IMF Country Reports 19/280

Maldives: 2002 Article IV Consultation-Public Information Notice; Staff Report; and Statement by the Executive Director for Maldives

INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/280

MALDIVES

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2002 ARTICLE IV CONSULTATION—PUBLIC INFORMATION NOTICE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALDIVES

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation with Maldives, the following documents have been released and are included in this package:

- A **Public Information Notice** summarizing the views of the Executive Board as expressed during its January 8, 2003 consideration of the staff report that concluded the Article IV consultation with Maldives.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 8, 2003, following discussions that ended on October 14, 2002, with the officials of Maldives on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 17, 2002.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Maldives.

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Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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February 19, 2003

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2002 Article IV Consultation with Maldives

On January 8, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the 2002 Article IV consultation with Maldives.[1]

Background

The Maldivian economy has prospered over the past decade with the rapid expansion of tourism and the modernization of the fisheries sector. During the 1990s, annual GDP growth averaged around 8 percent, raising per capita income to about US$2,200 in 2001. Though poverty incidence in the outer atolls remains high, social indicators have improved steadily.

Economic growth slowed, however, in recent years, and continues to be dampened by the tourism slowdown which began in mid-2001. Growth is estimated at 4.3 percent for 2002, driven by a gradual recovery in tourism and an improving fish catch, as well as government spending. Despite the July 2001 devaluation of the rufiyaa, inflation has been kept in check. International competitiveness of resorts and fisheries does not seem to be at issue.

After a loss of international reserves in 2001, the balance of payments has improved. Reserves recovered to about 3 and a half months of imports by November 2002. The external current account deficit is expected to remain wide, but capital inflows, both public and private, have provided the necessary financing. External debt, most of which is on concessional terms, has

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

risen to around 42 percent of GDP in 2002, with debt service about 5.5 percent of exports of goods and nonfactor services.

After several years of improving fiscal performance, the budget deficit has widened recently. It is expected to have reached 7 percent of GDP in 2002, reflecting strong capital expenditures, increasingly financed externally on commercial terms. Current spending has also continued to grow, mainly in the areas of general administration and social services. Falling yields in tourism-related taxes have further weakened the budgetary outturn.

Monetary developments in 2002 have been characterized by continued central bank financing of budgetary imbalances. Effective liquidity management remains an issue, while the banking system is being challenged by slowing growth, removal of credit ceilings, and stronger competition.

Structural reforms are gaining momentum. Important economic laws are in the works and inroads are being made toward the privatization of key state-owned enterprises.

Executive Board Assessment

Executive Directors noted that, after a commendable performance characterized by fast growth, low inflation, and broad macroeconomic stability, that had raised living standards consistently for some twenty years, growth has been interrupted recently by temporary exogenous shocks, policy slippages, and remaining structural weaknesses—some of which are related to the small-island and geographic nature of the Maldives economy. Macroeconomic and structural policies need to be refocused to reduce existing imbalances and to set Maldives once again on the path of medium-term sustainable growth. While the emerging signs of recovery in the tourism and fisheries sectors—the pillars of Maldives's economy—were encouraging, the authorities should nevertheless move forcefully to bolster the public finances, broaden the economy's productive base, and improve the environment for private sector investment and activity. Improving social conditions in the country's outer islands, where poverty remains high, is also a continuing priority.

Directors emphasized that growing fiscal deficits financed by central bank resources pose a threat to the fixed exchange rate regime, and a risk to Maldives's external viability. Both revenue and expenditure measures are needed to contain the deficit, including broadening the tax base, reassessing tax rates, and managing more carefully government current and capital spending. Several Directors considered that an increase in the tourism tax to restore its real value, and higher rental fees for public land use, would go a long way toward strengthening the fiscal position. Other Directors, however, noted that given the prevailing weaknesses in tourism, the timing and rate of increase in the bed tax should be set so as to minimize the effect of the increase on the sector. Spending on general administration and wages should also be contained, and public projects carefully prioritized. Directors welcomed the authorities' intention to operationalize quickly the planned expenditure monitoring mechanism, which should assist in controlling spending, following the revamping of the public accounting system.

Given the importance of breaking the pattern of widening fiscal imbalances, Directors were disappointed that the 2003 budget does not contain firmer consolidation measures. However, they welcomed indications from the authorities that in the event that the planned foreign financing is less than anticipated, they would take action to avoid additional recourse to central bank funds to cover the deficit.

Directors indicated that institutional and administrative reforms are also required to improve the public finances. They recommended in particular the early introduction of government securities, and an overhaul of the system of allowances for public sector employees. Prudence in tapping external commercial funds to finance public investment is also essential to prevent an unsustainable buildup in the public debt in the longer term.

Directors welcomed recent steps taken to limit the use of direct instruments of monetary control, including the dismantling of bank-by-bank credit ceilings. Monetary operations could be strengthened through more flexible terms for the sale of central bank papers. Directors agreed that consideration of a gradual reduction in reserve requirements should be deferred until more effective liquidity management tools are in place.

Directors noted that the devaluation of the rufiyaa in 2001 had succeeded in restoring the level of international reserves and eliminating the parallel foreign exchange market, and had strengthened Maldives's competitiveness. They agreed that the pegged exchange rate system has served Maldives well, and should continue to be an important element of the macroeconomic framework. However, the financing of budgetary deficits on a continuing virtually automatic basis threatens the fixed exchange rate regime and weakens fiscal discipline; curtailment of the government's overdraft facility at the central bank should therefore be a priority. Early enactment of the revised Maldives Monetary Authority Act would help in strengthening monetary policy independence.

Directors welcomed the progress made in promoting greater competition in the banking sector, which holds out the promise of improved access to credit for the private sector. At the same time, prudential supervision needs to keep pace with financial sector developments, and it will therefore be important to review the adequacy of current regulations on loan classification and provisioning.

Directors considered that gradually moving away from government intervention in the economy, enhancing the role of the private sector, and broadening the production base would help to make Maldives more resilient to external shocks. They emphasized the importance of paying attention to the sequencing and timing in the application of policies to help diversify the economy. Directors welcomed the recent progress made in restructuring and privatizing state-owned enterprises. The authorities are encouraged, however, to press ahead with privatization and legal reform—in particular, early implementation of legislation to strengthen the accountability and operational efficiency of state enterprises—with a view to further divestment.

Directors observed that Maldives's trade policy remains moderately restrictive, with wide dispersion of tariff rates and a complex system of exemptions. They urged the authorities to use the opportunity presented by the upcoming WTO trade policy review to move ahead with trade liberalization.

Directors encouraged the authorities to continue their efforts to strengthen legislation to combat money-laundering and the financing of terrorism.

Directors welcomed recent improvements in the compilation of economic statistics, but noted that data quality in many areas remains inadequate for effective policy design and evaluation. They encouraged the authorities to persevere in their efforts to build statistical capacity.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Maldives: Selected Economic Indicators, 1998-2001

	1998	1999	2000 Est.	2001 Est.
	(Annual percentage change)			
Growth and prices				
Real GDP	9.8	7.2	4.8	3.5
Consumer prices (period average)	-1.4	3.0	-1.2	0.7
	(Percent of GDP)			
Central government				
Revenue and grants	30.4	32.1	32.3	33.0
Expenditure and net lending	32.3	36.1	36.7	37.7
Of which: Capital spending	12.8	13.7	11.8	12.3
Overall balance	-1.9	-4.1	-4.4	-4.7
Financing				
Domestic	-0.1	3.2	4.3	2.8
Foreign	2.0	0.8	0.0	1.9
	(Twelve-month change at year-end)			
Money and credit				
Domestic credit	18.6	8.0	14.5	19.4
Public sector	9.2	14.1	23.3	7.0
Central government, net	1.4	12.9	30.9	8.4
Private sector	25.7	4.0	8.0	29.9
Broad money	22.8	3.6	4.1	9.0
	(In millions of U.S. dollars)			
Balance of payments				
Exports (including re-exports)	95.6	91.5	108.7	110.2
Imports	-311.5	-353.9	-342.0	-348.3
Non-factor services, net	232.4	234.6	238.8	244.8
Current account balance	-23.3	-81.6	-53.0	-57.3
(In percent of GDP)	-4.3	-13.8	-8.5	-9.2
Overall balance	29.1	-7.2	-7.9	-21.4
Gross official reserves (year-end)	119.9	128.5	124.1	94.3
(In months of following year's imports of GNFS) 1/	3.1	3.4	3.3	2.5
External debt (year-end)	200.8	212.9	211.6	209.8
(In percent of GDP)	37.2	36.1	33.9	33.6
Debt service	16.3	19.0	22.1	22.0
(In percent of GNFS exports, net of goods re-exports) 1/	4.0	4.7	5.2	5.1
(In percent of total exports of GNFS) 1/	3.8	4.4	4.8	4.7
Exchange rate				
Rufiyaa per US$ (period average)	11.77	11.77	11.77	12.24
Nominal Effective Exchange Rate (percent change)	5.4	0.5	6.7	0.8
Real Effective Exchange Rate (in percent change)	2.3	2.6	3.4	-0.6
Memorandum item:				
Nominal GDP (millions of rufiyaa)	6,357	6,935	7,348	7,651

Sources: Maldivian authorities; IMF staff estimates and projections.

1/ GNFS = Goods and Non Factor Services.

INTERNATIONAL MONETARY FUND

MALDIVES

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the
2002 Consultation with Maldives

Approved by Daniel Citrin and Shigeo Kashiwagi

December 17, 2002

- A staff team—comprising Messrs. Zanello (Head), Becker, and Ms. Kongsamut (all APD)—held discussions in Male during October 6-14 with Mr. Jaleel (Minister of State for Finance and Treasury and Vice-Governor of the Maldives Monetary Authority (MMA)), Mr. Zaki (Minister of Planning and National Development), Mr. Kamaluddeen (Minister of Human Resources, Employment, and Labor), Ms. Ahmed (Minister of Women Affairs and Social Security), as well as other senior officials and representatives of the private business community. The mission was accompanied by World Bank staff (Mr. Bell).

- At the conclusion of the last Article IV consultation on August 30, 2001, Executive Directors noted that policy performance had deteriorated and the growth outlook had become more uncertain. They urged the authorities to reverse fiscal slippages in order to curb excess demand and benefit from the recent devaluation. The elimination of automatic deficit financing from central bank resources was in their view key to restoring macroeconomic stability and the viability of the fixed exchange rate regime. Directors also underscored that medium-term fiscal and structural reforms were needed to boost growth prospects.

- Despite improvements in recent years, gaps and inconsistencies in economic data continue to hamper surveillance and policy design.

- Maldives no longer maintains restrictions under Article XIV but continues to avail itself of that article's transitional arrangements.

- This report is the product of a team effort led by Alessandro Zanello.

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Executive Summary

Key Issues

- **The weak external environment continues to depress growth**. Tourism and fisheries—the Maldives' economic lifelines—are slowly recovering, but have not yet regained the ground lost in 2001. After over two decades of uninterrupted gains, per capita income likely remained flat in 2002. The pass-through from last year's devaluation has been contained and inflation is not a policy concern.

- **The international competitiveness of resorts and fisheries is not at issue and the balance of payments has recently improved**. The devaluation and the weaker dollar have brought the effective real exchange rate closer to that of main competitors. Reserves have clawed back some of the losses in the aftermath of the devaluation.

- **Widening fiscal deficits financed by money creation are undermining the viability of the fixed exchange rate regime**. The pattern of central-bank financed budgetary imbalances continued in 2002, adding to the liquidity overhang in the banking sector. Credit growth surged after credit ceilings were lifted, and NPLs are on the rise.

- **Structural reforms are gathering momentum**. Important economic laws are in the works; the restructuring of a key state-owned enterprise is to be implemented soon; and the banking sector is adapting to greater competition.

Policy Issues

- **There was agreement that fiscal and monetary policy need to be refocused to support the peg**. The disappearance of the parallel market after the devaluation suggest that the exchange rate level is broadly appropriate.

- **The staff urged institutional changes to prevent future deficit monetization**. Early passage of the MMA Act and improvements in liquidity management are key to greater operational independence of the central bank.

- **There was consensus that fiscal consolidation is urgent, but views differed on how to bring it about**. The staff suggested measures on both the revenue and the expenditure side of the budget to achieve an adjustment of some 1½ percent of GDP in 2003. The authorities are reluctant to increase tourism-related taxes in the weaker economic environment, and think that better expenditure control may suffice.

- **Structural reforms must continue apace to bolster medium-term prospects**. Legal reforms and further privatization are needed to foster greater private sector participation and export diversification. Financial liberalization needs to be supported by strengthened supervision.

I. Introduction and Background

1. **The performance of the Maldivian economy was strong through most of the past decade, despite handicaps arising from its small size and vulnerability to external developments.**[1] Tourism and fisheries gave impetus to real GDP growth, while access to concessional financing and a liberal expatriate labor policy spurred the development of infrastructures and provided a buffer against external shocks. With the benefit of greater stability than in most other small island economies, per capita GDP rose from US$1,000 in 1990 to over US$2,200 by the end of the decade, and social indicators improved steadily (Annex IV). Yet, economic development has been uneven across the country, and the narrow production and export base remains a fundamental source of vulnerability.

2. **In recent years, slower growth and policy inconsistencies led to imbalances which culminated in a devaluation in 2001**. Growth slowed sharply in the late 1990s with the end of the boom in resort construction and a worsening terms of trade (Figure 1). Policy developments were characterized by central bank financing of ever-larger fiscal deficits, undermining the fixed exchange rate regime. Structural reforms also stalled. Notwithstanding increasing reliance on administrative controls of domestic liquidity and rationing of foreign exchange, pressure on reserves mounted, leading to a 9 percent devaluation of the rufiyaa against its anchor currency (the U. S. dollar) in July 2001.

3. **In an already weakened macroeconomic environment, the global tourism slowdown of late 2001 brought to the fore the need for a policy reorientation to reinvigorate the economy**. The 2002 Article IV discussions presented the opportunity to reassess progress toward restoring the soundness of macroeconomic and structural policies. To ensure a favorable medium-term performance for the Maldives, policies need to support the fixed exchange rate and adapt to ongoing structural changes—notably, the progressive liberalization of the financial sector, further private sector participation in activities still dominated by state-owned enterprises, and the likely tapering off of external assistance.

