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October 24, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Maldives - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Maldives. A draft decision appears on page 15.

This subject has been tentatively scheduled for discussion on Monday, November 14, 1983.

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INTERNATIONAL MONETARY FUND

MALDIVES

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the 1983 Article IV Consultation with the Maldives

Approved by Tun Thin and Manuel Guitian

October 21, 1983

Contents

I. Introduction

The 1983 Article IV consultation discussions with Maldives were held in Male during August 5-16, 1983. The representatives of Maldives included the Ministers of External Affairs, Trade and Industry, Atolls Administration, Fisheries, and Transport and Shipping, as well as the Deputy Minister of Planning and Development, the Director of the Department of Finance, the General Manager of the Maldives Monetary Authority, and other senior officials concerned with economic and financial matters. The head of the mission also met with the President, Mr. Maumoon Abdul Gayoom. The staff team consisted of Mr. K. Al-Eyd (ASD, Head), Mrs. E. Gurgen, Mr. T. Yanagita, Mr. H. Mendis, and Mrs. O. Goodger (all ASD).

Maldives continues to avail itself of the transitional arrangements of Article XIV. Summaries of Maldives' relations with the Fund and the IBRD are provided in Annexes I and II, and selected economic indicators, in Annex III.

II. Background and Recent Economic Trends

Growth performance in Maldives--a small and open island economy--has been favorable in recent years, with real GDP growth averaging 9 percent annually during 1981-83, largely on the strength of rising productivity in fishing, rapid expansion in tourism, and heavy public investment in infrastructure projects (Table 1). The development effort was aimed at exploiting the country's marine resources, promoting the growth of tourism and shipping, and diversifying the productive base in manufacturing. The role of agriculture, however, remains constrained by the small area of arable land, poor soil conditions, and the underdeveloped interisland transport system.

The fisheries sector plays a major role in the Maldivian economy, accounting for 80 percent of merchandise exports and over 40 percent of total employment. The sector is subject to the vagaries in the international fish market, but has benefited from increased mechanization of fishing vessels and improvements in fish collection and refrigeration facilities. Tourism has grown rapidly, particularly after the completion of the Male International Airport in 1981, and it has become a major source of foreign exchange earnings. Its contribution to GDP has risen from 9 percent in 1979 to 15 percent in 1983. In addition, receipts from taxes on tourism constitute an important source of revenue for the Central Government. Shipping is another major industry, making sizable contributions to the balance of payments and the budget. The recent contraction in world trade, however, has adversely affected the operations of the government-owned Maldives Shipping Limited (MSL) which provides shipping services between the Far East, Middle East, and Africa. Until 1980, the manufacturing sector consisted of a few enterprises producing consumer goods for

Table 1. Maldives: Gross Domestic Product
by Sector of Origin, 1980-83

	1980 Percentage shares in GDP (current market prices)	Annual real rates of growth			
		1980	1981	1982	1983 Est.
GDP	100.0	18.7	8.0	9.0	10.0
Primary sector	32.9	16.3	1.3	5.5	7.4
Of which: Fisheries	(18.5)	(10.2)	(-4.3)	(7.9)	(8.1)
Secondary sector 1/	12.5	-9.7	13.2	13.0	6.1
Services sector	54.6	29.0	6.6	9.8	12.5
Of which:					
Tourism	(12.5)	(54.9)	(24.2)	(10.5)	(14.3)
Trade and transportation	(20.2)	(27.0)	(14.0)	(11.7)	(11.5)
Government services	(13.6)	(46.1)	(1.0)	(8.4)	(10.2)

Source: Ministry of Planning and Development.
1/ Construction, manufacturing, and electricity.

the local market. Two garment factories were established in 1981, and garment manufacturing has since become an important source of employment and exports.

Fiscal developments in 1982 reflected two financial adjustments. First, the use of the official accounting rate in valuing government foreign exchange transactions was terminated. Second, it was decided to charge the cost of subsidies provided on basic items to the budget.1/ The cost of subsidies (Rf 25 million) accounted for 57 percent of the total increase in current expenditures in 1982 (Table 2). Due in part to a sharp decrease in development expenditures following the completion of the airport, the overall budget deficit declined to 4.1 percent of GDP in 1982 from 5.7 percent in 1981.

The 1983 budget is characterized by a slowing down in revenue growth, due mainly to shortfalls in contributions from public enterprises, particularly the MSL, a slower growth in current expenditures, and a threefold increase in capital expenditures. MSL contributions to the budget are expected to be zero in 1983, in addition to which, the Government has had to assume a foreign loan repayment on behalf of the MSL. The sharp increase in capital expenditures reflects spending on fisheries, including the acquisition of refrigerated fishing ships, fish collecting vessels, and supporting fishing boats; a land reclamation project; and atoll development programs. Consequently, the budget deficit is estimated at close to 15 percent of GDP. As in previous years, the deficit will be financed largely through concessional foreign loans; borrowing from the domestic banking system is likely to remain at less than 2 percent of GDP.

Monetary expansion which had picked up during the second half of 1982, continued to accelerate in 1983. On an annual basis, the growth in total liquidity accelerated from 20 percent during 1982 to 34 percent during the 12 months ended June 1983 (Table 3). This expansion was fueled by the sharp growth in domestic credit, and occurred despite a further deterioration in the net foreign asset position of the banking system. The stock of net credit to the public sector more than doubled

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1/ Until early 1982, Maldives maintained a dual exchange rate system consisting of a market exchange rate (Rf 7.55 per US$1) and an official accounting rate (Rf 3.93 per US$1) used for the accounting of all government transactions in foreign currency, the valuation of imports for customs purposes, and the determination of the domestic procurement prices of fish as well as the domestic sales prices of basic consumer goods. This system resulted in implicit taxation of fish exports and implicit subsidization of imported basic consumer goods. In January 1982, the use of the official exchange rate was confined to the valuation of imports for customs purposes and determination of the domestic prices of essential imports; the link between the official exchange rate and the procurement price of fish was abandoned in favor of a flexible system designed to provide incentives to fishermen. For details see SM/82/39, 2/19/82.

