Maldives

The Maldives is attempting to push through major fiscal reform, but government efforts to implement deficit-reduction measures have been impeded by political sensitivities. The passage of new tax bills in 2010, although it took longer than scheduled, will generate revenue gains in the near term. Nevertheless, the government will need to formulate a strong medium-term adjustment strategy in order to get its economic program supported by international financial institutions.

Economic performance

The government struggled to implement fiscal reforms in 2010. Since the president's party is in the minority in the *Majlis*, it faced difficulties in pushing reforms through Parliament. The agenda included a Tourist General Service Tax (T-GST) and Business Profit Tax (BPT). As the political situation worsened from midyear—the cabinet resigned en masse—progress in fiscal reforms has slowed, especially in the area of expenditure reduction.

The T-GST was, however, passed in August, becoming effective in January this year; the BPT was passed in December and takes effect in July this year. The fiscal gap would have been larger had it not been for a temporary cut in civil servants' wages. An improvement in revenue on the back of a rebound in tourist arrivals also helped to narrow the budget deficit for the year.

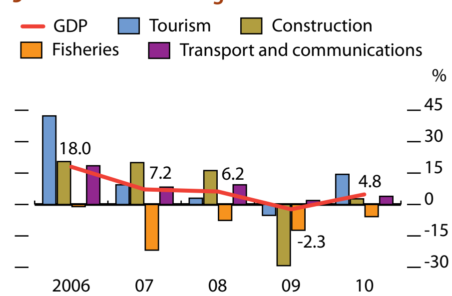
Against this backdrop, GDP growth recovered to 4.8% in 2010 after contracting by 2.3% in 2009 (Figure 3.18.1). A key driver was a better than expected upswing in tourism, which accounts for almost a third of GDP. Tourist arrivals registered a rebound of 20.7% in 2010. An influx of visitors from the People's Republic of China, the Republic of Korea, India, and other Asian countries outpaced a slower renaissance in European arrivals, a market usually accounting for around two-thirds of total visitors (Figure 3.18.2). As tourism gathered momentum, its linked sectors—transport and communications, and wholesale and retail—saw growth of 3.9% and 4.8%.

Fisheries have been performing poorly since 2006, reflecting a decline in the fish catch, and, contracting by 5.8%, were a drag on growth. Despite constituting only 3.2% of GDP, the industry is a major source of employment in many of the outer atolls.

Due to the country's import-dependent nature, rising international prices for fuel and food exerted upward pressure on domestic prices in the second half of 2010 (Figure 3.18.3). Inflation was 5.1% in December 2010, 1.1 percentage points higher than a year earlier.

While credit to the private sector continued to fall (by 2.4% year on

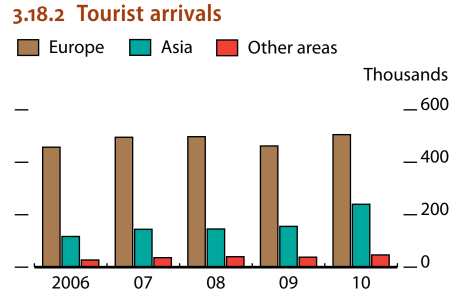
3.18.1 Selected GDP growth indicators



Source: Maldives Monetary Authority. 2011. *Monthly Statistics*. February. http://www.mma.gov.mv

Click here for figure data

3.18.2 Tourist arrivals



Source: Maldives Monetary Authority. 2011. *Monthly Statistics*. February. http://www.mma.gov.mv

Click here for figure data

This chapter was written by Eleanor Bacani and Tadateru Hayashi of the South Asia Department, ADB, Manila.

year in December 2010), Treasury bills held by banks rose by 28.4% as part of a 32.9% expansion in net credit to the government. Broad money increased by 16.5%. The interest rate on T-bills declined in the first half of 2010, but partly came back during the second (Figure 3.18.4).

The fiscal deficit is estimated to have narrowed to 16.4% of GDP in 2010 from 30.9% in 2009 (Figure 3.18.5). Although total revenue (excluding grants) is expected to have picked up by 14.6%, reflecting a rebound in tourism-related earnings and profits received from the airport concession, it was 11% below the original projection after the T-GST and BPT did not materialize in time to boost 2010 revenue as planned. Expenditure dropped by 10.2% as the government put through temporary fiscal austerity measures, such as wage cuts for public servants.

The Rf12.37 billion ($962.6 million) budget for 2011, passed in December 2010, sets only a slight reduction in the deficit to 15.3% of the GDP. Upfront payments by resort islands for lease extensions, from 25 to 50 years, as well as new tax measures, will increase fiscal revenue. But there is so far no clear road map for long-term expenditure saving.

On the external front, the current account deficit is estimated to have slightly narrowed to 31.3% of GDP in 2010 from 31.8% in 2009, as the gain in tourism receipts was outweighed by higher imports (Figure 3.18.6). While reserves declined through most of the year they spiked in November, on a $74 million upfront payment by the airport concession. This transaction helped to push the overall balance of payments into surplus, lifting gross international reserves by about one-third to $349.9 million in 2010, yielding 3.3 months of import cover. The Maldives Monetary Authority continued its currency peg to US dollar at a rate of Rf12.8, though foreign exchange shortages and a parallel market premium persisted during the year.

