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Maldives Development Update



*Poverty Reduction, Economic
Management, South Asia Region*

The World Bank

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This report was prepared by Camilo Gomez Osorio and Daminda Eymard Fonseka with inputs from Somil Nagpal, Silvia Redaelli, and D. H. C. Aturupane

Overview

The political situation remains fluid in the Maldives. The second round of the Presidential election was due to take place as this Update was being prepared, on September 28, 2013. It will be followed by the majlis (parliamentary) election in the second quarter of 2014. Both elections are expected to be keenly contested, which implies there could be limited space for reforms.

Real GDP growth moderated and will likely close 2013 at over 4.3 percent. Tourism demand is slowly picking up, and the growing Chinese tourist segment will continue to compensate for the weaker volume of arrivals from Europe. This will have a positive impact on the non-tourism sectors, such as construction, communications, and fisheries, which will remain dynamic with a positive contribution to the economy.

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

Loose fiscal policy has led to a significant accumulation of debt at 81 percent of GDP in 2012. Arrears have become a significant fiscal risk and could be close to 6 percent of GDP.

The balance of payments is weak and external reserves are critically low. Reserves have held up better than expected, even after the settlement of significant external debt commitments in early 2013. They will continue to be under pressure from high public spending, high demand for imports, pressure on the currency, and a risk that settlement of the terminated GMR airport concession and arbitration process could lead to a significant payment due.

Recent Political and Economic Developments

The political situation will remain fluid over the coming months with the results of the presidential election and the upcoming majlis election in the balance

The political debate will be intense in the Maldives over the coming months, especially since the Supreme Court has cast doubt on the outcome of the first round of the Presidential election in early September. Former President Nasheed of the Maldives Democratic Party (MDP) was declared winner of the first round of the Presidential election on September 7 2013, over incumbent President Mohamed Waheed Hassan Manik. Since no candidate obtained the required 50 percent-plus-one vote to win an outright majority in the first round, the election was scheduled to go to a second round between Mr. Nasheed and the second-placed Abdulla Yameen, on September, 28 2013. But, just days before the ballot, the Supreme Court postponed the second round indefinitely, citing irregularities in the first round. This sparked renewed controversy and public protests. Mr. Yameen is the half-brother of former President Maumoon Gayoom, who ruled Maldives for 30 years, from 1978-2008. His narrow win (less than 3,000 votes) over the third-placed contender, business tycoon and former Finance Minister Ibrahim Gasim, prompted Mr. Gasim and others to turn to the court to halt the process. Meanwhile, the majlis (parliamentary) elections are scheduled for the second quarter of 2014. Both elections are expected to be keenly contested, and the majlis elections could lead to another hung parliament.

GDP growth moderated and will remain modest, but tourism demand is slowly picking up

Real GDP growth moderated to 3.4 percent in 2012 due to weaker tourism demand and will most likely close 2013 at over 4.3 percent.¹ While averaging 7 percent for 2010-11, growth moderated due to weaker tourism demand (Figures 1 and 3). Tourism directly and indirectly accounts for two-thirds of economic activity in Maldives, and impacts many other activities and sectors such as services, transport, and telecommunications. In 2013, it will contribute over 3 percentage points of real growth. Tourism demand from its largest market, Europe declined by 3.7 percent in 2012, but non-tourism sectors have been more dynamic. Construction, representing 9 percent of the economy, will grow at around 5.6 percent on the back of housing and land reclamation projects. While dynamic, it is down from the double-digit growth the sector experienced over the past two years, and the contribution from public investment declined in 2013. The primary sector, agriculture, and fisheries will grow by over 1.35 percent, but these account for only a small share of the economy, just 3 percent of GDP. (Figure 4)

The composition of tourist arrivals is changing, with the Chinese segment growing to partly offset the weaker European demand. A combination of weaker economic conditions in Europe and travel advisories over the political uncertainty, intensified by the ousting of President Nasheed in January 2012, led to a 3.7 percent decline in European arrivals in 2012. Total arrivals reached slightly over 958,000, which was below the government's goal of 1 million in 2012. During the first seven months of 2013, total tourist arrivals increased by an impressive 17.3 percent (y-o-y) due to the increased arrivals

¹ The Maldives Monetary Authority (MMA) forecasts 4.3 percent of real GDP growth in 2013.

from China. By end-July 2013, China accounted for 28.5 percent of total arrivals, compared to just 6 percent in 2008. European arrivals remained flat during the first seven months of 2013. This shift in composition has also led to a change in the type of services offered to tourists. Chinese tend to travel more across islands and pursue a variety of activities, but stay for shorter periods of time than Europeans. As a result the overall length of stay in Maldives has dropped from an average 7 nights in 2011 to 6.4 nights in 2013.

