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Maldives
Country Economic Update

Sustaining Robust Dev elopment

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Poverty Reduction and Economic Management Sector Unit
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CURRENCY EQUIVALENTS

The external value of Maldives rufiyaa (Rf.) is fixed at Rf. 12.80 per U.S. dollar since July 25, 2001 under a *de facto* fixed exchange rate policy vis-á-vis the U.S. dollar. Accordingly:

Annual Averages

1992	US$1.00	=	Rf 10.57
1993	US$1.00	=	Rf 10.96
1994	US$1.00	=	Rf 11.59
1995	US$1.00	=	Rf 11.77
1996	US$1.00	=	Rf 11.77
1997	US$1.00	=	Rf 11.77
1998	US$1.00	=	Rf 11.77
1999	US$1.00	=	Rf 11.77
2000	US$1.00	=	Rf 11.77
2001	US$1.00	=	Rf 12.24
2002	US$1.00	=	Rf 12.80
2003	US$1.00	=	Rf 12.80

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Abbreviations and Acronyms

ADB	Asian Development Bank
BOM	Bank of Maldives
CEM	Country Economic Memorandum
CFAA	Country Financial Accountability Assessment
DIR	Department of Inland Revenue
GDP	Gross Domestic Product
GoM	Government of Maldives
GST	Goods and Service Tax
HDF	Housing Development Finance Corporation
HIES	Household Income and Expenditure Survey
HSBC	HongKong Shanghai Bank Corporation
IDA	International Development Association
IMF	International Monetary Fund
MFLC	Maldives Finance Leasing Corporation
MFT	Ministry of Finance and Treasury
MIFCO	Maldives Industrial Fisheries Company Ltd.
MMA	Maldives Monetary Authority
MNSL	Maldives National Shipping Limited
MPND	Ministry of Planning and National Development
MTCC	Maldives Transport and Contracting Company
MTFF	Medium-Term Fiscal Framework
NDR	Northern Development Region
NGO	Non-Governmental Organization
PAS	Public Accounts System
PEM	Public Expenditure Management
PER	Public Expenditure Review
PRSP	Poverty Reduction Strategy Paper
PSIP	Public Sector Investment Program
SDR	Southern Development Region
SAFTA	South Asia Free Trade Area
SNDP	Sixth National Development Plan
SOE	State Owned Enterprise
STELCO	State Electricity Company Limited
STO	State Trading Organization
TA	Technical Assistance
VPA	Vulnerability and Poverty Assessment
W&MA	Ways and Means Account

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Executive Summary

1. This Country Economic Update is anchored in the 2000 CAS that recommends an increase in the frequency and scope of non-lending activities, emphasizing technical assistance and capacity building, and underpinning a gradual shift in the Bank's engagement to a more programmatic approach.

Recent Economic Developments

2. ***Favorable recent economic developments show that the Maldives is in a strong position to continue the robust economic performance of the past 25 years.*** Real GDP growth accelerated to 8.5 percent in 2003, lifting nominal GDP to over US$ 715 million, and per capita income to about US$2,509 in 2003, the highest in the South Asia region. Growth was led by tourism, which expanded by over 15 percent in 2003 and accounted for about 33 percent of GDP. Tourist arrivals were encouraged by the depreciation of the rufiyaa together with the US dollar against the euro, making the Maldives a relatively cheaper destination for Europeans. Activity in the fishery sector (about 6 percent of GDP) was slightly above the high level attained in 2002. Inflation has been subdued. The current account deficit narrowed slightly in 2003 and financing was adequate to allow for a modest increase in foreign exchange reserves, reaching US$161 million at the end of 2003.

3. ***Still, the incidence of income poverty remains a significant issue, especially among the people residing in the outer atolls and depending mainly on fisheries and subsistence agriculture.*** Data on poverty is limited, but it suggests that poverty declined substantially between 1998/99 and 2003. The Government of Maldives (GoM) remains committed to poverty reduction and seeks to find a good balance between attempting to reach the poorest in the outer atolls (but at a high marginal cost of service provision), and focusing efforts on the Male area where there is the highest concentration of population and economic activity. This balance is manifest in the GoM's efforts to promote regional development through the focus islands, and the ongoing development of Hulhumale (the large land reclamation project near the capital, Male).

4. ***The emerging trends of continued fiscal deficits and growing public debt warrant careful monitoring.*** Since 1999, the overall fiscal deficit including grants has been between 4 and 5 percent of GDP, as the GoM seeks to expand the provision of public services in the outer atolls (especially in education and health) and develop Hulhumale. Public debt continues to grow, reaching the equivalent of 46.5 percent of GDP in 2003 (up from 40.9 percent in 2000), but debt service remains manageable since most external borrowing is contracted on concessional terms. The GoM is reviewing measures to widen the revenue base, including implementing a business profits tax, and in April 2004, the GoM increased the bed tax to $8 with effect from November 1, 2004

(the bed tax had remained fixed at US$6 per bed night since 1988). Total expenditure, including net lending, grew by 10 percent in 2003 to the equivalent of 38.5 percent of GDP, compared with 32.3 percent of GDP in 1998. Expansionary fiscal policy manifests itself as an increase in liquidity in the banking system (which the MMA absorbs with the issuance of certificates of deposit) and pressure on reserves, rather than inflation. The GoM is mindful that policy needs to remain focused on macroeconomic stability and the maintenance of the fixed exchange rate at 12.8 rufiyaa to the US dollar.

Key Development Issues

5. ***With sustained development behind it, the GoM is now focused on the Maldives joining the ranks of upper middle income countries, but will need to manage carefully growing fiscal burdens as it seeks to address several key issues.*** These include: mitigating vulnerability, fostering private sector led growth, strengthening land management and housing finance, developing "focus" islands to lower the marginal cost of service provision, and improving fiscal systems. These priorities were articulated by the GoM in the Vision 2020 document (prepared in 2000), in the Sixth National Development Plan (SNDP) covering the years 2001-2005, and in its ongoing dialogue with the Bank. The Bank's recent analytical and advisory work also identifies these issues as central to strong development progress in the Maldives.

6. ***Mitigating vulnerability remains a key challenge for the Maldives.*** Vulnerability stems from social, economic and environmental factors. Social vulnerability arises due to the small size of the population and its dispersion, often in very small subsistence communities of less than 500 people. Economic vulnerability stems from a significant incidence of poverty, especially in the outer atolls, and the high dependence on tourism and fish, which are subject to exogenous shocks. Finally, environmental vulnerability is due to the fragile ecosystem and geography of the Maldives, and the potential effects of global warming. Vulnerability is also a key issue in the ongoing discussions about graduation from LDC status. While many of these vulnerabilities are likely to remain, several measures are feasible, some of which the GoM is already pursuing. These include promoting economic diversification, strengthening the fiscal accounts, and developing focus islands which can be defended from the sea more easily.

7. ***Fostering private sector led growth and employment is a major priority of the GoM and hinges on ensuring a sound investment climate.*** The Maldivian experience with private sector development of resorts and telecoms has been favorable, but the share of GDP spent by the GoM continues to grow. Gaining a better understanding of the investment climate and implementing targeted policy reforms would help sustain robust development. This would involve several dimensions of a sound investment climate, including implementing public enterprise reforms, enhancing employment and labor laws, strengthening the financial sector, and fostering foreign direct investment.

8. ***With a view to relieving the constraints on growth and poverty reduction stemming from land scarcity, the GoM is proceeding with the development of the very***

large Hulhumale land reclamation project, trying to improve the system of land management, and creating a new housing finance institution. Population growth is slowing, but land scarcity and pressure is mounting. About 74,000 people, more than a quarter of the population, live in Male on a total land area of under 2.0 square kilometers. The scarcity of land is made worse by inefficient land management systems, weak land tenure, and limited access to housing finance. This results in public entities occupying more land than they need at nominal fees, while private citizens pay around 40 percent of their income on rent and find it difficult to use property as collateral for loans. Amendments to the Land Act were passed by the Majlis in April 2004, aiming to encourage property development and housing finance. The Housing Development and Finance Corporation was established in February 2004, capitalized by the GoM and through the issuance of government backed bonds. The success of Hulhumale, the effective operation of land markets, and the availability of housing finance will be critical to sustaining robust development.

9. ***Consolidating economic and human resources on larger "focus" islands is a central component of the GoM's long term strategy to strengthen the economic base, diversify away from fishing, address vulnerability, and adapt to global warming.*** The GoM plans to facilitate the relocation of those people living in the outer atolls who wish to move toward the focus islands to take advantage of better public services. The Bank is helping to strengthen public services on these focus islands and mitigate the escalating unit costs of improving social services. The initiative also seeks to foster alternatives to Male and the capital region, in terms of economic opportunities, social services and infrastructure.

10. ***There are substantial fiscal costs associated with addressing these development challenges.*** For example, encouraging private sector development through public enterprise reform implies the loss of dividend transfers that the government currently receives. Addressing skills mis-match issues will require higher education and training expenditures. Developing Hulhumale has involved significant government spending and will entail further expenditures over the coming years. Providing high quality public services on designated focus islands will eventually lower the unit cost of service provision, but implies elevated public spending in the medium term. Progress in attending to these structural issues will help sustain growth and mitigate vulnerability, but entail growing fiscal burdens.

11. ***Strengthening fiscal systems can make an important contribution to managing these growing fiscal burdens and increasing the effectives of public spending. Three key issues stand out: (1) developing a multi-year budget, including in some key sectors like education and health, (2) creating improved means of financing deficits, without recourse to the Maldives Monetary Authority (MMA), and (3) strengthening public expenditure management.*** The GoM's commitment to addressing these issues was reflected in a policy announcement made during the presentation of the 2004 budget to the Majlis, indicating that the GoM will implement a multi-year budget starting with the 2005-2007 period, and that it will no longer draw upon the MMA. The Bank is providing assistance to the multi-year budgeting effort with an ongoing TA/capacity building

program. Establishing alternative financing instruments, including bills for short-term cash management and bonds for longer term financing, will be critical to the GoM's ability to avoid seeking financing from the MMA (it would also spur the development of financial markets). A Public Accounts System and modern auditing process are also being established with the assistance of the Asian Development Bank.

12. ***To conclude, there are many challenges but the outlook for the Maldives is favorable.*** With the expansion of tourism, some diversification into areas like transshipment, and continued sound macroeconomic policies, strong growth is likely to be sustained. The major challenge will be to address the structural reform agenda without jeopardizing fiscal sustainability. Key recommendations, many of which the GoM is already acting upon, are compiled in Box 1. Others are elaborated in the text.

Box 1: Summary of Suggested Priority Actions

Fiscal and Public Expenditure Management

- Constrain recurrent expenditure in order to create adequate fiscal space for the public investment needed to sustain robust development.
- Check the expansion of overall expenditures to enable adequate credit for private sector led growth, especially through small and medium sized enterprises.
- Establish a market for treasury bills and bonds to ensure that the GoM can meet its commitment not to draw upon the Ways & Means account of the MMA to finance its activities. Creating a market in tradeable government securities would also spur the development of the financial sector.
- Revise the Medium Term Expenditure Framework initiated in March 2004 with a view to strengthening the macroeconomic projections, the revenue forecasts, and the overall fiscal envelop needed to bolster fiscal discipline.
- Revise the education sector multi-year budget prepared in March 2004, and develop sectoral medium term frameworks in other key ministries, to more effectively tie national objectives to the available budget and link recurrent and capital expenditure.
- Implement revenue widening measures, especially a business profits tax, to reduce dependence on transfers from SOEs, Study and revise the system of taxation on the tourism industry, with a view to instituting an ad valorem tax in lieu of the fixed bed tax, and reducing the uncertainty faced by resort owners in the lease rent renegotiation process. The increase in the flat bed tax from the US$6 to US$8 per bed night passed in April 2004 with effect from November 1, 2004 was an important first step.

Other Structural Factors

- Deepen public enterprise reform to open more activities to private sector participation. Virtually all SOEs make positive net contributions to the GoM's coffers, and several such initiatives have already yielded positive results, such as in the fishery and telecoms sectors. Extending the process further would help underpin economic dynamism.
- Ensure that the ambitious changes planned in the legal environment strengthen the investment climate and foster greater private sector activity. The amendments to the Land Act passed in April 2004 are especially important in this regard, to spur mortgage financing and the development of Hulhumale. Similarly, there appears to be substantial scope for sharpening competition in the financial sector.
- Strengthen the linkages between tourism and local communities by providing training and technical assistance in hospitality oriented activities.
- Promote economic diversification aided by foreign direct investment, such as the planned transshipment facilities in the northern most atoll.
- Implement measures to smooth the transition through LDC graduation.

Maldives: Country Economic Update
Sustaining Robust Development

I. Introduction

1. The people of the Maldives have made substantial progress over the past two decades, as reflected in rising incomes and improving social indicators. This report provides an update on this progress, with an integrative analysis of the Maldivian economy, including recent economic developments, macroeconomic policies, and prospects for growth and poverty reduction. In seeking to become an upper middle income country, the Government of Maldives (GoM) will need to address several key development issues while managing the associated fiscal impacts, which is a core theme of the report. These issues include mitigating vulnerability, fostering private sector led growth, strengthening land management and housing finance, developing focus islands to lower the marginal cost of service provision, and improving fiscal systems. The GoM articulated these development priorities in the Vision 2020 document and in the Sixth National Development Plan (SNDP) covering the years 2001-2005, and they are a part of a continuing dialogue with the Bank. This Country Economic Update (CEU) outlines these issues and sets the stage for deeper analysis in future.

2. The rationale for a CEU grows out of the most recent CAS (2000), which was prepared in consultation with the GoM. It seeks to shift the Bank's engagement to a more "programmatic approach," and calls for an increase in the frequency and scope of non-lending activities, with a focus on institutional capacity building and knowledge transfer. Some of these activities will also help prepare for programmatic lending and help lift the Bank's engagement in support of the Maldives' development objectives and strategies, emphasizing sustained broad-based growth with rising standards of living, especially in the outer atolls.

3. The CEU is organized as follows: the remainder of the introduction briefly outlines the goals and strategies articulated in Vision 2020 and the SNDP, provides country background information, and reviews progress on poverty alleviation and social development. Section 2 examines recent economic developments, including growth, the balance of payments, and external debt. Section 3 analyzes macroeconomic policy. Section 4 discusses the five key development issues noted above, including (a) mitigating vulnerability, (b) fostering private sector led growth, (c) strengthening land management, (d) developing focus islands to lower the marginal cost of service provision, and (e) improving fiscal systems. Section 5 concludes with medium term development prospects and challenges.

Vision 2020 and the Sixth National Development Plan

4. The GoM articulated a series of long-term aspirations for the Maldives in the Vision 2020 document (prepared in 2000), including (i) becoming a top-ranking middle income country, (ii) achieving gender equality, (iii) establishing a minimum of 10 years of formal schooling and good tertiary education, (iv) ensuring access to quality medical care and health insurance, and (v) promoting the conditions for rapid economic growth, with the Maldives serving as a hub of regional free trade. The SNDP for the period 2001-2005 was prepared to provide the strategic policy framework for achieving these objectives during the first five years of Vision 2020. It was compiled through a consultative process involving the Government, NGOs, and various private sector organizations and individuals. Economic development is to be guided by two key principles during the SNDP: (1) promoting greater private participation in economic development, and (2) focusing on regional development. The broad objectives and key development opportunities and challenges outlined in the SNDP are presented in Box 2.

Box 2: The Sixth National Development Plan (2001-2005)

The SNDP lists seven broad objectives:

1. Diversify and expand the economy by further developing existing industries and by exploring new economic activities, while ensuring the sustainability of physical and natural resources.
2. Increase the role of the private sector in the development process, particularly in expanding the economic base of the country.
3. Improve the quality and relevance of education, health and social services, while ensuring that the benefits of development are shared equitably among the population.
4. Increase human resource capacity and productivity by providing relevant training and employment opportunities.
5. Pursue legislative, regulatory, governance and administrative reforms to facilitate rapid economic and social development.
6. Develop a sustainable and cost-effective transportation and telecommunication infrastructure to facilitate economic, social and regional development.
7. Ensure socio-political stability and the democratic participation of all in the development process, while upholding national unity and social cohesiveness based on shared social, cultural and religious values.

The SNDP identifies several key advantages...

1. Socio-political stability.
2. Exotic tropical environment and marine biological diversity.
3. Macroeconomic stability.
4. Good human development as reflected in one of the highest rankings among LDCs on the Human Development Index.
5. Relatively small population size.

...And development challenges.

1. Diversifying the economic base.
2. Protecting the environment and sustaining development.
3. Addressing geographical dispersion.
4. Minimizing diseconomies of scale in the provision of services.
5. Increasing labor force participation.
6. Fostering human resources development.
7. Strengthening the entrepreneurial base.
8. Minimizing the negative impact of graduation from LDC status.

Source: Ministry of Planning and National Development, 2001. *Sixth National Development Plan, 2001-2005*, Male, Republic of Maldives, pp 1-5.

5. President Gayoom further augmented this framework by outlining five strategic areas for action at his inauguration in December 2003 (President Gayoom won a plebiscite confirming his re-election by the People's Majlis for a sixth five-year term as president in October 2003). These include: i) strengthening democratic institutions and processes of governance, ii) establishing a government that listens and works with openness and transparency, iii) streamlining and reducing the size of the public service in order to increase productivity and the value of services, iv) instituting modern management practices and re-orienting government departments to be more results oriented, and v) promoting greater participation of all sectors of society in nation-building.

6. In order to achieve the broad goals outlined in the SNDP and other policy statements, it will be important for the GoM to prioritize and link specific initiatives to the budget. The SNDP, for example, contains 130 policies, each with up to 12 strategies. Still, the overall framework underpins the government's commitment to sustaining robust development in the Maldives.

Brief Country Background

7. Benefiting from sound economic management, strong tourism growth and the mechanization of fishing, the Maldives has developed rapidly over the last two decades.[1] This is reflected in growing per capita income (reaching US$2,509 in 2003), and improving social indicators. Efforts to sustain this strong performance, however, face several constraints. The small size and geographic dispersion of the population greatly increases the marginal cost of providing services, and makes it very difficult for the people of the Maldives to take advantage of economies of scale. The economy is heavily dependent on tourism and fisheries, which are major sources of employment, foreign exchange earnings and government revenue, but are also vulnerable to external shocks. In addition, while the enclave nature of the resorts is consistent with GoM desires to limit the impact of tourists on the shared cultural, social and religious values of Maldivians, it also constrains the local value added of the industry through links between tourism and surrounding islands. Almost everything except fish products is imported. Environmental risks, including a potential rise in the sea level, are serious concerns. These factors frame the unique development opportunities and challenges faced by the Maldives.

[1] The Maldives comprise 1,192 low-lying, small coral islands dispersed over 500 miles from north to south in the Indian Ocean. The islands do not exceed a length of 4.5 miles or an altitude of 6 feet above sea level. The population of 285,066 people (2003) inhabits 199 of these islands, and another 87 islands have been developed as resort enclaves. Of the 200 inhabited islands, 76 have fewer than 500 inhabitants and 142 islands have less than 1,000 inhabitants, according to the census of 2000. More than one quarter of the population lives in the capital, Male, with a total land area of less than one square mile. Male is the economic hub of the country, and the people living in the outer atolls rely mostly on fisheries and subsistence agriculture.

Poverty and Social Development

8. The people of the Maldives have made significant progress in human development over the last two decades, but the GoM will need to manage the growing fiscal burden of ongoing efforts in order to attain further improvement. In 2003, life expectancy at birth exceeded 70 years, the infant mortality rate fell to 14 per thousand live births, and the crude death rate declined to 4 per thousand (Table 1). Available data to 2002 indicate that the net primary school enrollment rate increased to 100 percent of the age group, and the adult literacy rate reached 97 percent. Population growth decelerated to 1.6 percent in 2002 from 2.4 percent in 1996. According to the 2003 UN Human Development Report, the Maldives is the most desirable country to live in South Asia.