Economic prospects

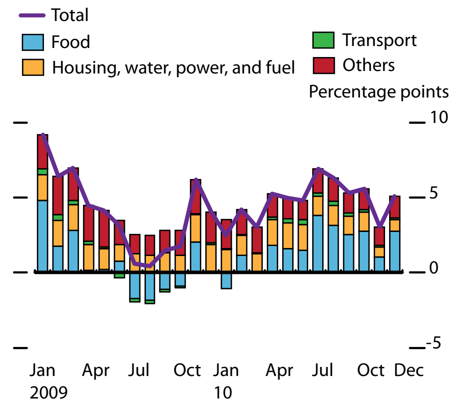
Tourism is likely to lead economic growth. Tourist arrivals from Europe should continue recovering, and the number of Asian tourists will continue growing, as their disposable incomes improve.

The 2011 budget plans about a 25% increase in total expenditure, and the medium-term fiscal framework projects the same level of expenditure in 2012, a marked turnaround from the near 12% decline a year earlier. At nearly three-fifths of GDP if fully carried out, these plans represent a marked expansion in domestic demand. On the basis that planned expenditure is scaled down and tourism makes further gains, GDP is expected to grow by 5.0% in each of the next 2 years.

On the assumption that the global oil and food prices rise substantially in 2011 and moderate in 2012, and budget expenditure pressures on domestic inflation. It is projected that inflation will rise to 8.0% or more in 2011, and moderate to 7.0% in 2012.

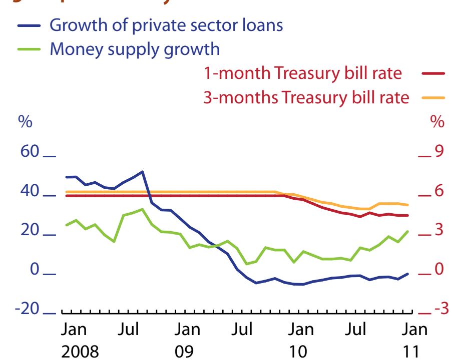
Steady economic growth, primarily due to the tourism rebound, and higher international commodity prices will buttress merchandise import growth. Assuming that the currency peg to the US dollar continues, growth in imports will continue to outpace tourism receipts, the current account deficit is expected to widen to 35% of GDP in 2011 and will remain at this level in 2012.

3.18.3 Contributions to inflation



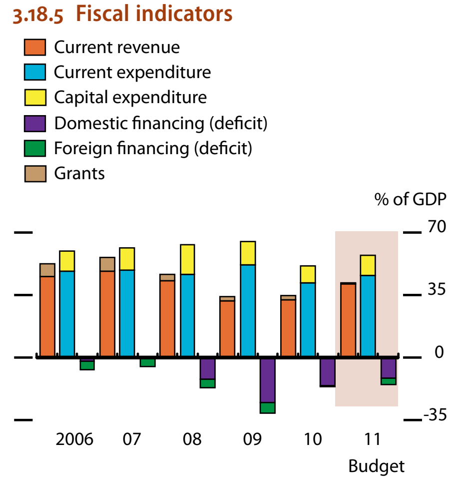
Source: Maldives Monetary Authority. 2011. *Monthly Statistics*. February. http://www.mma.gov.mv
Click here for figure data

3.18.4 Monetary indicators



Source: Maldives Monetary Authority. 2011. *Monthly Statistics*. February. http://www.mma.gov.mv
Click here for figure data

3.18.5 Fiscal indicators



Source: Maldives Monetary Authority. 2011. *Monthly Statistics*. February. http://www.mma.gov.mv
Click here for figure data

Development challenges

Persistent fiscal and external imbalances have rendered the country vulnerable to external shocks. International financial institutions have therefore been supporting the government's reform initiatives, including a stand-by arrangement with the IMF. The lack of a political consensus has prevented agreement on the next steps in the country's medium-term adjustment strategy, though these are expected to be resolved in due course.

Reducing income disparities between Malé and the atolls is important. Private sector development, especially promotion of micro-, small- and medium-sized enterprises outside Malé, is therefore critical. Such promotion is also an important mandate of the government through its decentralization policy.

Weak institutions and human resources are major constraints. Public sector institutions face capacity constraints, since pay in the civil service lags far behind the private sector, and second jobs among public employees are common. While heavy reliance on expatriate labor has allowed the Maldives to grow strongly for many years, the downside is that existing institutions do not have adequate capabilities.

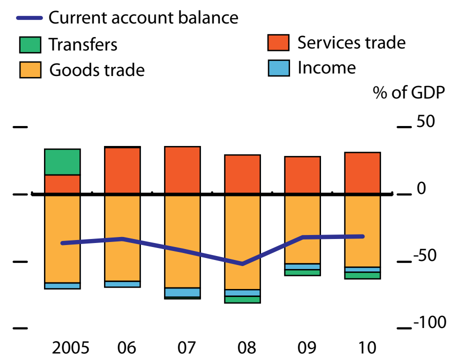
As one of the world's most vulnerable nations to sea-level rise, the government has announced plans to become the first carbon-neutral country in the world within a decade. It is preparing an investment plan along these lines, and hopes that it will not only serve as a blueprint for other nations but also draw world attention to climate change.

3.18.1 Selected economic indicators (%)

	2011	2012
GDP growth	5.0	5.0
Inflation	8.0	7.0
Current account balance (share of GDP)	-35.0	-35.0

Source: ADB estimates.

3.18.6 Current account indicators



Source: Maldives Monetary Authority. 2011. *Monthly Statistics*. February. http://www.mma.gov.mv

Click here for figure data