Figure 1: Total Tourism and Chinese Tourist Arrivals, 2008-2013 (July)

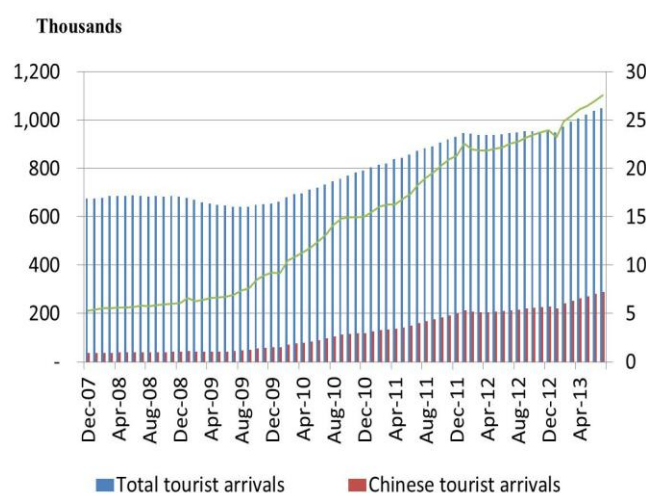
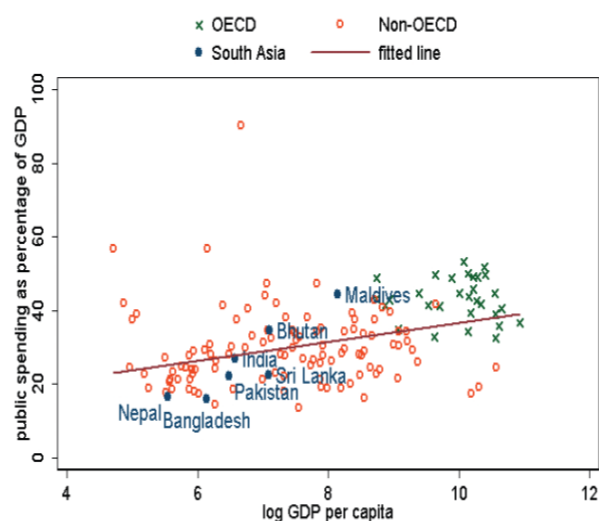


Figure 2: Public Spending and GDP per capita, 2012



Sources: Maldives Monetary Authority and WB staff estimates

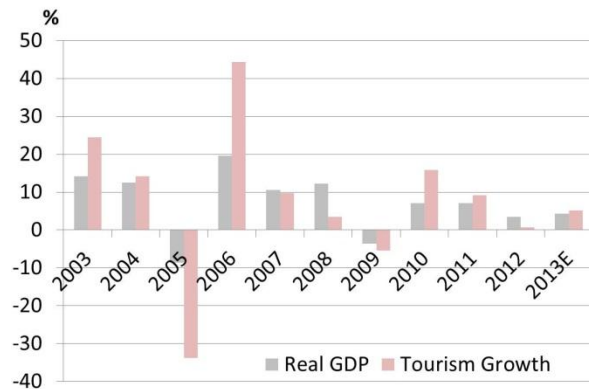
Maldives is spending beyond its means; financing the budget risks affecting the real economy

Public expenditure trends over the past five years show an increasing gap between revenues and expenditures, financed by unsustainable levels of public debt (Figure 2). Public finance imbalances in Maldives seem to lie on the expenditure side, rather than on the revenue side. In 2012, total expenditures were above 42 percent of GDP, in line with many OECD countries (in per capita terms), while total revenue collection stood at about 29 percent of GDP, the highest in South Asia (Figure 3). The debt-to-GDP ratio reached 81 percent of GDP in 2012 and projected to deteriorate further, to about 96 percent by 2015. This debt path is unsustainable and suggests there is little room for additional borrowing.

The Maldivian Economy at a Glance

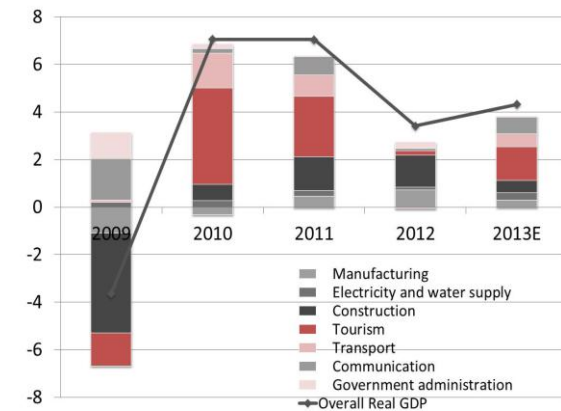
Growth is moderating...

Figure 3. Growth and Tourism Growth



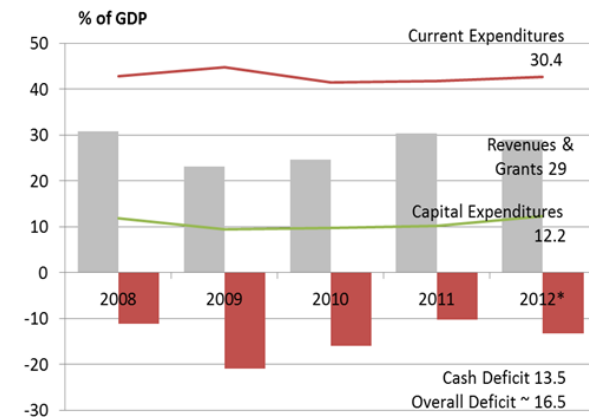
and tourism is the driver of growth...

