Maldives

For a small, comparatively isolated and fragmented archipelagic economy, the Maldives has had an impressive economic performance over the past decade. Although the rate of growth has slipped recently, the overall prospects for the economy remain bright. There remains ample scope for the development of tourism and fisheries, which have been the mainstays of the economy's dynamism. However, macroeconomic imbalances have now emerged and correcting these is the immediate task ahead. Over the longer term, greater care must also be taken to protect the Maldives' fragile environment, which is essential if the country's economic development is to be sustained.

Recent Trends and Prospects

Real GDP growth in 1995 slowed to 5.8 percent from 6.6 percent in 1994, reflecting the structural adjustment measures now being pursued by the Government, as well as the comparatively sluggish performance of the fisheries sector. Poor fish catches in the early part of 1995, combined with large stock levels in the frozen fish export market, resulted in depressed fisheries activity in 1995. In addition, the construction and services sectors were adversely affected by the Government's budgetary restraint in 1995. However, while growth was slower than in 1994, tourism and related activities nevertheless remained brisk. Tourism's buoyancy was aided by the recovery of incomes in European economies, and the establishment of additional air travel connections and new tourist sources.

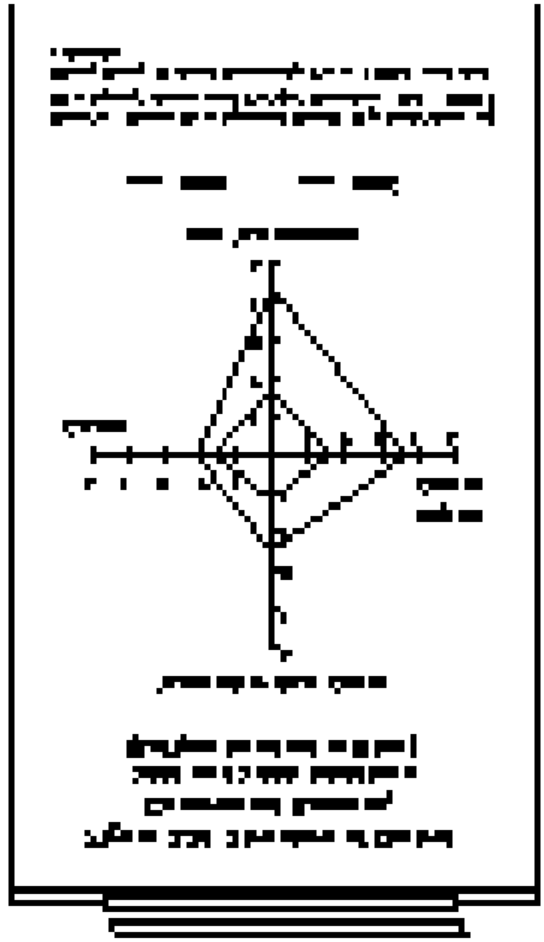
The overall fiscal deficit in 1995 is estimated to have increased to 10.9 percent of GDP from 6.6 percent in 1994 mainly because some of the factors that boosted revenue in 1994 were not repeated. Although measures designed to help fiscal consolidation continued in 1995, government revenue remains narrowly based (Figure 2.20). Some 90 percent of tax revenues are derived from import duties and tourism-related taxes; both just kept pace with the growth of nominal GDP in 1995.

Government recurrent expenditure in 1995 is estimated to have declined as a percentage of GDP compared with what it was in 1994. Both wages and salaries and other recurrent expenditure were trimmed further as part of a broader program of fiscal and monetary consolidation.

In 1995, consumer price inflation was estimated to be 7.7 percent, down from the double-digit levels of inflation experienced since 1991. Inflation in 1995 was contained by a slowdown in monetary growth, achieved primarily through a reduction in borrowing from the monetary authority by government and state enterprises. Total domestic credit is estimated to have grown by only 6.1 percent in 1995, down from over 13 percent in the previous year. The rufiyaa (Rf) exchange rate was pegged at around Rf11.77 to the US dollar throughout 1995, little changed from 1994. The stability of the rufiyaa also helped contain imported inflation in 1995. There is, however, evidence that the rufiyaa is overvalued, and that this is penalizing the development of some export sectors.

Fish remain the principal export commodity of the Maldives. In 1995, domestic exports of fish of all forms remained at around $45 million, somewhat lower than in 1994. The only other substantive export commodity produced in the Maldives is garments, which constitute about 10 percent of total exports, though with considerable year-to-year variation. Overall import demand grew strongly in 1995, rising to $228 million from $195 million in 1994. The conjunction of stagnant exports and growing import demand caused the trade deficit to widen. On the services account, an increase in net revenues was experienced, primarily as a result of buoyant tourism receipts. However, the improvement in services was insufficient to offset the trade deficit, and the current account declined further. It is estimated that in 1995 the current account deficit was $33.8 million, almost twice its 1994 level and equivalent to 11.2 percent of GDP. Official medium- and long-term capital flows continue to help finance the current account deficit. Disbursements of official capital more than doubled in 1995 and, with steady private sector capital inflows, led to an overall balance-of-payments surplus of $8.4 million.

In 1996, it is likely that GDP growth will be around 6 percent. Activity in the fisheries sector is likely to improve and the tourism sector will remain strong. A successful structural reform program should lead to private capital gradually replacing official capital flows as the principal source of external finance. The liberalization of export policies is likely to encourage much larger private investment in the fisheries sector and trigger a corresponding expansion in export activity. Completion of resorts in the Ari atoll is also likely to give a boost to foreign exchange revenues. Despite some depreciation of the rufiyaa, inflation may be expected to moderate gradually over the next two years and fall to under 5 percent by 1997. The fiscal deficit should also contract further in the coming two years, falling to around 3 percent of GDP by 1997. The external account is, however, unlikely to show quick improvement and the current account deficit may remain at over 10 percent of GDP in both 1996 and 1997.



Policy and Development Issues

Despite fast economic growth, macroeconomic balances in the Maldives are seriously out of alignment. This has led to escalating debt, a high rate of inflation, an overvalued nominal exchange rate, and weak levels of foreign exchange reserves. The public sector still plays a prominent role in domestic economic activity and this has stifled private sector initiatives. Making the transition from a highly regulated economy to one in which markets and the private sector are allowed freer rein is the major development challenge ahead. Reforming the banking and financial sector, broadening the tax base, and curtailing public expenditure, especially recurrent expenditure, are the key requirements for meeting that challenge. To the extent that such reforms can be successfully implemented, the Government will have a greater capacity to make further progress in the provision of needed social services. The Government must also turn its attention to the high rate of population growth. The high dependency ratio that such growth has engendered has placed a heavy burden on the economy, and is one reason why the Maldives has had difficulty in raising the level of domestic saving.