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Maldives Development Update



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Overview

Real GDP growth stood at 3.7 percent in 2013 and its outlook is positive at 4.5 percent for 2014. The tourism demand is slowly picking up and having a positive impact on growth in the non-tourism sectors. Chinese tourists continue to compensate for the weaker demand from Europe, but overall the length of stay has declined, as well as spending per tourist.

Growth while dynamic was less inclusive, as the tourism industry is operating on an enclave model of development. The share of GDP from the primary sector, agriculture, mining and fisheries that employ the largest share of Maldivians in the outer atolls, was less than 0.3% of GDP in 2013.

Loose fiscal policy in a context of moderating economic growth has led to rising macroeconomic imbalances. While revenue collection has been strong, over the past five years the gap between revenues and expenditures has widened, financed through unsustainable levels of public debt at increasing interest rates.

The 2014 Budget comes with a record high envelope of MVR 17.95 billion (around 50 percent of GDP), about MVR 3 billion in new revenue measures, and an estimated 3.2 percent financing gap. Financing such high level of spending and meeting this ambitious financing gap would be difficult. Cash management will be tight through 2014.

Inflation moderated to 6 percent in 2013 in 2013 although food inflation remained high.

Recent Political and Economic Developments

The political situation will remain fluid with the results of the upcoming Majlis election in the balance

President Abdulla Yameen took office in November 2013. President Yameen is the half-brother of former President Maumoon Gayoom, who ruled Maldives from 1978-2008 and took oath on November 17, 2013. The victory marked the end of a contested election where opposition candidate and former President Mohamed Nasheed won the first round in September, but failed to secure the 50 percent required for an outright victory. Mr. Nasheed's victory in the first round election was overturned by the Supreme Court following allegations of irregularities in voter registration. Mr. Yameen has pledged to end two years of political turmoil, while the Maldives Democratic Party (MDP) under the leadership of Mr. Nasheed has echoed to carry on in opposition.

The Majlis (parliamentary) Elections are scheduled for March 22, 2014. Mr. Nasheed has declared that the MDP will boycott the Majlis Elections if the Supreme Court removes EC members ahead of next month's polls. It is speculated that, if all major parties contest, the Majlis Elections could lead to another hung parliament.

The tourism demand is slowly picking up and having a positive impact on growth and the non- tourism sectors.

Real GDP growth stood at 3.7 percent in 2013 and its outlook is positive at 4.5 percent for 2014. After averaging almost 7 percent for 2010-11, real GDP growth moderated in 2013. Tourism directly and indirectly accounts for two-thirds of economic activity in Maldives and impacts other activities and sectors, such as: services, transport, and telecommunications. The sector has taken a hit from weaker demand from Europe, the country's largest market, but demand is slowly picking up and the growing Chinese tourist segment is projected to compensate for the weaker volume of arrivals from Europe. In 2013, tourist arrivals grew by 17.4 percent. This strong performance will have a positive impact on the non-tourism sectors, such as construction, communications, and fisheries, which are expected to remain dynamic with a positive contribution to the economy.

Tourism is recovering and the composition of tourists is changing. The composition of tourist is changing and Chinese tourist are compensating for the weaker demand from Europe. The European market has grown by an average of less than 2 percent per year during 2008-13, mostly the result of weaker European economic conditions and travel advisories that followed the political events in Maldives. In contrast, the Chinese market share grew from 6 to 29 percent of total arrivals in 2013 leading to strong overall growth in tourist arrivals at 17.4 percent. (Figure 1) However, the average length of stay in Maldives has dropped from 8 nights in 2008 to 6.3 nights, which explains a share of the moderation of real GDP growth. Chinese tourists tend to travel more across islands and pursue a variety of activities, but stay for shorter periods and therefore spend less. The tourism receipts per tourist have been on the decline during the past few years and in 2013 dropped by 9 percent to USD 1,778 per tourist.

The non-tourism sectors are recovering along with tourism growth. Tourism has deep roots in Maldivian economy and most non-tourist segments benefit from this demand for good & services. In the services sector, communications accounted for 10.3 percent of the economy in 2013 grew at 7.6 percent, whilst transport with a contribution of 9.3 percent to GDP grew by 5.1 percent. A decline in

manufacturing of 5.3 percent and construction at 2.1 resulted in a 1.2 contraction in the secondary sector.

Figure 1. Tourist Receipts and Composition Arrivals

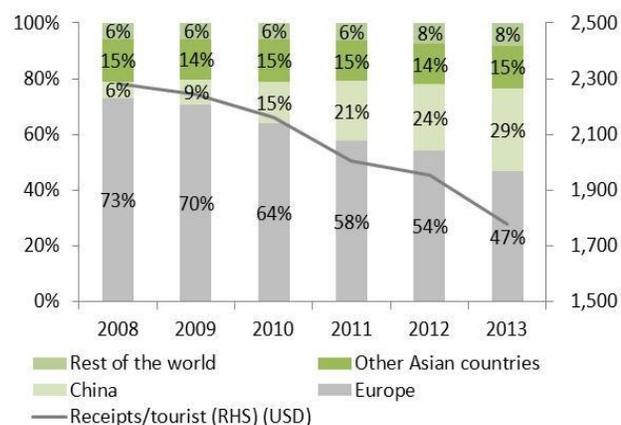
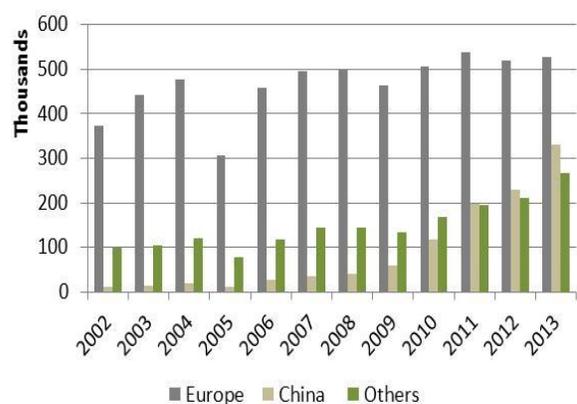


Figure 2. Tourist Arrivals by Country



Source: MMA, Ministry of Tourism, Arts and Culture

Growth was dynamic, but less inclusive.

