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2001 ARTICLE IV CONSULTATION—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 2001 Article IV consultation with Maldives, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 30, 2001, following discussions that ended on June 7, 2001, 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 August 13, 2001.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Maldives.

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INTERNATIONAL MONETARY FUND

MALDIVES

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the
2001 Consultation with Maldives

Approved by Charles Collyns and Mark Allen

August 13, 2001

- The 2001 Article IV consultation discussions were held in Male during May 27–June 7, 2001. The staff team comprised Mr. Arnason (Head, TRE), Ms. Kongsamut, and Mr. Cheunsomchit (both APD). Mr. Dornseif, a technical assistance expert in the monetary area, overlapped with the mission.
- The staff team met with the Minister of State for Finance and Treasury and Vice Governor of the Maldives Monetary Authority Jaleel (Minister Jaleel holds both positions); the Ministers of Planning and National Development, Tourism, Industry and Trade, Fisheries, and Labor and Human Resources, and the Attorney General; and other senior officials and private sector representatives.
- Maldives continues to avail itself of the transitional arrangements under Article XIV, but no longer maintains restrictions under Article XIV. In late 2000 and early 2001, limits on the availability of foreign exchange resulted in a significant premium in the parallel market and undue delays in the making of current international payments. On July 25, the rufiyaa was devalued by 9 percent.
- Despite improvements in recent years, gaps and inconsistencies in economic data in a number of areas continue to impede surveillance and policy design.
- The authorities do not plan to publish the staff report or issue a PIN at the conclusion of the 2001 Article IV consultation.
- The principal authors of this report are Mr. Arnason and Ms. Kongsamut.

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I. Introduction and Background

1. **The economic challenges faced by Maldives are strongly influenced by geography and environment.** Maldives is an archipelago of close to 1,200 coral islands in the Indian Ocean, some 200 of which are inhabited. The country's total area is 900,000 square kilometers, of which only 300 square kilometers are land. Maldives is simultaneously confronted with a widely dispersed population, with high costs of providing social infrastructure and services, and an acute shortage of land, especially in Male. The government's overarching development strategy consists of creating new growth centers in the north and the south of the country and massive land reclamation in the vicinity of Male. The coral marine environment is particularly fragile, and the authorities' tourism development strategy has placed a strong emphasis on environmental protection. Maldives is also seriously threatened by the prospect of rising sea levels in coming decades as a result of global warming.

2. **Notwithstanding a slowdown in growth in 2000, Maldives' economy has prospered with the rapid expansion of tourism and the modernization of the fisheries.** During the 1990s, annual GDP growth averaged around 8 percent, raising per capita income by more than 70 percent, to above US$2,000 in 2000 (Annex IV).[1] Social indicators have improved markedly,[2] although the incidence of poverty remains high in the *atolls* (outer islands), where half of the population lives on less than 15 rufiyaa (US$1.2) per day. As a least developed country (LDC), Maldives has enjoyed generous levels of foreign aid. However, the relative importance of external aid has gradually declined, a trend that is set to continue.

3. **At the conclusion of the last Article IV consultation on November 9, 2000, Executive Directors praised Maldives' overall performance but warned of emerging imbalances.** Directors observed that generally sound macroeconomic management, an open trade and exchange system, and a liberal expatriate employment policy had contributed to Maldives' prosperity. However, they expressed concern about widening budget and current account deficits, and saw a need for tighter financial policies. Highlighting Maldives' vulnerability to external shocks and the prospects for a decline in external assistance, Directors called for measures to reduce fiscal imbalances and diversify the economy.

4. **Fiscal slippage, compounded by adverse external developments, has been the main cause of recent imbalances in the Maldivian economy, manifested in rapid monetary expansion and sustained pressure on the exchange rate.** Repeated spending overruns have resulted in fiscal deficits that have largely been financed with central bank

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[1]Maldives' national income accounts are being updated, resulting in a large upward revision in the levels of the main aggregates; overall growth rates are less affected (Box 1).

[2]Life expectancy has risen by 10 years since the 1980s, the immunization rate of children is nearly universal, access to safe water is close to 90 percent, and illiteracy is very low.

BOX 1. REVISION OF THE NATIONAL INCOME ACCOUNTS

With technical assistance from the AsDB, a project has been underway within the Ministry of Planning and National Development since 1996 to strengthen the national income accounts of the Maldives. This project is scheduled to be completed in 2002, but first results are making their way into the official statistics and are reflected in the GDP figures used in this report.

Until 2000, 1985 was the base year for the published GDP figures. A switch has now been made to 1995 as the base year, based on a prototype supply and use table for that year. In addition to changing the base year, efforts have been made to move closer to the procedures of the 1993 System of National Accounts, by, for example including estimates for financial intermediation services indirectly measured (FISIM) and imputed rent of owner-occupied dwellings.

The updated national income figures result in a sharp increase in the estimated level of nominal GDP and also point to a significantly different production structure of the Maldivian economy than the 1985 based accounts. On the other hand, the overall impression of GDP growth, even for the period 1985-95, has not changed much, although it has been revised upward. For 1995-99, the upward change is very small.

Nominal GDP in 1995 was 34 percent higher according to the new estimates than in the old official accounts. This step increase in the level of GDP carries into subsequent years. Thus, the new estimates for nominal GDP in 1999 are 42 percent higher than the figure reported in last year's staff report. This increase in the estimated aggregate level of GDP, of course, also lifts per capita GDP figures. For 1998, the new per capita GDP figure is US$1,987 whereas last year's staff report had a figure of US$1,420.

The main change in the structure of the economy revealed by the new GDP estimates is an increase in the contribution of tourism 18 percent to 34 percent and a decline in the contribution of the fisheries from 11 percent to 8 percent.

The cumulative real growth in the economy from 1985 to 1995 was 126 percent according to the old estimates but 138 percent according to the new ones, an overall difference of about 5 percent. Overall growth from 1995-99 was 40 percent according to the new figures and 39 percent according the old ones.

Whereas the 1985 base estimates provided only production side GDP estimates, the 1995 base estimates, as well as subsequent updates, will also present the expenditure side of the national income accounts, and therefore give ready access to estimates of the savings-investment balance.

resources, giving a strong boost to domestic credit expansion. Along with depressed hard currency receipts from the tourism sector (because of soft prices), low world market prices for tuna, and an appreciated real effective exchange rate (reflecting the peg to the U.S. dollar), deficit monetization has led to mounting pressures in the foreign exchange market.

5. **During the latter part of 2000 and into 2001, the authorities failed to provide sufficient foreign exchange to meet demand at the official exchange rate.** After the closure of the Post Office Exchange Counter (POEC) in July 2000, the Maldives Monetary Authority (MMA) provided foreign exchange to the commercial banks at about the same rate (in net terms) as it had sold directly to the public in the previous year.[3] However, the foreign exchange channeled from the MMA to the commercial banks turned out to be inadequate to allow the market to clear at the official exchange rate.

6. **Administrative limits on the availability of foreign exchange in the context of a general shortage of hard currency constitutes a foreign exchange restriction.** The staff team found evidence of a significant parallel market in foreign exchange with a premium of 6–12 percent over the official exchange rate. The team also discovered that traders were experiencing undue delays in obtaining foreign exchange for making payments for bona fide current international transactions.[4] The team, therefore, concluded that a foreign exchange restriction had arisen, subject to approval under Article VIII.

7. **On July 25, 2001, the authorities devalued the rufiyaa by 9 percent.** The rufiyaa had been pegged to the U.S. dollar at a central rate of 11.77 rufiyaa per dollar since October 1994. On July 24, the authorities announced new buying and selling rates for the U.S. dollar of 12.75 rufiyaa and 12.85 rufiyaa, respectively, with effect from the following day.

II. Recent Developments and Outlook

A. Developments and Outlook for 2001

8. **In 2000, economic growth slowed and inflation turned negative.** GDP growth slowed to 4.8 percent in 2000, from 7.4 percent in 1999 (Figure 1 and Table 1). A strong increase in tourist arrivals was partially offset by a shortening in the average duration of stay, while construction and related sectors were hit by the end of the 1997–99 investment boom in the tourist sector. The expansion in bed capacity caused capacity utilization to decline and led to soft prices. The tuna catch also declined. Despite an increase in domestic tuna prices

[3]On July 19, 2000, the MMA closed the POEC, over which it had sold foreign exchange to the public since 1987. The counter mainly serviced the needs of the non-business private sector, including small-scale importers, travel and educational expenses, and repatriation of expatriates' earnings. The MMA instructed the commercial banks to take over this function against a commitment that it would sell to the banks the requisite foreign exchange.

[4]Some instances of short-term arrears on suppliers' credit were reported.

and in imported fuel prices,[5] the appreciation of the nominal effective exchange rate resulted in a 1.1 percent decline in the CPI in the twelve months to end-2000.

9. **Growth is set to recover in 2001, while the devaluation will give a sharp boost to inflation**. As the contraction in construction activity is set to come to an end, growth is expected to recover to 7 percent in 2001. With another strong increase in tourist arrivals, capacity utilization and prices in resorts are expected to recover; also, world tuna prices are expected to return to more normal levels. The July 25 devaluation is likely to have a sizable and immediate effect on inflation.[6] Staff estimates that the twelve-month inflation rate will rise above 4 percent at end-2001 and peak at 6–7 percent in early 2002, provided wage pressures are contained and the exchange rate does not move further.

10. **The real effective exchange rate appreciated in 2000**. Because of the strong dollar, the real effective exchange rate appreciated by 4 percent in 2000, bringing the total appreciation from 1997 to almost 10 percent (Figure 2).[7] Although both tourism and the fisheries suffered a loss in competitiveness as a consequence of the real exchange rate appreciation, other external factors were equally important for the profitability of these sectors (dollar strength, low world tuna prices; Box 2).

11. **After a sharp widening in 1999,[8] the current account deficit has narrowed.** Despite the soft prices faced by tourist resorts, with investment-related demand declining sharply and domestic exports (i.e., exports excluding re-exports) recovering, the current account deficit narrowed to 9.5 percent of GDP in 2000 (Table 2). Private capital inflows, and to a lesser extent concessional loans, covered the lion's share of the current account deficit. The remainder, equivalent to 1.4 percent of GDP, was financed from the net foreign assets of the banking system. With capacity utilization in the resorts increasing and prices rising, and with tuna prices returning closer to historical norms, the current account deficit should narrow further in 2001. Taking into account the impact of the devaluation, the current account deficit is projected to be 8.4 percent of GDP.[9]

[5]Movements in domestic and world tuna prices can easily diverge; domestic prices are determined by local supply conditions in the fresh fish market in Male.

[6]Imports constitute about 60 percent of the CPI basket.

[7]During 1996–97, the real exchange rate, however, appreciated by more than 20 percent.

[8]A number of factors combined to cause a trebling of the current account deficit in 1999, to 14.6 percent of GDP, including high levels of investment in tourism and public sector infrastructure, growing remittances by the large expatriate work force and terms of trade shocks (especially the record low world market prices for tuna).

[9]Staff estimates that the full-year improvement in the current account balance flowing from devaluation of 9 percent is marginally higher than 1 percent of GDP. The devaluation also lowers the value of GDP measured in U.S. dollars.

BOX 2. COMPETITIVENESS AND THE REAL EFFECTIVE EXCHANGE RATE

While the relative strengthening of the rufiyaa in recent years has adversely affected both tourism and fisheries, implications for competitiveness of each sector are somewhat different.

The real effective exchange rate of the rufiyaa is not a particularly good indicator of the competitiveness of Maldivian tourism, for which most costs are invoiced in U.S. dollars. Not only are all of the supplies for the resorts imported, but also a majority of workers in the resorts, especially skilled workers, are expatriates from the region whose pay is set and settled in U.S. dollars. The competitiveness and profitability of tourism are, however, likely to have been hurt by the appreciation of the U.S. dollar against the euro and other European currencies, through downward pressure on its prices in its main markets, as well as against the currencies of Maldives' competitors in tourism.

