

## Chapter 20

# South Asian Trade: What it Means to Maldives

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*Ismail Nashid*<sup>1</sup>

### 20.1 Introduction

South Asia, counted among the fastest-growing regions in the world, has the most geographically diverse composition in terms of the size, populations and resources of its countries. It is anticipated that the fast growth in South Asia will benefit from young demographics, new waves of globalisation, increased labour mobility and the rise of the middle class in the coming years (Ghani 2011).

As with globalisation, regional economic co-operation and integration are seen as the route to economic prosperity. Data on South Asia shows much potential for further growth; of the region's total trade volume of US\$400.6 billion in 2011, only 4 per cent was intra-regional trade. Given the advantages of proximity, the similarity in production structures and levels of technology, plus the familiarity of cultures, it is likely that a more pronounced set of benefits will accrue from intra-regional trade and investment taken alongside their extra-regional counterparts.

Although the South Asian Association for Regional Cooperation (SAARC) Preferential Trading Arrangement (SAPTA) and the South Asian Free Trade Area (SAFTA) came into force in 1995 and 2006, respectively, under the objective to stimulate trade and foster deeper integration and regional co-operation, full liberalisation and co-operation have not taken effect. Intra-regional trade is far below its potential level. For example, the region witnessed US\$16.17 billion intra-regional trade against a potential of US\$37.55 billion in 2010. South Asia has succeeded, so far, in achieving only 43 per cent of its trade potential, where the realisation rate (of trade potential) varies from the highest 83 per cent (Maldives) to the lowest 42 per cent (Pakistan) (see Chapter 10). In this context, South Asia as a region has lagged behind in terms of its openness to trade in spite of the fact that most South Asian countries have continued to undertake trade reforms since the 1990s.

A cursory examination of intra-regional trade shows that India has the largest share in total exports at 87 per cent, which is merely 4 per cent of the trade it does with the rest of the world. Maldives having the smallest share with only 0.1 per cent has 8 per cent of its export trade in merchandise within the region (Table 20.1).

When considering overall national trade, Nepal seems to have the greatest linkage of its economy to the region, where 61 per cent and 58 per cent of its exports and imports respectively are traded (Tables 20.1 and 20.2).

Given the fact that intra-regional trade in South Asia is discouragingly low, it is important to note that Maldives has considerable interests tied to the region with

**Table 20.1 Share in intra-regional exports of South Asian countries in 2011 (US\$ million)**

	Bangladesh	India	Maldives	Nepal	Pakistan	Sri Lanka	Total	Country-wise share(%) in intra-SAARC exports
Bangladesh							353.34	2%
India	3,789.20	289.96	124.60	9.27	43.29	10.82	12,555.72	87%
Maldives		2.30		2,721.57	1,541.56	4,378.79	14.70	0.10%
Nepal	14.69	254.39			0.77	12.40	269.85	2%
Pakistan	352.56	178.64				169.31	700.51	5%
Sri Lanka	33.00	376.00	41.00		55.00		505.00	4%
Total SAARC	<b>23,717.73</b>	<b>338,372.40</b>	<b>179.39</b>	<b>442.30</b>	<b>28,118.00</b>	<b>9,789.00</b>	<b>14,399.12</b>	
World	1%	4%	8%	61%	2%	5%		
Intra-regional exports as (%) of SAARC exports to world								

**Source:** IMF Direction of Trade Statistics

Table 20.2 Share in intra-regional imports of South Asian countries in 2011 (US\$ million)

	Bangladesh	India	Maldives	Nepal	Pakistan	Sri Lanka	Total	Country-wise share(%) in intra-SAARC imports
Bangladesh								
India	<b>584.64</b>	2,710.11		16.26	388.13	15.48	3,129.98	22%
Maldives	0.90	134.00	<b>19.92</b>	549.97	<b>401.19</b>	<b>720.89</b>	2,276.61	16%
Nepal	10.05	1,646.95			5.00	74.00	213.90	1%
Pakistan	47.94	1,032.27			0.77		1,657.77	12%
Sri Lanka	17.00	3,126.00	15.00		241.00	46.39	1,126.60	8%
Total SAARC	<b>38,571.10</b>	<b>509,574.00</b>	<b>1,639.99</b>	<b>2,847.75</b>	<b>52,552.10</b>	<b>18,364.00</b>	<b>11,803.86</b>	
World	8%	0.4%	13%	58%	2%	19%		
Intra-regional exports as (%) of SAARC imports to world								

**Source:** IMF Direction of Trade Statistics

almost 10 per cent of its exports and imports transacted within the region. The question then is whether the vast dynamism in South Asia will allow its smallest member to further benefit from regional trade.

