MALDIVES

OVERCOMING THE CHALLENGES OF A SMALL ISLAND STATE

COUNTRY DIAGNOSTIC STUDY

ASIAN DEVELOPMENT BANK

ADB

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Foreword

The successful presidential election in November 2013 was the first step in addressing the political turmoil that has afflicted the Maldives and our economy in the last few years. The country has always been proud of its independence and sovereignty. Its vision, principles, and policies are all guided by the tenets of its Islamic faith. The new administration promises to usher in a prolonged period of peace, harmony, and stability, which will help the country achieve high and sustained inclusive economic growth. Among the administration's key priorities in moving forward is to ensure a stable political environment to enable the creation of economic opportunities, especially for the growing Maldivian population.

The Maldives, as the report notes, has been able to capitalize on tourism, resulting in the country's gross domestic product growing at an average of about 6.4% per annum during 2001–2014 despite the catastrophic effect of the 2004 tsunami and the global financial crisis. The government hopes to improve economic performance even further by expanding the economic base beyond tourism and fisheries. The administration is committed to achieving fiscal consolidation and prioritizing expenditures that can address its development objectives, in particular, enhancing physical connectivity and strengthening the provision of basic services, including social safety nets.

Although the Maldives achieved middle-income status in 2011, daunting challenges remain, especially in making growth more resilient to internal and external shocks, as well as more inclusive. Past growth has not been able to create sufficient employment opportunities for the increasing population of young people and the quality of and opportunities for higher education for those living outside the capital. Consequently, inequality has widened across income groups and among the atolls. These challenges can only be overcome by implementing policies and structural reforms that are timely and decisive.

The report provides important insights on how the Maldives' earlier development experiences have shaped its current growth path. The report also offers policy options that government can consider in charting the course of development in the medium term. The consultative process that was adopted and the involvement of many relevant stakeholders in conducting the study has enriched the analysis and, hopefully, the study can deepen the cooperation between the government and our development partners. The government gratefully acknowledges the support of the Asian Development Bank and the efforts of those involved in the study.

Mr. Abdulla Jihad
Minister of Finance and Treasury

Preface

The Maldives has propelled itself to middle-income status despite the geographic constraints and usual challenges that a small island economy faces. In the last 5 years, economic growth has averaged 4.5% per year, mainly on account of tourism, but also supported by transport, communications, and construction. Continued growth, however, needs to be more inclusive and balanced. The Maldives has one of the lowest poverty rates in South Asia, but wide regional disparities in poverty rates and relatively high income inequality continue to be a concern. Separately, as a small island developing state, the effects of climate change and environmental degradation, if not addressed, can severely impede efforts to achieve economic development and improve the quality of peoples' lives.

This report identifies four critical constraints to inclusive growth in the Maldives: (1) inadequate and poor quality maritime infrastructure that constrains connectivity, limits provision of basic goods and services, and results in high transport and logistics costs; (2) lack of professionals and highly skilled human resources, as evidenced by the low level of educational attainment and skills among the national labor force; (3) the high public debt and narrow fiscal space, which limit public investment in infrastructure and social services; and (4) weak financial intermediation that inhibits the development and expansion of micro, small, and medium enterprises (MSMEs), which are important for generating productive employment opportunities.

How then can the Maldives sustain its economic growth and improve the pace of its poverty reduction? First, expanding and upgrading maritime transport infrastructure, such as modernization of vessels and harbor facilities, can enhance connectivity and improve access to economic opportunities and social services, improve mobility of people and access to goods and services, and help reduce transport and logistics costs for businesses. Second, providing additional higher-secondary school infrastructure, financial incentives, and scholarships can enhance access to education and vocational training. Regular assessments of learning outcomes at different educational levels as well as alignment of teaching and training content to the requirements of the labor market can help address skills shortages and improve the quality of Maldivian labor. Third, increasing revenue mobilization and implementing a well-prioritized expenditure program can create fiscal space to finance high-priority infrastructure and social spending. Fourth, establishing support systems such as credit guarantee mechanisms, insurance products, liquidity pools, or other business development services can help reduce financing costs for MSMEs and financial institutions. Microfinance lending through island community and village cooperatives can also be explored to enhance MSMEs' access to finance. Finally, strengthening coordination mechanisms for disaster mitigation and response programs, given the country's experience with natural disasters and the predicted impacts of climate change, can improve the country's resilience to such events.

We look forward to continuing our productive dialogue and engagement with the government and other stakeholders in pursuing the country's efforts to further economic growth and enhance the lives and livelihoods of the Maldivian people.

Shang-Jin Wei
Chief Economist and Director General
Economic Research and Regional Cooperation Department

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The study benefitted from a series of consultative processes with the Government of the Maldives and key stakeholders including civil society, development partners, and the private sector. The study team is grateful to the support provided by the Government. It particularly thanks Hon. Abdulla Jihad, Minister of Finance and Treasury for his keen interest in, and guidance for completing, the study. The team also thanks the Economic and Youth Council of the President's office for their valuable comments on the findings of the study. The team appreciates the support provided by the Ministry of Finance and Treasury during the conduct of the study. Representatives from the President's Office, Maldives Monetary Authority, Ministry of Economic Development, Ministry of Education, Ministry of Environment and Energy, Ministry of Fisheries and Agriculture, Ministry of Health, Ministry of Home Affairs, Ministry of Youth and Sports, National Bureau of Statistics, civil society, the private sector, and representative organizations that participated in the workshops also deserve thanks.

The study was conducted by a team from the Economic Analysis and Operational Support Division, under the supervision of Cyn-Young Park, Director, Economic Research and Regional Cooperation Department, ADB. The study team that prepared the report included Cyn-Young Park, Kee-Yung Nam and Maria Rowena M. Cham. Valerie Blackman-Mercer, Kaukab Naqvi, and Paulo Rodelio Halili provided valuable comments in its finalization. The report benefitted from background papers prepared by a team of experts comprising Gilbert Llanto, Kazutoshi Chatani, and Ahmed Shaig. Research assistance was provided by Amador Foronda, Regina Salve Baroma, Arlene Evangelio, and Lotis Quiao. Economic editing was done by John Weiss. Jill Gale de Villa did the manuscript and style editing. Michael Cortes provided layout, cover design, and typesetting. Maria Melissa Gregorio-de la Paz, Ricasol Cruz-Calaluan, Rhina Lopez Tolentino, and Gee Ann Carol Burac provided administrative and secretarial support. Finally, appreciation is expressed to Muhammad Ehsan Khan who initiated the conduct of the study and to our colleagues from South Asia Department— Hun Kim, Diwesh Sharan, Sekhar Bonu, Gambhir Bhatta, Huiping Huang, and Masato Nakane—for providing valuable comments on the report and fostering the collaboration with the Government, which facilitated the conduct of the study.

Abbreviations and Acronyms

ACC	Anti-Corruption Commission
ADB	Asian Development Bank
AusAID	Australian Agency for International Development
DFAT	Department of Foreign Affairs and Trade
DNP	Department of National Planning
GDP	gross domestic product
HDI	human development index
HIES	Household Income and Expenditure Survey
IBE	International Bureau of Education
ILO	International Labour Organization
IMF	International Monetary Fund
INIA	Ibrahim Nasir International Airport
ITN	Integrated Transport Network
JICA	Japan International Cooperation Agency
MCH	Malé Commercial Harbour
MMA	Maldives Monetary Authority
MNH	Malé North Harbour
MPND	Ministry of Planning and National Development
MNQF	Maldives National Qualifications Framework
MoWASS	Ministry of Women Affairs and Social Security
MRR	minimum reserve requirement
MSMEs	micro, small and medium enterprises
MTMP	Maritime Transport Master Plan
NDP	National Development Plan
NER	Net Enrolment Rate
NGO	nongovernment organization
NPL	nonperforming loans
RCA	revealed comparative advantage
Rf	rufiyaa
RoRo	roll-on, roll-off
SAARC	South Asian Association of Regional Cooperation
SAP	Strategic Action Plan
SDBS	Statistical Database System
SIDS	small island developing states
SPI	social protection index
SREP	Scaling-up Renewable Energy Program
STELCO	State Electric Company, Limited
TI	Transparency International
TVET	technical and vocational education and training
UN Comtrade	United Nations Commodity Trade
UN DESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
US	United States
UNSD	United Nations Statistics Division
WDI	World Development Indicators
WGI	Worldwide Governance Indicators

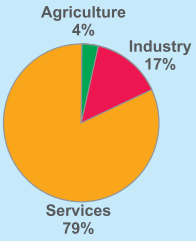
Weights and Measures

Kg	kilogram
km	kilometer
km2	square kilometer
TEU	twenty-foot equivalent unit

MALDIVES FAST FACTS
as of 2014

Economy

$2.6 billion nominal GDP
GDP per capita of $7,517
2011–2014 average sector shares in GDP



People & Resources

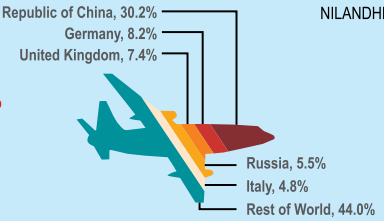
341,256 population
122,000 tons of tuna catch

Foreign Trade

Exports: $0.30 billion (12% of GDP)
Imports: $1.96 billion (76% of GDP)
Top 3 exports: Tuna, metalliferous ores and metal scrap, and industrial machinery
Top 3 imports: Petroleum products, food, and construction materials
Top 3 exports trading partners: France, Great Britain, and Thailand

Tourism

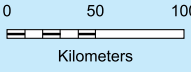
28% of GDP came from tourism sector
1.2 million tourists, 30.2% came from People's Republic of China
$2.6 billion spent during their stay



Social Indicators

15% poor population (2010)
28% unemployment rate (2010)
98.4% adult literacy (2012)
98.6% net enrolment rate in primary education
73.9 years of life expectancy (2012)
Infant mortality of 9 per 1,000 live births (2012)
Maternal mortality of 13 per 100,000 live births (2012)

Notes:
(1) GDP and GDP per capita are valued at basic prices.
(2) Population includes Maldivians only.



Executive Summary

The Maldives, a chain of 26 coral atolls to India's southwest, is one of the smallest countries in Asia and the Pacific by population and land area. Its estimated 341,200 people are widely dispersed over 188 inhabited islands across an archipelago more than 800 kilometers long and 130 kilometers wide. The capital city, Malé, is home to one-third of the people, yet has a total land area of less than 2 square kilometers.

The country has to a great extent met these serious geographical challenges by developing its many islands into high-end tourist resorts. Strong growth in the tourism sector, with support from fisheries and tourism-related activities, enabled the Maldives to transition from least-developed to middle-income status by 2011. In spite of a number of adverse internal and external factors, its growth performance has been strong, averaging 7.4% during 1986–2014. Real gross domestic product per capita, at $6,154 in 2014, is the highest in South Asia. This impressive record over four and a half decades provides inspiring lessons for other small island economies.

Yet the country continues to face great challenges in making growth more socially inclusive and regionally balanced. Economic disparities have widened between Malé and the other islands and between groups of different socioeconomic status. The wide dispersion of the population, coupled with limited transport infrastructure, hampers the creation of sizeable domestic markets and presents a formidable challenge in sustaining growth and providing adequate public services.

Inadequacies in maritime transport and limited availability of domestic skilled labor hold back private sector investment outside high-end tourism. Educational attainment remains generally low, leaving the national labor force with a lack of skills and forcing a heavy reliance on expatriate labor. Overcoming this shortfall will require substantial public sector investment, which is currently constrained by the limited budgetary room and the increasing public sector debt burden.

Creating more inclusive growth will also require a sharper focus on the development and expansion of micro, small, and medium enterprises (MSMEs), which are an important source of productive employment. Currently, access to credit is weak and its cost high, with smaller firms having particular difficulty in getting long-term credit.

This report recommends priority reforms and policy options to promote private investment in the Maldives based on an analysis of the most binding constraints to achieving sustained high, inclusive, and regionally balanced growth.

Provide adequate infrastructure to enhance transport connectivity and improve access to economic opportunities and social services

Improving the country's harbor infrastructure and the maritime transport services connecting Malé and the other atolls is central to better transport of both cargo and people. Doing so will also help reduce transport and logistics costs for businesses.

The government is indeed committed to linking Malé with the atolls, as evidenced by its adoption of a Maritime Transport Master Plan. The plan maps out institutional and regulatory reforms for the sector's development, including: (i) appointing an overall agency to manage the sector; (ii) establishing an independent and competent regulatory authority; and (iii) formulating a sound legal and institutional framework to help attract private sector participation in infrastructure development and management in general, and maritime transport provision in particular. The latter involves establishing clear guidelines on the scope for private sector participation in building regional port infrastructure, privatizing the operation and management of ports, and providing maritime transport services. The master plan also identifies high priority infrastructure investments.

The government needs to not only set aside adequate funding to ensure that these projects get implemented,

but also identify revenue-raising schemes from port operations and services to augment limited government resources.

Improve quality and access to education and vocational training to address the skills shortage

The government has achieved universal access to basic education by rapidly expanding primary-level enrollment, and has continued to improve education quality. But access to good quality secondary, tertiary, and vocational education remains limited across the atolls. The use of expatriate workers remains extensive, despite a high unemployment rate, particularly among the younger labor force, reflecting the lack of qualified and skilled national labor force.

Building on better primary education, the focus now should fall on improving quality of and access to upper secondary, tertiary, and vocational levels. This requires regular reviews of curricula to bring these in line with good international practice. Teaching and training content should also be more closely aligned with projected skill requirements of the labor market. Continuing the comprehensive teacher training and development program, which began in 2014, can improve teacher competence, especially in the outer atolls. Regular assessments of national learning outcomes at different education levels can also help enhance the quality of education.

Further investment in upgrading and expanding higher secondary school infrastructure will be needed, especially for atolls where access remains limited. Provision of scholarships and other financial incentives to poor but well-qualified students, targeted at these atolls, will help increase the pool of trained labor and enhance inclusion. Establishing a system of internships and on-the-job training in cooperation with the private sector can help prepare school leavers and other graduates for future employment.

Create ample fiscal space for needed infrastructure and social spending

Increasing capital expenditure for transport infrastructure and improving provision of social services requires more fiscal space. Indeed, the government narrowed its budget deficit in 2014 and implemented tax reforms to improve revenue collection. And it is committed to further fiscal consolidation and reform of public financial management for longer-term fiscal sustainability and greater macroeconomic stability.

Nevertheless, current public spending patterns do not fully support medium- to long-term fiscal plans. For instance, the pace of salary increases for civil servants could be restrained to better control recurrent budget expenditures. In addition, subsidies and cash transfers to help the poor could be designed more efficiently through better targeting to maximize impact and minimize waste.

The government could consider adopting a medium-term budget framework to help improve resource allocation and predictability of spending. This involves establishing key parameters for the total budget, which would guide individual ministries in conducting their expenditure reviews, allowing them to better prioritize expenditure programs for the cost-effective delivery of public goods and services. It is also important for the framework to offer guidelines for monitoring and managing medium-term fiscal risks to avoid undermining ongoing fiscal consolidation efforts. Compliance with the Fiscal Responsibility Law (2014) can support longer-term fiscal goals through prudent policies that could help ensure, for example, conformity with debt and deficit limits, and achieve a targeted primary balance in the medium term.

Higher public sector expenditure will require more vigorous domestic revenue mobilization. The government has made very good progress on tax reform since 2011 and it is imperative that efforts to broaden the tax base and improve tax administration continue. The implementation of the tourism goods and services tax, the business profit tax, and the general goods and services tax that took effect in May 2014, merits strict monitoring. At the same time, imposing new taxes, such as excise duties on jet fuel, gasoline, and vehicles, could be considered for additional sources of revenue.

Sources of nontax revenue could also be explored, such as imposing or raising fees for selected government services, and selectively privatizing state-owned enterprises (though primarily for efficiency, not revenue, reasons).

Enhance access to finance for micro, small, and medium enterprises

The Maldives ranks 36th out of 51 upper-middle-income economies for ease of getting credit, according

to the World Bank Ease of Doing Business Survey. To improve access to finance, it will be important to strengthen the banking system.

That said, the country's challenging geography has been an impediment to establishing bank branches in the atolls. While the use of information and communications technologies in innovative approaches to mobile banking has the potential to ease accessibility, the necessary institutional and regulatory framework encompassing guidelines on consumer protection has yet to be established. The government could consider giving high priority to adopting an appropriate legal and regulatory framework to help facilitate branchless banking transactions on a more secure basis.

The Maldives Monetary Authority has already introduced major reforms in the finance sector, including the establishment of the Credit Information Bureau. Further support systems are also needed, such as credit guarantee mechanisms, insurance products, a liquidity pool, and additional business development services, which can help reduce the cost of financing for both MSMEs and financial institutions.

Similarly, extending the coverage of the credit information system to collect and facilitate sharing of information on MSMEs can improve the quality of information, reduce credit risk, and help establish a secured transaction framework.

In addition, ways of extending the reach of microfinance lending to include savings associations and island community and village cooperatives could be explored, as could ways of strengthening existing microfinance institutions. Financial literacy campaigns and training courses for MSMEs, particularly in the outer atolls, will help them with loan applications and financial planning and thus facilitate their access to finance.

Addressing the challenges faced by small island developing states

Maldives, as well as other small island economies, faces unique challenges in achieving and sustaining economic growth and addressing inequalities. Because of its vulnerability to economic and climatic shocks, it is especially important to maintain stability and build resiliency to such shocks.

Achieving macroeconomic resilience is a top priority. To do so, the government needs to balance fiscal consolidation with development spending to create the fiscal space necessary to respond to potential economic shocks and natural disasters. Improving the capacity of government institutions to effectively plan the budget and implement prudent macroeconomic policies is likewise crucial.

Implementing structural reforms to improve long-term economic resilience to shocks is also important. Effective structural policies aimed at creating a business-friendly environment can help increase investor confidence and encourage private sector investment. Financial sector development with a view to enhancing financial inclusion will help promote micro and small enterprises and facilitate private sector development.

Identifying potential niche markets can often help small island developing states to overcome their unique challenges and expand export receipts. For example, Fiji successfully exports water, charging a premium in developed markets. The success of niche markets depends on a variety of factors such as financing availability, efficient information flow, an enabling regulatory environment, adequate infrastructure, and a marketing network to facilitate transactions. Government policies may help facilitate the market process. For example, trade policies, customs, and regulatory practices that are aligned with those of major trade partners can help lower transaction costs and improve competitiveness.

Finally, the government may wish to give top priority to risk mitigation and preparedness for future natural disasters. It is important to strengthen the coordination mechanism for disaster response among the government, donor partners, civil society, and the private sector, especially when funds are insufficient and domestic administrative capacity is limited. The national budget framework needs to incorporate the projected costs of natural disasters to allow the government to immediately deploy the spending required in times of need while at the same time ensuring medium-term fiscal sustainability.

Chapter 1
Development Performance

1.1. Introduction

The Maldives is one of the smallest countries in Asia and the Pacific by population and land area, and its people are scattered across 194 islands. Located in the Indian Ocean to the southwest of the Indian subcontinent, the Maldives comprises an archipelago of about 1,190 low-lying coral reef islands in an ocean area more than 800 kilometers (km) long and 130 km wide. The land area, which includes about 26 natural atolls, is grouped into 20 administrative atolls.

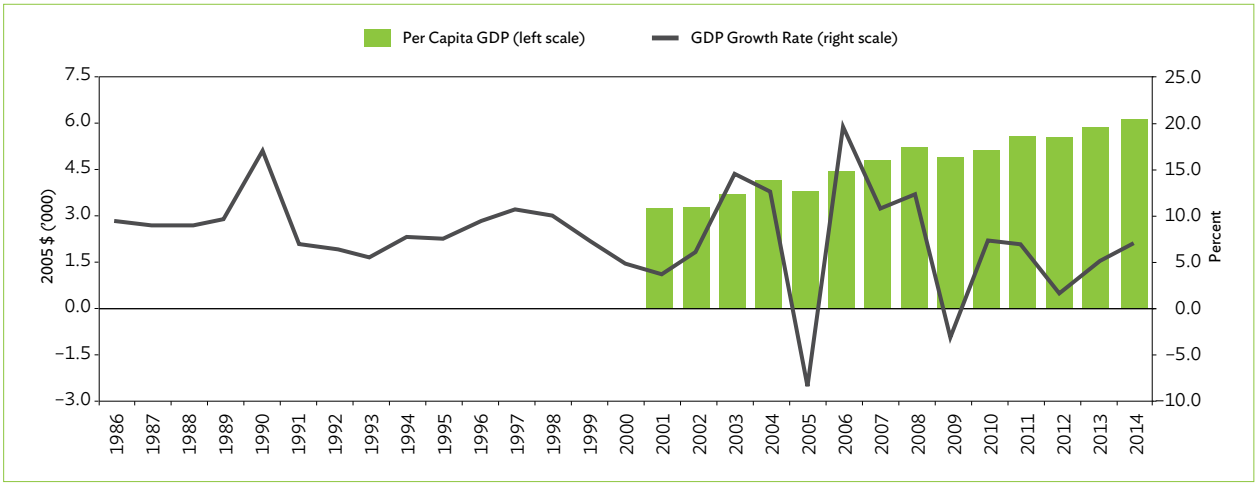
The population, estimated at 341,256 (NBS 2014), is widely dispersed across 188 inhabited islands of which about 125 islands have fewer than 1,000 inhabitants. Some islands are reported to have fewer than 500 inhabitants. One-third of the population lives in the capital city, Malé, which is an island of less than 2 square km. The dispersal of the population over such a wide expanse of atolls with limited transport infrastructure and service hampers connectivity and presents a formidable challenge to sustaining growth and providing the Maldivians with public goods and services.

Like other small island developing countries, the Maldives experiences specific problems that arise from the interplay of its small size and external factors. Its small size means that the country is undiversified across economic sectors and lacks arable land and natural resources other than fisheries. The dispersion of its islands has resulted in diseconomies of scale, high transport costs, a limited internal market, heavy dependence on imports, and vulnerability to exogenous economic and financial shocks. The Maldives' economy is very open, with its trade as a share of gross domestic product (GDP) equivalent to 223% in 2012.[1] The Maldives is also vulnerable to natural disasters, as the extremely low elevation of its islands (averaging about 1.5 meters above mean sea level) increases its susceptibility to tsunamis and effects of climate change.

Tourism from other Asian countries has been the engine of growth during the last 4 decades, propelling the Maldives to middle-income status. Since 1972, the government has been able to turn the dispersion of its islands into an opportunity to develop its tourism industry by converting some of the islands into high-end resorts. Thus, despite the daunting challenges of geography and a widely dispersed population, the Maldives has recorded significantly high growth in the last decades: real GDP growth averaged about 7.4% per year during 1986–2014 (Figure 1.1). The Maldives was able to graduate from a least-developed country in the 1970s to middle-income country status in 2011.[2] The Maldives has reported the highest GDP per capita among the South Asian countries since 1995. Its per capita GDP at constant 2005 $ in 2014 was $6,154—almost three times the South Asia subregion's average,

[1] Trade is the sum of exports and imports of goods and services measured as a share of GDP. Data are sourced from World Bank, World Development Indicators (accessed 29 May 2015).
[2] UN DESA and the Committee for Development Policy Secretariat (2012).

Figure 1.1: Per Capita GDP and GDP Growth



GDP = gross domestic product.
Notes:
(1) GDP growth is at constant 2003 basic prices; while per capita GDP is at constant 2005 $.
(2) Data on per capita GDP is available from 2001 only.
Source: For GDP growth, DNP (various years); for per capital GDP, World Bank, World Development Indicators (accessed July 2015).

Table 1.1: Broad Socioeconomic Indicators

	1986	1990	1995	2000	2005	2010	2014
Real GDP ($ million)	372.8	498.8	601.7	806.2	975.7	1,493.2	1,497.6
GDP Growth Rate (%)	9.4	17.0	7.4	4.8	−8.7	7.1	6.8
Inflation Rate (%)	9.7	3.6	5.5	−1.2	1.3	6.1	2.4
Current Account Balance ($ million)	−0.3	9.9	−18.2	−51.5	−273.0	−355.9	−191.1
Fiscal Balance ($ million)[a]	−9.1	−17.3	−25.5	−27.3	−81.6	−333.4	−102.7
International Reserves ($ million)	6.9	24.4	48.0	122.8	189.0	350.2	614.7
Exchange Rate (rufiyaa/$)	7.15	9.60	11.80	11.80	12.80	12.80	15.40
Poverty Incidence (%)				21.0 (2003)		15.0 (2010)	
Gini Coefficient				0.41 (2003)		0.37 (2010)	

GDP = gross domestic product.
[a] Average annual exchange rate was used to estimate fiscal balance in dollars.
Note: Real GDP is at basic prices.
Sources: For current account balance and international reserves: IMF, International Financial Statistics (accessed March 2015) for 1986–2006 data; MMA (2015b) for 2010 and 2014. For exchange rates: IMF, International Financial Statistics (accessed March 2015) for 1986–2010 data; MMA (2015b) for 2014. For fiscal balance: ADB, Statistical Database System (accessed March 2015) for 1986–2009 data; MMA (2015b) for 2010–2014. For poverty incidence and Gini coefficient: DNP (2012b). For others: DNP (various years).

3 times that of Bhutan, at $2,068, and 14 times that of Nepal at $426.[3] (Measured at 2011 purchasing power parity international dollars, the Maldives' per capita GDP in 2014 was $14,095, more than twice the average level of the South Asia subregion.)

This growth has enabled the government to support poverty reduction initiatives and implement social development programs. Investments in social development programs led to visible progress in achieving the Millennium Development Goals. Table 1.1 presents a brief summary of the Maldives' socioeconomic development during the last 2.5 decades.

At the same time, the country's small size and dispersion creates enormous challenges in terms of public service delivery, so the government has been tackling these through consolidation. The government has recognized that to create scale in

[3] World Bank, World Development Indicators (accessed June 2015).

economic activities and efficiency in delivering various services, consolidating the population into fewer islands is a prime option. Population and development consolidation continues to be envisaged as one means to bring down the cost of service delivery, address connectivity, and deal with the threat of rising sea levels and natural calamities. The 7th National Development Plan states that the government is bent on pursuing "the Population and Development Consolidation program."[4] Under this program, the government plans to offer incentives for people to migrate from islands that are environmentally vulnerable and/or from islands with populations less than 1,000 (MPND 2007). The policy also encourages people to move voluntarily to less vulnerable islands. However, the government has first to address its mounting public debt, as the resettlement program will require a huge amount of resources.

Following interruptions induced by political uncertainty, the main development agenda of the government going forward includes expanding social welfare and economic diversification. In November 2009, the government crafted a strategic action plan (SAP) outlining the national framework for development for 2009–2013.[5] The SAP was intended to be the government's principal planning document for delivering its pledges and programs outlined in the Maldivian Democratic Party Alliance Manifesto. However, the political and social unrest and the ensuing uncertainty from 2011 to 2013 delayed implementation of the SAP. The government that was elected in November 2013 formulated a development plan following the President elect's campaign promises. The plan's main pillars included creating desirable jobs especially for the youth, addressing law-and-order problems, and tackling social welfare issues such as state-provided health care and housing. The plan also aims to pursue greater economic diversity and expand agriculture so as to reduce dependency on food imports. The return of political stability following the 2013 presidential elections and the 2014 parliamentary elections enhanced the environment for business investment.

1.2. Small Economy

Due to its small size, the economy is vulnerable to shocks. The Maldives' growth performance has been highly successful considering a number of adverse factors, both internal and external, that have transpired in the last 28 years. Tourism has been the main driver of growth, but its importance has also exposed the economy to greater volatility. External developments such as the Asian Financial Crisis of 1997–1998, the Indian Ocean tsunami of 2004, and the 2007–2008 global financial crisis demonstrated how the Maldives' heavy dependence on one sector—tourism—creates underlying vulnerabilities.

The impact of the 2004 tsunami was particularly devastating. Financial damage due to the tsunami was estimated at $470 million (44% of the country's 2004 GDP), excluding the environmental costs, i.e. the value of the topsoil and reclaimed land that was washed out to sea (World Bank 2005). The tourism industry was severely affected the following year, as it contracted by 34% and the economy as a whole contracted by 8.7%. The economy was able to recover from the tsunami to register double digit growth rates between 2006 and 2008. However, the substantial increase in public spending following the tsunami had a major impact on the fiscal position.

The country suffered another shock in the late 2000s as the world economy faltered in the aftermath of the global financial crisis of 2007–2008. The economy contracted by 3.6% in 2009 due to a fall in tourism receipts, capital inflows, and exports. Along with acute dollar shortages and falling reserves, the fiscal condition deteriorated sharply while the increased monetization of the fiscal deficit fueled inflation.

[4] The Maldives' economic growth and development have been guided by a series of national development plans, which spelled out the government's development agenda. The most recent of these development plans is the 7th National Development Plan (2006–2010), which established the priority development areas, specific goals, and targets that have guided planning and investment over the plan period.

[5] The key themes of the SAP were good governance, social justice, and economic development. The SAP's main objectives included (1) guiding the development processes in the country; (2) being an instrument of allocation of budgetary and fiscal responsibilities to various sectors and government ministries; and (3) serving as a mechanism of accountability to the citizens of the country toward achieving promised development benefits and enhancing access to goods and services.

Vulnerabilities are still palpable. The economic rebound in 2010–2011, driven by the recovery of tourism, has been relatively weak as the uncertainty about global economic recovery continues. Real GDP is projected to grow at 6.3% in 2015, about 0.5 percentage points lower than 6.8% growth in 2014. The country continues to face severe fiscal and external imbalances, with a high risk of debt distress.

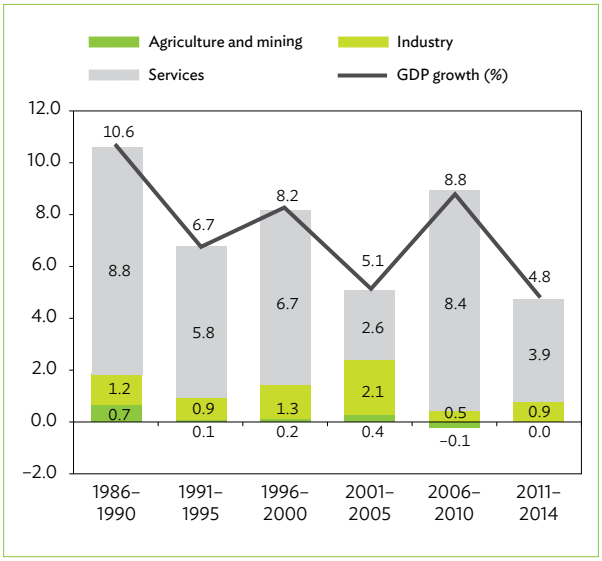
1.3. Growth by Sources of Production

The Maldives' archipelagic structure constrains the country's range of economic activities. As is typical of countries composed of dispersed islands, the Maldives' services sector, of which tourism is the biggest component, has been the main driver of growth for almost 3 decades. Agriculture, which has been constrained by a dearth of arable land, and industry, with limited manufacturing activities, have played a minor role in the economy (Figure 1.2).

The services sector averaged 82.8% of GDP during 1986–2014, and has been by far the largest contributor to GDP during the last 3 decades. The exception was in 2004–2005, when the 2004 tsunami led to a dramatic fall in GDP, with the services sector contributing only 2.6%. The growth of services has been even more important in relative terms since the 2007 recession, given the lackluster growth and weak recovery of the other sectors following the global financial crisis. The sudden increase in output of the public sector in 2008—due to a sizable increase in recurrent expenditures—counteracted to some extent the sharp drop in tourism activity. The real gross value added of the services sector has been on an increasing trend since tourism has flourished as one of the main growth drivers.

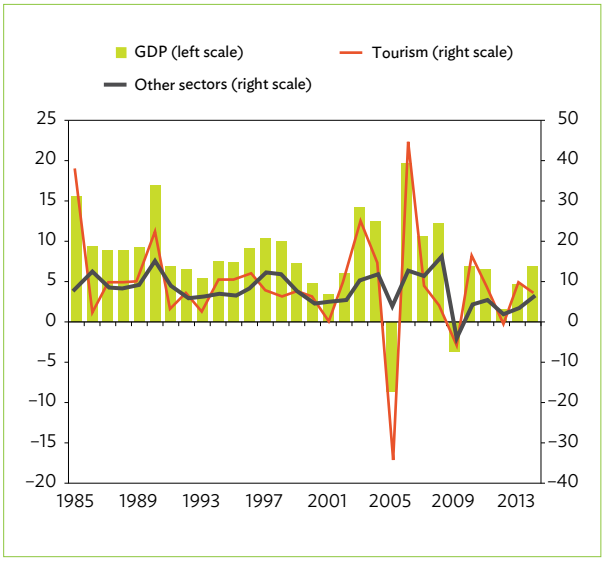
Tourism continues to be the mainstay of the economy, averaging 35% of services' share in GDP during 2001–2014. Since the first tourist resorts opened in 1972, tourism reached a 26,891 bed-night capacity on 104 resort islands at the end of 2014. Tourism has also been the country's major source of foreign exchange. Moreover, given its large share of GDP, trends in tourism explain the bulk of fluctuations in economic activity. Figure 1.3 shows how, in 2005, tourism declined by 34% following the 2004 tsunami and resulted in contraction of the GDP. As tourism recovered the following year and registered a very strong growth of 44%, the economy also recorded a strong growth of nearly 20%. The global economic crisis led to another contraction of GDP, by 3.6% in 2009, when tourism also declined by 5.4%.

Figure 1.2: Average Contributions of Major Sectors to GDP Growth, 1986–2014 (percentage points)



GDP = gross domestic product.
Source: Calculations based on DNP (various years).

Figure 1.3: Growth Rates of Real GDP, Tourism, and Other Sectors, 1985–2014 (%)



GDP = gross domestic product.
Source: Calculations based on DNP (various years).

Table 1.2: Average Shares of GDP and Contribution to GDP Growth by Expenditure Component, 1996–2012 (%)

Period	Consumption			Government			Investment					Net Exports	
	Growth Rate	Share of GDP	Contribution to GDP Growth Rate	Growth Rate	Share of GDP	Contribution to GDP Growth Rate	Growth Rate	Share of GDP	Contribution to GDP Growth Rate	Exports Growth Rate	Imports Growth Rate	Share of GDP	Contribution to GDP Growth Rate
1996–2000	4.2	47.0	25.2	13.8	15.8	31.9	7.8	21.6	18.6	9.0	8.5	15.6	24.3
2001–2005	6.8	40.7	60.1	8.2	19.5	36.9	19.8	25.3	99.1	3.1	10.5	14.4	–96.0
2006–2012	3.9	36.6	54.0	5.4	22.8	41.3	0.5	29.0	5.3	13.1	12.4	11.6	–0.7
1996–2012	4.9	39.5	46.1	8.6	22.1	36.8	8.0	26.1	37.7	8.9	10.7	12.3	–20.6

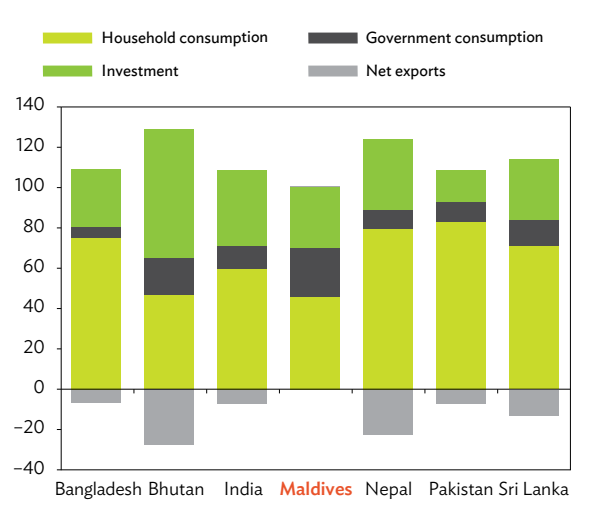
GDP = gross domestic product.
Note: Data used are in constant 2005 market prices.
Source: Calculations based on UNSD, National Accounts Official Country Data (accessed March 2015).

The garments industry had been the only major manufacturing activity in the country, at just under 9% of GDP. With the abolition of quotas under the Multi-Fiber Arrangement in January 2005, foreign investors, mostly Sri Lankan garment manufacturers, who had previously established operations in the Maldives to take advantage of the low level of the country's quota utilization, closed their factories and moved to countries that offered incentives to remain competitive and profitable.

Agriculture's share of GDP (which includes fishery and mining) has been declining continuously. The sector's share fell from about 9% in 1986 to 3.6% during 2011–2014, largely on account of low productivity growth and the dwindling fish catch. While fishing has been the country's second largest foreign exchange earner after tourism and an important employer of Maldivian labor, the declining catch has been exacerbated by the slowdown of the European economy, which is the main market for tuna exports. Meanwhile, agriculture production has been constrained by the availability of arable land, and soil that is not conducive for a whole range of agricultural products.

GDP growth by expenditure components (Figure 1.4) shows the increasing importance of the government in the economy. On the demand side, the economy was driven by strong household consumption and investment (both public and private), which contributed an average of 46% and 38% to GDP growth, respectively, during 1996–2012.[6] Net exports had a negative contribution to GDP growth during 1996–2012, at –20.6%, reflecting the increasing demand for imports and slower growth of exports (Table 1.2). Private household consumption is relatively lower than in other countries of the subregion, averaging 46% of GDP, while government consumption—at more than 24% of GDP—is very high by subregional standards. Indeed, the rising share of government domestic consumption in GDP—from 14% of GDP in 1995 to 24% in 2012—came mostly at the cost of lower household consumption.

Figure 1.4: GDP by Expenditure Component in South Asia, 2012 (%)



Source: Calculations based on data from UNSD, National Accounts Official Country Data (accessed March 2015).

[6] A breakdown of expenditure components for 2013 and 2014 was not available as of June 2015.

1.4. Macroeconomic Environment

1.4.1. The External Sector

The Maldives exports just a few items but imports a wide variety of consumption goods, reflecting its limited agricultural output and small domestic manufacturing base. The Maldives' foreign merchandise trade normally records a large deficit. Domestic nontourism exports consist primarily of fish and fish products (with fresh, chilled, or frozen tuna the main export commodity followed by dried and salted dried tuna, and canned or pouched tuna). The re-export of jet fuel, which is sold to air carriers, has also increased. Imports, which normally exceed exports by several multiples, are varied and include food, electronics, machinery and transport, construction materials and equipment, oil and petrochemicals, and other products (Figure 1.5).

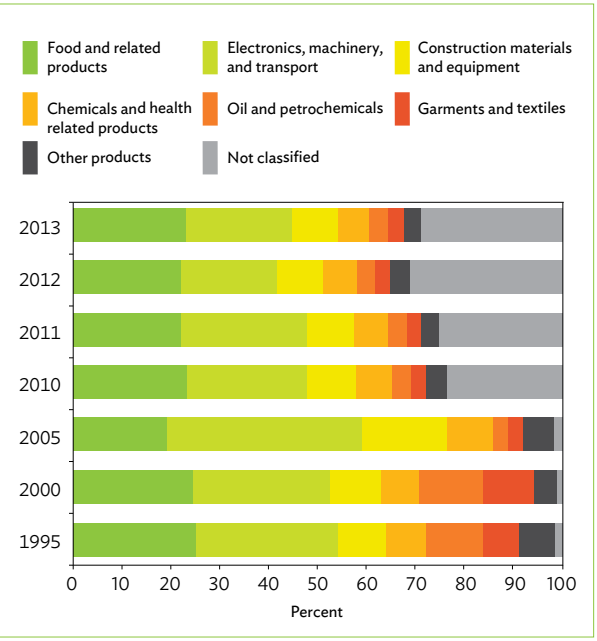
The current account deficit has been consistently high, reflecting the large dependence on imports typical of small island economies.[7] From double-digit levels in the last 7–8 years, the external environment has improved since 2011—the exchange rate has been more favorable and tourism receipts increased. As a result, the deficit trended down to a single-digit level in 2012 (Table 1.3). Meanwhile, the country's gross international reserve levels have been volatile and can cover only 3.7 months of imports of goods and services.

1.4.2. Inflation, Exchange Rate, and Monetary Policy

Inflation in the country has been highly erratic partly on account of rising import prices, particularly of food and fuel, over which the economy has no control given its high dependence

[7] Some discussion in this sector has been constrained by the data gaps in measurement and coverage, which the Government of Maldives is still trying to address. For example, the Maldives Monetary Authority (MMA) has reported major data deficiencies in the capital and financial account, such as positive errors and omissions, which have been reported since 2002. However, these errors and omissions exceeded $100 million during 2008 and 2010–2012 and $300 million during 2008, 2011, and 2012, which are more than the value of recorded exports of goods in each of these years. These figures therefore indicate unrecorded net inflows of foreign exchange suggesting the presence of a sizeable parallel currency market that is not factored in the discussions.

Figure 1.5: Composition of the Maldives' Imports, 1995–2013 ($ million)



Source: Calculations based on UNSD, Comtrade (accessed April 2015).

on imports. After averaging 1.8% during 2001–2006, inflation surged to 6.8% in 2007 and 12.0% in 2008. The increase in prices was partly due to the effects of high global food and fuel prices, although demand-side factors exacerbated inflation as the money supply expanded rapidly to finance government expenditures. Inflation eased in 2009 and 2010, but again breached the double-digit level in 2011 and 2012 due to the depreciation of the rufiyaa in 2011. The increase in prices was exacerbated by the 20% devaluation of the rufiyaa against the United States (US) dollar (Figure 1.6). Inflation then slowed to 2.4% in 2014, reflecting declining prices of fish, oil, housing, and consumer goods. The dampening of inflationary pressure can also be attributable to the relatively stable global energy prices since mid-2012.

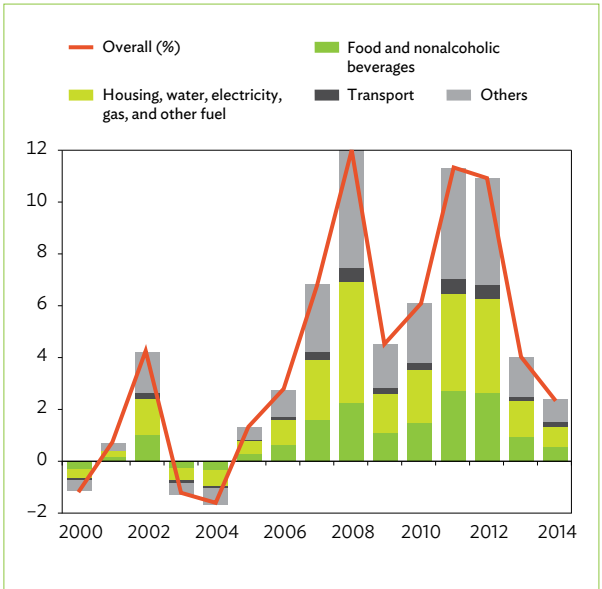
Most of the movement in the consumer price inflation can be explained by price changes of just a few household goods and services, and the exchange rate. Given that "food and housing, and water," and "electricity and fuels," carry large weights in the domestic consumption basket, they are the main drivers of the Maldives' inflation. In turn, food and fuel prices move very closely with international commodity prices. Inflation can vary significantly across atolls and

Table 1.3: Summary of Balance of Payments, 2007–2014 ($ million)

	2007	2008	2009	2010	2011	2012	2013	2014
Current Account Balance	**–266.6**	**–673.2**	**–276.0**	**–355.9**	**–393.4**	**–186.1**	**–119.8**	**–191.1**
(as % of GDP at basic prices)	–14.8	–35.6	–13.9	–16.7	–18.1	–8.4	–5.2	–7.5
(as % of GDP at market prices)	–15.0	–31.7	–12.7	–15.3	–16.0	–7.4	–4.4	–6.3
Balance on Goods	–1,077.8	–1,317.6	–912.7	–1,059.4	–1,370.5	–1,261.4	–1,372.0	–1,660.0
Balance on Services	1,248.4	1,178.4	1,117.3	1,224.0	1,527.5	1,613.4	1,909.1	2,211.7
Balance on Income	–280.6	–319.6	–300.4	–323.3	–308.7	–278.9	–369.7	–394.2
Balance on Current Transfers	–156.5	–214.4	–180.3	–197.3	–241.8	–259.2	–287.2	–348.7
Overall Balance	**76.9**	**–67.8**	**20.4**	**89.2**	**–15.3**	**–30.4**	**63.8**	**246.4**
Gross Official Reserves	**308.5**	**240.6**	**261.0**	**350.2**	**334.9**	**304.5**	**368.3**	**614.7**
Months of Total Imports	3.0	2.1	3.3	3.9	2.7	2.4	2.5	3.7

Source: MMA Monthly Statistics (various issues).

Figure 1.6: Inflation, 2000–2014 (percentage points, June 2012 = 100)



Source: DNP (various years).

islands. Moreover, the exchange rate pass-through to consumer inflation in the Maldives is very high in absolute terms, and relative to other countries. In other words, changes in the nominal effective exchange rate tend to have immediate and strong impacts on consumer and producer prices, and these changes are relatively persistent over time (Masha and Park 2012).

On the exchange rate front, the pegged exchange rate regime ended in 2011 as the country's international reserves position deteriorated further, thus making monetary policy more challenging. Since 1994, the exchange rate in the Maldives has moved only twice. The first instance was through an 8.8% devaluation in 2001; the second was in April 2011, when a more flexible exchange rate regime was adopted to ease the pressure from the foreign exchange market. The Maldivian rufiyaa was allowed to fluctuate within a horizontal band of 20% on either side of a central parity of Rf12.85/$. This had an important one-time upward effect on producer and consumer prices that year. In the 3 years prior to that, the real effective exchange had been appreciating broadly following the movements of the US dollar. But since the introduction of the exchange rate band, the rufiyaa has depreciated by 20% against the US dollar, thus reaching the limits of the band. To maintain the rate within the band, the central bank has been rationing foreign exchange to commercial banks. In the coming years, the rufiyaa may need to be devalued further given still low international reserve levels and high demand for imports, which can result in current account deficits. This will likely immediately affect prices and the purchasing power of consumers, particularly of inhabitants in remote areas that depend on imports. As of December 2014, the exchange rate was Rf15.4/$.

