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INTERNATIONAL FINANCE CORPORATION

AND

MULTILATERAL INVESTMENT GUARANTEE AGENCY

INTERIM STRATEGY NOTE

FOR

THE REPUBLIC OF MALDIVES

FOR THE PERIOD FY14-FY16

May 15, 2014

**Sri Lanka and Maldives Country Management Unit
South Asia Region**

**The International Finance Corporation
South Asia Department**

**Multilateral Investment Guarantee Agency
Asia and the Pacific Region**

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The last Country Assistance Strategy was discussed by the Board on January 8, 2008.

Currency & Equivalents

Currency Unit = Maldives rufiyaa (MVR)

US\$ 1= 15.33 MVR

(as of April 24, 2014)

Fiscal Year

January 1 – December 31

Abbreviations and Acronyms

AAA	Analytical and Advisory Activities	IMF	International Monetary Fund
ADB	Asian Development Bank	IsDB	Islamic Development Bank
ASPIRE	Accelerating Sustainable Private Investments in Renewable Energy	ISN	Interim Strategy Note
BoP	Balance of Payments	IWMC	Island Waste Management Center
CAS	Country Assistance Strategy	MDG	Millennium Development Goal
CCTF	Climate Change Trust Fund	MIGA	Multilateral Investment Guarantee Agency
CPF	Country Partnership Framework	MPAO	Maldives Pension Administration Office
DSA	Debt Sustainability Analysis	PEFA	Public Expenditure and Financial Accountability
EU	European Union	PFM	Public Financial Management
FY	Fiscal Year	PPP	Public Private Partnerships
GCE O/L	General Certificate of Education Ordinary Level	SCD	Systematic Country Diagnostic
GDP	Gross Domestic Product	SDR	Special Drawing Rights
GoM	Government of Maldives	SME	Small and Medium-sized Enterprise
HDFC	Housing Development Finance Corporation Project	SOE	State-owned Enterprise
IDA	International Development Association	SREP	Scaling-Up Renewable Energy Program
IDF	Industrial Development and Finance	WBG	World Bank Group
IFC	International Finance Corporation		

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REPUBLIC OF MALDIVES
INTERIM STRATEGY NOTE

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I. INTRODUCTION AND RATIONALE

1. **Maldives is in the sixth year of a complex political transition to a multi-party democracy.** Its development agenda has been ambitious, working to cement newly established democratic institutions and taking a leading role in international efforts on climate change. Implementation of this agenda has taken place within the context of a challenging macro-fiscal situation which started deteriorating with the Asian Tsunami of 2004 and was exacerbated by the food and fuel crisis of 2007-08 and the subsequent global financial crisis of 2009. As Maldives is a small, tourism-based, open economy, importing almost the entirety of its food and fuel needs, these external shocks were deeply felt in the country.

2. **The political environment has been volatile.** In 2008, the country adopted a new Constitution. Following highly contested Presidential and Parliamentary elections, Mohamed Nasheed was elected as President while political parties from the opposition obtained a majority in Parliament. Elections involving multiple rounds eventually led to the election of Abdulla Yameen as President in November 2013. Local elections were held in January 2014, followed by Parliamentary elections on March 22 which resulted in the victory of a Government majority coalition. Each set of elections has demonstrated high levels of contestation and sharp division among the country's political parties.

3. **Maldives' macroeconomic environment is significantly distressed, limiting prospects for a medium-term engagement strategy.** Maldives entered the global economic crisis of 2008-2009 in a weak macroeconomic position. At the onset of the crisis, the Government's expenditure patterns proved unsustainable as tourism-related revenues declined sharply. The European debt crisis added to these challenges. Public debt has increased significantly in recent years, and the country is deemed at high risk of debt distress.¹ Substantial fiscal and external imbalances remain, with high fiscal deficits continuing to threaten macroeconomic sustainability and public service delivery. The Government, which has not engaged in a program with the International Monetary Fund (IMF) since 2009, plans to develop a medium-term development strategy in the coming months to address some of the challenges facing the country.

4. **In this context, the FY14 - FY16 World Bank Group Interim Strategy Note (ISN) sets out a selective program to support Maldives during this period of uncertainty and transition** and lay the foundations for the resumption of a full country program. In light of the macroeconomic challenges facing Maldives and drawing on lessons learned from the FY08-FY12 Country Assistance Strategy (CAS), the WBG engagement during this transitional period will aim primarily to deepen dialogue and support on macro-fiscal issues while strengthening the analytical foundations which would underpin a future program. At the onset of the ISN, two new lending operations currently under preparation are planned to be delivered to meet some of the country's most pressing needs in the areas of public financial management (PFM) and renewable energy, while selected results will also be sought through continued implementation of ongoing successful interventions. International Finance Corporation (IFC) will selectively invest in priority sectors during this period. Given the uncertainty of the environment, the WBG

¹ Joint Bank-Fund Debt Sustainability Analysis (DSA), January 2013

engagement will be managed flexibly to respond to evolving Government needs and priorities. While the ISN is planned to span over a 24-month period, the preparation of the next Country Partnership Framework could be brought forward if opportunities emerge to support a full-fledged medium-term government program for macroeconomic stability and sustainable growth.

II. COUNTRY CONTEXT AND KEY DEVELOPMENT CHALLENGES

5. **Maldives consists of 1,192 small tropical islands of which 190 are inhabited, 105 are self-contained tourist resorts and 21 are used for commercial activities.** Maldives territory is crossing strategic shipping routes and the marine environment is richly diverse. With more territorial sea than land, marine resources have played a vital role shaping the contours of economic development, with nature-based tourism and fishing being key drivers of economic growth. Until recently², Maldives has been a development success story. In the early 1980s it was one of the world's twenty poorest countries with a population of 156,000. Today, with a population of 326,000, it is a middle-income country with a per capita income of over of US\$7,177.³ Real Gross Domestic Product (GDP) growth, while volatile in step with the fortunes of the tourism industry, has averaged nearly 7 percent since 2000. The sustained growth and rising prosperity of the last three decades was founded on a private sector-led tourism industry based upon the country's extraordinary natural assets. Tourism directly and indirectly accounts for about 75 percent of economic activity in the country.

A. Poverty and Social Indicators

6. **Poverty in Maldives has declined over time, but with varying experiences between Male and the atolls** (Table 1). Poverty rates, as measured by the headcount ratio and Government statistics, fell steeply from 40 percent in 1997 to 28 percent in 2004⁴. Based on a poverty line of US\$1.25 per person per day, the overall incidence of poverty further declined from 9 percent to 8 percent between 2003 and 2010. This poverty reduction was mainly driven by improvements in living conditions in the atolls, with the poverty rates falling in the atolls from 12 percent in 2003 to 8 percent in 2010. However, in Male, the capital city, the poverty rate rose from 2 percent in 2003 to 7 percent in 2010 over the same period. Using the higher poverty line of US\$2 per day, the overall incidence of poverty fell from 31 percent in 2003 to 24 percent in 2010. In the atolls the poverty rates declined steeply from 39 percent in 2003 to 27 percent in 2010, but the incidence of poverty increased significantly in Male, from 9 percent to 19 percent over the same period. The poverty decline in the atolls thus appears to be caused mainly by an increase in internal migration, with relatively poorer people from the atolls moving to Male to seek employment opportunities and better access to services. Further work is required to understand the determinants of poverty.

² Until the Asian Tsunami in late 2004.

³ GNI (Atlas) per capita, 2013, World Bank.

⁴ The GoM reports these poverty rates based on a poverty line of MVR 15 per day, which is equivalent to US\$1.17 using the nominal exchange rate, or US\$3.45 in purchasing power parity terms.

Table 1 - Evolution of Poverty Headcount Ratios

Headcount ratio for Republic, Male' and Atolls-2002/03 and 2009/10.						
Relative Poverty Lines	Republic		Male'		Atolls	
	2003	2010	2003	2010	2003	2010
International poverty line of US \$ 1.25 (\$1-a-day poverty line used in MDGs)	9%	8%	2%	7%	12%	8%
International poverty line of US \$ 2	31%	24%	9%	19%	39%	27%
Rf. 44 (Median of Atoll expenditure per person per day for HIES 2009/10)	66%	51%	40%	44%	75%	55%
Rf. 22 (Half the Median of Atoll expenditure per person per day for HIES 2009/10)	21%	15%	4%	12%	27%	16%
Gini Coefficient	0.41	0.37	0.35	0.38	0.40	0.36

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

7. **Maldives is seeking to promote economic prosperity and accelerate human development.** The country ranked 104th in the Human Development Index (HDI) for 2012, which is low for its level of income. The improvement of human capital will be of vital importance to the future progress of Maldives. Key human development indicators, such as infant mortality, maternal mortality and educational attainment, have registered improvements. The country is on track to meet most of the Millennium Development Goals (MDGs), and has already met the MDGs on eradicating extreme poverty and hunger, achieving universal primary education, reducing child mortality, improving maternal health, and combating Human Immunodeficiency Virus infection/Acquired Immunodeficiency Syndrome (HIV/AIDS), malaria and other diseases.⁵

8. **Efforts on promoting gender equality and empowering women, as well as ensuring environmental sustainability and effective adaptation to climate change will need to be sustained to reach these MDGs.** While Maldives' global ranking on gender equality has improved⁶, boosted by an increase in the primary education ratio, higher female enrollment in tertiary education and an increase in the percentage of women holding ministerial positions (which rose from 7 percent in 2011 to 21 percent in 2012), gender gaps persist. Women remain under-represented in local and national government, particularly in policy making positions. In 2010, 55 percent of women over 15 were found to be participating in the labor force, as compared to 76 percent of men over 15. Opportunities for women to work outside the home are limited. Lack of access to resources and isolation continue to deter women's participation in the economy. Women also continue to face legal obstacles in terms of property rights, inheritance and access to legal services. The share of female-headed households in Maldives is amongst the highest in the world.

⁵ Millennium Development Goals – Maldives Country Report 2007, Government of Maldives.

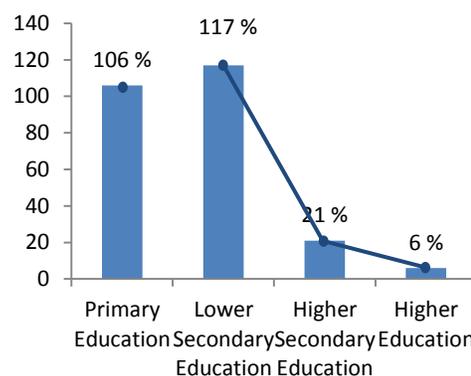
⁶ Maldives ranked 52nd out of 146 countries in the 2011 UN Gender Inequality Index, higher than Sri Lanka (74) and Bangladesh (112).

9. Maldives has performed well in providing access to primary and lower secondary education, but lags sharply behind in education attainment at the upper secondary level.

While the gross primary and lower secondary enrollment rates have reached 106 percent and 117 percent respectively, net rates are much lower which indicates that there is considerable grade repetition. Furthermore, higher secondary gross enrollment is only about 21 percent, which 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 84 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, with only 4 schools in the entire country providing higher secondary education. The Government has now expanded this number to 37 schools: 3 schools in Male and 34 schools in the atolls. Many of these schools, however, are overcrowded and congested and require more facilities and equipment, leadership and management strengthening, and teacher development.

Higher education participation is also low for a middle-income country. The gross higher education enrollment rate is only 6 percent. The main reasons for the low enrollment in higher education are: (a) the small flow of students completing higher secondary education and moving onto higher education; and (b) limited provision of higher education in the country. There is one public university, the Maldives' National University (MNU), and about 7 private education institutions. However, over 95 percent of enrollment in these private education institutions is in pre-degree level diploma and certificate programs.

Figure 1 - Gross Enrollment Rates



Source: Ministry of Education statistics.

