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Maldives Economic Update

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Overview

- *The political situation remains in a state of flux in the Maldives, with crucial elections coming up. The Presidential elections are scheduled for early September 2013, and the Majlis (parliamentary) elections for April 2014. Both elections are expected to be keenly contested. The Majlis elections could end up with another hung parliament.*

- *Real GDP growth is expected to have recorded 3.4 percent in 2012 on the back of sluggish tourism performance. Inflation has remained subdued on account of favorable global commodity prices, especially food and fuel. However, recent increases in global fuel prices are likely to stoke inflationary pressures.*

- *The fiscal position remains in a precarious situation, with the government cash-flow position considerably weakened. Against this backdrop, the government has resorted to very imprudent means of managing the cash-flow situation: (i) ad-hoc borrowings from the banking and private sectors at high interest rates, (ii) monetizing, and (iii) running huge payment arrears, amounting to over 10 percent of GDP. Continuation of these measures will likely stoke significant imbalances in the economy.*

- *The precarious external situation presents the biggest challenge to the country. The situation has been aggravated by continued high fiscal deficits as well as recent debt settlements. Current gross official reserves are below two months of imports and, in face of increased monetization of the deficits, could deteriorate further.*

- *In light of the precarious external situation, external debt sustainability has also become a major concern. Under current trajectories, total external debt obligations are projected to reach over 115 percent of GDP by 2015—a seriously vulnerable situation, given the recent slowdown in tourism, and the susceptibility of the economy to external shocks (such as commodity price hikes).*

Recent Political and Economic Developments

Political uncertainty continues in the lead-up to the Presidential and Majlis elections

1. ***Notwithstanding the political tensions that have persisted since the change of government in February 2012, the administration under the new government of President Waheed Hassan has been operating for over a year.*** Political tensions have remained high since the resignation of former President Mohammed Nasheed under very controversial circumstances. Tensions have recently heightened further following the arrest of Nasheed in early 2013 to face trial for having ordered the arrest of the head of the Maldives criminal court during his administration – an action, the former President maintains is politically motivated to bar him from running for the Presidency in the upcoming election.

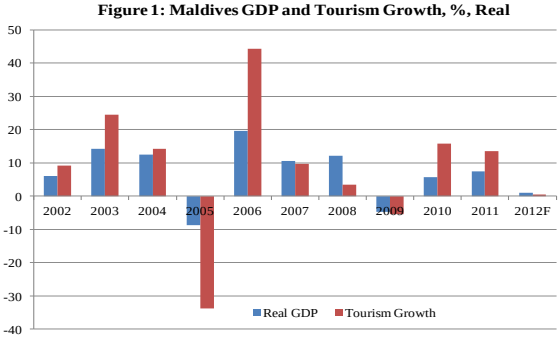
2. ***Presidential elections have been scheduled for September 2013***. Currently, five candidates have expressed their intention of contesting the election including former President Nasheed of the Maldives Democratic Party (MDP), a former Finance Minister Ibrahim Gassim of the Jumhoree Party, Abdulla Yamin, the half-brother of the former President Maumoon Gayoom (who ruled Maldives for 30 years from 1978-2008) representing the Progressive Party of Maldives (PPM), and Thasmeen Ali, head of the Dhivehi Rayyithunge Party (DRP). The incumbent President Waheed will also contest the Presidency under his own party – the Gaumee Ihthihad Party (GIP) – which recently entered into a coalition with the religious conservative Adhaalath Party (AP). The fate of former President Nasheed contesting the election remains in the balance following his arrest in February 2013.

3. ***Following the Presidential elections, parliamentary (Majlis) elections are scheduled for early-mid 2014***. Both the Presidential and Majlis elections are expected to be keenly contested. In the first ever multi-party elections conducted in 2008/9 no clear winner emerged in either the Presidential election, which was forced into a second round run-off or the Majlis elections, which resulted in a hung parliament. Considerable volatility ensued. Given the current state of affairs, a similar outcome this time around remains a strong possibility

GDP growth has moderated and is likely to remain modest on the back of weak tourism-sector performance

4. ***Real GDP growth in 2012 is estimated to have moderated substantially on the back of depressed tourism-sector performance.*** Latest estimates by the Department of National Planning (DNP)[1] show economic growth in 2012 slowed to 3.4 percent from 7 percent in 2011. Tourist arrivals, which had maintained strong momentum during 2010/11,[2] hit a snag in 2012 with the onset of the European debt crisis. Arrivals from Europe—still