The Maldives Monetary Authority (MMA) has continued to introduce new monetary policy instruments to effectively carry out its main objective of ensuring macroeconomic stability through price stability and preserving a stable level of foreign exchange (MMA 2012a). The current monetary policy

framework uses the exchange rate as its main anchor, and monetary operations are used to manage the overall excess liquidity in the banking system. Among the main monetary policy instruments in use are the open market operations; the MMA standing facilities, which consist of the overnight deposit facility and the overnight Lombard facility; and the minimum reserve requirement.

For the MMA to continue to perform its mandate, it has introduced several changes to the monetary policy framework. The aim is to increase the framework's effectiveness and develop the interbank market in the country. Among the MMA initiatives in 2014 are (1) reducing the minimum reserve requirement from 25% to 20% to facilitate private sector lending and to reduce the cost of borrowing for commercial banks; (2) temporarily stopping open market operations, to help the government raise financing through the market; and (3) lowering the interest rate on the overnight deposit facility and the overnight Lombard facility and reducing the indicative policy rate to rationalize the overall interest rate structure in the banking system. Changes initiated in 2013 include (1) narrowing the interest rate corridor by increasing the overnight deposit facility from 0.25% to 3.00%, (2) reducing the overnight Lombard facility from 16.0% to 12.0%, and (3) redefining the indicative policy rate to be used as the indicative rate for open market operations instead of using it only as a cut-off rate.

The economy faced large external imbalances in 2009 resulting from the global financial crisis and unsustainable fiscal expansion, which increased inflationary pressures and led to reserve losses. Monetary policy was tightened as part of the economic policy measures under the International Monetary Fund program 2009–2011. The active open market operations and termination of deficit monetization successfully reduced excessive liquidity. However, because of the economic slowdown, the MMA's enforcement of new prudential regulations, and the large number of nonperforming loans, the banks became more cautious in new lending activities, and opted instead to invest in risk-free instruments such as Treasury bills. As a result, credit to the private sector fell in 2012. At the same time, there was a large expansion in net credit to the government, which crowded out private sector credit. Credit to the private sector reverted to positive growth in 2013, but so did public sector credit, as the government had to rely on domestic sources to meet the rest of its financing requirements for 2013 (MMA 2014b).

1.4.3. Fiscal Policy

Fiscal consolidation continues to be the main item on the macroeconomic agenda, with the persistent fiscal deficits adding to public debt levels. Slippage in both the revenue collection and expenditure cutbacks continue to lead to fiscal deficits that are higher than the government target. On the expenditure side, despite efforts to curb spending on wages and salaries in recent years, fiscal deficits have meant lower capital expenditures. As a result, the total government debt has continued to rise since 2007, particularly domestic debt. Public debt reached 89.0% of GDP at the end of 2014 from 45.3% in 2007. External debt declined to 32.6% of GDP in 2014 from 45.3% in 2007.

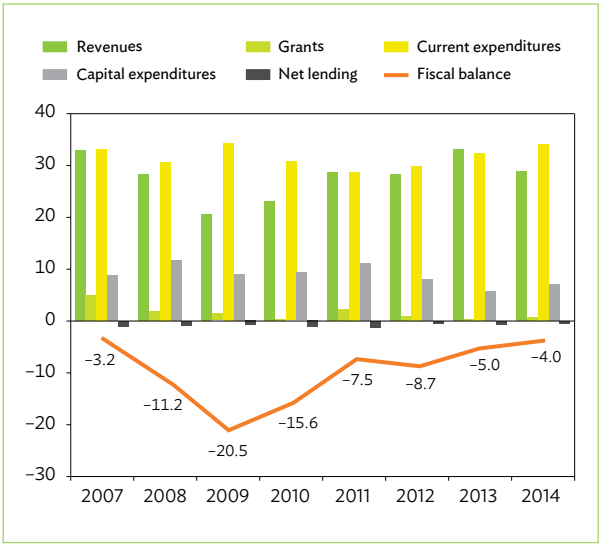
The 2008 global financial crisis had a significant negative impact on the fiscal balance (Figure 1.7). GDP shrank with lower tourism, affecting general tax revenues, while taxes from international trade shrank given lower import demand. The decrease in the share of total revenue and grants as a ratio of GDP also contributed to the deficit as the new revenue measures envisaged to support the 2008 budget did not materialize.[8] The deterioration in the government's fiscal position had already begun in 2004 when total expenditure grew rapidly, to 43% of GDP in 2008, mainly due to the increase in subsidy payments and other current expenditures.

To address the severe fiscal and external imbalances, a comprehensive adjustment program[9] supported by the International Monetary Fund was implemented in

[8] The new measures include advance lease rents from developing Gulhifalhu and phase 2 of Hulhumale' development and payments from developing a transhipment port and an economic zone in North Ihavandhipolhu.

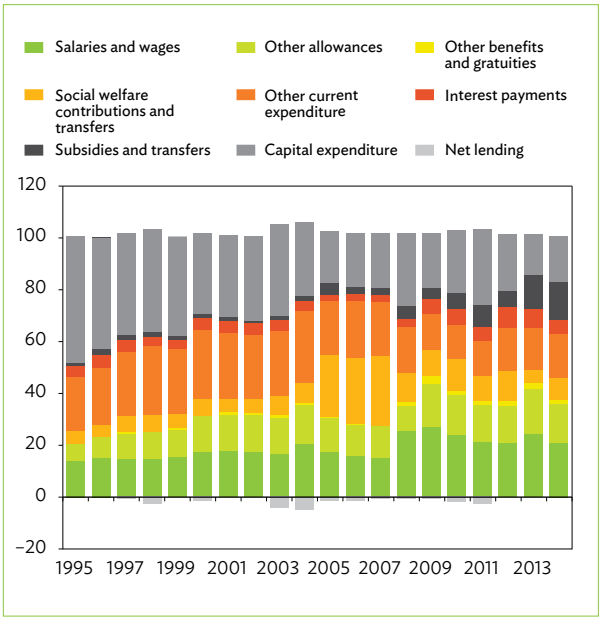
[9] A blend of a stand-by arrangement (special drawing rights 49.2 million) and an arrangement under the Exogenous Shocks Facility—special drawing rights 8.2 million) approved on 4 December 2009 that centered on a strong fiscal adjustment to put public finances back on a sustainable medium-term path, complemented by monetary tightening and measures to strengthen the banking sector.

Figure 1.7: Fiscal Indicators, 2007–2014 (% of GDP)



GDP = gross domestic product.
GDP is valued at basic prices.
Source: MMA (2015b).

Figure 1.8: Components of Government Expenditure in the Maldives, 1995–2014 (% of total expenditure)



Sources: Calculations based on data from DNP (various years) for 1995–2012 and MMA (2015b) for 2013–2014.

2009. The government initiated several expenditure reduction measures in the second half of 2009 to curb the growing fiscal deficit. A temporary wage reduction program for civil servants was implemented in the fourth quarter of 2009, which brought down the share of salaries and wages in total government expenditure to about 22% for 2012–2014, compared with 27% in 2009 (Figure 1.8). The temporary wage cuts helped moderate government spending in 2010 but the need to contain the fiscal deficit at manageable levels prevented the government from investing in much-needed physical infrastructure.

Following the fiscal measures, the government was able to narrow the fiscal deficit to 7.5% of GDP in 2011 from 15.6% in 2010, but the consolidation was short-lived.[10] Increases in revenue collections from tourism-related earnings and profits received from the government concessions, as well as from the Tourism Goods and Services Tax that came into effect, helped reduce the deficit. However, with revenue collection falling well below budgeted levels due to the reduced customs duties and shortfalls in nontax revenues, the deficit increased to 8.7% in 2012. The higher-than-budgeted expenditures from increased subsidies and social welfare payments and the transfers to state-owned enterprises aggravated the situation. In 2013, the fiscal deficit declined to 5.0% of GDP due to higher revenues and lower spending. With most of the major tax policies well under way, total government revenue increased by about 18% in 2013 from the previous year, although it fell short of the target by about 4%. The budget deficit narrowed in 2014 to 4.0% of GDP as the economy grew; however, government expenditures still increased compared to the previous year.

The achievement of fiscal consolidation remains questionable, as efforts to stem spending on wages and salaries and other current expenditures since 2007 came at the cost of higher transfers to the public pension and lower capital expenditures. Social welfare contributions and transfers (from the pension scheme of government employees) has become a large expenditure item, increasing significantly since 2005. In 2010, while compensation declined by 16%, subsidies and transfers to employee pension contributions

[10] Expenditure reducing measures such as cuts in civil servants' nominal pay, increases in electricity tariffs with elimination of universal subsidies, initiation of a public employment reform program to reduce the bureaucracy, increases in tariffs for certain services, and imposition of new taxes such as the goods and service tax on tourism and the Business Profit Tax .

grew by almost 52% under the Maldives Pension Act. In 2014, subsidies, social welfare contributions, and pensions and other benefits comprised 33% of the current account expenditures. The largest share of the government's social welfare contributions went to the universal health insurance scheme, Aasandha; the second largest contribution to the growth in current account expenditure came from subsidies and transfers due to the marked increase in pensions with the introduction of a senior citizens' allowance in February 2014.

1.5. Poverty and Inequality

With the Maldives' strong economic growth performance and the government's regional development policy, the efforts to spread economic and social infrastructure equitably have helped reduce poverty in the country. Despite the tsunami and the global financial crisis, which resulted in significant loss of assets and decline in per capita income, the country was able to bring the national poverty incidence down from an estimated 21% in 2003 to 15% in 2010. Based on the latest available data, the Maldives has one of the lowest poverty rates in South Asia (Table 1.4).

The 2013 Human Development Report classifies the Maldives as having medium human development (UNDP 2013). With a human development index of 0.688, the Maldives ranks 104th of 187 countries and 2nd, after Sri Lanka, in South Asia. The index captures nonincome dimensions of poverty, based on four criteria: life expectancy at birth, mean years of schooling, expected years of schooling, and gross national income per capita.

Wide regional disparities persist in the country's development. Despite the government's continued commitment to balanced development across the country through its Regionalization and Decentralization Programme, which was highlighted under the SAP (2009–2013), the disparity in poverty incidence between Malé and the atolls and between income deciles within Malé continues to be a concern. The poverty incidence has risen in Malé between 2003 and 2010 (from 4% to 12%), mainly due to migration from rural atolls to Malé in search of employment opportunities. The inability to create an adequate number of jobs in Malé and provide sufficient infrastructure to match the rapid in-migration has resulted in the social problems that Malé has been encountering. At the regional level, wide disparities in poverty rates were also evident based on the latest available Household Income and Expenditure Survey (HIES) conducted by the government (DNP 2012b). The poverty incidence (Figure 1.9) was high in Region 2 (North), Region 6 (Upper South), and Region 5 (South Central).

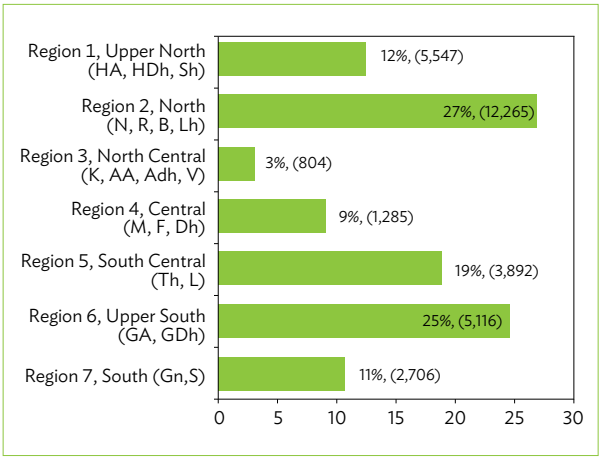
Although the Maldives has the highest per capita income in South Asia, it also has relatively high income inequality by subregional standards, and one of the highest Gini coefficients in South Asia. The Gini coefficient for the entire country declined slightly in recent years (from 0.41 in 2003 to 0.37 in 2010). However, income inequality in Malé continued

Table 1.4: Poverty Incidence as Indicated by Poverty Lines for South Asian Countries (%)

Country	National Poverty Line		$ 1.25-a-day Poverty Line		$ 2-a-day Poverty Line	
	Previous	Latest	Previous	Latest	Previous	Latest
Bangladesh	48.9 (2000)	31.5 (2010)	58.6 (2000)	43.3 (2010)	84.4 (2000)	76.5 (2010)
Bhutan	31.7 (2003)	12.0 (2012)	24.0 (2003)	2.4 (2012)	46.9 (2003)	15.5 (2012)
India	37.2 (2004)	21.9 (2010)	41.6 (2004)	23.6 (2011)	75.6 (2004)	59.2 (2011)
Maldives[a]	**21.0 (2003)**	**15.0 (2010)**	**9.0 (2003)**	**8.0 (2010)**	**31.0 (2003)**	**24.0 (2010)**
Nepal	..	25.2 (2010)	3.1 (2003)	23.7 (2010)	77.3 (2003)	56.0 (2010)
Pakistan	34.5 (2001)	22.3 (2005)	22.6 (2004)	12.7 (2010)	60.3 (2004)	50.7 (2010)
Sri Lanka	22.7 (2002)	8.9 (2009)	4.0 (2002)	4.1 (2009)	39.7 (2002)	23.9 (2009)

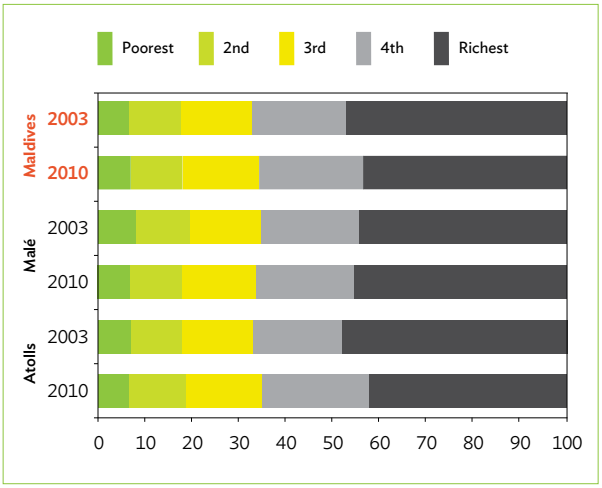
...= data not available.
Source: For Maldives: DNP (2012b); for other countries: World Bank, WDI (accessed June 2015).

Figure 1.9: Poverty Incidence by Region, 2010 (%)



Note: Regional classification = Region 1 (Upper North): Haa Alifu (HA), Haa Dhaalu (HDh), and Shaviyani (Sh); Region 2 (North): Noonu (N), Raa (R), Baa (B), and Lhaviyani (Lh); Region 3 (North Central): Kaafu (K) and Alifu Alifu (AA); Region 4 (Central): Dhaalu (Dh), Mulakatholhu (M), and Faafu (F); Region 5 (South Central): Thaa (Th) and Laamu (L); Region 6 (Upper South): Gaafu Alifu (GA) and Gaafu Dhaalu (GDh); Region 7 (South): Gnaviyani (Gn) and Seenu (S). Values inside the parentheses are the total poor population.
Source: Calculations based on DNP (2012a).

Figure 1.10: Expenditure Share by Quintiles, 2003 and 2010 (%)



Source: DNP (2012b).

to widen slightly, from 0.35 in 2003 to 0.38 in 2010, as conditions have worsened for some new migrants seeking employment opportunities, while property values in the city have risen.[11] Figure 1.10 shows the distribution of household expenditure by quintile.

[11] In Malé, the richest quintile increased its share in expenditures, while the poorest two quintiles reduced theirs, thus worsening inequality between 2003 and 2010.

1.6. The Challenges Going Forward

The Maldives' development experience in the last 4.5 decades has shown that a small island economy can propel itself to become a middle-income country despite the constraints and risks that it faces. The Maldives can continue to exploit its strengths, notably its pristine natural environment, which helped it establish a strong foothold in the global tourism industry, to sustain its strong growth performance. However, various internal and external factors threaten this growth as the country continues to face a number of development challenges. Box 1.1 provides a snapshot of the Maldives' major characteristics in terms of the strengths and weaknesses, and the opportunities and threats it faces. If the weaknesses are not addressed or mitigated, this can jeopardize the country's ability to achieve its objective of inclusive growth and development.

Geography plays a major role in determining the Maldives' growth possibilities and the constraints to its economy. The archipelagic and environmentally vulnerable nature of the economy is a challenge for its small population. The population's dispersal likewise results in a number of socioeconomic and governance issues, with insufficient water transport a key bottleneck. A shortage of skills, the impossibility of developing significant agriculture, and high transport costs combine to make it difficult to diversify the economy. The need for significant expenditure to protect against climate vulnerability and to improve water transport links places a huge burden on the government's limited capital budget. Further, the need to continuously import petroleum products and the pressure to protect consumers from the most severe effects of oil price increases have created a demand for subsidies on utilities, particularly electricity. Together these demands put additional pressure on a very tight government budget and have contributed to the chronic budget deficit problem that has yet to be addressed. The domestic funding of this deficit has in turn affected both the cost of borrowing for the private sector and the availability of finance, especially for investment purposes. How the political situation evolves with the newly elected government will also be a major factor influencing growth.

Box 1.1: The Maldives' Strengths, Weaknesses, Opportunities, and Threats

Strengths	Weaknesses
• Pristine environment and rich marine resources • Vibrant tourism industry • Relatively high gross domestic product per capita and low poverty incidence • Good track record on most Millennium Development Goals • Good English language skills	• Narrow economic base • Income inequalities and poor access to basic social services for many scattered atolls • Dispersed population • Limited sources of revenue • Lack of adequate human resources • Weak institutions • Large and unsustainable size of the government • Heavily subsidized social services • Lack of physical and social infrastructure • Highly import dependent • Regional inequalities and inequities • Lack of employment opportunities (youth unemployment and heavy reliance on expatriate labor)
Opportunities	**Threats**
• Diversification and development of local industries • Potential for renewable energy • Development of uninhabited islands for tourism or other economic activities • Development of the services sector by linking more closely with tourism	• Vulnerability to climate change and natural disasters • Vulnerability to external shocks (oil price hike, global financial crisis) • Political instability • High and unsustainable debt • Increasing social problems (drug addiction, crimes)

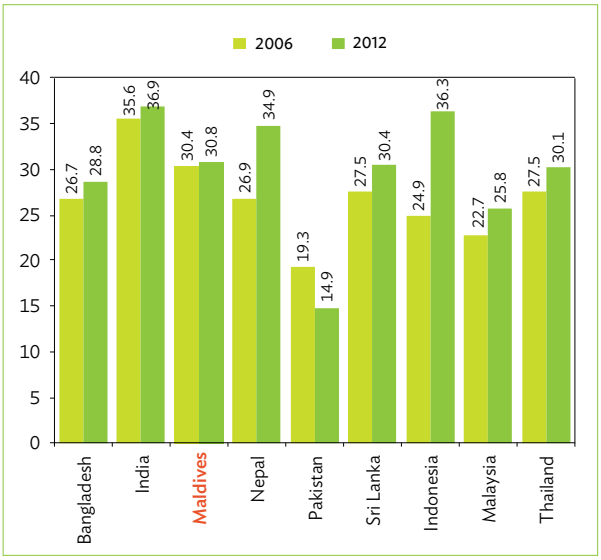
Source: ADB.

The rest of the report is organized as follows: Chapters 2 and 3 discuss the critical constraints to growth and poverty and inequality, respectively. The growth diagnostics focus on constraints that may create low returns to investment or prevent adequate access to finance. The poverty and inequality diagnostics examine constraints to the availability of productive employment opportunities, access to opportunities, and provision of adequate social safety nets. Chapter 4 discusses the common issues and challenges faced by small island development states such as the Maldives. Chapter 5 summarizes the findings and discusses policy implications for sustaining the economic gains and promoting more inclusive growth.

Chapter 2
Critical Constraints to Growth

As discussed in Chapter 1, growth in the Maldives has been rapid in the last 20 years, driven largely by strong investment associated with tourism development, much of this coming from foreign investors attracted by the country's natural environment and the incentives offered. The Maldives has relatively high investment rates, at about 31% of its gross domestic product (GDP), comparable with the investment rate of selected countries in South and Southeast Asia (Figure 2.1).

Figure 2.1: Investment in Selected Countries, 2006 and 2012 (% of GDP)



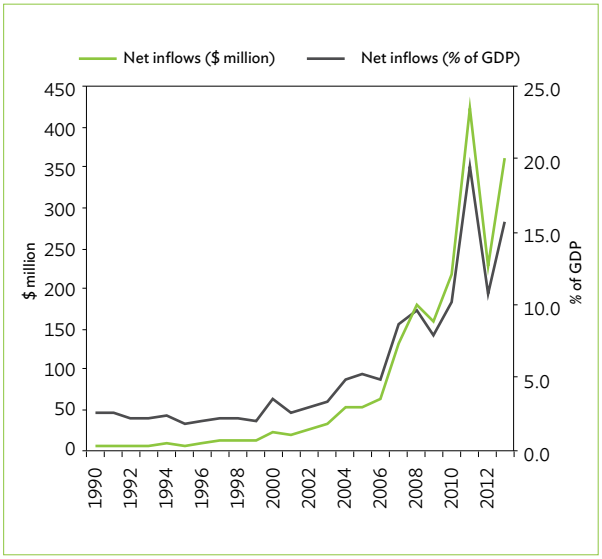
GDP = gross domestic product.
Source: Calculations based on UNSD, National Accounts Official Country Data (accessed May 2015).

The success of foreign investments, especially in the tourism sector, can be attributed to the country's open and liberal economic environment. The process of registering a foreign investment, as required by the Law on Foreign Investment in the Republic of Maldives,[12] is relatively simple and straightforward. The wide range of incentives offered includes exemption from income tax, corporate tax, or property tax in the Maldives; right to 100% foreign ownership; legally backed investment guarantee; provision for overseas arbitration of disputes; long-term contractual agreements and lease of land; freedom to use foreign managerial, technical, and unskilled workers; and no foreign exchange restrictions. For these reasons, total foreign direct investments rose from about $6 million in 1990 to $361 million in 2013, which is approximately 16% of GDP (Figure 2.2).

However, the range of sectors with foreign investment remains narrow. The generous incentives offered to foreign investors resulted in the influx of international hotel chains. The Maldives' white beaches, extraordinary underwater scenery, and clear blue water continue to be ideal for resort development. However, the incentives failed to attract significant investments in other sectors. The Foreign Services Investment Bureau noted that foreign investments have been made in some other sectors—transport and telecommunications, water production and distribution, and finance—but they only account for a small percentage of the total foreign investments.

[12] The process of foreign investment is governed by Law No. 25/79 (Law on Foreign Investment in the Republic of Maldives) amended by the Citizens' Majlis on 1 February 1989 (Government of the Maldives 1989).

Figure 2.2: Foreign Direct Investment, Net Inflows, 1990–2013 ($ million and % of GDP)



GDP = gross domestic product.
Source: World Bank, World Development Indicators (accessed May 2015).

The fishing industry, a major sector of the economy, accounted for about 1.5%–6.5% of GDP during 1984–2012, but has not received significant foreign or domestic investment in the last 2 decades. While some investment has been made to modernize the fishing fleet and upgrade its support infrastructure to world-class fish processing and marketing facilities, the decline in fish catch in the Maldives and in the Indian Ocean, and the political situation prior to the September 2013 presidential elections, were disincentives for the private sector to invest in fishing.

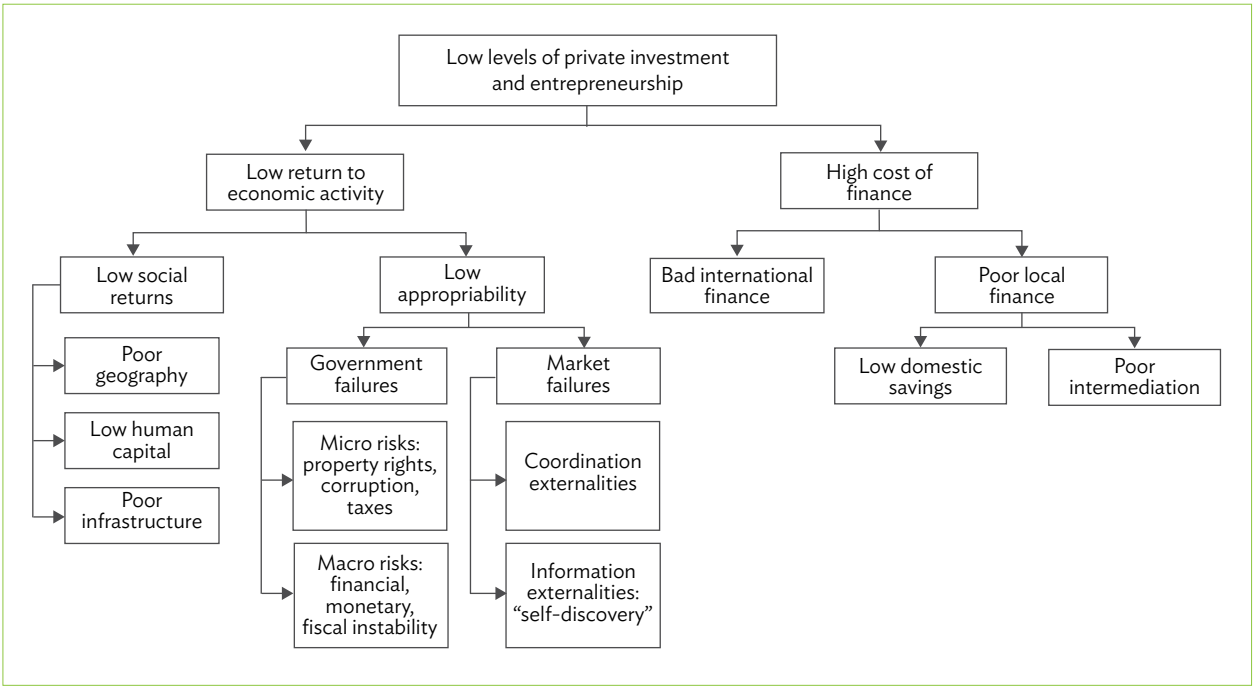
In moving forward, diversifying the economic base beyond tourism, improving employment opportunities, and implementing timely structural reforms are key challenges facing the government. Previous development plans highlighted the importance of stimulating private sector investment not only in tourism, but also in construction, fisheries, mariculture, and other sectors to attain the government's goal of "eliminating poverty and bringing non-declining well-being to all Maldivians" (MPND 2007). However, to enable the country to attract investments, it is important to determine what factors are constraining private investments that can diversify sources of growth and provide additional employment to the local population.

This chapter endeavors to identify the factors that currently constrain efforts to stimulate private investment in areas that have potential for high returns and could diversify the sources of growth and help achieve growth that is broad-based and inclusive. The concern is how far the economy can diversify away from its reliance on tourism. To organize the discussion, the chapter uses the growth diagnostic framework of Hausmann, Rodrik, and Velasco (2005). The framework (Figure 2.3) helps identify the key factors that keep returns to investment low and thereby discourage private investments, and helps analyze whether access to finance is a constraint for private investors.

In the Maldives, outside of tourism, returns on new investment are held back by poor connectivity and lack of transport infrastructure and by a skills shortage and low education attainment among nationals. Both of these constraints are strongly related to the difficulties the Maldives has linking islands to provide a strong education and skills base. The problem is compounded by macroeconomic factors such as the chronic budget deficit and increasing debt burden, which constrain government finances. At the same time, access to finance continues to be a key bottleneck, especially to small and medium investors, resulting from weak financial intermediation and inefficiencies in the financial sector.

Other potential issues or risks identified include aspects of governance such as institutional and regulatory quality, political uncertainty, and inefficient and high cost of nontransport infrastructure such as electricity and water supply and sanitation services. Although these issues are not perceived as critical now, they may emerge as such in the future and can restrict the diversification of investment.

Figure 2.3: Growth Diagnostic Framework



Source: Hausmann, Rodrik, and Velasco (2005)

2.1. Low Returns to Economic Activity

2.1.1. Poor Connectivity: Inadequate and Inefficient Transport Infrastructure

Sector Structure

Because the Maldives comprises many islands spread widely apart, an efficient transport network is critical for increasing private investment. The World Bank's most recent logistics performance index indicates that the quality of infrastructure in the Maldives continues to lag behind that of India and Pakistan, but is relatively better than other countries in South Asia. The 2014 index ranks the Maldives 82nd of 160 countries and 3rd in South Asia. Although the Maldives' score and ranking have improved in the last 3 survey years, and the country even overtook Sri Lanka in 2014, connectivity between atolls remains a huge issue for majority of the population (Table 2.1).

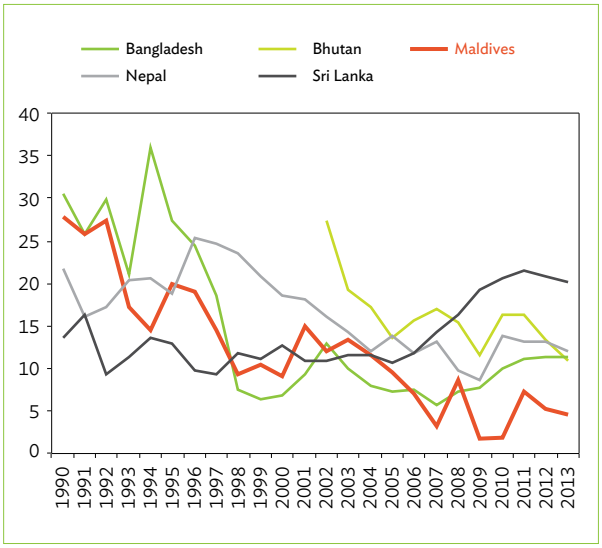
Table 2.1: Quality of Infrastructure: 2010, 2012, and 2014

	2010		Movement 2010 vs. 2012		2012		Movement 2012 vs 2014		2014	
Country	Score	Ranking	Score	Ranking	Score	Ranking	Score	Rank	Score	Ranking
India	2.91	47	↓	↓	2.87	56	↑	↓	2.88	58
Pakistan	2.08	120	↑	↑	2.69	71	↓	↑	2.67	69
Maldives	**2.16**	**111**	↑	↑	**2.47**	**93**	↑	↑	**2.56**	**82**
Nepal	1.80	143	↑	↓	1.87	149	↑	↑	2.26	122
Sri Lanka	1.88	138	↑	↑	2.50	89	↓	↓	2.23	126
Bhutan	1.83	140	↑	↑	2.29	117	↓	↓	2.18	132
Bangladesh	2.49	72	...	...	...	...	...	...	2.11	138
Afghanistan	1.87	139	↑	↓	2.00	141	↓	↓	1.82	158

... = no data available.
Note: The score for quality of infrastructure ranges from 1 to 5, with 1 being the lowest. Ranking is out of 155 economies for 2010 and 2012, and 160 economies for 2014.
Source: World Bank, Logistics Performance Index (various years).

The share of government expenditure allocated to infrastructure spending, which is relatively low by subregional standards, has declined significantly. During 2004–2013, the average share of expenditure on infrastructure in total expenditure was 6.1%, whereas the average was 13.7% during 1995–2003 (Figure 2.4). The decrease was mainly on account of the decline in capital-related expenditures—from an average of 38% in 1995–2003 to about 23% during 2004–2013.[13] This was in part due to the need to contain the deficit.

Figure 2.4: Share of Expenditure on Infrastructure in Total Government Expenditures, 1990–2013 (%)



Note: Infrastructure expenditure comprises expenditure recorded under "Electricity, Gas, and Water" and "Transportation and Communications."
Source: ADB, Statistical Database System (accessed 5 May 2015).

Transport sector development had proceeded in an ad-hoc manner. Without a comprehensive master plan, projects were implemented in response to site-specific bottlenecks and under different government programs. In November 2013, the government approved the first maritime transport master plan, drafted together with the Asian Development Bank. Figure 2.5 maps the existing harbors, airports, and the main transport infrastructure.

[13] Figures refer to the percentage of total capital expenditures of the central government in total expenditures of the central government.

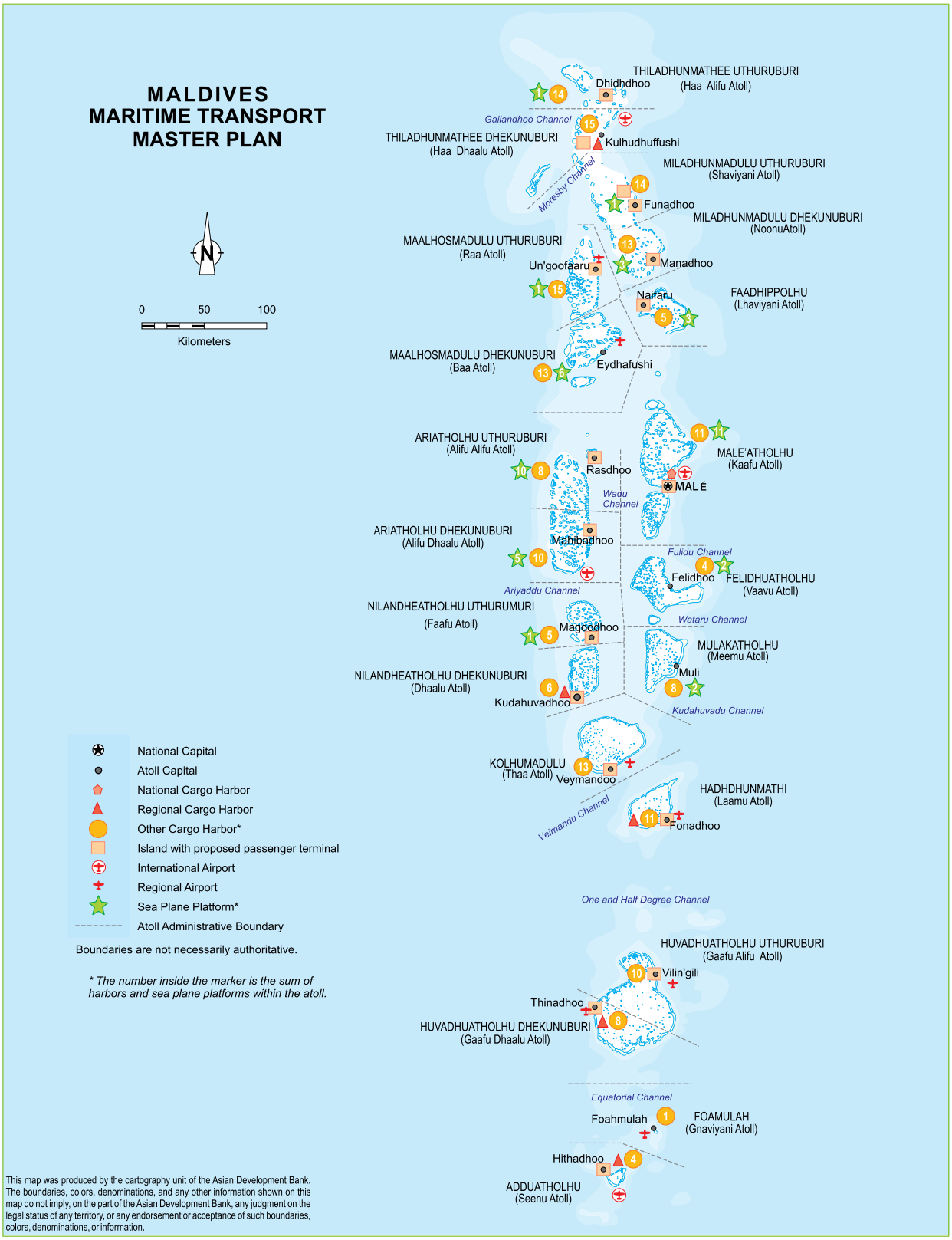
Prior to its abolition in June 2014, the Ministry of Transport and Communications oversaw all matters relating to transport and communications, including policy making, and planning of land, maritime, and aviation transport. The new arrangement (1) transferred administration of regional airports to the Ministry of Tourism; (2) placed the Transport Authority under the Ministry of Economic Development; and (3) placed the Communication Authority of Maldives under the Ministry of Home Affairs. The Transport Authority is the regulatory body for land-based transport, and regulates maritime transport in coordination with the Maldives Port Limited. Ports management is under several agencies and private entities, which include the Ministry of Housing and Infrastructure, Housing Development Corporation, Airports Company, Maldives Ports Limited, and other private companies.

The Maldives Civil Aviation Authority was established in 2012 to develop and administer policies and regulations to ensure a safe, secure, and orderly air transport sector. While institutional restructuring initiatives have been implemented, transport sector development remains constrained by the limited capacity of public agencies and high staff turnover, which has led to poor planning, including delayed project implementation.

Maritime Transport

Insufficient sea transport services and harbor facilities limit connectivity, constrain the mobility of people, and increase the cost of doing business. In the Maldives, with many atolls scattered over a wide area in the Indian Ocean, infrastructure development consists largely of civil aviation and shipping. However, an efficient and regular sea-based integrated public transport network between the atolls has yet to be established. The Maldives' ports network includes international and regional ports, proprietary terminals mainly used for cement and petroleum products, private jetties on resort islands, and public jetties on the outer islands. Interisland transport facilities are limited. Moreover, regular repair and maintenance of government port, jetty, and breakwater structures has been inadequate due to limited funding. Island

Figure 2.5: Harbors and Airports



Sources: Based on ADB, AusAID, and DFAT (2013), subsequently updated using data from Maldives Civil Aviation Authority website (accessed June 2015); Ministry of Transport and Communication (2013); Zahuva (2015).

development committees, which are responsible for day-to-day operation and maintenance of ports and their facilities, do not have the authority to levy fees and therefore need to augment funds even to support operation and maintenance. Port development has also been concentrated mainly in Malé, which has led to congestion in the capital.

Poor transport infrastructure and connectivity remain a major constraint on investment. Transport costs are high because of the long distance between islands and atolls, underinvestment in critical sea transport infrastructure, and heavy reliance on imported fuel. Almost half of the inhabited islands do not have proper harbor and access facilities (ADB 2011a), and 25 islands have no harbors at all.[14] Those with no harbor facilities are remote islands with a small population; 9 of the 25 have less than 500 people, and 11 have 500–1,000 people. The limited population and low volume of trading activities in these islands also make a regular ferry service unprofitable, given high operating cost for fuel.

Connectivity is not a problem for the tourist resorts. The government has provided major infrastructure facilities (international airports, jetties, and related transport facilities) and hotel companies have constructed the necessary infrastructure in their own resorts and use high-speed boats to take tourists between the international airport and the resorts.

However, inadequate transport infrastructure is a serious constraint for micro, small, and medium-sized enterprises (MSMEs) and private individuals on the atolls. To get around this constraint, some small and medium enterprises have been resorting to chartering private ferries when the need arises, which increases the firms' operating expenses. In 2011, chartering a ferry cost about Rf1,000 or about $65 (Nazeer 2011). High cost of moving goods domestically has been a major concern of entrepreneurs from the atolls. A study in 2006 estimated the cost of transporting a container of cargo from one atoll to another at $1,000–$1,100. This was almost the same cost as transporting goods internationally—for example, from Singapore to Malé, which was about $1,200 per container (World Bank 2006b).

Domestic sea transport has been mainly between Malé and other atolls. Due to limited market size and inadequate infrastructure, only small vessels of 50 ton–250 ton capacities provide service to outer islands. Interisland shipping is provided almost entirely by private vessels. To improve transport services, facilitate movement of goods between development centers and outer atolls, and improve access of the population to public facilities, the government established the Integrated Transport Network (ITN). The ITN provided ferry services to all atolls at low cost—Rf5–Rf25 ($0.32–$1.62)—for a round trip to the atoll capital or the nearest business center.

The ITN started operation in 2009. It has been trying to attract private capital to develop transport nodes and provide transport services. A few private transport providers have entered the sector. The Maldives Transport and Contracting Company, a state-owned enterprise, has been the transport provider for the North-Central region since 2007 (even before the ITN), and is the only transport provider for heavy-duty cargo. In 2010, Vermillion International Pvt. Ltd. was awarded the concession to operate in the Central Region. Other concession holders are Trinus CAE Holdings, Dheebaja Holdings, Maldives Dhoni Services, and MVK Maldives. The government continues to provide incentives to private transport service providers, such as exemption from fuel duties, to expand the transport services to outer atolls.

Despite these efforts, ferry trips are still infrequent. Most atolls have only one or two trips to Malé daily, and only a limited number of ferries are operating under the ITN. Infrequent sea transport services delay the transport of goods, thus constraining the growth and profitability of enterprises in the islands and discouraging new investments in potentially profitable areas (Table 2.2).

[14] The data are based on MNPD (2011).

Table 2.2: Schedule and Cost of Ferry Trips under the Integrated Transport Network

Atoll	Population	Capital	Cost per Passenger (Rf)	Frequency of Trips to Atoll Capital		
				From Small Islands	From Large Islands	Remarks
Haa Alifu	13,175	Didhdhoo	25	3–4 per week	3–4 per week	
Haa Dhaalu	18,300	Kulhudhuffushi	25	2 per week	2–4 per week	
Shaviyani	12,310	Milandhoo	25	...	...	
Noonu	11,100	Manadhoo	5 to 20	1 daily	1 daily	
Raa	15,120	U'ngoofaaru	5 to 20	1 daily	1 daily	
Baa	9,990	Eydhafushi	5 to 20	1–2 per week most small islands	1–4 times per week	
Lhaviyani	8,725	Naifaru	5 to 20	2 daily	2 daily	
Kaafu	16,908	Male	20	No small island	1 daily in most islands	Kaashidhoo and Gaafaru have 3 trips/week
Alif Alif	6,474	Rasdhoo	20	1 daily	1–3 daily	Small islands travel to capital via Ukulhas which has 3 trips to the capital per day
Alif Dhaalu	10,127	Mahibadhoo	20	1 daily	1–2 daily	Only Maamigili has 2 trips in a day
Vaavu	1,635	Felidhoo	20	1 daily	1 daily	
Meemu	4,814	Muli	25	3–6 per week	3–6 per week	Veyvah, Mulah and Naalafushi have 6 trips a week
Faafu	4,089	Nilandhoo	25	1 daily	1 daily	
Dhaalu	5,908	Kudahuvadhoo	25	3 per week	3 per week	
Thaa	9,012	Veymandoo	10	1 daily	2 daily	
Laamu	12,075	Fonadhoo	10	1 daily	1 daily	
Gaafu Alif	8,868	Villingili	20	1 daily	2 daily	
Gaafu Dhaalu	11,765	Thinadhoo	20	1 daily	5 daily	
Gnaviyani	8,055	Fuvahmulah	20	1 daily	1 daily	Trips are to Maradhoo
Addu	19,787	Mathandhoo	20	no small island	1 daily	

... = data not available, Rf = rufiyaa.
Notes:
(1) For Kaafu Atoll, ferry trips are mostly to Malé but the capital is Thulusdhoo.
(2) Islands with less than 500 people are considered small; other islands are considered big.
(3) There are no trips on Fridays.
Sources: Based on ferry schedules published by the Maldives Transport Authority website (accessed August 2014), Maldives Transport and Contracting Company PLC website (accessed August 2014), and Vermillion Transport (accessed August 2014). Population is from National Bureau of Statistics (2014).

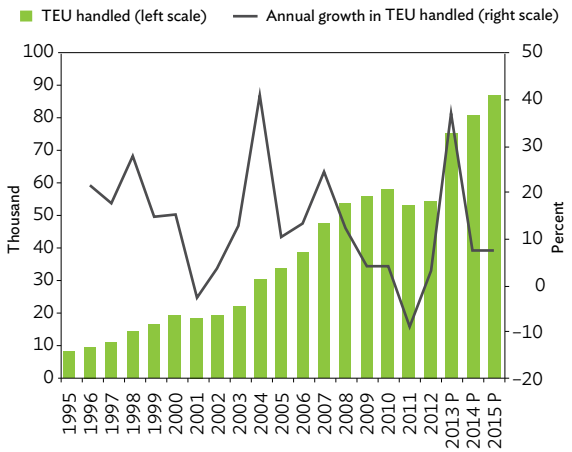
The Maldives' three international ports are in Malé, Kulhudhuffushi, and Hithadhoo. In Malé, where most business and trade transactions take place, transit costs are high because Malé Commercial Harbour (MCH) has only one container berth and limited storage space. This creates congestion and longer, costly port and terminal handling. Importers and exporters pay at least $500 per twenty-foot equivalent unit for port entry charges and port-related charges such as anchorage fees, berth charges, and tug services. This is one of the highest charges in the subregion and constitutes at least 30% of the total cost to import or export. Port and terminal handling takes 8 days for imports and 6 days for exports. These durations are longer than the subregional averages of 5.25 days for imports and 4.25 for exports (Table 2.3). Container vessels currently only call at Malé (Figure 2.6). The Kulhudhuffushi and Hithadhoo

Table 2.3: Duration and Cost of Handling of Cargo per TEU, 2014

	Total Days to Import	Total Cost to Import	Ports and Terminal Handling of Imports		Inland Transportation and Handling of Imports		Total Days to Export	Total Cost to Export	Ports and Terminal Handling of Exports		Inland Transportation and Handling of Exports	
	Days	Cost per TEU ($)	Days	Cost per TEU ($)	Days	Cost per TEU ($)	Days	Cost per TEU ($)	Days	Cost per TEU ($)	Days	Cost per TEU ($)
Afghanistan	91	5,680	5	200	30	4,500	86	5,045	4	175	30	4,000
Bangladesh (Dhaka)	34	1,570	7	650	3	400	29	1,325	5	6,000	4	350
Bhutan	37	2,330	6	350	11	1,350	38	2,230	6	350	13	1,350
India (New Delhi)	28	1,158	6	200	7	650	25	1,077	3	175	4	608
Maldives	**22**	**1,610**	**8**	**550**	**1**	**400**	**21**	**1,625**	**6**	**500**	**2**	**550**
Nepal	39	2,650	6	300	14	1,800	40	2,545	4	300	18	1,650
Pakistan (Karachi)	17	725	3	150	2	200	20	660	3	150	4	200
Sri Lanka	13	690	2	150	2	115	16	560	3	150	2	115

TEU = twenty-foot equivalent unit.
Source: World Bank, Doing Business (accessed May 2015).

Figure 2.6: Container Cargo Handled at the Malé Commercial Harbour, Actual and Projected, 1995–2015



TEU = twenty-foot equivalent unit.
Note: 2013 to 2015 are projected numbers of container cargoes.
Source: Maldives Ports Limited website (accessed March 2015) for 2000–2012 data; Adam (2009) for other years.

international ports mainly handle imported construction materials for building resorts.

