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MALDIVES

Systematic Country Diagnostic

Identifying Opportunities and
Constraints to Ending Poverty and
Promoting Shared Prosperity



WORLD BANK GROUP

MALDIVES

Systematic
Country Diagnostic

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LIST OF ABBREVIATIONS

ADB	Asian Development Bank	MRPS	Maldives Retirement Pension Scheme
CSR	Corporate Social Responsibility	MTDC	Maldives Tourism Development Corporation
DSA	Debt Sustainability Analysis	MVR	Maldivian Rufiyaa
EEZ	Exclusive Economic Zone	MW	Megawatt
EU	European Union	NDS	National Development Strategy
FAO	Food and Agriculture Organization	NGO	Non-Governmental Organization
FDI	Foreign Direct Investment	OABP	Old Age Basic Pension
G.C.E. A/L	General Certificate of Education – Advanced Level	PCB	Privatization and Corporatization Board
GDP	Gross Domestic Product	PPD	Public Private Dialogue
GERP	Growth elasticity of poverty	PPP	Public-Private Partnership or Purchasing Power Parity
GOM	Government of Maldives	R&D	Research and Development
GST/TGST	[Tourism] Goods and Services Tax	SAR	South Asia Region
HDI	Human Development Index	SCD	Systematic Country Diagnostic
HIES	Household Income and Expenditure Survey	SEZ	Special Economic Zone
IBRD	International Bank for Reconstruction and Development	SIDS	Small Island Developing States
IFC	International Finance Corporation	SME	Small and Medium Enterprises
ILO	International Labor Organization	SOE	State-Owned Enterprise
IMF	International Monetary Fund	TFR	Total Fertility Rate
LIC	Lower Income Country	TVET	Technical and Vocational Education Program
LMIC	Lower Middle Income Country	UMIC	Upper Middle Income Country
MDGs	Millennium Development Goals	UNDP	United Nations Development Programme
MIC	Middle Income Country	VAT	Value Added Tax
MIGA	Multilateral Investment Guarantee Agency	VPA	Vulnerability and Poverty Analysis
MMA	Maldives Monetary Authority	WBG	World Bank Group
MMPRC	Maldives Marketing and Public Relations Corporation	WDI	World Development Indicators
MNU	Maldives National University	WGI	World Governance Indicators
MoF	Ministry of Finance		

THE SYSTEMATIC COUNTRY DIAGNOSTIC

Under its new approach to working with its country partners, the World Bank Group (WBG) requires the preparation of a Systematic Country Diagnostic (SCD) to precede the development of Country Partnership Frameworks which guide programming. The objective of an SCD is to identify the most critical constraints and opportunities facing a country in accelerating progress toward the goals of ending extreme poverty and promoting shared prosperity in a sustainable manner. The SCD is expected to produce an objective, evidence-based, candid assessment of the main challenges facing the country, without limitation to the areas where the WBG is currently engaged.

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The team was led by Emanuel Salinas [Program Leader, Trade & Competitiveness], Ralph Van Doorn [Senior Economist] and Silvia Redaelli [Senior Economist]. The team received guidance from Francoise Clottes [World Bank Country Director] and Adam Sack [IFC Country Manager]. Andrea Gallina and Hafiz Zainudeen coordinated consultations with stakeholders in Maldives. The peer reviewers were Gabriela Inchauste, Rafael Munoz, and Raju Singh.

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DATA DISCLAIMER

The systematic analysis of opportunities and obstacles for poverty reduction and shared prosperity in Maldives is limited by shortcomings in official statistics. The lack of consistent and comprehensive data on micro and macro-economic aspects in Maldives has been identified as a significant obstacle for evidence-based policymaking and policy advice.

Understanding of poverty issues in Maldives is limited by shortcomings in the current poverty measurement framework and by data quality and comparability constraints. The latest available household survey data to assess evolution of poverty was conducted in 2009-10; differences in survey instruments and possibly in data quality limit ability to profile the evolution of poverty.

Due to the open nature of the economy and capacity constraints, macroeconomic, balance of payments and fiscal data are not always accurate. In particular, it has been suggested that the size of the tourism sector, even after recent revisions, is still underestimated. On the other hand, the official fiscal expenditure may be underreported.

The analysis of the real sector trends is constrained by lack of information on industries composition and out-of-date enterprise surveys. Lack of recent reliable labor force data, especially within the tourism sector, limits potential for analysis of youth labor market challenges. Similarly, data on role, size, management and fiscal risk of SOEs is not publicly available.

In undertaking this diagnostic, the team has aimed at complementing official sources of data with information from stakeholders gathered through surveys, focus groups and consultations. The team acknowledges the limitations in these approaches and thus data stemming from these exercises is duly identified throughout the document and used only as means of identification of main issues, rather than as a basis for conclusive assessment of policies.

Data and knowledge gaps are identified in the relevant sections of the document.



Malé, Maldives capital, is one of the cities in South Asia with highest population density at 53,700 people per square kilometer versus only 1,900 people per square kilometer in outer Atolls.

EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

GDP per capita increased from \$275 in 1980 to \$6,666 in 2013.

But Maldives' development model has not been sufficiently inclusive and its immediate fiscal, environmental and social sustainability is at stake.

Tourism-led growth has followed an enclave model, reliant on imported goods, labor and finance.

Maldives is an island nation scattered in the Indian Ocean comprising 1,190 small coral islands of which 190 are inhabited by a local population of 341,000. Maldives' unique archipelagic coral island provides the country with an extremely rich and diverse marine ecological system. With more territorial sea than land, marine resources have played a vital role shaping the contours of economic development, with nature-based tourism being the key driver of economic growth and fisheries an important sector of employment for the local population.

Maldives developed a successful high-end tourism sector, whose sizable rents have been redistributed to the population to address its development challenges. Gross Domestic Product (GDP) per capita increased from \$275 in 1980 to \$6,666 in 2013. This growth rate, which averaged 7 percent between 2002 and 2013, is mainly driven by tourism and non-tradable tourism-related activities. This impressive track record of economic growth has been supported by capital accumulation through investment in resorts, and by an increase in the labor force mainly benefiting foreign workers. Fiscal revenues generated in the tourism sector have been used to address some of the structural development challenges of Maldives' economy.

However, Maldives' development model has not been sufficiently inclusive and its immediate fiscal, environmental and social sustainability is at stake. Although this economic model based on tourism-led growth and redistribution of tourism-generated revenues has contributed to improving well-being of Maldivian population, poverty reduction has been below potential and the level of inequality – and lack of shared prosperity – remain a major challenge. Moreover, recent political and socio-economic developments have brought to evidence the inherent vulnerability of Maldives' development model and raise immediate concerns about its fiscal, environmental and social sustainability.

This Systematic Country Diagnostic for Maldives aims at identifying the most critical constraints and opportunities facing the country as it works towards promoting sustainable growth, reducing poverty and boosting shared prosperity. In addition to serving as a public good for the government, civil society, research and academic community, and local and international development partners, the findings of the SCD will be used as key inputs in the preparation of the WBG strategy, the Country Partnership Framework, which will outline how the Bank Group's engagement in Maldives can best contribute towards achieving the twin goals.

GROWTH AND REDISTRIBUTION

Bound by structural constraints and endowed with extraordinary natural assets Maldives developed a high-end tourism sector, which has resulted in a very high pace of economic growth over the past three decades. However, its form of tourism-led growth has followed an enclave model, reliant on imported goods, labor and finance. While tourism accounts for about a third of the country's GDP, it only contributes to 16 percent of the employment in the country. Linkages between resorts and local economy are similarly limited, with very few products and services supplied by local enterprises. The employment of Maldivian women in the tourism industry faces particular

obstacles. Apart from tourism and fisheries, which is a large employment and export revenue generator, there are few sizable economic activities in the country.

The development of the tourism sector in Maldives has created sizable rents, which, through taxation and other fiscal means, have been used to address some of the structural development challenges of Maldives' economy. In particular, tourism revenues have been used to support job creation in the public sector, to finance the provision of public services and expand access to primary health and education facilities beyond the capital area Malé. They also have helped insulate the local economy from international price fluctuations through a system of universal subsidies on food. The new constitution introducing democracy in the late 2000s has been accompanied by an increase in the level of redistribution: [i] the introduction of explicit electricity subsidies; [ii] the introduction of a universal health insurance scheme; and [iii] an increase in coverage and generosity of pension system.

POVERTY REDUCTION AND SHARED PROSPERITY

Poverty declined nationwide but not uniformly across Maldives' territory.

Poverty incidence in Maldives is substantially in line with that of an upper middle-income country. According to the latest available Household Income and Expenditure Survey (HIES) collected in 2009/10, the share of population living with less than \$1.25 in 2005 PPP a day was 4.9 percent, whereas the corresponding share using the \$2 a day poverty line was 17.02 percent. These figures are very similar to the average poverty outcomes of upper middle-income countries (UMIC), two of the small Pacific islands, and neighboring Sri Lanka. Maldives performs better than the other countries in South Asia with respect to several socio-economic indicators. Maldives ranks first in terms of per-capita GDP and second only to Sri Lanka based on the Human Development Index ranking.

Over the seven years between 2003 and 2010, poverty declined nationwide but not uniformly across Maldives' territory. Poverty declined in the Atolls while it remained stable in the capital area Malé. The poverty rate is the highest in the Central North and Southern atolls, while the capital area Malé is home to the largest share of poor individuals. Sustained migration from the atolls to the capital accounts for most of the diverging poverty trends at the subnational level.

Despite progress, the pace of poverty reduction has been below potential when considering the fast GDP growth of the Maldivian economy between 2003 and 2010 due to growing inequality. The growth elasticity of poverty reduction (GEPR) in Maldives of about 1.2 percent is relatively low by international standards. This is evident in comparison to other countries. For example, while Maldives and Sri Lanka shared the same growth rate (approximately 4.8 percent a year over the period), poverty reduction in Maldives was one-third less than experienced in Sri Lanka.¹ Given the slow pace of poverty reduction, Maldives will be able to reduce extreme poverty under 1 percent

¹ Poverty decreased at about 0.5 percent per year in Maldives as opposed to 1.6 percent in Sri Lanka.

EXECUTIVE SUMMARY (CONTD.)

The unequal impact of growth is further reflected by an increase in the gap between the poorest and richest segments of the population.

Maldives is highly vulnerable to shocks due to its small size, lack of economic diversification outside tourism, heavy reliance on imports, and rigid budget.

by 2040, a much longer period than upper middle-income countries, and other countries in South Asia. The lack of shared prosperity in Maldives is the main determinant of the limited impact of growth on poverty reduction. The unequal impact of growth is further reflected by an increase in the gap between the poorest and richest segments of the population.

Limited jobs opportunities, especially for low-skilled labor might have played an important role in limiting contribution of growth to poverty reduction. In particular, the lack of growth in fisheries is an important determinant of the limited contribution of growth to poverty reduction, especially in the Atolls. As labor income is the main source of household income for the poor, an inclusive development of the labor market is key for reducing poverty and boosting shared prosperity.

SUSTAINABILITY

Recent socio-economic and political developments have raised concerns regarding the fiscal, political, social and environmental sustainability of Maldives' development model.

MACRO AND FISCAL SUSTAINABILITY

Maldives is highly vulnerable to shocks due to its small size, lack of economic diversification outside tourism and heavy reliance on imports, while its rigid budget adds more risk. Especially in recent years, the development model has led to an increasing share of revenue dependent on tourism, while an increasing share of expenditure has become "rigid." The lack of macro policy buffers leaves the country with few instruments to stabilize the economy in the event of a downturn in tourism.

Unless adjustments are made to revenues and expenditures, the current development model raises immediate fiscal sustainability concerns. At current trends it is projected to lead to ever increasing levels of public debt and interest payments, even after the fiscal consolidation measures budgeted in 2015. The widening fiscal deficit has forced the country to accumulate more and more domestic debt at ever higher interest rates. Weaknesses in the Public Financial Management system and management of State-Owned Enterprises (SOEs) pose further short-term risks to fiscal sustainability.

POLITICAL AND INSTITUTIONAL RISKS

As Maldives' transition to a democratic system is still in progress, powers and relationships among democratic institutions remain to be settled. Institutional and political uncertainty constrain the sustainability of Maldives' development model moving forward.

SOCIAL SUSTAINABILITY AND VULNERABILITY

Economic opportunities in Maldives are out of sync with growth and shared prosperity. The interplay of socio-demographic trends and fiscal constraints adds to the social sustainability challenge of Maldives' development model. Particularly vulnerable to these challenges are youth and women.

Limited education opportunities and skill endowments challenge the capacity of the youth to realize their aspirations.

Climate change could cause annual economic losses of more than 12 percent of Maldives' GDP by 2100.

One of the most pressing issues relate to shortcomings in the management of natural resources, particularly with regard to sewage and solid waste management.

A growing gap between aspirations and opportunities for socio-economic inclusion contributed to fostering disenfranchisement among Maldivian youth. Limited education opportunities and skill endowments challenge youth capacity to realize their aspirations through a productive labor market engagement. High levels of actual and perceived inequality coupled with a progressive deterioration of the social contract further contribute to widening youth aspiration gap. State and familial structures combine to create a situation where youth and their families do not have the incentive to temper youth aspirations, gain skills or search for jobs, feeding into young people's limited productive engagement with the economy and society. Social ills such as gang violence and drug abuse are on the rise, and further contribute to strengthening the exclusion of "youth at risk" from the social fabric. Moreover, a growing support of more conservative religious practices among the youth and negative perceptions towards the tourism industry challenge the inclusiveness and social sustainability of Maldives' development model.

ENVIRONMENTAL VULNERABILITY AND SUSTAINABILITY ISSUES

Climate change is major threat in the long run. Climate change could cause annual economic losses of more than 12 percent of Maldives' GDP by 2100. Due to rising sea levels, the entire country could be submerged before the end of the century as 80 percent of land is less than one meter above sea level. With 42 percent of the population and more than 70 percent of critical infrastructure within 100 meters of shoreline, this would have dire social and economic consequences, notably for the poorer and most vulnerable.

There are also short-term threats to environment sustainability. The most pressing issues relate to shortcomings in the management of natural resources, particularly with regard to sewage and solid waste management. There is also a growing demand for ground water and rain water as source of fresh water, which are at high risk due to climate change and are vulnerable to shocks due to the lack of back-up arrangements. Loss of coral reef due to rising sea temperatures, pollution and damage represents a threat to the sustainability of the tourism industry and fisheries, and is also compounding the effects of climate change. Meanwhile, the institutional capacity for managing the country's natural resources is relatively weak. The cost of electricity generation through imported diesel in Maldives is the highest in South Asia, especially in the atolls, while subsidies have led to overconsumption and underinvestment in renewable sources of energy.

OPPORTUNITIES FOR GROWTH

TOURISM

Tourism is the most important industry in Maldives, but the linkages with the local economy are limited. Although Maldives has managed to position itself as a high-end destination, the sustainability of such premium cannot be taken for granted and an increase in the number of hotels may lead to lower profitability in the tourism sector. Governance shortcomings in the current model for allocation of resort leases may be hampering the development of tourism and preventing the country from maximizing benefits and enhancing inclusive growth, while concerns

EXECUTIVE SUMMARY (CONTD.)

Better linkages between the resorts and the local enterprises may help to leverage tourism growth for development of other tradable sectors.

The sustainability of fisheries is jeopardized by inadequate fisheries management and overfishing.

over the investment climate and political risk may undermine the ability of Maldives to attract reputable investors in the future. The industry has developed as an enclave, with limited positive spillovers to the local communities.

A more inclusive industry may hold the key to shared prosperity in the country. Better linkages between the resorts and the local enterprises may help to leverage tourism growth for development of other tradable sectors. Tourism is a large and rapidly growing source of jobs, but most of them are not seized by local population due to a host of factors, including: [1] reservation wage that is too high for unskilled jobs; [2] lack of skills for technical and managerial jobs; [3] social norms; and [4] lack of adequate transport. A nascent segment of community-based tourism, such as locally owned guesthouses, may represent a valuable option for diversification and inclusive growth through integration with local communities. Growth in this segment has some limitations and risks. There are still unrealized opportunities for linkages between tourism and local providers of fish and agriculture products, while opportunities for service-provision linkages are more limited, as many resorts already own and operate their support services and ancillary functions.

FISHERIES

The fisheries sector is a critical contributing sector for the country's national economy and in almost all of the country's inhabited islands. The sector traditionally provides employment, exports and food security. Environmentally friendly fishing methods have enhanced Maldives' ability to access premium markets. Marine aquaculture is nascent in Maldives, supported by government pilot aquaculture projects and a private aquaculture farm. This can be an important source of economic growth and diversification, poverty alleviation and foreign exchange earnings, but the future development of aquaculture is hindered by the limited availability of financing and technology and a lack of clarity on the legal and policy framework.

The sustainability of fisheries is jeopardized by inadequate fisheries management and overfishing. The industry is experiencing a declining trend, with both catch and employment falling. Employment of women in the downstream fish processing industry has been reduced to practically nil. Maldives fisheries sector benefits from high value stocks, but its recent trends highlight vulnerability to a mix of factors, including overfishing, higher fuel costs, temperature rise leading to change in schools aggregation and lack of more effective regional eco-systemic management of the shared skipjack tuna stock. Governance deficiencies [limited number of skipjack tuna processing licenses] appear to have hampered the development of fisheries and the value they bring to the economy. Overfishing of reef fish and climate change present risks to the sustainability of the tuna fisheries as well as tourism. Threats to the health of the coral reefs that are significant to the fishery sector also come from habitat degradation and loss due to pollution, harbor construction and reclamation.

The cost of providing basic services in a fragmented country is high.

Addressing investment climate shortcomings will be essential in order to enable the creation of inclusive economic activities in Maldives.

AGRICULTURE

Food security concerns have revitalized the interest in development of the local agriculture production. Agriculture is a relatively minor activity in Maldives and has contributed only marginally to long-term growth. Potential for agriculture is limited due to the scarcity and dispersion of arable land and high cost of fresh water for irrigation, and the country will remain dependent on imported food into the future. There are opportunities as well: there may be more potential to cater to resorts, growth in agriculture will benefit women who form the majority of employment in the sector, other higher-value fruits and vegetables could be tried tested for cultivation, and low-cost smallholder greenhouse technologies combined with household based-irrigation/ ‘fertigation’ systems could be explored.

CONSTRAINTS

Maldives suffers from the same size and geography challenges as other small island states, limiting its production base and competitiveness. As a result of these challenges, the cost of providing basic services in a fragmented country is raised across the board. Public expenditure in Maldives is structurally high, although Maldives remains an outlier in terms of spending even if accounting for its size, insularity and openness, and the duality of its economy. With its small population dispersed over many islands across long distances, the country faces the choice whether to address the challenge of the high cost of service delivery through consolidation of population closer to Malé or through improving services and connectivity to populations at their current locations. There has been a steady migration from smaller to larger islands -- in particular to the Malé City area -- leading to conditions of overcrowding in Malé, a development successive governments have tried to address with limited success.

The investment climate in Maldives features important constraints for new entrepreneurs and for the growth of existing firms. The investment climate in Maldives is much more challenging than that of similar island economies and other South Asian countries. Challenges extend beyond what is captured by Doing Business rankings [enabling environment for a firm to start operations, grow its business and resolve disputes or unwind operations in an orderly, swift and fair manner]. They include lack of access to foreign currency and sudden changes in the legal and regulatory environment taking place in absence of sufficient consultation with private-sector stakeholders. Addressing investment climate shortcomings will be essential in order to enable the creation of inclusive economic activities in Maldives.

The uniqueness of Maldives' natural resources has enabled the country to attract large amounts of foreign direct investment [FDI] in spite of shortcomings in the investment climate. However, this type of FDI, typically into the development of single-island resorts, has had limited positive spillover to the economy. Moreover, recent events, such as civil disturbances in Male and a high-profile dispute and costly legal proceedings related to the contract for investment in the international airport, have the potential to significantly undermine the confidence of foreign investors on

EXECUTIVE SUMMARY (CONTD.)

Sustainable enhancement of access to finance in Maldives will require the development and implementation of a strategy for financial sector development that addresses the shortcomings faced by the sector.

Maldives is facing important governance challenges that affect the business environment and the soundness and sustainability of economic and fiscal management.

Expanding and improving human capital will be of vital importance to promote economic prosperity and increase jobs for young people.

Maldives. That could reduce its attractiveness as a long-term investment destination in favor of jurisdictions that can provide a higher degree of certainty to foreign investors.

Access to finance has been identified as a major constraint for the development of enterprises in Maldives. Financing to the private sector has been lower than the pace of economic growth, reflecting a lack of investment opportunities in the local economy. In particular, this has affected manufacturing, fisheries and agriculture credit, which has fallen since 2007. High collateralization requirements represent major hurdles to borrowers, especially for small and medium enterprises and new entrepreneurs. Lack of access to finance has been identified by authorities as a major obstacle for entrepreneurship in Maldives, but this challenge will not be resolved through concessional credit initiatives. Instead, sustainable enhancement of access to finance in Maldives will require the development and implementation of a strategy for financial sector development that addresses the shortcomings faced by the sector.

Maldives is facing important governance challenges that affect the business environment and the soundness and sustainability of economic and fiscal management. In the public sector, limited capacity, a complex institutional framework and inter-institutional conflicts also limit the ability of the state to support social and economic progress. Institutional capacity remains much lower than that of an average upper middle-income country. A significant amount of procurement in the country is carried out by SOEs and the Ministry of Health outside the scope of national rules and central government controls, leading to doubts if public resources are spent in the most effective and efficient manner. Public-sector management suffers from inefficiencies. The lack of settlement in the political and institutional framework impairs the state's effectiveness, which has led in particular to weak rule of law. Governance issues also extend to the resort tourism sector, where a few business groups control a large share of the market.

Expanding and improving human capital will be of vital importance to promote economic prosperity and increase jobs for young people. Maldives has performed well in providing access to primary and lower secondary education. However, the country lags sharply behind in education attainment at the higher secondary level, while higher education participation is extremely low for a middle-income country. The quality of education at all levels is a major challenge facing Maldives, both in terms of inputs and outcomes. A major challenge is to equip school and university graduates with the "soft skills" demanded by employers in the country, the lack of which is linked to high youth unemployment. The quality of current Technical and Vocational Education and Training (TVET) services needs to be improved so that it becomes both more attractive for youth and more relevant for employers. For this, the gap between youth aspirations for employment (white-collar jobs) and the actual opportunities for employment (e.g., perceived lower-status jobs) needs to be addressed.

The contribution of social spending to poverty reduction and shared prosperity in Maldives is declining over time. Recently introduced social insurance schemes have created perverse economic incentives that challenge poverty reduction and shared prosperity moving forward. In

Universal electricity subsidies disproportionately benefit the richer households.

Given the importance of tourism in Maldives, a more inclusive industry represents a major opportunity for shared prosperity going forward.

Sustainable and inclusive growth of the fisheries sector will not be based on increasing the volume of catch.

particular, universal electricity subsidies disproportionately benefit the richer households, while the generosity of the social pension system has exacerbated intergenerational equity issues and potentially contributed to increasing distortions on the labor market. [Increasing trends for inter-generational transfers within the household and increasing reservation wages might challenge direct participation of the youth in the growth process.] Moreover, the defined contribution pension schemes disadvantage elderly women, given the gender income and wage disparity in Maldives.

PRIORITIZATION

Based on existing evidence and analysis conducted as part of the Systematic Country Diagnostic, The World Bank identified three priority areas to promote growth, poverty reduction and shared prosperity in a sustainable way in Maldives. The first is improving opportunities in tourism and fisheries for the local population. The second is enhancing the enabling environment, including investment climate, access to finance and skills. The third is improving the efficiency and efficacy of public resource management and reducing macro fiscal risk. These priority areas were confirmed in consultations with local stakeholders and used to further validate hypotheses and analysis.

Governance issues appear in many of these priority areas as an important cross-cutting constraint. Various dimensions of governance constraints can be identified, including lack of transparency in tourism, overlapping roles of government agencies in fisheries, incomplete legal and regulatory framework hampering the investment climate, weakness of capacity, in particular in natural resource management, and deficiencies in the management of SOEs.

PRIORITY AREA 1: ENHANCING OPPORTUNITIES IN TOURISM AND FISHERIES FOR THE LOCAL POPULATION

Given the importance of tourism in Maldives, a more inclusive industry represents a major opportunity for shared prosperity going forward. There are four potential complementary avenues to improving the inclusiveness of tourism going forward: [1] enhancing the implementation of the current resort model; [2] enabling sustainable economic diversification within the tourism sector; [3] enabling local employment; and [4] strengthening linkages between tourism and local providers of goods and services.

Maldives also has the opportunity to further develop its fisheries sector, and to capitalize on the potential benefits to enhance economic growth and sustainable development at a national level. As sustainable and inclusive growth of the fisheries sector will likely not be based on increasing the volume of catch, a transition to a wealth-based fisheries management system may hold promise for the future. There are a range of targeted options for exploiting the opportunities presented to Maldives fisheries sector at present, but effective strategies and plans will need to be developed in order to identify not only economic potential, but also environmental impact.

EXECUTIVE SUMMARY (CONTD.)

Improving the enabling environment will enhance the potential for entrepreneurship, creation of new firms and growth of existing ones.

The sustainability of Maldives' development model is dependent on how well the authorities manage the country's wealth-generating natural resources and its financial resources to redistribute this wealth, and how resilient the country is to external and domestic shocks.

PRIORITY AREA 2. ENABLING OPPORTUNITIES FOR CREATION OF NEW SOURCES OF GROWTH

Economic diversification and competitiveness in Maldives are hampered by significant structural and spatial constraints, but improving the enabling environment will enhance the potential for entrepreneurship, creation of new firms and growth of existing ones. Maldives faces similar structural challenges of other small island states that restrict the extent to which the country can attain competitiveness across the board. However, there are visible untapped opportunities where potential [in terms of existing demand and proved production capacity] exists, both within value chains of existing industries, as well as potential new economic activities.

Enabling the local population to seize these opportunities will require addressing a host of factors that represent the overall enabling environment in the country. These factors include enhancing the investment climate, access to finance and human capital.

PRIORITY AREA 3: IMPROVING THE EFFICIENCY AND EFFICACY OF PUBLIC RESOURCE MANAGEMENT AND REDUCING MACRO FISCAL RISK

The sustainability of Maldives' development model is dependent on how well the authorities manage the country's wealth-generating natural resources and its financial resources to redistribute this wealth, and how resilient the country is to external and domestic shocks. Maldives' natural resources are its marine life and its coral reefs, but there are weaknesses in the exploitation of its natural resources and in its preparedness for natural hazards. It appears that a lack of planning capacity at the local and national government level is the main constraint to dealing with the challenge of sustainability.

The main mechanisms to redistribute the wealth generated by tourism are public sector employment, social services, subsidies and transfers. The sustainability of the positive outcomes achieved through this redistribution system crucially depends on improving its efficiency and cost-effectiveness. The public sector employment freeze contributes to managing the wage bills and improving fiscal sustainability, and fiscal savings can be used to mitigate the negative impact on employment. While it is important to continue to provide wide access to health and education services, more careful planning based on the demographic distribution of the population could improve efficiency of spending and free resources to improve quality. Targeting reform of electricity and food subsidies could improve efficiency of spending while freeing resources to protect the poor. Operational savings in the universal health insurance system Aasandha could cut its cost significantly, while preserving the principle of universal health insurance. Finally, there could be fiscal savings from improving SOE management and procurement.

Better management of its resources may also make Maldives more resilient to external shocks. Maldives will remain exposed to external shocks from tourism under its current development model. While it cannot eliminate its vulnerability to shocks Maldives has opportunities to reduce its vulnerability and increase its resilience within limits by: [1] reducing exposure to shocks by diversifying its sources of tourism and reducing its reliance on fossil fuel; [2] improving international conditions to reduce the domestic transmission of shocks by reforming public expenditure and reducing the risk of the public debt portfolio; and [3] increasing its risk management through improving institutional quality, including public financing management and planning capacity, and increasing policy space.

A wide-angle photograph of a sunset over the ocean. The sky is filled with large, billowing clouds, some illuminated from behind by the setting sun, which creates a bright, golden glow. In the foreground, the dark blue ocean has small white-capped waves. A single white boat is visible on the water, moving towards the horizon. The overall atmosphere is serene and majestic.

Maldives has positioned itself
as a premium destination
for tourism and benefits
from high quality fish stocks.
These industries offer major
opportunities, but growth
can be more inclusive and
sustainable.

1. COUNTRY CONTEXT

1. COUNTRY CONTEXT

SECTION I : COUNTRY CONTEXT

Maldives is an island nation in the Indian Ocean comprising 1,190 small coral islands of which 199 are inhabited by a local population of 341,000.² Maldives' unique archipelagic coral island provides the country with an extremely rich and diverse marine ecological system. With more territorial sea than land, marine resources have played a vital role shaping the contours of economic development, with nature-based tourism being the key driver of economic growth and fisheries an important sector of employment for the local population. The population geography in Maldives is strongly polarized. The capital Malé, strategically located at the center of the archipelago and served by the first and busiest international airport, is the single most populous island of Maldives, with density as high as 53,700 people per square kilometer³ against an average of approximately 1,900 people per square kilometer in the atolls [Figure 1].⁴

LOCAL POPULATION

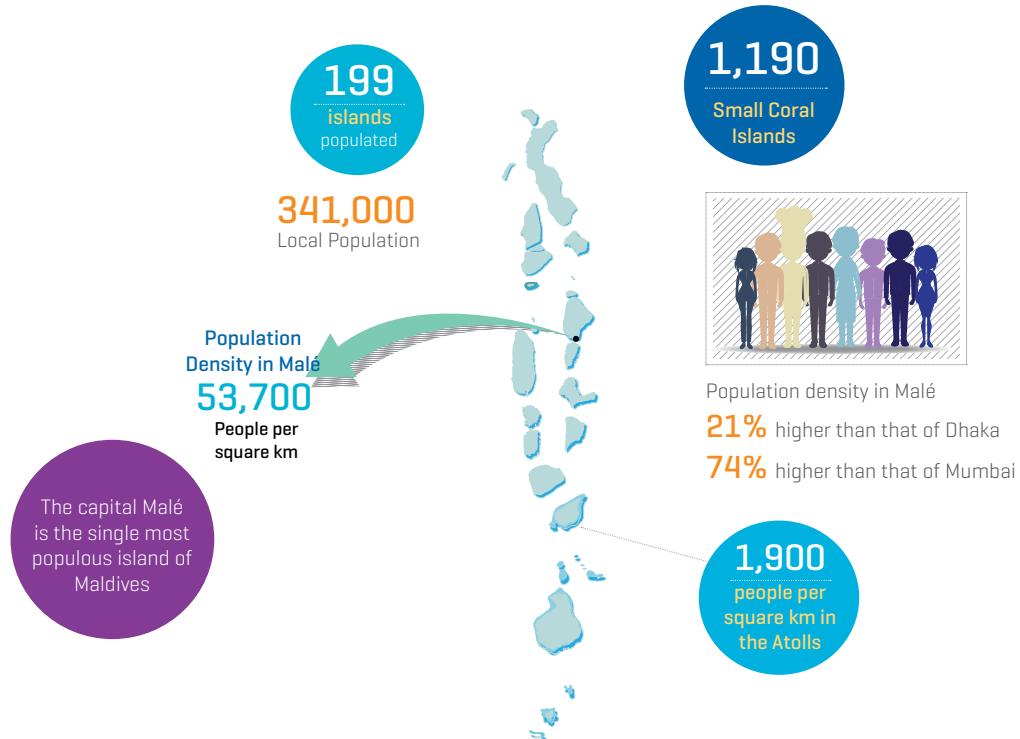


Figure 1.

Distribution of local population.

Source: National Bureau of Statistics

2 Ministry of Finance and Treasury, National Bureau of Statistics [2014], Preliminary results of the 2014 Census. Based on the same source, foreigners working in Maldives account for additional 58,682 individuals, leading to a total of about 400,000 individual

3 The population density in Malé is approximately 21 percent higher than that of Bangladesh capital Dhaka, and 74% higher than population density in Mumbai [World Atlas, 2012].

4 Ministry of Finance and Treasury, National Bureau of Statistics [2014], [2006], Maldives Population Census

Maldives shares many of the Small Island Developing States development challenges. However, in the case of Maldives, these challenges are compounded by its high geographic dispersion with 1,190 coral islands.

Over the past 30 years, Maldives has successfully built on its extraordinary natural assets to promote growth and socio-economic development. Maldives shares many of the Small Island Developing States development challenges, such as: a small domestic market; a narrow and fragile resource base; a shortage of skilled manpower; difficult inter-island transport and communication; high cost of social and economic infrastructure provision; and heavy dependence on external trade and vulnerability to external shocks and natural disasters. However, in the case of Maldives, these challenges are compounded by its high geographic dispersion with 1,190 coral islands [199 of which are inhabited] grouped in 26 atolls, spread over roughly 90,000 square kilometers. Nevertheless, the development of a profitable high-end tourism sector has fueled sustained growth rates and supported public investments in health and education. In the early 1980s, Maldives was one of the world's 20 poorest countries. Thirty years later, its inhabitants enjoy the same levels of GDP per capita and human development outcomes as a middle-income country.

However, Maldives' model of economic development has not been inclusive and its future sustainability is at stake. Although this economic model based on tourism-led growth and redistribution of tourism-generated revenues has contributed to improving well-being of Maldivian population, poverty reduction has been below potential and the level of inequality – and lack of shared prosperity – remain a major challenge. Moreover, recent political and socio-economic developments have brought to evidence the inherent vulnerability of Maldives' development model and raise immediate concerns about its fiscal, environmental and social sustainability.

This Systematic Country Diagnostic for Maldives aims to help identify the most critical constraints and opportunities facing the country as it works towards promoting sustainable growth, reducing poverty and boosting shared prosperity. In addition to serving as a public good for the government, civil society, research and academic community, and local and international development partners, the findings of the SCD will be used as key inputs in the preparation of the WBG strategy, the Country Partnership Framework, which will outline how the Bank Group's engagement in Maldives can best contribute towards achieving the twin goals.



Malé's port receives most of the country's imports, which are subsequently distributed at high cost to outer Atolls.

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY

Key Messages

- Maldives development model is based on tourism-led growth and redistribution of tourism generated revenue
- Maldives development model has led to a very high pace of growth
- Poverty reduction in Maldives is below potential due to lack of shared prosperity
- Public expenditure has increased over past five years
- Maldives' fiscal deficit has been widening leading to high public debt, while its foreign exchange reserves are very low

Maldives' model of socio-economic development relies on tourism-led growth and redistribution of tourism-generated revenue [Figure 3]. The redistribution of revenue through public service delivery is complicated by the geographical dispersion of the archipelago that prevents achieving economies of scale, and ultimately leads to question whether this model is sustainable. The performance of this development model will be assessed on its ability to: [1] generate growth; [2] include as much of the population as possible in the growth process though productive forms of employment; and [3] efficiently redistribute resources towards the neediest segment of the population to facilitate poverty reduction and shared prosperity.



Figure 3.
Maldives' development model

Source: Authors

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

GROWTH

Bound by structural constraints and endowed with extraordinary natural assets Maldives developed a high-end tourism sector, which has resulted in a very high pace of economic growth over the past three decades. GDP per capita increased from \$275 in 1980 to \$6,666 in 2013 [Figure 4]. This growth rate, which averaged 7 percent between 2002 and 2013 is mainly driven by tourism and non-tradable tourism-related activities [including construction, transport and communications] [Figure 5]. This impressive track record of economic growth has been supported by capital accumulation through investment in resorts, and by an increase in the labor force mainly benefiting foreign workers.

Economic growth in Maldives has been reliant on the development of tourism, with very limited contribution of other economic activities. Tourism accounts directly for around 30 percent of nominal GDP⁵ and has accounted for about 28 percent of real GDP growth between 2002 and 2013. Including tourism-related sectors,⁶ these numbers increase to 64 percent of nominal GDP and 65 percent of real growth. There are few other primary industries contributing to economic growth, and they are small in relative size. Manufacturing, fisheries and agriculture combined accounted for 9.6 percent of GDP in 2013, and private sector-led growth outside of the tourism sector has been limited.

Figure 4.
GDP and GDP per Capita

Source: WDI

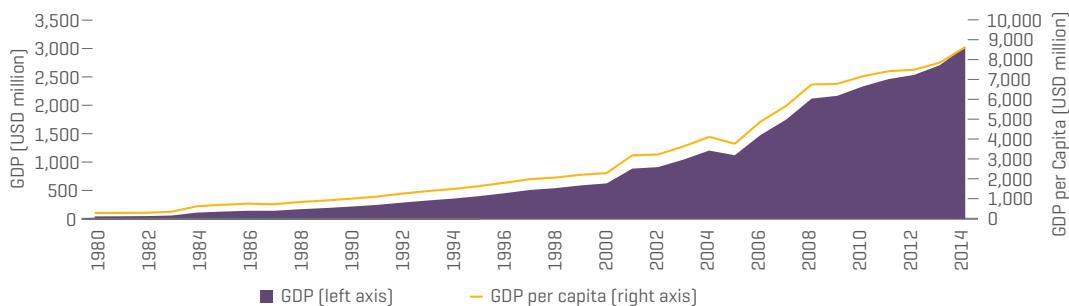


Figure 5.
GDP growth by sector

Percentage growth,
percentage point
contribution

Source: National Bureau of
Statistics



5 Relative to GDP at basic prices.

6 Transport, communication, financial services and business services benefit directly from tourism activity and tend to be highly correlated to tourism bed-nights, while real estate and construction are heavily determined by investment in the tourism sector.

GROSS DOMESTIC PRODUCT [GDP]

GDP Average growth rate

GDP Per Capita growth rate averaged 7% between 2002 and 2013

Tourism accounts for

30%

of nominal GDP

Increase in GDP Per Capita

\$275 → \$6,666

1980 → 2013

But Maldives' form of tourism-led growth has followed an enclave model, reliant on imported goods, labor and finance. Accordingly, while tourism accounts for about a third of the country's GDP, it only contributes to an estimated 16 percent of the employment in the country. Even when including sectors that benefit indirectly from tourism employment increases to only 22 percent of the total (Figure 35). Linkages between resorts and local economy are similarly limited, with very few products and services supplied by local enterprises. Manufacturing firms are small in size and lack the quality and reliability demanded by high-end resorts.

Maldives' form of tourism-led growth has followed an enclave model, reliant on imported goods, labor and finance.

TOURISM AND ECONOMY



28%
2002-2013
Real GDP growth from tourism



65%
2002 - 2013
Real growth from tourism and tourism related sectors

The participation of women in tourism jobs has been low. Even when Maldivians are employed, only about 30 percent are women, according to data from the 2009/10 HIES. Research suggests that social dynamics influence employment decisions such that families are reluctant to allow young women to take jobs in the tourism sector because they would have to travel from home to other islands and because the tourism sector is associated with "immoral and unethical" practices.⁷ A lack of child-care or residential facilities for employed women in the tourism sector further exacerbates familial unwillingness to allow young women to work away from home. Women's limited control of transportation means to travel to and from resorts adds another hurdle.⁸

7 Hope for Women [2012], ADB [2014a], Gunatilaka, R. [2013].

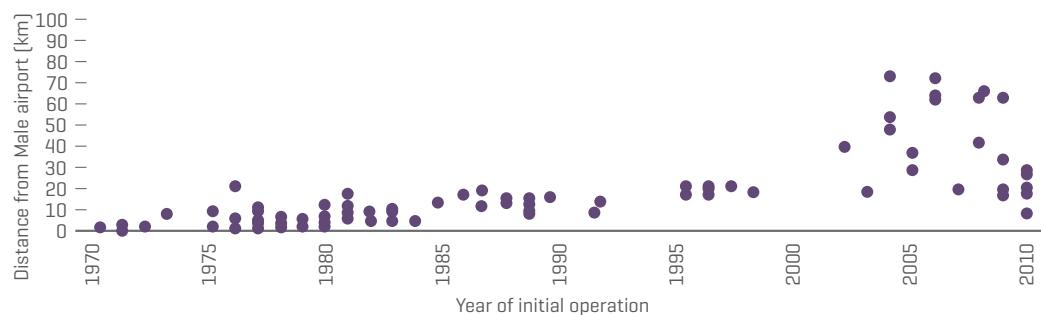
8 Hope for Women [2012], ADB [2014a].