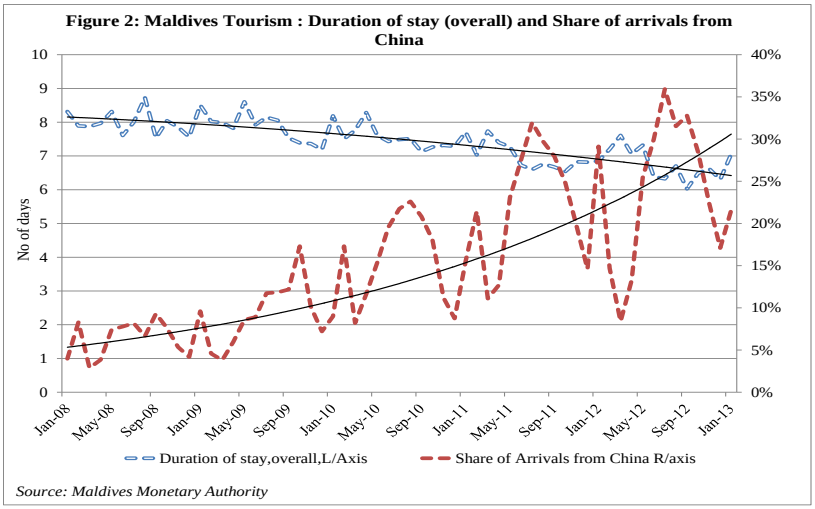
Figure 1: Maldives GDP and Tourism Growth, %, Real



Sources: Maldives Monetary Authority and WB staff estimates

[1] The statistical agency in the Maldives.
[2] The post-global financial crisis period.

the single largest market for Maldives tourism[3]—dropped 3.7 percent, as total arrivals reached slightly over 958,000, disappointing the 1 million goal set by the government at the beginning of the year. However, the performance was a marginal 3 per cent increase over 2011—achieved only because of sustained demand from China, whence arrivals rose by 15.6 percent in 2012. However, growth in the Chinese share of arrivals since the onset of the global financial crisis[4] has been associated with falling duration of stay, leading to overall low growth in tourist bed nights. Total tourist bed nights contracted by 1.2 percent in 2012, mainly because average duration of stay fell from 7 days to 6.7 days. This resulted in 0.7 percent growth overall in the tourism sector, greatly dampening the country's growth.

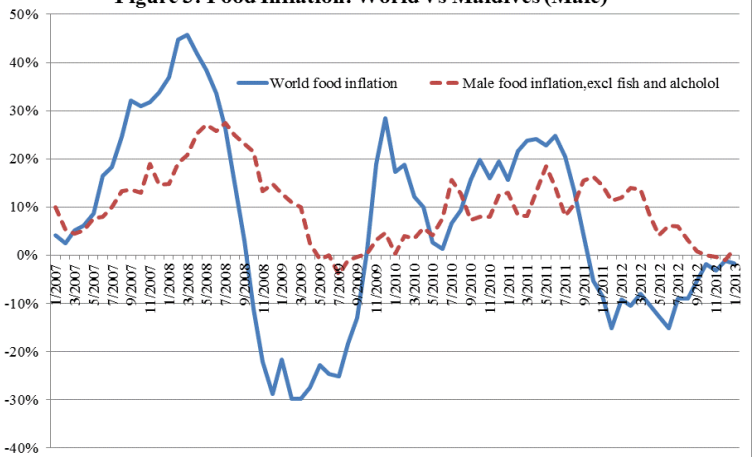


5. ***Non-tourism sectors, however—notably construction, fishing and manufacturing—performed well.*** According to preliminary estimates, these sectors posted growths of 16.1 percent, 9.7 percent and 17.5 percent in 2012. Fishing recorded robust growth after years of lackluster performance. Strong international fish prices—particularly for the Maldives famous skipjack and yellow-fin tuna, which fetched average prices of US$ 2,197 per metric ton (skipjack) and US$ 5,084 per metric ton (yellow-fin) in 2012 compared to the previous year's average of US$ 1,699 per metric ton and US$ 4,869 per metric ton respectively—boosted Maldives' fish production in 2012. Nevertheless, the fishing sector remains relatively insignificant to the overall economy, accounting for less than 2 percent of GDP.[5] Growth in construction was buoyed mainly by housing construction and property development in Male[6]—neither of which were related to the tourism sector. Housing construction has been supported by financial assistance from the government of China, mainly for projects in the main population centers of Male and Hulumale. Manufacturing output has been robust since 2010 mainly because of increased output of fish products.[7]

[3] Accounting for nearly 55 percent of total arrivals.
[4] During 2008 and 2009.
[5] Having fallen from nearly 25 percent of GDP in early 1980's.
[6] Largely commercial establishments for trading.
[7] Notably packaged and canned tuna.

6. ***Inflation moderated considerably as the once-off effects of the devaluation in 2011 wore off and aided by benign international commodity prices.*** Headline[8] inflation in Male reached 5.4 percent in December 2012, having fallen steadily from 17.7 percent in March 2012.[9] The decrease in the inflation rate has been driven by moderation in inflation in the food and non-alcoholic beverages sub-category—which recorded deflationary levels by end of the year, as well as continued deflation in prices of the health sector. This occurred despite a significant increase in the general goods and services tax (GGST) rate, from 3.5 percent in 2011 to 6 percent from beginning of 2012[10]. Given Maldives' high dependence on imported food, the decline in food inflation is due mainly to the decline in the world food price index (Figure 3). Maldives also benefitted from generally lower energy prices prevailing in 2012—with the administered prices of gasoline and diesel being revised down in January 2012.[11] However, prices were increased in September 2012 and again in January 2013 in light of the increased world oil prices.