This chapter aims to look at what SAFTA means for regional trade integration for Maldives, as well as how Maldives trade should be further integrated to regional trade in order to reap the maximum benefit from potential South Asian growth.

## 20.2 Overview of the Maldivian economy

Maldives is a nation consisting of approximately 1,190 low-lying coral islands which form a chain that stretches over an area of 90,000 sq. km of the Indian Ocean, and is surrounded by an exclusive economic zone (EEZ) covering 859,000 sq. km. The nation's capital Malé, with around 2.5 sq. km of total land area, has over one-quarter of the entire population of 270,101, while approximately 71 per cent of the rest of the 200 inhabited islands have fewer than 1,000 inhabitants according to the 2000 census information. Maldives has a relatively young population with almost 41 per cent under 15 years of age and around 3 per cent over 65 years of age. With regard to human development trends, the country ranks high among Asia-Pacific countries.

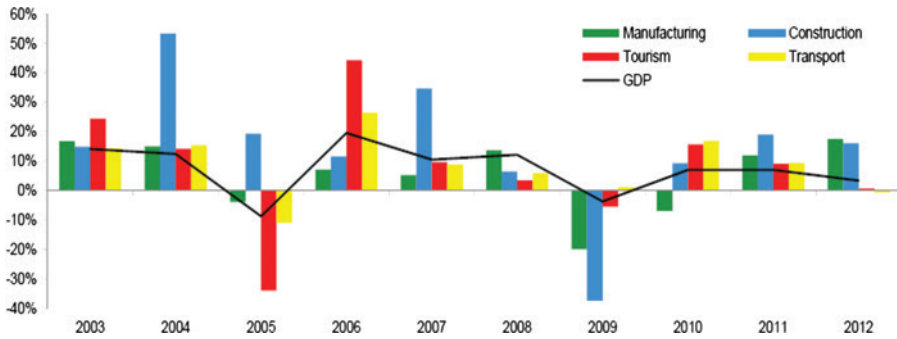
The Maldivian economy is very open. Trade in goods typically accounts for around 75–80 per cent of the gross domestic product (GDP). If services are taken into account, trade in goods and services account for approximately 150 per cent of GDP. Imports of goods typically outweigh exports of goods by a factor of between three and four. However, this large shortfall in foreign exchange earnings is, to a large extent, compensated by revenues from the export of services via the tourism sector.

There is currently very limited production activity in Maldives. This adversely affects the country's capacity to trade, both internationally and domestically. Factors contributing to the low productivity level include limited economic diversification, shortfalls in the supply-side and productive capacity, prevention of market linkages due to hurdles in the economic infrastructure, lack of an enabling business regulatory framework, weak institutional and limited technical capacity.

The Maldivian economy is heavily dependent on fisheries and tourism, which are the major sources of foreign exchange earnings and government revenue, and which together directly account for about 40 per cent of GDP, while indirectly accounting for a much larger proportion. In terms of employment, these two sectors alone account for more than one-third of total employment, according to the results of the 2000 census. The total labour force of the country is estimated at around 50 per cent of the working-age population, which, coupled with the low level of educated labour, has led to a high proportion of expatriate workforce in the country. Expatriate labour has, therefore, played a key role in the development of the Maldivian economy, and includes teachers, medical personnel and other professionals as well as a large number of lower-skilled workers such as domestic helpers and construction workers.