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

The tourism industry has contributed to an already large geographical spread of activity. Starting in the atolls around the main international airport in Malé [Central North], the tourism sector is still largely concentrated around Malé, with 84 percent of resorts within 130 kilometers from Malé airport. However, the industry has been slowly taking advantage of advances in transportation opening up atolls to the north and south. In fact, the first resort outside this range was opened in 2005 and there has been a steady increase since. [Figure 6].

Figure 6.
Geographical spread of tourism resorts

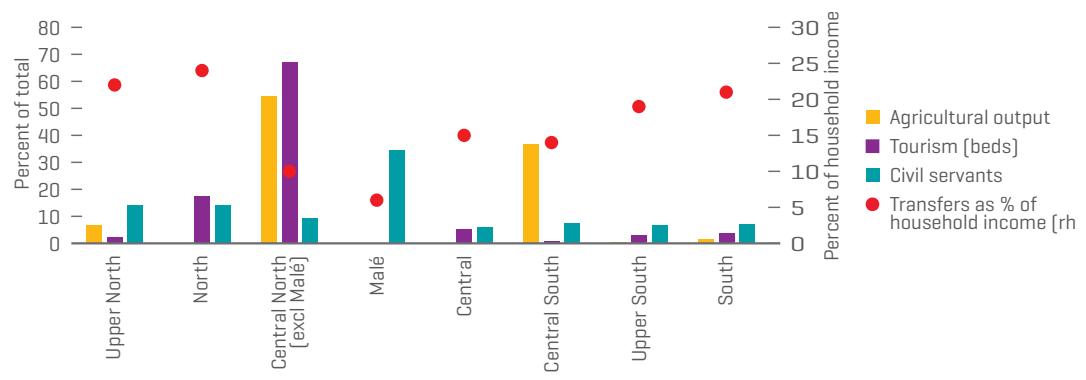
Source: Ministry of Tourism



Other economic activities also show large geographic dispersion. While public service jobs are also concentrated on Malé, with limited spread to the atolls, agricultural production takes place mainly in the Central North and Central South regions. For households in the outer atolls, public and private transfers are important source of household income [Figure 7].

Figure 7.
Geographical spread of activity

Source: Ministry of Agriculture and Fisheries, Ministry of Tourism, Household Income and Expenditure Survey [2009/10]



Note: Transfers include public and private transfers.

Fisheries make up the second most prominent industry in the country after tourism, and are the largest goods export earner.

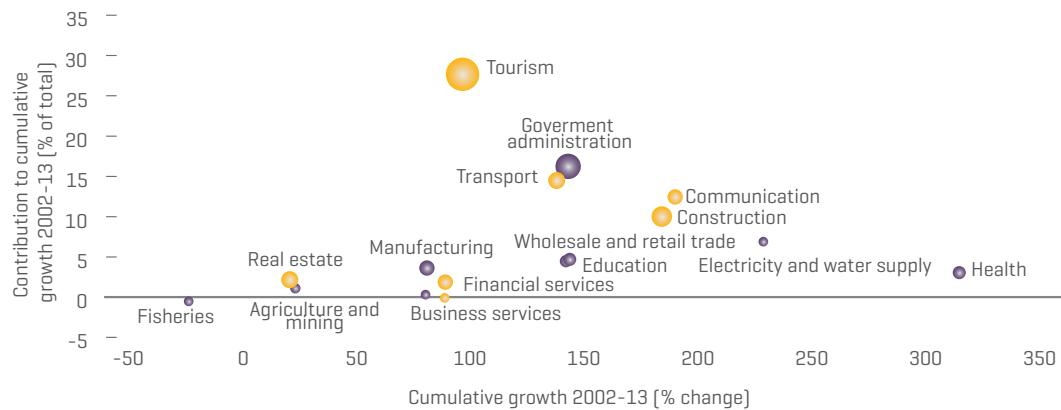
Apart from tourism, there are few sizeable economic activities in the country. Fisheries make up the second most prominent industry in the country after tourism, and are the largest goods export earner. Maldives benefits from access to high quality fisheries stock, but a large share of its value is lost through export of fish as commodities to intermediary markets. As opposed to tourism, fisheries accounts for a very small contribution to GDP (1.7 percent) but a larger share of employment (10.5 percent).⁹ Agriculture provides 2.3 percent of GDP and 4.5 percent of employment, but it does not export. However, while the economy doubled in size between 2002 and 2013, fisheries shrunk by 21 percent, and agriculture grew by only 24 percent over that period [Figure 8].

⁹ Data as of 2010.

Figure 8.

The role of tourism and other sectors in GDP growth

Source: Department of National Planning, World Bank



Note: the bubble size shows the share of each sector in nominal GDP in 2013. Bubbles in yellow are sectors that depend largely on tourism.

Tourism revenues have been used to support job creation in the public sector, to finance the provision of public services and expand access to primary health and education facilities beyond the capital area.

ROLE OF THE STATE AND REDISTRIBUTION

The development of the tourism sector in Maldives has created significant sources of revenues to the country. Since the nationalization of all land in the country in 1979 and the revocation of all permits to operate guesthouses on inhabited islands in 1984, the development of the tourism sector in Maldives has been largely dominated by a limited number of local businessmen.¹⁰ Barriers to entry and capacity controls contributed to limiting competition and diversification of investors, but also have increased rents for the state as it has managed to extract increasing fees from concessions and lease agreements¹¹ (Figure 9).

Revenues generated in the tourism sectors have been used to address some of the structural development challenges of Maldives' SIDS economy. In particular, tourism revenues have been used to support job creation in the public sector,¹² to finance the provision of public services and expand access to primary health and education facilities beyond the capital area Malé; to provide social insurance against financial risks of old age and out-of-pocket health expenditures, as well as to insulate the local economy from international price fluctuations through a system of universal subsidies on food and energy (Figure 10).

10 Mihdha (2008).

11 The tourism sector is taxed directly through the Tourism Tax (or bed-night tax), the Airport Departure Tax, the Goods and Services Tax on Tourism (TGST), while tourism also has a significant impact on import duty and Business Profit Tax revenue. Resort lease rent provides a large share of non-tax revenue.

12 Jobs in the public sector account for 17.3 percent of total employment, while jobs in education, health and social services account for 20.5 percent of employment (as of 2010).

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

Figure 9.

Tourism-related revenue

Source: Ministry of Finance and Treasury, IMF, World Bank staff calculations

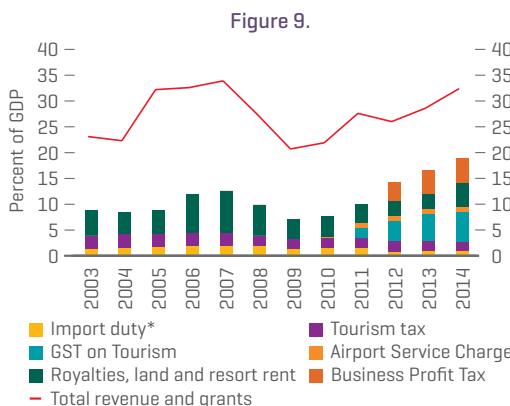
Figure 10.

Selected spending items

Source: Ministry of Finance and Treasury, IMF, World Bank staff calculations

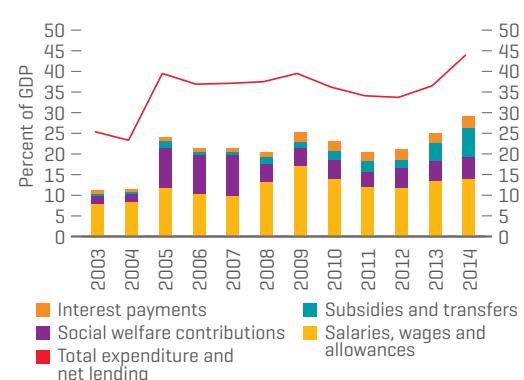
SOEs play a dominant role in many sectors, including trade, fisheries, finance, construction, transport, health and utilities.

Over the last four years, spending on electricity subsidies increased nine times, escalating from 0.3 percent of GDP in 2010 to 2.7 percent in 2014.



* An estimated 20 percent of import duty can be attributed directly to tourism. Business Profit Tax can be attributed to a large extent to tourism and related activities.

Figure 10.



The large number of SOEs further contributes to strengthening the role of the state in Maldives' economy. SOEs play a dominant role in many sectors, including trade, fisheries, finance, construction, transport, health and utilities. Although their contribution in total fiscal revenue has declined from 19 percent in 2003 to 4 percent in 2013, thanks to the shift towards new forms of taxation, combined revenue of the main three SOEs was still equivalent to 37 percent of GDP in 2013. There are currently around 84 SOEs¹³, about half of which require active monitoring, whereas 28 have been identified by the government for liquidation.¹⁴

The new constitution introducing democracy in the late 2000s has been accompanied by an increase in the level of redistribution. In particular, the increase in public spending has been mostly driven by:

- The introduction of explicit electricity subsidies. Due to high costs of domestic electricity production and distribution, the country has a long history of subsidized energy prices.¹⁵ The current system of explicit electricity subsidies was introduced in 2009 in parallel with the reform of electricity tariffs. While the electricity tariff reform was meant to curb utility providers' losses by allowing a cost-recovering pricing, the contemporaneous introduction of subsidies had the effect of transferring the cost of the electricity tariff reform and of any future increase in fuel prices onto the government's budget. Over the last four years, spending on electricity subsidies increased nine times, escalating from 0.3 percent of GDP in 2010 to 2.7 percent in 2014 [Figure 11].

13 Because of complex ownership structures, the number of firms in which the state has a combined direct and indirect stake of at least 5 percent increases to 92. The state has a control of at least 50 percent in 61 firms, out of which it has 100 percent control of 46.

14 Draft Aide-Memoire, Maldives Governance of State Owned Enterprises [SOE] mission, World Bank, June 22 - 29, 2014

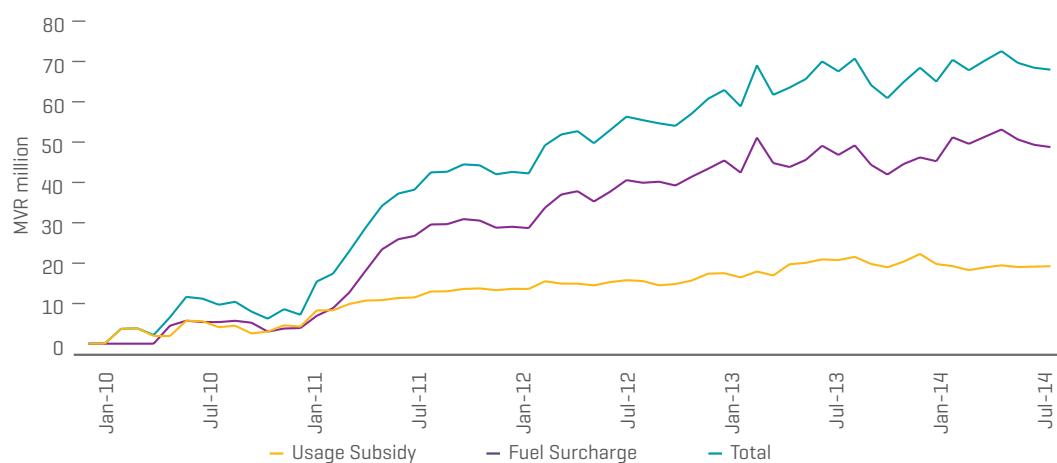
15 Due to Maldives' reliance on imported diesel for electricity generation and inefficiencies in generators' capacity, the cost of electricity production in Maldives is up to five times as high as in neighboring countries. In particular, electricity production in Maldives is 2.5, 3.3 and 5 times more expensive than in Pakistan, India and Bangladesh, respectively.

Maldives spent 9.2 percent of its GDP on health in 2011.

- The introduction of a universal health insurance scheme. The country's geography and dispersed population, along with its high dependence on imports of medical consumables and expatriate manpower, have meant that health services come at substantially higher costs when compared with other countries in the region. Maldives spent 9.2 percent of its GDP on health in 2011, about half of which came from the government treasury and the rest from household sources. Responding to a growing demand for financial assistance to cope with out-of-pocket health expenditure, the government introduced a universal health insurance system, Aasandha, in January 2012. However, the piecemeal nature of the reform, continuing capacity issues within the government and inadequate preparation and planning for these reforms have contributed to continuing efficiency, impact and cost challenges. In its first year of introduction, the scheme received claims for MVR 943.6 million [corresponding to 2.4 percent of GDP], well in excess of the amounts approved in the government budget.¹⁶
- An increase in coverage and generosity of pension system. The 2009 Pension Act extended old-age protection beyond workers employed in the civil sector and mandated the introduction of a two-pillar pension system comprising of Maldives Retirement Pension Scheme [a new contributory pension scheme based on a defined contribution model] and the Old Age Basic Pension [OABP] [a universal non-contributory pension system for individuals 65 and older]. While the extension of coverage of the pension system is aimed at closing protection gaps between the public and private sector, implementation challenges during the reform and the particular generosity of the OABP scheme have contributed to increasing government spending.

Figure 11.
Fiscal cost of Electricity
(2009-14)

Source: WB staff calculations,
based on NSPA data –
December 2014



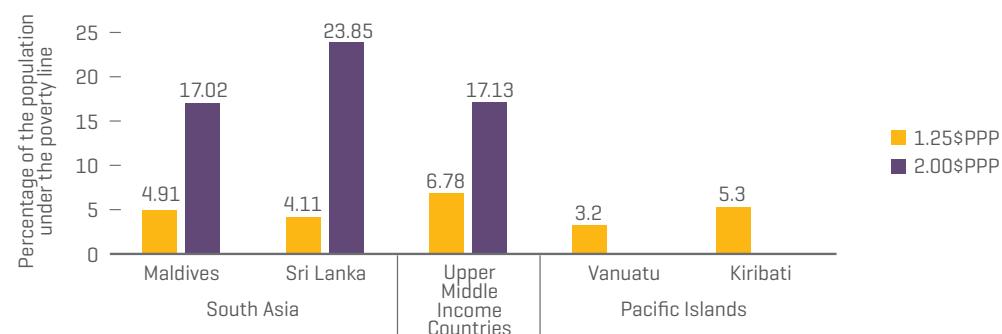
16 Budget provisions for Aasandha have been between MVR 720 and 750 million.

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

Figure 12.
International Poverty Rates, circa 2010

Source: Maldives [HIES data]; Sri Lanka and Upper Middle Income Countries [World Development Indicators]; Pacific Islands [Systematic Country Diagnostic for Eight Small Pacific Island Countries, forthcoming]

POVERTY AND SHARED PROSPERITY



Note: For the Pacific Island States the poverty line is about 1.25\$ per day. Data for Sri Lanka refers to 2009.

48,000 Individuals Deemed Poor
(one out of six Maldivians)



Maldives' poverty incidence is substantially in line with that of upper middle-income countries. According to the latest available HIES, collected in 2009/10, the share of population living with less than \$1.25 in 2005 PPP a day was 4.9 percent, where the corresponding share using the \$2 a day poverty line was 17.02 percent. These shares are very similar to the average poverty outcomes of UMICs, two of the small Pacific islands, and neighboring Sri Lanka, as shown in Figure 12. Still, these figures represent that in 2009/10, approximately 48,000 individuals [about one out of six Maldivians] were deemed poor, i.e. they were consuming at a level not sufficient to satisfy minimum food and non-food needs.

POVERTY IN FIGURES

PERCENTAGE OF THE POPULATION
LIVING WITH **\$1.25** A DAY

4.9%

PERCENTAGE OF THE POPULATION
LIVING WITH **\$2.00** A DAY

17.02%

Maldives performs better than the other countries in South Asia with respect to different socio-economic indicators and gender equality. Compared to other countries in South Asia, Maldives ranks first in terms of per-capita GDP and it is second only to Sri Lanka based on the Human Development Index ranking [Figure 13, left panel]. In 2010, life expectancy at birth was 76.8, three years higher than both the average for UMICs and Sri Lanka, the second best of the South Asia

region. Further, Maldives performance is better than the average UMC also with respect to infant mortality rate, although it is second to Sri Lanka in the South Asia region (Figure 13, right panel). Maldives fares significantly better than many countries when it comes to gender equality, ranking 49th on the Gender Inequality Index in the 2014 Global Human Development Report of UNDP, in comparison with its Human Development Index ranking of 103th. The island nation has the least disparities between men and women, when compared with other medium human development countries as well as its South Asian neighbors. The country has attained gender parity in primary and secondary enrollment, and the number of Maldivian women attaining university degrees is at par with that of men.

Figure 13.
Selected socio-economic indicators, South Asia Countries 2010

Source: HDI rank (UNDP, Human Development Reports), GDP per capita (World Development Indicators), Infant mortality rate and Life expectancy at birth (World Development Indicators).

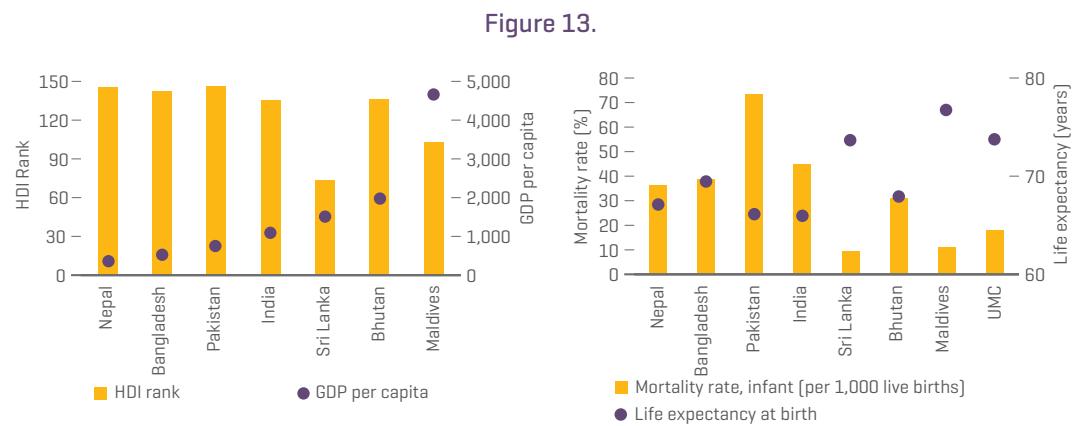


Figure 14.
National Poverty Rates, 2003 and 2010

Source: Bank staff elaboration on HIES data.



Over the seven years between 2003 and 2010, Maldives achieved a substantial decline in poverty. The poverty headcount based on the national poverty line declined by seven percentage points, from 23 percent in 2003 to approximately 16 percent in 2010. Depth and severity of poverty declined from 6 to 4 percent and from 2.3 to 1.6 percent, respectively. Similar positive trends are observed considering the \$2 PPP international poverty line. On the other hand, no statistically significant poverty decline is registered when considering the \$1.25 PPP international poverty line (Figure 14).

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

Poverty declined in the atolls while remaining stable in the capital area Malé. The decline in poverty observed at national level is the result of opposite poverty trends at regional level. In particular, while poverty remained substantially stable at around 18 percent in the capital area Malé, it declined markedly in the atolls – going from 25 percent in 2003 to 14 percent in 2010. Similar patterns are observed using the international poverty lines (see Figure 15).

Figure 15.

Poverty Rates, Malé and atolls, 2003 and 2010

Source: Bank staff elaboration on HIES 2003 and 2010 data.

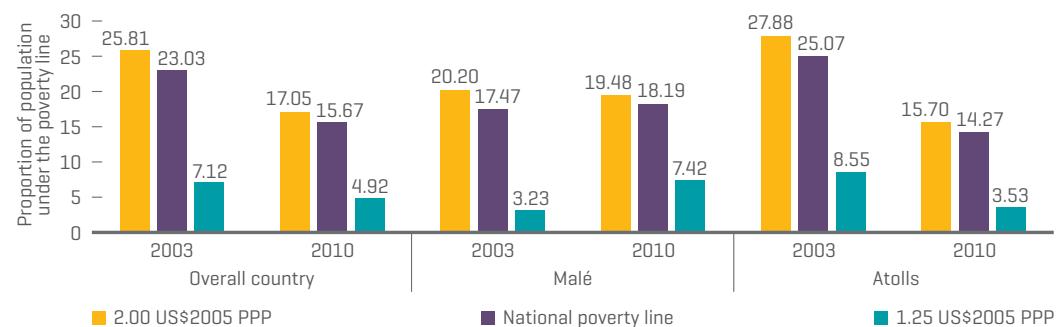
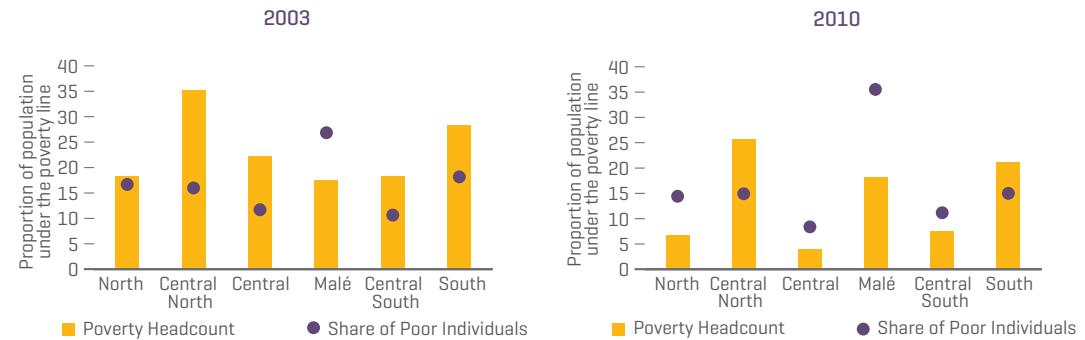


Figure 16.

Poverty headcount and share of poor individuals, by region

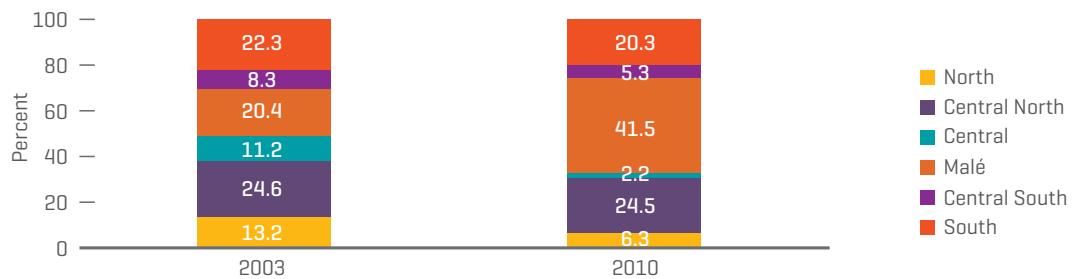
Source: Bank staff elaboration on HIES 2003 and 2010 data.



The poverty rate is the highest in the Central North and Southern atolls, while the capital area Malé is home to the largest share of poor individuals. The Central North region of the archipelagos is the poorest in both years, with poverty rates of 35 percent in 2003 and 25 percent in 2010. This is followed by the Southern region, with 28 percent poor individuals in 2003 and 21 percent in 2010. The Central region reduced its poverty rate by more than 80 percent in seven years (see Figure 16).

Figure 17.
Distribution of population, by regions

Source: Staff elaboration based on HIES data.



The pace of poverty reduction is below potential when considering the fast GDP growth of the Maldivian economy between 2003 and 2010.

Given the slow pace of poverty reduction, Maldives will be able to reduce extreme poverty under 1 percent by 2040, a much longer period than similar upper middle-income countries, and other countries in South Asia.

Sustained migration from the atolls to the capital accounts for most of the diverging poverty trends at the subnational level. The seven years between 2003 and 2010 are characterized by substantial population movement from the atolls towards the capital area Malé. The share of individuals living in Malé increased from 20 percent to 42 percent of the overall population. With only the exception of the Central North region, where the population remained stable at around 24 percent, all other regions saw a reduction in their population shares, particularly the Central and the Northern regions [Figure 17].

The pace of poverty reduction is below potential when considering the fast GDP growth of the Maldivian economy between 2003 and 2010. The GEPD in Maldives is relatively low by international standards. In particular, considering the \$2 PPP poverty line, the GEPD in Maldives is about 1.2 percent, meaning that for each percent increase in Maldives' per capita GDP, poverty fell by a mere 1.2 percent. The limited contribution of growth to poverty reduction in Maldives is evident when compared to other countries. For example, while Maldives and Sri Lanka shared the same growth rate [approximately 4.8 percent a year over the period], poverty reduction in Maldives was one-third less than experienced in Sri Lanka.¹⁷ Even Nepal and Pakistan managed to reduce poverty faster than Maldives, although in these two countries GDP growth was, respectively, 2 and 2.5 percentage points lower [Figure 18, left panel]. Maldives' limited performance in terms of poverty reduction is even more striking when considering its relatively high potential as suggested by the initial level of per capita income. With a per capita GDP of \$3,360 in 2003, Maldives started with the highest poverty reduction potential of the South Asia region. Despite the large income lever that could have helped lift individuals out of poverty, Maldives' elasticity of poverty to GDP growth was significantly lower than countries starting from similar levels of per capita GDP, and closer to that of countries with lower levels of per capita GDP such as India or Bangladesh [Figure 18, right panel].

Given the slow pace of poverty reduction, Maldives will be able to reduce extreme poverty under 1 percent by 2040, a much longer period than similar upper middle-income countries, and other countries in South Asia. If poverty keeps decreasing at the same rate as in the period 2003–2010, Maldives will reduce extreme poverty below 1 percent in 30 years, as opposed to only eight years needed to Sri Lanka, and more than double the time of the average middle-income country [14 years]. Even Pakistan and Nepal, which start with much higher poverty rates, will be two years faster than Maldives in defeating extreme poverty [see Figure 19].

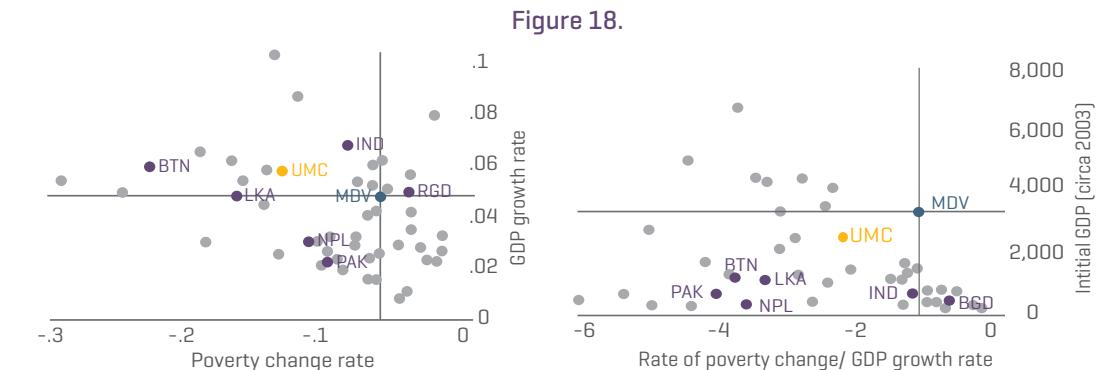
¹⁷ Poverty decreased at about 0.5 percent per year in Maldives as opposed to 1.6 percent in Sri Lanka.

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

Figure 18.

Relationship between annualized poverty changes and GDP over the period 2003-2010, an international comparison

Source: Maldives, MDV [Bank staff elaboration on HIES 2003 and 2010 data]; All other countries [World Development Indicators database].



Note: Initial and Final years varies across countries, depending on availability, and it may be one to two years before or after 2003 and 2010. GDP is expressed in constant 2000 US\$.

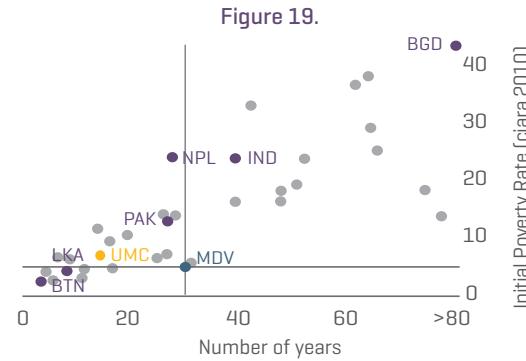
Figure 19.

Years needed to reduce extreme poverty [1.25\$ PPP] below 1 percent

Figure 20.

Growth Incidence Curve, 2003-2010

Source: Bank staff elaboration on HIES data

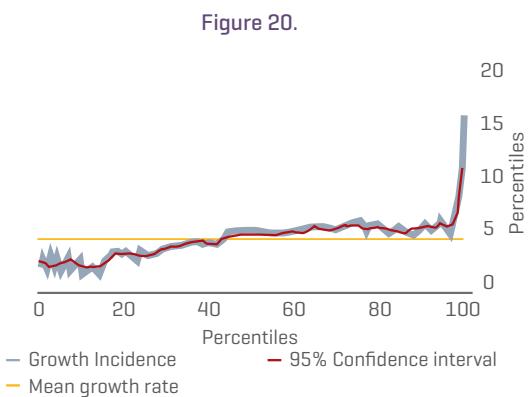


Note: The figure has been cut at 80 years for better scaling: Bangladesh would need 122 years to fight extreme poverty, given current poverty decay.

Growth is not equally shared by all sections of the distribution: the bottom 40 percent is growing less than average, while people in the upper part of the distribution are growing much faster.

The lack of shared prosperity in Maldives is the main determinant of the limited impact of growth on poverty reduction. Shared prosperity remains a major challenge for Maldives. As shown in Figure 20, growth is not equally shared by all sections of the distribution: the bottom 40 percent is growing less than average, while people in the upper part of the distribution are growing much faster. This un-equalizing impact of growth slowed down poverty reduction. Had all the segments of the population benefited equally from growth [i.e. had growth been distribution neutral], poverty would have declined by as much as 11 percentage points [Figure 21].

The unequal impact of growth is further reflected by an increase in the gap between the poorest and richest segments of the population. The increase in inequality induced by growth deepened the polarization of welfare distribution in Maldives. While inequality as measured by the Gini index declined slightly from 39.9 percent in 2003 to 38.6 in 2010, the polarization as measured by quintile ratios increased.¹⁸ In particular, if in 2003 the poorest individual in the top 10 percent



18 The Gini index is more sensitive to capturing changes around the mean of a distribution, and it is therefore poorly suited to capturing polarization and changes around the tails.

Figure 21.

Decomposition of the poverty change in Growth and Redistribution, 2003-2010

Source: Bank staff elaboration on HIES data.

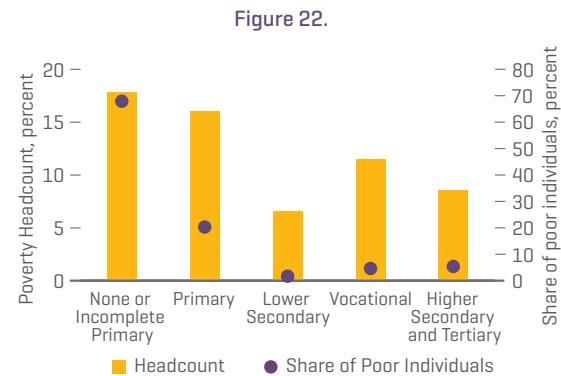
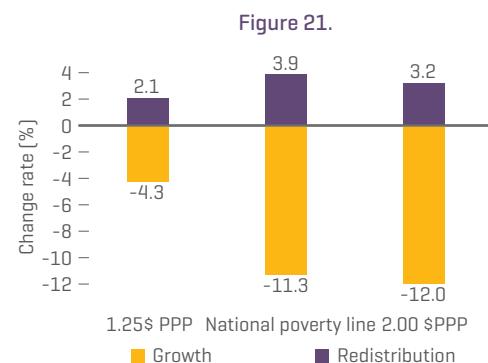
Figure 22.

Distribution of poor individuals and bottom 40 percent by level of education of the household head, 2010

Source: Bank staff elaboration on HIES data

Limited job opportunities, especially for low-skilled labor, might have played an important role in limiting the contribution of growth to poverty reduction.

of the distribution was consuming four times more than the richest individual in the bottom 10 percent of the distribution, in 2010 that individual was consuming 5.3 times more. Polarizing trends are reflected by the unequal distribution of resources: in 2010, the top 20 percent of the population commanded as much as 45 percent of total consumption against only 17 percent of the bottom 40 percent.



INEQUALITY IN NUMBERS

Total consumption



Percentage of total consumption by bottom 40% of population



Percentage of total consumption by top 20% of population

Limited job opportunities, especially for low-skilled labor, might have played an important role in limiting the contribution of growth to poverty reduction. Low education levels, inactivity and unemployment are strongly associated with a higher risk of poverty. According to HIES 2009/10 data, the lower the educational attainment of the household head, the higher is the likelihood that the household is poor. About 88 percent of the poor (and 84 percent of those in the bottom 40 percent) live in households whose head has only completed primary education (see Figure 22). Looking at labor market outcomes, Maldivian households whose head is unemployed or inactive are on average 1.5 and 1.2 times more likely to be poor than average.

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

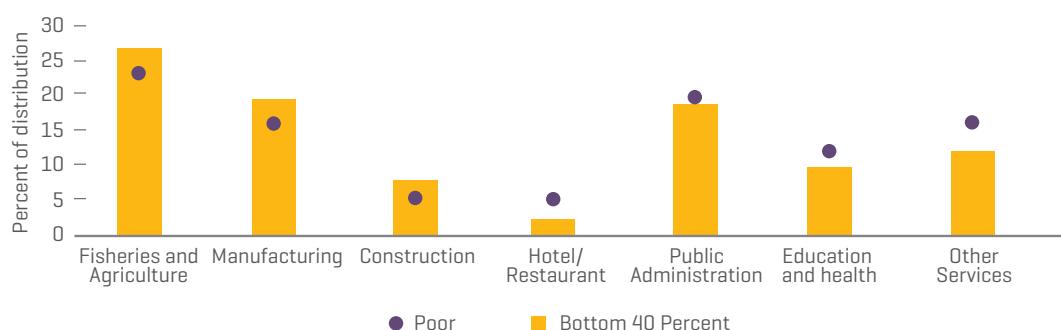
WHERE YOU WORK MATTERS FOR POVERTY REDUCTION POVERTY RATES WHEN THE HEAD OF THE HOUSE HOLD WORKS IN THESE SECTORS



Employment at the lower spectrum of the skill distribution is associated with higher poverty rates. In particular, poverty rates are higher when the head of household is employed in construction [26 percent], manufacturing [18 percent] and fisheries/agriculture [17 percent]. Taken together, these three sectors account for more than 50 percent of the poor individuals with working household heads, and the fisheries sector alone accounts for about 26 percent of the total (Figure 23). Fisheries development is particularly important in the atolls, where 30 percent of the household heads work in the fishery sector (as opposed to only 1 percent in Malé). In the atolls, the fisheries sector alone accounts for 41 percent of poor individuals with a working household head.

As labor income is the main source of household income for the poor, an inclusive development of the labor market is key for reducing poverty and boosting shared prosperity. Labor income accounts for more than 70 percent of the total household income of the poor, and it is the main source of income for 70 percent of poor individuals. In Malé, where two-thirds of employed household heads work in public administration, education and health and services, labor income comes primarily from wages. In the atolls, where 45 percent of employed household heads work in fisheries and manufacturing, labor income is mainly self-employment income (see Figure 23).

Figure 23.
Distribution of poor individuals and bottom 40 percent by industry of employment of the household head, 2010



Source: Bank staff elaboration on HIES data.

Note: Sample restricted to households with employed household head.

RECENT MACROECONOMIC AND FISCAL TRENDS

After hitting 1.3 percent in 2012, economic growth has been steadily recovering and is estimated to amount to 5 percent in 2014.¹⁹ Most other service sectors are estimated to have grown as well in 2014, while the industrial sector expanded by 13.2 percent in 2014, driven by construction, following a contraction of 1.5 percent the previous year. However, the agriculture and fisheries sector is estimated to have contracted by 2.1 percent in 2014 after posting growth of 5 percent in 2013. [Figure 24]. See also Box 2 for a discussion on macro data.

Average stay continued its secular decline as the composition of tourism changes further. The average stay of tourists declined to 6.1 days, down from a recorded average of 7.1 days between 2009 and 2013, reflecting a structural shift in the composition of tourism. Between 2010 and 2014 the share of European tourists fell by 20 percentage points from 63.8 to 43.9 percent due to weaker economic conditions in Europe. The simultaneous increase in the number of Asian tourists and demand from Middle East mitigated the weakening European demand. During the 2010–2014 period the Asian share of tourists expanded by 15.2 percent while the share of Middle Eastern tourists grew by 1.6 percent [Figure 25].

TOURISM : RECENT TRENDS



Figure 24.
Sectoral contributions
to growth

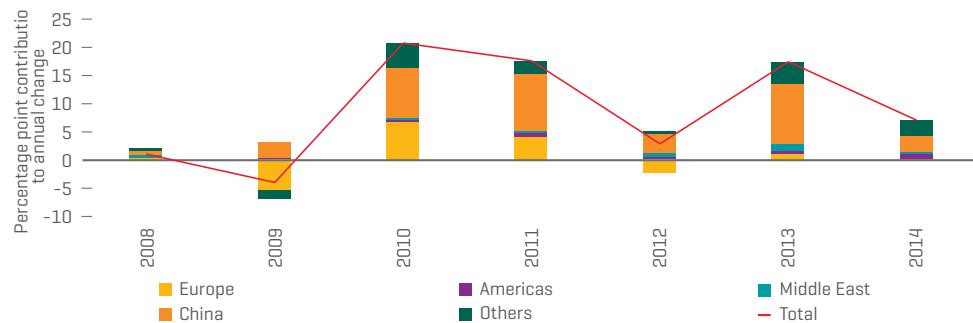
Source: National Bureau
of Statistics, MMA, staff
calculations

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

Figure 25.

Drivers of change in tourism arrivals

Source: MoT, MMA, staff calculations



Inflation in Malé has been unstable since 2009.

Figure 26.

Inflation in 2014

Source: National Bureau of Statistics, MMA, staff calculations

Figure 27.

Inflation trend over the years

Source: National Bureau of Statistics, MMA, staff calculations

Annual average inflation moderated even further in 2014, falling to 2.4 percent, down from 4 percent in 2013 driven by low food prices and international crude prices. The fall is particularly steep considering the 10.9 percent inflation rate recorded in 2012. As measured by the overall consumer price index, inflation in Malé has been unstable since 2009 with large fluctuations. Following a spike in inflation in 2011, when the currency was floated and sharply devalued, inflation started showing signs of moderation and fell to a low of 2.4 percent in 2014 [Figure 26]. During the second half of 2014, inflation fell even further, driven largely by a drop in food prices [Figure 27]. Prices for food and non-alcoholic beverages grew at a pace of 1 percent in 2014, as opposed to 7.5 percent in 2013.

New taxes in 2011 and 2012, mainly on the tourism sector, have increased fiscal revenue structurally; however, the fiscal deficit widened to an estimated 11.6 percent of GDP in 2014. These taxes include the new Tourism Goods and Services Tax (TGST, which was increased from 8 to 12 percent in November 2014) and an increase in the Airport Departure Tax. All these taxes are borne by tourists, who, according to the authorities, have an inelastic demand curve.²⁰ In addition, a Business Profits Tax²¹ and a General GST have been introduced. The net impact has been to increase revenue from 21.9 percent of GDP in 2010 to 32.4 percent of GDP in 2014 [Figure 28].

Figure 26.

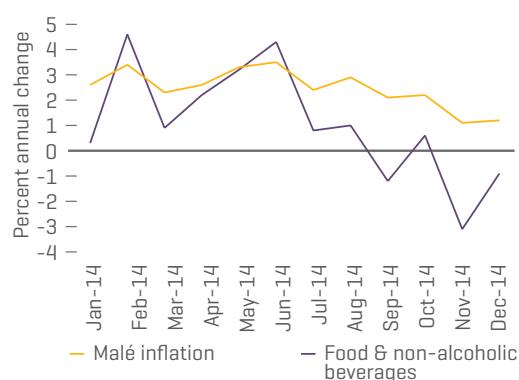
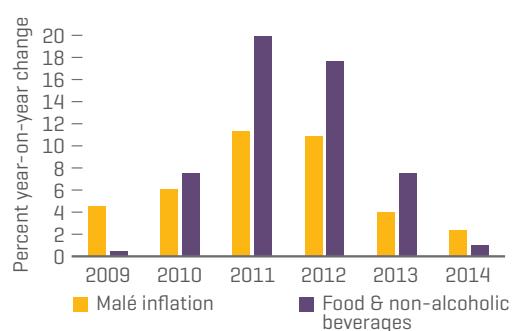


Figure 27.