4. **The authorities have made some progress in responding to key policy challenges**. Recent consultations have stressed the need for a stronger fiscal position and independent monetary management. First steps have been taken to strengthen the revenue base, for example with the 2001 imposition of a payment for public land use on state enterprises. A broader tax reform remains, however, on the unfinished agenda, in part for lack of implementation capacity. Control of public spending, including the public sector wage bill, is still a policy priority, as are institutional changes to prevent automatic deficit monetization. Technical assistance from the international community is in train to address these issues. The

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[1] The Maldives consists of some 1200 coral islands, 200 of which are inhabited, scattered over 900,000 square kilometers of rich fishing grounds. Its population is 276,000. The main export markets are Europe (tourism) and the United States (fish and garments); and the largest import partners are Singapore and Sri Lanka.

authorities' actions have been closer to Fund advice as regards financial and structural sector reforms, including the recent liberalization of interest rates, the removal of bank-by-bank credit ceilings, the closure of the Post Office Exchange Counter to rationalize the foreign exchange market, and the opening up of the fisheries sector to private operators. Improvements to the legal framework have also been made, although progress has been slow. Finally, the need to strengthen the statistical base has repeatedly been flagged in previous consultations. Some advances notwithstanding, further efforts at capacity building are needed.

II. Recent Developments and Outlook

5. **Output growth has fallen to around 2¼ percent in 2002, implying a stagnant per capita income** (Table 1). External demand has remained weak, notwithstanding a recovery in tourist arrivals to more normal seasonal patterns, and an expansion in catch-collecting capacity for tuna exports (Figure 1). Domestic demand has suffered from the weakened external sector,[2] with only a partial offset from higher government spending. Overall, per capita income is likely not to have grown for the first time in over twenty years. Following a post-devaluation spike, inflation has been kept in check by low world commodity prices and slack demand (Box 1).

6. **After a significant loss of reserves in late 2001, the balance of payments has improved**. The MMA has relaxed its grip on foreign exchange sales in the wake of the devaluation. In a less constrained environment, growth in dollar deposits resumed (Figure 2).[3] With falling export receipts in the last quarter of 2001, reserves bottomed out at the end of the year but have since recovered to about 3 months of imports (Figure 3, Table 2). The current account deficit is expected to remain wide at almost 9 percent of GDP, as gains from import compression have been more than countered by a decline in tourism revenues.[4] Official inflows continue to be strong, though, reflecting large capital expenditures underway.[5] Private inflows have also picked up with the establishment of two new financial institutions (a leasing company and a branch of a global bank).

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[2] Tourism and fisheries directly account for 40 percent of GDP and 22 percent of employment.

[3] Dollarization in the Maldives has been on a trend that tracks closely the relative importance of dollar-generating activities (tourism and fisheries). It appears to reflect transaction needs as well as asset substitution.

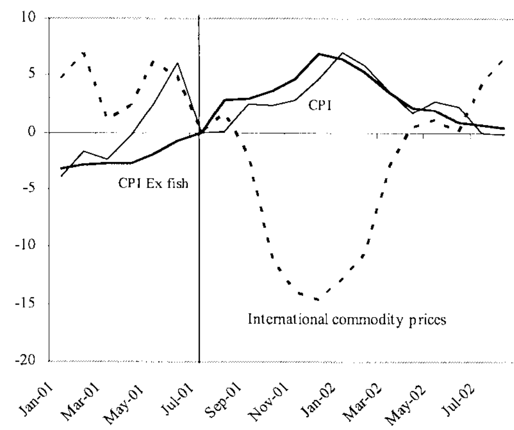
[4] Though tourist arrivals are recovering, prices remain soft.

[5] The largest undertaking is the Hulhumale land reclamation project. It is meant to ease overcrowding in Male.

BOX 1. THE 2001 DEVALUATION AND INFLATION

Despite a very large import share in the consumer basket, the nine percent devaluation in July 2001 has had a minimal impact on prices. Inflation was well contained at 3 percent in 2001, and has averaged 2 percent in 2002 (through September). The effect of the exchange rate adjustment built gradually and peaked in January 2002 (Chart).1/ Inflation (excluding volatile fish prices) has fallen since and is near pre-devaluation levels. Three factors appear to explain the relative absence of pass-through:

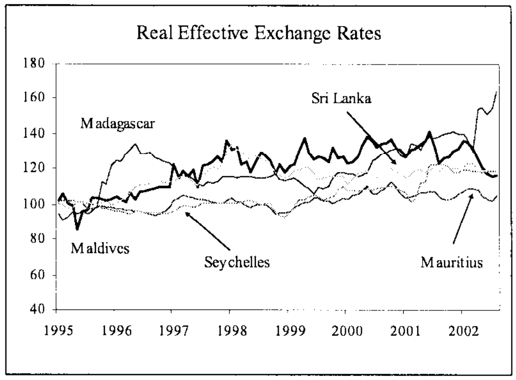
- Falling international commodity prices;
- Weakening domestic demand; and
- Price-smoothing by the State Trading Organization (STO).With a market share at 80 percent, STO has a virtual monopoly in the provision of staple goods (including rice, flour and sugar) and it operates with the social mandate of providing them throughout the atolls at stable prices. STO is also the major importer of petroleum products, whose retail prices show less volatility than international prices. Notwithstanding growing competition in import trade, STO remains a highly profitable state-enterprise, contributing to the budget some 20 percent of income from state enterprises, yearly.



Looking ahead, inflation may pick up, as international commodity prices are rising once again. In addition, the recent rapid credit expansion could feed into inflation, although any demand pressures are more likely to be felt in international reserves.

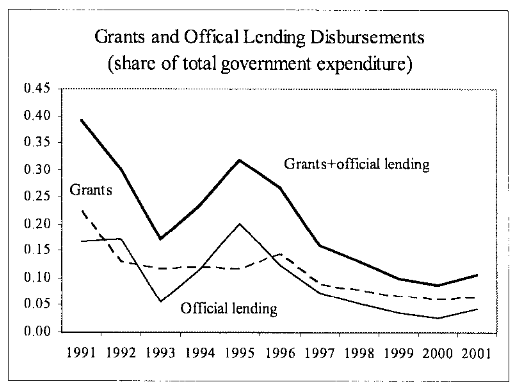
1/ The index has been rebased to zero in the month of the devaluation (July 2001), so that the chart's scale shows the percentage change in prices relative to that month.

7. **The 2001 devaluation and a weaker dollar have strengthened the Maldives' international competitiveness**. Recent changes in the real effective exchange rate have reversed an earlier loss of competitiveness vis-à-vis comparable tourist destinations (Text Chart). In addition, increased specialization in the processing of yellow-fin tuna is boosting the share of domestic fisheries in the international fish market. A further indication of the broadly appropriate exchange rate level stems from the reported disappearance of the parallel market that had emerged in the run-up to the devaluation.



8. **Fiscal deficits have continued to widen on the back of strong expenditure growth**. With slowing activity and falling tourism tax yields, the deficit worsened in 2001 for the fourth year in a row (Figure 4, Table 3). The budgetary imbalance is expected to widen again in 2002 to about 6 percent of GDP. Sustained growth in the wage bill and greater reliance on non-concessional borrowing have kept expenditures on an upward trend, while revenues have been held back by the lower imports and tourist arrivals.[6]

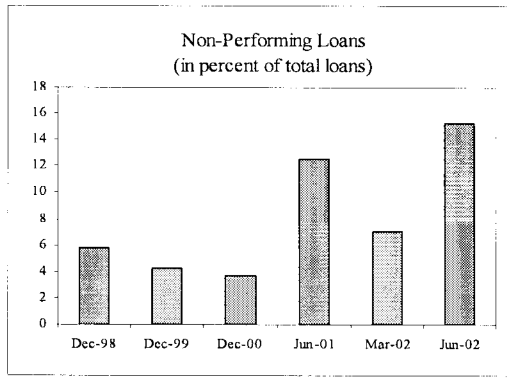
9. **Monetary developments have been characterized for some time by central bank financing of the fiscal imbalances.**[7] Budgetary shortfalls continue to be filled by overdrafts from the MMA, in the face of dwindling foreign resources (Text Chart). The recent lifting of credit ceilings has released a long-standing liquidity overhang. Credit to the private sector has surged by 23 percent this year, while broad money grew at a more moderate 13 percent through September (Table 4). Until recently, this increase in credit has been financed by a decline in the banking system's NFA position.



[6] Import duties and tourism taxes represented over 90 percent of tax revenues in 2001, or about 40 percent of current revenues.

[7] At the time of the dismantlement of credit ceilings in mid-2001, outstanding credit from the MMA was nearly 20 percent of GDP or one-third of total public debt.

10. **The banking sector is challenged by greater competition and slowing growth.**[8] With a captive market and little competition, Maldivian banks have historically been quite profitable, notwithstanding high funding costs implied by a 35 percent reserve requirement on deposits. The situation is changing with the entry of new financial institutions. Once-rigid lending rates have shown first signs of downward flexibility. Furthermore, in the weaker economic environment, nonperforming loans (NPLs) have risen, especially at the largest bank (Text Chart).[9]



11. **Structural reform is gathering momentum on some fronts**. Fish exports have been opened to private operators, and the authorities are considering plans for restructuring the loss-making Maldives Industrial Fisheries Company (MIFCO). Shares of the State Trading Organization (STO) have finally been sold to the public, supporting other efforts to foster a fledgling capital market. Key economic laws are in the works, notably a Public Finance Act and revised Banking and MMA Acts. In addition, initial steps have been taken to overhaul the operational framework of the MMA, including the lifting of bank-by-bank credit ceilings, the abolition of the cap on the interest rate spread, and the establishment of a facility for emergency liquidity assistance.

12. **The near-term outlook is for a modest pick up of activity, but prospects remain hostage to external vulnerabilities** (Table 5). The ongoing recovery in tourism, along with greater dynamism in fisheries, should help raise growth to some 3 percent in 2003. Yet, hesitations in the global recovery, geopolitical uncertainties, and the impact on Maldivian tourism of the October 2002 Bali bombings, may undermine performance.[10]

III. Policy Discussions

The discussion focused on the policy requirements to bring the Maldives back to a stronger and sustainable growth path and the need to strengthen the policy framework to regain room for maneuver over the medium term.

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[8] The banking system comprises three state-owned foreign banks (from India, Pakistan, Sri Lanka), a local state-owned bank (Bank of Maldives), and a new entrant (HSBC). A leasing company partly owned by the IFC also started operation in 2002.

[9] Recent lending has reportedly provided bridge financing to distressed enterprises burdened by the high interest rates and short maturity of outstanding obligations.

[10] Three-fourths of visitors to the Maldives come from Europe. Their travel typically entails a stop-over in the Middle East.

A. Macroeconomic Policies

Monetary and Exchange Rate Policy

13. **There was agreement that the pegged exchange rate should continue to be the cornerstone of the macroeconomic framework**. The Maldives' high degree of openness and small size, its currency composition of trade and limited integration in world capital markets, as well as institutional shortcomings, all argue for the appropriateness of maintaining the U.S. dollar peg. The authorities noted that the 2001 devaluation has been effective in eliminating the parallel market and shoring up international competitiveness. With pressures on reserves gone, outright rationing of foreign exchange has ended. The mission found no evidence of any restriction subject to approval under Article VIII, but cautioned against even the use of moral suasion to constrain the demand for dollars, a practice that by some accounts had not fully disappeared. There was agreement that, notwithstanding the evolving trade linkages, shifting the peg to a Euro/dollar basket was at best premature, given a limited institutional capacity and the need to preserve a simple and transparent nominal anchor.

14. **The authorities were pleased with the recent build up in reserves but thought that import cover should be higher still**. A reserve target of 5 months of imports is in their view warranted by the Maldives' intrinsic vulnerability to external shocks and its liberal exchange rate regime. The mission agreed on the strategy of reconstituting a buffer of foreign exchange—and budgetary—resources over the medium term, but thought that current policies are incompatible with its fulfillment.

15. **There was agreement that monetary policy should be geared toward supporting the fixed exchange rate regime**. The authorities noted that budgetary recourse to central bank financing in 2002 had been the result of unforeseen revenue shortfalls. They also pointed out that steps away from direct monetary controls had been taken, and that the use of central bank's certificate of deposits to absorb liquidity had proved helpful. The mission acknowledged the advances, but expressed concern about the continued monetization of fiscal deficits. In its view, without more far-reaching institutional changes—such as closing the government's overdraft facility at the MMA (the Ways and Means account), the introduction of treasury bills, and the establishment of a legal basis for central bank independence—fiscal pressures would continue to constrain the ability of the MMA to focus on policies supporting the peg.

Fiscal Policy

16. **The authorities are aware that the fiscal stance is putting stress on the system**. The 2003 budget process had just started at the time of the mission with the Ministry of Finance issuing guidelines for line ministries to cut expenditure. However, preliminary budget requests from spending agencies were coming in well above 2002 levels, suggesting difficulties in implementing meaningful consolidation next year. The mission argued that the risks from a continuation of an expansionary fiscal policy are compounded by the likelihood

of further deficit monetization as in the past. It urged the authorities to make an upfront fiscal adjustment in the 2003 budget, and to speed up reforms to curb fiscal dominance. In its view, a deficit of about 3¾ percent of GDP (implying an adjustment of about 1½ percent of GDP) would be achievable and mark a credible start of fiscal adjustment.[11] The authorities agreed with the mission's call for consolidation, but were not yet ready to formulate specific measures at the early stage of the budgetary process. They reiterated, nonetheless, their intention to avoid recourse to central bank financing through expenditure containment and more efficient use of the available concessional funds.

17. **The authorities agreed that there was scope to widen the tax base and reassess tax rates, but only over the medium term**. In their assessment, the current environment is not propitious for tax increases. The mission countered that the seriousness of the fiscal imbalance calls for immediate measures. The bed tax, last adjusted in 1988, could be increased to US$8 to restore its real value, with minimal impact on tourist arrivals.[12] The rental on public land use by state enterprises could also be raised from its present (almost symbolic) rate of one rufiyaa per square foot. Together, these measures could yield revenues on the order of 1-1½ percent of GDP. In line with previous advice, the mission also suggested that the tax base should be widened over time through the introduction of property and business taxes. The authorities did not disagree, but prefer to defer action until a (AsDB-sponsored) study on tax reform is completed and administrative capacity improves. There was agreement that over the longer term revenues could be made less susceptible to external developments with a shift from import duties to a general sales tax.