Figure 4. Contribution to GDP, (in %)



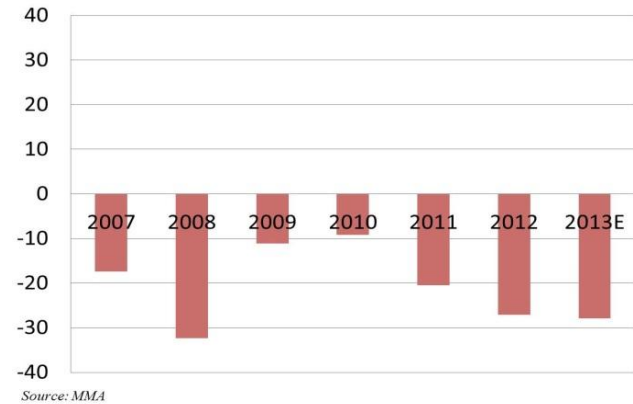
High spending is leading to high deficits...

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



and to an increasing import demand that is widening the current account balance.

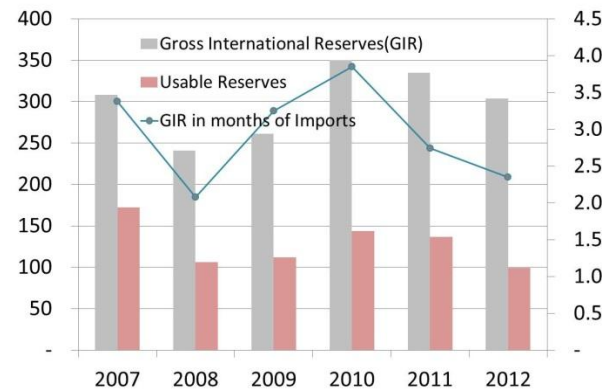
Figure 6. Current Account Balance (% of GDP)



Source: MMA

Reserves remain critically low...

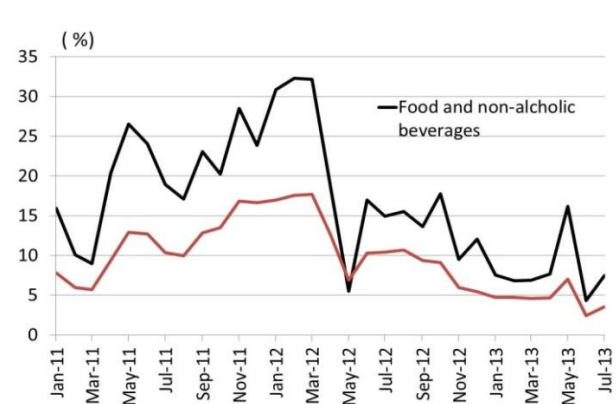
Figure 7. Reserves, (US\$ mn)



Sources: MMA and IMF Article IV

and inflation moderated.

Figure 8. Inflation and Food Inflation (Male)



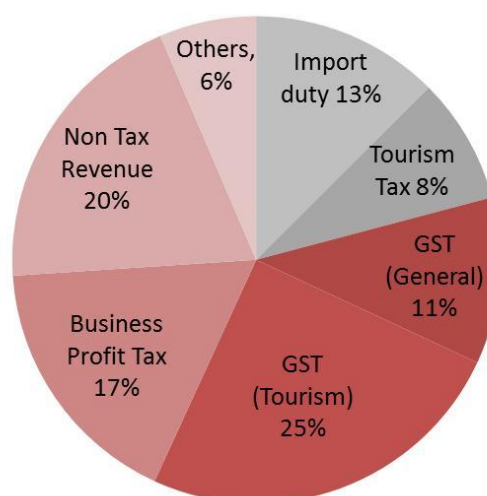
The country closed the fiscal year in 2012 with an approximated 13.5 percent of GDP cash deficit, but at around 16.5-19 percent of GDP when considering unpaid commitments through arrears. (Figure 5) Compared to the 9 percent of GDP approved budget deficit, the government found itself in a tight cash position that led to the further accumulation of arrears, which the Ministry of Finance and Treasury (MoFT) estimates will total 3 percent of GDP but the WB estimates will be closer to 6 percent of GDP. Sustaining such a high level of spending has become a challenge for government and, with limited financing options, imbalances risk affecting the real economy.

Revenue collection has been dynamic and is on track to meeting the 2013 budget target.

Total revenue and grants increased by 17.1 percent by mid- 2013 against the full year growth target of 28.4 percent. Tax revenues increased 32.6 percent (y-o-y) during the first six months of 2013 on the back of higher Business Profit Tax (BPT) and Tourism Goods and Services Tax (TGST) collection. BPT collection exceeded expectations² to record MVR 929 million in the first semester of the year, an impressive 82.5 percent (y-o-y) growth. This tax was introduced in 2012 and with companies filing their audited accounts from 2013 onwards, the revenue authority will be able to glimpse corporate earnings in Maldives. Furthermore, TGST collection increased by 54 percent over the same period, driven by the increase from 6 percent to 8 percent from January 2013 and increased tourist arrivals.³

Non-tax revenue collection was well below the expected levels due to lower transfers from state-owned enterprises (SOEs), which used to issue dividends but now are requiring transfers to cover operational losses. (Figure 9)

Figure 9: Breakdown of Total Revenues, 2013 (% , first 7 months)



Source: MIRA, World Bank calculations

² BPT collection during first eight months reached MVR 1.5 billion – close to the full-year target of MVR 1.6 billion – representing a 41 percent increase over the 2012 collection.

³ Total tourist arrivals and total bed-nights increased by 18 percent (y-o-y) and 8 percent (y-o-y) in 1H13.