The share of GDP from the primary sector, agriculture, mining and fisheries, was less than 0.3 percent of GDP in 2013. This segment employs the largest share of Maldivians in the outer atolls, in particular fisheries. The primary sector grew only at 1.7 percent 2013 and below the national average at 3.7 percent, while fisheries recovered from negative growth in 2012 it grew by 2.1 percent in 2013. These figures suggest that making growth more inclusive could be a challenge and that a significant share of the population could benefit more from growth, which is driven by the tourism industry and operating as an enclave model of development.

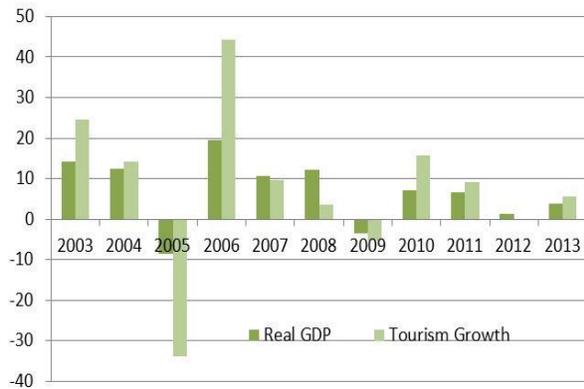
Maldives is spending beyond its means and financing the budget risks affecting the real economy

Public finance imbalances in Maldives seem to lie on the expenditure side. While revenue collection has been strong, over the past five years the gap between revenues and expenditures has widened, financed through unsustainable levels of public debt at increasing interest rates. (Figure) Total revenue collection at about 32.8 percent of GDP in 2013 is the highest in SAR and higher even for upper middle income countries. Along these lines, total public spending at over 42 percent of GDP is at the level of many OECD countries and welfare states. The WB- IMF Debt Sustainability Assessment (DSA) 2013 ranked Maldives as “high risk” of debt distress with a debt to GDP ratio at around 86 percent of GDP. Debt dynamics are projected to deteriorate further to 96 percent by 2015 (baseline scenario). The government has opted for domestic financing with short term maturity and T-bills interest rates have reached unsustainable levels at around 10 percent. (Figure xx) Arrears have become a significant fiscal risk and, while there is no monitoring of arrears, World Bank (WB) calculations suggest that they amount to close to 3 percent of GDP (Figure 4).

The Maldivian Economy at a Glance

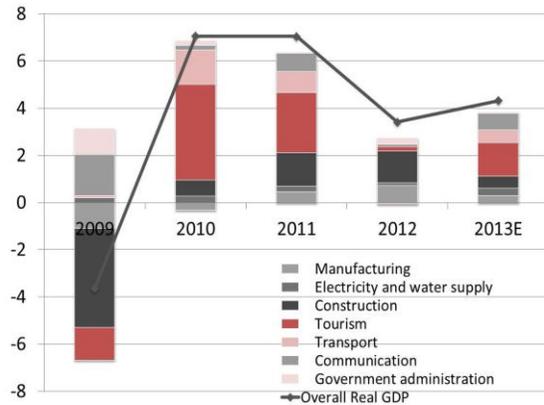
Growth moderated and slowly picking up...

Figure 3. Growth and Tourism Growth



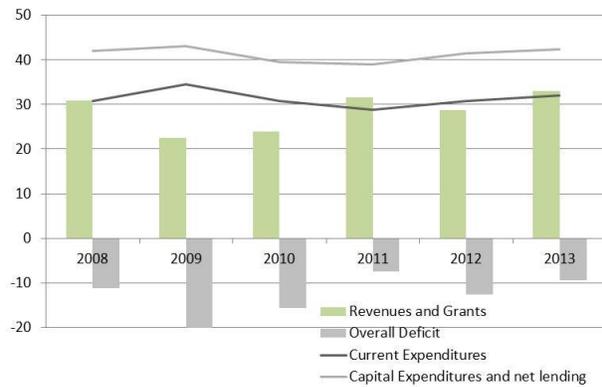
tourism is the driver of growth.

Figure 4. Contribution to real GDP growth, (in %)



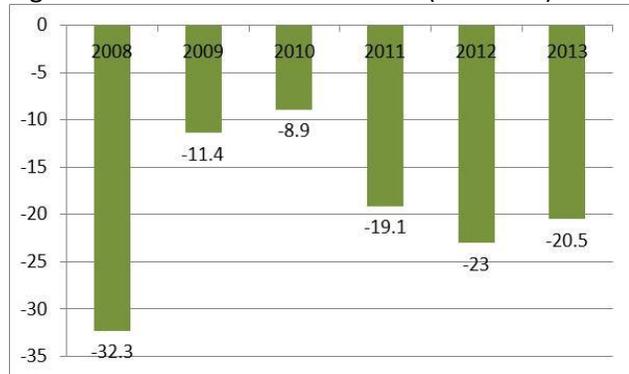
High spending is leading to high deficits...

Figure 5. Revenues and Expenditures, (% of GDP)



an increasing import demand and sustained large current account deficits.

Figure 6. Current Account Balance (% of GDP)



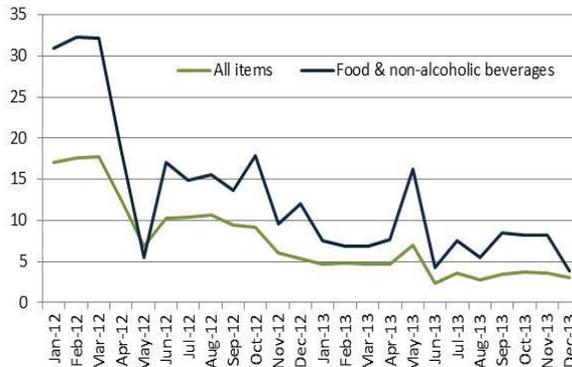
Reserves remain critically low...

Figure 7. Reserves, (US\$ mn)



and inflation moderated.