18. **The authorities saw more room for adjustment on the expenditure side of the budget**. In their view, a more effective mechanism of expenditure control would become operational soon with a revamped public accounting system. Growth in current spending could be reined in by limiting salary increases and the planned overhaul of social security. Capital spending could also be better prioritized. The mission agreed on the need to take measures on the expenditure side and reminded the authorities of the specific steps to rationalize public spending identified in the recent World Bank Public Expenditure Review. In particular, there is scope for trimming back general administration expenses including by containing the wage bill, while preserving spending on education and healthcare; capital spending could be rationalized in the context of a multi-year plan, with due consideration of the recurring expenditure implications of public projects; and civil service reform should

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[11] Of the suggested decline in the deficit from 6.0 percent of GDP to 3.8 percent of GDP, around ½ percent of GDP is accounted for by a projected reduction in capital spending due to the completion of a large public project.

[12] The bed tax is a specific tax of US$6. Its transformation into an ad valorem tax seems premature because of weaknesses in tax administration and the fact that the price of vacations in the Maldives is determined by tour operators overseas and thus is not easily monitored by the authorities.

remain on the agenda. More broadly, the mission stressed that expenditure adjustments should complement, rather than substitute for, tax measures in prospective budgets.

19. **Budgetary developments are also being shaped by the continued decline of concessional lending and grants**. Private financing is slowly taking the place of donor assistance. Access to concessional funds may diminish further with the possible graduation of the Maldives from the United Nations' LDC status (Box 2). The mission noted that increased reliance on commercial borrowing raises the issue of debt sustainability in the longer run, although the large share of concessional loans keeps the debt service ratio low in the medium term.[13] The authorities agreed on caution in debt management, but also underscored the unmet development needs that must continue to receive a high priority in policy design.

20. **The authorities stressed the importance of continued support from donors to reduce poverty**.[14] In their view, graduation of the Maldives from the United Nations' LDC status would be damaging. Preferential market access to the European Union is also slated to expire in 2005. Although the economic growth over the last decades had improved several social indicators, the authorities argued that poverty remains widespread and the vulnerabilities arising from the Maldives' limited resource base justify continued financial and technical assistance from the donor community.

B. Medium-Term Outlook

21. **Without a policy reorientation reserves are likely to be reduced to a minimum over the medium term**. Under the mission's current-policies scenario (Table 6), fiscal deficits remain large until the deteriorating reserve position forces policy action in 2005. To safeguard external viability, import-intensive public projects take the brunt of adjustment, depressing activity. In the absence of reforms, slow growth in fish exports and tourism receipts, as well as debt service, hamper a build-up of reserves. By the end of the projection period, significant fiscal consolidation and some recovery in reserves have taken place, but in

[13] The Maldives' external debt to GDP ratio is about 42 percent (80 percent of which is public sector debt), but most borrowing has been on concessional terms. Debt service amounts to about 5½ percent of exports of goods and services.

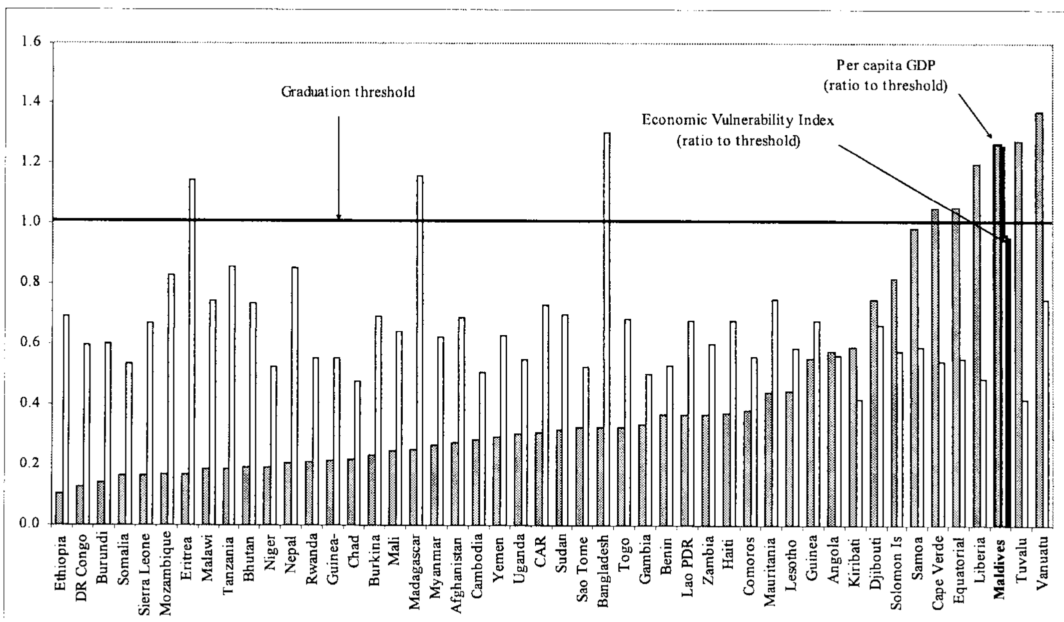
[14] The World Bank estimates that poverty incidence is as high as 50 percent in the outer atolls.

BOX 2. THE MALDIVES' LDC STATUS

The Maldives' LDC status will be reviewed by the United Nations' Committee on Development Policy (CDP) in 2003. Graduation would imply a loss of preferential treatment in trade and some access to concessional borrowing. The Maldives is currently eligible for IDA funds on a "small island" exception.

The CDP uses three quantitative measures to determine eligibility for LDC status: the augmented physical quality of life index (APQLI); GDP per capita; and an economic vulnerability index (EVI). When a country is close to the threshold level for any of these measures, a more comprehensive study is undertaken to decide on graduation.

In the 2000 review (covering developments through 1997), the Maldives was above the graduation threshold for GDP per capita and the APQLI, while the EVI was just below it (Box Chart). With further improvements in social indicators, the case for graduation appears to be strong. However, the Maldivian authorities stress that the graduation criteria do not take into account the country's fundamental vulnerability (including to ecological developments) and its continued need for poverty alleviation. Moreover, measurement issues make, in their view, some of the UN indicators problematic.



Source: United Nations Committee on Developmen Policy, and staff calculations a manner detrimental to growth. In addition, a protracted period of fiscal profligacy brings about an undesirable change in the output mix, with severe crowding-out of the private sector.[15] The authorities broadly agree with this analysis.

22. **Under a reform scenario, adjustment would safeguard growth prospects** (Table 7). Fiscal consolidation is started in 2003, along with a strong implementation of structural and legal reforms and a speedier execution of projects with concessional financing. Tax measures are undertaken upfront, including raising the bed tax and the land rent for state-owned enterprises.[16] Current expenditure developments reflect in part slower wage growth in 2003 than under current policies. Reforms pave the way for a gradual acceleration of growth on the back of greater private sector participation and improved access to credit. Though the adjustment in the current account deficit is broadly similar in the two scenarios, the level of reserves is much more comfortable in the reform scenario, and debt service is less of a burden. More importantly, prospects for sustained growth over the longer term are greatly enhanced by policies that do not delay adjustment. Such policies are consistent with the medium-term objectives laid out in the recent Sixth National Development Plan.

C. Financial Sector Issues

23. **The authorities thought that ongoing financial liberalization was paving the way for greater private sector participation in the economy**. In their view, lack of competition among banks has long stifled access to credit and the development of private enterprises.[17] They hoped that the recent entry of a internationally-reputable bank and the establishment of a leasing company would improve the terms and availability of financing, especially for small firms. The mission welcomed these steps, but also pointed to other structural weaknesses that undermined effective bank intermediation, including the lack of an interbank market and the high reserve requirements. Both issues should be addressed in the context of a gradual strategy to enhance monetary operations.

24. **Views differed as to the significance of emerging NPLs**. The authorities conceded that monitoring was warranted but stressed that banks were overall well capitalized and that

[15] The Maldives' garment industry is expected to be dismantled as preferential access to industrial markets ceases. Although garment exports account for almost half of merchandise exports, domestic content in value added is minimal, and the authorities do not envisage any significant macroeconomic impact from the industry's demise.

[16] The tax revenue to GDP ratio is projected to fall over the medium term because the yield from trade taxes is constrained by a relatively low income elasticity of import demand and the decline in oil prices assumed in the current WEO. In addition, the fact that the bed tax is a specific tax limits its buoyancy.

[17] Difficulty in obtaining credit has been singled out as a limiting factor for the expansion of small operators in fisheries.

the deterioration of their balance sheets reflected temporary developments affecting a handful of borrowers.[18] The mission cautioned against complacency: the current level of NPLs at a key bank is on the order of 4 percent of GDP and its deposits amount to about 20 percent of GDP. As a result, significant fiscal costs might arise from a further impairment of that bank's assets. Thus, the mission stressed the need to strengthen supervision, and develop a strategy to deal with potential systemic issues. Reviewing the regulatory framework for loan classification and provisioning, and strengthening on-site supervision should be immediate priorities.

D. Structural Policies and Other Issues

25. **There has been some progress on privatization of state enterprises**. The authorities noted, however, that the public offering of 10 percent of the shares in STO had been only partially subscribed, owing to an inadequate information campaign and the still underdeveloped capital market. Although no deadline had been set for re-offering the unsold shares, steps to strengthen the trading infrastructure are underway, including the enactment of a Securities Law and a possible role for the Provident Fund (which manages the voluntary pension contributions of government employees). The long-awaited restructuring of MIFCO is also in the offing, with a final plan ready for cabinet approval. The mission urged the authorities to step up divestment of activities that could be undertaken by the private sector—and to increase pressure on state enterprises to operate on a commercial basis by strengthening governance and accountability.

26. **There are no immediate plans for rationalizing the tariff structure**.[19] In light of the Maldives' limited production base, the authorities continue to view tariffs as a key revenue source rather than as an instrument of protection. Pending broader tax reforms, changes in the tariff structure should thus avoid burdening the budget. The mission countered that the current trade regime is nonetheless a source of distortions and there is scope for improvement. Tariffication of existing quotas (on some staples) and elimination of widespread exemptions should be considered a first order of business. A reassessment of current arrangements is planned in the context of the upcoming WTO trade policy review.

27. **Legal reform has been slow, but the newly instituted Law Commission could speed up the legislative process**. Several draft laws are under consideration, but limited

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[18] The limit on credit to a single borrower is currently set to 15 percent of a bank's unimpaired capital and reserves.

[19] The Maldives has rating of 7 in the Fund's index of trade restrictiveness which ranges from "1" (most open) to "10" (most restrictive). Its tariff structure consists of 10 rates ranging from zero to 200 percent, with an average of about 23 percent and a standard deviation of 25 percent. The difference between the simple average across tariff lines (46 percent) and the effective tariff rate (around 14 percent) points to a complex system of exemptions.

domestic expertise is delaying their enactment. The mission stressed the need to press ahead with the legal reforms needed to create a business-friendly environment and encourage foreign investment. Passage of the Securities Act and the Land Act have been steps in the right direction but other important economic laws—notably the MMA Act (which will sanction central bank independence) and Public Finance Act (which will contain provisions for issuing government paper)—still await adoption.

28. **The authorities thought that the Maldives was in line with international guidelines to combat money-laundering and the financing of terrorism.** The Fund questionnaire on this topic was still being compiled at the time of the mission, and discussions had to be deferred.

29. **Notwithstanding some improvements, the statistical base remains weak**. Surveillance and policy design continue to be hampered by gaps and inconsistencies in economic data, which the authorities are trying to address with the assistance of the AsDB and other bilateral donors. In particular, national accounts data are available only at an annual frequency and are often subject to large revisions; private capital flows are roughly estimated in the balance of payments; and data on private external debt are very limited. An additional area that should receive special attention is collection and analysis of data which would help the MMA better gauge developments in the foreign exchange market.

30. **The authorities are not ready to accept the obligations under Article VIII, Sections 2, 3, and 4, of the Fund's Articles of Agreement**. In response to the mission's encouragement, they noted that the issue would be considered in the near future.

IV. Staff Appraisal

31. **After a long period of commendable performance, growth has recently been undermined by policy slippages, temporary shocks, and structural weaknesses**. There is a need to refocus macroeconomic and structural policies to contain outstanding imbalances and buttress prospects over the medium term. In light of the intrinsic exposure of the Maldives to external developments, the overarching strategy should aim at restoring foreign currency reserves and room for fiscal maneuver as a shield against unforeseen contingencies, while pursuing structural reforms to broaden the production and export base and heighten the resilience of the supply side. Elements of this strategy are implicit in the latest National Development Plan but still await decisive implementation.

32. **The pegged exchange rate should continue to be the cornerstone of the macroeconomic framework**. The fixed exchange rate regime is justified by the Maldives' openness and small size, its limited integration in world capital markets, as well as its constrained institutional capacity and flexible labor market. The current level of the exchange rate appears consistent with a favorable outlook for the competitiveness of the tourism and fisheries sectors in the medium term. The credibility of the arrangement would be threatened by any constraints on access to foreign exchange and needs to be safeguarded by an

appropriate policy mix. Transparency as well as institutional considerations argue against a shift from a peg to the U.S. dollar to a basket of currencies any time soon.

33. **Monetary management must be geared to supporting the peg**. Monetization of budgetary deficits undermines the fixed exchange rate and sanctions fiscal profligacy. Closure of the overdraft facility for government access to central bank funds (the Ways and Means Account) should be of the highest priority. More broadly, early enactment of the revised MMA Act is key to establishing operational autonomy for monetary policy. In time, an overhaul of the MMA's governance structure to secure full central bank independence would serve the Maldives best.

34. **Recent steps away from reliance on direct instruments of monetary control are in the right direction and should continue**. There is scope for better adapting to market conditions the terms of the central bank paper currently used to absorb liquidity, in particular by offering shorter maturities or more attractive interest rates. Over time, a gradual reduction of high reserve requirements could be considered to curb banks' funding costs, but only once effective liquidity management is in place.

35. **The present stance of fiscal policy jeopardizes external viability**. Fiscal discipline needs to be restored quickly and the 2003 budget should mark the start of credible consolidation. An increase to more realistic levels in the tourism bed tax and in land rent for state-owned enterprises would provide a helpful boost to revenues. On the expenditure side of the budget, there is ample scope for containing expenditures on general administration and the wage bill, and prioritizing capital spending. The authorities are correct in planning no recourse to central bank funds for deficit financing, and should not tolerate—as they have in the past—slippages on this front.

36. **Sound public finances also require further institutional and administrative reforms**. There is a need to strengthen mechanisms of expenditure controls and introduce government securities to tap domestic savings for deficit financing. The ongoing work to overhaul the public accounting system and an early passage of the Public Finance Act should help address both issues. The system of allowances for public sector employees should be reviewed in the context of social security and civil service reform. Capital spending should be smoothed in a multi-year public investment program, with due consideration for the recurring expenditure implications of public projects. It will be prudent to limit reliance on commercial funds to finance public investments, lest public debt sustainability becomes an issue in the longer term. Finally, revenues could be made less susceptible to external shocks with the introduction of a property tax and a business profit tax and, in time, by shifting from import duties to a general sales tax.

