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Maldives: Sources of Growth

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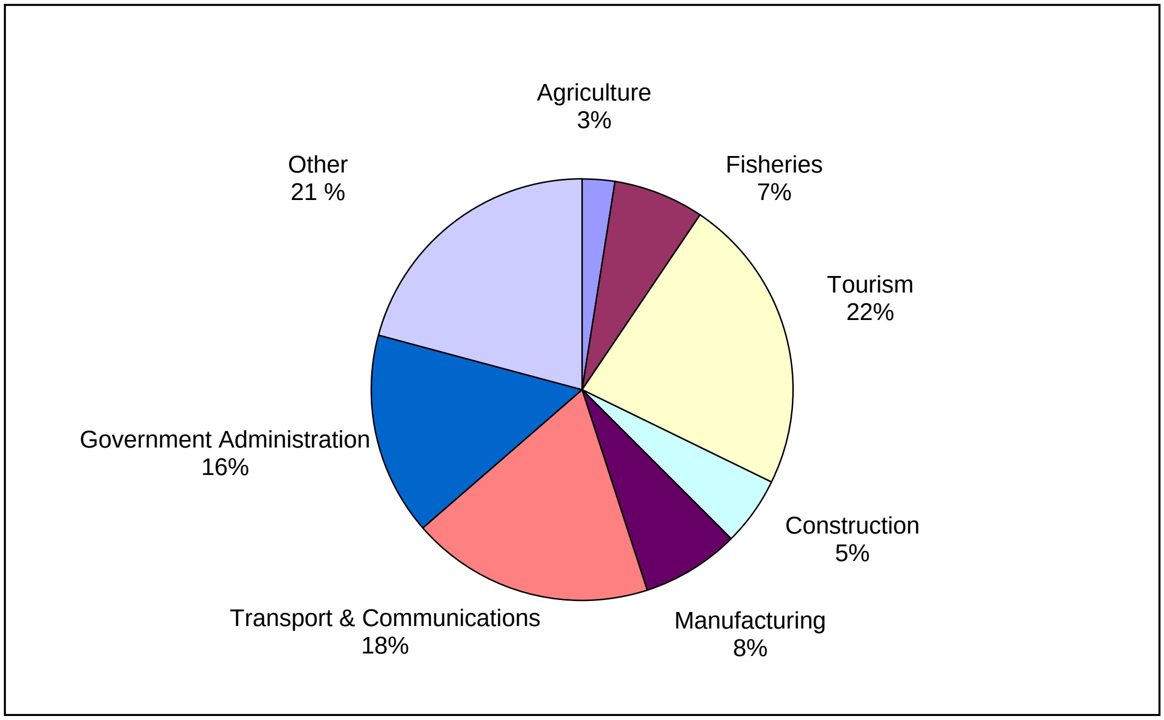
A. Introduction

1. The Maldives economy is dominated by the tertiary sector, which comprises around 79% of GDP on average. The two largest service sectors are tourism and transport and communications, which collectively account for around 40% of GDP (Figure 1). The average contribution of the primary and secondary sectors to GDP is around 10 and 15%, respectively. The overall share of the primary and secondary sectors has increased slightly at the expense of the tertiary sector's share during the current decade.[1]

Figure 1: Composition of Gross Domestic Product, 2005



Source: Maldives Monetary Authority. 2006. *Monthly Statistics* (*August 2006)*. Malé.

2. GDP growth averaged 6.6% per annum between 2000 and 2004 but fell abruptly to 4.5% in 2005 on account of the tsunami which, according to official estimates, destroyed assets valued at nearly 60% of GDP in a matter of a few minutes (Table 1). The two worst hit sectors were tourism and manufacturing, which recorded negative growth rates of 33.1% and 10.0%, respectively. In 2006, GDP growth rebounded to a robust 19.1%, led by a 50% year-to-year increase in visitor arrivals and strong fisheries exports.

[1] GDP figures are estimated with some margin of error due to lack of input-output tables and recent industry surveys. GDP by expenditure category is not estimated in the Maldives, making it difficult to assess performance in factor accumulation and productivity.