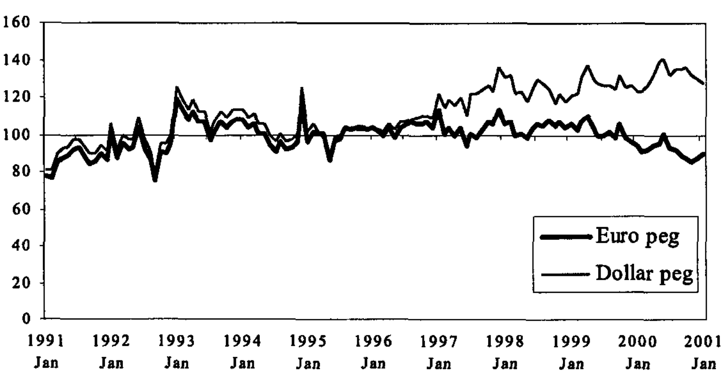
For the fisheries sector, and notably the state-owned Maldives Industrial Fishing Corporation (MIFCO), movements in the real exchange rate need to be seen alongside movements in world market prices of tuna and tuna products, and more broadly the development of the terms of trade. Tuna prices rose sharply in 1996 and 1997, offsetting the real appreciation of the rufiyaa during those years. Since 1999, however, the profitability of the fisheries sector has been squeezed by the combination of low export prices, high oil prices and an appreciated real effective exchange rate. Staff estimates that Maldives' terms of trade deteriorated by close to 30 percent in 1999, and a further 3 percent in 2000, reflecting mainly movements in tuna prices. Tuna prices have recovered strongly in recent months. If the increases hold and oil prices remain stable, the terms of trade should improve significantly in 2001.

Any downward adjustment in the rufiyaa-U.S. dollar peg would be of limited benefit to tourism, but could enhance the competitiveness of fisheries as long as the exchange rate adjustment was not fully reflected in domestic costs, especially fish procurement prices.

Almost all of the appreciation of the real effective exchange rate since 1995 (of the order of 30 percent) reflects a rising nominal effective exchange rate, driven by the overall strengthening of the U.S. dollar (to which the rufiyaa has been pegged since late 1994) in this period. The accompanying figure shows what would have happened to the real effective exchange rate during 1995-2000 had the rufiyaa instead been pegged to the euro. (A synthetic measure of the euro is used for the period before the euro was introduced at the beginning of 1999.) In this counterfactual, the real effective exchange rate would have fluctuated around its 1995 level until mid-1999, and depreciated thereafter as the euro weakened against the U.S. dollar. This lends some credence to the view that the euro would be a better peg for the rufiyaa than the U.S. dollar.

Real effective exchange rates, 1991-2001

1995=100



12. **The 2000 budget deficit was sharply larger than planned, and significant recourse was made to central bank financing**. The outturn for the deficit was 4.6 percent of GDP, more than three times higher than the budget target of 1.2 percent, reflecting overruns in both capital and current expenditure (Figure 3 and Table 3). More rapid-than-expected project implementation—largely financed by soft loans—was responsible for a part of the higher-than-expected spending, but more than half of it reflected a surge in current expenditure. Current spending grew by 18 percent compared with a target growth rate of 10 percent, mainly in the areas of general administration and social services.[10] A shortfall in tax revenue was offset by increases in SOE profit payments and external grants. More than half of the 2000 budget deficit (2.4 percent of GDP) was financed through additional drawings on the Ways and Means Account at the MMA.

13. **While there is considerable uncertainty about the fiscal outturn in 2001, continued slippage and deficit monetization is likely**. The fiscal deficit will almost certainly be lower than the budget target of over 8 percent of GDP because less than half of the hoped for foreign financing of capital projects (of 7.7 percent of GDP) is likely to materialize. On the other hand, financing from the MMA during the first half of the year suggests that current spending has again been running well ahead of schedule. Taking account of usual seasonal variations, and in the absence of direct measures on the fiscal front, MMA financing for the whole year is likely to be close to 2.5 percent of GDP, whereas virtually none was planned. While the July devaluation is likely to improve the overall fiscal balance,[11] the authorities' fiscal intentions have also become less clear (for example, in regard to spending cuts in 2001). The staff, therefore, projects a fiscal deficit of 5.2 percent of GDP in 2001, which represents an increase of 0.5 percentage points over 2000.[12]

14. **Monetary developments have been dominated by central bank financing of fiscal deficits and excess demand for foreign exchange** (Table 4). Slow growth of broad money in 2000 (4.1 percent) masked, on the one hand, strong growth in credit to the central government (30.9 percent), mainly due to deficit financing from MMA, and, on the other, a decline in the net foreign asset position of the monetary system (6.6 percent). Compared to previous years, private sector credit growth was subdued in 2000. At end-2000, the official reserves amounted to US$124 million, and provided cover for 3.3 months of imports of goods and nonfactor services. In the wake of the devaluation, staff projects that the official

[10]This mirrored developments in 1998–1999. Underestimation of the recurrent spending associated with past capital investment projects appears to be a major culprit in the under budgeting of current spending in recent years.

[11]Staff estimates that the full-year impact of a devaluation of 9 percent on the overall fiscal balance is almost 1 percent of GDP.

[12]For comparison, in the scenario that the staff team presented alongside its recommended course of action to deal with the situation in the foreign exchange market, the 2001 budget deficit was 4 percent of GDP.

reserves will increase marginally in dollar terms in 2001, but that their import coverage will decline to 3.1 months by year-end.[13]

15. **The banking system remains generally sound.** The share of nonperforming loans is low, risk-weighted capital asset ratios are high, and the balance between foreign currency-denominated assets and liabilities is favorable (Box 3).

B. Medium-Term Prospects

16. **The outlook for the Maldivian economy over the medium term remains broadly favorable, provided that fiscal policy is put on a sustainable course.** Growth is likely to moderate from the rapid pace of the past decade, as natural constraints on growth begin to be felt and the catch-up effect becomes smaller. An illustrative medium-term scenario shows GDP growth stabilizing at around 6 percent per year, including continuing strong contributions from tourism (Table 5). The scenario also assumes the adoption and implementation of a stabilization and reform agenda to meet the challenges of lessening Maldives' vulnerability to external shocks, the declining availability of concessional foreign financing, and further integration of Maldives into the international economy through the WTO and regional trading arrangements. In the scenario, fiscal expenditure growth is maintained in line with that of nominal GDP. In addition, the revenue structure is reformed, with a switch toward more reliance on tax revenues (through the introduction of the business profit tax, see below), and less dependence on nontax revenue (mainly profit transfers from public enterprises and resort rents). The overall fiscal deficit stabilizes at around 2 percent of GDP, while the current account deficit gradually declines and official reserves remain broadly stable in terms of their import cover of under three months. Foreign debt and debt service remain well contained, partly because of the assumption that a significant share of foreign capital inflows will be in the form of direct investment.

17. **The outlook is not without risk.** Failure to contain spending growth and implement fiscal reform, including limiting central bank financing of budget deficits, would likely result in repeated episodes of intense pressures in the foreign exchange market, periodic devaluations and higher inflation.[14]

III. Policy Discussions

18. **The discussions focused on**: (i) the short-term policies needed to address the excess demand for foreign currency and eliminate the foreign exchange restriction in the context of Maldives' exchange rate system, and (ii) macroeconomic policy reforms required over the

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[13]Under the staff recommendation to provide additional hard currency to the market, the import coverage of the official reserves was projected to decline to 2.9 months by end-2001.

[14]There are also risks on the external side, but Maldives generally scores adequately in terms of traditional indicators of external vulnerability (Table 6).

Box 3. Indicators of Banking System Vulnerability

Maldives' banking system consists of four commercial banks, three of which are branches of foreign state-owned banks. Banking sector indicators of risk show that the system is basically sound (tabulation):

- The average share of non-performing loans is low and declining, to less than 4 percent in 2000. This ratio is heavily influenced by one large nonperforming loan in a foreign bank which is currently being resolved.
- The average risk-weighted capital asset ratio is high, at over 30 percent in 2000, reflecting the excess liquidity associated with high minimum reserve requirements and credit ceilings.

Banks in Maldives are exposed to risks related to foreign exchange and sectoral concentration of credit:

- The share of foreign exchange loans in total lending, though declining, is high at close to 60 percent. However, this lending is not being financed by foreign borrowing on the part of the banks, but rather mainly by foreign currency deposits. In the meantime, the overall balance between foreign currency denominated assets and liabilities is generally favorable. The MMA is planning to introduce net open position limits in foreign currency.
- Over 80 percent of foreign currency loans are to foreign-exchange earning tourist enterprises, and are thus naturally hedged. However, banks remain vulnerable to credit risk from adverse shocks to the tourism sector, as over 50 percent of all loans are to that sector.

Interest rate risk would appear to be limited at present because of the fixed margin between deposit and lending rates; with interest rates set to become more flexible, this will likely change in the future.

Banking supervision has recently been upgraded in line with international best practices. With AsDB assistance, capital adequacy requirements were imposed; loan classification and provisioning rules were standardized, along with the definition of non-performing loans; and tax deductibility of loan loss provisioning introduced (for further details, see Box 5 in SM/99/261).

Maldives: Banking Sector Indicators

	1991-96	1997	1998	1999	2000
			(In percent)		
Banking sector indicators of risk					
Share of non-performing loans in total loans	...	...	5.8	4.3	3.7
Risk-based capital asset ratio (capital over risk-weighted assets)	...	...	25.9	25.1	32.8
Financial sector indicators					
Share of foreign exchange loans in total lending	64.2	65.9	66.7	61.7	57.7
Share of foreign deposits in total deposits	44.2	56.0	58.0	50.0	43.0
Share of foreign currency denominated liabilities in total liabilities	58.8	48.0	49.0	45.0	39.0
Average maturity of lending (in years)	1-3	1-3	1-3	1-3	1-3
Average maturity of deposits (in years)	1-2	1-2	1-2	1-2	1-2
Share of private credit collateralized by real estate	...	...	...	...	84.0
Share of real estate sector in private credit 1/	5.8	5.8	5.9	5.5	8.3
Share of tourism sector in private credit	48.6	40.9	48.5	55.2	53.4
Market assessment					
Spread between lowest and highest deposit rates (U.S. dollar term deposits) 2/	1.6	2.0	2.0	2.0	2.0

Source: Maldives Monetary Authority

1/ Average from 1992-96.
2/ Average from 1995-96.

medium-term to ensure a consistent policy framework able to support the achievement of the economy's growth potential.

A. Addressing the Foreign Exchange Pressures

19. **The staff team concluded that an adjustment of the exchange rate was not warranted until other options had been explored more fully**. In considering how to address the imbalances in the foreign exchange market, the staff team emphasized the need to focus on their roots in expansionary fiscal policies. In particular, the team questioned whether the benefits of a devaluation could be sustained without strong action to restore fiscal discipline and end the practice of monetizing budget deficits. On balance, the team indicated that it would be preferable to forestall adjustment of the exchange rate until other options had been more fully explored, including spending cuts and the provision of additional hard currency to the market from the official reserves.

20. **The benefits of exchange rate adjustment were uncertain and the costs significant**. The staff team cautioned that devaluation would bring only limited benefits that would be short-lived if not supported by stronger policies. While tourism had been hit by the appreciation of the U.S. dollar against European currencies, devaluation would do little to restore the sector's competitiveness, given that most inputs into production, including labor, are imported and their costs are dollar-denominated. It also appeared that the negative terms of trade shocks, affecting mainly the fisheries, would be temporary as world market prices for tuna were returning to more normal levels from their historical lows and oil prices had retreated from their peak. The benefits of a devaluation would, therefore, mainly be relatively small improvements in the current account balance and government finances.[15] These benefits needed to be judged against the costs of higher inflation and the loss of the nominal anchor that had been in place since October 1994. Furthermore, unless supported by non-accommodative financial policies, the favorable impact of devaluation on the real exchange rate would prove short-lived.