37. **Strengthening the Maldives' resilience to shocks requires not only prudent macroeconomic management but also continuing structural reforms to enhance the role of the private sector and foster non-traditional exports**. Privatization of state enterprises involved in activities that could be undertaken by the private sector should continue, as

appropriate. To that end, reforms to strengthen the accountability and operational efficiency of state enterprises, particularly MIFCO, should not be delayed.

38. **The authorities are to be commended for promoting greater liberalization and competition in the banking sector.** Their policies should, however, go hand-in-hand with strengthened supervision and a review of the MMA's preparedness in dealing with any potential systemic concerns. In particular, it is important to reassess urgently the adequacy of current regulation on loans classification and provisioning. Finally, the unfinished legal reform agenda needs to be pursued aggressively by the newly established Law Commission, with a view to establish rapidly an enabling legal environment that supports business formation and foreign investment.

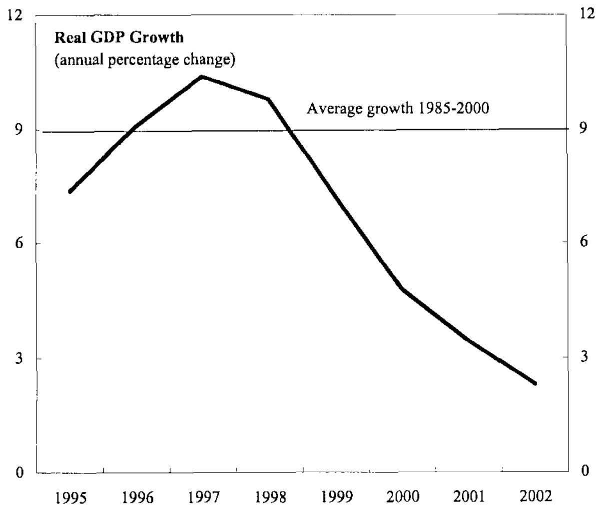
39. **While the Maldives has a commendably liberal exchange regime, its trade policies remain moderately restrictive**. The current tariff structure suggests distortions and an opaque system of exemptions. The upcoming WTO trade policy review offers a welcome opportunity to rationalize existing arrangements and push forward trade liberalization.

40. **Some progress notwithstanding, surveillance and policy design continue to be hampered by gaps and inconsistencies in economic data**. The authorities are to be commended for their efforts to build statistical capacity with the help of donor assistance. An area that should receive special attention is collection and analysis of data which would help the MMA better gauge developments in the foreign exchange market.

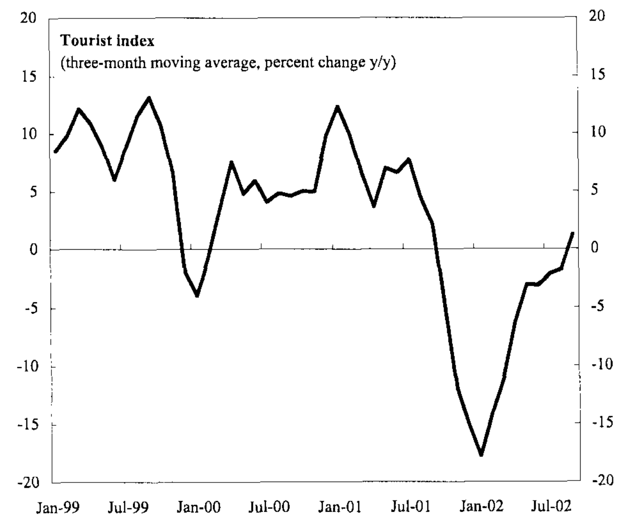
41. It is recommended that the next Article IV consultation with the Maldives take place on the standard 12-month cycle.

Figure 1: Real Sector Developments, 1995-2002

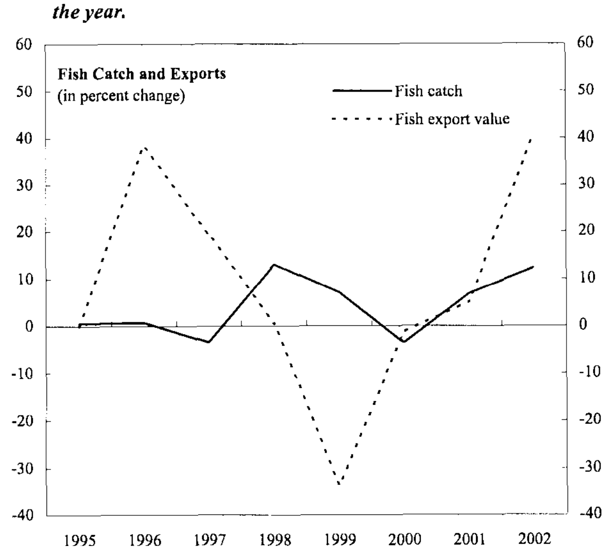
Output growth is expected to slow further...



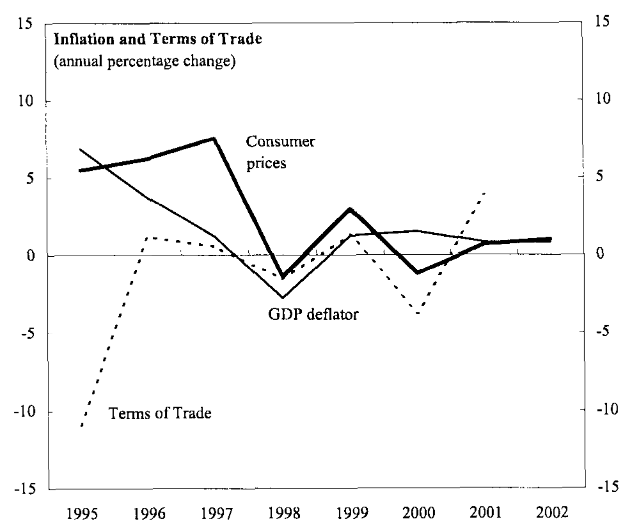
...as a result of a still recovering tourist sector...



...though fisheries have performed well in the first half of the year.



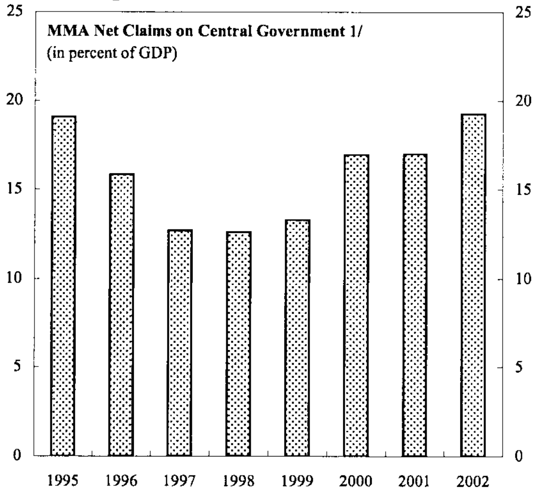
Inflation remains in check.



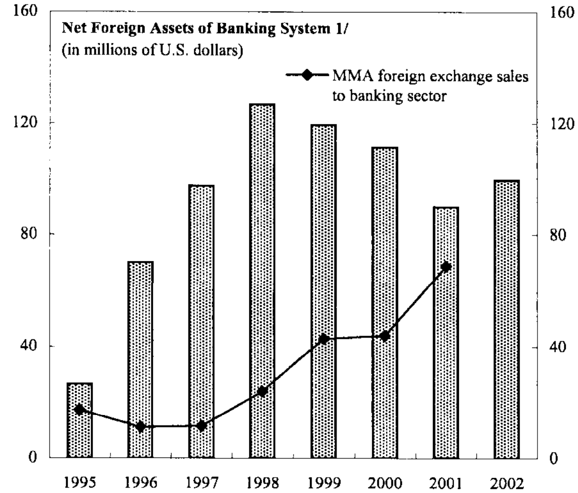
Source: Maldivian authorities and staff estimates.

Figure 2: Monetary Sector Developments, 1992-2002

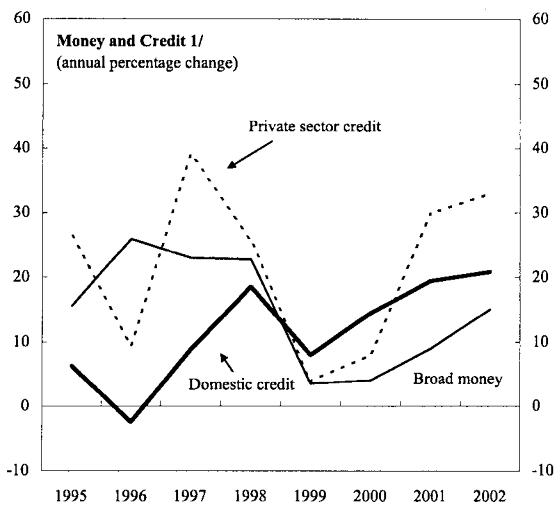
Since 1998, fiscal profligacy has resulted in an increasing stock of government debt to the MMA and a liquidity overhang.



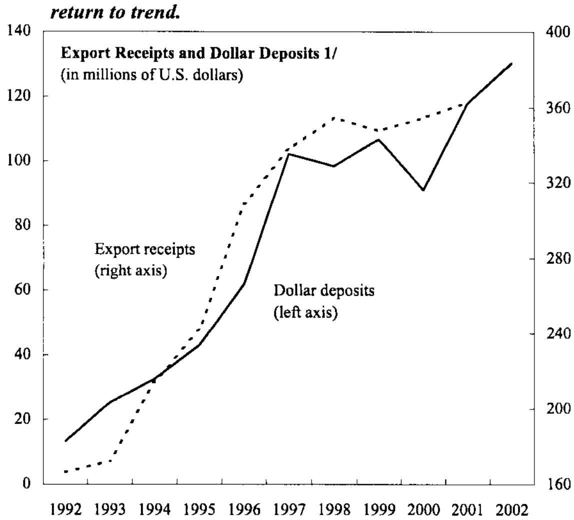
Falling NFA of the banking system and an insufficient supply of dollars from the MMA added to the foreign exchange market pressures in 2000-mid 2001.



The lifting of credit ceilings in 2001 has released the liquidity overhang mainly to the private sector...

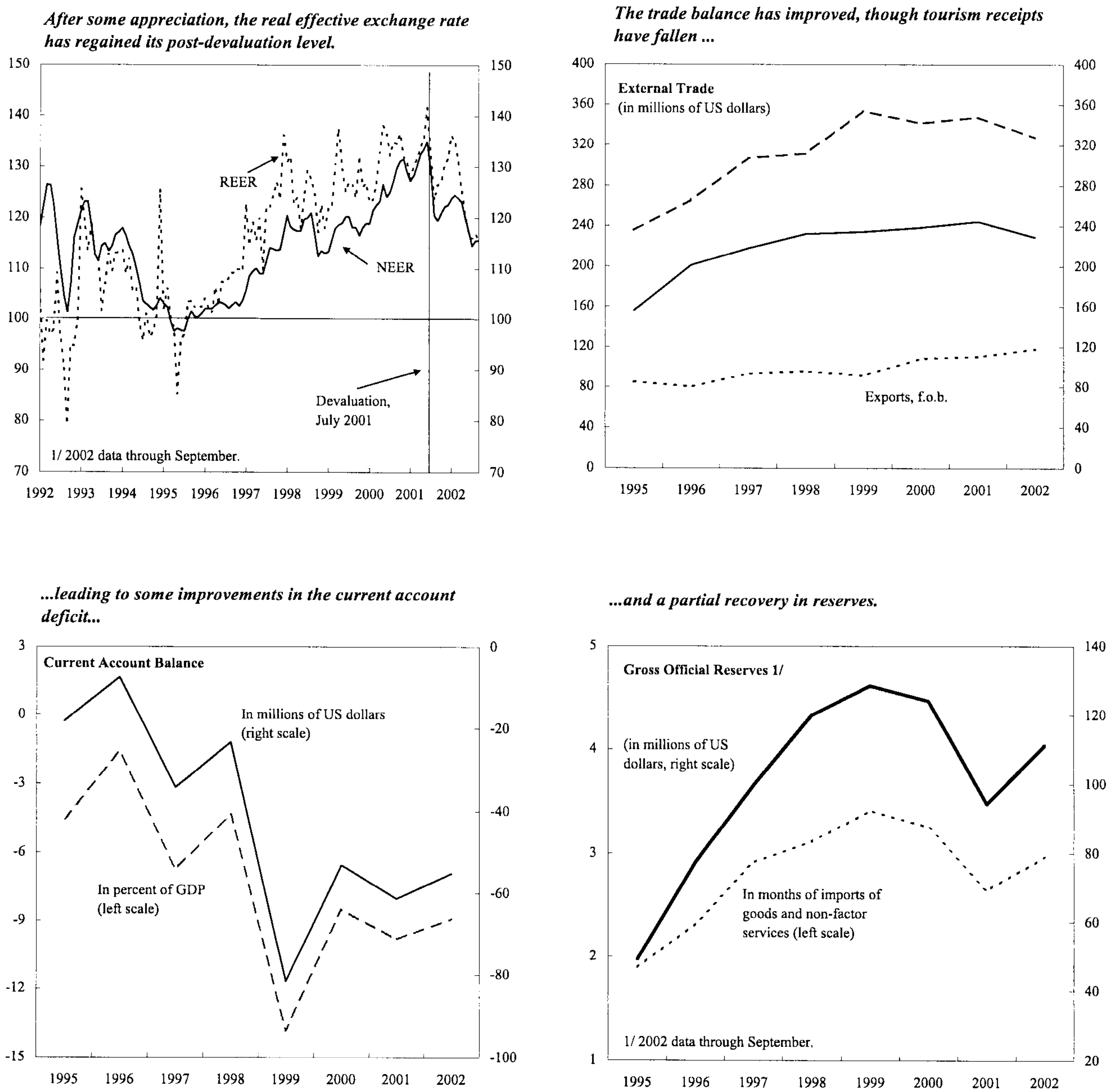


... while the devaluation and subsequent availability of foreign exchange has allowed dollar deposits to return to trend.