Current spending is under pressure from the civil service wage bill, subsidies and social contributions, and transfers to SOEs. The civil service, employing 11 percent of the population and representing 12 percent of GDP in 2012, accounts for one-third of total spending, with significant allowances that top up salaries. In 2012, the rolling out of the Aasandha universal health scheme also pressured spending, when usage per week (at about MVR 19-20 million) proved 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.

Table I: Maldives Government Finances

<i>In Rfy Million</i>	Actual 2012	Budget 2013	% Change	First six months ¹		% Change
				2012	2013	
Total Revenue and Grants	9,818	12,602	28.4	4,665	5,462	17.1
Total Revenue	9,353	12,041	28.8	4,608	5,426	17.8
Tax Revenue	6,719	8,469	26.0	3,205	4,251	32.6
O/W: Import duty	1,354	1,642	21.3	599	679	13.3
Tourism Tax	813	434	(46.6)	432	454	5.1
GST (General)	979	1,029	5.1	490	600	22.4
GST (Tourism)	1,579	2,848	80.4	878	1,351	54.0
Airport Service Charge	310	392	26.6	172	165	(3.9)
Business Profit Tax	1,377	1,594	15.7	509	929	82.5
Other	308	531	72.3	126	73	(42.2)
Non Tax Revenue	2,633	3,572	35.7	1,384	1,064	(23.1)
Transfers from SOEs	401	675	68.3	236	31	(86.9)
Resort lease rent	1,089	1,756	61.2	507	532	5.0
Other	1,143	1,142	(0.1)	641	501	(21.9)
Capital Revenue				19	111	495.2
Grants	466	560	20.4	57	36	(37.8)
Total Expenditure excl net lending	14,216	14,084	(0.9)	7,926	8,084	2.0
Current Expenditure	10,522	10,265	(2.4)	6,267	6,783	8.2
O/w: Salaries and Wages	2,527	2,993	18.4	1,252	1,946	55.4
Other Allowances	1,694	2,370	39.9	813	1,431	76.0
Interest Payments	780	1,327	70.1	264	352	33.3
Social Welfare Contributions	2,756	1,433	(48.0)	1,176	997	-15.2
Subsidies and Transfers	780	1,327	70.1			
Capital expenditure	3,694	3,819	3.4	1,659	1,302	(21.5)
Overall balance excluding net lending	(4,398)	(1,482)	(66.3)	(3,261)	(2,623)	(19.6)
Current account balance	(704)	2,336	(431.8)	(1,602)	(1,321)	(17.5)
Primary balance	(3,618)	(156)	(95.7)	(2,997)	(2,271)	(24.2)
Memorandum Item:						
Nominal GDP	34,148	38,153		34,148	38,153	

Over the first seven months of 2013, salary expenditures increased by 55 percent in 2013, while capital spending was reduced by 20 percent. Wages and allowances were driven by an overdue payment of salary arrears,⁴ and a salary increase for the police and Maldives National Defense Force (MNDF). At the same time, capital expenditure contracted by 17.5 percent, but was still on track to exceed the full year's target of MVR 1.6 billion. Considering that parliamentary elections are due in early 2014, there is a possibility that the government issue an interim budget for 2014.

Loose fiscal policy has led to significant accumulation of debt in a short period of time. Financing has been mostly through short-term domestic sources, treasury bills (TBs). During the first six months of 2013, TBs outstanding increased by MVR 2.0 billion (from MVR 6.5 billion at end-2012 to MVR 8.5 billion

⁴ The Supreme Court ordered back-payment of salary cuts that had been imposed in 2010. The first payment was made in 2H12 and the second was in 1H13.

by end-June 2013). The private sector's appetite for TBs has declined, forcing the government to pay higher returns. Thus, the short-term interest rates for 28-day TBs and 91-day TBs rose by 98 basis points and 105 basis points. Debt is on an unsustainable path with little room for further borrowing.

Arrears have become a significant fiscal risk. While there is no monitoring of arrears, these could be between 3 percent (MoFT estimate) and 6 percent or higher (World Bank estimate). Because most of these payments are owed to SOEs providing utilities and services, and a smaller share to private suppliers, the government may not be able to continue postponing payments and is taking a hit through lower dividends and higher operational losses. About half of these arrears are owed to the State Trading Organization (STO), which is responsible for all trading activity on behalf of the Maldivian government. The bulk of the liabilities come from the import of fuel for supplying electricity. Since the company has been relying on credit from suppliers to continue operations, in the event that unpaid invoices disrupt fuel imports, the electricity supply in certain islands could be affected.

Inflation moderated over the first 7 months of 2013 with a monthly average overall inflation in Male at 4.5 percent (Figure 8).⁵ After the depreciation in April 2011, inflation (as measured by overall CPI) had been on the rise in Maldives. The controlled prices of rice, flour, sugar, diesel, petrol, electricity, remain unchanged, while the price of kerosene was revised in March 2013⁶. Given that food is mostly imported, the pass-through of prices is high at nearly 80 percent.⁷ Both domestic and external factors are pressuring the CPI. Domestically, loose fiscal policy is pressuring the demand for imported food, consumer products and oil. Fish prices, which make an important part of the Maldivian diet, have increased significantly and depend on the seasonal catch. The prices for furnishing and household goods also increased pressuring inflation further. Externally, rising global food prices and high oil prices have pressured the CPI. International oil prices remained high, ranging from US\$95-105 per barrel, and the domestic prices of kerosene saw an increase of 37 percent. 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.

