Opportunities for Economic Growth and Investment in the Maldives

A background paper prepared by the Ministry of Economic Development and Trade (MEDT), and the Foreign Investment Services Bureau (FISB) for the Maldives Partnership Forum to be held in the Maldives on 26 June 2006

Introduction

The Maldives has a small open economy largely driven by its buoyant tourism and fishery industries. Despite the limited endowment of resources, the Maldives has enjoyed consistently high economic growth over the two decades preceding the tsunami, averaging about 8 percent per annum. The size of the economy coupled with its narrow industrial base makes the Maldives one of the most economically vulnerable small states in the world today. This vulnerability is further exacerbated by the fiercely competitive nature of the international tourism and fishery markets, both of which are highly susceptible to external shocks.

The nation's modern economic history is both triumphant and tragic. While the United Nations currently lists the Maldives as a Least Developed Country (LDC), the world organization had been prepared to promote the Maldives to a Middle Income Country (MIC) in December 2004 in recognition of the remarkable strides that had been achieved in both the social and economic spheres. However, the tsunami of 26 December 2004 intervened on the very eve of that action; and the consequent impact on the economy has led to a decision to postpone the nation's economic elevation until 2011.

Key Challenges

Today the country faces a number of major challenges that need to be carefully managed if the Maldives is to continue to enjoy the economic growth of the past two decades and at the same time alleviate poverty and reduce income inequality. Foremost amongst these is, of course, the economy's ability to address the post-tsunami recovery as well as the proposed elevation of the nation's status in 2011.

The tsunami has called for major investments in reconstruction and infrastructure development, especially in the outer atolls, straining the already tight fiscal situation and resulting in a record budget deficit in 2005 and an even higher expected deficit in 2006. In the medium term the proposed elevation to MIC status is expected to have significant effects on the economy. For instance, on the one hand it will reduce the country's ability to draw international donor assistance, which is currently significant for the Maldives. On the other hand, the new status will have far reaching implications on the preferential trade arrangements that the country now enjoys as an LDC. For instance, the European Union's Everything But Arms (EBA) initiative, which offers zero import duty for all exports from the Maldives, provides a very valuable market access opportunity for the country's fish exporters

The limited financial resources available for investment and development are another key issue facing the country, and are considered a major impediment to economic growth. The government, having acknowledged these limitations, has been pro-active in developing policies and institutions aimed at enhancing such resources—notably the introduction of capital markets aimed at mobilizing private savings for productive investments. In addition, the government is strongly committed to instilling corporate governance practices in the country, which is expected to increase investor confidence. Furthermore, having recognized the importance of foreign direct investments, the government has always welcomed foreign investors in all major economic activities.

Another key challenge facing the Maldives in its quest for private-sector led growth relates to the limitation of the country's key trade facilitating infrastructure, notably the Male' port and airport. The proposed expansion of the tourism sector through the release of an additional 35 islands for development and the government's push towards greater liberalization of the fishery sector, combined with the expected increase in foreign direct investment (FDI) in other sectors due to the proposed relaxation of foreign investment policy, are expected to significantly increase the level of investment in the country. Given that the Male' International Airport currently operates at or above capacity during peak hours, often resulting in long delays, the projected growth in tourism is expected to tax the system even further. This could lead to a decline in service levels, which would in turn undermine the tourism sector itself. Similarly, the commercial port in Male' is currently operating above its intended capacity, leading to serious economic inefficiencies. The future growth of the economy is therefore critically linked to the development of these infrastructures, and the government is actively seeking prospective investors for these two infrastructure projects.

Current investment policy and environment

The Maldives' consistently high economic growth over the 20 years preceding the tsunami can largely be attributed to the country's relative political stability over the period and the dynamism of the private sector. Investments in the key sectors of tourism and fishery have been largely driven by the private sector, the latter sector being liberalized just a few years ago. While the government has traditionally played a dominant role in business, its current strategic direction is to gradually reduce its direct involvement in the economy, providing greater opportunities for private investors.

Foreign investments have been an integral part of the Maldives economy for a considerable time. In fact, Maldives is one of the most open economies in South Asia for foreign investments according to a recent Investment Climate Assessment Survey conducted by the World Bank. Foreign investments in the country are governed by the Foreign Investment Law (Law no: 25/79) under which foreign investments in the tourism sector are required to be registered with the Ministry of Tourism and Civil Aviation while all non-tourism foreign investments are required to be registered with the FISB. Under current procedures all non-tourism foreign investments are granted approval by the FISB on the recommendation of the Foreign Investment Board. While foreigners are welcomed to enter and operate in all sectors of the economy except for a limited number of businesses such as wholesale and retail trading, the approval procedure is cumbersome and often involves considerable time.

Proposed changes to the foreign investment policy

In preparation for the more competitive investment and trading environment in which the Maldives will operate following its MIC status in 2011, and given the need for additional financial resources for investment and growth in the wake of the tsunami, the government is increasingly recognizing that foreign investments will have to play an important role in the future economic development of the country. Thus the government is currently reviewing the foreign investment regime, which, as noted above, is already one of the most liberal amongst the South-Asian countries.

Current laws, regulations, and procedures on foreign investments are seen as lacking clarity and transparency. In addition, the entry and approval process facing foreign investors is cumbersome and often long. The new review has two primary objectives: first, to eliminate all unnecessary red-tape and to introduce greater transparency and predictability in the regulatory environment facing foreign investors; second and more importantly, to further liberalize foreign investments, thereby enabling the economy to tap foreign financial resources to fuel growth. Taken together, it is hoped that these changes will further increase the flow of FDI and will encourage joint ventures between local businessmen and foreign investors for years to come.