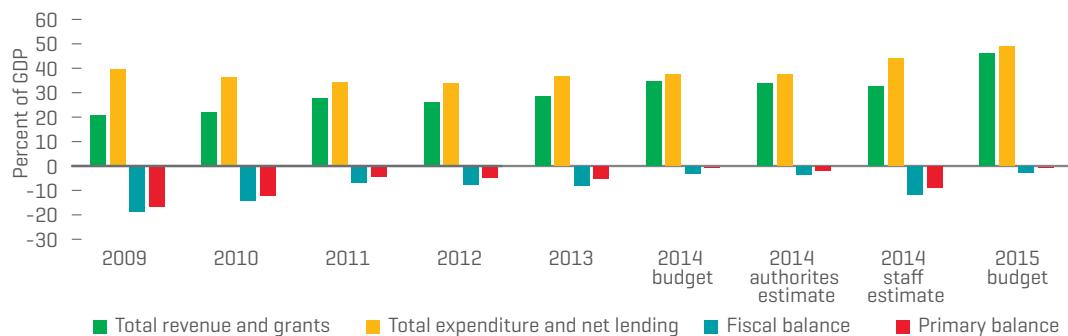


20 Ministry of Tourism, Arts and Culture [2012].

21 The BPT is also applied to resorts and related operations, which provide the bulk of revenue.

Figure 28.
Fiscal accounts,
actuals, budget and
estimates

Source: MoF, MMA, IMF, staff
calculations



Persistent and
widening fiscal
deficits have led to
a high level of public
debt.

The banking sector
shows limited
appetite to invest
in the domestic
economy.

However, persistent and widening fiscal deficits have led to a high level of public debt, which stood at 74.6 percent of GDP at end of 2014. This represented a net increase of 36.8 percent from 2003. This increase was driven by persistent deficits, while fast GDP growth relative to the average real interest rate on debt provided some downward pressure on the level of debt.

Recognizing the unsustainable outlook of its fiscal accounts, the Government has proposed fiscal consolidation measures in its 2015 budget. On the revenue side this includes a “green tax” on tourism [which effectively replaces the Tourism Tax, which was abolished in late 2014, although at a lower rate], increases in import duties, a one-off revenue boost from Special Economic Zones (SEZ) acquisition fees and the extension of resort leases. On the expenditure side, the budget proposes to better target subsidies and freeze public employment. Although these measures, if properly implemented, will help reduce the deficit, they are unlikely to be sufficient to decrease the upward path of public debt, and further fiscal consolidation through expenditure and revenue measures will be needed in the short and medium term.

Driven by high fiscal expenditure, the current account has been persistently in deficit, reaching an estimated 8.4 percent of GDP in 2014. The goods trade deficit is roughly offset by tourism revenue, but net income outflows [such as dividends and interest payments on external debt] and remittance outflows lead to an overall structural current account deficit. The deficit has been financed through foreign direct investment, while net capital outflows by private banks reflect the limited investment opportunities in the non-tourism sector.

Indeed, apart from buying Treasury bills, the banking sector shows limited appetite to invest in the domestic economy. While the government has started to borrow increasingly from banks in recent years, a significant proportion of remaining bank assets are parked at the central bank, earning a very low overnight night rate,²² or are sent abroad.²³

22 The Overnight Deposit Facility was introduced in 2010, and the rate has been 1.5 percent since September 2014 [as of May 2015].

23 This may be a combination of repayments of earlier loans incurred in the mid-2000s and investments.

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

Figure 29.

Distribution of banks assets

Source: MMA, staff calculations

Credit to the private sector growth has mostly stagnated since 2008 and is concentrated in tourism.

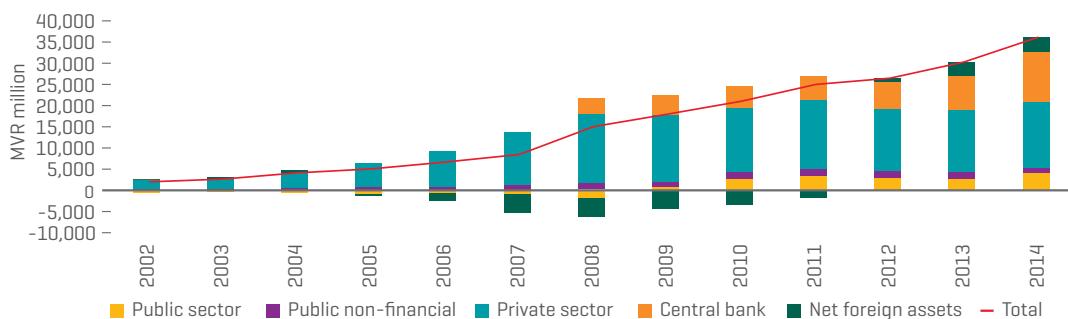
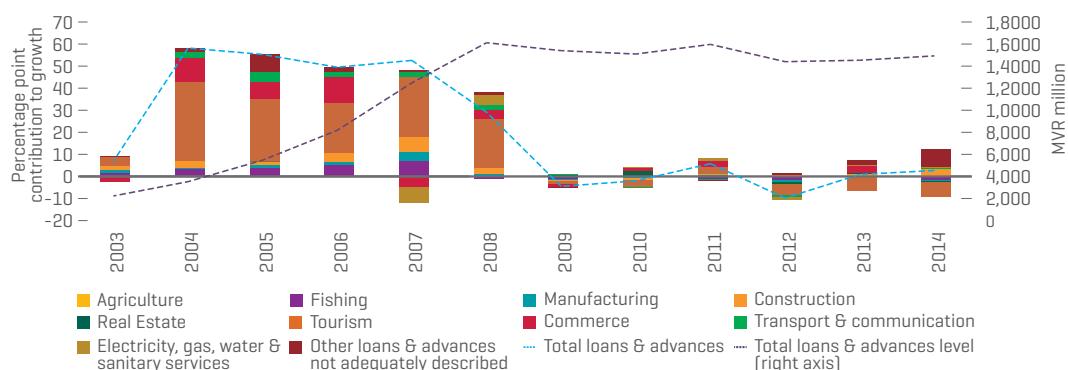


Figure 30.

Distribution of bank credit to the private sector

Source: MMA, staff calculations



At the end of 2014, gross international reserves increased, but net usable reserves remained low at only \$120 million, covering less than a month of imports. As a result of the large improvement in net capital inflows, gross official reserves have increased from \$368 million at the end of 2013 to \$614 million at the end of 2014, covering 3.7 months of imports of goods and services. However, the stable exchange rate and the parallel market premium do not signal any shortages. In practice, the amount of reserves in the economy may be much larger, and the tourism industry appears to supply sufficient quantities of foreign exchange at a stable premium over the official exchange rate. The exchange rate remained at MVR 15.4 per USD, while the premium declined, as major SOEs abstained from the secondary market.

24 MMA, [2012b].

Box 2. A real crisis or a macro data crisis?

It has often said that Maldives is perennially at the verge of a crisis. When looking at the macro data the question is indeed why the country is not in a crisis.

According to the IMF's 2013 Debt Sustainability Analysis update, Maldives was at high risk of debt distress. In particular, the country had a persistent current account deficit of around 20 percent of GDP; public domestic and external debt was 73 percent of GDP at end-2011, while private external debt was estimated at 38 percent of GDP. By February 2013, official reserves amounted to \$304 million, equivalent to just 1.6 months of imports, and freely usable reserves amounted to only \$99 million. Despite these challenges, stores were stocked with imported items and the exchange rate premium was modest.

How can this puzzle be explained?

First, the tourism industry seems to hold sufficient amounts of reserves at home and abroad to be able to supply sufficient quantities to the parallel market to keep the premium stable. Second, given the extreme openness of the economy, the measurement of financial flows through the current and capital account are inaccurate. Similarly, poor financial management and recording practices contribute to underreporting on the expenditure side.

The national accounts were revised recently according to international practice resulting in an increase of nominal GDP over previous estimates (e.g., by 13 percent in 2013, Figure 2.1).^a At the same time, significant revisions have been made to the balance of payments data using new data sources, better methods and new data in line with IMF technical assistance recommendations. This resulted in large changes to the services balance (mostly tourism), goods balance (imports) and financial accounts, leading to a substantially narrower current account deficit (Figure 2.2), higher estimates of FDI inflows and reduced private-sector borrowing. Moreover, surveys and anecdotal evidence suggest that the tourism exports could still be underestimated.

As a result of these adjustments, the current account deficit in 2013 has been revised from 20.5 percent of GDP to 6.5 percent of GDP. The level of public debt at end-2011 has been revised down to 59 percent of GDP, while the estimated level of private external debt has been revised down to 13 percent of GDP.

2. GROWTH, REDISTRIBUTION, POVERTY AND SHARED PROSPERITY (CONTD.)

Figure 2.1

Revisions to GDP

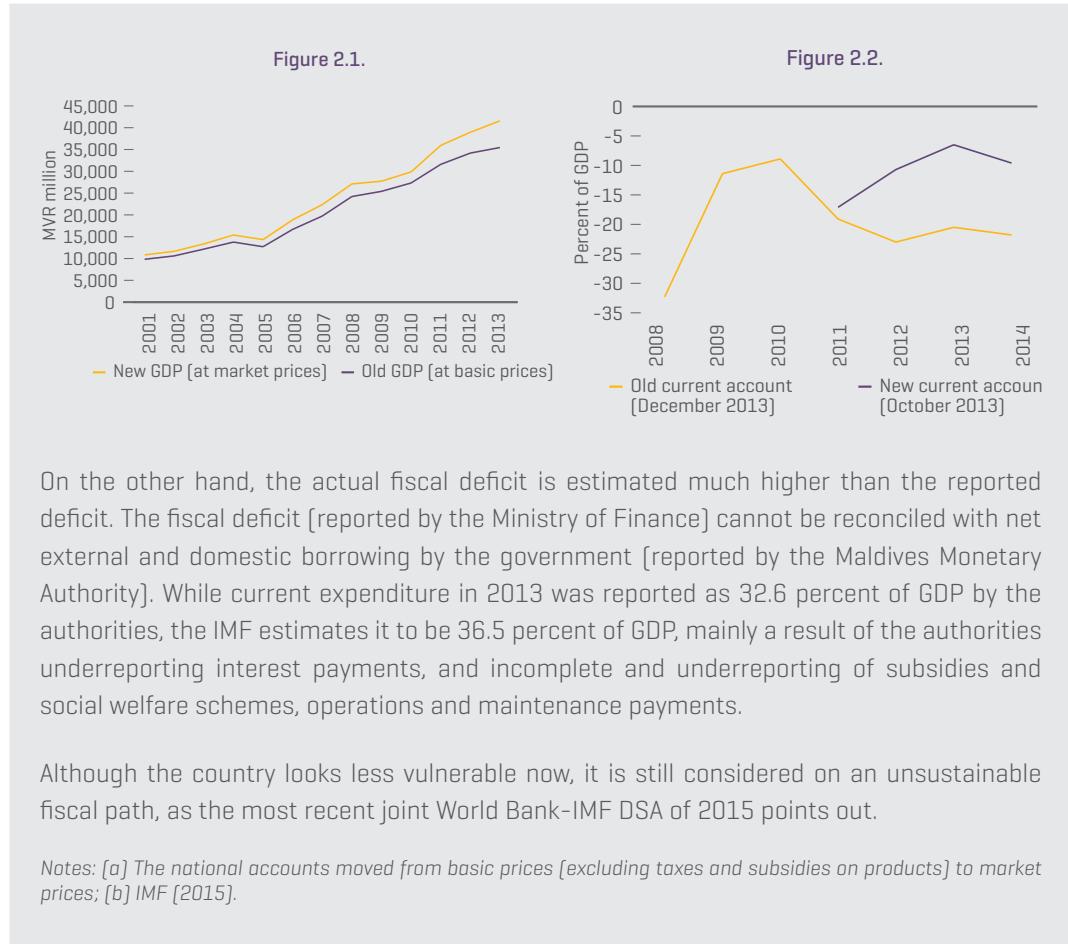
Source: National Bureau of Statistics

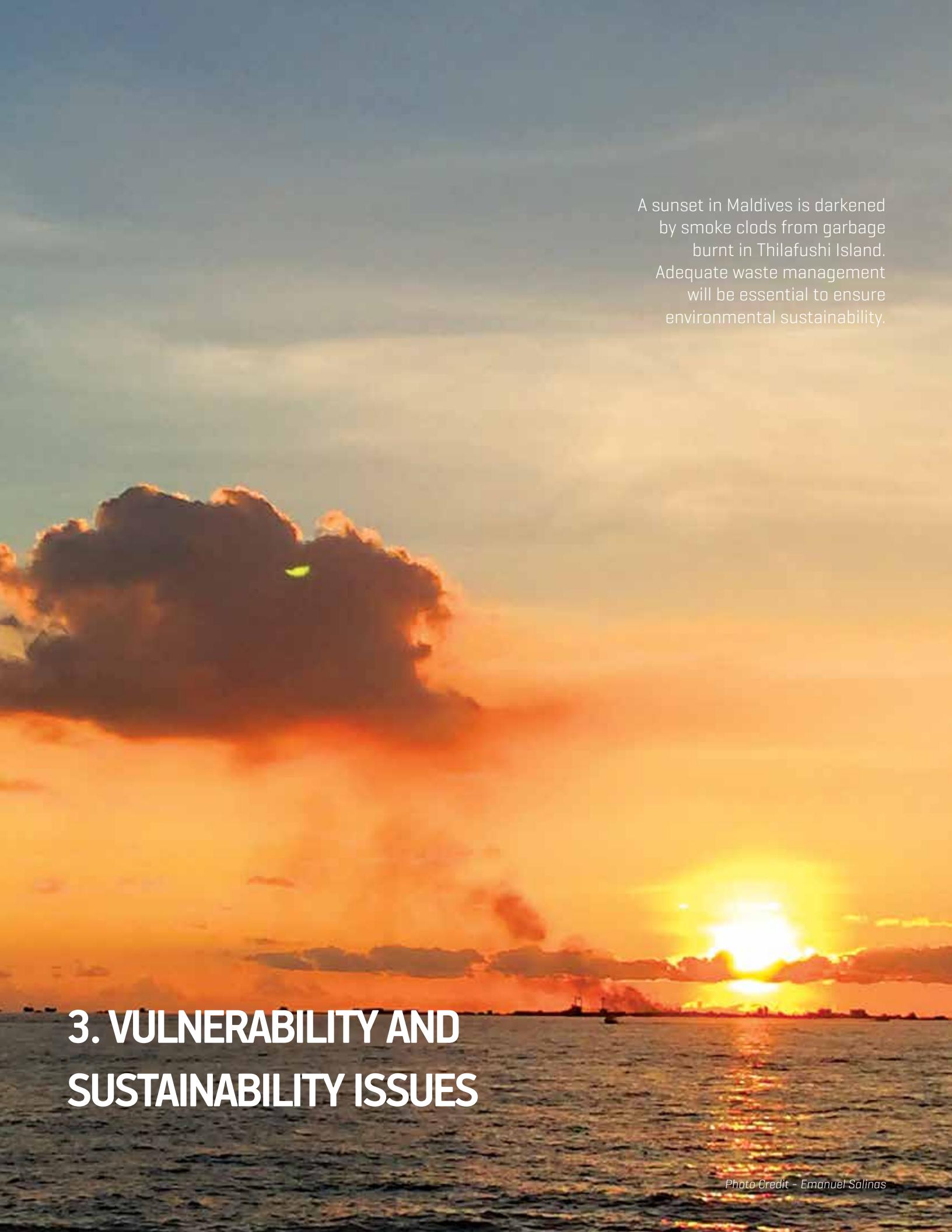
Figure 2.2

Revisions to current account

Source: MMA

Although the country looks less vulnerable now, it is still considered on an unsustainable fiscal path.



A photograph of a sunset over a body of water. In the foreground, the dark blue surface of the ocean reflects the warm orange and yellow hues of the setting sun. A large, dark, billowing cloud of smoke or steam dominates the left side of the frame, its edges glowing with the fiery colors of the sunset. The sky transitions from a deep orange near the horizon to a lighter, pale yellow higher up. In the far distance, a faint silhouette of buildings or structures is visible across the water.

A sunset in Maldives is darkened by smoke clods from garbage burnt in Thilafushi Island. Adequate waste management will be essential to ensure environmental sustainability.

3. VULNERABILITY AND SUSTAINABILITY ISSUES

3. VULNERABILITY AND SUSTAINABILITY ISSUES

Key Messages

Maldives development model is inherently vulnerable to shocks and increasingly not sustainable. In particular:

- Maldives is highly vulnerable to external macro shocks
- Maldives democratic transition is still in progress and political instability high
- Maldives social contract is at risk due to lack of inclusiveness, especially of youth
- Environmental sustainability is at risk due to climate change, lack of preparedness for natural disasters, waste management and lack of access to potable water
- Electricity generation cost is the highest in South Asia

Maldives is highly vulnerable to shocks due to its small size, lack of economic diversification and heavy reliance on imports.

Recent socio-economic and political developments have raised concerns regarding the sustainability of Maldives' development model. Despite a long period of sustained economic growth, the vulnerability of Maldives' model of development is increasing over time, especially with respect to its fiscal, social, political and environmental sustainability.

MACROECONOMIC VULNERABILITY AND SUSTAINABILITY

Maldives is highly vulnerable to shocks due to its small size, lack of economic diversification and heavy reliance on imports. Furthermore, increasing macroeconomic imbalances and escalating public debt represent a growing source of external vulnerability. While the Maldivian economy has shown resilience in the past, the country may currently lack appropriate buffers to cope with a shock that would affect the tourism sector, terms of trade or interest rates.

Box 3. How "special" is Maldives?

Before the tsunami hit in 2004, expenditure levels were in line with other island states, such as Cape Verde, Sao Tome and Principe, Barbados and Dominica, which are all countries with higher tourist receipts, large fiscal deficits, large current account deficits and a soft-peg exchange rate. Moreover, expenditure was in the 20th to 80th percentile of emerging and developing countries. After the tsunami and the introduction of democracy, expenditure has moved to the top 20th percentile and has stayed there [Figure 3.1].

Maldives is also an outlier in many ways compared to the rest of the world. Its exports and imports are the 97th percentile of the world, its current account in the 8th percentile [although the recent revision makes the current account deficit less exceptional], and expenditure in the 77th percentile [Figure 3.2].

Figure 3.1
General government total expenditure, against selected island states

Source: Find my Friends tool using IMF WEO 2014

Figure 3.2
Maldives's economic features and percentile comparison to the world

Source: WDI, WEO data using the Find my Friends tool.

As a small island state with a high level of imports, the country is vulnerable to changes in commodity prices.

In terms of growth volatility as measured by the standard deviation of real GDP growth over 2003-13, Maldives ranks in the 94th percentile compared to all countries, and it has the highest standard deviation among all five peer island states mentioned above.

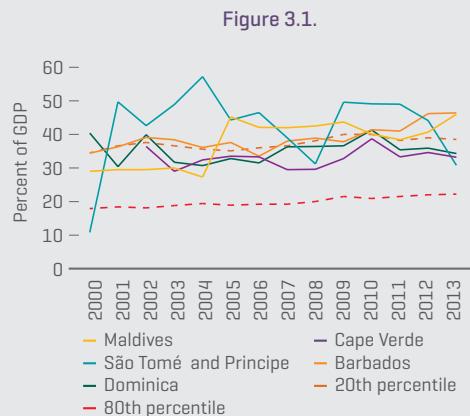
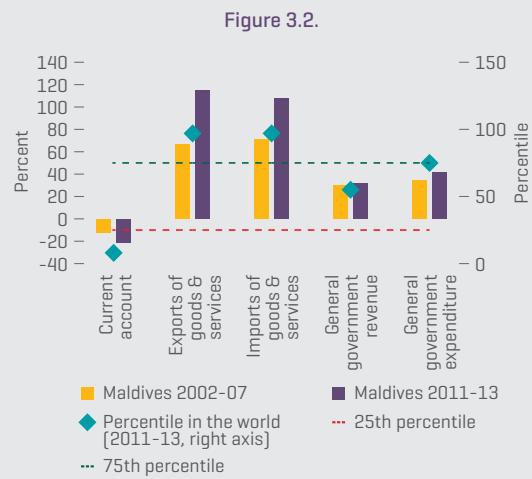


Figure 3.1.



The bars indicate the level of each variable in Maldives relative to GDP [left axis], while the diamonds show the percentile for each variable in Maldives compared to the world [left axis]. The dotted lines indicate the 25th and 75th percentiles for reference.

As a small island state with a high level of imports, the country is vulnerable to food and fuel commodity prices through the balance of payments. Moreover, as it subsidizes flour, rice and sugar, and diesel-based electricity generation, the fiscal accounts are equally vulnerable to price shocks. Indeed, 2011, the year of the exchange rate devaluation, saw a one-off spike in subsidies of 0.7 percent of GDP.

Tourism has created additional channels of external vulnerability to shocks, which has created significant volatility for the economy as a whole. The trends over the past decade have highlighted the fact that tourism can be affected by a host of factors beyond the control of the country. These include environmental events [the tsunami affecting Maldives directly], global economic trends [the 2001 recession and the recent global financial crisis affecting wealth of European travelers], and even security concerns abroad [September 11 terror attacks limiting air travel]. These external shocks have been passed on to the economy as a whole, given the high dependence of Maldives on tourism.

3. VULNERABILITY AND SUSTAINABILITY ISSUES (CONTD.)

Figure 31

Fiscal trends since 2003

Source: Ministry of Finance and Treasury, Staff calculations.



Note: Rigid expenditure defined as salaries, wages and allowances, social welfare contributions, interest payments and subsidies and transfers. Tourism-related revenue defined as tourism tax, GST on tourism, Airport Service Charge, royalties, land and resort rent, [part of] import duty revenue and Business Profit Tax.

Especially in recent years, the development model has led to an increasing share of revenue dependent on tourism, while an increasing share of expenditure has become “rigid”. That is, an increasing share of expenditure consists of items that are not easily adjusted in the event of a downturn in revenue: subsidies and transfers, social welfare contributions, salaries and wages and interest payments [Figure 31].

Unless adjustments are made to revenue and expenditure, the current development model will lead to ever increasing levels of public debt.

The lack of macro policy buffers leaves the country with few instruments to stabilize the economy in the event of a downturn in tourism. With high debt and an already high fiscal deficit, it will be difficult to increase expenditure or reduce taxes in the case of a downturn. Moreover, for a small island state with most consumption goods imported and a high pass-through of exchange rate fluctuations into inflation,²⁵ exchange rate stability is of utmost importance. The country’s official foreign exchange reserves have frequently reached levels below three month’s import coverage.²⁶ This limits the country’s ability to respond to pressure on the exchange rate, which has led to devaluations in 2001 and 2011 and to balance of payment support in 2005 after the tsunami and in 2009 after the global financial crisis.

Maldives’ already high level of public debt and fiscal path leads to immediate fiscal sustainability concerns. Unless adjustments are made to revenue and expenditure, the current development model will lead to ever increasing levels of public debt, even after the fiscal consolidation measures budgeted in 2015. Overall public debt [including domestic debt] is estimated at 74.6 percent of GDP at the end of 2014, well above the benchmark of 56 percent of GDP established under the LIC-Debt Sustainability Framework.²⁷ It is projected to continue to grow throughout the projection horizon, driven by a persistent primary fiscal deficit. An increasing share of the budget will be devoted to paying interest on debt. Moreover, growth shocks and fiscal slippages would lead to even higher

25 88 percent of a change in the nominal effective exchange rate is passed to consumer prices within one year [Masha and Park, 2012].

26 It should be noted though that a lot of foreign exchange remains outside the central bank, and private agents are often able to find foreign exchange when needed.

27 A joint Bank-Fund Debt Sustainability Analysis (DSA) has been carried out.

levels of debt. Meanwhile, the persistent current account deficit has led to an increasing level of external debt, and the country is at “moderate risk of debt distress.” Although the level of debt is below the policy-dependent thresholds, a shock to tourism exports could make it difficult for the country to service its external debt [Figure 32 and 33].

Figure 32.

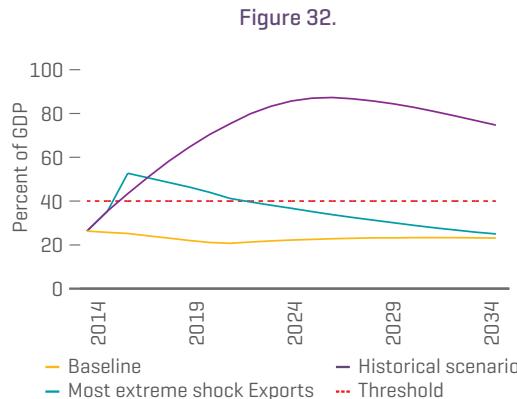
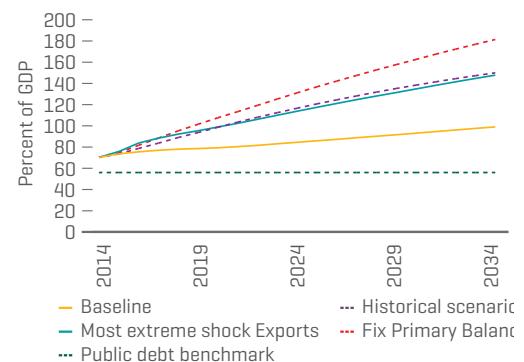
Present value of external public debt-to-GDP ratio

Source: Bank-Fund DSA 2015

Figure 33.

Present value of total public debt-to-GDP ratio

Source: Bank-Fund DSA 2015

**Figure 33.**

Note: Unlike the face value, the present value takes into account debt concessionality.

Moreover, the widening fiscal deficit has led to rising interest rates. The widening fiscal deficit has forced the country to accumulate more and more domestic debt. As a result, the government has resorted to central bank debt financing [until May 2014] and domestic arrears²⁸ as additional financing sources. As market interest rates started to increase strongly by mid-2013, the authorities put a cap on interest rates [called a “tap” system], which has temporarily stabilized interest cost on domestic debt.

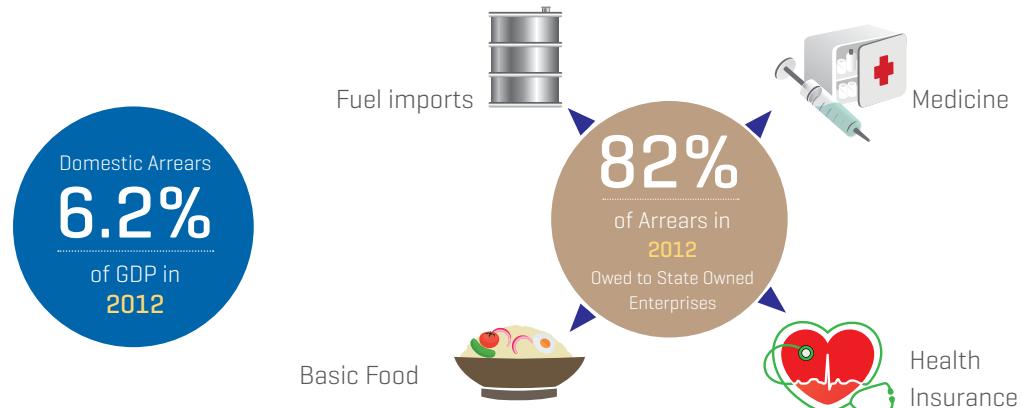
Accumulated domestic arrears add an additional fiscal burden. The stock of accumulated domestic arrears was estimated at 6.2 percent of GDP at the end of 2012. About 82 percent was owed to SOEs, in particular to the government-owned importer of fuel, medicine and basic food, and to the Aasandha Company [health insurance]. The emergence of arrears is the result of both unrealistic budget envelopes and a lack of expenditure controls.²⁹

28 The IMF estimates arrears in order of 6.3 percent of GDP in 2013 [World Bank and IMF, 2015].
29 IMF (2015)

3. VULNERABILITY AND SUSTAINABILITY ISSUES (CONTD.)

Shortcomings in the operations and oversight of SOEs contribute to macro-fiscal risks, due to inadequate regulation and supervision.

DOMESTIC ARREARS



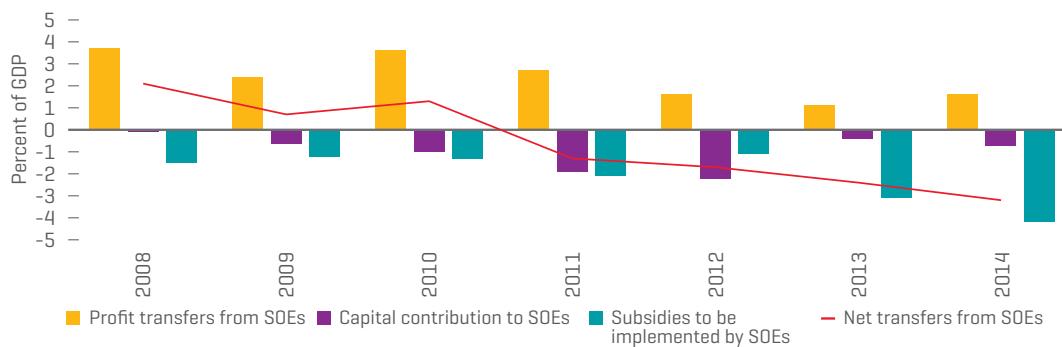
This points to weaknesses in public financial management as a source of fiscal risk. The budget as a policy document suffers from a lack of credibility and limited policy orientation. Expenditure composition variations are significant at more than 15 percent of the original budget. Furthermore, there is no credible medium-term macro-fiscal framework and it has a weak and inefficient system of budget review. Existing cash constraints limit the predictability and control of the budget. Moreover, although consolidated financial statements have been produced since 2011, data quality and consistency are a concern. The government does not meet the basic practices of fiscal risk disclosure and analysis on contingent liabilities and actual liabilities. There is no complete picture of contingent liabilities that may arise from loan guarantees that have been issued as the government does not report on the main risks to its fiscal forecasts.³⁰

SOEs may pose further risks to fiscal sustainability as most are loss-making and depend on government support, with only nine companies having contributed dividends to the budget in the last four years. Shortcomings in the operations and oversight of SOEs contribute to macro-fiscal risks, due to inadequate regulation and supervision. Most SOEs operate at a loss, and represent a drain to the budget and a source of risk associated to costly fuel imports, foreign exchange transactions, and payment arrears. Capital transfers to SOEs and subsidy transfers have contributed substantially to the growth in expenditures in recent years [Figure 34]. An independent centralized ownership entity [the Privatization and Corporatization Board] was established under a comprehensive legal framework in 2013, but final decisions on the appropriate institutional arrangements are still under consideration.

³⁰ IMF (2014b)

Figure 34
Impact of SOEs on the budget

Source: Ministry of Finance and Treasury



POLITICAL AND INSTITUTIONAL RISKS

Maldives democratic transition started recently. The country adopted a new constitution in 2008, ushering in multi-party elections as well as a set of new state institutions at central and local levels, often with mandated high degrees of independence. The new constitution enacted a mechanism for separation of powers by creating independent branches of the Legislature, Executive and Judiciary for the first time in the history of the country.

Powers of and relationships among democratic institutions are still being defined. For instance, until recently parliamentarians were able to simply add expenditures to the budget on their own initiative without concern for expenditure limits and all independent commissions created their own human resource regimes. More importantly, Maldives is a split polity where political contestation is not always handled through institutional channels. There have been frequent incidences of political unrest over the past 10 years and election processes have been criticized by observers as lacking credibility in many key aspects. Institutional incoherence and political instability currently hamper the ability of the government to provide goods and services and to carry out its redistribution function, which is central to social and economic inclusion in Maldives. It poses a longer-term risk to improving government operations and, more generally, public trust in the state.

Institutional and political instability constrain the sustainability of Maldives' development model moving forward. There is widespread consensus that political stability was critical to the development of the tourism industry in Maldives. The current polarization of the political party system, resulting political unrest and the limits of checks and balances between powers, all contribute to aggravating political and institutional risks as well as macro and social sustainability issues.

3. VULNERABILITY AND SUSTAINABILITY ISSUES (CONTD.)

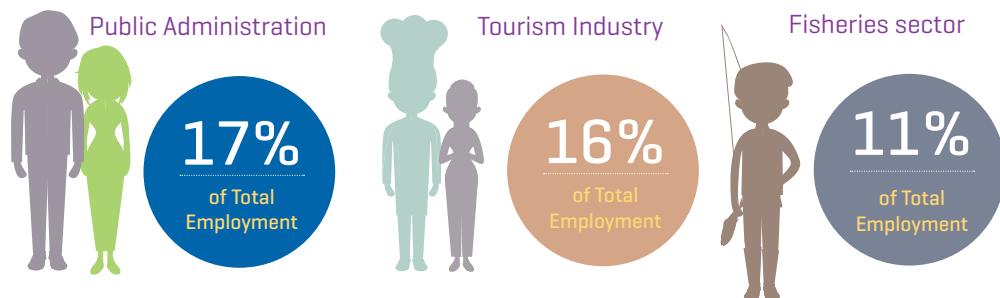
Public administration is the primary sector of employment in Maldives, particularly for the educated local workforce.

The increase in the working age population, with a shift toward a relatively more educated young labor force, puts enormous pressure on the absorption capacity of Maldives labor market.

SOCIAL SUSTAINABILITY AND VULNERABILITY

Economic opportunities in Maldives are out of sync with growth and shared prosperity. Public administration is the primary sector of employment in Maldives, particularly for the educated local workforce. Alone, it accounts for 17 percent of total employment and one-fourth of the employment for workers with secondary or higher levels of education. The tourism industry, while driving the growth process and being the main contributor to GDP, accounts for only 16 percent of employment and relies disproportionately on expatriate workforce for both high- and low-skilled jobs. The fisheries sector, which is a crucial sector for poverty reduction and shared prosperity, accounts for 11 percent of total employment and one-fourth of the workforce with less than secondary education [Figure 35].

SOURCES OF EMPLOYMENT

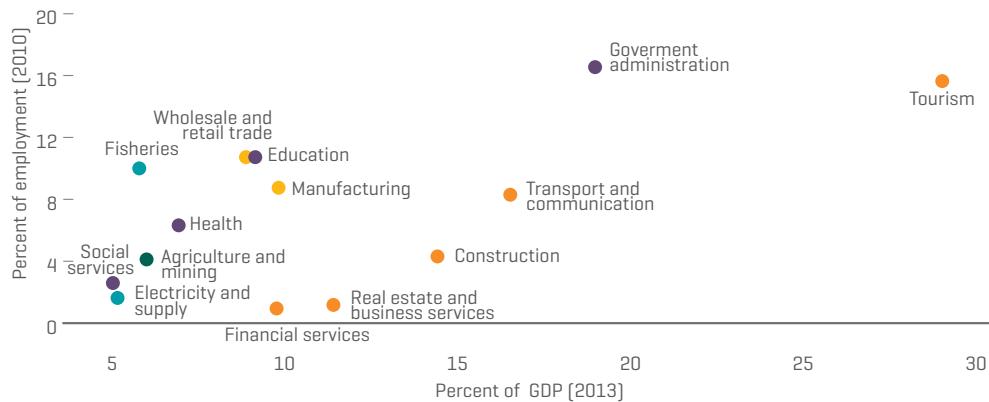


The interplay of socio-demographic trends and fiscal constraints adds to the social sustainability challenge of Maldives' development model. The progress in health indicators, notably the reduction in mortality rates over the past decades, has contributed to Maldives demographic transition. With a reduction in the total fertility rate to population replacement rates, the population growth has stabilized, creating the opportunity for a demographic dividend [Figures 36 and 37]. The increase in the working age population, with a shift toward a relatively more educated young labor force, puts enormous pressure on the absorption capacity of Maldives labor market. That is especially the case in view of the hiring freeze of the public sector – which constitutes the main employer for high-skilled jobs – and the increasing competition coming from a relatively cheaper (low-skilled jobs) and better educated (high-skilled jobs) expatriate workforce.

Figure 35

Sources of growth and employment

Source: Ministry of Finance and Treasury

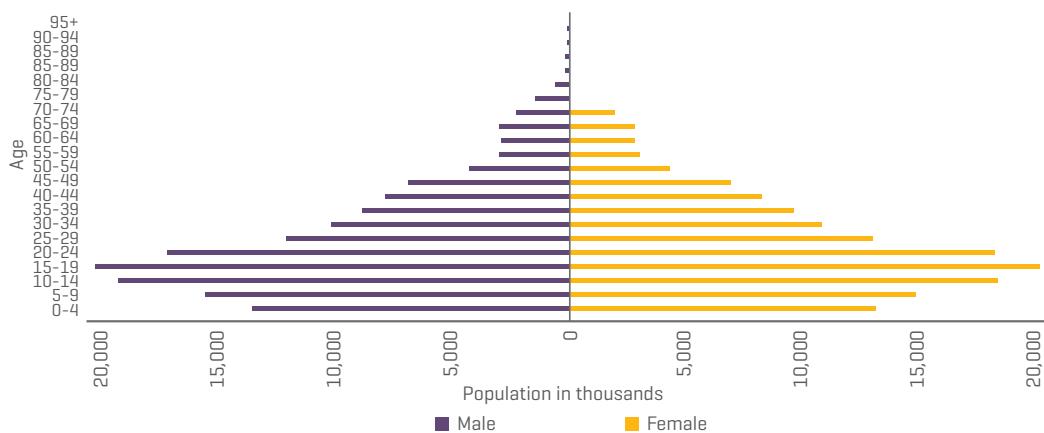


Note: Employment in tourism includes reported employment in hotels and restaurants, and rough estimates of local employment in resorts by extrapolating the actual number of local employees per resort in 2006 with the increase in bed capacity, published in the HIES 2009/10. Source: National Bureau of Statistics, HIES 2009/10

Figure 36

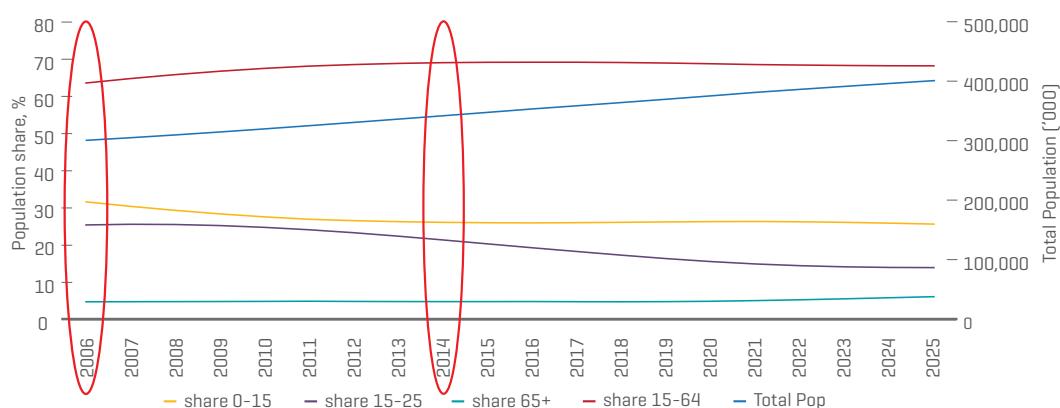
Population pyramid of Maldives, 2006

Source: Maldives Statistical Yearbook, 2014

**Figure 37**

Population projections

Source: UN projections



3. VULNERABILITY AND SUSTAINABILITY ISSUES (CONTD.)

Youth and women are particularly vulnerable to the social sustainability challenges of Maldives development model.

After 30 years of sustained economic growth and social development, the current generation of youth is the first faced with the prospect of not being able to achieve the same level of wellbeing as their parents.

Youth and women are particularly vulnerable to the social sustainability challenges of Maldives' development model:

- The increasing supply of educated youth in a context characterized by limited labor demand by the public sector and a skills mismatch in the private sector has contributed to high youth unemployment. In 2010, according to HIES data, the unemployment rate for individuals in the 15 to 24 age group was 25 percent, more than double the unemployment rate of the total workforce [11.8 percent]. The lack of economic opportunities for the youth is contributing to other social ills, such as drug abuse and gang-related violence, especially among male youth.
- The public sector has traditionally been the biggest employer of women in Maldives, with 34 percent of female employment in the health and education sector and 15 percent employment in public administration. Limited working hours and availability of jobs on inhabited islands have made public employment particularly appealing for women and contributed to sustaining relatively high female labor force participation [58 percent]. Fiscal constraints to job creation in the public sector have contributed to increasing female unemployment vis-à-vis males.