A slowdown in growth in the tourism sector led to a significant deceleration of economic growth in the country in 2012. Throughout 2012, the tourism sector

**Figure 20.1 GDP growth by selected sectors, 2003–12 (growth in annual percentage change)**



**Source:** Department of National Planning, Maldives

continued to be affected by weak economic conditions in Europe – the main tourism market for Maldives. In terms of growth rates, real GDP growth slowed from 7 per cent in the preceding two years to 3.4 per cent during 2012 (Figure 20.1), despite the improved performance of the construction, fishing and manufacturing sectors. The tourism sector slowed down significantly to 0.7 per cent during 2012 in contrast to the expected growth of 7.5 per cent. This marked slowdown was driven by the decline in tourist arrivals from Europe owing to weak economic conditions in the main European source markets, although it was partly offset by the robust growth in Chinese tourists. With the slowdown in the overall economic activity, especially in the tourism sector, the growth of the distribution sector (comprising the wholesale and retail trade) moderated to 5.0 per cent, following 8.2 per cent growth in 2011 (Maldives Monetary Authority 2013).

With effect from 11 April 2011, the Maldivian rufiyaa was allowed to fluctuate within a horizontal band of 20 per cent on either side of a central parity of MVR12.85 per US dollar. With the introduction of the exchange rate band, the exchange rate of the rufiyaa per US dollar moved towards the upper limit of the band, owing to persistent foreign exchange pressures in the economy.

By the end of December 2012, in annual terms, the rufiyaa appreciated by less than 1 per cent against the US dollar. As for the bilateral exchange rates, the rufiyaa depreciated against the Singapore dollar by 6 per cent, by 4 per cent against the pound sterling and against the euro by 2 per cent at the end of 2012. Conversely, the rufiyaa appreciated against the Japanese yen by 10 per cent, against the Sri Lankan rupee by 11 per cent and against the Indian rupee by 3 per cent (Maldives Monetary Authority 2013).

### 20.3 Trade policy framework

Maldives has undergone considerable political, constitutional and judicial change since the early 2000s. As a member of the WTO, Maldives accords most favoured nation (MFN) treatment to all members. Although Maldives graduated from LDC to middle-income country status on 1 January 2011, Maldives still benefits from

**Table 20.3 Changes in the tariff structure effective from 1 January 2012**

Duty rates	Tariff structure prior to 1 January 2012		Tariff structure since 1 January 2012	
	No. of tariff lines	% share of tariff structure	No. of tariff lines	% share of tariff structure
<b>0%</b>	16	0.29	<b>2,247</b>	<b>40.43</b>
5%	271	4.88	85	1.53
10%	503	9.05	396	7.12
15%	1,020	18.35	345	6.21
20%	780	14.03	1,941	34.92
<b>25%</b>	<b>2,699</b>	<b>48.56</b>	279	5.02
35%	154	2.77	183	3.29
50%	14	0.25	41	0.74
100%	92	1.66	19	0.34
150%			13	0.23
200%	9	0.16		
400%			9	0.16
<b>Total lines</b>	<b>5,558</b>		<b>5,558</b>	

**Source:** Maldives Customs Service

quota-free and duty-free access to the European Community (EC) and Japan, two of the main destinations for its exports of fish and fish products. The foreign investment regime is liberal, with 100 per cent foreign ownership permitted in all sectors.

In addition to SAPTA and SAFTA, Maldives has bilateral trade agreements with India, China and the USA. Up until 1 January 2012, import tariffs were Maldives' principal source of tax revenue, accounting for approximately two-thirds of tax receipts, as well as acting its main trade policy instrument. On 1 January 2012, goods and services tax was introduced for the first time, which was later followed by the introduction of business profit tax. This led to a subsequent reduction and reform in the tariff structure of the country.

Prior to reform in the import tariff structure, almost 49 per cent of tariff lines carried an applied rate of 25 per cent cost, insurance and freight (CIF), while after the reform 40 per cent of lines have an applied rate of zero per cent (Table 20.3). This subsequently led to a drastic revision of the sensitive list of Maldives under SAFTA where all food, clothing, cosmetics and domestic-use items now carry an applied rate duty of 0 per cent.

The export regime is relatively open, although exports of certain marine species are prohibited, exports of timber are controlled and ambergris exports are taxed.