Table 1: Key Economic Indicators, 1995–2006

Item	1995–2004 Average	2005	2006 Estimate
GDP Growth	7.4	(4.5)	19.1
Tourism Growth	7.9	(35.9)	52.4
Revenue/GDP	36.0	39.1	44.6
Current Expenditure/GDP	28.0	48.3	56.7
Fiscal Balance/GDP	(3.7)	(10.9)	(7.3)

( ) = negative, GDP = gross domestic product.
Sources: Maldives Monetary Authority, Quarterly Bulletin, various issues.

3. The Maldives is largely a service-oriented economy. Due to the small population and the absence of large land masses, the scope for agricultural and industrial development is limited. Tourism is the largest sector of the economy, accounting for nearly one-third of the GDP and around 90% of service exports. The country has a total tourism capacity of about 16,000 beds of which 82% or some 4,822 bed-nights were utilized in 2006. Western Europe is by far the largest source of tourists to the Maldives, followed by Asia. Tourist arrivals totaled 601,000 in 2006 compared to 365,600 in 1997, which represents an increase of about 66%.

4. The fisheries sector is the country's second largest industry, contributing 5-6% to GDP and around 90% to domestic export earnings, and continues to remain the key source of income and livelihood for the people inhabiting the outer atolls. Fishing employs over 11% of the total population with around 20% of the population depending on fisheries as their primary source of income. Hence, fisheries along with tourism are the two main engines of growth in the Maldives. Fish production tripled over 25 years as a result of vessel mechanization, and the introduction of fish freezing and canning. During the past ten years vessel technology has further evolved. Strong demand for fresh and selected frozen fish products and the increasing availability of air and refrigerated transport have opened-up new markets for Maldivian products, causing another doubling of production since 1995.

5. Pole and line fishing is the sole method used by coastal fishers for landing tuna, the principle export commodity, and net fishing is prohibited by the government. Commercial fishing is by and large a "dolphin-friendly" enterprise, an image which, with proper advertising, could be used as an effective marketing tool. In recent years there have been significant improvements in the volume of fish landings, to which tuna varieties (mainly skipjack and yellow fin tuna) contribute over 90%. The total fish catch was 181,000 metric tons in 2006 as against 101,800 metric tons in 1997, which represents an increase of around 77%.

6. Although the local fishing fleet has declined over the years (from 1,664 vessels in 1996 to 1,103 vessels in 2005 (119 vessels were damaged by the tsunami), the vast bulk of the fishing vessels have doubled in size (from 15 meters to over 30 meters). Greater capacity together with sophisticated technology has contributed significantly to the growth of this industry. The fisheries sector recovered quickly form the effects of the tsunami as most of the larger boats were not damaged and indeed the sector was able to register a significant increase in fish landings in 2005 (183,000 tons compared to 152,000 tons in 2004).

7. The agricultural sector accounts for 2-3% of GDP. The country is self-sufficient in fish, but most of the other food items are imported, primarily from Sri Lanka. There is no livestock industry in the Maldives, hence, the major source of animal protein is fish, which is abundantly

available. The agricultural sector was also affected by the tsunami waves, which inundated the soil and destroyed a range of food crops as well as the natural vegetation. Indeed, there are no trees remaining in some of the worst-affected islands. Consequently, the agricultural sector recorded negative GDP growth in 2005. It is likely that this sector will take some time to recover from the extensive damage caused to land and other capital assets caused by the tsunami.

B. Structural Reform Contributes to a Take-Off in Fisheries Sector Performance

8. Until 2000, the fisheries sector was heavily protected and subsidized by the government with the state-owned Maldives Industrial Fisheries Company (MIFCO) enjoying exclusive commercial rights to purchase fish from local fishermen for processing and export. However, prominence was given in the 6NDP (2001-05) to the potential role of the private sector in the development and modernization of the fisheries industry. In response, the Government partially liberalized the processing and export activities of the fisheries sector in 2000. The country was divided into four zones, with private parties being accorded a license to operate in two of the zones, while MIFCO operates in the other two.