21. **In the staff team's view, fiscal retrenchment was the most appropriate response to the excess demand in the economy as a whole, and more specifically in the foreign exchange market**. Overly rapid spending growth, financed through recourse to central bank funds, was the main reason behind excessive import demand. The staff team recognized the difficulties in cutting current expenditure in the middle of a budget year, but pointed out that cuts in domestically-financed capital spending would, in view of its high import content (over 80 percent), have an immediate and large impact on the overall demand for foreign

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[15]The staff team provided estimates that a 10 percent devaluation against the U.S. dollar would strengthen the current account balance—mainly because of the income effect—and the fiscal balance—because a higher share of revenue than expenditure is dollar-denominated—each by 1 percent of GDP, on a full-year basis, but raise inflation by about 6 percentage points in the first year.

exchange. The staff team recommended a cut in domestically-financed capital spending of 1½–2 percent of GDP (less than 20 percent of full-year spending under this item).

22. **At the same time, greater MMA sales of foreign currency to the commercial banks would increase supply, and help eliminate the foreign exchange restriction that had arisen**. The staff team observed that under a fixed exchange rate regime it was incumbent on the MMA to supply enough foreign exchange to the market to meet demand arising from the need to make current international payments. The MMA had not been doing this, giving rise to a foreign exchange restriction and a parallel foreign exchange market. In view of the official reserve position, the team recommended that the MMA increase its allocation of foreign currency to the commercial banks for resale to the public by 50–100 percent for the next few months, or until the supply situation improved with the next tourist season in the latter part of 2001. On a half-year basis, this recommendation called for using 10–15 percent of the official reserves in support of the official exchange rate, bringing their import coverage down to around 2.9 months at end-2001.

23. **The authorities expressed broad agreement with the staff team's analysis and indicated that they would implement measures in line with its recommendations**. The authorities confirmed that they would provide more foreign currency to the commercial banks in coming months with a view to easing pressures in the foreign exchange market. The authorities also indicated that there was scope for holding domestically-financed capital expenditure below target (by almost 2 percent of GDP), although reaching political consensus on this policy was bound to be problematic.

24. **Nevertheless, subsequent to the mission, the authorities announced the devaluation of the rufiyaa on July 25, citing a lack of improvement in the foreign exchange situation**. After supplying additional hard currency amounting to less than 2 percent of the official reserves to the foreign exchange market during June and July, the authorities determined that the improvement in the foreign exchange market situation had been inadequate; shortages of hard currency remained and the parallel market premium had not declined appreciably.

B. Needed Macroeconomic Policy Reforms

25. **The fixed exchange rate arrangement had been at the heart of the macroeconomic policy framework, but had received insufficient support from fiscal and monetary policies in recent years**. The staff team noted that fiscal discipline had eroded in recent years, which in turn had undermined the monetary policy framework because of the budget's automatic access to MMA financing. It was imperative to begin formulating policies in a medium-term macroeconomic framework that would enforce consistency between the actions of various ministries, public enterprises, and the MMA. It was to be hoped that the Sixth National Development Plan, which was under preparation, would incorporate such a framework.

Exchange rate policy

26. **The exchange rate peg against the U.S. dollar had served Maldives well as an important source of stability, transparency, and confidence**. The authorities indicated a clear preference for a pegged exchange rate arrangement, even if a devaluation turned out to be inevitable, a view that was shared by the staff team. A floating arrangement was precluded by limitations on implementation capacity and insufficiently developed financial markets. There was also agreement that the U.S. dollar remained the only realistic peg for the rufiyaa. Given that most tourists came from Europe, the euro appeared to be a natural candidate as a peg. However, switching at this point to the severely undervalued euro would clearly not be desirable. Furthermore, the introduction of actual euro notes and coins would not take place until 2002. Over time, as the euro strengthened and it began to circulate widely within tourist areas, the arguments for pegging the rufiyaa to the euro would likely become stronger. Alternatively, pegging to a trade-weighted basket of currencies lacked the transparency of a single currency peg.

27. **The closure of the POEC had removed one obstacle to Maldives' acceptance of the obligations of Article VIII**. The authorities indicated that once the conditions in the foreign exchange market had settled, they would be ready to consider acceptance of the obligations of Article VIII. The staff team indicated that such a move would be an important step to reducing the risk of the recurrence of exchange restrictions in the future and offered the assistance of the LEG and MAE departments in determining the required changes in the foreign exchange system.

Fiscal policy

28. **Fiscal consolidation was essential to maintain macroeconomic stability in a medium-term context**. This was made all the more urgent with the coming graduation of Maldives from the LDC group, and the associated loss of foreign grants and soft loans. While Maldives still enjoyed a "small island" exception from IDA, and was viewed as an LDC by bilateral donors, this would not last much longer as GDP per capita in Maldives rapidly approached emerging-market country levels. Staff suggested that the following measures were needed to achieve the type of outcome presented in the illustrative medium-term scenario: (i) strengthening of the revenue base, (ii) more effective controls on expenditure, and (iii) elimination of long-term deficit financing by the MMA.

29. **The revenue system needed an overhaul**. The authorities indicated that they had begun to review the revenue system by updating various fees and charges, the real value of which had declined because of inflation over the years. They also had plans to strengthen taxation by introducing a property rental value tax and a business profit tax. The staff team suggested that, in the short run, there was scope for raising additional revenue from tourism (by adjusting the flat per-head tax unchanged since 1988) and customs (by closing duty exemptions). Furthermore, over the longer term, pressures on the tariff regime from WTO commitments and the development of regional trading arrangements also spoke for replacing customs duties with a general sales tax and excises.

30. **Strengthening expenditure control was imperative.** The staff team underscored that hard budget constraints needed to be imposed on spending ministries in order to make headway in reducing overall access to direct MMA financing through the Ways and Means Account. The public sector investment program (PSIP) should be formulated in a multi-year, rolling framework with the aim of smoothing capital expenditure, and due allowance needed to be made for the recurrent spending commitments arising from completed capital projects. Capital spending by the SOEs also needed to be coordinated with the PSIP. Expenditures should be prioritized with a view to protecting social expenditures on education and health care at the expense of less productive spending.[16] Overall, the growth of current expenditure should be limited to that of nominal GDP. The authorities agreed with the importance of curtailing access to the Ways and Means Account. They noted that they had done away with the "unspent balances" approach, which had contributed to the persistent spending overruns.[17] They viewed the public accounting system project (supported by the AsDB) as a prerequisite for the restoration of fiscal discipline and hoped to be able to begin the implementation of the project in the near future.

31. **The Ways and Means Account needed to be replaced with alternative sources of government debt finance.** The authorities noted that a public finance act was being drafted which would allow for the introduction of treasury bills for cash management and bonds for longer-term government debt financing. The timing of the introduction of such instruments was, however, uncertain. The staff team encouraged the authorities to move ahead with the development of these instruments in order to facilitate an end to central bank deficit financing. Such an approach would also support capital market development in Maldives and provide the basis for the introduction of indirect instruments of monetary policy. An important preliminary step in this direction would be to ensure that the government paid market interest rates on its borrowing from the MMA.

Monetary policy

32. **The monetary policy framework needed to be strengthened and monetary policy re-directed toward supporting the fixed exchange rate.** The staff team pointed out that containment of access to automatic deficit financing from the MMA would create scope for the implementation of long overdue reforms of the monetary policy framework, and would allow monetary policy to play its proper role in the fixed exchange rate regime. The authorities recognized that the monetary framework had become deeply flawed. Interest rate controls on rufiyaa loans and deposits, a high minimum reserve requirement and ineffective bank-by-bank credit ceilings were distortionary and inefficient and had drained the financial

[16]The World Bank's ongoing Public Expenditure Review will provide more specific details in coming months.

[17]Unspent balances were an administrative measure designed to limit spending by line ministries (and were to be temporary). These earmarked expenditures were supposed to be withheld, but were actually included in the approved budget authorizations.

market of dynamism. They were convinced that a comprehensive reform of the monetary policy setting was needed. The staff team suggested that the overall aim of monetary policy reform should be to move toward indirect monetary policy management by a more independent MMA. However, implementation of monetary policy should remain subordinate to the overriding goal of supporting the exchange rate.

33. **There was broad agreement on the first steps in monetary policy reform.** The initial reform measures included: (i) the abolition of the bank-by-bank credit ceilings; (ii) the elimination of the 7 percentage point maximum allowable differential between rufiyaa lending and deposit rates, with the 20 percent ceiling on rufiyaa lending rates to follow soon after; (iii) gradual lowering of the 35 percent minimum reserve requirement and an increase in the effective rate of remuneration; (iv) an improved program for liquidity management, including flexible interest rates and auctions for MMA certificates of deposit (CDs), to pave the way for the establishment of the market for treasury bills and help wean the government from its reliance on the Ways and Means Account; and (v) a standing facility for providing short-term, and fairly costly, liquidity support to banks. In late June, the MMA Board authorized the implementation of these reforms. On July 1, the MMA abolished the bank-specific credit ceilings and expanded the CD program to include, on the buying side, public enterprises in addition to the commercial banks. The elimination of the rufiyaa interest rate differential was expected to follow within a few weeks, while the lowering of the minimum reserve requirement and additional improvements in the CD program would be implemented in 2002. Technical assistance was being provided from MAE in the sequencing and timing of these reforms.

C. Other Issues

34. **Deregulation aimed at fostering a larger and more dynamic private sector would help sustain growth in the future.** While state-owned enterprises (SOEs) continued to dominate much of commercial activity in Maldives, the authorities indicated that, in the context of the preparation of the Sixth National Development Plan, some initial discussions of a possible review of the role and scope of public enterprises in the economy had taken place. A concrete development in this area was the introduction of greater private participation and competition in the fisheries sector through the Skipjack Investment Liberalization Program (Box 4). This program should lead to greater efficiency within the sector, and could be seen as a first step in the eventual privatization of the Maldives Industrial Fisheries Company (MIFCO). The staff team welcomed the authorities' greater openness toward reform of the SOE sector, including privatization. The team underscored that the social objectives served by some of the SOEs could be achieved through less distortionary and more transparent policies, including direct subsidies from the budget.[18] The

[18]Such as the role MIFCO has played in providing income support for fishing communities, and the perceived role of the State Trading Organization (STO) in ensuring adequate supplies and preventing excessive price volatility of basic commodities.

BOX 4. THE SKIPJACK INVESTMENT LIBERALIZATION PROGRAM

Over the last decade, the Maldives Industrial Fisheries Corporation (MIFCO) has had an export monopoly on canned and frozen skipjack (tuna). MIFCO was from the outset saddled with large loans taken earlier on behalf of the fisheries sector and never performed well in financial terms. Losses have been particularly large in the recent period of extremely low world market prices for tuna, which has provided the impetus for a reorganization of government policy toward the fisheries sector. The reform plan, dubbed the Skipjack Investment Liberalization Program, effectively abolishes MIFCO's export monopoly, and can be seen as a first step toward privatization of MIFCO.

The program aims for greater private sector involvement in the fisheries sector and for a viable mechanism for the utilization of the local skipjack catch. Private investors can participate in the development of the Maldivian skipjack industry through investments in the purchase, processing and exports of the local skipjack fisheries. Investors are, however, not allowed to engage in fishing operations themselves.

The program divides Maldives' exclusive economic zone into four geographic areas of operation, with two areas open to private investment and the other two areas set aside for MIFCO.

The hope is that private sector participation in the fisheries sector will create competition and lead to efficiency improvements, including for MIFCO. If private operators turn out to be able to offer local fishermen consistently higher prices than MIFCO, pressures for more complete liberalization of the fisheries sector, including the full privatization of MIFCO, are likely to become intense.

authorities saw privatization being preceded by the introduction of corporate taxation to make up for the loss of SOE profit payments to the budget.