10. In recent years, Maldives has witnessed major changes in the way in which health services are financed in the country, but fiscal sustainability is an issue. One of the most significant changes was the introduction of Aasandha, a universal health insurance program, on January 1, 2012. The scope of Aasandha benefits is comprehensive, covering most inpatient and outpatient treatment including drugs and diagnostics. Its main challenge, however, is fiscal sustainability. The analysis of expenditure data from the Household Income and Expenditure Survey (HIES) reveals a 42 percent increase in the real health per capita expenditure over the period 2003/04 to 2009/10. This increase in per capita expenditure occurred before the introduction of Aasandha and right at the onset of its predecessor, Madhana. More recently, the announcement of unlimited health insurance will further escalate health costs, while cost effective primary care investments are on the decline. Measures to contain the total health expenditure and to improve financial protection of households against health episodes are the twin policy objectives that face the Maldives' policymakers. This also creates a strong case for system-wide reform in the health sector, rather than piecemeal, short-term solutions. The recent history of a runaway rise in the country's total health expenditure — both government and household — continues to face the risk of further exacerbation by a health insurance program that does not make adequate efforts toward cost containment. Focus on adequate financial protection for the households, especially in the atolls (where health expenditure has risen steeply as a share of the household's total expenditure) needs to be coupled with innovative purchasing of health services and improving the cost efficiency of the health system.

11. **Maldives faces major fiscal challenges arising from the pension system.** Following the introduction of mandatory retirement for civil servants in 2008, and in anticipation that it would take time to build new systems of retirement benefit provisions under the new pension law, the Civil Service Commission introduced a transitional benefit approximating in nature the old defined benefit provisions. It was expected that the temporary norms would be in place until the new pension scheme is fully functional. However, these norms have never been phased out and continue to operate on top of the new pension provisions, resulting in duplication of retirement benefit and excessive costs to the budget since 2010. Additionally, Maldives was ranked as one of the highest in terms of benefit level of non-contributory pension relative to income level in 2012, higher than most developing and developed countries with universal social pension to elder citizens. The recent increase in the benefit level from the current level of Rufiyaa 2300 per month to Rufiyaa 5000 would double the government expenditure on the scheme, from around 1.1 percent of GDP in 2013 to around 2.3 percent in 2014. Moreover, if the Government implements its promise to further increase this pension benefit, the expenditures under scheme will reach over 3 percent of GDP. These increases in benefits are paid out of general government expenditures (with only a small portion paid out of contributions) and contribute substantially to the Government's deficit.

B. Recent Economic Developments

12. **Economic growth has been sustained, albeit at a slower pace.** Annual GDP growth moderated to 3.4 percent and 3.7 percent respectively in 2012 and 2013. The growth outlook is positive at an estimated 4.5 percent for 2014. The tourism sector has taken a hit from weaker demand from Europe, the country's largest market, but demand is slowly picking up as Maldives has been able to diversify into the Chinese market. As a result, tourist arrivals grew by 17.4 percent in 2013.

13. **External and fiscal imbalances have increased substantially and Maldives is at high risk of debt distress.**⁷ The overall fiscal deficit rose from 11.3 percent of GDP in 2011 to 13.5 percent in 2012 and closed 2013 at about 9.8 percent, excluding arrears. Public debt escalated sharply, rising from 58 percent in 2009 to 86 percent in 2013. On the external front, the current account deficit reached 20.5 percent of GDP in 2013. Total external debt also increased, reaching 98 percent of GDP in 2013 (compared to 58 percent in 2010), equivalent to 107 percent of domestic goods and non-factor services exports.⁸

14. **The underlying imbalance in the Maldives' macroeconomic framework is that the country is spending beyond its means.** This is evident from expenditure trends over the past three years that show an increasing gap between revenues and expenditures, financed by unsustainable levels of public debt. In 2013, total expenditures were above 42 percent of GDP, while total revenue and grants stood at above 32 percent of GDP (the highest in the region and close to the Organization for Economic Co-operation and Development country averages. In Maldives, with many of the islands having less than 1,000 inhabitants, high fixed costs can be expected and some of the high cost of public service delivery is unavoidable. However, increases in public spending have been driven primarily by higher-than-budgeted expenditures on the wage

⁷ The WB-IMF DSA, 2013

⁸ The WB-IMF DSA, 2013

bill (15.8 percent of GDP), universal subsidies (including food and electricity subsidies), social welfare payments (linked to pensions and to the universal health insurance scheme), transfers to state-owned enterprises (SOEs) and capital spending in the outer atolls. In this context, management of the constrained cash flow has become a burgeoning challenge. The Government has resorted largely to extraordinary means of deficit financing, including building up arrears, monetization and ad hoc borrowings from the banking and private sectors at high interest rates. While the 2013 budget introduced a host of measures to curtail expenditures and increase revenues, their impact has been limited in the absence of clear policies to ensure their implementation. Arrears, at an estimated three percent of GDP, pose a significant fiscal risk⁹.

15. Loose fiscal policy has made macroeconomic management difficult, putting pressure on the balance of payments (BoP) and external reserves. While the impact of high public spending and deficit monetization on prices has been contained – inflation moderated to 4 percent at end 2013¹⁰ as commodity prices eased and the effects of previous tax increases elapsed – pressures on the balance of payment and the exchange rate have increased. Maldives follows a pegged exchange rate regime with a horizontal band of 20 percent on either side of a central parity at 15.4 MVR per US dollar. The Government’s rationing of forex has resulted in a parallel dollar market, where the premium has reached 10 to 15 percent.¹¹ As the parallel market contributed to meet some of the demand for dollars, reserves have held up better than expected. As of end 2013, gross reserves stood at US\$344.7 million or around 2.3 months of imports. Usable reserves¹² were critically low at around US\$100 million, or three weeks of imports.¹³

16. Macroeconomic imbalances are putting stress on the banking system, which is confronted with increasing exposure to sovereign risk. High budget deficits have led to dramatic public sector credit expansion.¹⁴ In the absence of an effective non-banking sector, much of the domestic financing requirement has fallen on the banking sector. This has been crowding out credit to the private sector and putting the banks’ balance sheets at risk. Banks have also been reluctant to extend credit to the private sector because of rising non-performing loans (NPLs), which in 2013 stood at 18 percent. Foreign exchange rationing is also exposing banks to dollar liquidity shocks. These stresses are compounded by the banks’ high exposure to the tourism sector, a concentration of loans on a few borrowers, and limited financing options (e.g., lines of credit, parent financing). Consequently, financial sector risks have been rising.

⁹ There is no monitoring of arrears in Maldives. While the Ministry of Finance estimates arrears at 3 percent, the World Bank estimate is 6 percent or higher according to Maldives Development Update, October 2013.

¹⁰ The fact that inflation has been subdued in an environment where a share of the deficit is financed through monetization is explained, to some extent, by the high level of arrears, which has contained the impact on prices. Also, during the year the nominal value of the Maldivian Rufiyaa remained stable against the currencies of its major trading partners, and this in turn helped curtail inflation at a manageable level.

¹¹ IMF Article IV 2013.

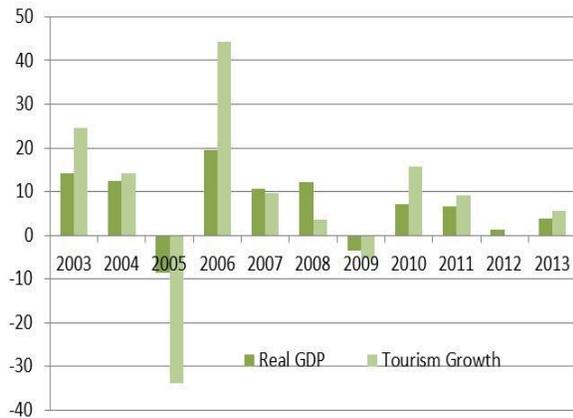
¹² IMF and Staff estimates.

¹³ The national accounts are underestimating flows and growth because the tourism industry works as an enclave, with tourism receipts mostly outside the formal Maldivian economy. There is also an inflow of dollars into the economy in the form of cash and outside the formal banking system, which cannot be quantified and which does not appear in the BoP numbers.

¹⁴ Commercial banks account for about 50 percent of the current T-bills outstanding portfolio.

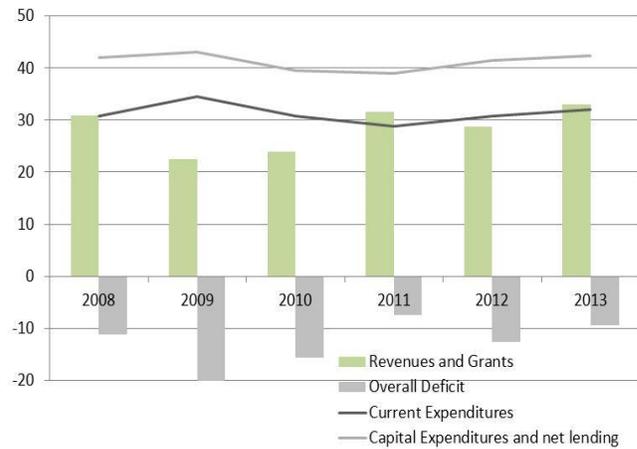
Growth moderated and is slowly picking up.

Figure 2
Growth and Tourism Growth



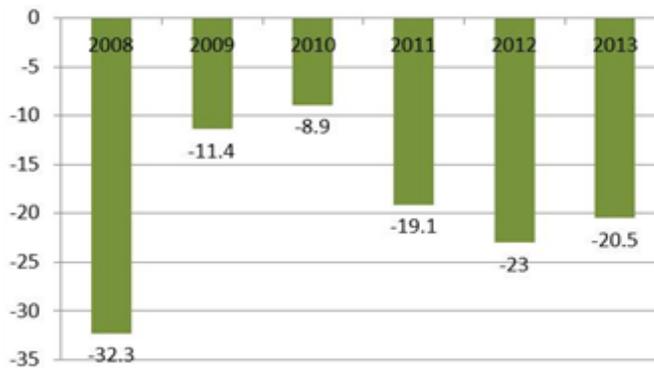
High spending is leading to high deficits...

Figure 3
Revenues and Expenditures (percent of GDP)



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

Figure 4
Current Account Balance (percent of GDP)



Reserves remain critically low.

Figure 5
Reserves (US\$m)



C. Economic Outlook

17. **Going forward, the growth outlook is positive.** GDP growth is projected to reach 4.5 percent in 2014, driven by a robust increase in tourist arrivals. This strong performance is expected to have some positive impact on the non-tourism sectors, including construction,

communications, and fisheries, which are expected to remain dynamic and contribute positively to the economy.

18. **Macro-stability will however continue to be threatened by loose fiscal policy, with increasing fiscal and balance of payments (BoP) pressures and rising risks of debt distress.** Recent measures to increase pensions and health benefits will add further to spending pressures in 2014. In this context, the overall fiscal deficit is projected to remain above 12 percent of GDP over the next two to three years. Financing is expected to become more challenging going forward. Continued reliance on costly short-term commercial borrowing from the banking and private sector, monetization of the deficit, and build-up of payment arrears will fuel further fiscal pressures and weigh on the financial and real sectors. Public debt is expected to escalate further to 96 percent of GDP in 2015. Much stronger and concerted (albeit painful) fiscal consolidation measures would be needed to bring the fiscal and debt situation back to sustainability.

19. **The balance of payments and the external financing gap remain of particular concern and threaten exchange rate and price stability.** In the absence of decisive fiscal consolidation efforts, BoP pressures emanating from high fiscal deficits and recourse to monetary financing are expected to increase. Maldives' external current account deficit is projected to remain high over the next couple of years, at around 25 percent of GDP, particularly given the economy's strong dependence on imports. In the absence of viable external financing flows, large current account deficits are likely to translate into a high overall BoP deficit. High public spending and heavy reliance on imports will continue to pressure the Maldivian rufiyaa. With low gross reserves, the Maldives Monetary Authority (Central Bank) has limited room for maneuver. Furthermore, pressures on the exchange rate could be exacerbated if the Government is found to be liable to pay compensation in connection to the reversal of the GMR Infrastructure Limited (GMR, India) airport concession,¹⁵ in which IFC played an advisory role. Given the country's high dependence on fuel and food imports, a sharp devaluation would likely impact domestic prices and would have an adverse impact on poverty.