Table 2. Maldives: Central Government Budget, 1980-83

(In millions of rufiyaa)

	1980	1981	1982	1983
	Actuals		Prov.	Est.
Revenue and grants	57.4	81.8	122.6	134.5
Revenue	45.9	73.5	99.5	121.5
Grants	11.5	8.3	23.1	13.0
Expenditure and net lending	139.2	108.2	144.1	229.7
Current expenditure	39.4	52.3	96.4	106.1
Of which: Subsidies	(--)	(--)	(25.1)	(10.0)
Capital expenditure	64.4	55.8	45.6	122.7
Net lending and capital contributions	35.4	0.1	2.1	0.9
Overall deficit (-)	-81.8	-26.4	-21.5	-95.2
Financing				
Foreign borrowing (net)	47.0	26.3	13.8	85.9
Disbursements	47.0	26.5	14.9	90.4
Repayments	--	-0.2	-1.1	-4.5
Domestic borrowing, and changes in deposits and cash balances	34.8 1/	0.1	7.7	9.3

Sources: Department of Finance; and Maldives Monetary Authority.

1/ Represents mostly drawing down of a government deposit to finance capital contributions to public enterprises.

Table 3. Maldives: Monetary Survey, 1980-83 1/

(In millions of rufiyaa; end of period)

	1980	1981	1982 June	1982 Dec.	1983 June
Net foreign assets	11.4	-58.8	-27.2	-83.7	-88.3
Of which: Commercial banks	(11.4)	(-65.5)	(-24.1)	(-91.9)	(-80.0)
Net domestic assets	84.0	146.2	119.9	188.4	212.2
Domestic credit	94.8	137.8	122.5	198.8	243.3
Public sector (net)	72.7	86.5	56.4	99.2	134.7
Private sector	22.1	51.3	66.1	99.6	108.6
Other items (net) 2/	-10.8	8.4	-2.6	-10.4	-31.1
Total liquidity	95.4	87.4	92.7	104.7	123.9
Money	33.3	39.4	53.0	57.2	69.2
Quasi-money	62.1	48.0	39.7	47.5	54.7

Source: Maldives Monetary Authority.

1/ The 1980 figures are based on data from commercial banks only and are not comparable with the 1981-83 figures which also include data for the MMA (established in 1981).

2/ The large increase in liabilities under other items (net) since 1981 reflects mainly the growth in paid up capital and reserves of banks following the establishment of two new banks in 1982 and the increase in assigned capital of banks in February, 1983.

between June 1982 and June 1983, raising the public sector's share in total domestic credit from 46 percent to 55 percent. The rise in public sector credit largely reflected a sharp drawing down of government deposits with the banking system; the growth in gross claims on the public sector was much less pronounced. Credit to the private sector expanded strongly in the second half of 1982, but moderated thereafter as measures were taken to curb private sector demand for imports.

Domestic price developments in Maldives have been strongly influenced by price developments abroad. After rising by 19 percent in 1981, consumer prices were virtually stable in 1982, due largely to the moderation in world prices of a number of food products and oil, which are major import items, and to the appreciation of the rufiyaa. The rate of inflation has increased sharply in recent months and is now estimated at 17 percent in 1983, reflecting mainly the progressive depreciation of the accounting rate for duty purposes, somewhat higher import prices, and domestic demand pressures generated in part by the strong growth in government spending. In general, however, increased availability of imported consumer goods has helped ease pressure on prices during periods of vigorous economic activity.

The balance of payments has traditionally shown a large deficit on the trade account and a surplus on services and transfers (Table 4). The current account deficit (including official transfers) has been financed largely through concessional long-term loans mainly from Middle Eastern countries; foreign investment, especially in tourism; and short-term capital inflows. The overall balance has generally shown a small surplus, and until recently the net foreign asset position of the Monetary Authority remained more or less unchanged.

In 1982, exports (excluding re-exports) stagnated, due mainly to a decline in both the volume and price of fish exports, while import growth was resumed following a decline in the previous year, reflecting a surge in demand for consumer as well as capital goods. At the same time, the world recession adversely affected the earnings of the MSL, causing net outflow on shipping to peak at US$10 million. Consequently, notwithstanding the continued strong growth in tourism receipts, the current account deficit widened to US$24 million. In 1983, imports are estimated to increase by 22 percent. However, due largely to the improvement in the services account, the current account deficit is estimated to stabilize in absolute terms, and to decline to 26 percent of GDP from 33 percent in 1982.

External public debt, which is mostly concessional, is projected at 71 percent of GDP at the end of 1983. Debt service, including interest payments on short-term debt, is estimated to rise from an average of 3.5 percent of exports of goods and services during 1980-82 to just over 6 percent in 1983 as initial repayments on a number of major loans become due. Although the debt service ratio will rise further, it is not projected to exceed 10 percent in the next two years.

Table 4. Maldives: Summary Balance of Payments, 1980-83

(In millions of U.S. dollars)

	1980	1981	1982 Prov.	1983 Est.
Trade balance	-31.3	-25.9	-28.7	-36.2
Exports, f.o.b.	12.7	15.8	17.3	19.8
Of which: re-exports	(2.7)	(4.5)	(5.9)	(4.0)
Imports, f.o.b.	-44.0	-41.7	-46.0	-56.0
Services (net)	6.7	3.3	1.3	8.7
Of which:				
Travel	8.9	11.9	18.0	23.0
Shipment 1/	3.8	-1.6	-10.5	-5.1
Transfers	2.4	2.4	3.3	3.3
Official	2.6	2.7	4.6	4.3
Private	-0.2	-0.3	-1.3	-1.0
Current account	-22.2	-20.2	-24.1	-24.2
Current account excluding official transfers	(-24.8)	(-22.9)	(-28.7)	(-28.5)
Nonmonetary capital (net)	22.3	20.4	23.6	24.2
Public sector (net)	15.2	15.5	6.1	12.5
Long-term	(18.1)	(12.8)	(5.3)	(12.5)
Short-term	(-2.9)	(2.7)	(0.8)	(--)
Commercial banks (net)	-1.0	11.2	4.4	2.0
Private capital and errors and omissions 2/	8.1	-6.3	13.1	9.7
SDR allocation	0.1	0.1	--	--
Overall balance	0.2	0.3	-0.5	--
Monetary authority	-0.2	-0.3	0.5	--
Change in foreign assets (- = increase)	--	-0.2	-7.3	--
Change in foreign liabilities (+ = increase)	-0.2	-0.1	7.8 3/	--

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

1/ Reflects MSL operations.