9. Initially, Zones 1 and 3 were licensed exclusively for the private parties; however, under new regulations introduced in 2005, operators in the South (Zones 3 and 4–the regions with the highest fish catch) are allowed to purchase/process fish from each other's Zones whilst operators in the North (Zones 1 and 2) are also permitted to operate in the same manner. It is anticipated that these new arrangements will make the industry more flexible and competitive with fisherman being able to sell their catch at more favorable prices. Evidence indicates that partial liberalization of the sector has led to improved competitiveness in fish processing and exports with local fishermen receiving better prices than in the past. On the production side, fish collection by private operators has grown from 1% of the national catch in 2002 to over 16% in 2005 (29,800 metric tons). Exports by private operators consist almost entirely of frozen tuna. During 2003–2005, export earnings of private operators increased from $4.7 million to $12.8 million, due to a strengthening of the export price of fresh/frozen skipjack in 2005.

10. Though MIFCO continues to dominate processing and export activities, private processing companies are broadening their operations by investing in collector vessels, cold storage, freezing facilities, as well as in development of new, shore-based facilities such as ice plants and processing plans, Diversification of the product mix through processing of high quality fresh tuna for the export market is also underway. Thus, opening up of the fisheries industry to private sector participation in processing and exports has lead to considerable modernization of the industry through technology transfer in collection, processing and product development. The ongoing liberalization program, therefore, is helping the industry move up the value chain—a development the government will continue to foster and promote in order to enhance its international competitiveness.

C. Binding Constraints to Inclusive Growth

11. Binding constraints to growth differ in the Maldives depending primarily on location, sector, gender, and access to finance and skills. Overall, access to markets, the quality of the private sector enabling environment, and access to economic infrastructure (electricity and other services) are the key determinants of both the level and productivity of private sector investment. But the factors that determine both the availability and the sustainability of these economic enablers are overwhelmingly institutional in nature. It is here that the Maldives suffers from severe capacity constraints and governance weaknesses that must be overcome, particularly if the Maldives is to make the growth process more inclusive by widening its scope to include

those lower income groups in the outer islands, the newly educated youth, and larger groups of women. In addition to weaknesses in economic management weaknesses, the Maldives faces many of the growth constraints which are typical to small island economies.[2] These include remoteness, vulnerability to external shocks, a narrow economic base, restricted comparative advantages, small labor markets, a high degree of openness to international trade, and capacity constraints both in the public and private sectors.

12. **Growth options are limited in the Maldives.** The small and dispersed population presents serious challenges for transportation and market access, and makes it difficult for the Maldives to develop economic activities other than tourism and fisheries. Tourism is the mainstay of the economy, impacting many other sectors such as construction, wholesale and retail trade, transportation and communication, but is subject to external shocks and environmental challenges. Continuing to rely heavily on these two sectors to drive the economy, however, may be a risky strategy in respect of the country's future development, given the capricious and unstable nature of sun and sand tourism and the global fisheries market. On the one hand, the country needs to move up the value chain in order to ensure that these two sectors remain globally competitive; on the other, it needs to widen the economic base and enhance employment prospects through diversification into new growth sectors. The Maldives has a number of advantages that can be built on, including a strong track record in tourism and fisheries, a relatively open labor market, political stability, and up to recently, generally prudent economic management, even though some long standing structural issues have remained unaddressed. Effective management of the economy will require building on past strengths, addressing long standing structural issues and tapping emerging opportunities while rising to meet the challenges and threats to progress.

13. With the Maldives having attained MIC status, it must also face the reality that by 2011, it will cease to enjoy preferential market access with adverse consequences for exports. Due to the major economic setbacks caused by the tsunami, the developed nations will assist the Maldives in its efforts to recover from this crisis by continuing to provide preferential treatment for exports as well as foreign aid till 2011. The country should, therefore, make maximum use of this "grace' period to strengthen its economy.