In addition to MCH, Malé has Malé North Harbour (MNH), Malé City Council Harbour, and South Western Harbour, which serve different purposes. MNH accommodates large interisland cargo–passenger vessels. About 40% of imported cargo arriving at MCH is transported to outer atolls, and 90% of it goes through MNH. In the same way, 90% of goods from the outer atolls intended for Malé's consumption and for export also go through MNH. Cargo for export is then transported to MCH for distribution to foreign markets. The Malé City Council Harbour handles fisheries-related, resort-owned, intra-Malé vessels and ferries to the airport and Hulhumale while the South Western Harbour handles waste management vessels, ferries to Villingili and Thilafushi, government-owned vessels, and small vessels of up to 20 meters length.

Current transshipment facilities are inadequate to facilitate cargo shipment procedures efficiently. Inefficient cargo handling delays cargo and passenger transport. Mixed passenger and cargo transport also raises safety related concerns, given that some vessels carry flammable items such as liquefied petroleum gas and diesel. Figure 2.7 presents the flow of goods from Malé harbors to atolls.

To ease congestion in the Malé ports, the government built harbors in the nearby islands of Hulhule, Hulhumale, Thilafushi, and Villingili, and in the regions. Two regional ports were also established in 2005—Kulhudhuffushi Regional Port, which handles cargo interchange between the Haa Dhaalu atoll and the

Figure 2.7: Flow of Goods from Malé Commercial Harbour to Regional Ports

Photo credit: ADB Photo Library.
Source: Based on information from UNDP (2006).

northern atolls, and Hithadhoo Regional Port, which accommodates vessels operating between Seenu Atoll and southern atolls. Most ports and harbors, except those in Malé, have low traffic volumes due to limited facilities and thus have not helped address the congestion problem in Malé ports. Table 2.4 summarizes available information on harbors outside Malé.

The Government of Maldives recognizes the need for a maritime transport plan to handle the recent increases in sea transport activities, and sought technical assistance from the Asian Development Bank to draft the Maritime Transport Master Plan (MTMP). The MTMP, which was finalized in 2013, includes projections of passenger and cargo traffic until 2032 based on indicators such as population growth, GDP growth, and tourist arrivals. The MTMP indicates that passenger traffic to Malé is expected to increase by 181% from 2012 to 2032. Alifu Dhaalu, Laamu, Raa, Shaviyani, and Thaa will experience increases in passenger traffic ranging from 5% to 16%; the other atolls will see declines from 4% to 21% during the same period. Cargo traffic will increase significantly, as shown in Table 2.5. Box 2.1 provides a summary of the MTMP.

Air and Land Transport

Although problems emerging in air and land transport are less central to addressing connectivity issues, upgrading of air transport facilities is important to cater to the expected growth in tourist arrivals and help improve

Table 2.4: Harbors Outside Malé

Harbor	Facilities	Users	Management
Villingili Harbour (Old)	Quay: 164m length, 65m width Depth: –2.7m	Passenger and tourist boats	Ministry of Housing and Infrastructure
Villingili Harbour (New)	Quay: 464m length, 60m width Depth: –2.7m		
Hulhumale Harbour	Depth: –3m	Tourist safari boats, passenger boats operating between Malé and Hulhumale	Housing Development Corporation
Hulhule Harbour	Quay: 1,000m length, 150m width Depth: –3.5m, –2.5m	Passenger and cargo ferries between Malé and Ibrahim Nassir International Airport, resort-owned boats	Airports Company
Thilafushi Official Harbour		Private ferries of industrial companies, waste disposal ferries,	Waste Management Section and private companies
Thilafushi Commercial Harbour	Quay: 110m length Depth: –3m	MTCC-owned ferries	
Resort Waste Unloading Harbor	Quay: 30m length Depth: –5m		
Private Quays	Depth: –30m		
Kulhudhuffushi Regional Port	Depth: –5m	Ferries operating for HDh and the Northern atolls	Maldives Ports Limited
Hitadhoo Regional Port	Cargo Handling Facilities: 150-ton mobile crane and 25-ton fork lift, 4-ton forklifts	Cargo and fisheries-related ferries	

HDh = Haa Dhaalu Atoll, m = meter, MTCC = Maldives Transport and Contracting Company.
Source: ADB, AusAID, and DFAT (2013).

Table 2.5: Projected Cargo Traffic, 2007–2032 (tons)

	2017	2022	2027	2032
Inbound Cargo				
Low Scenario	1,366,280	1,675,390	2,055,090	2,521,510
Medium Scenario	1,473,430	1,949,040	2,579,530	3,415,340
High Scenario	1,594,600	2,283,620	3,272,800	4,692,890
Outbound Cargo	**52,240**	**63,590**	**77,400**	**94,190**

Source: ADB, AusAID, and DFAT (2013).

mobility across the various islands. Most international tourist traffic arrives at the Ibrahim Nasir International Airport (INIA), which has only a single runway and is operating near or at its maximum capacity. One other international airport is located in Gan, but is sparingly used. There are also seven regional airports strategically located in the northern, central, and southern parts of the country and a few domestic airports (Table 2.6). Domestic flights are mainly used to transport tourists to resorts; cargo is transferred by sea transport. Flight availability is not an issue from Malé to the bigger atolls as domestic airline service providers have regular flights to the domestic airports. Air fares are significantly higher than sea fares (Table 2.7).

Airport activity increased significantly during the last 2 decades, driven by the tourism sector (Figure 2.8). Increase in passengers and cargo handled by the INIA have been substantial. The government is concerned about whether existing infrastructure can keep pace with the expected growth of tourism. An earlier projection suggested passenger traffic in the INIA would reach 3.2 million by 2015, 4.4 million by 2025, and 5.2 million in 2035, well above the current capacity of 3.0 million passengers per annum. Cargo traffic was also projected to increase sharply between 2005

Box 2.1: Summary of the Maritime Transport Master Plan

Vision Statement: "To maximize the international role and maritime stature of the Maldives, whilst developing the national passenger and cargo networks and facilities to support economic growth and social development, without compromising environmental sustainability."

Seven Strategy Elements

(1) **Increase the capacity of the maritime network.** Improve ports facilities, including the depth of quays, cargo handling space and facilities, apron space for cargo loading/unloading to the cargo vessels at the North Harbour, and anchorage for safari boats.
(2) **Implement a hub and spoke network** (Malé and regional harbors for cargo, terminal islands for passenger network). The main national hub for cargo will be at Malé (new port at Thilafushi), with six regional harbors—Fonadhoo, Hinnavaru, Hithadhoo, Kudahuvadhoo, Kulhudhuffushi, and Thinadhoo. To handle passenger traffic, terminal islands will be built.
(3) **Separation of cargo and passenger network.** To relieve congestion, Thilafushi port will be developed so that international cargo handling can be moved to it, thus separating cargo and passenger traffic in Malé.
(4) **Improve passenger accessibility**. Aside from implementing a hub and spoke network, frequencies of ferry services are to be improved. Provide two round trips at almost all atolls,
(5) **Ensure maritime safety.** Increase operational capacity of vessels. Improve safety of operation and navigation. Develop a system for operating and maintaining harbors and navigational aids.
(6) **Environmental protection.** Implement an environmental management strategy.
(7) **Institutional strengthening and capacity development.** Improve the legal and regulatory framework.

The Maritime Transport Master Plan lists subprojects and interventions to achieve the above strategies under four categories—infrastructure, strategic, environmental protection, and institutional. Subprojects are then evaluated and categorized as low, medium, or high priority.

High-Priority Subprojects

(1) Infrastructure projects: (a) transfer Malé Commercial Harbour operations to Thilafushi, (b) develop the maintenance and operation of navigational aids, and (c) construct a new ferry terminal to serve Malé and Hulhumale ferry services.
(2) Strategic projects: (a) introduce a new national shipping line, (b) implement a hub and spoke transport system for passenger and cargo transport, (c) shift the logistics center to Thilafushi, and (d) rationalize ports and shipping, including RoRo berth construction and RoRo vessel deployment.
(3) Environmental management: no high-priority subprojects.
(4) Institutional strengthening: (a) develop a system for maintenance and operation of harbors, (b) establish the Maldives Ports and Maritime Authority, and (c) widen packages of institutional and regulatory measures.

RoRo = roll-on/roll-off.
Source: ADB, AusAID, and DFAT (2013).

and 2035—from 39 million kilograms (kg) in 2015 to 56 million kg in 2025 and 76 million kg in 2035 (AECOM and GMD Male International Airport Pvt. Ltd 2011).

The expansion of INIA facilities is constrained mainly by the availability of land and capital. In response to the capital constraint, the government privatized the INIA in 2010; however, implementation of the 25-year concession agreement with GMR Group-India and Malaysia Airports Berhad consortium was terminated following a change in government in 2012. The government regained control of the INIA on 27 November 2012. Although the handover went smoothly, the government suffered a setback when the international arbitration tribunal decided in favor of the infrastructure developer, and ruled the

Table 2.6: Airports, June 2015

Atoll	Island	Airport Name	Operator	Runway Length (m)	Maximum Aircraft Type (in current use)	Status
Kaafu	Hulhulé	Ibrahim Nasir International Airport	Maldives Airports Company Ltd.	3,200	Boeing 747	Certified 2010
Seenu	Gan	Gan International Airport	Addu International Airport Pvt. Ltd	2,650	Boeing 777	Certified 2007
Alifu Dhaalu	Maamigili	Villa International Airport Maamigili	Villa Shipping and Trading Company Pvt, Ltd.	1,200	ATR-42	Certified 2011
Haa Dhaalu	Hanimaadhoo	Hanimaadhoo International Airport	Regional Airports/ Ministry of Transport and Communication	1,200	Dash 8	Certified
Baa	Dharavandhoo	Dharavandhoo Airport	Island Aviation Services Ltd.	1,200	Dash 8	Certified
Gaafu Dhaalu	Kaadedhdhoo	Kaadedhdhoo Airport	Regional Airports/ Ministry of Transport and Communication	1,200	Dash 8	Uncertified
Laamu	Kadhdhoo	Kadhdhoo Airport	Regional Airports/ Ministry of Transport and Communication	1,200	Dash 8	Uncertified
Gnaviyani	Fuvahmulah	Fuvahmulah Airport	State Trading Organization PLC	1,200	Dash 8	Certified 2011
Gaafu Alifu	Kooddoo	Kooddoo	Keong Hong Construction Pte. Ltd.	1,200	Dash 8	Opened Sep 2012
Thaa	Thimarafushi	Thimarafushi Airport	Island Aviation Services Limited	1,200	...	Uncertified.
Raa	Ifuru	Ifuru Airport	Island Aviation Services Limited	1,200	...	Opened May 2015

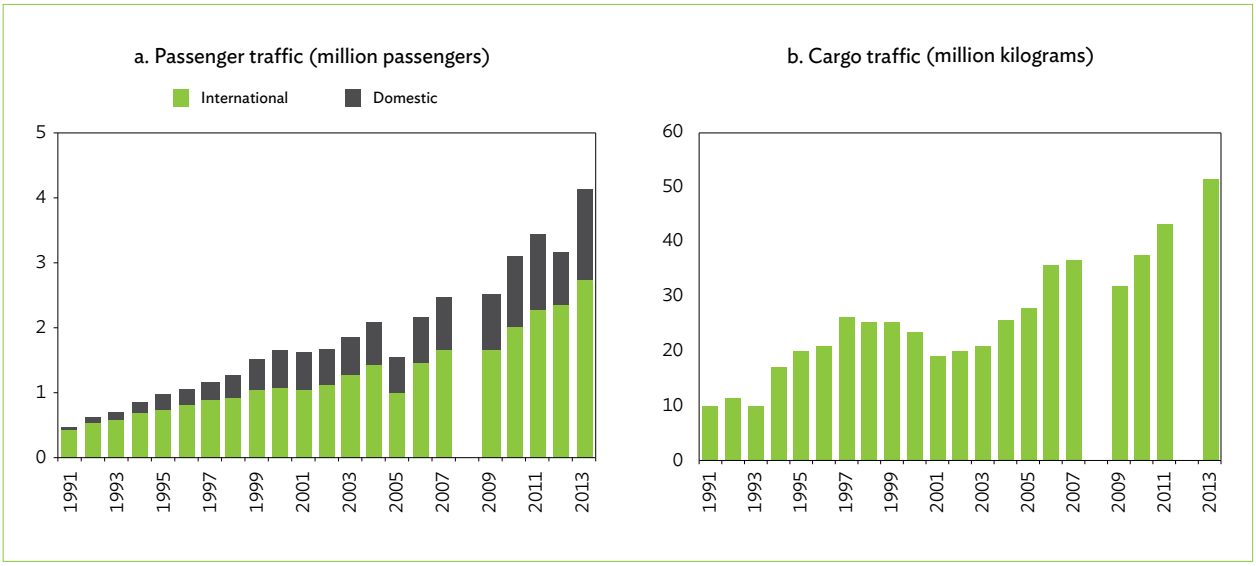
... not available, m = meter.
Note: Runways on all airports listed are bitumen.
Source: ADB, AusAID, and DFAT (2013); Maldives Civil Aviation Authority website (accessed June 2015); Ministry of Transport and Communication (2013); Zahuva (2015).

Table 2.7: Cost and Schedule of Maldivian Air Flights (as of November 2013)

Destination	Cost		Travel Time	Frequency
	$	Rf		
Malé to Gan	150	1,150	95 min	5–8 per day
Malé to Fuvahmulakuh	145	1,090	80 min	1 per day
Malé to Kaadedhdhoo	130	975	70 min	5–6 per day
Malé to Kooddoo	130	975	50 min	3 per day
Malé to Hanimadhoo	110	800	50 min	5–10 per day
Malé to Kadhdhoo	110	800	50 min	5 per day
Kaadedhdhoo to Fuvahmulakuh	60	495	*	*
Kadhdhoo to Fuvahmulah	90	705	*	*
Gan to Fuvahmulakuh	50	300	*	*
Kadhdhoo to Kaadedhdhoo	70	535	*	2 per day (summer)
Kaadedhdhoo to Gan	60	495	35 min	3–7 per week
Kadhdhoo to Gan	90	705	*	*

* = no published schedule, min = minute, Rf = rufiyaa.
Source: Maldivian Airlines website (accessed November 2013).

Figure 2.8: Traffic at the Ibrahim Nassir International Airport, 1991–2013



Note: Gaps indicate data are not available.
Source: DNP (various years).

concession was valid and that government was liable to pay the damages. This delayed the planned airport development and, more importantly, the contract termination sent a negative signal to prospective investors about the sanctity of contracts and the rule of law, which are vital underpinnings for attracting large-scale funds from private sources for infrastructure-related development.

Despite the limited use and availability of land transport, road safety needs improving and the road network in the capital and larger atolls need better maintenance. The use of land transport in the Maldives is very limited and most of the road network on the islands comprises coral sand roads. Paved roads are found only in Malé and a few atolls.

Roads in Malé are narrow and inaccessible to large container trucks. Thus, imported goods are transferred from ship containers to small vans. Cargo delivery is further delayed by congestion in the roads of Malé due to an increasing number of vehicles and poor road conditions and traffic management. The number of registered vehicles in the Maldives rose annually by about 20% from 2003 to 2009, and about 8% from 2010 to 2012.[15] The Ministry of Health identified the risk to island dwellers' respiratory systems arising from the passage of vehicles over coral sand. Improvements to roads and the traffic management system are clearly desirable, and concerns about road safety and the quality of environment have been rising.

2.1.2. Skills Shortage

The lack of professional and highly skilled human resources continues to hamper social returns, and the poor educational base makes it difficult for Maldivians to access productive opportunities. Studies[16] conducted in 2005 and 2006 already pointed to the lack of skills as a main constraint identified by private investors. In the 2006 Investment Climate Survey (World Bank 2006b), entrepreneurs in the tourism sector, the main driver of the economy, identified the lack of skilled labor as the third highest constraint on investment decisions (Table 2.8). Similarly, in a 2005 study to help identify skills and training needs in the Maldives, 238 firms that were surveyed indicated the need to improve the formal training institutions' delivery of employment-orientated skills development, vocational, technical, and continuing education to nationals (Rober 2005).

[15] 2012 data show that 83% of total registered vehicles are motorcycles, which comprised about 75% of total vehicles in Malé.

[16] World Bank (2006b), Human Rights Commission of the Maldives (2006), and World Bank (2011).

Table 2.8: Top 5 Constraints Faced by Firms in the Maldives, 2006

Type of Business or Enterprise	Rank of Constraint				
	1st	2nd	3rd	4th	5th
All Firms	Access to finance	Cost of finance	Access to land	Skills and education	Corruption
Tourism	Access to finance	Cost of finance	Skills and education and corruption	Legal system	Access to land
Manufacturing	Access to finance	Access to land	Cost of finance	Skills and education	Corruption
Telecommunication	Access to land	Cost of finance	Access to finance	Skills and education	Regulatory uncertainty

Source: World Bank (2006b).

Of the 23 types of firms surveyed,[17] skills shortage were most pronounced in construction, health and social work, other business activities, recreational and sports activities, hotels and restaurants, travel agencies and auxiliary services, footwear manufacture, and food and beverage. The Diagnostic Trade Integration Study conducted in 2006 (UNDP 2006) likewise noted that the lack of training and skills relevant to the needs of the economy stifles business development and the growth of small and medium scale enterprises that is crucial to generating employment. Lack of skills also inhibit the establishment of intra- and inter-sectoral linkages and efforts to ensure the most efficient use of scarce resources. The lack of employable skills remains a constraint that is well recognized by the government. The 2004 Vulnerability and Poverty Assessment II Report and the Seventh National Development Plan 2006–2010 noted that an increasing number of young people remained unemployed because they lacked the skills required in the labor market (MPND 2007). Youth unemployment was estimated at over 40% in 2010 in the HIES 2009/2010 (DNP 2012a).

Data on the education level of the employed reported in the HIES 2009/2010 (DNP 2012a) indicate that only 2% of them had a university-level education, and almost 40% had at most lower secondary education (Table 2.9).

The Maldives has not been able to produce an adequate number of professionals and skilled workers despite provision of universal access to school education and the mainstreaming of technical and vocational education and training, such as introducing

[17] Firms were categorized according to the international standards industrial classification (ISIC) heading

Table 2.9: Education Level of the Employed, 2010

Level of Education Completed	Number of Employed Individuals	Percent of Total
No Education	749	0.8
Below Primary	4,487	4.6
Primary Education	18,993	19.3
Lower Secondary	14,135	14.4
Higher Secondary	6,362	6.5
Vocational Training and Professional Certificate	22,145	22.5
University and above	2,059	2.1
Others	28,124	28.6
Total[a]	**97,072**	

[a] There are 1,321 observations with no response on the highest level of education completed. Note that total employed individuals were 98,393, as reported in Table 3.1 in Chapter 3.
Source: Calculations based on DNP (2012a).

Edexcel BTEC[18] courses in many schools. The number of schools offering higher secondary and tertiary education and vocational training remains limited, especially in the atolls. As such, educational institutions are currently unable to supply local workers with the education, skills, and training demanded in the labor market (Box 2.2).

The government has been investing heavily in education since the latter half of the 1980s. Public spending on education as a share of total public expenditure increased from 7.2% in 1986 to 16.0% in 2010 (Biswajit and Mukhopadhyay 2012). As a share of GDP, public spending on education increased from 2.3% to 8.7% during the same period but has tapered

[18] BTEC is a vocational qualification taken in England and Wales and Northern Ireland by young people aged 14 and over and by adults. The qualification is organized and awarded by the Edexcel Foundation within the BTEC brand. BTEC courses are designed as specialist work-related qualifications for a range of sectors, including business, engineering, and information and communications technology.

Box 2.2: Snapshot of the Maldives' Education System

Formal preschool education caters to children aged 4 to 5 years and lasts 2 years (divided into lower and upper kindergarten). In recent years, preschools have expanded into the atolls, as more *edhurge* (gathering of children in a private home to learn to read the *Koran*) are being transformed into modern preschools, with fully or partly trained teachers.

Primary Education
Primary education starts from age 6. Arabic and English are the media of instruction in government-run schools. In the past, the 5-year primary program was followed by 2 years of upper primary education (middle school) leading to secondary education. These two levels have been unified into one comprehensive program (basic education) lasting 7 years (grades 1–7). Students who complete basic education can enroll in vocational programs leading to a Certificate II (15 weeks full-time training, equivalent to 40 credits, level 2 qualification of the Maldives National Qualifications Framework [MNQF]) and a Certificate III (15 weeks of full-time training, equivalent to 40 credits, level 3 MNQF qualification).

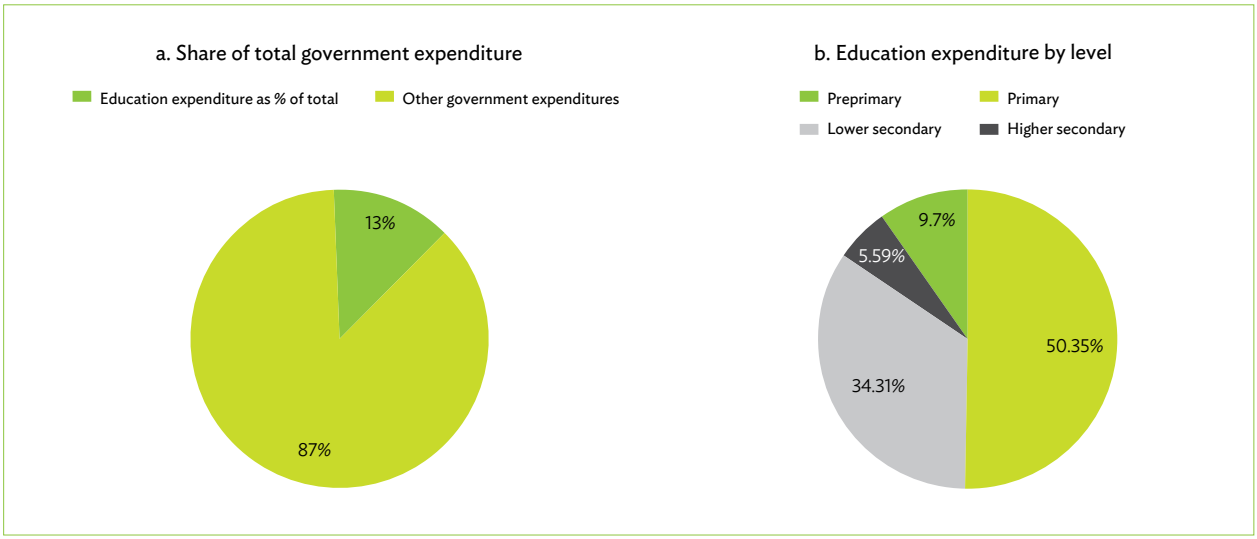
Secondary Education
Secondary education comprises two levels: lower secondary lasting 3 years (grades 8–10), and higher secondary lasting 2 year (grades 11 and 12). The General Certificate of Education Ordinary Level (GCE O-level) and Advanced Level (A-level) are taught in the lower secondary and higher secondary grades, respectively. To obtain an International General Certificate of Secondary Education, students can take examinations administered by the Cambridge International Examinations or the London Examinations, Edexcel International. There are also two national examinations: the Secondary School Certificate Examination (for Islamic Studies and Dhivehi, the national language) introduced in 1986, and the Higher Secondary School Certificate examination introduced in 1987. Lower secondary education graduates can enroll in vocational programs leading to a Certificate IV (30 weeks or 1-year full-time training, equivalent to 120 credits, level 4 MNQF qualification).

Tertiary Education
Tertiary and university education is offered at the newly established Maldives National University (previously the College of Higher Education), which has 5 campuses and some outreach posts in outer islands, and several private training institutions. At the postsecondary level, programs leading to a diploma (level 5 of the MNQF) take 1 year (for higher secondary graduates or MNQF level 4 qualification holders) or 2 years to complete (for lower secondary graduates or MNQF level 3 qualification holders). Programs leading to an advanced diploma, an associate degree, or a foundation degree (MNQF level 6 qualifications) normally last 2 years (1 year for holders of a MNQF level 5 qualification in the relevant field); professional certificates requiring 15 weeks of full-time training are also included at the MNQF level 6. Programs leading to a bachelor's degree (MNQF level 7) typically require 3 years of full-time study (or 350 credits); 1-year programs lead to a professional diploma. A bachelor's degree with honors (MNQF level 8) requires an additional year of study beyond the bachelor's degree; 1-year graduate/postgraduate diploma programs are offered at the MNQF level 8. At MNQF level 9, a master's degree requires 2 years of full-time study (240 credits), and an advanced professional diploma, 1 year. At MNQF level 10, a doctoral degree requires 2–5 years of study, and a higher professional diploma requires 120 credits.

Technical and Vocational Education and Training
Various institutions work to promote this important area in the field of education. The Ministry of Education, Education Development Centre, and Centre for Continuing Education are working in conjunction to promote skills development and vocational education through integration in the formal school system to prepare the students for the different levels or grades through university. The Ministry of Youth, through the technical and vocational education and training programs, prepares learners for employment and then helps them to continue their education part time. Vocational courses are offered by institutions such as Maldives Polytechnic, which offers both long- and short-term courses.

Source: IBE (2011).

Figure 2.9: Education Expenditure, 2008 (%)



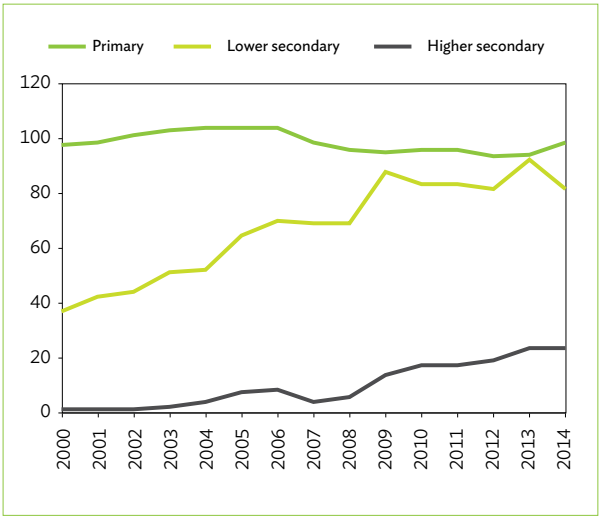
Note: As of 2012, education expenditure accounted for 15.2% of total government expenditure. Education expenditure by level is not available in 2012.
Source: World Bank, Education Statistics (accessed 5 May 2015).

off to about 6.8% in 2012 and 6.2% in 2013.[19] Education expenditures were concentrated in primary and lower secondary levels to achieve the goal of universal primary education and further developing the quality of lower secondary schools to cater for the 13–15 year age group (Figure 2.9). This focus on primary education was highly successful—with primary net enrolments reaching 98.6% in 2014 (Figure 2.10).

The focus on primary education, however, meant limited resources for higher secondary and tertiary education. Based on available data, 50% of the education budget in 2008 was allocated to expenditures in primary education alone (MOE 2014). Net enrolment at the higher secondary education level continues to be low (Figure 2.10). In 2014, higher secondary education enrollment was only 23.6%, because the budget allows for only a limited number of schools offering higher secondary level education. For example, of the Maldives' 249 secondary schools, only 56 provide higher secondary education: 8 in Malé and 48 in the atolls (MOE 2014). While support for primary education is important as it builds the foundation for a strong and qualified human resources base, similar efforts are needed to improve secondary, tertiary, and technical and vocational and education.

[19] Computed based on Ministry of Finance and Treasury 2014b.

Figure 2.10: Net Enrollment Rates, 2000–2014 (%)



Note: Net enrolment rate above 100 is a result of using estimated population in the calculation and data duplication from schools.
Source: MOE (2014).

The low secondary enrollment has translated into the low number of tertiary education enrollees; for example, only 15,000–16,000 students were enrolled in tertiary institutions in 2011. The Maldives National University accounted for 4,500–5,000 students, but most of these were enrolled in the predegree (certificate and diploma) levels. The Maldives Polytechnic, another public institution, had about

750–800 students. The remaining 11,000 students were enrolled in private higher educational institutions for predegree and certificate programs (Table 2.10). The gross enrollment rate at the tertiary or university level was 3% in school year 2010/2011—below that of countries such as Bangladesh, Nepal, and Pakistan, which have much lower per capita GDP (World Bank 2012b). In addition to the limited number of tertiary educational institutions and courses offered, the accessibility and affordability of acquiring a university degree, especially for those living in outer atolls, are key considerations for pursuing tertiary education.

In addition to this unbalanced education structure, the quality of education in the Maldives needed significant improvement. National assessments in 2008 for learning outcomes of grade 4 students showed that learning levels in primary grades were unsatisfactory (Table 2.11). The mean score for English was 32%, and that for mathematics was 39%, with 50% set as the pass rate. Similarly poor results were reported at the secondary level (Table 2.12). Another indicator of the low quality of secondary education was the number of candidates that sat the General Certificate of Examination Ordinary Level and Advanced Level and their pass rate. The number of Ordinary Level candidates who passed the examination has declined since 2008, and in 2012, only 59% passed 3 or more subjects (DNP 2013). The Advanced Level showed a similar picture. 2010 data from the Department of Public Examinations of the Ministry of Education indicate that only 35% of boys and 43% of girls who took the examinations passed. Although pass rates have improved in recent years, a 40%–50% failure rate suggests quality issues in secondary education.

Table 2.10: Student Enrollment and Graduate Output in Higher Education Institutions in the Maldives, 2011

Education Institution	Type of Institution		Full Time	Part Time	Total
The Maldives National University	Government	University	4,347	131	4,478
Maldives Polytechnic	Government	Polytechnic	310	392	702
Villa College	Private	College	1,838	0	1,838
Institute of Governance and Development	Private	Institution	224	0	224
Maldives Music and Art Centre	Private	Mobile	159	0	159
International Centre for Career Development	Private	Institution	0	471	471
International Institute for Professional Development	Private	Institution	0	276	276
MAPS college	Private	College	394	0	394
Maritime Academy of Maldives	Government	Institution	52	0	52
Focus Education Centre	Private	Institution	175	437	612
Mandhu College	Private	College	246	40	286
Clique College	Private	College	0	728	728
College of Islamic Studies	Government	College	649	1,390	2,039
Malé Business School	Private	Open Learning	0	276	276
Avid Training Centre	Private	Institution	143	0	143
Port Training Centre	Government	Open Learning	1,017	0	1,017
Cyryx College	Private	College	0	2,060	2,060
Total			**9,954**	**6,201**	**15,755**

Source: DNP (2012b).

Table 2.11: Results of National Assessments of Learning Outcomes in Grade 4, English and Mathematics, 2008

Subject	Mean Score (%)	Standard Deviation	Median Score (%)	Number of Students Tested
English	32	18	29	5,503
Mathematics	39	18	38	5,686

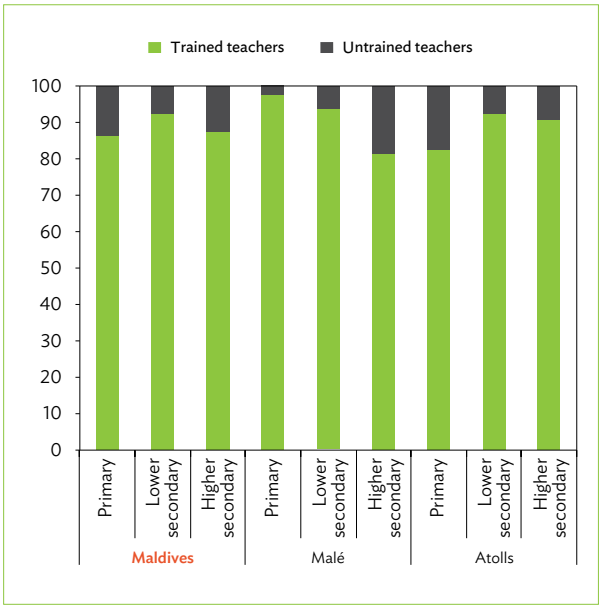
Source: World Bank (2012b).

Table 2.12: Secondary School Students' Passing Rates in English and Mathematics, 2003–2013 (%)

Subject	2003	2004	2005	2008	2009	2013
English	8.0	8.0	5.0	20.0	26.3	38.8
Mathematics	24.0	27.0	27.0	33.2	39.7	48.6

Sources: MOE (2007); DNP (2010); MOE (2013).

Figure 2.11: Quality of Teachers, 2014 (% of teachers who are trained)



Note: "Trained" is defined as having a Maldives Accreditation Board advanced certificate or higher teaching qualification.
Source: MOE (2014).

Efforts have been made to address these shortcomings; for example, school boards have been established, a compulsory professional development program for teachers has been started, free textbooks and other learning materials are provided to all students, science laboratories are established in all secondary schools, and computers and internet access are now provided.[20] How far these will address the deficiencies remains to be established, particularly because the quality of teachers has been a critical factor. Schools have a high proportion of teachers who have not yet completed their bachelor's degrees or been trained[21] (Figure 2.11). The shortage of qualified teachers has necessitated the employment of a large number of foreign teachers, mostly deployed in the atolls. Similarly, the Maldives' only university, the Maldives National University, employs 146 full-time academic staff but only 3 of its professors have a doctoral degree and 40 others have yet to complete their first degree (UNESCO 2009).

The government introduced the Technical and Vocational Educational Program in schools in 2006 to provide skills training for unemployed youth and to meet the demands of the labor market. Six years after the introduction of the program, only 561 students were enrolled in technical education, and no women were enrolled on a diploma course (Table 2.13). A recent evaluation of the program indicated that the low enrollment was partly because Maldivians were reluctant to participate and lacked interest in improving their skills, and partly because participants considered the program not directly relevant to their needs (Behzad 2011b).

The factors just discussed have resulted in a low number of highly qualified professionals and skilled laborers from nationals of the country. Consequently, the economy relies on foreign labor to fill the gaps.

During 2003–2011, expatriate employment rose continuously at an annual rate of 12% (Table 2.13 and Figure 2.12). In 2011, 79,777 foreign workers were registered, which was about 34% of the working population. Expatriate labor, however, is engaged in professional and skilled work, and in semi-skilled and unskilled occupations (Figure 2.13). For example, the number of expatriate workers employed in

[20] Initial assessments from the Ministry of Education suggests that efforts are slowly paying off, as the results of school end exam (Cambridge Ordinary Level) for 5 subject pass percentage had gone up to 43% in 2013 from 27% in 2008. Similarly, about 80% of upper secondary students achieved 3 Edexcel Advanced Level in 2012 and 2013.

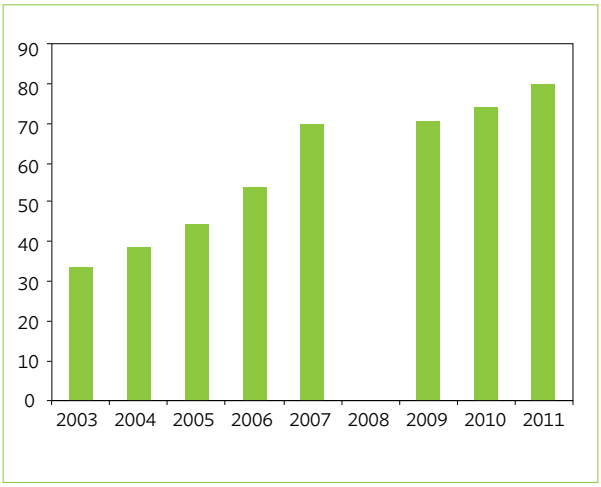
[21] "Trained" is defined as having acquired a Maldives Accreditation Board advanced certificate or higher teaching qualification.

Table 2.13: Student Enrollment in Technical Education, by Type of Training and Sex, 2012

Type of Training	Total	Male	Female
Total	**561**	**561**	**0**
Maldives Polytechnic			
Advanced Diploma (Civil Engineering, Mechanical Engineering, Electronics Engineering, 2.5 years)	0	0	0
Diploma (Building Construction, 2 years)	1	1	0
Diploma (Architecture, Construction Management, Electronics Engineering, 1.5 years)	0	0	0
Advance Certificate (Engine Repair and Maintenance, Electrical Engineering, Electrical and Electronics Engineering, Refrigeration and Air-Conditioning, Power Systems Operation and Maintenance, Welding and Sheet Metal, Machining and Mechanical Fitting, 1.5 years)	270	270	0
Certificate III Course (Welding and Sheet Metal, Machining and Mechanical Fitting)	5	5	0
Regional Youth Vocational Training Centers			
Advance Certificate Course (Electrical and Electronics Engineering, Power Systems Operation and Maintenance, Engine Repair and Maintenance, Desalination System Operation and Maintenance, Wooden and Fiberglass Boatbuilding, 1.5 years)	4	4	0
Certificate III Course (Furniture Carpentry and Joinary course, Engine Repair and Maintenance, 15 weeks)	0	0	0
Short Courses (Refrigeration and Airconditioning Mechanics, Arc Welding, Welding, Marine Mechanics, Electrician, Information Technology Technican, Electrician)	37	37	0
Mobile Courses (Coastal Navigation, Road Worthiness Inspection Training Programme)	21	21	0
Integrated Human Development Project Courses	25	25	0
Hunaru Project Courses	198	198	0

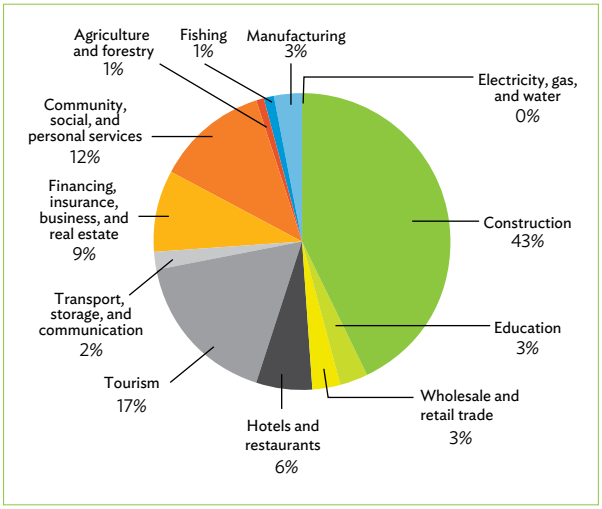
Source: DNP (2013).

Figure 2.12: Expatriate Employment, 2003–2011 ('000 people)



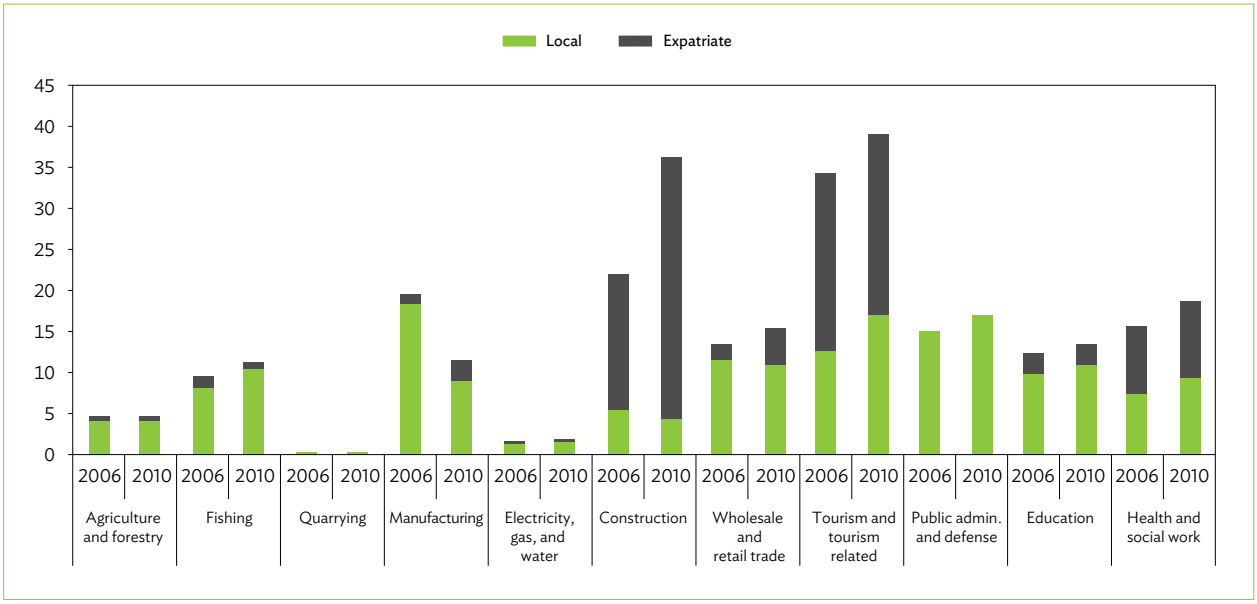
Note: Gap indicates data are not available.
Source: DNP (various years).

Figure 2.13: Expatriate Employment by Economic Activity, 2011



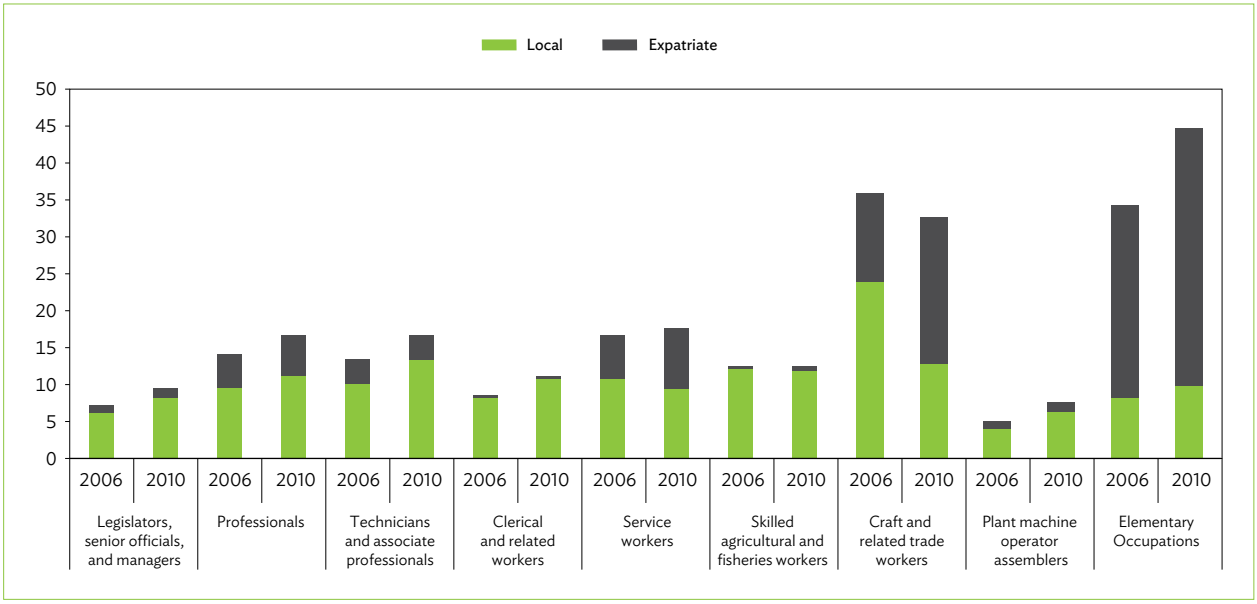
Source: DNP (2012c).

Figure 2.14: Local and Expatriate Employment by Economic Activity, 2006 and 2010 ('000 people)



Sources: For total number of local employment, DNP (2012b); for total number of expatriate workers, DNP (2007, 2011).

Figure 2.15: Local and Expatriate Employment by Occupation, 2006 and 2010 ('000 people)



Note: The International Labour Organization's International Standard Classification of Occupations defines "elementary occupation" extensively, as including occupations such as selling goods in streets, washing windows, collecting garbage, etc.
Sources: For total number of local employment data, DNP (2012b); for total number of expatriate workers data, DNP (2007, 2011).

construction and tourism had increased between 2006 and 2011 (Figure 2.14). Types of occupation are mainly elementary occupations,[22] craft and related trade work, and services (Figure 2.15).

A significant number of the jobs taken by expatriates are unlikely to require much education or high technical skills, suggesting either that local workers are unwilling to do manual or blue collar jobs due to cultural, religious, and other reasons, or that expatriate labor is willing to accept much lower wages and benefits than most Maldivians. However, more than half of

[22] The International Labour Organization's International Standard Classification of Occupations defines "elementary occupation" extensively, as including occupations such as selling goods in streets, washing windows, collecting garbage, etc.

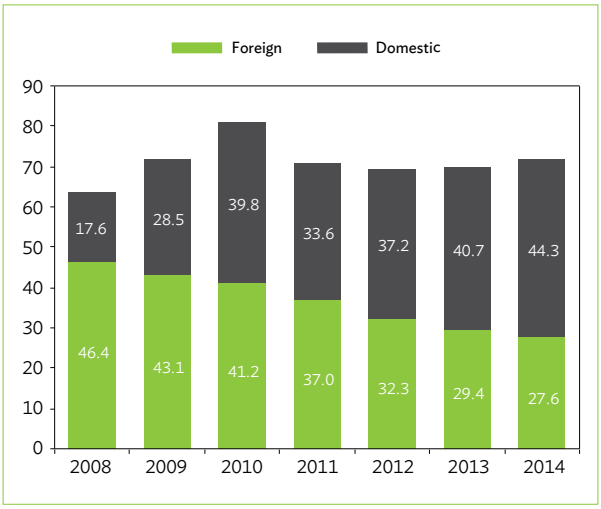
the expatriates are employed in skilled nonmanual occupations. Reliance on expatriate workers need not be an overall constraint on growth, but it is a serious issue if the growth is to be inclusive, as employment creation is a key mechanism for translating the benefits of growth to the local population.

2.1.3. Weaknesses in the Macroeconomy

A chronic fiscal deficit and increasing public debt constrain government spending on critical public infrastructure, and, more importantly, crowd the private sector out from accessing credit. Fiscal consolidation has become a policy priority as the widening fiscal deficit has significantly increased total public debt and threatens the medium-term economic prospects and overall debt sustainability. The relatively high fiscal deficits since the 2004 tsunami have led to a rapid buildup in total public debt, which increased from 55% of GDP in 2004 to 72% of GDP in 2014 (Figure 2.16). Based on the assessment of public external debt under the 2014 IMF Article IV Consultation, if the Maldives continues with its current fiscal policies, its public debt would become unsustainable and the country would face a moderate risk of external debt distress (IMF 2015). The analysis highlights the country's vulnerability to shocks to the tourism sector, considerable import dependence, and heavy reliance on domestic debt. Moreover, because the Maldives has recently acquired middle-income status, foreign grants and concessional loans from the donor community and other foreign sources are expected to decline significantly. Without strong fiscal consolidation measures in the near term, both public and external debt are likely to remain on an unsustainable path.