YOUTH AND WOMEN EMPLOYMENT



A growing gap between aspirations and opportunities for socio-economic inclusion has contributed to fostering disenfranchisement among Maldivian youth. After 30 years of sustained economic growth and social development, the current generation of youth is the first faced with the prospect of not being able to achieve the same level of wellbeing as their parents. Increasing competition from foreign labor for high- and low-end jobs and limited opportunities for employment in the public sector contribute to worsening social mobility prospects for the new generation. Disenfranchisement and frustration are growing, especially in the capital area Malé where many youth migrated with the hope of building a future.

Limited education opportunities and skills challenge youth capacity to realize their aspirations through a productive labor market engagement. Employment status is crucial to shape life satisfaction,

The current economic model has proved unable to provide the youth with the skills and knowledge necessary to compete on a globalized labor market.

Social ills such as gang violence and drug abuse are on the rise, and further contribute to strengthening the exclusion of “youth at risk” from the social fabric.

wellbeing and self-esteem, especially among young males (WDR 2013).³¹ Facing competition from foreign labor and lacking sufficient skills to face the challenge, Maldivian youth are increasingly confronted with bleak labor market³² opportunities and a failure to meet their aspirations in terms of social mobility. The current economic model has proved unable to provide the youth with the skills and knowledge necessary to compete on a globalized labor market and low productivity public sector jobs are becoming increasingly unappealing and scarce due to government budget constraints.

High levels of actual and perceived inequality coupled with a progressive deterioration of the social contract further contribute to widening youth aspiration gap. As discussed in Chapter 2, high and increasing levels of inequality between the poorest and the richest segments of the population, as well as unequal opportunities between Malé and the atolls, all contribute to the emergence of social cleavages that work against cohesion and social development³³. Moreover, governance constraints, such as the lack of transparency and accountability, together with the inability of politics to address the most urgent social and economic concerns, add to youth frustration and challenge future prospects of inclusive economic development in Maldives. These ongoing social dynamics contribute to widening the gap between the adult generation – currently in power and benefiting from the security associated with the redistribution of the rents from past economic development -- and a young generation struggling to find social space and identity under uncertain socio-economic circumstances.

Social ills such as gang violence and drug abuse are on the rise, and further contribute to strengthening the exclusion of “youth at risk” from the social fabric. Anecdotal evidence suggests that gang participation and violence is on the rise among young men. In Malé alone there are 20-30 active gangs, each with 50-400 members, a majority of whom have suffered from violence or perpetrated violence. Moreover, the intensity of gang violence is reportedly rising.³⁴ This increase in gang violence is likely an effect of the social, political and economic exclusion of the country’s youth because of their disengagement from the labor market and other spheres of public life. Gangs offer a form of inclusion by offering a sense of identity and group belonging, and provide financial rewards: a significant proportion of young men in gangs are deemed to be engaged in drug dealing.³⁵ Illicit drug use among gang members is also increasingly problematic, and is further fueling gang-related and broader social violence. Though drug users are overwhelmingly male, there is evidence to suggest that it is an increasing problem for women who are increasingly subject to sexual and gender-based violence.³⁶

31 As discussed in the WDR (2013), job opportunities contribute to determine individuals’ status within a society and how people view themselves in relation to others.

32 This lack of skills includes technical skills, as well as the so-called ‘soft skills’ to secure employment, and when employed, to stay in a job, such as positive attitudes toward work and learning, respectful professional relationships, time management and good attendance, self-esteem and confidence, and sound professional decision-making. Consequently, young Maldivians may not get the jobs they desire because they are perceived to be less responsible, and have a poorer work ethic than the older generation or the large numbers of migrant workers. Employers interviewed for a recent gender assessment of the Maldives opined that they are unwilling to hire young Maldivians because those they had hired in the past regularly came to work late, take unscheduled leave, are unresponsive to supervisor input, and sometimes vanish altogether without any explanation. World Bank, [2014c].

33 Empirical evidence strongly points out that income inequality leads to greater social and political instability. See Alesina and Rodrik, 1994, Alesina et al 1996. Briguglio et al. [2006] include social development among the essential components of economic resilience in SIDS. According to the authors (*ibid*: 275), “Social development [...] indicates the extent to which social relations in a society are properly developed, enabling an effective functioning of the economic apparatus without the hindrance of civil unrest. Social development can also indicate the extent to which effective social dialogue takes place in an economy, which would in turn enable collaborative approaches towards the undertaking of corrective measures in the face of adverse shocks.”

34 Asia Foundation[2012]

35 *ibid.*; p.15.

36 According to data from the most recent DHS, over one-quarter (28.4%) of Maldivian women have experienced physical and/or sexual violence at some point in their lives by either partners or non-partners. Though this proportion is lower than other South Asian countries, it is higher than in other middle-income Asian countries like Malaysia (14.5%), Indonesia (3.7%) or the Philippines

3. VULNERABILITY AND SUSTAINABILITY ISSUES (CONTD.)

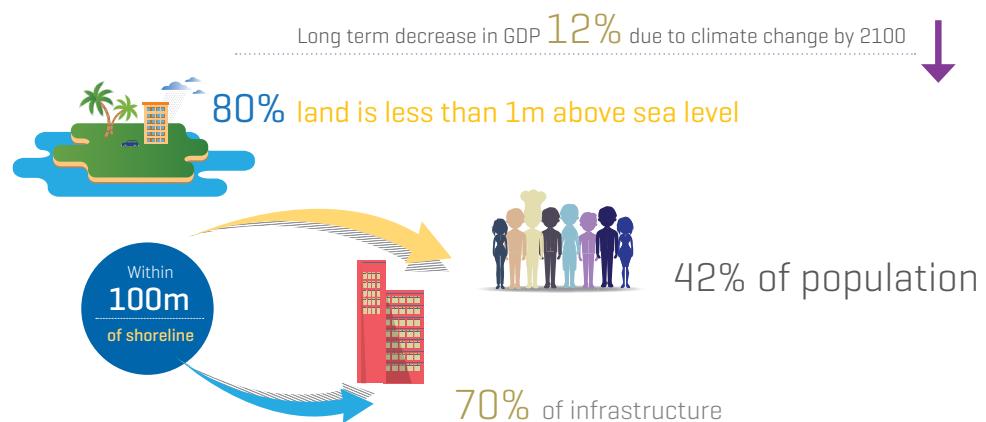
These dynamics might further limit opportunities for socio-economic inclusion, particularly of Maldivian women. According to the HIES [2010], while the major reason given by both women and men for being unemployed was their inability to find suitable employment, 22 percent of women cited household chores as a reason, and another 3 percent were deterred by objection from family members. Thus, lack of supporting environment in the family was a major factor discouraging a significant number of women from seeking employment. In particular, marriage and pregnancy at a young age, geographical isolation, and social norms restricting women's mobility are factors that limit women's contribution to national development.

ENVIRONMENTAL VULNERABILITY AND SUSTAINABILITY ISSUES

Natural resources represent the country's main asset but there are growing concerns in terms of sustainability.

Natural resources represent the country's main asset but there are growing concerns in terms of sustainability. Climate change could cause annual economic losses of more than 12 percent of Maldives' GDP by 2100.³⁷ Due to rising sea levels, the entire country could be submerged before the end of the century as 80 percent of land is less than 1 meter above sea level. With 42 percent of the population and more than 70 percent of critical infrastructure within 100 meters of shoreline, this would have dire social and economic consequences, notably for the poorer and most vulnerable. Despite past efforts, the country is not prepared to withstand a rise in sea levels, as most lifeline infrastructure (such as power houses, hospitals and harbors), population centers (such as schools) and dwellings are not adequately designed. Indeed, "the most serious underlying driver of increasing vulnerability to climate change in Maldives appears to be the absence of systematic adaptation planning and practice. Climatic risks and long-term resilience are not adequately integrated into island land use planning or into coastal development and protection policies and practice, and past autonomous risk reduction efforts have sometimes had mal-adaptive effects".³⁸ In order to partially address this, the government prepared a Strategic National Action Plan in June 2011 to integrate Disaster Risk Reduction and Climate Change Adaptation, but its actual implementation appears to be limited.³⁹

Climate Change Vulnerability



The most pressing issues relate to shortcomings in the management of natural resources, particularly with regard to sewage and solid waste management.

However the most pressing issues relate to shortcomings in the management of natural resources, particularly with regard to sewage and solid waste management. An estimated 248,000 tons of solid waste was generated in 2007, most coming from urban areas [Figure 38], and this figure is expected to increase to 660,000 tons by 2020.⁴⁰ Despite the scale of the challenge, most of the 134 Island Waste Management Centers, covering 66 percent of the islands, are not fully functional, as no program for transport of waste from these centers to a regional or central waste-processing center has been established.⁴¹ Regulation seems to be poorly enforced. Resorts, in particular, have been accused of dumping waste in the sea and not using incinerators as mandated by law [Figure 39], although this assertion has not been documented. Adequate management of solid waste is hindered by the high cost of service delivery in the country, associated with the low volume of waste on each island and the high cost of transportation. Land scarcity also limits the options for establishing and managing adequate landfills. The issue of sewage and solid waste is particularly challenging, as it has a direct impact on the country's most valuable natural resources – coral reefs and fisheries. Uncontrolled waste disposal and floating debris at tourist resorts are the most visible threats to the country's reputation as a pristine high-end tourist destination. They also affect the quality of ground water, with a direct impact on island communities.

Figure 38
Waste generation patterns

Source: Ministry of Environment and Energy
Source: Visvanathan and Glawé

Figure 39
Waste disposal methods

Source: Ministry of Environment and Energy
Source: Visvanathan and Glawé

Figure 38.

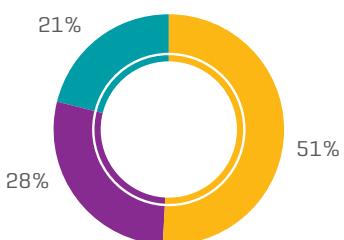
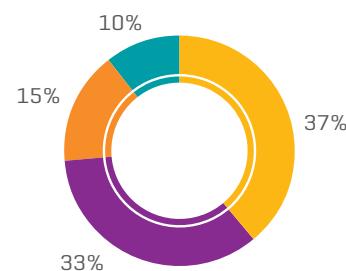


Figure 39.



Urban Areas ● Island Communities ● Tourism

● Sent to central island waste management dumped within the islands
● Burnt
● Disposed at the beach or the sea
● Buried



40 World Bank, [2012c]

41 Thilafushi Island, a municipal landfill where waste is burned, does not qualify as a proper waste processing center.

3. VULNERABILITY AND SUSTAINABILITY ISSUES (CONTD.)

Per capita water availability will decline by 34 percent by 2035.

The loss of coral reef represents a threat to the sustainability of the tourism industry and fisheries, and is also compounding the effects of climate change.

Most of the Maldivian population depends on the ground water and rain water as source of fresh water, which are at high risk due to climate change. As Maldives consists of low-lying islands, the rise in sea-levels would force salt water intrusion into fresh water lens. Minimum projected sea level rise of 1mm per year shows that the groundwater safe yield will decrease at least by 3 percent between 2012 and 2030. In addition, in most inhabited islands the groundwater is contaminated due to untreated sewage disposal into the ground. It is estimated that per capita water availability will decline by 34 percent from the 2009 level of 103 cubic meters per year to 76.6 cubic meters per year by 2035. The shifting in the rainfall pattern from drier and more inter-annually variable rainfall regime over the next 20 years and increase in temperature of 0.5°C to 3.5°C expected by 2100 will increase water demand leading to high competition over scarce resources, making water security for potable and irrigation purposes continue to be a serious problem.⁴² Confronted by diminishing resources, more than 100 islands have requested emergency fresh water shipments since 2005, and the challenge is likely to increase over time due to continued population pressure.⁴³ The institutional framework for managing fresh water supply needs strengthening, as the government does not have any single and unifying body overseeing the water and sanitation sector and therefore no quality checks are performed.

The country is also vulnerable to shocks to drinking water supply due to the lack of back-up arrangements. This vulnerability was shown clearly by the water crisis in December 2014, when a fire in a water treatment plant in Malé led to acute shortages of drinking water and required emergency supplies from neighboring countries.

The loss of coral reef represents a threat to the sustainability of the tourism industry and fisheries, and is also compounding the effects of climate change. Coral reefs are a major tourist attraction in Maldives but are affected by the rise in sea temperature and pollution. However, the damage to coral reefs caused by harbor dredging and reclamation are much more significant now as a result of the current development model. Other pressures include damage caused by divers, illegal collection of corals and unsustainable exploitation of high-value reef resources. As coral reefs also play an important role in protecting shores against rising sea levels, their destruction may also aggravate the impact of climate change. Furthermore, the loss of coral reef is resulting in the loss of valuable bait fish which are used for tuna fisheries, a major source of food and income in outer atolls.

42 World Bank [2013a].

43 Demand of clean water is expected to increase by about 66 percent over the next 15 years.

Environmental management is largely done on a limited and voluntary basis on the islands.

The country relies almost entirely on imported fossil fuel to supply the generators, costing about 15 percent of GDP in 2013.

Institutional capacity for managing the country's natural resources is relatively weak. Because of limited resources, environmental management is largely done on a limited and voluntary basis on the islands. Governmental environmental agencies face important issues in retaining scarce qualified staff.



Maldives has a significant potential for lowering the cost of electricity generation through wider use of renewable energy. At the present time power is supplied by diesel generators through isolated, island-specific grids, spread over 900 square kilometers. The country relies almost entirely on imported fossil fuel to supply the generators, costing about 15 percent of GDP in 2013. Furthermore, due to the high costs of domestic electricity production and distribution, the country has a long history of subsidized energy prices that have contributed to over-consumption and limited incentives opportunities to invest in alternative and environmentally sustainable renewable energy sources. Currently, the cumulative installed photovoltaic-based generation capacity is less than 2 MW, spread across several islands and programs. While the installed PV capacity is still limited, it has demonstrated its viability as a source of cheaper and cleaner energy. Going forward, wider adoption of renewable energy will require, among other things innovative financing approaches such as PPPs and a review of the incentives scheme, including the current subsidies on diesel-based electricity generation.



Tourism and fisheries are the two main sources of growth in Maldives and their sustainability depends on preservation of the country's natural resources.

4. SOURCES OF GROWTH AND SHARED PROSPERITY

4. SOURCES OF GROWTH AND SHARED PROSPERITY

Maldives has experienced a high pace of growth, but the main challenge will be to enhance its inclusiveness going forward.

Key Messages

- Maldives main challenge is to improve inclusiveness of the development model
- Tourism has developed as enclave model; opportunities for inclusiveness require improving:
 - Transparency lease allocation for resorts' development
 - Linkages to local economy
 - Employment opportunities for local population
 - Opportunities for sustainable community-based tourism development
- Fisheries development is key sector for improving incomes of the poor; opportunities for sector development require improving:
 - Industry competitiveness
 - Management of natural resources
 - Investment opportunities in sub-industries
- Agriculture has untapped potential for growth and employment generation; opportunities for sector development require improving:
 - Linkages between supply and demand/value chains with tourism
 - Adoption of new technologies

Maldives has experienced a high pace of growth, but the main challenge will be to enhance its inclusiveness going forward. As discussed in previous sections, the Maldivian economy is dominated by tourism, while tradable sectors and physical exports are largely limited to fisheries. Tourism has leveraged the country's endowments to underpin a very rapid growth, but the largely high-end tourism industry has developed in an enclave way, with limited linkages with the local communities. Fisheries are a significant source of employment, particularly for the poor, but the industry has stalled and much of the value is lost through low-added-value exports. The small size of the economy, together with other structural environment factors, has limited the development of other economic activities. Accordingly, the rapid overall economic growth of the country has not been accompanied by a commensurate growth in opportunities and jobs for the Maldivian population – especially for the youth, and for women whether youth or adult.

4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

TOURISM IN FIGURES



Tourism is the most important industry in Maldives. Tourism constitutes by far the biggest contributor to GDP at 28 percent, and is the greatest generator of foreign exchange earnings at more than 60 percent in 2014. Revenue from the sector accounts for 38 percent of government revenue, derived from various taxes and lease of islands.⁴⁴ Additional contributions from airport service charges, import duty and revenue from ancillary industries increase the overall impact of the tourism sector in the economy.

Tourism in Maldives has grown steadily since 1970s and Maldives has managed to position itself as a high-end destination [Figure 40]. Tourism in Maldives has developed as a supply-driven industry whose development was initially led by the private sector – as opposed to through government policies or support programs. Notably, while the supply for touristic facilities is constantly increasing, the country so far has been largely able to maintain both high occupancy rates [Figure 41] as well as a high premium (deemed as high as 40 percent⁴⁵ over other touristic destinations). Such premium is deemed to be based on the unique natural resources of the country, as well as on the exclusivity of facilities – which, in turn, is underpinned by the geographic dispersion of islands and the enclave conditions of resorts.

Figure 40
International tourist arrivals

Source: Ministry of Tourism

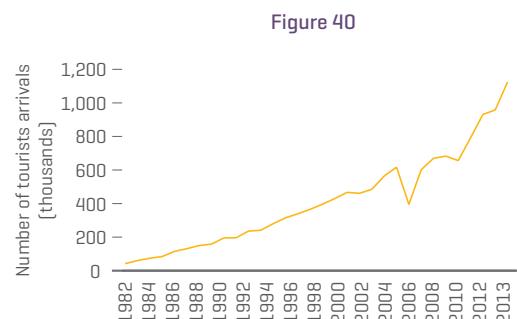
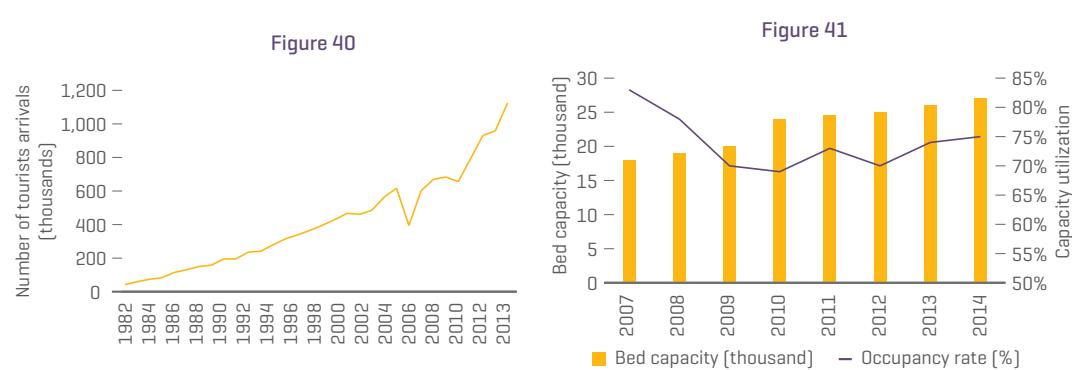


Figure 41
Capacity utilization

Source: Ministry of Tourism



⁴⁴ This includes all tourism-related taxes: [part of] import duty, Tourism tax, GST on Tourism, Airport Service Charge, Royalties, land and resort rent, Business Profit Tax.

⁴⁵ World Bank (2011f).

Figure 42
Composition of Arrivals

Source: Ministry of Tourism

Figure 43
Arrivals and length of stay

Source: Ministry of Tourism

Governance shortcomings in the current model for allocation of resort leases may be hampering the development of tourism and preventing the country from maximizing benefits and enhancing inclusive growth.

However, the sustainability of such premium cannot be taken for granted. The tourism industry has been susceptible to external shocks and changes in global trends. Most recently, the global financial crisis prompted a structural shift in the composition of arrivals, from Europe to Asia. Between 2008 and 2013, the share of European tourists fell by 26 percentage points mainly due to weaker economic conditions in Europe. Conversely, the share of Chinese tourists expanded by 23 percentage points [Figure 42]. This shift in demand was pursued by the industry, which made important marketing efforts in China and Middle East to compensate for the declining demand from Europe. While this shift helped maintain the volume of arrivals and occupancy, the overall profitability of the industry appears to be declining. The average length of stay fell from eight nights in 2008 to 6.1 in 2014 and is expected to continue declining as Chinese travelers favor shorter stays than European ones [Figure 43] and have a lower demand for ancillary activities such as diving and fishing, which generate additional revenue for the industry.

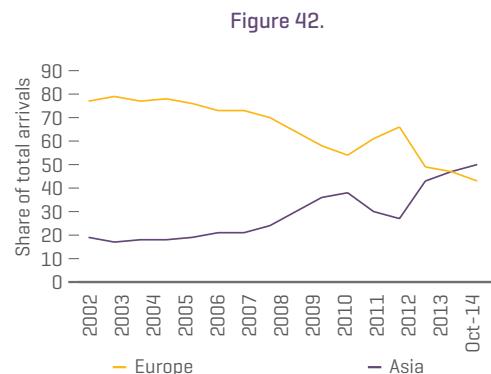


Figure 42.

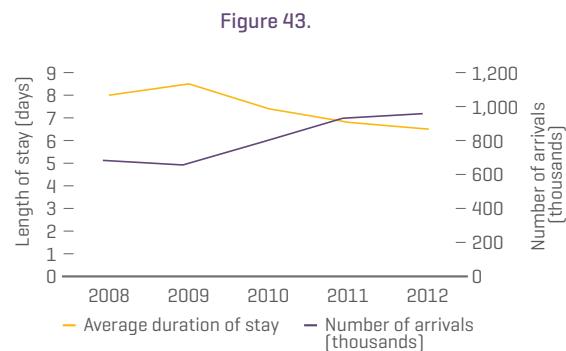


Figure 43.

And increase in supply may enhance downward pressures on the profitability of tourism. The volume of development of new tourism capacity has been growing and is expected to continue growing. At the present time, there are 89 new resorts under development with a planned capacity of 14,153 additional beds.⁴⁶ If completed, these new resorts would increase the supply of beds by 52 percent over the established capacity at the end of 2014. This evolution could translate into an increase in revenues as has been the case in the past, but it could also reach an inflection point where increased capacity will start driving down prices and premium. Lack of planning has led to sub-optimal growth and development proposition as potential resort developments are brought to market with little analysis or coordination with other sectors (such as transport⁴⁷ or skills training). While investor interest has remained strong, these challenges often threaten the financial viability of new projects and their ability to attract financing.

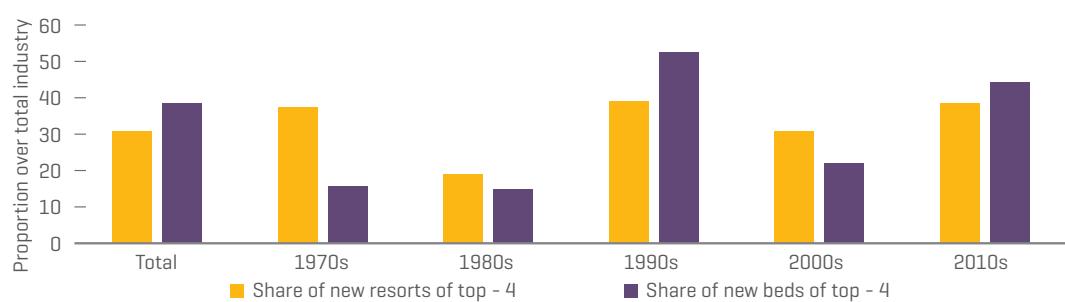
Governance shortcomings in the current model for allocation of resort leases may be hampering the development of tourism and preventing the country from maximizing benefits and enhancing inclusive growth in three main ways. First, although the resort sector is open to competition on paper, in practice the sector is dominated by a few large groups. In theory the legal framework

46 Data obtained from the Development Section of the Ministry of Tourism with figures as of 27/03/2014.

47 Private sector stakeholders interviewed during the preparation of this diagnostic and consultations consistently raised the limited capacity at Ibrahim Nasir International Airport as a factor that affects prospects for longer-term investment and expansion.

4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

Figure 44
Influence of 4 of the largest tourism groups on resort sector
Source: 2014 Tourism Yearbook, company websites.



One-third of the licensed resorts have not come into operation more than five years after the license was granted, and 22 licensed resorts have experienced delays of around 10 years.

Second, the current methods for allocating leases has translated into sub-optimal investment levels, with a large number of leased islands remaining undeveloped or suffering severe delays in construction. At present there are 106 licenses granted for new resorts, but there have been significant delays in construction of the planned resorts. Indeed, one-third of the licensed resorts have not come into operation more than five years after the license was granted, and 22 licensed resorts have experienced delays of around 10 years. Altogether, the licensed but unfinished resorts would account for 21,000 additional beds⁵¹ that are planned but have not materialized as a source of income for the country [which would increase by 78 percent the capacity in the country; create 31,000 additional direct jobs;⁵² and provide significant revenue flows to the country through taxes and duties]. The significant delays in construction of resorts after a license is granted have been blamed on a host of factors, including lack of financing. While these factors may indeed become hurdles once a license has been granted, the delays in construction appear to evidence significant shortcomings in the process followed to grant the licenses in the first place. Stringent and clear criteria for licensing of resorts would have enabled the country to ensure that licenses are granted to investors than can demonstrate the qualifications, experience and financial ability to develop the resorts shortly after licenses are granted. Clear enforcement processes would enable authorities to cancel non-performing leases and grant them to better qualified investors.

48 Tourism law 1999, "This Invitation for Bids is open to individuals, partnerships and companies, local and foreign. Individuals submitting Bids shall be at least 18 [eighteen] years of age on the Bid Opening Date." [bidding document 2013]

49 Including, inter alia, limited financing sources for Lease Acquisition Fees and unclear bidding processes.

50 Based on the 2013 annual report the Ministry of Tourism and company websites.

51 Based on planned bed capacity per resort licensed.

52 As a standard, 1.5 direct jobs are created per resort bed.

Figure 45

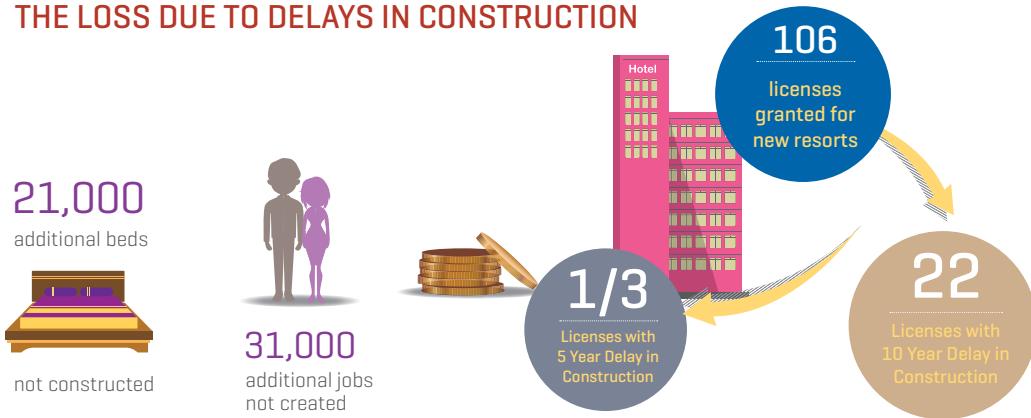
Cumulative planned beds and jobs not yet created

Source: Staff's calculations based on Ministry of Tourism data



THE LOSS DUE TO DELAYS IN CONSTRUCTION

Entities set up to promote the development of tourism may be contributing to undermining the governance of the sector.



Third, entities set up to promote the development of tourism may be helping to undermine the governance of the sector. The Maldives Marketing and Public Relations Cooperation (MMPRC) is as a state-owned enterprise formed in 2009 to promote and market the tourism industry. The Maldives Tourism Development Corporation (MTDC) was set up in 2006 as an entity with 47 percent government ownership and 53 percent private shareholding. Both MMPRC and MTDC can acquire leases for resort islands without being subjected to the standard bidding process and, in some cases, at below market rates. In turn, these leases can be developed or subleased to private parties. While the Ministry of Tourism has aimed to strengthen governance of leases through implementation of standard operation procedures, these subleases are not subject to the standard operating procedures of the Ministry of Tourism and both MTDC and MMPRC lack procedures to ensure transparency in subleases and prevent corruption. Further, the composition of the boards of directors of MTDC and MMPRC has raised concerns on lack of transparency on appointments and potential conflicts of interest. The later stems from the fact that board members include heads of private tourism companies that can benefit from subleases.⁵³ Notably, MTDC holds five leases that were granted nine years ago and represent an expected capacity of 1,280 beds that have not come into operation. This, together with governance concerns on their operations, calls into question the extent to which these two organizations are contributing to development of the tourism industry in a way that maximizes the benefits to the country.

53 At least one case has been identified of a private company linked to a board member which has been granted a sublease from MMPRC.

4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

Investment climate and political risk concerns may also undermine the ability of Maldives to attract reputable investors in the future.

The tourism industry has grown up in relative economic isolation with heavy reliance on foreign capital, foreign labor and limited economic linkages.

A more inclusive tourism industry may hold the key to improving shared prosperity in the country.

Investment climate and political risk concerns may also undermine the ability of Maldives to attract reputable investors in the future. Recent political unrest [which prompted travel advisories from various countries] together with international media reports highlighting the risk of radicalization have created concerns among tourism private stakeholders of a potential slowdown in demand from Western tourists as well as potential long-term deterioration of Maldives brand. Future additional investment may also be affected by investors' perception of instability in regulatory environment. This includes: a lack of formal consultation between government agencies, private sector and civil society on key policy decisions; a regulatory environment in a state of constant flux that leaves businesses financially exposed and unable to plan; and a potentially insufficient implementation period for the industry to adapt to new compliance measures.⁵⁴ Recent negative experience in FDI disputes likely works to undermine investors' confidence in Maldives [see also section on investment climate below].

And the industry has developed as an enclave, with limited positive spillovers to the local communities. The country's unique island geography presents many natural as well as socio-cultural barriers to integration. It is spatially dispersed with small surface areas, and has limited transport connections and a small population. As a result, the tourism industry has grown up in relative economic isolation with heavy reliance on foreign capital, foreign labor and limited economic linkages. There are also significant structural and social barriers to Maldivian women's employment in the tourism sector that contribute to its lack of inclusiveness.

Given the importance of tourism in Maldives, a more inclusive industry may hold the key to improving shared prosperity in the country. The industry is dominated by luxury enclave resorts, which have grown with heavy reliance on foreign capital and foreign labor and limited linkages to the rest of the economy. While there are a number of ancillary industries that have grown alongside tourism [notably through demands on the transport, construction and communication sectors], the linkages between tourism and the local economy remain modest. The participation of women in either the tourism sector per se or in ancillary industries is low. Tourism generated 38 percent of government tax revenue (2013)⁵⁵ and 83 percent of the country's foreign exchange earnings from exports of goods and services, but substantial leakages undermine the economic and social benefits of the industry. A large proportion of the revenue generated through tourism is lost through import of products, import of labor and financial outflows related to dividends and external debt servicing [as external debt largely fuels resorts development] and offshore booking of revenues originated by resorts. These areas are further discussed below.

Better linkages between the resorts and the local enterprises may help to leverage on tourism growth for development of other tradable sectors. According to anecdotal evidence, close to 100 percent of the goods required by resorts are imported. It is suggested that local enterprises lack the ability to provide goods with the quality and reliability needed to cater to the expectations of the high-end resorts. Government policies supporting import substitution have not translated into a visible growth in the real sector, which remains hampered by, among other things, the small size of the economy [with limited economies of scale], high dispersion of the population, and

54 A commonly-cited example is the T-GST, increased from 8 percent to 12 percent in November 2014, and a green tax of US\$6 a bed-night that will be introduced at the end of 2015, replacing the bed tax.

55 Tourist tax, Goods & Services Tax on Tourism, Airport Service Charge

high transport costs. Given the structural limitations of the country, the potential for backward linkages between tourism and local enterprises is likely modest and probably limited to a handful of products.

Tourism is a large and rapidly growing source of jobs, but most of them are not seized by local population due to a host of factors. While tourism creates a large number of jobs, the Maldivian population does not take advantage of them. Across the board, only 15 percent of employed Maldivian men and 4 percent of employed Maldivian women work in the tourism sector, while the number of foreign nationals employed in the sector has increased constantly over time (Figures 45 and 46). A government-imposed quota (requiring 55 percent of employees in tourism to be Maldivian nationals) is customarily unmet⁵⁶ and, in general, appears to have failed to sustainably enhance the participation of Maldivian nationals in tourism. Tourism in Maldives has created more than 28,000 direct jobs⁵⁷ and government targets for new resorts⁵⁸ imply an added annual requirement for 3,300 new staff. The relative importance of this figure is evident when compared to the unemployment figures in the country. The total number of the unemployed in Maldives is estimated around 11,000, of which around 8,000 are young people. The lack of participation in tourism jobs is particularly dire among women, who account for less than 3 percent of the labor in the industry.

Tourism is a large and rapidly growing source of jobs, but most of them are not seized by local population.

TOURISM SECTOR



The obstacles to enhance broader participation of the Maldivian nationals in tourism appear to be manifold. Information collected from stakeholders, civil society and youth through interviews and consultations during the preparation of this diagnostic identified a number of factors that appear to be at play in restricting broader participation of the local population on tourism. These include: [1] reservation wage that is too high for unskilled jobs; [2] lack of skills for technical and managerial jobs (see section on skills below); [3] social norms (see section on youth below); and [4] lack of adequate transport (resorts that are close to inhabited islands and have good transport links have a much higher proportion of Maldivian workers). However, data does not currently exist to validate these perceptions in a conclusive manner.⁵⁹

56 According to the 2014 census (published by the National Bureau of statistics) the foreign nationals account for 58.4 percent of all tourism employees, but anecdotal evidence suggests that this figure may be significantly higher.

57 According to the 2014 census (published by the National Bureau of statistics) there were 11,425 Maldivian employees (10,991 male and 435 female) at resorts, and 16,342 foreign employees (14,339 male and 2,003 female). However, according to the Ministry of Tourism, by early 2015, a total of 23,917 resort beds creates an approximate total employment demand (at a ratio of 1:1.5) of 31,000 staff.

58 The Government's plans for development of tourism consider ten resorts (average bed capacity is 220) each year. Source: Ministry of Tourism.

59 This has been confirmed in interviews with Maldivians for the youth and gender studies.

4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

Figure 46

Foreign migrant employment, 2001-10

Source: WB staff calculations with data from MMA and Ministry of Tourism

Figure 47

Number of employees in tourism [2008]

Source: Human Resource Situation in the Tourism Sector of Maldives, Statistics & Research Section; Ministry of Tourism & Civil Aviation
27/01/2008

Community-based tourism may represent a valuable option for diversification and inclusive growth.

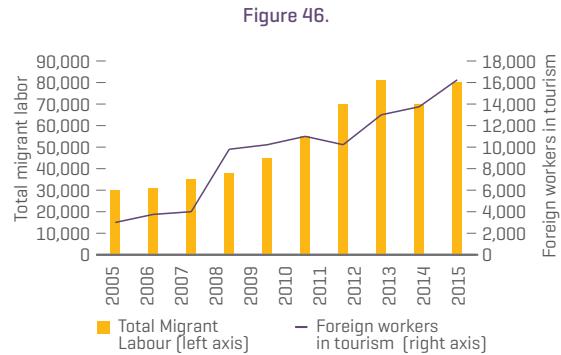
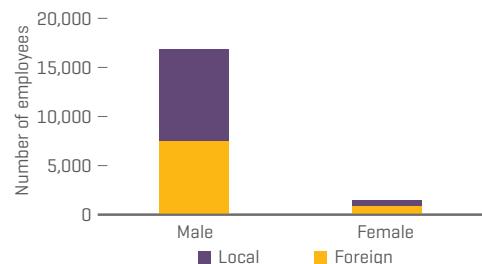


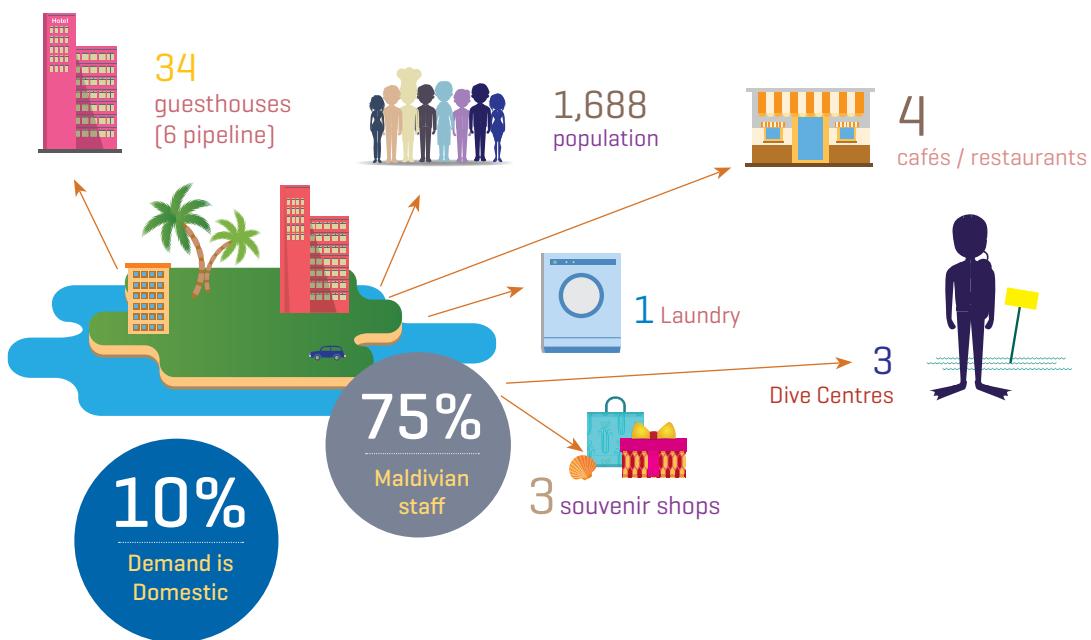
Figure 46.

Figure 47.



A nascent segment of community-based tourism may represent a valuable option for diversification and inclusive growth [Figures 47 and 48]. Most importantly, this segment appears to create opportunities for tourism that is well integrated with local communities. Guesthouse development is the fastest growing segment. New legislation in 2009 allowed islanders to develop their homes into guesthouses. This new product has grown rapidly, totaling approximately 238 facilities with 3,565 rooms, with likelihood of doubling in the next three years. Every atoll [bar one] is now hosting some kind of guesthouse or hotel on inhabited islands, with the majority concentrated in the urban centers of Hulhumalé and Malé [79 establishments]. Attracting a different market, this product does not represent competition for resorts other than at an infrastructure level – considering the existing limitations of the international airport.

MAAFUSHI ISLAND, A GUESTHOUSE DESTINATION



But the rapid and unplanned growth of guest houses has already translated into visible negative impact on the environment compounding the existing challenges in inhabited islands.

Figure 47.
Number of beds [2012]

Source: Ministry of Tourism

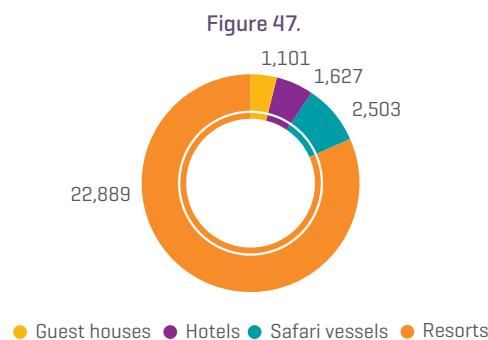
Figure 48.
Growth in number of beds

Source: Ministry of Tourism

There are still unrealized opportunities for linkages between tourism and local providers of goods and services.

Notably, the potential for integration of this market segment with local communities appears high. First, the proportion of Maldivian nationals working in this market segment (estimated by the industry at 75 percent of total workforce, see box) is significantly higher than in resorts (estimated below 45 percent). Second, there is evidence of a nascent 'ecosystem' of local suppliers of goods and services around guesthouses. Third, closer interaction between tourists and islanders in an every-day setting has been relatively positive in this situation, and may be a case study in 'exposure' and breaking of socio-cultural stigmas towards the sector in general.

