

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 Maldives' 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.