## 20.4 Trade in merchandise

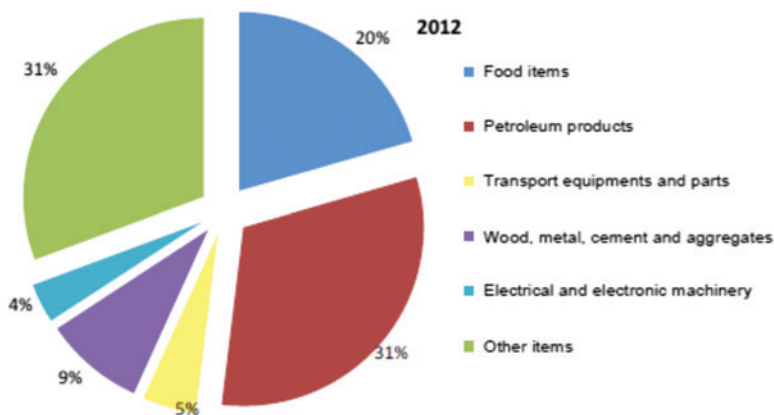
The merchandise trade deficit increased by 14 per cent in 2012 to a record US\$1,387.9 million (Table 20.4), reflecting the growth in imports. Merchandise exports, which are divided into domestic exports and re-exports, declined owing to a marked fall in re-exports despite the increase in domestic exports during the year. Domestic exports as a share of total exports rose to 40 per cent in 2012.

**Table 20.4 Merchandise trade deficit (2008–12)**

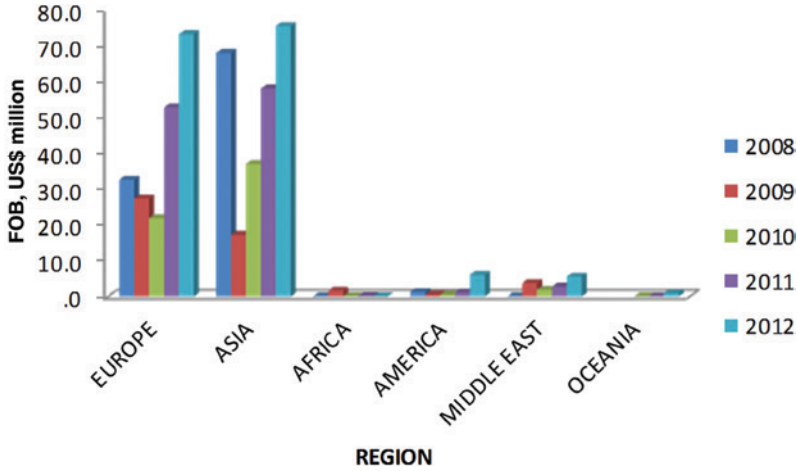
Year	Exports (free on board), US\$ million	Imports (cost, insurance and freight), US\$ million	Annual increase in exports	Annual increase in imports
2008	104.9	1,151.8		
2009	63.6	802.1	-39%	-30%
2010	61.6	909.0	-3%	13%
2011	114.8	1,328.5	86%	46%
2012	161.0	1,548.9	40%	17%

Domestic exports, which almost entirely comprise fish exports (97 per cent), registered a favourable growth of 12 per cent during 2012. The value of domestic exports rose from US\$114.4 million in 2011 to US\$161.6 million in 2012. The composition of fish exports was dominated by the fresh, chilled or frozen tuna category, which accounted for 82 per cent of the total value of fish.

Regarding the composition of imports, petroleum products accounted for the largest share (31 per cent) of total imports in 2012; followed by food items, which accounted for 21 per cent; and wood, metal, cement and aggregates, which accounted for 9 per cent (Figure 20.2). Expenditure on petroleum products rose by 33 per cent compared with 2011, with value adding up to US\$488.3 million in 2012, while imports of food items rose by 7 per cent during the year, in total by US\$318.9 million. The majority of Maldivian exports were traded with Asian countries (50 per cent) followed by Europe (45 per cent). Exports to Thailand accounted for more than half (54 per cent) of the total exports to Asia, while exports to Sri Lanka comprised 14 per cent of total exports to Asian countries. Other main export markets included France, Italy and the UK, which accounted for 36 per cent, 17 per cent and 16 per cent of the total exports to the region respectively (Figure 20.3).