2/ Consists mainly of foreign investment in tourism.

3/ Includes a short-term loan from Kuwait in the amount of US$7.5 million.

III. Report on the Discussions

1. Economic development policies

The Government has set three principal objectives for its economic and social development in the medium term: improvement in the standard of living of the population; a better regional balance in economic development; and gradual reduction in reliance on foreign financial and technical assistance.

Until 1981, development strategy had concentrated mainly on the promotion of the fisheries and tourism sectors. Over the past two years, emphasis has turned to diversifying production and exports, and to achieving a more regionally balanced distribution of the benefits of economic progress. In order to achieve better coordination between the various ministries and departments, improve the implementation of the annual investment programs, and evolve medium-term development plans, the Government has recently transformed the National Planning Agency into the Ministry of Planning and Development. The Ministry is currently engaged in the formulation of a three-year plan covering the period 1984-86.

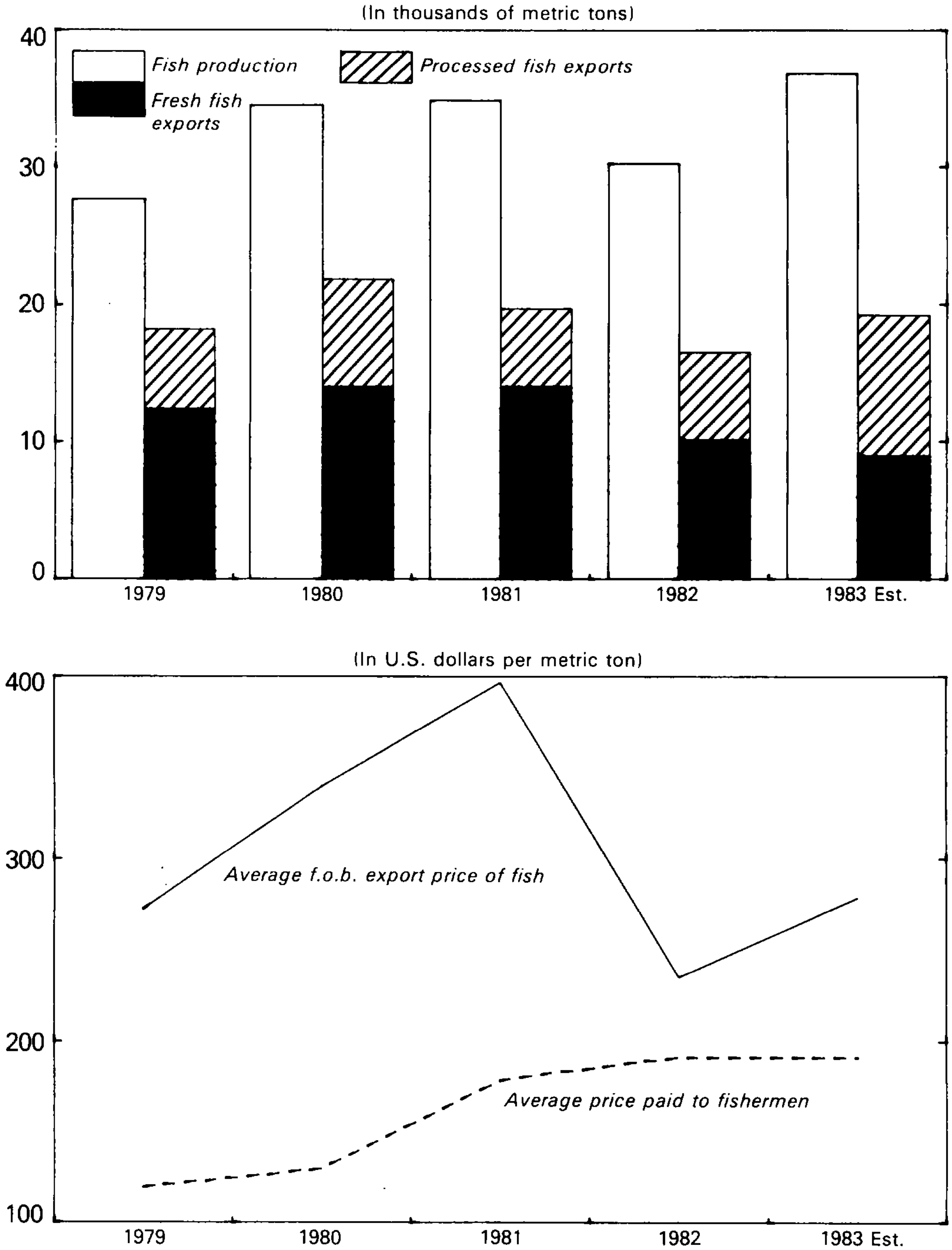
The growth in output and employment in the fisheries sector has continued despite recent adverse developments, including unfavorable fishing conditions, the sluggish recovery in world market prices of fish, and transitional difficulties encountered during the shift in fish collection and canning operations from foreign companies to domestic operators in early 1983. The sector has benefited from increased mechanization of fishing vessels and improvements in the diesel supply system. The number of mechanized dhonis (fishing boats) rose from about 800 at the end of 1980 to almost 1,300 by August 1983. Three refrigerated ships are on order from a Korean company, while nine collecting vessels and 100 dhonis are under construction in Male, all of which are expected to be in operation by the end of 1984. The State Trading Organization (STO) and the Fisheries Corporation are now primarily responsible for the collection and marketing of fish, and nearby markets (e.g., Thailand) are being promoted. The procurement prices paid by the STO to fishermen were maintained despite the sharp drop in export prices that began in mid-1981 (Chart 1). This action resulted in lower profits for the STO on its fish operations, which curbed the growth in its contribution to the budget.