35. **Supervision of financial institutions needed to keep up with developments in the financial sector**. The staff team noted that the abolition of credit ceilings and interest rate controls would require a strengthening of supervisory capacity to keep pace with developments in the market. The authorities indicated that they were planning to tackle the most urgent task in this area, namely to place limits on the open positions banks could take in foreign currency. In addition, they noted the need for an upgrade of their capacity to regulate and supervise nonbank financial institutions (insurance companies, leasing companies, etc.), and indicated that they intended to request Fund technical assistance in this area. In conjunction with the monetary reform measures approved in late June, the MMA was also given authorization to impose limits on open positions in foreign currency.

36. **The inadequacy of capital market legislation had become an obstacle to diversification and future growth in Maldives**. The authorities pointed to some steps that had been taken to put in place the institutional and legal framework that would allow the development of markets in longer term borrowing instruments and equity shares, including the establishment of a capital markets unit within the MMA. The staff team noted that it was important to pass enabling capital market legislation to lay the groundwork for the development of the capital market, and encouraged the authorities to move expeditiously on this front.

37. **Tariff rates had been left unchanged since the passage of a new export-import law in 2000.**[19] Maldives, however, planned to lower its tariffs in line with WTO commitments, and there was always the possibility that progress on the South Asian Free Trade Area (SAFTA) would necessitate the lowering of intra-regional tariffs. In view of rising purchasing power in Maldives, the staff team warned against the possibility that import-substituting production could develop behind tariffs, which had so far exclusively been imposed for revenue generation.

38. **Despite improvements in recent years, gaps and inconsistencies in economic data continued to impede surveillance and policy design.** The staff team reiterated that reliable, comprehensive, and timely economic data were essential for effective economic management. The team noted the revision of the national income accounts and the efforts the MMA was putting into preparing more useful import data. Additional work was, however, needed to strengthen data gathering on financial flows and the labor market, and to better reconcile the fiscal and monetary accounts in terms of timing and coverage. The authorities indicated that they were committed to making improvements in the statistical area and that a long-term plan had been drawn up to establish an autonomous Bureau of Statistics with comprehensive data gathering responsibilities (Box 5).

BOX 5. AN AUTONOMOUS BUREAU OF STATISTICS

Over the last two decades, the systematic collection of economic statistics in Maldives has mainly been the responsibility of the Statistics section of the Ministry of Planning and National Development. In implementing the national income accounts project (see Box 1), the need has become apparent for an independent and credible statistical organization, operating in a firm legal environment, with well educated staff, that could create confidence and guarantee confidentiality in handling data from the corporate sector.

In the near future a new Statistical Law will be enacted that will provide for a Department or Bureau of Statistics to collect and disseminate a wide array of timely and reliable statistical information, in the first instance to the public administration, but also to the private sector and the general public. This mandate will require a guarantee of the autonomy of the statistical bureau in the gathering, collating and storing of confidentially collected information. The Law will also stipulate that the Bureau of Statistics, under the general auspices of the Ministry of Planning and National Development, will act as a central coordinating agency in producing and disseminating major statistics required for national planning purposes and in approving data collection activities by other public and private institutions.

An overall design for the autonomous Bureau of Statistics has been promulgated that outlines its basic objectives, functions, and organizational structure. A human resource development plan has also been drawn up that identifies the Bureau's staffing needs and how they can be met through programs of overseas and domestic diploma fellowships.

In the grand scheme of things, the statistical system of Maldives should be functioning and rendering statistical services on par with developed statistical systems in the world by 2010.

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[19] See **Staff Report for the 2000 Article IV Consultation**, SM/00/191, August 14, 2000, Box 3. Maldives' ranking on the Fund's ten point index of overall trade restrictiveness remains 7.

39. **Greater transparency about the government's policies could contribute to a more stable macroeconomic environment**. The staff team pointed out that the lack of information about policy intensions, as well as about important economic variables, could have contributed to the tensions in the foreign exchange market by engendering confusion, rumor mongering and panic. The team drew the authorities' attention to the Codes of Good Practices on Fiscal Transparency and on Transparency in Monetary and Financial Policies. The authorities indicated that they planned to move toward a more open information policy, but wanted to choose the launch point of such a policy carefully.[20]

IV. Staff Appraisal

40. **Maldives' growth performance over the last decade has been strong, but the outlook has become more uncertain**. The slowdown in growth in 2000 is likely to prove temporary and a rebound is expected in 2001. Medium-term prospects are generally favorable, provided policy discipline is restored within a consistent macroeconomic policy framework, and inflationary pressures arising from the recent devaluation are contained.

41. **A gradual erosion of fiscal discipline has contributed to rapid credit growth and created pressures in the foreign exchange market**. Recent years have seen large overruns in expenditure, especially in current spending, which, for the most part, have been financed through the overdraft facility at the MMA. The credit-financed fiscal expansion has contributed to excess demand for hard currency, while adverse external developments affecting tourism and the fisheries have pushed hard currency flows to the market below normal levels. The excess demand in the foreign exchange market has been compounded by the limitations on the availability of foreign currency from the MMA, giving rise to a foreign exchange restriction, subject to approval under Article VIII.

42. **The recent devaluation of the rufiyaa exchange rate will only bring lasting benefits if it is supported by additional measures**. It is highly likely that the devaluation will provide only fleeting improvements in external competitiveness and the current account balance if it is not supported by appropriately tight financial policies, based on fiscal consolidation, the development of new means of deficit financing and reform of the monetary policy framework. It is also uncertain whether the devaluation alone will suffice to eliminate the foreign exchange restriction, and the authorities should be prepared to increase sales of foreign exchange to the commercial banks—in larger amounts than ahead of the devaluation—as needed, to ensure that the market clears at the new official exchange rate. Some time will be needed for market conditions to settle down before a re-assessment of the situation in the foreign exchange market can be made. In the meantime, the staff does not recommend the approval of the foreign exchange restriction. The authorities are encouraged to move expeditiously toward acceptance of the obligations of Article VIII.

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[20]The Ministry of Planning and National Development has already launched a website which contains some economic statistics.

43. **There is an urgent need to address weaknesses in the economic policy framework that hamper the authorities' ability to maintain discipline and respond to external shocks.** The revenue base is too narrow, expenditure control is inadequate, and access to MMA overdraft financing is too easy; fiscal reform is lent added urgency by the likely graduation of Maldives from the LDC group in the near future. The monetary framework is outdated and undercut by the persistent recourse to monetization of budget deficits.

44. **Fiscal consolidation is essential to maintaining macroeconomic stability and ensuring the viability of the fixed exchange rate regime.** The revenue base would be strengthened through the introduction of new taxes, including the planned business profits tax and property rental value tax, as well as a general sales tax and excises. Cuts in capital spending in the short term need to be followed by the imposition of hard budget constraints on spending ministries over the medium term. Elimination of the unspent balance approach is an important step in this direction. The Ways and Means Account should be phased out and replaced with government debt financing through market-based instruments, such as treasury bills and bonds.

45. **Increased fiscal discipline would create scope for reform of the monetary framework and allow monetary policy to be re-oriented toward its proper role of supporting the pegged exchange rate at its new level.** The authorities' intentions regarding monetary reform, which are fully consistent with long-standing Fund recommendations, are most welcome. The elimination of bank-specific credit ceilings, lifting of rufiyaa interest rate controls, lowering of minimum reserve requirements, and improvements in the MMA's CD program are important steps in the development of a system of indirect monetary management. A stronger monetary policy framework will be better equipped to support the primary goal of a pegged exchange rate.

46. **Gradual progress is being made in structural reforms, but an extensive agenda remains.** The greater receptiveness to the need for SOE reform, including privatization, is encouraging. The Skipjack Investment Liberalization Plan is a welcome development in the fisheries that should lead to greater competition and efficiency in the sector, and could be the first steps in the eventual privatization of MIFCO. The supervisory capacity of the MMA needs to keep pace with developments in financial markets. Limits on banks' net open positions in foreign currency should be imposed quickly. In addition, early passage of capital market legislation is needed to ensure the development of debt and equity instruments to finance the budget through appropriate means and to sustain investment and future growth.

47. **The authorities are encouraged to undertake more ambitious trade reforms than those planned on the basis of WTO commitments.** Elimination of duty exemptions and an overall lowering of tariff rates are desirable in this regard.

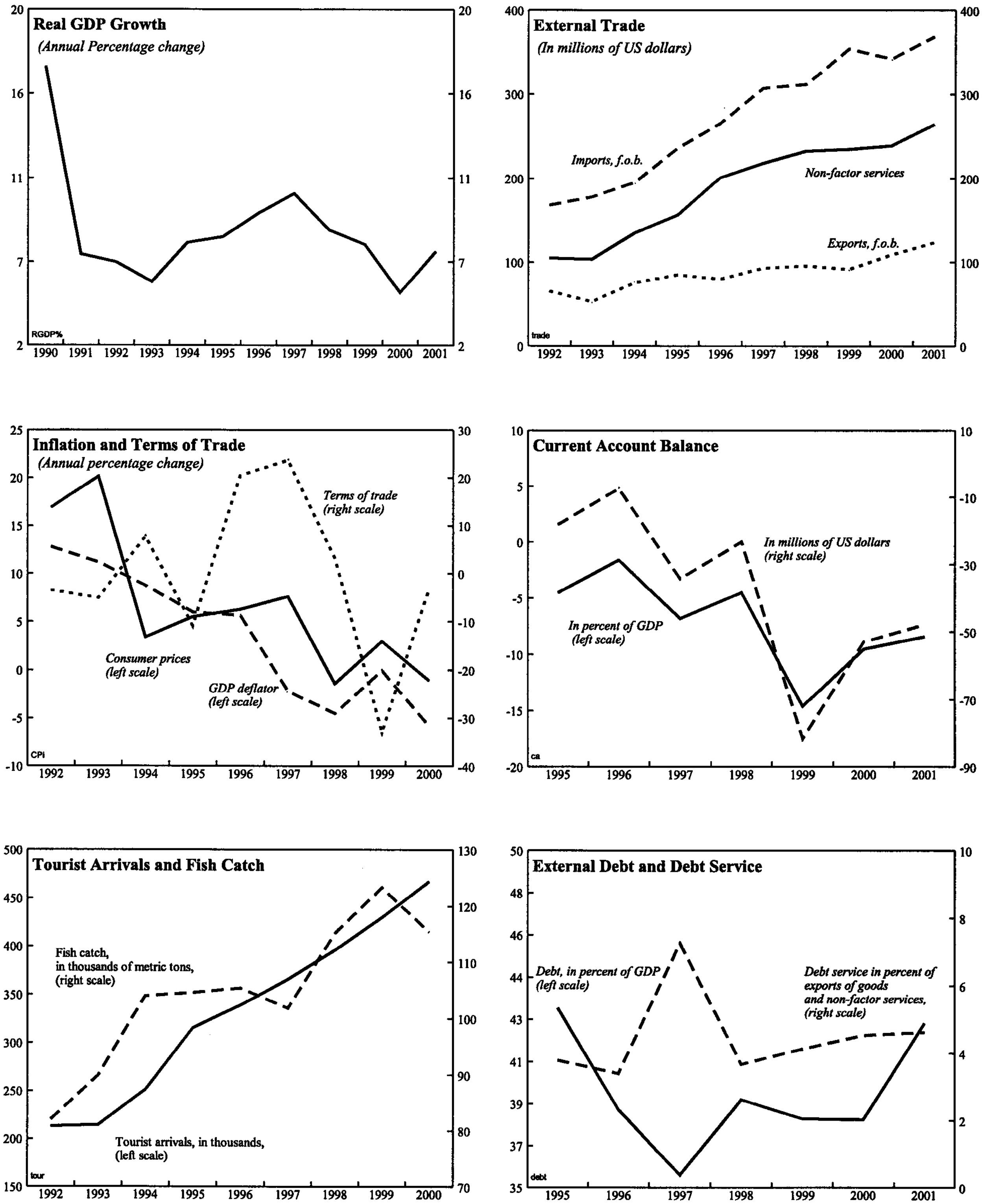
48. **Maldives' economic statistics are being improved, although deficiencies remain.** The revision of the national income accounts is welcome, as are efforts to improve import data. Additional work is needed to strengthen the collection of data on financial flows in the

balance of payments and on the labor market, and to reconcile the fiscal and monetary accounts. Staff strongly endorses the authorities' plans to establish an autonomous Bureau of Statistics.