Table 1: Key Human Development Indicators

	1996	1997	1998	1999	2000	2001	2002	2003
Total Population	250144	255460	260777	266093	270101	275975	280549	285066
Population growth rate (%)	2.4	2.1	2.1	2.0	1.5	2.2	1.7	1.6
Infant Mortality Rate (per 1,000 live births - under 1 yr.)	28	27	24	20	21	17	18	14
Child Mortality Rate (per 1,000 live births - under 5 yr.)	39	39	27	28	30	26	23	18
Crude Birth Rates (per 1,000 population)	26	24	22	20	20	18	18	18
Crude Death Rates (per 1,000 population)	5	5	4	4	4	4	4	4
Maternal Mortality Rate (per 1,000 live births)	2	2	2	1	1	1	2	1
Still Birth Rate (per 1,000 live births)	22	25	21	18	15	17	10	11
Life Expectancy at Birth (Years)	..	70	71	73	71	72	73	70
Net enrolment rate (%), primary level (Gr. 1-7, Age 6-12)	..	..	99.7	..	..	98.2	100.9	..
Net enrolment rate (%), lower secondary level (Gr. 8-10, Age 13-15)	..	..	..	..	..	44.7	44.2	..
Literacy rate, adult (% of people ages 15 and above)	96.1	96.4	96.5	96.8	96.9	97.0	97.2	..
Public education expenditure as % of GDP	4.6	5.4	6.8	6.5	7.3	6.7	7.8	8.1
Public education expenditure as % of Government spending	14.5	16.7	20.4	18.1	19.8	17.7	20.3	20.3

Source: Ministry of Planning and National Development, Ministry of Education, World Development Indicators, and IMF.

9. Poverty reduction has been one of the GoM's major policy objectives over the last three decades, but monitoring poverty in the Maldives has been limited to ad-hoc surveys and several project specific monitoring and evaluation systems which provide additional poverty related information. The 1998 Vulnerability and Poverty Assessment (VPA), prepared with the assistance of the UNDP is the basis for much of the existing information on poverty in the Maldives. The GoM is in the process of strengthening the poverty monitoring. The UNDP helped with the 2003 Household Income and Expenditure Survey (HIES), and poverty analysis based on the HIES data is under preparation. A new VPA is being prepared with the assistance of the World Bank, and

survey work was completed in 2004. The GoM aims to update the VPA every few years. In order to compile the various surveys and other sector specific information into national poverty indicators for use by decision makers, it is urgent that a national poverty monitoring system be created. An important step in this regard would be the establishment of a government sanctioned, widely accepted poverty line, forming the basis of poverty numbers that can be tracked over time. A poverty profile based on the HIES data is to be published before the end of 2004. This will yield poverty estimates that are comparable to the findings of the 1998 VPA, contributing to ongoing GoM discussions on poverty issues. Information on poverty will be bolstered by the additional data that was gathered through the VPA.

10. Despite the paucity of information, preliminary analysis of the HIES data suggests several features of poverty in the Maldives:

- Vulnerabilities of various kinds persist (including to health shocks) and poverty remains a serious issue, particularly among the 74 percent of the population residing in the outer atolls. Poverty in the Maldives is closely related to isolation and limited access to social services, such as health and education.
- The average poor person comes from a large household, lacks formal employment, and resides in atolls where income earning opportunities are limited by the high cost of transportation and the inability to generate economies of scale.
- Non-income dimensions of poverty and vulnerability appear very important and child malnutrition is high in some communities.
- Still, the poverty gap appears small, suggesting that poverty is neither massive, nor deep. One does not encounter the hunger and destitution familiar elsewhere in South Asia.
- In addition, poverty appears to have declined significantly between 1997/98 and 2002/03, largely as a result of strong economic growth and the deliberate efforts of the GoM to enable people in the atolls to share in growth through an expansion of public services.

The full poverty profile will yield a better understanding of poverty in the Maldives, and the VPA planned for mid-2004 will provide much needed detail.

11. The GoM's efforts to reduce poverty emphasize strengthening the social safety net, improving access to education and health, and fostering regional development. These are important steps as the Maldives becomes a wealthier middle income country, but the GoM will need to manage and contain the fiscal burden that these initiatives entail.

Social Safety Nets: The above indications about the key features of poverty in the Maldives suggest that well-targeted public safety nets have the potential to reduce poverty significantly and protect against vulnerability. The GoM is currently reviewing its safety nets with a view to expanding and rationalizing them, a process commonly seen in growing middle income countries.

Education: Skills mis-match has been identified as one of the key impediments to employment creation and poverty reduction, both in the Male area and in the outer

atolls. In addition, education is highly valued by the people of the Maldives, as evidenced by the large expenditures relative to income that individuals are willing to bear in financing room and board for their children in order to be able to attend secondary school on another island. Hence, the GoM has made expanding access to education and improving quality one of its highest priorities, which is reflected in an expenditure share of over 8 percent of GDP in 2003, one of the highest in the world. Despite the remoteness and dispersion of the population, access to primary education is universal, and adult literacy was over 97 percent in 2002. The quality of education remains a major issue, however, due to a lack of trained and qualified teachers, poor curriculum development and limited opportunities for post-secondary education outside Male. Quality concerns are manifested in pass/continuation rates of only about 60 percent in the 8th grade, and a pass rate of only 25 percent in 10th grade O-levels exams (a rate which has fallen with the expansion of access to education). Those who are educated tend to migrate to the Male area in search of employment, weakening the impact of expanding access on regional disparities.

Health Care: Although much has been achieved in improving the health of the average Maldivian, important issues remain. For example, both stunting and wasting stand at very high levels, with more than 30% of children under 5 below two standard deviations of the norm for weight and age. Malnutrition is much higher in the atolls compared to the capital, and is almost comparable to low-income South Asian and African countries. Malnutrition appears to be caused by micronutrient deficiencies, improper weaning, and poor foods practices. Achieving significant improvements will require targeted nutrition approaches. The GoM seeks to build capacity and strengthen health services, especially in the outer atolls, and is undertaking substantial investment to this end on focus islands. The World Bank is supporting this effort.

Regional Development: As described in greater detail below in Section 4, the GoM seeks to lower the marginal cost of service provision by developing focus islands in each atoll, where the full complement of services would be offered. These focus islands are also to serve as growth centers, fostering employment and income generation opportunities by developing community based tourism and small scale enterprises through micro-financing services and technical support. The initiative is supported by lending from the World Bank and aims to reduce poverty directly and help lessen regional income disparities.

12. The GoM has sought strong engagement from donors to address poverty in the Maldives. The ADB prepared a Poverty Analysis in 2001 and signed the Poverty Partnership in 2002. The World Bank is supporting GoM efforts with the 2003 HIES and the 2004 VPA, and the GoM is working on preparing a Poverty Reduction Strategy Paper (PRSP). Building on the existing policy framework, a cover-note is to be prepared, which together with the SNDP will form the PRSP. The cover-note will elaborate on several areas, including a medium term fiscal framework (MTFF), the current state of poverty indicators, a poverty assessment, an update on sectoral strategies, and a

description of the consultative process underpinning the SNDP. The World Bank is providing technical assistance for the preparation of the MTFF. The PRSP exercise is to help form a bridge between the Sixth National Development Plan (2001-2005), and the Seventh National Development Plan (2006-2011), which is to be prepared over the next 18 months. At the request of the GoM, the World Bank is also preparing a social protection study and engaging in TA on social safety nets and pensions.

13. The GoM remains committed to poverty reduction and is trying to balance efforts to reach the poorest in the outer atolls but at a high marginal cost of service provision, or focusing resources in the Male area where population and economic activity are concentrated. Hence, the GoM is promoting regional development through the focus islands, while pressing on with the ongoing development of Hulhumale. As further progress is made on the poverty reduction agenda, the GoM needs to ensure that associated fiscal burdens are sustainable.

2. Recent Economic Developments

14. The Maldives has enjoyed strong economic performance over a sustained period of time, with real GDP growth averaging over 7.9 percent in the 15 years to 2003. This section provides an update on these developments and presents an integrated analysis of the policies underpinning the positive trend, including several policy recommendations.

Real GDP Growth

15. After growth slowed to 3.5 percent in 2001 largely due to the impact of 9/11 on tourism, activity accelerated to 6.5 percent in 2002, and is estimated to have reached 8.5 percent in 2003 (Table 2). Sustained growth has lifted nominal GDP to over US$ 715 million, and GDP per capita to about US$2,509 in 2003, the highest in the region.

Table 2: GDP Growth and Prices

	1998	1999	2000	2001	2002	2003
			(Annual percentage change)			
Real GDP	9.8	7.2	4.8	3.5	6.5	8.5
Primary	7.0	3.5	-0.7	5.1	15.9	2.1
Secondary	17.2	12.3	1.6	8.1	10.4	7.9
Tertiary	8.9	6.8	6.0	2.4	4.7	9.5
Consumer prices	-1.4	3.0	-1.2	0.7	0.9	-2.9

Source: Ministry of Planning and National Development, and IMF.

16. Domestic demand in 2001 and 2002 was led by government investment, as the GoM expanded the facilities needed to strengthen the provision of government services, especially in health and education in the outer atolls, and proceeded with the development of Hulhumale. Government consumption has also been buoyant, largely driven by higher spending on social services. Budget data suggest that these trends continued in 2003. Increased government activity, however, appears to be crowding out the private sector. Interest rates have fallen somewhat with the lowering of the minimum reserve requirement, but as described in greater detail in Annex 1, the interest rate spread remains substantial, and loans with maturities beyond 3-5 years are largely unavailable to finance private sector investment. Private consumption as a share of GDP also fell from 35.2 percent in 1999 to 30.5 percent in 2002. The external sector made a positive contribution to domestic demand in 2002, but was a drag on growth in 2003, as strong tourism receipts were not able fully to offset buoyant imports.

17. Turning to the supply side, the tourism and fisheries sectors continue to dominate the Maldivian economy, together accounting for over 39 percent of GDP in 2003. As described in greater detail in Annex 2, the tourism sector contributed strongly to growth, expanding by 15.0 percent in 2003, and growing by over 20 percent in the first half of 2004 compared with the same period in 2003. In that year, arrivals rose to 563,593, and with the average stay remaining at about 8.3 days, bed capacity utilization increased to 77.2, the highest since 1997. In real terms, the tourism sector has registered positive growth in every year since 1984 except 2001, when it declined slightly following the 9/11 attacks in the US. Expanding tourism also helps propel activity in other sectors, such as construction and transportation, which grew by 20.0 and 8.1 percent in 2003 respectively.

The rapid expansion in the first half of 2004 of bank credit to the construction sector and the accelerated imports of building materials suggest that the buoyancy of the sector has continued into 2004. In a trend that appears to have continued in the first half of 2004, growth in the fisheries sector was sluggish, increasing by 0.7 percent in 2003 compared with the very strong outturn in 2002. The sector benefited from liberalization in 2001 and 2002, and private participation in fish processing is expanding rapidly.

18. Generating adequate employment for rapidly growing cohorts of school leavers is a major concern. While formal unemployment is about 2 percent according to the national census of 2000, other sources suggest it is closer to 10 percent. A labor force survey is planned with a view to gaining a clearer picture of employment conditions. Government employment grew by an annual average of 4.0 percent between 1998 and 2003, largely as a result of GoM efforts to improve health and education services. Unemployment is driven in part by skills mis-match, and is reflected in the increasing employment of expatriate workers, accounting for about one third of total formal employment and about 12 percent of the population in 2003.

Balance of Payments and External Debt

19. The current account deficit narrowed slightly from US$35.7 million in 2002 to US$31.8 million in 2003, equivalent to about 4.5 percent of GDP (Table 3). An increase in the merchandize trade deficit and larger net transfers was more than offset by higher services exports, mainly tourism.

Table 3: Summary Balance of Payments

	1998	1999	2000	2001	2002	2003
						Rev. Est.
			(In millions of U.S. dollars)			
Current account balance	-21.9	-78.9	-51.5	-58.7	-35.7	-31.8
Trade Balance	-215.9	-262.4	-233.3	-236.0	-212.4	-262.3
Exports, f.o.b.	95.6	91.5	108.7	110.2	132.3	152.0
Imports, f.o.b.	-311.5	-353.9	-342.0	-346.3	-344.7	-414.3
Services (net)	204.3	203.6	208.8	207.0	216.3	272.7
Receipts	331.3	342.8	348.5	354.1	362.9	432.1
Of which tourism receipts	303.0	313.5	320.7	327.1	337.1	401.6
Payments	-98.9	-108.1	-109.7	-109.8	-111.1	-121.0
Unrequited transfers (net)	-10.3	-20.1	-27.0	-29.7	-39.6	-42.3
Non-monetary capital (net)	50.9	71.7	43.5	37.3	75.5	106.1
Overall balance	29.1	-7.2	-7.9	-21.4	39.8	74.3
Monetary movements	-29.1	7.2	7.9	21.4	-39.8	-74.3
Maldives Monetary Authority	-20.2	-8.6	4.4	29.7	-40.2	-26.5
Commercial Banks	-8.8	15.8	3.5	-8.3	0.4	-47.8

Source: Maldives Monetary Authority and IMF.

20. Export receipts rose to US$152.0 million in 2003 (including re-exports of fuel), growing by 14.8 percent compared with 2002. Non-fuel exports consist almost entirely of marine products and garments (about 68 and 32 percent of total exports respectively). The value of marine exports rose due to higher volumes which offset the reduction in

prices received. Although fish landings showed a small decline in 2003, export volumes were higher, possibly as the result of exports of frozen fish in 2003 that were landed at year-end in 2002. As noted above, the sector is benefiting from increased private sector participation, bringing new technology to fish processing and developing new markets for Maldivian marine products. Garment exports also grew by 4.2 percent in 2003, but the sector is likely to decline sharply in the coming years with the expiry of the multi-fiber agreement. In the first half of 2004, exports fell by about 2 percent compared with the same period in 2003, mainly due to a decline in fish related earnings.

21. The value of imports (f.o.b.) rose by 20.2 percent to US$414.3 million in 2003, equivalent to about 58 percent of GDP. Almost everything in the Maldives is imported, and growth in the tourism industry spurs the demand for imports. Indeed, tourism related imports grew by 34.1 percent in 2003, as the import of transport related equipment doubled, and the development of new resorts and the renovation of existing resorts sharply increased imports of construction materials. This trend continued in the first half of 2004, as imports rose by over 30 compared with the same period in 2003.

22. Tourism receipts grew by 19.1 percent in 2003 compared with the previous year, reaching US$401.6 million. Even netting out higher tourism related imports, the earnings from tourism rose by 10.9 percent in 2003. Arrivals continue to be buoyant in 2004, further encouraged by the depreciation of the rufiyaa together with the US dollar against the euro, making the Maldives a relatively cheaper destination for Europeans. Net transfers registered a larger outflow. Official transfers were US$13 million in 2003 compared with around US$20 million in each year between 1998 and 2001, and increasing numbers of expatriate employees are sending remittances abroad.

23. The 2003 current account deficit was financed by net official medium and long-term flows of US$34 million, and private capital inflows of US$55 million. Increased government borrowing in recent years is largely explained by financing for the Hulhumale project and efforts to strengthen the provision of services in the atolls. Private capital flows in 2003 were associated with the renovation of two large tourist resorts, the increase in capital of the Maldives Finance Leasing Corporation (MFLC), and an IFC investment. These flows permitted an increase in official reserves to US$161 million at the end of 2003, rising further to US$177 million in March 2004, equivalent to over 4 months of imports.

24. External debt consists of medium and long-term government or government guaranteed borrowings, and short-term debt contracted by the banking sector. The total stock of external debt rose to US$280.9 million in 2003, equivalent to 40.4 percent of GDP. This represents a significant increase from 2001 when debt stocks were equivalent to about 33.6 percent of GDP. The GoM borrowed mainly to finance the development of Hulhumale (described in greater detail in Section 4 and Annex 4), the upgrading of Gan airport, and the expansion of services in the outer atolls. Since about 70 percent of the borrowing is from multilateral and bilateral creditors on concessional terms, however, debt service as a percentage of exports has remained between 4 and 5 percent in recent

years. The remaining 30 percent of borrowings are accounted for by suppliers' credits with some concessional component, and commercial loans.

25. The government seeks to borrow primarily from concessional sources. When these are insufficient to meet key priorities, however, the government also contracts commercial loans, especially to finance investment projects that are expected to generate returns to service the loans. With the decline in grants from an average of 3.4 percent of GDP during the 1990s to around 1.5 percent of GDP in 2002 and 2003, borrowing on more commercial terms is likely to increase. The fall in grants and a possible reduction in concessional financing over the medium-term is partly related to strong economic performance and the potential graduation of the Maldives from LDC status in the coming years. As discussed in greater detail below, although the Maldives technically met the criteria for graduation, and the UN Economic and Social Council in 2003 endorsed a resolution that Maldives graduate from LDC status, the earliest it would take effect is 2007, and the council is developing a new mechanism to ensure a smooth transition. The GoM needs to explore additional sources of financing if there is also a fall in concessional borrowing opportunities. The ADB is supporting a program to strengthen debt management with a view to building capacity to develop a forward-looking debt strategy.

3. Macroeconomic Policy

26. Prudent macroeconomic management has underpinned strong economic performance over the past 25 years, and is reflected in improving human development indicators and an increase in per capita income to the level of lower middle income countries. In order to continue on this trajectory, the authorities will need to re-focus fiscal policy, to constrain current spending and create more space for capital expenditures, and strengthen monetary policy, to ensure the preservation of the dollar-peg, all while addressing several key development issues discussed in Section 4.

Fiscal Policy

27. The GoM's fiscal policy stance has been expansionary in recent years, and the overall deficit including grants has lain between 4 and 5 percent of GDP since 1999 (Table 4), as the GoM has sought to meet budgetary expenses associated with delivering services at levels expected of middle income countries. In 2003, the overall deficit was 4.0 percent of GDP, and the 2004 budget anticipates a widening to 4.5 percent of GDP. Despite strong revenue growth, expenditures have been growing faster, partly due to the extension of general administration and the implementation of major projects such as Hulhumale. Preliminary budget data from the first half of 2004 suggest that the fiscal position has strengthened compared with the same period in 2003, as revenue growth was robust while expenditures were constrained.

Table 4: Summary of Central Government Finance

	1998	1999	2000	2001	2002	2003	2004
						Prov. Est.	*Budget*
			(In millions of rufiyaa)				
Total revenue and grants	1930.2	2225.3	2372.7	2522.6	2714.9	3061.8	3259.9
Expenditure and net lending	2053.3	2506.4	2694.2	2885.9	3117.3	3428.4	3688.7
Overall balance	-123.1	-281.1	-321.5	-363.3	-402.4	-366.6	-428.8
Overal balance exclusing grants	-287.6	-443.8	-487.4	575.0	-534.9	-489.0	-503.5
Current balance	465.7	513.1	326.7	322.9	468.5	537.1	473.9
Total public debt (end of period)	2605.5	2782.9	3002.9	3326.4	3856.9	4139.3	4534.9
Of which foreign	1625.2	1681.9	1685.5	1831.3	2203.7	2674.6	3073.8
			(In percent of GDP)				
Total revenue and grants	30.4	32.1	32.3	33.0	33.1	33.4	34.2
Expenditure and net lending	32.3	36.1	36.7	37.7	38.0	37.4	38.7
Overall balance	-1.9	-4.1	-4.4	-4.7	-4.9	-4.0	-4.5
Overal balance excluding grants	-4.5	-6.4	-6.6	-7.5	-6.5	-5.3	-5.3
Current balance	7.3	7.4	4.4	4.2	5.7	5.9	5.0
Total public debt (end of period)	41.0	40.1	40.9	43.5	47.0	45.2	47.6
Of which foreign	25.6	24.3	22.9	23.9	26.9	29.2	32.3
Memorandum item:							
Nominal GDP (millions of rufiyaa) (1)	6,356.9	6,935.4	7,348.4	7,650.8	8,201.0	9,156.7	9,529.6

Source: Ministry of Finance and Treasury, and IMF.