Figure 3: Food Inflation: World Vs Maldives (Male)



Sources: Food and Agriculture Organization of the United Nations and Maldives Monetary Authority

Unsustainable fiscal position continues to present enormous challenges

7. ***The overall fiscal deficit (after grants) has far exceeded planned levels, while the government cash-flow crunch became more acute in 2012.*** Revenue collection in 2012 fell well below budgeted levels due to harder-than-expected hits from reduced customs duties[12] and shortfalls in non-tax revenues. In 2012, the government also encountered higher-than-budgeted expenditures from increased subsidies and social welfare payments, as well as transfers to state-owned enterprises (SOEs). The latest estimates by the IMF indicate that the government deficit (after grants) has reached 13.4 percent of GDP in 2012—purely in cash terms. When one includes payment arrears (discussed below), the deficit is likely to be considerably higher.[13] The outcome for 2012 contrasted with a budgeted deficit of 9 percent of GDP. Financing of such a sustained high budget deficit over the past number of years has resulted in a significant increase in public debt. The IMF Debt Sustainability Assessment ranked Maldives as high risk of debt distress, with a public debt--GDP ratio of over 80 percent of GDP, which suggests little room for additional (debt-creating) financing. Indeed domestic financing of the government deficit has become increasingly challenging with the government embarking on three very imprudent means of financing: (a)

[8] Or point-to-point.
[9] The devaluation of the currency happened in April 2011, so by March 2012 the effects had dissipated.
[10] The GGST commenced in October 2011at a rate of 3.5 percent. A number of food and other essential items are zero rated under the GST – which served to mitigate price impacts following the increase of the GGST rate.
[11] Maldives has an automatic pass-through of the international price of gasoline and diesel to pump prices.
[12] Wide-ranging customs-duty reductions on a wide array of goods became effective on January 1, 2012.
[13] In its budget for 2013, the government estimated the deficit for 2012 to be 12.6 percent of GDP. However, given the high degree of uncertainty surrounding the fiscal numbers the government estimate is likely to be low.

ad-hoc borrowings from the banking sector and the private sector at high interest rates, (b) increased monetization, and (c) running payment arrears.[14]

8. ***Revenue collection has improved since the introduction of new tax measures in 2011[15] but is still insufficient to meet larger expenditure needs.*** Total revenue collection[16] in 2012 is expected to have reached MVR 9.8 billion—almost the same as in 2011[17]—but a 15 percent shortfall against the budget. The reason for the lackluster growth in revenues was the sharp drop in customs duty collection—to nearly half the intake in 2011—due mainly to far-ranging import duty cuts effective from the beginning of 2012. However, some offsetting impacts were exerted with increased intake from GST[18]—made possible by a rate increase, from 3.5 percent to 6 percent at the beginning of 2012. Non-tax revenues declined sharply in 2012, from MVR 4.0 billion in 2011 to MVR 2.3 billion in 2012. This was due mainly to declines in resort lease payments as well as a fall in profit transfers from SOE's. The former was largely due to a court ruling in late 2011 that required the government to refund some of the lease extension premiums collected in 2011, or offset them from receivables in 2012. In 2012, the government also failed to realize a substantial part of the concession fees from the airport concession awarded to GMR of India (Box 1).

Table 1: Central Government Finances, 2010 - 2012

(In millions of Rufiyaa)

	2010	2011 Est.	2012 Budget	2012 Estimates
Total Revenue and grants	**6,547**	**9,905**	**11,481**	**9,832**
Total Revenue (excl.privatization receipts)	**6,393**	**9,173**	**10,870**	**9,367**
Tax revenue	**2,931**	**4,893**	**7,390**	**6,720**
o/w Import duty	2,056	2,587	1,961	1,354
Business profit tax	-	35	764	1,377
Goods and Services Tax	-	908	3,237	2,558
O/w: General GST	-	243	1,658	979
Tourism GST	-	665	1,579	1,579
Tourism Tax (US$ 8 bed tax)	597	751	875	813
Bank profit tax	203	230	230	256
Nontax revenue	**3,412**	**3,745**	**3,449**	**2,633**
SOE profit transfers	1,080	974	753	401
Royalties, land & resort rent	1,264	1,312	1,972	1,234
Other	1,068	1,459	724	999
Capital revenue	**49**	**535**	**31**	**14**
Grants	**155**	**732**	**611**	**466**
Total expenditure and net lending	**10,816**	**12,265**	**14,662**	**14,146**
Current expenditure	**8,429**	**9,076**	**10,751**	**10,522**
o/w Salaries and wages	2,487	2,596	2,615	2,527
Social welfare contributions	1,361	1,299	2,364	2,756
Subsidies and transfers	639	998	779	780
Interest	676	726	934	925
Capital expenditure	**2,568**	**3,588**	**4,037**	**3,694**
Net lending 3/	**(181)**	**(399)**	**(126)**	**(70)**
Overall Balance	**(4,268)**	**(2,360)**	**(3,181)**	**(4,313)**
Overall Balance excluding Grants	**(4,423)**	**(3,092)**	**(3,792)**	**(4,779)**
Financing	**4,268**	**2,360**	**3,181**	**4,313**
Foreign Financing	**1,228**	**1,417**	**2,924**	
Domestic financing	**3,040**	**943**	**258**	

[14] That is financing by default of payments.