49. **Greater transparency regarding economic information and policies is desirable.** Recent steps in this direction are welcome, including the opening of the Ministry of Planning and National Development's website. Staff encourages the authorities to adopt a more open policy in regard to economic data and public debate about economic policies, including by the publication of consultation reports and PINs.

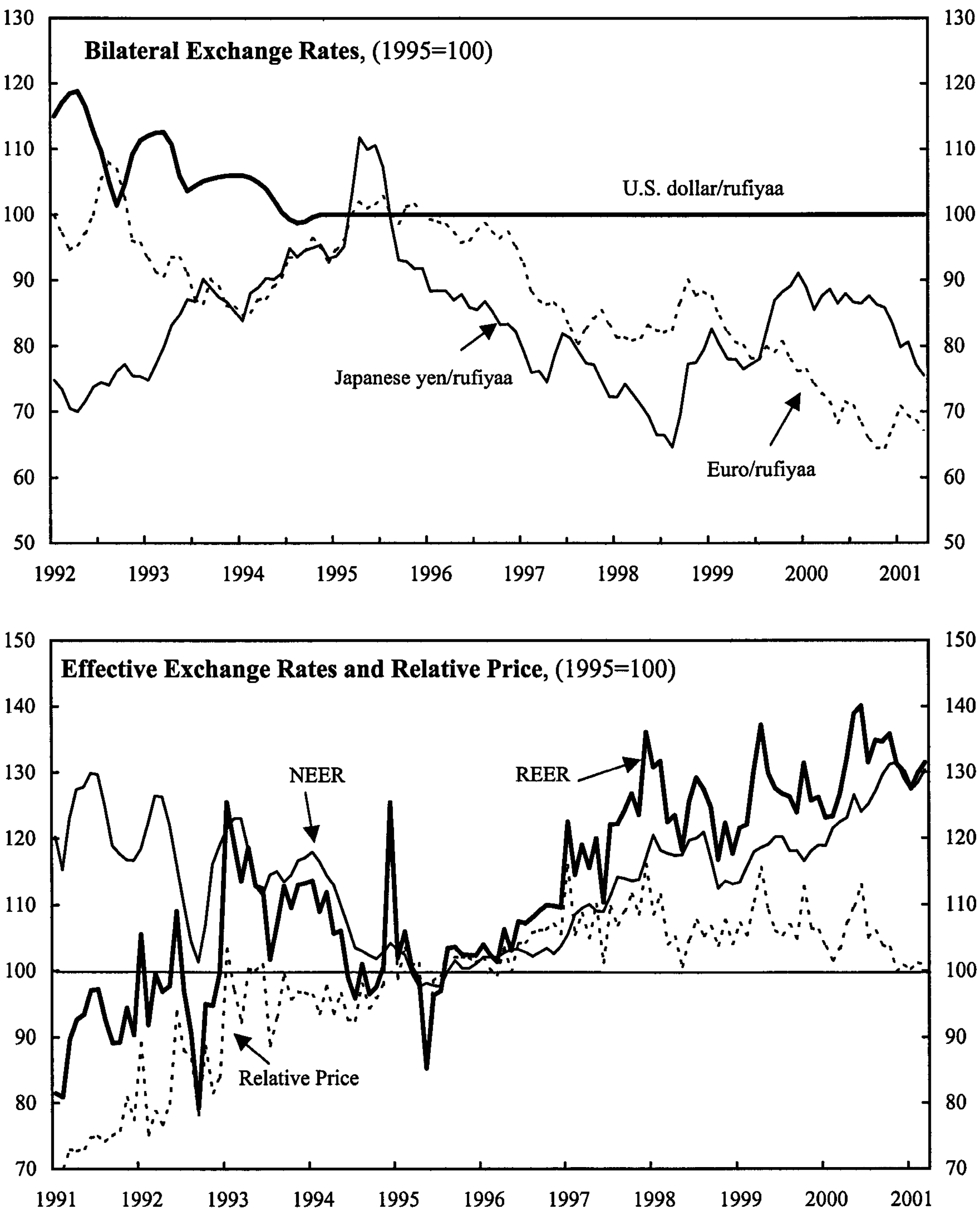
50. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Maldives: Economic and External Developments, 1992-2001



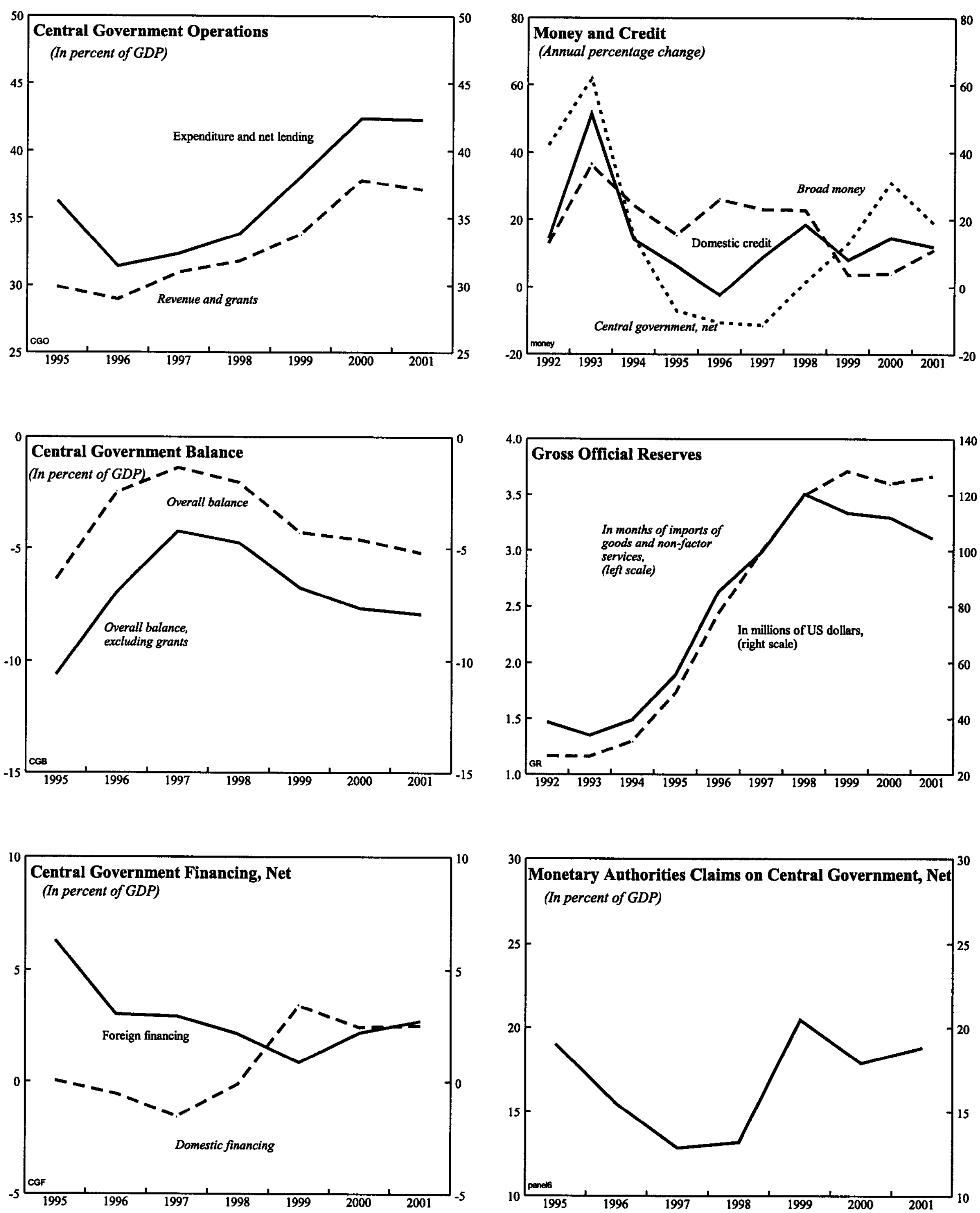
Source: Data provided by the Maldivian authorities and staff estimates.

Figure 2. Maldives: Exchange Rate Developments, 1992-2001



Source: Information Notice System, and staff estimates.

Figure 3. Maldives: Fiscal and Monetary Developments, 1992-2001



Source: Data provided by the Maldivian authorities and staff estimates.

Table 1. Maldives: Selected Economic Indicators, 1995–2001

Population (2000)	270,101
Nominal GDP (2000):	$556 million
GDP per capita (2000):	$2,059
Quota:	SDR 8.2 million

	1995	1996	1997	1998	1999	2000 Est.	2001 Budget proj. 1/	2001 Staff Recomm. 2/	2001 Revised proj. 3/
(Annual percentage change)									
Growth and prices									
Real GDP	7.8	9.1	10.2	8.2	7.4	4.8	7.0	7.0	7.0
Consumer prices (period average)	5.5	6.2	7.6	-1.4	3.0	-1.1	3.0	1.5	3.7
(Percent of GDP)									
Central government									
Revenue and grants	29.9	28.9	31.0	31.8	33.8	37.8	35.6	36.7	37.1
Of which: Grants	4.2	4.5	2.9	2.7	2.5	3.1	2.4	2.6	2.7
Expenditure and net lending	36.3	31.4	32.3	33.8	38.1	42.4	43.7	40.7	42.3
Of which: Capital spending	17.8	13.6	12.8	13.4	14.4	15.2	17.8	11.5	13.5
Overall balance	-6.4	-2.5	-1.4	-2.0	-4.3	-4.6	-8.1	-4.0	-5.2
Overall balance, excl. grants	-10.6	-7.0	-4.2	-4.7	-6.7	-7.7	-10.5	-6.5	-7.9
Financing									
Domestic	0.0	-0.5	-1.5	-0.1	3.4	2.4	0.3	1.3	2.5
Foreign	6.3	3.0	2.9	2.1	0.9	2.2	7.7	2.7	2.7
(Twelve-month change at year-end)									
Money and credit									
Domestic credit	6.3	-2.4	8.8	18.6	8.0	14.5	7.7	10.3	11.9
Public sector	-3.6	-10.2	-15.1	9.2	14.1	23.3	10.1	8.5	16.0
Central government, net	-7.1	-10.6	-11.4	1.4	12.9	30.9	10.1	10.1	18.9
Public enterprises	18.1	-8.4	-33.2	59.3	18.9	-5.9	0.0	0.0	0.0
Private sector	26.4	9.5	38.9	25.7	4.0	8.0	6.3	11.9	8.5
Broad money	15.6	26.0	23.1	22.8	3.6	4.1	6.0	8.6	10.9
Velocity (level)	3.2	2.9	2.6	2.1	2.2	2.1	2.4	2.1	2.1
Interest rates									
Deposits	5-6.5	5-6.5	5-6.5	5-6.5	5-6.5	5-6.5	...	...	...
Loans	12-15	12-15	12-15	12-15	12-15	12-15	...	...	...
(In millions of U.S. dollars)									
Balance of payments									
Exports 4/	85.0	79.9	93.0	95.6	91.5	108.7	123.1	123.1	123.1
Imports	-235.8	-265.5	-307.0	-311.5	-353.9	-342.0	-403.5	-365.5	-368.3
Trade balance	-150.8	-185.6	-214.0	-215.9	-262.4	-233.3	-280.4	-242.4	-245.2
Nonfactor services, net	156.1	201.1	218.0	232.4	234.7	238.8	275.0	264.0	264.0
Current account	-18.2	-7.4	-34.2	-23.3	-81.6	-53.0	-71.4	-45.0	-47.8
(In percent of GDP)	-4.5	-1.6	-6.8	-4.5	-14.6	-9.5	-11.0	-7.5	-8.4
Official capital (net)	24.8	17.3	21.9	14.7	5.2	-2.1	37.6	14.5	14.5
Private capital (net)	33.6	41.0	42.9	42.9	42.9	25.6	32.7	28.0	28.0
Errors and omissions (net)	-24.9	-7.1	-3.2	-5.3	26.3	21.6	0.0	0.0	0.0
Overall balance	15.3	43.7	27.4	29.1	-7.2	-7.9	-1.0	-2.5	-5.3
Gross official reserves (year-end)	49.3	77.6	99.7	119.9	128.5	124.1	123.2	117.1	126.7
(In months of imports of goods and nonfactor services (NFS))	1.9	2.6	3.0	3.5	3.3	3.3	2.8	2.9	3.1
(In percent of short-term ext. debt)	171.0	206.1	417.9	420.3	307.3	249.6	247.8	235.5	254.8
External debt (year-end)	172.2	177.2	178.1	200.8	212.9	211.6	265.6	240.1	240.1
(In percent of GDP)	43.0	38.5	35.6	38.9	38.1	38.0	41.1	39.7	42.3
Debt service 5/	10.7	11.8	27.9	14.9	16.8	19.2	21.0	21.8	21.8
(In percent of exports of goods and NFS)	3.8	3.4	7.2	3.7	4.1	4.5	4.4	4.6	4.6
Exchange rate									
Rufiyaa per US$	11.77	11.77	11.77	11.77	11.77	11.77	11.77	11.77	12.8
NEER (percent change)	-7.5	2.8	8.4	5.4	0.5	6.7	...	...	...
REER (in percent change)	-5.0	6.5	14.0	2.3	2.6	3.6	...	...	...
Memorandum items:									
Nominal GDP (in millions of rufiyaa)	4,714	5,419	5,894	6,070	6,583	6,547	7,608	7,110	7,261
Terms of trade (percent change)	-10.9	20.5	23.6	3.1	-32.9	-3.2	...	...	...