(1) GDP for 2004 is based on a 5% growth forecast.

28. It should be emphasized that beyond conventional analyses of government spending, there is an important vulnerability component that should be borne in mind in the case of the Maldives. Given that the tourism and fisheries sectors are vulnerable to external shocks, and that the Maldives faces vulnerabilities associated with its geography, maintaining a balanced budget or even a surplus during times when adverse shocks are

not manifest constitutes an important mitigation measure. This is a strategic fiscal policy objective pursued by several successful countries in the Caribbean.

Revenues

29. Led by tourism taxes and dividends from the SOEs, total revenue including grants rose by 12.8 percent in 2003, reaching the equivalent of 33.4 percent of GDP. The trend of strong revenue growth continued in the first half of 2004. Buoyant tourism arrivals raised the receipts received by the government from the flat US$6 bed tax. Tourism also spurred greater imports, increasing revenue from customs duties, and boosting the dividends from the SOEs. For example, the telecom Dhiraagu was able to transfer more dividends to the government due to higher earnings from cell-phone roaming services, and the Maldives Airports Authority also increased its profitability in connection with the rapid expansion of tourism activity. In contrast, grants amounted to 1.3 percent of GDP in 2003, about half the average received by the Maldives over the previous 10 years. Grants are also falling in absolute terms, as Maldives approaches graduation from LDC status.

30. The GoM is reviewing measures to widen the revenue base. Currently, there are no income taxes or general sales taxes. After leaving the bed tax unchanged at US$6 per bed night since 1988, the Majlis in April 2004 passed an increase to US$8 per bed night, with effect from November 1, 2004. Revenues from this source are vulnerable to fluctuations in tourist arrivals, and implementing the tax increase late in the budget cycle meant that the impact of this change was small in 2004. An increase in the commercial land tax and the recovery of resort lease rent arrears from two resorts is expected in 2004. As a part of a "Revenue Diversification Project," the ADB is providing technical assistance on several other GoM efforts, including the preparation of a Property Rental Value Bill, a Business Profits Tax Bill, and a Tax Administration Bill, which were submitted to the Majlis in 2004.

31. The urgency of these initiatives was underscored by preliminary forecasts of revenues as a part of an exercise to develop an MTFF for 2005-2007 (described in Section 4) which showed a fall in revenues unless policy adjustments are implemented. For example, the signing of SAFTA means that revenue from duties on imports from SAARC countries, which account for about 20 percent of the total, will fall over the medium term. Revenues from Dhiraagu are also expected to fall as new entrants start providing cell-phone services and competition intensifies.

32. The GoM needs to implement revenue broadening measures in a timely way, and should undertake a more detailed study of tourism taxation, for example, comparing the fixed bed tax to an ad valorem tax, or estimating the price elasticity of demand for tourism services.

Expenditures

33. Total expenditure, including net lending, increased by 10.0 percent in 2003, reaching the equivalent of 38.5 percent of GDP compared with 32.3 percent of GDP in 1998. Both current and capital expenditure rose by about 12.5 percent due to the continued implementation of the large Hulhumale project and regional development efforts. Spending on salaries and wages grew by an average of 6.5 percent between 2001 and 2003, driven by a growing number of government employees while wages were held fixed. However, a 20 percent pay increase is being implemented in 2004. The larger overall size of government is due to higher recurrent expenditures, and capital expenditure has been relatively stable at between 11.0 and 13.0 percent of GDP. Much of this higher recurrent expenditure is associated with the expansion of public services in the outer atolls, especially in the areas of education and health. Indeed, the GoM spent 8.1 percent of GDP on education and 4.2 percent of GDP on health in 2003, reflecting the high marginal cost of service provision in the Maldives (largely the result of geography) and the high priority of these two sectors in the Maldives. In the first half of 2004, the GoM appears to have been able to limit spending, strengthening the fiscal position.

34. The GoM needs to constrain expenditure in order to create more space for the public investment needed for the expansion of services, and for the private expenditure needed to fuel private sector led growth. As described in greater detail in Section 4, public expenditure management could be strengthened by addressing several structural issues. For example, the link between current and capital expenditure remains weak. The GoM seeks to address this issue by developing an MTFF for the 2005-2007 budget period (Table 5 in Section 4 below), and should follow through on the significant first steps taken in February/March 2004.

Financing the Budget Deficit and Fiscal Sustainability

35. A substantial part of the deficit has been monetized in recent years, but in 2003 external financing was sufficient to meet the deficit and enable the GoM to make net repayments to the Ways and Means Advances account (W&MA) at the Maldives Monetary Authority. In a policy announcement during the presentation of the 2004 budget to the Majlis, the GoM indicated that it will no longer draw upon the W&MA except for very short-term cash management purposes. Indeed, in the first half of 2004, the GoM reduced its borrowings from the MMA, and net credit to government declined by 36 percent compared with the previous year. The GoM urgently needs to establish alternative financing instruments, including bills for short-term cash management and bonds for longer term financing to ensure this policy objective continues to be met. This would also help spur the development of the financial markets.

36. Persistent budget deficits and public borrowing has led to the accumulation of public debt, which rose from the equivalent of about 40.9 percent of GDP in 2000 to 47.6 percent in 2003. These trends raise the question of sustainability. As a part of the IMF Article IV consultations in the first half of 2004, Fund staff analyzed public sector debt sustainability and performed various stress tests based on scenarios involving increases in

interest rates, slower GDP growth, a deterioration in the primary balance, a depreciation of the exchange rate, and a combination of these changes. There is no objectively "right" level of indebtedness, and indicators for the Maldives are substantially below thresholds that are associated with heightened risk of debt difficulties among low income countries. Still, a continuation of current trends could pose problems in the future, especially if new borrowing is contracted on non-concessional terms. The GoM needs to ensure that non-concessional borrowing is focused on investments that generate returns able to service the debt, while constraining overall public borrowing.

Monetary and Exchange Rate Policy

Monetary Policy

37. The Maldives Monetary Authority (MMA) aims monetary policy at ensuring price stability and economic growth, while maintaining an adequate level of foreign reserves. In recent years, monetary policy has been driven by the need to finance budget deficits and address the resulting liquidity and pressure on the exchange rate. As described in greater detail in Section 4, the GoM has resorted to substantial monetization of the deficit through withdrawals from the W&MA, ranging from 2.8 percent to 4.3 percent of GDP between 1999 and 2001. In 2003, however, buoyant tourism activity boosted revenues, shrinking the deficit from the 8.5 percent of GDP projected in the 2003 budget to an estimated 4.0 percent of GDP. External financing was sufficient to allow the GoM to make net repayments to the W&MA of the MMA of about Rf. 100 million, enabling a reduction in the minimum reserve requirement (MRR). This trend has continued in the first half of 2004. In general, GoM deficit spending generates liquidity in the banking sector, which leads primarily to pressure on the exchange rate rather than manifesting itself in inflation. The MMA addresses this by absorbing the liquidity with CDs. In the medium-term, the GoM should grant the MMA greater independence. More detail on monetary policy is contained in Annex 1.

38. The CPI fell by 2.9 percent in 2003, after increasing by less than 1 percent in both 2001 and 2002. Food, beverages and tobacco, and fish account for about 37 percent of the index, and the prices of these items fell sharply. Fish prices fell by 8 percent in 2003. In the first half of 2004, the CPI rose by 1.8 percent compared with the same period in 2003, largely due to a rebound in fish prices. As noted above, the monetization of the deficit in the years prior to 2003 was reflected not in price pressure but in growing liquidity and exchange rate pressure. Since the MMA absorbs much of this liquidity through the issuance of CDs, and almost all things are imported, inflation remains subdued in the Maldives. The GoM should seek to expand the price information collection points, to ensure that the CPI is broadly representative, including the outer atolls.

Exchange Rate Policy

39. The authorities continue to peg the exchange rate at 12.80 rufiyaa to the US dollar, a rate that has been maintained since July 2001, when the rufiyaa was devalued by

9 percent from 11.77 rufiyaa to the US dollar due to excess domestic demand and falling tuna prices. After several years of real effective appreciation, the competitiveness of the rufiyaa increased in 2003 with the depreciation of the dollar, especially against the euro. This boosted tourism, as most of the tourists visiting the Maldives come from Europe. Switching to a euro peg is viewed as unduly disruptive, and the IMF has indicated through its Article IV consultations that the existing exchange rate regime is broadly appropriate for the Maldives.

40. As noted above, the MMA made net purchases of foreign exchange during 2003, and there are no signs of a parallel market. There are no exchange controls, and both residents and non-residents can freely import and export capital through the foreign exchange market. Residents are able to maintain foreign currency accounts either at home or abroad. Macroeconomic policies should remain focused on the maintenance of the fixed exchange rate.

Trade policy

41. The average tariff is about 23 percent, some quotas are in effect, and there are some exemptions, such as for the imports needed to develop new resorts or agribusiness. Taxes on imports are relatively non-distortionary, however, since there are virtually no import competing domestic industries, and differences in tariff rates across goods are maintained largely for the same reasons that excise taxes are commonly imposed on certain goods or activities in the rest of the world. Tariffs are in place mainly in order to raise revenue at low administrative cost (compared to implementing a sales tax or VAT), accounting for over 60 percent of tax revenue and almost 25 percent of total revenues and grants. Still, the GoM should consider reviewing trade policy, eliminate quotas to induce private sector involvement, and develop alternative sources of revenue.

42. At a regional summit meeting in January, 2004, the SAARC countries signed the South Asian Free Trade Agreement (SAFTA), which is to come into effect in 2 years. Except for the planned development of transshipment services in the coming years, the scope for expanded exports as a result of SAFTA is limited, as the Maldives already enjoys preferential access to Sri Lanka which serves as a transshipment point, and the Maldives will have difficulty meeting domestic content requirements since most inputs are imported. Although the small LDCs of the grouping will be able to phase in tariff reductions more slowly, the agreement has major implications for the Maldives, especially in relation to revenues from customs duties. The agreement provides for the establishment of sensitive lists, and the GoM plans to develop revenue sensitive lists. Still, if the GoM is to meet the objective of becoming a hub for regional free trade as indicated in its Vision 2020 statement, the GoM will need to identify alternative sources of revenue and manage the fiscal impact of any associated infrastructure investments.

43. As discussed in greater detail in Annex 3, the possible graduation of the Maldives from LDC status also has important trade related implications. Treaty obligations will become more onerous, and exports of tuna to the EU will no longer be exempt from the 24.3 percent MFN tariff levied by the EU on tuna imports. While canned tuna may be

produced more cheaply in other countries, like Thailand, the Maldives is one of the few countries relying solely on long-line fishing for tuna, and there is scope for strengthening the marketing of the sustainable and eco-friendly fishing practices used to produce Maldivian tuna.

4. Key Development Issues

44. As the Maldives moves squarely into the ranks of middle income countries, it faces several key development challenges and opportunities, which have been identified by the GoM in the SNDP and in its dialogue with the Bank. The GoM will need to manage carefully the budgetary implications of these priority areas, which include mitigating vulnerability, fostering private sector led growth, strengthening land management and housing finance, developing focus islands to lower the marginal cost of service provision, and improving fiscal systems.

Mitigating Vulnerability

45. Despite progress on social indicators and rapid economic growth, vulnerability remains a key development concern and challenge for the Maldives. There are several dimensions to this vulnerability, including social, economic and environmental. The social vulnerability stems from the dispersion of the population, much of which lives in very small subsistence communities of less than 500 people. The economic vulnerability results from the high dependence on tourism and fisheries, accounting for 33 percent and 7 percent of 2003 GDP respectively, which are subject to external shocks. Finally, environmental vulnerability stems from the fragile ecosystem and geography of the Maldives. Most of the islands do not exceed an altitude of 6 feet above sea-level, and increasing sea temperatures in 1998, for example, led to coral bleaching, jeopardizing local eco-systems and an important tourist attraction.

46. These vulnerabilities have been recognized by the international community and are reflected in continued LDC status, and access to concessional finance, including IDA. As described in Box 4 and Annex 3, vulnerability is a key issue in the ongoing deliberations on graduation from LDC status. This has been delayed since 2000, but given that the Maldives meets the criteria for graduation, it is increasingly likely to graduate unless there is a substantial change in the rules. Overall, as the Maldives continues to make progress and move more squarely into the ranks of middle income countries, some of the concessions associated with LDC status are likely to be foregone. In addition, the cost of borrowing is likely to rise (even as new sources become available), and the GoM may wish to explore becoming a blend country and access IBRD financing in addition to IDA monies.

47. Many of the vulnerabilities described above are likely to remain, but several mitigating measures are feasible, some of which the GoM is already pursuing. These include fostering economic diversification, strengthening the fiscal accounts, and developing focus islands which can be defended from the sea more easily.

Box 3: LDC Status and Graduation

Graduation from Least Developed Country (LDC) status has been a recurring issue for the Maldives. Noting strong economic performance in the Maldives over the 1990s and strong scores on several indicators used to determine LDC status, the Committee for Development Policy (CDP) of the United Nations recommended that the island nation be graduated at a triennial review in 2000, but the United Nations Economic and Social Council (ECOSOC) was persuaded to delay graduation pending further study on the implications of such a step. At the CDP meeting held in April 2003, it was again observed that technically the Maldives meets the criteria for graduation, but the ECOSOC indicated that graduation should involve a smooth transition and postponed the move. At its sixth session in April 2004, the CDP again found that Maldives was eligible for graduation from LDC status, and recommended Maldives' graduation, and ECOSOC endorsed a resolution that Maldives graduate from LDC status. The UN General Assembly still needs to vote on the measure, however, and the earliest it would take effect is 2007. In addition, the council called for more study on the impact of graduation, and is developing a new mechanism to ensure a smooth transition.

Some of the effects of potential graduation from LDC status are relatively clear, including losing tariff free access (otherwise 24.3 percent) and quota free access to the European Union's tuna market, while other effects need more study. The GoM opposes graduation, citing continuing vulnerability and the need to implement transition measures. More detail on the process and graduation criteria are included in Annex 3.

Economic Diversification

48. The scope for economic diversification in the Maldives is limited, and efforts towards this goal should not undermine the success and potential for future expansion of the mainstays of the Maldivian economy – tourism and fish. In particular, the openness of the trade regime has served the Maldives well, and import restrictions should not be imposed with a view to fostering domestic import competing activities. In addition, the establishment of businesses with government ownership is also not a good option, as evidenced by the mixed performance of the Maldives Industrial Fishing Company Ltd. (MIFCO) and experience from other parts of the world. The GoM should take advantage of not being saddled with large, loss making enterprises, restructure existing operations and avoid creating new ones. Hence, the primary avenue for diversification lies in creating a sound investment climate, enabling the development of other activities, like the proposed transshipment port in the north to be financed by FDI, and facilitating the diversification of activities and products within sectors, such as offering a wider range of tourism products, such as yachting safaris, or a changing mix of marine products through fish farming, the sale of up-scale chilled fish, or the export of live fish. The GoM is already taking measures with these considerations in mind, such as improving the attractiveness of the Maldives for FDI, but a more systematic study of investment climate issues, as noted above, would help ensure that the GoM's policy framework encourages private sector actors to seize available opportunities in the Maldives and help sustain further robust development.

Strengthening the Fiscal Accounts

49. Another important step towards mitigating vulnerability is the government budget. Beyond conventional analyses of the appropriate size of government and the

sustainability of public deficits and debt, there is also an important vulnerability dimension, as noted above. To the extent that tourism and fisheries are vulnerable to external shocks, the GoM should consider various contingencies and estimate associated fiscal costs of a smoothed adjustment. This might argue for greater emphasis on the maintenance of fiscal balance or a surplus when the tourism and fisheries sectors are performing well, helping mitigate adverse effects during downturns. Indeed, several successful Caribbean countries pursue this strategy.

Developing Focus Islands

50. In addition to seeking to lower the marginal cost of service provision, the GoM's effort to develop focus islands in each atoll aims to mitigate vulnerability to environmental changes outside of the Maldives' control. Representatives of the GoM are outspoken supporters of measures to curb the emission of greenhouse gases, and stave-off global warming and the projected rise in sea level. Despite substantial uncertainty about these effects, however, the Maldives is at risk of losing many islands, and efforts to concentrate development on higher lying islands (still only 2 meters above sea level) is part of a strategy of adaptation, as these islands would be easier to defend against rising waters. Fortunately, the Maldives lies within a band close to the equator that is free from the major storms and hurricanes that menace other parts of the world, like the Caribbean. Investing in focus islands entails a substantial budgetary commitment, however, and the GoM will need to be mindful of the sustainability and broader fiscal implications of the measures.

Looking Ahead

51. In order to develop an effective strategy for mitigating vulnerability and maximize the opportunities of joining the ranks of middle-income countries, the GoM should consider studying these issues in greater detail, including: (a) the specific impact of potential LDC graduation on treaty obligations and preferential market access, (b) the prospects for accessing international capital markets and the IBRD, (c) the role of the investment climate in facilitating economic diversification, (d) the link between the public budget and vulnerability, and (e) the fiscal impact of the focus island initiative.

Fostering Private Sector Led Growth

52. As noted above, increasing the role of the private sector is one of the overarching goals of the SNDP. The experience with private sector led development of the tourist resorts and the recent opening of fishery activities and telecoms to the private sector, for example, have been very positive. Still, the share of GDP spent by the GoM rose by over 5 percentage points to 37.4 percent between 1998 and 2003, and is to rise further to 38.7 percent of GDP according to the 2004 budget. Private sector dynamism and a sound investment climate are crucial for generating future growth and employment. They are also important in encouraging economic diversification, which is a recurring theme in policy discussions concerned about LDC graduation, continuing vulnerability, and structural changes like the end of the multi-fiber agreement and looming decline of the

garment industry. Gaining a better understanding of the investment climate and implementing targeted policy reforms mindful of these considerations would help sustain robust development, especially as large areas of Hulhumale are opened for commercial activities. There are several dimensions to a sound investment climate, including: public enterprise reform, employment and labor law, the financial sector, and foreign direct investment.

Public Enterprise Reform

53. It is notable that with the exception of MIFCO (which was restructured in 2003) and the printing section of the government, all SOEs made positive contributions to the GoM's coffers in 2003, as many activities are run on a commercial basis and the economy has been performing well. Indeed, the loss of recurrent revenues from SOEs that would result from privatization without first establishing a business profits tax or other sources of government revenue is an impediment to deepening public enterprise reform, and the sequencing of reforms will be instrumental. Still, the GoM should consider other areas for increasing the role of the private sector, including some of the activities currently undertaken by the State Trading Organization, and seek to ensure a level playing field, with private parties and SOEs, for example, paying the same amount for land rental or public services.

Employment and Labor Laws

54. An important feature of the investment climate is the availability of skilled labor and the flexibility of the labor market. Although unemployment appears to be relatively low at present, generating adequate employment for rapidly growing cohorts of school leavers is a major concern. As noted above, skills mis-match appears to be an important factor in causing unemployment, and is reflected in the increasing employment of expatriate workers, which accounted for about one third of total formal employment and about 12 percent of the population in 2003. In general, it appears that the average Maldivian has benefited greatly from the influx of expatriate talent and initiative, as expatriates often promote training and capacity building, and tend to complement local workers, raising their productivity and income earning power. The GoM has maintained labor market flexibility and contributed to a good investment climate in this regard, and work permits are issued relatively freely. If an employer is unable to fill job openings after publishing vacancy announcements in newspapers for 3 days, the employer can apply for a quota. These typically take about 14 days to process, and once an employer receives a quota, a work permit can be received within 3 days for a specific expatriate employee. The GoM seeks to address the skills issue by promoting vocational training programs (such as in hospitality) and scholarships for university studies overseas (there is no university in the Maldives). The World Bank is also supporting these efforts. The GoM is in the process of preparing a Labor Law, and will need to be mindful of its impact on the investment climate.