D. Development Challenges

20. **Maldives has successfully built on its extraordinary natural assets to promote growth and development, but, as a small, multi-island, open economy, the country faces a number of inter-related structural and policy challenges.** Structural challenges are linked to Maldives' small scale, lack of economic diversification, scattered population and high vulnerability to economic and climatic shocks. Furthermore, the country has followed a dualistic development pattern, centered on resort-based tourism as the main source of growth and foreign exchange, but with heavy reliance on skilled foreign labor and imported supplies, and limited backward and forward linkages with the non-tourism sectors. In parallel, the population benefits from generous social spending and across-the-board subsidies and transfers, which, despite the

¹⁵ **PPP Advisory for Male International Airport concession:** With IFC's transaction advisory service to the then GoM, the airport concession was awarded to a consortium of GMR and Malaysia Airports Holdings Berhad (MAHB, Malaysia). However, after the change in presidency in February 2012, the new government announced its opposition to the project and in December 2012 declared the agreement with GMR-MAHB void from its outset. Arbitration proceedings are ongoing in Singapore between GMR-MAHB and the GoM.

high level of revenue collection in the country, have become a significant challenge to fiscal and debt sustainability.

Macroeconomic instability

21. **Unsustainable public spending, escalating debt and high external vulnerabilities represent an immediate and significant development challenge for Maldives, and pose a substantial risk to the country's economic outlook.** Compounded with the general level of policy uncertainty, these factors are negatively affecting private sector investment and growth prospects. The serious cash flow constraint faced by the Government has also severely compromised development expenditures. Furthermore, despite its vulnerability to external shocks, Maldives lacks adequate buffers in a context of high debt, limited fiscal space and depleted reserves.

22. **Weaknesses in the public financial management system and debt management add to the fiscal risks.** While the Government has made progress in those areas, the reform agenda remains largely unfinished. These weaknesses undermine the Government's capacity to undertake necessary fiscal adjustments in an efficient manner. The Public Expenditure and Financial Accountability (PEFA) assessment carried out by the IMF jointly with the World Bank and the Government of Maldives in early 2014 underscores the need for significant improvements in the country's PFM systems, namely in the broad PFM areas of budget credibility, predictability and control in budget execution and accounting, recording, and reporting. For example, the existing control environment is insufficient to ensure effective control of the fiscal aggregates. As a result, the Government of Maldives (GoM) lacks a clear accounting of arrears or, in the case of SOEs, of total disbursements. PFM support will also include assistance for Government procurement practices, monitoring and oversight, which can be an important way to improve value for money in Government spending. Additionally, a comprehensive legislative framework and robust organizational structures for PFM institutions — two key pillars for creating an enabling PFM environment — are still lacking in the country. State oversight of SOEs is particularly problematic insofar as there is no systematic financial reporting, auditing, or accounting for *de facto* transfers made under several budget categories.

23. **The path towards fiscal and debt sustainability in Maldives will require short-term measures to address the current cash crunch, as well as long-term structural measures** that are important but will face major trade-offs which would entail political and social implications. An array of measures could be combined in a policy package accompanied with a communication strategy to sensitize the public on the need to adopt and implement these reforms. The timing of these measures is important. If expenditure cuts are delayed, resources will become even scarcer and the type of adjustment required later would be even more costly.

Costly public service provision

24. **Cost effective and quality service delivery is a structural challenge in small island nations, but the democratic transition has added another level of complexity in Maldives.** Maldives is geographically dispersed. Male, with around 2.5 sq. km of total land area, has over a quarter of the entire population, while approximately 71 percent of the rest of the 200 inhabited islands have less than 1,000 inhabitants. As a consequence, Maldives faces high unit costs of

infrastructure and other public service provision. Enshrined in the new Constitution is the requirement to decentralize public services to the inhabited islands. Access to public services is defined as a constitutional right. Without careful planning, ambitious decentralization plans risk lowering the quality of service delivery, while raising the costs of provision. This is particularly relevant in the provision of health and education services where it is difficult to provide a consistent level of quality on all islands in a fiscally sustainable manner.

Human capital shortages and youth unemployment

25. **The quality of education at all levels is a major development challenge facing Maldives.** Learning outcomes in primary and secondary education are low. The average scores for English at grades 4 and 7 are merely 32 percent and 29 percent respectively, and the average scores for mathematics are only 39 percent and 30 percent at the same grades. There are also substantial regional disparities. Learning outcomes are considerably higher in Male 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 result in poor performance of students at national examinations: for instance, at the General Certificate of Examinations Ordinary Level (GCE O/L) only about 40 percent students pass in five subjects, while just 19 percent students pass in eight subjects.

26. **Due to the lack of well-educated Maldivians, the country faces a severe shortage of qualified personnel** for technical, and middle and senior management jobs. It is estimated that there are currently over 100,000 expatriate workers in the country. These include expatriates working in senior management positions in tourism, as well as banking, finance, trade and shipping. In addition, Maldives faces the challenge of producing human capital with the skills and competencies needed for a small multi-island nation to operate in the modern global economy. Employers in the country require high levels of “soft skills” from employees. The soft skills of Maldivian workers are considered inadequate by employers serving modern markets, especially in tourism, but also in areas such as banking, insurance, financial services, management, trade and marketing. Innovative, cost effective approaches for equipping graduates with the managerial, technical and soft skills necessary to sustain inclusive economic growth and be globally competitive will be critically needed to achieve the Government’s goals.

27. **Youth unemployment is high.** An estimated 32 percent of youth aged 20-24 years are neither participating in education nor working. Labor market programs are not effectively promoting the employability of the youth, who constitute over 60 percent of Maldives’ population. Rising youth unemployment is contributing to other social ills such as drug abuse and gang-related violence. Lack of employable skills and quality technical/vocational training opportunities pose constraints on some youth to lead a productive life.

Energy dependency

28. **The complete reliance on fossil fuels for electricity generation places a significant economic burden on the national economy, especially in the context of fragmentation of generation in the absence of a grid.** Imports of fossil fuels currently cost Maldives more than 20 percent of its GDP, annually. Furthermore, due to the high costs of domestic electricity production and distribution – the highest in the South Asia region – the country has a long

history of subsidized energy prices. These universal subsidies represent a fiscally significant burden, and improving their equity and financial sustainability is high on the Government's agenda. Overall, greater independence from carbon-based fuels, if achieved through energy efficiency improvements and use of indigenous renewable energy resources, would both provide energy security and avoid the costly imports of fossil fuels. In a demonstration of international leadership on climate action, Maldives in 2009 declared a policy commitment to become the world's first carbon neutral country by 2020.

Limited water resources

29. **Water resource management and the provision of water and sanitation services are expensive and complex.** Changing environmental conditions and urbanizing populations are placing even more pressure on the sector. Increasing salinity of island freshwater and pollution of aquifers by human waste have reduced use of historically important groundwater as a potable water source in the islands. The low-lying land areas of Maldives make it particularly vulnerable to rising sea levels with associated saltwater intrusion and flooding problems. Household groundwater is contaminated in most of the islands and is not suitable for drinking. In addition, limited rainwater harvesting capacity, the high cost of desalination, and financial and institutional capacity constraints have made progress in improving water management in the inhabited islands difficult. Management of the limited water resources is further complicated due to the small catchment areas for rainfall, limited rainwater and groundwater storage capacity, long dry seasons and high costs of transporting water to the outer islands during the dry seasons, and the susceptibility of groundwater aquifers to pollution from poor sanitation.

Environmental sustainability

30. **Environmental sustainability remains an important development challenge.** Environment based sectors contribute over 70 percent of national employment, over half of public revenues, almost the entirety of exports and close to 80 percent of GDP.¹⁶ Environmental pressures stem from the country's fragile geography, compounded by rising population densities, increased tourism and changing consumption patterns. Maldives faces growing problems with solid waste management and pollution from sewage and other effluents emanating from urban settlements, hotels, fish-processing plants, ships and other sources. 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. Habitat degradation threatens marine assets. Coral mining for construction and dredging of lagoons for reclamation are the most prevalent causes of reef destruction. Other pressures include damage caused by divers, illegal collection of corals and unsustainable exploitation of high-value reef resources. Terrestrial threats include timber harvesting and destruction of mangroves, while pollutants from numerous sources lead to coral reef damage. These environmental challenges could hamper the country's economic growth especially if they undermine tourism. From an economic growth and development standpoint, the management of the country's natural resources and complex ecosystems will continue to determine the country's comparative advantage and growth prospects into the future.

¹⁶ Millennium Development Goals, Maldives Country Report 2010. Ministry of Finance and Treasury.

31. **Maldives is one of the countries in the world which are most vulnerable countries to climate change, particularly with regard to rising sea levels.** The Maldivian islands are regularly exposed to multiple natural hazards. Its unique geography makes this archipelagic small-islands nation particularly vulnerable to projected adverse consequences of climate change, including sea-level rise, as well as increases in sea surface temperature, ocean acidification and frequency/intensity of droughts and storms. For example, sea levels are projected to rise within the range of 10 to 100 centimeters by year 2100, threatening submergence of the entire country in the worst-case scenario. Extreme rainfall events are likely to occur at twice the current frequency by 2050. Higher ocean temperatures increase the rate of coral bleaching and increase the risk of massive coral die-off during the local ocean temperature spikes that occur during El Niño events.¹⁷

Political transition and institutional building

32. **The democratic transition has meant a change in the institutional landscape of the country.** The new constitution of 2008 instituted separation of powers with strong safeguards of independence for Parliament and for the judiciary, set up independent institutions, commissions and elected local councils, and guaranteed a set of fundamental rights and freedoms to the people for the first time in the history of Maldives. While these institutions, including the independent Supreme Court, the independent Civil Services Commission, the Auditor General's Office and others provide the people of Maldives voice accountability and a participatory form of governance, they are proving more difficult and costly than anticipated to function effectively. Establishing their extent of authority and responsibility has been an ongoing and at times contentious process. There have been numerous instances of institutional conflicts involving branches of government as well as the independent commissions. This institutional set-up combined with strong political competition has at times undermined the effectiveness of the State and affected policy making and implementation.

33. **Capacity constraints are also affecting the effectiveness of the State.** Institutional capacity remains much lower than that of an average upper middle income country. The institutional complexity created by the new constitution has not been accompanied by a corresponding increase in the human capital and skills needed to make the new institutions effective.

E. Development Strategy of the Government of Maldives

34. **Senior officials have articulated several important policy priorities for addressing the economic and social challenges facing Maldives and sustaining the country's development.** As highlighted in the Government's Manifesto, a key objective going forward is to achieve higher economic growth, diversification and employment through the establishment of regional island centers, the creation of Special Economic Zones and the launching of Government-sponsored infrastructure projects with due consideration to the environment. The Government also aims to make growth more inclusive through the promotion of greater

¹⁷ For example, the severe 1998 El Niño raised sea surface temperatures around Maldives by as much as 5°C.

employment opportunities for the Maldivians, particularly the youth. In this connection, the Government targets substantial improvements in health and education outcomes, so as to build human capital for the future and address the pervasive skills mismatches which prevail in the labor market. Improvements in transport infrastructure, energy and housing are also planned to accompany and support the development process.

35. **These broad objectives now need to be translated into a medium-term development strategy and program**, which the Government plans to elaborate over the coming months. A key challenge in designing the strategy will be to ensure that the Government's social and economic goals are fully consistent with the urgent need for fiscal consolidation to restore fiscal and debt sustainability going forward. An important goal of the WBG engagement over the ISN period will be to inform these policy choices and engage in dialogue with relevant stakeholders on these issues.