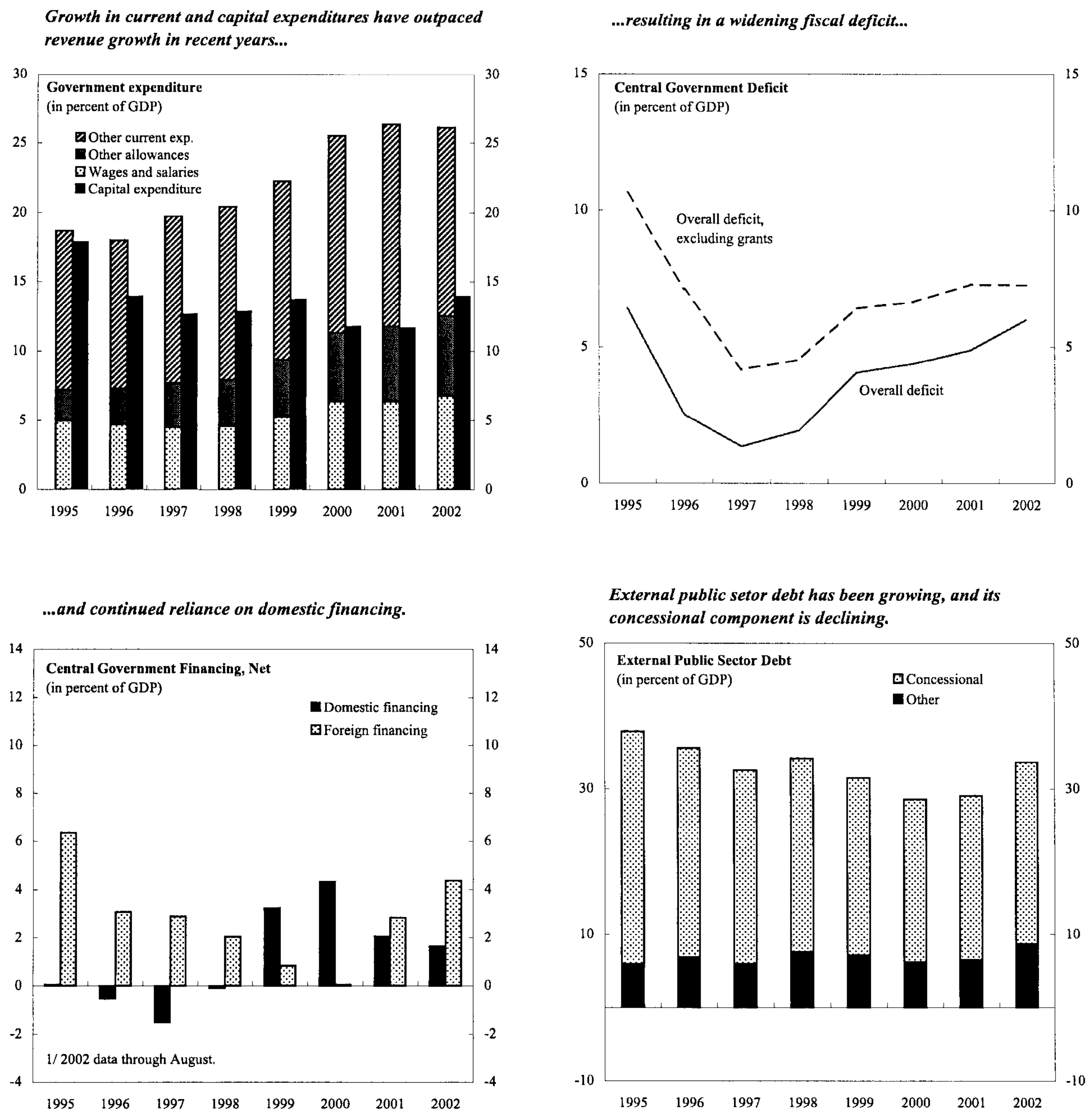
Source: Maldivian authorities and staff estimates.
1/ 2002 data for end-September.

Figure 3: External Sector Developments, 1992-2002



Source: Maldivian authorities and staff estimates.

Figure 4: Fiscal Developments, 1995-2002



Source: Maldivian authorities and staff estimates.

Table 1. Maldives: Selected Economic Indicators, 1998-2003

Population (2001):	275,975
Nominal GDP (in millions of U.S. dollars, 2001):	625
GDP per capita (in U.S. dollars, 2001):	2265
Quota (in millions of SDRs):	8.2

	1998	1999	2000 Est.	2001 Est.	2002 Staff	2003 Staff
			(Annual percentage change)			
Growth and prices						
Real GDP	9.8	7.2	4.8	3.5	2.3	3.2
Consumer prices (period average)	-1.4	3.0	-1.2	0.7	1.0	1.2
			(Percent of GDP)			
Central government						
Revenue and grants	30.4	32.1	32.3	32.8	33.7	34.0
Of which: Grants	2.6	2.3	2.3	2.4	1.3	1.6
Expenditure and net lending	32.3	36.1	36.7	37.7	39.6	41.2
Of which: Capital spending	12.8	13.7	11.8	11.7	13.9	13.5
Overall balance	-1.9	-4.1	-4.4	-4.9	-6.0	-7.2
Overall balance, excl. grants	-4.5	-6.4	-6.6	-7.3	-7.2	-8.7
Financing						
Domestic	-0.1	3.2	4.3	2.0	1.6	4.7
Foreign	2.0	0.8	0.0	2.8	4.4	2.5
			(Twelve-month change at year-end)			
Money and credit						
Domestic credit	18.6	8.0	14.5	19.4	18.4	16.3
Public sector	9.2	14.1	23.3	7.0	14.6	26.7
Central government, net	1.4	12.9	30.9	8.4	11.9	32.1
Private sector	25.7	4.0	8.0	29.9	21.1	9.5
Broad money	22.8	3.6	4.1	9.0	10.5	7.8
			(In millions of U.S. dollars)			
Balance of payments						
Exports (incl re-exports)	95.6	91.5	108.7	110.2	118.2	121.0
Imports	-311.5	-353.9	-342.0	-348.0	-327.9	-344.8
Trade balance	-215.9	-262.4	-233.3	-237.8	-209.7	-223.7
Non-factor services, net	232.4	234.6	238.8	244.6	229.4	230.7
Current account	-23.3	-81.6	-53.0	-61.3	-55.1	-73.3
(In percent of GDP)	-4.3	-13.8	-8.5	-9.8	-8.9	-11.4
Official capital (net)	14.7	5.2	-2.0	7.8	23.1	19.0
Private capital (net)	42.9	42.9	25.6	24.3	32.9	30.0
Errors and omissions (net)	-5.3	26.3	21.6	7.8	3.9	0.0
Overall balance	29.1	-7.2	-7.9	-21.4	4.9	-24.3
Gross official reserves (year-end)	119.9	128.5	124.1	94.3	111.3	86.9
(In months of following year's imports of GNFS) 2/	3.1	3.4	3.3	2.6	3.0	2.3
(In percent of short-term ext. debt)	420.3	308.4	252.1	208.3	155.7	123.0
External debt (year-end)	200.8	212.9	211.6	209.8	262.2	281.2
(In percent of GDP)	37.2	36.1	33.9	33.6	42.4	43.6
Debt service	16.3	19.0	22.1	22.0	24.7	22.5
(In percent of domestic exports of GNFS) 3/	4.0	4.7	5.2	5.1	5.5	4.9
Exchange rate						
Rufiyaa per US$ (period average)	11.77	11.77	11.77	12.24	...	...
NEER (percent change)	5.4	0.5	6.7	0.8	-3.2 1/	...
REER (in percent change)	2.3	2.6	3.4	-0.6	-8.5 1/	...
Memorandum items:						
Nominal GDP (millions of rufiyaa)	6,357	6,935	7,348	7,651	7,906	8,257
Terms of trade (percent change)	4.9	-31.0	-2.8	9.9	...	...

Sources: Maldivian authorities; Fund staff estimates and projections.

1/ End-September 2002.
2/ Domestic exports are defined as merchandise exports net of re-exports.
3/ GNFS = Goods and Non Factor Services.

Table 2. Maldives: Balance of Payments, 1997-2003

	1997	1998	1999	2000 Est.	2001 Prel.	2002 Staff	2003 Staff
	(In millions of U.S. dollars)						
Current account balance	-34.2	-23.3	-81.6	-53.0	-61.3	-55.1	-73.3
Trade balance	-214.0	-215.9	-262.4	-233.3	-237.8	-209.7	-223.7
Exports, f.o.b (includes re-exports)	93.0	95.6	91.5	108.7	110.2	118.2	121.0
Imports, f.o.b	-307.0	-311.5	-353.9	-342.0	-348.0	-327.9	-344.8
Services (net)	190.5	204.3	203.6	208.8	206.1	196.4	196.4
Balance on nonfactor services	218.0	232.4	234.6	238.8	244.6	229.4	230.7
Receipts	312.2	331.3	342.8	348.5	354.1	329.3	335.6
o/w: tourism receipts	286.0	303.0	313.5	320.7	327.1	304.2	310.0
Payments	-94.2	-98.9	-108.1	-109.7	-109.4	-99.9	-104.9
Balance on factor services	-27.4	-28.2	-31.0	-30.0	-38.6	-32.9	-34.3
Receipts	7.5	8.6	9.0	10.3	6.8	7.5	8.1
Payments	-34.9	-36.8	-40.1	-40.3	-45.4	-40.4	-42.4
Unrequited transfers (net)	-10.8	-11.7	-22.8	-28.5	-29.5	-41.8	-46.0
Official	17.2	18.9	17.7	17.7	20.1	8.2	10.0
Private	-27.9	-30.6	-40.5	-46.2	-49.6	-50.0	-56.0
Non-monetary capital (net)	61.3	52.3	74.4	45.3	39.9	60.0	49.0
Official medium-and long-term	21.5	14.7	5.2	-2.0	7.8	23.1	19.0
Disbursements	30.7	25.8	17.6	12.4	23.4	40.1	36.0
Amortization	-9.2	-11.1	-12.5	-14.4	-15.6	-17.0	-17.0
Private capital	42.9	42.9	42.9	25.6	24.3	32.9	30.0
Net errors/omissions	-3.2	-5.3	26.3	21.6	7.8	3.9	0.0
Overall balance	27.4	29.1	-7.2	-7.9	-21.4	4.9	-24.3
Monetary movements	-27.4	-29.1	7.2	7.9	21.4	-4.9	24.3
Maldives Monetary Authority	-37.5	-20.2	-8.6	4.4	29.7	-16.9	24.3
Commercial banks	10.1	-8.8	15.8	3.5	-8.3	12.1	0.0
Memorandum items:							
Domestic export growth (value, in percent) 1/	23.8	1.5	-14.3	19.1	0.4	6.0	3.0
Import growth (value, in percent)	15.6	1.5	13.6	-3.4	1.8	-5.8	5.1
Tourism receipts growth (in percent)	7.7	5.9	3.5	2.3	2.0	-7.0	1.9
Current account balance (in percent of GDP)	-6.7	-4.3	-13.8	-8.5	-9.8	-8.9	-11.4
Gross official reserves (in millions of U.S. dollars)	99.7	119.9	128.5	124.1	94.3	111.3	86.9
(in months of following year's imports of GNFS) 2/	2.9	3.1	3.4	3.3	2.6	3.0	2.3
(in percent of short-term external debt, residual maturity)	417.5	420.3	308.4	252.1	208.3	155.7	123.0
External debt (millions of U.S. dollars)	178.1	200.8	212.9	211.6	209.8	262.2	281.2
External debt (percent of GDP)	35.0	37.2	36.1	33.9	33.6	42.4	43.6
Debt service (U.S. dollars)	29.1	16.3	19.0	22.1	22.0	24.7	22.5
Debt service (percent of domestic exports of GNFS) 1/	7.6	4.0	4.7	5.2	5.1	5.5	4.9
Exchange rate (Rufiyaa/U.S. dollar, per avg)	11.8	11.8	11.8	11.8	12.2	...	...
GDP (in millions of U.S. dollars)	508.2	540.1	589.2	624.3	625.0	617.6	645.1

Sources: Maldivian authorities; Fund staff estimates and projections.

1/ Domestic exports are defined as merchandise exports net of re-exports.
2/ GNFS = Goods and Nonfactor Services.

Table 3. Maldives: Central Government Finance, 1997-2003

	1997	1998	1999	2000	2001 Rev.	2002 Staff	2003 Staff
				(In millions of rufiyaa)			
Total revenue and grants	1,824.7	1,930.2	2,225.3	2,372.7	2,513.2	2,660.8	2,810.1
Current revenue	1,652.0	1,763.6	2,058.6	2,202.6	2,317.2	2,557.7	2,677.1
Tax revenue	864.1	902.7	977.3	1,013.8	1,039.9	1,062.5	1,105.7
Non-tax revenue	787.9	860.9	1,081.3	1,188.8	1,277.3	1,495.2	1,571.4
Capital revenue	4.5	2.1	4.0	4.2	13.0	3.6	5.0
Grants	168.2	164.5	162.7	165.9	183.0	99.5	128.0
Expenditure and net lending	1,906.0	2,053.3	2,506.4	2,694.2	2,886.2	3,134.0	3,401.7
Current expenditure	1,182.0	1,297.9	1,545.5	1,875.9	2,021.1	2,069.7	2,325.9
Capital expenditure	754.9	816.0	949.4	864.0	891.8	1,101.5	1,114.6
Net lending	-30.9	-60.6	11.5	-45.7	-26.7	-37.2	-38.9
Overall balance	-81.3	-123.1	-281.1	-321.5	-373.0	-473.2	-591.7
Overall balance excluding grants	-249.5	-287.6	-443.8	-487.4	-556.0	-572.7	-719.7
Current balance	470.0	465.7	513.1	326.7	296.1	488.0	351.1
Foreign financing	172.2	129.3	56.7	3.6	216.7	345.2	204.8
Domestic financing	-90.9	-6.2	224.4	317.9	156.3	128.0	386.9
Government debt (end of period)	2,373.0	2,605.5	2,782.9	3,002.9	3,397.3	3,870.5	4,462.2
Of which: Foreign	1,495.9	1,625.2	1,681.9	1,685.5	1,902.2	2,247.4	2,452.2
				(In percent of GDP)			
Total revenue and grants	30.5	30.4	32.1	32.3	32.8	33.7	34.0
Current revenue	27.6	27.7	29.7	30.0	30.3	32.4	32.4
Tax revenue	14.4	14.2	14.1	13.8	13.6	13.4	13.4
Non-tax revenue	13.2	13.5	15.6	16.2	16.7	18.9	19.0
Capital revenue	0.1	0.0	0.1	0.1	0.2	0.0	0.1
Grants	2.8	2.6	2.3	2.3	2.4	1.3	1.6
Expenditure and net lending	31.9	32.3	36.1	36.7	37.7	39.6	41.2
Current expenditure	19.8	20.4	22.3	25.5	26.4	26.2	28.2
Capital expenditure	12.6	12.8	13.7	11.8	11.7	13.9	13.5
Net lending	-0.5	-1.0	0.2	-0.6	-0.3	-0.5	-0.5
Overall balance	-1.4	-1.9	-4.1	-4.4	-4.9	-6.0	-7.2
Overall balance excluding grants	-4.2	-4.5	-6.4	-6.6	-7.3	-7.2	-8.7
Current balance	7.9	7.3	7.4	4.4	3.9	6.2	4.3
Foreign financing	2.9	2.0	0.8	0.0	2.8	4.4	2.5
Domestic financing	-1.5	-0.1	3.2	4.3	2.0	1.6	4.7
Government debt (end of period)	39.7	41.0	40.1	40.9	44.4	49.0	54.0
Of which: Foreign	25.0	25.6	24.3	22.9	24.9	28.4	29.7
Memorandum item:							
Public saving	673.6	692.9	668.3	542.5	518.8	628.3	523.0
Exchange rate (rufiyaa/U.S. dollar, average)	11.77	11.77	11.77	11.77	12.24	....	...
Growth in current expenditures	23.7	9.8	19.1	21.4	7.7	2.4	12.4
Nominal GDP (millions of rufiyaa)	5,982	6,357	6,935	7,348	7,651	7,906	8,257

Sources: Maldivian authorities; Fund staff estimates and projections.