Foreign Direct Investment

55. An important indication of the investment climate and the potential for stimulating private sector activity with foreign participation is the treatment of foreign direct investment (FDI). The tourism and related services industries currently attract the most FDI, and the application process is relatively fast, taking about 1 month. Still, preferences are given to local investors, and foreigners are not permitted to buy shares. The GoM is preparing a Foreign Investment Act for submission to the Majlis in 2004, which will address some of these issues, and establish a negative list (including the production of arms or alcoholic beverages), a restricted list where decisions are to be rendered in less than 14 days, and an open list (covering most areas) where decisions would be made within 3 days. Overall, the GoM seeks to encourage foreign investment in the Maldives. For example, a foreign consortium is studying the feasibility of establishing a deep water port in the north for the development of transshipment services (mainly for the Indian market). Other areas needing private entrepreneurship include exploring the potential for aquaculture and hydroponics. The World Bank group is providing policy advice to help the people of the Maldives benefit from the capital, technology, and training that is typically associated with FDI.

Financial Sector

56. The GoM recognizes the importance of a well functioning financial sector to making further progress on the path to development, and has taken measures to increase competition in the financial sector, including facilitating the entry of Hong Kong Shanghai Bank (HSBC), the creation of the MLFC and the establishment of the Housing Development Finance Corporation (HDFC). In addition, the MMA founded an equity market that currently has 3 listings: the Bank of Maldives (BoM), the Maldives Transport & Contracting Company (MTCC), and the State Trading Organization (STO). The authorities also lowered the MRR in 2003 and removed credit ceilings a few years ago. As described in greater detail in Annex 1, however, banks are generally unwilling to make loans with maturities of more than 3-5 years, spreads remain high, and much of the banks' assets are deployed in meeting the MRR (set at 30 percent), buying CDs issued by the MMA, or in vault cash. This suggests that there remains substantial scope for sharpening competition, to ensure adequate financing to the private sector, especially for small and medium scale enterprises which will be central to generating growth and employment. Strong growth in credit to the private sector in the first half of 2004 indicates that this may already be happening. Further stock market development is important for enabling companies to raise domestic equity finance. The GoM may also wish to consider a syndicated international bond issue, which could lead to a credit rating and help private borrowers access international capital markets.

Looking Ahead

57. The GoM is engaged in an ambitious legislative agenda, involving 30 proposed bills, many of which will have a significant impact on the economy. Several are to be submitted to the first session of the Majlis, including a Bill on Human Rights

Commission, a Bill on Securities, a Bill on Treasury, a Bill on Audit, and a Bill on Business Profit Tax. As noted above, in April 2004 the Majlis passed an increase in the tourism bed tax from US$6 to US$8 (with effect from November 1), and Amendments to the Land Act. The GoM should be mindful about the effect such legislative changes will have on transactions costs and the investment climate. For example, the Land Act of 2003 formalized restrictions on foreclosure and eviction in cases of non-payment, making it more difficult for property owners to use their assets as collateral for mortgages. This raised the transactions costs associated with mortgage finance, and led to a sharp drop in bank financing to real estate in mid-2003 after the Land Act was passed. Contemplated reforms to the current pension system are another example. The current system covers only public sector workers, making it difficult to switch to the private sector since the public sector employees' time-in would be lost. These are important considerations if the legislative reform agenda is to support the evolution of an improved investment climate and facilitate private sector led growth in the coming years.

Hulhumale, Land Management, and Housing Finance

58. Despite slowing population growth, land scarcity and pressure are mounting. This is reflected in a difficult housing situation, which has become a major social issue. About 74,000 people (out of a population of 270,101 in 2000) live in the capital, Male, with a total land area of under 2.0 square kilometers. Male is the economic hub of the country, and suffers significant overcrowding, resulting in congestion and housing prices out of proportion with wages. According to a Household Survey conducted in 2000, about a third of Male residents live in rental accommodations, with most spending 40-50 percent of their household income on rent. Consequently, people from lower income groups have little option than to share living quarters, and many live in shelters lacking amenities.

59. The scarcity of land is compounded by inefficiencies in land management systems, weak land tenure, and poorly functioning market mechanisms. The current system results in under-consumption by households, which pay very high rents, and over-consumption by state owned enterprises and institutions, which make only nominal payments for the land they occupy and cannot trade unneeded land. Until recently, the GoM owned all land, which it then allocated as plots for housing free of rent, or leased for agricultural activities and for the development of resorts, at competitively determined rents for 20 and 35 years respectively. Every head of household is entitled to a land holding on the island of his residence rent-free, in perpetuity and with the right of inheritance according to Islamic Law. The free allocation system has now been ended by the government. It led to an extreme division of land holdings into ever smaller plots, and a social rift between the actual beneficiary of allotments in dense areas and the other households. However, the ownership of the land holding is limited to a leasehold in perpetuity, without the right to sell or transfer the land. Furthermore, legal property and land-use rights have been poorly defined, which undermines the capability of financial institutions to provide long-term mortgages and limits their financing activities to short-term (3-5 years) construction loans. The required quick repayment of loans is one of the

factors pushing up rents. Overall, the allotment of plots has had little impact on the housing needs of lower and middle income groups at least in the capital region.

60. In an effort to mitigate the constraints land scarcity poses for growth, and address the social issue of housing, the GoM has engaged in a major land reclamation project with substantial fiscal implications. The GoM also seeks to improve land management systems and strengthen housing finance. The passage of amendments to the Land Act in April 2004, was an important step in this regard.

Increasing the supply of land - Hulhumale

61. Hulhumale is the largest and most complex land reclamation project undertaken by the government, with the objective of easing the overcrowding and congestion in the Male region while enabling an agglomeration of people and activity to benefit from scale economies and a lower marginal cost of service provision. The initiative also seeks to mitigate environmental vulnerability by building a large island 2 meters above sea level. Significant progress has been made to date. The land reclamation for the first phase was completed in 2002 at a total cost of US$32 million. A loan from the Thai Eximbank of US$30 million financed the construction of 280 standard apartment units, a primary and secondary integrated school, public buildings for government and other social services, a 50 bed hospital, 48 commercial units in 4 commercial buildings, and a road network for the first settlements. By the end of 2003, the first 220 plots of land and 280 apartments were offered for sale/lease/rent which attracted over 5,000 applications, and permanent residents moved to Hulhumale starting in 2004. These positive developments are relieving some of the fiscal burden on the GoM, but additional funds need to be attracted to the project to finance further development.

62. Several issues related to Hulhumale warrant further study, including its impact on the poor and its macroeconomic effects on the balance of payments, debt, and fiscal accounts. Another important issue is the potential indirect impact on banks' portfolios if the development of Hulhumale leads to a significant fall in rents in Male and undermines the ability of borrowers to repay construction loans that were contracted on the basis of an expected stream of high rental income. The Hulhumale project is discussed in greater detail in Annex 4.

Improving Land Management

63. Given the scarcity of land and the high cost of reclamation, effective land use and management is particularly important in the Maldivian context. The GoM has taken a number of steps towards creating an enabling environment for promoting the private ownership of land. As noted above, the new Land Act provides a legal framework underpinning a multi-ownership regime for apartment buildings, and an interim property registration system. It also includes measures enabling urban leases, the adjustment of the mortgage framework and the allocation of state owned land. However, the 2003 Land Act encountered several difficulties in its provisions for giving property as a gift or bequest, and for mortgaging property in whole or in parts when the land is still formally

owned by the state. In addition, as noted above, the 2003 Land Act formalized restrictions on eviction and foreclosure for non-payment which previously had been implicit. For example, under the 2003 Land Act, eviction and foreclosure was not possible unless those being evicted had another home. These concerns contributed to a steep fall in bank lending to real estate in mid-2003, and the GoM passed amendments to the Act in April 2004 to address some of these issues.

The development of housing finance

64. Long-term financing for housing has been a persistent problem despite efforts made by the GoM. The contribution of the financial sector to home financing is currently very limited. Banks tend to lend for the construction of buildings to be rented, where there is a capacity to repay the loan over a period of 3-5 years, at interest rates of 11-12 percent, which can be prohibitive. The limited scope of bank lending in this area also demonstrates a lack of confidence in the security of a mortgage as collateral, since there are no clearly defined legal property rights. The Land Act of May 2003 was an important step in this regard, but as noted above, it did not strengthen the confidence of banks in making long-term loans and Amendments were passed in April 2004 to address these issues. The availability of long term housing finance will be critical for the success of the Hulhumale project over the medium term.

65. In order to address this concern, the GoM established the HDFC in February 2004, and the new institution started issuing loans in April. The longest maturity is to be 20 years, with 1 year of grace, at interest rates of 9 percent, 11 percent and 12 percent, for a maximum loan amount of Rf. 1 million (US$78,125). The authorities capitalized the institution through the sale of HDFC bonds, while the MMA concurrently reduced its issuance of CDs. The issuance was over-subscribed, and the main buyers were state owned enterprises. The HDFC offered 1, 3, and 5 year bonds for sale, but only sold bonds with 1 year maturities. With the exception of the Bank of Maldives, the banks continue to invest their excess rufiyaa holdings in the shorter-term CDs, despite earning 1.5 percent less on the CDs. Financial markets are at a nascent stage in the Maldives, but efforts are being made to deepen financial intermediation to help foster development. The HDFC plans to issue further bonds, in small denominations and open to the public, and plans to become a publicly traded company on the growing Maldives stock exchange.

66. The authorities are mindful about the likely impact that a shift in holdings from CDs to HDFC bonds would have on liquidity and foreign exchange reserves. The HDFC will use the funds raised through the sale of bonds to make housing loans, which the borrower will then use to finance housing. This boosts liquidity, increases imports and puts pressure on reserves, since most of the inputs into real estate development are imported. The wider impact on the balance of payments of HDFC financing is only likely to become noticeable, however, once additional property development is undertaken.

67. The Maldives Finance and Leasing Company (MFLC), which started operations in 2002 (the IFC holds a 25 percent stake) is also expected to help provide financing, but

the MFLC finances mostly commercial projects, targeting mobile capital equipment (like boats and vessels) and tourism related investments. To date, the MFLC has no involvement in financing Hulhumale property development.

68. Widening access to housing depends critically on the success of developing longer term finance, in order to spread the cost of purchasing or building a home over many years. Even so, the purchase of a flat or home in Hulhumale can be afforded mostly by higher income individuals. Housing finance could act as an important spur to the financial sector more generally. Home ownership should be a strong driver of personal savings (like in the rest of the world), and the creation of secured investment instruments, like mortgages, can generate long term investment opportunities that are presently lacking.

Looking Ahead

69. Several factors warrant further study and will be important to fostering the development of Hulhumale, improving land management, and generating adequate housing finance. The GoM should investigate the broader implications of the next steps anticipated in Hulhumale. The GoM could also improve land management by strengthening the property rights framework, and ensuring that the use of land by SOEs and public institutions is rationalized. Finally, in developing housing finance, the GoM will need to: (i) avoid monopolizing the provision of long-term housing finance and seek the entry of banks into the market, (ii) foster competition in the financial sector, which is currently characterized by high (though falling) intermediation margins, and (iii) enforce arms length recourse in the new system to avoid the non-payment culture that plagues the existing public housing sector. These steps will be central to underpinning economic dynamism.

Developing Focus Islands

70. The SNDP outlines a proposal to consolidate economic and human resources on a selected number of "focus" islands, in order to foster the development of regional growth centers and to lower the marginal cost of reaching communities with high quality public services. For equity and other reasons, government policy once encouraged population dispersion, by installing a school on one island and a health clinic on a neighboring island, for example. Over the last ten years, however, the GoM has encouraged the consolidation of population on fewer, larger islands, as part of a long term strategy to strengthen the economic base, diversify away from fishing, address vulnerability and adapt to global warming. In addition to the land reclamation on Hulhumale, the GoM also seeks to reach the poor in the outer atolls and contribute to the development of a viable alternative to Male and the capital region, in terms of economic opportunities, social services and infrastructure.

71. Key services desired by islanders are dredged and protected ports, electrification, health clinics, and schools. All inhabited islands have schools up to grade 6, but only 4 islands have schools reaching the 12th grade, and many children study on neighboring

islands, requiring that parents pay for room and board (equivalent to about US $30-40 per month). Once children graduate, they frequently do not return to their home island, but instead seek employment where it is available, often in resorts, larger islands, or Male. There are currently 14-15 island communities seeking government assistance to move to larger islands to take advantage of better public services.

72. Male has emerged as the hub of economic activity and human settlements, as people from outer atolls have migrated to the capital in search of better job opportunities and services. The growing population and continued rural-urban migration is increasing the demand for employment, services and social infrastructure in Male. This has contributed to congestion and overcrowding in Male, and impinged development and the provision of basic social services in the outer atolls.

73. The GoM's first major regional development initiative targets the Northern Development Region (NDR) and the Southern Development Region (SDR) with support from the ADB and the Islamic Development Bank (Box 4). These areas were chosen because both have the potential for establishing the critical mass needed for economic growth.

Box 4: First Regional Development Project

The project promotes equity through the development of focus islands in the Haa Alifu, Haa Dhaalu and Shaviyani Atolls in the Northern region and the Gaafu Alifu, Gaafu Dhaalu, Gnaviyni and Addu atolls in the Southern region. The islands were selected based on population density and cost effectiveness in the provision of services, and are to become centers offering people an alternative to Male.

The project is improving the living conditions on the focus islands by upgrading a 10.5 km road connecting Gan to Hithadhoo, enhancing streets in the urban areas, providing rainwater collection and storage for 2,000 households in the NDR and SDR, providing appropriate sanitation technology for 1,000 households in the NDR, constructing a 70 meter bridge and 200 meter culverted causeway in the SDR, improving solid waste disposal, de-sludging septic tanks, and setting up permanent environmental monitoring of the fresh water lens, coastal geomorphology, and marine ecology of the focus islands.

The project is directly benefiting a population of 19,000 in the NDR and 21,000 in the SDR. More than 100,000 will indirectly profit from the activities of the Regional Development Office, and have the opportunity to influence what development takes place on their own atolls. Migration to Male and the capital region is expected to slow as development activities in the focus islands gain momentum.

74. The implementation of the project is well underway. A Regional Development Management Office has been established. A detailed survey of data needs has been carried out. The location and design of the road and bridge have been agreed at the community and Government levels. GoM initiatives in tourism, harbor construction, fisheries and the development of an international airport on Gan island (a former British Royal Airforce Base) are expected to create jobs and opportunities for the people living on the focus islands.

75. The World Bank is also supporting the initiative, with a US$15.6 million Integrated Human Development Project. It will finance the infrastructure, training and

capacity building needed to set up and administer "social delivery centers" on several of the focus islands, and is designed to address the escalating unit costs of social services (Annex 5). The project was approved in July 2004, and it is to be launched in January 2005.

Looking Ahead

76. Several issues warrant further study going forward, including:

(a) the possible environmental impacts resulting from the regional development centers, given the construction of roads, bridges, community houses, schools and hospitals in the fragile ecosystem.

(b) opportunities for promoting community based rural and cultural tourism, whereby facilities could be developed with an indigenous orientation emphasizing traditional food and cultural activities. Local communities could be trained to manage the tourist facilities and offer tour guiding services, helping the focus islands retain tourism receipts and enhancing the income of local communities.

(c) the continued participation of local communities, as the success of the focus islands will depend substantially on how meaningfully they are involved in selecting the focus islands and the choice of development activities.

While the development of focus islands is expected to lower the unit costs of service provision over the long term, the GoM will need to manage carefully the fiscal burden associated with these initiatives over the medium term.

Improving Fiscal Systems

77. As discussed in the sections above, addressing the key development challenges associated with progressing towards becoming an upper middle income country has substantial fiscal implications. Strengthening fiscal systems can make an important contribution to managing these growing fiscal burdens and increasing the effectives of public spending.

78. As noted in Section 3, the overall fiscal balance (total expenditure and net lending less total revenue) has been in deficit for the past several years and has fluctuated within a band of 4 and 5 percent of GDP. This deficit has been financed by external grants and borrowing, both from external agencies and the MMA through the W&MA. The current balance (current expenditure less current revenue) has been in surplus indicating that government savings are being used along with foreign grants and borrowings to finance capital expenditure and net lending. As described above, however, public spending as a percentage of GDP continues to rise (Table 4).

79. The Public Expenditure Review (PER), which was completed in 2002, provided an in-depth analysis of some of the structural underpinnings of these trends, and

developed a series of recommendations, some of which have been acted upon (Annex 6). In light of current fiscal developments and the analyses that were carried out as a part of the PER, three key issues stand out: (1) developing a Medium Term Fiscal Framework (MTFF), including multi-year budgets some key sectors like education and health, (2) creating improved means of financing deficits, without recourse to the W&MA of the MMA, and (3) strengthening public expenditure management. Improvements in these areas will be central to the sustainability of the public accounts.

Developing a Medium Term Fiscal Framework

80. The GoM's medium term strategic vision is laid out in its SNDP. Although the plan lays out 130 policies (as noted above), each with up to 12 strategies, no assessment has been made of the feasibility and costs of these initiatives. Hence, it is unclear how these policies and strategies are to be translated into fiscal objectives through the budget. The annual budget is largely prepared in annual increments, and provides little information about the cost implications of policy choices. In addition, the budget process is unable to fully incorporate the multi-year cost implications of GoM policies. When funding decisions are made without adequately anticipating future recurrent costs, projects end prematurely or function ineffectively. Several important components of the budget, like external grants and the cost of debt service would also be better understood in a multi-year budget framework with systematic forecasting of future recurrent costs against projected revenues.

81. The Ministry of Finance and Treasury recognizes the importance of moving to multi-year budgeting as an instrument to facilitate the establishment of a fiscal envelop, improve resource allocation and strengthen expenditure control. During the presentation of the 2004 budget at the end of December, 2003, the Minister of State of the Ministry of Finance and Treasury announced that starting with the 2005-2007 budget period, the GoM would implement a multi-year budget. Experience suggests that this is a difficult process, however, that requires perseverance over several years. The World Bank, together with other development partners, are supporting the initiative.

82. In a continuation of the extensive engagement in this area stemming from the PER (2002), Bank staff, in collaboration with IMF and ADB colleagues, prepared a technical assistance (TA) program that was initiated in February/March 2004. It was designed to help build local capacity for preparing a medium-term fiscal framework (MTFF), including producing detailed revenue and expenditure forecasts, developing a fiscal strategy (involving the specification of budget targets), and generating a sectoral multi-year expenditure framework in the Ministry of Education. The most important and valuable output of this TA activity was the shared learning and knowledge transfer on issues that are critical for improving the development effectiveness and poverty reducing impact of public expenditure. The TA program facilitated learning through presentations and engaging discussions, especially among the representatives of the various agencies and ministries whose interaction appears somewhat limited otherwise. In addition to this learning-by-doing, two strategy notes were prepared by the GoM with assistance from the

Bank team: a preliminary MTFF for 2005-2007, and a pilot multi-year budget for the education sector.

83. Table 5 provides the preliminary MTFF, which was prepared as part of this training activity. It is based on the following assumptions:

- The overall balance in 2004 is budgeted to be -5.3 percent of GDP, and is the fiscal policy target variable. It is to decline to -5.1 in 2005, -4.8 in 2006 and -4.5 in 2007.
- Total revenue and grants are expected to fall as a share of GDP between 2005 and 2007, with minimal growth in nominal terms.
- The targeted reduction in the overall balance is to be achieved by increasing the surplus in the current balance, while capital expenditure as a share of GDP is to remain constant.
- The total budget (total expenditure and net lending) over the next 3 years shows little growth in absolute terms, and declines from 38.7 percent of GDP in 2004 to 32.5 percent in 2007.

