



Maldives

The Maldives consolidated its growth during 1997, and growth is projected to continue at 6 percent per year in 1998 and 1999. The economy continues to depend heavily on fishing and tourism, and the authorities should ensure that future development does not damage the environment, on which these industries depend. The policy priorities for the future are to liberalize and modernize the financial sector; to reduce the government's role in the commercial sector; and to develop human resources, so that the economy can become less dependent on foreign workers.

RECENT TRENDS AND PROSPECTS

Real GDP growth was approximately 6 percent in 1997. Tourist arrivals in the first half of the year amounted to almost 177,000, 6 percent higher than during the corresponding period of 1996. This was associated with an increase of nearly 2 percent in total hotel bed capacity and an increase in the occupancy rate from 75 to 78 percent. Fisheries' output declined in volume in 1997, but the total value of production remained relatively stable because of a significant increase in the price of fresh fish. Construction activity was brisk as work started on several new tourist resorts scheduled to open in 1998 and 1999, and continued on some key economic and social infrastructure (ports, schools, hospitals) in the atolls outside Malé. Transportation and communications also grew rapidly, while retail and wholesale trade remained relatively stable.

Inflation was about 8 percent in 1997, somewhat higher than the 6.2 percent registered in 1996. Higher fish prices caused by the low catch and the increased demand from the brisk construction activity were the main reasons behind the rise. Monetary growth was about 20 percent in 1997, compared with 24 percent in 1996. Credit expan-

sion was a modest 3 percent, reflecting a decline in net credit to the government. However, credit to the private sector and public entities increased. Foreign workers increased by 17 percent in response to stronger demand for labor in the face of a relatively stable domestic labor supply. Foreign labor, both skilled and unskilled, now accounts for nearly a quarter of the labor force. Consequently, job opportunities for nationals are likely to be plentiful in the future if the present growth momentum continues and domestic workers can upgrade their skills.

The Maldives continued to pursue a prudent fiscal policy in 1997. The modest deficit was financed through concessional foreign loans, eliminating, for the second consecutive year, the need to resort to monetary financing from the Monetary Authority. While more than 90 percent of government revenues are still derived from import duties and tourism tax receipts, some diversification is expected in 1998 with the introduction of a rental income and business turnover tax.

In the first half of 1997 the trade deficit deteriorated to \$86 million, compared with \$75.8 million during the same period of 1996. The increase in fish prices partly offset the reduced catch, while tourism receipts compensated for the growth in

imports. As a result, the overall balance-of-payments position improved. At the end of 1997 international reserves stood at about four months worth of imports, despite the repayment of a balance-of-payments support loan contracted earlier.

The outlook for 1998 and 1999 remains bright, with growth rates projected at 6 percent. As Asian tourists account for approximately 20 percent of arrivals in the Maldives, the recent currency crisis in East Asia may lead to a modest decline in tourism. In addition, the increase in resort construction in 1998 and 1999 may result in some inflationary pressures and in a further increase in the foreign labor force.

CRITICAL ISSUES IN SHORT-TERM ECONOMIC MANAGEMENT

The macroeconomic stabilization measures implemented in 1994 succeeded in eliminating the excessive budget deficits and high inflation that characterized the early 1990s. They have, however, left a legacy of high domestic debt contracted by the Treasury with the Monetary Authority. Macroeconomic policies should continue to be cautious to facilitate noninflationary growth. Somewhat greater flexibility than in the recent past may be advisable in the management of the exchange rate, especially in light of the substantial depreciation of the Southeast Asian currencies. There is still a need for structural reform in the financial sector. The scope for liberalizing and modernizing the financial sector by shifting from direct to indirect instruments of monetary control is considerable. A prerequisite for this course of action would be gradually to retire outstanding government debt, followed by securitization of the balance. A gradual reduction in the role of public enterprises is also needed, as is the improvement of the legal and regulatory

framework (particularly commercial and bankruptcy laws) in order to foster private sector development.

POLICY AND DEVELOPMENT ISSUES

The Malé atoll suffers from both population and environmental pressures. To relieve these, the government will have to ensure that growth and infrastructure development are more widely distributed among the atolls. The government has started to respond to these issues and has identified growth centers in the north and south where investment in infrastructure is being concentrated. However, the government will have to attempt to maintain a balance between developing the economy and preserving the environment to avoid undermining the sustainability of tourism and fisheries, the two pillars of the economy.

The Maldives will also need to respond to two main challenges in relation to human resource development. First, the successful implementation of a number of social policies has resulted in such achievements as the virtual eradication of malaria, nearly universal literacy rates, and greatly improved life expectancy. However, the population growth rate, at nearly 3 percent per year, is still one of the highest in the world, and if this is sustained it will lead to considerable pressures on the country's natural resources, including land. Thus the government needs to adopt more effective policies to reduce population growth. The second challenge is to continue the expansion of educational opportunities at all levels, especially for girls and women. Those who acquire secondary and postsecondary education will be able to compete for relatively high-paying jobs currently occupied by foreign workers. This is necessary if the country is to sustain its current level of growth and dynamism.