Table 4. Maldives: Summary of Monetary Accounts and MMA Balance Sheet, 1999-2002

	1999	2000	2001 Jun.	2001 Dec.	2002 Mar.	2002 Jun.	2002 Sep.	2002 Dec. Staff
				(In millions of rufiyaa)				
Monetary survey								
Broad money	2,929.8	3,049.9	3,419.1	3,324.7	3,622.9	3,700.5	3,755.4	3,673.6
Net foreign assets	1,405.4	1,312.1	1,351.6	1,153.2	1,322.1	1,270.2	1,274.5	1,214.5
Monetary Authorities (net)	1,502.2	1,450.4	1,465.8	1,197.1	1,252.9	1,362.8	1,472.9	1,412.9
Commercial banks (net)	-96.8	-138.2	-114.2	-43.9	69.2	-92.6	-198.4	-198.4
Net domestic assets	1,524.3	1,737.7	2,067.5	2,171.5	2,300.9	2,430.3	2,480.9	2,459.0
Domestic credit	2,259.3	2,586.8	2,927.2	3,089.8	3,345.8	3,567.1	3,666.6	3,659.7
Central govt (net)	760.2	995.0	1,183.4	1,078.6	1,309.5	1,324.8	1,248.5	1,206.6
Other	1,499.1	1,591.8	1,743.8	2,011.3	2,036.2	2,242.3	2,418.1	2,453.1
Public enterprises	196.3	184.7	218.5	184.0	140.4	136.8	176.8	240.8
Private sector	1,302.8	1,407.1	1,525.2	1,827.2	1,895.9	2,105.6	2,241.3	2,212.3
Other items (net)	-734.9	-849.1	-859.6	-918.3	-1,044.9	-1,136.8	-1,185.6	-1,200.6
MMA balance sheet								
Reserve money	1,651.3	1,733.5	1,909.2	1,871.5	2,163.6	2,151.0	2,174.0	2,156.2
Net foreign assets	1,502.2	1,450.4	1,465.8	1,197.1	1,252.9	1,362.8	1,472.9	1,412.9
Net domestic assets	149.1	283.1	443.4	674.4	910.7	788.2	701.1	743.3
Net credit to government	921.1	1,177.2	1,409.8	1,300.7	1,563.6	1,603.3	1,522.2	1,428.7
Claims on PNFE and comm banks	3.9	1.6	9.2	1.5	1.5	1.5	1.5	1.5
MMA C/Ds	-569.0	-666.9	-702.3	-323.0	-331.0	-477.6	-487.3	-351.6
Other items, net	-207.0	-228.7	-273.2	-304.7	-323.5	-339.0	-335.3	-335.3
				(In annual percentage change)				
Broad money	3.6	4.1	4.7	9.0	9.7	8.2	15.1	10.5
Net foreign assets	-5.7	-6.6	-3.6	-12.1	-6.4	-6.0	-0.5	5.3
Domestic credit	8.0	14.5	8.7	19.4	22.5	21.9	20.9	18.4
Central government, net	12.9	30.9	5.4	8.4	15.0	11.9	12.8	11.9
Other	5.7	6.2	11.1	26.4	27.9	28.6	25.5	22.0
Public enterprises	18.9	-5.9	-0.2	-0.4	-32.6	-37.4	-26.9	30.9
Private sector	4.0	8.0	12.9	29.9	37.0	38.0	33.0	21.1
Reserve money	7.2	5.0	-1.4	8.0	13.0	12.7	12.8	15.2
Net foreign assets	7.2	-3.5	2.9	-8.3	-9.9	-7.1	-1.6	18.0
Net domestic assets	7.0	89.9	-4.3	21.9	26.1	21.2	15.7	10.2
Net credit to government	15.3	27.8	7.0	10.5	15.9	13.7	14.5	9.8
MMA C/Ds	18.5	17.2	10.4	-51.6	-51.1	-32.0	23.0	8.9
Memo:								
GDP (in millions of rufiyaa)	6,935	7,348	7,651	7,651	7,906	7,906	7,906	7,906
Rufiyaa/U.S. dollar	11.8	11.8	11.8	12.8	12.8	12.8	12.8	...
Velocity, end period	2.4	2.5	2.2	2.3	2.2	2.1	2.1	2.2
Money multiplier	1.8	1.8	1.8	1.7	1.7	1.8	1.7	1.7
Official reserves (millions of US dollars)	128.5	124.1	125.4	94.3	98.7	107.3	115.9	111.3
Commercial banks' NFA (US$ mns)	-8.2	-11.7	-9.7	-3.4	5.4	-7.2	-15.5	-15.5

Sources: Maldivian authorities; Fund staff estimates and projections.

Table 5. Maldives: Indicators of External Vulnerability, 1991-2002

	1991-96	1997	1998	1999	2000	2001 Est.	2002 Latest Data	2002 Date	2002 Staff proj.
	(In percent of GDP, unless otherwise indicated)								
Financial indicators									
Government debt 1/	45.2	39.7	41.0	40.1	40.9	44.4	...	...	49.0
Broad money (annual percent change) 2/	23.3	23.1	22.8	3.6	4.1	5.0	15.1	Sep	10.5
Private sector credit (annual percent change) 2/	20.3	38.9	25.7	4.0	8.0	24.3	33.0	Sep	21.1
External Indicators									
Domestic exports (annual percent change, in US$)	12.1	23.8	1.5	-14.3	19.1	0.4	15.0	Jan-Jul	6.0
Imports (annual percent change, in US$)	12.3	15.6	1.5	13.6	-3.4	1.8	-9.1	Jan-Jul	-5.8
Terms of Trade (annual percent change)	1.8	23.7	4.9	-31.0	-2.8	9.9	...	...	...
Current account balance 1/	-3.1	-6.7	-4.3	-13.8	-8.5	-9.8	...	...	-8.9
Capital and financial account balance	9.7	12.1	9.7	12.6	7.2	6.4	...	...	9.7
o/w: Official medium- and long-term loans (net)	4.9	4.2	2.7	0.9	-0.3	1.2	...	...	3.7
Other	4.8	7.8	7.0	11.7	7.6	5.1	...	...	6.0
Gross official reserves (in US$ millions)	42.4	99.7	119.9	128.5	124.1	94.3	115.9	Sep	111.3
Central Bank short-term foreign liabilities (in US$ millions)	10.7	0.9	0.9	0.9	0.9	0.8	0.9	Sep	0.9
Short term foreign assets of the banking sector (in US$ millions)	14.4	11.5	23.7	19.1	21.9	24.9	39.0	Sep	39.0
Short term foreign liabilities of the banking sector (in US$ millions)	18.2	12.8	16.1	27.3	33.6	28.3	54.5	Sep	54.5
Official reserves in months of following year's imports GNFS 3/	1.7	2.9	3.1	3.4	3.3	2.6	3.3	Sep	3.0
Broad money to reserves	2.8	2.0	2.0	1.9	2.1	2.8	2.5	Sep	2.6
Total reserves to short term external debt (residual maturity)	142.4	417.5	420.3	308.4	252.1	208.3	...	...	155.7
Total external debt	40.8	35.0	37.2	36.1	33.9	33.6	...	...	42.4
o/w: Government debt	24.8	25.0	25.6	24.3	22.9	24.9	...	...	28.4
Total external debt to domestic exports GNFS 4/	59.3	46.2	49.5	52.4	49.9	48.8	...	...	63.9
Debt service to domestic exports GNFS	4.3	7.6	4.0	4.7	5.2	5.1	...	...	5.5
Exchange rate (per US$, end period)	11.3	11.8	11.8	11.8	11.8	12.8	12.8	Sep	...
REER appreciation (+) (period average, 12 month basis)	3.0	14.0	2.3	2.6	3.4	-0.6	-8.5	Sep	...

Sources: Maldivian authorities, and staff estimates and projections.

1/ The first entry is the average for 1995-96.
2/ Adjusted for the exchange rate change in 2001.
3/ GNFS = Goods and Non Factor Services.
4/ Domestic exports are defined as merchandise exports net of re-exports.

Table 6. Maldives: Current Policies with Eventual Forced Adjustment Scenario, 2001-2007

	2001 Prel.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.
	(In annual percentage change)						
Output and prices							
Real GDP growth	3.5	2.3	3.2	3.5	2.4	2.3	2.2
Consumer prices (period average)	0.7	1.0	1.2	2.2	2.8	3.5	3.5
	(In percent of GDP)						
Central government							
Revenue and grants	32.8	33.7	34.0	33.9	34.3	33.9	34.1
Tax revenue	13.6	13.4	13.4	13.2	13.2	12.4	12.3
Non-tax revenue	16.7	18.9	19.0	19.2	19.7	20.1	20.6
Grants	2.4	1.3	1.6	1.5	1.4	1.3	1.2
Expenditure and net lending	37.7	39.6	41.2	41.0	38.5	36.8	36.9
Current expenditure	26.4	26.2	28.2	28.5	29.0	29.3	29.3
Capital expenditure	11.7	13.9	13.5	13.0	10.0	8.0	8.0
Overall balance	-4.9	-6.0	-7.2	-7.1	-4.3	-2.9	-2.8
Overall balance, excl. grants	-7.3	-7.2	-8.7	-8.6	-5.6	-4.2	-4.0
Financing							
Domestic	2.0	1.6	4.7	4.9	2.6	1.3	1.3
Foreign	2.8	4.4	2.5	2.2	1.7	1.6	1.5
Total public sector debt	51.0	56.3	61.3	64.7	65.2	65.1	65.0
Total government debt	44.4	49.0	54.0	58.2	59.6	59.2	58.7
Of which: Foreign debt	24.9	28.4	29.7	30.3	30.4	30.3	30.2
Public enterprise debt	6.6	7.3	7.2	6.5	5.6	5.9	6.3
Monetary survey	(In percent change, annual)						
Broad money	9.0	10.5	7.8	6.6	6.0	5.9	5.8
Domestic credit	19.4	18.4	16.3	15.4	7.6	4.5	3.0
Credit to government (net)	8.4	11.9	32.1	26.9	11.7	5.8	5.5
Credit to the private sector	29.9	21.1	9.5	9.3	5.1	3.8	1.1
	(In millions of U.S. dollars, unless otherwise indicated)						
Balance of payments							
Domestic exports (in percent change) 2/	0.4	6.0	3.0	3.0	3.0	-48.5 1/	3.0
Merchandise imports (in percent change)	1.8	-5.8	5.1	1.7	-4.4	-11.3	1.5
Tourism receipts (in percent change)	2.0	-7.0	1.9	1.9	4.6	4.5	4.5
Trade balance	-237.8	-209.7	-223.7	-230.3	-211.5	-216.4	-218.0
Non-factor services, net	244.6	229.4	230.7	231.7	242.0	252.4	263.2
Current account balance	-61.3	-55.1	-73.3	-80.7	-56.3	-44.9	-40.4
(In percent of GDP)	-9.8	-8.9	-11.4	-11.8	-7.8	-5.9	-5.0
Overall balance	-21.4	4.9	-24.3	-30.7	-9.3	2.1	7.6
Memorandum items:							
Gross official reserves (year-end)	94.3	111.3	86.9	56.2	46.9	49.0	57.6
(In months of current year's imports of goods)	2.9	3.2	2.3	1.5	1.2	1.3	1.5
(In months of following year's imports of GNFS) 3/	2.6	3.0	2.3	1.5	1.3	1.4	...
External debt (year-end)	209.8	262.2	281.2	296.2	308.2	320.2	332.2
(In percent of GDP)	33.6	42.4	43.6	43.4	42.9	42.1	41.3
Debt service	22.0	24.7	22.5	22.1	23.3	25.2	25.0
(In percent of exports of GNFS) 3/	5.1	5.5	4.9	4.8	4.8	5.5	5.3

Sources: Maldivian authorities; Fund staff estimates and projections.

1/ The decline in exports in 2006 reflects the expiration of garment export privileges. Garments account for almost half of merchandise exports.
2/ Domestic exports are defined as merchandise exports net of re-exports.
3/ GNFS = Goods and Nonfactor Services.