III. REVIEW OF THE WORLD BANK GROUP'S ENGAGEMENT

A. The Last Country Assistance Strategy and Lessons Learned

36. **The FY08-FY12 CAS for Maldives was implemented in a challenging political and economic environment.** During the CAS period, Maldives made a transition to an electoral democracy and its economy was deeply affected by the global crisis. These events tested the limited capacity of the Government as well as the actual reach of the World Bank Group's small program and limited lending envelope. The design of the FY08-FY12 CAS, however, was highly relevant to the challenges the country faced: fiscal sustainability, governance and environmentally sustainable development.

37. **The performance of the Maldives program has been moderately satisfactory.** The future strategy is expected to continue to be implemented in a difficult and complex macroeconomic and political environment, limited capacity and high vulnerability. Over the short to medium term, finding the right mechanisms for effective service delivery and for preserving the environment will remain paramount challenges for delivery of higher levels of welfare and for reducing vulnerability. A number of lessons learned and recommendations for the next strategy, including the importance of broad based consultations on key national projects, have been factored into the design of this ISN.

38. **Limited local implementation capacity and a distant and dispersed population increase the challenge of delivering timely and quality support, especially when the program is small.** Distance increases delivery costs and weak implementation capacity often means limited progress between missions, as the local implementing agencies may lack expertise and support to address the challenges that emerge. These factors become even more constraining when authorities face a serious fiscal crisis or a difficult political environment.

39. **Capacity constraints and the small size of the program increase the need for selectivity to avoid fragmentation of small infrastructure projects.** Capacity constraints are particularly binding in areas where the tasks must be performed by Government, where a significant amount of coordination is needed and the effort must be sustained over a long period of time, and where the task is not high in the priority of the administration. These factors were

largely behind the slow progress of PFM reform and the mobile banking project under implementation during the last CAS. A sharp alignment with the priorities of Government will increase the likelihood that World Bank Group resources (and efforts) find needed complementary resources to be effective. Projects and/or programs must consider the capacity limitations and include the needed remedies.

40. **Partnerships within and outside of the World Bank Group need to be strengthened further.** The fiscal year 2008-2012 CAS provides examples of successful cooperation. IFC and International Development Association (IDA) collaboration in support of Maldives financial sector strategy and in the renewable energy space are two such examples that produced effective results. The cooperation with the European Union (EU) and Department of Foreign Affairs and Trade (DFAT)¹⁸ for implementation of the first phase of the Climate Change Trust Fund (CCTF) is an additional example. The next program of support can build on these foundations to not only help mobilize and leverage additional resources from the IDA, IFC and Multilateral Investment Guarantee Agency (MIGA) but also to coordinate designs and implementation efforts, including analytical work.

B. The World Bank Group Portfolio

41. **The lending portfolio** as of end February 2014 comprises three IDA projects with a net commitment value of US\$39 million, out of which 40 percent is undisbursed. These are supporting education (26 percent of the portfolio), environmental management (34 percent of the portfolio), as well as social protection and pension administration (40 percent of the portfolio). Maldives has a highly-rated project portfolio. No projects are at risk and there are no problem projects in the portfolio. The disbursement ratio has fared consistently well over the past three years, with a rate of 26.9 percent recorded for the fiscal year ending June 30, 2013.

42. **IFC's committed and outstanding investment portfolio stood at US\$26.5 million as of March 31, 2014,** supporting tourism, housing finance and leasing. IFC has an ongoing advisory project that assists with the development of a new Act to regulate non-bank financial institutions. MIGA has not provided any guarantees in Maldives to date. A significant body of analytical work and non-lending technical assistance has also underpinned the Bank Group's program, the most recent including human capital development, water security, targeting social assistance, national health insurance and tourism.

43. **Given the size of the lending envelope, trust fund resources have served as a vital complement to the World Bank Group's program, supporting lending activities, technical assistance and analytical work.** As of end February 2014, trust-funded activities totaled over US\$11 million, benefitting renewable energy and adaptation to climate change activities in particular. The Maldives' CCTF is supplementing the World Bank's Environmental Management Project, in particular, by addressing clean energy, solid waste management, wetland conservation and coral reef monitoring. Trust funds have also been supporting development of the investment plan for scaling up the renewably energy program, as well as renewable energy resource mapping and geospatial planning to provide the Government with a spatial planning framework to guide commercial investments in the sector. In addition, trust

¹⁸ Formerly known as AusAID.

funds provided critical support for a host of analytical work, from youth development to fiscal sustainability and to statistical capacity building. An Institutional Development Fund (IDF) grant is also supporting capacity building for the Auditor General. (See Annex 8 for full list of trust funded activities).

IV. THE WORLD BANK GROUP'S INTERIM STRATEGY FY14 - FY16

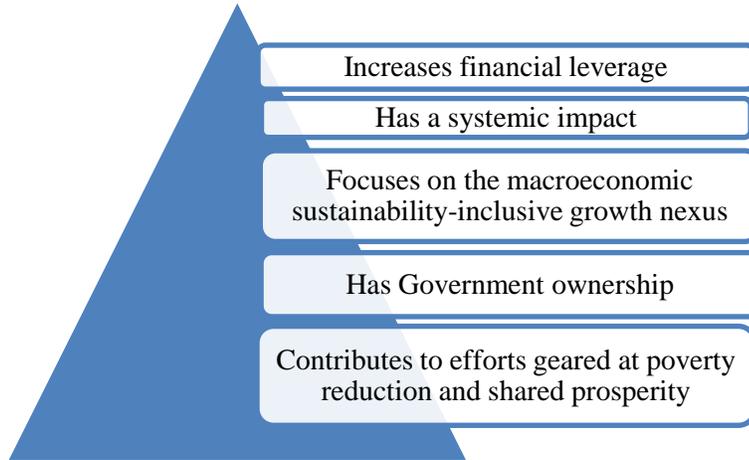
A. Strategic focus and criteria for future engagement

44. **The ISN proposes a selective program of engagement in Maldives over the next 25 months to accompany the transition and lay the foundations for the resumption of a full country program.** This will be primarily supported through policy dialogue and analytical work to inform the Government's decisions and to build a shared understanding of the issues facing the country. To this end, a Systematic Country Diagnostic (SCD) is planned to be prepared in close consultation with the authorities and other partners to shed light on the country's challenges and opportunities for achieving more inclusive growth, reduced poverty and enhanced prosperity of the Maldivian people. The SCD will inform policy dialogue and provide the analytical basis for scoping out the next Country Partnership Framework (CPF). Proposed building blocks of the SCD include a public expenditure review (including health insurance and social protection spending), poverty analysis, youth and gender studies and growth analysis.

45. **A priority of the WBG engagement will be to continue to be involved in the macro-fiscal dialogue while monitoring closely developments in this area.** In this regard, a proposed Public Financial Management Systems Strengthening Project (FY14) is expected to provide a useful basis for furthering dialogue on fiscal policy, PFM, debt management and SOE reform. To the extent possible, policy dialogue will aim to highlight the key trade-offs and choices which need to be addressed by policy makers for enhanced macroeconomic sustainability in the broad areas of fiscal, public financial management and debt management; promotion of economic growth; social protection and service delivery; and environmental and natural resource management. Close coordination with the IMF, the Islamic Development Bank (IsDB), the Asian Development Bank (ADB) and other development partners on macro-fiscal issues will be systemically sought.

46. **Over the ISN period, selectivity will be actively pursued** to optimize the use of WBG resources and maintain a strong strategic focus in the WBG engagement. Selectivity will be driven by the application of a filter (Figure 6) to ensure that the engagement is consistent with the WBG's comparative advantage and mission - ending extreme poverty and boosting shared prosperity. At the same time, the selectivity filter is aligned with the core policy objectives of the Government, aimed at restoring macroeconomic sustainability while promoting social inclusion, economic diversification and growth. In light of the unique geographical features of Maldives, priority will be given to activities that lead to across-the-board improvements in the country's national systems over one-off, geographically circumscribed projects. Furthermore, the Bank will prioritize activities which bring about substantial financial leverage from other development partners, trust funds or the private sector.

Figure 6 - Filter for WBG selective engagement



47. **The engagement will be managed flexibly in light of the uncertainties surrounding the country’s economic outlook and the lack of a government medium-term program.** In the very near term, two lending operations are being prepared to meet some of the country’s urgent needs in the areas of PFM and renewable energy and will be presented jointly with this ISN. They seek to address some of the most pressing challenges affecting Maldives’ development prospects, including weaknesses in the management of public resources and the high cost of energy. These two operations pass the selectivity filter discussed above and use the entire of the remaining available IDA16 resources during FY14. At this point, the ISN does not propose any programming of the IDA17 lending envelope. The SCD, scheduled for FY15, together with the expected strategy of the Government, will provide the basis for planning the use of the IDA17 funding envelope and help shape future engagement. Building on this, it is also planned that the preparation of the CPF may be brought forward if conditions permit, notably once the policy framework becomes more conducive to restoring macroeconomic sustainability.

48. **The proposed program was underpinned by a series of consultative events** amongst a wide cross section of Maldivian society and involving nearly 50 participants. The participants at the consultations included local government representatives and Maldivian nationals representing youth, gender, small and medium-sized enterprises (SMEs), scholars and academia. While the discussions were multi-faceted, common themes emerged, such as the impact of social issues on the Maldivian society, the importance of further developing service provision and the range of doing business improvements that were required to develop the SME sector and increase labor force participation. A detailed summary of consultations is provided in Annex 9.

B. Objectives and Areas of Engagement

49. **The proposed program seeks to support the Government’s efforts in this transition period while deepening the analytical foundations which would underpin a future program of engagement.** In light of the macroeconomic challenges facing Maldives, an important objective for the WBG at the onset of the ISN period is to strengthen further its engagement in the area of fiscal policy, PFM and debt management. Building on ongoing activities and leveraging additional resources to meet urgent needs, the WBG program also aims to achieve

selected results for enhanced environmental and natural resource management¹⁹. Furthermore, ongoing successful interventions in education and social protection will be complemented with analytical work for a more in-depth understanding of constraints to improved social inclusion and service delivery. In parallel, the WBG will selectively target analytical work and IFC and MIGA interventions in support of the Government's longer-term objective of promoting growth and economic diversification in the Maldives in the context of reforms to improve governance and business environment. The strategy is closely aligned with the development challenges identified above.

Fiscal policy, PFM and debt management

50. **The WBG program targets improvements in macro-fiscal planning, debt management, cash management, as well as improvements to the legislative and institutional framework for PFM.** It also targets greater and more efficient usage of the existing Public Accounting System as a tool for better budget execution, internal control, oversight of SOE, procurement practices, accounting and fiscal reporting. Over time, this is expected to result in enhanced budget credibility, transparency and improved financial reporting of central government finances and SOEs. Without such interventions, any attempt to fiscal consolidation will see only limited progress. To this end, Government has requested World Bank support to strengthen its public financial management systems. Building on the fundamental work underway, a Public Financial Management Systems Strengthening Project is currently under preparation for FY14 delivery, building on the recently completed Public Expenditure and Financial Accountability (PEFA) assessment. By the end of the ISN period, it is expected that deviation between aggregate expenditure outturn and the original approved budget will be reduced and also that the quality of debt data and reporting will improve.

51. **Policy dialogue will focus on further raising awareness on pressing fiscal and debt sustainability issues, and shed light on policy options to support fiscal consolidation efforts and address macroeconomic vulnerabilities.** Emphasis will be placed on the need to contain and rationalize public spending, improve the efficiency and equity of social spending and service delivery and address issues pertaining to the commercial banking sector. Close coordination with the IMF and other partners will continue to be sought. A joint WBG-IMF DSA is under preparation for completion by June 2014. As a core building block of the planned SCD, an in-depth public expenditure review will also be conducted to inform policy dialogue and decision-making.

