Maldives

A sharp slowdown in tourist arrivals dragged down economic growth. Fiscal and external imbalances intensified. The outlook is for a modest recovery on limited improvement in tourism, the economic mainstay. Inadequate political backing for implementing decisive fiscal measures in recent years and the difficulty of achieving economic diversification and generating employment threaten to restrain rapid and inclusive growth.

Economic performance

GDP growth in 2012 slowed to 3.4% from 7.0% in 2011 as tourism and related activities, which directly provide 28% of GDP, sharply decelerated (Figure 3.18.1). Other related tertiary sectors such as wholesale and retail trade, transportation, and communications are also affected. Growth in tourist arrivals slumped to 2.9% in 2012 from 17.6% in 2011, as recession in Europe and the slowdown in the global economy combined with uncertainty created by domestic events to stymie the industry (Figure 3.18.2). The continued influx of visitors from the People’s Republic of China, up by 15.6%, was the bright spot in the market, while growth in arrivals from other Asian countries slowed to 1.5%. Tourist arrivals from Europe fell by 3.7%, slashing the European market share to 54% from over 70% only 5 years earlier, as the Asian share nearly doubled to 38%. Tourist spending edged up a miniscule 0.3% in 2012, stalling from 9% growth a year earlier.

Strong growth in important areas of the economy—manufacturing (4.7% of GDP) up by 17.5%, construction (9.3%) up by 16.1%, and fisheries (the main employer in the atolls) up by 9.7%—was insufficient to offset the headwinds from tourism and related industries.

The sudden resignation of President Mohamed Nasheed on 7 February 2012 under disputed circumstances set off major political unrest. Since then his Maldives Democratic Party has organized protest rallies and blocked the parliament for several weeks. A presidential election is scheduled for September 2013, but it is unclear if the former president will be qualified to run. If not, political unrest is expected to intensify.

Inflation remained high despite falling global commodity and food prices. Inflation eased to an average of 10.9% in 2012 (Figure 3.18.3). Upward pressures on prices included the introduction of a general goods service tax in the first quarter of 2011 and pressures from limited foreign exchange availability and the exchange rate. The rufiyaa, which since April 2011 has been allowed to move within a band 20% above and below Rf12.8 to $1, has remained near the upper bound.
The central bank maintained the reverse–repo rate at 7% to curb inflation despite the economic slowdown. Net credit to the government rose by 12.9% in 2012, much more slowly than the 27% increase in 2011, as the government relied heavily on foreign borrowing to finance its widening deficit. Credit to the private sector fell by 9.1%, with about half of the falloff affecting the tourism sector, mainly a reduction in loans for working capital and resort renovation. Broad money growth consequently slowed to 5.0% in 2012 from 20% a year earlier.

The budget deficit in 2012 is estimated to have widened substantially to 12.6% of GDP from 7.5% in 2011 (Figure 3.18.4). Government revenue fell by 0.7% despite marked increases in goods and service taxes, both general and for tourists, because import duties dropped by nearly half, owing to the decline in imports for tourism and some duty reductions. Total revenue fell to 28.8% of GDP, a drop of 2.7 percentage points from a year earlier. This accounted for just over half of the 5.1 percentage point increase in the deficit in relation to GDP. Expenditure increased by 2.4 percentage points to 41.4% of GDP, the rise entirely owing to a 15.9% increase in current expenditure to 30.8% of GDP, as there was relatively little increase in capital spending or net lending to public enterprises. The bulk of the deficit was financed through foreign borrowings and grants, with about one-fifth coming from the central bank. Total public external debt was 38.2% of GDP in 2012.

The current account deficit widened to 26.3% of GDP from 21.4% in 2011 (Figure 3.18.5). The deterioration reflected an increase in the trade deficit on weaker exports, stagnation in income from tourism, and higher remittances made by expatriate workers. The trade deficit, at 63.6% of GDP in 2012, illustrates the country’s substantial reliance on imports, especially for the tourist industry. The bulk of the large current account deficit was financed by unrecorded financial inflows and the errors and omissions item in balance-of-payments accounting, indicating weakness in data currently available. The overall balance of payments was in deficit by $37.4 million, equivalent to 1.6% of GDP. Gross official reserves at the end of 2012 were $304.6 million, enough to cover only 2.1 months of projected imports of goods in 2013.

**Economic prospects**

The economy is forecast to recover modestly to grow by 4.3% in 2013 and 5.5% in 2014, as the anticipated gradual global economic recovery boosts tourism. Higher spending ahead of the planned August 2013 national elections is expected to add a fillip to growth. In 2014, the new government may initiate the implementation of its intermediate macroeconomic policy, and the direction thus provided may improve local investment in the tourism sector.

In light of an expected surge in pre-election expenditures and recent experience, the budget deficit is expected to be 7.9% of GDP in 2013, or more than double the official budget deficit estimate of 3.6%. To achieve the official estimate, the government would have to commit to fiscal consolidation measures such as streamlining the civil service and improving tax administration. In the past, implementing similar policies has entailed lengthy administrative and legislative procedures, making
these developments unlikely to materialize within the year. Nevertheless, stabilizing the huge public debt, which now is near 80% of GDP, will become daunting unless forceful measures are quickly adopted.

Inflation will likely ease to 9.3% in 2013 and 8.5% in 2014 because of base effects and the improved availability of foreign exchange—and despite spending ahead of the elections sustaining inflation pressure in the first half of 2013. The modest pickup in tourism may improve the current account balance somewhat, but the deficit is expected to remain wide, even deteriorating slightly to 27.8% of GDP in 2013 before improving to 22.0% in 2014.

### Policy challenge—fostering inclusive growth

The Maldives faces a slew of medium-term development challenges. Worrisome youth unemployment causes social problems and political instability. High unemployment reflects the narrow employment base and the mismatch between the youths’ skills and labor market requirements. Many jobs are therefore filled by expatriate workers. A substantial investment in skills development is a pressing need. Creating jobs requires developing new industries beyond fishing that are viable in a small, dispersed island nation. A key challenge is lifting the economy’s overreliance on tourism and thereby alleviating the country’s vulnerability to external shocks. The 2004 tsunami and 2008–2009 global financial crisis devastated tourism and sent the economy into a tailspin.

An extremely dispersed population in small island communities has long been recognized as a challenge to sustainable social and economic development. Communities must be consolidated to foster the creation of new industries and diversify the economy beyond tourism. Developing a stronger economic base is essential to cope with the country’s heavy reliance on imports and persistently large current account deficits.

The Maldives also faces challenges to the environment and from climate change. The pollution caused by the untreated wastes of the dispersed population can undermine the archipelago’s blue economy and image as a tourist paradise. Overdependence on imported oil for segmented and inefficient power generation adds to the challenge of the Maldives’ becoming carbon neutral by 2020. The lack of economies of scale poses severe challenges to attracting finance for water and sanitation, waste treatment, and power projects, as well as for their proper operation and maintenance.

Population consolidation may be a long-term process, but action today is critical. The selection of large islands must be based not only on geographic convenience but also on business potential in areas such as shipping, trade and financial services, fish processing, and manufacturing. Islands that will serve as regional centers can be developed on a pilot basis to accommodate the scattered surrounding islands in that region. Gradually, these islands will become, like Malé, significant population centers.

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<th>3.18.1 Selected economic indicators (%)</th>
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<td>2013</td>
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<td>Current account balance (share of GDP)</td>
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Source: ADB estimates.