14. **Growth Forecasts.** GDP growth is targeted at 7% per annum during the medium-term (2006–2010) in the 7NDP. GDP growth, which went into decline on account of the tsunami, is estimated by the MOFT to have increased to 19.1% in 2006 due to the massive infrastructure rehabilitation and reconstruction effort mounted by the government as well as the recovery of the tourist sector from a severe distress situation in 2005. After this initial bounce back, the growth rate is expected to decline to 8.2% in 2007 and to then stabilize at around 6.5% by 2010. These medium-term projections, however, are based on the critical assumption that the government will introduce prudent measures to reduce the fiscal deficit from 7.2% of GDP in 2006 to zero by 2010. If a better budget balance does not materialize, inflation will rise, and public sector borrowing could crowd-out the private sector from the shallow domestic financial market. Fiscal consolidation, therefore, is critical to sustaining high rates of economic growth in the medium to long-run.

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[2] Commonwealth Secretariat/World Bank Joint Taskforce on Small Economies. 2000. *Small States Meeting Challenges in the Global Economy*.

D. Fostering Sustainable and Inclusive Growth

15. The Government's Vision 2020 envisions the Maldives embarking on a rapid and sustainable growth path and becoming a prosperous nation within 20 years, with the majority of people enjoying a high standard of living. The 7NDP consists of four building blocks or road maps to foster inclusive and sustainable growth, namely (i) economic development; (ii) infrastructure development and environment management; (iii) social development; and (iv) good governance. In all sectors, the Government has emphasized the need to actively promote employment of women and school leavers.

1. Tourism

16. In the Government's plans, tourism is poised for a rapid expansion. Opening of 10 new domestic airports, and greater utilization of the new international airport in Gan, signals Government's intention to spread the benefits of tourism development to new regions of the country, to involve the private sector in developing supportive economic infrastructure, and most importantly, to include local communities residing nearby the new airports-cum-resorts in resort-based employment. The Government's short-term objectives are to rapidly expand capacity in the tourism sector, while strengthening linkages between tourism and outer atoll development.

17. A major expansion of tourism capacity over the next decade is envisaged, with much of the growth in visitor arrivals targeted for the Asia source markets. In addition to opening the Gan airport for international flights, the Government has announced that 10 domestic airports are to be developed, and these are to be managed by the private sector in exchange for rights to develop a resort or establish a hotel on the same island. The Government has also announced that new leases will be provided for 48 new resorts by 2009, which would amount to a 50% increase in bed capacity for the tourism industry as a whole, and that these will be located closer to the islands where the local population resides. While the time-frame for this expansion may be overly ambitious, particularly in light of construction capacity constraints, it signals the Government's intention to substantially boost tourism's role in the economy.

18. Government plans to strengthen linkages between tourism development and local communities in several ways. By locating new resorts near already populated islands, the Government hopes to encourage more Maldivians to commute, on a daily or weekly basis, to work on the resorts. The Government also hopes to establish linkages with food, fisheries and agricultural sectors in selected "showcase" islands, which could also serve as key tourists' attractions by offering a range of traditional Maldivian dishes prepared by expert chefs using mainly locally harvested fisheries and agricultural products. Government, and its development partners, are also supporting the creation of a number of handicraft production centers, and are establishing linkages between these and selected resorts. The Government continues to emphasize vocational and foreign language training for secondary school students, in an effort to improve the qualifications of the Maldivian youth for tourism-related employment.

2. Fisheries

19. The fisheries sector remains dependent on a few fish species. In particular, skipjack tuna constitutes some four-fifths of total production. Global markets for some skipjack products have proven particularly volatile, reflecting substantial variations in supply and demand. Other fish resources, such as species inhabiting coral reefs, cannot sustain heavy exploitation. Past efforts to exploit these resources have been excessive and must be controlled and reduced. In recent years, a combination of rapid expansion of the fishing fleet, increasing vessel sizes, growing

demand for ice and port infrastructure, and private sector investment in processing have created major imbalances between catching capacity, infrastructure availability and processing requirements.