Table 7. Maldives: Reform Policies Scenario, 2001-2007

	2001 Prel.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.
				(In annual percentage change)			
Output and prices							
Real GDP growth	3.5	2.3	2.8	5.0	5.6	6.8	7.3
Consumer prices (period average)	0.7	1.0	1.5	1.9	2.5	2.7	3.0
				(In percent of GDP)			
Central government							
Revenue and grants	32.8	33.7	35.6	35.1	35.1	34.6	34.2
Tax revenue	13.6	13.4	14.9	14.4	14.1	13.5	12.9
Non-tax revenue	16.7	18.9	19.0	19.2	19.6	19.9	20.1
Grants	2.4	1.3	1.6	1.5	1.3	1.2	1.1
Expenditure and net lending	37.7	39.6	39.4	37.9	37.6	37.0	36.1
Current expenditure	26.4	26.2	26.3	26.4	26.1	25.4	24.6
Capital expenditure	11.7	13.9	13.5	12.0	12.0	12.0	12.0
Overall balance	-4.9	-6.0	-3.8	-2.8	-2.5	-2.3	-2.0
Overall balance, excl. grants	-7.3	-7.2	-5.4	-4.2	-3.8	-3.5	-3.1
Financing							
Domestic	2.0	1.6	0.9	-0.1	-0.2	-0.1	-0.2
Foreign	2.8	4.4	2.9	2.9	2.7	2.4	2.2
Total public sector debt	51.0	56.3	57.9	56.5	54.0	52.0	49.5
Total government debt	44.4	49.0	50.7	50.2	48.9	46.9	44.4
Of which: Foreign debt	24.9	28.4	30.1	31.1	31.4	31.1	30.3
Estimated public enterprise debt	6.6	7.3	7.2	6.3	5.2	5.1	5.1
Monetary survey				(In percent change, annual)			
Broad money	9.0	10.5	5.9	8.9	8.0	10.0	10.5
Domestic credit	19.4	18.4	11.8	12.5	6.8	7.0	4.0
Credit to government (net)	8.4	11.9	6.4	-0.9	-1.4	-1.0	-2.3
Credit to the private sector	29.9	21.1	16.0	20.3	10.7	10.5	6.3
				(In millions of U.S. dollars, unless otherwise indicated)			
Balance of payments							
Domestic exports (in percent change) 2/	0.4	6.0	5.0	6.0	7.0	-46.3 1/	8.0
Merchandise imports (in percent change)	1.8	-5.8	4.0	1.3	2.7	-6.2	3.5
Tourism receipts (in percent change)	2.0	-7.0	1.9	2.9	6.4	6.4	6.4
Trade balance	-237.8	-209.7	-218.5	-220.8	-222.6	-244.3	-249.4
Non-factor services, net	244.6	229.4	230.5	235.0	251.5	269.1	287.9
Current account balance	-61.3	-55.1	-68.3	-67.8	-57.9	-56.2	-47.1
(In percent of GDP)	-9.8	-8.9	-10.6	-9.8	-7.8	-6.9	-5.2
Overall balance	-21.4	4.9	-16.8	-12.8	2.1	8.8	23.9
Memorandum items:							
Gross official reserves (year-end)	94.3	111.3	94.5	81.7	83.7	92.5	117.5
(In months of current year's imports of goods)	2.9	3.2	2.6	2.1	2.2	2.3	2.9
(In months of following year's imports of GNFS) 3/	2.6	3.0	2.5	2.1	2.2	2.4	...
External debt (year-end)	209.8	262.2	283.7	303.7	323.7	343.7	363.7
(In percent of GDP)	33.6	42.4	44.0	44.1	43.4	42.0	40.2
Debt service	22.0	24.7	22.5	22.2	23.5	23.0	23.4
(In percent of domestic exports of GNFS) 3/	5.1	5.5	4.9	4.7	4.7	4.8	4.6

Sources: Maldivian authorities; Fund staff estimates and projections.

1/ The decline in exports in 2006 reflects the expiration of garment export privileges. Garments account for almost half of total merchandise exports.
2/ Domestic exports are defined as merchandise exports net of re-exports.
3/ GNFS = Goods and Nonfactor Services.

Maldives: Fund Relations
(As of November 30, 2002)

I. **Membership Status**: Joined 1/13/78; Article XIV

II. General Resources Account:	SDR Million	% Quota
Quota	8.20	100.00
Fund holdings of currency	6.65	81.05
Reserve position in Fund	1.55	18.95

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	0.28	100.00
Holdings	0.28	98.80

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund**: None

VII. **Exchange Arrangements**

From March 1, 1982 to June 30, 1985, the Maldivian rufiyaa was pegged to the U.S. dollar. Beginning in July 1985, the exchange rate of the rufiyaa was linked to a trade-weighted basket of currencies, but the exchange rate vis-à-vis the U.S. dollar remained relatively stable until February 1987. On March 1, 1987, the rufiyaa was devalued by 29 percent vis-à-vis the U.S. dollar. From 1987 to 1994, the exchange rate of the rufiyaa was adjusted periodically. Since October 1994, the exchange rate of the rufiyaa remained unchanged at Rf 11.77 per U.S. dollar, until July 25, 2001, when the rufiyaa was devalued to Rf. 12.8 per U.S. dollar.

Maldives continues to avail itself of the transitional arrangements under the provisions of Article XIV, but no longer maintains restrictions under Article XIV. Under these circumstances, any exchange rate restrictions that arise are subject to approval under Article VIII. Maldives' Post Office Exchange Counter (which existed until July 2000) did not by itself give rise to an exchange rate restriction. However, a restriction arises from time to time (as found in 1994-95) in the context of a general foreign exchange shortage and undue delays in the making of current international payments.

VIII. **Last Article IV Consultation**

The 2001 Article IV consultation (SM/01/253, August 14, 2001) was concluded by the Executive Board on August 31, 2001 (EBM/01/86).

IX. Technical Assistance

FAD: In April 1994, Mr. Potter and Ms. Bédague visited Male to advise on budget management. This was followed by periodic assistance from Mr. Webber (consultant) over the period November 1994 to December 1995. In July 1994, Mr. Faria and Mr. Kambil (consultant) assisted in formulating a strategy for revenue reform. This was followed by a visit by Mr. Kambil in August/September 1995 to draft tax legislation. In October 1996, a tax administration mission visited Male to develop a strategy to establish an Inland Revenue Department and a follow-up mission by a consultant took place in June 1997.

MAE: In March 1993, a consultant provided assistance on the introduction of treasury bills. In November 1994, a mission headed by Mr. Taniguchi provided assistance on monetary management, foreign exchange operations, and bank supervision. In February/June 1995, a consultant provided assistance for the development of a treasury bill and MMA certificate market. In February/March 1996, a mission headed by Mr. Swinburne provided advice on the reform of monetary operations and exchange system. This was followed by a visit of a foreign exchange advisor in May 1997. In early 2001, two consultants provided assistance on foreign exchange and monetary management, of two mission each. In July 2001, a consultant provided assistance on monetary management following the lifting of credit ceilings and further impending changes in the monetary framework. In October 2002, a multi-purpose mission took stock of developments and provided recommendations in the areas of banking, foreign exchange operations, and foreign exchange reserves management.

STA: In June 1993 and February 1994, assistance was provided on monetary and balance of payments statistics, respectively. In May 1995, a STA consultant provided assistance on the compilation of a new consumer price index, which was followed by further assistance in August 1996.

MALDIVES: RELATIONS WITH THE WORLD BANK GROUP[1]
(As of October 31, 2002)

IBRD/IDA Lending Operations

	Commitments	Of which: Undisbursed
	(In millions of U.S. dollars net of cancellation)	
Current Portfolio (IDA):		
Education and Training III	17.6	12.9
sub-total	17.6	12.9
Closed projects (IDA):		
Fisheries I	2.48	0.0
Fisheries II	4.93	0.0
Fisheries III	8.62	0.0
Male Airport Upgrading	7.29	0.0
Education and Training	7.92	0.0
Education and Training II	13.40	0.0
sub-total	44.64	0.0
Total	**62.24**	**12.9**

Project Implementation

The International Development Association's (IDA's) involvement in the Maldives has focused on the leading economic activities and related infrastructure, as well as human resource development. IDA's first credit to the Maldives, Fisheries I, became effective on August 10, 1979. Since then, IDA has supported six additional projects, totaling about $62 million. The first, Second, and Third Fisheries Projects contributed to increased fish production, exports, and the incomes of the fishermen in the outer atolls. IDA supported the development of tourism through the Male Airport Upgrading project that was approved on May 29, 1990. IDA has also supported human resource development in Maldives by widening access to secondary education, improving planning and management capacity in the

[1]Prepared by World Bank staff.

Ministry of Education, providing overseas scholarships for critical skills training and training for teachers in country. The Maldives also received a \$243,000 Institutional Development Fund (IDF) grant to strengthen the Public Enterprise Monitoring unit in the Ministry of Finance and Treasury.

The current IDA portfolio has one project, Third Education and Training, which is building upon the successes of the First and Second education projects. IDA is also providing technical assistance (\$245,000-IDF) to the Government to develop an appropriate legal/regulatory framework for efficient land and housing markets in Maldives. In the current Country Assistance Strategy (CAS) dated November 17, 2000, the Bank outlines its strategic choice to increase the frequency and scope of non-lending activities, and gradually shift from sector-specific project lending to a programmatic approach to lending. The objective of this strategy is to reduce poverty and the regional disparities in access to social and infrastructure services in the Maldives. A new project is currently being considered to support the Government's objective of fostering regional growth centers in the outer atolls.

MALDIVES: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]
(As of August 31, 2002)

The Asian Development Bank (AsDB) has provided 11 Special Fund loans for a total of $71.3 million to Maldives since 1981. Until late 1990s, AsDB's loan projects focused on infrastructure development in Male'. However, the focus has shifted in the recent years to social infrastructure development in the atolls and education. As of August 2002 cumulative disbursements amounted to $43.3 million, or 61 percent of the amount available for withdrawal. In addition, the AsDB has provided 28 advisory technical assistance (TA) grants for $11.39 million and 14 TA grants amounting to $3.19 million for preparation of loan projects.

List of Loans

Loan Name	Year of Loan Approval	Net Loan Amount	Of which: Disbursed
	(In millions of U. S. dollars)		
Inter-island Transport Project (closed)	1981	0.85	0.85
Multi-project (closed)	1984	2.88	2.88
Power System Development Project (closed)	1987	6.54	6.54
Male Port Development Project (closed)	1988	6.75	6.75
Second Power System Development Project (closed)	1991	9.21	9.21
Second Male Port Development Project (closed)	1993	7.85	7.85
Third Power System Development Project	1997	6.46	4.72
Post Secondary Education Development Project	1998	5.96	1.32
Regional Development Project	1999	7.47	3.17
Information Technology Development	2001	9.40	0.00
Outer Islands Electrification	2001	7.90	0.00
Total		71.27	43.29

[1]Prepared by the Asian Development Bank.

Maldives: Social and Demographic Indicators

	Latest single year	
	1980-85	1995-2001
GDP per capita:	$469	$2,265
Land area:	298 km	298 km
Population:		
Total population	180,088	275,975
Rate of growth (percent per annum)	2.8	2.0
Density in Male (persons per sq. km.)		70,000
Population characteristics (1998):		
Infant mortality at birth (per 1,000)	86.8	27.8
Crude birth rate (per 1,000)	49.5	19
Crude death rate (per 1,000)	8.8	4
Life expectancy at birth (years)	58.7	68.3
Labor force (in percent of working-age population):		
Labor force participation rate	46.7	54.8
Male	69.6	71.7
Female	21.4	37.4
Unemployment rate (1995)		0.8
Health care (1997):		
Access to safe water	17	89
Immunization (DPT, percent of children under age one)	28	92
Population per physician	7,889	1,328
Population per nurse	10,080	1,068
Population per hospital bed	1500	687
Education:		
School enrollment, primary (gross, 1997)	145.6	128.3
School enrollment, secondary (gross, 1996)	4.1	59.5
Adult illiteracy rate (percent, ages 15 and above)	6.8	3.3

Sources: *Statistical Yearbook of Maldives, various years* ; Maldivian authorities; World Development Indicators 2000; and IMF staff estimates.

MALDIVES: STATISTICAL ISSUES

The Maldives has substantially improved its macroeconomic statistics in recent years, with technical assistance from STA and the Asian Development Bank (AsDB). However, problems with the compilation and reporting of basic economic data remain, especially with respect to balance of payments statistics. The main official statistical publication is the *Statistical Yearbook of Maldives* for which the latest version refers to 2002. APD also receives, albeit with a lag, the *Quarterly Economic Bulletin* and the *Annual Report* of the Maldives Monetary Authority.

I. Real Sector

Substantial progress has been made regarding national accounts. The AsDB is assisting the authorities in setting up a framework for compiling more comprehensive national accounts. Results from this work are beginning to be seen, with rebased figures on the production side, and preliminary figures on the expenditure side.

The CPI based on the 1993 income and expenditure survey and incorporating improved data collection procedures was developed with STA assistance—and has been compiled since June 1995. A STA consumer price statistics mission of August 1996 recommended that the authorities develop additional price indices for a more comprehensive analysis of inflation.

II. Fiscal Sector

In 1996, the authorities resumed regular reporting of data for publication in the *GFS Yearbook* and the latest published data refer to 2000.

III. Monetary sector

In 2001 the Maldives Monetary Authority (MMA) began reporting monetary data on a monthly basis. However, there are inconsistencies between monetary and fiscal data regarding the financing of the fiscal deficit. Reconciliation involves issues of timing and coverage.

IV. External Sector

Following the 1994 STA mission, a number of measures were taken to improve data coverage and quality for the balance of payments. However, problems of coverage remain. Travel receipts are still estimated on the basis of a small-sample inquiry of resorts/hotels to determine daily average expenditure by tourists. Estimates of profit remittances and reinvested earnings in the tourism sector are still unsatisfactory. Information on private capital flows is incomplete.

Official reserves are reported monthly with a (variable) two week lag. Predetermined drains on foreign currency assets (mainly debt service payments) are known and reported at the time of the annual missions, while contingent drains on foreign currency assets have not been identified.

Quarterly data on external debt and debt service is available for the government and the monetary authority, and to a limited extent for the banking sector, while no data is reported for the corporate sector. Data is made available at the time of the annual missions.

Maldives: Survey of Reporting of Main Statistical Indicators 1/
(As of December 16, 2002)

	Exchange Rates	International Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance 2/	GDP/ GNP	External Debt	Debt Service
Date of latest observation	11/08/02	Sept. 02	Sept. 02	Sept. 02	Sept. 02	Sept. 02	Sept. 02	Aug. 02	2001	2001	2001	2002Q2	2002Q2
Date received	11/08/02	10/15/02	10/15/02	10/15/02	10/15/02	10/15/02	11/05/02	10/15/02	8/15/02	8/15/02	12/16/02	10/15/02	10/15/02
Frequency of data 3/	D	M	M	M	M	M	M	M	A	A	A	Q	Q
Frequency of reporting 4/	M	M	M	M	M	M	M	M	V	V	V	V	V
Source of data 5/	E	E	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting 6/	E	E	E	E	E	E	E	E	E	E	E	E	E
Confidentiality 7/	C	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of publication	Q	Q	Q	Q	Q	Q	M	Q	A	A	A	A	A

1/ Data available on both gross official reserve assets and net international reserves.
2/ Cetral government balance
3/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, or O-other.
4/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, V-irregularly in conjunction with staff visits, or O-other irregular basis.
5/ A-direct reporting by central bank, Ministry of Finance, or other official agency, N-official publication or press release, P-commercial publication, C-commercial electronic data provider, E-IMF=s Economic Information System (EIS), O-other.
6/ E-electronic data transfer, C-cable or facsimile, T-telephone, M-mail, V-staff visits, O-other.
7/ A-for use by the staff only, B-use by the staff and the Executive Board, C-unrestricted use, D-embargoed for a specified period and thereafter for unrestricted use, E-subject to other use restrictions.