Sources: Data provided by the Maldivian authorities; and IMF staff estimates and projections.

1/ Based on assumptions underlying the 2001 budget, prepared in November/December 2000.
2/ Projections based on staff recommendations at the time of the mission and data through April 2001.
3/ Revised projections following the July 25 devaluation, and data through June 2001.
4/ Includes re-exports.
5/ Includes the repayment of a $15 million medium-term balance of payments loan from Kuwait in August 1997.

Table 2. Maldives: Balance of Payments, 1997–2001

	1997	1998	1999	2000 Est.	2001 Budget proj. 1/	2001 Staff recomm. 2/	2001 Revised proj. 3/
			(In millions of U.S. dollars)				
Current account balance	-34.2	-23.3	-81.6	-53.0	-71.4	-45.0	-47.8
Trade balance	-214.0	-215.9	-262.4	-233.3	-280.4	-242.4	-245.2
Exports, f.o.b 4/	93.0	95.6	91.5	108.7	123.1	123.1	123.1
Domestic exports	73.2	74.3	63.7	75.9	88.0	88.0	88.0
Re-exports	19.7	21.3	27.8	32.8	35.1	35.1	35.1
Imports, f.o.b	-307.0	-311.5	-353.9	-342.0	-403.5	-365.5	-368.3
Services (net)	190.5	204.3	203.6	208.8	241.9	230.2	230.2
Balance on nonfactor services	218.0	232.4	234.7	238.8	275.0	264.0	264.0
Receipts	312.2	331.3	342.8	348.5	395.2	384.1	384.1
Of which: tourism receipts	286.0	303.0	313.5	320.8	363.7		353.5
Payments	-94.2	-98.9	-108.1	-109.7	-120.1	-120.1	-120.1
Balance on factor services	-27.4	-28.2	-31.1	-30.0	-33.1	-33.8	-33.8
Receipts	7.5	8.6	9.0	10.3	10.3	10.3	10.3
Payments	-34.9	-36.8	-40.1	-40.3	-43.5	-44.1	-44.1
Unrequited transfers (net)	-10.8	-11.7	-22.8	-28.5	-32.8	-32.8	-32.8
Official	17.2	18.9	17.7	17.7	17.3	17.3	17.3
Private	-27.9	-30.6	-40.5	-46.2	-50.1	-50.1	-50.1
Non-monetary capital (net)	61.6	52.3	74.4	45.1	70.3	42.5	42.5
Official medium- and long-term	21.9	14.7	5.2	-2.1	37.6	14.5	14.5
Disbursements	30.7	25.8	17.6	12.4	64.0	30.0	30.0
Amortization	-8.8	-11.1	-12.5	-14.5	-15.5	-15.5	-15.5
Private capital incl.	42.9	42.9	42.9	25.6	32.7	28.0	28.0
Net errors/omissions	-3.2	-5.3	26.3	21.6	0.0	0.0	0.0
Overall balance	27.4	29.1	-7.2	-7.9	-1.0	-2.5	-5.3
Monetary movements	-27.4	-29.1	7.2	7.9	1.0	2.5	5.3
Maldives Monetary Authority	-37.5	-20.2	-8.6	4.4	0.9	7.0	-2.6
Commercial banks	10.1	-8.8	15.8	3.5	0.2	-4.5	7.9
Memorandum items:							
Domestic export growth (value, in percent)	23.8	1.5	-14.3	19.2	15.9	15.9	15.9
Import growth (value, in percent)	15.6	1.5	13.6	-3.4	18.0	6.9	7.7
Tourism receipts growth (in percent)	7.7	5.9	3.5	2.3	13.4	10.2	10.2
Current account balance (in percent of GDP)	-6.8	-4.5	-14.6	-9.5	-11.0	-7.5	-8.4
Gross official reserves (in millions of U.S. dollars)	99.7	119.9	128.5	124.1	123.2	117.1	126.7
(In months of imports of G&NFS)	3.0	3.5	3.3	3.3	2.8	2.9	3.1
(In percent of short-term external debt, resid. Mat.)	417.9	420.3	307.3	249.6	247.8	235.5	254.8
External debt (in millions of U.S. dollars)	178.1	200.8	212.9	211.6	265.6	240.1	240.1
Of which: Short-term debt (original maturity)	12.8	16.1	27.3	33.6	33.6	33.6	33.6
Of which: Short-term debt (residual maturity)	23.9	28.5	41.8	49.7	49.7	49.7	49.7
External debt (percent of GDP)	35.6	38.9	38.1	38.0	41.1	39.7	42.3
Debt service (U.S. dollars) 5/	27.9	14.9	16.8	19.2	21.0	21.8	21.8
Debt service (percent of domestic exports of GNFS)	7.2	3.7	4.1	4.5	4.4	4.6	4.6
Exchange rate (rufiyaa/U.S. dollar)	11.77	11.77	11.77	11.77	11.77	11.77	12.80
GDP (in millions of U.S. dollars)	500.8	515.7	559.3	556.2	646.4	604.1	567.3

Source: Data provided by the Maldives Monetary Authority; and IMF staff estimates.

1/ Based on assumptions underlying the 2001 budget, prepared in November/December 2000.
2/ Projections based on staff recommendations at the time of the mission and data through April 2001.
3/ Revised projections following the July 25 devaluation, and data through June 2001.
4/ Includes re-exports.
5/ Includes the repayment of a $15 million medium-term balance of payments loan from Kuwait in August 1997.

Table 3. Maldives: Central Government Finance, 1997–2001

	1997	1998	1999	2000 Budget	2000 Prel.	2001 Budget proj. 1/	2001 Staff recomm. 2/	2001 Revised proj. 3/
				(In millions of rufiyaa)				
Total revenue and grants	1,824.7	1,930.2	2,225.3	2,403.8	2,474.9	2,710.4	2,612.4	2,694.1
Current revenue	1,652.0	1,763.6	2,058.6	2,234.2	2,269.6	2,514.1	2,416.1	2,481.9
Tax revenue	864.1	902.7	977.3	1,084.3	1,040.7	1,131.6	1,079.6	1,125.6
Nontax revenue	787.9	860.9	1,081.3	1,149.9	1,228.9	1,382.5	1,336.5	1,356.3
Capital revenue	4.5	2.1	4.0	1.1	3.5	14.2	14.2	14.2
Grants	168.2	164.5	162.7	168.5	201.8	182.1	182.1	198.0
Expenditure and net lending	1,906.0	2,053.3	2,506.4	2,480.4	2,776.0	3,325.7	2,895.2	3,071.9
Current expenditure	1,182.0	1,297.9	1,545.5	1,700.0	1,825.6	2,017.9	2,120.9	2,136.8
Capital expenditure	754.9	816.0	949.4	860.6	994.3	1,353.3	819.8	980.6
Net lending	-30.9	-60.6	11.5	-80.2	-43.9	-45.5	-45.5	-45.5
Overall balance	-81.3	-123.1	-281.1	-76.6	-301.1	-615.3	-282.8	-377.8
Overall balance excluding grants	-249.5	-287.6	-443.8	-245.1	-502.9	-797.4	-464.9	-575.9
Current balance	470.0	465.7	513.1	534.2	444.0	496.2	295.2	345.0
Foreign financing	172.2	129.3	56.7	38.4	142.3	589.6	189.1	196.0
Domestic financing	-90.9	-6.2	224.4	38.2	158.8	25.7	93.7	181.8
Total debt (end of period)	2,373.0	2,605.5	2,782.9	2,802.0	3,141.6	3,744.1	3,424.4	3,519.4
Of which: Foreign	1,495.9	1,625.2	1,681.9	1,703.9	1,824.2	2,413.8	1,893.0	2,020.2
				(In percent of GDP)				
Total revenue and grants	31.0	31.8	33.8	36.7	37.8	35.6	36.7	37.1
Current revenue	28.0	29.1	31.3	34.1	34.7	33.0	34.0	34.2
Tax revenue	14.7	14.9	14.8	16.6	15.9	14.9	15.2	15.5
Nontax revenue	13.4	14.2	16.4	17.6	18.8	18.2	18.8	18.7
Capital revenue	0.1	0.0	0.1	0.0	0.1	0.2	0.2	0.2
Grants	2.9	2.7	2.5	2.6	3.1	2.4	2.6	2.7
Expenditure and net lending	32.3	33.8	38.1	37.9	42.4	43.7	40.7	42.3
Current expenditure	20.1	21.4	23.5	26.0	27.9	26.5	29.8	29.4
Capital expenditure	12.8	13.4	14.4	13.1	15.2	17.8	11.5	13.5
Net lending	-0.5	-1.0	0.2	-1.2	-0.7	-0.6	-0.6	-0.6
Overall balance	-1.4	-2.0	-4.3	-1.2	-4.6	-8.1	-4.0	-5.2
Overall balance excluding grants	-4.2	-4.7	-6.7	-3.7	-7.7	-10.5	-6.5	-7.9
Current balance	8.0	7.7	7.8	8.2	6.8	6.5	4.2	4.8
Foreign financing	2.9	2.1	0.9	0.6	2.2	7.7	2.7	2.7
Domestic financing	-1.5	-0.1	3.4	0.6	2.4	0.3	1.3	2.5
Total debt (end of period)	40.3	42.9	42.3	42.8	48.0	49.2	48.2	48.5
Of which: Foreign	25.4	26.8	25.6	26.0	27.9	31.7	26.6	27.8
Memorandum item:								
Exchange rate (rufiyaa/U.S. dollar)	11.77	11.77	11.77	11.77	11.77	11.77	11.77	12.80
Nominal GDP (in millions of rufiyaa)	5,894	6,070	6,583	6,547	6,547	7,608	7,110	7,261

Source: Ministry of Finance and Treasury; and IMF staff estimates.

1/ Based on assumptions underlying the 2001 budget, prepared in November/December 2000.

2/ Projections based on staff recommendations at the time of the mission and data through April 2001.

3/ Revised projections following the July 25 devaluation, and data through June 2001.