Figure 8. Inflation and Food Inflation (Male)



Tax revenue collection has been robust at about 25 percent of GDP in 2013. Collection overshoot the 2013 Budget target by 2 percent and grew by 28 percent over the tax collection in 2012. This robust growth was broad-based with notable contributions from the Tourism (TGST), and its rate increase from 6 to 8 percent in January 2013, the GST, and the Business Profit Tax with 33 percent growth. However, non-tax revenues declined by 2.4 percent in 2013, a reflection of the deteriorating finances in large SOE's which used to provide dividends and now require transfers to cover operational losses.

Figure xx. Revenue Composition 2013

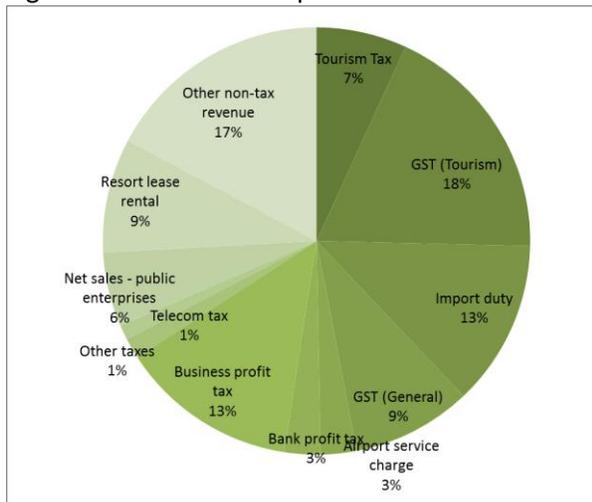
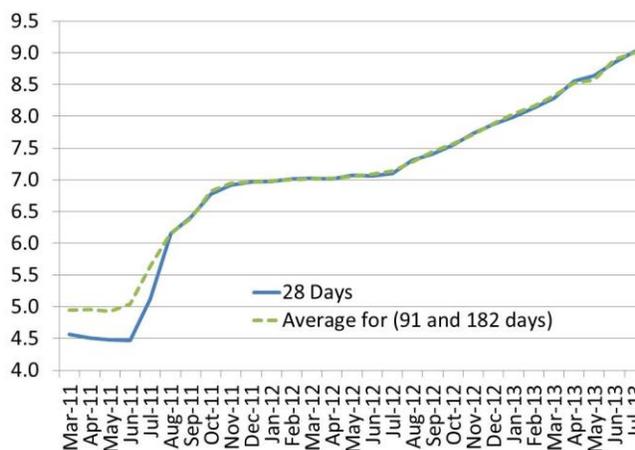


Figure xx. Maldives Treasury Bills Interest Rates



Source, MIRA, and Maldives Monetary Authority

The 2014 Budget comes with a record high envelope of MVR 17.95 billion (around 50 percent of GDP), about MVR 3 billion in new revenue measures, and an estimated 3.2 percent financing gap. These new revenue measures became a source of intense debate in Parliament because they required legislation changes for implementation, but collection estimates were already discounted in the estimation of the financing gap. If implemented as planned, financing such high level of spending and meeting this ambitious financing gap would be difficult. Cash management will be tight through 2014. Among the newly approved revenue measures the biggest ticket items were the change in the Tourism GST from 8 to 12 percent and the introduction of a GST tax for telecommunication services. Other revenue measure included: revisions to custom duties, a one year extension for the tourism bed tax (previously due expire on Dec 31, 2013), and the increase in the airport departure charge for foreign passengers from US\$18 to 25. Also, 12 more islands were identified for leasing for new resort developments. During better times, the leasing of new islands would have generated great interest amongst investors, but under current circumstances there is limited appetite for investment and leasing prices have significantly come down in comparison to what used to be collected 5 years ago.

Maldives closed 2013 with an approximated 9.8 percent of GDP cash deficit, but at around 13 percent of GDP when considering unpaid commitments through arrears. (Figure 5) Compared to the 3.9 percent of GDP approved financing gap, the government found itself in a tight cash position that led to the further accumulation of arrears. The deficit financing during the remainder of the year will be challenging. The government has opted for financing through several ways that could pose macro risks: (i) increasing reliance on short-term commercial borrowing from the banking, private sector, and high net worth individuals at high interest rates, (ii) increased monetization of the deficit, and (iii) build-up of payment arrears. While there is no monitoring of arrears WB estimates suggest these could be at around 3 percent of GDP or higher and have become a significant fiscal risk.

Maldives Government Finances

In MVR Million

	Actual	Actual	% of GDP	% change
	2012	2013	2013	2013 vs. 2012
Total Revenue and Grants	9,976	11,595	32.8%	16.2%
Total Revenue	9,817	11,502	32.5%	17.2%
Tax Revenue	6,880	8,789	24.9%	27.7%
O/W: Import duty	1,369	1,574	4.5%	15.0%
Tourism Tax	805	836	2.4%	3.9%
GST (General)	1,006	801	2.3%	-20.4%
GST (Tourism)	1,554	2,860	8.1%	84.1%
Airport Service Charge	300	350	1.0%	16.7%
Business Profit Tax	1,401	1,868	5.3%	33.3%
Other	446	500	1.4%	12.1%
Non Tax Revenue	2,889	2,447	6.9%	-15.3%
Transfers from SOEs	705	338	1.0%	-52.0%
Resort lease rent	1,139	1,222	3.5%	7.3%
Other	1,045	887	2.5%	-15.1%
Capital Revenue	48	266	0.8%	452.8%
Grants	159	93	0.3%	-41.4%
Total Expenditure excl. net lending	14,216	15,069	42.6%	6.0%
Current Expenditure	10,522	12,937	36.6%	22.9%
O/w: Salaries and Wages	2,730	3,292	9.3%	20.6%
Other Allowances	1,836	2,314	6.5%	26.0%
Interest Payments	1,107	894	2.5%	-19.3%
Subsidies, Transfers, Social Welfare	3,112	3,629	10.3%	16.6%
Pensions	408	787	2.2%	93.0%
Others	1,329	2,022	5.7%	52.1%
Capital expenditure and net lending	3,694	2,132	6.0%	-42.3%
Overall balance	(4,240)	(3,474)	-9.8%	(18.06)
Primary balance	(3,133)	(2,580)	-7.3%	(17.63)
Memorandum Item:				
Nominal GDP	34,012	35,341		