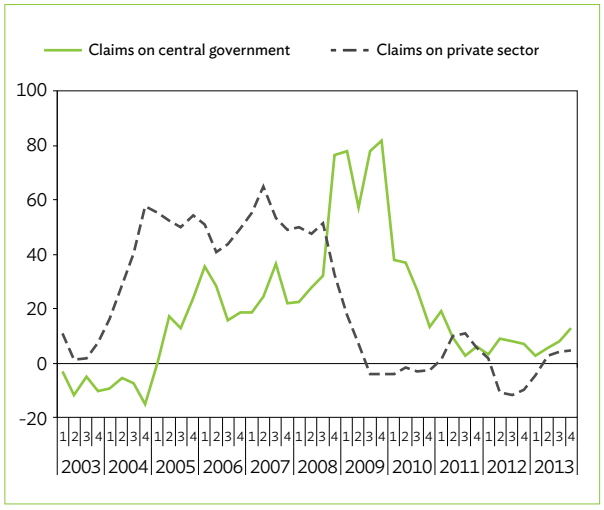
The Maldives' external debt rose following the tsunami as funding flowed into the country starting in 2005. Even after the global crisis in 2007–2008, external debt continued to increase until 2010, when the outstanding external debt reached $961.7 million. As funds from external sources dwindled, the government resorted to domestic borrowing to finance its increasing fiscal deficit. From 2008 to the first half of 2009, the Maldives Monetary Authority (MMA) was financing the budget deficit. The government debt with the MMA represented almost 50% of the central government's domestic debt in fiscal year 2008/2009. Deficit monetization was discontinued in September 2009, and the deficit has since been financed through sales of Treasury bills and bonds to commercial banks (Figure 2.17). By 2010, the domestic debt had risen to

Figure 2.16: Foreign and Domestic Debt, 2008–2014 (% of GDP)



GDP = gross domestic product.
Note: Foreign or external debt refers to all public total external debt outstanding and disbursed; domestic debt refers to claims on central government by domestic corporations.
Source: MMA (2015b).

Figure 2.17: Growth of Claims on the Central Government and the Private Sector by Depository Corporations, 2003-2013 (year-on-year % change)



Sources: MMA (various issues).

Rf11.89 billion (equivalent to $776.60 million[23]) and it reached Rf20.64 billion ($1.10 billion)[24] by the end of 2013 (MMA 2015d). The continuous rise in public debt increases debt service burden and constrains the resources available for public sector investments.

On the expenditure front, government spending in the Maldives prior to the 2004 tsunami was comparable to that in similar island economies. With the tsunami wiping out about two-thirds of the country's capital stock, the fiscal deficit rose to 15% of GDP in 2005. The government had to redirect the budget for rehabilitation, reconstruction activities, and expanded provision of social services. Subsidies had to be increased from Rf50 million ($4.0 million) in 2004 to Rf228 million ($17.8 million) in 2005 and the mandated increase in salaries, wages, allowances, social welfare contributions, and transfers that the Parliament approved in December 2004 and that took effect in 2005 exacerbated the fiscal situation. The deficit continued in 2006 as the government pursued a large spending program based on highly optimistic revenue assumptions.

While the fiscal deficit improved in 2007 as the government cut planned expenditures in line with a shortfall in revenues, recurrent expenditures continued to grow, resulting in the deficit reaching 22% of GDP in 2009. This was largely on account of civil servants' salaries and emoluments. On average, civil servants' compensation and other emoluments grew by 32% during 2005–2009, while capital expenditures grew at a more modest rate except for a slight increase in 2008 and 2011 (see Figure 1.7).

Between 2002 and 2014, capital expenditures under economic services[25] has not increased as a share of total government expenditures. At 14.9% in 2004, it even decreased to 11.6% in 2014; although, in absolute terms, budget allocation increased from Rf563.7 million in 2004 to Rf2.07 billion in 2014 (Ministry of Finance and Treasury 2014a). The expansionary fiscal policy mainly on recurrent expenditures that the government pursued had widened the fiscal deficit. In rufiyaa terms, the budget deficit grew by 20 times, from Rf251 million ($19.6 million) in 2004 to Rf5.21 billion ($407.8 million) in 2009, due to the tremendous increase mostly in recurrent-related expenditures. The deficit since then has been reduced, to 4.7% of GDP by the end of 2013. However, this is at the expense of lower capital expenditures, as total revenue has not kept pace with the growth in recurrent expenditures.

The phasing out of the MMA's deficit monetization function in the latter part of 2009 helped move toward fiscal consolidation. However, the burden of financing the fiscal outlays was shifted to the domestic banking sector through the considerable increase in their purchases of government securities. With the money market consisting mainly of MMA open-market operations, Treasury bills are purchased mostly by commercial banks, other financial corporations, and state-owned enterprises, resulting in increased pressure on domestic finance, leading to the tight domestic liquidity. Outstanding Treasury bills held by commercial banks, other financial corporations, and state-owned enterprises have been increasing since 2009 and reached Rf11.154 billion ($723.77 million) in 2014.

Because the government continued to face a fiscal deficit in 2013 that it could not fund entirely from foreign sources, it had no recourse but to turn to domestic sources to meet the financing requirement for the year. Difficulties in raising finance through the domestic market meant the government had to again resort to monetization. As a result, net credit to the government by the MMA increased from Rf4.7 billion at the end of 2012 to Rf5.3 billion ($197.8 million) at the end of 2014 (MMA 2015a).

The sustained increase in government borrowing has strained the domestic liquidity condition, as bank purchases of government securities constrained commercial bank lending to the private sector, which started to decline steeply after 2008 following the global credit crunch. The banks also shifted their investments to Treasury bills to accommodate the government's large financing requirements. As a result, private sector credit declined as commercial banks were inclined to invest in less risky assets.

[23] Exchange rate 2010: Rf12.8 = $1.
[24] Exchange rate 2013: Rf15.41 = $1.
[25] Under the government's functional classification, economic services comprise six major sectors: fisheries and agriculture, transport, telecommunication, tourism, trade and industries, and electricity.

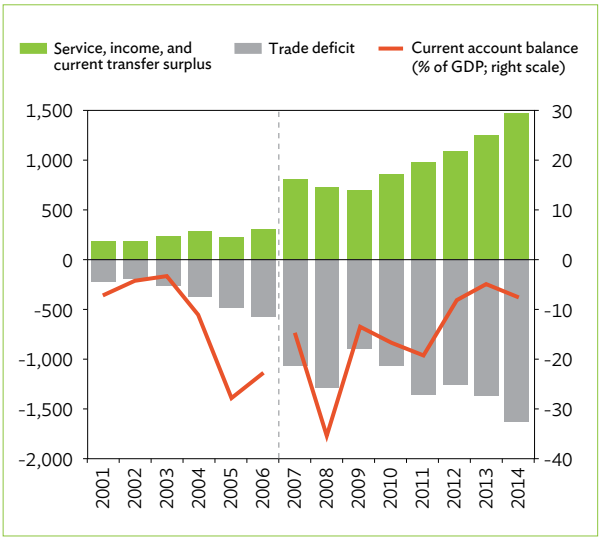
The balance-of-payment position remains weak and can threaten macroeconomic stability. Historically, the Maldives has run a current account deficit (Figure 2.18). The current account deficit reached a high of 35.9% in 2008 but the government was able to narrow this down in 2009. The current account deficit began to rise again in 2010. Rising prices for imported food and fuel, internal demand pressures on imports, the widening trade deficit, the increased transfers account deficit, and the decrease in the services account surplus were key factors in the weakening of the current account in 2008, 2010, and 2011. In 2012, the deficit improved to 8.4% of GDP and was about 5.2% in 2013 (see Table 1.3)

The largest contributor to the current account deficit was the increase in merchandise imports. While merchandise exports have also been rising in recent years due to an increase in the share of domestic exports (fresh chilled or frozen tuna), these were largely offset by the growth in merchandise imports. Petroleum products, food, and other items imported by both the private and public sectors comprised about 75%–80% of imports. The sharp rise in the value of merchandise imports also reflected the spike in global fuel prices in the last few years and the increase in domestic demand for petroleum products. And, as the economy continues to rebound, demand for these imports is expected to persist.

While the services account has been on an increasing trend mainly because of the travel receipts, this has failed to offset the sharp increase in merchandise imports. The balance on services grew from $1.212 billion in 2008 to $2.212 billion in 2013, while the income account balance deficit stood at $394.0 million in 2014 owing to the rise in reinvested earnings and profit remittances on direct investment. The balance of current transfers continues to be in deficit due to remittances of the expatriate labor force. From negative $215.0 million in 2008, the current transfers balance declined further to $349.0 million in 2014. This was despite the $26.9 million in official grants received by the government in 2014. The financial account has been fluctuating during 2008–2012, dropped significantly in 2013 due to the decrease in "net other investment," and recovered in 2014 at $510.3 million (Figure 2.19).

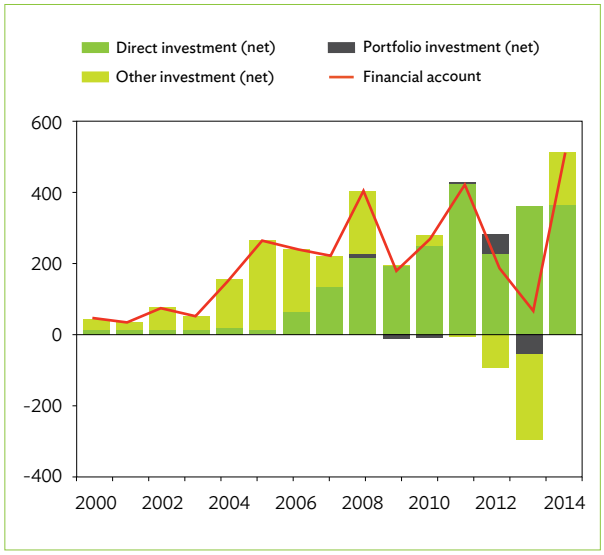
While the Maldives has been able to bounce back and record balance-of-payment surpluses in 2009, 2010, 2013, and 2014 (Chapter 1, Table 1.5), maintaining a

Figure 2.18: Current Account Balance, 2001–2014 ($ million)



GDP = gross domestic product.
Note: The gap in the line graph between 2006 and 2007 represents a break in the series. As part of the Maldives Monetary Authority's efforts to improve the coverage of the balance-of-payments statistics, the methodology and assumptions have been revised. This new series, which covers 2007–2014, is therefore not comparable with balance-of-payments data published prior to September 2012.
Sources: DNP (various years) for 2001–2006 data; MMA, *Monthly Statistics* (various issues) for 2007–2015 data.

Figure 2.19: Financial Account, 2000–2014 ($ million)



Source: For 2000–2007, MMA through ADB, Statistical Database System (accessed March 2015); for 2008–2014, MMA (2015d).

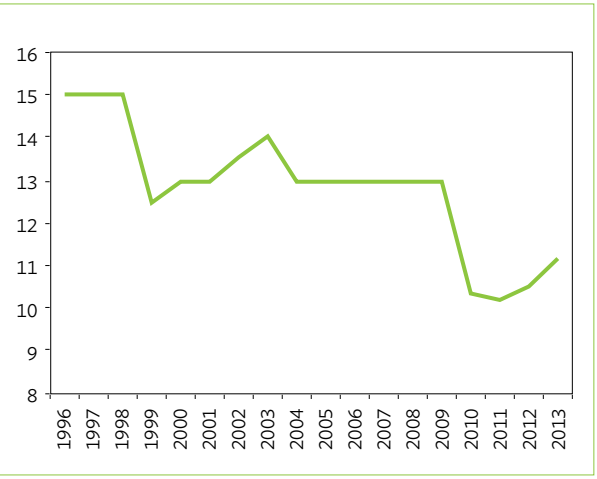
surplus is highly dependent on whether the economy can maintain a manageable level of current account deficit and the strong performance of the service account. High levels of public spending and continued dependence on imports will continue to put pressure on the rufiyaa. The gross international reserve in 2014 was at $614.7 million—just enough to cover about 2.5 months of imports.

2.2. High Cost of and Limited Access to Finance

The cost of finance in the Maldives is high due to weak financial intermediation and large public sector borrowing from the domestic financial market. The cost of borrowing has been high since the mid-1990s, although it fell in nominal terms in 2009 before rising again in 2012 and 2013 (Figure 2.20). The high cost of and poor access to finance have been cited as a constraint in various reports and investment climate surveys (e.g., World Bank 2006b, ADB 2005, IBP 2012). The MMA has acknowledged in its Annual Economic Reviews that the lending rates of commercial banks are generally very high, "reflecting the risk component and also partly due to insufficient competition in the market" (MMA 2012a).[26] The lending interest rate has gone down by almost 4 percentage points since late 1996; however, it remained in double digits in 2013, at 11.2%.

The high cost of borrowing can be partly attributed to the increase in fiscal deficits.[27] Even when monetization of the deficit is ruled out, increased government borrowing would leave less funding for private projects and put pressure on interest rates, thereby risking crowding out private investment. The government through the MMA introduced the Treasury bills in 2006 to shift to market financing of the deficit. During 2008–2012, the fiscal deficit was financed largely by domestic borrowing, mainly through the sale of Treasury bills (MMA 2012a) and Treasury bonds. In 2013, financing of the fiscal deficit was programmed to be mainly from external sources, but (as noted earlier) the worsening financing difficulties forced the government to rely heavily on domestic sources and the MMA, with its claims on government increasing to about 18% of GDP in 2013 (ADB 2014a).

Figure 2.20: Lending Interest Rates, 1996–2013 (%)



Source: IMF, International Finance Statistics (accessed March 2015).

The increased pressure on domestic finance (due to tight domestic liquidity and an increase in sovereign risk) has resulted in the Treasury bill rate increasing gradually. The interbank transactions rates, which are usually carried out at the benchmark interest rates (that is, the 28-day Treasury bill interest rate and the reverse repurchase rates) have also been increasing. Table 2.14 shows the interest rates for loans denominated in rufiyaa and foreign currencies during 2007 to April 2014 compared with the Treasury bill rates for various maturities.

Monetary tightening, which the MMA utilized to stabilize prices and absorb excess liquidity, has not achieved fiscal consolidation and has contributed to the high cost of finance in the country. Inflation has been highly erratic, mainly on account of rising import prices of goods and fuel, and because of significant increases in monetary aggregates. To curb liquidity, the MMA has been using the monetary operations as its main tool, given the limitation within the Maldives' fixed exchange rate regime. In 2005, the minimum reserve requirement (MRR) for both domestic and foreign currency deposits was at 30% but the MMA lowered this to 25% in 2006 to encourage the commercial banks to lower their cost of lending

[26] The same observation was made in the MMA Annual Economic Reviews of 2009 and 2010.

[27] The main reason for the steep decline in credit was the global credit crunch. This was exacerbated by the chronic fiscal deficit and the deterioration of the quality of the banking system's assets.

Table 2.14: Interest Rates on Loans and Advances, 2007–2014[a] (% per annum, end of period)

	2007	2008	2009	2010	2011	2012	2013	2014[c]
Public Nonfinancial Corporations								
Min nc	8.00	8.00	8.00	7.50	7.50	7.50		
Max nc	13.00	13.00	13.00	12.00	12.00	12.00		
Weighted Average nc	–	–	–	8.75	8.71	8.95	11.02	11.0
Min fc	7.50	5.50	5.50	8.50	7.00	7.00		
Max fc	13.00	13.00	13.00	13.00	13.08	13.00		
Weighted Average fc	–	–	–	10.01	9.73	9.33	9.24	9.05
Private Sector								
Min nc	8.00	8.00	8.00	5.00	5.00	5.00		
Max nc	13.00	13.00	13.00	14.00	14.00	14.00		
Weighted Average nc	–	–	–	10.45	10.17	10.51	11.43	11.37
Min fc	7.50	5.50	5.50	2.91	2.00	2.86		
Max fc	13.00	13.00	13.00	19.30	18.00	18.00		
Weighted Average fc	–	–	–	8.28	8.42	8.68	8.58	8.34
Treasury Bills[b]								
28-day (weighted average)	6.00	6.00	5.97	4.51	6.97	7.87	10.03	9.12
91-day (weighted average)	6.25	6.25	6.13	5.35	6.96	7.90	10.21	9.52
182-day (weighted average)	–	–	–	5.50	6.97	7.85	10.00	10.57

– = not indicated, nc = rufiyaa denominated loans, fc = foreign currency denominated loans.
[a] Loans and advances minimum and maximum rates include the penal rates charged on unplanned advances or overdrafts and overdue installments.
[b] Treasury bills were issued on 11 September 2006 replacing certificates of deposit. Since 27 December 2009, the rates represent the weighted average interest rate accepted by the government.
[c] Figures are averages for January to May 2014.
Sources: MMA (2014a, 2014 d).

and to dampen the upward pressure on the interest rates. While this policy stance has helped bring down inflation and contain credit growth, it also contributed to reducing the credit supply and contributed to the high bank lending rates. Inadvertently, the high MRR has added to financial intermediation costs and raised banks' effective cost of funds. The MRR and statutory reserve requirement of 25% has raised banks' effective cost of funds by 200–250 basis points at an average lending rate of 10%–11% per annum (Siriwardena and Wijiwardena 2009a). The MRR was brought further down to 20% in February 2014 to enable banks to provide more credit and help address credit demand of both public and private sector.

In terms of financial intermediation, the financial sector remains small and underdeveloped, and is dominated by banks, which have been under significant stress due to the global financial crisis and the domestic economic downturn (Table 2.15). The development of the domestic capital market began only in 2006 with the Maldives Securities Act; thus, it is only at a nascent stage, and has not been a major source of financing for private sector investments.

Table 2.15: Banks Operating in the Maldives, May 2015

Bank	Year Established
(1) State Bank of India	1974—established as a foreign bank branch
(2) Habib Bank Limited	1976—established as a foreign bank branch
(3) Bank of Ceylon	1981—established as a foreign bank branch
(4) Bank of Maldives Plc	1982—established as a public limited company with majority ownership by the Government of Maldives
(5) Hongkong Shanghai Banking Corporation Ltd	2002—established as a foreign bank branch
(6) Mauritius Commercial Bank Maldives Pvt. Ltd.	2008—established as a branch of the Mauritius Commercial Bank and converted to a subsidiary of the Mauritius Commercial Bank in September 2010.
(7) Maldives Islamic Bank Pvt Ltd.	2011—owned by Islamic Corporation for Development of the Private Sector and the Government of Maldives.

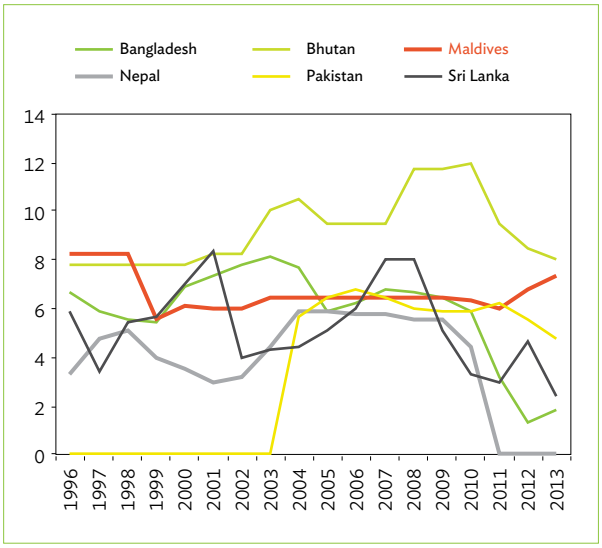
Source: MMA website (accessed May 2015).

Inefficiencies in financial intermediation are another factor behind the high cost of finance. The spread between the deposit and lending rates is a common indicator of banking efficiency, and spreads in the Maldives are some of the highest in the subregion although the spread has narrowed slightly in recent years (from an average of 7 percentage points during 2003–2009 to 6 percentage points in 2010). The spreads increased again starting in 2012, showing that there is scope for further improvement in financial intermediation (Figure 2.21).

Domestic credit to the private sector is highly concentrated in larger firms and in the tourism industry. Domestic credit to the private sector as a share of GDP is high by subregional standards but has been declining since 2008 (Figure 2.22). The decline was partly due to the effects of the global financial crisis and the lending shift in favor of the government to cater for its large financing requirement.

Notably, more than half of the total private loans and advances made by other depository corporations[28]

Figure 2.21: Interest Rate Spread, 1996–2013 (percentage points)



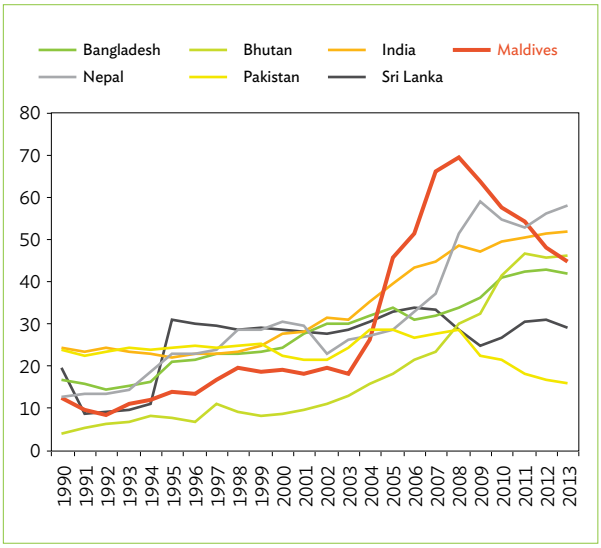
Source: World Bank, World Development Indicators (accessed 5 May 2015).

[28] The other depository corporations subsector consists of all residential financial corporations (except the central bank) and quasi-corporations that are mainly engaged in financial intermediation and that issue liabilities included in the national definition of broad money. Examples of the designations given to institutional units in the other depository corporations subsector are commercial banks, merchant banks, savings banks, savings and loan associations, building societies and mortgage banks, credit unions and credit cooperatives, rural and agricultural banks, and travelers' companies that mainly engage in financial corporation activities (IMF 2000).

during 2007–2014 went to the tourism sector, averaging 54.6% during the period (Figure 2.23). The second largest share during the same period went to commerce (wholesale and retail and restaurants and cafés), followed by construction (Table 2.16).

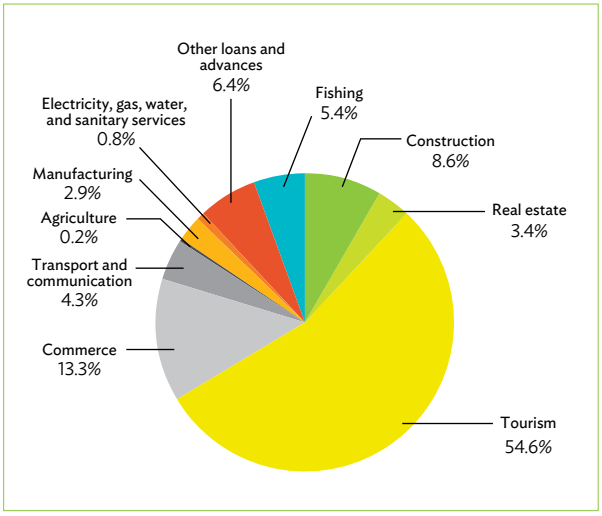
A study by the United Nations Development Programme and Maldives Ministry of Economic Development and Trade highlighted that the average lending rates in the Maldives of 10%–11% per annum

Figure 2.22: Domestic Credit Provided to the Private Sector, 1990–2013 (% of GDP)



Source: World Bank, World Development Indicators (accessed 5 May 2015).

Figure 2.23: Breakdown of Private Sector Loans and Advances, 2007–2014 (average share of total)



Sources: MMA (2012a, 2013, 2015c).

Table 2.16: Other Depository Corporations Private Sector Loans and Advances, by Economic Group, 2007–2014 (in Rf million unless stated otherwise; end of period)

	2007	2008	2009	2010	2011	2012	2013	2014[a]
Total	**12,486.4**	**16,121.8**	**15,403.6**	**15,094.2**	**15,970.3**	**14,403.3**	**14,533.5**	**14,928.3**
Agriculture	38.0	38.8	31.3	28.7	25.0	15.9	10.3	7.9
Fishing	1,182.9	1,088.8	960.5	896.0	772.3	551.9	546.6	399.8
Manufacturing	490.8	581.0	532.0	493.1	492.0	324.1	316.5	199.2
Construction	1,053.7	1,368.9	1,264.0	1,119.7	1,187.4	1,205.8	1,327.2	1,734.2
Residential/housing	853.6	1,159.4	1,121.0	1,011.3	961.5			
Commercial building	114.5	129.8	84.7	80.0	165.8			
Other	85.7	79.7	58.3	28.4	60.0			
Real Estate	153.2	296.0	357.8	691.2	721.1	605.2	713.0	619.5
Residential/housing	99.3	235.8	291.4	218.2	109.3			
Commercial building	53.2	59.8	66.4	335.6	481.3			
Other	0.6	0.4	-	137.4	130.5			
Tourism	6,536.1	9,317.0	9,148.9	8,698.3	9,170.3	8,326.8	7,430.1	6,476
New resort development	3,073.8	4,545.4	4,790.9	4,986.8	6,040.2			
Renovation of resorts	1,577.1	1,747.7	1,388.1	898.5	784.2			
Yacht safari buildings	60.9	624.1	733.9	830.3	186.4			
Working capital	1,824.4	2,399.7	2,235.9	1,982.7	2,159.5			
Commerce	1,299.3	1,837.3	1,587.9	1,774.3	2,131.1	2,144.3	2,551.7	2,515.6
Wholesale and retail	796.6	904.3	701.5	902.2	2,112.7			
Restaurants and café	502.7	933.0	886.4	872.1	18.4			
Transport and Communication	550.6	786.7	814.5	677.7	614.0	480.0	520.0	643.6
Transport								
Communication	464.1	736.9	774.9	644.6	585.6			
Electricity, Gas, Water and	86.6	49.9	39.6	33.1	28.4			
Sanitary Services	573.1	0.3	3.8	7.7	241.0	0.7	11.4	54.0
Other Loans and Advances not Adequately Described[b]	608.7	807.0	702.9	707.5	616.0	748.4	1,113.3	2,278.7
As a Percentage of Total; End of Period								
Fishing	9.5	6.8	6.2	5.9	4.8	3.8	3.8	2.7
Construction	8.4	8.5	8.2	7.4	7.4	8.4	9.1	11.6
Real Estate	1.2	1.8	2.3	4.6	4.5	4.2	4.9	4.1
Tourism	52.3	57.8	59.4	57.6	57.4	57.8	51.1	43.4
Commerce	10.4	11.4	10.3	11.8	13.3	14.9	17.6	16.9
Transport and Communication	4.4	4.9	5.3	4.5	3.8	3.3	3.6	4.6
Annual Percentage Change								
Total	52.6	29.1	–4.5	–2.0	5.8	–9.8	0.9	2.7
Fishing	84.4	–8.0	–11.8	–6.7	–13.8	–28.5	–1.0	–26.9
Construction	100.4	29.9	–7.7	–11.4	6.0	1.6	9.5	31.3
Real Estate		93.2	20.9	93.2	4.3	–16.1	17.8	–13.1
Tourism	52.1	42.5	–1.8	–4.9	5.4	–9.2	–10.8	–12.8
Commerce	–21.5	41.4	–13.6	11.7	20.1	0.6	19.0	–1.4
Transport and Communications	49.9	42.9	3.5	–16.8	–9.4	–21.8	8.3	23.8

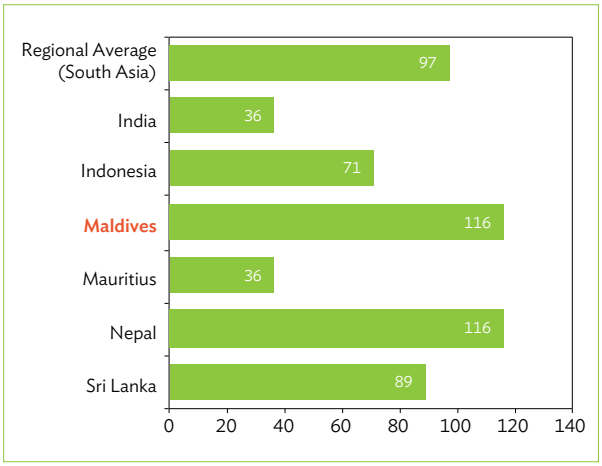
[a] Figures are as of April 2015.
[b] Includes total loans and advances to private sector excluding accrued interest receivable and accounts receivables except for 2007 which includes accrued interest receivable and accounts receivable from private sector.
Sources: IMF 2000; MMA (2012a, 2013); MMA (2014c, 2015d).

made medium- to long-term borrowing for projects unviable, unless the intended economic activity could pass the high borrowing cost on to customers (Siriwardena and Wijiwardena 2009a). Thus, banks lent overwhelmingly to the tourism sector—hotels and resorts could easily pass on higher costs to their customers. The result has been an overconcentration of loan portfolios in tourism, which has contributed to underdevelopment of other sectors that lacked access to affordable financing.[29]

Micro, small, and medium-sized enterprises have difficulty accessing credit. The Ease of Doing

[29] The examples given in the United Nations Development Programme study are "fisheries and other exportable products where Maldives is a price taker and, therefore, has to minimize the domestic costs to compete in the market."

Figure 2.24: Rank in "Ease of Getting Credit" in the Maldives and Selected South Asian Countries



Note: Rank is of 189 countries. Lower rank indicates easier access to credit.
Source: World Bank (2014a).

Business Survey 2015 ranked the Maldives 116th of 189 economies in terms of the ease of getting credit (World Bank 2014a). The Maldives' rank is lower than that of most countries in the subregion, indicating a lack of support, particularly for MSMEs (Figure 2.24).

Table 2.17 gives the ranking by specific indicators for ease of getting credit in the Maldives during 2010–2014. The economy scored 4 out of 10 on the strength of legal rights index, and 4 out of 6 on the depth of credit information index. Public registry coverage is 17.5% (of adults) while private bureau coverage is 0, implying that no information was available on the borrowing history for the last 5 years for individuals and firms listed in the private credit registry. The MMA Credit Information Bureau collects some information related to the credit worthiness of companies and individuals, and the information is on a shared database that is limited to its subscribers. Thus, the credit information system and collateral and bankruptcy laws in the Maldives have not facilitated local entrepreneurs' access to credit in the last few years.

As noted earlier, lack of access to finance was ranked first among the constraints identified by the respondents in the 2005 World Bank Investment Climate Survey (World Bank 2006b). Apart from government, it is mostly the larger firms, notably those engaged in tourism and tourism-related activities, commerce, and construction, that are able to access

Table 2.17: Ease of Getting Credit in the Maldives

Indicator	Doing Business Survey					
	2010	2011	2012	2013	2014	2015
Rank	-	-	165	105	109	116
Strength of Legal Rights Index (0–10)	4	4	4	4	4	2[a]
Depth of Credit Information Index (0–6)	4	4	4	4	4	5[b]
Public Registry Coverage (% of adults)	17.7	17.7	17.7	17.7	17.5	17.3
Private Bureau Coverage (% of adults)	0.0	0.0	0.0	0.0	0.0	0.0

[a] Scoring changed to (0–12).
[b] Scoring changed to (0–8).
Notes:
(1) A lower rank indicates easier access to credit. Rank is out of 183 economies for 2010 to 2012 Doing Business Surveys, 185 economies for 2013, and 189 economies for 2014 and 2015.
(2) The strength of legal rights index measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending.
(3) The depth of credit information index measures rules and practices affecting the coverage, scope, and accessibility of credit information available through either a public credit registry or a private credit bureau.
(4) The public credit registry coverage indicator reports the number of individuals and firms listed in a public credit registry with information on their borrowing history from the past 5 years. The number is expressed as a percentage of the adult population (the population age 15 and above in 2011, according to the World Bank's World Development Indicators).
(5) The private credit bureau coverage indicator reports the number of individuals and firms listed by a private credit bureau with information on their borrowing history from the past 5 years. The number is expressed as a percentage of the adult population (the population age 15 and above in 2011, according to the World Bank's World Development Indicators' classification).
Source: World Bank (2014a).

finance even at relatively high borrowing rates. With limited funds for credit, banks can choose to lend to entities that can bear the high cost of borrowing, have good credit histories, and are able to provide the desired land collateral. Loan provision in the Maldives is highly collateralized, with commercial banks normally taking property as security for up to 150% to 200% of the amount of the loan (Siriwardena and Wijiwardena 2009a). The high loan security requirement has, thus, restricted access for MSMEs. This fact has been recognized in the Strategic Action Plan, which mentioned that various studies have documented obstacles to the development of MSMEs, including limited access to finance, high collateral requirements, and lack of access to banking facilities (Ministry of Economic Development website).

As there are no special windows or financial products that cater to MSMEs' funding requirements, MSMEs have to rely on higher-cost loans from informal lenders or self-financing. In other countries, microcredit institutions provide finance to MSMEs and other small-scale borrowers but the microfinance sector remains undeveloped in the Maldives. Microcredit is provided almost solely by the government through the Development Banking Cell established within the Bank of Maldives with assistance from the donor community. Only two microfinance institutions operate in the country and nongovernment microfinance institutions, which are very popular microlending institutions elsewhere in the subregion, are not found in the Maldives (Sinha 2009). Box 2.3 provides a snapshot of the development of the microfinance sector in the Maldives.

In some other countries, microfinance has received proportional regulation that has helped its expansion, whereas microfinance in the Maldives is regulated and supervised in the same way as regular commercial loans and other financial services. Thus, microfinance institutions faced the same stringent requirements and regulations applied to commercial banks. A major development in 2011 was the issuance of the Credit Information Regulation that took effect in July 2011, and the establishment of the CIB to strengthen the Maldives' credit information system with a view to facilitating access to finance by small- and medium-scale borrowers. Armed with the required information, clients are expected to negotiate with banks even in the absence or shortage of collateral. So far, however, the impact of the credit information system is unclear.[30]

Until 2013, the Maldives had no specific law or regulations on microfinance or development banking. In April 2013, the Small and Medium Enterprises (SME) Bill was passed. It governs the policies and principles for regulating MSMEs and aims to facilitate access to finance, promote business skills, coordinate government policies, and provide employment opportunities within MSMEs. An SME Council has been formed to develop a national integrated strategy for promoting and developing the MSME sector and implementing the objectives of the SME Bill.

[30] A study by Siriwardena and Wijiwardena (2009b) indicated that banks are still not willing to provide smaller loans without acceptable collateral.

The Maldives' geographical spread and wide dispersal of the population pose significant challenges to delivering financial services. Another aspect of access to finance is physical access to banks, ATMs, and other financial institutions that provide financial services. Providing such access in the Maldives is challenged by its geographical spread, widely dispersed population, and inadequate transport and connectivity between islands. The dispersed population has prevented banks from opening branches in far-flung islands (Sinha 2009) as it is costly to deliver financial services through traditional branch networks. Physically transferring cash to the inhabited islands by sea transport results in high operating costs for banks (World Bank 2006b).

Notwithstanding these challenges, access to banks has improved in recent years—the number of ATMs per 100,000 adults and number of depositors with commercial banks per 1,000 adults have increased (Table 2.18). As of July 2014, the Maldives' commercial banks had 35 branches and 66 ATMs, which is an increase from 22 branches and 15 ATMs in 2004 (MMA 2014e).[31] Much of the progress continues to be in the urban areas, which have about a third (10 of the 35) of the total commercial bank branches.

The Maldives' financial sector has been undergoing major reforms in recent years primarily aimed at improving and strengthening the legal and regulatory framework, which may have also contributed to the spread of banking services. The landmark reforms include the enactment of the first Banking Act of Maldives in 2010 followed by the Islamic Banking Regulation that took effect in 2011. While the goals of the Banking Act have still to be fully achieved, one immediate positive effect of issuing the Islamic Banking Regulation was the establishment of the first Islamic bank in the country, the Maldives Islamic Bank, Pvt. Ltd. (MIB), which started operating in March 2011. This led to a strong response in deposit mobilization since MIB has been in operation (MMA Annual Report and Financial Statements 2011 [MMA 2012a]). By the end of 2011, the banking industry's aggregate deposits had increased by 18% with the establishment of the MIB having a strong impact on deposits (MMA 2012a).

[31] Based on data provided by Maldives' Department of National Planning and MMA website, Register of Banks. http://www.mma.gov.mv/banking/bankregister.pdf (accessed 24 July 2014).

Box 2.3: Microfinance in the Maldives

Microfinance in the Maldives was primarily done through the Development Banking Cell (DBC) in the Bank of Maldives (BML). The DBC was established in 1980 to implement developmental banking projects in the atolls initiated by the Government of Maldives and BML. The DBC provides targeted credit geared toward atolls that are underdeveloped and distant from Malé. Funding is mainly from the United Nations Development Programme (UNDP) and International Fund for Agricultural Development (IFAD). Prior to 2006, various government ministries were also allowed to undertake credit programs directly with targeted clients. However, the Finance Act of 2006 restricted to the banking system the implementation of credit programs. Under this Act, the DBC manages the credit component of all international and bilateral programs in the Maldives.

Microfinance Programs in the Maldives

Year	Program
1980s	Start of the Atoll Development Project funded by UNDP, which included the provision of rural credit and livelihood promotion.
1990	DBC established within BML to extend formal banking services to people living in far atolls. DBC was set up as a separate financial entity with financial autonomy to undertake development projects with funding from IFAD and UNDP.
1990–1996	The Atolls Credit and Development Banking Project funded by the Government of Maldives, IFAD, and UNDP to lay the foundations of development banking for the Maldives, reduce income disparities between Malé and the outer atolls by providing employment opportunities, and develop a framework for supporting future nutritional programs.
1996–2006	The second phase of the Atolls Credit and Development Banking Project was initiated as the Southern Atolls Development Project, funded by IFAD, the Organization of Petroleum Exporting Countries (OPEC), UNDP, United Nations Children's Fund (UNICEF), Government of Maldives, and BML, to create and expand income generation and employment opportunities
	Micro-Credit Loan Scheme was initiated in 2000 by the Ministry of Women Affairs and Social Security to lend to women for microenterprises and livelihoods.
	Projects initiated by other government ministries, including an agricultural revolving fund for economic development (loans disbursed for agriculture, tailoring, embroidery, operation of clinics); credit to the fisheries sector (1998) for fishing boats and fish processing; and the atoll electrification project (1999), comprising loans disbursed for electrification of smaller islands
	UNDP's Atoll Development for Sustainable Livelihood Project included a credit component for income generation activities and was implemented in five atolls through the Ministry of Atolls Development.
	Tsunami Recovery Livelihood Project, a multi-donor project implemented by UNDP and the Government of Maldives, targeting the vulnerable population, especially women.
	Other projects supported by IFAD (for agriculture and fisheries) and the Asian Development Bank (ADB), for small and cottage industries, new livelihoods for Tsunami affected fishermen.
	ADB-sponsored Small and Medium Enterprise Development Program, targeting the more vulnerable in the atolls and outer islands, women, and young people.

Source: Sinha (2009).

Sinha (2009) noted that DBC's targeted financial services start with a minimum loan size of Rf15,000 ($1,175). This compares to the average microcredit loan size of $200–$300 in other South Asian countries. However, the DBC level is 33% of per capita gross national income of the Maldives, representing a relatively small loan. The microfinance methodology for delivering targeted financial services differs according to the type of program. The most common methodology is collateral-free individual lending. In a program such as BML's Atoll Development for Sustainable Livelihood Project and Ministry of Women Affairs and Social Security loans are given to a group of borrowers for establishing microenterprises. The interest rates charged to the borrowers vary with the program. The Ministry of Fisheries, Agriculture, and Marine Resources' program for promoting fish processing charges borrowers 7.0% per annum. Ministry of Women Affairs and Social Security loans charge 6.0% per annum to women entrepreneurs while BML charges 7.00%–11.75% depending on the project presented by borrowers. As of 2007, the DBC had 21,623 borrowers with an average loan amount of $1,341.

More recently, the ADB Inclusive Micro, Small, and Medium-Size Enterprise (MSME) Development Project, aimed at enhancing MSMEs' access to finance, provided BML with a line credit facility that piloted credit assistance for MSMEs in designated regions and created a central movable asset registry to facilitate the use of collateral for business financing. The loan also established business development service centers and a cost-sharing facility designed to meet MSMEs' special needs, with additional capacity development of related government support agencies and chambers of commerce.

Sources: Institute of Microfinance (n.d.); Sinha (2009).

Table 2.18: Access to Banks, 2004–2013

Year	ATMs (per 100,000 adults)	Commercial Bank Branches (per 100,000 adults)	Borrowers from Commercial Banks (per 1,000 adults)	Depositors with Commercial Banks (per 1,000 adults)
2004	7.96	13.80	79.18	709.43
2005	8.19	13.30	159.16	799.59
2006	7.91	15.32	180.08	874.31
2007	19.62	15.79	193.96	974.55
2008	19.03	16.71	192.42	1,055.83
2009	19.84	16.23	138.77	1,144.58
2010	19.73	15.78	126.14	1,172.79
2011	20.07	15.80	167.06	1,320.67
2012	24.15	15.82	166.29	1,272.39
2013	26.64	16.24	138.23	1,328.16

ATM = automated teller machine.
Source: IMF, Financial Access Survey (accessed May 2015).

Since the third quarter of 2011, the MIB has also been offering Shariah-compliant financing products (MMA Annual Report and Financial Statements 2011). Box 2.4 shows the banking activities allowed under the Islamic Banking Regulation of 2011.

Another major development was the issuance of the Credit Information Regulation that took effect in July 2011, and the establishment of the CIB to strengthen the country's credit information system with a view to facilitating access to finance by small and medium scale borrowers. Table 2.19 lists recent reforms implemented in the sector.

The banking sector is still healthy, but the deteriorating quality of loan portfolios is an emerging concern. Prior to May 2009, the required minimum capital adequacy ratio of banks in the Maldives was 8% of risk-weighted assets. This was raised to 12% of total risk-weighted assets in May 2009 and a minimum equity capital ratio of 5% was also introduced (SAARC 2011). Banks in the Maldives appear healthy and well-capitalized with the total risk-based capital adequacy ratio and the equity capital (leverage) ratio of the banking sector well above the minimum requirements throughout recent years (Figure 2.25).[32]

[32] In 2011, the risk-based capital ratios of the banks remained well above the required minimum levels with the tier 1 risk weighted capital ratio at 26%, total risk-weighted capital ratio at 31%, and the leverage capital ratio at 16%, against the minimum requirements of 6%, 12%, and 5%, respectively (MMA 2012a).

Box 2.4: Islamic Banking in the Maldives

Under the Islamic Banking Regulation 2011 of Maldives, an Islamic bank or a bank engaging in Islamic banking business, may engage in any of the following:

- mobilize funds in the form of deposits such as demand deposits, savings, or other compatible forms based on contracts acceptable in Islamic Shariah;
- provide investment products based on contracts acceptable in Islamic Shariah;
- distribute financing of leasing moveable or immovable goods to customers based on the contract ijarah, and/or lease purchase in the form of ijarah or other contract not contradictory to the Islamic Shariah;
- grant loans or debt based on contracts acceptable in Islamic Shariah;
- engage in debit or credit card business based on contracts acceptable in Islamic Shariah;
- conduct custody for the interest of other parties, such as providing safety deposit boxes, based on contracts acceptable in Islamic Shariah;
- transfer money, for own interest and/or the interest of customers based on contracts acceptable in Islamic Shariah;
- provide letter of credit facilities and bank guarantees based on contracts acceptable in Islamic Shariah; and
- engage in any other Islamic banking business authorized by the Maldives Monetary Authority as being appropriate to be carried by Islamic banks.

Source: Islamic Banking Regulation 2011, MMA. Laws & Regulations webpage (accessed March 2015).

During 2008–2012, the level of nonperforming loans (NPLs) was increasing and reached about Rf3.38 billion or $219.9 million (Figure 2.26). The increase was directly related to the impact of the economic slowdown since 2008, which has adversely affected the repayment capacity of large loans (SAARC 2011). In 2008, NPLs amounted to 9% of total loans; by the end of 2012, NPLs had more than doubled and reached 21%, principally due to the default of a few large loans (MMA 2012a). The few large recoveries in early 2013 improved the NPL status, as this decreased to about Rf2.81 billion ($182.3 million) or a reduction of about 17% (Rf580.7 million or $37.7 million) from the previous year. However, the level of NPLs remains a concern, at 16% as of December 2014 (MMA 2015).