Table 5: Medium-Term Fiscal Framework, 2005-2007

	2002	2003	2004	2005	2006	2007
		Prov. Est.	*Budget*	*Proj.*	*Proj.*	*Proj.*
			(In millions of rufiyaa)			
Total expenditure and net lending	3,117.3	3,428.4	3,688.7	3,725.7	3,805.5	3,899.0
Total revenue and grants	2,714.9	3,061.8	3,259.9	3,260.1	3,336.2	3,426.2
Overall balance	-402.4	-366.6	-428.8	-465.6	-469.3	-472.8
Overall balance excluding grants	-534.9	-489.0	-503.5	-527.6	-536.3	-545.5
Current balance	468.5	537.1	473.9	538.0	614.5	703.2
Total debt (end of period)	3,856.9	4,139.3	4,534.9	5,000.5	5,469.8	5,942.6
Of which: Foreign	2,203.7	2,674.6	3,073.8	3,539.4	4,008.7	4,481.5
			(In percent of GDP)			
Total expenditure and net lending	33.1	33.4	33.8	31.5	29.9	28.3
Total revenue and grants	38.0	37.4	38.3	36.0	34.1	32.2
Overall balance (1)	-4.9	-4.0	-4.4	-4.5	-4.2	-3.9
Overall balance excluding grants	-6.5	-5.3	-5.2	-5.1	-4.8	-4.5
Current balance (2)	5.7	5.9	4.9	5.2	5.5	5.8
Total debt (end of period)	47.0	45.2	47.0	48.3	49.0	49.0
Of which: Foreign	26.9	29.2	31.9	34.2	35.9	37.0
Memorandum items:						
Nominal GDP (millions of rufiyaa)	8,201	9,157	9,642	10,346	11,174	12,123
Real GDP (millions of rufiyaa)	6,993	7,586	7,965	8,363	8,823	9,353
Real GDP growth (%)	6.5	8.5	5.0	5.0	5.5	6.0
Interest payments (millions rufiyaa)	136.5	134.8	146.8	166.8	179.4	195.3
Interest payments as a % of GDP	1.7	1.5	1.5	1.6	1.6	1.6
Consumer prices (%)	0.9	-2.8	0.3	2.3	2.5	2.5

Source: Ministry of Finance and Treasury.

(1) Overall Balance is total revenue and grants less total expenditure and net-lending.

(2) Current Balance is defined as current revenue less current expenditure.

84. In view of the projected marginal increase in revenue (in millions of rufiyaa) and the fiscal policy target to reduce the overall fiscal deficit, the implication is that current expenditure will have to be curtailed over the medium term. Less reliance on borrowing will improve the fiscal situation in the long-run and will ensure that debt is sustainable.

85. The GoM should revise this preliminary framework, and seek to implement measures that will make it operational. There is little room for slippage if the GoM is to meet its stated objective of moving to multi-year budgeting, and further effort will be needed as the 2005 budget is prepared. The Bank is providing further assistance through an Institutional Development Fund grant, and is supporting GoM efforts to revise the project selection process of the public sector investment program.

Deficit Financing Through the Maldives Monetary Authority

86. Since there are no debt instruments for domestic borrowing such as bonds and treasury bills, any budget deficit that cannot be covered with external funds is financed from the MMA through automatic advances from the W&MA at the rate of 6 percent interest, with an unspecified term. There is also no legal limit on the amount that the GoM may borrow from the MMA. Between 1999 and 2001, weakening public finances and a lack of foreign financing led to a significant monetization of the deficit, ranging from 2.8 to 4.3 percent of GDP, more than half of the budget deficit. In 2002, the budget deficit widened further, but foreign financing met most of the shortfall, and borrowing from the MMA fell to 0.4 percent of GDP. A narrowing of the deficit and ample foreign financing enabled net repayments to the account in 2003.

87. During the presentation of the 2004 budget at the end of December, 2003, the Minister of State of the Ministry of Finance and Treasury also announced that all borrowing from the MMA would cease. Adhering to this commitment will help underpin the macroeconomic framework, reduce pressure on the balance of payments and support the fixed exchange rate regime. In this effort, it will be important for the GoM to contain the budget deficit within sustainable levels, and develop alternative financing mechanisms by introducing bonds for long-term financing and treasury bills for short-term cash management.

Strengthening Public Expenditure Management and Establishing a Public Accounts System

88. The Ministry of Finance and Treasury is responsible for the preparation of the national budget and the overall management of public expenditure. The systems in place are relatively rudimentary, and technical capacity is a significant constraint on the management of public spending. All financial information is recorded manually based on a single entry accounting system. The chart of accounts used does not enable the accumulation of expenditure information beyond broad functional classifications. For example, ready expenditure aggregation by approved programs is not available. Several budget related activities, including lending to individuals and public enterprises, are not

counted in public expenditures and the budget, raising questions about its comprehensiveness. The future recurrent cost implications of new projects are not closely linked to public expenditure management. These limitations impede the GoM's ability to effectively monitor public spending.

89. The most recent Country Financial Accountability Assessment (CFAA) (2000) prepared by the Bank reported that financial management and accountability are at a nascent stage in the Maldives. The PER (2002) underscored the importance of judicious management of public expenditure to ensure that the allocated funds are being spent for the stated objective within the agreed time frame. Accordingly, it was recommended that the GoM establish a Public Accounts System (PAS) that will provide correct and timely financial information. The Asian Development Bank (ADB) is actively engaged in this area and is supporting the implementation of a modern auditing system that will enhance accountability. Further technical assistance is to be provided by the ADB to develop a modern, computerized, public accounting system.

Looking Ahead

As the Maldives becomes a wealthier middle income country, the fiscal burden of GoM efforts to provide services typical of higher income countries, like universal quality education or good social safety nets, is likely to grow. In addition, several of the challenges that the GoM will need to address in order to sustain robust development also have significant fiscal implications. Making improvements in the structural public expenditure management issues outlined above will be important over the coming stages of development.

5. Medium-term Development Prospects and Conclusions

90. After the robust performance of 2003 and the first half of 2004, the Maldivian economy is in an advantageous position. Real GDP growth is likely to exceed 5.0 percent in the medium term, and despite some widening in the current account deficit as imports of capital goods, construction materials and tourism related items continue to grow, there is no apparent pressure on the exchange rate and the authorities aim to maintain foreign exchange reserves adequate to cover more than 4 months of imports (Table 6). The 2004 budget anticipates a widening of the fiscal deficit (including grants), as expenditures continue to grow (especially on wages and salaries), while some components of revenue, like grants and transfers from the SOEs, are stable or falling. The GoM aims to limit the overall deficit including grants to between 4 and 5 percent of GDP in the years to 2007, and it is to be financed from abroad, as no further GoM recourse to the W&MA of the MMA is to be made going forward (except for very short-term cash management purposes).

Table 6: Selected Economic Indicators - Medium-Term Outlook

	2002	2003	2004	2005	2006	2007
		Prov. Est.		*Proj.*		
			(Percentage Change)			
Real GDP	6.5	8.5	5.0	5.0	5.5	6.0
Consumer prices	0.9	-2.9	0.3	2.3	2.5	2.5
			(In millions of U.S. dollars)			
Balance of Payments						
Current account balance	-35.7	-31.8	-67.6	-80.9	-71.2	-75.7
Trade Balance	-212.4	-255.2	-278.6	-308.0	-314.9	-337.2
Exports, f.o.b.	132.3	151.9				
Imports, f.o.b.	-344.7	-407.2				
Services (net)	251.7	256.0				
Receipts	362.9	415.1				
Of which tourism receipts	337.1	387.8				
Payments	-111.1	-119.6				
External reserves (months of imports (c.i.f.))	4.1	4.1	4.2	4.2	4.2	4.2
Exchange rate (Rufiyaa/US$, period average)	12.80	12.80	12.80	12.80	12.80	12.80
Central government			*(In percent of GDP)*			
Total expenditure and net lending	33.1	33.4	33.8	31.5	29.9	28.3
Total revenue and grants	38.0	37.4	38.3	36.0	34.1	32.2
Overall balance (including grants)	-4.9	-4.0	-4.4	-4.5	-4.2	-3.9
Total debt (end of period)	40.4	40.4	41.2	41.0	40.1	39.1
Memorandum items:						
Nominal GDP (millions of rufiyaa)	8,201.0	9,156.7	9,642.0	10,345.9	11,173.5	12,123.3
Tourist arrivals ('000)	484.7	563.6	591.8	615.5	637.0	656.1
Tourist bed nights ('000)	4,066.0	4,705.0	4,911.8	5,108.2	5,287.0	5,445.6
(Annual percentage change)	3.4	15.7	4.4	4.0	3.5	3.0
Average Bed capacity (Resorts/Hotels)	16,131	16,692	16,758	17,200	17,756	18,750
Bed night capacity ('000)	5,887	6,092	6,192	6,278	6,481	6,844
Average Capacity utilization rate (%)	69.0	77.2	80.0	80.0	80.0	80.0
Average stay (days)	8.4	8.3	8.3	8.3	8.3	8.3
Fish Landings ('000 MTs)	163.4	155.4	150.0	150.0	150.0	150.0

Source: MMA, MPND, MOT, MHREL, MOFAMR, MoFT, Maldives Customs Service, MACL, President's Office, World Bank and IMF staff estimates.

91. This favorable outlook is predicated on several factors.

- Establishing more resorts will be key to enabling the continued rapid expansion of the tourism industry. The sector remains the main driver of growth, but faces capacity constraints, as reflected in the very high capacity utilization rate of over 77 percent reached in 2003 (described in Annex 2). The tourism master-plan calls for the addition of 1,000 beds a year, reaching 20,000 by 2007, with significant knock-on effects in construction and other related activities.
- Maintaining the high levels of fish production seen in the past two years will depend on boosting private participation and increasing the value added from fishing activities, including in the EEZ of the Maldives where many foreign operators are active.
- Further developing Hulhumale will be central to the outlook in the coming years, as the sale of government land and real estate will relieve pressure on the fiscal accounts, spur an agglomeration of activity, and help address overcrowding in Male.
- Building on the progress to date in deepening the financial services available to finance investment and housing will be important to fostering growth over the medium term.

Several policy issues will also need to be addressed:

- In order to strengthen the linkages between tourism and local communities, and help promote employment generation, the GoM needs to heighten efforts to provide training and technical assistance in hospitality oriented activities.
- Public enterprise reform to open more activities to private sector participation would help underpin economic dynamism. Several such initiatives have already yielded positive results, such as in the fishery and telecoms sectors, and could be deepened.
- The GoM will need to be mindful of ensuring adequate revenue buoyancy. The revenue anticipated in the 2004 budget depends on collecting arrears from 2 resorts, which have not been developed yet. Hence, collection may be difficult. In addition, the 2004 budget includes an increase in the bed tax from US$6 to US$8 per night. This was previously expected in mid-2004, but although the Majlis passed the increase in April 2004, it did not take effect until November 1, 2004.
- Current expenditure has grown rapidly in recent years, and slowing the expansion of these expenditures in order to generate adequate fiscal space for investment will be a challenge, especially in 2004, when the GoM plans to implement a 20 percent increase in government wages, which were last raised in 1999.

- In order to maintain the fixed exchange rate and keep inflation low, it will be important for the GoM to adhere to its policy commitment not to borrow from the MMA (except for very short-term cash management purposes). Maintaining a measure of fiscal discipline and avoiding domestic financing of the budget deficit will help ensure that credit to the private sector is adequate for the investment and real estate development needed to fuel private sector led growth.
- An ambitious legislative agenda is underway, and the GoM needs to ensure that changes to the institutional environment lower transactions costs and do not repeat in other areas the experience of the 2003 Land Act, which led to a fall in bank lending to real estate.
- The potential graduation of the Maldives from LDC status remains an important issue, and further investigation is needed to identify measures that would smooth the transition.
- Over the longer term, the GoM needs to improve the investment climate and diversify the economy beyond tourism and fisheries, possibly aided by foreign direct investment in areas like the planned transshipment facilities in the northern most atoll. This will be important to moderating vulnerability and creating a more stable employment and income base.

The GoM will need to focus on these issues and mitigate the effects of any fiscal slippage in order to sustain robust development and poverty reduction over the medium term.

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Annexes

Annex 1.

Monetary and Exchange Rate Policy

As noted above, the Maldives Monetary Authority (MMA) aims monetary policy at ensuring price stability and economic growth, while maintaining foreign reserves. The two most important instruments of monetary policy are the minimum reserve requirement (MRR), and the sale of Certificates of Deposit (CDs), which the MMA started issuing in 1995 to absorb liquidity in the banking system. In August 2003, the MRR was lowered by 5 percentage points to 30 percent (the MMA pays 2.5 percent interest on MRR funds above 15 percent), generating Rf. 200 million in loanable funds. Banks invested most of this in CDs, however, despite a concurrent interest rate reduction on CDs from 8 percent to 6 percent. The maturity and interest rate on CDs offered by the MMA are determined at the time of sale. Typical MMA offers in 2004 involved 1 month CDs at 5 percent interest, and 3 month CDs at a 6 percent interest, with banks deciding how much to buy. The CDs do not apply towards the MRR and they are not tradeable.

In recent years, monetary policy has been driven by the need to finance budget deficits and address the resulting liquidity and pressure on the exchange rate. As described above, the GoM has resorted to substantial monetization of the deficit through withdrawals from the W&MA, ranging from 2.8 percent to 4.3 percent of GDP between 1999 and 2001. In 2003, however, buoyant tourism activity boosted revenues, shrinking the deficit from the 8.5 percent of GDP projected in the 2003 budget to an estimated 4.0 percent of GDP. External financing was sufficient to allow the GoM to make net repayments to the W&MA of the MMA of about Rf. 100 million, enabling the reduction in the MRR.

In general, GoM deficit spending generates liquidity in the banking sector, which leads primarily to pressure on the exchange rate rather than manifesting itself in inflation. The MMA addresses this by absorbing the liquidity with CDs. Borrowing by the GoM from the W&MA stood at Rf. 1 billion in 2003, equivalent to about 11 percent of GDP. At the same time banks held about Rf. 684.1 million in CDs. The perception among banks is that good lending opportunities are limited, and with the stock market and financial system in their infancy, CDs remain the only low risk rufiyaa denominated asset available. Indeed, much of banks' assets are held mostly in CDs, vault cash, and MRR deposits with the MMA.

Total liquidity, or M2, grew by 15 percent in 2003, fueled by a rapid increase in net foreign assets. This trend continued in the first half of 2004. Strong growth in foreign currency deposits raised the dollarization ratio to 51 percent in 2003, compared with 47 and 45 percent in 2002 and 2001, respectively. Domestic credit contracted by 6 percent in 2003, as net credit to the government and credit to the SOEs both fell. Net credit to the government fell by over 36 percent in the first half of 2004 compared with the same period in 2003, and credit the SOEs also fell further over the same period. The lifting of credit ceilings in July 2001 sparked a surge in private sector credit in 2001 and 2002, but the expansion of credit to the private sector slowed to 7 percent in 2003. In the

first half of 2004, credit to the private sector accelerated again, expanding by 13 percent compared to a year earlier. Increased credit to the private sector was largely associated with tourism, while lending for real estate contracted due to uncertainty associated with the 2003 Land Act, which formalized restrictions on the selling of land and on foreclosure for non-payment. The law was amended in April 2004 to spur mortgage lending and the development of Hulhumale.

Banks are free to set interest rates on both rufiyaa and dollar denominated deposits and loans. The 7 percent restriction on the maximum spread between deposit and lending rates was lifted in August 2001, and the only remaining restriction is a ceiling on lending rates of 20 percent. Since 2001, however, the spread between deposit and lending rates has widened in both rufiyaa and dollars, ranging between 6 and 11 percent in June 2004. This suggests that there is substantial scope for improving the efficiency of the financial sector. The arrival of HSBC in 2002 is a welcome development in this regard. Important steps include lowering the MRR further, introducing other tradeable financial instruments like treasury bills and bonds, and facilitating (a) foreclosure for non-payment and (b) the sale of land, which would enable the use of property as collateral. It is worth noting that banks in the Maldives typically do not make loans with more than 3-5 year maturities, making housing finance difficult.

A draft MMA Act is being considered, which would supercede the MMA Act of 1981. The aim is to improve the management effectiveness of the governing structure, restrict and formalize any future borrowing from the MMA by the GoM, strengthen the regulatory powers of the MMA, and clarify the key goal of the MMA as price stability.

Annex 2

Developments in the Tourism and Fishery Sectors

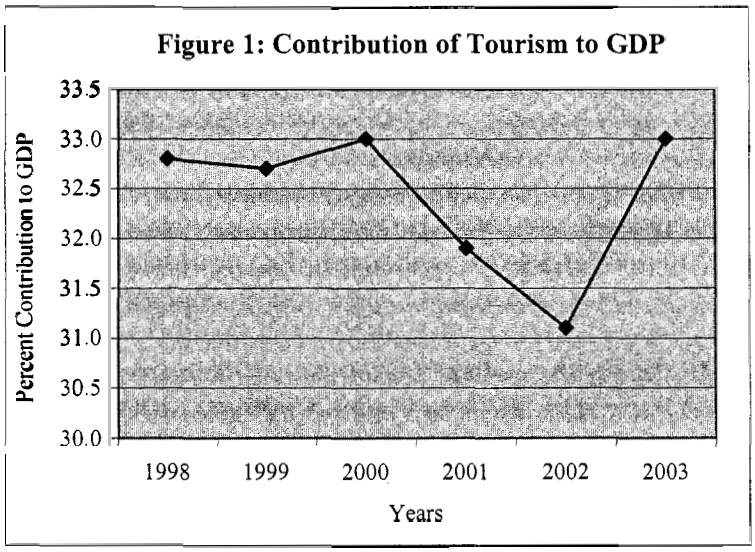
As noted above, the tourism and fishery sectors together accounted for 39.3 percent of GDP in 2003. Hence, the prospects for sustaining robust growth and poverty reduction are closely tied to these two dominant sectors, and warrant a more detailed analysis.

Tourism

Tourism is the leading industry in the Maldives, accounting for about one third of GDP (Table A.3), but it is vulnerable to exogenous shocks, such as the 9/11 terrorist attacks in the US. The tourism policy outlined in the SNDP and the tourism master-plan is geared towards expanding tourism to all the atolls so that more local communities can benefit from the activity. The main challenges are sustaining the rapid growth and reducing vulnerability.

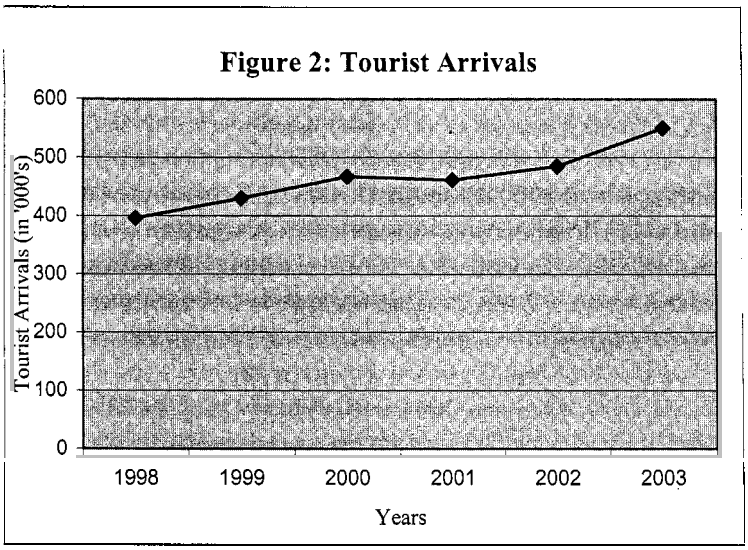
Recent Developments

Despite the war in Iraq and the SARS outbreak, the tourism sector performed exceptionally well in 2003 and expanded by 14.8 percent, compared with 3.3 percent growth in 2002. The sector's share in GDP increased to 33 percent in 2003 from 31 percent the previous year. Figure 1 and Figure 2 show the recovery of the sector from the effects of the 9/11.