Source: MOF WB Staff estimates

Current expenditures are the main drivers of spending and have crowded out capital investment. The Budget is under pressure from the civil service wage bill, subsidies and social contributions and transfers to SOE's. The public service wage bill, salaries, including allowances and overtime pay, stood at 15.8 percent of GDP. Since 2012, the rolling out of the Aasandha universal health scheme is pressuring spending and usage per week (at about MVR 19-20 million) is proving significantly higher than budgeted. In addition, the electricity subsidy, particularly the fuel surcharge that benefits households in Male and businesses and households in the atolls, was hit by higher-than-budgeted international oil prices. Also, transfers to SOE's have increased significantly to cover operational losses

and salary increases for SOE staff, which are not subject to the stricter compensation guidelines of the civil service. The capital budget reduced by half from 12 to 6% of GDP during 2012-13 and mostly on domestically financed projects where the government has discretion. Those resources were redirected for current spending.

Public sector employment expenditures accounted for 37% of the budget or 15.8% of GDP in 2013, Considering that it represented 43.3% of the 2009 Budget and 18.7% of GDP, the effective freeze on civil service wages instituted since 2011 has slightly brought down costs. Allowances make up about 40% of the compensation package for the public sector and have grown to compensate for actual wages that have been frozen for the past three years. This fiscal burden of public service compensation is not sustainable. Civil service pension also weighs on the fiscal situation and are accumulating medium term liabilities.

Inflation moderated in 2013, but food inflation remained high

Inflation in Male decreased to 6 percent in 2013 from 10.9 percent in 2012, as measured by overall CPI. The controlled prices of rice, flour, sugar, diesel, petrol, electricity, were unchanged, while the price of kerosene was revised upward in March 2013 to MVR 15.8 per liter from MVR 11.5 per liter. Given that food is mostly imported, the pass-through of prices is high at nearly 80.0 percent¹. Domestically, loose fiscal policy continued to pressure the demand for imported items and prices of basic food and beverages remained above the overall inflation at 7.5 percent. International food prices have been declining in world markets after reaching their peak increase of 17.7 percent in 2012. Domestic inflation is linked to fish prices that make an important part of the Maldivian diet and volatile depending on the seasonal catch.

The fact that inflation has been subdued in an environment where a share of the deficit financing has been through monetization is an interesting paradox. Domestically one would have expected a higher rise in prices in 2013. A possible explanation is that the high level of arrears at over 3 % of GDP owed to private suppliers and public utility companies has contained the impact on prices. Private suppliers report that invoices for services rendered almost a year ago have not been paid. This has meant that the effect of such spending would impact domestic demand with a lag. In a small island economy like Maldives with a large contribution from the public sector, everyone has either been directly affected by payment delays or indirectly through linkages with a domestic supplier that has been affected. During the year the nominal value of the Maldivian rufiyaa remained stable against the currencies of its major trading partners and this in turn helped curtail inflation to a manageable level.

Managing external sector imbalances will continue to be a challenge

The current account deficit remained high at US\$469 million or 20.5 percent of GDP in 2013. Total imports increased by 11.5 percent to US\$1,733.4 million over the 2012, mostly driven by food imports that reported 19 percent growth. Petroleum products that account for 30 percent of the total imports also grew at 3.1 percent. At the same time, total exports grew but a much slower pace at 4.9 percent reaching US\$ 329.7 million. Maldivian exports of fish grew by 1.0 percent, while re-exports that account for half of exported goods increased by 6.7 percent. The large current account deficit is linked to high public spending. It drives the demand for imports directly, but also indirectly through private

¹ Masha, Iyabo and Chanho Park, "Exchange Rate Pass Through to Price in Maldives," IMF Working Paper, 2012.

consumption and public-sector salaries. The IMF estimates that the current account deficit will remain around 25 percent of GDP during 2012–15. This means reserves will continue to face pressures in the future, which could be exacerbated if the government is forced to pay compensation for the reversal of the GMR airport concession (December 2012).

External reserves are critically low, but have held better than expected and grew by 6% in 2013

Loose fiscal policy has made macro management difficult with pressure on the balance of payments and low external reserves. The impact on the balance of payments has been mitigated by debt financing and public sector arrears, which to some extent have contained private sector imports and some of the demand for dollars. As of end 2013, gross reserves stood at US\$ 344.7 Mn or around 2.3-2.4 months of imports, of which usable reserves² were critically low at around US\$ 100 Mn or 3 weeks of imports. As a result of higher than expected revenue collection and strong tourism receipts, reserves have held up better than expected and grew by 6% in 2013.

The government's rationing of forex has resulted in a parallel dollar market, where the Rufiyaa is trading at a 10 –15% premium. The fact that the gap between the official and parallel markets has not widened beyond this 15% premium over the past year means there are enough dollars and foreign currency in the market and those transactions are outside the formal banking channels. Economic activity is flourishing and supermarkets and stores are fully stocked in Male. The tourism sector is bringing in dollars on a much larger scale than what is captured through official MMA accounts and tourism receipts. With the introduction of forex controls by the MMA to contain the demand for imports and dollars, a significant share of economic activity is currently conducted on a cash basis. Monitoring the gap between the parallel market and the official exchange rate is important and large movements could signal balance of payment imbalances in the Maldivian economy.

Challenges and Opportunities

Public employment in the Maldives at an estimated 8.3% of the population, exclusive of police, military, and councilors, is a relatively high for a small island state and unsustainable. As an island nation, Maldives faces the particular challenge of having deliver services to a disperse population that requires a large number of public servants, but affordability is crucial. The public service in Maldives accounts for 45-50 percent of the formal wage employment. There are roughly 26,000 public employees in the Maldives excluding police, military, and paid local councilors.³ Until 2012, the number of civil servants steadily declined due to corporatization of some services and the removal of health care workers from civil service rolls. Outside of the civil service, there are 544 political appointees and an estimated 1,000-1,500 staff in independent commissions, parliamentary services, and the judiciary. These figures do not include the police, military, or the roughly 1000 paid local councilors.