[15] The Tourism Goods and Services Tax (TGST) came into effect on January 1, 2011, a General Goods and Services Tax (GGST) came into Operation on October 1, 2011, and a Business Profits Tax (BPT) came into operation in July 2011.

[16] Inclusive of grants.

[17] i.e. flat growth in revenues

[18] Both tourism GST and General GST

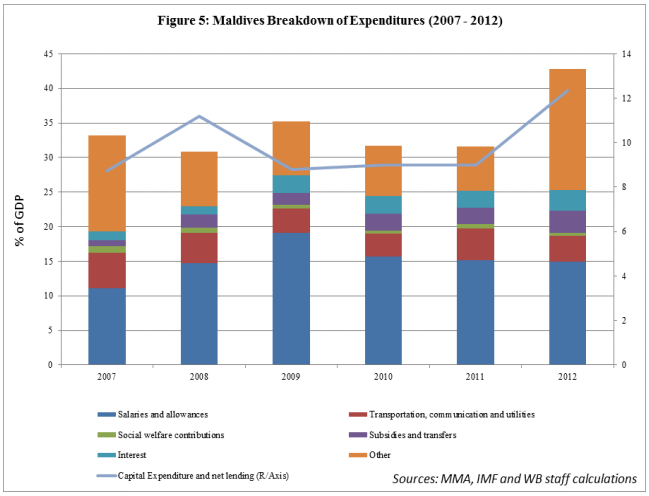
The INIA-GMR Development

In mid-2010, the then-government of President Mohamed Nasheed, assisted by the IFC, awarded a 25-year concession to upgrade and operate the international airport (the Ibrahim Nasir International Airport, or INIA) in Malé. After a long bidding and evaluation process the contract was awarded to the Indian GMR Group-Malaysia Airports Berhad (MAHB) consortium.

The US$511 million concession agreement included an upfront US$78 million payment to the government as well as periodic payment of concession and other fees based on an agreed formula. In late 2011 the Civil Court of Maldives determined that the airport development charge (ADC) which GMR was allowed to impose as part of the concession —was invalid as it had not been authorized by the Majlis. The court ruling effectively prevented the GMR consortium for levying the charge, with the onus falling on the government to absorb the loss (as foregone revenue).

In August 2012, the new government of President Waheed issued a stop order on the consortium after which construction work initiated by the GMR-MAHB on the INIA stopped. In late November, the government declared the concession agreement void and subsequently the airport was handed back to the government on December 8. The issue is currently under arbitration.

9. ***Total expenditures remained high at over 42 percent of GDP—due largely to unmanageable public-sector remunerations costs—while in 2012 expenditures rose substantially through transfers, subsidies and social contribution costs***. The principle scourge of public expenditures in the Maldives is the high public-sector remunerations cost which accounts for nearly one-third of total expenditures (or around 14 percent of GDP). Over the years, both the increase in number of public sector workers[19] as well as their salaries and allowances has resulted in a significant fiscal burden which is unlikely to be effectively addressed in the near term. Transfers to SOE's increased significantly in 2012—reaching over MVR 1 billion (or 3 percent of GDP), as the government covered higher operational losses and salary increases of SOE staff[20] through budgetary transfers. The government's universal health insurance scheme, *Aasandha*,[21] turned out to be costlier than anticipated, with the entirety of the allocation for 2012 (MVR 720 million) being exhausted by July.[22] The government estimates total *Aasandha* claims to have reached MVR 1.2 billion by year-end. The electricity subsidy has also proved more costly than anticipated and is expected to have exceeded the total allocated budget of MVR 358 million, by around MVR 70 million by year-end. All

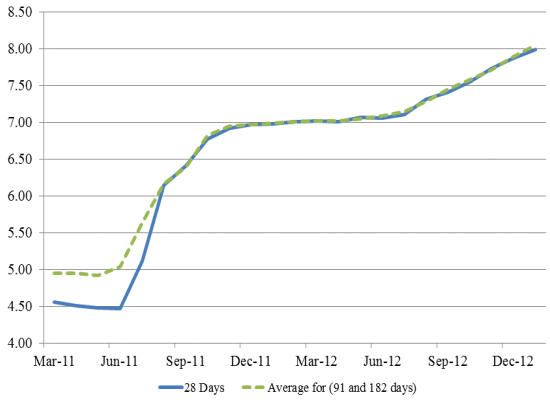


[19] Which is currently estimated at over 33,000 – or nearly one-quarter of the labor force.
[20] Who are not subject to the stricter compensation guidelines of the civil service
[21] Introduced from 2012.
[22] However, claims on government made by the *Aasandha* company for the settlement of patients' bills have not been settled by the government since March. This is a major source of current arrears build-up.

subsidy and social protection schemes in Maldives suffer from lack of proper targeting, which renders the schemes somewhat inefficient. For example, the food subsidies provide essential food staples (rice, flour and sugar) to all at low administered prices.[23] This implies that even the resort sector (which by and large caters to an extreme high-end niche segment of tourist) becomes eligible for food subsidies. Further, the electricity subsidy benefits all households in Male and both businesses and households in the atoll islands. Some form of rationalization of the subsidy schemes, and better targeting, is vital for fiscal consolidation to succeed.