The tourism sector has shown a steady growth over the years, with both tourist arrivals and expenditures more than doubling between 1980 and 1983. The number of tourist resorts and bed-capacity has increased sharply while capacity utilization has also risen. To minimize the risks that could result from heavy reliance on tourism, and avoid, to the extent possible, infrastructural bottlenecks and diversion of resources from other sectors, future investment will be selective. The emphasis will now be on the renovation of existing resorts and the development of one additional tourism zone, in Ari atoll, which is

CHART 1

MALDIVES

FISH PRODUCTION, EXPORTS, AND PRICES, 1979-83



Source. Data provided by the Maldivian authorities.

near Male atoll. Twenty seven islands have been selected in Ari atoll, 14 of which are to be privately developed and the rest to be developed by the Government and leased to private operators. Nine resorts are expected to be in operation before the end of 1983, and the entire project (with 5,000 bed-capacity) is to be completed by 1986. Concessional foreign loans will finance public sector investment in the new zone.

The two garment factories on Gan island, which are operated jointly by the STO and Hong Kong-based partners, have increased output and employment since their establishment in 1981, but are currently facing severe difficulties because of quotas imposed on their exports of woolen garments. At present, the two factories are operating at slightly above 50 percent capacity, while plans for a third factory in the Male region have temporarily been abandoned. Although alternative markets are being sought, so far the effort has not been successful, due in part to the high shipping costs relative to the small number of orders received.

More emphasis will be placed in 1984 and beyond on infrastructural projects, including, in particular, water supply and harbor facilities in Male, health and education services in the outer atolls, and inter-island transport and communication systems. External concessional loans and grants will continue to be the primary source of development financing, while additional domestic resources will be generated largely through the further promotion of fisheries, tourism, and export-oriented industries. While recognizing the merits of the development strategy, the staff stressed the need to adopt a selective approach to investment in order to limit the growth in government expenditures to sustainable levels and ease the pressures on the balance of payments.

2. Fiscal policies

The central government budget is characterized by a narrow revenue base, consisting basically of receipts from taxes on imports and tourism and profit transfers from state enterprises; there are no income or property taxes. With the strong growth in imports and tourism and rapid expansion in the operations of the MSL and the STO, revenue growth has been impressive in recent years. Government revenue in relation to GDP rose from 16 percent in 1981 to 19 percent in 1982, and is estimated to remain at the same level in 1983. On an overall basis, the budget registered an annual deficit, the size of which was largely determined by capital spending, while a current surplus was recorded in each year beginning in 1980 (Chart 2). In order to mobilize additional domestic resources and compensate for the expected shortfall in transfers by public enterprises, a number of revenue measures--yielding approximately Rf 5.5 million, equivalent to about 1 percent of GDP on an annual basis--were introduced in 1983. Chief among these measures were the gradual depreciation of the accounting exchange rate used for valuation of imports for duty purposes from Rf 4.0 per US$1 at the end of 1982 to Rf 5.5 per US$1 by August 1983, and adjustments in a number of government fees and charges.

Preparations for the 1984 budget had just started at the time of the discussions. The authorities indicated that expenditure growth, which had accelerated sharply in 1983, will continue to be strong in 1984. While there may be some cuts in current expenditures, reductions in spending on ongoing development projects are not being contemplated. Priority will continue to be placed on the atoll development program in order to ease congestion in the Male region. In addition, the Male water and sewerage projects are to be initiated in 1984, while work on Male land reclamation continues. The construction of a new harbor and loading platforms on reclaimed land is under active consideration. The Government is considering a number of measures intended to mobilize additional resources and to curb the growth in certain categories of expenditures. Decisions have been taken, in principle, to eliminate subsidies on basic consumer items; to continue depreciating the accounting exchange rate used in customs valuation until it is at par with the market exchange rate by early 1984; and to reform the tax structure, including the valuation of imports on a c.i.f. basis for customs duty purposes, and the taxation of imports for personal use with higher rates on luxury items. The introduction of income and property taxes, however, is not currently being contemplated, mainly because of administrative difficulties.

The staff welcomed the intention to introduce new fiscal measures in the 1984 budget, and pointed out that there appears to be scope for increasing tax revenue which remains low at about 8 percent of GDP. A more equitable distribution of the tax burden is also possible through increased taxation of tourism, as well as the introduction of income and property taxes. In addition, more efficient management and control of government spending could be achieved through increased coordination in the preparation and execution of the budget. It was further pointed out that it would be useful if a Treasury Unit could be set up to centralize control over government transactions.