Growth in this segment has some limitations and risks. It is likely to be highly concentrated around transport hubs (airports) since elasticity of demand will be lower in this segment. Most importantly, the rapid and unplanned growth of this market segment has already translated into visible negative impact on the environment compounding the existing challenges in inhabited islands. Waste management, land-use planning, population displacement and environmental management are some of the issues at the forefront of inhabited islands already. Simply supporting the increase of supply will put pressure on island resources to the detriment of all.



There are still unrealized opportunities for linkages between tourism and local providers of goods and services. The tourism industry is a large and rapidly growing source of demand for goods. In 2014, food items alone (grains, fruit, meat, beverages) were imported at a total cost of \$407 million⁶⁰ and demand is expected to increase substantially as the sector grows over time (see figure). The tourism sector's demand for inputs represents a major opportunity for local producers (Figure 49). But at the present time most of the goods are imported, given limitations in local supply. Resorts report⁶¹ a high willingness to purchase inputs locally and are prepared to pay a premium for fresh produce. Maldives is deemed to have potential for competitiveness in producing a number of agriculture and fishery goods,⁶² which are already being produced successfully, but in quantities still lower than demand.⁶³ Local cooperatives and agricultural-focused islands⁶⁴

60 MMA (2015).

61 Based on information collected during the preparation of this diagnostic through interviews and consultations with private sector stakeholders.

62 Ten crops have been selected by the Ministry of Agriculture and Fisheries for high potential in achieving self-sufficiency. Applying other filters such as consistent and growing demand from the tourism industry, and a low barrier to entry for Maldivian producers yields a list that includes; bananas, papaya, coconuts, lettuce, cucumber, flowers and tuna amongst others.

63 For example, according to Ministry of Fisheries and Agriculture's estimates (no country-wide statistics exist) local producers are deemed to produce around 400,000 kgs of bananas, a 52 percent of the estimated demand from resorts (755,000 kgs per year).

64 There are eight agricultural islands and various production cooperatives.

4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

Figure 49
Total resort purchasing selected products 2015 - 2020

Source: World Bank estimates based on figures from market participants

have already demonstrated the viability for local production, but they are still hampered by infrastructure, quality and scale shortcomings. Encouraging women's participation in such local production could also have a beneficial impact on women's unemployment, which is higher than that of men, and in addressing high poverty levels among women-headed households.



The fisheries sector is a critical contributing sector for the country's national economy and forms the most important primary economic activity in almost all of the country's inhabited islands.

Opportunities for service-provision linkages more constrained. Most resorts own and operate all of their support services and ancillary functions⁶⁵ due to factors including geo-spatial challenges and quality in service provision. Accordingly, opportunities may be limited to:

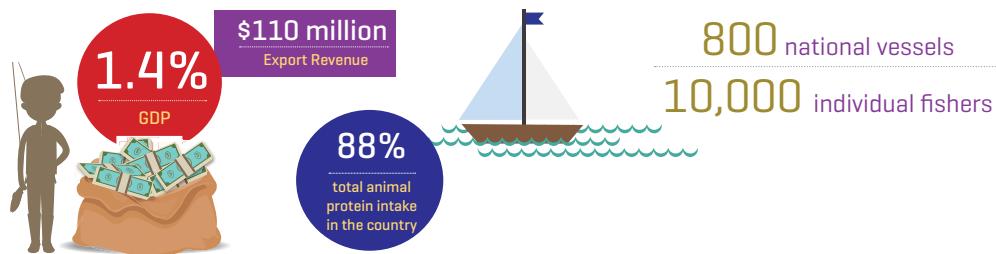
- A small number of services that Maldivians have a competitive advantage in providing, and are equally in demand by the tourism sector. These include authentic and cultural-heritage based excursions or handicraft. While all of these are fairly small-scale, the economic impact of better linkages for local communities is likely to be significant.
- Development of an ecosystem of service suppliers for the guesthouses niche.

FISHERIES

The fisheries sector is a critical contributing sector for the country's national economy and forms the most important primary economic activity in almost all of the country's inhabited islands. Before the development of tourism, fisheries was the most important industry and source of growth for Maldives and, to a large extent, fisheries remains an important reference in Maldives culture. Although the relative importance of the fisheries sector has declined since the late 1970s (due mainly to the rapid growth of tourism), its role in the Maldivian economy remains significant. Fisheries remain a large, source of employment (see below), the largest source of physical exports, one of the few local industries supplying the touristic resorts, and a major source of food supply for the local market. In 2011, it accounted directly for 1.4 percent of GDP and currently generates \$110 million in export revenue.

65 Including tourist excursions, dive centers, supply-boat operations, laundry, security, sports facilities and spas

TOURISM CONTRIBUTION



Source: WB staff's calculations with data from Ministry of Fisheries and Agriculture

Maldives has benefited in terms of both food security and trade. Along with the tourism sector, the productive fisheries sector has been a leader in the country's growth and development. The fisheries sector has remained vital in terms of trade, employment and subsistence especially on islands not dominated by the tourism industry. With a fishing-fleet of about 800 national vessels⁶⁶, close to 10,000 individual fishers and their families depend on fishing. In addition, fish is a staple food across the archipelago and it remains the main source of protein for the population, covering around 88 percent of the total animal protein intake (FAO, 2011). Maldives is among the highest fish consuming countries in the world⁶⁷; 49 percent of the fish catch is consumed locally.⁶⁸ Fish and fish products account for almost 98 percent of Maldives physical exports.

The fisheries industry is experiencing a declining trend evidenced by lower catch, lower employment and lower contribution to GDP.

However, the industry is experiencing a declining trend (Figures 50 and 51 and Table 1). A marked decrease (-28 percent) in catch volumes between 2006 and 2013 has undermined the contribution of fisheries to GDP (-54 percent) and translated into rapidly decreasing employment in direct fishing activities (32 percent reduction between 2006 and 2013⁶⁹). While these figures do not include jobs in processing and ancillary industries, the reduction in direct employment is particularly concerning given the fact that fisheries represent the single most important source of jobs in many islands, especially those that are not close to the capital or touristic resorts. The reduction in women's employment in fisheries is particularly dire; the increased mechanization of the fisheries has largely taken over the fish processing activities that were the foundation of female employment in this sector. Thus women's work in fisheries has been phased out such that female employment is practically nil in this sector.⁶⁹ In spite of these negative trends, the value of fisheries exports has increased over the same period, reflecting higher prices for fisheries exports and thus signaling the unrealized potential economic contribution that a more thriving fisheries industry could make to the country.

⁶⁶ The Maldivian government imposed the termination of foreign long-line licensing in May 2010.

⁶⁷ It is assessed that 341 kcal of fish are consumed per capita per day (FAO, 2011).

⁶⁸ Worldwide, about a billion people rely on fish as their main source of animal proteins. About 20% of the world's population derives at least one-fifth of its animal protein intake from fish, and some small island states depend almost exclusively on fish. WHO (2015)

⁶⁹ ADB (2014a)

4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

Figure 50

Fisheries employment and contribution to GDP

Source: Staff calculations with data from MMA and Ministry of Fisheries and Agriculture.

Figure 51

Total catch

Source: Staff calculations with data from MMA and Ministry of Fisheries and Agriculture.

Table 1

Fisheries sector statistics

Source: MMA and Ministry of Fisheries and Agriculture

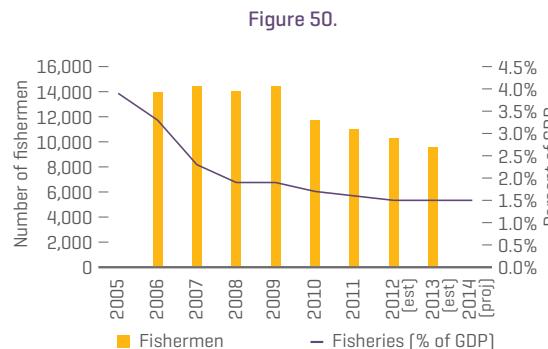


Figure 51.

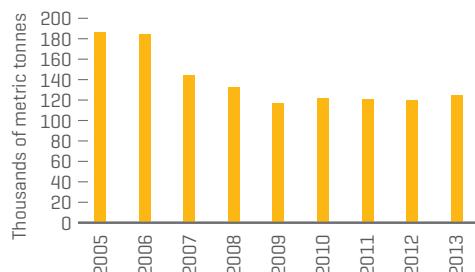


Table 1.

	2006	2013	Change
Contribution to GDP [%]	3	1.5	-54%
Catch [thousands of metric tonnes]	181	130	-28%
Exports [metric tonnes]	110,232	40,601	-63%
Exports [USD million]	132	165	25%
Number of fishermen	13,980	9,554	-32%

THE DECLINE OF FISHERIES



Maldives fisheries sector benefits from high value stocks, but its recent trends highlight vulnerability to external factors. While the country benefits from access to vast fishing resources spread over 90,000 sq. km of territorial waters, the bulk of fisheries catch (82 percent) is dominated by two types of tuna (skipjack and yellow fin), which are exported. The Maldivian tuna is considered as a premium product benefiting both from high quality fish stocks as well as sustainable fishing methods (pole and line). In 2013, 95 percent of the 130,000 tons of fish catch was tuna⁷⁰. The current fish catch consists of skipjack tuna (57 percent), yellowfin tuna (35 percent), and other

⁷⁰ Ministry of Fisheries and Agriculture, [2013]

Governance deficiencies appear to have hampered the development of fisheries and their value to the economy.

kinds of tuna (3 percent). Catches of skipjack tuna have decreased drastically over the past years due to a mix of factors including overfishing, higher fuel costs, temperature rise leading to change in schools aggregation and lack of more effective regional, eco-systemic management of the shared skipjack stock. Conversely, catches of yellowfin tuna are increasing thanks to its increasing price in foreign markets and the rapid growth of the hand-line fishery [Figures 52 and 53]. Reef fish, which account for 16 percent of catch, are mainly used for internal consumption and supply to resorts.

Governance deficiencies appear to have hampered the development of fisheries and their value to the economy. The market for skipjack tuna is controlled by a four processing licenses.⁷¹ On the contrary, yellowfin tuna is not regulated through similar licenses. Interestingly, these two market segments have evolved in a very different manner. For skipjack tuna, the catch volumes have plummeted, the tuna is largely exported as raw commodity to intermediary markets and its export price is low and volatile. On the contrary, the [unlicensed] market for yellowfin tuna has a different pattern of development, with rapid growth in catch volume, development of 12 EU-certified processing facilities, which give it access to final markets, and a more stable and higher export price (estimated at 2.5 higher than that of skipjack tuna, Figure 54). Accordingly, governance issues seem to influence the development of fisheries, including the industry's ability to reap the value of the country's stocks and develop ancillary processing industries, as well as the levels of investment that the private sector undertakes in the fisheries industry. The very different development trends of the licensed and the unlicensed market segments call into question the need and/or the suitability of the current licensing framework for skipjack tuna. If licenses for processing are maintained, it appears necessary to revise the licensing process in order to ensure that: licenses are granted in a transparent and competitive manner, and; the selection criteria for licensees emphasizes technical and financial capabilities as well as fit-for-purpose considerations.

Figure 52

Catch

Source: Staff's calculations with data from MMA, World Bank WDI and market prices

Figure 53

Share of exports

Source: Staff's calculations with data from MMA, World Bank WDI and market prices

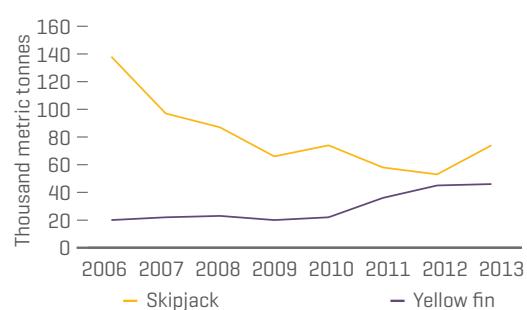
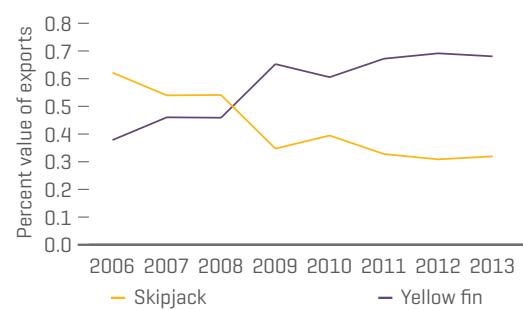


Figure 52

Figure 53.



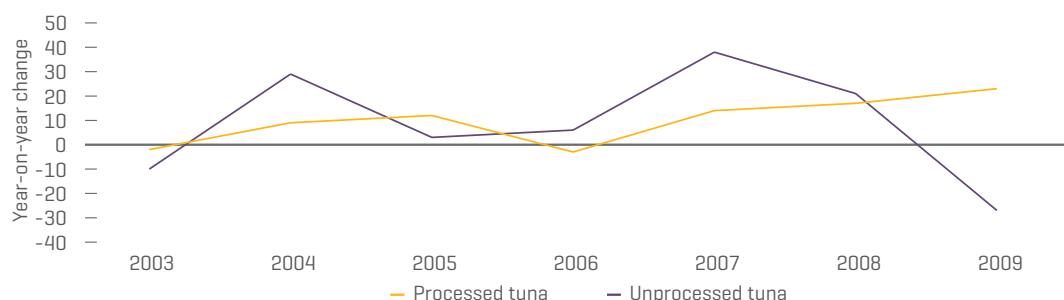
⁷¹ There are 4 skipjack tuna collection permit holders, who have exclusive contracts with the government to purchase, process and export skipjack fish from designated fishery zones.

4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

Figure 54

Change in price

Source: Staff's calculations with data from MMA, World Bank WDI and market prices



The sustainability of fisheries is jeopardized by inadequate fisheries management.

Environmentally friendly fishing methods for tuna have enhanced Maldives' ability to access premium markets. The Maldivian pole-and-line fishery is one of the largest coastal fisheries in the Indian Ocean, and is estimated to account for 18-20 percent of the total catch of skipjack tuna in the region⁷². The fishery received considerable attention as a potential model for coastal states, owing to both its commercial success and its adherence to ecological best practices. Pole-and-line fishery has been promoted for its environmentally friendly nature⁷³. That has enabled a pathway to the export-markets of Europe and allowed it to extract a premium compared to other similar fisheries. However, it is important to note that while pole and line fishing is deemed environmentally friendly due to low by-catch, it does not prevent over-fishing, which has indeed been a problem [see below].

However, the sustainability of fisheries is jeopardized by inadequate fisheries management. Tuna and reef fisheries are either fully or over-exploited and catches are stagnating or declining as mentioned above. Destructive fishing methods (especially for reef fish) and over-exploitation of reef fish⁷⁴ also raise issues of sustainability. This is mostly due to sub-optimal fisheries management, environmental change resulting in increased sea surface temperature, and the estimated high levels of illegal, unreported and unregulated fishing in the Exclusive Economic Zone. Development and management of capture fisheries is governed by the Fisheries Law of Maldives. However, the emphasis of the law is mainly on protecting local fishers and the sovereignty of Maldivian waters, with less consideration of fisheries management. Other than two tuna fisheries, there are currently few management measures in place for the local harvesting sector. Some important steps have, however, already been undertaken: a fisheries licensing scheme⁷⁵ was introduced in 2010, and the Environmental Protection and Conservation Act contains provisions to limit fishing for the conservation of biological diversity through 33 protected areas and natural reserves.

72 Adam, M.S. and Kolody, Dale, [2011].

73 In 2012, the Maldivian skipjack tuna fishery successfully completed the process of official certification by the Marine Stewardship Council (MSC) recognizing the best practice nature of this fishery.

74 The sustainability of reef fish is threatened by three factors, namely: a) the tuna fishery in Maldives is heavily dependent on the coral reefs for bait. For every 7-10 kg of tuna caught, a kilogram of live bait is required, suggesting a bait conversion ratio of 8:1 on average; b) anecdotal evidence identifies negative impacts of bait fishing on the ecosystem due to removal of juvenile reef fish and on physical environment due to anchoring pole-and-line boats in coral areas; and c) demand for reef fish has increased threefold in the last 15 years with the increasing demand coming from tourist resorts and export industry. Source: Marine Research Centre, [2010].

75 According to the "Licensing regulation for fishing, processing and aquaculture intending for export" every fisher intending to export fish or sell to an exporter is required to get licensed under the regulation. The license is renewed annually after paying a nominal fee

Overfishing of reef fish is a risk to the sustainability of the tuna fisheries as well as tourism.

Marine aquaculture is nascent in Maldives and can be an important source of economic growth and diversification, poverty alleviation and foreign exchange earnings.

Overfishing of reef fish is a risk to the sustainability of the tuna fisheries as well as tourism. The sustainability of reef fish is threatened by three factors: [1] The tuna fishery in Maldives is heavily dependent on the coral reefs for bait. For every 7-10 kg of tuna caught, a kilogram of live bait is required, suggesting a bait conversion ratio of 8:1 on average⁷⁶; [2] anecdotal evidence identifies negative impacts of bait fishing on the ecosystem due to removal of juvenile reef fish and on physical environment due to anchoring pole-and-line boats in coral areas; and [3] demand for reef fish has increased threefold⁷⁷ in the last 15 years, with the increasing demand coming from tourist resorts and export industry. While there are no reliable statistics to validate over-fishing of reef fisheries, if overfished the health of the coral reef ecosystem (a major touristic attraction) can be significantly affected. If unchecked, there is a high potential of over-fishing, which could result in exhausting of stocks as experienced for giant clam fishery in 1990⁷⁸ and the near collapse of sea cucumber fishery in 1997. Fishery bans were imposed on black coral, giant clams in 1991, turtles in 1995 and sharks in 2010. However, there is little adequate monitoring to ensure the effectiveness of these bans.

The sustainability of fisheries is also threatened by climate change. Climate change impacts such as dilution of seawater with the sea level rise and higher temperatures can result in the mortality of corals. Changes in surface water temperature and ocean acidification can compromise the calcification potential of coral reefs due to changes in the association between corals and their symbiotic micro-organisms; hence, result in slow growth and productivity.⁷⁹ Coral reefs are made further vulnerable due to dependency of reproduction on environmental conditions. Similarly, tuna is highly attuned to the biophysical conditions of the pelagic environment, particularly El Nino Southern Oscillation and associated changes in surface sea temperatures. Recent observations of changes in tuna aggregation and migration patterns observed is partly attributed to the rising ocean temperatures and ocean acidification that are altering marine ecosystems and impacting the fish distribution. Tuna movement and abundance in the Indian Ocean is closely linked to the climate-change-driven ocean productivity.⁸⁰

Threats to the health of the coral reefs that are significant to the fishery sector also come from habitat degradation and loss due to pollution, harbor construction and reclamation. However, the extent of the damage that these activities inflict on the health of coral reefs and marine species has not been quantified (see also section on environmental sustainability).

In light of declining trends in the capture fisheries, marine aquaculture is nascent in Maldives and can be an important source of economic growth and diversification, poverty alleviation and foreign exchange earnings. With a view to diversifying the country's fisheries sector, the government has been implementing pilot aquaculture projects for a decade with pearl oysters, Maldivian clownfish, and brown marbled groupers. A private aquaculture farm is also producing sea cucumbers,

76 Marine Research Centre, (2010).

77 Sattar, S.A., (2008).

78 Naseer, A., (1997).

79 Naseer, A. (2006).

80 Adam, M.S. (2006).

4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

producing the larvae in hatcheries before growing them in mangroves and lagoons. The future development of aquaculture is however hindered by limited availability of financing and technology. Operators are also expressing the need to better define the legal and policy framework to clarify the business environment, develop the value-chains and facilitate longer-term investments and research.

AGRICULTURE

Maldives produces less than an estimated 10 percent of its food requirements, reaching self-sufficiency in fish only. All other staples are imported (Figure 55). As a result, food items account for 21 percent of imports⁸¹. Food imports are required not only to meet domestic food demand for the Maldivian people but are also essential to cater to the tourism industry in Maldives. Outside of Malé, fishing and subsistence agriculture are the main sources of food security and livelihoods for the vast majority of the people. Except for coconut and fresh tuna, 90 percent of all food items are imported.

Food security concerns have revitalized interest in the development of the local agriculture production. Import dependency, limited storage facilities and ad hoc distribution pose food security risks. In response to the recent food and fuel crises, Maldives has integrated food security considerations into national planning. It has removed tariffs on imported food items, agricultural inputs and fuel, and is looking for ways to intensify and diversify agriculture and fisheries. The government is working with international agencies and private-sector partners to develop agriculture by introducing new and innovative techniques and technology to strengthen the contribution of farming to rural development.

Agriculture is a relatively minor activity in Maldives and has contributed only marginally to long-term growth. Agriculture accounts for 1.7 percent of GDP [even though its value has grown in real terms over the past 20 years]. Agriculture has traditionally been undertaken as subsistence crops in 12 atolls, and only recently higher volume production has been developed (Figure 56).

Maldives total land area is around 30,000 hectares of which 4,000 hectares are estimated to be arable. In 2013, approximately 50 islands large enough to support commercial agriculture activity had been leased for agricultural production, spanning a total area of about 1,300 hectares. Bananas, coconuts, fresh fruits and vegetables [papaya, eggplant, melons, pineapple and chilies] are the main commercial crops produced locally in Maldives.

⁸¹ USD 318.9 million in 2012

Figure 55
Top imports, Maldives
2011

Source: FAO stats

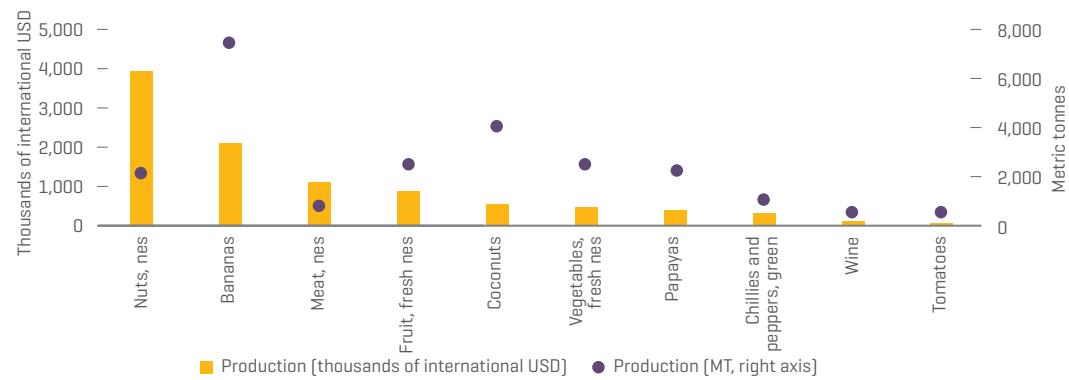


Maldives faces a number of structural challenges and resource constraints that will limit the country's potential for agriculture development.

Maldives, however, faces a number of structural challenges and resource constraints that will limit the country's potential for agriculture development. Arable land is extremely limited and scattered among many locations, inhibiting the horizontal expansion of farming areas and the achievement of economies of scale. Soils are generally infertile or unsuitable for productive agriculture, requiring high levels of supplemental fertilization. Fresh water resources for irrigation purposes are limited and new irrigation technologies and technologies to desalinate seawater for agriculture production purposes may be prohibitively costly. Start-up investments in high-tech agriculture, including production facilities, storage and transport infrastructure, and the associated economic risks are high as well. Ensuring predictable product quantities from smallholder producers and ensuring product quality that meet expectations and standards of resorts will be challenging. Public R&D and extension support systems will be costly to establish domestically (as opposed to R&D systems in fisheries where the potential for expansion and take by private sector is significantly larger). Given these constraints, Maldives will remain dependent on imports (and vulnerable to the associated risk of price shocks) for most of its food demand into the future.

Figure 56
Top production, Maldives 2012

Source: FAO stats



4. SOURCES OF GROWTH AND SHARED PROSPERITY (CONTD.)

There are however, a number of opportunities to capitalize on agriculture for local income growth.

There are however, a number of opportunities to capitalize on agriculture for local income growth. Though no official data exist, the linkages between local agricultural production and the tourism industry are still limited. Anecdotal evidence suggests that concerns on volume, quality and reliability of local production significantly reduce the incentives for resorts to source agricultural produce locally, in favor of imports. In spite of that, market participants from both supply and demand consider that there may be potential to further and more systematically exploit comparative local advantage in the production of various fruits and vegetables to cater to the resorts (see section on tourism). Such an emphasis may also have the added benefit of increasing women's employment, since agriculture has a predominantly female labor force (women represent 60 percent of total employment in agriculture). Currently, mostly bananas, melons, papaya are produced locally for resorts but it may be worthwhile to analyze more systematically what other high-value fruits and vegetables are suitable for cultivation.

In addition to broadening production choices and testing cultivation feasibility of a larger pool of fruits and vegetables, the feasibility of low-cost smallholder greenhouse technologies combined with household based-irrigation/ 'fertigation'⁸² systems could be explored. Producer groups or cooperatives of smallholders could help to bundle extension and marketing/ branding support, including the operating of local collection, grading, cooling and storage facilities, as well as transport to markets or consumers. Most likely, direct marketing arrangements between producer groups and selected resorts will be the most viable model for high-value agriculture. Corporate Social Responsibility schemes of international resort brands to promote community-based organic agriculture could be explored with support from and in partnership with specialized NGOs and government. Although there might be potential to strengthen the linkages between local producers and the tourism sector through such arrangements, local producers will continue to face production risks, as well as demand fluctuations due to the seasonality of tourist arrivals.

82 Fertigation is the combined application of water and nutrients to a crop – a mix of fertilizer and irrigation.

Tourism is an industry with high growth and revenues, but the linkages with the local economy remain limited.



5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY

Key Messages

Constraints to growth and shared prosperity include:

- Challenging investment climate constraining creation of new firms and growth of existing ones
- Limitations in access to finance reduce the ability of the private sector to grow
- Governance shortcomings undermine the ability of the private sector to grow in a sustainable and equitable manner and have hampered the ability of Maldives to maximize the benefits from its natural resources as a foundation for shared growth
- Limitations of education sector and mismatch between supply and demand for skills.
- High, unsustainable and increasingly regressive social spending

STRUCTURAL CONSTRAINTS

The geography and population dispersion in Maldives creates a unique set of structural constraints, beyond those experienced by other small island states.

The geography and population dispersion in Maldives creates a unique set of structural constraints, beyond those experienced by other small island states. In line with other small island states, size challenges limit Maldives' production base and competitiveness (Box 4). The country is vulnerable to external shocks. In fact, the volatility of its GDP growth is among the highest of all countries in the world (Box 3). Similarly, Maldives has a narrow economic base (tourism and fisheries), and the small size of the economy limits its ability to sustainably develop local production of other goods or services, enhancing its reliance on imports. While the tourism resort industry is able to access foreign capital through FDI and borrowing, most other sectors are not, thereby further limiting their ability to grow. Beyond that, as opposed to many small island states, which are composed of a single island, Maldives is a widely dispersed multi-island state with population disperse among more than 190 inhabited islands.

As an illustration, island transport facilities are limited leading to high inter-island transport costs and limited connectivity. Maldives' islands are dispersed within 90,000 square kilometers of territorial waters. As of 2005 only 105 inhabited islands (58 percent of all inhabited islands) had adequate harbor and access facilities.⁸³ As of 2011, 25 islands still had no harbor facilities.⁸⁴ To illustrate this point further, while transporting a 20-foot container from Singapore to Male would cost about \$1,200, the cost for transporting building materials to an island would be about the same (\$1,000-1,100) with additional costs incurred due to lack of jetty facilities in some of the islands.⁸⁵

83 7th National Development Plan, 2006-10. <http://www.planning.gov.mv/ndp/7ndp/pages/spatial/goal-3/transport.php>

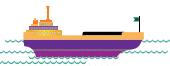
84 Based on draft "Maldives Country Diagnostic Study" by the Asian Development Bank, December 2014.

85 World Bank. 2006. "The Maldives. Sustaining Growth & Improving the Investment Climate". April, 2006

The cost of providing basic services in a fragmented country is raised across the board, and public expenditure in Maldives is structurally high.

COST OF TRANSPORT (PER CONTAINER)

Singapore to Male - **\$ 1200**



Inter-Island transport - **US\$ 1,000 - 1,100**

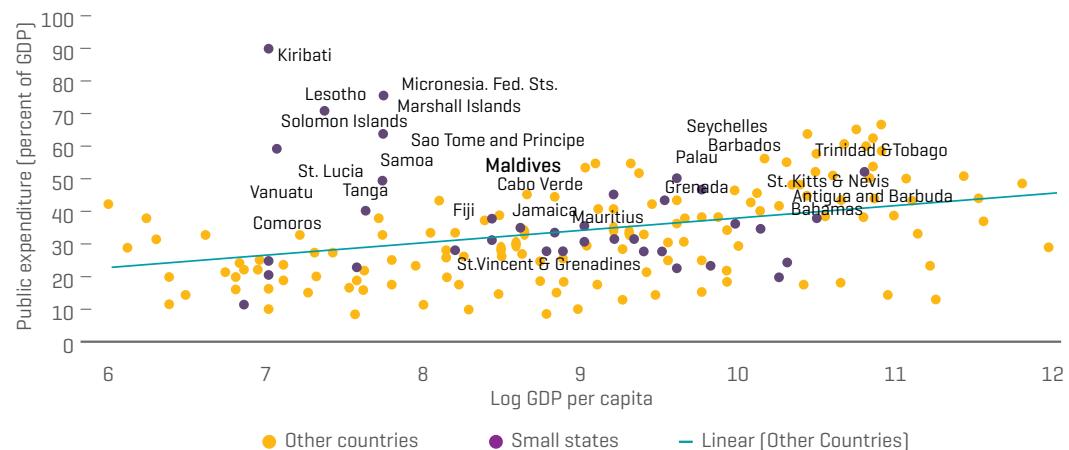


As a result of these challenges, the cost of providing basic services in a fragmented country is raised across the board, and public expenditure in Maldives is structurally high. Maldives' public spending is well above the level predicted for countries with a similar GDP per capita, although a number of other highly dispersed island states [Kiribati, Micronesia, Marshall Islands and Solomon Islands] have an even higher level of public spending [Figure 57]. Indeed, when taking into account its small size [leading to relatively high fixed costs of government], its insularity [a scattered population across an archipelago increases the marginal cost of service delivery], the duality of its economy [using taxing and spending to redistribute resort rents] and its openness [larger government provides insurance against volatile incomes], Maldives moves closer to but still above the predicted level of spending.

Figure 57

Public expenditure in Maldives versus GDP per capita compared to other countries

Source: World Bank staff calculations



Note: Diamond shaped markers are all small states, while the ones with the label are island states

The small and dispersed population presents the country with a public service and infrastructure dilemma. With its population dispersed over many islands across long distances, the country faces the choice whether to address the challenge of the high cost of service delivery through consolidation of population closer to Malé or through improving services and connectivity to populations at their current locations. Each choice will generate different demands on public services such as health, education and infrastructure, and will require a strengthening public investment management capacity.

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

Box 4. Small states challenges

More than 40 countries have a population under 1.5 million, out of which 26 are small island states. These countries vary greatly in their level of development and the size of their economies. They are also spread out geographically, with most of them clustered in the Caribbean, the Pacific and in Africa. Despite their diversity, these countries share a common set of development challenges.

Size

Vulnerability to economic shocks and income volatility. Because of the small size of their economies, growth strategies in small states rely on foreign markets. A high degree of openness however means that they are heavily exposed to external shocks in global markets. Moreover, their narrow resource base and small domestic markets prevent small economies from diversifying into a wide range of activities, making them more vulnerable to terms of trade shocks. When one dominant activity declines, it has an impact throughout the economy, exposing the population to income volatility that can create additional hardships as the poorest are less able to weather shocks to their incomes. Government revenues are also volatile because they rely more heavily on taxing imports as a source of revenue. As tariffs are reduced, so is the government's income.

Limited capacity. Because of their size, small states are traditionally face challenges in training and retaining the right skills in the public sector. They also tend to have larger public sectors than other countries. In some states, a widely scattered population adds to the challenge. Small states also lack sufficient institutional capacity to participate fully in international fora, which can profoundly affect their economies.

Difficulty accessing external capital. Access to global capital markets is important for small states, and is one way to compensate for adverse shocks and income volatility. But private markets tend to see small states as more risky than larger countries, so spreads are higher and market access is more difficult.

Geography

Limited competitiveness. Three out of four of developing small states are islands or widely dispersed multi-island states; others are land-locked, and some are located far from major markets. Their remoteness and isolation make it difficult and costly for these states to access world markets to compensate for small domestic markets — a situation that increases the cost of intermediated inputs and imports and prevents efficiency and innovation. Domestic competition is also limited, which hampers successful development.

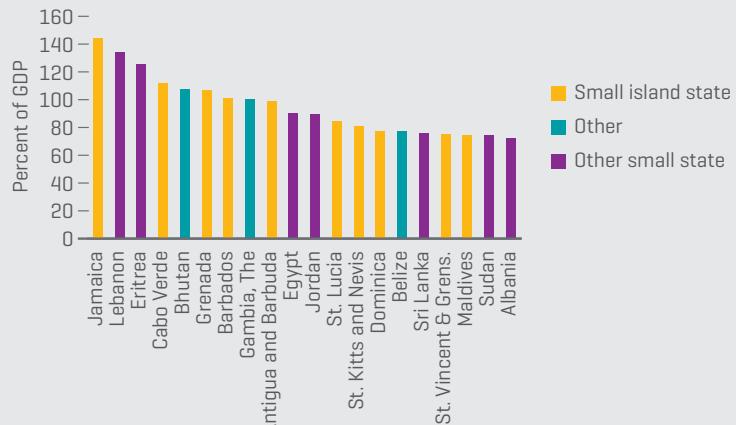
Susceptibility to natural disasters and climate change. Most small states are vulnerable to climate-change-related impacts and natural disasters such as hurricanes, cyclones, droughts, and volcanic eruptions that typically affect an entire population and economy. The impact on the government's finances can be overwhelming, limiting a country's ability to build cushions for development programs and future needs.

A combination of a narrow production of export base combined with a vulnerability to shocks can lead to persistent fiscal and external imbalances and high levels of debt. Indeed, among the 20 countries with the highest levels of public debt relative to GDP, small island states account for 10 countries, and other small states for another three.

Figure 4.1

Countries ranked by public debt-to-GDP ratio, 2014

Source: *World Economic Outlook*, World Bank staff



Source: World Bank Small States program and staff calculations

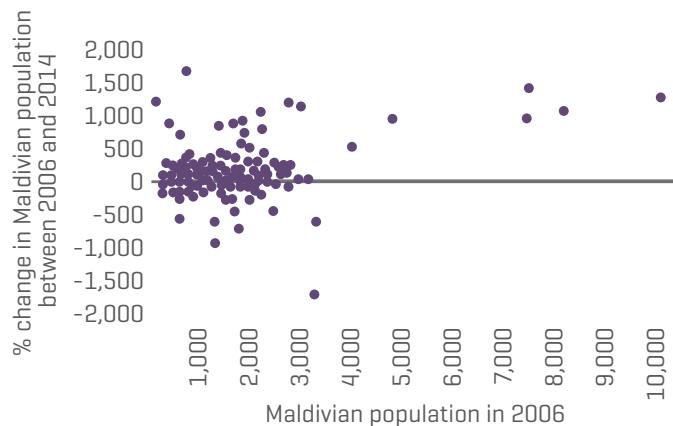
Meanwhile, there has been a steady migration of smaller to larger islands, in particular to the Malé City area. Internal migration has happened for a long time, often in response to natural disasters, including the 2004 tsunami, the difference in the cost of living (the high cost of food and other goods and services in the atolls compared to Malé),⁸⁶ quality of service delivery, and economic opportunities. Recent data shows a net decline of population in many small islands; indeed, all islands that lost population between 2006 and 2014 had a population below 3,000 in 2006 (Figure 58). During that period Malé and Hulhumalé saw increases in population of 37 percent (by 34,524) and 450 percent (by 12,903), respectively (see also section on Poverty).

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

Figure 58

Change in population between 2006 and 2014

Source: preliminary results
2014 Census, National
Bureau of Statistics



Note: Malé and Hulhumalé not displayed

POPULATION TRENDS

Malé's population density of 53,700 per square kilometer puts it well ahead of large, densely populated cities, such as Mumbai and Dhaka



Net decline of population
in small islands from 2006-2014

↑ 37% increase in Malé Population

↑ 450% increase in Hulhumalé Population

Conditions of overcrowding in Malé show that there are limits to centering activity on Malé. Between 2003 and 2010 household expenditure on housing, water and electricity in Malé more than doubled, and overtook food and beverages as the single largest expenditure item. Between 2010 and 2013, the number of vehicles in Malé increased by 23 percent, and currently there are about 36 vehicles per 100 inhabitants in Malé compared to 5.5 in the atolls excluding Addu City and Hulhumalé. As noted earlier, Malé's population density of 53,700 per square kilometer puts it well ahead of large, densely populated cities, such as Mumbai and Dhaka [Footnote 3].

Successive governments, including the current one, tried to address the structural constraints, while attempting to stem the net migration into Malé, through various programs of investment and voluntary resettlement programs. The current government's party manifesto for 2013-17 pledged to address these issues through a number of actions, including:⁸⁷

- Malé City area.⁸⁸ Reduce congestion in Malé, develop Hulhumalé as a modern cosmopolitan city, construct bridges to link different parts of Malé City area, develop Thilafushi as an industrial zone.

87 Manifesto of the Progressive Party of Maldives (PPM) 2013-17, unofficial translation. This manifesto is being developed into a National Development Strategy with ADB support.

88 This includes Malé and nearby Hulhulé airport/Hulhumalé, Villingili and Thilafushi islands.

- Housing. Provide social housing and loans to renovate housing.
- Infrastructure. Establish adequate harbors in islands, establish effective sewerage systems, ensure safe drinking water through desalination plants for islands with large populations and increased water storage capacity.
- Reliable transport. Construct airport in islands and connecting ferry services, establish permanent system to enable transport of agricultural produce between islands.
- Special Economic Zones. Establish SEZs for tourism, business incubation, free ports, ICT, etc., granting special incentives including exemptions from Goods and Services Tax for 10 years, Business Profit Tax and Import Duty.⁸⁹

In particular, Hulhumalé, an artificial island off Malé, has been constructed to relieve congestion in Malé and to attract residents from islands with small populations. Reclamation of 188 hectares of land and primary development took place between 1997 and 2004, leading to a population of just over 1,000. A resident population of 60,000 is targeted by 2020.⁹⁰ The next phase of development consists of a further reclamation of 240 hectares, catering to a population of 100,000.⁹¹ The president recently issued a call to residents of islands with small populations to migrate, as the government is unable to meet the socio-economic needs of small islands.⁹²

Beyond structural constraints, a number of shortcomings associated with investment climate, access to finance, governance and human capital restrict the potential for existing economic activities in Maldives to grow and for new ones to be created.

The investment climate in Maldives is much more challenging than that of similar island economies and other South Asian countries.

INVESTMENT CLIMATE

The investment climate in Maldives features important constraints for new entrepreneurs and for the growth of existing firms. The investment climate in Maldives is much more challenging than that of similar island economies and other South Asian countries. In 2015 Maldives ranked 116th in the World Bank's Doing Business ranking (out of 189 economies ranked). This ranking was two places lower than the previous year, signaling a lower conduciveness of the investment climate in the country as compared to other economies ranked. According to Doing Business rankings (Figure 59), while it is relatively easy to register a new firm in Maldives, there are significant deficiencies in the enabling environment for that firm to start operations (register property, obtain electricity connection, access finance), to grow its business (access finance, import and export) and to resolve disputes or unwind operations in an orderly, swift and fair manner (enforce contracts, protect investors and resolve insolvency). A comparison with other small island states highlights the significantly higher challenges across the board in the investment climate in Maldives.

⁸⁹ Special Economic Zones Act [24/2014], translated. <http://investmaldives.org/investmaldives/wp-content/uploads/2014/09/SEZ-Act-Translation.pdf>

⁹⁰ The 2014 Census estimates the population of Hulhumalé at slightly under 16,000.