The Maldives celebrated the arrival of the 500,000th tourist in November 2003, and tourist arrivals during 2003 increased by 16.3 percent to reach 563,593 (Fig. 2).

Arrivals continued to rise briskly in the first half of 2004. Maldives attracts medium-high and high-end tourists mostly from Europe, accounting for 78.6 percent of the tourists visiting the Maldives, followed by 18.1 percent coming from Asia. The average stay was 8.3 days, and capacity utilization reached 77.2 percent in 2003, substantially higher than the historical average of about 69 percent.

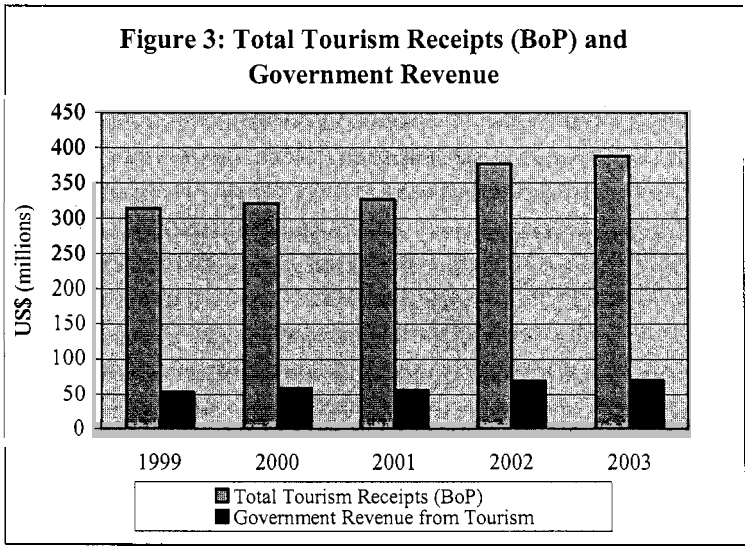


Resort lease rent and the tourism tax are the main sources of government revenues from tourism, and account for about 31 percent of total revenues. Resort lease rents on new islands to be developed are determined through a bidding process, where the lease is awarded to developers based on several criteria, including the bid for lease rent to be paid per bed per year.

The initial bid is for 5 years of lease rents, which are then renegotiated for another 10 years. The lease period is 25 years, unless the investment is over US$10 million and owned by Maldivians, in which case the lease period is extended to 35 years. About 60 percent of resorts are domestically owned, 30 percent are foreign owned, and 10 percent are joint ventures between domestic and foreign owners.

The lease rent on existing resorts previously was renegotiated every 5 years, but this term was extended in 2003 to 10 years, and is determined on the basis of distance from Male, the rates paid by comparable resorts, market conditions, and several other criteria. The GoM should seek to reduce the uncertainty for resort owners associated with this process.

The tourism tax has been levied at the fixed rate of US$6 per tourist bed night since 1988. The Majlis passed an increase in the bed tax to US$8 in April, with effect from November 1, 2004. As shown in Fig 3, total government revenue from tourism rose to about US $70.0 million in 2003, out of total tourism receipts given in the balance of payments of US $387.8 million. Government revenue as a proportion of these receipts has remained roughly constant at around 18 percent.



Growth in the tourism sector helps propel activity in other sectors such as construction and transportation which grew by 20.0 percent and 8.1 percent respectively in 2003. About 24 percent of the total economically active population is engaged in tourism related activities.[2] The sector employs a high number of expatriates, mostly from the region, comprising about 46.6 percent of the total tourism employment.[3] The level of tourist arrivals is also positively correlated with imports and import duties, which accounts for about one fourth of government revenue. All of these features underscore the importance of the tourism sector.

Sustainable Tourism Practices

The GoM has developed appropriate polices, legislation, and enforcement mechanisms to ensure that resort owners adhere to strict environmental standards in the construction and operation of resorts and related facilities. Since 1995, all resorts treat their sewage and dispose of their waste by means of compactors and incinerators. As a result, tourism development has had minimal environmental impact, and environmental conditions are better on resorts than on other inhabited islands. The GoM needs to remain vigilant, however, as resort development, coastal modifications, reclamation, harbor dredging, and the like continue in pristine areas of the country.

Prospects for growth

Growth in the tourism sector hinges on the installed capacity of the resorts, the utilization rates, the range of vacation experiences on offer (such as yacht safaris), the linkages between the tourism sector and the local communities (domestic value added), and the number of tourist arrivals. The current, 10-year, tourism master-plan runs

[2] Labour Force Survey, Ministry of Planning and national Development, Government of Maldives, 2000.
[3] Maldives Statistical Year Book 2004.

through 2005, and calls for capacity increases to about 20,000 beds by the end of 2005. Two resorts with 400-500 beds are to come on stream late in 2004, but these are behind schedule. In 2004, 11 new resort leases were offered on islands in atolls currently without any resorts, and the bidding attracted over 100 interested parties. Successful bidders must develop the resort islands in one and a half years. Three further picnic islands were also made available. Largely due to capacity constraints, however, tourism growth is expected to slow to between 4 and 5 percent in 2004, before accelerating again with new resorts coming on stream. Substantial expansion is feasible over the medium term. A land survey completed in 2003 identified another 324 islands as suitable for resort development. The GoM is in the process of upgrading the airport on Gan island, which was a former British Air Force base. This will enable direct international flights to the south of the Maldives, and open new atolls to tourism development. There is a 100% duty exemption on imports of materials needed to develop resorts.

Key Issues

Vulnerability to external shocks remains a key issue. The threat of terrorism in the outside world, international health scares, and the like, have the potential to sharply reduce the number of tourists visiting the Maldives. The GoM seeks to mitigate this vulnerability by promoting economic diversification, but this is a longer term goal.

Building national capacity is a high priority for the sector, which employs large numbers of expatriates mainly due to a shortage of skills. Efforts are underway to establish training facilities in the areas of resort management, food preparation, tour guiding and other related tourist activities, and will serve as a basis for strengthening national capacity over the medium term.

Diversifying the market orientation and tourism product would help strengthen the sector and mitigate vulnerability. Tourist arrivals are currently dominated by visitors from Europe, but the Asian market has been expanding rapidly and could be pursued more aggressively. The one island – one resort concept has been very successful in the Maldives. Some product diversification would also help sustain tourist arrivals, and might involve promoting cultural tourism by engaging local communities and using local resources, attracting marine research/knowledge tourism, and fostering sport tourism and sporting events.

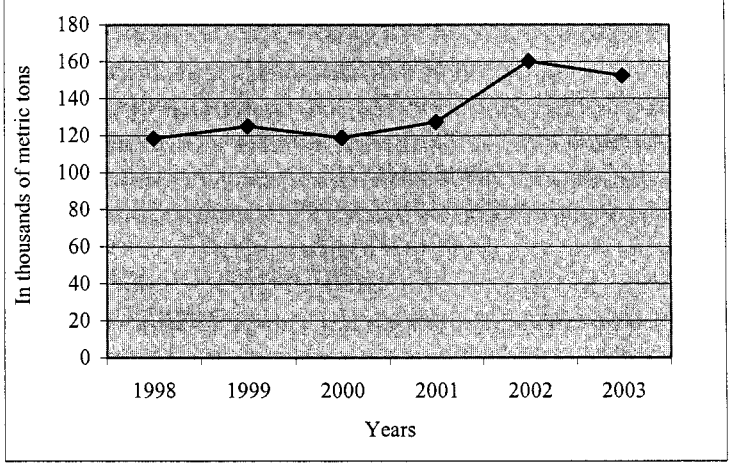
Fisheries

The fisheries sector remains very important in the Maldives, accounting for 6.6 percent of GDP in 2003, the bulk of exports, and most of the economic activity in the outer atolls (Table A.4). The GoM has been liberalizing the sector over the past few years, aiming to boost competitiveness while seeking to protect some of the core social functions of the sector. Exploiting fisheries in an environmentally sustainable fashion is also a key priority for the GoM.

Recent Developments

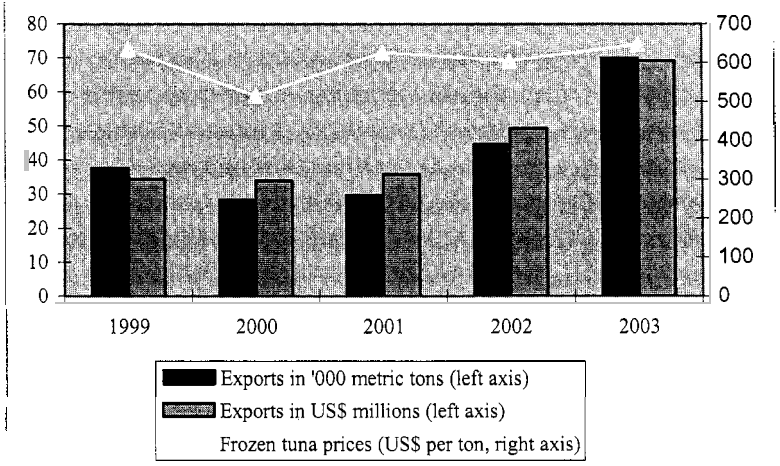
Growth in the fisheries sector decelerated to 0.7 percent in 2003 and appears to have declined further in the first half of 2004, following the rapid 22.9 percent expansion in 2002. The deceleration is largely due to comparison with the very strong performance of the sector in 2002. Fish landings by weight declined by 4.9 percent in 2003 compared with the high catches in 2002, but were still significantly higher than in years past, excluding 2002 (Figure 4). Skipjack and yellow fin tuna are the two dominant species in Maldives and accounted for 84.4 percent of the total fish catch in 2003. The opposite movements of the sector as tracked by the real national income accounts and by landings is explained by the changing composition of the fish caught and processing techniques. The increases in catches over time are mainly due to the continuing mechanization of fishing vessels, which accounted for about 95 percent of the fish landings in 2002, compared to 70 percent in late 1990s.

Figure 4: Total Fish Landings



Total fish exports increased to 69.8 metric tons in 2003 from 44.6 metric tons in 2002 (Figure 5). Total earnings from fish exports increased by 40.4 percent in 2003 over the same period to US$ 69.1 million. The sharp rise in export earnings stems from an increase in the quantity of frozen tuna exported, accounting for 60 percent of total fish exports. Export earnings are highly sensitive to fluctuations of international fish prices, which rose to US$646 per metric ton in 2003, compared with US$605 the previous year. Exports of live reef fish to far eastern destinations started in 2004.

Figure 5: Fishery Exports and Prices



To ensure quality and promote exports, a system of issuing health certificates for every shipment exported was established by the GoM in 2003 and is mandatory.

The labor force survey of 2000, reported that about 11 percent of the labor force was engaged in the fisheries sector, down from 20 percent in 1990s. Migration of the rural population to the urban centers of Male appears to be the main reason. The migration survey of 2003 is expected to provide new information on the level and impact of rural urban migration on the fisheries sector.[4]

Liberalization of the Fisheries Industry

While fishing has always been private, processing for export was previously monopolized by the Maldives Industrial Fishing Company Ltd. (MIFCO). The opening of fish processing and exporting to the private sector has made a significant and positive impact. In addition to the liberalization of exports of dried/salted tuna in 1990 and fresh yellow fin tuna in 1996, two private sector parties were given licenses in 2001 to process and export frozen tuna with exclusive rights in Zone I. These two parties accounted for 15 percent of the frozen tuna exports in 2003. Two more private parties also received licenses in 2003 to process and export frozen tuna with exclusive rights in Zone III. These are positive steps and will help foster competition.

Maldives Industrial Fisheries Company Ltd. (MIFCO)

Encouraged by the recommendations of various studies and reports for privatization, MIFCO was restructured in 2003. MIFCO operates in fishing zones II and IV, and is facing competition from the private sector which will pressure management to

[4] The Migration Survey conducted by the Ministry of Planning and National Development, Dec. 2003

improve performance. Indeed, for the first time in several years, MIFCO is expected to make a nominal dividend transfer to the GoM treasury in 2004.[5]

Sustainable exploitation of the fisheries resources

The fisheries sector is focused on very few varieties of fish, with skipjack tuna being the most heavily exploited. Research indicates potential problems may be emerging in skipjack resources, both in terms of the catch rates and the average size of fish. The Ministry of Fisheries is studying the causes of a decline in grouper fishing reported in 2003. These are signs of over-fishing and growing pressure on stocks. As fishing has a direct impact on marine biodiversity, measures should be adopted to ensure sustainable fishing practices. Determining the maximum sustainable yield and inviting third party certifiers, like the Marine Stewardship Council (MSC), to assess practices and certify the Maldivian fishery would be positive steps.

Prospects for growth

The liberalization of fish processing is likely to spur growth. Participation of the private sector in the export of frozen tuna will bring competition and improve efficiency in fish production. Larger mechanized fishing vessels with the ability to exploit more of the Maldives' Exclusive Economic Zone (EEZ) would help raise fish landings, supplanting foreign vessels currently licensed to exploit the EEZ for relatively low fees. Eco-labeling and other marketing efforts might also boost exports. Several issues need to be addressed in order to stimulate and sustain growth in the fisheries sector:

Key issues

Capacity building is a high priority as the fisheries industry is confronted with inadequate local technical expertise in production technologies, limited facilities for research, and a shortage of skilled and semi-skilled local labor. Increased local capacity in processing is critical to enable the higher value added fish exports. The system of issuing health certificates for every shipment is a positive step in ensuring quality control.

Community based fisheries resources management is also important, given that the outer atolls account for more than 91 percent of total fish landings. Explicit community based fishing rights will help to maintain fish landings at a sustainable level and help avoid over-fishing. An active collaboration between rural fisherman, the private sector and the Government will be instrumental in this context.

[5] Budget estimates, Ministry of Finance and Treasury, Government of Maldives, Jan 2004.

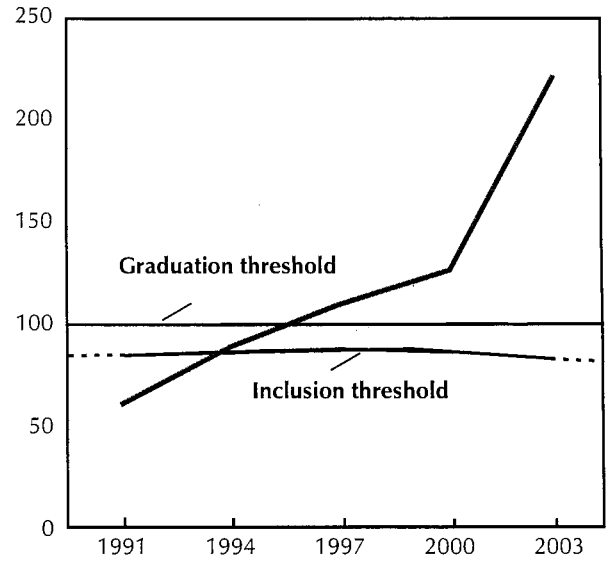
Annex 3

LDC Status and Graduation

Graduation from Least Developed Country (LDC) status has been a recurring issue for the Maldives. Noting strong economic performance in the Maldives over the 1990s, the Committee for Development Policy (CDP) of the United Nations recommended that the island nation be graduated from LDC status at a triennial review in 2000, but the United Nations Economic and Social Council (ECOSOC) was persuaded to delay graduation pending further study on the implications of such a step. At the CDP meeting held in April 2004, the CDP observed that technically, the Maldives meets the criteria for graduation, and the Economic and Social Council of the UN (ECOSOC) has endorsed a resolution that Maldives graduate from LDC status. The UN General Assembly will consider the resolution soon, and absent major protest from either the government of Maldives or Cape Verde (the other country recommended for graduation), it is likely to accept the resolution. It should be noted, however, that at the same meeting of ECOSOC, a new mechanism seeking to ensure a smooth transition from LDC status was agreed, and even if the UN General Assembly resolves that the Maldives graduate from LDC status, it would not take effect until 2007. In the interim, the full implications of such a move would be studied. Some of the effects of graduation are relatively clear, including losing tariff free (otherwise 24.3 percent), quota free access to the European Union's tuna market, while other effects need more study. The GoM opposes graduation, citing continuing vulnerability and the need to implement transition measures. The review of the list of LDCs in 2003 was based on 3 criteria:

(1) **Gross national income per capita** (GNI), with a threshold for graduation of a three-year average of US$900. The latest three-year average GNI per capita for the Maldives was US$2,221, exceeding the threshold by a large margin (see Figure 6).[6]

Figure 6 - Maldives: Low-Income Criterion
(index of per capita GDP until 2000, per capita GNI in 2003)

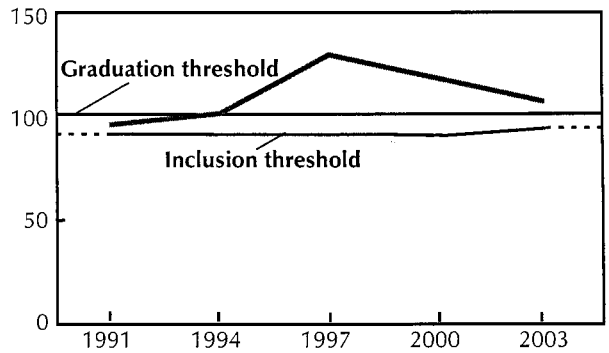


(Source: UNCTAD)

[6] To make inter-temporal comparisons possible regarding the country's distance to the graduation threshold under any of the three criteria, all performance data have been standardized in the form of an index under which the graduation threshold equals 100. If the country's score exceeds 100, the country has passed the graduation threshold, which means that this particular graduation criterion has been met. Each graph, at the same time, shows a line representing the inclusion threshold. The distance between the graduation threshold line and the inclusion threshold line depicts the margin between the thresholds.

(2) **Human Assets Index** (HAI), reflecting (a) nutrition, measured by the average calorie intake per capita as a percentage of the minimum requirement; (b) health, measured by the under-five child mortality rate; and (c) education, measured by: (i) the adult literacy rate and (ii) the gross secondary school enrolment ratio. The threshold index value for graduation was 61 in 2003. The latest value for Maldives was 65.2, again exceeding the threshold value (see Figure 7).

Figure 7: Maldives: Human Capital Weakness Criterion
(APQLI until 2000, HAI in 2003)

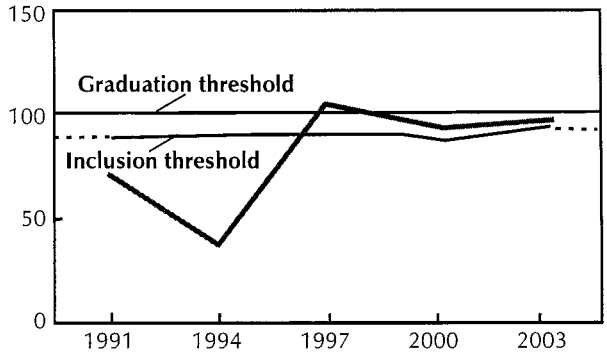


(Source: UNCTAD)

(3) **Economic Vulnerability Index** (EVI), consisting of an average of five indicators: (a) an index of merchandise export concentration; (b) an index of instability of export earnings (goods and services); (c) an index of instability of agricultural production; (d) share of manufacturing and modern services in GDP; and (e) population size. The notion of economic vulnerability became a central element of deliberations on LDC status in 1997, and the index was introduced into the methodology for determining LDC status in 2000. In 2003, the threshold for graduation was an index score of 33, or 34 with the inclusion of the percentage of the population displaced by natural disasters. The latest EVI for the Maldives was 33.6, just below the threshold (see Figure 8). According to the index, the biggest contributor to Maldives' vulnerability is its small population size (see Figure 9).[7] The "export instability component" contributes the least to the EVI, and is dominated by tourism receipts which have been growing continuously for two decades.