10. ***Financing of the unsustainably high fiscal deficit is becoming increasingly challenging.*** From the second quarter of 2012 the government was faced with a serious cash flow constraint. For much of its deficit financing in recent years the government has turned to the domestic markets, through sale of government securities.[24] This has seen a steady increase in treasury-bill (T-bill) yields (Figure 6) while the interest cost has more than doubled, from 1.2 percent of GDP in 2007 to 2.7 percent of GDP in 2012. However, selling more T-bills to the market had become challenging as its main subscribers—commercial banks—have become increasingly reluctant to hold government paper,[25] while efforts by the government to promote its securities to the wider public did not prove successful. Against this backdrop, the government has been forced into three very imprudent forms of financing which are likely to have far-reaching consequences for the economy. These are: (i) increased reliance on ad-hoc forms of borrowings from both the banking and private sectors at high interest rates, (ii) increased monetization of the deficit, and (iii) build-up of payment arrears. In May, the government raised a MVR 300 million facility from the predominantly state-owned Bank of Maldives at a rate of 9 percent[26]—roughly 200 bps above the T-bill rate, while in July 2012 and again in January 2013 it undertook several borrowings (in both rufiyaa and US dollars) from private-sector resort owners. Considerable recourse to monetization was also witnessed in 2012 with a buildup of large outstanding balances in the Public Bank Account (PBA)[27] of government with the Maldives Monetary Authority (MMA). This was partly due to the absorption of all unsubscribed T-bills in the primary auctions into the PBA account.[28] Since 2011,[29] the government has also resorted to payment defaults as a means of financing. The current *arrears* payments are now estimated to be in the order of MVR 3.5 billion (or over 10 percent of GDP). The government is finding accumulation of further arrears increasingly difficult as it has had a particular crippling effect on some entities—notably the State

Figure 6: Maldives Treasury Bill Rates, %



Source: Maldives Monetary Authority

[23] Around MVR 4 per kg for all rice, sugar and flour.
[24] Government issues 28-day, 91-day, and 180-day T-bills to market participants. It currently offers no T-bonds to the public.
[25] See also the discussion in monetary and exchange rate developments.
[26] On a two-year tenor.
[27] This used to be called the Ways and Means account.
[28] Seen in light of the lackluster demand for government securities, discussed earlier.
[29] The political administration in 2011 was different to the current government.

Trading Organization[30]—for which government arrears currently amount to MVR 1.9 billion, as well as several entities in the private sector.

11. ***Fully realizing the fiscal predicament of the country, the new administration in its maiden budget (for 2013) introduced a host of hardening measures aimed at pruning expenditures and increasing revenue.*** The most important measure was the increase of the Tourism GST to 12 percent (from 8 percent) from July 2013. Further measures were also announced to increase the base for GGST as well as raise the airport departure tax from US$18 to US$25. On the expenditure side, measures were announced to reduce subsidies and welfare payment outlays, and the Majlis introduced sweeping cuts on line-agency allocations before passing the budget. However, such initiatives—laudable though -- they are unlikely to substantially reduce the fiscal deficit, given the absence of specific policies to implement the expenditure cuts—and because other expenditure-enhancing and revenue-compromising measures were introduced as well with the budget.[31] In this context, the IMF expects the deficit to remain unchanged in 2013 (around 13.5 percent of GDP). The authorities will need to take much stronger and concerted (albeit painful), measures to bring the fiscal situation sustainably under control. However, this is unlikely to materialize during the election period.

Monetary policy conduct has been increasingly accommodative in face of the untenable fiscal position