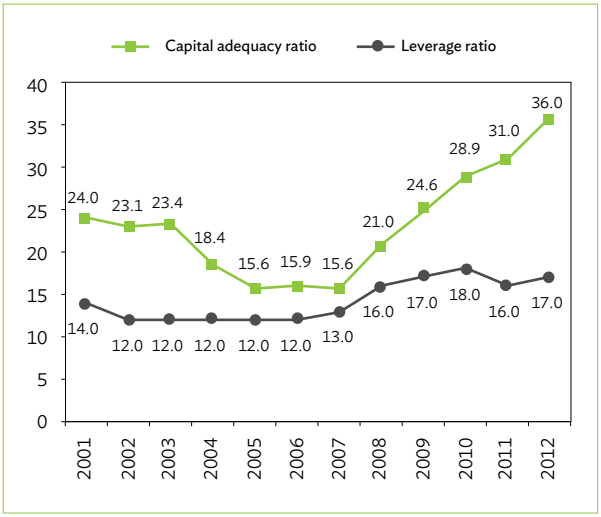
Table 2.19: Recent Reforms in the Maldives' Financial Sector

Reform	Objective
Maldives Banking Act (took effect on 12 December 2010)	Enacted for the purposes of providing for licensing of banks to conduct banking business in the Maldives, a system for operating banks in the Maldives, policies for operating banks in a safe and prudent manner, supervision of banks, appointment of conservators and receivers, liquidation of banks, and other related purposes.
Movement from a fixed exchange rate regime to a managed float, effective 11 April 2011 (the Maldivian rufiyaa was allowed to fluctuate within a horizontal band of 20% on either side of a central parity of Rf12.85/$)	To ease the pressure prevailing in the foreign exchange market
Credit Information Regulation (effective 4 July 2011)	Issued pursuant to Sections 37 and 65 of Law No. 24/2010 (Maldives Banking Act). Its purpose is to provide a legal framework to establish the rights, liabilities, and responsibilities of the Authority and Members of the Credit Information System established by the MMA.
Islamic Banking Regulation 2011 (effective 6 March 2011)	Issued pursuant to Sections 11 and 65 of Law No. 24/2010, (Maldives Banking Act), in performing MMA's duties, to provide for the licensing and regulating Islamic banking business in the Maldives.
Introduction of foreign currency swap facility (effective July 2011)	To manage liquidity in the banking system
Prevention of Money Laundering and Terrorism Financing Act (effective October 2014)	To criminalize money laundering and terrorist financing, provide preventive measures to combat money laundering and terrorist financing, and establish a Financial Intelligence Unit
Changes in the monetary policy framework (effective April 2013): (1) narrowed the interest rate corridor by increasing the interest rate of the overnight deposit facility from 0.25% to 3.00%, (2) reduced the rate of the overnight Lombard facility from 16% to 12%, and (3) redefined the indicative policy rate introduced in May 2011 from being a cut-off rate to be used as an indicative rate for open market operations.	To make monetary policy more effective
Changes in the monetary policy framework (effective 2014): (1) revised the interest rate corridor by decreasing the overnight deposit facility from 3.0% to 1.5%; (2) decreased the overnight Lombard facility from 12% to 10%; (3) lowered the indicative policy rate from 7% to 4%; (4) reduced the minimum reserve requirement from 25% to 29% in February (and discontinued the previous policy to maintain 3% of the minimum reserve requirement in United States dollars); and (5) temporarily stopped open market operations.	To make monetary policy more effective and facilitate the development of the interbank market in the country To enable banks to provide more credit and to reduce the cost of borrowing for commercial banks To help the government raise finances through market-based sources, and to ease the continued difficulties the government faced in financing the fiscal deficit, which, in the past, was being heavily monetized

MMA = Maldives Monetary Authority.
Source: Compiled by ADB Staff.

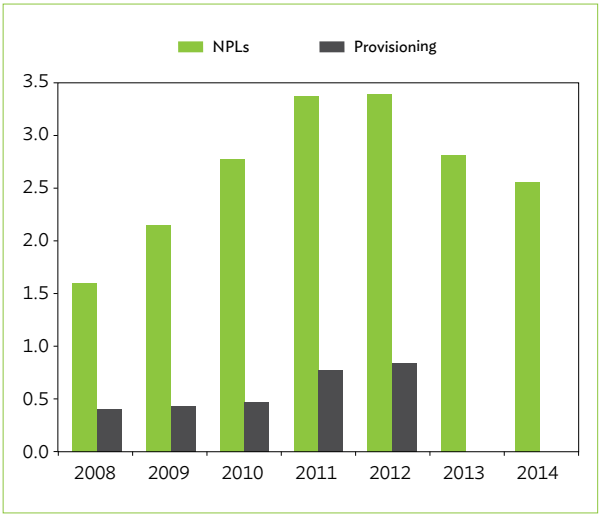
In summary, the cost of finance in the Maldives is high. The key factors are heavy public sector borrowing from the domestic financial market, inefficiencies in financial intermediation, and (to some extent) monetary tightening aimed at stabilizing prices and absorbing excess liquidity in the system. However, the government and the larger firms principally engaged in tourism and tourism-related activities have access to finance even at relatively high borrowing rates. For the MSMEs, the cost of and access to finance are a critical constraint due to the high cost of borrowing, the highly collateralized nature of bank lending, the presence of information asymmetry resulting in insufficient credit information, and the inability of banks to provide rural areas with adequate banking facilities make access to credit difficult.

Figure 2.25: Capital Adequacy and Leverage Ratios, 2001–2012



Sources: SAARC (2011); MMA (2012a, 2013).

Figure 2.26: Nonperforming Loans and Provisioning, 2008–2014 (Rf billion)



NPL = nonperforming loan, Rf = rufiyaa.
Note: No data on loan provisioning was cited in the MMA *Annual Economic Report* for 2013.
Sources: For NPLs: MMA (various years); for provisioning: MMA (2012b) and MMA (2012a, chart titled "NPLs and Provisioning, 2008–2011").

2.3. Risks that May Become Critical in the Medium to Long Term

2.3.1. Energy, Electricity, Water, and Sanitation Infrastructure

The Maldives relies entirely on imported petroleum for its energy needs, leaving its economy vulnerable to global oil shocks. The country has no significant conventional energy (coal, oil, or gas) resources. Renewable energy could be acquired from solar heat, wind, and biomass; however, utilization of these sources has been very limited. Recent economic growth has resulted in a huge increase in energy demand. In 2011, the total final energy consumption amounted to 396,000 tons of oil equivalent, which is about 70% higher than the 2005 level. The increases were driven mainly by the surge in demand for electricity and transport. Imported diesel is the main energy source.

The country has been depending almost entirely on fuel imports for its energy requirements and this reliance has intensified in recent years. The share of petroleum products in total imports rose to 29% in 2014, from only 16% in 1990. The Maldives spent $572 million for imported fuel,[33] or roughly 19% of the country's GDP in 2014 (MMA May 2015).

High reliance on imported energy exposes the country to risks resulting from fuel price fluctuations in the world market. The oil price vulnerability index of the Regional Energy Programme of the United Nations Programme Regional Centre ranks the Maldives as the most vulnerable to oil price variations among 24 countries in Asia and the Pacific (UNDP 2007). The record high escalation of world oil prices in 2008 resulted in a huge increase in the Maldives' fuel import cost (MMA 2009), leading to significant deficit in the balance of payments during that year. High fuel prices have pushed the government to provide subsidies to protect consumers through an electricity subsidy and a fuel subsidy, further weakening the fiscal position.

[33] Imported fuel comprised 337,531 tons of diesel, 93,865 tons of jet fuel, 38,008 tons of petrol, and 10,919 tons of liquefied petroleum gas.

Fuel cost is relatively high in the Maldives because it cannot purchase fuel in large quantities. The limited capacity of the country's storage facilities does not allow it to import when prices are low. In addition, access to commercial sources of energy is geographically skewed, with outer atolls severely disadvantaged. Consumers in outer atolls bear the additional cost imposed by the relatively inefficient interisland transport system.

The government's energy policy embodied in the National Energy Policy and Strategy 2010 includes the objectives of promoting conservation and energy security by diversifying sources and developing renewables. Renewable energy is very important for the Maldives, to decrease its dependence on fossil fuels. Given the country's target of being the first carbon-neutral country in the world by 2020 (Ministry of Environment and Energy 2012), the government urgently needs to find alternative sources of energy that will provide energy efficiency and sustain economic activity. The Investment Plan for Scaling-up Renewable Energy Program (SREP) 2013–2017 emphasizes investment in solar, wind, and waste for energy use. Under this plan, a 40-megawatt (MW) solar photovoltaic system will be installed to meet 30% of day time peak demand in all inhabited islands within the next 5 years. The SREP aims to transform the electricity sector and develop renewable energy on a larger scale. It also aims to improve energy efficiency and conservation of energy and encourage the adoption of low-carbon technologies in production, distribution, and consumption of energy. The SREP targets a reduction of greenhouse gas emissions by about 90,000 tons of carbon dioxide per year, and a saving of about 36 million liters of diesel annually. While there is clear potential for using renewable energy sources, challenges need to be addressed to push forward with the SREP. The challenges include an absence of a comprehensive assessment of renewable energy resources; the need to come up with a concrete strategy and plan to implement the renewable energy program; the cost implications of developing renewable energy sources, and thus, the concern about the financing requirements for renewable energy projects; the limited availability of financial support from the private sector; and the concern over the intermittent nature of renewable energy. How successful the plans for renewable energy will remain an important issue.

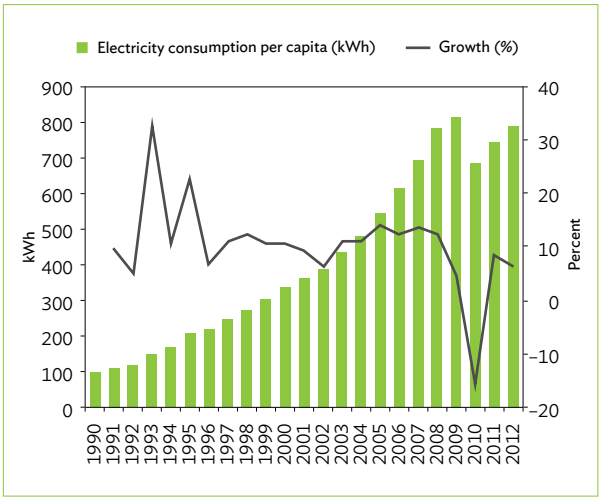
While electricity provision is not a major constraint to doing businesses (World Bank 2006b), rising subsidies add to the fiscal burden. The Maldives, despite being an island economy with a sparsely distributed population, achieved universal electrification in 2009, with South Asia's highest electrification ratio (Figure 2.27). In 1990, only six islands had access to 24-hour electricity. With funding from international agencies, the Maldives was able to expand power supply to 40 outer islands in 2010, and, by 2011, all islands had access to a 24-hour electricity supply. In 2012, the country's electricity generation capacity was 245 MW, distributed as follows: 120 MW on inhabited islands, 105 MW on the resort islands, and 20 MW on industrial islands. Malé accounted for 48 MW, about one-fifth of the total generation capacity.

The Maldives' electricity consumption per capita (Figure 2.28) is now higher than all South Asian countries except Bhutan (Figure 2.29), largely on account of the tourism boom and the increased economic activity.

Figure 2.27: Electrification Rate, Selected South Asian Countries (% of total population)

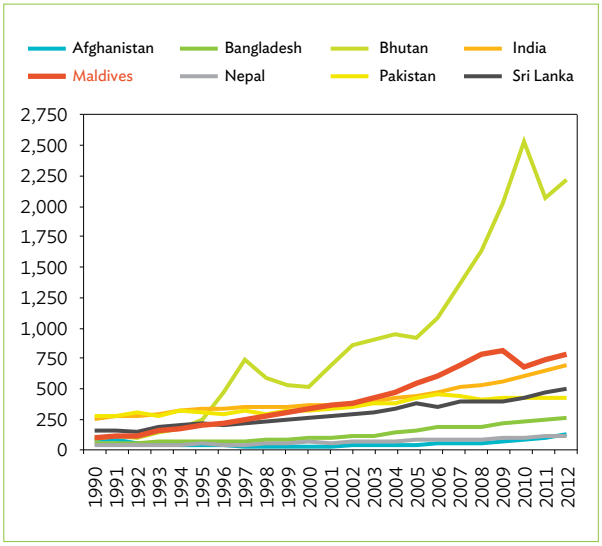
Sources: ADB (2014b); World Bank, World Development Indicators (accessed 6 May 2015).

Figure 2.28: Electricity Consumption per Capita, 1990–2012



kWh = kilowatt-hour.
Sources: Calculated based on data from US Energy Information Administration, International Energy Statistics (accessed 6 May 2015); World Bank, World Development Indicators (accessed 6 May 2015).

Figure 2.29: Electricity Consumption per Capita, Selected South Asian Countries, 1990–2012 (kWh)



kWh = kilowatt-hour.
Sources: Calculated based on data from US Energy Information Administration, International Energy Statistics (accessed 6 May 2015); World Bank, World Development Indicators (accessed 6 May 2015).

The State Electric Company, Limited (STELCO), national electricity utility, serves Malé and the North Central region. Power supply in STELCO-serviced areas has been reliable. Islands outside STELCO's area of operation were previously served by community-owned generators managed by island development committees. However, in most of the islands, electricity supply remained intermittent as it was developed without proper planning and technical know-how. In 2009, six regional utilities were established to consolidate the power system. In line with this, a number of generators managed by island development committees and private operators were absorbed by the regional utilities. In June 2012, FENAKA Corporation Limited was established by a presidential decree under the Companies Act of 10/96 to provide island communities with electricity, water, and sewerage. FENAKA took over the operations of the regional utilities, with the objective of improving efficiency and transparency of operations. FENAKA now serves 149 of the 194 inhabited islands, while STELCO manages and operates power systems in 10 islands. Island councils provide electricity to 30 islands and private entities provide electricity to 2 islands (Ministry of Environment and Energy 2012). Large enterprises such as ice plants and resorts operate their own generators.

Given the Maldives' dispersed islands and population, it would be extremely expensive to establish a single national grid to serve the islands. Instead, each island has its own powerhouse and distribution facility and technical specifications and capacities vary between islands because they were developed in an ad-hoc manner. The disparity between large and small islands in terms of quality of power infrastructure is evident. Large islands have advanced and stable powerhouses serviced by STELCO; small islands mostly rely on generators. Consequently, powerhouses in large islands have higher fuel efficiency and lower generation costs, and provide more reliable electricity supply than those in small, outer islands (Table 2.20).

Because most of the Maldives' generation plants run on diesel fuel, which accounts for 70%–80% of the generation cost,[34] the country currently has among the highest power generation costs in South Asia[35] at Rf4.54 ($0.31) per kilowatt-hour (kWh) in large islands and Rf7.07 ($0.46) per kWh in small islands.

[34] Electricity generation is almost entirely from diesel. In 2012, Maldives consumed nearly 120 million liters of diesel (approximately 106,200 metric tons) for electricity generation purposes.
[35] Renewable Energy and Energy Efficiency Partnership Policy Database (accessed May 2015),

Table 2.20: Quality of Power Systems, by Amount of Electricity Consumed

Island Size	Average Population	Electricity Consumption/ Year	Quality of Power System	Fuel Efficiency (liter/kWh)	Generation Cost ($/kWh)
Large (9 islands)	5,723	More than 3 GWh	Systems are properly designed and installed	0.35	0.31
Medium (21 islands)	2,447	1–3 GWh	Some of systems have been upgraded, while some need upgrading	0.261–0.521	0.34
Small (62 islands)	1,141	250 MWh to 1 GWh	On most of these islands power systems are considered inefficient.	0.271–0.681	0.40
Very small (20+ islands)	519	Less than 250 MWh	Extremely inefficient system.	0.311–0.671	0.46

GWh = gigawatt-hour, kWh = kilowatt-hour, MWh = megawatt-hour.
Source: Ministry of Environment and Energy (2012).

Table 2.21: Electricity Tariff Rates in Selected Islands, May 2015

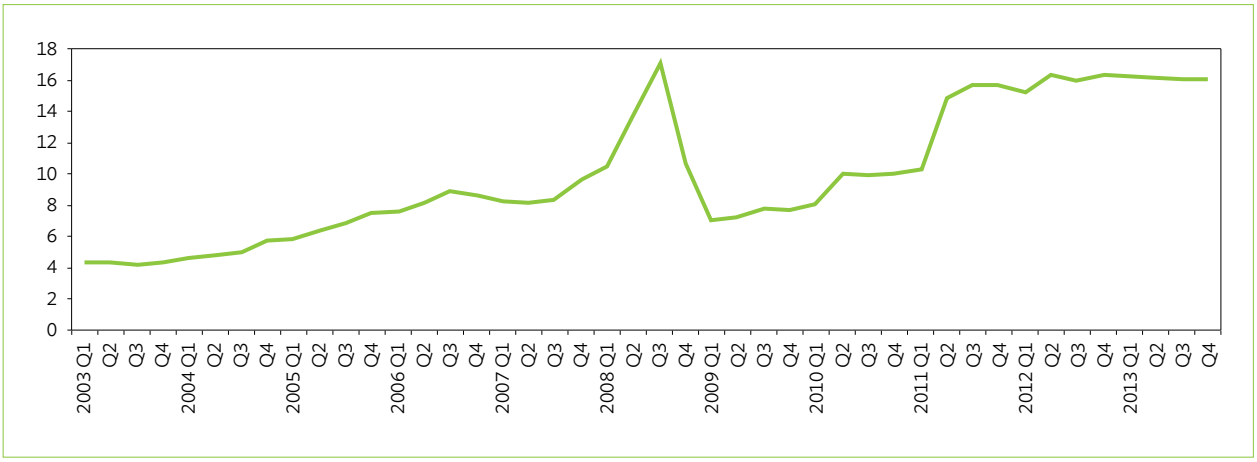
Electricity Consumption Band	Base Rate, Domestic (Rf per kWh)	Base Rate, Commercial, Government, and Institutes (Rf per kWh)	Total Tariff Rates,[a] Domestic (Rf per kWh)	Total Tariff Rates,[a] Commercial, Government, and Institutes (Rf per kWh)
Malé, K. Villigili, Hulhumale and Thilafushi				
0–100 kWh	2.25	3.30	3.15	4.20
101–300 kWh	2.50	3.35	3.40	4.25
301–500 kWh	2.95	3.65	3.85	4.55
501–600 kWh	3.55	4.00	4.45	4.90
More than 600 kWh	3.85	4.35	4.75	5.25
K. Guraidhoo, K. Maafushi, K. Himmafushi, K. Thulusdhoo and K. Kaashidhoo				
0–100 kWh	2.20	4.50	...	...
101–200 kWh	2.75	5.75	...	...
201–300 kWh	3.50	6.50	...	...
More than 300 kWh	3.50	7.50	...	...

... = data not available, kWh = kilowatt-hour, Rf = rufiyaa.
[a] Total tariff rate is the base rate plus fuel surcharge. No data were provided by the Ministry of Energy and Environment for the fuel surcharge for islands in Guraidhoo, Maafushi, Himmafushi, Thulusdhoo, and Kaashidhoo atolls indicated in the table.
Source: STELCO website (accessed 6 May 2015).

The difference in the quality of power systems and cost of generation determine the tariff rates charged to users in the different regions. Basic tariff rates charged by STELCO range from Rf2.20 to Rf3.85 ($0.14 to $0.25) per kWh for domestic use and Rf3.30 to Rf7.50 ($0.21 to $0.49) per kWh for nondomestic use (business, government, and others). Small, outer atolls are charged higher tariff rates (Table 2.21). As of 6 May 2015, the fuel surcharge was Rf0.90 ($0.06) per kWh for Hulhumale, Villigili Atoll, Malé, and Thilafushi. The electricity tariff for businesses is among the highest in South Asia.

Fuel price increases in 2008 and 2010 (Figure 2.30) resulted in the government increasing subsidies to stabilize the users' price of electricity. The government has provided subsidies to domestic users in two forms—cross-subsidies and direct subsidies. By cross-subsidization, the government charges higher rates to businesses and government institutions to compensate for low rates charged to domestic users. Direct subsidies come in two forms—a fuel surcharge subsidy and usage subsidy. The government fully covers the fuel surcharge of domestic users with consumption below 400 kWh, and the usage subsidy is applied as a lower tariff rate for consumption below 400 kWh.

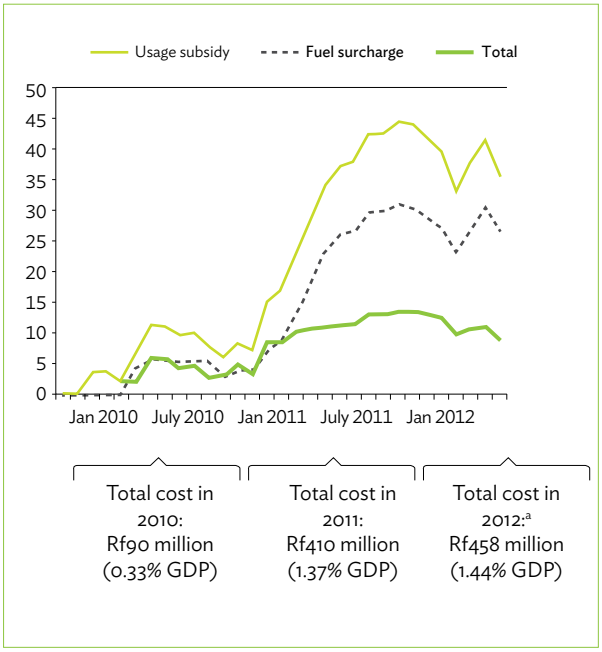
Figure 2.30: Average Diesel Price in the Maldives, 2003–2013 (Rf/liter)



Rf = rufiyaa.
Sources: DNP (2013, 2014).

Due to fuel price increases in the world market and the devaluation of the rufiyaa, electricity subsidies increased from Rf90 million to Rf458 million ($7.0 million to $35.8 million), translating to 0.3%–1.4% of GDP during 2010–2012 (Figure 2.31). The National Social Protection Agency estimated that the government subsidy in 2011 averaged Rf0.76 per kWh ($0.05 per kWh). While the provision of subsidies has made electricity affordable to many consumers, the subsidies will not be sustainable in the long run given the current fiscal position. As the government needs to contain the budget deficit, the subsidies will need to be reviewed with closer targeting at lower income users.

Figure 2.31: Monthly Fiscal Cost of Subsidies in the Maldives, 2010–2012 (Rf million)



[a] 2012 forecast
GDP = gross domestic product, Rf = rufiyaa.
Source: Ministry of Environment and Energy (2013).

Access to good quality water and improved sanitation is needed and the demand has increased with the growth of the economy. The Maldives has no permanent rivers or streams, only ponds and freshwater lakes. The Maldives relies mainly on rainwater, groundwater, and desalinated water for its water needs. Groundwater withdrawal is mainly done by municipalities and used mostly for drinking, cooking, bathing, and other domestic purposes. Agriculture is not a major economic sector, and, while there is some subsistence agriculture, it is rain fed or manually watered, and irrigation infrastructure is not necessary.

For islands that do not have sufficient rain and groundwater, desalination is needed. Desalinated water is distributed through pipelines by water utilities. Only Malé and five other densely populated islands have a desalinated piped network with household connections. Based on figures provided by the Ministry of Environment and Energy, only about 39% of the country's population has access to improved water

sources.[36] Because fossil fuel is needed to operate desalination plants, tariffs for desalinated water are relatively high[37] and on average, a household spends $40–$60 per month on water (FAO 2012). In most islands, the population depends heavily on rainwater for drinking and cooking, and on groundwater for other purposes. Resort islands operate their own desalination plants.

The 2004 tsunami devastated aquifers and rainwater storage systems. Salt water intrusion and the destruction of the sanitation system have contaminated the ground water system. Most islands have little or no potable water. As part of the recovery program, several donors, including the International Federation of Red Cross and Red Crescent Societies, Japan International Cooperation Agency, Malaysian Investment and Development Agency, and United Nations Children's Fund (UNICEF), together with the government, distributed free rain water storage tanks to every household. Also, 52 desalination plants were provided to islands across the country. Currently, only 16 plants remain operational, while the rest are not operating due to inadequate funding for maintenance. Because of continued dependence on groundwater for drinking, cooking, and nonpotable purposes, especially during dry periods, investment in water is needed to ensure a safe year-round supply.

While the Maldives outperforms neighboring countries in access to improved sanitation facilities based on sanitation-related indicators,[38] only Malé and 30 other islands have sewerage systems with household connections. Further, the sewerage infrastructure needs upgrading, modernizing, and expanding to other inhabited islands to prevent serious health problems from afflicting the population.

[36] The Ministry of Energy and Environment defines access to improved water sources as piped desalinated water supply with household connections.

[37] Aside from a fixed monthly charge, water tariff varies, depending on whether it is used for domestically or commercially. The tariff for domestic use ranges from Rf22 to Rf95 per cubic meter depending on the total liters consumed for the month. Water for institutional consumption and for commercial use is charged Rf75.95 and Rf101.26 per cubic meter, respectively, on top of the fixed monthly charge.

[38] World Bank, World Development Indicators (accessed_April 2015).

2.3.2. Institutional Risks

The Maldives is doing well, but institutional risks should be addressed to avoid discouraging more and diversified private investment. Overall, the World Bank Ease of Doing Business Survey still ranks the Maldives relatively higher than other South Asian countries, despite the decline in its ranking between 2013 and 2015 (Table 2.22).

Table 2.22: Rank in Ease of Doing Business, 2013, 2014, 2015

Country	Doing Business Survey		
	2015	2014	2013
Afghanistan	183	164	170
Bangladesh	173	130	132
Bhutan	125	141	146
India	142	134	131
Maldives	**116**	**95**	**81**
Nepal	108	105	103
Pakistan	128	110	106
Sri Lanka	99	85	83

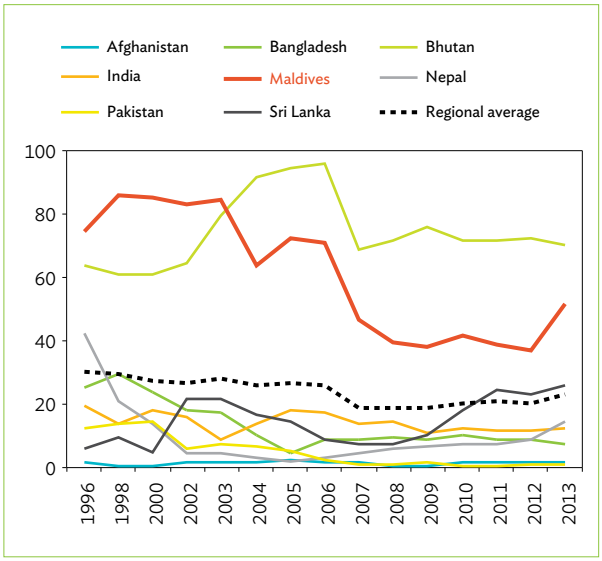
Note: A lower number indicates a better rank. Rankings are for 185 economies in 2013 and 189 economies in 2014 and 2015.
Sources: World Bank (2012a, 2013, 2014a).

The Maldives' decline is largely attributed to the rise in tax payments needed to address the fiscal deficit, as discussed above. Hence, while some institutional and governance indicators have deteriorated in recent years, by subregional standards, the Maldives is still doing relatively well and the overall Ease of Doing Business ranking indicates that the country's business environment remains relatively positive. Further slippage in political stability, corruption, government effectiveness, and application of the rule of law would clearly be a cause for concern and, if it occurs, could become a critical constraint in the future. However, overall, governance and institutions are not a critical constraint at present, although it is clear that improvements could be made.

Changes in government and the perception of irregularities, including mismanagement of resources and corruption, have led to policy uncertainty, which reduces investor confidence.

Private investments have typically long horizons and place a substantial premium on good governance, which includes aspects of political stability, absence of violence, and control of corruption. Maintaining policy stability and demonstrating effective management of resources are concerns in the Maldives, just as in many other countries. Since 2008, the Maldives has implemented a number of key institutional reforms, which include enacting a new Constitution that provided clearer delineation of powers between the executive, legislative, and judiciary and created independent institutions to monitor the three branches of government and safeguard human rights (Hussain 2008). The first multiparty elections ended a 30-year rule in 2008. The World Bank World Governance Indicators (Figure 2.32) characterize the Maldives as stable. While the Maldives still fared better than other South Asian countries in recent years, its political stability rank has declined due to disturbances that started in 2003 and escalated in 2007. The country's political stability ranking was 42 in 2010.[39] The ranking declined to 37 in 2012 but improved to 52 after the election of the new president in 2013, as all political parties have accepted the poll result.

Figure 2.32: Political Stability and Absence of Violence, 1996–2013 (percentile rank)



Note: Percentile rank indicates the percentage of countries worldwide that rate below the selected country. Higher values indicate better governance ratings.
Source: World Bank, Worldwide Governance Indicators (accessed 7 May 2015).

[39] Percentile rank indicates the percentage of countries worldwide that rate below the selected country. Higher values indicate better governance ratings.

Table 2.23: Corruption Perception Index Score, 2007–2011

Country	2007	2008	2009	2010	2011
Afghanistan	1.8	1.5	1.3	1.4	1.5
Bangladesh	2.0	2.1	2.4	2.4	2.7
Bhutan	5.0	5.2	5.0	5.7	5.7
India	3.5	3.4	3.4	3.3	3.1
Maldives	**3.3**	**2.8**	**2.5**	**2.3**	**2.5**
Nepal	2.5	2.7	2.3	2.2	2.2
Pakistan	2.4	2.4	2.4	2.3	2.5
Sri Lanka	3.2	3.2	3.1	3.2	3.3

Source: TI (various years).

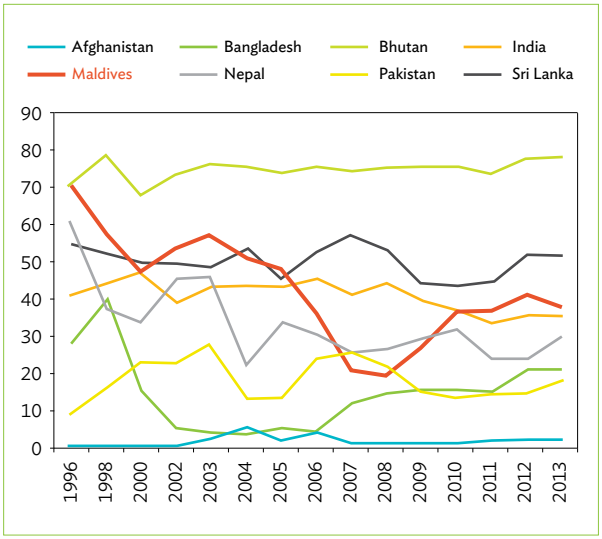
The investment climate can also be affected negatively by the perception of irregularities such as corruption. Control of corruption weakened in the recent past and the corruption indicator declined in various surveys. As shown in Table 2.23, the Maldives scored 2.5 on the corruption perception index (TI 2011), a decline from 3.3 in 2007.[40] Consequently, its rank among the surveyed economies slipped from 84 of 180 in 2007 to 134 out of 183 in 2011.[41] The 2013 Global Corruption Barometer Survey (TI 2013) reported that 83% of the 1,002 respondents felt that corruption in the country had increased or stayed the same in the previous 2 years and 56% believed that the government's action in fighting corruption was ineffective.

From 1996 to 2005, the Maldives was among the subregion's top three countries in terms of controlling corruption. But its ranking started to decline during 2006–2008. Although its ranking has recovered since 2009, it has not reverted to the level attained in 1996 (Figure 2.33).

The 2013 Global Corruption Barometer Survey showed that the most common reason for paying a bribe in the Maldives is to speed things up, next is to obtain a service, and last is as a gift or gratitude. In the perception of the degree of corruption of the Maldives' institutions, the Parliament and Legislature, political parties, and judiciary were the top three on the list.

[40] On a scale of 0–10, 0 means the "most corrupt" and 10 means the "cleanest."
[41] The Maldives was not included in the countries ranked from 2012 to 2014.

Figure 2.33: Control of Corruption, 1996–2013 (percentile rank)



Note: Percentile rank indicates the percentage of countries worldwide that rate below the selected country. Higher values indicate better control of corruption ratings.
Source: World Bank, Worldwide Governance Indicators (accessed 7 May 2015).

The government has attempted to combat corruption and acceded to the United Nations Convention against Corruption in March 2007. In addition, the independent Anti-Corruption Commission (ACC) was established in December 2008. The ACC was established to replace the old Anti-Corruption Board. The Auditor General's Office was also established in 2008 to audit all government departments and state enterprises. The most recent effort to help combat corruption is the passage of the Right to Information Act in January 2014. It aims to widen and improve the scope of the citizen's rights to information in order to increase transparency and accountability in the state institutions. The Act also provides for the protection of whistleblowers who publicize information about corruption and breach of law (Rasheed 2014).

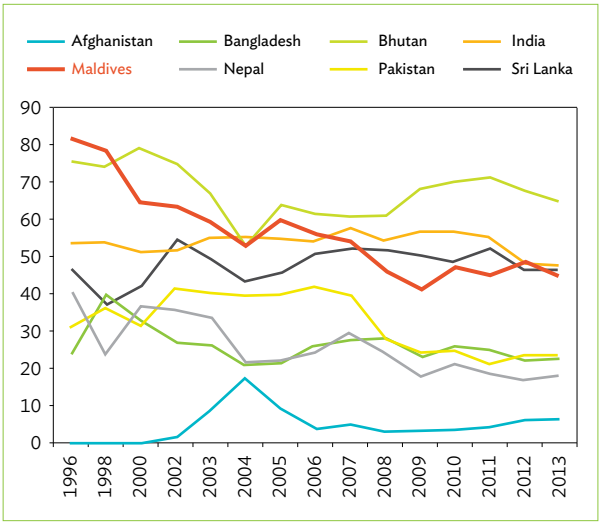
Since the establishment of the ACC, the number of complaints has risen quickly and steadily and the number of cases the ACC has processed has also increased. Reported cases have increased from 254 in 2009 to 917 in 2010 and, as of April 2011, 260 cases had already been reported for the year (UNDP 2012). However, the ACC cannot fully perform its mandate due to limitations in its powers and financial resources. The ACC can initiate investigations but not prosecute them, and must instead forward the cases to the Prosecutor General for further action. And with no formal guarantees of financial independence, the ACC's access to resources is subject to compromise.[42] Moreover, a Supreme Court judgment in September 2012 that limited the ACC's powers to halt projects or issue binding orders or injunctions has restricted the ACC's ability to carry out its corruption investigation activities. In response to this, the revised bill on anticorruption submitted to Parliament contains provisions to enhance the ACC's preventive powers. At present, however, injunctions issued by the ACC are not binding and are deemed only to be recommendations or advice (Transparency Maldives 2014).

Government effectiveness, as defined by the World Bank's Worldwide Governance Indicators, covers the quality of public service provision and the bureaucracy, the competence of civil servants, the independence of civil service from political pressure, and the credibility of government commitment to policies. The Maldives' ranking for government effectiveness has been declining (Figure 2.34). The recent decline coincides with the decentralization program, perhaps reflecting a transitional position as the general population and officials at various levels of government adjust to the change in functions that have now been devolved (ADB, ILO, and IsDB 2010).

The Maldives' Civil Service Commission was formed on October 2007 to ensure a more independent management of the civil service. Prior to that, the President's Office was responsible for managing the civil service. The Commission is the embodiment of two very important principles that are relatively new to the Maldives: (1) that civil service management be removed from the President's Office and vested in an independent body, and (2) that a distinction be made for the first time between political appointees and civil servants. The Civil Service Strategic Plan 2011–2015 was formulated to map out the programs and activities

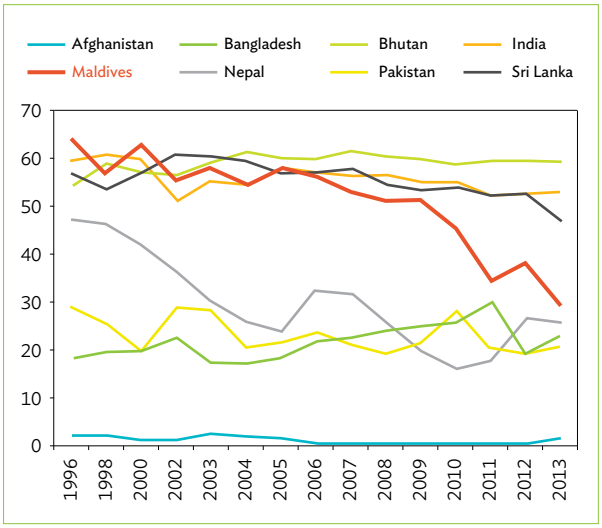
[42] The ACC's annual budget must be prepared in consultation and agreement with the Minister of Finance and Treasury, and submitted to the Parliament along with the state budget. Although the ACC is consulted in the process, this limits the ACC's authority to prescribe its own budget, as the Finance Minister has a say in budgetary allocations to the ACC when submitting the state budget to the Parliament, and the Parliament has full discretion in passing the proposed budgetary allocations with or without variations (Transparency Maldives 2014).

Figure 2.34: Government Effectiveness, 1996–2013 (percentile rank)



Note: Percentile rank indicates the percentage of countries worldwide that rate below the selected country. Higher values indicate better governance ratings.
Source: World Bank, Worldwide Governance Indicators (accessed 7 May 2015).

Figure 2.35: Rule of Law, 1996–2013 (percentile rank)



Note: Percentile rank indicates the percentage of countries worldwide that rate below the selected country. Higher values indicate better governance ratings.
Source: World Bank, Worldwide Governance Indicators (accessed 7 May 2015).

relating to the overall development and modernization of the civil service (Civil Service Commission, Maldives Civil Service Strategic Plan 2011–2015).

Deterioration in the rule of law and regulatory quality can undermine the gains made in the quality of the investment climate. Information on the investment climate in the country is available from the international World Governance Indicators database and from country-specific surveys of firms. The database defines the rule of law as the extent to which agents have confidence in and abide by the rules of society, and particularly the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence (World Bank 2010). This is generally recognized as an important aspect of the investment climate of an economy. The Maldives' percentile ranking for Rule of Law has been declining since 2005, although there was an improvement in 2012 (Figure 2.35).

One recent case that has impacted investor confidence was the cancellation of the 25-year concession agreement entered into in 2010 between the GMR Group for the modernization and operation of Malé's Ibrahim Nasir International Airport (INIA). After a change of government, the new government terminated the contract in 2012.

The findings of the Investment Climate Survey of 2006 revealed that investor confidence in the Maldives judicial system and the rule of law was low at 38% compared with India (71%) and Sri Lanka (69%), with differences across sectors (World Bank 2006b). About 41% of the entrepreneurs in manufacturing and tourism were confident that the judicial system would enforce contractual rights in business disputes, but the share was about 27% among transport and logistics entrepreneurs. The same survey also revealed that exit barriers in the Maldives are also perceived to be relatively prohibitive, as there are no insolvency and bankruptcy laws. At the time of the survey, the average time taken to close a business was 6.7 years compared to the subregional average of 4.2 years. Enforcing a contract took 434 days compared to the subregional average of 385 days, but the cost—at percent of debt—was lower than the subregional average of 36.7% (World Bank 2006).[43] More recent data show an improvement in resolving insolvency[44] because it now takes only 1.5 years (with a recovery rate of about 50.4%), while the enforcement of contracts seems to have worsened to 665 days, with 41 procedures involved (World Bank 2013).

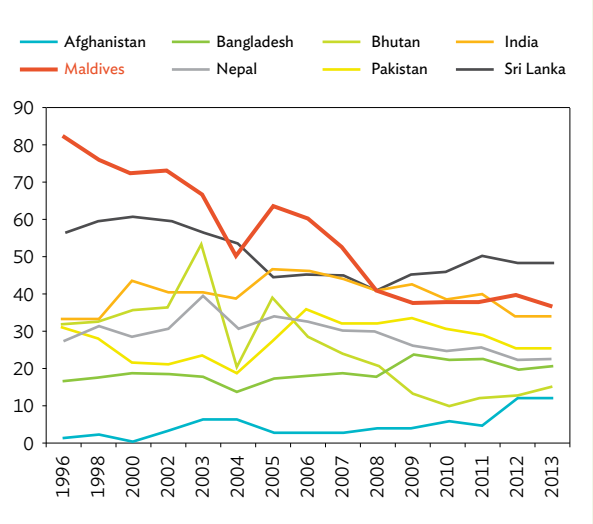
[43] Nonetheless, the banks have complained that the recovery of bad debt, despite court orders, has been time consuming and costly, leading to relatively high NPLs in the past.

[44] The "Resolving Insolvency" Indicator in the Doing Business Surveys was formerly the "Closing a Business" indicator.

The government recognizes the need to strengthen the rule of law and to increase public confidence in the courts and judicial system. Thus, rule of law and justice is one of its focus areas under the good governance sector policy theme of the country's Strategic Action Plan 2009–2013. The government also aims to ensure full independence of the judiciary through a policy of noninterference and prioritizes the establishment of restorative and rehabilitative justice as well as improving the overall access to justice. As part of this process, the first Supreme Court was established on 18 September 2008 and a Judicature Act defining the powers and jurisdiction of the Supreme Court and other courts was enacted in 2010. Other institutions established in recent years aimed at improving the rule of law include the Prosecutor General's Office, Police Integrity Commission, and Employment Tribunal. Despite the initiatives, the Maldives' ranking for rule of law still has not improved significantly in the World Governance Indicators.

The World Governance Indicators defines "regulatory quality" as the government's ability to formulate and implement sound policies and regulations that permit and promote private sector development (World Bank 2010). The Maldives' ranking in regulatory quality has worsened significantly since the mid-1990s, although it remains above that of several other South Asian economies (Figure 2.36). Moreover, during 1996–2003 and 2005–2007, the Maldives had the highest percentile ranking for regulatory quality among the South Asian countries.

Figure 2.36: Regulatory Quality, 1996–2013 (percentile rank)



Note: Percentile rank indicates the percentage of countries worldwide that rate below the selected country. Higher values indicate better regulatory quality ratings.
Source: World Bank, Worldwide Governance Indicators (accessed 7 May 2015).

2.3.3. Insufficient Export Diversification

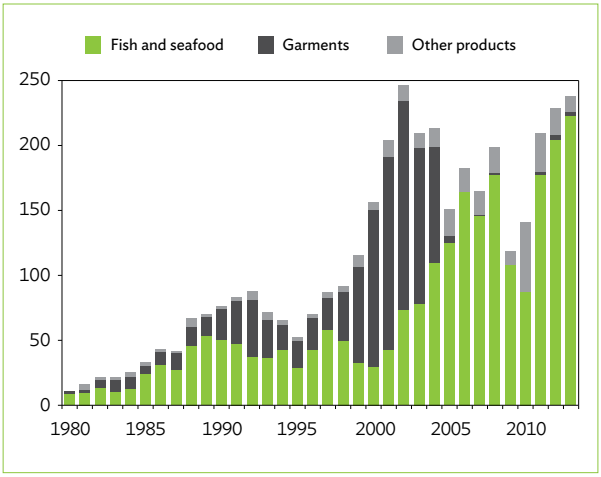
The Maldives' exports are insufficiently diversified, but this is not yet a critical constraint on economic growth.

The Maldives's small manufacturing sector has low technological content and provides a narrow scope for structural transformation. In the future, new export activity in addition to tourism and fisheries may be needed to diversify sources of foreign exchange to finance the demand for imports of foodstuffs, petroleum, and capital goods that will be created by future economic growth. However, the manufacturing sector is small and low technology, providing little scope for structural transformation. In manufacturing, fish preparation and processing account for about 65% of gross value added. Between 1995 and 2004, the Maldives had a thriving garment industry, which all but vanished in 2005 when the general system of quotas under the World Trade Organization Agreement on Textiles and Clothing was terminated. Without quota protection, local production was uncompetitive due to high wage costs, a reliance on expatriate labor, lack of local raw materials, and relatively high transport costs. Foreign garment investors in the Maldives moved elsewhere. The discontinuation of garment production for export after the termination of the quota system highlighted the failure to develop a domestic manufacturing capability. Within manufacturing, some small firms are producing simple machinery parts, metal and nonferrous metals, and basic chemicals.

Figure 2.37 shows the composition of exports since 1980. The large share of "other products" in 2010 and 2011 was mainly due to the reexport of fuel products.

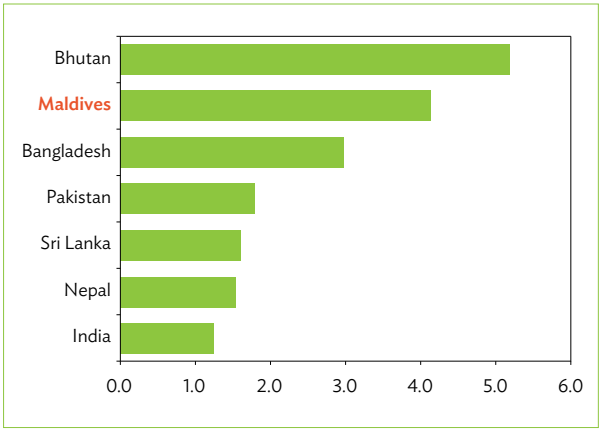
At present, exports are highly concentrated on a very limited number of products and are more concentrated than elsewhere in the subregion as measured by the

Figure 2.37: Composition of Exports, 1980–2013 ($ million)



Notes:
(1) "Other products" includes aircraft parts, chemicals and health-related products, construction materials and equipment, electronic machinery, precious stones, processed minerals, and others.
(2) Classification is based on the community of products used by Hausmann, Hidalgo, et. al. (2011).
Source: Calculations based on UNSD, UN Comtrade (accessed April 2015).

Figure 2.38: Index of Export Concentration Ratio of South Asian Countries, Average of 2010–2013



Source: Calculations based on UNSD, UN Comtrade (accessed April 2015).

Herfindahl–Hirschmann index.[45] The concentration index for the Maldives is more than double the average of the other South Asian countries covered (except Bhutan). Thus, the Maldives is vulnerable to exogenous shocks (Figure 2.38).

While the Maldives' export basket has shown relatively more sophistication than that of neighboring countries in recent years, it still shows little diversification. The Maldives' export basket can be characterized as relatively sophisticated but insufficiently diversified. A lack of diversity leaves little opportunity to expand productive capabilities to new product categories. The development of new capabilities will require new private investment and a supportive policy environment. A key insight from the recent literature on structural transformation is that, in the long run, a country's income is determined by the nature (the sophistication) and the variety (diversification) of the products it makes and exports successfully (Hausmann, Hwang, and Rodrik 2007). In terms of the EXPY[46] measure of export sophistication, in the early 1990s, the technology sophistication of the Maldives' export basket ranked third in the subregion, behind Bhutan and India (Figure 2.39). This was largely on account of the high share of fresh and processed tuna and some equipment parts in the Maldives' export basket at that time, both of which are associated with a mid-level of technological sophistication.