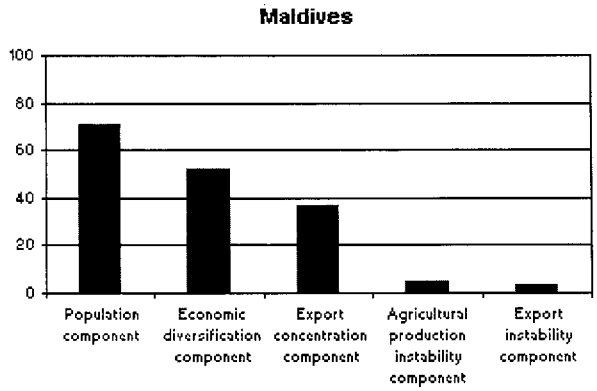
[7] The Figure depicts the relative importance of each of the five individual components of the composite EVI. The data are index figures between 0 and 100 (a larger number indicates more vulnerability), representing the relative importance of the five components that make up the EVI score, which is a composite index based on an average of the five individual indices.

Figure 8: Maldives: Economic Vulnerability Criterion
(Economic Diversification Index before 2000,
Economic Vulnerability Index from 2000)



(Source: UNCTAD)

Figure 9: Determinants of Scores Under the Economic Vulnerability Index



(Source: UNCTAD)

Technically, if a country meets the threshold levels on at least 2 out of the 3 criteria during at least 2 consecutive reviews, it qualifies for graduation. In the case of the Maldives, its per capita GNI is more than double the threshold level and the HAI is slightly above. The EVI is close to the threshold level, but still shows a degree of economic vulnerability.

The criteria for inclusion/exclusion from the list are not symmetrical. In order to be added to the list of LDC countries, a country must meet *all three* criteria (and have a population of less than 75 million); symmetry would then suggest that a country graduate when it improves above any *one* of the criteria. Instead, a country is eligible for graduation when it meets at least two of the three criteria.

It is worth noting that no countries that are eligible for LDC status have been included on the list when the move was opposed by the country's government, and no country has graduated from the list against the wishes of the country's government. The

only country that graduated since the UN's General Assembly approved the original list in 1971 is Botswana (1994).

A decision on the question of Maldives graduation will in principle be taken by the UN General Assembly in the second half of 2004.

Annex 4

Increasing the supply of land - Hulhumale

Hulhumale is the largest and most complex land reclamation project undertaken by the government, with the objective of easing the overcrowding and congestion in the Male region while enabling an agglomeration of people and activity to benefit from scale economies and a lower marginal cost of service provision. The project was started in 1997 in an area about 1.3 kilometers away from Male, and is to reclaim about 740 hectares in 3 phases. The island is being developed for housing, industry and commercial activity, and will eventually accommodate about 150,000 people. It promises opportunities for better homes, education, health, employment and the provision of basic services. The scope of the Hulhumale project is presented in Box 5.

Box 5: Scope of the Hulhumale Land Reclamation Project

Phase I involved the reclamation of 188 hectares dedicated to housing, social infrastructure, and commercial and industrial activities to generate employment. About 53,000 people, or 8,925 households are to be accommodated in this area.

Phase II is to see a further reclamation of 240 hectares, accommodating a population of 100,000.

Phase III focuses on reclaiming a land area of 305 hectares dedicated to the extension and further development of the airport.

The total cost of the project is estimated to exceed $350 Million

Source: Hulhumale Physical Development Master Plan, September 2001

Significant progress has been made to date. Phase I of the project began in 1997 with the dredging of an existing one meter deep lagoon to create a harbor about 30 meters deep and 188.8 hectares of reclaimed land two meters above the sea level. This is an area about the size of Male, but in an effort to mitigate vulnerability to rising sea levels, it was built higher than Male, which is only about 1 meter above sea-level. The land reclamation for the first phase was completed in 2002 at a total cost of US$32 million. A loan from the Thai Eximbank of US$30 million financed the construction of 280 standard apartment units, a primary and secondary integrated school, public buildings for government and other social services, a 50 bed hospital, 48 commercial units in 4 commercial buildings, and a road network for the first settlements. By the end of 2003, the first 220 plots of land and 280 apartments were offered for sale/lease/rent which attracted over 5,000 applications. With the apartments selling for between US$25,000 and US$35,000 depending on the number of bedrooms, and the land plots selling for between US$30,000 and US$100,000, the GoM expects to recoup a significant portion of its investment in Hulhumale. Although the prices of the apartments and of the land per square foot are fixed, the total amount likely to be raised from the impending sales is uncertain because many units will be rented or leased.

Based on the guidelines approved by the GoM, the Maldives Housing and Urban Development Board published the list of 222 recipients of flats and plots.[8] Allotments in Hulhumale were made based on a points system depending on 4 criteria: (a) years of residency in Male, (b) age, (c) number of children, and (d) number of parents being cared for in the home. The Housing Board indicated that 116 people were qualified for the plots that would be sold at auction, and 1,294 people qualified for the 109 plots available from the beach area. Finally, 1,932 people were qualified for the 26 plots that will be released from inland areas. Permanent residents moved into developed properties in the first half of 2004.

The Land Act enacted in May 2003 enables the private ownership of apartments, and private land in Hulhummale can be resold without the waiting period of five years normally required to obtain a court certificate. The Land Act was amended in May 2004 to help spur housing finance.

[8] Guidelines for the selection and allocation of flats and plots from the Hulhumale project was approved by the cabinet on 4th December 2003 based on the proposal submitted by the Housing and Urban Development Board

Annex 5

Integrated Human Development (IHD) Project

The development objective of the US$15.6 million IHD project (which was approved in July 2004 and is to be launched in January 2005) is to improve social service provision and economic opportunities in four selected ecologically viable focus islands: Eydhafushi in Baa Atoll, Naifaru in Lhaviyani Atoll, Kudahuvadhoo in Dhalu Atoll and Gan in Lamu Atoll. Helping to provide an alternative to Male and the capital region on these islands, the project seeks to:

(a) Foster education by providing distance learning for teachers, training IT trainers, upgrading other skills, and constructing residential learning centers in focus islands for students from other islands.

(b) Improve the quality of health services by providing better training, a partial transport cost subsidy for attending regular health services, nutritional promotion to reduce the prevalence of micro-nutrient deficiencies, distance learning for health and related staff, IT training, and tele-medicine.

(c) Promote employment generation and income earning opportunities for youth and the poor on the focus islands through the creation of a job information center and providing other related services.

(d) Encourage and train NGOs, CBOs and co-operatives to provide seed capital or small loans enabling its members to start small businesses, and help the GoM create a business support network with information on marketing and technical advice for improved product quality.

(e) Lower the costs of duplicate infrastructure on different islands and promote the more effective use of existing public facilities.

(f) Supporting Island Development Committees in planning, coordinating and managing service provision and public assets, financing multi-purpose buildings where necessary and capacity building support for island co-operatives to manage electricity and water services.

(g) Provide local internet services.

Annex 6.

Box 6: Recommendations of the Public Expenditure Review (2002)

1.Broadening the tax revenue base and improving the pattern of deficit financing for fiscal sustainability and macroeconomic stability

- Strengthen the Department of Inland Revenue
- Convert the fixed tourism tax to an ad valorem rate
- Complete the drafting and enactment of the Finance Bill, enabling the GoM to issue long-term bonds for domestic borrowing and treasury bills for cash management. Until then, introducing a ceiling on borrowing from the Ways and Means Account with the MMA and paying market interest rates on any such borrowing

2. Strengthening public expenditure management

- Develop a medium-term fiscal framework (MTFF).
- Complete the review of the Audit Bill and establish a "Public Accounts Committee."
- Address critical areas of institutional capacity building in public expenditure management

3. Improving education expenditures

- Raise the quality of elementary education in the atolls and reconsider the time frame for universalizing lower secondary education (the current target of 2005 appears short).
- Implement the repayment system under the ongoing overseas tertiary education scholarship program, and extend the latter to scholarships funded by bilateral grants. Reduce gradually the subsidy element in financial support provided for overseas training.
- Develop and implement the planned Educational Monitoring and Information System (EMIS).

4. Targeting health sector spending

- Strengthen the financial commitment to nutrition programs, reproductive health programs, and targeted water and sanitation programs.
- Build capacity in the Ministry of Health for expenditure identification, review, and prioritization.
- Develop a national health accounts and monitoring system and increase the capacity to collect information on private sector spending on health.

5. Reforming infrastructure expenditures

- Strengthen the legal/regulatory framework for defining and protecting property rights in land-use, housing/rental markets, mortgage, and debt recovery.
- Define clearly the role of the GoM in the Hulhumalé land development project, with a particular focus on the critical issues of financing, impact on the budget, use of the reclaimed land, and property rights, limiting the GoM's financial involvement and exposure to the Hulhumalé project.
- Discontinue the Treasury's involvement in electrification lending, transferring this function to the Bank of Maldives, and eliminating sovereign guarantees on such private loans.

Statistical Appendix

Table A.1: Key Economic Indicators

	1996	1997	1998	1999	2000	2001	2002	2003 Prov. Est.
				(Annual percentage change)				
Growth and prices								
Real GDP	9.1	10.4	9.8	7.2	4.8	3.5	6.5	8.5
Consumer prices	6.2	7.6	-1.4	3.0	-1.2	0.7	0.9	-2.9
				(Percent of GDP)				
Central government								
Revenue and grants	28.9	31.0	30.4	32.1	32.3	33.0	33.1	33.4
Of which: Grants	4.5	2.9	2.6	2.3	2.3	2.8	1.6	1.3
Expenditure and net lending	31.4	32.3	32.3	36.1	36.7	37.7	38.0	37.4
Of which: Capital spending	13.6	12.8	12.8	13.7	11.8	12.3	12.5	12.6
Overall balance	-2.5	-1.4	-1.9	-4.1	-4.4	-4.7	-4.9	-4.0
Overall balance, excl. grants	-7.0	-4.2	-4.5	-6.4	-6.6	-7.5	-6.5	-5.3
Financing								
Domestic	-0.5	-1.5	-0.1	3.2	4.3	2.8	0.4	-1.1
Foreign	3.0	2.9	2.0	0.8	0.0	1.9	4.5	5.1
				(Twelve-month percentage change at year-end)				
Money and credit								
Domestic credit	-2.4	8.8	18.6	8.0	14.5	19.4	11.5	-5.8
Public sector	-10.2	-15.1	9.2	14.1	23.3	7.0	6.5	-25.5
Central government, net	-10.6	-11.4	1.4	12.9	30.9	8.4	5.1	-19.6
Private sector	9.5	38.9	25.7	4.0	8.0	29.9	15.0	6.8
Broad money	26.0	23.1	22.8	3.6	4.1	9.0	19.3	14.6
				(In millions of U.S. dollars)				
Balance of payments								
Current account	-7.4	-34.7	-21.9	-78.9	-51.5	-58.7	-35.7	-31.8
(In percent of GDP)	-1.6	-6.8	-4.0	-13.4	-8.2	-9.4	-5.6	-4.5
Trade balance	-185.6	-217.3	-215.9	-262.4	-233.3	-236.0	-212.4	-262.3
Exports (1)	79.9	89.7	95.6	91.5	108.7	110.2	132.3	152.0
Imports	-265.5	-307.0	-311.5	-353.9	-342.0	-346.3	-344.7	-414.3
Non-factor services, net	201.1	218.0	232.4	234.6	238.8	244.2	251.7	311.1
Official capital (net)	17.3	6.6	14.6	5.2	-1.9	7.8	26.8	33.8
Private capital (net) (2)	41.0	42.9	42.9	42.9	25.6	24.3	33.9	56.8
Errors and omissions (net)	-7.1	12.6	-6.6	23.6	19.9	5.2	14.9	15.5
Overall balance	43.7	27.4	29.1	-7.2	-7.9	-21.4	39.8	74.3
Gross official reserves (year-end)	77.6	99.7	119.9	128.5	124.1	94.3	134.5	161.0
(In months of the following year's imports of goods and non-factor services (NFS))	2.6	3.0	3.5	3.4	3.3	2.5	3.1	3.4
(In percent of short-term ext. debt)	572.9	781.5	745.7	308.4	252.1	209.3	252.5	419.7
External debt (year-end)	177.2	178.1	200.8	212.9	211.6	209.8	259.0	280.9
(In percent of GDP)	38.5	35.6	37.2	36.1	33.9	33.6	40.4	39.3
Debt service	11.8	27.9	16.3	19.0	22.1	22.0	23.3	22.9
(In percent of exports of goods and NFS)	3.2	6.9	3.8	4.4	4.8	4.8	4.6	4.0
Exchange rates								
Rufiyaa per US$	11.77	11.77	11.77	11.77	11.77	12.24	12.80	12.80
NEER (percent change)	2.8	8.4	5.4	0.5	6.7	0.8	-6.4	-9.4
REER (percent change)	6.5	14.0	2.3	2.6	3.4	-0.6	-6.6	-14.5
Memorandum items:								
Nominal GDP (millions of rufiyaa)	5,301.0	5,981.8	6,356.9	6,935.4	7,348.4	7,650.8	8,201.0	9,156.7
Nominal GDP (millions of U.S. dollars)	450.4	508.2	540.1	589.2	624.3	625.1	640.7	715.4
GDP Per Capita (in U.S. dollars)	1800	1989	2071	2214	2300	2265	2284	2509

Source: Ministry of Finance and Treasury, Ministry of Planning and National Development, Maldives Monetary Authority, and IMF.

(1) Includes re-exports.

(2) Estimated private capital inflows of US$ 128.7 million to the tourist sector have been spread evenly over 1997-99.

Table A.2: Gross Domestic Product by Sectoral Origin

	1998	1999	2000	2001	2002	2003
			(In millions of rufiyaa at constant 1995 prices)			
Gross Domestic Product	5648.2	6056.6	6345.5	6564.4	6992.8	7585.8
Primary	578.8	599.2	595.2	625.5	724.8	740.0
Agriculture	165.5	168.8	174.7	181.4	188.6	196.3
Fisheries	373.8	388.1	381.2	402.4	494.7	498.0
Coral and sand mining	39.5	42.2	39.3	41.7	41.5	45.7
Secondary	801.2	900.5	914.9	989.0	1091.7	1177.7
Manufacturing	435.4	483.3	505.1	532.4	615.0	629.8
Electricity and water supply	156.4	178.5	203.9	226.3	247.6	273.0
Construction	209.4	238.7	205.8	230.3	229.0	274.9
Tertiary	4493.5	4798.7	5084.6	5205.4	5448.8	5968.9
Wholesale and retail trade	270.4	278.9	287.8	288.9	295.6	308.3
Tourism (Resorts, etc)	1854.2	1982.3	2094.0	2093.5	2162.4	2482.5
Transport and communications	825.4	854.2	919.1	934.2	998.0	1078.8
Financial services	194.3	208.6	215.1	220.4	235.1	259.4
Real Estate	460.6	483.9	496.7	507.4	530.7	566.9
Business services	166.1	178.3	183.9	188.4	201.0	221.9
Government Administration	590.5	677.8	750.7	833.0	883.9	906.8
Education, health and social services	131.9	134.6	137.2	139.6	141.9	144.2
			(Annual percentage change)			
Gross Domestic Product	9.8	7.2	4.8	3.5	6.5	8.5
Primary	7.0	3.5	-0.7	5.1	15.9	2.1
Secondary	17.2	12.3	1.6	8.1	10.4	7.9
Tertiary	8.9	6.8	6.0	2.4	4.7	9.5
			(Percent of GDP)			
Primary Sector	10.2	9.9	9.4	9.5	10.4	9.8
Secondary Sector	14.2	14.9	14.4	15.1	15.6	15.5
Tertiary Sector	79.6	79.2	80.1	79.3	77.9	78.7
Memorandum items:						
Nominal GDP (millions of rufiyaa)	6356.9	6935.4	7348.4	7650.8	8201.0	9156.7
Nominal GDP (millions of US$)	540.1	589.2	624.3	625.1	640.7	715.4
GDP per capita (US$)	2071.0	2214.0	2300.0	2265.0	2284.0	2509.0
GDP deflator (percent change)	2.0	-4.0	3.0	3.0	...	...
CPI (percent change)	-1.4	3.0	-1.2	0.7	0.9	-2.9

Source: Ministry of Planning and National Development, and IMF.

Table A.3: Key Tourism Indicators

	1998	1999	2000	2001	2002	2003
Total arrivals	419779	456048	496117	492044	513852	594082
of which :Tourists	395725	429666	467154	460984	484680	563593
Growth in tourist arrivals (in percent)	8.3	8.6	8.7	-1.3	5.1	16.3
Total tourist nights (000's)	3467	3718	3937	3933	4066	4705
Average stay (days)	8.8	8.7	8.4	8.6	8.4	8.3
Total tourism receipts (US$ millions)	303.0	313.5	320.7	327.1	337.1	401.6
Gov. revenue from tourism (US$ millions)	45.0	53.6	58.9	55.9	69.0	70.2
Average tourist expenditure per night (US$)	87	84	81	83	83	82
Bed-night capacty ('000)	4546	5348	5788	6015	5887	6092
Capacity utlization (in percent)	76.2	69.7	68.2	65.6	69.0	77.2
Number of Resorts	79	84	86	87	87	87
Registered Bed Capacity	16096	17531	18730	18765	18827	19110
Resorts	13808	15044	15914	16318	16400	16444
Hotels	418	466	744	688	670	670
Guest houses	293	321	356	367	282	360
Safari vessels	1577	1700	1716	1392	1475	1636
Tourism Contribution to GDP (in percent)	32.8	32.7	33.0	31.9	30.9	32.7

Source: Ministry of Tourism.

Table A.4: Key Fisheries Indicators

	1998	1999	2000	2001	2002	2003
Total Catch ('000 metric tonnes)	118.3	125.0	118.9	127.2	163.4	155.4
Local Consumption	41.5	50.0	56.5	57.4	76.5	37.6
Exports	70.8	63.0	57.3	64.8	79.3	112
Stock (of current year)	6.0	12.0	5.1	2.7	4.5	5.8
Growth in Fish Catch (in percent)	10.1	5.7	-4.9	7.0	28.5	-4.9
Composition of Fish Catch: (in metric tonnes)						
Skipjack	78,409	92,888	79,683	88,044	115,322	108,329
Yellowfin	17,164	15,079	15,706	15,246	24,525	22,914
Other Tuna Related Species	8,312	5,520	6,339	6,778	7,219	7,508
Other Marine Fish	14,230	10,622	17,236	17,115	16,322	16,664
Total Export Earnings (US$ millions)	56.5	34.4	34.0	35.8	49.2	69.1
Growth in Export Earnings (in percent)	-10.8	-39.1	-1.2	5.3	37.4	40.4
Average No. of Vessels Engaged in Fishing						
Mechanized Masdhoni	1,271	1,206	1,137	1,128	1,102	1,104
Sail Masdhoni	30	52	41	66	90	117
Mechanized Vadhu	61	70	58	49	59	49
Sailing Vadhu	125	68	72	40	9	8
Trolling Vessels			19			
Rowing Boats	24	15	49	13	16	18
Total Number of Dhonis						
Mechanized	1,647	1,647	1,647	1,647	1,647	
Bond Completed	1,484	1,526	1,544	1,582	1,593	
Fisheries Contribution to GDP (in percent)	6.6	6.4	6.0	6.1	7.1	6.6

Source: Ministry of Planning and National Development, and IMF.