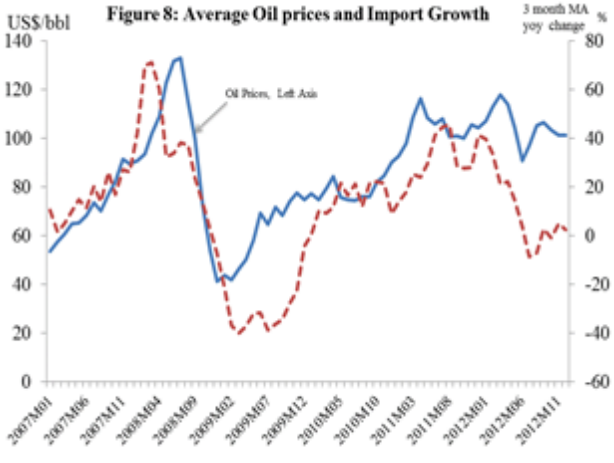
12. ***Continued high fiscal deficits are pressurizing monetary policy conduct with increased recourse to monetization in the absence of sufficient adjustment.*** Since 2008, the MMA has run successful open market operations to mop up excess liquidity in the system. However, in 2012 several of these operations were cancelled at the behest of the government—to create *space* for it to issue more government securities.[32] Furthermore, all of the unsubscribed treasuries at the primary auctions have been absorbed into the PBA. Further forms of accommodation have been extended by the MMA when it absorbed the maturing debt obligations on account of State Bank of India—whereby a US dollar facility[33] was settled on behalf of the government with consequent increase in government assets of the MMA.[34] As a result, net claims by the MMA on the central government rose a substantial 33 percent in 2012, the fastest growth since 2008. Notwithstanding the increase in net domestic assets of the MMA, overall reserve money growth in 2012 was contained because of commensurate fall in net foreign assets as the MMA ran down its foreign exchange reserves—particularly to meet the SBI bond retirement.

13. ***Credit growth to the private sector continues to remain weak.*** Total credit to the private sector shrank by 9 percent in 2012 as banks maintained a cautious stance in face of deteriorating asset quality, difficulties in loan recovery and the need to comply with the MMA's single-borrower limits, as well as internal guidelines on sectoral exposures.

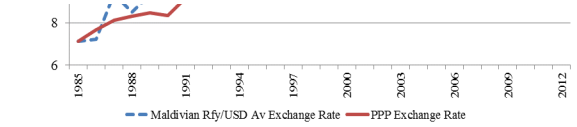
[30] The SOE which imports much of the country's staple food and fuel.
[31] For example, the abolition of the tourism bed tax in July 2013 (six months ahead of schedule), and the increased allocation to public investment projects.
[32] To a large extent subscribed by the commercial banks.
[33] Amounting to a total of US$100 million – half in December 2012 and the other half in February 2013.
[34] This resulted in a significant run-down on foreign reserves, as discussed below.

14. ***Pressure remains on the rufiyaa which continues to be misalignment with the purchasing power parity (PPP) exchange rate***. The Maldivian rufiyaa continues to trade at the higher limit of the exchange rate band announced in April 2011: around MVR 15.42 per US dollar, in official transactions. With the recent slowing in the tourism sector and payment of maturing foreign debt, the formal markets for exchange have been increasingly short of liquidity while the parallel market for foreign exchange has been burgeoning. The availability of ample liquidity in this segment vis-à-vis the formal segment has kept parallel exchange rate premiums remarkably stable for a long period of time, with the currency currently trading at a 5-10 percent premium. The lack of foreign exchange in the formal market has forced the MMA to ration foreign exchange to banks. For nearly the entire past 12 months, the PPP exchange rate has languished below the nominal exchange rate indicating that that the rufiyaa is overvalued. In addition, the steady depreciation of the PPP exchange rate since July 2012 is adding increasing pressure on the rufiyaa.

Figure 8: Average Oil prices and Import Growth



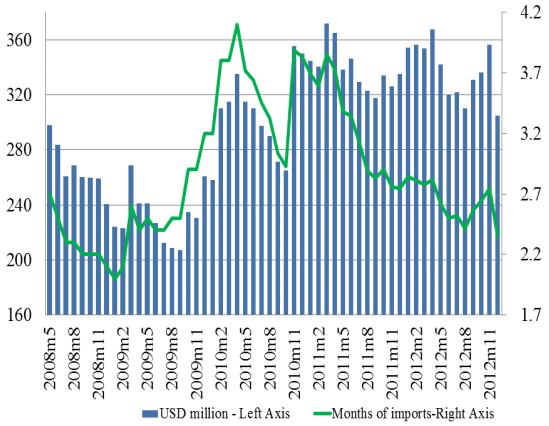
Source: Global Economic Monitor, World Bank and MMA



Source: Maldives Monetary Authority and WB staff calculations

The balance of payments (BoP) remains tenuous after recent debt settlements and because of monetization pressures.

Figure 9: Maldives Gross International Reserves



Source: Maldives Monetary Authority

15. ***The external current account deficit rose substantially in 2012***[35]**.** The current account deficit (CAD) widened in 2012 to 26.5 percent of GDP from 20.5 percent of GDP in 2011[37]. The sustained high fiscal deficits are putting enormous pressure on the CAD with much of the government expenditures—particularly outlays on the salaries and wages—likely to end up in imports[38]. In 2012, much of the increase in the CAD was attributed to the increase in merchandise imports—which reached US$1,779 million (from US$ 1,725 million in 2011)—and higher outflow of migrant worker remittance. The increase in imports is also likely to have been caused in part by the wide-ranging customs duty cuts, made effective in 2012, which led to an increase in imported food items. However, the largest growth in imports was witnessed in relation to petroleum imports—in particular increased consignments of petrol, diesel and aviation fuel. Fish exports—the only significant goods export—increased by

[35] Balance of Payments numbers are estimates made by the IMF

29 percent—due largely to strong international fish prices – while fish export volumes also increased by 6 percent. With the advent of the tourism-specific GST, the country has been better able to estimate earnings from that sector, which are expected to have reached US$1.87 billion in 2012, almost the same as in 2011, which is attributed to almost-flat growth in tourism bed nights. The rate of worker remittance repatriation has increased since 2011, due possibly to increased uncertainty about the economy, especially the US dollar liquidity situation. There are an estimated 100,000 foreign expatriate workers currently in the Maldives.