**Figure 20.2 Composition of imports (2011–12)**

**Figure 20.3 Export destinations by region (2008–12)**



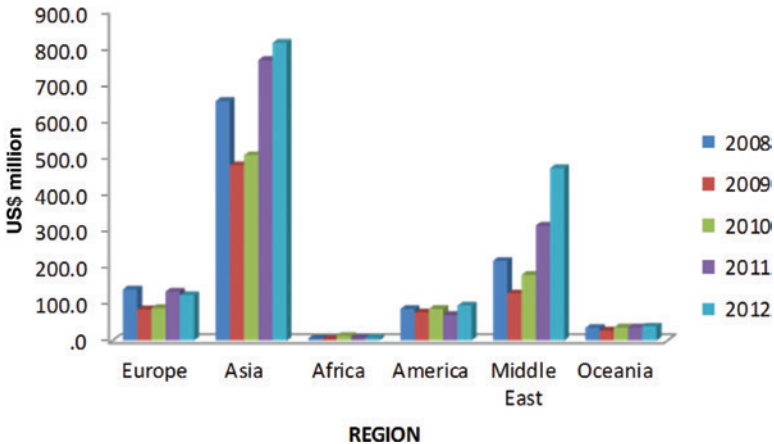
Source: Maldives Customs Service

With respect to the direction of imports, 83 per cent of imports came from Asian countries. As for the major source countries, 37 per cent of imports came from the UAE, followed by Singapore (22 per cent) and India (11 per cent). Meanwhile, imports from the European region accounted for 8 per cent of total imports (Figure 20.4).

### 20.5 Trade with South Asia: Application of SAFTA

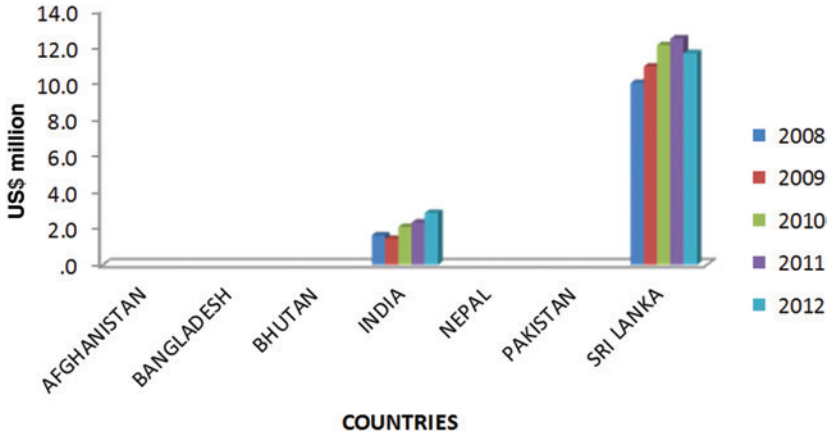
Both in terms of exports and import, Asia is one of the major trading regions. However, out of the total Asian trade, the South Asian share is 20 per cent and 30 per cent for exports and imports, respectively. For exports Sri Lanka is the main destination accounting for 10 per cent of export trade with the world, while the Indian share is around 3 per cent of total export trade of Maldives (Figure 20.5).

**Figure 20.4 Import origins by region (2008–12)**



Source: Maldives Customs Service

**Figure 20.5 Export countries in South Asia (2008–12)**

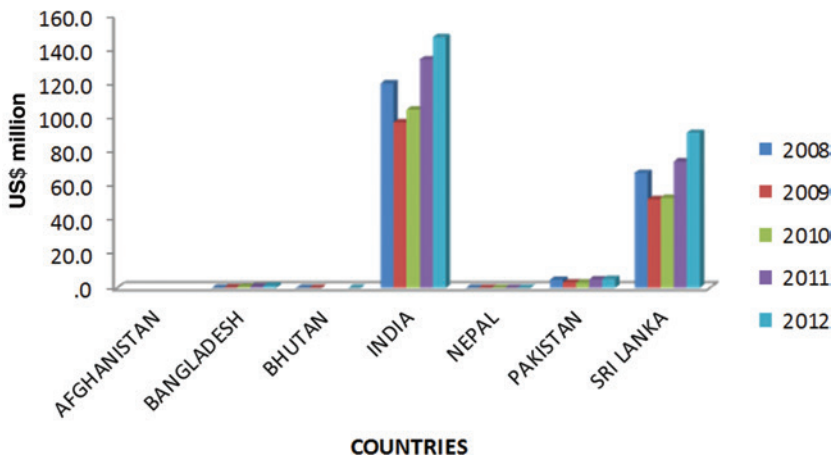


Source: Maldives Customs Service

Similarly in imports, India and Sri Lanka happen to be the main trading partners within South Asia. However, India’s share in imports is higher with 10 per cent followed by Sri Lanka (5 per cent) while other countries in South Asia have abysmal values when compared with trade with the rest of the world (Figure 20.6).