Table A.5: Balance of Payments

	1998	1999	2000	2001	2002	2003
						Rev. Est.
			(In millions of U.S. dollars)			
Current account balance	-21.9	-78.9	-51.5	-58.7	-35.7	-31.8
Trade Balance	-215.9	-262.4	-233.3	-236.0	-212.4	-262.3
Exports, f.o.b.	95.6	91.5	108.7	110.2	132.3	152.0
Domestic exports	74.3	63.7	75.9	76.2	90.4	112.5
Re-exports	21.3	27.8	32.8	34.0	41.9	39.5
Imports, f.o.b.	-311.5	-353.9	-342.0	-346.3	-344.7	-414.3
Services (net)	204.3	203.6	208.8	207.0	216.3	272.7
Balance on nonfactor services	232.4	234.6	238.8	244.2	251.7	311.1
Receipts	331.3	342.8	348.5	354.1	362.9	432.1
Of which tourism receipts	303.0	313.5	320.7	327.1	337.1	401.6
Payments	-98.9	-108.1	-109.7	-109.8	-111.1	-121.0
Balance on factor services	-28.2	-31.0	-30.0	-37.2	-35.4	-38.4
Receipts	8.6	9.0	10.3	8.2	5.6	6.2
Payments	-36.8	-40.1	-40.3	-45.4	-41.1	-44.6
Unrequited transfers (net)	-10.3	-20.1	-27.0	-29.7	-39.6	-42.3
Official	20.3	20.4	19.3	19.9	10.6	12.7
Private	-30.6	-40.5	-46.2	-49.6	-50.2	-54.9
Non-monetary capital (net)	50.9	71.7	43.5	37.3	75.5	106.1
Official medium-and long-term	14.6	5.2	-1.9	7.8	26.8	33.8
Disbursements	25.7	17.6	12.4	23.4	43.5	51.1
Amortization	-11.1	-12.5	-14.3	-15.6	-16.7	-17.4
Private capital incl.	42.9	42.9	25.6	24.3	33.9	56.8
Net errors/omissions.	-6.6	23.6	19.9	5.2	14.9	15.5
Overall balance	29.1	-7.2	-7.9	-21.4	39.8	74.3
Monetary movements	-29.1	7.2	7.9	21.4	-39.8	-74.3
Maldives Monetary Authority	-20.2	-8.6	4.4	29.7	-40.2	-26.5
Commercial Banks	-8.8	15.8	3.5	-8.3	0.4	-47.8
Memorandum items:						
Domestic export growth (value, in percent)	6.3	-14.3	19.1	0.4	18.6	24.5
Import growth (value, in percent)	1.5	13.6	-3.4	1.3	-0.4	20.2
Tourism receipts growth (in percent)	5.9	3.5	2.3	2.0	3.0	19.1
Current account balance (in percent of GDP)	-4.0	-13.4	-8.2	-9.4	-5.6	-4.5
Gross official reserves (millions of US$)	119.9	128.5	124.1	94.3	134.5	161.0
In months of the goods imports	4.1	3.8	3.8	2.9	4.1	4.1
External Debt (millions of US$)	200.8	212.9	211.6	209.8	259.0	280.9
External Debt (percent of GDP)	37.2	36.1	33.9	33.6	40.4	40.4
Debt service (millions of US$)	16.3	19.0	22.1	22.0	23.3	22.9
Debt service (% exports, goods and NFS)	3.8	4.4	4.8	4.8	4.6	4.0
Exchange rate (Rufiyaa/US$)	11.77	11.77	11.77	12.24	12.80	12.80
GDP (millions of US$)	540.1	589.2	624.3	625.1	640.7	715.4

Source: Maldives Monetary Authority and IMF.

Table A.6: External Debt and Debt Service

	1998	1999	2000	2001	2002	2003 Rev. Est.
			(In millions of U.S. dollars)			
Total external debt outstanding & disbursed	200.8	212.9	211.6	209.8	259.0	280.9
Medium- and long-term (DOD)	184.7	185.6	178.0	181.5	223.1	264.2
Official creditors	144.0	143.6	139.4	141.3	164.7	184.3
Multilateral	114.2	116.5	114.9	118.6	140.4	157.7
Bilateral	29.8	27.1	24.5	22.7	24.3	26.5
Private creditors	40.7	42.0	38.6	40.2	58.4	80.0
Suppliers	27.5	25.3	23.5	25.2	48.7	72.3
Financial markets	13.2	16.7	15.1	15.0	9.7	7.6
Short-term debt	16.1	27.3	33.6	28.3	35.9	16.6
Maldives Monetary Authority	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	16.1	27.3	33.6	28.3	35.9	16.6
Debt service	16.3	19.0	22.1	22.0	23.3	22.9
Amortization	11.1	12.5	14.4	15.6	16.7	17.4
Interest payments	5.2	6.5	7.7	6.5	6.1	5.3
			(Percent of GDP)			
Total external debt, % of GDP	37.2	36.1	33.9	33.6	40.4	39.3
Medium- and long-term debt/GDP	34.2	31.5	28.5	29.0	34.8	38.0
Short-term debt/GDP	3.0	4.6	5.4	4.5	5.6	2.4
Debt service ratio (In percent of exports of goods and NFS)	3.8	4.4	4.8	4.8	4.6	4.0
Memorandum items:						
Nominal GDP (millions of U S. dollars)	540.1	589.2	624.3	625.1	640.7	715.4
Exchange rate (rufiyaa per U.S $)	11.8	11.8	11.8	12.2	12.8	12.8
Exports of goods & nonfactor services	426.9	434.3	457.2	464.3	495.2	584.1

Source: Maldives Monetary Authority and IMF.

Table A.7: Summary of Central Government Finance

Years	1998	1999	2000	2001	2002	2003	2004
						Prov. Est.	*Bud. Est.*
			(In millions of rufiyaa)				
Total revenue and grants	1930.2	2225.3	2372.7	2522.6	2714.9	3061.8	3259.9
Total revenue	1765.7	2062.6	2206.8	2310.9	2582.4	2939.4	3185.2
Current revenue	1763.6	2058.6	2202.6	2294.3	2577.9	2912.2	3168.6
Capital revenue	2.1	4.0	4.2	16.6	4.5	27.2	16.6
Grants	164.5	162.7	165.9	211.7	132.5	122.4	74.7
Expenditure and net lending	2053.3	2506.4	2694.2	2885.9	3117.3	3428.4	3688.7
Total expenditure	2113.9	2494.9	2739.9	2912.1	3135.5	3529.2	3785.9
Current expenditure	1297.9	1545.5	1875.9	1971.4	2109.4	2375.1	2694.7
Capital expenditure	816.0	949.4	864.0	940.7	1026.1	1154.1	1091.2
Net lending	-60.6	11.5	-45.7	-26.2	-18.2	-100.8	-97.2
Current balance	465.7	513.1	326.7	322.9	468.5	537.1	473.9
Primary balance	-41.5	-182.4	-215.1	-246.8	-265.9	-231.8	-282.0
Overall balance excluding grants	-287.6	-443.8	-487.4	-575.0	-534.9	-489.0	-503.5
Overall balance	-123.1	-281.1	-321.5	-363.3	-402.4	-366.6	-428.8
Financing	123.1	281.1	321.5	363.3	402.4	366.6	428.8
Foreign financing	129.3	56.7	3.6	145.8	372.4	470.9	399.2
Domestic financing	-6.2	224.4	317.9	217.5	30.0	-104.3	29.6
Total public debt (end of period)	2605.5	2782.9	3002.9	3326.4	3856.9	4139.3	4534.9
Of which foreign	1625.2	1681.9	1685.5	1831.3	2203.7	2674.6	3073.8
			(Percent of GDP)				
Total revenue and grants	30.4	32.1	32.3	33.0	33.1	33.4	34.2
Total revenue	27.8	29.7	30.0	30.2	31.5	32.1	33.4
Current revenue	27.7	29.7	30.0	30.0	31.4	31.8	33.3
Capital revenue	0.0	0.1	0.1	0.2	0.1	0.3	0.2
Grants	2.6	2.3	2.3	2.8	1.6	1.3	0.8
Expenditure and net lending	32.3	36.1	36.7	37.7	38.0	37.4	38.7
Total expenditure	33.3	36.0	37.3	38.1	38.2	38.5	39.7
Current expenditure	20.4	22.3	25.5	25.8	25.7	25.9	28.3
Capital expenditure	12.8	13.7	11.8	12.3	12.5	12.6	11.5
Net lending	-1.0	0.2	-0.6	-0.3	-0.2	-1.1	-1.0
Current balance	7.3	7.4	4.4	4.2	5.7	5.9	5.0
Primary balance	-0.7	-2.6	-2.9	-3.2	-3.2	-2.5	-3.0
Overall balance excluding grants	-4.5	-6.4	-6.6	-7.5	-6.5	-5.3	-5.3
Overall balance	-1.9	-4.1	-4.4	-4.7	-4.9	-4.0	-4.5
Financing	1.9	4.1	4.4	4.7	4.9	4.0	4.5
Foreign financing	2.0	0.8	0.0	1.9	4.5	5.1	4.2
Domestic financing	-0.1	3.2	4.3	2.8	0.4	-1.1	0.3
Total public debt (end of period)	41.0	40.1	40.9	43.5	47.0	45.2	47.6
Of which foreign	25.6	24.3	22.9	23.9	26.9	29.2	32.3
Memorandum item:							
Nominal GDP (millions of rufiyaa) (1)	6,356.9	6,935.4	7,348.4	7,650.8	8,201.0	9,156.7	9,529.6

Source: Ministry of Finance and Treasury, and IMF.

(1) GDP for 2004 is based on a 5% growth forecast.

Table A.8: Government Revenue and Grants

Years	2001	2002	2003	2004	2001	2002	2003	2004
			Prov. Est.	*Budget*			*Prov. Est.*	*Budget*
		(In millions of Rufiyaa)				*(Percent of GDP)*		
Total Revenue and grants	2522.6	2714.9	3016.8	3259.9	33.0	33.1	32.9	34.2
Total Revenue	2310.9	2582.4	2939.4	3185.2	30.2	31.5	32.1	33.4
Current Revenue	2294.3	2577.9	2912.2	3168.6	30.0	31.4	31.8	33.3
Tax revenue	1046.6	1091.7	1233.3	1365.7	13.7	13.3	13.5	14.3
Import Duty	661.7	692.1	783.8	822.3	8.6	8.4	8.6	8.6
Tourism Tax	292.7	305.2	356.9	430.4	3.8	3.7	3.9	4.5
Bank Profit Tax	52.4	50.9	46.2	55.1	0.7	0.6	0.5	0.6
Others (1)	39.8	43.5	46.4	57.9	0.5	0.5	0.5	0.6
Nontax Revenue	1247.7	1486.2	1678.9	1802.9	16.3	18.1	18.3	18.9
Enterpreneurial & Property income	942.6	1180.9	1317.6	1421.4	12.3	14.4	14.4	14.9
Net Sales to Public Enterprises	383.7	422.6	572.0	552.7	5.0	5.2	6.2	5.8
STO	65.0	109.2	122.7	100.8	0.8	1.3	1.3	1.1
State Electric Company	25.0	15.0	15.0	20.0	0.3	0.2	0.2	0.2
Dhivehi Rajjeege Gulhun Ptd.	96.8	106.2	185.9	161.9	1.3	1.3	2.0	1.7
Maldives Posts Limited	8.4	6.9	8.4	8.5	0.1	0.1	0.1	0.1
Maldives Monetary Authority	64.8	39.2	31.2	49.0	0.8	0.5	0.3	0.5
Island Aviation Services Ltd.	3.0	4.5	10.0	15.7	0.0	0.1	0.1	0.2
Building Cons. and Mech. Workshop	0.3	0.3	0.3	0.5	0.0	0.0	0.0	0.0
Maldives Transport & Contracting Co.	2.9	3.3	3.3	3.5	0.0	0.0	0.0	0.0
Maldives Ports Authority	15.0	15.9	15.0	20.0	0.2	0.2	0.2	0.2
Bank of Maldives	5.3	5.3	5.3	5.3	0.1	0.1	0.1	0.1
Maldives Airports Authority	64.2	72.5	125.5	123.1	0.8	0.9	1.4	1.3
Printing section	3.6	4.6	...	...	0.0	0.1 ...	...	
Government Hotels	2.8	1.5	1.4	2.2	0.0	0.0	0.0	0.0
Maldives Inflight Catering Services	7.8	14.3	16.3	16.3	0.1	0.2	0.2	0.2
Maldives Water & Swerage Company	18.8	23.9	31.7	25.0	0.2	0.3	0.3	0.3
Royalities, land & resort rent	479.8	665.8	645.4	776.7	6.3	8.1	7.0	8.2
Resort lease rent	423.2	577.9	539.3	614.5	5.5	7.0	5.9	6.4
Land rent	9.9	23.1	30.1	67.3	0.1	0.3	0.3	0.7
Royalities	46.7	64.8	76.0	94.9	0.6	0.8	0.8	1.0
Interest	79.1	92.5	100.2	92.0	1.0	1.1	1.1	1.0
Aministrative fees and charges	224.6	224.7	263.5	304.4	2.9	2.7	2.9	3.2
Permit fee	48.1	48.2	59.3	68.4	0.6	0.6	0.6	0.7
Administrative fee	68.5	72.0	78.7	95.5	0.9	0.9	0.9	1.0
Building Rent	18.7	20.6	23.9	26.0	0.2	0.3	0.3	0.3
Non-industrial sales	89.3	83.9	101.6	114.5	1.2	1.0	1.1	1.2
Fines & Forfeits	20.4	24.6	18.0	14.4	0.3	0.3	0.2	0.2
Others	60.1	56.0	79.8	62.7	0.8	0.7	0.9	0.7
Capital Revenue	16.6	4.5	27.2	16.6	0.2	0.1	0.3	0.2
Grants (2)	211.7	132.5	122.4	74.7	2.8	1.6	1.3	0.8
Cash grant	44.1	60.1	47.8	50.0	0.6	0.7	0.5	0.5
Project grant	167.6	72.4	74.6	24.7	2.2	0.9	0.8	0.3
Memorandum item:								
Nominal GDP (millions of rufiyaa) (3)	7650.8	8201.0	9156.7	9529.6				

Source: Ministry of Finance and Treasury, and IMF.

(1) Includes licence fees, company registration fees, revenue stamps and motor vehicle taxes.

(2) Includes grants-in-kind and cash but excludes direct expenditure by donors.

(3) GDP for 2004 is based on a 5% growth forecast.

Table A.9: Economic Classification of Central Government Expenditure and Net Lending

	1998	1999	2000	2001	2002	2003	2004
						Prov. Est.	*Budget*
			(In millions of Rufiyaa)				
Expenditure and net lending	2053.3	2506.4	2694.2	2885.9	3117.3	3428.4	3688.7
Total Expenditure	2113.9	2494.9	2739.9	2912.1	3135.5	3529.2	3785.9
Current expenditure	1297.9	1545.5	1875.9	1971.4	2109.4	2375.1	2694.7
Expenditure on goods and services	1184.4	1421.8	1741.2	1824.8	1939.0	2192.3	2497.3
Salaries and wages	290.7	366.1	466.9	505.8	533.9	559.9	690.2
Other allowances	212.4	282.3	363.1	413.7	438.9	424.9	497.9
Other benefits and gratuities	6.3	7.7	9.1	9.7	10.5	11.0	15.3
Travel expenses	49.4	56.4	61.2	57.3	58.6	68.8	77.1
Supplies and requisites	172.2	206.8	221.3	238.6	212.4	260.8	292.5
Repairs and maintenance	61.4	71.7	85.1	86.6	92.2	101.4	113.0
Transportation, communication, utilities, and other services	246.7	285.1	351.4	358.7	391.8	431.5	503.1
Subscriptions, membership fees, etc, to international organizations	8.4	9.9	9.0	9.8	10.3	17.9	18.5
Social welfare contributions	140.9	135.8	174.1	144.6	191.2	316.6	289.7
Interest payments	81.6	98.7	106.4	116.5	136.5	134.8	146.8
Subsidies and transfers	27.9	25.0	28.3	30.1	33.1	48.0	50.6
Food, medicine and other	16.2	8.8	7.8	6.1	5.1	5.9	9.8
Pension	11.7	16.2	20.5	24.0	28.0	42.1	40.8
Capital expenditure and net lending	755.4	960.9	818.3	914.5	1007.9	1053.3	994.0
Development expenditure	816.0	949.4	864.0	940.7	1026.1	1154.1	1091.2
Foreign loan-financed	204.2	175.7	86.7	295.6	500.6	578.9	556.9
Others (1)	611.8	773.7	777.3	645.1	525.5	575.2	534.3
Net lending	-60.6	11.5	-45.7	-26.2	-18.2	-100.8	-97.2
Memorandum item:							
Capital contributions to foreign organizations	2.0	13.3	0.0	0.0	0.2	0.0	3.8

Source: Ministry of Finance and Treasury.

(1) Comprises development expenditure financed from domestic sources and by foreign grants.

Table A.10: Functional Classification of Central Government Expenditure

Years	1998	1999	2000	2001	2002	2003	2004
						Prov. Est	*Budget*
			(In millions of Rufiya)				
Expenditure and net lending	2053.3	2506.4	2694.2	2,885.9	3,117.3	3,428.4	3,688.7
Total Expenditure	2113.9	2494.9	2739.9	2,912.1	3,135.5	3,529.2	3,785.9
Public services	797.1	1061.4	1164.5	1088.1	1029.6	1186.3	1340.4
General administration	426.8	534.3	715.6	642.2	610.3	680.1	770.2
Public order and Internal security	370.3	527.1	448.9	463.9	369.3	480.9	540.2
Social services	993.7	1022.9	1140.5	1198.3	1532.8	1648.7	1715.5
Education	432.1	450.8	541.2	515.6	636.8	717.0	720.3
Health	224.2	259.4	299.2	300.8	316.8	375.2	428.7
Social security and Welfare services	71.3	70.0	77.0	99.7	99.1	121.0	127.9
Community programmes	266.1	242.7	223.1	282.2	480.1	435.5	438.6
Economic services	241.5	311.9	328.5	509.2	436.6	559.4	583.2
Fisheries and Agriculture	22.0	23.2	47.7	39.3	17.9	21.5	31.4
Transportation	159.1	215.6	166.2	305.9	306.3	419.6	410.9
Post & Telecommunication	2.3	22.3	4.5	33.2	8.1	14.1	41.9
Tourism	15.8	22.9	27.7	31.4	35.9	37.5	52.5
Trade and Industries	6.3	7.0	6.1	4.7	5.0	21.8	27.8
Electricity	36.0	20.9	76.3	94.7	63.4	44.9	18.7
Interest on public debt	81.6	98.7	106.4	116.5	136.5	134.8	146.8
			(Percent of GDP)				
Expenditure & Net Landing	32.3	36.0	36.2	37.7	38.0	38.5	38.7
Total Expenditure	33.3	35.9	36.9	38.1	38.2	39.6	39.7
Public services	12.5	15.3	15.7	14.2	12.6	13.3	14.1
General administration	6.7	7.7	9.6	8.4	7.4	7.6	8.1
Public order and Internal security	5.8	7.6	6.0	6.1	4.5	5.4	5.7
Social services	15.6	14.7	15.3	15.7	18.7	18.5	18.0
Education	6.8	6.5	7.3	6.7	7.8	8.1	7.6
Health	3.5	3.7	4.0	3.9	3.9	4.2	4.5
Social security and welfare service	1.1	1.0	1.0	1.3	1.2	1.4	1.3
Community programmes	4.2	3.5	3.0	3.7	5.9	4.9	4.6
Economic services	3.8	4.5	4.4	6.7	5.3	6.3	6.1
Fisheries and Agriculture	0.3	0.3	0.6	0.5	0.2	0.2	0.3
Transportation	2.5	3.1	2.2	4.0	3.7	4.7	4.3
Post & Telecommunication	0.0	0.3	0.1	0.4	0.1	0.2	0.4
Tourism	0.2	0.3	0.4	0.4	0.4	0.4	0.6
Trade and Industries	0.1	0.1	0.1	0.1	0.1	0.2	0.3
Electricity	0.6	0.3	1.0	1.2	0.8	0.5	0.2
Interest on public debt	1.3	1.4	1.4	1.5	1.7	1.5	1.5
Memorandam Item:							
Nominal GDP (millions of rufiyaas) (1)	6,357.0	6,953.4	7,433.1	7,650.8	8,201.0	8,905.8	9,529.6

Source: Ministry of Finance and Treasury, and IMF.

(1) GDP for 2004 is based on a 5% growth forecast.