The balance of payments is weak and external reserves are critically low. Managing external sector imbalances will continue to be a challenge

Authorities estimate the current account deficit will reach US\$690 million in 2013, or 28 percent of GDP, while the overall balance is likely reach a trade deficit of US\$6 million in 2013 (US\$37 million in 2012). (Figure 6) This large current account deficit has less to do with dynamic private-sector growth than with public spending. Public spending in Maldives has direct import content and there is an indirect effect through higher private consumption and public-sector salaries that fuel the demand for imports. The IMF estimates the current account deficit will remain at over 25 percent of GDP during 2012–15. This means reserves will continue to face serious 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).

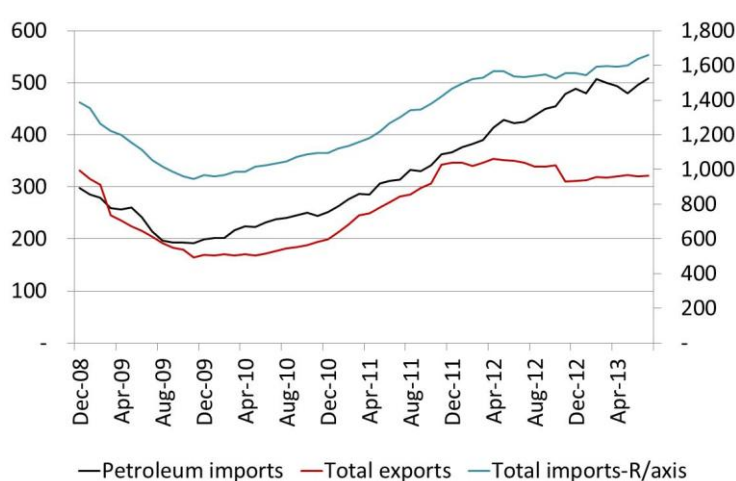
⁵ Compared to the monthly average of 13.2 percent for the same period in 2012.

⁶ Domestic kerosene prices increased to MVR 15.8 per liter from MVR 11.5 per liter.

⁷ Masha, Iyabo and Chanh Park, "Exchange Rate Pass Through to Price in Maldives," IMF Working Paper, 2012.

Import bills rose in 2013, pressured by higher petroleum imports. Total imports reached US\$989 million⁸ during the first seven months of 2013, due largely to higher imports of petroleum products, which account for 30 percent of the total. This would put the full-year imports at US\$1,659 million and US\$ 508 million for the total and for petroleum alone, which would be historic highs.⁹ This reflects largely the 8 percent rise in oil prices evident over the past four months. In April, the barrel price rose to around US\$103 and then to \$ 111 in August 2013. Re-exports remained flat, which are the largest export income earner and account for around 50 percent of total exports. The sale of jet fuel alone accounts for 80-85 percent of the total re-exports. Total exports grew by 8 percent, due mainly to higher fish exports (Figure 10).

Figure 10: Imports and Exports (US\$ million)



Source: Maldives, Monetary Authority. Note: FY2013 based on 12-month cumulative

Reserves have held up better than expected. The impact of loose fiscal policy on the balance of payments has been partially mitigated by debt financing and arrears, which to some extent have contained private-sector imports and the demand for dollars. At the beginning of 2013, Maldives had only US\$305 million in GIR, or 2.4 months of imports, with a settlement of a US\$ 50 million bond due in February 2013. Yet, by end-July 2013, the gross reserves had improved to US\$350 million, or 2.6 months of imports, even after the bond settlement. The build-up was due largely to the Inland Revenue Authority (MIRA)'s high revenue collection over the first half of 2013. While reserves continue to be at a critical level, there are two other main reasons for the positive increase in reserves. Firstly, the MMA continued to ratio foreign exchange, which has led to an active parallel market where it is trading at a premium of 10-15 percent over the official pegged rate. Secondly, strong tourism receipts have maintained the inflow of foreign currency. As a result of the rationing measures, a significant share of economic activity is currently conducted on a cash basis, and since dollars are available in the parallel market, the differential has been relatively moderate. (Figure 7)

⁸ A 12 percent increase over the US\$884 million of the same period in 2012.

⁹ Based on a 12-month cumulative as of July 2013.

Challenges and Opportunities

Delaying reforms would risk further deterioration in Maldivian economic indicators and could undermine the real economy. With inflation pressures on the rise and the risk of instability in the exchange rate, households and investors could postpone tourism investments, much needed to sustain growth, and consumption decisions. Without adequate resources for the MMA to play its macro-management role, as a result of drawing down of reserves, the Maldivian economy would be even more vulnerable to external shocks and price fluctuations.

Preparing and approving a realistic budget is a challenge. The approved budgets for 2012 and 2013 were unrealistic and projected a lower financing gap (excluding grants) by increasing taxes and cutting expenditures. Meeting the approved 3.9 percent of GDP deficit for 2013, given the 13.5 percent cash deficit of the previous year, would require significant fiscal consolidation and policy measures that are absent from the budget discussion. As a result, the MoFT is managing operations on a day-to-day basis under a tight cash situation. The government has opted for financing through ways that carry macro risks: (i) increasing reliance on short-term commercial borrowing from the banking, private sector, and high net-worth Maldivians at high interest rates, (ii) increased monetization of the deficit, and (iii) building up payment arrears. Sustaining loose fiscal policy has become a challenge for government and fiscal imbalances risk affecting the real economy.