16. ***The overall BoP is expected to have registered a deficit of US$260 million, but the impact on reserves was moderate with the parallel market absorbing much of the US dollar demand.*** Accordingly, gross official reserves (GOR) fell by just US$31 billion to US$304 million by end-2012—sufficient for less than two months of imports[36]. This outcome also reflected the settlement of the SBI bond in December 2012. A second bond settlement in February 2013 is likely to have depressed GOR to around US$240 million by the end of that month. These pressures are likely to intensify in the face of further monetization, and with other planned amortization falling due in the next 12-24 months. Coupled with the woeful external situation is the consideration of external debt sustainability. According to the latest DSA update, the country's external debt obligations—comprising both public-sector external debt and private external debt—is likely to have reached 86 percent of GDP in 2012, and is projected to reach over 115 percent of GDP by 2015.[37] This presents a significant vulnerability, particularly in light of moderating tourism sector growth, and possible adverse external shocks, such as a commodity price increase.

[36] In terms of goods and non-factor services imports (GNFS)

[37] Of this, the public and public-guaranteed (PPG) external debt was estimated at 39 percent of GDP in 2012, and projected to increase to 51 percent of GDP by 2015.

Economic Outlook

18. Continued political tensions are likely to prevail in the lead-up to the elections. Both the Presidential elections (September 2013) and the Majlis elections (April 2014) are likely to be keenly contested, with the possibility of an indecisive outcome, which would likely prolong the tensions.

19. Growth prospects for 2013 and beyond is likely to remain weak in the face of sluggish global prospects, while the political crisis would also act as a dampening factor. The IMF predicts only slow growth over the medium term—reaching 3.8 percent in 2013, and thereafter around 4 percent growth in 2014 and 2015. This is strongly commensurate with the expected low growth in the tourism sector, mainly in view of the falling average duration of stay.

20. The fiscal position has weakened considerably and the recourse to highly imprudent means of financing the cash-flow shortfall could have far-reaching consequences for the economy. Taking due cognizance of this fact, the 2013 budget laid much emphasis on the consolidation of the fiscal situation—by increasing taxes and cutting expenditures. However, the effectiveness of these measures—particular the expenditure cuts, which lacks specific policies to ensure compliance—is highly debatable. Meanwhile, the authorities need to do more. Better targeting of the main subsidy schemes—particularly electricity and the *Aasandha*—should be an urgent priority. Freezing of capital expenditure in 2013 and beyond may also be a viable option. In the medium term the government should also look to address the biggest scourge of the public finance system: the size of the public sector and associated high costs of pay and allowances. A pay commission was established with the 2013 budget, but this needs to be supported by a targeted program to rationalize[38] the public sector and its payroll. In the absence of sufficient adjustment on the fiscal side, the government may be compelled to seek greater accommodation from the MMA and/or accumulate further arrears—which could seriously compromise domestic stability and erode the precious little foreign exchange reserves.

Figure 10: Monthly Fiscal Cost of Subsidies

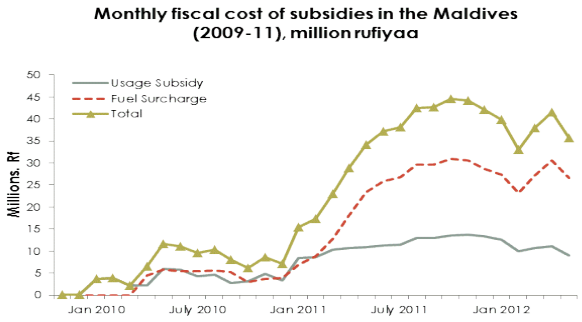
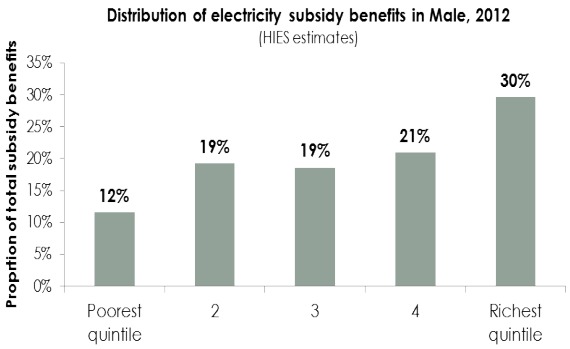


Figure 11: Distribution of Electricity Subsidy Benefits



Source: World Bank staff estimates

21. ***As long as the unsustainable fiscal deficits persist, the rufiyaa will be under pressure.*** The prospects of further money printing threaten the external stability and risk a sharp adjustment in the