3. Monetary and credit policies

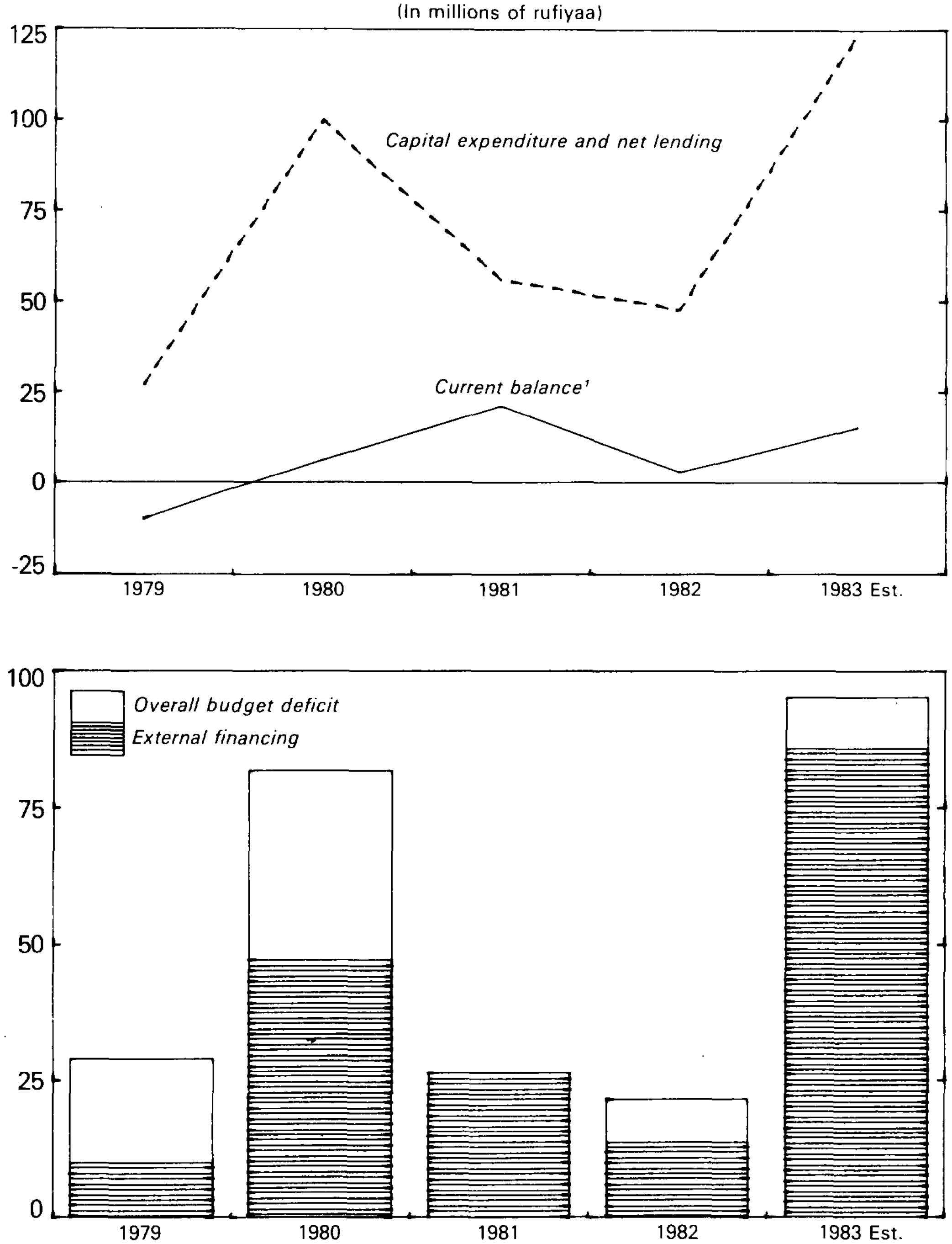
Monetary expansion was rapid during 1982-83, in line with fiscal developments and the surge in private sector activity. The competition among banks also helped fuel the growth of credit, particularly to finance resort building and trade. The authorities reacted to these developments by introducing measures to curb private sector demand for imports and by bringing the growth in domestic credit under control. Reserve requirements on banks, first introduced in early 1982, were raised three times through June 1983. Currently, reserve requirements are 25 percent on demand and time deposits. In addition, a 50 percent advance deposit requirement on private sector imports against letters of credit has been in effect since November 1982. Finally, in July 1983, a temporary freeze was placed on commercial banks' foreign

CHART 2

MALDIVES

CENTRAL GOVERNMENT BUDGET, 1979-83

(In millions of rufiyaa)



Source. Department of Finance.
[1] Revenue less current expenditure.

exchange overdrafts available to the private sector.1/ While endorsing the efforts to contain credit expansion and dampen private demand for imports, the staff pointed out that the import deposit scheme gave rise to a multiple currency practice, and urged the authorities to eliminate the practice at the earliest opportunity. The authorities indicated that the advance deposit scheme was temporary and would be eliminated in the near future.

A major proportion of the foreign exchange circulating in the economy was absorbed into the banking system following the decree issued on January 25, 1982 prohibiting the use of foreign exchange as a means of domestic payment in Maldives. This has helped improve the MMA's ability to exercise monetary control. There has also been a noticeable shift in favor of deposits and loans denominated in domestic currency after the increase of interest rates in February 1982 and the unification of rates applicable to domestic and foreign currency loans and deposits. Presently, interest rates on deposits, of up to one year range from 9-10 percent, while lending rates range from 17-18 percent. In view of the acceleration in the rate of inflation, deposit rates have become negative in real terms in 1983, while ex-post real lending rates continue to be slightly positive. The staff recommended the adoption of a more active interest rate policy aimed at maintaining both deposit and lending rates positive in real terms in order to mobilize savings and stem excessive demand for credit.

4. External policies and prospects

The trade deficit is expected to rise sharply in 1983, due mainly to the strong growth in imports in line with the high level of economic activity, particularly the rapid increase in public sector spending on capital projects. Other factors contributing to the growth in imports are the continued application of the more appreciated accounting exchange rate for duty purposes and the exemption of personal imports from customs duties. Export growth has been modest due to the sluggish recovery in export prices of fish. Moreover, the volume of re-export trade has been falling since the beginning of 1983 and is projected to decline further in the coming years. The recent contraction in the volume of world trade has had a negative impact on earnings from shipping services. Consequently, notwithstanding the strong growth in tourism receipts and substantial flows of official grants, the current account deficit is expected to remain sizable in 1983 (Chart 3).

In March 1982, the market exchange rate for the rufiyaa was appreciated from Rf 7.55 per US$1 to Rf 7.05 per US$1 (mid-rates).2/ Movements in the relative prices in Maldives and its trading partners in subsequent months, together with the appreciation of the U.S. dollar to which the

1/ The freeze was lifted on September 6, 1983.

2/ The market exchange rate is quoted by the MMA, based, in principle, on supply and demand conditions in the foreign exchange market. The rate has remained stable in recent years.

rufiyaa is pegged, resulted in a significant real appreciation of the rufiyaa vis-a-vis other major currencies. The real appreciation of the rufiyaa was even more pronounced for the tourism sector (Chart 4). These developments further stimulated the demand for imports, which was already rising, and added to the pressures on the balance of payments.

Gross official reserves rose from less than one month's imports at the end of 1981 to 2.4 months' imports by March 1982, largely as a result of a one-year loan of US$7.5 million extended by Kuwait to the MMA in February 1982. Despite the subsequent rollover of this loan for an additional year, gross official reserves have been declining in recent months and currently stand at 1.5 months' imports. The decline in reserves has been a source of particular concern to the authorities, prompting them to take measures to control private sector demand for imports, including the temporary freeze on overdraft facilities introduced in July and the placement of all imports on a letter of credit basis effective October 1, 1983.