INTERNATIONAL MONETARY FUND

MALDIVES

Staff Report for the 2002 Article IV Consultation – Supplementary Information

Prepared by the Asia and Pacific Department
(In consultation with other departments)

Approved by Daniel Citrin and Martin Fetherston

January 6, 2003

1. This supplement summarizes information that has become available since the staff report (SM/02/379) was finalized. These developments, in particular the recently passed 2003 budget, reinforce the staff's appraisal of policy requirements.

I. Recent Economic Developments

2. The recovery in tourism has firmed. In January-November 2002, tourist arrivals grew by 2.3 percent over the same period in 2001. Partly as a result of the improved performance of the tourist sector, GDP growth estimates have been revised upwards. The authorities now estimate growth in 2002 at 4.3 percent, higher than the earlier estimate by two percentage points.

3. Inflation has picked up but remains low at 3.3 percent (12-month change) in November 2002.

4. Official reserves have almost fully reversed their losses, reaching US$127 million at end-November (3.4 months of imports), compared with US$131 million in April 2000.

II. Fiscal Developments in 2002 and the 2003 Budget

5. Very preliminary estimates for 2002 provided by the authorities point to a budget deficit of 7 percent of GDP, an outturn close to that targeted at the time of budget formulation, but larger than expected by staff at the time of the consultation discussions. Expenditures are reported to have risen by 3 percentage points of GDP from 2001, mainly due to higher capital spending (mostly foreign-financed), which were partially offset by stronger than expected inflows of grants.[1] The estimated 2002 deficit, up from 4.7 percent of

[1] The higher reported deficit relative to the staff projection also reflects higher foreign-financed capital expenditures. It should be noted that in previous years, these figures have been subject to significant revisions.

GDP in 2001, would represent a continuation of a pattern of widening fiscal imbalances, albeit with reduced recourse to central bank financing.[2]

6. The 2003 budget was approved by Parliament at end-December. It targets a widening in the overall deficit to 8½ percent of GDP, mainly driven by further spending increases. Current expenditure is budgeted to rise by 1½ percentage points of GDP and capital expenditure by 2½ percentage points of GDP, with higher revenues, including from leases of tourism resorts, providing only a partial offset. The authorities expect the deficit to be mostly foreign-financed, with central bank financing projected to fall to 0.3 percent of GDP. Details on the prospective sources of foreign financing are not yet available. The fiscal target is inconsistent with the pressing need for fiscal restraint. In addition, there is a concern that if the planned foreign financing does not materialize, central bank funds might, as in the past, be used to finance the deficit. Such recourse to domestic financing would jeopardize external viability. Excessive reliance on foreign financing at commercial terms may also pose risks, as discussed in the staff report.

[2] 2001 figures have been slightly revised.

FOR AGENDA

SM/02/379
Supplement 1
Correction 1

January 7, 2003

To: Members of the Executive Board

From: The Secretary

Subject: **Maldives—Staff Report for the 2002 Article IV Consultation**

The attached page 3 was inadvertently omitted from the supplement to the staff report for the 2002 Article IV consultation with Maldives (SM/02/379, Sup. 1, 1/6/03), which is scheduled for discussion tomorrow, **Wednesday, January 8, 2003**.

Questions may be referred to Mr. Zanello (ext. 34708), Mr. Becker (ext. 34428), and Ms. Kongsamut (ext. 34541) in APD.

Att: (1)

Other Distribution:
Department Heads

Table 1. Maldives: Central Government Finance, 2001-2003

	2001 Budget	2001 Rev. Est.	2002 Budget	2002 Prel. Est.	2003 Budget
	(In millions of Rufiyaa)				
Total revenue and grants	2,710.4	2,522.6	2,740.3	2,725.3	2,986.8
Total revenue	2,528.3	2,310.9	2,640.8	2,578.1	2,873.4
Current revenue	2,514.1	2,294.3	2,628.5	2,574.5	2,825.6
Tax revenue	1,131.6	1,046.6	1,100.3	1,071.2	1,130.9
Non-tax revenue	1,382.5	1,247.7	1,528.2	1,503.3	1,694.7
Capital revenue	14.2	16.6	12.3	3.6	47.8
Grants	182.1	211.7	99.5	147.2	113.4
Expenditure and net lending	3,325.7	2,885.9	3,279.3	3,293.7	3,704.6
Current expenditure	2,017.9	1,971.4	2,113.0	2,136.1	2,367.5
Capital expenditure	1,353.3	940.7	1,207.8	1,198.0	1,459.0
Net lending	-45.5	-26.2	-41.5	-40.4	-121.9
Overall balance	-615.3	-363.3	-539.0	-568.4	-717.8
Overall balance excluding grants	-797.4	-575.0	-638.5	-715.6	-831.2
Current balance	496.2	322.9	515.5	438.4	458.1
Foreign financing	589.6	145.8	511.0	506.8	689.8
Domestic financing	25.7	217.5	28.0	61.6	28.0
	(in percent of GDP)				
Total revenue and grants	35.6	33.0	38.8	33.8	35.5
Current revenue	33.0	30.0	37.2	31.9	33.6
Tax revenue	14.9	13.7	15.6	13.3	13.4
Non-tax revenue	18.2	16.3	21.7	18.6	20.1
Capital revenue	0.2	0.2	0.2	0.0	0.6
Grants	2.4	2.8	1.4	1.8	1.3
Expenditure and net lending	43.7	37.7	46.5	40.8	44.0
Current expenditure	26.5	25.8	29.9	26.5	28.1
Capital expenditure	17.8	12.3	15.3	14.9	17.3
Net lending	-0.6	-0.3	-0.6	-0.5	-1.4
Overall balance	-8.1	-4.7	-7.6	-7.0	-8.5
Overall balance excluding grants	-10.5	-7.5	-9.0	-8.9	-9.9
Current balance	6.5	4.2	7.3	5.4	5.4
Foreign financing	7.7	1.9	7.2	6.3	8.2
Domestic financing	0.3	2.8	0.4	0.8	0.3

Source: Data provided by the Maldivian authorities.

Statement by Mr. Shaalan on Maldives
Executive Board Meeting 03/1
January 8, 2003

At the outset, I would like to convey the Maldives authorities' sincere appreciation for the staff's valuable assessment of recent economic developments and policy recommendations during the consultation process. The authorities are also grateful for the most helpful technical assistance the Fund has been providing over the years. They attach considerable weight to both aspects of the Fund's work in Maldives in designing the country's economic policies. They are in broad agreement with the analysis and with the thrust of the policy recommendations contained in the well written staff report.

Background

The authorities' policy focus over the past decade has been on expanding the productive base of the economy while improving the living conditions of the Maldivian people by building a reliable human and physical infrastructure. They have achieved major progress on many fronts while maintaining a stable macro environment. Growth rates were consistently high, while inflation was kept under control. Per capita income in fact exceeded $2000, double the level of the previous decade, and social indicators, including in particular in the health and education sectors have improved appreciably.

These major advances are all the more significant when cast against the challenging geographic character of this small open economy where a good deal of the resources are used to connect the large number of islands, particularly the 200 inhabited ones. Furthermore, with a narrow productive base, important efficiency gains had to be generated to support the expansion of the two main sectors, namely the fisheries and tourism. Against this background, it is not surprising that access to concessional resources played a significant role in helping the authorities make the abovementioned social and economic gains.

Recent Developments

Developments more recently have generally been influenced by a combination of exogenous factors that have hindered the economy's ability to grow at the high rates that characterized previous years. The weaknesses registered in 2000 and early 2001(which were due in large part to the declining tuna fish catch and a relatively weak tourism season) were compounded by the effect of the events of 9/11 and subsequently in Asia on tourist arrivals. Recently, however, the recovery in tourism has strengthened and led to an improvement in the overall growth performance of the economy, which is projected by the authorities to reach 4.3 percent in 2002.

Diminishing access to concessional resources has added to the effect of the slowdown in the pace of economic activity on the fiscal position. With demands on the budget remaining high, the authorities had to resort to the domestic market, mainly the Maldives Monetary Authority (MMA), to compensate for falling foreign sources of financing. In the event, and in spite of the efforts to contain MMA financing of the budget, macro imbalances started to emerge adding pressure on the country's already tight reserve position.

In order to address the emerging shortages in the foreign exchange market and more importantly to reverse the competitiveness losses, the authorities effected a 9 percent adjustment in the exchange rate. They are confident that the new exchange rate is an adequate reflection of the prevailing economic fundamentals as clearly evidenced by the disappearance of the parallel market and the marked improvement in international competitiveness. In addition, international reserves have been restored back to $127 million by end-November 2002.

Macroeconomic Policies

The authorities are fully cognizant of the importance of safeguarding the gains achieved in the wake of the depreciation, including the stability of the exchange rate at the current level. Efforts have been underway to enhance both the fiscal and monetary policy frameworks in order to strengthen the ability of the authorities to effectively implement needed policies and address the remaining macro imbalances, while improving the medium-term prospects of the economy.

Fiscal Policy

In the fiscal area, the continued increase in the fiscal deficit, which has been partly due to revenue shortfalls associated with the decline in economic growth, has focused attention on the necessity of controlling the growth in spending. The authorities are determined to take steps in this direction in the context of the 2003 budget. In this regard, they are putting in place an expenditure monitoring mechanism that should effectively help to control the growth in spending. This mechanism will soon become operational once the revamped public accounting system is introduced. Given its considerable rise in recent years, the authorities intend to contain the growth in current outlays by limiting salary increases and reforming the social security system. They also agree with the staff that there is room for prioritizing capital spending. They are hopeful that with stronger monitoring of expenditures, resort to central bank financing will be reduced.

While committed to a path of consolidation through expenditure measures, the authorities are keen on ensuring that the ongoing effort to sustain and build on the recent gains in social indicators stays on track. Furthermore, given that the ongoing recovery is just starting to take hold, they do not wish to take fiscal measures that risk jeopardizing it. They intend to avoid cuts in the social sector areas and key capital projects, and to appropriate adequate resources for current expenditures associated with such projects. In addition, investment projects for 2003 are aimed at promoting the private sector and generating employment by further improving the country's infrastructure.

On the revenue side of the budget, the authorities are convinced that strengthening the revenue base is an essential element in consolidating the fiscal position over the medium term. In this regard, they see scope for increasing the level of taxation in the tourism sector once the health of the sector is restored. Notwithstanding the recent pick up, the sector is still suffering from weaknesses and as such it would not be wise at this time to overburden it with new taxes. In addition, the authorities are awaiting the AsDB sponsored study on tax reform to consider widening the tax base by implementing property and business taxes. As the country's administrative apparatus improves in the period ahead, the authorities would be better placed to take concrete actions to effectively strengthen revenue generation.

As I emphasized above, Maldives has been an effective user of concessional financial resources. The authorities are of the strong view that the country's remaining vulnerabilities, as clearly outlined by the staff, as well as its unique geographic and environmental characteristics, provide a strong case for maintaining the country's access to these resources to support their poverty reduction efforts. With these resources dwindling, recourse to non-concessional funds has increased and consequently placed some of the burden of financing the country's development requirements on its own narrow and vulnerable productive base.

Monetary Policy

Following the introduction of a number of measures to enhance the conduct of monetary policy, including the abolition of the cap on interest rate spread, the removal of bank specific credit ceiling, and the use of central bank certificate of deposits, the management of liquidity improved and the long standing liquidity overhang was released. As a result, private sector credit increased by 23 percent in 2002, while money growth was contained. For the period ahead, the aim of monetary policy will be to support the pegged exchange rate system. In this regard, the authorities will further develop the use of indirect monetary policy instruments to control liquidity, while moving to limit the government's automatic resort to the MMA overdraft facility. They are aware of the importance of laying the institutional groundwork for the introduction of treasury bills to replace the present overdraft system.

In line with the objective of building up the MMA reserve position, international reserves have already been restored to the equivalent of 3.4 months of imports. The authorities agree with the staff that continuing the accumulation of reserves to the equivalent of 5 months of imports needs to be underpinned by a stronger fiscal position.

Structural Reforms and Other Issues

In line with their conviction that promoting the role of the private sector is key to widening the country's production and export base, the authorities have revived the structural reform agenda. They have opened fish exports to private operators, and the restructuring of the loss making Maldives Industrial Fisheries Company is already in progress. In addition, notwithstanding the impact of the underdeveloped capital market, shares of the State Trading Organization (STO) were sold to the public. With a view to selling the remaining shares of STO, the authorities plan to take measures to improve the trading infrastructure, including by enacting a securities law and possibly giving a role to the Provident Fund in this regard. On the institutional front, the Law Commission has been established and should lead to speeding up the legislative process and pass a number of legal reforms needed to improve the business environment.

The authorities are in the process of introducing reforms aimed at liberalizing and improving the efficiency of the banking sector. The recent entry of an international bank and the establishment of a leasing company should hopefully remove some of the difficulties small firms face in obtaining credit. The authorities share staff's view that efforts in the period ahead should be directed at reducing the reserve requirements and establishing an interbank market. While domestic banks are profitable and well capitalized, the authorities agree that improving the regulatory and supervisory framework is warranted in light of the growing competition in the market. Furthermore, notwithstanding the fact that at present non-performing loans (NPLs) do not represent a serious concern, their recent emergence in light of the economic slowdown merits a closer look at loan classification and provisioning. It should be noted here that the big jump in NPLs in June 2002 is mainly attributable to a rise in NPLs at one of the largest banks which reached 25 percent of total loans. The authorities would like to emphasize that this issue is a localized problem and has no implications on the banking system in general.

Finally, the authorities are well aware of the statistical limitations in their economic database. They are currently working closely with the AsDB and other donors to address the existing weaknesses. Clearly, these weaknesses are symptomatic of the serious capacity constraints that span a wide range of government activities and limit the authorities' ability to aggressively move on a number of essential reforms. In this regard, they look forward for continued cooperation with the Fund and other donors to support their efforts to build-up the implementation capacity of the government. This is obviously a long-term endeavor that requires improvements in the absorptive capacity of the government.