The ability of island and atoll councils to borrow without the oversight of the MoFT poses a potential fiscal risk, particularly in the current cash-constrained environment. The 2010 Act allowed island and atoll councils to borrow from financial institutions to fund development activities, offer council assets as loan securities, and create funds for other undertakings without a formal approval from the MoFT. They can also issue financial instruments such as bonds, bills, and securities to fund development activities. While to date the councils have not incurred debt, this could pose a fiscal risk in the near future.

Generating jobs and diversifying the Maldivian economy away from tourism into other sectors will be a challenge. While tourism will continue to dominate economic activity, the local economy could integrate more and supply services and small manufactured goods that are currently imported. Diversifying into other non-tourism sectors could generate jobs and growth, particularly in the outer atolls. Similar island states in the Caribbean and Seychelles, have managed to develop smaller services sectors that are labour intensive. Developing private activity in the outer atolls will be crucial to ensure that there are jobs outside of Male for the younger population, so as to curb a rising unemployment rate, currently at 11.7 percent.¹⁰ Making growth more inclusive and creating new job categories will be a challenge.

Maldives has made steady progress in reducing the national poverty level. 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 line¹¹ shows that about 9 percent of Maldivians lived with less than 1.25 dollars per day in 2002-03. Poverty has been declining in the atolls, according to the latest

¹⁰ Refers to the ILO definition of unemployment.

¹¹ 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.

HIES 2009/10, mainly because of improved living conditions. 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 recent food price shocks. Inequality, too, is on the rise in Male, even after several years of high growth, which is an indication that making growth more inclusive remains a challenge. (Table II)

Table II. Poverty Estimates

Headcount	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%
MVR 44 (Upper Relative PL: Median of Atoll expenditure per person per day for HIES 2009/10)	66%	51%	40%	44%	75%	55%
MVR 22 (Lower Prelative PL: Half the Median of Atoll expenditure per person per day for HIES 2009/10)	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 significant progress in primary education outcomes, but limited progress on higher education. With about 62,000 students and 6,000 teachers, in approximately 220 public schools, its overall net primary enrolment rate is high, at 94 percent.¹² The system has also achieved gender parity and the net primary enrollment for both boys and girls stands at 94 percent. However, while net lower secondary enrollment rate stands at 81 percent, there is a sharp drop in net enrollment at the higher secondary education level to 19 percent. The main reason for such a sharp drop in participation at the higher secondary level has been the limited number of schools offering grades 11-12. Thus, out of about 220 schools in the Maldives, until recently only 5 provided higher secondary education. Enrollment in tertiary education is also low, at just 3 percent.

With modest learning outcomes in both primary and secondary education and substantial regional disparities, improving the quality of education in Maldives is a challenge. For example, at grade 4 the average score of students in the English language is 32 percent and in mathematics 38 percent, while in grade 8 these drop to 29 percent in English and 30 percent in mathematics. At the General Certificate of Examinations (GCE O/L) in 2010 only 33 percent of boys and 37 percent of girls passed. Aware of these challenges, the Ministry of Education (MoE) has increased the number of schools offering higher secondary education in atolls, where there are sufficient student numbers to make this expansion viable, to 38 schools: 4 schools in Male and 34 schools in the atolls. In addition, the MoE is promoting private-public partnerships to increase tertiary education opportunities (for a more detailed discussion of the spending on health, see Special Focus section below).

Human development indicators, such as infant mortality, maternal mortality and educational attainment, have registered improvements. The country is on track to meet most of the Millennium Development Goals (MDGs), and has already met the MDGs on eradicating extreme poverty and hunger, achieving universal primary education, reducing child mortality, improving maternal health, and

¹² A small number of private education institutions, which enroll about 1,700 students.

combating HIV/AIDS, malaria and other diseases.¹³ However, more needs to be done to promote gender equality and empower women, and ensure environmental sustainability and effective adaptation in order to reach these MDG goals.

The government is making population consolidation a priority to foster sustainable economic development. Currently, around 130 Maldivian islands have a population of less than 6,000, which makes the cost of service delivery high due to limited economies of scale. Through voluntary population consolidation programs, service delivery could be provided to remote outer islands where basics needs are not currently being met.

Economic Outlook

The political situation will remain fluid. The fact that results from the first round of the Presidential election are in dispute and the upcoming Parliamentary election is due in early 2014, suggests the political debate will be especially intense in the coming months. If the Presidency is in dispute and the government faces a hung Parliament, the power to enact policy measures will be limited. If the debate spurs intensified unrest, it could deter tourism arrivals and further weaken the demand for tourism, the main driver of growth in Maldives. There is a risk that loud politics will adversely impact growth.

Growth will likely close at over 4.3 percent in 2013. The IMF forecasts that 2014 could see 4 percent real growth. The stronger performance of the tourism sector during the first seven months of 2013 suggests that the economy is well-positioned to meet the government's target. Tourism has a direct impact on other sectors such as construction and services, and the growing Chinese demand will continue to compensate for the weaker tourist arrivals from Europe. The non-tourism sectors will remain dynamic maintaining their positive contribution to the economy. The construction sector will face the demand for upcoming new resorts, while the fisheries and non-fisheries segment will continue to meet the local demand. The services sector will remain dynamic with high domestic demand for communications and from tourists.