Reforms aimed at ensuring affordability for public employment should take into account a fit-for-purpose of the public sector cadre, rather than rationalization through numerical targets. In order to prevent adverse effects in service delivery, the goal of bringing affordability to public employment should be pursued through staffing plans for agencies that match priority needs. Much of the public

² IMF and Staff estimates.

³ Maldives Civil Service Commission

sector consists of younger, lower skilled employees. Currently, there are 44 grades, of which less than 1% of staff are executive grades (EX3 and above), while over 54% are technical support staff, and 24% are auxiliary support (2012)⁴. Nearly 2/3 of the civil service is under 40 years old. At the same time, the salary structure is roughly compressed. The 1% executive grades receive salaries ranging from 10,000-20,000 Rufiyaa, while the weighted average for auxiliary support staff is just under 2000 Rufiyaa and for technical support is about 5400 Rufiyaa. The average salary of executive staff (EX3 and up) is 6.5 times the average salary of auxiliary support staff among employees classed as civil servants. Functional reviews need to inform the rationalization of staffing. In 2012, reviews were carried out in certain ministries, but findings were not widely implemented or publicly discussed. These reviews could identify non-essential functions carried out by public sector staff that could be either outsourced or reduced.

Poverty in Maldives has steadily declined over time. Considering that Maldives was a low-income country two decades ago, its national poverty rate of 8 percent (2010) is a remarkable achievement. The international poverty line⁵ shows that about 9 percent of Maldivians lived with less than 1.25 dollars per day. . Poverty has been declining in the atolls mainly because of improved living conditions according to the latest HIES 2009/10. However, in the capital Male, poverty rose from 2 percent to 7 percent between 2003 and 2010, possibly due in large part to the impact of rising food prices. Inequality, too, is on the rise in Male, even after several years of high growth. The measurement of poverty in Maldives follows a *relative* approach, and the official poverty line is set at half the median of daily per capita expenditure in the Atolls. Using data from the *Vulnerability and Poverty Assessment Survey (VPA)*, in 2004, 21 percent of people lived below the poverty line, down from 44 percent in 1997-98. Similar trends emerge from the most recent two rounds of the *Household Income and Expenditure Survey (HIES)*, with poverty headcount declining from 21 percent in 2003-04 to 15 percent in 2009-10

Table 3: Poverty Headcount Rates, by geographical location

	Republic		Male'		Atolls	
	2003	2010	2003	2010	2003	2010
MDG Line of US \$ 1.25	9%	8%	2%	7%	12%	8%
MDG Line of US \$ 2	31%	24%	9%	19%	39%	27%
Rf. 22 (Relative PL in xx prices)	21%	15%	4%	12%	27%	16%
Gini	0.41	0.37	0.35	0.38	0.40	0.36

Note: International poverty line measure in purchase power parity (PPP) dollars US\$1.25 per day to MVR 17 (adjusted for inflation) in 2010 and MVR 12 in 2003.

The Maldives has made great progress in education outcomes, providing access to primary and lower secondary education. With about 62,000 students and 6,000 teachers, in approximately 220 public schools, its overall net primary enrolment rate is high, at 96 percent.⁶ The system has also achieved

⁴ 2012 figures; technical support staff are Grades MS1-2 and GS3-4; Auxiliary staff are Grades SS1-4.

⁵ The international poverty line of US\$1.25 per person per day is an average of national poverty lines from the 15 poorest countries, PCE per capita from national accounts (PPP adjusted, 2005 prices) is less than US\$60 per day. The reference countries are Malawi, Mali, Ethiopia, Sierra Leone, Niger, Uganda, Gambia, Rwanda, Guinea-Bissau, Tanzania, Tajikistan, Mozambique, Chad, Nepal, and Ghana.

⁶ A small number of private education institutions, which enroll about 1,700 students.

gender parity and the net primary enrollment for both boys and girls stands at 94 percent. The gross lower secondary enrollment rate is 117 percent, while the lower secondary rate is 84 percent. However, the gross higher secondary net enrollment rate is about 21 percent (see Figure 11), which is low when compared to the average for middle income countries at 61 percent, and for upper middle-income at 84 percent.

The quality of education at all levels is a major policy challenge. Learning outcomes in primary and secondary education in Maldives are low. The average score for English among students at grade 4 is just 32 percent, and the average score for mathematics only 39 percent. At grade 7 the average score for English is merely 29 percent, while the average score for mathematics is just 30 percent. For example, at the General Certificate of Examinations (GCE O/L) only about 40 percent students pass in five subjects, while just 19 percent students pass in eight subjects. Higher secondary education is constrained by the limited number of schools offering grades 11-12. The government has now expanded this number to 37 schools: 3 schools in Male and 34 schools in the atolls. Gross higher education enrollment rate is only 6 percent and is also constrained by supply with only one public university, the Maldives National University (MNU), and about 7 private education institutions. Over 95 percent of enrolment in these private education institutions is in pre-degree level diploma and certificate programs.