Table 4. Maldives: Summary of Monetary Accounts and MMA Balance Sheet, 1997–2001

	1997	1998	1999	2000	2001 Staff Recomm . 1/	2001 Revised proj. 2/
			(In millions of rufiyaa)			
Monetary survey						
Broad money	2,303.4	2,828.7	2,929.8	3,049.8	3,312.3	3,382.7
Net foreign assets	1,148.5	1,490.5	1,405.4	1,312.2	1,311.8	1,347.5
Monetary Authorities (net)	1,163.4	1,401.5	1,502.2	1,450.4	1,357.8	1,599.5
Commercial banks (net)	-14.8	89.1	-96.8	-138.2	-46.0	-252.1
Foreign assets	135.3	278.4	224.7	257.5	376.4	358.1
Foreign liabilities	-150.2	-189.3	-321.4	-395.7	-422.4	-610.2
Domestic assets (net)	1,154.9	1,338.1	1,524.3	1,737.7	2,000.4	2,035.3
Domestic credit	1,764.1	2,091.4	2,259.3	2,586.8	2,854.4	2,895.0
Central govt (net)	663.6	673.1	760.2	995.0	1,095.2	1,183.3
Gross claims on govt.	920.1	1,024.4	1,156.1	1,409.0	1,502.7	1,590.8
Govt. deposits	-256.5	-351.3	-396.0	-414.0	-407.5	-407.5
Other	1,100.4	1,418.3	1,499.1	1,591.8	1,759.2	1,711.6
Public enterprises	103.6	165.1	196.3	184.7	184.7	184.7
Private sector	996.8	1,253.2	1,302.8	1,407.1	1,574.5	1,526.9
Other items (net)	-609.2	-753.3	-734.9	-849.1	-854.0	-859.7
MMA balance sheet						
Reserve money	1,403.8	1,540.8	1,651.3	1,733.5	1,882.6	1,922.7
Net foreign assets	1,163.4	1,401.5	1,502.2	1,450.4	1,368.0	1,610.6
Net domestic assets	240.4	139.3	149.1	283.1	514.7	312.1
Net credit to government	757.1	799.2	921.1	1,177.2	1,277.4	1,365.5
Credit to government	920.1	1,024.4	1,156.1	1,409.0	1,502.7	1,590.8
Govt. deposits	-163.0	-225.2	-235.0	-231.8	-225.3	-225.3
Claims on PNFE and comm banks	1.2	5.6	3.9	1.6	7.7	1.6
MMA C/Ds	-330.0	-480.0	-569.0	-666.9	-528.1	-812.6
Other items, net	-187.9	-185.5	-207.0	-228.7	-242.3	-242.3
			(In percentage change)			
Broad money	23.1	22.8	3.6	4.1	8.6	10.9
Net foreign assets	39.1	29.8	-5.7	-6.6	0.0	2.7
Domestic credit	8.8	18.6	8.0	14.5	10.3	11.9
Central government, net	-11.4	1.4	12.9	30.9	10.1	18.9
Other (pvt+nfpe)	26.1	28.9	5.7	6.2	10.5	7.5
Public enterprises	-33.2	59.3	18.9	-5.9	0.0	0.0
Private sector	38.9	25.7	4.0	8.0	11.9	8.5
Reserve money	15.6	9.8	7.2	5.0	8.6	10.9
Net foreign assets	61.1	20.5	7.2	-3.5	-5.7	11.0
Net domestic assets	-51.2	-42.1	7.0	89.9	81.8	10.3
Net credit to government	-9.8	5.6	15.3	27.8	8.5	16.0
MMA C/Ds	65.8	45.5	18.5	17.2	-20.8	21.9
Memo:						
GDP (in millions of rufiyaa)	5,893.9	6,069.6	6,582.5	6,546.7	7,110.0	7,261.3
Rufiyaa/U.S. dollar	11.8	11.8	11.8	11.8	11.8	12.8
Velocity	2.6	2.1	2.2	2.1	2.1	2.1
Money multiplier	1.6	1.8	1.8	1.8	1.8	1.8
Official reserves (millions of US dollars)	99.7	119.9	128.5	124.1	117.1	126.7
Commercial banks' NFA (US$ mns)	-1.3	7.6	-8.2	-11.7	-3.9	-19.7

Source: Data provided by the Maldives Monetary Authority; and IMF staff estimates.

1/ Projections based on staff recommendations at the time of the mission and data through April 2001.

2/ Revised projections following the July 25 devaluation, and data through June 2001.

Table 5. Maldives: Illustrative Medium-Term Scenario, 2001–2006

	2001 Revised proj.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.
	(Annual percentage change)					
Output and prices						
Real GDP growth	7.0	6.0	6.0	6.0	6.0	6.0
Consumer prices (period average)	3.7	5.7	4.3	3.3	3.0	3.0
	(In percent of GDP)					
Central government						
Revenue and grants	37.1	36.8	38.3	38.1	38.1	38.0
Tax revenue	15.5	16.3	19.0	21.0	26.2	30.3
Nontax revenue	18.7	18.0	17.0	15.0	10.0	6.0
Grants	2.7	2.4	2.2	2.0	1.9	1.7
Expenditure and net lending	42.3	40.0	40.0	40.0	40.0	40.0
Current expenditure	29.4	27.0	27.0	27.0	27.0	27.0
Capital expenditure	13.5	13.0	13.0	13.0	13.0	13.0
Overall balance	-5.2	-3.2	-1.7	-1.9	-1.9	-2.0
Overall balance, excl. grants	-7.9	-5.6	-3.9	-3.9	-3.8	-3.7
Financing						
Domestic	2.5	1.2	-0.3	0.4	0.9	1.5
Foreign	2.7	2.0	2.0	1.5	1.0	0.5
Total government debt	48.5	47.6	45.3	43.4	41.7	40.1
Of which : Foreign debt	27.8	27.5	27.2	26.4	25.2	23.6
	(In millions of U.S. dollars, unless otherwise indicated)					
Balance of payments						
Exports (in percent change)	15.9	7.0	6.0	6.0	6.0	6.0
Imports (in percent change)	7.7	7.4	6.5	5.9	5.9	6.1
Tourism receipts (in percent change)	10.2	9.2	9.2	8.1	8.2	8.2
Trade balance	-245.2	-263.3	-280.0	-295.2	-311.3	-328.9
Nonfactor services, net	264.0	289.5	317.4	343.2	371.2	401.5
Current account balance	-47.8	-48.5	-43.3	-39.2	-34.2	-29.0
(In percent of GDP)	-8.4	-7.8	-6.4	-5.3	-4.2	-3.3
Overall balance	-5.3	6.5	11.7	15.8	15.8	21.0
Memorandum items:						
Gross official reserves (year-end)	126.7	126.5	132.5	134.4	140.5	144.9
(In months of imports GNFS)	3.1	2.9	2.8	2.7	2.6	2.6
External debt (year-end)	240.1	280.1	317.6	352.6	382.6	392.6
(In percent of GDP)	42.3	45.2	47.0	47.8	47.5	44.6
Debt service	21.8	25.5	28.9	32.0	34.8	35.7
(In percent of exports of goods and nonfactor services)	4.6	4.6	4.8	5.0	5.0	4.7

Sources: Data provided by the Maldivian authorities; and IMF staff estimates and projections.

Table 6. Maldives: Indicators of External Vulnerability, 1991–2001

	1991-96	1997	1998	1999	2000 Est.	2001 Latest Estimate	2001 Date	2001 Proj.
	(In percent of GDP, unless otherwise indicated)							
Financial indicators								
Public sector debt 1/	44.6	40.3	42.9	42.3	48.0	...	...	48.5
Broad money (percent change, 12-month basis)	23.3	23.1	22.8	3.6	4.1	4.7	Jun.	10.9
Private sector credit (percent change, 12 month basis)	20.3	38.9	25.7	4.0	8.0	12.9	Jun.	8.5
External Indicators								
Domestic exports (percent change, 12-month basis in US$)	4.5	23.8	1.5	-14.3	19.2	...	...	15.9
Imports (percent change, 12-month basis in US$)	13.5	15.6	1.5	13.6	-3.4	...	...	7.7
Terms of Trade (percent change, 12 month basis)	1.9	23.6	3.1	-32.9	-3.2	...	...	...
Current account balance 1/	-3.1	-6.8	-4.5	-14.6	-9.5	...	...	-8.4
Capital and financial account balance	9.7	12.3	10.2	13.3	8.1	...	...	7.5
Of which : Official medium- and long-term loans (net)	5.0	4.4	2.9	0.9	-0.4	...	...	2.6
Other	4.8	7.9	7.3	12.4	8.5	...	...	4.9
Gross official reserves (in US$ millions)	42.4	99.7	119.9	128.5	124.1	125.4	Jun.	126.7
Central Bank short-term foreign liabilities (in US$)	10.7	0.9	0.9	0.9	0.9	0.9	Jun.	0.9
Short term foreign assets of the banking sector (in US$)	13.9	11.5	23.7	19.1	21.9	28.0	Jun.	...
Short term foreign liabilities of the banking sector (in US$)	17.4	12.8	16.1	27.3	33.6	37.7	Jun.	...
Official reserves in months of imports goods & non-factor services	1.8	3.0	3.5	3.3	3.3	3.1	Jun.	3.1
Broad money to reserves	2.8	2.0	2.0	1.9	2.1	2.3	Jun.	2.1
Total reserves to short term external debt (residual maturity)	142.5	417.9	420.3	307.3	249.6	...	...	254.8
Total external debt	40.7	35.6	38.9	38.1	38.0	...	...	42.3
Of which : Public sector debt	24.5	25.4	26.8	25.6	27.9	...	...	27.8
Total external debt to domestic exports GS	59.3	46.2	49.5	52.4	49.9	...	...	50.9
Debt service to domestic exports GS	3.8	7.2	3.7	4.1	4.5	...	...	4.6
Exchange rate (per US$, period average)	11.3	11.8	11.8	11.8	11.8	12.8	Aug	12.8
REER appreciation (+) (12 month basis)	3.0	14.0	2.3	2.6	3.6	3.8	Mar.	...

Sources: Data provided by the Maldivian authorities, and IMF staff estimates and projections.

1/ Average for 1995-96.

MALDIVES: FUND RELATIONS
(As of June 30, 2001)

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

II. **General Resources Account**:	**SDR Million**	**% Quota**
Quota	8.20	100.0
Fund holdings of currency	6.65	81.1
Reserve position in Fund	1.55	19.0

III. **SDR Department**:	**SDR Million**	**% Allocation**
Net cumulative allocation	0.28	100.0
Holdings	0.23	80.7

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 2000 Article IV consultation (SM/00/191, August 14, 2000) was concluded by the Executive Board on November 3, 2000 (EBM/00/108).

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.

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 July 31, 2001)

IBRD/IDA Lending Operations

	Commitments	Of which: Undisbursed
	(In millions of U.S. dollars net of cancellation)	
Current Portfolio (IDA):		
Education and Training III	17.5	13.2
sub-total	17.5	13.2
Closed projects (IDA):		
Fisheries I	2.48	0.0
Fisheries II	4.93	0.0
Fisheries III	10.00	0.0
Male Airport Upgrading	7.59	0.0
Education and Training	7.92	0.0
Education and Training II	13.40	0.0
sub-total	46.32	0.0
Total	**63.82**	**13.2**

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.

MALDIVES: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]
(As of May 31, 2001)

The Asian Development Bank (AsDB) has provided 9 Special Fund loans for a total of $53.81 million to Maldives since 1981. All of these loans (except for one in education) were for projects in the infrastructure or energy sectors. As of May 31, 2001, cumulative disbursements amounted to $36.96 million or 68.7 percent of the amount available for withdrawal. In addition, the AsDB has provided 28 advisory technical assistance (TA) grants for $11.24 million and 11 TA grants amounting to $2.24 million for preparation of loan projects.