Environmental and Natural Resource Management

52. **The proposed program targets improvements in waste management, water resource management and increased generation of renewable energy.** These objectives are at the core of the environmental challenges facing Maldives. The ISN will provide for the continuation of existing interventions in climate change and natural resource management as well as new initiatives aimed at supporting long term development of environmentally sound energy production. The CCTF, established in 2010 as a means of financing adaptation and mitigation

¹⁹ This could be supported through trust fund resources and possibly with additional financing instruments.

measures to combat climate change, with funding from the European Union and the Australian Government, represents one of the main WBG engagements on this front. A second phase of the CCTF (CCTF II) is being planned for FY15. Together with the ongoing IDA-funded Environment Management Project, by the end of the ISN period it is expected that this support will contribute to improved management of environmental risks to fragile coral reefs and other wetland habitats, greater capacity for rain water harvesting and improved solid waste management.

53. **The World Bank Group will continue supporting the Government’s agenda to move to a carbon-neutral economy**, by shifting away from diesel as the primary fuel for electricity generation and by acquiring the necessary technical and institutional capacity in renewable energy technologies in order to make a seamless transition in this respect. Maldives is one of only eight countries in the world participating in the Scaling-Up Renewable Energy Program (SREP) for low-income countries. As part of the SREP Investment Plan, the Government has requested World Bank support for Accelerating Sustainable Private Investments in Renewable Energy (ASPIRE). The ASPIRE program, currently under preparation for FY14 delivery, aims to leverage IDA and SREP funds to attract other donors and private sector investments for the development of renewable energy projects. The program seeks to combine technical assistance, concessional financing, and innovative risk mitigation instruments to provide confidence to private sector investors in a nascent market. The project is being designed as a partial risk guarantee supporting standardized project contracts in the photovoltaic sector. The Government will draw on support from the World Bank and SREP to address several key barriers in the renewable energy sector, including the challenges of a small market size, lack of track record for private investments in this sector, currency and payment risks, and still evolving regulatory frameworks. By the end of the ISN period, it is expected that increased generation capacity for solar energy will be developed. Building on its support for this area – such as through promoting resource efficiency in the resorts, IFC and MIGA will consider investing in or guaranteeing projects under ASPIRE to catalyze private sector interests in renewable energy.

Social Inclusion and Service Delivery

54. **The WBG engagement over the ISN period will aim to support the Government’s efforts for enhanced quality and efficiency in education and improved institutional framework for social protection.** The WBG aims to continue its support to higher quality in secondary education, and by the end of the ISN period it is expected that an increase in students’ accomplishment rates will be achieved. This will be done mainly through the ongoing Enhancing Education Development Project. The program will also seek to further strengthen capacity and systems of key agencies for improved targeting and delivery of social protection programs, with the twin objective of enhancing the programs’ equity and fiscal sustainability. In that regard, by the end of the ISN period it is expected that the Maldives’ Pension Administration Office will be fully operationalized. The ongoing Pension and Social Protection Administration Project will contribute to this objective.

55. **The program also seeks to shed light on constraints to eliminating poverty and enhancing shared prosperity in the Maldives, including issues and opportunities affecting the participation of the youth and women in the economy.** The poverty analysis planned as a core building block of the SCD will be instrumental to deepen the analysis in these areas, so as to

inform the Government's strategy and plans and the WBG's future engagement. Furthermore, analysis of skills, youth and jobs will be completed in FY14 to help better orient young people to the world of work. Further analytical work on gender is also planned to be carried out in FY15.

Growth and economic diversification

56. **The WBG will seek to inform the Government's policy choices as it designs its strategy and programs for accelerated and diversified economic growth.** Analytical work is planned to be carried out in FY15 to propose policy options for creating a conducive business environment and alleviating key constraints to growth in an inclusive and fiscally sustainable way. An important objective will be to shed light on the constraints to growth associated with the challenging macroeconomic situation and weaknesses in the investment climate. The country's growth is not diversified and is entirely dependent on tourism, while links to the tourism-led growth are limited. Building stronger linkages to the domestic economy by developing the local hospitality industry through support for the SMEs and targeted vocational training would be an important contributor to more jobs for Maldivians. Therefore, the proposed Growth Study will include analysis of backward-forward linkages to the tourism industry to strengthen the SME sector and create revenues and jobs, while also examining trade and competitiveness issues. Agriculture, mining and fisheries employ the largest share of Maldivians, particularly in the outer islands, but these sectors currently have a minor contribution to GDP. Given the potential importance of the fishery sector for growth and economic diversification, assistance to the preparation of a strategic plan for Sustainable Fisheries is also proposed in FY15, and this is a sector that IFC will consider supporting. IFC and MIGA will also aim to selectively invest in or guarantee projects that increase access to finance and strengthen sectors such as tourism, housing and infrastructure. The proposed IDA Program during FY14-FY16 is indicated in Table 2 below.

Table 2 - Proposed IDA Program, FY14-FY16

Fiscal Year	Activity	Lending/TF/ AAA	Amount (US\$m)	Areas of Engagement*			
				1	2	3	4
Ongoing	Enhancing Education Development Project	Lending	10			X	
	Pension and Social Protection Administration	Lending	15.8			X	
	Environmental Management Project	Lending	13.2				X
	CCTF I (three projects)	TF	7.7				X
	Statistical Capacity Building	TF	0.2	X			
FY14	Public Financial Management Systems Strengthening Project	Lending	6.5	X			
	ASPIRE Project	Lending	4				X
	Youth Study	AAA				X	
FY15	CCTF II	TF	4.5				X
	Systematic Country Diagnostic	AAA					
	Growth Study	AAA			X		
	Strategic Plan for Sustainable Fisheries	AAA			X		
	Gender Study	AAA				X	
FY16	To be determined						

- * Area 1 - Fiscal, PFM and Debt Management
- Area 2 - Sustainable Growth
- Area 3 - Social Inclusion and Service Delivery
- Area 4 - Environmental and Natural Resource Management

C. Implementing the ISN

57. **The Bank Group engagement during the period covered by the Interim Strategy will be implemented through a combination of lending and non-lending activities.** The IDA Investment Project Financing (IPF) instrument for the PFM project will be supplemented by an IDA partial risk guarantee instrument for the ASPIRE project. IFC and MIGA expect to support a number of private sector investments in priority sectors. Advisory services and capacity building will play a critical role in the Bank Group's engagement during this ISN. Responding to the Government's interest in targeted and timely advisory support, the Bank's non-lending program will continue to extend both "just in time" support and programmatic Analytic and Advisory Activities (AAA) offering focused intermediate outputs.

58. **The indicative IDA17 envelope for Maldives is expected to be in line with the previous allocation.**²⁰ The IDA allocation for Maldives is in line given the country's high risk of debt distress. The Bank Group will seek to leverage additional sources of financing, preferably in the form of grants, for projects that would have significant developmental impact. Trust funds will continue to supplement IDA support to the country, particularly in the area of climate change.

D. Partnerships

59. **Going forward, partnerships within and outside the World Bank Group will play a critical role.** This will be particularly important in view of the need to leverage additional resources to increase development impact. On macro-fiscal issues, the WBG will seek to coordinate dialogue and support with the IMF, the IsDB, the ADB, and other stakeholders, to enhance leverage and impact. The Bank and IFC will also continue to work closely together in the area of solid waste management and renewable energy; internal collaboration may be strengthened further to include MIGA support. In the area of solid waste management, increased collaboration through a public private partnership (PPP) for investment and operational support for regional solid waste management is being explored. In the area of renewable energy, the joint IDA, IFC and ADB support for the preparation of the investment plan for the SREP, will be continued within the framework of the ASPIRE project. In the implementation phase, IFC and MIGA are considering support to leverage the proposed guarantee program for renewable energy, subject to the usual due diligence, and ADB is also considering investing more for additional leverage. The World Bank Group has had a strong partnership with the ADB to transform the sector and develop innovative financing schemes through the scale-up of renewable energy technologies in the country. The partnership with the EU will also continue, with CCTF II expected to deepen and scale up the wetlands conservation and coral reef monitoring efforts during FY15.

V. RISKS

60. **The proposed WBG engagement program with Maldives is expected to play an important role** in supporting Maldives in this transition period, but faces a number of short-term risks and uncertainties. The main risks include risks to macroeconomic and debt sustainability, political tensions and social unrest, and insufficient institutional capacity and/or ownership risks.

61. **Macroeconomic instability.** The primary short-term risk for Maldives remains macroeconomic instability. Should the Government fail to restrain public spending, fiscal and external imbalances would continue to widen, public debt would escalate further and pressures on the exchange rate would increase, resulting potentially in a currency crisis, inflation and debt distress. The Bank will continue to seek entry points over the ISN period to shed light on these risks through policy dialogue and analytical work in order to help inform Government's policy choices. Should a crisis occur, the core areas of the WBG program would remain relevant.

²⁰ The actual financing envelope for the IDA17 period will depend on: (i) total IDA resources available, (ii) the country's own performance, GNI per capita, and population; (iii) the terms of IDA assistance (grants/credits); (iv) the performance, other allocation parameters, and IDA assistance terms for other IDA borrowers; (v) the amount of compensatory resources received for MDRI; and (vi) the number of IDA-eligible countries.

However, the political, social and economic consequences of a crisis may reshape the Government's development agenda and likely call for an adjustment in the Bank engagement. As a small, tourism-based, import-dependent economy, Maldives is also highly vulnerable to external shocks, even though the tourism sector has shown resilience to the global crisis. In a context of high debt, limited fiscal space and depleted reserves, the country lacks adequate buffers, which poses a potential threat to the economic outlook.

62. **Debt distress.** External shocks and fiscal imbalances have rendered debt sustainability a major issue for the country. The country is already at high risk of debt distress and recent ad-hoc borrowings are likely to have aggravated the debt situation even further. In conjunction with the IMF, the Bank team will continue to monitor the development on the public debt situation and will engage the authorities in dialogue to help address the issue. Additionally, technical assistance and capacity building on debt management will be provided through the Public Financial Management Systems Strengthening Project.

63. **Continued political volatility.** Maldives went through a divisive Presidential election in late 2013 which showed strong tensions among political forces combined with a weak institutional framework for resolving those issues. On March 22, 2014, the Government coalition attained majority of seats (53 of the 85 seats) in Parliament with a five year term, which bodes well for engaging on structural reforms. However should political turmoil resume, the WBG may consider limiting its engagement until such time when the politics stabilize.

64. **Social unrest.** Deterioration of the economic situation or failure to make rapid decisive progress in offering greater opportunities for the population may increase the threat of social unrest in the country, particularly among the youth. The Government is very much aware of this challenge and has made increasing employment opportunities for the youth a key priority. In the event of social unrest, the Bank's engagement would be managed flexibly to respond to emerging priorities and challenges.

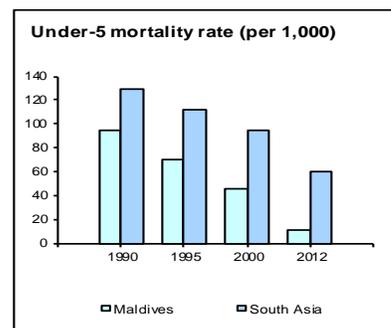
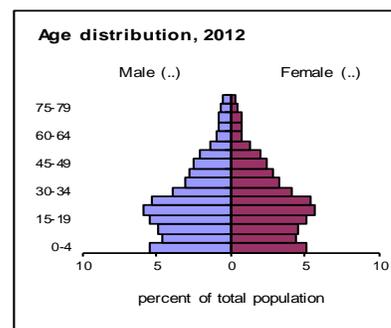
65. **Insufficient institutional capacity and/or ownership.** Lessons learned from previous engagement in Maldives underscore that adequate institutional capacity and strong ownership of the projects or reform agenda by the Government and other stakeholders are critically needed for actual impact. Insufficient capacity may affect achieving expected results, notably in the areas of public financial management and renewable energy. At the same time, the uncertain political environment has made it difficult to build a strong constituency for reform. Going forward, this risk will be mitigated by institutional capacity building activities and the application of the proposed filter, so as to ensure that the Bank engagement is highly selective and focused on areas which benefit from strong ownership among the Government and other stakeholders.