⁹¹ <http://hdc.com.mv/hulhumale/>

⁹² <http://minivannews.com/politics/president-yameen-calls-on-youth-to-relocate-to-hulhumale-92174#sthash.H775bfue.dpbs>

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

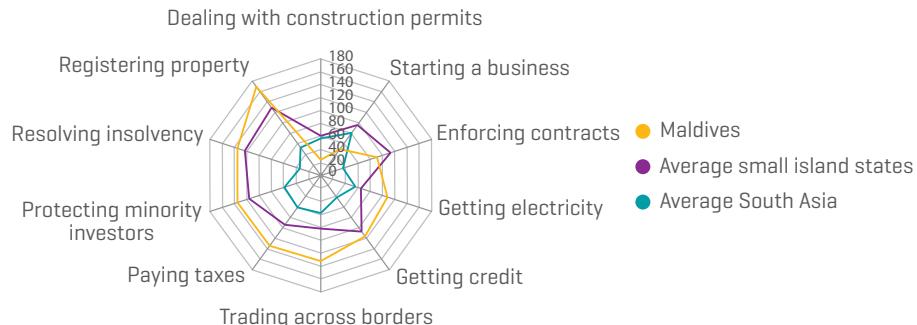
Figure 59
Rankings on Doing
Business areas –
Maldives 2015

Source: *Doing Business 2015*

Sudden changes
in the legal
and regulatory
environment taking
place in absence
of sufficient
consultation with
private-sector
stakeholders.

Addressing
investment climate
shortcomings will be
essential in order to
enable the creation
of inclusive economic
activities in Maldives.

However, it is important to highlight the fact that the business environment obstacles faced by firms in Maldives go beyond those areas identified by global indicators such as Doing Business. Enterprises interviewed during the preparation of this diagnostic identified various other obstacles in the investment climate in Maldives, including difficulties in accessing foreign currency,⁹³ that limit the ability of firms to operate, invest in foreign capital goods and trade. Other factors cited by firms include sudden changes in the legal and regulatory environment taking place in absence of sufficient consultation with private-sector stakeholders.



There are major gaps in the legal framework governing activities of private enterprise. A number of issues have been identified⁹⁴ that restrict the effectiveness of the legal framework governing firms' activities, including:

- The need to define basic legal foundations of a system of commercial justice in order to reduce legal uncertainty. Courts function without a complete and adequate set of legal rules; enforcement mechanisms were found to be non-functional; the system of appeals was deemed to generate long delays; and there is lack of technical expertise and knowledge of business concepts. There are no alternative dispute resolution mechanisms in place.
- Lack of clarity concerning legal sources further undermines legal certainty. The position of Sharia law in the private law system has not been fully established; it is unclear whether the laws governing commercial activities and Sharia law are compatible.
- Lack of basic regulation in the area of secured transactions and registration of rights. Legislation regulating financial distress and insolvency was found to be incomplete and outdated. This was also the case with a number of basic private law regulations, including contract law, tort law and statute of limitations. In turn, the lack of adequate laws governing secured transactions severely undermines the ability of the financial sector to provide credit to enterprises, as it enhances the risk of losses in case of borrowers' defaults due to unpredictable, lengthy and costly legal resolution. These deficiencies contribute to reducing the availability of credit, increasing its cost and enhancing the amount of collateral required by lenders.

⁹³ The apparent contradiction with the observation that there seems to be sufficient liquidity in the market [IMF, 2015] could be due to the timing of the reports or to the difference between macro and micro observations.

⁹⁴ World Bank [2013f]

The large state presence in economic activities is not only a fiscal sustainability concern, but it also undermines the ability of the private sector to flourish by crowding it out of large segments of the market.

Maldives has been able to attract large volumes of FDI to tourism, but it has had limited positive spillovers to the economy

- Competition law and industrial property law are missing in Maldives. These are key elements of the legal framework needed in order to ensure a level playing field and fair treatment of investors. The absence of these laws likely undermines the ability of Maldives to attract and retain investment beyond tourism.

Addressing investment climate shortcomings will be essential in order to enable the creation of inclusive economic activities in Maldives. Evidence worldwide demonstrates⁹⁵ that investment climate hurdles reduce incentives for entrepreneurship, reduce the attractiveness of the country as investment destination, foster informality and significantly affect the competitiveness of enterprises. So far, in spite of the investment climate shortcomings, Maldives has been able to develop a tourism industry leveraging the uniqueness of its natural resources. However, investment climate deficiencies have played a significant role⁹⁶ in preventing the development of an ecosystem of local enterprises around tourism as suppliers of goods and services. That, in turn, has translated into the current model whereby tourism remains largely an enclave industry. Investment climate shortcomings also undermine the ability of the country to diversify its economy through creation of new firms in new economic activities.

Governance issues contribute negatively to development of the private sector in Maldives. The large state presence in economic activities [through SOEs] is not only a fiscal sustainability concern, but it also undermines the ability of the private sector to flourish by crowding it out of large segments of the market. This is demonstrated by a large number of SOEs that are mostly loss-making [paragraphs 54 and 89], the large size of public workforce [Figure 35] that may lead to higher reservation wages on the part of the domestic labor force [section on Human Capital], and large public-sector borrowing that may be crowding out the private sector [paragraph 161]. This, together with the governance issues affecting tourism and fisheries [paragraphs 113 and 130], contribute to create a set of significant challenges to private enterprises that go beyond the difficulties stemming from business regulation bottlenecks.

INVESTMENT CLIMATE AND FDI

Maldives has been able to attract large volumes of FDI to tourism, but it has had limited positive spillovers to the economy [Figure 59]. The uniqueness of Maldives' natural resources has enabled the country to attract large [and frequently lumpy] amounts of FDI [Figure 60] in spite of shortcomings in the investment climate. However, FDI inflows have been largely focused on development of single-island resorts, with a very limited proportion reaching sectors of the economy that are associated with networks of production. In turn, this has contributed to the current enclave model of the tourism industry. Going forward, as the country seeks to foster economic diversification through foreign and local investment, its ability to attract FDI into other industries or sectors will likely be affected by investment climate challenges.

⁹⁵ World Bank (2015c)

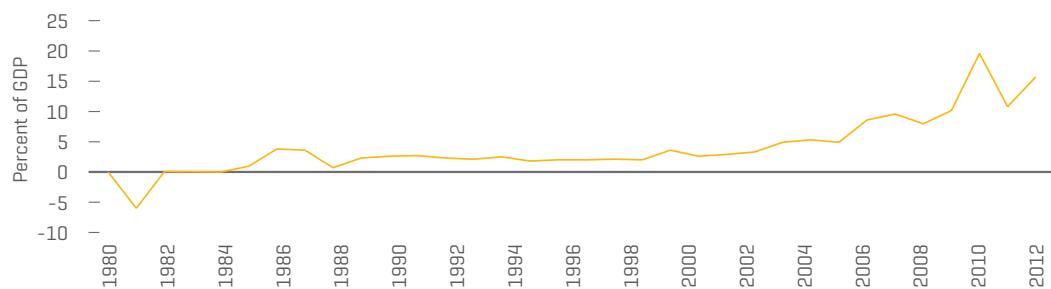
⁹⁶ Anecdotal evidence collected through interviews and consultations with stakeholders undertaken during the preparation of the SCD coincide on the view that investment climate shortcomings have had a major negative impact on entrepreneurship in Maldives. However, the lack of statistics including recent business surveys significantly limit the ability to substantiate these views.

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

Recent events have the potential to undermine the confidence of foreign investors on Maldives and reduce its competitiveness as a long-term investment destination in favor of jurisdictions that can provide a higher degree of certainty to foreign investors. A recent survey of global investors identified the main factors that drive selection of investment destinations. After macroeconomic stability, the second most important factor for global investors⁹⁷ when selecting an investment destination is political risk⁹⁸. Recent events in Maldives – including civil disturbances in Malé; a high-profile dispute related to a contract for investment in the international airport, and anecdotal evidence reported in international media of radicalization and urban violence – have the potential to undermine the attractiveness of Maldives to foreign investments, including PPPs.

Figure 60
FDI net inflows in 2013
Percent of GDP

Source: World Bank WDI



Access to finance has been identified as a major constraint for the development of enterprises in Maldives.

Credit to the private sector as a proportion of GDP decreased from 69 percent in 2008 to 44 percent in 2013,

ACCESS TO FINANCE CONSTRAINTS

Access to finance has been identified as a major constraint for the development of enterprises in Maldives. A World Bank survey of enterprises⁹⁹ in Maldives in 2005 found that 66 percent of firms identified access to finance as the most significant constraint to firms' growth. While these figures are admittedly old, other recent statistics and anecdotal evidence suggests that the situation has not improved since then. Indeed, a business survey by Ministry of Finance in 2013 found that up to 70 percent of companies in manufacturing have difficulties accessing finance [Figure 61]. Similarly, views expressed by private-sector participants during interviews and consultations undertaken during the preparation of this diagnostic highlighted significant difficulties in accessing finance, which restricts their ability to make long-term capital investments as well as to finance working capital requirements for day-to-day business [Figure 62].

Financing to the private sector has been lower than the pace of economic growth. Credit to the private sector as a proportion of GDP decreased from 69 percent in 2008 to 44 percent in 2013, a proportion that is much lower than that of economies with similar income level [Figure 63]. These economy-wide aggregate figures support private-sector stakeholders' perception of a narrowing availability of financing to private enterprises and entrepreneurs beyond tourism.

97 MIGA [2013].

98 In this context political risk includes adverse and abrupt regulatory changes, breach of contract, transfer and convertibility restrictions, civil disturbances, expropriation and acts of war and terrorism.

99 World Bank [2006b]

Figure 61

Main obstacles to firm growth (2005)

Source: World Bank Enterprise Surveys

Figure 62

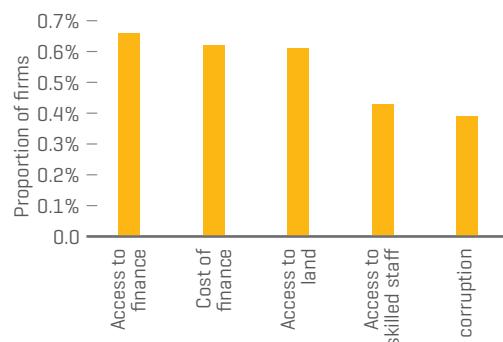
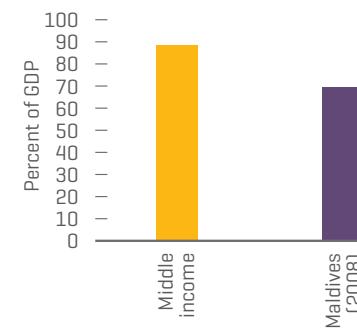
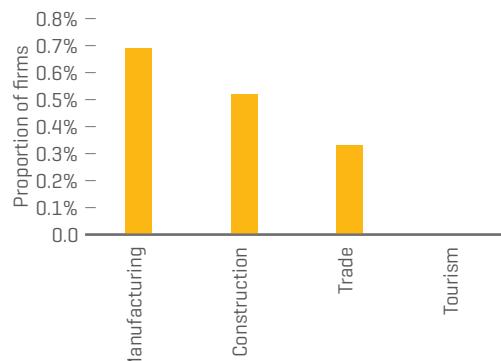
Proportion of firms with difficulty accessing finance and firms undertaking capital investments (September 2013)

Source: Ministry of Finance

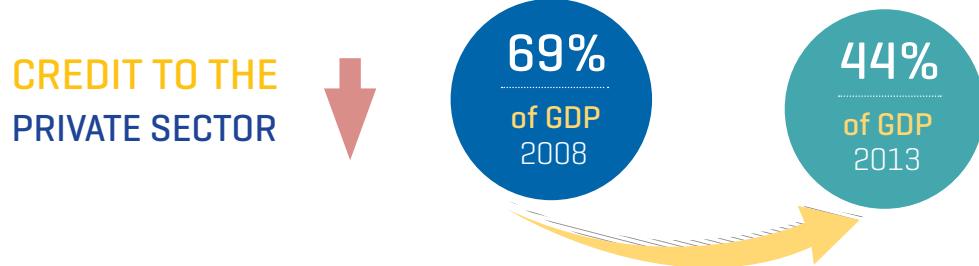
Figure 63

Domestic credit to private sector

Source: MMA statistical bulletin

Figure 61**Figure 62**

CREDIT TO THE PRIVATE SECTOR



Credit growth has recently been driven by lending to real estate and commerce, while credit to tradable sectors has decreased substantially since 2007

And some sectors of the economy are more affected than others. As discussed above, while 70 percent of manufacturing firms surveyed reportedly have difficulties accessing bank credit, this proportion is much lower for other sectors such as construction (50 percent) and trade (32 percent). None of the firms in tourism surveyed reported difficulties in accessing finance. This is consistent with the breakdown of banks' credit portfolio, which is highly concentrated in tourism and, to a lesser extent, in commerce, while tradable sectors account for a marginal proportion of bank loans [4 percent for fisheries, 2 percent for manufacturing and 0.1 percent for agriculture]. Moreover, credit growth has recently been driven by lending to real estate and commerce, while credit to tradable sectors has decreased substantially since 2007 (Figures 64 and 65). A breakdown of banks' portfolios by size of the borrower is not available, but anecdotal evidence suggests that large enterprises (both public and private) enjoy easier access to bank credit than SMEs and small entrepreneurs.

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

Figure 64
Bank Loans in Oct 2014

Source: MMA

Figure 65
Change in bank loans
2007-2014

Source: MMA

Lack of access to finance is a major obstacle for entrepreneurship in Maldives, but this challenge will not be resolved through cheap credit.

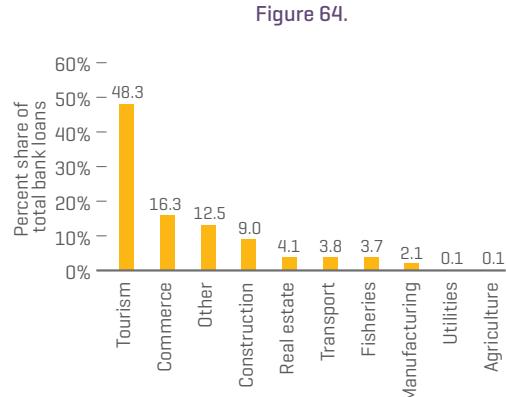


Figure 64.

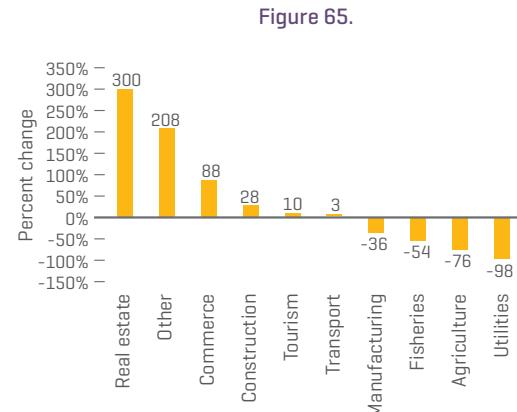


Figure 65.

High collateralization requirements represent major hurdles to borrowers. Companies surveyed in 2006¹⁰⁰ reportedly were required by banks to post collateral amounting to more than 150 percent of the value of the loan on average¹⁰¹. Views collected through interviews and consultations during the preparation of this diagnostic confirm that high collateral requirements still represent a significant obstacle to credit, especially for SMEs and new entrepreneurs.

Lack of access to finance has been identified by authorities as a major obstacle for entrepreneurship in Maldives, but this challenge will not be resolved through concessional credit. Enhancing access to finance for entrepreneurs is one of the priority areas under the Government Manifesto as well as in the draft National Development Strategy. The government's 2009-2013 National Strategic Action Plan also recommended that the government provide women with self-help grants for small- and medium-sized enterprises and promote microcredit programs. This focus was intended to help bridge the disadvantage women face in accessing credit. For instance, in 2011 only one-third of the Bank of Maldives borrowers for development schemes or loans and advances were women.¹⁰² In response to the lack of access to finance for entrepreneurs overall in Maldives, the government had put in place a program to provide financing to young entrepreneurs. The program [GETSET] considered the provision of non-collateralized loans with subsidized interest rates. While the ultimate objective of the program [enhancing access to finance for entrepreneurs] is laudable, it does not address the shortcomings limiting the adequate functioning of the financial sector and thus does not represent a lasting or sustainable solution to the needs of enterprises and entrepreneurs. On the contrary, concessional directed lending programs often aggravate access to finance deficiencies by helping erode the credit culture in the population, reducing incentives for established commercial lenders to innovate, and crowding out the financial sector by creating dependence of entrepreneurs on subsidized interest rates.

100 Ibid

101 Ibid

102 ADB (2014a).

Enhanced public-private dialogue between all stakeholders will be needed in order to further identify obstacles and opportunities, as well as to prioritize actions.

Governance deficiencies have hampered the ability of Maldives to maximize the benefits from its natural resources as a foundation for shared growth.

Sustainable enhancement of access to finance in Maldives will require the development and implementation of a strategy for financial sector development that addresses the shortcomings faced by the sector. The factors limiting the willingness and ability of financial intermediaries to provide credit on a sustainable and fair basis to the various sectors of the private sector are wide-ranging. Included in Table 2 is a list of shortcomings that have been identified in the past¹⁰³ that illustrate the range of challenges facing the sector, including deficiencies in the legal framework governing credit activities, shortcomings in credit infrastructure and underdeveloped financial institutions. However, this list is not exhaustive and additional factors may be at play. Enhanced public-private dialogue between all stakeholders [authorities, financial institutions and borrowers] will be needed in order to further identify obstacles and opportunities, as well as to prioritize actions. These issues are addressed in more detail in Annex 3.

GOVERNANCE CONSTRAINTS

Maldives is facing important governance challenges that affect the business environment and the soundness and sustainability of economic and fiscal management. Overall, an indeterminate but significant connection between a few parties and the political system – related to the absence of basic legislation in many areas, including procurement – and a lack of legal clarity weigh on the economic activity. In particular, a significant amount of procurement in the country is carried out by SOEs and the Ministry of Health outside the scope of national rules and central government controls, leading to doubts about whether public resources are spent in the most effective and efficient manner. In the public sector, limited capacity, a complex institutional framework, and inter-institutional conflicts also limit the ability of the state to support social and economic progress. Institutional capacity remains much lower than that of an average upper middle-income country.

Governance deficiencies have hampered the ability of Maldives to maximize the benefits from its natural resources as a foundation for shared growth. Significant governance constraints appear to have undermined the development of the two main industries in the country (tourism and fisheries). These shortcomings appear to have translated into sub-optimal investment, unrealized potential for job creation and loss revenues for the government [see tourism and fisheries sections]. Deficiencies include: lack of transparency in allocation of licenses for exploitation of natural resources; suboptimal selection of licensees, and: lack of mechanisms to minimize conflict of interest [see paragraphs sections on tourism and fisheries].

Public-sector management suffers from inefficiencies. The public sector plays an important role in Maldives' overall economic model in redistributing some of the rents generated by the resort sector to the rest of the population. This is done both through transfers and directly in the form of relatively large public employment in both civil administration and state-owned enterprises. In both cases there are significant inefficiencies that undermine both the effectiveness of the

¹⁰³ World Bank, (2011a)

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

There are fundamental gaps in law, including: the lack of a civil procedure code; non-functional enforcement mechanisms; a system of appeals that generates long delays, and; weak capacity among judges, particularly on commercial matters.

redistributive model and the fulfillment of public-sector functions in service provision and regulation. With civil service skewed towards relatively young workers, its effectiveness is far lower than what might be expected of a middle-income country. Public financial management suffers from inadequate accounting and poor cost controls.

The unsettled political and institutional framework impairs the state's effectiveness. Maldives has been undergoing a contentious political transition for the past 10 years. The 2008 Constitution created an extensive set of governance institutions and confrontational elections characterized by interference of state bodies that has undermined credibility. Branches of government and independent commissions are frequently in conflict, reflecting the interests of individuals in what is a sharply divided polity. The lack of political and institutional settlement diverts the attention of the state from carrying out public-sector functions and prompts decision-making driven to an unusual degree by short-term political issues.

This has led in particular to weak rule of law. Maldives' legal system is based on several foundations, including both common law and the sharia, with lack of harmonization evident in much legislation, particularly for commercial activity. There are fundamental gaps in law, including: the lack of a civil procedure code; seemingly non-functional enforcement mechanisms; a system of appeals that generates long delays, and; weak capacity among judges, particularly on commercial matters. Uncertainties about the legal framework are amplified by the diverse legal backgrounds of judges [all judicial education is obtained outside of Maldives], which leads to inconsistency in adjudication. More generally, while the 2008 Constitution provided grounds for strong independence of the judiciary, the composition of the judicial service commission has led to strong politicization of the courts according to many observers (most notably the UN Special Rapporteur on Judicial Independence). The judiciary has been highly proactive in recent political and electoral disputes.

HUMAN CAPITAL CONSTRAINTS

Expanding and improving human capital will be of vital importance to promote economic prosperity and increase jobs for young people. The country ranked only 103rd in the Human Development Index for 2014, which is low for a middle-income country approaching \$9,900 GNI per capita.

Maldives has performed well in providing access to primary and lower secondary education, but there is room for improvement. The primary gross enrollment rate is 104 percent and the primary net enrollment rate 99 percent. The lower secondary gross enrollment rate is 107 percent (Figure 66), while the lower secondary net rate is 82 percent. This suggests that, while participation in primary and lower secondary education is high, there is considerable grade repetition and early/late entry, especially in lower secondary education. The country needs to improve the internal efficiency of the education system.

The low proportion of Maldivians with higher education qualifications means that the country lacks sufficient professionals, managers and technical experts to support economic growth and social development.

ACCESS TO EDUCATION



The country lags sharply behind in education attainment at the higher secondary level. The gross higher secondary net enrollment rate is about 35 percent [Figure 67]. This is very low by international standards. The average higher secondary gross enrollment rate for middle-income countries is 61 percent, and for upper middle-income countries 76 percent. The main reason for the low enrollment in higher secondary education in Maldives is the limited number of schools that offered grades 11-12 until recently, although almost each atoll has at least one school providing higher secondary education. The government has now expanded this number to 51 schools: three schools in Malé and 48 schools in the atolls [Figure 67]. Many of these schools are over-crowded and congested and require more facilities and equipment. In addition, higher secondary schools require greater management and leadership capability, and the professional development of teachers. At present, the higher secondary school system relies heavily on human resources from overseas.

Figure 66
Gross Enrollment Rates
Figure

Source: Ministry of Education Statistics

Figure 67
Number of schools by type

Source: School Statistics, 2014, Ministry of Education

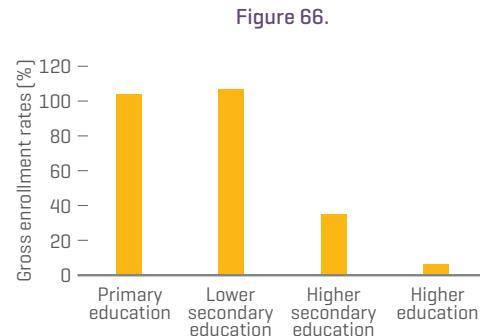


Figure 66.

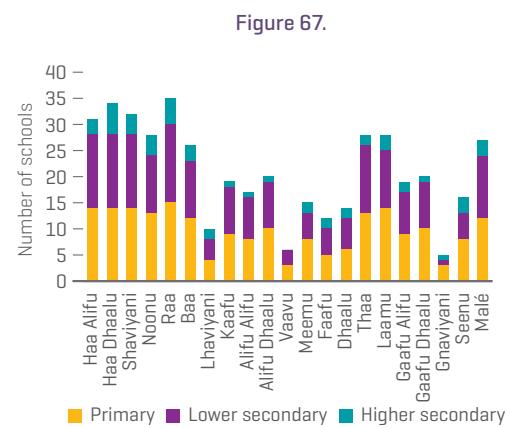


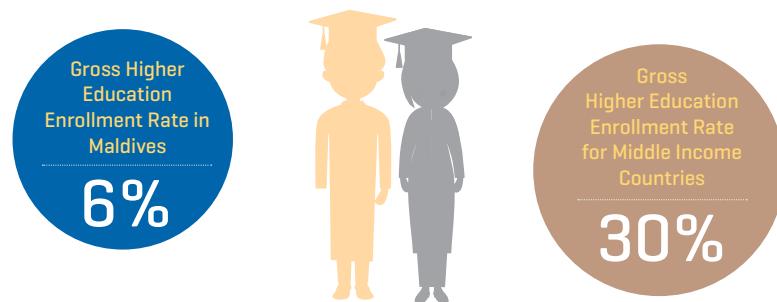
Figure 67.

Higher education participation is extremely low for a middle-income country. The gross higher education enrollment rate is only about 6 percent in Maldives, [Figure 67] whereas the gross higher education enrollment rate for middle-income countries is around 30 percent. The low proportion of Maldivians with higher education qualifications means that the country lacks sufficient professionals, managers and technical experts to support economic growth and social development. The main reasons for the low enrollment in higher education are: [1] the small number of students completing higher secondary education and moving onto higher education;

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

and [2] limited access to higher education in the country. Higher education is mainly provided by Maldives National University [MNU] and about seven private higher education institutions. However, over 85 percent of enrollment in these private higher education institutions is actually in pre-degree level diploma and certificate programs. A considerable proportion of enrollment in the MNU, too, is in pre-degree level qualifications.

HIGHER EDUCATION PARTICIPATION



The quality of education at all levels is a major challenge facing Maldives.

The quality of education at all levels is a major challenge facing Maldives, both in terms of inputs and outcomes. The teacher-student ratio varies between 6 [Vaavu Atoll] and 16 [Malé], but lower teacher-student ratios tend to be associated with a larger share of untrained teachers [Figure 68]. At the same time, learning outcomes in primary and secondary education 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. These very low averages show that learning levels in both primary and lower secondary education are weak. There are also substantial regional disparities [Figure 69]. Learning outcomes are considerably higher in Malé than in the atolls, especially in a subject such as English language, which is vitally important for employment in a tourism-based economy. The low levels of cognitive skills results in poor performance of students at national examinations. For instance, 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.

Figure 68
Student-teacher ratio and share of untrained teachers

Source: School Statistics, 2014, Ministry of Education

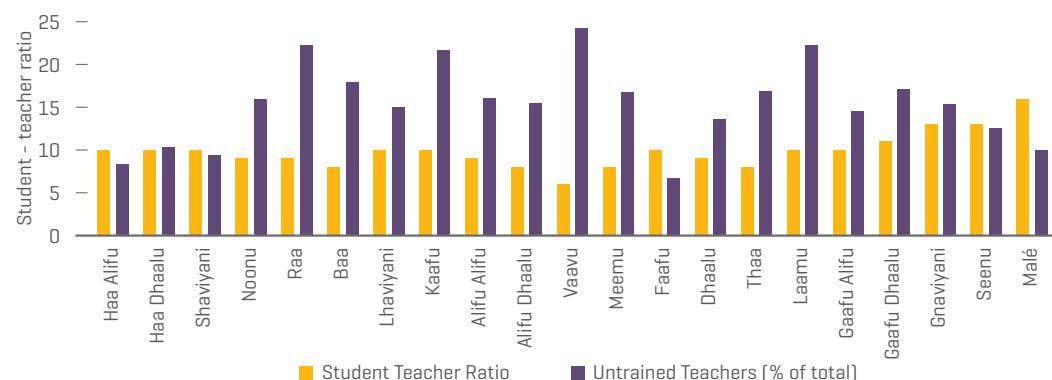


Figure 69

Average English language learning outcomes at grade 7 by Atoll, 2008

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

Due to the lack of well-educated Maldivians the country also faces a severe shortage of qualified personnel for technical, and middle and senior management, jobs.

The quality of existing TVET services needs to be improved so that it becomes both more attractive for youth and more relevant for employers.



High youth unemployment is linked with skills deficiencies. The share of the labor force ages 15-24 without work but available for and seeking employment was 27 percent in 2013. Due to the lack of well-educated Maldivians the country also faces a severe shortage of qualified personnel for technical, and middle and senior management, jobs. According to private-sector stakeholders consulted during the preparation of this diagnostic [Annex 2], the above-mentioned deficiencies in “soft skills” together with shortcomings in technical and vocational education contribute to the high level of expatriate workers, especially for up-market tourism and commercial and financial activities.

The quality of existing TVET services needs to be improved so that it becomes both more attractive for youth and more relevant for employers. The government has established the Technical and Vocational Education Program (TVET) with aim of creating a skilled workforce that meets labor market demands. The program has been diversified to offer training in hospitality and tourism, construction and building, agriculture, electrical wiring and engineering and handicrafts. There are more than 80 training providers in the country. However, the quality of these TVET programs is considered limited and youth graduating with technical and vocational qualifications can face lengthy job search periods. Another important constraint is that technical and vocational education and training is considered an inferior option to academic qualifications by Maldivian youth, so that the demand for TVET is limited. The education and training system has not yet developed career guidance and counseling to help youth identify their aptitudes and talents, nor a method to stream students into knowledge and/or skills-based programs depending on these aptitudes and talents. One possible experiment that could be further studied in this regard is the Ministry of Education’s UFAA program, which attempts to connect high schools, counselors and employers, and provide at-risk youth the technical and soft skills to enhance employability.

The gap between youth aspirations for employment and the actual opportunities for employment needs to be addressed. The rapidity of economic growth for Maldives has altered the perceptions of the ‘ideal’ desired job for today’s youth. Qualitative data reveal that young educated Maldivian men

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

High youth unemployment might inhibit Maldives' future growth trajectory and the ability of its development to be inclusive.

Maldives is the country in South Asia spending the highest share of GDP on health and education. But access to secondary education remains low

Figure 70
Spending on health

Source: World Bank's World Development Indicators database.

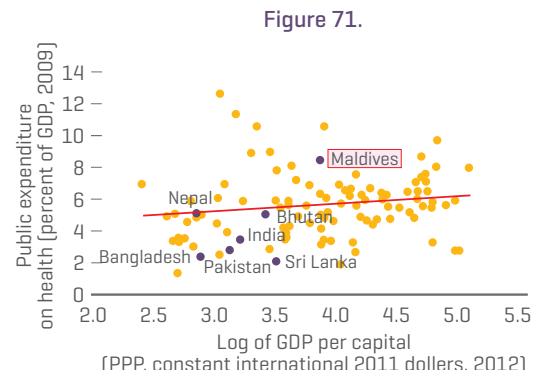
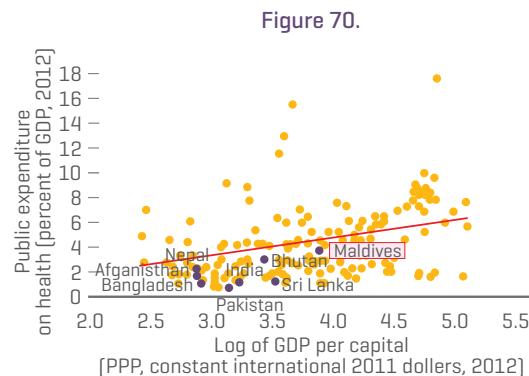
Figure 71
Spending on education

Source: World Bank's World Development Indicators database.

and women – and their households – aspire to white-collar, high-paying jobs and are unwilling to settle for the perceived lower-status [if not lower-paying] jobs in fisheries or other non-white-collar sectors. Financial pressures on unemployed youth are deemed to be reduced through parental support even for unemployed adult children. These factors create a high reservation wage for youth.¹⁰⁴ Parents supporting a large family do not, in turn, feel any financial pressure because of government subsidization of daily necessities, such as basic food items, fuel, electricity and education. Thus, parents have little motivation to temper their own high aspirations and pressure their children to settle for a job that may be less than ideal. In Maldives and elsewhere this phenomenon is referred to as 'voluntary unemployment'.¹⁰⁵ The resultant high youth unemployment might inhibit Maldives' future growth trajectory and the ability of its development to be inclusive.

SOCIAL SPENDING CONSTRAINTS

Maldives' geography and polarized population distribution throughout the archipelago contribute to high cost of service delivery. Maldives' population is scattered over 194 inhabited island over an archipelago of more than 800 kilometers in length. Guaranteeing access to services throughout this territory is further complicated by a very polarized distribution of the population, characterized by high density in the capital area Malé, which is home to two-thirds of the population, and very low density in the atolls.¹⁰⁶ In 2014, education and health services together accounted for 22 percent of total government spending. Maldives is the country in South Asia spending the highest share of GDP on health and education [Figures 70 and 71]. Interestingly, and despite a spending on education that is significantly above international average, the Maldivian government has been so far unable to improve access to secondary education and address outstanding learning and education-quality issues.



¹⁰⁴ World Bank. 2014. "Youth in the Maldives: Shaping a New Future for Young Women and Men through Engagement and Empowerment." Washington, D.C.: World Bank.

¹⁰⁵ Ibid.

¹⁰⁶ Population density in Malé is as high as 53,700 people per square kilometer against an average of approximately 1900 per square kilometer in the Atolls.

Maldives lacks a comprehensive, effective and efficient system of social protection.

Poor targeting and weak coordination in administration greatly reduce the potential impact of safety net programs and challenge their fiscal sustainability.

While the poor spend a significantly higher share of their budget on food and utilities, the rich benefit the most from universal subsidies.

Maldives lacks a comprehensive, effective and efficient system of social protection. Maldives' safety net programs have undertaken major changes since the government's Strategic Action Plan 2009-2013 was drawn up.¹⁰⁷ While tremendous progress has been made towards adding new programs and expanding coverage of existing ones, Maldives is still far from its policy goal of transforming fragmented social safety net programs into a comprehensive social protection system. Universal subsidies on food and electricity and universal health insurance represent the bulk of social expenditure together with social pension (Old Age Basic Pension) and Senior Citizens Allowance (Table 3). Smaller safety net programs include disability and single parent allowances.¹⁰⁸ Poor targeting and weak coordination in administration greatly reduce the potential impact of safety net programs and challenge their fiscal sustainability and, ultimately, the quality of assistance to those most vulnerable.

The increase in spending on universal subsidies is a challenge to shared prosperity and poverty reduction in Maldives. As discussed in Chapter 2, Maldives' performance in reducing poverty and boosting shared prosperity has been lackluster. While there is no recent poverty data to confirm this hypothesis, the increase in public spending during the past few years might not have contributed to better poverty and shared prosperity outcomes, especially because most of the increase has been driven by spending on universal subsidies.¹⁰⁹ In fact, as revealed in the poverty and social impact analysis, while the poor spend a significantly higher share of their budget on food and utilities, the rich benefit the most from universal subsidies due to their higher levels of consumption (Figures 72 and 73). Because of their inherently regressive nature, universal subsidies represent an inefficient instrument for guaranteeing affordability of basic needs for the poorest segments of the population. Nevertheless, lacking a coherent safety net system explicitly targeting the poor, universal subsidies are the only mechanism of "income support" currently available.

Table 3.

Percent of total public expenditure	2014
Recurrent expenditure	75.7
Personal Emoluments	32.6
Pensions, Retirement Benefits & Gratuities	7.9
Travel Expenses	0.6
Supplies and Requisites	2.1
Operational Services	7.5
Supplies and Requisites for Service Provision	1.7
Training	1.7
Repairs and Maintenance	0.9

¹⁰⁷ Following this policy framework, the government has passed three legislations governing specific social protection interventions – Disability Act [2010], National Social Health Insurance Act [2011], and Social Protection Act [2014].

¹⁰⁸ According to the Social Protection Act, the government is also responsible to provide assistance to citizens for psychiatric treatment, water bill, housing, education needs, and whose small or medium sized business is facing a difficult incident.

¹⁰⁹ See Chapter 2

5. CONSTRAINTS TO GROWTH AND SHARED PROSPERITY (CONTD.)

Table 3

Public expenditure items in 2014

Source: MOF, staff calculations

Recently introduced social insurance schemes have created perverse economic incentives that challenge poverty reduction and shared prosperity moving forward.

	Percent of total public expenditure	2014
Interest Payments		4.7
Grants, Contributions and Subsidies, of which		14.5
Electricity subsidies		5.5
Food subsidies		1.6
Aasandha		3.7
Payments against losses and right-offs		1.6
Capital expenditure		16.5
Development Projects		0.3
Public Sector Investment Program		13.6
Capital Equipment		0.8
Capital Contribution to profit oriented public agencies		1.7
Debt Amortization		7.8

Moreover, recently introduced social insurance schemes have created perverse economic incentives that challenge poverty reduction and shared prosperity moving forward. While the introduction of universal health insurance (Aasandha) has benefited disproportionately the poorest segments of the population,¹¹⁰ poor design and limited implementation capacity have contributed to increasing utilization trends and escalating costs that challenge its future fiscal sustainability. Similarly, the generosity of the pension system has exacerbated inter-generational equity issues and potentially contributed to increase distortions on the labor market. In particular, increasing trends for inter-generational transfers within the household and increasing reservation wages might challenge direct participation of the youth in the growth process (as noted above) and add to fiscal and social sustainability concerns moving forward.¹¹¹

Figure 72

Share of expenditure on food and per capita expenditure on food, by quintile

Source: Authors' calculations, HIES 2009-10

Figure 73

Distribution of electricity subsidy benefits in Male, 2012

Source: Authors' calculations, HIES 2009-10

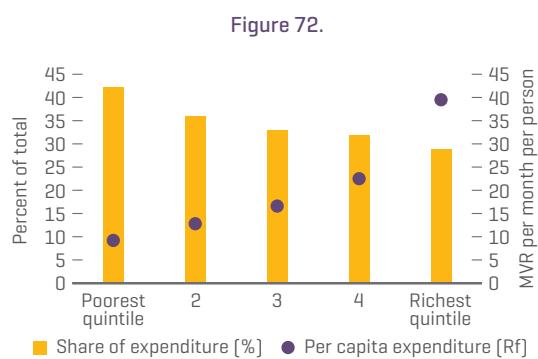


Figure 72.

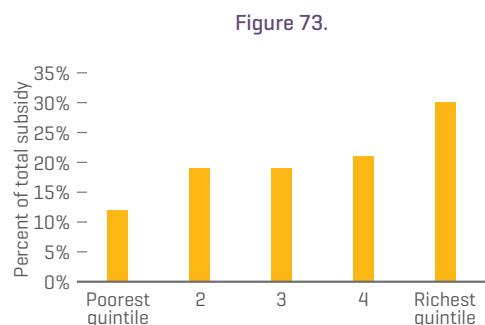
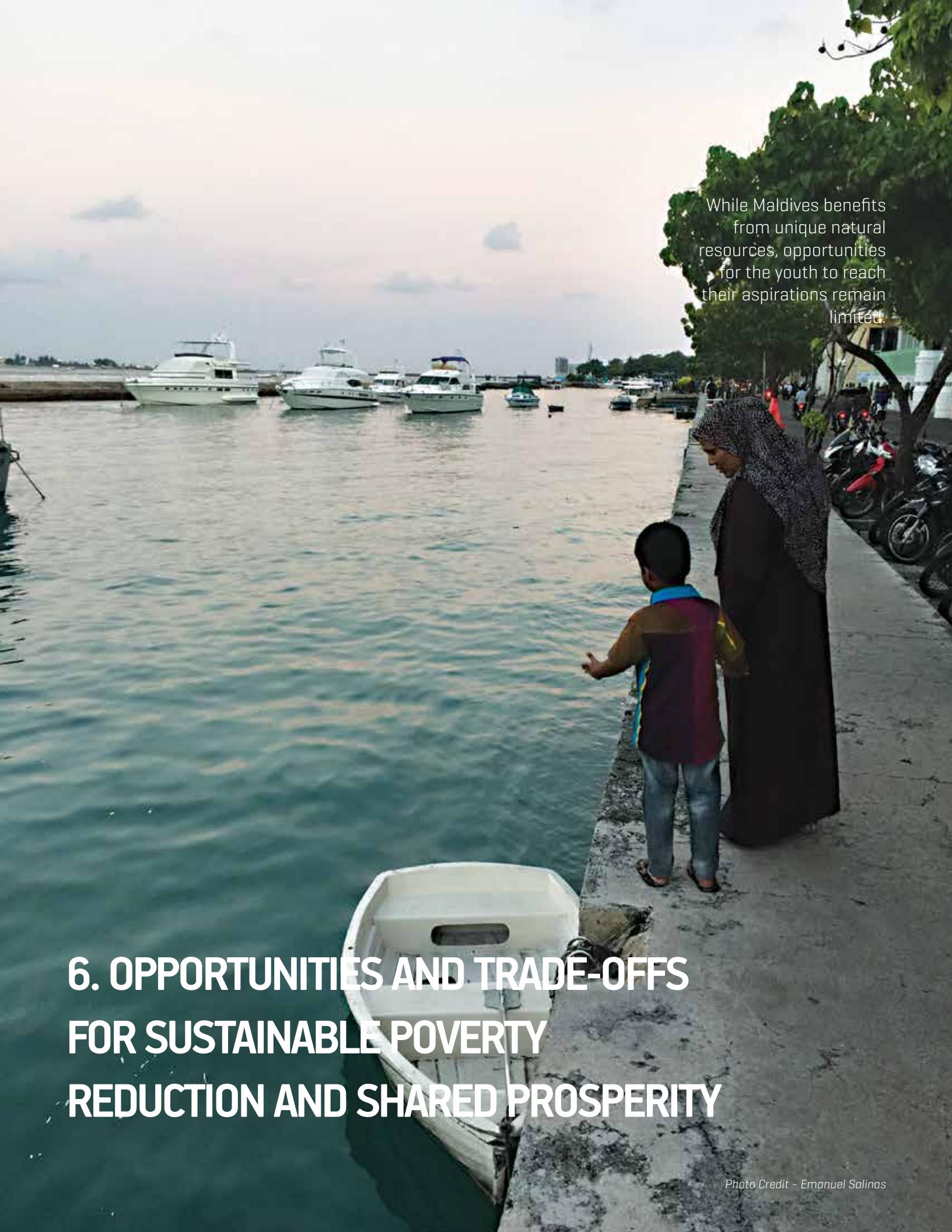


Figure 73.