No significant improvement in the balance of payments is expected over the next two years. Export growth will remain sluggish due to the continued decline in re-exports and the anticipated stabilization in the prices of traditional export items. The expected surge in net income from services will help counter the further deterioration in the trade balance, so that, excluding official transfers, the current account deficit will, on average, be about the same as in 1982-83. Concessional loan disbursements are expected to decline sharply in 1984-85, due largely to the completion of a major fisheries project financed by Kuwait. However, this will be offset by an increase in official transfers, with additional grants from Saudi Arabia, Norway, West Germany, China, and U.N. agencies.

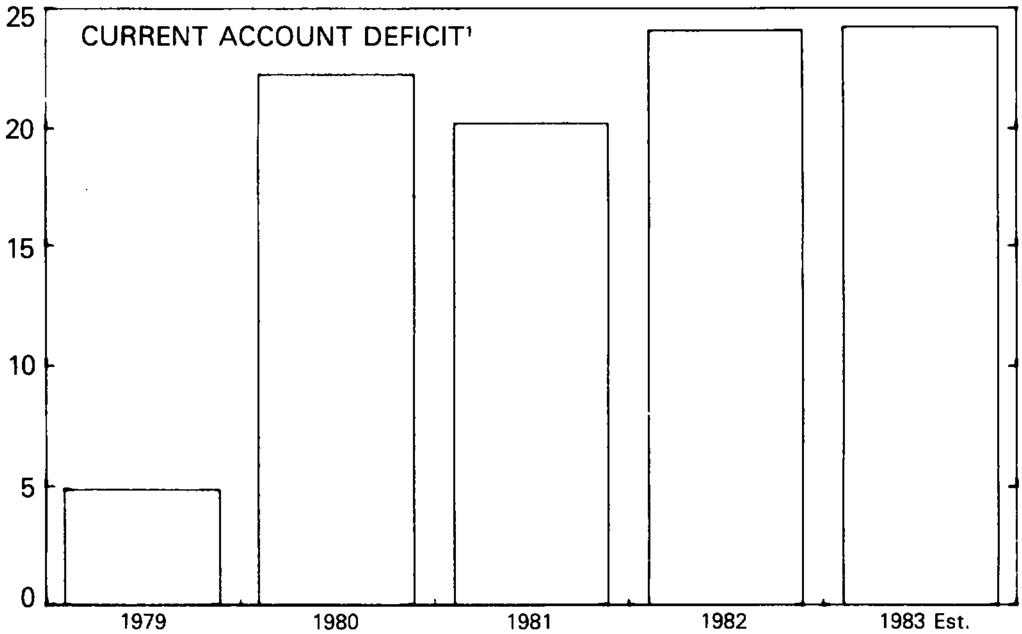
The staff emphasized the importance of appropriate fiscal, monetary, and exchange rate policies to further stimulate exports and to restrain domestic demand in order to ease the pressures on the balance of payments. It was stressed that the need for external adjustment was made all the more pressing by the recent sharp drop in gross international reserves and by the debt service burden, which, although low, has been on a rising trend since 1980. The authorities agreed that in view of the difficult foreign exchange situation, it was essential to complete the pricing, taxation, and tariff reforms as soon as possible. While not disputing the staff's assessment that exchange rate policy could play a useful role in strengthening the balance of payments, the authorities did not think that an adjustment in the exchange rate would be feasible in the near future. The subject, however, will be reviewed early next year following the completion of the above-mentioned reforms. The authorities are confident that the recent measures taken to control domestic credit and limit the growth in imports will ease pressures on the balance of payments in the near future, while further measures for external adjustment are implemented. The staff welcomed the policy initiatives aimed at curbing the growth in domestic credit, and commended the authorities' decision not to resort to quantitative controls on imports.

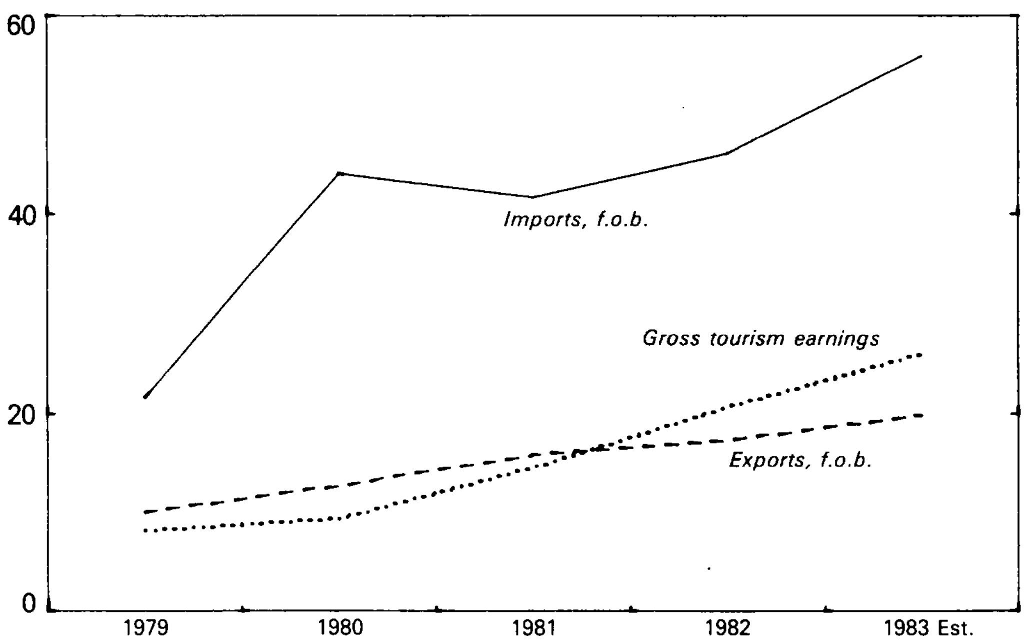
CHART 3

MALDIVES

EXTERNAL CURRENT ACCOUNT, 1979-83

(In millions of U.S. dollars)