Annex 1: Maldives at a glance

Key Development Indicators	Maldives	South Asia	Upper middle income
(2012)			
Population, mid-year (millions)	0.34	1,649	2,391
Surface area (thousand sq. km)	0.3	5,131	43,472
Population growth (%)	2.0	1.3	0.8
Urban population (% of total population)	42	31	61
GNI (Atlas method, US\$ billions)	1.9	2,370	16,661
GNI per capita (Atlas method, US\$)	5,750	1,437	6,969
GNI per capita (PPP, international \$)	7,560	3,503	10,621
GDP growth (%)	3.4	4.9	5.0
GDP per capita growth (%)	14	3.5	4.2

(most recent estimate, 2005–2012)

Poverty headcount ratio at \$1.25 a day (PPP, %)	<2 ^a	31	8.4
Poverty headcount ratio at \$2.00 a day (PPP, %)	12 ^a	67	19.5
Life expectancy at birth (years)	77	67	74
Infant mortality (per 1,000 live births)	9	47	16
Child malnutrition (% of children under 5)	18	32	3
Adult literacy, male (% of ages 15 and older)	98	73	96
Adult literacy, female (% of ages 15 and older)	98	50	91
Gross primary enrollment, male (% of age group)	100	111	111
Gross primary enrollment, female (% of age group)	97	109	110
Access to an improved water source (% of population)	99	91	93
Access to improved sanitation facilities (% of population)	98	40	74

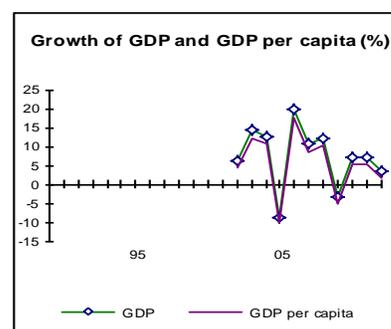


Net Aid Flows	1980	1990	2000	2012
<i>(US\$ millions)</i>				
Net ODA and official aid	21	21	19	58
<i>Top 3 donors (in 2012):</i>				
Australia	1	0	2	9
Japan	1	6	8	6
European Union Institutions	0	1	0	5
Aid (% of GNI)	..	10.8	3.2	3.1
Aid per capita (US\$)	136	97	70	171

Long-Term Economic Trends

Consumer prices (annual % change)	23.8	3.6	-12	0.6
GDP implicit deflator (annual % change)	..	..	17	5.0
Exchange rate (annual average, local per US\$)	7.6	9.6	11.8	15.4
Terms of trade index (2000 = 100)	..	98	100	..

Population, mid-year (millions)	0.2	0.2	0.3	0.3	3.4	2.3	1.8
GDP (US\$ millions)	42	215	624	2,222	..	..	8.1
					<i>(% of GDP)</i>		
Agriculture	..	..	8.8	4.0	..	..	0.7
Industry	..	..	15.0	21.4	..	..	2.1
Manufacturing	..	..	8.0	6.7	..	..	5.6
Services	..	..	76.2	74.6	..	..	7.8
Household final consumption expenditure	..	..	32.9	81.5	..	..	..
General gov't final consumption expenditure	..	..	22.9	16.8	..	..	..
Gross capital formation	..	..	26.3	40.4	..	..	..
Exports of goods and services	153.5	85.5	89.5	105.8	..	..	..
Imports of goods and services	205.1	82.6	71.6	106.8	..	..	..
Gross savings	..	..	..	..	..	..	..



1980–90 1990–2000 2000–12 (average annual growth %)

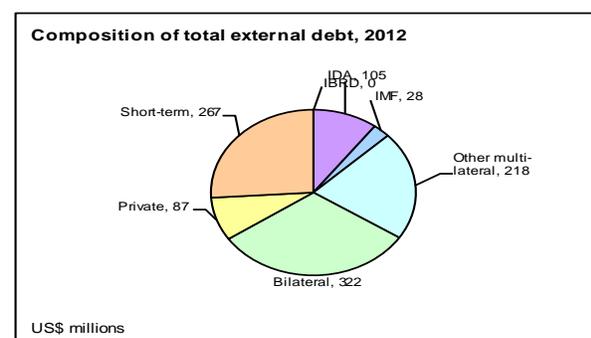
Note: Figures in italics are for years other than those specified. .. indicates data are not available.

^a Country poverty estimate is for earlier period.

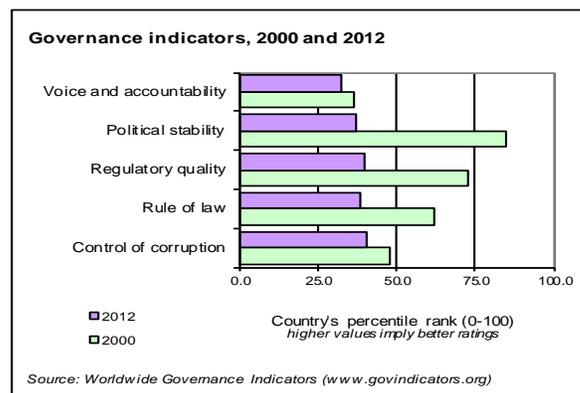
Development Economics, Development Data Group (DECDG).

Annex 1: Maldives at a glance (Continued)

Balance of Payments and Trade	2000	2012
<i>(US\$ millions)</i>		
Total merchandise exports (fob)	109	330
Total merchandise imports (cif)	389	1,779
Net trade in goods and services	-25	-20
Current account balance as a % of GDP	-52	-601
	-8.2	-27.0
Workers' remittances and compensation of employees (receipts)	2	3
Reserves, including gold	123	305
Central Government Finance		
<i>(% of GDP)</i>		
Current revenue (including grants)	32.2	28.8
Tax revenue	13.2	19.7
Current expenditure	0.0	30.8
Overall surplus/deficit	-4.4	-12.6
Highest marginal tax rate (%)		
Individual	..	..
Corporate	..	..
External Debt and Resource Flows		
<i>(US\$ millions)</i>		
Total debt outstanding and disbursed	206	1,027
Total debt service	20	90
Debt relief (HIPC, MDR)	-	-
Total debt (% of GDP)	33.1	46.2
Total debt service (% of exports)	4.1	3.8
Foreign direct investment (net inflows)	13	..
Portfolio equity (net inflows)	0	..



Private Sector Development	2000	2012
Time required to start a business (days)	-	9
Cost to start a business (% of GNI per capita)	-	6.0
Time required to register property (days)	-	57
Ranked as a major constraint to business (% of managers surveyed who agreed)	2000	2012
n.a.	..	..
n.a.	..	..
Stock market capitalization (% of GDP)	..	..
Bank capital to asset ratio (%)	..	..



Technology and Infrastructure	2000	2012
Paved roads (% of total)	..	100.0
Fixed line and mobile phone subscribers (per 100 people)	12	172
High technology exports (% of manufactured exports)	..	0.0
Environment		
Agricultural land (% of land area)	30	23
Forest area (% of land area)	3.0	3.0
Terrestrial protected areas (% of land area)	..	..
Freshwater resources per capita (cu. meters)	106	90
Freshwater withdrawal (% of internal resources)	11.3	19.7
CO2 emissions per capita (mt)	18	3.3
GDP per unit of energy use (2005 PPP \$ per kg of oil equivalent)	..	6.9
Energy use per capita (kg of oil equivalent)	..	970

World Bank Group portfolio	2000	2012
<i>(US\$ millions)</i>		
IBRD		
Total debt outstanding and disbursed	-	-
Disbursements	-	-
Principal repayments	-	-
Interest payments	-	-
IDA		
Total debt outstanding and disbursed	46	105
Disbursements	3	4
Total debt service	1	3
IFC (fiscal year)		
Total disbursed and outstanding portfolio of which IFC own account	4	58
Disbursements for IFC own account	4	57
Portfolio sales, prepayments and repayments for IFC own account	0	4
	1	22
MIGA		
Gross exposure	-	-
New guarantees	-	-

Note: Figures in italics are for years other than those specified.
.. indicates data are not available. - indicates observation is not applicable.

Development Economics, Development Data Group (DECDG).

Annex 2: Maldives - Selected Indicators* of Bank Portfolio Performance Management

As Of Date 3/13/2014

Indicator	2011	2012	2013	2014
Portfolio Assessment				
Number of Projects Under Implementation ^a	3	3	3	3
Average Implementation Period (years) ^b	2.8	3.8	3.1	3.8
Percent of Problem Projects by Number ^{a, c}	0.0	0.0	0.0	0.0
Percent of Problem Projects by Amount ^{a, c}	0.0	0.0	0.0	0.0
Percent of Projects at Risk by Number ^{a, d}	0.0	0.0	0.0	0.0
Percent of Projects at Risk by Amount ^{a, d}	0.0	0.0	0.0	0.0
Disbursement Ratio (%) ^e	41.4	18.8	26.9	33.7
Portfolio Management				
CPPR during the year (yes/no)				
Supervision Resources (total US\$)				
Average Supervision (US\$/project)				

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	9	3
Proj Eval by OED by Amt (US\$ millions)	98.6	37.7
% of OED Projects Rated U or HU by Number	22.2	66.7
% of OED Projects Rated U or HU by Amt	23.9	62.5

- a. As shown in the Annual Report on Portfolio Performance (except for current FY).
- b. Average age of projects in the Bank's country portfolio.
- c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
- d. As defined under the Portfolio Improvement Program.
- e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.
- * All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

Annex 3: Maldives - Key Economic Indicators

Indicator	Actual						
	2007	2008	2009	2010	2011	2012	2013
National accounts (as % of GDP)							
Gross domestic product ^a	100	100	100	100	100	100	100
Agriculture	6	6	6	6	6	5	5
Industry	14	17	12	12	13	13	13
Services	81	77	82	82	82	82	82
Total Consumption	--	--	--	--	--	--	--
Gross domestic fixed investment	--	--	--	--	--	--	--
Government investment	--	--	--	--	--	--	--
Private investment	--	--	--	--	--	--	--
Exports (GNFS) ^b	105	95	83	97	114	102	97
Imports (GNFS)	106	110	76	82	110	106	103
Gross domestic savings	--	--	--	--	--	--	--
Gross national savings ^c	--	--	--	--	--	--	--
<i>Memorandum items</i>							
Gross domestic product (US\$ million at current prices)	1542	1892	1942	2076	2050	2178	2354
GNI per capita (US\$, Atlas method)	4010	4950	5110	5530	5720	5790	5870
Real annual growth rates (% , calculated from 85 prices)							
Gross domestic product at market prices	10.6	12.2	-4.7	5.7	7.5	3.5	3.8
Gross Domestic Income	--	12.2	-4.7	5.7	7.5	3.5	3.8
Real annual per capita growth rates (% , calculated from 85 prices)							
Gross domestic product at market prices	9.1	10.7	-6.0	4.3	6.1	2.2	2.5
Total consumption	--	--	--	--	--	--	--
Private consumption	--	--	--	--	--	--	--
Balance of Payments (US\$ millions)							
Exports (GNFS) ^b	1621	1804	1605	2007	2327	2230	2275
Merchandise FOB	227	331	169	198	346	331	327
Imports (GNFS) ^b	1642	2077	1482	1693	2265	2298	2416
Merchandise FOB	1305	1649	1082	1242	1725	1819	1908
Resource balance	-21	-274	123	315	62	-68	-141
Net current transfers	--	--	--	--	--	--	--
Current account balance	-460	-777	-334	-207	-490	-640	-765
Net private foreign direct investment	126	175	154	217	282	164	218
Long-term loans (net)	36	61	71	75	67	48	112
Official	22	27	83	78	38	190	181
Private	14	33	-12	-4	29	-142	-69
Other capital (net, incl. errors & omissions)	222	610	89	-173	157	483	413
Change in reserves ^d	77	-68	20	89	-15	-55	22
<i>Memorandum items</i>							
Resource balance (% of GDP)	-1.3	-14.5	6.4	15.2	3.0	-3.1	-6.0
Real annual growth rates (YR85 prices)							
Merchandise exports (FOB)	--	--	--	--	--	--	--
Primary	--	--	--	--	--	--	--
Manufactures	--	--	--	--	--	--	--
Merchandise imports (CIF)	--	--	--	--	--	--	--