The garment industry that flourished in the late 1990s belongs to the group with a low level of sophistication and this pulled the sophistication measure down during 1995–1999 and 2000–2004. The increasing relative share of fishery products in 2010 and 2011 and the re-export of fuel raised the indicator for these years; however, the Maldives' overall export basket is dominated by products in low sophistication categories.[47]

[45] The Herfindahl-Hirschmann index, is calculated as

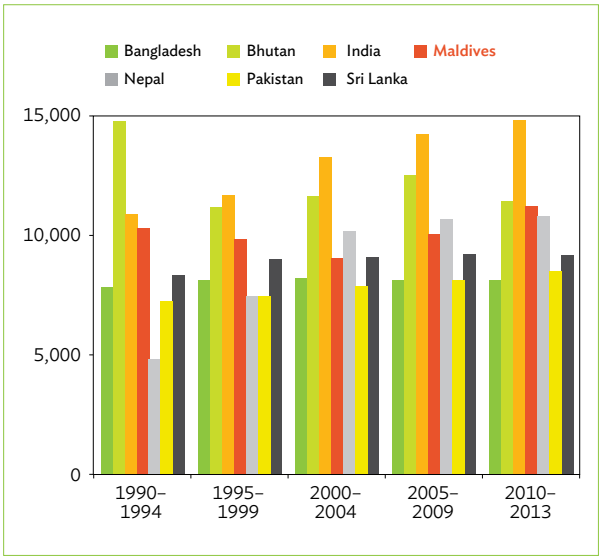
$$H_{ij} = 100 * \left[\frac{\sqrt{\Sigma_i \left(\frac{X_{ij}}{Xj}\right)^2} - \sqrt{\frac{1}{n}}}{1 - \sqrt{\frac{1}{n}}} \right]$$

where *Xij* is the country *j*'s exports of product *i* and *Xj* is country *j*'s total exports; and n is the total number of products. The higher the index, which is bounded between 0 and 1, the more a country relies on fewer products for export earnings.

[46] Sophistication of a country's export basket is measured using the concept of EXPY from Hausmann, Hwang, and Rodrik (2007). EXPY is a weighted average of the sophistication level of the products that a country exports, weights being the share in the country's exports, with sophistication measured by PRODY. PRODY is in turn calculated for individual products as the weighted average of per capita incomes of the different country exporters of the product on the world market with weights determined by the revealed comparative advantage of each exporter in that product. Weiss (2010) explains this and an alternative way of measuring trade sophistication.

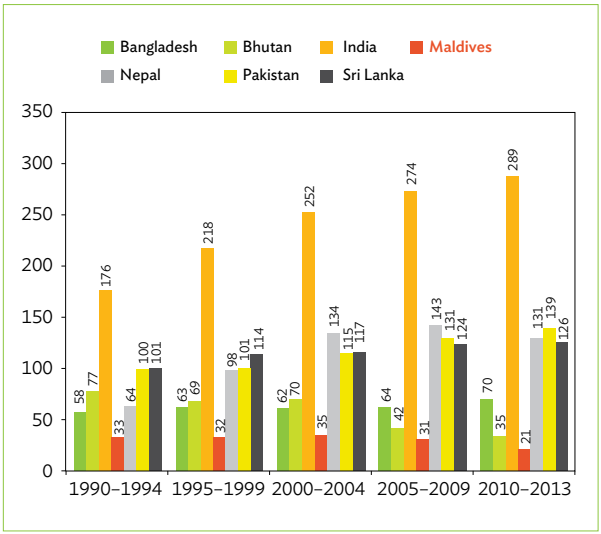
[47] The relatively high sophistication score for fisheries products reflects the fact that high-income countries have fairly well-developed fishery industries. How far this can be interpreted as genuine technology sophistication is open to doubt.

Figure 2.39: Technological Sophistication of Exports (EXPY), 1990–2013



Source: Calculations based on UNSD, UN Comtrade (accessed April 2015).

Figure 2.40: Average Product Diversification (Products with Revealed Comparative Advantage), 1990–2013



Source: Calculations based on UNSD, UN Comtrade (accessed April 2015).

Although the Maldives' sophistication measure is near the subregional average, using the number of export products in which an economy has a revealed comparative advantage as a measure of diversification, the Maldives' exports appear to be highly concentrated.[48] The number of products exported with real competitive advantage above 1.0 has fallen during the last 30 years (31 commodities in 1980 compared with only 21 commodities in 2013). Most of the exports are fishery products and simple machinery parts. This number is low in comparison with that of other countries in the subregion (Figure 2.40).

In terms of developing new or nontraditional exports for any economy, there will be a set of "nearby" products that are currently not produced or exported, but that appear to be within reach given the capabilities acquired for the current export basket. These are new exports that, in principle, would be easiest for an economy to move into. For the Maldives, with its limited natural resources and dispersed, remote islands, such products are likely to include

- food waste and prepared animal feed,
- fat and oils of fish and marine mammals, and
- parts of internal combustion piston engines for aircraft (if existing capabilities from production of parts of helicopter and boats are applicable).[49]

However, this list is not exhaustive and private investors should determine what new sectors have potential to be successfully developed.

2.4. Conclusion

If tourism continues to prosper, the economy can be expected to continue its high growth path, but to ensure that growth is sustainable, the economy needs to diversify and encourage private investment in other sectors. Using the growth diagnostic framework, four critical constraints that can derail growth were identified

- a transport network that is inadequate for enhancing connectivity among various atolls;
- a weak human capital and skills base;
- the chronic fiscal deficit and increasing debt burden; and
- the high cost of and limited access to finance especially for micro, small, and medium investors.

[48] The real comparative advantage for an individual product is the share of the product in a country's exports divided by the product's share in world trade. Where this ratio is greater than unity, the country is said to have a specialization in the product.

[49] These have been identified using the "product space" analysis of Hausmann and Klinger (2006).

In addition, some risks may become constraints in the future—particularly institutional and governance issues and infrastructure-related issues such as the high cost of electricity and the availability of adequate water supply. Table 2.24 summarizes the critical constraints to growth in the Maldives.

Table 2.24: Summary of Diagnosis of Constraints to Growth

Broad Determinants of Growth	Factors Affecting Determinants of Growth	Why is the Factor a Constraint to Growth?	Critical Constraint	Likely to Impact Inclusiveness?
Social Returns to Investments	Maritime transport network	• Infrequent sea transport service and inadequate harbor facilities	Critical (particularly for atolls)	✓
		• High cost and long turnaround time in sea transport		✓
	Human capital	• Lack of professionals and highly skilled human resources	Critical	✓
		• Poor quality of education at the secondary and tertiary level		✓
		• Low level of enrollment and graduates in higher secondary education		✓
	Energy	• High reliance on imported energy sources	May become critical in the medium to long term	
	Electricity	• High cost of electricity hence requiring subsidies from government	May become critical in the medium to long term	
	Water and sanitation	• Limited water source • Expensive water tariff • Old and inefficient water and sewerage system	May become critical in the medium to long term	
Appropriability of Returns to Investment	Macroeconomic risks	• Chronic fiscal deficit • Increasing debt burden	Critical	✓
	Institutional risks	• Policy uncertainty and presence of irregularities such as corruption	May become critical in the medium to long term	
		• Decline in government effectiveness, regulatory quality and rule of law		
	Lack of diversification	• Highly concentrated manufacturing sector low on technological quality	Not critical	
		• Lack of diversity in the exports basket limiting technical transferability of production capabilities		
Cost of Finance	High cost of and limited access to finance	• High lending rates • Few alternative financing options (banks are the chief source)	Critical (particularly for micro, small, and medium enterprises)	✓

Source: ADB.

Chapter 3
Critical Constraints to Inclusiveness

The Maldives' strong economic performance has allowed for substantial improvements in the welfare of the population and 5 out of 8 of the Millennium Development Goals (MDGs) have been achieved.[50] However, some vulnerability persists, and poverty remains high in many islands that depend solely on fishing. Maldivians living in the north region have low incomes, and migration of at least one member of the household is a common coping strategy to enhance incomes.

As shown in Chapter 1, poverty rates vary widely across the country (see Figure 1.9). Poverty is high in Regions 2 (North), 6 (Upper South), and 5 (South Central), but is considerably lower in Region 3 (North Central). The regional inequality reflects the unequal distribution of benefits from the economic growth of recent years and highlights the economy's inability to create a regionally inclusive growth process.

3.1. Poverty and Inequality Diagnostics Framework

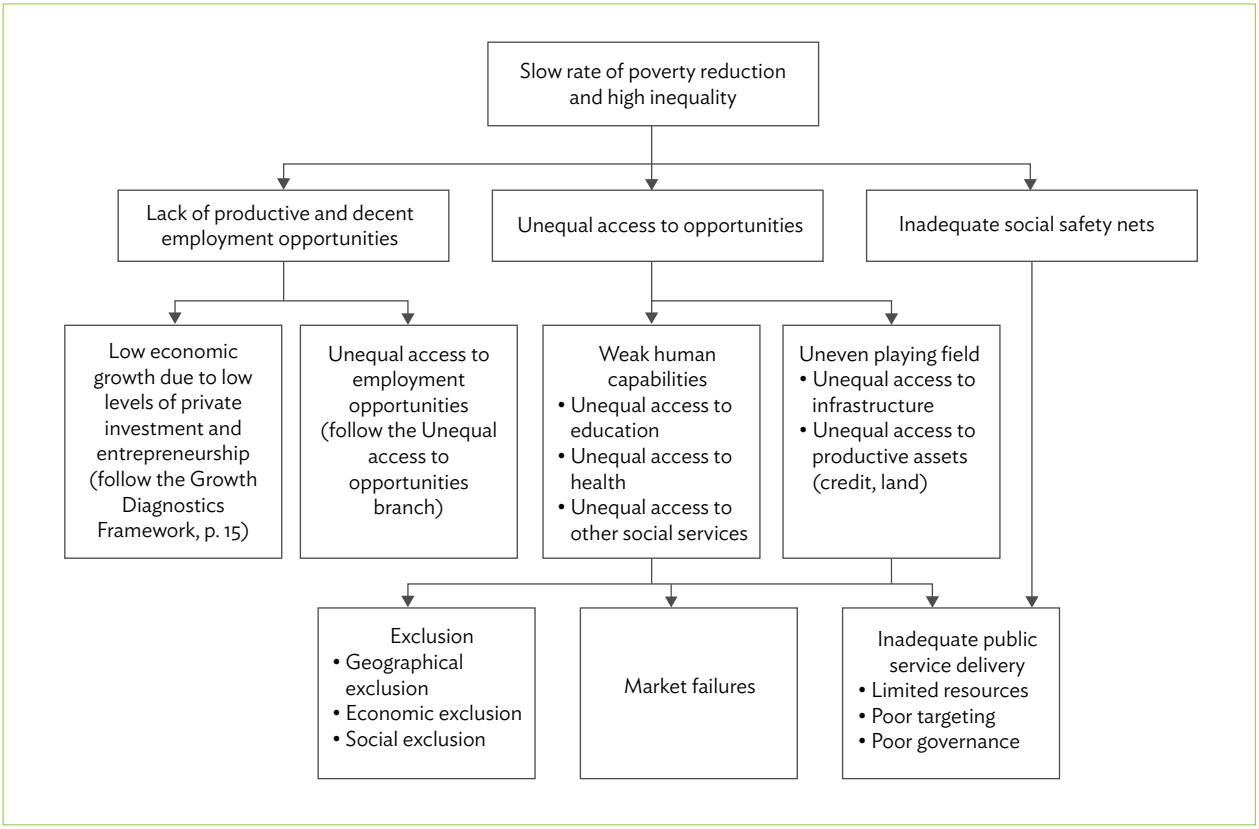
Growth is inclusive when all segments of society can participate in and benefit from the opportunities it creates, while receiving adequate protection from economic shocks and transitions (Ali and Son 2007). A diagnostics approach can be used to analyze the key factors that constrain greater inclusion (Figure 3.1).

The availability of productive and decent employment opportunities is a key ingredient to ensuring inclusion. However, people need to be able to access these opportunities. Inequitable access can be attributable to weak human capabilities and/or an uneven playing field, both of which can prevent people from participating in the growth process. Certain groups or individuals may have weaker human capabilities than others, partly due to unequal access to education, health, and other services. Inequity in accessing opportunities can also be caused by unequal access to infrastructure and productive assets, such as land and credit. Inclusion also requires governments to provide social safety nets to mitigate the effects of external and transitory livelihood shocks, as well as to meet the minimum needs of daily life (Zhuang 2008).

Each of the foregoing deficiencies (weak human capabilities, uneven playing field, and inadequate social safety nets) may, in turn, be caused by deeper factors, including market failures, government failures to deliver adequate public services, and various forms of social discrimination and exclusion. The key role of the government in promoting inclusiveness is to address these market, institutional, and policy failures.

[50] These include MDG 1: Eradicating extreme poverty and hunger, MDG 2: Universal access to primary education, MDG 4: Reduce child mortality, MDG 5: Improve maternal health, and MDG 6: Combat HIV/AIDS, Malaria, and other infectious diseases.

Figure 3.1: Diagnostics Framework for Constraints to Reducing Poverty and Inequality



Source: ADB.

Using the diagnostics framework, this chapter identifies the critical constraints to the inclusiveness of growth by focusing on the three key aspects:

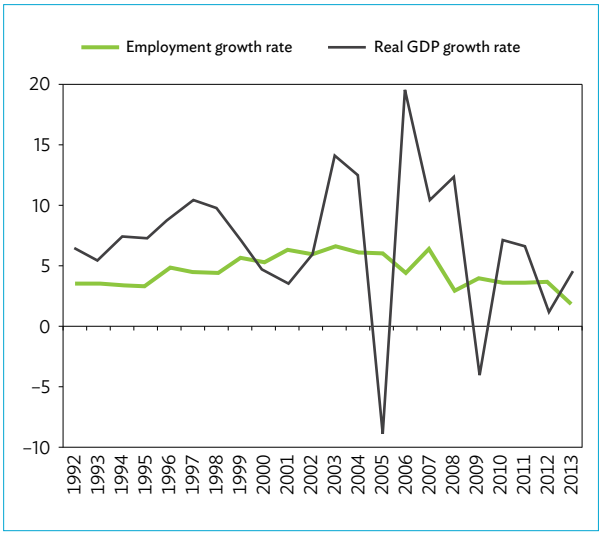
- limited productive employment opportunities;
- the principal factors creating unequal access to opportunities (failures of the education system, unequal access to infrastructure, and the difficulty that enterprises and households have accessing productive assets such as land and credit); and
- the role of social safety nets.

3.2. Productive Employment Opportunities

The lack of productive employment opportunities for Maldivians is a critical constraint to inclusiveness. Employment growth in the Maldives has not kept pace with growth of the economy. The number of employed Maldivians increased by an annual average of 4.7% during 1992–2013 (4.0% during 2006–2013), while the economy grew annually on average by 6.8% during 1992–2013—and by 7.1% during 2006–2013 (Figure 3.2).[51] Until tourism was introduced in the late 1970s, the public sector was the main employer. Now the tourism sector accounts for 17.4% of total employment, although the public sector continues to be the main source of employment at 25.5%.[52] Employment grew at 5.0% during 1992–2004 until the tsunami hit and affected the tourism sector severely. While economic growth recovered in 2006, employment opportunities did not expand as expected. Between 2006 and 2010, the labor force increased by more than 19,000 people—a growth of 17%.[53] But the number of employed people fell

[51] Gross domestic product (GDP) used as comparison is in basic prices.
[52] Tourism-related sectors include hotels and restaurants; transport, storage, and communication; financial intermediation; and real estate, renting, and business activities.
[53] "Labor force" is defined as people who are 15 years and older and are employed or (if unemployed) are looking for employment.

Figure 3.2: Employment and Real GDP Growth Rates, 1992–2013 (%)



GDP = gross domestic product.
Sources: For GDP data, MMA (various years); for employment data, ILO, Key Indicators of the Labor Market, 8th Edition (accessed May 2015).

and the unemployment rate almost doubled to 28% in same period (Table 3.1). Many of the new jobs, particularly in tourism and construction industries, have been taken by foreign workers because Maldivian workers avoid manual, semi-skilled, and unskilled jobs (Table 3.2). Data on labor force and employment statistics in Tables 3.1 and 3.3 include only the local population, and exclude the sizable expatriate workforce (DNP 2012a: 29). Expatriate workers have also taken up technical and professional jobs in various sectors (Chapter 2) where Maldivians do not have the requisite skills. For example, despite job vacancy announcements in the private and tourism sectors, 2,505 jobs remained vacant as of 2012.[54]

Inequality of access to employment opportunities is also a key concern, with varying degrees across sectors, gender, age group, educational attainment, and location. Figure 3.3 provides an overview of the Maldivian labor market in 2006 and 2010, and Figure 3.4 gives the unemployment situation by area, region, gender, age group, and educational attainment in 2010.

Opportunities for employment varied significantly across the regions. In 2010, the national unemployment rate stood at 28%: at 24% in Malé and 31% in the atolls. Between 2006 and 2010, unemployment rose sharply particularly in Malé, from 11% in 2006 to 24%, as a result of significant in-migration from the rural areas. Workers in Malé earn close to double what people earn in the atolls—in 2010 averaging Rf8,300 ($648.4) per month in Malé versus Rf4,665 ($364.5) in the atolls.[55] This is despite government efforts to establish regional growth centers to increase and promote equal employment opportunities across the country and to facilitate employment for job seekers in their native regions (Government of Maldives 2009).

The services sector has increasingly dominated the provision of employment opportunities, accounting for roughly 60% of jobs in 2006 and 70% in 2010 (Figure 3.5).[56] Most of these new jobs were in tourism and tourism-related sectors; transport, storage, and communication; financial intermediation; and real estate but, as discussed in Chapter 2, a good number of the jobs were taken by expatriate workers. Employment in industry fell as manufacturing of garments ceased and companies engaged in fish preparation were

Table 3.1: Labor Force, Employment, and Unemployment, 2006 and 2010

Year	Adult Population 15+	Labor Force[a] 15+	LFPR (%)	Employed Persons 15+	Unemployed 15+	Unemployment Rate
2006	193,771	117,434	60.6	98,941	18,493	15.7
2010	213,872	136,886	64.0	98,393	38,393	28.0

HIES = Household Income and Expenditure Survey, LFPR = labor force participation rate.
Note: Broad definition of labor force includes the discouraged workers. The 2006 data were from the 2006 census, which were retabulated to make them comparable to the 2010 survey data.
Source: DNP (2012b).

[54] For private and tourism jobs, all the job announcements are taken from www.iulaan.com and jobmaldives website (www.job-maldives.com).

[55] Based on the broad definition used by the government that includes discouraged workers not seeking work among the unemployed.

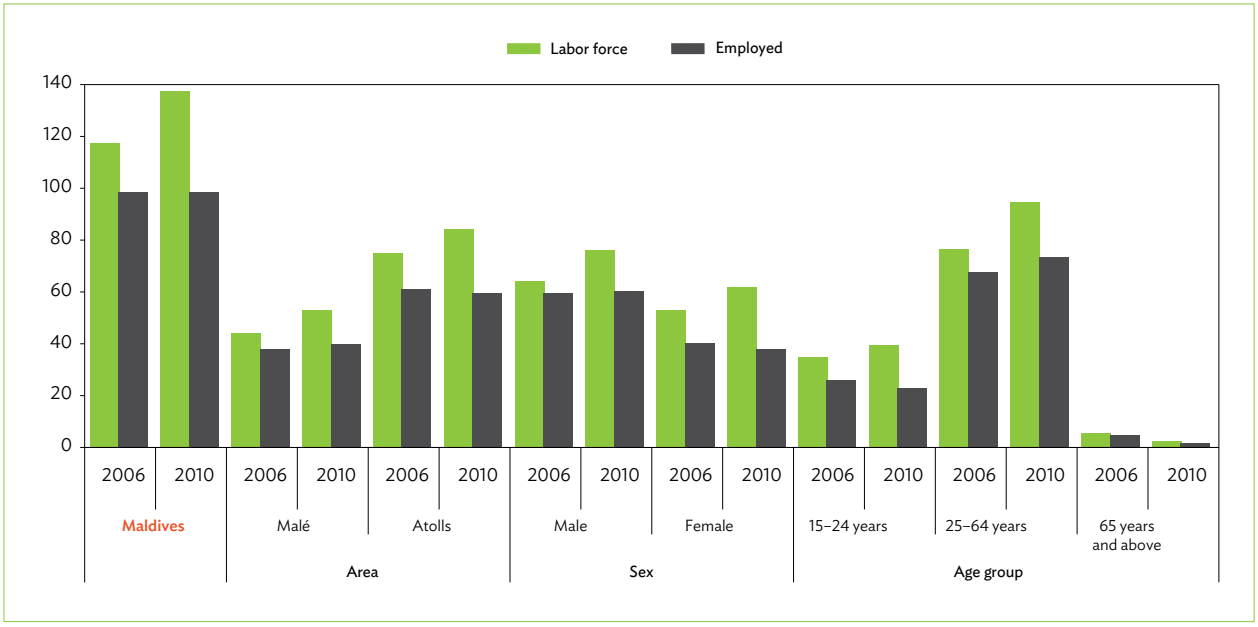
[56] The Household Income and Expenditure Survey 2009/2010 Findings retabulated the Census 2006 data using only the administrative islands to make the 2006 data comparable to the survey data generated in 2009–2010.

Table 3.2: Local and Expatriate Employment, 2010

	Total	Total Employed		Shares of Total Employment (%)	
		Local	Expatriate	Local	Expatriate
Total	**172,233**	**98,393**	**73,840**	**57.1**	**42.9**
Agriculture	**16,188**	**14,666**	**1,522**	**90.6**	**9.4**
Agriculture and forestry	4,641	4,121	520	88.8	11.2
Fishing	11,286	10,284	1,002	91.1	8.9
Quarrying	261	261	0	100.0	0.0
Industry	**49,544**	**15,171**	**34,373**	**30.6**	**69.4**
Manufacturing	11,389	8,976	2,413	78.8	21.2
Electricity, gas, and water	1,831	1,737	94	94.9	5.1
Construction	36,325	4,459	31,866	12.3	87.7
Services	**106,500**	**68,555**	**37,945**	**64.4**	**35.6**
Wholesale and retail trade	15,347	11,026	4,321	71.8	28.2
Tourism and tourism-related industries	38,885	17,082	21,803	43.9	56.1
Public admin. and defense	17,001	17,001		100.0	0.0
Education	13,420	10,875	2,545	81.0	19.0
Health and social work and other community, social, and personal services activities	18,539	9,263	9,276	50.0	50.0
Private households with employed persons	599	599	0	100.0	0.0
Extraterritorial organizations and bodies	74	74	0	100.0	0.0

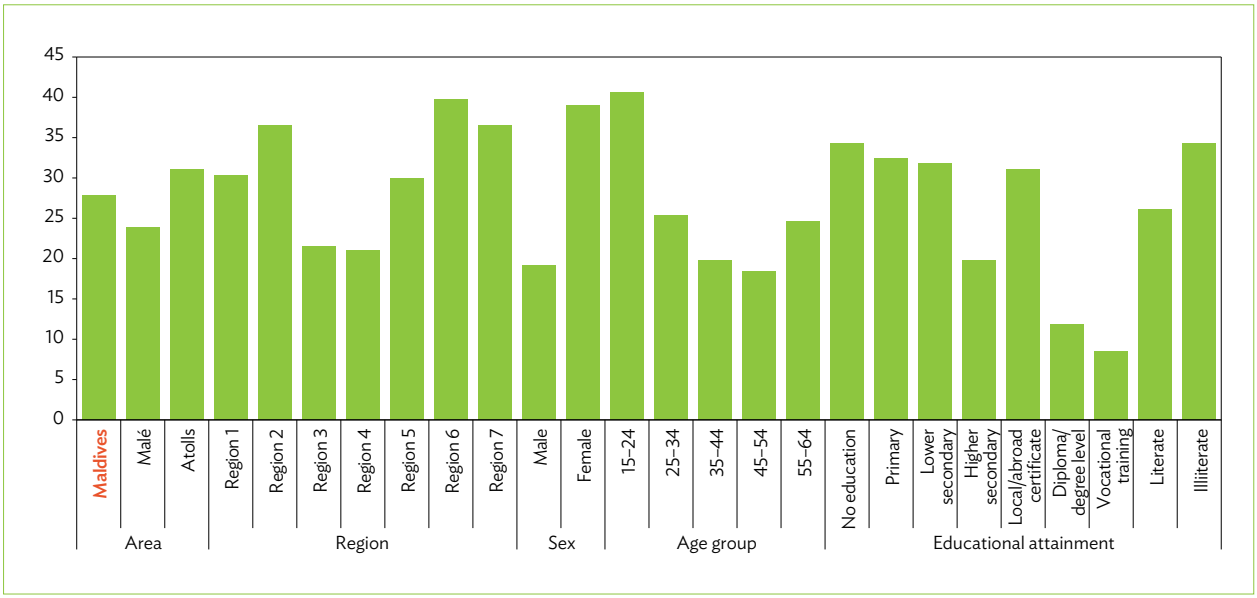
Note: Tourism and tourism-related industries include hotels and restaurants; transport, storage. and communication; financial intermediation; and real estate, renting, and business activities.
Source: For local employment data, DNP (2012b); for expatriate workers data, DNP (2011).

Figure 3.3: Overview of the Labor Market, 2006 and 2010 ('000 people)



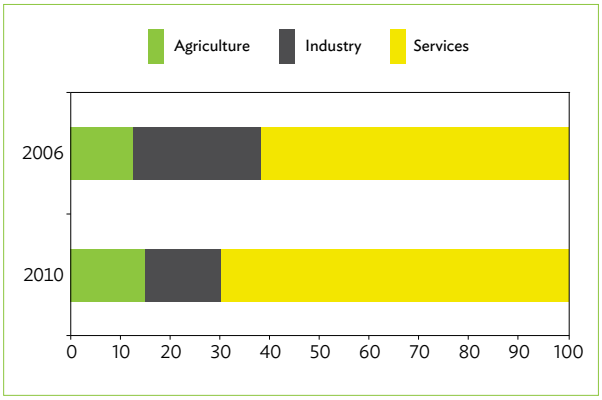
Source: DNP (2012b).

Figure 3.4: Unemployment Rate, by Area, Region, Gender, Age Group, and Educational Attainment, 2010 (%)



Note: "Unemployment rate" uses the broad definition of unemployment.
Source: Calculations based on DNP (2012a).

Figure 3.5: Share of Employment, by Sector (%)



Source: DNP (2012b).

forced to scale down production because of the mass harvesting of fish stocks by foreign fishing vessels just outside the country's exclusive economic zone.

More than 7,000 jobs were created between 2006 and 2010 in the services sector. The government continues to be a major employer of Maldivians in the services sector, creating nearly 2,000 new jobs during the same period and accounting for 26% of the total employment in 2010.[57] In the same year, public administration, education, health, and social work accounted for 35% of the jobs in the country. During 2006–2010, an additional 2,035 jobs were created in agriculture, mainly in fishing, while there was a substantial job loss in industry, with more than 10,000 jobs lost in manufacturing and construction (Table 3.3).

Male workers constituted 62% of the total employed in the Maldives in 2010 (Figure 3.6). Women are mainly engaged in agriculture and forestry, health and social work, education, hotels and restaurants, and wholesale and retail trade. They are also engaged in small-scale manufacturing activities such as manufacture of wooden articles; cork, straw, and plaiting materials; production of materials from coconut leaves; processing and preservation of fish and fish products; and sewing of clothes. These occupations are categorized as "unorganized work" because they are mostly home-based. With the economic downturn following the tsunami and global financial crisis, the employment of women in industry, especially in manufacturing, declined by about 52% between 2006 and 2010 (Table 3.3).

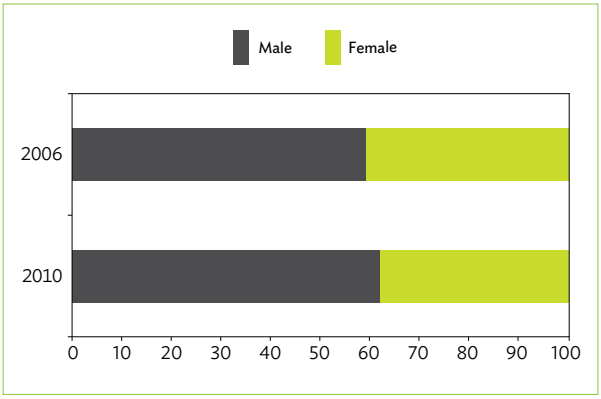
[57] Calculations based on DNP (2012a).

Table 3.3: Changes in Employment, by Sector and Sex, 2006 and 2010

	2006			2010		
	Total	Male	Female	Total	Male	Female
Agriculture	**12,631**	**9,730**	**2,901**	**14,666**	**12,199**	**2,467**
Agriculture and forestry	4,209	1,485	2,724	4,121	1,654	2,467
Fishing	8,084	7,935	149	10,284	10,284	...
Quarrying	338	310	28	261	261	...
Industry	**25,021**	**12,219**	**12,802**	**15,171**	**8,943**	**6,228**
Manufacturing	18,332	5,878	12,454	8,976	3,027	5,949
Electricity, gas, and water	1,226	1,071	155	1,737	1,687	49
Construction	5,463	5,270	193	4,459	4,229	230
Services	**61,289**	**36,742**	**24,547**	**68,555**	**39,686**	**28,870**
Wholesale and retail trade	11,558	7,269	4,289	11,026	7,152	3,874
Hotels and restaurants	4,412	3,086	1,326	6,257	4,382	1,875
Transport, storage, and communication	6,350	5,431	919	8,392	7,180	1,212
Financial intermediation	582	254	328	1,046	464	583
Real estate, renting, and business activities	1,141	858	283	1,387	1,043	344
Public administration and defence	15,059	10,826	4,233	17,001	11,494	5,507
Education	9,870	2,742	7,128	10,875	2,962	7,913
Health and social work	4,176	1,342	2,834	6,579	1,818	4,761
Other community, social, and personal services activities	3,239	2,133	1,106	2,684	1,448	1,236
Private households with employed persons	...	...	...	599	70	529
Extraterritorial organizations and bodies	216	139	77	74	37	36
Not stated	4,686	2,662	2,024	2,636	1,636	1,000
Total	**98,941**	**58,691**	**40,250**	**98,393**	**60,828**	**37,565**

... = no data available.
Source: DNP (2012b).

Figure 3.6: Share of Employment, by Sex (%)

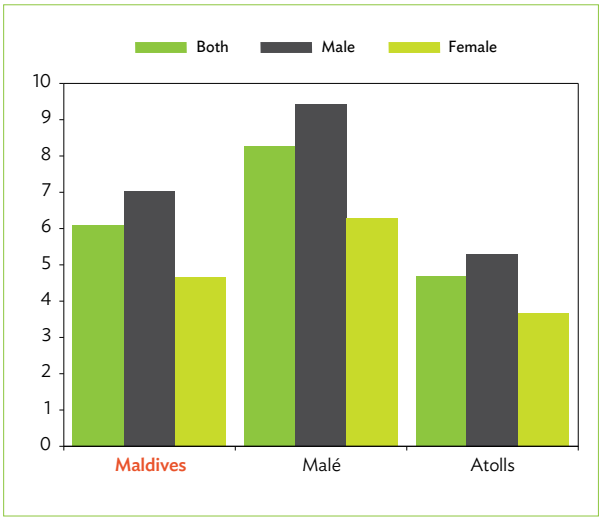


Source: DNP (2012b).

There is an apparent employment bias against women in the Maldives. Reasons cited include cultural, religious, and social issues (Behzad 2011a). Thus, employment opportunities for women remain limited. The unemployment rate of women was 39% in 2010 (compared with 24% in 2006), whereas the unemployment rate of men was 19% in 2010 (Figure 3.4). In addition, on average, employed women earn less than their male counterparts. In 2010, the average monthly earnings of females was Rf4,674 ($365.2) versus Rf7,036 ($549.7) a month for males[58] (Figure 3.7). The Strategic Action Plan 2009–2013 set out initiatives to provide credit and training for women, but it remains unclear how effective these have been.

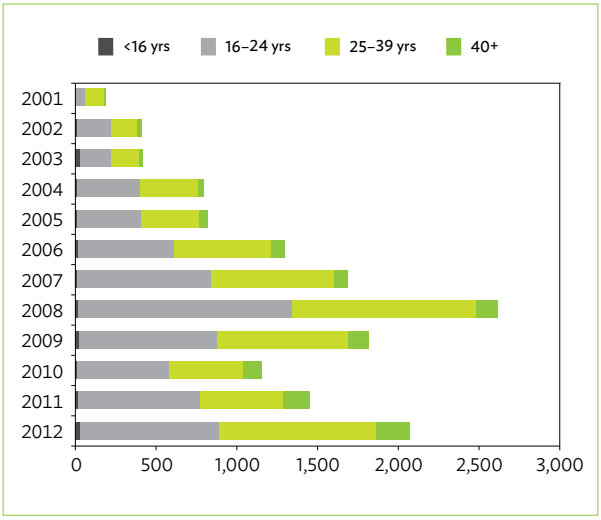
[58] This is a simple average comparison that takes no account of occupational or skill differences.

Figure 3.7: Average Monthly Income, by Location and Gender (Rf '000)



Rf = rufiyaa.
Source: DNP (2012b).

Figure 3.8: Drug Abuse Cases, by Age Group, 2001–2012



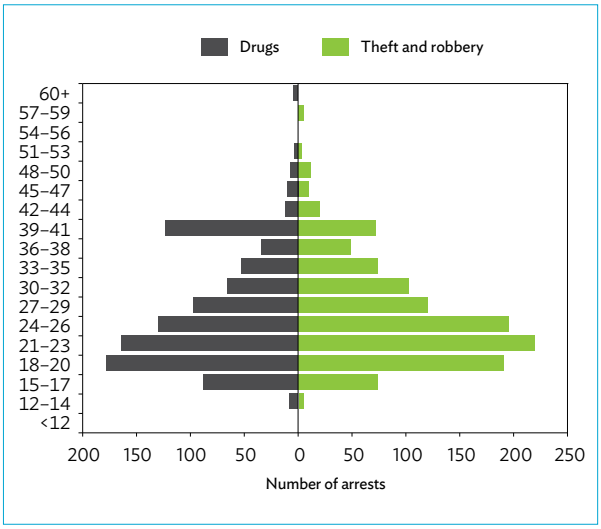
Source: Ministry of Health (2013).

Youth unemployment, even among the educated, is rising, which creates social tensions. The Maldives has a relatively young workforce and a key feature of the labor market is the high unemployment rate among the youth. The youth unemployment rate (age group 15–24) was 41% in 2010 (Figure 3.5), the highest among the working age groups, suggesting that school leavers face serious difficulty in the transition from school to the workplace. The rates are even higher in the atolls than in Malé. Unemployed youth have limited opportunities to engage in income generating activities, especially in the atolls.

Idleness puts the youth at risk of contact with drugs and gangs. Increasing substance abuse among the young has emerged as a social and medical problem in recent years, principally in Malé. The increase in drug-related offenses has also been associated with rising crime rates in the capital. Drug abuse in the Maldives (Figure 3.8) was reported to have increased more than 40-fold between 1977 and 2005, although there is also evidence that the incidence has abated in response to government initiatives (Government of Maldives 2009).

Most of the offenders in drug-related crimes and associated gang violence in Malé and some atolls are aged 15 to 41 (Figure 3.9). In the 2011 Asia Foundation survey, Malé residents indicated that gang violence had become a major problem in the city and even gang members had expressed concern about the escalating violence (Asia Foundation 2012).

Figure 3.9: Theft, Robbery, and Drugs-Related Arrests, by Age Group, 2010



Source: Maldives Police Service, Crime Statistics (accessed September 2014).

Several factors work against the employment of school leavers. First, as discussed in Chapter 2, the skill level of entrants to the labor market does not match the

skills required by employers. The skills development program (technical vocational education and training) introduced in 2006 has yet to produce substantial results in equipping local workers with the skills required in the labor market. The skills mismatch (Behzad 2011b) has led to the influx of foreign workers who dominate not only technical, managerial, and professional jobs but also "blue collar" jobs in the private sector. In the tourism sector alone, slightly more than half of the jobs are taken by expatriates. Expatriate workers also dominate the top-end technical jobs such as general managers, chefs, and dive instructors (DNP 2012c).

Second, employers often prefer to hire experienced workers over recent school graduates whose skill level and training may not meet the job requirement (Human Rights Commission 2009). Employers perceive the youth as not having the right commitment to their jobs and are, therefore, less inclined to invest in training new young workers.

Third, it is widely believed that there is a general bias among Maldivian workers, especially among school leavers, against manual labor, which is often associated in their minds with low status and low wages (Human Rights Commission 2009). One study concluded that the greatest barrier to employment is the lack of interest and determination of local job seekers to improve their competencies in knowledge and skills and to seek work (Behzad 2011a).

Because local workers, especially school leavers, are reluctant to be employed in semi-skilled and unskilled jobs, employers bring in foreign workers who are willing to work for lower wages and benefits. Based on the Investment Climate Study of 2006, a typical unskilled foreign worker is paid Rf2,000 ($156.3) per month whereas local unskilled workers average Rf2,500 ($195.3) per month (World Bank 2006b).

To encourage employment of local workers, the government has introduced an employment quota ratio of 55:45 between foreign and local workers, particularly in tourist resorts. However, the implementation of this policy is relatively lax as resort owners, even if they have exceeded the quota, are able to apply for permission to extend employment of foreign workers based on a need for specific expertise.

In summary, the lack of access to productive employment opportunities is a serious problem in the Maldives. Skill levels are deficient; there is evidence of aversion to manual or service-related work and of gender bias partly due to religious and cultural beliefs. Economic growth has been rapid but Maldivian workers have not been able to sufficiently exploit the benefits of the growth in terms of employment opportunities.

3.3. Unequal Access to Opportunities

Certain segments of the population have less easy access to opportunities because of difficulties accessing education, health care, and other services.

3.3.1. Access to and Quality of Education

Unequal access to education limits employment opportunities. Education provides access to productive employment and contributes to improving a household's welfare and standard of living. Unemployment rates vary by educational status. Unemployment rates are also found to be higher among people with lower education attainments. Based on the HIES 2009/2010, the unemployment rate for Maldivians without education was 34% (Figure 3.4). The unemployment rates for people with primary and lower secondary levels of education were 33% and 32%, respectively, and for those with a diploma or a bachelor's degree it was 12%. For people with vocational training, the unemployment rate was lowest at 9% (DNP 2012b).

The HIES reveals that poverty is highest where heads of household have no or only primary education and are unemployed, or, if employed, are working outside the services sector. Table 3.4 shows the poverty incidence by household reflecting the characteristics of household heads. About 85% of poor households had heads with no more than primary education and 54% of poor households' heads were unemployed. Households with heads employed in the services sector had the lowest poverty incidence, reflecting the growth of tourism-related employment.

Table 3.4: Poverty Incidence by Household Head's Gender, Education, and Employment, 2010 (%)

	Poverty Incidence	Population Share	Proportion of Poor Households
Sex			
Female	13	56.2	53.1
Male	14	43.9	46.9
Educational Attainment			
No education	25	1.7	5.0
Below primary	14	14.4	23.0
Primary education	11	42.3	54.3
Lower secondary	2	8.5	1.9
Higher secondary	5	6.1	3.3
Vocational training and professional certificate	4	25.0	12.5
University and above	0	1.8	0.0
Sector of Employment			
Agriculture	20	11.6	17.1
Industry	15	11.3	12.4
Services	7	32.9	16.2
Unemployed	16	44.2	54.3

Note: The agriculture sector includes agriculture and fishing. The industry sector includes mining; manufacturing; electricity, gas, and water supply; and construction. The services sector includes wholesale and retail; hotels and restaurants; transport, storage, and communication; financial intermediation; real estate, renting, and business activities; public administration and defense; education, health, and social work; other community and personal services; activities of private households; and extraterritorial organizations.
Source: Calculations based on DNP (2012a).

In recent years, the government has improved the delivery of education to fulfill the right of all citizens to education as stipulated in Article 36 of the Constitution of the Maldives. Significant progress in access to primary education has been made.

The Maldives leads other countries in the subregion in the share of GDP spent on public education, with this lead widening over time (Figure 3.10). Near universal primary education (Grades 1–7) has been provided in all the inhabited islands since 2004 and, during the last decade, the share of school age children enrolled in lower secondary education (Grades 8–10) has increased notably (IBE 2011)—see Figure 2.10.

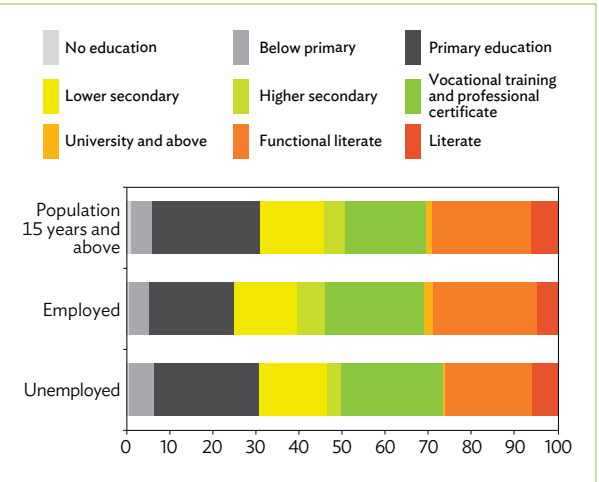
The educational attainment of the Maldivian working population remains low and regional disparity is high due to limited access to secondary and tertiary education. As explained in Chapter 2, in 2010, 31% of the working population had attained no more than primary level education, and 19% had received vocational training. Only 1% of the total work force has a university degree. Low educational attainment limits employment opportunities. More than 30% of unemployed people have not gone beyond primary education, compared to 25% of the total employed with no more than primary education (Figure 3.11). The employed also show a higher rate of educational attainment beyond higher secondary, technical, or university education.

Figure 3.10: Public Expenditure on Education in South Asia (% of GDP)

GDP = gross domestic product.
Note: Maldives data are for 2002 and 2012; Bangladesh, 2000 and 2009; Bhutan, 2000 and 2011; Nepal, 2000 and 2010; and Pakistan and India, 2000 and 2012.
Source: World Bank, World Development Indicators (accessed May 2015).

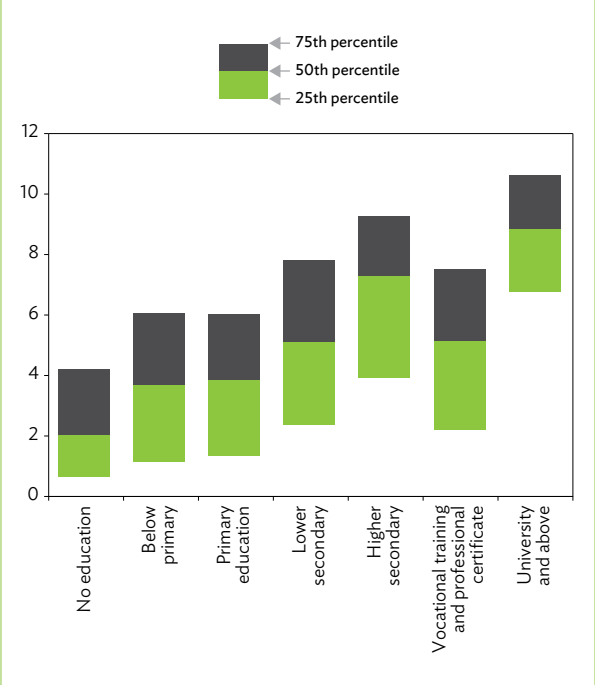
Educational attainment and earnings are positively related. The median monthly income of workers with at least a university degree is Rf8,797 ($687.3), more than double that of workers who have only completed primary education. Conversely, monthly incomes of workers with vocational training and professional certification are lower than those of workers with lower and/or higher secondary education (Figure 3.12). Vocational training is generally perceived in Maldivian society as an inferior alternative to general education particularly for students with weak educational achievements. Although attending vocational training may increase the probability of being employed, the income rewards have been relatively low.

Figure 3.11: Educational Attainment among People Aged 15+, Employed and Unemployed, 2010 (%)



Source: Calculations based on DNP (2012a).

Figure 3.12: Monthly Incomes at the 25th, 50th, and 75th Percentiles, by Educational Attainment, 2010 (Rf '000)



Rf = rufiyaa.
Source: Calculations based on DNP (2012a).

While the net enrollment rate in higher secondary education (Grades 11–12) has been increasing steadily in the last decade, it is still low, at only 23.6% in 2014 (see Figure 2.10). Unlike the primary and lower secondary level, there is a serious inequity in the distribution of higher secondary schools between the atolls and Malé. On average, there are only 1–3 higher secondary schools per atoll, versus 8 in Malé. Access to higher secondary education is particularly limited in the North Central region. Vaavu Atoll does not have any higher secondary school while the other atolls only have one higher secondary school each (Figure 3.13). As a result, students have to spend time and money to travel long distances to a higher secondary school or to stay with a relative who lives on an atoll where there is a higher secondary school. Thus, distance and cost are serious barriers to widening access to higher secondary education.

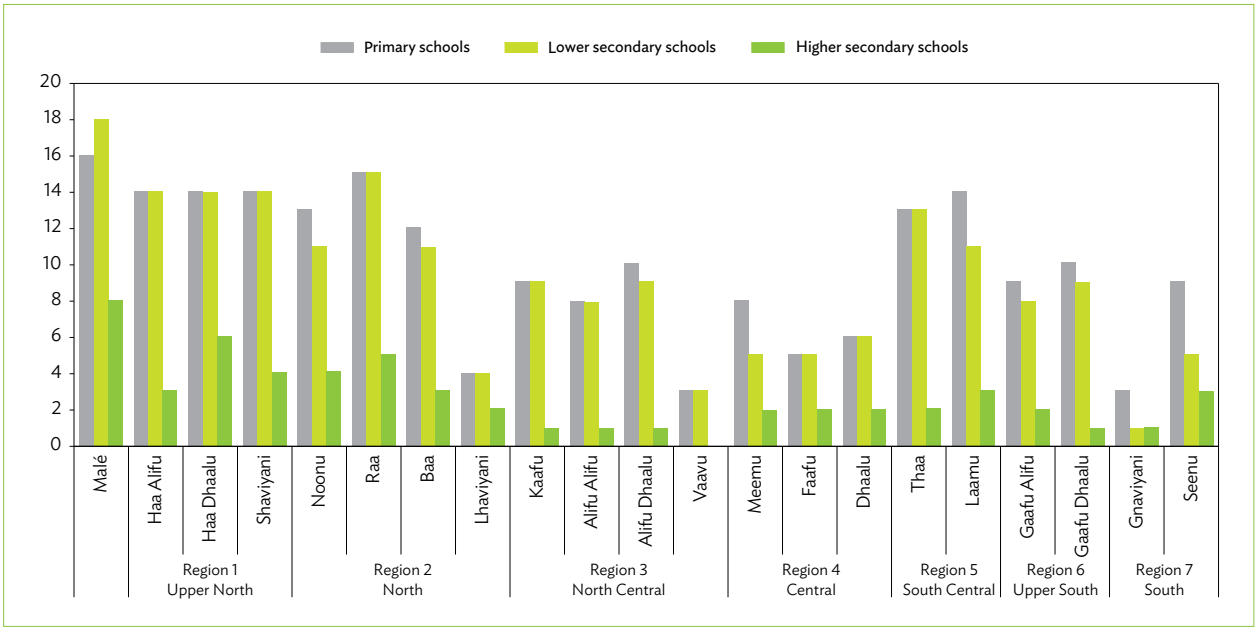
The same is true for tertiary education. All of the country's tertiary institutions (colleges and the only university) are in Malé. Thus, access to higher education is limited to people who can afford traveling to and staying in the capital city or overseas. It is therefore not surprising that proportionately more Malé residents have higher education than residents elsewhere in the country (Figure 3.14).