20. In the fisheries area, the Government has defined a five-pronged approach to support the sustainable development of the sector. First, diversification of the sector is to be supported to reduce vulnerability to overseas market volatility. This is to be accomplished through efforts to promote non-skipjack fisheries, both in terms of public awareness, and through provision of technology and outreach services to diversify the catch. Second, the Government will continue to encourage skipjack tuna development through measures such as developing supportive infrastructure, encouraging canning and processing of the catch, and promoting use of skipjack waste materials. Third, the Government will support the development of a mariculture industry, by accelerating efforts to build the research and technology base, to foster commercialization of promising technologies, and to provide extension and outreach for mariculture development. Fourth, the Government will promote an orderly restructuring of the sector, by preparing a 15 year master plan, and by establishing a regulatory agency to oversee and facilitate private sector involvement in the sector. Fifth, the Government will develop the country's human and institutional capacity to support the sector's development, particularly in the area of vocational skills for mariculture development, and in terms of the Ministry of Fisheries, Agriculture and Marine Resources' technical, regulatory and policy making capacities.

3. Logistics Services

21. One of the new areas for diversifying the growth base is to establish a reliable inter-region and intra-region transportation system to support the development of core economic clusters in the Maldives and to extend the role of the commercial port in the North to complement other ports in South Asia for cargo transshipment in the long-term. The establishment of linkages among major ports, sub-ports and airports within the Maldives is critical for supporting the expansion of the traditional sectors (i.e. fisheries, tourism and agriculture). In the short-term, the main focus is to establish the logistic linkages between Malé and key "hub" ports in the Northern and Southern Growth regions, as well as an intra-island transport network within these Growth Regions. The government has already established a hub port in the South (Hithadoo) for developing these linkages. The port can play a key role in facilitating the collection and distribution of marine resources, agricultural products, handicrafts and other goods. Infrastructure facilities such as cold storage, chilling and handling could also be established for supporting development of the fisheries and agricultural sectors. In the medium-term, developing the airport in Gan and establishing a network of 14 domestic airports in total (10 new and 4 existing) will further enhance the whole distribution network.

4. Income-Generating Activities in Remote Atolls

22. Micro, small and medium-scale income-generating activities play a vital role in improving and sustaining incomes for about 70% of the Maldivian population. Since the early 1990s, there have been 3 major donor-funded initiatives undertaken by the government for promoting income-generating activities (IGA) in the atolls. All have embraced poverty reduction as the overarching goal and job creation as the central strategy for achieving it. These 3 specific initiatives—the first two supported by the International Fund for Agricultural Development (IFAD) and the third, by the UNDP which has been extended to 2007 comprise the following:

(i) The Atolls Credit and Development Banking Project,1990–1996 (ACDP);
(ii) The Southern Atolls Development Project, 1996–2002 (SADP); and
(iii) The Atoll Development Project for Sustainable Livelihoods, 1996 to present (ADP).

23. A study of IGAs in 147 islands was undertaken by the United Nations Economic and Social Commission for Asia and the Pacific and UNDP for the Ministry of Atolls Development in 2004. This was a comprehensive attempt at understanding the opportunities available for island communities to engage in income generation activities. It highlights the continuing role of fisheries and agriculture as the primary occupations whilst noting the important contribution to family incomes made by a wide range of other non-traditional IGAs. The survey results indicate that micro, small and medium enterprises (MSMEs) have a vital role to play in generating income and employment, particularly on the more remote islands. Key findings of the study are: (i) that MSMEs are the main source of income in the islands surveyed; (ii) that they are full-time operations; (iii) that the owner-managers know their business well, except for some weaknesses in such areas as bookkeeping, costing, and financial analysis; and (iv) that it is factors such as remoteness from markets and a dearth of technical skills, rather than access to capital, that is the binding constraint to expanding IGA opportunities. Interestingly, the study found that the most successful and sustainable MSME's developed on their own initiative, rather than through support of any particular government or donor-assisted project. The findings of the study also suggest that, although agriculture and marine related activities continue to remain key sources of income for the island communities, a gradual shift in occupational distribution towards service-oriented jobs in the tertiary sector seems to be occurring, even in the more remote atolls. Those MSMEs with the highest rates of return on investment are tailoring, spice processing, jewelry, computer services, ironworks and hydroponics. Hence, these could be considered as promising fields in which the growth process could both be diversified, as well as broadened geographically.