List of Loans

Loan Name	Year of Loan Approval	Net Loan Amount[1]	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	6.41	1.22
Post Secondary Education Development Project	1998	5.91	0.25
Regional Development Project	1999	7.41	1.41
Total		**53.81**	**36.96**

[1]Current value as of May 31, 2001 less cancellations.

[1]Prepared by Asian Development Bank staff.

Maldives: Social and Demographic Indicators

	Latest single year	
	1980-85	1995-2000
GDP per capita:	$469	$2,059
Land area:	298 km	298 km
Population:		
Total population	180,088	270,101
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	29.2
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	67.9
Labor force (in percent of working-age population):		
Labor force participation rate	46.7	44.4
Male	69.6	63.9
Female	21.4	24.4
Unemployment rate (1995)		0.8
Health care (1997):		
Access to safe water	17	89
Immunization (DPT, percent of children under age one)	28	97
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)	150.7	128.3
School enrollment, secondary (gross)	10.4	69.1
Adult illiteracy rate (percent, ages 15 and above)	7.5	3.8

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

MALDIVES: STATISTICAL ISSUES

Maldives has substantially improved its financial and economic statistics in recent years, with the help of several technical assistance missions from STA. However, problems with the compilation and reporting of basic economic data remain, especially with respect to national accounts, fiscal and balance of payments statistics. Improvement in national accounts and balance of payments statistics will be aided by the enactment of statistical legislation. The main official statistical publication is the *Statistical Yearbook of Maldives* for which the latest version is 2000. APD also receives, albeit with a lag, the *Quarterly Economic Bulletin* and the *Annual Report* of the Maldives Monetary Authority and the *Quarterly Fiscal Report* from the Ministry of Finance and Treasury.

National Accounts

Substantial progress has been made. The Asian Development Bank 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.

CPI

The publication of a CPI was discontinued by the authorities in 1994 because of outdated weights, data inconsistencies and compilation difficulties. In response, a STA expert visited Male in May 1995 to help construct a new CPI series based on a 1993 income and expenditure survey, and to develop new price collection procedures. A new CPI has been compiled since June 1995, which incorporates more stringent data collection procedures. A STA consumer price statistics mission of August 1996 recommended that the authorities develop additional price indices for a more comprehensive analysis of inflation.

Government finance

In 1996, the authorities resumed regular reporting of data for publication in the *GFS Yearbook* and the latest published data are for 1999. The latest summary data provided by the Maldives Monetary Authority for publication in *IFS* pertain to 2000.

Balance of payments

Following the STA mission of February 1994, a number of measures were taken to improve data coverage and quality for the balance of payments. However, problems of coverage and timing remain with regard to imports. Travel receipts are still estimated on the basis of a small-sample inquiry of resorts/hotels made in February 1994 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.

Money and banking

Data reporting to STA was irregular, in bunches covering several months, but in 2001 the Maldives Monetary Authority (MMA) started reporting 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. In addition, there are some inconsistencies between the reported data on monetary authorities and on other depository corporations.

Maldives: Survey of Reporting of Main Statistical Indicators

(As of July 25, 2001)

	Exchange rate	International reserves	Reserve/base money	Central bank balance sheet	Broad money	Interest rates	Consumer price Index	Exports/ Imports	Current account balance	External debt/debt service	Overall government balance	GDP
Date of latest observation	6/30/01	June 2001	June 2001	June 2001	June 2001	June 2001	March 2001	March 2001	2000	2000	2000	2000
Date received	7/15/01	7/15/01	7/15/01	7/15/01	7/15/01	7/15/01	6/1/01	6/1/01	4/1/01	4/1/01	4/1/01	4/1/01
Frequency of data 1/	D	M	M	M	M	M	M	M	A	A	A	A
Frequency of reporting 2/	M	M	M	M	M	M	M	M	V	V	V	V
Source of data 3/	E	E	A	A	A	A	A	N	A	A	A	N
Mode of reporting 4/	M	M	M	M	M	M	V	M	M	V	V	V
Confidentiality 5/	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

1/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, or O-other.
2/ D-daily, W-weekly, M-monthly, Q-quarterly, A-annually, V-irregularly in conjunction with staff visits, or O-other irregular basis.
3/ 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.
4/ E-electronic data transfer, C-cable or facsimile, T-telephone, M-mail, V-staff visits, O-other.
5/ 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.

Statement by Mr. Shaalan on Maldives
Executive Board Meeting 01/86
August 30, 2001

The Maldives authorities would like to express their appreciation for the staff's valuable policy advice and for the most helpful technical assistance they have been receiving including recently in the area of monetary policy. They are particularly pleased with the close cooperation with the staff and the continuity in the consultation process over the past two years. This has proved exceptionally valuable in the efforts to advance some key reform measures, particularly in the monetary area, which have been under discussion in the past two years.

Background

Major advances in a number of policy areas have been achieved over the past several years. While efforts were focused on developing the productive base of the economy through the provision of adequate resources to building a solid human and physical infrastructure and hence promote healthy growth, significant importance was accorded to maintaining a stable macroeconomic environment. Driven mostly by an expanding tourism sector and in spite of the declining importance of the fisheries sector, solid economic growth was registered over a prolonged period of time and was accompanied by significant strides in social conditions and a noticeable amelioration in the standards of living. Growth averaged close to 9 percent since the mid 1990's, with per capita income rising to around $2000 and indicators of health and education markedly improving. At the same time, the pursuit of prudent macro policies in the context of a fixed exchange rate system has contributed to broad macroeconomic stability and to keeping inflation under control. The recent economic development report prepared by the staff provides a very useful description of developments in the various sectors of the economy since the mid 1990's.

One of the main contributing factors to these positive developments has been Maldives' access to concessional resources, which has started to diminish and is likely to continue on a declining trend in the period ahead. Given the challenges the country's geography and environment present as well as the remaining vulnerability to external shocks emanating from the narrow productive base of the economy, the authorities feel that continuing access to adequate concessional resources remain indispensable to the developmental needs of the country. This is required for the country to sustain and consolidate the gains made so far in the social areas.

Recent Developments

Developments in 2000 continued to be broadly influenced by the terms of trade shock, real effective exchange rate appreciation, declining tuna catch, and a tourism season that fell somewhat short of expectations. The adverse trends associated with these factors, however, started to be reversed in the second half of the year and the outlook for 2001 is generally favorable. In particular, along with an expected pick up in construction activities, the recovery in prices in the tourist sector and the tuna market is likely to result in an increase in growth from 4 percent in 2000 to 7 percent in 2001. The recent rufiyaa devaluation – discussed below—will also help by restoring the competitiveness of the economy.
The deterioration in the external current account has also been reversed as the terms of trade started to improve and the investment boom in tourism and public sector has wound down. In 2000, the deficit narrowed significantly to 9.5 percent of GDP and was mainly financed by large private capital inflows and some concessional loans.

Overruns in government spending have influenced developments in the fiscal and monetary areas. These overruns reflected to a large extent some weaknesses in the budgetary process which were exposed by the expansion in the physical infrastructure associated with the recent surge in capital investment. While large investment projects were adequately financed, allocation of resources for current spending associated with new projects, including maintenance, operation, and management, fell short of the required levels. The limited administrative apparatus in Maldives, which hampers the ability of the authorities to accurately estimate recurrent spending particularly in the changing environment which characterized Maldives over the past few years, is the major underlying reason for these overruns.

As a result of these overruns, the fiscal deficit overshot the budgeted level in 2000 and reached 4.6 percent of GDP, but was only slightly higher than the 1999 level as actual revenues exceeded their projected level. In the absence of other alternatives, the authorities had to resort to the central bank to finance the deficit. This had added to the existing pressures on the exchange rate pressures emanating from the adverse external factors whose effect has recently diminished as discussed above.

Economic Policy

Exchange rate policy

The events of the past two years have brought into focus the discussion on the appropriateness of the exchange rate. Following a long discussion with the staff on the costs and benefits of a devaluation, the authorities came to the conclusion that at the existing level, the exchange rate was presenting a drag on the economy and that mounting pressures in the exchange market have led to the emergence of shortages, which needed to be addressed decisively. The devaluation, which was seen as inevitable in the prevailing conditions, was carefully carried out taking into account a number of critical factors. Before elaborating on these factors, it is important to point out that the authorities continue to believe that a fixed exchange rate system remains most suitable for Maldives. They stand ready to provide sufficient foreign exchange to maintain the rate at its new level and prevent the occurrence of any shortages and will spare no effort at implementing the necessary macroeconomic policies to support the new rate.

As the staff report points out, the real effective exchange rate has appreciated markedly particularly in light of the strength of the US dollar. The authorities believe that both tourism (due in the most part to the weakness of the euro) and fisheries have been hurt by the appreciation. While they concur with the staff that the effect of a devaluation for the year may not be substantial, they view this issue from a longer-term perspective and note that real appreciation has amounted to 10 percent since 1997 and more than 20 percent since 1995. In any case, quantifying the effect of an exchange rate change (costs and benefits) is fraught with difficulties and more so in Maldives where data quality, as both the authorities and the staff agree, is weak. In addition, after a long year of mounting pressures in the exchange market, the authorities recognized the potential danger of trying to maintain the existing exchange rate at a time when foreign exchange reserves were at only around three months of import. The authorities are convinced that the 9 percent devaluation represents an appropriate level of adjustment in the rate needed to restore competitiveness and calm down pressures in the market that resulted from previous macro imbalances.

Fiscal Policy

Having made the exchange rate adjustment, the authorities recognize the importance of preserving the benefits of the change and maintaining the stability the fixed exchange rate system has yielded. In fact, efforts in both the fiscal and monetary areas are focused on strengthening the macroeconomic policy framework and tools to enhance the authorities' ability to preserve the financially sound environment that prevailed for most of the 1990's and more broadly to effectively deal with external shocks.

Reforms in the fiscal area take on an added importance when seen from a medium term perspective especially given the declining access to foreign concessional resources. In order to strengthen the revenue base, the authorities have initiated a review of the revenue system and consequently updated various charges and fees, and introduced property and business profit taxes. They did not feel that consideration should be given to raising additional revenues from tourism until there is strong evidence that the sector is on very firm ground. The well being of the Maldives economy rests on the healthy functioning and growth of this sector. It is therefore essential that using this sector to increase government revenues is approached with the utmost care. On the spending side, the authorities recognize the necessity of strengthening expenditure control and agreed with the staff that controlling access to central bank financing is essential to prevent spending overruns. With a view to establishing fiscal discipline, they are working on a new public accounting system with the assistance of AsDB which they hope can be finalized soon and used to effectively monitor expenditures. Furthermore, a public finance law that would pave the way for the introduction of treasury bills and bonds and hence less reliance on central bank financing is under preparation.

Monetary Policy

In the monetary area, major progress in reforming the monetary framework has been achieved recently. In particular, and in line with the staff's recommendation, the MMA has decided to introduce a mass of measures to revitalize the financial market and move to a more market based monetary management system. These include, among other things, the abolishment of bank specific credit ceiling (which were imposed in 1995), the expansion of the MMA certificate of deposit program to allow public enterprise to participate, the elimination of the maximum allowable interest differential between lending and deposit rate, and the introduction of a discount facility. Measures relating to the reduction of reserve requirement and the increase in the rate of remuneration on reserves are planned for 2002. In this regard, it should be noted that the provision of technical assistance from MAE has been critical to the implementation and sequencing of these measures. The authorities recognize that while these far reaching changes are taking hold, supervision of financial institutions needs to be upgraded. In this connection, they have placed priority on establishing prudential limits on the foreign exchange open positions of banks.

Other Issues

Moving to structural issues, as was envisaged last year in the context of the discussions on the Sixth National Development Plan which is still under consideration, emphasis has been placed on promoting the role of the private sector in the economy. In this regard, a key step in the efforts to reform the fisheries sector was the opening of the local skipjack catch industry to private sector participation which should lead to enhanced competition.

Finally, with a view to further improve the statistical data base in Maldives, a new statistical law is planned to provide for the establishment of an independent statistical agency that would collect and disseminate a range of timely and accurate statistical information.