¹¹⁰ Nagpal, Redaelli (2013).

¹¹¹ This has been confirmed in interviews with Maldivians for the youth and gender studies.

A photograph showing a woman in a dark, patterned headscarf and a child in a maroon vest standing on a concrete pier. They are looking out over a body of water where several large white yachts are docked. In the background, there are more boats and some greenery. The sky is overcast.

While Maldives benefits from unique natural resources, opportunities for the youth to reach their aspirations remain limited.

6. OPPORTUNITIES AND TRADE-OFFS FOR SUSTAINABLE POVERTY REDUCTION AND SHARED PROSPERITY

6. OPPORTUNITIES AND TRADE-OFFS FOR SUSTAINABLE POVERTY REDUCTION AND SHARED PROSPERITY

The Systematic Country Diagnostic aims to identify the most important opportunities and obstacles to poverty reduction and shared prosperity in Maldives. Based on evidence presented thus far and analysis conducted as part of this Systematic Country Diagnostic, this section creates a framework to identify the highest priority areas for reform and lays out a potential path forward for shared and sustainable growth and poverty reduction in Maldives.

The identification of the priorities areas is the result of a three-step process. First, during the concept stage, hypotheses on the functioning of Maldives' development model and on the drivers of its vulnerabilities were formulated, and knowledge gaps identified. Second, during the SCD development stage, these hypotheses were confirmed by additional analysis and knowledge gaps filled whenever feasible under the given timeline. Third, consultations with local stakeholders were used to further validate hypotheses and analysis [Annex 2].

Enabling the local population to seize opportunities for entrepreneurship will require addressing a host of factors that combined represent the overall enabling environment in the country.

Priority area 1: Enhancing opportunities for the local population to benefit from existing industries. Enhancing these opportunities would contribute to poverty reduction and shared prosperity. However, the impact may not be immediate and indeed relies on improving infrastructure, training and regulations, among other things. It also could reduce social risk by improving employment opportunities for the most vulnerable segments of the population, notably for youth and women. Actions under this pillar appear politically feasible as both the current and the previous government have endorsed reforms in both sectors to make them more inclusive.

Priority area 2: Enabling opportunities for creation of new sources of growth. Enabling the local population to seize opportunities for entrepreneurship will require addressing a host of factors that combined represent the overall enabling environment in the country. These factors include: minimizing the regulatory burden and consequent cost to doing business; enhancing the ability of creditworthy firms and entrepreneurs to access finance; and enhancing human capital through the formation of professionals and technicians with the skills that are in demand and are the key to better jobs. These priorities are discussed below.

Priority area 3: Improving efficiency and efficacy of public resource management and reducing macro fiscal risk. Addressing the challenges identified in this priority area would make the economic model in Maldives more sustainable and resilient to shocks. More directly, better management of public resources would free up space to benefit the poor and increase opportunities for the youth through, for example, better education. The impact of reform of subsidies and the public wage bill would have an immediate and medium-term impact on fiscal sustainability, but they require both careful planning to mitigate the negative impact on the poor and political courage. Improving the preparedness for disasters and climate change would have a medium- to long-term impact.

The analysis identified governance and labor market as a fundamental cross-cutting issues constraining growth, poverty reduction and shared prosperity in Maldives. Governance and labor

A strong public-sector presence in key sectors of the economy and a lack of transparency and accountability in SOEs' management negatively impact fiscal sustainability as well as private sector's ability to flourish.

Growth in itself will not be enough to ensure the inclusiveness of the tourism industry.

Adequate planning and transparent implementation of resorts development can help to enhance the benefits for the economy as a whole.

market issues are at the heart of many of the constraints that challenge the inclusiveness and sustainability of Maldives' socio-economic model of development. A strong public-sector presence in key sectors of the economy and a lack of transparency and accountability in SOEs' management negatively impact fiscal sustainability as well as private sector's ability to flourish. Moreover, the weakness of the overall legal framework together with the poor management of the country's natural assets challenge the sustainability of the economic model moving forward. Similarly, labor market distortions and an increasing mismatch between labor demand and supply make it harder for the growth process to be inclusive and put the social contract at great risk. Given the fundamental role played by governance and labor market constraints, the SCD has identified the need to fill existing knowledge gaps in these areas to more effectively identify policy priorities moving forward.

PRIORITY AREA 1. SHARING PROSPERITY - ENHANCING OPPORTUNITIES FOR THE LOCAL POPULATION TO BENEFIT FROM EXISTING INDUSTRIES

OPPORTUNITIES AND OBSTACLES TO ENHANCE INCLUSIVENESS OF TOURISM GROWTH

Given the importance of tourism in Maldives, a more inclusive industry represents a major opportunity for shared prosperity going forward. Maintaining underlying growth of tourism will be a key factor for the sustainability of growth in the economy as a whole. However, growth in itself will not be enough to ensure the inclusiveness of the tourism industry and the realization of its potential positive spillovers. There are four potential complementary avenues to enhance the inclusiveness of tourism:

First: Enhancing the implementation of the current resort model. Adequate planning and transparent implementation of resorts development can help to enhance the benefits for the economy as a whole and result in positive spillovers for local communities by attracting reputable international investors with extensive industry know-how and networks. Realizing this opportunity will require, among other things:

- Holistic planning and implementation of integrated destination management components [transport, infrastructure, skills training, marketing, economic clustering] to increase the viability of new resort projects, particularly in outer atolls where there are higher incidences of poverty.
- A more strategic and transparent approach to ensure that leases are awarded to reputable investors with demonstrable track record in the tourism industry to enhance the viability of new developments and lead to positive spillovers to the local communities.
- Transparency in the management of leases to avoid numerous non-performing leases.

6. OPPORTUNITIES AND TRADE-OFFS FOR SUSTAINABLE POVERTY REDUCTION AND SHARED PROSPERITY (CONTD.)

The sustainability of the growth in guesthouses will depend on adequate planning and regulation of tourism development in inhabited islands.

Tourism generated 28,000 jobs in 2014, only 40 percent of which are filled by Maldivian staff.

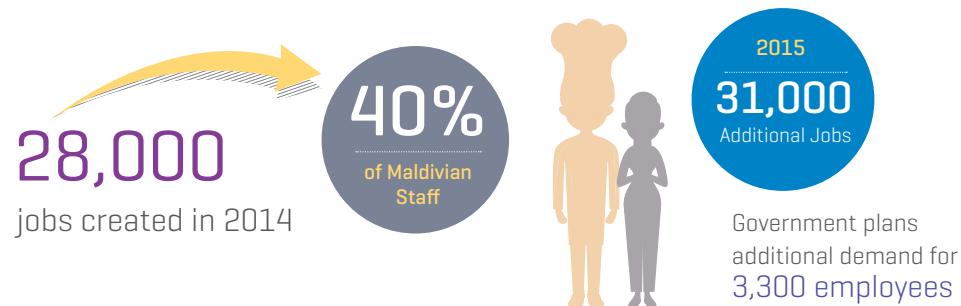
- Strategic planning to reduce the risk of over-supply in key market segments.

Second: Enabling sustainable economic diversification within the tourism sector. Non-resort market niches [e.g. guesthouses and safari boats] have demonstrated the viability of business models that are more closely integrated with local communities, through local ownership, higher local employment [deemed as high as 75 percent of total staff] and reportedly higher ability to mobilize women as part of the workforce. These new market niches have also demonstrated the ability to co-exist with the higher-end resorts, providing lower-cost options to other demand segments. Realizing this opportunity will require, among other things:

- Destination planning and management. The sustainability of the growth in guesthouses will depend on adequate planning and regulation of tourism development in inhabited islands. This includes sufficient analysis of carrying capacities, consistent management of land-use plans and a requirement for Environmental Impact Assessments. The absence of these foundations in the most developed case [Maafushi Island] had led to an increasingly overburdened infrastructure system [especially waste management], and, anecdotally, to property inflation and displacement of local population.
- Better and more cost-effective infrastructure to mitigate the high cost of transport, which limits the potential of new market niches to islands clustered close to the capital [as they cater to more price-sensitive tourists]. This would facilitate the development of new market niches in remote islands, where poverty levels are higher.

Third: Enabling local employment. Tourism is a large and growing source of jobs. According to the census, tourism generated 28,000 jobs in 2014, only 40 percent of which are filled by Maldivian staff. By 2015 the industry was deemed to generate 31,000 jobs. The implementation of industry growth in line with government plans would imply an additional demand for 3,300 new employees in the mainstream resort industry¹¹². Despite a government-imposed quota requiring at least 45 percent of staff to be Maldivian, the tourism industry consistently reports significant difficulties finding and retaining qualified local staff. Unlocking the access of Maldivian population to more and better jobs in tourism will require addressing a number of factors, including:

IMPACT OF TOURISM ON EMPLOYMENT



¹¹² Government plans target ten resorts per year with an average capacity of 220 beds each year. An industry standard considers a ratio of 1.5 staff per bed. This implies an annual requirement for 3300 new staff.

A closer collaboration between the technical education institutions and the private sector may help to enhance the relevance and quality of the technical training provided by TVET.

- Establishing a partnership between the government and the private sector to identify and address the obstacles to local employment. The normative approach (government-imposed quotas) to enforce localization of employment has not lead to a sustainable inclusiveness in the tourism industry. Anecdotal evidence suggests that local employment in the industry is lower than the government-imposed quota.¹¹³
- Improving the alignment between technical training and demand. Market participants interviewed consistently highlighted a major gap between the quality and relevance of the technical training provided by TVET and the demands of the market. This prompts many resorts to implement their own trainee programs for local youth. However, the high cost of these programs and the high turnover of trained local staff are incentives to hire experienced foreign staff. A closer collaboration between the technical education institutions and the private sector may help to enhance the relevance and quality of the technical training provided by TVET. That, in turn, could enhance the employability of technical graduates while making it easier for the tourism sector to find qualified local staff.
- Addressing social perceptions that appear to limit the desirability of technical jobs within and outside the tourism industry to young people. Anecdotal evidence collected through extensive consultations with youth and private-sector stakeholders consistently identified social norms that appear to prevent the willingness of the youth to get training and seek technical jobs in spite of great demand from various industries for qualified technical staff. These norms appear to include social conventions, family expectations and social media role models.
- Addressing transport limitations that restrict the ability of Maldivians living in inhabited islands to commute to work in resorts. While many resorts provide accommodation to employees, anecdotal evidence suggests that Maldivians place a high premium on the ability to live on their home island and commute to work. Such evidence is supported by a much higher proportion of local employment¹¹⁴ in resorts that are close to inhabited islands and with good transport connections.
- Mitigating social and structural barriers that restrict the ability of young women to work in the tourism sector. Social norms dictating appropriate employment for young women contribute to making families reluctant to allow young women to take tourism-related jobs because they would have to travel from home to other islands and because the tourism sector is associated with “immoral and unethical” practices.¹¹⁵ Structural barriers that further exacerbate familial unwillingness to allow young women to work away from home include the lack of child-care or residential facilities for employed women in the tourism sector. Women’s limited control of transportation adds an economic hurdle to their ability to travel to resort islands for work.¹¹⁶

Fourth: Strengthening linkages between tourism and local providers of goods and services. The tourism industry is a large and rapidly growing source of demand for goods and services. The tourism sector’s demand for inputs represents a major opportunity for local producers. But at the

¹¹³ The absence of credible and comprehensive official figures make it difficult to verify this.

¹¹⁴ Estimated to be as high as 70 percent by market participants interviewed.

¹¹⁵ Hope for Women 2012. Maldives NGO Shadow Report to the Committee on the Elimination of Discrimination against Women, 2012. Maldives: Hope for Women NGO; Asian Development Bank [ADB]. 2014. “Maldives - Gender Equality Diagnostic of Selected Sectors.” Mandaluyong City, Philippines: Asian Development Bank, 2014; Gunatilaka, R. 2013. Employment Challenges in the Maldives. Sri Lanka and the Maldives: ILO.

¹¹⁶ Hope for Women 2012. Maldives NGO Shadow Report to the Committee on the Elimination of Discrimination against Women, 2012. Maldives: Hope for Women NGO; Asian Development Bank [ADB]. 2014. “Maldives - Gender Equality Diagnostic of Selected Sectors.” Mandaluyong City, Philippines: Asian Development Bank, 2014.

6. OPPORTUNITIES AND TRADE-OFFS FOR SUSTAINABLE POVERTY REDUCTION AND SHARED PROSPERITY (CONTD.)

Shortcomings in quality, quantity and consistency of supply affect the development potential for many local producers.

The fisheries sector can generate a range of sustainable benefits for Maldives.

present time, given limitation in local supply, most of the goods are imported. The potential for creation of supply chains between local producers and tourism industry is hampered by a number of obstacles, including:

- Fundamental challenges to local supply due to the small size of the economy, limited economies of scale, high dispersion of the population and high transport costs. However, there is ample potential for production focused on specific products and crops, signaling the need for specialization.
- Shortcomings in quality, quantity and consistency of supply affect the development potential for many local producers. According to anecdotal evidence, previous attempts by cooperatives and grower associations to enhance reliability and professionalism have failed to radically improve the reliability of supply. In light of that, many tourism operators prefer to reduce uncertainty through imports. A large proportion of agricultural products come from small producers. Aggregation and coordination has been attempted by cooperatives and corporate sponsors, but it remains challenging.¹¹⁷
- Limited collaboration between supply and demand of agricultural products. While there have been some success stories in production in agricultural islands, of the 52 leased islands, only eight are actually operating, signaling potential missed opportunities for enhancement of the local production. Further analysis of priority crop production, the calculation of supply and demand, key constraints including inputs, logistics, knowledge and employment desirability, and availability of land may help to enhance the certainty in supply.
- The fact that, at present, agricultural production throughout the country is centralized in Malé due to lack of market places for fresh produce in other atolls¹¹⁸. This reduces the competitiveness of local production by increasing transport costs and reducing the freshness of products.

OPPORTUNITIES AND OBSTACLES FOR UNLEASHING THE POTENTIAL OF FISHERIES AND ANCILLARY INDUSTRIES.

Maldives has the opportunity to further develop its fisheries sector, and to capitalize on the potential benefits to enhance economic growth and sustainable development at a national level. Unlike the fisheries sectors in many countries throughout the world, Maldives has a range of factors in its favor that provide the opportunity for further development. The fisheries sector can generate a range of sustainable benefits for Maldives – direct benefits such as employment, income and food for fish-workers and indirect benefits such as contributions to the national exchequer through various fiscal mechanisms. Yet, significant challenges lay ahead to undertake sector development within an economically efficient and sustainable fisheries management system.

Enhancing the governance of the sector will be necessary to unleash its potential. The development of the skipjack tuna (a segment regulated through processing licenses) and yellowfin tuna

¹¹⁷ While there are various examples of successful cooperatives, notably the Addu Meedhoo cooperative supplying the Shangri-La Hotel, the concept is not well suited to the Maldives and is not inherently replicable across Atolls

¹¹⁸ Effectively, a product may be produced in a remote Atoll, brought to Malé at great cost and transport time, bought in Malé and returned to the same Atoll by the buyer.

Enhancing the governance of the fisheries sector will be necessary to unleash its potential.

Many countries that once had ample fish resources are now faced with overcapitalized fishing fleets, overfished stocks and unsustainable levels of public subsidies to their fishery sectors.

[a segment that does not have similar licensing in place] highlights two widely varying trends. Where the licensed market segment is characterized by plummeting catch, low added-value exports and declining employment, the unlicensed segment is characterized by increasing catch volumes, high-value exports to prime markets and increasing employment. While other factors may contribute to these trends, it is worth reviewing the governance framework in the sector, including the rationale for licensing of particular activities and whether such framework has a positive contribution to the economy as a whole. If licenses are maintained, a transparent licensing process should be put in place with emphasis on ensuring that licenses are granted to the most qualified enterprises with demonstrated ability to contribute to the sustainable growth of the sector.

The sustainable and inclusive growth of the fisheries sector will likely not be based on increasing the volume of catch. Currently, most of Maldives fisheries operate under free and open-access conditions. The sector's growth is based largely on traditional policy goals of maximizing production through increased fish landings, supported by improved technology that can lead to increased fishing yields. Global experience shows, however, that this approach usually results in low levels of success in generating sustained economic benefits. In some cases, this leads to reduced revenues from the fishery, diminishing profitability and, in the worst case, stock collapse from overfishing¹¹⁹ and waste¹²⁰. Many countries that once had ample fish resources are now faced with overcapitalized fishing fleets, overfished stocks and unsustainable levels of public subsidies to their fishery sectors.

A transition to a wealth-based fisheries management system may hold promise for the future. Rather than pursuing the traditional goal of increasing fish landings, wealth-based fisheries management systems focus on maximizing net returns in fishery-sector development within an economically efficient fisheries management system. For inshore reef and lagoon fisheries, such systems can involve the development of local community-based management systems. For coastal and high-seas fisheries, such systems might be based around the design and introduction of rights-based fishing within a sound management planning framework. These approaches have worked well for other countries. However, it is important to note that a transition process requires a careful implementation and a long-term planning horizon. Prudent management of the marine environment also underpins the valuable tourism industry and the perception of Maldives as a pristine environment. It is essential, therefore, to capitalize on emerging international best practice in fisheries and reef management to ensure that Maldives' fisheries management system is economically efficient, sustainable and profitable in the future.

¹¹⁹ The classic example is the Canadian Atlantic cod fishery in the 1980s, culminating in the closure of the fishery in 1992, with massive economic costs to local fishers, processors, and governments. In Maldives, there are some indications of fleet overcapitalization in the tuna fisheries.

¹²⁰ Another systemic issue is the logistical and capacity problems between harvesters and processors during peak fishing periods.

6. OPPORTUNITIES AND TRADE-OFFS FOR SUSTAINABLE POVERTY REDUCTION AND SHARED PROSPERITY (CONTD.)

Enhanced and more balanced stakeholder involvement between fishers, industry and government in decision-making will help chart a steadier course at the national level.

There are a range of targeted options¹²¹ for exploiting the opportunities presented to the Maldives' fisheries sector at present, but effective strategies and plans will need to be developed in order to identify not only economic potential, but also environmental impact.

- With tuna harvesting and processing, there are possibilities for developing new domestic fisheries such as long-lining, and for re-organizing the current system for collecting and buying fish to overcome seasonal gluts and enhance the share of returns for the producers of [dried] Maldives fish. Onshore, there are possibilities for locating new processing and fish-handling facilities on different islands to take advantage of the seasonal changes in fishing grounds and fish concentrations and new infrastructure, such as harbors and airports. The impact of selecting a particular development option on local communities, on livelihoods and on the economies of scale and logistics of the value chain will need careful consideration and cooperation between both private and public actors.
- There are strong possibilities for developing new products and entering new markets, in particular capitalizing on Maldives pole- and line-caught tuna as an individually caught, 'ecologically-friendly' product from one of the world's cleanest environments. The culture of high-value, small-volume products can also capitalize on the environmental image of Maldives. But, international seafood markets are highly competitive and demanding, and Maldives will need to exploit its comparative advantage for seafood exports by building a careful business and investment strategy.
- There are opportunities for addressing infrastructure and logistical constraints that affect some fishing islands. The trade in fish products will depend on better facilities and transport links to access export markets, but investments will require sound financial and technical assessments and close public-private cooperation including PPPs, particularly given the government's current fiscal situation.
- The need to increase stakeholder involvement in decision-making and policy implementation is constrained by the overlapping mandates of different ministries. The lack of a clear definition of the respective roles of the public and private actors has major implications for the longer-term functioning and effectiveness of the sector, especially in a transition towards a wealth-based fisheries management system. Enhanced and more balanced stakeholder involvement between fishers, industry and government in decision-making will help chart a steadier course at the national level. It is particularly imperative that fishers have a stronger voice in policy development at the national level.
- Finally, the issue of international partnerships also presents options for Maldives. The extent to which Maldives' participation in the Indian Ocean Tuna Commission has benefited the country over shared stocks, and the options for entering into partnerships with foreign investors for the further development of enterprises such as the tuna transshipping trade are the types of major issues that need to be considered in the context of sectoral and national development policy.

¹²¹ These options stem from technical background analyses as well as stakeholders' consultations.

PRIORITY AREA 2. ENABLING OPPORTUNITIES FOR CREATION OF NEW SOURCES OF GROWTH

Enhancing the enabling environment will increase the potential for entrepreneurship, creation of new firms and growth of existing ones.

Minimizing unnecessary regulatory hurdles will be essential in order to foster entrepreneurship in Maldives.

Economic diversification and competitiveness in Maldives are hampered by significant structural and spatial constraints, but enhancing the enabling environment will increase the potential for entrepreneurship, creation of new firms and growth of existing ones. Maldives faces similar structural challenges of other small island states that restrict the extent to which the country can attain competitiveness across the board. However, as discussed in previous sections, there are visible untapped opportunities where potential (in terms of existing demand and proved production capacity) exists, both within value chains of existing industries, as well as potential new economic activities.

Enabling the local population to seize these opportunities will require addressing a host of factors that combined restrict the overall enabling environment in the country. These factors include: minimizing the regulatory burden and consequent cost of doing business; enhancing the ability of creditworthy firms and entrepreneurs to access finance, and; enhancing human capital through the formation of professionals and technicians with the skills that are in demand and are the key to better jobs. These priorities are discussed below.

ENHANCING INVESTMENT CLIMATE

Enhancing the investment climate will be essential to facilitate entrepreneurship and attract investment. As discussed in previous sections, the challenges related to the investment climate are higher in Maldives than in other small island states and other countries in the region. Global research documents extensively the negative link between investment climate challenges and growth and competitiveness in the private sector. As the government strives to enhance entrepreneurship and economic diversification in the country, the opportunities for improvement of the investment climate are significant, including:

- Reducing the cost of regulatory compliance. Global indicators such as Doing Business identify a number of regulatory shortcomings that currently create additional transaction costs to entrepreneurs at all stages of the business cycle (from firm creation and connection to basic utilities, to expansion and resolution of disputes and insolvency). These deficiencies in the regulatory framework have the potential to discourage entrepreneurship and to reduce the overall competitiveness of enterprises. Minimizing unnecessary regulatory hurdles will be essential in order to foster entrepreneurship in Maldives..
- Addressing shortcomings in the legal framework governing private-sector activities. Deficiencies in basic legal foundations of the system of commercial justice create legal uncertainty and diminish incentives for investment. Key elements of the legal framework needed in order to ensure a level playing field and fair treatment of investors (competition and industrial property laws) are missing, further undermining the confidence of potential new

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Addressing shortcomings in the legal framework will be important to increase investor confidence and provide entrepreneurs with legal certainty.

Public-private dialogue platform on investment climate can provide a channel for the private sector to inform government policies and define priorities for reform.

Rethinking the role of SOEs and the rationale for their participation in economic activities is necessary to ensure that SOEs do not become an obstacle to entrepreneurship.

investors. The lack of adequate laws governing secured transactions severely undercuts the ability of the financial sector to provide credit to enterprises because it increases the risk of losses in case of borrowers' defaults due to unpredictable, lengthy and costly legal resolution. Addressing these shortcomings in the legal framework, together with the capacity of the judiciary to implement laws in a consistent and objective way, will be important to increase investor confidence and provide entrepreneurs with legal certainty.

- Enhancing the participation of the private sector in the reform of the investment climate. While global indicators provide a benchmark of some key areas of the investment climate, identifying and addressing the key constraints faced by enterprises and entrepreneurs in Maldives will require the active and continuous participation of the private sector. Development of a formal public-private dialogue platform on investment climate can provide a channel for the private sector to inform government policies and define priorities for reform. The close consultation with private sector can also help to reduce the risk of disruption in enterprises' operations from sudden changes in laws and regulations.
- Addressing governance issues affecting the development of the private sector. In particular, SOEs have the potential to crowd out private enterprises from major economic activities through unfair advantages, including wider access to financial services, broader ability to attract the limited human capital available in the country, and preferential treatment related to business regulations. Rethinking the role of SOEs and the rationale for their participation in economic activities that could be undertaken by private enterprises is necessary to ensure that SOEs do not become an obstacle to entrepreneurship and private-sector-led growth.

ENHANCING ACCESS TO FINANCIAL SERVICES

Improving access to adequate financial services will be essential to enhance the ability of creditworthy firms and entrepreneurs to invest and reduce transaction costs. Enterprises and entrepreneurs have identified access to finance as a major constraint for their day-to-day operations and longer-term growth. The high dependence of banks' credit decisions on real estate collateral, together with the inability of mechanisms for entrepreneurs with viable business plans to demonstrate their creditworthiness, has translated into concentration of credit in a few segments of the economy, most particularly larger borrowers in tourism-related activities. Recognizing these challenges, authorities in Maldives have tried to provide concessional credit to foster entrepreneurship. However, sustainably enhancing access to financial services will likely require addressing a range of factors that currently undermine the efficient operations of the financial sector, including:

- Improving credit infrastructure. Enhancing the depth and scope of information included in the credit registries will be necessary to increase the ability of lenders to identify borrowers with good track records. The inception of an electronic collateral registry will improve the ability of borrowers in remote atolls to post use their assets as collateral.

Sustainably enhancing access to financial services will likely require addressing a range of factors that currently undermine the efficient operations of the financial sector.

Mobile banking will help the population in remote atolls to have access to basic financial services and reduce transaction costs.

Expanding and improving human capital will be of vital importance to promote economic prosperity and increase jobs for young people.

- Enhancing financial inclusion of population in remote islands. Development of mobile banking will help the population in remote atolls to have access to basic financial services and reduce the currently very high transaction costs of financial operations.
- Improving the legal framework governing financial activities. Lack of clarity and certainty on application of laws translates into lengthy and costly legal processes. This increases the risk aversion of lenders, which, increases the collateralization requirements. Losses stemming from these deficiencies are passed on to new clients in the form of higher interest rates. More clarity and consistent application of the laws governing foreclosure, together with the clarification of the application of Shariah law in financial disputes will be necessary to minimize uncertainty and risk aversion.
- Enhancing the development of non-bank financial institutions [NBFIs]. NBFIs can increase accessibility to financial services by reaching out to segments of the market not covered by large commercial banks. Important types of NBFIs [including microfinance, leasing and factoring] are currently either missing or underdeveloped in Maldives. Previous experience in the country demonstrates the potential for some of these NBFIs, but also shows that challenges in the legal framework contributed to diminish that potential over time. Creating an enabling environment that fosters the orderly and sustainable development of NBFIs, including adequate oversight, can enhance supply of financial services to currently underserved market segments.

ADDRESSING HUMAN CAPITAL CONSTRAINTS

Expanding and improving human capital will be of vital importance to promote economic prosperity and increase jobs for young people. From the demand side, enterprises have consistently identified the lack of staff with the adequate skills and qualifications as a major constraint to growth. Over the last few years, this has led to vast employment of expatriates. From the supply side, young people in Maldives aspire to high-paid jobs, but often lack the required skills. While there are various factors at play affecting the participation of youth in employment, the gap between the skills demanded and those in supply is wide at the present time. Reducing this gap presents a significant potential for shared prosperity, and will require, among other factors, the following:

- Enhancing Maldivian youths' 'soft skills'. Soft skills [including workplace ethics and the ability to collaborate effectively within an organization and be responsive to clients] are missing from academic programs, but are widely identified as priorities for employers in the country. Such skills often rank higher than technical skills as decision elements for employment. The introduction of these skills in education programs will increase the employability of the Maldivian youth and will likely have a positive impact on their contribution to firms' productivity.
- Improving the quality and relevance of technical and vocational education. While Maldives has a Technical and Vocational Education Program [TVET] in place, the quality and relevance of the training provided has failed to meet the demands from the private sector. This, together

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The sustainability of Maldives' development model is dependent on how well the authorities manage the country's wealth-generating natural resources and its financial assets to redistribute this wealth.

with the prevailing perception of Maldivian youth that vocational education and training is an inferior option to academic qualifications, has contributed to further lower the interest in TVET. A closer collaboration between the private sector and TVET will be necessary to increase the relevance of programs provided, and participation of industry experts may enhance the quality of the degrees. Ensuring responsiveness of TVET and other relevant academic institutions to the private sector will be necessary to unleash the potential for technical and vocational education.

- Enhancing participation and relevance of higher education. Enrollment in higher education is much lower in Maldives than in countries of similar income level. The low proportion of Maldivians with higher education qualifications means that the country lacks sufficient professionals, managers and technical experts to support economic growth and social development. Enrollment in higher education in Maldives is affected by the high dispersion in population [with tertiary education provided mainly in Male], but other factors – such as low completion rates in higher secondary education [which is provided in the atolls] play a role. While enrollment in higher education will remain hampered by Maldives spatial constraints, enhancing the relevance and quality of the programs will be essential to ensure that they are responsive to the needs of the country.

PRIORITY AREA 3. IMPROVE PUBLIC RESOURCE MANAGEMENT AND REDUCE MACRO-FISCAL RISK

The sustainability of Maldives' development model is dependent on how well the authorities manage the country's wealth-generating natural resources and its financial assets to redistribute this wealth, and how resilient it is to external and domestic shocks.

MANAGING NATURAL RESOURCES

Maldives' natural resources are its marine life, coral reefs and its islands. As discussed earlier, there are weaknesses in the exploitation of its natural resources and in its preparedness for natural hazards¹²².

- Continued population development will lead to more sewage and solid waste, which impacts tourism and fisheries, and growing demand for clean water for island communities, a development that is compounded by a growing competition between water for potable and irrigation purposes.
- Loss of coral reefs due to the warming of ocean water and pollution may result in the loss of bait fish for tuna fisheries.
- In the tourism sector, de facto high barriers to entry and the lack of transparency in the allocation of leases for resort islands makes it difficult to assess if the government maximizes the benefits from its main natural resource.

¹²² Discussed in the section on Environmental vulnerability and sustainability issues and governance constraints.

- The government's plan to increase passenger arrivals from 1.2 million¹²³ in 2014 to 5 million¹²⁴ will add more environmental pressure through the construction of new airports and facilities and increased flights.
- Much of the population and critical infrastructure reside within 100 meters of the shoreline, making them vulnerable to both disaster and sea-level rise, while climate change itself will also affect the quality of its coral reefs.

A number of dimensions of governance problems prevent the government from managing its natural resources well and dealing with the emerging challenge of sustainability.

- Environment and natural resource management issues are typically complex, often uncertain and dynamic, and affect multiple sectors, organizations and individuals. As a result, it requires strong leadership, a high degree of coordination, stakeholder involvement, expertise and resources to ensure sustainability.
- Although there are multiple public institutions mandated to conserve and protect the natural resources with backing of legal instruments, their overlapping roles, undefined relationships and lack of incentive to coordinate have a negative impact on management effectiveness.
- Lack of funds, human resources and expertise are making enforcement weak. Poor stakeholder involvement, especially local authorities and communities in management efforts, reduces enforcement capability.
- Poor capacity of civil servants is impacting implementation and monitoring of policies, strategies and programs. The private sector, which is the biggest beneficiary of natural resources and who can play a significant role in bringing resources, monitoring and managements, is playing only a limited role due to lack of opportunity and effort to mainstream.

Governance problems prevent the government from managing its natural resources well and dealing with the emerging challenge of sustainability.

MANAGING PUBLIC FINANCIAL RESOURCES

The main mechanisms to redistribute the wealth generated by tourism are public sector employment, social services, subsidies and transfers. The current system of redistribution has contributed to achieving important development outcomes.

- Public-sector employment, including education, health and social services¹²⁵ has played an important role in Maldives, accounting for 35 percent of employment in 2010.¹²⁶ Moreover, employment in the public sector has contributed to Maldives' relatively high female labor force participation, as well as to poverty reduction¹²⁷.

¹²³ Tourist arrivals in 2014.

¹²⁴ Manifesto of the Progressive Party of the Maldives.

¹²⁵ Although health and education are not necessarily government activities, in Maldives about 90 percent of employment in the health sector is in the public sector [Maldives Health Statistics 2013]. In the education sector, about 70 percent of students are enrolled in government schools [Maldives Statistical Yearbook 2013], and it is assumed that a similar percentage of teachers are employed in government schools.

¹²⁶ This does not include employment at SOEs.

¹²⁷ See section on Poverty and shared prosperity.

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- Public services, and in particular the expansion of education and health services provision to populations living in the atolls, have contributed to a significant improvement of human development outcomes and human capital accumulation.
- Electricity and food subsidies have contributed to mitigating the high cost of energy and food supply in Maldives, thereby improving living standards of the population. Similarly, the introduction of universal social pensions and health insurance have helped extend protections against the challenges of old age and the risk of catastrophic health expenditure to the entire population.

Sustainability of the positive outcomes achieved through the redistribution system crucially depends on improving its efficiency and cost-effectiveness.

Apart from the food and electricity subsidies delivered through SOEs, capital contributions to SOEs are another large public expenditure item. Although a few SOEs returned annual average dividends equal to 1.8 percent of GDP between 2011 and 2014 to the budget, annual average capital contributions to SOEs amounted to 1.3 percent of GDP over the same period.

However, sustainability of the positive outcomes achieved through the redistribution system crucially depends on improving its efficiency and cost-effectiveness. Given the already widening fiscal deficits and high public debt, these mechanisms are not fiscally sustainable at current trends, and the government will need to carefully weigh the fiscal costs and social benefits of each of the expenditure items.

The public sector employment freeze contributes to managing the wage bills and improve fiscal sustainability. A more structural solution, which could include a review of local government pay structures and a public-sector-wide pay scale, could be helpful to ensure consistency of wages and salaries across public service and drive public service reform.¹²⁸ It is important that structural reform be accompanied by efforts to improve conditions for employment in the private sector, especially for women.

There is growing evidence that the expansion of access to services to the atolls has been accompanied by a decline in the overall quality of service provision.

While it is important to continue to provide wide access to health and education services, more careful planning based on the demographic distribution of the population could improve efficiency of spending and free resources to improve quality. There is growing evidence that the expansion of access to services to the atolls has been accompanied by a decline in the overall quality of service provision.¹²⁹ The failure to close the quantity and quality gap in service provision between Malé and the atolls contributes to continued population migration toward the capital and exacerbates the (per capita) cost of service provision in the atolls (Figure 74). Still, tailoring service provision on the demographic profile of the population in the different parts of the country (Figure 75) could result in significant cost savings and potentially free up resources to improve quality of service provision.

¹²⁸ IMF Article IV, January 2015.

¹²⁹ The lack of supply of qualified medical and education professionals within the local Maldivian population, forced the central Government to rely on expatriate workforce for expanding service delivery outside Malé [Maldives Health Statistics 2013, Ministry of Health; School Statistics 2014, Ministry of Education]. However, high turnover and limited integration of these professionals with the local population resulted suboptimal quality of service provision.

Figure 74

Population growth dynamics, Malé - Atolls

Source: Staff elaboration on Census 2000 and 2006 data

Figure 75

Age group composition, by location

Source: Staff elaboration on Census 2000 and 2006 data

Targeting reform of electricity and food subsidies could improve efficiency of spending while freeing resources to protect the poor.

Improving SOE governance could improve fiscal and environmental sustainability.

**Figure 74.****Figure 75.**

Targeting reform of electricity and food subsidies could improve efficiency of spending while freeing resources to protect the poor. Building on international experience, a cut to explicit subsidies would need to be accompanied by interventions to protect the most vulnerable segments of the population, and to limit losses of utility providers. Such strategy would aim at: [1] enabling consumption efficiency; [2] increasing supply-side efficiency; and [3] substituting universal subsidies with a targeted transfers system. The government has already started to target electricity subsidies by reassessing who is eligible to receive them.

Operational savings in Aasanda could cut its cost significantly, while preserving the principle of universal health insurance. These savings could be achieved mainly through three channels: [1] reducing the cost of medicines through the bulk procurement of essential and generic drugs; [2] reducing expenditure on overseas treatment through negotiation of close-ended package rates with providers; and [3] improving attention to early detection and secondary prevention of chronic diseases at the primary care level, which will be helpful in slowing down disease progress and delaying the occurrence of complications. Substantial capacity building of the National Social Protection Agency would also be needed to plan, implement and monitor these reforms.¹³⁰

Improving SOE governance could improve fiscal and environmental sustainability. The key sources of fiscal risks include: [1] political interference in the management of the SOEs, in the form of uncompensated subsidies, service requirements, and tolerance of soft budget constraints resulting in inter-SOE debts; [2] lack of macroeconomic planning capacity, leading to potential losses as macroeconomic variables develop differently than expected; and [3] management challenges, such as lack of coherence between public sector and SOE investment plans. Procurement by SOEs could be made more transparent to assess whether it delivers enough value for money. As SOEs play a key role in many utility sectors (e.g., electricity, water and waste management), improvement in their performance could also help alleviate some of the environmental constraints on growth.

¹³⁰ Systematic costing, adequate autonomy at the facility level, and appropriate incentive mechanisms being put in place at the design stage, to encourage high productivity and cost containment, would be pre-requisites for such reform. Improved information systems making possible continuous analysis of Aasanda's administrative data would be important for internal controls and informing ongoing reforms, as would be regular compilation and analysis of household survey data to periodically check on the scheme's performance and distributional implications.

6. OPPORTUNITIES AND TRADE-OFFS FOR SUSTAINABLE POVERTY REDUCTION AND SHARED PROSPERITY (CONTD.)

As a small island state Maldives is inherently vulnerable to external shocks, and its heavy reliance on tourism adds a channel of exposure.

While it cannot eliminate its vulnerability to shocks, Maldives has opportunities to reduce its vulnerability and increase its resilience

INCREASING MACROECONOMIC RESILIENCE

Better management of its resources may also make Maldives more resilient to external shocks and help it mitigate risks. As a small island state Maldives is inherently vulnerable to external shocks, and its heavy reliance on tourism adds a channel of exposure. Indeed, besides the exposure it shares with other island states to natural disasters and commodity prices, Maldives is also vulnerable to recessions in certain key tourism sectors and the indirect impact on tourism of events such as the 9/11 attacks. Additionally, recent domestic unrest may lead to negative travel advisories.

Maldives will remain exposed to external shocks from tourism under its current development model so it needs to decrease its vulnerability to other shocks and increase its resilience. In order to analyze the options to reduce vulnerability and increase resilience, vulnerability is decomposed into three parts: [1] exposure to shocks; [2] internal conditions that may amplify or attenuate shocks domestically; and [3] risk management in the form of ex-ante institutional quality and ex-post policy space to mitigate the impact of shocks.¹³¹

- Exposure: Maldives is mainly exposed to external demand shocks through tourism, external supply shocks from commodity prices and natural disasters.
- Internal conditions: Fiscal revenue is highly dependent on tourism, while a large part of public expenditure is rigid and difficult to adjust. Combined with high public debt, this makes the fiscal accounts also vulnerable to shocks. In addition, the country is structurally highly open to trade, and any countercyclical fiscal policy would lead to more imports and potentially destabilizing the external sector.
- Institutional quality: Maldives has low ratings for policies and institutions, in particular for fiscal policy and for debt policy and management.¹³²
- Policy space: The country has limited macroeconomic and fiscal space to deal with an external shock. It has low usable official foreign exchange reserves,¹³³ and it runs a persistent fiscal deficit.