(Cont)

Annex 3: Maldives - Key Economic Indicators (Continued)

Indicator	Actual						
	2007	2008	2009	2010	2011	2012	2013
Public finance (as % of GDP at market prices)^e							
Revenues and grants	38.2	30.8	22.6	24.0	31.5	28.8	33.0
Current expenditures	33.2	30.8	34.5	30.9	28.9	30.8	32.0
Current account surplus (+) or deficit (-)	4.9	0.0	-11.9	-6.9	2.6	-2.1	1.0
Capital expenditure	8.7	11.2	8.6	8.7	10.1	10.6	10.4
Foreign financing	..	..	..	..	..	..	..
Monetary indicators							
M2/GDP	50.4	50.0	54.5	58.1	60.6	58.6	67.0
Growth of M2 (%)	24.1	21.8	14.4	14.6	20.0	4.9	18.4
Price indices (YR85 =100)							
Merchandise export price index	..	..	..	..	..	..	..
Merchandise import price index	..	..	..	..	..	..	..
Merchandise terms of trade index	..	..	..	..	..	..	..
Real exchange rate (US\$/LCU) ^f	..	..	..	..	..	..	..
Real interest rates							
Consumer price index (% change)	6.8	12.0	4.5	6.2	11.3	10.9	6.0
GDP deflator (% change)	7.0	9.3	8.9	0.4	7.5	5.0	4.2

a. GDP at factor cost

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Consolidated central government.

f. "LCU" denotes "local currency units." An increase in US\$/LCU denotes appreciation.

Annex 4: Maldives - Key Exposure Indicators

Indicator	Actual			Estimated			Projected		
	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total debt outstanding and disbursed (TDO) (US\$m) ^a	853	917	981	1007	983	1141	1375	1615	1894
Net disbursements (US\$m) ^a	54	78	94	113	51	158	234	240	278
Total debt service (TDS) (US\$m) ^a	80	96	93	84	94	129	140	99	86
Debt and debt service indicators (%)									
TDO/XGS ^b	51.8	50.5	60.9	50.1	42.1	51.0	60.2	66.3	73.0
TDO/GDP	55.3	48.5	50.5	48.5	47.9	52.4	58.4	62.0	66.3
TDS/XGS	4.9	5.3	5.8	4.2	4.0	5.8	6.1	4.0	3.3
Concessional/TDO	30.1	28.6	29.5	37.4	45.1	53.8	54.9	53.5	51.1
IBRD exposure indicators (%)									
IBRD DS/public DS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Preferred creditor DS/public DS (%) ^c	29.1	39.4	33.6	35.3	30.3	21.0	23.5	39.0	38.5
IBRD DS/XGS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IBRD TDO (US\$m) ^d	0	0	0	0	0	0	0	0	0
Of which present value of guarantees (US\$m)									
Share of IBRD portfolio (%)	0	0	0	0	0	0	0	0	0
IDA TDO (US\$m) ^d	77	79	84	99	103	110	118	126	135
IFC (US\$m) /e									
Loans	61.7	53.2	44.2	83.2	72.2	53.8	32.2	23.2	n/a
Equity and quasi-equity /f	3.1	2.1	3.4	3.4	3.4	3.4	3.4	3.4	n/a
MIGA									
MIGA guarantees (US\$m)									

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. All figures are actuals. 2014 figures are as of March 31, 2014.

f. Includes all equity and quasi-equity (of loan- and equity-types).

Annex 5: Maldives - Operations Portfolio (IDA)

As of Date 3/12/2014

Closed Projects 11

IDA *

Total Disbursed (Active)	22.61
of w hich has been repaid	0.00
Total Disbursed (Closed)	56.45
of w hich has been repaid	15.75
Total Disbursed (Active + Closed)	79.06
of w hich has been repaid	15.75
Total Undisbursed (Active)	14.59
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	14.59

Active Projects

Project ID	Project Name	Last PSR		Fiscal Year	Original Amount in US\$ Millions			Difference Between Expected and Actual Disbursements ^d		
		Supervision Rating			IBRD	IDA	GRANT	Cancel.	Undisb.	Orig. Frm Rev'd
		Development Objectives	Implementation Progress							
P131331	Enhancing Education Devel S	S	✓	2013		10		8.677646	-1.327171	
P108078	MV: Environmental Manag MS	MS	✓	2008		13.15		0.479556	1.3264957	
P104743	MV: Pension and Social Pr S	MS	✓	2009		15.8		5.436752	-6.483298	1.047131
Overall Result						38.95		14.59395	-6.483973	1.047131

Annex 6: Maldives - IFC Investment Operations Program

	2010*	2011	2012	2013	2014**
<u>Original Commitments (US\$m)</u>					
IFC and Participants	2.5	-	-	-	-
IFC's Own Accounts only	2.5	-	-	-	-
<u>Original Commitments by Sector (%)- IFC Accounts only</u>					
Accommodation and Tourism	100	-	-	-	-
Total	100	-	-	-	-
<u>Original Commitments by Investment Instrument (%)- IFC Accounts only</u>					
Equity	-	-	-	-	-
Guarantee	-	-	-	-	-
Loan	100	-	-	-	-
Quasi equity	-	-	-	-	-
Quasi loan	-	-	-	-	-
Total	100	-	-	-	-

*An additional \$20 million investment was supported for a Maldivian Company to invest in Seychelles.

**as of April 7, 2014

Annex 7: Maldives - IFC's Committed and Disbursed Outstanding Investment Portfolio

As of 3/31/2014

(In USD Millions)

<u>FY Approval</u>	<u>Company</u>	<u>Committed</u>					<u>Disbursed Outstanding</u>				
		<u>Loan</u>	<u>Equity</u>	<u>**Quasi Equity</u>	<u>*GT/RM</u>	<u>Partici pant</u>	<u>Loan</u>	<u>Equity</u>	<u>**Quasi Equity</u>	<u>*GT/RM</u>	<u>Partici pant</u>
2009	Addu Investments	20.0	-	-	-	-	20.0	-	-	-	-
2009	HDFC Maldives	3.2	2.3	-	-	-	3.2	2.3	-	-	-
2002/ 2004	MFLC	-	1.1	-	-	-	-	1.1	-	-	-
Total Portfolio:		23.2	3.4	-	-	-	23.2	3.4	-	-	-

* Denotes Guarantee and Risk Management Products.

** Quasi Equity includes both loan and equity types.

Annex 8: Maldives - Trust Fund Activities

Project ID	Fund	Fund Name	Program	Grant Amount USD (thousand)
P132309	TF013524	Capacity Development Support for Auditor General's Office, Maldives	IDF	750
P133230	TF013570	Maldives Statistical Capacity Building	TFSCB	200
P128278	TF011853	Wetlands Conservation and Coral Reef Monitoring for Adaptation to Climate Change	MACC	3,830
P128268	TF011858	Clean Energy for Climate Mitigation	MACC	2,530
P145482	TF014565	Maldives - ASPIRE Project Preparation Grant	CSCFIA	1,000
P130163	TF013101	Maldives - Ari Atoll Solid Waste Management Pilot Project	MACC	1,326
P146018	TF015531	Renewable Energy Resource Mapping and Geospatial Planning	ESMAP	500

Annex 9: Summary of Consultations

OVERVIEW

- **A series of six consultations involving nearly 50 participants was carried out as part of the preparation of this ISN** in Male and in Ghuli Island in the South K Atoll. Participants in the consultations included representatives of the central and local governments; service providers; the youth; women; SMEs; academia and scholars. The round of consultations served the twin objective of understanding better the views of a range of stakeholders on the challenges and priorities facing Maldives, while allowing the World Bank Group to discuss its engagement in the country.

- **The consultations included:** (i) technical meetings in Male and Ghuli Island focused on fiscal policy, growth and investment; skills for jobs, youth at risk, public service delivery, cross-cutting gender issues and institutional issues; and (ii) a one-day brainstorming session with representatives of the Government and the Central Bank. In this session, the WBG proposed a comprehensive framework to help anchor the discussions on the country's development challenges. The framework was articulated around four main areas: (i) fiscal and public financial management and debt management; (ii) sustainable growth; (iii) social inclusion and service delivery; and (iv) environmental and natural resource management. This helped to shed light on some of the key trade-offs which will need to be addressed by policy makers for more sustainable and inclusive growth in Maldives.

- **Three objectives guided the consultation process:**
 - i. To discuss the priorities and economic, social and environmental challenges facing Maldives, and the role of the World Bank Group in the country;
 - ii. To gather the views of stakeholders with a weaker voice, such as women, youth and small entrepreneurs; and
 - iii. To discuss with stakeholders the critical issue of public service provision in the islands. Service delivery to smaller islands was the main focus of the consultations in Ghuli Island with the island's service providers and local authorities. These services included water, sanitation, solid waste disposal, energy, education and health.

- **Consensus emerged on some of the key priorities facing Maldives and the main thrust of the ISN** in this context. The consultations encouraged free and open dialogue and led to rich and frank discussions among stakeholders. Significant convergence of views was expressed on the importance of addressing current macroeconomic imbalances and setting the stage for enhanced fiscal and environmental sustainability. Reducing the dependency on oil imports through nationwide adoption of renewable energy technologies, provision of safe water, sanitation and solid waste management were also identified as priorities. Greater inclusion of the Maldivian population in the growth process, notably the youth and women, was seen as a major challenge. The following report presents recurring points noted during consultations.

DEBATES AND RECOMMENDATIONS

GROWTH AND INVESTMENT

Fiscal and debt sustainability

1. **Stakeholders underscored the need for a holistic approach to address the challenges facing Maldives.** The issues of high debt and unsustainable public spending and deficits were raised in the consultations with the Government, and concerns were expressed that the challenging macroeconomic situation has started affecting investors' perceptions while domestic financing is crowding out the private sector.

2. **A rationalization of universal subsidy schemes was called for** by participants in the consultations with Government and academics – especially blanket subsidies granted to all users, including resorts clients – and the need to articulate a good targeting mechanism to enhance equity and fiscal sustainability of these schemes. Emphasis was also placed on the need to accelerate economic growth and diversify the economy for enhanced sustainability.

“People have to be told that services provided need to be paid for”

Drivers of and constraints to growth

3. **The general consensus was that the tourism sector has great potential for generating further development and job opportunities.** Recommendations focused on the need for a clearer government policy on island tourism (specifically with regards to licensing of guest houses), a stronger monitoring and evaluation framework on tourism and support to the development of backward-linkages between the tourism resort segment and SMEs.

4. **The fisheries sector was also seen as having potential for positive returns.** With the fisheries sector having last peaked in 2006, the harvest has since been on the decline. Sustainable fishing has managed however to fetch higher market prices for the fish from Maldives. Participants in several instances recommended the development of a strategic policy framework and plans for sustainable fisheries.

5. **Lack of skills was raised repeatedly as an overarching issue constraining business development and growth in Maldives,** despite the country's vast potential in industries such as mariculture, transport, agriculture and business outsourcing for resorts (in laundry, transport, cleaning, water sports and excursions). Participants in consultations with academics called for an urgent need to create greater opportunities through a better enabling environment that encouraged entrepreneurial activity. The creation of business incubators was also recommended.