The application of SAFTA is non-existent for Maldives because the main exporting destination, Sri Lanka, has fish and fish products included in the sensitive list under SAFTA. Almost 100 per cent of exports from Maldives to Sri Lanka are fish and fish products. On the other hand, almost 70 per cent of exports to India are scrapped iron, steel and aluminium, which are also negative items for India under SAFTA. However, a large share of trade with Sri Lanka accounting for around 70 per cent on average is done under SAPTA (Table 20.5).

**Figure 20.6 Import countries in South Asia (2008–12)**



Source: Maldives Customs Service

**Table 20.5 Export trade with Sri Lanka (2008–12), (US\$ million)**

DESCRIPTION	2008	2009	2010	2011	2012
Exports to Sri Lanka	10.0	10.9	12.0	12.4	11.6
Value traded under SAFTA					
Value traded under SAPTA	5.3	8.4	9.8	8.4	4.4
Share (%) traded under SAPTA	53%	77%	82%	68%	38%

**Source:** Maldives Customs Service

## 20.6 Barriers to effective application of free trade agreements

### 20.6.1 Sensitive list issues

It is obvious that a reduction in the size of sensitive lists is important to increase the quantum regional trade. Efforts are needed to take those products that are of export interest to the SAARC member states out of the sensitive lists for trade within South Asia.

In the absence of such revisions, the benefits and full potential of the intended trade liberalisation are effectively left unachieved.

### 20.6.2 Information gap

The Asian Development Bank (ADB) has an extensive database and numerous trend analyses on free trade agreements (FTAs) in Asia. According to research conducted by Dr Ganeshan Wignaraja, Principal Economist at ADB, firm size, ownership of firms, age of firms, and awareness of FTA provisions have a significant impact on effective applications.

These findings are very applicable to the trade environment of this region. It was found in this research that the firms that use FTAs are significantly larger than non-users. The trade environment of Maldives mainly consists of a large number of very small firms which at times lack the knowledge and expertise required for effective utilisation.

It was also found that firms that use FTAs are significantly older than non-users. One other important factor that came out in this research was that the extent of the awareness and the knowledge of the provisions in firms made a great impact on the utilisation of benefits.

In Maldives around 70 per cent of traders are not fully aware of the rules, benefits and implications of existing FTAs for Maldives trade.

This also highlights the issue of substantial informal trade in the region, given the large number of very small players in the market.

### 20.6.3 Rules of origin complications

Administrative complications of rules of origin (RoO) create restrictions at times, where dual restrictive criteria are required for both value of 40 per cent content and change of tariff classification to prove origin. Accumulation is allowed, but at

50 per cent regional value content (RVC) provided 20 per cent is domestic value. Lack of co-ordination and reporting mechanisms for certificates of origin (CO) among members, as well as the issuance of CO solely placed with government agencies creates other barriers for effective utilisation.

#### 20.6.4 Slow progress in tariff reduction

Substantial reduction of tariffs has been a trend that the world has been following at a greater speed since the 1950s. South Asia to date has shown very slow momentum in this aspect. However, it has started to show signs in that direction.

Maldives tariff regime saw a tremendous reduction effective from 1 January 2012. Since 1 January 2012, out of 5,558 tariff lines almost 45 per cent now carry zero per cent duty rates whereas, before the revision, close to 50 per cent of lines carried a 25 per cent duty. This gigantic change is in support of the overall fiscal policy reform in Maldives, to transfer the burden of government revenue from import duty to more direct taxes.