Figure 11-Gross Enrollment Rates

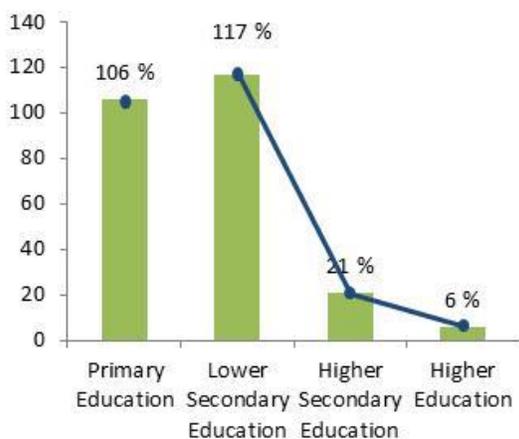
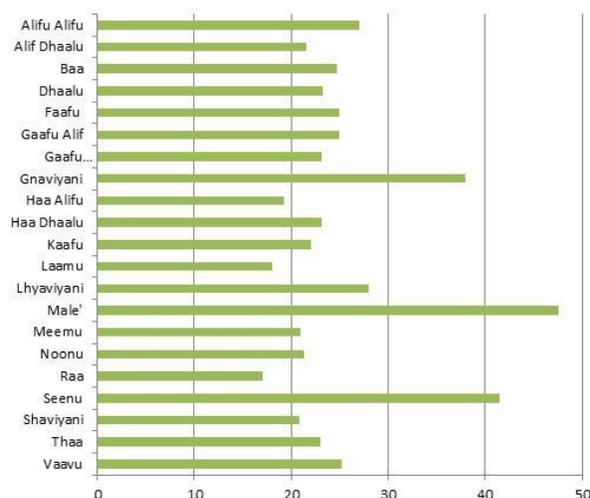


Figure 12-Average English Language Learning Outcomes at Grade 7 by Atoll, 2008



Source: Achievement in English at Grade 7, Ministry of Education

Youth unemployment is high and 32 percent of youth aged 20-24 years are neither participating in education nor working. Employers in the country, particularly in the thriving tourism sector face shortages of qualified personnel for technical, and middle and senior management jobs. This is the reflection of an education system that is not preparing enough graduates with relevant skills for the country's private sector. As a result, over 100,000 expatriate workers are imported and assuming these mid-career and senior management positions in the tourism, banking, finance, trade and shipping industries. Overall unemployment rate is high at 11.7 percent, of which 9.2 percent is in Male

and 13.3 percent in Atolls (according to the Household Income and Expenditure Survey 2010).⁷ This represents a twofold growth in the level of unemployment from 2006. The unemployment is particularly acute among women.

The overall business environment in Maldives is affected by market size, macroeconomic conditions, and business regulations. In the WB *Doing Business* 2014⁸, the country (represented by Malé) ranks 95th out of 189 countries in the ease of doing business and ahead of most countries in South Asia, with the exception of Sri Lanka. The country performs well in the areas of construction permits (18), but ranks lower in criteria like access to registering property (161), trade logistics (138), getting electricity (131) and getting credit (109). In 2013, the investment climate was positively affected by the ease of paying taxes with the introduction of an electronic tax filing system. In terms of resolving insolvency issues and dealing with construction permits, Maldives ranks high in the Doing Business indicator ranking. The GoM intends now to pursue an ambitious reform agenda in several areas, including business and property registration, access to credit (e.g., secured transactions), the protection of minority shareholders, trade logistics, the resolution of commercial disputes, and the insolvency regime.

The Maldives ranks highest in region FDI inflows as share of GDP (5%) and has a diverse spectrum of contributors from both East and West. The government of Maldives (GoM) is keen to develop new, labor-intensive sectors, such as off-port shipping services, IT, and financial services in order to reduce Maldives' current vulnerability to slow tourism demand. Creating a more favorable business climate in the Maldives has also the potential to boost competitiveness and improve firms' growth and productivity.

Figure. Xx. Maldives Doing Business 2014



Source: WB Doing Business 2014

⁷ Published in 2012

⁸ The World Bank Group's *Doing Business* indicators focus on the impact of laws, regulations and their enforcement on the ease of doing business for domestic firms in 10 areas that affect the life of a firm, from inception to closure. While the *Doing Business* indicators only show some aspects of the regulatory environment for firms in the Maldives, they point to areas where the private sector could benefit from simplification of the regulatory burden or stronger legal protections.

According to the Logistics Performance Index 2012 Maldives ranked 104th out of 155 countries and behind other peers in South Asia, like India, Pakistan and Sri Lanka. This is the result of results in the area of clearance processes for customs (119), quality of trade and transport related infrastructure (93), ease of arranging competitively priced shipments (117), competence and quality of logistics services (81), ability to track and trace consignments (118), frequency with which shipments reach the consignee within the expected delivery time (102).

The Maldives is one of the world's most vulnerable countries to climate change. Over 80 percent of land area is less than 1 m above mean sea-level and 50 percent of all inhabited islands and 45 percent of tourist resorts face varying degrees of beach erosion. With future sea levels projected to increase in the range of 60 to 115 centimeters by the year 2100, the entire country could be affected by rising sea levels.⁹ In addition, solid waste is the most visible environmental threat to the Maldives. With a population spread across numerous islands, there is little scope for economies of scale in solid waste management. The amount of waste generated far exceeds the capacity of available landfills, which are often uncontained open dumps. Current arrangements for solid waste management on most inhabited islands are inadequate and a major portion of the wastes are dumped onto the island foreshore and burned at low combustion temperatures.

Economic Outlook

The outlook for growth is positive at 4.5% in 2014. This will be driven by strong tourist arrivals and strong growth in the Chinese tourist segment. The MMA projects the tourism sector to grow at 5.2 percent in 2014. The prospects of domestic political stability after the Parliamentary elections will be conducive for growth. Also, the recovery of the European market will have a positive impact on the length of stay, which has been declining, and in turn in the contribution from tourism receipts. The non-tourism sectors will also contribute to growth, through demand for telecom and services exports. The construction sector will be particularly dynamic on back of ongoing new resort development and the leasing of 12 new islands.

The path towards fiscal sustainability in Maldives will require short-term measures to address the current cash crunch, as well as long-term structural measures that could entail political and social costs. Spending is under pressure from the civil service wage bill, subsidies and social contributions, transfers to State-Owned Enterprises (SOEs), and capital spending in the outer atolls. An array of measures could be combined in a policy package accompanied with a communication strategy to sensitize the public on the need to implement reforms. The timing of these measures is important. If expenditure cuts are delayed, resources will become scarcer, and the government could face difficulties in paying salaries. The type of adjustment required later would be even more costly.