Based on 2010 data, educational attainment does not vary greatly by gender (Figure 3.15), but a slightly higher share of women (1.7%) than men (1.0%) have university degrees.

The quality of education remains poor, especially in the atolls. Chapter 2 cited evidence of poor educational attainment in general and across the islands. The results of the National Assessment of Learning Outcomes administered in 2008 indicated that passing rates of students in the atolls were consistently lower than of their counterparts in Malé. Figures 3.16 and 3.17 provide the results disaggregated by atoll for grades 4 and 7 students in English and Mathematics. The results show a poorer quality of primary education in the atolls than in Malé, which aggravates regional disparities in access to opportunities.

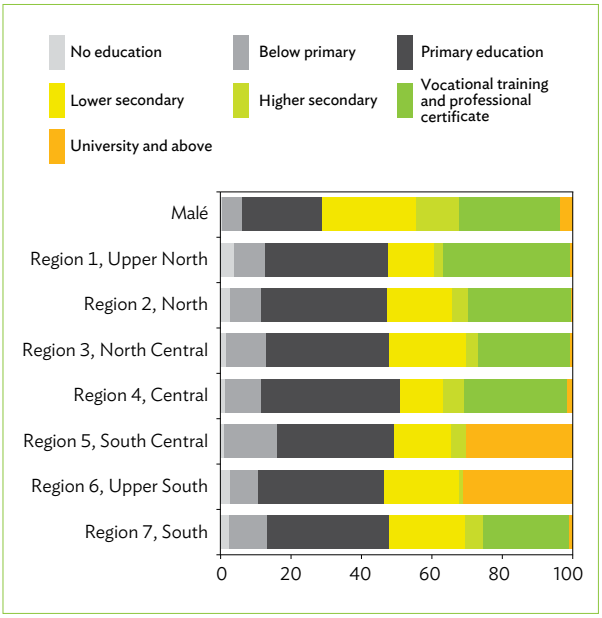
Similar disparities were evident in the outcome of the General Certificate of Education Ordinary-Level examination (Figure 3.18). In 2009, 55% of students

Figure 3.13: Number of Schools, by Education Level, 2014



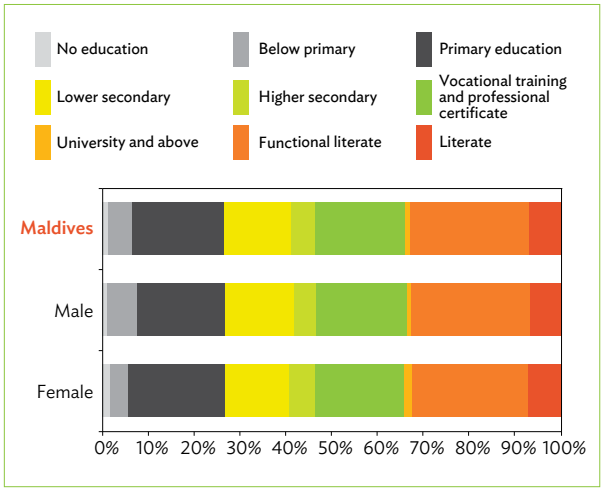
Source: MOE (2014).

Figure 3.14: Educational Attainment of Population 18 and Over, by Region, 2010 (%)



Note: In the Maldives, students are supposed to have finished the upper secondary level by age 18.
Source: DNP (2012b).

Figure 3.15: Educational Attainment of Population aged 18 and Over, by Gender, 2010 (%)



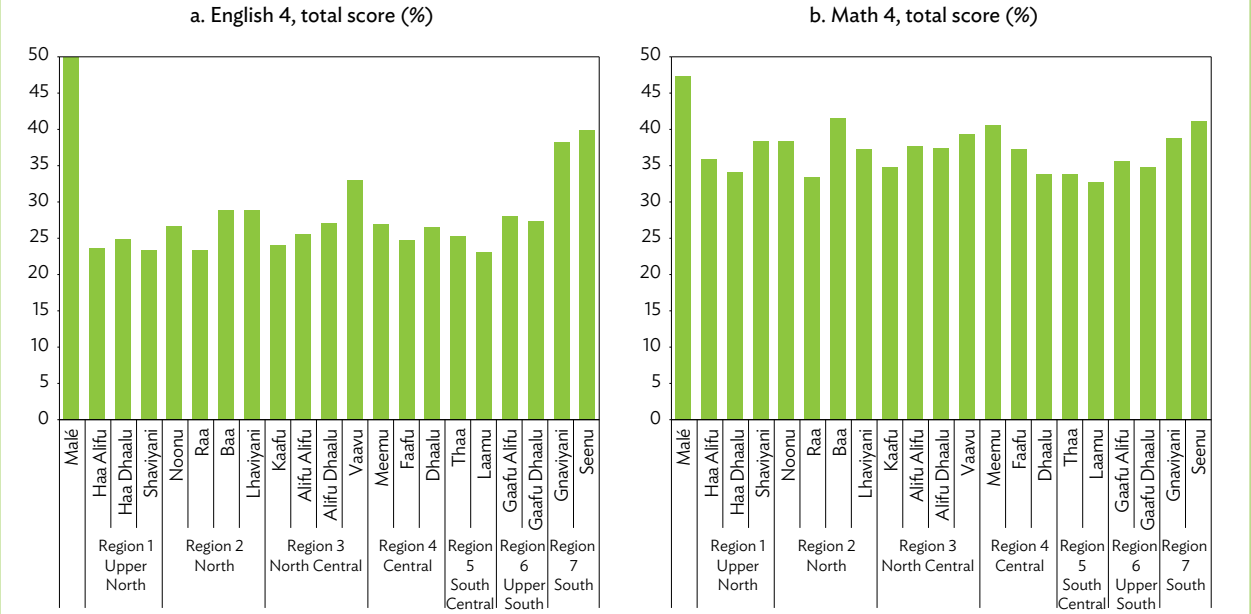
Source: Calculations based on DNP (2012a).

in Malé passed the examination while the pass rate was only 17% in the South Central provinces and 13% in the North Central provinces (IBE 2011).

A higher proportion of female students passed the examination than of males during 2008–2010 (Figure 3.19).

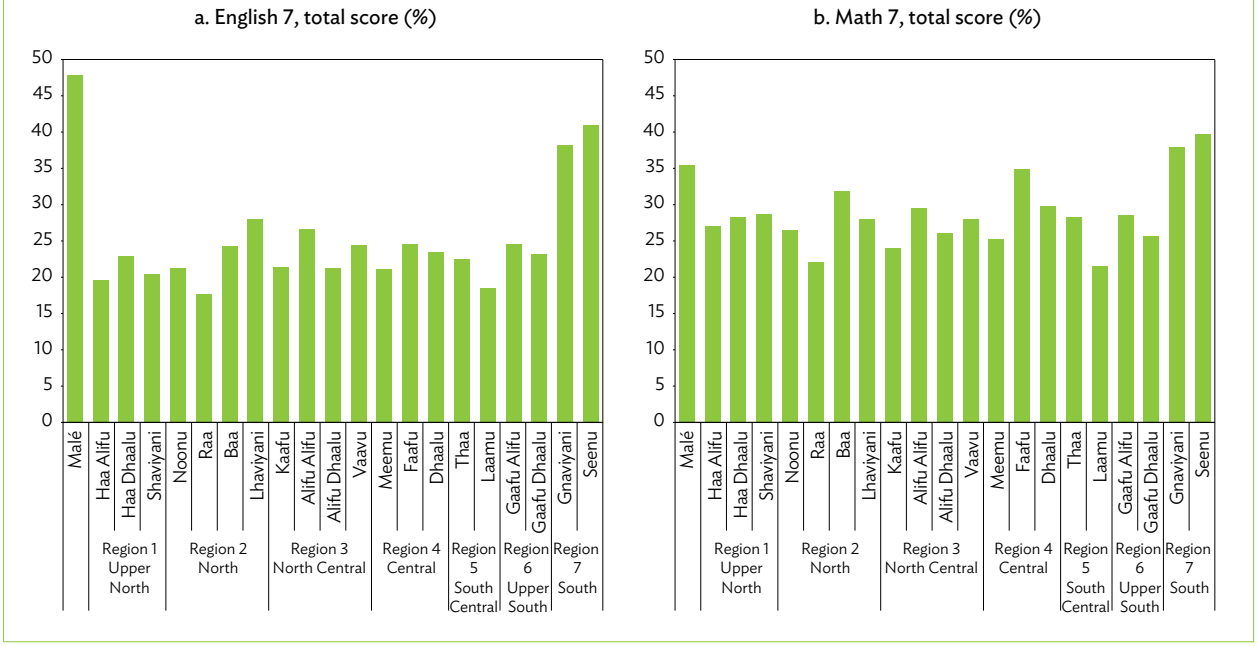
As discussed in Chapter 2, students' weak learning outcomes have been linked with the lack of qualified teachers and it has been particularly difficult to

Figure 3.16: Average English and Mathematics Learning Outcomes at Grade 4, by Atoll, 2008



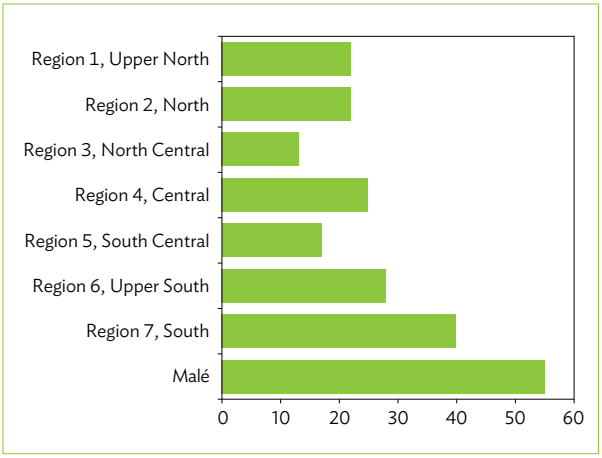
Source: World Bank (2011).

Figure 3.17: Average English and Mathematics Learning Outcomes at Grade 7, by Atoll, 2008



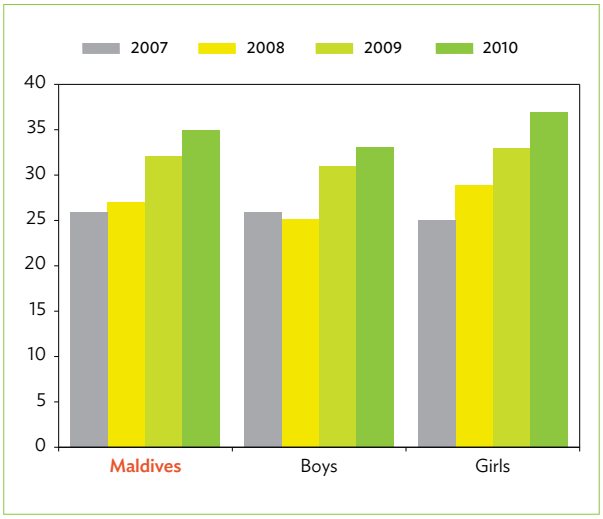
Source: World Bank (2011).

Figure 3.18: Results of General Certificate of Examinations Ordinary Level, by Region, 2009 (%)



Note: The bars indicate overall percentage of students passing the Ordinary Level examination in five (or more) subjects.
Source: IBE (2011).

Figure 3.19: Proportion of Students Passing the General Certificate of Examinations Ordinary Level, 2007–2010 (%)



Source: IBE (2011).

attract well-qualified teachers to the remote atolls (Figure 3.20).

Although the government has already taken some initiatives to improve access to good quality education,[59] education beyond primary level continues to be weak. Serious inequity in the delivery of education services persists as the wide dispersion of the islands has proved to be a key obstacle to making the growth process fully inclusive by offering equal opportunities to all regardless of their place of residence.

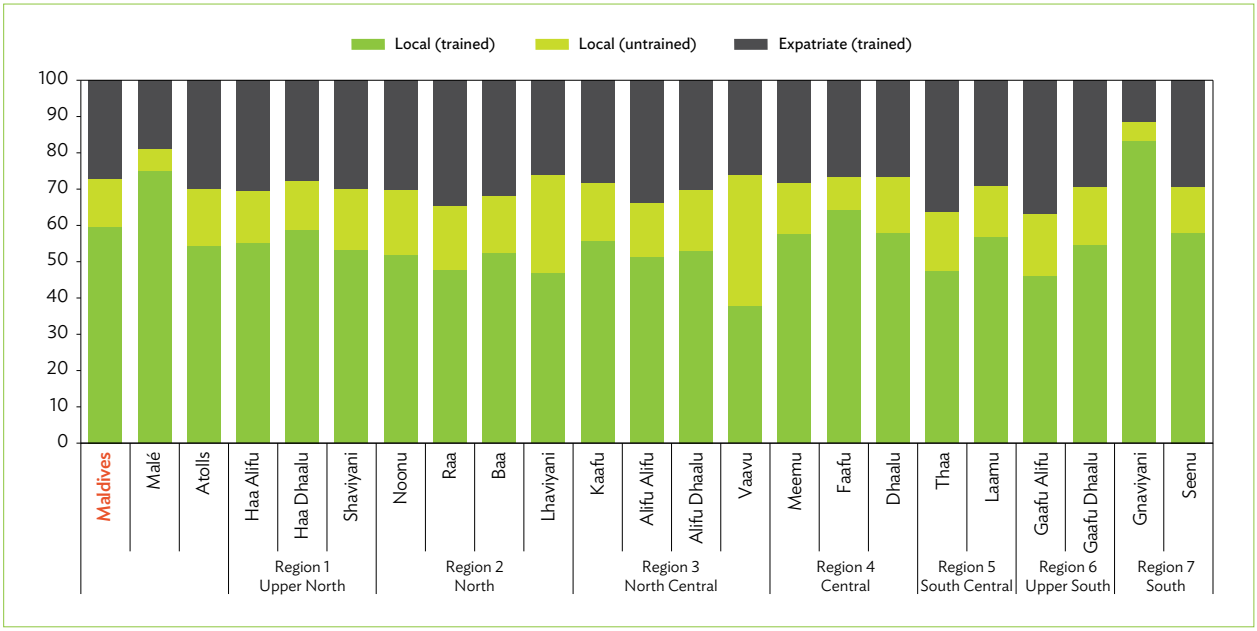
3.3.2. Public Health Outcomes and Access

Public health outcomes have improved significantly, driven by increased government health expenditure. Health is an important component of human capabilities. Poor health adversely affects labor productivity and earning capability. The wide dispersion of the Maldives' population poses a significant challenge to the equitable delivery of health services, but government allocation of significant resources to the health sector has successfully contributed to significant improvements in health indicators.

Life expectancy at birth has increased from 70 years to 74 years between 2001 and 2012, which is a major achievement in a short period of time (Figure 3.21). Infant and under-5 mortality rates have declined across the country, by almost 50% and 60%, respectively, between 2001 and 2012. In 2012, male infant mortality rates in Malé were higher than in the atolls, but female rates were lower (Figure 3.22). The under-5 mortality rates showed the same trend (Figure 3.23). The nutrition of children has also improved in the last decade, with a decline in wasting, stunting, and underweight children below 5 years of age. Between genders, cases of malnutrition, however, were higher among boys under 5 (Figure 3.24). The improvement in children's nutritional status between 2001 and 2009 is partly due to the implementation of the government's National Nutrition Strategic Plan 2001–2006.

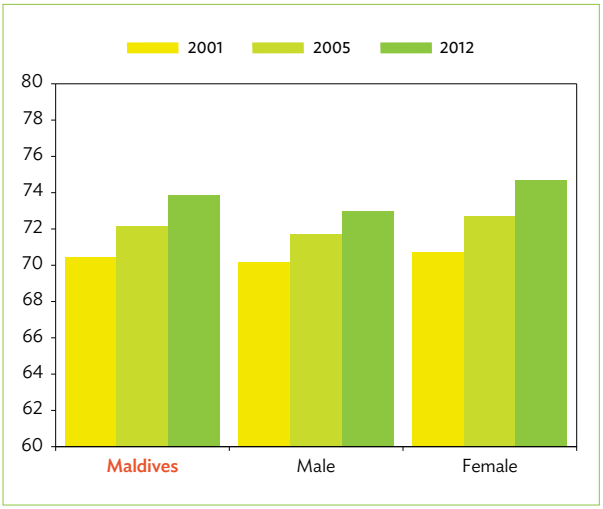
[59] Initiatives include establishing school boards, converting 124 schools to a single session, introducing school-based management and assessment policies, and implementing a compulsory professionsl evelopment program for teachers.

Figure 3.20: Quality of Teachers in the Maldives, 2014 (%)



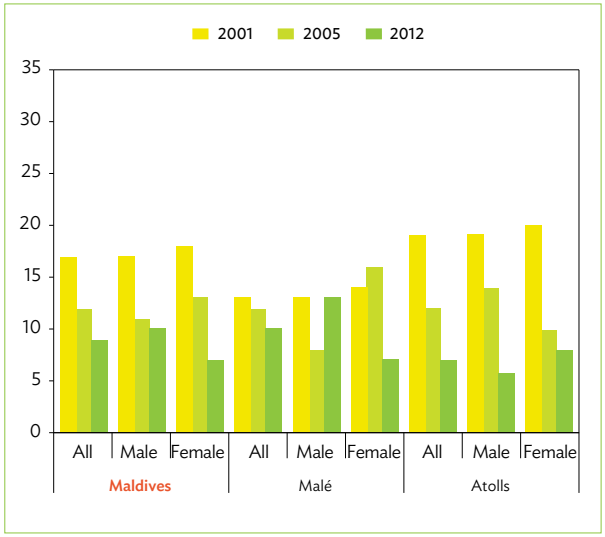
Note: No expatriate teachers are "untrained." Trained teachers have an advanced certificate or higher teaching qualification accredited by the Maldives Accreditation Board.
Source: MOE (2014).

Figure 3.21: Life Expectancy at Birth, 2001, 2005, 2012 (number of years)



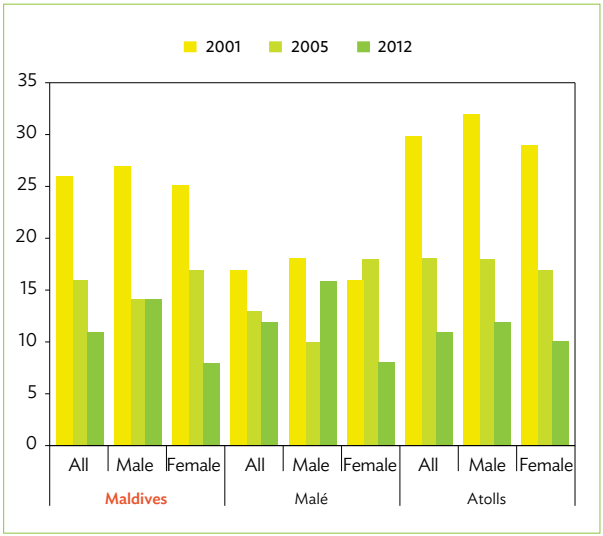
Note: Data on life expectancy were computed as the weighted average of the life expectancy of males and females. Population share used was sourced from the Statistical Yearbook of Maldives 2014 (DNP 2014).
Source: Ministry of Health and Gender (2014).

Figure 3.22: Infant Mortality Rate, by Location and Gender, 2001, 2005, and 2012 (per 1,000 live births)



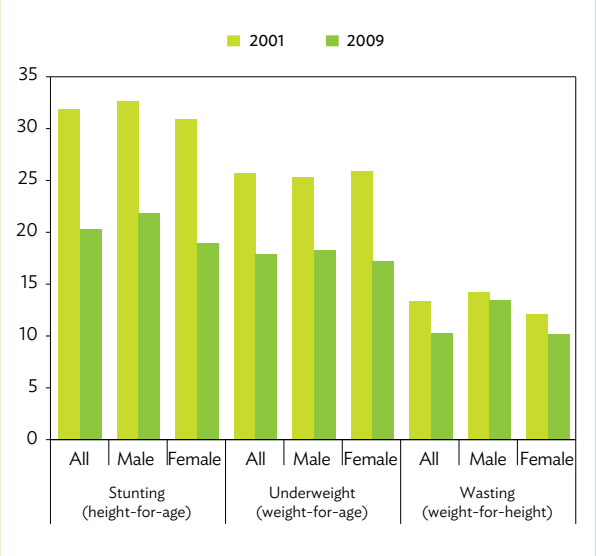
Source: Ministry of Health (various years).

Figure 3.23: Under-5 Mortality Rate, by Location and Gender, 2001, 2005, and 2012 (per 1,000 live births)



Source: Ministry of Health (various years).

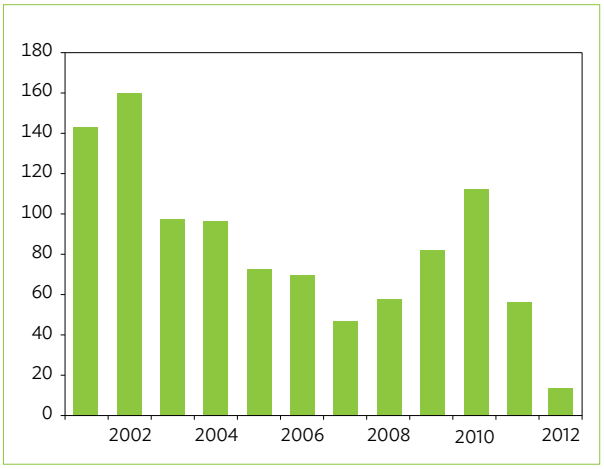
Figure 3.24: Malnutrition Prevalence of Children under 5, by Gender, 2001 and 2009 (%)



Source: World Bank, World Development Indicators (accessed May 2015).

Maternal mortality declined between 2001 and 2012 (Figure 3.25). The reduction resulted from the upgrading of atoll health centers to hospitals with a comprehensive obstetric care facility, which allowed the phasing out of the services of traditional birth attendants with little or no training.[60]

Figure 3.25: Maternal Mortality Ratio, 2001–2012 (per 100,000 live births)



Source: Ministry of Health and Gender (2014).

Overall, the Maldives achieved its MDG health goals of reducing child mortality by two-thirds and maternal mortality by three-quarters between 1990 and 2015 (ADB 2014c). Using health outcome indicators sourced from the World Development Indicators, the Maldives compares favorably with other countries in the subregion, although this is to be expected given its higher per capita income (Table 3.5). Moreover, expenditure on health as a share of GDP has been high, considerably greater than that of other countries in the subregion (Figure 3.26).

The health of small island states such as the Maldives is vulnerable to the impacts of climate variability. Climate change and global warming, for example, can affect a small island's water sources and facilitate the introduction of vector-borne diseases. For example, acute respiratory infections, diarrhea, dengue, chikungunya, scrub typhus, toxoplasmosis, and leptospirosis have recently emerged as health risks to the population.

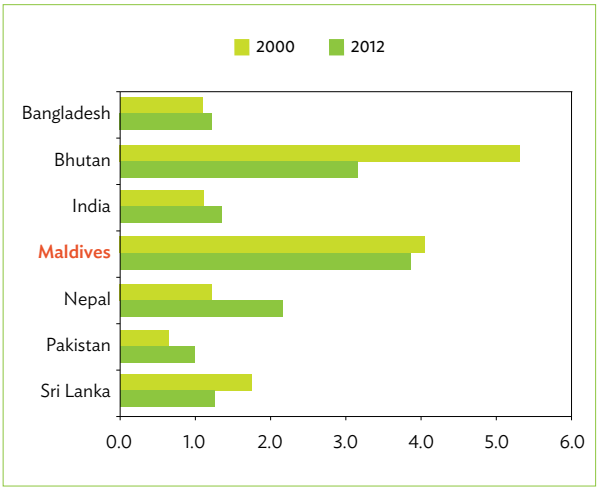
[60] Data provided by Ministry of Health indicate that, in 2012, maternal mortality was at 13 per 100,000 live births. Ministry of Health and Gender (2014).

Table 3.5: Health Outcomes of Selected South Asian Countries

Country	Life Expectancy at Birth, 2012 (years)	Infant Mortality, 2013 (per 1,000 live births)	Under 5 Mortality, 2013 (per 1,000 live births)	Maternal Mortality, 2013 (per 100,000 live births)
Bangladesh	70	33	41	170
Bhutan	68	30	36	120
India	66	41	53	190
Maldives	**78**	**8**	**10**	**31**
Nepal	68	32	40	190
Pakistan	66	69	86	170
Sri Lanka	74	8	10	29

Note: The World Development Indicators defines the maternal mortality ratio as the number of women who die from pregnancy-related causes while pregnant or within 42 days of pregnancy termination per 100,000 live births. The data were estimated with a regression model using information on the proportion of maternal deaths among non-AIDS deaths in women aged 15–49, fertility, birth attendants, and gross domestic product.
Source: World Bank, World Development Indicators (accessed May 2015).

Figure 3.26: Public Health Expenditure in South Asian Countries, 2000 and 2012 (% of GDP)



GDP = gross domestic product.
Note: Public health expenditures include spending on health services (preventive and curative), family planning activities, nutrition activities, and emergency aid designated for health, but do not include provision of water and sanitation.
Source: World Bank, World Development Indicators (accessed May 2015).

Unequal access to health services remains an obstacle to inclusive growth. Although achievements in narrowing disparities between Malé and the atolls have been significant, inequality in access to health services remains. While primary curative services are available at the island level, secondary and tertiary level curative services are only available at regional hospitals or at the Indira Gandhi Memorial Hospital in Malé and a few private hospitals in Malé and some atolls.

In 2001, the Maldives started to implement a five-tier (i.e. central, regional, atoll, sub-atoll, and island level) referral system for health services. The medical functions and specializations of health institutions differ depending on which tier they operate under. Community and family health workers provide basic curative and preventive health services at the island level. Patients who need secondary care are referred to a health center at the sub-atoll level. Hospitals at the atoll level perform surgery and handle obstetric emergencies. Regional hospitals provide secondary curative services and play an important role in health administration by supervising health services at the lower levels and implementing preventive health programs. At the central level, the Indira Gandhi Memorial Hospital provides tertiary curative care and acts as the country's central referral hospital. Currently, aside from the 2 hospitals in Malé, the Maldives has only 6 regional hospitals (in the Gaaf Dhaal, Haa Dhaal, Laamu, Meemu, Raa, and Seenu atolls) and 13 atoll hospitals providing various health services. The government has started upgrading two regional hospitals in the atolls to tertiary level and the Ministry of Health has signed an agreement with the State Trading Organization to establish pharmacies in all inhabited islands.

Doctors and other medical professionals are deployed in accordance with the five-tier referral system (Table 3.6). As a result, specialist doctors and paramedical staff are relatively concentrated in Malé. General practitioners and nurses are deployed in proportion to the distribution of the population. There is one general practitioner per 1,046 citizens in Malé and one per 932 citizens in the atolls. The nurse-to-population ratio was 168 for Malé and 173

Table 3.6: Distribution of Medical Professionals, by Location, 2010

	Malé	Atolls
Doctors	**219**	**306**
General practitioners	106	224
Specialists	113	82
Nurses	**660**	**1,208**
Paramedical Staff	**358**	**271**
Laboratory technicians[a]	141	135
Physiotherapists	14	8
Radiographers	31	21
Dentists[b]	27	5
Pharmacists/ pharmacy assistant[c]	145	102
Community Health Personnel	**2**	**803**
Community health workers	2	276
Family health workers	0	313
Traditional Birth Attendants (Foolhuma)	**0**	**214**

[a] Includes laboratory technicians, laboratory assistants, food technologists, and microbiologists.
[b] Dentists, dental mechanics, and dental hygienists.
[c] Only ADK Hospital and International Medical and Diagnostic Center contributed to private sector data.
Source: Ministry of Health (2013).

for the atolls.[61] Hence, the inequity in access relates to specialized hospital services, not to the services of general doctors or nurses.

More than half of the health professionals in the country are expatriates. In 2010, 82% of the doctors and 55% of the nurses were foreign health professionals. In the atolls, 97% of the general practitioner doctors and 100% of the specialist doctors are expatriates (Ministry of Health 2013). The dependency on foreign medical practitioners poses a challenge to the sustainability of health care provision, given the high turnover of expatriate medical professionals each year (Government of Maldives 2009).

As local medical institutions cannot provide some types of medical care due to the lack of specialist doctors, medical equipment, and laboratory facilities, better-off Maldivians tend to seek medical treatment abroad, particularly in Sri Lanka. As Table 3.7. indicates, nearly one of three households has at least one family

[61] The doctor/nurse-to-population ratio was calculated based on the figures in Table 3.6 and population census conducted in 2006. As the trend of migration to Malé has continued since the last census, the actual ratios in Malé may be worse than presented in this report. Differences in population growth rates in Malé and the atolls also affect the ratios.

Table 3.7: Prevalence of Travel Abroad for Medical Care in the Last 12 Months (%)

Region	Percentage of Households with Member who Travelled Abroad for Medical Care
Maldives	**32.8**
Malé	45.6
Region 1: Upper North	27.4
Region 2: North	19.1
Region 3: North Central	38.2
Region 4: Central	35.5
Region 5: South Central	21.8
Region 6: Upper South	22.0
Region 7: South	32.9

Source: Calculations based on DNP (2012a).

member who has gone abroad for medical care (DNP 2012b).

For many people, foreign medical care remains the preferred option in view of the perceived low quality of domestic medical services, along with the lack of legal framework to protect the patients involved in medico-legal issues.[62] Reflecting the prevalence of Maldivians seeking medical assistance overseas, the national health insurance system also covers foreign medical and travel-related costs, which adds to the government's funding problem.

Overall access to health services in general is not a critical constraint to achieving inclusiveness. However, unequal access to health services is affected by the country's dispersed islands, with the pattern of expenditures in health provision favoring the capital and some selected atoll centers due to the high unit cost of delivering health services in remote areas. Access to safe drinking water and sanitation is also an important factor in improving health outcomes. The Maldives shows good performance in terms of the internationally accepted definition of access to improved water sources and sanitation; however, the government defines improved access as having piped connections to either the desalinated water supply or sanitation system. By this definition, access of

[62] Such foreign medical trips results in a heavy drain of foreign currency (DNP 2012b). The Strategic Action Plan 2009–2013 has pledged to improve the quality of local medical care to address this.

rural areas remains low at 18.3%, implying that a large number of households in the remote areas do not yet have access to improved water and sanitation services (Ministry of Health and Family 2010).

3.4. Access to Infrastructure, Land, and Finance

Poor connectivity between outer islands and centers of economic activity constitutes a critical constraint to the inclusiveness of growth. As discussed in Chapter 2, poor connectivity due to inadequate infrastructure, principally the underdeveloped maritime transport network linking the islands, is a critical constraint to growth. It is also a key obstacle to ensuring that growth benefits all. This is recognized in the Strategic Action Plan 2009–2013, which points out that limited transport connectivity undermines development of the islands, and thus fails to narrow the socioeconomic disparities between Malé and the atolls.

With the sparsely distributed population, infrastructure facilities clearly will not be equally distributed across the atolls. Sea transport, the main means of transport between atolls, remains irregular (see Table 2.2). While the government has made significant investment in enhancing connectivity across the archipelago through a scheduled ferry service network and a series of harbor construction and channel deepening projects, the distance between islands necessitates further investment if full inclusiveness is to be achieved.

There is marked disparity in access to transport among income groups. The lowest income quartile (most of which lives in the farthest atolls) have to travel twice as long as the highest income quartile (living in urban areas and Malé) to access economic or social services. Improved sea transport would open up opportunities for the poor to raise their productivity. In rural areas or far flung atolls, where most of the poor reside and where fishing and subsistence agriculture remain the main source of income, improved sea transport could lower the costs of inputs and facilitate the sale of outputs, while increasing the range of opportunities for wage employment. Improved sea and road transport infrastructure can also improve access to health, education, and other social services for the poor and lower the cost of providing public and social services, reducing the gap in nonincome poverty.

While access to electricity is not a constraint as all households have had electricity since 2010, connectivity in terms of information, communication, and technology remains deficient across the atolls and islands.

Telecommunications density and internet subscription compare favorably by subregional standards,[63] but differences in the Maldives in terms of internet and telecommunications usage rates are apparent. The HIES 2009/2010 reported that only 9% of households in the atolls have access to a telephone facility compared with 38% in Malé (DNP 2012b). Similarly, while 49% of households in Malé have an internet connection, the figure in the atolls is only 13% (Table 3.8). Improved access in the atolls would help to improve inclusiveness.

Limited access to land for business enterprises and households engaged in small-scale agriculture pose a constraint to poverty reduction. In countries where a significant proportion of the poor are engaged in agriculture for their livelihood, access to land, especially irrigated land, is of critical importance. However, the situation in the Maldives is very different, given that it has only 300 square kilometers of land, of which 70 square kilometers are used for agriculture,[64] with the bulk of it used in subsistence farming. Despite this, there has been some development in horticulture

Table 3.8: Households with Telephone, Mobile Phone, and Internet, 2010 (%)

	Maldives	Malé	Atolls
Telephone	16	38	9
Mobile Phone	97	100	95
Internet	24	49	13

Source: Calculation based on DNP (2012a).

[63] Mobile cellular subscriptions expanded rapidly from 2000 to 2013 and internet subscription has also risen rapidly from a very low base in 2000 so that by 2013, one-third of the population was subscribed.

[64] World Bank, World Development Indicators (accessed May 2015).

and the government sees the potential for attaining self-sufficiency in a few selected crops such as melon, papaya, pumpkin, cucumber, and tomatoes. How to maximize the opportunities to increase agricultural production in these selected crops given the limited land available is what government and stakeholders have to decide on and plan for.

The government enacted the Land Act in 2002 to enable changes in land tenure, including procedures for holding, acquiring, and transferring land. Prior to the Land Act, all land in the Maldives was owned by the state and only the state could grant permission for a private individual to construct a building or to transfer rights to land. The intention of the Land Act was to create a land market by selling reclaimed land under the Hulumale Development Project and to conduct cadastral surveys. However, the formulation of the National Land Administration Policy framework is still pending and clear policy and enabling laws have yet to be established. This lack of clarity on property rights is a significant constraint particularly in accessing finance, as lenders are unwilling to take land as collateral if they are unable to sell it freely upon a borrower's default.

Access to land was ranked as the third most critical constraint affecting enterprise performance. A poorly developed property market and overlapping and cumbersome bureaucratic procedures were major concerns raised by respondents to the Investment Climate Survey. Based on the survey results, only 10% of businesses in tourism own land, while in manufacturing and transport logistics, the shares are 18% and 25%, respectively (World Bank 2006b), enterprises identified limited access to land as a barrier to investment. Therefore, access to land poses a constraint to employment creation.

Access to financial services is limited and remains unequal, thus constituting a constraint to inclusiveness. Accessibility to financial services plays a key role in ensuring equal access to economic opportunities and in helping households smooth out fluctuations in consumption. Residents of the atolls are disadvantaged by the limited availability of financial services. Residents of remote atolls are mainly served by the Bank of Maldives' Development Banking Cell with funds provided by the government and donors.

The high transaction cost associated with serving a highly dispersed rural population has clearly been a disincentive to the spread of financial services. Only 23 of about 200 inhabited islands, other than Malé, have bank branches (Sinha 2009). Although mobile phone banking was initiated in 2008 to enhance financial inclusion, it did not achieve its objective of extending financial services to all Maldivians in a cost-effective manner (World Bank 2014b).

The narrow base of the financial sector, the absence of a credit information system,[65] and weak legal rights of lenders and borrowers in collateral and bankruptcy laws have constrained access to credit, especially for micro, small, and medium enterprises. As discussed in Chapter 2, unlike other countries in the subregion, the operation and coverage of microfinance institutions in rural areas are not extensive, although there are a few limited schemes. Various donor-funded projects have microcredit components and programs of line ministries have implemented microfinance schemes to serve target groups or sectors (Sinha 2009).

3.5. Social Safety Nets for Inclusiveness

The provision of social security schemes reflects the government's commitment to reducing poverty and inequality in the Maldives. Social safety nets, along with productive employment opportunities and equal access to opportunities, are one of the key drivers for enhancing inclusive growth. Poor households are more vulnerable to the negative effects of transitory livelihood shocks caused by sickness and injury, joblessness, macroeconomic crisis, and natural disasters, and safety nets are aimed to cushion the effects of such shocks, as well as to provide a minimum welfare level for the chronic or long-term poor (Zhuang and Ali 2010).

[65] The Maldives Monetary Authority established the country's credit information bureau in February 2011.

The government's commitment stated in the 7th National Development Plan is to develop an effective social protection system that is consistent with the level of income and implementation capacity of the country. In the past, social protection programs had been implemented in an ad hoc manner. Several small programs were run by various government ministries, with minimal coordination and few guidelines on program targeting, contributing to waste of resources and inefficient implementation (ADB 2012). The current system has been improved and expanded; however, despite stated commitments to reach the poor and vulnerable, the social safety net system remains relatively modest in scale, has limited coverage, and at times has not reached critical vulnerable groups. The difficulties attendant to reaching far-flung communities constrain effective and equitable provision of social security schemes, especially in the more remote islands (Government of Maldives 2009).

Details of the social protection programs available in the country are in Table 3.9. Early programs concentrated on support for government employees but a poverty-targeted cash transfer scheme, the Absolute Poverty Scheme, was introduced in 2003 to provide a modest stipend of Rf500 ($39) per month for the highly vulnerable.[66] In addition, the government subsidizes school fees and distributes to low-income households vouchers[67] that can be used to buy text books, uniforms, and shoes from a selected provider. Another major public social assistance program is financial assistance for emergency medical evacuations within the country and abroad, if necessary medical care is not available in the Maldives. The assistance is open to all Maldivians. In addition, the government provides assistive devices such as hearing aids, crutches, and wheelchairs in case of permanent disability.

Prior to 2008, the main beneficiaries of government social security and welfare programs were government employees. Under the Civil Service Pension, a social security scheme fully funded by the government, civil servants are entitled to a pension equal to 50% of base pay for 20 years of uninterrupted service. Those with 40 years of uninterrupted service are entitled to benefits under the Government Provident Fund, which is a defined contribution arrangement.[68]

In 2008, the government also introduced universal pension and health insurance schemes open to all citizens. The Maldives Pensions Act (Act No 8/2009) stipulates that the Old Age Basic Pension Plan covers all resident citizens age 65 and over, irrespective of the beneficiary's contribution history to pension funds or previous occupation.[69] In the same year, the government also introduced a national health insurance scheme, Madhana, which is also open to all citizens age 65 and over. Other citizens can benefit from the social insurance by paying the insurance premium. Madhana provides free medical consultation and patient care. In 2011, about one-third of the population was enrolled in the Madhana and an additional 14,547 were enrolled in the Madhana Plus, which covers medical care abroad with an additional insurance premium in 2011 (DNP 2012c).

Health insurance coverage was expanded in 2012 through a public–private partnership with Allied Insurance Company, to create a universal health insurance scheme, Aasandha. All citizens holding a valid national identity card are covered under the fully government-sponsored universal health care insurance that covers expenses for medical treatment, all in-patient and out-patient services, domestic emergency evacuation, prescription medicine, and diagnostic and therapeutic services, up to Rf100,000 ($6,500) per year. If necessary treatment is not available in the Maldives, the health insurance provides for treatment abroad, usually in India and Sri Lanka.[70]

[66] The scheme targets the deprived and has stringent eligibility criteria, including (1) living on one meal a day, (2) possessing no more than two sets of clothing, or (3) being homeless.

[67] A point system is used to identify the beneficiaries. Those scoring above a determined minimum will receive the benefits. The eligibility criteria/factors considered for awarding points are (1) single parent family, (2) children with parents in custody, (3) disabled parents, (4) family income, (5) number of school-attending children in a family, and (6) academic performance.

[68] This is a voluntary savings scheme with in which civil servants and the government (as employer) contribute 5% of the base salary to the fund. Government employees are also entitled to a medical allowance worth Rf1,000 annually.

[69] In addition to a universal income guarantee in old age, Article 12 of the Act mandated participation of employees in both the public and the private sectors and the self-employed in the contribution-based Maldives Retirement Pension Scheme.

[70] Universal health insurance has suffered financial difficulties, however, and the Finance Committee of the Peoples' Majlis halted the coverage of Aasandha in private hospitals and clinics due to a substantial shortfall in budget. Aasandha coverage for treatment at private hospitals and clinics was reopened in August 2012, but with the introduction of charges to patients (Maldives Times 2012).

Table 3.9: Social Protection Programs in the Maldives

Year	Social Protection Scheme	Function	Intended Beneficiaries	Coverage (number of people)	Budgetary Allocation or Expenditure or per Capita Expenditure
1988	Government Pension Program	Old age	Public sector employees	34,000 (January–December 2005)	Rf40,575,373 (January–December 2005)
1988	Government Employees Provident Fund (Ministry of Finance and Transport)	Old age	Public sector employees	34,000 (January–December 2005)	Rf14,015,138 (January–December 2005)
1988	Medical Allowance Scheme for Government Employees	Sickness and health	Public sector employees	34,000 (January–December 2005)	Rf39,461,165 (January–December 2005)
2003	Absolute Poverty Scheme—Cash vouchers	Other income support / assistance	Total population	648 (January–December 2005)	Rf500 per month per household Rf3,889,166 (January–December 2005)
____	Financial Assistance to Obtain School Materials (Ministry of Higher Education, Employment, and Social Security)	Basic education	Total population	1,182 (January–December 2005)	Rf 938,000 (January–December 2005)
____	Education Support Fund (Ministry of Education)—Provision of Fees (Ordinary and Advanced Level)	Basic education	Total population	293 (January – December 2005)	Rf 596,950 (January–December 2005)
____	Education Support Fund (Ministry of Education)—Provision of Fees (primary and junior secondary)	Basic education	Total population	95 (January–December 2005)	Rf 254,232
____	Education Support Fund (Ministry of Education)—Free Textbooks and Uniforms	Basic education	Total population	2,086 (January–December 2005)	Rf1,408,260 (January–December 2005)
____	Financial Assistance to Obtain Health Care from within the Maldives	Sickness and health	Total population	3,639 (January–December 2005)	Rf3,805,782 (January–December 2005)
____	Financial Assistance to Obtain Health Care from Abroad	Sickness and health	Total population	1,422 (January–December 2005)	Rf11,026,000 (January–December 2005)
____	Financial Support for Assistive Devices for Disabled—Including Mental Illness (Ministry of Higher Education, Employment and Social Security)—Financial Support to Obtain Assistive Devices for People with Disabilities	Sickness and health	Total population	201 (January–December 2005)	Rf327,300 (January–December 2005)
2005	Emergency Support—Cash Transfer to Tsunami Victims	Emergency support	Affected families	63,000 households	Per capita expenditure Rf1,687
2008	National Health Insurance Schemes: Madhana Aasandha,	Sickness and health	All resident Maldivians	____	____
2009	Universal Pension (Maldives Pensions Act); Maldives Retirement Pension Scheme	Old age	All resident Maldivians	____	____
2012	National Health Insurance Schemes Aasandha	Sickness and health	All resident Maldivians	____	____
2014	National Health Insurance Schemes Husnava Aasandha	Sickness and health	All resident Maldivians	____	____
____	Zakath Programs (Islamic Charities)	Other income support / assistance	Total Individuals	58,300 (January–December 2005)	Rf6,923,948 (January–December 2005)

Rf = rufiyaa.
Source: ILO, Social Security Inquiry (accessed May 2015).

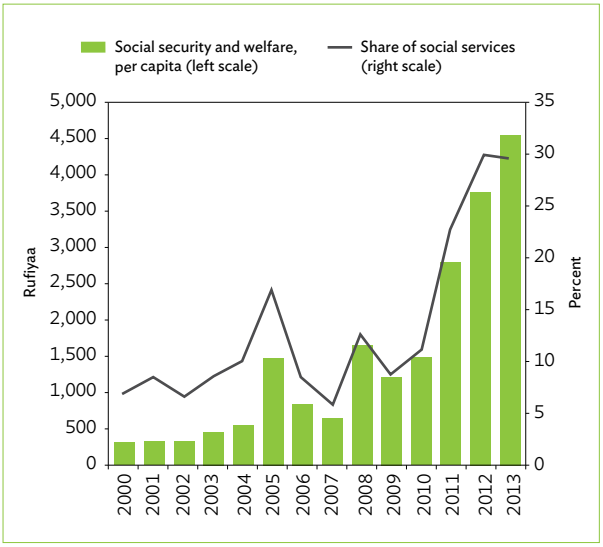
In 2014, the government launched a new insurance scheme, Husnava Aasandha—Health Insurance for All—without a ceiling protection limit. It covers all transport fees of emergency cases, annual medical checkup for those over age 30 and children under 18, full medical coverage during pregnancy, and medical coverage for terminally ill patients and those with special needs.

Outside the public social safety net system, an Islamic charity (Zakath) promotes inter-household income redistribution based on religious obligation. Collected contributions are distributed to the poor and needy, in accordance with the *Koran*. The average benefit distributed by Zakath is low and was previously estimated at Rf120 ($9.4) per beneficiary (ADB 2007).