With a weaker fiscal position, the deficit financing during the remainder of the year will be very challenging. Already the government has encountered serious cash flow issues and this is likely to worsen into the fourth quarter of 2013. It will most likely face a financing gap 4 times that approved in the 2013 Budget. This would mean a continuation of ad-hoc expensive financing of the budget and the accumulation of more arrears. Debt would continue to accumulate to over 91.5 percent of GDP by 2014. However, the arrears may not be postponed much longer and when suppliers stop providing services there could be a disruption in service delivery, like the supply of electricity in the outer atolls.

The new government could seek an adjustment mechanism to curtail expenditures and raise revenues. Better targeting of the main subsidy schemes – particularly the electricity subsidy and the Aasandha – should be a priority, while postponing capital expenditure beyond 2014, may also be a viable option. In the medium term the government may look to structurally address pressures on public finances: the size of the civil service and associated high costs of pay and allowances. A pay commission was established with the 2013 budget, but this needs to be supported with a targeted program to rationalize the public sector and its payroll. Furthermore, limiting the direct budget transfers to SOEs

¹³ Millennium Development Goals – Maldives Country Report 2007, Government of Maldives.

would require containing operational losses and contingent liabilities. Finally, the consolidation of taxation measures – raising tax rates (particularly GST) and reversing or rationalizing the import-duty rate reductions may help to close the gap.

With persistent loose fiscal policy, the rufiyaa and reserves will be under considerable pressure. The government and the MMA are increasingly concerned about debt service commitments, which could wipe out the current usable reserves. The impact on the balance of payments has been partially mitigated by debt financing and arrears, but the pressures on the currency from imports and the demand for dollars will continue. The risk of money printing, due to the cash constraints, could threaten external stability, inflation, and risk sharp adjustment in the exchange rate. The biggest risk posed by a sharp exchange rate adjustment is its possible impact on poverty, since the most basic food items in Maldives are imported. 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.

Special Focus: Universal Health Insurance in the Maldives – The Aasandha Program

In recent years, Maldives has witnessed major changes in the way in which health is financed in the country. Data from the Household Income and Expenditure Survey (HIES) reveals a 42 percent increase in real per capita expenditure on health over the period 2003/04 to 2009/10. On January 1, 2012, the country introduced Aasandha, its universal health insurance program, expanding on the earlier Madhana insurance administered by the National Social Protection Agency (NSPA) under the Ministry of Health and Family.¹⁴ The earlier scheme covered about 25 percent of the population, mostly comprising of civil servants, senior citizens, and voluntarily enrolled individuals. Health expenditure in the Maldives, both incurred by the government and the amount spent out-of-pocket by households, has risen steeply in recent years, in line with overall improvements in the population's living conditions and the expansion of health care supply.

The scope of Aasandha benefits is comprehensive. It covers inpatient and outpatient treatment including drugs and diagnostics within an overall cap of MVR 100,000 per person per year. Though subject to certain specified exclusions and conditions,¹⁵ the entire population of over 330,000 citizens is eligible for benefits without any premium contributions.

The Aasandha represented about 2.8 percent of GDP in 2012 and proved costlier than envisaged by the government. Despite some cost containment measures introduced during the year,¹⁶ the government budgeted MVR 720 million (or 2.3 percent of GDP and average MVR 2750 per beneficiary), but spent over MVR 900 million.

¹⁴ The scheme is implemented through an insurance company, Aasandha Private Ltd¹⁴, at a contracted price of 2,750 Maldivian rufiyaa (MVR) 14 per person for the first year (2012).

¹⁵ Within the overall cap, certain outpatient treatment categories have a specific annual sub-ceiling, namely: (i) medial prescriptions (MVR 10,000); (ii) accident dental treatment (MVR 10,000); (iii) emergency evacuations (MVR 30,000); (iv) overseas travel costs (MVR 15,000); and (v) eyeglasses (MVR 1,000)

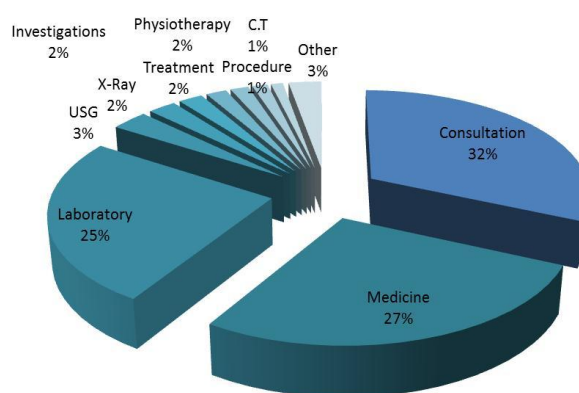
¹⁶ During the year, Aasandha introduced reimbursement caps on medicines, and followed it up with a cap on the consultation fee and certain other services in private clinics and hospitals.

During the first year of implementation administrative data suggest the scheme was over-utilized. As of December 31, 2012, a total of 276,033 citizens, or about 84 percent of the population, had already used the scheme at least once during the first year of implementation. While the average premium was about MVR 16 million per week per beneficiary, the average claim stood at MVR 20 million per week (Nagpal and Redaelli 2013b). Overall, a total of about 3.6 million transactions were recorded in the first year that represented an average 13.2 transactions per patient, a relatively high figure for a country with a predominantly young population and limited availability of medical service providers. These figures are much higher than the previous Madhana scheme, where its first year experience (2009) was in the range of six annual transactions per beneficiary. The fact that access is universal has led to a significant increase in the demand for services.

