companies are financing investment out of their own funds such as retained earnings (figure 4.2).

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

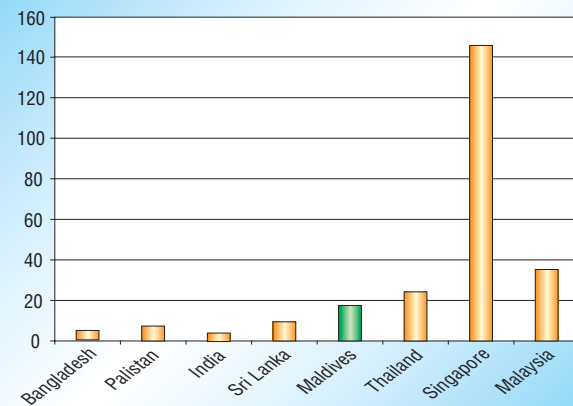
The Maldives firms are getting more bank financing than the average South Asian firm. Approximately 20 percent of new investments in Maldives are being financed from commercial banks, while the bulk has to be financed through the entrepreneurs' own funds and alternate sources.

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.

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

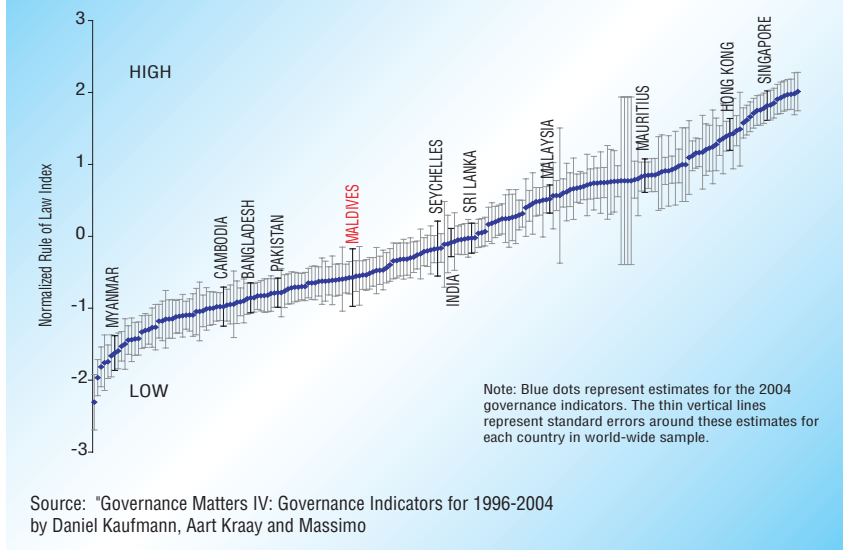


Table 4.4 : Confidence in the Judicial System and Predictability of Interpretation of Regulation in Maldives, 2005

%	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).

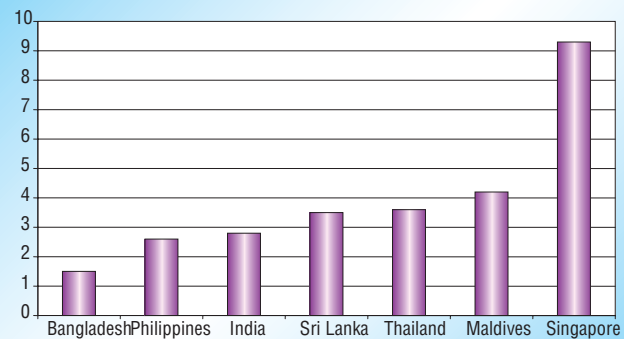
However, the ICA survey data also reveals that more than 50 percent of the firms have made informal payments totaling a value of approximately 6 percent of sales; this is three times higher than the South Asian average of 2 percent of sales and the highest in the region (table 4.5). In terms of the time 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.

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

**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%

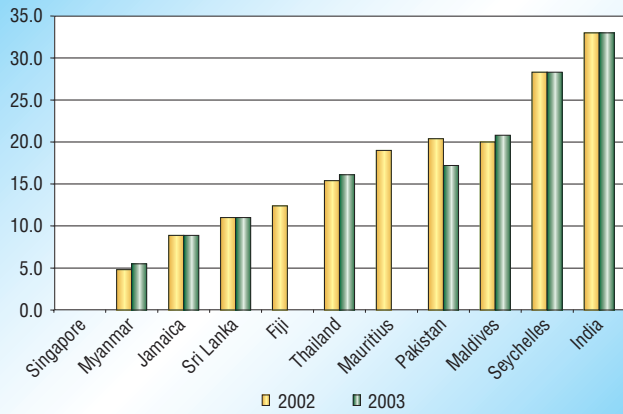
Source : World Bank Enterprise Survey Database, 2005

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.

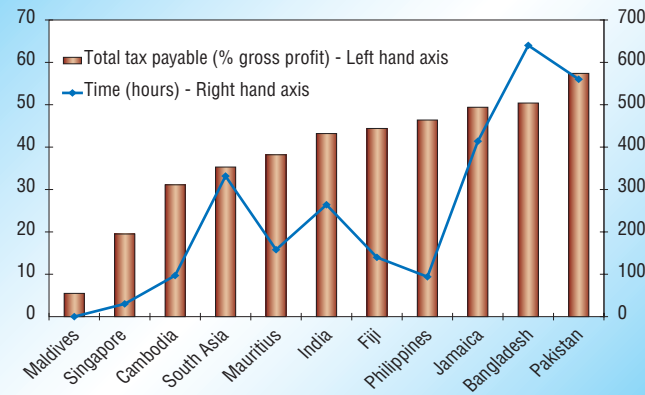
Figure 4.6
Average Tariff Rates, 2002 and 2003



Source: World Bank Trade database, 2005

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 4.7
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.