#### 20.6.5 Weak connectivity

It is noted that currently Maldives is trading with only India and Sri Lanka at a noteworthy level in the region. Given the demographics and the emerging markets in other countries, Maldives has the potential to enhance its trade with these other countries as well. However, this is impeded by barriers of transportation and infrastructure. Maldives being an island nation, all trade is conducted either by air or sea. Therefore, lack of proper transport connectivity both via sea and air is a prominent barrier when considering access to the markets of these countries. Therefore, development of infrastructure connectivity of the subregion could greatly enhance the potential for Maldives to develop its trade with other countries through transit arrangements.

### 20.7 Way forward: Greater trade facilitation through the elimination of non-tariff barriers

Trade facilitation is now being acknowledged and recognised to be the most crucial and significant aspect for international trade development. Tariffs will no longer be the main obstacle to trade with gradual reductions that will come into force. Yet, there remain significant costs to international trade mainly associated with unnecessarily complex customs and the at-the-border procedures, or with inefficient transit arrangements.

In the 'Doing Business 2012' publication by the World Bank and International Finance Corporation (IFC), South Asia has some of the lowest figures in comparison with other regions, especially in the 'Trading across borders' index. Among the 183 countries compared, the South Asian average is 125. After Eastern Europe and Central Asia, South Asia has the lowest figures.

In SAARC, a sub-group on customs co-operation is in operation under the objective to harmonise and simplify customs procedures and processes to promote and integrate trade in the region. The latest meeting of the sub-group, which was the

**Table 20.6 Trading across borders index**

Region	Regional average
Asia-Pacific Economic Cooperation	43
East Asia and Pacific	77
Eastern Europe and Central Asia	127
European Union	38
Latin America	97
Middle East and North Africa	79
South Asia	125

**Source:** World Bank (2012), 'Doing Business 2012: Doing Business in a More Transparent World'

ninth meeting, was held in Colombo, Sri Lanka, from 20 to 21 June 2013. During all the nine meetings of the sub-group, the themes of discussions and agreements made are similar. They include: building infrastructure including roads and railway networks near the land customs stations (LCSs); smoothing customs clearance procedures at LCSs; working with customs administrations to consider a system of customs facilitation in which export documentation of one member state could be considered by the customs administration in the importing country for the purposes of assessing and clearing the consignment; working towards developing an electronic data exchange system within the region; and the SAARC Secretariat is to develop a regional/subregional project to set up automated customs clearing mechanisms at the designated LCSs.

The focus of the discussions and the agreements made under the SAARC mechanism is in line with the modern trade facilitation and trade integration approaches and concepts practised across the globe. However, the speed of implementation or the levels of output generated through these agreements are abysmal. As such SAARC needs to transform into to a more result-focused entity rather than focussing on concepts and policy formulation.

## 20.8 Conclusion

Regional trade in South Asia has great potential for improvement. FTAs in the region can also be made more effective. Duplication of FTA agreements and exponential growth in the number of agreements is also a trend identified globally. A similar pattern is noticeable in South Asia where numerous bilateral trade agreements are made which effectively duplicate those that already exist at a regional level. Increases in number of FTAs that duplicate the provisions of existing ones complicate implementation and also minimise the effectiveness of such agreements.

Regional trade integration should be deepened, for instance, through revision of SAFTA sensitive lists and simplification of RoO, rather than initiating new agreements in the region. Also greater awareness is required on the merits of regional trade integration among key stakeholders in the private sector. Progress in regional integration will need to be supported by adequate connectivity mechanisms. As has been discussed and agreed at many SAARC summits, intra-regional transport connectivity is indispensable to further integrate trade in South Asia. The initiatives

for building supply capabilities and trade liberalisation in the South Asian region need to be complemented by a new approach towards connectivity and transit facilities for making the sub-continent interconnected and competitive.

Trade facilitation can be greatly improved by adhering to what has been very rightly agreed by the sub-group on customs co-operation, which is also in line with the current trade facilitation negotiations in the WTO. Efforts on trade facilitation should be aligned and integrated with the World Customs Organization (WCO) and South Asia Subregional Economic Cooperation (SASEC) activities that are ongoing in the region to further consolidate and streamline trade facilitation efforts carried out in different countries at an individual or bilateral level.

## Note

1 This chapter has benefitted from research support provided by Ritwika Sen.

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