Reserves will continue to be under pressure in 2014 and at critical levels. The size of the 2014 budget and financing pressures suggests there will be little fiscal space to accumulate reserves. Such high level of spending could boost the demand for imports and fuel the need for foreign exchange putting pressure on reserves. However, the fact that the outlook for the tourism sectors is positive means there will be an inflow of dollars that could contain the pressure on the exchange and sustain the parallel

⁹ The World Bank 2013. Turn Down The Heat: Climate Extremes, Regional Impacts and the Case for Resilience. Sea-level rise is projected to be approximately 100-115 cm in a 4°C world and 60-80 cm in a 2°C world by the end of the 21st century relative to 1986-2005, with the highest values expected for the Maldives.

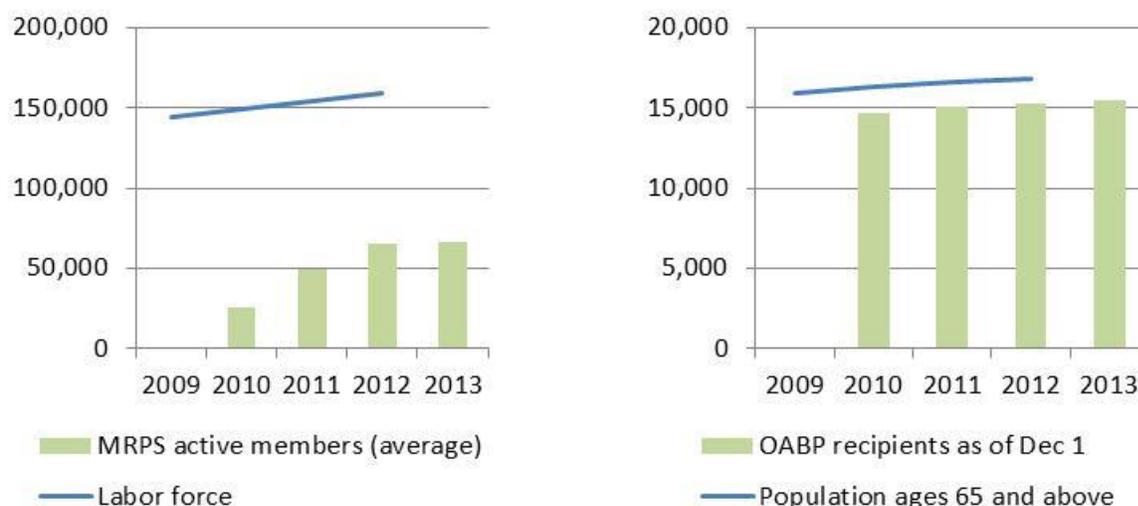
dollar market at the current 10-15% premium level. The airport concession arbitration process to be decided during the course of 2014 would put significant pressure on reserves if a large payment is due.

Special Focus: The Maldives Pension System – An unfinished reform agenda

Maldives has witnessed major changes in its pension system in recent years. As a consequence of the pension reform, pensions doubled from 2012-13 and today account for 2.2% of GDP. The government initiated pension system reform in late 2006 with the aim to establish a two-pillar pension system, including: i) a new contributory pension scheme based on a defined contribution model, and ii) a non-contributory pension system for Maldivians aged 65 and above. The first scheme would be financed out of employer and employee contributions, while the latter would be financed from the general budget. The defined contribution scheme would, in the first phase, replace the one that then operated for civil servants. In the second phase, it would be extended to the entire formal sector labor force and would be open to the self-employed. In 2009, the Maldives Pension Act established the Maldives Retirement Pension Scheme (MRPS) and the Old Age Basic Pension (OABP).

The Maldives Pension Act laid down a sound foundation to ensure a reliable income after retirement for all Maldivians. Prior to the introduction of MRPS, a pension privileges were open only to civil servants who had to continue to work only in the public sector for 20 years or more to become eligible irrespective of their age of retirement. The new scheme opens for private sector and therefore provided flexibility for employees to move from public sector to private sector. Starting in 2014, the MRPS opens also for self-employed and foreign workers. Moreover, instead of financing pension benefits from the general budget under the old program, the pension benefits under MRPS are based on the accumulated contributions that pensioners and their employers have made by themselves plus the investment yields over time. The universal basic pension also provides a sizable monthly income for a large share of population age 65 and above, who are not covered by any safety net programs.

Figure xx. Coverage of MRPS and OABP



Source: MRPS and OABP numbers are from MPAO while population ages 65 and above and labor force are WDI estimates

The coverage gaps in terms of both contributors to MRPS and beneficiaries of OABP have been greatly reduced. In 2004, only 28,000 government employees, nearly a quarter of Maldives labor force, were eligible to civil servant pension if working more than 20 years. By the end of 2013, there were more than 110,000 formal sector workers (including civil servants) enrolled into MRPS and more than 80,000 have

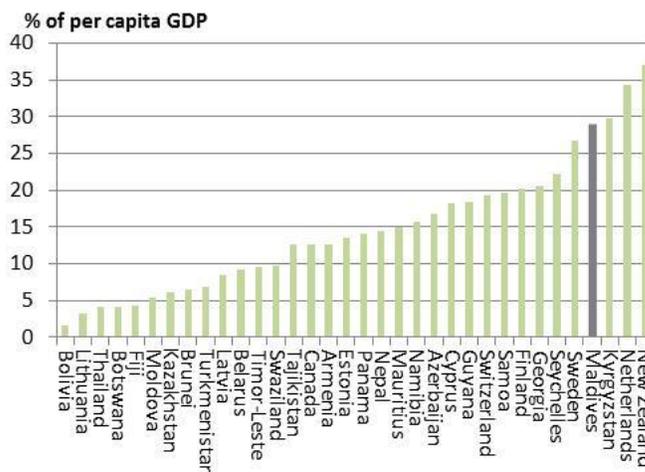
been regularly contributing into their retirement accounts. The expansion of number of old age beneficiaries is equally impressive. In 2007, Only 5,000 elders age 65 and over (equivalent to a little over one third of elder population) are estimated to receive some pension benefits. Now over 16,000 beneficiaries are receiving pension payment every month under OABP.