[38] Or right-sizing

exchange rate. The biggest risk posed by a further exchange-rate adjustment is the possible impact it could have on poverty; the recent HIES shows that poverty rates remain high despite years of fast per-capital income growths (Table 2). However, a move to a more flexible exchange rate system—perhaps through the widening of the existing band of the managed float, or outright currency flotation—would be futile in the face of persistently high fiscal deficits. The monetary authorities need to liaise closely with their fiscal counterparts to bring about the necessary adjustments, even though such adjustments are bound to be painful. A proper and sufficient level of adjustment, on the other hand, would likely see the resumption of the stalled IMF program, and open the door for more donor support.

Table 2: Headcount ratio for Republic, Male' and Atolls-2002/03 and 2009/10.

Relative Poverty Lines	**Republic**		**Male'**		**Atolls**	
	2003	**2010**	**2003**	**2010**	**2003**	**2010**
International poverty line of US $ 1.25 ($1-a-day poverty line used in MDGs)	9%	8%	2%	7%	12%	8%
International poverty line of US $ 2	31%	24%	9%	19%	39%	27%
Rf. 44 (Median of Atoll expenditure per person per day for HIES 2009/10)	66%	51%	40%	44%	75%	55%
Rf. 22 (Half the Median of Atoll expenditure per person per day for HIES 2009/10)	21%	15%	4%	12%	27%	16%
Gini Coefficient	**0.41**	**0.37**	**0.35**	**0.38**	**0.40**	**0.36**

Note: International poverty line is measured in purchasing power parity(PPP) dollars. 1.25US$ is equivalent to Rfy 17 (with adjustment for inflation) in 2010 and Rfy 12 in 2003.

World Bank Engagement in the Maldives

22. ***The World Bank lending envelope in the Maldives has traditionally been limited.*** As of end-December 2012, the Maldives portfolio comprised of two IDA projects with a net commitment value of US$29 million, supporting environmental management as well as social protection and pension administration. A US$7.7 million mobile phone banking project of US$7.7m has fully disbursed. A significant body of analytical work and non-lending technical assistance has underpinned the Bank program over the past few years, including on human capital development, water security, the national health insurance scheme and tourism.

23. **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** (Table 2). As of December 2012, trust-funded activities totaled US$10.13 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.

Table 3: Maldives Ongoing World Bank Program

Lending (IDA, Trust Fund):

- Pension & Social Protection Administration
- Environmental Management
- Mobile Phone Banking Project
- Clean Energy for Climate Mitigation
- Ari Atoll Solid Waste Management
- Wetland Conservation and Coral Reef Monitoring for Adaptation to Climate Change
- Scaling Up Renewable Energy Program in Low Income Countries (SREP) Investment Plan
- Statistical Capacity Building

Analytical and Advisory Activities:

- Youth Development and Gender in Maldives
- Water Security in the Maldives
- Assessment of National Health Insurance
- PSIA on Health and Electricity Subsidy
- Fiscal Sustainability
- Insurance Regulation and Supervisory Advancement
- Capacity Development Support for Auditor General's Office

Maldives Selected Economic Indicators

	2007	2008	2009	2010	2011	2012E
GDP, Current, Maldives rufiyaa Mn	19,737	24,213	25,403	27,316	31,447	34,012
GDP, Current, USD Mn	1,542	1,892	1,985	2,134	2,132	2,209
GDP per capita (ppp), Current International $	5,080	6,150	6,368	6,756	6,661	6,833
GDP real growth rate, %	10.6	12.2	(3.6)	7.1	7.0	3.4
Inflation, period average, %	6.8	12.0	4.5	6.1	11.3	12.3
Current Account Balance, % of GDP	(14.7)	(32.4)	(11.1)	(9.2)	(20.5)	(26.5)
Overall Balance, % of GDP	4.9	(3.6)	1.0	4.2	(0.7)	(1.4)
Gross International Reserves, US$ Mn, end period	308	241	261	350	335	305
Gross International Reserves (months of imports)	2.3	1.4	2.1	2.5	1.8	1.6
Exchange rate, end period, Maldives rufiyaa/US$	12.8	12.8	12.8	12.8	15.4	15.4
Government Revenue and grants, % of GDP	38.4	30.8	22.6	23.9	31.0	28.9
Government total expenditure, % of GDP	42.0	42.0	43.1	39.6	42.3	42.3
Fiscal deficit, % of GDP	(3.6)	(11.2)	(20.5)	(15.7)	(11.3)	(13.4)
Financing	3.6	11.2	20.5	15.7	11.3	13.4
Privatization, % of GDP	0.2	0.2	2.0	4.5	1.2	-
External Debt, % of GDP	3.5	3.1	3.4	3.1	3.8	7.7
Domestic Debt, % of GDP	(0.1)	7.9	15.1	8.1	6.3	5.7

Sources: Maldives Monetray Authority, IMF and WB Staff Estimates