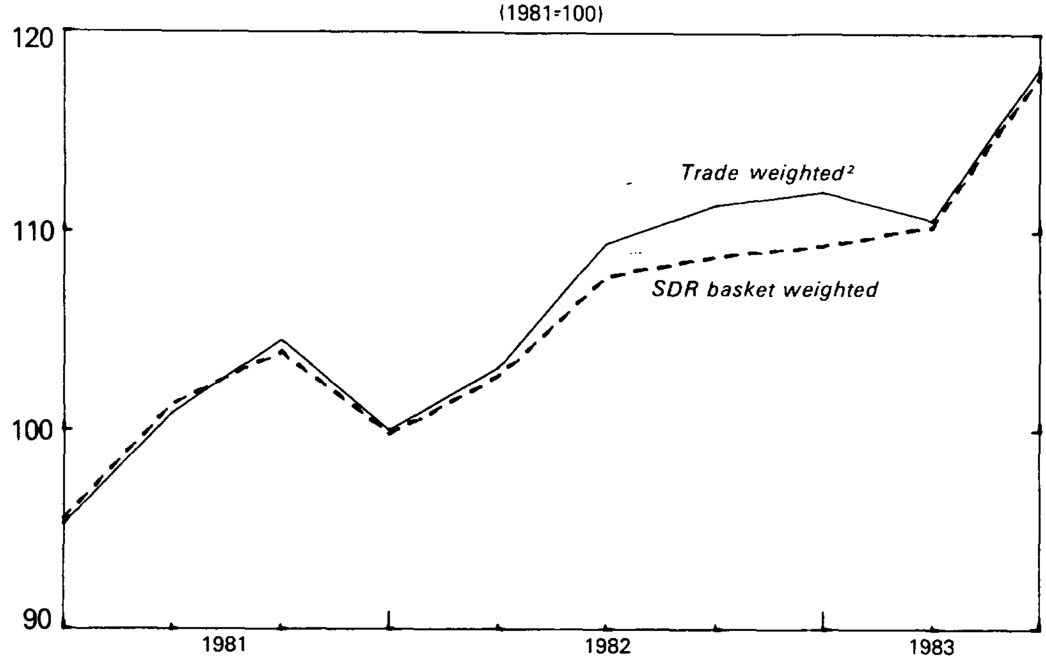
Source: Data provided by the Maldivian authorities and staff estimates.
[1] Including official transfers.

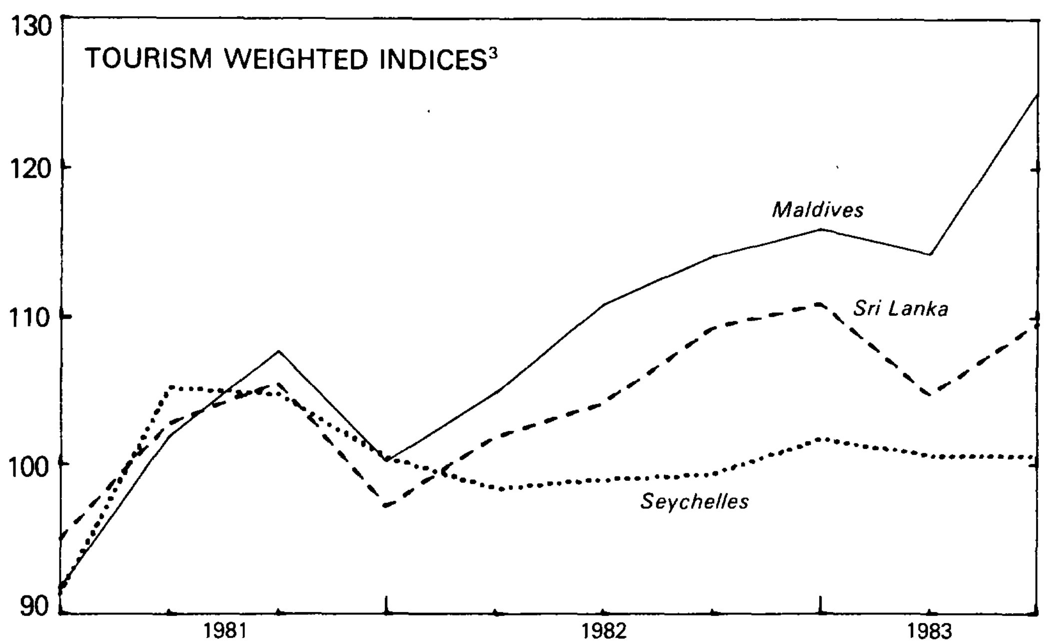
CHART 4

MALDIVES

REAL EFFECTIVE EXCHANGE RATE INDICES[1], 1981-83

(1981=100)





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

[1]An increase represents an effective appreciation.

[2]1981 trade data, including tourism earnings.

[3]Calculated on the basis of baskets derived from tourist arrivals by nationality; 1980 data.

IV. Staff Appraisal

Despite a limited resource base and adverse external developments, the growth performance of Maldives has been impressive in recent years. Fishing, tourism, and construction activities have expanded rapidly. The fisheries sector has suffered from a number of adverse factors, but major setbacks were avoided with appropriate and timely policies, in particular, the maintenance of procurement prices at a time when international fish prices were declining. The performance of tourism has been most notable. Considering the risks involved in excessive reliance on tourism, it is appropriate for the Government to pursue a cautious investment policy in this area. Efforts have been made to diversify the economy and achieve a more regionally balanced growth, as illustrated by the promotion of the garment industry. However, the growth in production and exports of garments could be halted unless quota limitations on exports are lifted or alternative markets are found.

Public enterprises have so far been major contributors to the government budget. Nevertheless, the vulnerability of these enterprises to external developments, as illustrated by the recent experience of the MSL, makes this source of revenue a rather unstable one. There is scope for raising revenue from other sources, including increasing the coverage and rate of taxation in a number of areas and increasing the share of tourism in the tax burden. The contemplated tariff reform, which will more adequately tax imports and review the possibilities of broadening the tax base, needs to be implemented soon, particularly in view of the desirability of sustaining the development effort and reducing excessive reliance on foreign resources.

The growth in overall public sector spending, coupled with the surge in private sector activity, has been at the root of the strong expansion in domestic demand in recent years. While the authorities have taken a number of corrective measures, the growth in domestic demand cannot effectively be controlled without a tightening of controls on government spending. There is also need for a greater restraint on spending by public enterprises. The adjustment of interest rates and the introduction of reserve requirements are appropriate. It is, however, essential to keep such policies under review, and to make further adjustments as warranted by economic conditions.