FY	new retirees	MRPS (Pension Act)	Civil Service Commission (Civil Service Act)		Total pension payout US\$ million
		Accrued rights US\$ million	Monthly benefits (Annualized) US\$ million	Lump sum benefits US\$ million	
2010	174	2.4	0.8	0.4	3.5
2011	190	1.9	1.5	0.4	3.8
2012	158	1.6	2.2	0.3	4.1
2013	206	2.2	3.1	0.5	5.7
2014	224	1.8	4.0	0.4	6.3
2015	227	2.2	5.0	0.5	7.7
2016	201	1.9	6.0	0.5	8.4

Note: all estimates are calculated by Maldives Pension Administration Office using average salaries and average life expectancy of 14 years after retirement

However, the reform on the civil servant pensions is pressuring current expenditures. In anticipation that it would take time to build new systems of retirement benefit provisions under the new pension law, the Civil Service Commission introduced a transitional benefit approximating in nature the old defined benefit provisions. It was expected that the temporary norms would be in place until the new pension scheme is fully functional. However, these norms were never phased out and continue to operate on top of the new pension provisions. This resulted in the duplication of retirement benefit and excessive costs to the budget since 2010. In other words, the

Figure xx. Benefit Level of Social Pension as % of Per Capita GDP in 2012



Source: HelpAge International

civil servants who have retired after the establishment of MRPS under the Maldives Pension Act 2009 actually receive “double pension benefits”. The table below s the estimates pension benefits payout to the civil servants retired since 2010 by both sources through 2016. Note that the benefit payout by the Civil Service Commission will continue to increase with the total number of retirees.

Maldives ranked as one of the most generous schemes with universal pension to elder citizens in 2012. Now, the system has become even more generous and in 2014 and benefits have been doubled from Rufiyaa 2300 to Rufiyaa 5000 per month. These benefits are not targeted to poor beneficiaries. The benefits level of the universal basic pension needs to be rationalized, taking account of not only fiscal sustainability, but also its potential longer term impact on labor supply and saving behavior.

The Maldives Retirement Pensions Scheme could provide a more balanced investment portfolio in order to keep value to members as one core saving option. Currently the MRPS investment portfolio suffers over exposure to T-bills, mainly due to lack of suitable investment options in the Maldives capital market. It is important for MPAO to define a long term investment strategy, which could adopt a maximum exposure limit to any single investment instrument. Furthermore, CMDA could proactively facilitate the development of domestic capital market as well as find a solution for possible overseas investment arrangement for MPAO.

World Bank Program in Maldives

The World Bank lending envelope in the Maldives has traditionally been limited. The International Development Association (IDA) allocation for the Maldives is provided in grants given the country's debt dynamics. As of end-August 2013, the current portfolio comprises three IDA projects with a net commitment value of US\$39 million, supporting education, environmental management as well as social protection and pension administration. A US\$7.7 million mobile phone banking project has fully disbursed. In terms of broad sectoral distribution, human development (pension and education reform) accounts for 55% of the portfolio followed by environment and renewable energy with 45%. A significant body of analytical work and non-lending technical assistance has underpinned the World Bank program over the past few years, including on human capital development, water security, tourism, the national health insurance scheme and targeting the poor.

With a limited lending envelope, trust fund resources have served as a vital complement to the World Bank Group's program, supporting lending activities, technical assistance and analytical work. As of end-August 2013, trust-funded activities totaled over US\$11 million, benefitting energy and climate change activities in particular. The Maldives Climate Change Trust Fund (CCTF) is supplementing the World Bank's Environmental Management Project, for instance, addressing climate change mitigation and adaptation. Trust funds have been supporting analytical efforts on a host of critical issues, from youth development to fiscal sustainability.

Maldives Selected Economic Indicators

	2007	2008	2009	2010	2011	2012	2013*
GDP, Current, Maldives Rufiyaa Mn	19,737	24,213	25,403	27,316	31,447	34,148	38,153
GDP, Current, USD Mn	1,542	1,892	1,985	2,134	2,142	2,103	2,477
GDP per capita (ppp, current International \$)	5,003	6,027	6,209	6,552	6,488	6,567	7,177
GDP real growth rate, %	10.6	12.2	(3.6)	7.1	7.0	3.4	3.7
Inflation, period average, %	6.8	12.0	4.5	6.2	11.3	10.9	6.0
Current Account Balance, % of GDP	(17.4)	(32.3)	(11.1)	(9.2)	(21.4)	(27.1)	(27.9)
Overall Balance, % of GDP	5.0	(3.6)	1.0	4.2	(0.7)	(1.7)	(0.2)
Gross International Reserves, US\$ Mn, end period	308	241	261	350	335	305	360
Gross International Reserves (months of imports)	3.4	2.1	3.3	3.9	2.7	2.4	2.6
Exchange rate, end period, Maldives rufiyaa/US\$	12.8	12.8	12.8	12.8	15.4	15.4	15.4
Government Revenue and grants, % of GDP	38.4	30.8	22.6	23.9	31.0	28.9	32.8
Government total expenditure, % of GDP	42.0	42.0	43.1	39.6	42.3	42.3	42.6
Fiscal deficit (cash*), % of GDP	(3.6)	(11.2)	(20.5)	(15.7)	(11.3)	(13.4)	(9.8)
Public and public guaranteed debt, % of GDP	45.3	45.7	58.6	65.7	72.4	81	86.2
Population	303,539	307,632	311,739	315,885	320,081	323,282	326,515
Life expectancy, years	75.4	75.8	76.2	76.6	76.9	77.4	79
Maternal mortality, per 100,000 live births	..	..	..	60	..	..	..
Malnutrition prevalence, weight for age (% of children under 5)	..	..	3.5	..	..	..	..
Poverty (% below national poverty line), Republic	21.0	..	..	15.0	..	..	..
Poverty (% below USD 1.25/day), Republic	9.0	..	..	8.0	..	..	..
Unemployment, %, ILO definition	5.0	..	12.0	..	..	..	..

Source: Maldives Monetary Authority, IMF, WB Staff estimates.

Note: *Excluding arrears, which in 2013 are estimate at around 3% of GDP.