While it cannot eliminate its vulnerability to shocks, Maldives has opportunities to reduce its vulnerability and increase its resilience within limits by:

- Diversifying sources of tourism. Maldives can try to diversify its sources of tourism by attracting tourists from other parts of the world and by attracting more tourists to its guest houses and other offerings outside resorts. Accessing different markets that are not perfectly synchronized could reduce the current volatility of tourist arrivals. The added benefit is the guest-house tourism is more inclusive for the local population (Priority area 1).
- Reducing reliance on imported fuel. Maldives is interested in introducing solar power to replace imported diesel. With diesel imports accounting for around 20 percent of total merchandise

131 Risk management framework introduced in the World Development Report in 2014.

132 Measures by the World Bank's Country Policy and Institutional Assessment [CPIA].

133 Although the secondary market for foreign exchange appears to be well stocked.

imports, this could have a significant effect on vulnerability to commodity price fluctuations. Installing and maintaining solar panels could have the added benefit of providing local employment for engineers. It should be noted that existing suppliers of diesel-based power may initially try to hinder efforts to switch to solar energy until they make the switch themselves.

- Reforming in public expenditure. Reforms in the system of wages, subsidies and transfers would make the budget more flexible to deal with revenue shocks without continuously increasing public debt. Moreover, it could reduce overconsumption of subsidized electricity and certain imported goods, which would reduce external exposure as well. However, this type of reform may be politically difficult, and will need a social safety net [such as targeted cash transfers] to protect the poorest.
- Decreasing risk of debt portfolio. As Maldives becomes richer, concessional external debt may become less available. Public domestic debt has a very short maturity, and is subject to refinancing and interest risk.¹³⁴ Extending the maturity profile would reduce the risk but could increase the cost of debt. There are natural buyers of longer-term public debt, such as pension funds and insurance companies. Establishing a yield curve beyond one year could also help the financial market better price risk, and it could deepen the financial market and make it easier for local SMEs to obtain credit.
- Improving public sector governance and planning capacity. Improvements in public financial management would lead to more credible budgets, expenditure controls, commitment to decreasing public debt and better selection and planning of investment projects. Improvement in planning capacity is needed to deal with the challenges of natural resource management, and to address the dilemma between consolidating the population closer to Malé and improving services and connectivity to populations at their current locations, and to plan the associated infrastructure needs.
- Increasing policy space. The low level of usable foreign exchange reserves leaves little space to manage the exchange rate and import essential goods. Mitigating this lack of space is the existence of a parallel market with sufficient quantities of foreign exchange. The country appears to have access to ad-hoc support from partners, but more formalized access to a credit line would reduce macroeconomic uncertainty. Fiscal space can be built up by reducing the budget deficit and reducing the level of public debt. As a dispersed island state with a commitment to provide social services to remote atolls, Maldives faces limits to how much expenditure savings can be made but, as explained in the previous section, there appears to be scope for efficiency gains. On the other side of the balance, there may be scope for increased revenue, including income tax revenue or a wealth tax, ideally from sources that are less correlated with fluctuations in tourism.

¹³⁴ In the current situation of apparent excess liquidity in the financial market and the absence of good investment opportunities in the private sector, this risk seems to be low. Under the “tap” system for Treasury bills, which fixes interest rates, interest rate risk is also low.

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ANNEXES

ANNEX 1. POVERTY MEASUREMENT IN MALDIVES

Understanding of poverty issues in Maldives is limited by data quality and comparability constraints and by pitfalls in the current poverty measurement framework.

DATA LIMITATIONS

The primary concern relates to data quality and comparability. The first household survey in Maldives [Vulnerability and Poverty Analysis - VPA] was conducted in 1998/99, with a panel followup in 2003/04. The VPA survey series was then replaced by Household Income and Expenditure Survey [HIES] – mostly focused on household budget measurement – which was implemented in 2003/04 and 2009/10. Differences in instruments and sample design do not permit comparison between the results obtained from VPA and HIES surveys. Moreover, differences in survey instruments and possibly in data quality within the two HIES rounds further limits the ability to profile the evolution of poverty in Maldives.

POVERTY MEASUREMENT FRAMEWORK

The most widespread poverty indicator is the share of individuals whose per capita consumption falls below the official poverty line. This indicator is usually defined in the literature as headcount index and it is a measure of the incidence of poverty. Antecedent to computing the headcount index are two steps: defining a welfare aggregate, e.g. the dimension with respect to which we define the minimally acceptable standard of living; and establishing a minimum acceptable standard of that indicator to separate the poor from the non-poor [the poverty line].

Maldives lacks an official and unique national poverty line. Since the first household survey in 1997/98, poverty measurement has relied on the use of several relative poverty lines, defined in terms of median or a fraction of median consumption of the population living in the atolls, excluding the capital Malé. No efforts had so far been made to assess which of these poverty lines actually corresponds to a reasonable minimum threshold by the standards of living prevailing in Maldives.

The consumption aggregate is the sum of the consumption expenditures of all food and non-food items of each household. Due to data limitations, the consumption aggregate does not include spending in durables and the flow of services from the primary dwelling [usually intended as rent for tenants, and imputed rent for home owners]. The validity of official poverty profiles is severely hindered by the lack of any adjustment of the consumption aggregate for spatial differences in living costs. The lack of spatial price adjustment represents a fundamental flaw of the current poverty measurement methodology, especially given the unequal distribution of economic opportunities throughout the Maldivian archipelago, relevance of transport costs and differential access to goods and services between the capital area Malé and other atolls.

POVERTY METHODOLOGY ADOPTED FOR THE SCD

In order to improve the comparability of the two HIES surveys, and to overcome the shortfalls of the official poverty methodology, a new consumption aggregate and a new poverty line have been estimated.

The new consumption aggregate is defined as the sum of all food and non-food household expenditures, excluding housing, lumpy expenditures [purchase of vehicles, major tools and equipment, household appliances, durables, furniture], and rare expenditures [jewelry, hay, wedding and parties]. The consumption aggregate so defined is then divided by the household size, defined as the sum of family members and paying guests. To take into account the spatial price differences, the consumption aggregate is deflated using regional food poverty lines.

Using the Cost of Basic Needs approach and HIES 2009-10 data, the national poverty line has been estimated at MVR 787.5. This value is equivalent to the minimum necessary to consume 1,826 Kilocalories per capita per day plus a non-food allowance equal to the average non-food expenditure of households with food expenditure just enough to reach the minimum caloric requirement.

The World Bank uses as extreme poverty line \$1.25 a day in 2005 PPP terms, which represents the mean of the poverty lines found in the poorest 15 countries ranked by per capita consumption among 88 surveyed countries over the period 1990-2005 [Ravallion, Chen and Sangraula, 2009]. Maldives' national poverty line is about \$1.90 a day in 2005 PPP. Other commonly used poverty lines for international comparisons across middle-income countries are \$2 and \$2.50 a day in 2005 PPP, which correspond, in turn, to MVR 821.3 and MVR 1,034.2 a month in 2010 prices. In addition to the national poverty line, the SCD use the international poverty lines for cross-country comparisons.

THE DEPTH AND SEVERITY OF POVERTY

Although the headcount index is the most widespread measure of poverty, it has a serious shortcoming in that it does not take into account the intensity of poverty, i.e. how far from the poverty line the poor are. A measure of poverty that overcomes this problem is the poverty gap index. The poverty gap index is the average shortfall of the total population from the poverty line as a share measured as a percentage of the poverty line itself, and it defines the depth of poverty. The squared poverty gap gives a higher weight on households furthest away from the poverty line and it is a measure of the severity of poverty. Both of these measures will complement the analysis of headcount poverty in the context of the SCD.

SHARED PROSPERITY

The World Bank has adopted two new targets to make explicit its goal of "A world free of poverty." The two targets are: ending extreme poverty by 2030 and promoting shared prosperity. Sustainability is an overarching priority in the pursuit of these goals: achieving them requires promoting environmental, social, and fiscal sustainability. The emphasis on reducing extreme poverty is in line with the commitment to halve extreme poverty enshrined in the first target of the Millennium Development Goals, which were adopted globally in 2000. Shared prosperity focuses explicitly on the less well off more broadly. Promoting shared prosperity is defined as maximizing income (or consumption) growth for the bottom 40 percent of the population. In Maldives, the consumption cut-off line for the bottom 40 percent (the threshold below which the poorest 40 percent of population falls) in 2010 is 1,266 MVR a month, or \$3.06 a day in 2005 PPP.

ANNEX 2. SUMMARY OF SCD CONSULTATIONS

SUMMARY OF SCD CONSULTATIONS IN MALDIVES

APRIL 27 – 30, 2015

OVERVIEW

A series of seven consultations involving nearly 100 participants was carried out as part of the preparation of this Systematic Country Diagnostic in Malé. Participants were drawn from government agencies, civil society organizations, youth groups, non-governmental organizations, student bodies, academia, development partner, and the private sector to ensure that diverse perspectives were represented.

The consultations were arranged under four thematic groups: [1] Opportunities for private-sector development and economic diversification; [2] Improving government delivery performance; [3] Addressing social risks; and [4] Tackling environmental vulnerability. In all sessions, the WBG highlighted the key messages that were emerging in the preparation of the Systematic County Diagnostic for Maldives and presented a broad overview of issues that were considered important to be addressed. The consultation process also included two technical meetings in Malé with representatives of the Government of Maldives. These meetings were used as a means of further understanding the current government strategy and as an opportunity to engage with the government team that was preparing the National Development Strategy.

Three objectives guided the consultation process:

- Obtaining perspectives from stakeholders on key economic, social and environmental challenges facing Maldives.
- Presenting an overview of the key findings of the SCD and validating the data used.
- Sharpening key messages in the SCD and identifying any new trends that were emerging .

Participants broadly agreed with the key areas identified as priorities facing Maldives and the main thrust of the SCD in this context. Tourism and fisheries remain the two main engines of growth. Participants agreed that while tourism has remained largely an enclave industry, fisheries has unrealized potential. Key vulnerabilities were also highlighted. They included: [1] a weak macro fiscal environment (largely linked to unsustainable cost of service provision to a small and dispersed population, coupled with inefficiencies in government expenditures); [2] social trends, (youth unemployment especially among women); [3] environmental vulnerabilities, (related to the lack of institutional capacity to adequately manage natural resources, deficiencies in waste, sewerage and management leading to pollution, and lower prioritization of environmental issues in government policies); and [4] governance issues. The following report presents recurring points noted during consultations.

1. OPPORTUNITIES FOR PRIVATE-SECTOR DEVELOPMENT AND ECONOMIC DIVERSIFICATION

Agriculture

Increasing linkages between agriculture SMEs and high-value sectors such as tourism were described as important income-generating activities for island communities. Agriculture was identified as a sector that could have significant impact on promoting shared prosperity. Participants explained that although demand for locally sourced produce exists in the tourism industry [as it is cheaper and involves less wastage], the lack of a single aggregated market and high transportation costs make imports more feasible for resorts. On the supply side, the lack of extension services and limited willingness of Maldivians farmers to cooperate on decisions related to the type of produce to grow on the limited land were also cited as key obstacles for the growth of agricultural SMEs.

The establishment of cooperative societies on islands have seen mixed results. Participants highlighted several instances where the establishment of cooperatives has led to significant income generation for farmers with value-added agricultural produce being sold resorts. However, there have also been several instances where cooperatives failed due to the inability of farmers to reach consensus on the type of crops to be grown and the manner in which scarce resources [water and land] were to be utilized. Some participants expressed concern that the lessons learned from previous failed attempts were not being analyzed and used in the implementation of new schemes. Participants further explained that the lack of quality extension services and access to finance were further obstacles to the development of agriculture in Maldives.

Fisheries

While investment in the fisheries sector is lucrative, low budget allocations, low reliance on technology and the lack of data sharing has impeded growth in this subsector. Participants highlighted the fact that the fisheries sector has been a source of steady income [with earnings in excess of \$1,000/month per fisherman]. However, declining revenues in the last five years was cited as a cause for concern. Participants pointed out that increased national budget allocations for the development of the sector would promote opportunities for substantially scaling up the fisheries industry. Low cooperation among fishermen to identify prime fishing sites, limited knowledge of and low use of technology, and unreliable data [specifically on harvesting trends] were identified as other issues impeding growth in the sector. The creation of better linkages with resorts was also cited as a possible step towards increasing revenues and expanding the fisheries industry. Labor regulations that prevented the use of migrant workers for harvesting of fish was cited as a possible factor in allowing all income generated by the industry to benefit Maldivians directly.

Access to finance

A conservative lending culture is impeding SME growth. Participants explained that access to finance was severely constrained for SMEs. Most SMEs [especially new ventures] do not have sufficient collateral to obtain loans and the lack of tailored financial products and instruments impede capital requirements for their expansion.. Loans for agriculture, in comparison, were cited as more easily obtained. However, as sufficient monitoring and evaluation was not being carried out in the sector, some loans were being used for private consumption and not for agricultural expansion. Participants also explained that conducting a needs assessment to identify the specific financial instruments required for SME development is an important first step to increase access to finance and also reduce the cost of finance.

2. IMPROVING GOVERNMENT DELIVERY PERFORMANCE

Issues concerning weak governance and the lack of strong public institutions were cited as key concerns for Maldivians at present. While participants were satisfied with overall government service provision, improving both the standard of education [from early childhood education to tertiary and vocational education] and health facilities was cited as important. Participants explained that the absence of sufficient checks and balances between the key arms of state, the perceived limited independence of the Judiciary, and low levels of transparency and accountability in the administration resulted in a weak institutional framework. This undermined public trust in the institutional framework and also led to the erosion of investor confidence. Participants cited examples such as bringing the Environment Protection Agency under the purview of the Ministry of Tourism [thus limiting the autonomy of the agency], the reversal of policies, and the lack of transparency in the granting of students loans and SME development loans as key instances where the governance mechanism had failed. Participants also described political instability as a major impediment in tackling key issues involving solid and liquid waste management, urban development and climate change resilience. Additionally participants indicated that the absence of a transparent, open and safe space for dialogue between public- and private-sector stakeholders and the lack of a participatory approach to policy making as key obstacles to improving the governance framework within Maldives.

3. ADDRESSING SOCIAL RISKS

Youth unemployment

Resolving issues related to youth, such as unemployment and skills development, was consistently cited as a key priority by participants at all four sessions. Employers and employees provided contradictory viewpoints as to why unemployment continued to a significant issue. Youth unemployment was attributed several factors by employers. Perceptions of poor work ethic among Maldivian youth, the inability to obtain the required skill sets [instances of difficulties in finding Maldivians with an adequate command of English were highlighted] and practical difficulties (such as the provision of transport to island communities to work in resorts) were key reasons cited by employers. Employees highlighted the bias against the hiring of Maldivians by Maldivians [specifically in the tourism sector for positions beyond a supervisor role and in the health sector for nurses], the lack of vocational training opportunities for employment as electricians, plumbers and carpenters [where significant labor demand exists], and the lax implementation of labor regulations [specifying

that half of employees should be Maldivians] in the tourism sector. Beyond skills, the consultations highlighted that youth unemployment stems from a disconnect between the aspirations of an ‘ideal’ job among the current generation of youth and their parents on the one hand, and the reality of the kinds of jobs that are available in a small island country with limited human capacity. Youth unemployment was cited as the key reason for increased drug abuse and the participation of young people in gangs. Current policy initiatives were also cited as being insufficient to address key youth issues and required the adoption of a holistic and contextual approach for increased success.

Intergenerational relations were highlighted as another driver exacerbating youth unemployment. Social norms that favor young people continuing to live at home relieve the young of the financial and social pressures to search for jobs. Even as affordable housing remains elusive and the size of homes shrinks, multigenerational homes continue to be the norm, and continue to provide a financial buffer for unemployed youth. The lack of space and house overcrowding had also encouraged many young people to look for a space outside the home in search of an identity. This helped lead to the proliferation of gangs and drug use.

Gender roles

While the civil law structure in Maldives promotes gender egalitarianism, the consultations revealed that gender norms in Maldives are strongly influenced by social dynamics. Participants explained that in the recent years Maldivian society has been shifting towards a form of conservatism that has strengthened taboos and social stigmas. This was described as having a negative impact on women’s choices to enroll in education and search for jobs. Participants highlighted the need for focused policy initiatives to combat the decrease in the number of women seeking employment and disengaging from playing an active role in Maldivian society.

4. TACKLING ENVIRONMENTAL VULNERABILITY

Efficient usage of land requires the analysis of the efficiency of allocation together with strengthened monitoring and evaluation frameworks within institutions. Participants explained that key decisions such as the allocation of islands for tourism should be juxtaposed in the context of using such land for the expansion of agriculture. With the inability to analyze the extent to which agricultural livelihoods have been lost due to the construction of resorts (especially for resorts where construction was not totally completed) owing to the lack of data, due consideration must be given to determining what effect future allocations will have in this regard. Although monitoring and evaluation is carried out on islands that have been leased out for agriculture, further cost benefit analysis will ensure allocative efficiencies.

Strong monitoring and evaluation frameworks are required to ensure the sustainable use of natural resources. Participants explained that while tuna fishery is heavily regulated (in line with obligations to the Indian Ocean Tuna Commission) and fishing for sharks is banned to prevent over-exploitation, no such protection exists for reef fish. Participants said that reef fish such as groupers were possibly over-fished on some reefs, thereby damaging ecosystems. Resource-sharing and linked management between the fisheries and tourism sectors (specifically in the sustainable management of the reef fish population) were also highlighted as being vital.

5. RECOMMENDATIONS

Future government strategies must incorporate integrated planning encompassing all sectors. Participants identified the lack of integrated planning (combining different sectors) as being a key obstacle for the successful implementation of new initiatives undertaken by the government. Integrated planning was seen as key means of ensuring success in high-growth sectors, such as tourism, which could benefit from increased linkages with the fisheries sector, (where the health of coral reefs are directly dependent on sustainable fishing practices). Participants explained that issues concerning the disposal of waste and sewerage, access to fresh water and the use of renewable energy sources could have been more easily resolved if integrated urban planning was consistently incorporated into government policy initiatives.

"The failure to equally address both environmental and fiscal challenges could potentially destroy Maldives in the near future."

While public infrastructure investments remain a priority for government, market-based solutions are required to induce behavior change. Public investments, specifically in port and airport infrastructure, were cited as priority to combat constraints to international trade. However, increasing social welfare, while ensuring fiscal consolidation, would require market-based solutions.

Improving statistics

Improving the reliability and consistency of key statistical data was seen as vital for the development of effective policy measures. Participants highlighted that critical discrepancies in statistics considerably distorted the policy planning process. Vital statistical data, such as income and employment generation in the fisheries and agriculture sectors, was described as severely under represented. Data was also described as sparse for various aspects of consumption, such as the quantum of public services being consumed by expatriates. Even critical analysis on issues such as youth unemployment was hindered by the lack of accurate data on the proportion of unemployed youth. Enacting legislation to ensure quality control of statistics was cited as one measure that could lead to accurate statistical data.

Creation of a consistent consultative process

The consultative process with both the private sector and civil society should be improved to ensure inclusive and sustainable development. Participants explained that private-sector involvement in policy discussions has been initiated several times but the outcomes were consistently undermined by political changes that led to the initiation of unfeasible plans based on election pledges. Participants also highlighted significant gaps between decisions reached by policymakers and technocrats. This led to government manifestos not being aligned with technical plans, resulting in changes to existing policy structure when governments changed. The creation of a central focal point for carrying out consultations and initiating central planning was also cited as key reform measures that would promote transparency in policy decisions and ensure successful collaboration with the private sector.

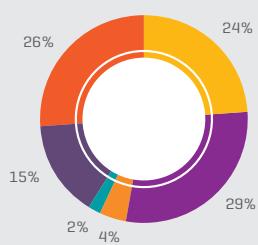
Box A.1

A snap poll (in the form of a written questionnaire) was also conducted among participants. The questionnaire consisted of five questions – two on the top three challenges for Maldives (immediately and in the medium-term), one on possible solutions to these challenges and two on potential steps to be taken immediately and in medium-term on the government reform agenda. Although the questionnaire drew a 95 percent response rate, the small sample size was a key drawback for obtaining conclusive results on the overall trend of responses. The exercise provided the means for obtaining information on issues that participants were reluctant to discuss (such as corruption). It also provided further assessment of the key thematic areas, verification of response patterns, and enabled the further prioritization of proposed reform actions to be initiated.

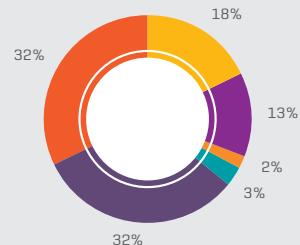
Survey respondents sector of affiliation [n=43]



Challenges faced by the Maldives today



Challenges the Maldives will likely face in the next 5-10 years



Note: Responses were grouped into the categories of Environment, Governance, Citizen Security, Energy, and social issues

ANNEX 2. WRITTEN RESPONSES RECEIVED FROM PARTICIPANTS SCD CONSULTATIONS

TOP 3 CHALLENGES FOR MALDIVES TODAY

Q1. Can you list the 3 key challenges that in your opinion the country is facing today?

Environment	Governance
Waste management [atolls, islands, regions]– waste piling up, fear of spread of diseases, disposal	Government Policy
Drinking water scarcity ground water contamination, Water resources management	Executive management incompetency – implementation- centralized executive, control of others
Urban environment deterioration/ Traffic, congestion	Delays in legal system judiciary
Access to clean water and waste management	No transparency in execution
Waste Management	Corrupt judiciary
Freshwater storage/ desalination / climate change	Deterioration of environmental governance- EIA changes/ lifestyle changes
Provision of clean and portable? Water to all	Political turbulences/ abuse of political power / instability
Attracting FDI due to fear of unknown related to climate change	Local level empowerment/ governance
Lack of clear policy on sustainable development	Integrated/ inter- sectoral planning process not practical
Climate change/ lack of knowledge on impacts	Weak governance, lack of accountability, transparency
Weak environmental regulation and enforcement	Lack of transparency and Politicization of independent institutions
Weakening of current EIA regulation	No proper development plan
Inappropriately designed coastal structures	Weak institution
Lack of appropriate laws [Water act], Regulation [plumbing standard]	Challenges faced in the justice system increase
Lack of natural resources	Increased mistrust in society due to corruption and non-transparency
Sustainable development policies at urban sector – no place for pedestrians and elderly in govt policies	National revenue not well distributed, limited development of public services
Sustainability in fisheries – barriers for local communities to do mariculture	Political instability / unrest
	Corruption
	Youth involvement in policy making etc
	Security for investors, political instability
	Transparency- public expenditure

Citizen Security	Energy	Social Issues	Economic Issues
<p>Intimidation/ lack of security</p> <p>Drugs/ crime / violence</p> <p>Crime rate</p>	<p>Energy production and security and waste / electricity for 24hrs for all islands</p>	<p>Restrictions to sexual and reproductive rights – unmarried youth</p> <p>Employment issue</p> <p>High youth unemployment and gang related violence, narcotics, dependency on state resources</p> <p>Disconnect between youth experiences and youth policies, low youth motivation</p> <p>Gender inequalities both subtle, systematic [low female representation at high levels] and overt [violence against women]</p> <p>Limited access to SRHR services [no CSE in schools]</p> <p>Politically driven community neglecting major issues and Values of society</p> <p>Huge influx of foreigners</p> <p>Population consolidation in Malé</p> <p>Lack of adequate Housing</p>	<p>No proper rehabilitation program</p> <p>Geographic dispersion</p> <p>Inequality – income distribution</p> <p>Poverty</p> <p>Supply chain needs improvement</p> <p>Shortage of industry targeted training</p> <p>Lack of skilled labor force</p> <p>Lack of proper Entrepreneurial System</p> <p>Solve privacy and data security issues</p> <p>Lack of cooperation between public and private sector /innovation and more focused on single industry</p> <p>Transportation regulation and enforcement</p> <p>Access to finance</p> <p>Proper legal framework to supplement management</p> <p>Collapse of SME in fisheries sector due to industrialization</p> <p>Lack of awareness on collection of data and stats for proper management of industries</p> <p>Budget deficit / public debt</p> <p>Resource allocation- govt to have more realistic way forward</p> <p>Dependence on foreign labor</p>

TOP 3 CHALLENGES FOR MALDIVES IN THE FUTURE

Q2. Can you list the 3 key challenges that in your opinion the country will likely face in the next 5-10 years?

Environment	Governance	Citizen Security
Disease outbreaks due to inadequate sanitation and waste management	Law enforcement not implemented	Social issues -Drugs/ crime / other social issues related to over population, increased crime and social justice
Challenges in sustaining public services/ Environmental services delivery	Lack of capacity to manage the system being implemented	
Possible decline in tourism through coral bleaching	Corruption among politicians and public servants	
Environmental issues / degradation	Political unrest / instability	
Spread of diseases from waste / ground water contamination	Shortage of planned targeted training	
Climate induced vulnerabilities [storm surges/ salt intrusion], adaptation issues, increasing beach erosion	Governance issues in general government administration	
Flooding from sea swells	Political disputes	
Water scarcity/ shortages and extreme high temperature	Weak institutions	
Waste, sewage disposal and treatment – manage waste at island level- high transportation cost	Large cooperation business controlling the government and loans made to favor few SME's	
Freshwater storage		
Balanced approach to bring the issues of climate change and at the same time attracting investment		
Over exploitation of certain marine species – eg groupers, sea cucumbers		

Energy	Social Issues	Economic Issues
<p>Electricity services on islands are going to have blackouts</p> <p>Energy production and security</p>	<p>Conflicts due to high energy prices and scarcity of water</p> <p>Unemployment</p> <p>Lack of cooperation and corporate values among people</p> <p>Religious extremism</p> <p>Lack of women contributing to national development</p> <p>Safety and health problems in urban areas especially elderly and children</p> <p>Brain drain from the country</p> <p>Increased poverty, Increase crime</p> <p>Emigration</p> <p>High Foreign labor force</p> <p>Unhealthy working population</p> <p>Public health decline</p> <p>Psychosocial issues</p> <p>More expats at jobs- imported skilled labor</p> <p>Over population of Malé and related issues</p> <p>Regression to women rights</p> <p>Large cohort of young people unskilled unemployed and excluded</p> <p>Stigmatization of currently excluded groups [young people, migrants and other minorities]</p> <p>Youth becoming increasingly disenfranchised and engaging in high risk behaviors / rising violence</p> <p>Health issues- lack of access</p> <p>Becoming a dichotomous society [extreme fundamentalism and liberalism]</p> <p>Increased unemployment</p>	<p>Increase in food prices – rising cost of living for locals / inflation of Malé</p> <p>Vocational trainings is a must</p> <p>Unable to produce agriculture to meet local demand</p> <p>Unable to sustain the conventional fisheries sector due to unavailability of bait fish</p> <p>Economic development may slow down/ unsustainable public sector expenditure</p> <p>Breakdown of faulty construction infrastructure,</p> <p>Economic growth decline</p> <p>Poverty</p> <p>Economic diversification- no new sectors/ industries since early 1980s</p> <p>Increasing power of tourism sector – leading to widening gap in poverty</p> <p>Inflation – cost of living increasing compared to wage rates</p> <p>Limited resources/ booming population</p> <p>Economic sustainability</p> <p>No Strategic planning</p> <p>Implementing privacy laws/ protecting foreign investments</p> <p>Due to less concentration on sustainable development expect many changes, - e.g. transport</p> <p>Transportation</p> <p>High public debt</p> <p>Inequality leading</p> <p>Tourism sector not being able to sustain growth</p> <p>Uninhabited islands transformed into resorts quality due to income- widening gap</p>

POSSIBLE SOLUTIONS FOR SHORT AND LONG TERM CHALLENGES

Q3. What would you suggest as solutions for the short and long term challenges that Maldives face?

Environment	Governance
Establish waste management centers/ regional facility with proper frameworks	Educate judges
Information dissemination to be increase, people need to analyze the raw data they have	Good governance, transparent, rational governance / local governance strengthening
Getting assistance from foreign universities to improve coastal designs	Tackle corruption
Increase awareness among natives about challenges	Reliable legal system/ judiciary
Environmental awareness – conservation	Improved and truly independent/judiciary system
Conservation, water storage	Take action to prevent corruption
Develop value addition of limited resources in Maldives	Stabilize the Government
Drinking water production/ storage	Private and civil society taking responsibilities themselves
Utilizing waste heat from generator	Partnership for development [govt, pvt sector, civil society]
Hope for better healthier cleaner life	Development policies clearly established/ evidence based long-term planning
Further climate mitigation efforts , knowledge	Strengthen civil society
Better management of resources to tackle waste / energy / water issues	Strengthen governance and ensure accountability and transparency
Have strategic goal of delivering key infrastructure such as harbor, Sewerage, water, power, waste management which is not capital intensive	Public sector spending
“Seriously” take environment into policy formulation and execution	Oversight mechanisms need strengthening
Mainstream climate change (adaptation mitigation) into all development aspects	Remove conflict of interest
	Strengthening Decentralization
	Judiciary need to reform
	Youth empowerment –in policy making
	Ban and fine people who litter
	Improve participation of youth in policy formulation
	Legal framework/ laws/Regulation
	Increase State agencies and CSOs
	Peace and Freedom
	Objective media
	Politicians held accountable by citizens
	Better resource allocation- better govt policies implemented
	Government to be more benevolent
	Participatory decision making
	Political awareness

Energy	Social Issues	Economic Issues
<p>Island integration through govt for electricity</p> <p>Concession for renewable energy projects</p>	<p>Listen to marginalized citizens</p> <p>Active efforts to counter religious conservatives</p> <p>Improve inclusivity and equality [providing health services etc]</p> <p>Educate youth about how countries run without social unrest</p> <p>Incorporation of CSE in school curriculum</p> <p>Use spiritual leaders who are more moderate from a religious perspective</p> <p>Setting up youth friendly services/ health centers / drop in centers e.g. career guidance</p> <p>Fee based service delivery with 'properly tuned' service providers</p> <p>Empower women and youth to make informed decisions</p> <p>Population relocation, developmental zones, decentralized development</p> <p>Long-term investment in public health risks</p> <p>Enforce more Maldivians to work</p> <p>Work towards cooperative models in islands</p> <p>Reduce illegal expat workers</p> <p>Reform education system</p> <p>Realistic expectations</p> <p>Lifestyle changes</p>	<p>Development of islands , infrastructure investment</p> <p>Expand agri sector to include locally grown food</p> <p>Dev tourism sector as it does not go beyond carrying capacity</p> <p>Promote g/house tourism in local islands</p> <p>Widen job market</p> <p>Bring changes to the economy so that we do not depend heavily on tourism</p> <p>New economic activity need to be introduced nationwide [aquaculture]</p> <p>Investment to be increased such as in agribusiness</p> <p>Training, career guidance [schools]</p> <p>Professional and vocational training - training locals for skills</p> <p>Facilitate mariculture program (small-scale) remove barriers</p> <p>Diversify economic activities</p> <p>Need for Maldives to invest overseas – Mauritius model</p> <p>Develop infrastructure and facilities in atolls</p> <p>Empower private sector</p> <p>Establish start up accelerators , educate entrepreneurs, etc</p> <p>Secure investors- current and potential</p> <p>Strong economic policy</p> <p>Create jobs through FDIs and govt investments</p> <p>Professionalization of industries such as fisheries</p>

POLICY REFORM PRIORITIES FOR TACKLING MALDIVES' PRESENT CHALLENGES

Q4. What are in your opinion the 3 most urgent reforms that need to be implemented in the next year?

Environment	Governance
Mandatory awareness programs on environment and energy- policy	Change constitution favoring a parliamentary system to govern the nation
Solid detailed policies on waste management	Proper government appointed by people not judiciary
Environment protection agency Act [independent inst]	Give local councils more authority
Concentrate on sustainability	Good governance , justice, strengthen governance, law enforcement
Maldives economy is run on environment. Hence carry out development in a sustainable manner through a strong development tool	Reduce corruption
Take into serious consideration climate changes into all development policies to ensure Maldivian do not become climate refugees	Policy changed to reduce waste of resources at institutional level
Increase awareness on Climate change	Increase public participation in policy making process
Strengthening EIA regulation	Decentralization policy must be enhanced
Implementing coastal infrastructure guidelines	Democratic system strengthened
A system by which environmental data can be stored/ shared between public and private sector	Make judiciary more accountable trustworthy
Mainstream policies for sustainable development	Ensure citizens basic human rights
Environment Awareness	Political stability, strengthen local governance
	Stakeholder discussion and dialogue
	Strengthen local governments with funds or know-how
	Proper laws to local government
	Develop a culture of developing implementing strategic plans
	Let donors and bilaterals assist in developing such a culture
	Civil society empowerment and acceptance s equal development partner
	Stable govt for 5 year term
	Decentralization
	Policy dialogue with public
	Law on political parties
	Reform of the Judicial system
	Public policy improvement
	Ensure independence of institutions
	Government that respects rule of law
	Corruption of public officials
	Transparency in govt
	Policy reform/ enforcement

Citizen Security	Energy	Social Issues	Economic Issues
Change laws to improve the rising crime issues	Renewable energy policy, energy security	<p>Increase in salary for teachers, nurses, etc</p> <p>Provisions for gender equality within systems from systematic discrimination</p> <p>Policies to protect minorities [e.g. migrants LGBT]</p> <p>Educational reform to teach tolerance and gender sensitivity to inform on health behaviors</p> <p>Reform related to gender equality,</p> <p>Employment opportunities for youth</p> <p>Public health reform [as advocates for positive health growth]</p> <p>Training opportunity to be established in local community</p> <p>Targeting social security schemes to target needy</p> <p>Gender equality and social protection for vulnerable groups</p> <p>Education and health for vulnerable groups</p> <p>Higher education loans</p> <p>Improve public health awareness</p> <p>More relevant Youth Bill</p> <p>Priorities basic necessities of community</p> <p>Reforming education system - implementing civic education, reproductive health, etc</p>	<p>Economic reform for tourism</p> <p>Tourism law need to be revised 80% Maldivian employees and proper monitoring</p> <p>New activity need to get tax exemption</p> <p>Easier access to infrastructure loans</p> <p>Strict policies for protection of natural resources</p> <p>Strategies should be implanted to reduce poverty</p> <p>Improve education system</p> <p>Urban regeneration- this term never used in Maldives so far</p> <p>Decentralization of industrial activities</p> <p>Invest overseas to help Maldives to expand its strengths - seaplane, tourism, fisheries</p> <p>Educating the public regarding risks</p> <p>Control on real estate prices</p> <p>Minimum wage policy</p> <p>Develop up with global policies that help us reach global markets</p> <p>Try to meet public expectations</p> <p>Certification process of workers through trainings e.g. fisheries and others</p> <p>More opportunities for cooperative through govt policies</p> <p>Resources management laws and regulations</p> <p>Strategies to reduce cost of living</p> <p>Tax system improving</p> <p>Targeted subsidies</p> <p>High revenue from tourism industry</p> <p>Proper tax system – better income source</p>

POLICY REFORM PRIORITIES FOR TACKLING MALDIVES' FUTURE CHALLENGES

Q5. What are in your opinion the most important reforms that need to be implemented in the next 10 years?

Environment	Governance
Drinking water guidelines and policy for tourist resorts/ country	Corruption free , enforce proper laws
Access to clean water/ pollution control	Freedom of media
Education policy to emphasize on sustainability/ environment/ efficiency	Strengthening local governance
Mainstream climate change – in strategic development planning, prepare and plan for climate change challenges	Justice Reform
Strategic plan with long term goals/ integrate environment into planning	Clear policies detached from political influence
Implement natural resource management	Judicial reform
Implement sustainable development framework in fisheries and tourism sector	Separation of powers
Environmental protection in islands	Meaningful engagement of public in decision making
	Decentralization/ funds and know-how
	More development opportunities in the islands / decentralized -More effective population consolidation
	Create empowered institutions
	Pressure the institutions to develop regulation
	Whole judiciary system reform / capacity building
	Making institutions strong
	Accountability
	Better governance
	Stable govt/ political system

Energy	Citizen Security	Social Issues	Economic Issues
Policy that encourages renewable energy Efficiency in energy use	Change laws to improve crime issues Peace/ safety	Strengthen policy, social security system A Law that enables minimize number of inhabited islands Education reform Accessing labor market needs to build a more skilled youth Policy for mental health and wellbeing Policy for aging population Employment law revision To have training centers nationwide Mental health issues Youth friendly program development Increase jobs for youth Lifestyle change of youth/awareness Public health Education	Plan for spatial development Concentrate on developing few islands Improving and overcoming current issues in the industries Income distribution to be more equal Diversification of economy Growth of fisheries sector Decentralization development should be encouraged Foreign currency- debt Develop domestic industries esp fishing and agriculture Develop cities – south, north and middle of Maldives

ANNEX 3. CHALLENGES IN THE FINANCIAL SECTOR

	Shortcomings	Impact
Legal framework	<p>Legal framework reduces the ability of banks to foreclose collateral on defaulted loans¹.</p> <p>Lack of standard rules for application of Shariah law brings additional complexities in resolution of defaulted loans.</p> <p>Current rules on filing of cases of mortgage and property-backed loan defaults and property rights have made borrowing from banks more onerous.</p>	<p>Lack of clarity and certainty on application of laws translates into lengthy and costly legal processes. This enhances the risk aversion of lenders, which, increases the collateralization requirements. Losses stemming from these deficiencies are passed on new clients in the form of higher interest rate.</p>
Credit infrastructure	<p>The credit registry in the country has a very limited coverage (17.3 percent of adult population). Important data stemming from retailers or utility companies is not included in the registry.</p> <p>Banks are required to produce the collateral in the location where the case is heard. There are no electronic collateral registries where the existence of the collaterals can be verified or offered as proof.</p> <p>Many remote islands remain cut off from financial services due to the economic unviability of establishing bank branches in all populated islands. The wide telecoms coverage has not been exploited as conduit for other delivery mechanisms such as mobile banking.</p>	<p>The limited coverage of credit registries severely limits the ability of banks to identify borrowers with good and bad credit record, which leads to higher risk aversion, lower credit and higher interest rates.</p> <p>The lack of electronic collateral registries together with the need to produce collateral on the location where the case is heard reduce the willingness of banks to lend outside of Malé.</p> <p>Financial inclusion of population in remote islands can be quite limited, resulting in high transaction costs, highly limited financing opportunities, and lack of security in safekeeping of people's savings.</p>
Non-bank financial institutions	<p>The legal framework protecting the property of leasing companies has been undermined by recent court rulings².</p> <p>Tax advantages³ on leasing commonly present in other countries are missing in Maldives.</p> <p>Factoring is underdeveloped as a financial service even though anecdotal evidence suggests that SMEs sell a vast amount of products and services on credit and face long lead times to receive payment.</p> <p>Even though there is basic infrastructure in place for capital markets, their volume of operations remain very limited.</p>	<p>The role of the judiciary in the leasing sector has created a loss of confidence on the viability of leasing, thereby drastically reducing the pace of growth in this financial service⁴.</p> <p>The lack of reasonable tax advantages reduces the attractiveness of leasing for enterprises.</p> <p>SMEs in Maldives reportedly struggle to obtain working capital financing while having vast large stocks of accounts receivable. Lack of an active factoring reduces SMEs' ability to make productive use of those assets as collateral.</p> <p>The lack of a liquid capital market may reduce the local financing for larger investments. However the lack of a critical mass of potentially qualifying issuers and institutional investors pose major challenges on the potential viability of capital markets in Maldives. Political risk considerations may undermine the ability of capital markets to attract foreign investors.</p>

[Footnotes]

- 1 According to banks interviewed, loans backed by properties take up to 10 years for settlement in case of default.
- 2 Courts ruled in two cases against MFLC, the largest leasing company denying access to enforce claims on the leased assets, against the basic principle of leasing, which is based on the ownership of the asset by the leasing company and usually provides for an expedite repossession of the asset in case of default.
- 3 Leasing has potential favorable tax treatment over a purchase of equipment. In a true lease, many jurisdictions allow the deduction of the entire amount of the monthly payment as an operating expense. This often results into a more favorable tax treatment for investment over the common depreciation of equipment in purchases.
- 4 Operations of MFLC, the largest leasing company in Maldives reduced sharply following the negative ruling on their ability to enforce claims on leased assets. It is estimated that following the ruling the company's leasing portfolio decreased by 21 percent, its borrowing by 38 percent, and its net worth by 18 percent. Management is using its cash to pay off debt and declare dividends rather than for funding new leases. Its management is now limiting new leasing primarily to repeat customers with whom it has been able to sign standard contractual end of term asset transfer options that will reduce risks of loss on the lease contracts.



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