The insurance company received claims amounting to about MVR 943.6 million in 2012 (equivalent to 2.8 percent GDP), though a significant share of the claims are being rejected due to incomplete documentation. If these were accepted in full, the insurer will lose some money (vis-à-vis the premium received from the government) on account of claim payments and administration. Given that most service providers are publicly owned, residual liabilities not paid by insurance would need to be covered by the Budget through direct transfers. A closer look at the breakdown of costs shows that the provision of drugs currently accounts for 30 percent (including outpatient utilization at pharmacies and inpatient and outpatient drugs billed directly by hospitals). Also, branded drugs predominate in the market and generics are not the norm, but the exception. Aasandha costs concentrate in the Male area, where most service providers are located. Over half spending occurred in Male atoll and mostly for outpatient care (93 percent), while about 30 percent of spending was spent in the atolls. Inpatient care abroad was the predominant item.

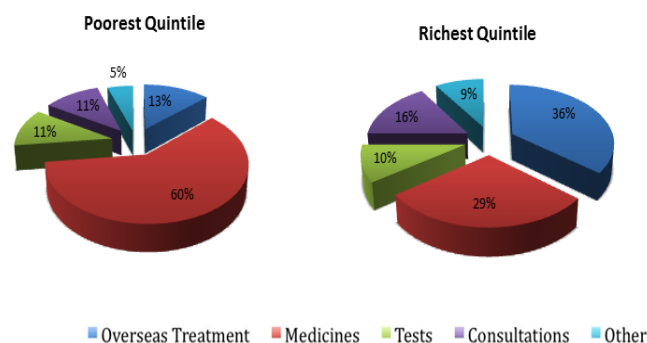
Only a small number of patients exhausted their outpatient cover during the year and had to pay out-of-pocket. A total of 0.18 percent of all transactions, corresponding to 6,089 claims, required out-of-pocket expenditures. This suggests that the coverage limits are high since few patients do exhaust them. These patients were most

Figure 11. Outpatient Services in Aasandha



Source: WB staff calculations. Note: Based on Aasandha records Jan1, 2012 – Sept 15, 2012

Figure 12: Out-of-Pocket Health Expenditure for Lowest and Highest Socio-Economic Quintiles



Source: Nagpal and Redaelli 2013b (based on HIES 2003/04, HIES 2009/10)

likely suffering from chronic illnesses that require frequent clinical attention. In addition, the composition of health expenditure varied significantly by level of wellbeing. The health expenditure of the poorest 20 percent of the Maldivian population is mostly devoted to medicines, which account for about 60 percent of their total health expenditure (against 29 percent for the richest), while treatment abroad is the largest component of out-of-pocket expenditure for the richest 20 percent of the population, standing at 36 percent of the total. (Figure 8)

Towards a More Sustainable Aasandha

The main challenge for Aasandha is fiscal sustainability. Substantive savings could be achieved without significantly compromising coverage and quality of services by re-designing the scheme with a focus on provider incentives. Measures could aim to address distributional implications, particularly with respect to the decrease in the cost of drugs that mostly affects the poorest segments of the population. The scheme could benefit from measures that ensure greater efficiency in the use of public resources and sustainability.

Medicine costs could be reduced through the bulk procurement of essential and generic drugs. The potential savings could be around MVR 200 million that along with a rigorous quality control system to boost consumer confidence in generic drugs.

Spending for overseas treatment could be limited through negotiation of close-ended package rates with providers. Aiming to provide all health services within Maldives may not be a feasible option and there will always be patients that require specialized care, equipment, and skilled specialists that need to be purchased from overseas centers. However, arrangements could be made to ensure that follow-up care, including chemotherapy of oncology cases for example, is available within Maldives to the extent feasible. Negotiating telemedicine arrangements at fixed time slots with specialists in these contracted overseas hospitals would be another way to reduce costs of overseas referrals for screening or follow-up consultations. With tighter controls for overseas treatment the system would benefit from savings of about MVR 60 million per annum at current levels of utilization.

The scheme could move away from its open-ended fee-for-service payment system to more close-ended provider payment systems. Providers of outpatient services could be paid on capitation basis, i.e. according to the number of beneficiaries served, for specified services over a period of time, along with bundled package rates for in-country inpatient services.¹⁷ In domestic public health facilities, re-configuring overtime payments for doctors and public health staff would further reduce costs to the system. Thus, to increase the productivity and accountability of staff, payments could be based on services performed rather than time spent.

Though universal in spirit, the system could target deeper benefits to needier groups of the population. Through targeting, identified populations could continue to enjoy subsidized prices, while other beneficiaries could contribute, to some extent, with co-payments. This would not only reduce cost, but could contain over-utilization. The focus could be on adequate financial protection for the poorer households, especially in the Atolls, where health expenditure has risen steeply as a share of the household's total expenditure.

¹⁷ Bundled package rates would imply a single, pre-agreed, consolidated fee for a range of hospital services, from admission to discharge.

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	4.3
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	31.0
Government total expenditure, % of GDP	42.0	42.0	43.1	39.6	42.3	42.3	41.0
Fiscal deficit (cash*), % of GDP	(3.6)	(11.2)	(20.5)	(15.7)	(11.3)	(13.4)	(11)
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 6% of GDP.