6. **Consensus emerged across participants in the various consultative events that there is a need for the Government to break the dependency of Maldivians upon free government services and subsidies and the development of an entrepreneurial culture.**

Challenges for SMEs

7. **SMEs were described in several consultations as key for growth and job creation.**

The most significant issues raised by the SMEs who were consulted were the following:

- Insufficient opportunities to penetrate the large scale tourist resorts;
- Lack of access to finance;
- Lack of a federation for SMEs that can take up the sector issues with the relevant authorities.

8. **Recommendations included:**

- Modernization of policies and laws that prevent SMEs from taking informed risks and challenges to develop their businesses;
- Establishment of a clear legal framework to protect SMEs' business interests;
- Implementation of stricter laws on licensing, labor and visa law enforcement, and repatriation of profits so as to ensure less informal competition and a level playing field for SMEs;
- Introduction in the country of stricter quality controls;
- Awareness campaigns to inform Maldivians about existing SME financial aid schemes so as to improve access to finances and SME growth.

“The business outlook is positive, but growth will benefit from better regulation”

9. **Participants in consultations with SMEs, Government, women groups and youth also noted** that the employee mindset of the average Maldivian has shown a tendency to avoid blue collar jobs with high preference for white collar jobs even with the absence of requisite skills. Participants pointed to deploy public information campaign to change citizen's perception, particular parent's perceptions on this point.

Environmental sustainability

10. **The importance of further improved environmental management and sustainable development**, notably in the tourism and fishery sectors, was recurrently underscored in the consultations with Government. In Ghuli Island, for instance, stakeholders pointed out that lack of land has also led to rapid deforestation on larger islands, leading to deterioration in soil quality, food variety and ground water salinity.

EDUCATION, SKILLS AND JOBS

11. **A key priority identified by participants was the development and upgrading of the education system** which was perceived as simply inadequate to deal with the contemporary challenges faced by youth in Maldives. Focus on vocational training needs to be increased as well, such as for skills needed for the tourism industry.

12. **The high cost of offering education services and a comprehensive curriculum to all students in this multi-island country** was underscored in several consultations. Budgets for education on islands are planned and executed by the Ministry of Education with a view to

provide adequate facilities on each of the inhabited islands. Teachers to student ratios are high, as Government policy aims to allow each student to be able to choose across a range of subjects in each island. The high cost of the current operation was mentioned by many.

13. **Low enrollment in upper secondary and higher education was raised as an issue** in the consultations with Government, youth, women groups and in Ghuli Island. All subjects apart from Islam and Divehi are taught in English. Students who pass a minimum of 5 subjects (at the 10th grade) can continue to 11-12th grades and higher education. Overall, only a small proportion of students (20-30 percent, with the vast majority among them being female), pass the tests at the end of 10th grade, and 52 percent of students enrolled in higher secondary are female. The lack of sufficient numbers of qualified, well trained and experienced teachers, notably local teachers, was cited in several instances as having a detrimental effect on the quality of education. This in turn impacts the quality of learning. Several groups also called for the development of learning facilities for children with special needs for needy families.

“Everyone who has had the means to leave Maldives has done so. The ones left behind are waiting to leave...”

14. **In Ghuli Island, participants underscored that upper secondary education, while government-sponsored, is available only in Male**, constraining families to pay for boarding and raising issues of affordability. Similarly, in discussions with youth, it was underlined that rental costs in Male have increased to unprecedented levels; as a result, poor students’ struggle to make ends meet. Consultations with women groups also emphasized that girls were particularly affected by the non-availability of higher education in the islands, with a sharp decline in the proportion of girls leaving their island to pursue secondary and tertiary education.

15. **The participants in the consultations with Government, academics and scholars noted with concern the high dependence of Maldives on imported skilled labor.** Academics highlighted that there had been a contraction in the local labor market of nearly 5,000 jobs within the last decade, with over 55 percent of the work force on resorts being foreign nationals. The perception that resorts have a preference for employing foreign labor was mentioned by a number of constituencies.

Youth unemployment

16. **Maldives is reported as having a relatively youthful** population, for which insertion in the labor market is a problematic issue. The topic of youth unemployment was identified as a major country challenge in all consultations held.

17. **Youth unemployment was represented as being principally driven by:**

- Lack of training on basic business principles and lack of exposure to entrepreneurial knowledge and skills;
- Lack of training opportunities for the vast majority of Maldivian youth who fail to enter tertiary education streams;

- Parents’ perceptions that discouraged children for accepting blue collar jobs or engaging in entrepreneurial activities;
- General negative public perception towards semi-skilled jobs;
- Over-emphasis on preparing for GCE Ordinary and Advanced level examinations and less attention to skills development;
- Lack of space for creative arts and lack of adequate recreational activities and facilities for the youth;
- Specialization in any fields requiring travel to another country (resulting in the escalation of costs to obtain basic qualifications), as very few opportunities for specialization exist in Maldives.

Female labor force participation

18. **Female labor force participation was raised as a challenge in several instances.** Several constraints were identified in discussions with women groups, including:

- Lack of skills training, which was seen as a key factor affecting employment opportunities for women;
- Parental reluctance to send their daughters to other islands for employment (especially to work in resorts);
- Women’s reluctance to work in the tourism industry due to negative perceptions regarding the safety and security of the tourism working environment;
- Increased levels of advocacy representing that women should not work outside the home;
- The wide-spread perception in society that women are less capable than men.

“If a man and a woman who are equally qualified apply for a job it is nearly always the man who gets it”

Job creation

19. **Some recommendations for job creation were discussed:**

- Participants in the consultations with academics and scholars noted that the decentralization of government services was required to enhance job creation in islands. In other instances, however, the high cost of service delivery in the islands was raised;
- The creation of a more formal SME culture through enabling policies was also cited in consultations with academics and scholars as a key factor for job creation.

YOUTH AT RISK

20. **The youth in Maldives faces a number of risks** which were abundantly discussed in consultations. While education and lack of job opportunities were raised as a major challenge for the youth in the consultations, other related issues were discussed, including sexual abuse, drugs, and additional health and social problems affecting the youth.

Sexual abuse

21. **Participants in the consultations with women’s groups expressed concern with what they report is an increasing incidence of sexual abuse on both girls and boys.** Abuse was also linked in perceptions to the concept of ‘boarding with families’, when children are sent to live with families in Male to pursue secondary and higher education. It was reported that research has been engaged on this issue, but that knowledge and action are still very limited. Stakeholders called for a structured response to better inform and address this social issue.

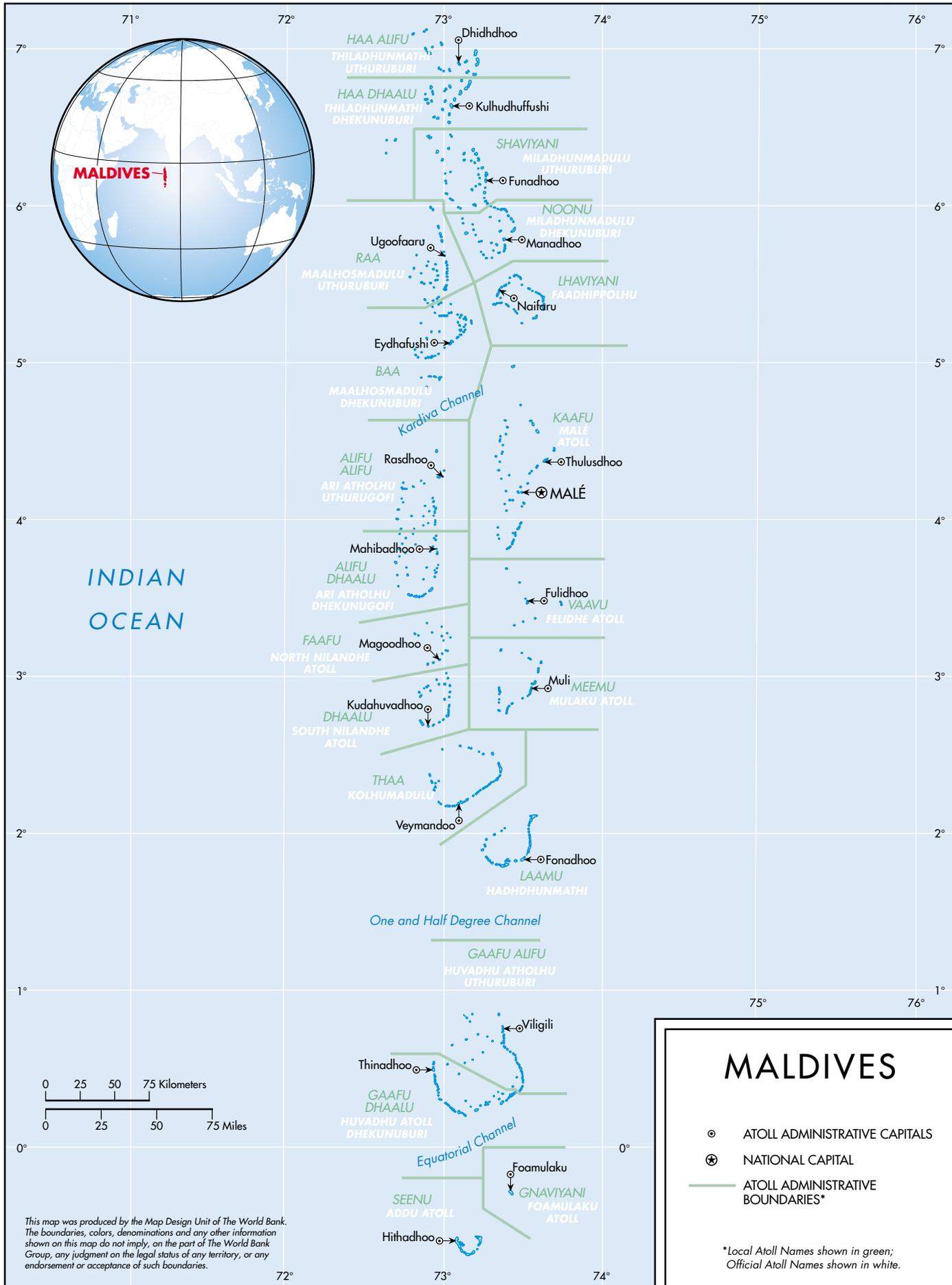
Drug abuse

22. **Drug abuse was highlighted as an increasingly serious social issue in the consultations with youth.** According to participants, the number of drug users and peddlers has increased dramatically in the last 5 years. The fact that many young boys have to leave their islands to come to Male is reported to be an increased risk factor, as these boys become particularly vulnerable to the predominant gang, drug usage and drug peddling culture. Youth unemployment was also associated with increased drug usage.

23. **Stakeholders pointed to the urgent need for increasing the capacity of rehabilitation centers** to avoid and prevent relapses, and called for the provision of medication in these centers. One rehabilitation center and two detoxification centers are available in Maldives. With drug use now having spread to islands, the participants also cited an urgent need for decentralized rehabilitation facilities. They also recommended the formulation of a national drug strategy or policy and proactive measures to curb drug abuse, so as to avoid a long lasting impact on the Maldivian society. An increase in gang culture was also noted with concern.

24. **Other youth-related risks were discussed in the consultations, including:**

- The rise of mental illnesses especially among the youth and school children, and the lack of adequate facilities to treat such patients;
- The lack of sex education in the school curriculum, due to a social taboo on the discussion of sex or drugs;
- A perceived rise in the number of HIV cases over the last decade;
- The escalating high cost of living.



MALDIVES

- ATOLL ADMINISTRATIVE CAPITALS
- ⊕ NATIONAL CAPITAL
- ATOLL ADMINISTRATIVE BOUNDARIES*

*Local Atoll Names shown in green;
Official Atoll Names shown in white.

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