The current account deficit of the balance of payments remains very high at around 26 percent of GDP, notwithstanding the availability of substantial flows of official grants. Full implementation of the envisaged development program is expected to lead to heavier debt service obligations in the medium term, although not at levels considered unsustainable. The progressive elimination of the official accounting rate and the associated changes in the pricing system will have a positive impact on the balance of payments. Nevertheless, a more active exchange rate policy should be considered in order to contain import demand and stimulate exports.

Measures designed to achieve balance of payments viability in the medium term will also help in the rebuilding of official reserves which have become uncomfortably low. An adequate level of gross official reserves is necessary in order to maintain the flow of essential imports and avoid the need to impose restrictive measures. The staff notes the intention of the authorities to remove at an early date the deposit requirement on private sector imports which constitutes a multiple currency practice. In the meantime, Executive Board approval of the practice is not recommended.

The authorities are in favor of holding the next Article IV consultation on the standard 12-month cycle.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Maldives' exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Maldives, in the light of the 1983 Article IV consultation with Maldives conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The introduction of the advance import deposit scheme of Maldives as described in SM/83/211 gives rise to a multiple currency practice. The Fund encourages the authorities to eliminate this practice as soon as possible.

Maldives: Fund Relations
(As of September 30, 1983)

Membership and status:	Maldives became a member of the Fund on January 13, 1978, with an Article XIV status.
Present quota:	SDR 1.4 million
Proposed quota:	SDR 2.0 million
Use of Trust Fund:	Not eligible
Use of Fund resources:	None
Fund holdings of rufiyaa:	SDR 1.1 million or 79 percent of quota.
SDR holdings:	SDR 0.15 million or 54.0 percent of net cumulative allocation of SDR 0.28 million.
Exchange rate:	On January 25, 1982, the MMA took over from the STO the responsibility for the administration of the exchange rate regime and began to conduct foreign exchange transactions at the market rate. On that date, the MMA offered to sell rufiyaa at Rf 7.50 = US$1, and on March 1, 1982 it offered to sell at Rf 7.00 = US$1. No margins in respect of exchange transactions are officially maintained.
Technical assistance:	CBD assisted in preparing draft legislation for the MMA, and two experts of the CBD panel are currently providing assistance to this institution. An expert from the fiscal panel provided technical assistance in budget formulation and expenditure control between October 1981 and April 1983.
Last Article IV consultation:	Staff discussions were held during November 27-December 11, 1981 (SM/82/39 and SM/82/52). Executive Board discussion of staff papers took place on April 2, 1982.

IBRD Operations in Maldives

A. Statement of IDA Credits (as of June 30, 1983) 1/

Credit No.	Year	Borrower	Purpose	Amount (Net of cancellations) (US$ mn.) Commitment	Undisbursed
907	1979	Government of Maldives	Fisheries	3.20	0.81
1320	1983	Government of Maldives	Fisheries	5.00	5.00

B. Project implementation

Credit No. 907 was signed on June 4, 1979; became effective on August 10, 1979; and was closed on March 31, 1983. The project was designed to finance 500 marine diesel engines for mechanization of fishing vessels, 5 engine maintenance and repair centers, 33 navigation lights and 40 buoys, while the United Nations Development Program financed supplementary technical assistance. Project implementation was satisfactory after an initial delay.

Credit No. 1320, the second fisheries project was signed on February 18, 1983. IFAD, the Government of Norway, and OPEC Fund are co-financing the project. This project is designed to increase foreign exchange earnings and the income of fishermen from tuna exports through strengthening of fisheries infrastructure, the establishment of a fuel distribution system, improvement in fish pricing mechanism, and technical assistance for training and management.

c. Other IBRD activities

Two Bank missions visited Maldives, in June 1982 and February 1983, and an updated economic report was issued in April 1983 (Report No. 4445-MAL).

1/ No bank loans or IFC investments have been made to Maldives.

MALDIVES--Basic Data

Area:	298 square kilometers			
Population (1982 estimate):	160,200			
Population growth rate (1977-82):	2.3 percent per year			
GDP (1982):	US$74 million			
GDP per capita (1982):	US$462			

	1980	1981	Prov. 1982	Est. 1983
	(Annual rate of change in percent)			
Output and prices:				
Real GDP	18.7	8.0	9.0	10.0
Consumer prices	28.0	19.0	1.0	17.0
GDP deflator	16.0	20.0	4.0	13.0
	(In millions of rufiyaa)			
Central Government budget				
Total revenue (including grants)	57.4	81.8	122.6	134.5
Total expenditure	139.2	108.2	144.1	229.7
Overall (deficit)	-81.8	-26.4	-21.5	-95.2
Money and credit (end of period)1/				
Domestic credit	94.8	137.8	198.8	243.3 2/
Total liquidity	95.4	87.4	104.7	123.9 2/
Interest rate (annual rate on one-year time deposit)	6-7	6-7	8	9-10
	(In millions of U.S. dollars)			
Balance of payments:				
Exports, f.o.b.	12.7	15.8	17.3	19.8
Imports, f.o.b.	-44.0	-41.7	-46.0	-56.0
Current account balance (including grants)	-22.2	-20.2	-24.1	-24.2
Overall balance	0.2	0.3	-0.5	--
Reserves and external debt:				
Gross official reserves (end-period)	...	2.1	9.4	7.3 2/
(In months of imports)	...	(0.7)	(2.5)	(1.5)
External public debt (end-period)	24.7	37.1	50.7	65.0
	(Rufiyaa per U.S. dollar)			
Exchange rate (end of period)				
Market rate (mid-rate)	7.55	7.55	7.05	7.05
Official accounting rate	3.93	3.93	4.00	5.50 3/
	(In percent)			
Selected economic ratios:				
Current account surplus (or deficit -)/GDP	-47.2	-33.1	-32.6	-26.3
Budget deficit (-)/GDP	-23.0	-5.7	-4.1	-14.7
External public debt/GDP	52.0	61.0	68.0	71.0
External debt service/exports of goods and services	1.8	2.7	6.1	6.3

1/ Figures for 1980 include commercial banks only.
2/ June 1983.
3/ August 1983.