Expenditures on social protection programs are still modest by middle-income country standards and are not well targeted. Disbursements on social security and welfare can provide an indicative measure of a safety net that is being supplied to the population. Per capita expenditure on social protection programs was Rf285 ($24.2) in 2000. This rose to Rf1,463 ($114.3) in 2005 after the tsunami and was Rf1,469 ($114.8) in 2010, after the introduction of the universal pension and national health insurance schemes. Social protection expenditure has more than doubled—to Rf4,559 ($295.8) in 2013 with the introduction of the universal health insurance scheme, Aasandha (Figure 3.27). Total social protection expenditure for 2010 was about 4.9% of the country's GDP, which was a major increase from 2009 and the highest share in the subregion. At least half of this expenditure was allotted for social assistance programs; the other half was earmarked for social insurance.

Even if the levels of expenditures have been rising, in 2010, the total expenditures on social protection identified and aimed at the poor was only Rf266 million ($20.8 million) versus Rf1,042 ($81.4 million) million for the nonpoor.[71] This was mainly because the bulk of expenditure was for pensions, redundancy, and early retirement for civil servants and the government provident fund. The concern is that the very poor are

Figure 3.27: Per Capita Government Expenditure on Social Security and Welfare, 2000–2013 (Rf)



Rf = rufiyaa.
Source: ADB (2014b).

usually not covered because they are usually not part of the civil service or other contributory pensions and are not able to afford insurance premiums. Recent documentation on the effectiveness of social safety nets in the Maldives is not available; however, one way to assess it is to use the rankings of countries in the subregion by the social protection index (SPI).[72] The Maldives' ranking improved between 2008 and 2010. Its overall score was the highest in the subregion and it overtook Bangladesh, India, and Sri Lanka (Table 3.10).

Although the Maldives has a considerably higher score in the SPI than most countries in the subregion, the SPI subindex results for depth[73] and breadth[74] of coverage of social protection programs indicate the potential for improvement. The SPI for depth increased between 2008 and 2010, from 0.16 to 0.39, which indicates that the average social protection benefits in the Maldives are 39% of the per capita poverty line. The SPI for

[71] ADB, Social Protection Index database (accessed May 2015)

[72] The SPI uses internationally comparable assessment standards and benchmarks the overall level of social protection activities in a country against comparators (Baulch, Weber, and Wood 2008). The SPI consists of four subcomponents: (1) social protection expenditures, (2) social protection coverage, (3) social protection distribution, and (4) social protection impact.

[73] Denotes the average expenditures per actual beneficiary of the social protection programs.

[74] Represents the actual beneficiaries per total potential beneficiaries. This is a nonmonetary coverage indicator.

Table 3.10: Social Protection Index, 2008 and 2010

Country	HDI		SPI Ranking		SPI		SP Expenditure (% of GDP)	
	2008	2010	2008	2010	2008	2010	2008	2010
Bangladesh	0.515	0.539	23	21	0.040	0.051	1.4	1.6
Bhutan	..	0.569	26	25	0.028	0.030	0.9	1.0
India	0.554	0.570	31	33	0.112	0.051	0.3	0.0
Maldives	**0.675**	**0.688**	**28**	**12**	**0.023**	**0.128**	**0.9**	**4.9**
Nepal	0.501	0.527	20	17	0.049	0.068	1.6	2.2
Pakistan	0.536	0.526	32	31	0.006	0.014	0.2	0.4
Sri Lanka	0.725	0.736	11	14	0.114	0.114	2.8	2.8

... = data not available, GDP = gross domestic product, HDI = human development index, SP = social protection, SPI = social protection index.
Note: SPI rankings are among 33 countries in the Asia and Pacific Region.
Sources: UNDP(2014); ADB, Social Protection Index Database (accessed May 2015).

breadth increased from 0.13 to 0.32 for the same period, meaning that about 32% of all potential beneficiaries are recipients of social protection benefits. The Maldives' scores for depth and breadth are not low compared to other countries in the subregion, but they indicate considerable potential for targeting social protection more closely to the poor and vulnerable.

The SPI results for the Maldives suggest good progress, but a need to expand social protection programs to reach more of the poor and vulnerable. Numerous vulnerabilities exist and adequate systems need to be put in place to deal with both short-term problems and the longer-term needs of the chronic poor. Reductions in government expenditures as part of medium-term fiscal consolidation will put further pressure on the ability of social protection schemes to foster inclusiveness in the country and may require closer targeting of support to the most needy.

3.6 Conclusion

This chapter has considered the barriers to inclusive growth focusing on limited opportunities for productive and decent employment particularly across atolls; unequal access to opportunities due to poor quality of education and unequal access to higher secondary and tertiary education; poor connectivity between outer islands and economic centers due to the underdeveloped maritime transport network; micro, small, and medium enterprises' limited access to land; and unequal access to financial services. Social protection programs have been expanded but not extensively enough to offset these constraints (Table 3.11).

Table 3.11: Summary of Diagnosis of Constraints to Reducing Poverty and Inequality

Broad Determinants of Poverty and Inequality	Factors Affecting Poverty and Inequality		Why Factor Constrains Reduction of Poverty and Inequality	Critical Constraint?	Impact on Growth
Productive and Decent Employment Opportunities	Employment opportunities		• High unemployment; limited employment growth vis-à-vis economic growth • Limited productive employment opportunities, especially for people from the atolls	Critical	✓
Access to Opportunities	Human capabilities	Education	• Limited access to and low quality of secondary and tertiary education • Limited appreciation of and access to vocational training	Critical	✓ ✓
		Health	• Health outcomes could still be improved (e.g. infant and maternal child malnutrition) • Health impacts of climate variability • Increasing substance abuse among the youth • Dearth of local healthcare and medical professionals and workers	Not critical	
		Other social services	• Access to clean water supply and improved sanitation facilities, especially in the rural areas and atolls	May become critical in medium to long term	
	Uneven access to infrastructure and productive assets	Infrastructure, particularly maritime transport	• Under-developed maritime transportation network limiting access to economic opportunities and services	Critical	✓
		Land	• Limited land for selected agricultural production to support self-sufficiency in selected crops. • Reduced land availability for business enterprises due to poorly developed property market, overlapping government red tape and cumbersome procedures	Critical	✓ ✓
		Credit	• Limited and unequal access to financial services	Critical	✓
Social Safety Nets	Social safety nets		• Several social protection programs in place but scope remains limited and may not be sustainable given the fiscal impact	Not critical	

Source: ADB.

Chapter 4
Challenges the Maldives and Other Small Island Developing States Face

4.1. Introduction

The United Nations classifies the Maldives as a small island developing state (SIDS). The SIDS classification came about with the recognition that a distinct group of countries faces specific economic, social, and environmental vulnerabilities due to their inherent characteristics. The 50 SIDSs are grouped into three regions by the Division of Sustainable Development of the United Nations Department of Economic and Social Affairs (UN DESA).[76] A few SIDSs have very high income levels, such as Singapore, or are in the upper-middle income bracket, such as the Maldives and some Caribbean countries; however, many SIDSs, especially those in the Pacific, belong to the low-income group. More importantly, such SIDSs are behind in terms of human development, as evidenced by their low social indicators.

Most SIDSs face similar challenges, which have influenced their economic performance and overall development. All economies, whether large or small, experience external and internal shocks, but lower-income SIDSs are particularly vulnerable to economic and environmental phenomena. SIDSs are at a particular disadvantage mainly due to their small size, remote location, and vulnerability to climate change and natural disasters.

The Maldives' size and geography have not prevented the country from achieving high per capita income growth during the last 20 years or from attaining most of its Millennium Development Goal targets. The question is how to ensure that the fruits of economic development are spread to all income groups, especially Maldivians living in the outer atolls. The government continues to seek solutions to the inequalities between Malé and the atolls through, for example, implementing a targeted policy such as "Population and Development Consolidation" (Box 4.1) by addressing the disparity in access to infrastructure, social services, and employment opportunities. However, the success of such efforts depends heavily not only on the policies and capacity of government but also on the sustainability of the country's economic performance. The SIDSs' economic performance is highly vulnerable to external economic and environmental factors over which their governments have little control.

Thus, achieving an inclusive and sustainable development continues to be a demanding task. To better understand the economic challenges SIDSs face, a brief discussion of the factors that put them in a disadvantaged position is merited.

[76] (1) Caribbean Sea (22 members): Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, British Virgin Islands, Cuba, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Montserrat, Puerto Rico, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, and the US Virgin Islands.
(2) The Pacific Ocean (20 members): American Samoa, Cook Islands, Federated States of Micronesia, Fiji, French Polynesia, Guam, Kiribati, Marshall Islands, Nauru, New Caledonia, Niue, Northern Mariana Islands, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.
(3) Africa and the Indian Ocean (8 members): Cape Verde, Comoros, Guinea-Bissau, Maldives, Mauritius, São Tomé and Príncipe, Seychelles, and Singapore. (UN DESA website, accessed March 2015).

Box 4.1: Population and Development Consolidation Programs in the Maldives

Program	Rationale	Key arguments
• Focal Development Centers • Focus Islands Development	Rationalizing service delivery	Inability to provide infrastructure and services to all settlements, particularly those with populations under 1,000 persons, due to the high cost of providing • new infrastructure such as health facilities, schools, sewerage, and harbors; and • basic services such as health care and education.
• Regional Development Project: Growth Centers in Kulhudhuffushi and Hithadhoo	Achieving economies of scale	Islands with larger populations tend to have better economic structure due to economies of scale and higher demand. People in smaller islands will voluntarily move to islands with opportunities.
• Regional Development Project: Growth Centers in Kulhudhuffushi and Hithadhoo	Reducing congestion in Malé	Migration to Malé Region can only be controlled through development of the outer islands or major settlements in the North and South.
• Safe Islands Programme • Resilient Islands Programme	Reducing hazard risks and climate risks	Not all islands can be protected against disasters but selected settlements can be protected. If the number of settlements is reduced, all can be made resilient to disasters and climate risks.
• Atoll Development Programme	Reducing poverty in atolls	Concentrated development within an atoll can help reduce poverty.

Source: Shaig (2014).

4.2. Characteristics of Small Island Developing States

SIDSs show considerable heterogeneity in income levels and human development and have distinct characteristics that differentiate them from developing economies. The "smallness" of SIDSs can be measured through population, land area, and/or total output or gross domestic product (GDP). Several SIDSs, especially those in the Pacific subregion, have a small population. The population of most SIDSs, especially those in Asia and the Pacific, is 10,000–1.5 million. A few exceptions are Haiti, Papua New Guinea, and Singapore.

The SIDSs' topographical and geographical features are also unique. Most SIDSs comprise widely dispersed islands. The composition of their lands ranges from coral atolls to volcanic or sedimentary and other materials from larger land masses. The majority of the populations are typically concentrated on a few major islands with the rest scattered across the remaining islands. In the Maldives for example, the average islands vary from 0.5 square kilometers (km^2) to 2 km^2. Only 33 islands have more than 1 km^2 of land. Of the inhabited islands, 85% have less than 1 km^2 of land, and only 3 inhabited islands have more than 4 km^2.

For most of the SIDSs, advances in technology have not fully resolved the problem of distance from major markets, which isolates their economies from potential trading partners. Remoteness is also a disadvantage for domestic connectivity, due to high transport costs and limited accessibility to international and domestic markets.

Many of the SIDSs face special disadvantages associated with their small size, insularity, remoteness, and proneness to natural disasters (Briguglio 1995). These factors leave their economies very vulnerable, especially to external factors, and thus have the following implications.

Limited ability to exploit economies of scale given a small domestic market. Small population size prevents producers of goods and services (public or private) from being able to spread fixed costs over a larger number of users or consumers. The indivisibilities, especially of public goods and services, and the limited scope for specialization result in higher unit costs of production. This is especially true for delivering public services because public services must be provided regardless of the number and location of the population. A small population that is widely dispersed increases the diseconomies of scale and increases unit costs of providing education, health, social, legal, and infrastructure services.

The small size of the market likewise inhibits the development of indigenous technologies that could partly address input requirements and lead to lower dependence on imports. A small domestic market will not be able to encourage competition and this results in an oligopolistic or monopolistic situation, wherein only one or two domestic producers exist and control the prices of goods unless they are subject to government control.

Limited natural resource endowments result in dependence on a few sectors. Although not true for all SIDSs, several of them have limited natural resource endowments and underdeveloped interindustry linkages. This results in dependence on imports even for basic commodities. Given a limited land mass, agriculture cannot be developed on a large scale. Some SIDSs are only competitive in one or two products or in services such as tourism, which makes them susceptible to global economic conditions. Pacific island economies rely mostly on fisheries, tourism, and a few commodities such as copra and sugar. Other SIDSs such as Papua New Guinea or Timor-Leste depend on resources such as natural gas and water for hydropower.

International market access and trade openness remains limited and is exacerbated by remoteness. Several factors affect SIDSs' access to the international market. In addition to the structural and capacity impediments, underdeveloped transport infrastructure, especially for remote SIDSs, limits the potential to gain from trade. Poor international and domestic connectivity coupled with high transport costs make the SIDSs' goods and services less competitive in the world market. High transport costs have inhibited trade integration for a number of remote SIDSs, which require sea and air transport to facilitate trading activities.

Delays and uncertainties in basic supplies and inputs to production are to be expected, especially in archipelagic and dispersed SIDSs that are far from main commercial centers.[77] And with irregular maritime and air transport services, enterprises in the islands find it difficult to meet sudden changes in demand unless they keep large stocks, which in turn raises working capital costs.

Unsustainable, large government. While there is no prescribed size of government for a given population, smaller states tend to have relatively larger governments than larger states, partly as a consequence of the diseconomies of scale that leave government no choice but to provide public services regardless of a small population. Current government expenditures as a percentage of GDP, especially in the micro states in the Pacific, are higher than in SIDSs with a much larger population, and the SIDSs' ratios of current expenditures to GDP are also higher than those of developing economies.[78]

Costs of frequent natural disasters are high. Although all economies face natural disasters in one form or another, their impact on island economies in

[77] Winters and Martins (2004) calculated the cost disadvantages of very small and small states based on percentage deviation of the costs from median states (population of about 10 million).

[78] Cas and Ota (2008) present evidence on the inverse relation between government size and country size. They also provide evidence of an inverse relationship between country size and the amount of both total public debt and external public debt. Small states tend to have higher government spending on goods and services, wages and salaries, and capital investment relative to GDP. Furthermore, the study finds that in small states weak governance (or low government effectiveness) is associated with higher total public and external debt.

terms of the damage and cost is more catastrophic due to the small size of the country. In the smaller islands in the Pacific and the Caribbean, natural disasters occur frequently and pose serious economic and social risks. Destruction of agricultural products and commodities affects the economy's output and disruption of infrastructure and other public services compounds the problem.

In 2014 alone, Asia and the Pacific experienced 119 disaster events. Although fatalities were only one third of the 2013 figures (6,050 versus 18,744), the region's economic losses amounted to about $59.6 billion. In the Caribbean, loss due to natural disasters averaged about 1.7% of GDP per year in the 2000s (IMF 2013). World Bank (2006a) noted that Pacific island economies had reported 207 disaster events, affecting almost 3.5 million people with estimated damage cost of $6.5 billion since the 1950s.

Environmental degradation from the pursuit of economic development. Most SIDSs have very fragile ecosystems and are important contributors to global environmental diversity. The exposures to outside influences have endangered endemic flora and fauna. Global warming is a rising concern, especially for low-lying islands, as a large proportion of their land area will be lost to a sudden rise of sea level. Erosion also threatens island coastlines, which are exposed to waves and wind. While all countries experience pressure brought about by the process of economic development, the pressure tends to be greater in SIDSs because of the demand on their limited land area and natural resource base. The SIDSs' ecosystems tend to be more fragile due to the intense use of coastal resources and zones for maritime and tourism activities.

Poorly developed financial sector. Except for some of the richer Caribbean economies that gained prominence as offshore financial centers, mostly serving nonresidents, the SIDSs' domestic financial sectors lack depth. This is due to a small market size that inhibits competition and development of the sector. The small size limits the scope for financial intermediation and places reliance for it on foreign funding sources. A few banks usually dominate the financial sector and high lending rates limit the population's access to finance and hinder private investment. Because the private sector cannot afford the funds available from banks, commercial banks instead end up financing the government requirements. In larger countries, government debt is usually owned not only by banks and nonbank institutions but also by private companies and individuals who are able to purchase government treasury bills and bonds; however, this is usually not the case in SIDSs.

4.3. Consequences of the Maldives' Unique Characteristics

The Maldives has achieved impressive outcomes in economic growth and meeting its Millennium Development Goal targets in the last decade. The achievements, however, tend to hide the challenges the country continues to face. Its small and dispersed population has been a challenge especially to achieving inclusive and sustained growth.

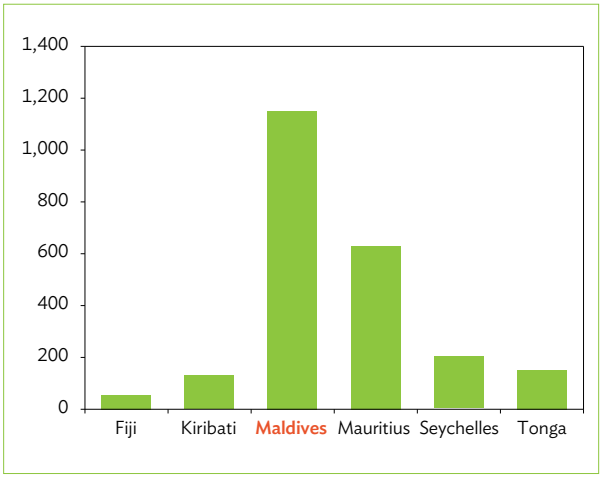
4.3.1. Small and Widely Dispersed Population

The Maldives has one of the smallest population and land areas in Asia and the Pacific. The Maldives' population in mid-2006 was 298,968 (MPND 2007), which had increased to 341,256 in 2014 (Ministry of Finance and Treasury 2014a). The population increased significantly after the late 1970s, when improvements in medical services, control of communicable diseases, and living conditions, began to take effect. The population growth rate is still estimated at less than 2.0% per annum.

The Maldives resembles a typical SIDS, wherein a single settlement has a disproportionately large concentration of people. Over one-third of the total population lives in the capital city, Malé. Less than 20% of the country's islands are inhabited, and its total land area is 300 km^2.[79] With a population density of about 1,150 per km^2, the Maldives is among the world's 10 most densely populated countries (Figure 4.1). Malé,

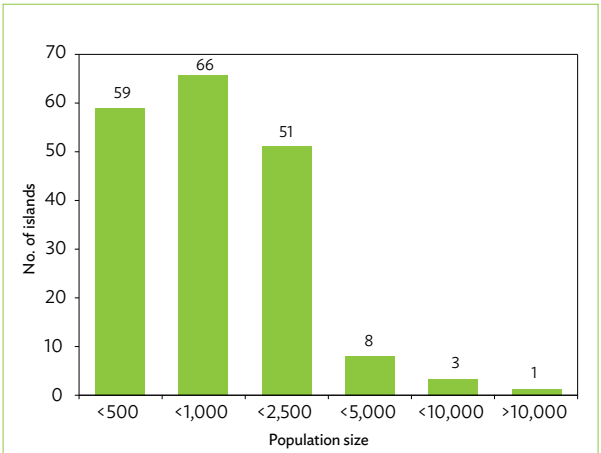
[79] World Bank, World Development Indicators (accessed June 2015).

Figure 4.1: Population Density in Selected Small Island Developing States, 2013 (people per square kilometer of land)



Source: World Bank, World Development Indicators (accessed June 2015)..

Figure 4.2: Island Populations, 2014



Notes: The figure includes administrative islands only. The only island with more than 10,000 people is Malé, which includes Galolhu, Henveiru, Maafannu, Machchangolhi, Villimale, and Hulhumale' and other areas.
Source: National Bureau of Statistics (2014).

also has one of the highest densities as a city, with about 56,000 people per km^2.[80]

Population growth in the outer islands has declined somewhat in the last few years and out-migration to Malé has been increasing. This has contributed to the uneven distribution of settlements across the archipelago. Based on NBS (2014) data from the Population and Housing Census 2014 (Preliminary Results), 59 islands have less than 500 inhabitants, 66 have 500 to less than 1,000, and 51 have 1,000 to less than 2,500 (Figure 4.2). The largest settlement is Malé, which is in the center of the country. Two moderately large settlements, Hithadhoo and Kulhudhuffushi, are in the northern and southern parts of the country (Figure 4.3). Each atoll has 1–2 medium-sized populations of over 2,500. Usually, the largest island in each atoll is the atoll capital.

Based on the most recent available data on age and sex composition, the population structure is that of a typical developing country, with a relatively large proportion of younger people and a smaller share of older people. The population structure in the outer islands has a higher share of women in most age groups, due to significant out-migration of men to the larger atolls seeking employment. Figure 4.4 shows the population structure of a typical large and small island.

The Maldives' total available land area presents a challenge for the growth of settlements, especially in the outer atolls. About 82% of the inhabited islands are smaller than 1 km^2. As urbanization takes place, population density increases significantly.

There is also an inherent link between size of an island population and vulnerability and poverty. In general, vulnerabilities are lower and living standards higher on islands with larger populations.[81] Smaller communities imply higher government costs for providing social infrastructure and facilities and higher cost of transport for people to avail of services (MPND 2007). The Vulnerability and Poverty Assessment Report (MPND and UNDP 1999, MPND and UNDP 2005) notes that people are less socially vulnerable on more populous islands. Based on the composite human vulnerability index,[82] islands with less than 200 inhabitants have an average index of 5.3 versus 4.0 for islands with more than 1,000 people, 2.4 for islands with over 2,000, and 2.1 for islands with over 4,000.

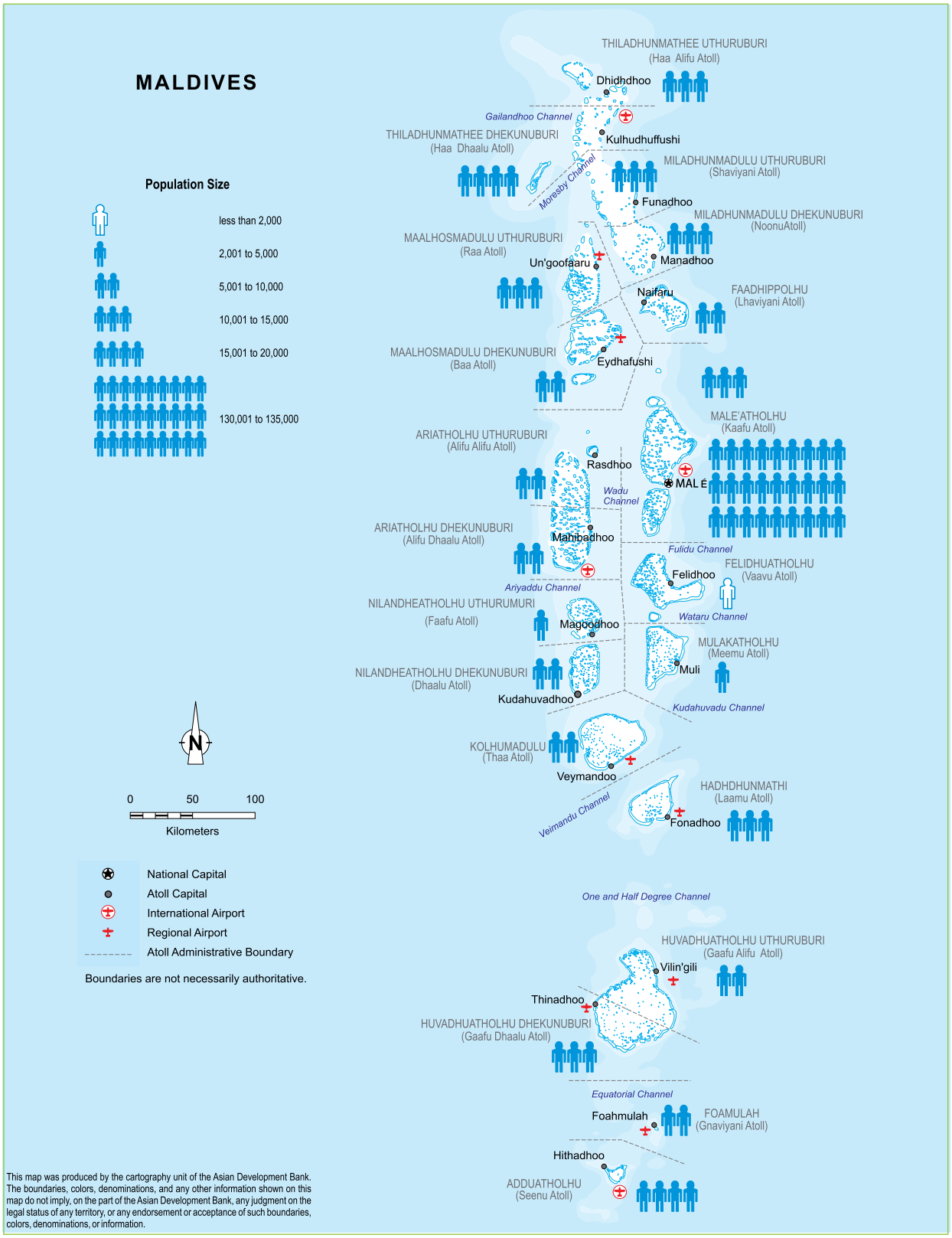
The human development index (HDI) placed the Maldives in 2013 in the medium human development category, with a value of 0.698. This HDI value was higher than the average of 0.64 for countries in the medium human development group and the average of 0.558 for countries in South Asia (UNDP 2013a). The overall gains in human development are significant, but mask the underlying inequalities. The *Maldives*

[80] City Population. Maldives. http://www.citypopulation.de/Maldives.html (accessed April 2015).

[81] The only exceptions are two overcrowded islands.

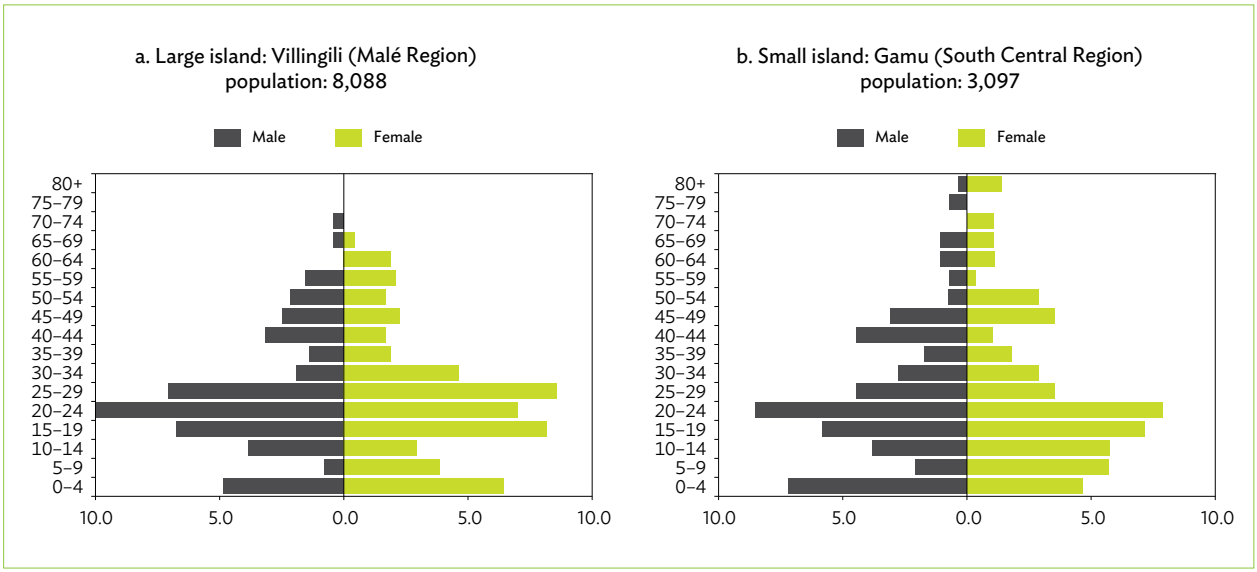
[82] Calculation consists of 12 living standard dimensions with a higher score reflecting greater vulnerability.

Figure 4.3: Settlement Distribution Map



Sources: ADB Map Department, based on data from National Bureau of Statistics (2014).

Figure 4.4: Sample Population Structures of Islands, 2010



Source: Calculations based on DNP (2012a).

Human Development Report 2014 presented the HDI in the country's regions to highlight the disparities across atolls and islands. The 2014 HDI reported that Malé continued to fare relatively well, with a value of 0.734, but the HDIs for the atolls (grouped into six regions) ranged from 0.59 to 0.64.

4.3.2. Economic and Environmental Challenges

A small and dispersed population results in a small domestic market that limits the ability to exploit economies of scale and makes delivery of public service very costly. Small countries such as the Maldives tend to have relatively larger governments due to diseconomies of scale, especially in the provision of public goods. These diseconomies can undermine public services such as protection from invasion, infrastructure, public health, public education, or tax collection. Moreover, domestic competition will not thrive in a small domestic market.

From a public administration perspective, a dispersed population makes delivery of public service challenging and expensive per unit cost because these services should be provided regardless of the population size. Given that settlements are separated by sea, regardless of the population size, each island needs to be self-sufficient in basic economic and social services such as power, water, sewerage, transport infrastructure, administration, health care, and religious and education facilities. In addition, the need to reduce vulnerability to natural disaster and risks due to a rising sea level means that mitigation measures such as shore protection and erosion mitigation are important priorities.[83] After many years of investment, several inhabited islands have established basic public service facilities. However, the availability of a wider range of and better quality services continues to be disproportionate and needs to be improved significantly. Costs of transport and other infrastructure services such as utilities (water, power, etc.) are usually higher for very small and small states due to the high cost of imported inputs and remoteness. For example, electricity costs differ across islands (see Table 2.21). As discussed in Chapters 2 and 3, a national power grid is not feasible, and each island has its own powerhouse and distribution facility. The quality of infrastructure varies between large and small islands, with small islands having substandard generators and lower fuel efficiency, leading to higher prices and an unreliable supply of electricity.

[83] About 90% of the inhabited islands reported severe erosion in 2011 (Azeez 2014).

The inequality in service delivery has been illustrated in Chapter 3, which highlights the unequal access to secondary and tertiary education in the outer atolls and islands as educational facilities are largely concentrated in main capital and some major atolls (see Figure 3.13). Similarly, with a five-tier referral system for health services, only general practitioners providing basic health services are available in outer islands while more advanced procedures are done in the atoll and regional hospitals. Private sector participation in providing utilities and public services is restricted by the diseconomies of scale. Private investments in utility services in smaller islands are mainly community investments (for example, power plants and preschools).

The Maldives has been spending more on education than other countries of a similar size. The Maldives' education expenditure in 2011 was 6.8% of GDP compared with Bhutan's 4.7% and Fiji's 4.1% in the same year. In 2012 however, the Maldives' education expenditure had decreased to 5.9% of GDP. The country also spends more in the health sector, with health expenditures amounting to 10.8% of GDP in 2013. Notwithstanding high levels of public spending in relation to GDP, the Maldives, like other SIDS, does not have a large enough population to support a full range of public goods and services. Thus, the cost of delivering health-related services and the menu of health services varies across the regions of the country. The per capita average monthly expenditure on health based on the HIES 2009/2010 showed that health expenditures in Regions 5–7, which have smaller populations and are in the southern portion of the country, were far higher than in other regions (Table 4.1).

Table 4.1: Per Capita Monthly Average Expenditure per Health Service, 2010 (Rf)

Island	Deliveries and Related Services
Region 1 Haa Alifu, Haa Dhaalu, and Shaviyani	412.3
Region 2 Noonu, Raa, Baa, Lhaviyani	76.3
Region 3 Kaafu, Alifu Alifu, Alifu Dhaalu, Vaavu	817.6
Region 4 Meemu, Faafu, and Dhaalu	487.8
Region 5 Thaa and Laamu	1,443.9
Region 6 Gaafu Alifu and Gaafu Dhaalu	1,907.6
Region 7 Gnaviyani and Seenu	2,640.8

Source: Calculations based on DNP (2012a).

The inability to diversify exports leaves the economy dependent on a limited number of products. Most SIDSs have a high ratio of foreign trade to GDP. The Maldives' economy is largely dependent on tourism receipts and export of fresh and processed tuna. Table 4.2 compares the Maldives and other small islands economies' dependence on trade via-à-vis other economies. The table shows that, by and large, the Maldives' exports and imports as a percentage of GDP are very high versus other SIDSs and least-developed economies. In export concentration, the Maldives has increased as measured by the Herfindahl index.[84] The Maldives' index rose from 0.35 in the 1980s to 0.45 by 2013 (Table 4.3). The Maldives' exports are even more concentrated than those of Fiji and Mauritius, but less so than the other SIDSs. There is also a concentration in the destination of exports, with about half of total exports heading to France and Thailand. In terms of major exports, garments and fish products accounted for 92% of total export receipts during 1980–2004. However from 2005 on, the share of garments in total exports dropped to 1% following the termination of the preferential agreement on textiles and clothing in 2005.

In 2013, the share of fish and seafood products in exports rose to 93%. This is reflected in the rising value of the concentration index and illustrates the lack of export diversification (Figure 4.5).

Despite respectable growth in last few years, the Maldives' current account position has been volatile.

[84] The Herfindahl-Hirschmann Index is calculated as follows:

$$H_{ij} = 100 * \left[\frac{\sqrt{\sum_i \left(\frac{X_{ij}}{Xj}\right)^2} - \sqrt{\frac{1}{n}}}{1 - \sqrt{\frac{1}{n}}} \right]$$

where Xij is country j's exports of product i, Xj is country j's total exports, and n is the total number of products. The higher the index, which is bounded between 0 and 1, the more a country relies on fewer products for export earnings.

Table 4.2: Indexes of Trade Dependence 2010–2013 (% of GDP)

2010–2013	Exports as % GDP	Imports as % of GDP	(Exports + Imports) as % of GDP
All Countries	30.6	29.8	60.4
Least Developed	31.1	36.7	67.8
Lower and Middle Income	29.1	28.6	57.7
Upper Middle Income	29.6	27.6	57.2
Small States	51.1	65.5	116.7
Maldives	**100.1**	**92.7**	**192.8**

GDP = gross domestic product.
Note: The numbers are the averages of exports, imports, and trade for the period 2010–2013 and are expressed as a ratio to GDP.
Source: Calculations based on World Bank, World Development Indicators (accessed 23 February 2015).

Table 4.3: Export Concentration 1980–2013

Country	1980s	1990s	2000s	2010	2013
Barbados	0.28	0.20	0.19	0.17	0.26
Fiji	0.53	0.35	0.25	0.20	0.23
Maldives	**0.35**	**0.32**	**0.39**	**0.37**	**0.45**
Mauritius	0.45	0.30	0.26	0.19	0.22
Palau	...	0.50	0.74	0.90	0.92
Papua New Guinea	0.46	0.39	0.38	0.42	0.37
Samoa	0.37	0.62	0.56	0.49	0.28
Solomon Islands	0.38	0.51	0.65	0.74	0.65
Timor-Leste	0.25	0.30	0.68	0.44	0.95
Tonga	0.29	0.48	0.37	0.30	0.26
Trinidad and Tobago	0.49	0.27	0.40	0.44	0.50
Vanuatu	0.61	0.40	0.56	0.58	0.65

... = no data available.
Source: Calculations based on World Bank, World Development Indicators (accessed 23 February 2015).

The country's capacity to mitigate external threats and to recover from shocks is quite limited. The heavy dependence on imports for consumption and other inputs undermines the sustainability of growth in the medium to long run, especially when external shocks affect the macroeconomic stability that has been achieved in recent years. Although one way to address current account volatility is to diversify the economy and look for new export products and niche markets, the Maldives' limited natural endowments, lack of technical know-how, and insufficient infrastructure to facilitate trade hamper the country's ability to increase exports.[85]

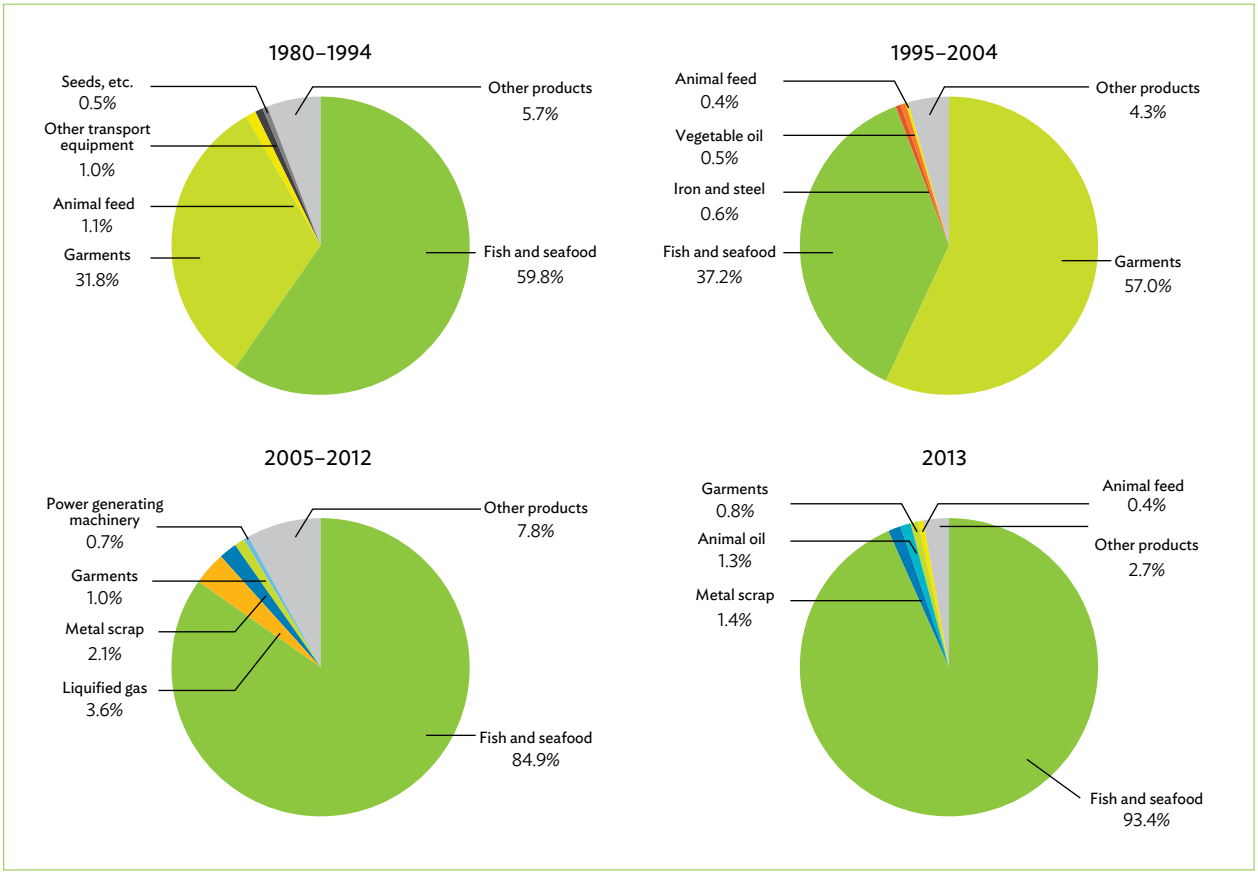
The high concentration of exports and volatility in the terms of trade suggest negative implications for the sustainability of growth in the medium to long term. What particularly impedes the process of structural transformation in the Maldives is its higher per unit cost of imports that, coupled with infrequent volumes of trade, has compounded the problem of remoteness and insularity. The absence of economies of scale, combined with remoteness and large distances from markets, results in suboptimal allocation of resources and lack of incentives for new investments.

Access to international markets and trade openness cannot be maximized when the cost of transport exacerbates the cost of trade. Winters and Martins (2004) show that small economies face significant input, production, and transaction costs and these translate into higher costs of doing business. The small, remote economies in general face cost disadvantages in sea freight and in utilities, which are factors needed to facilitate production and trade (Table 4.4). These disadvantages lower their gains or income from trade when compared to larger and better-located economies.

The Maldives' location, although not as remote as some Pacific countries, is one factor that makes imports and exports more costly. Given its archipelagic makeup, even interisland movement of goods and people is mostly via sea. With infrequent and inefficient transport service plus inadequate port infrastructure (see Chapter 2), the cost of transporting goods is high. Data on the cost of exporting a 20-foot container from the Doing Business 2014/2015 Surveys indicate that the Maldives' cost is high, at $1,625 (Table 4.5). This figure may understate the actual cost, as the data are only for traded products transported in a dry cargo, 20-foot, full container load; not requiring refrigeration or another special environment; and not requiring special phytosanitary or environmental safety standards other

[85] One view is that the export potential for small states lies mainly in markets where some form of quasi-rent (incentives) exists or can be created by preferences or other government support. The existence of rent in such economies seems to be a precondition for entrepreneurs to invest in new activities that otherwise would not be feasible due to high operating costs (Grynberg 2001).

Figure 4.5: The Maldives' Top Export Products, 1980–2013



Source: UNSD, UN Comtrade (accessed April 2015).

than accepted international standards, which may not be the case for the Maldives' tuna exports. Similarly, the cost of importing goods into the country is also relatively high.

A small and dispersed population is one cause of an unsustainable and large size of government. Cas and Ota (2008), using a fiscal dataset for 42 small states (including the Maldives), demonstrate that government size and country size are negatively related and that the result is statistically significant. The authors also provided evidence of an inverse relationship between country size and the amount of both public debt and external public debt in the small-state and large-country samples. Small states[86] tend to have higher government spending on goods and services, wages and salaries, and capital investment. The paper also revealed that small states tend to have bigger governments than large countries, as measured by both average total expenditure and most expenditure subcategories.

The government structure provided for under the 2008 Constitution of the Maldives resulted in expanding the bureaucracy. The Constitution created 7 provinces and 21 administrative divisions. It also provided for a unicameral parliament—the People's Majlis. Currently, the People's Majlis has 85 members, instated on 28 May 2014, with a term of 5 years.[87] Members are elected from multimember constituencies with the number of representatives being determined by the constituency's population size: two for the first 5,000 citizens and one additional representative for every additional 5,000 citizens.

[86] "Small states" are defined in the paper as developing and emerging-market countries that have a population of 2 million or less.

[87] People's Majlis website (accessed May 2015).

Table 4.4: Summary of Cost Disadvantages: Percentage Deviation of Costs from Those in the Average Economy

Cost Item	Island Population Size			
	Micro	Very Small	Threshold	Small
Air Freight	31.8	4.1	–1.8	–1.7
Sea Freight	219.6	70.5	20.5	9.1
Unskilled Wages	60.1	31.6	13.6	6.6
Semi-Skilled Wages	22.4	12.1	5.3	2.6
Skilled Wages	38.0	20.3	8.9	4.3
Telephone (marginal cost)	98.5	47.2	19.1	9.0
Electricity (marginal cost)	93.1	47.0	19.7	9.4
Water (marginal cost)	0	0	0	0
Fuel	53.8	28.3	12.3	5.9
Personal Air Travel	115.7	56.8	23.3	11.0
Land Rent	–3.5	–17.2	–14.2	–8.9

Notes:
(1) Maximum populations: Micro = 12,000 inhabitants, Very Small = 200,000 inhabitants; Threshold = 1,600,000 inhabitants; Small = 4,000,000 inhabitants, Average = more than 10,000,000 inhabitants
(2) The figures are averages of several specific costs such as types of fuel or transport.
Source: Winters and Martins (2004).

Table 4.5: Cost of Export and Import in Selected Small Island Developing States, 2014 ($ per container)

Country	Export	Import
Fiji	790	753
Maldives	**1,625**	**1,610**
Mauritius	675	710
Papua New Guinea	1,335	1,350
Seychelles	705	675
Tonga	515	500
Vanuatu	1,490	1,440

Source: World Bank (2014a).

The bureaucracy expanded further with the three-tier governance structure created through the 2010 Decentralization Act.[88] In addition, the judiciary had 164 judges and magistrates at the end of 2012 (DNP 2013).

[88] Two city councils, 19 atoll councils, and 181 island councils receive annual budgets from the Treasury, but also have the authority to generate own-source revenues (ADB 2011b).

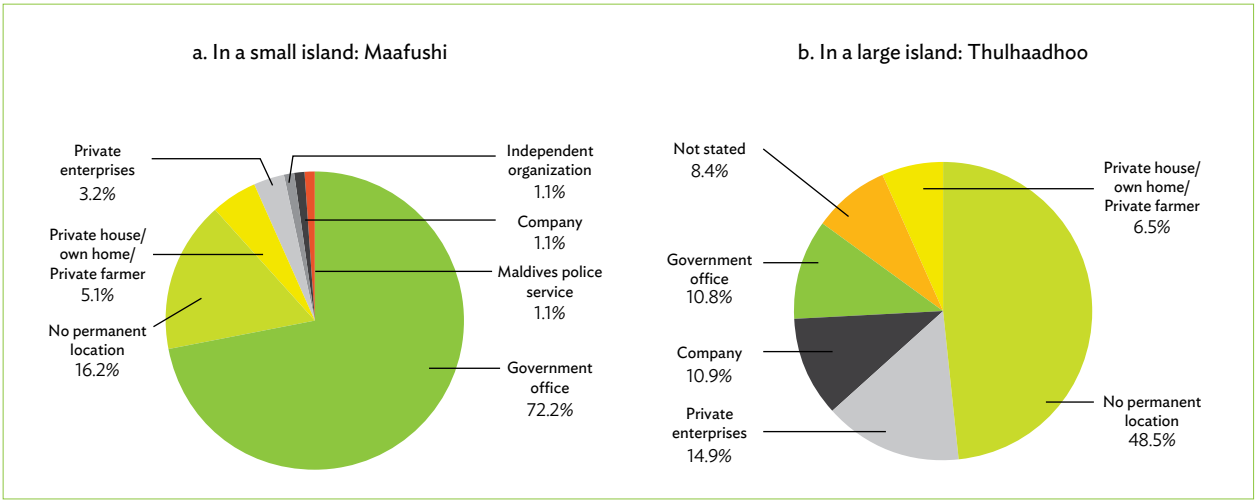
The Maldives also has 14 ministries and 7 independent agencies. As of 2012, there were 17,662 civil servants, of which 8,603 were male and 9,054 female. Forty-one percent of civil servants were employed in the education sector (DNP 2013).

With limited scope to expand economic activities due to the small population size and remote atolls with limited access to major islands and tourist resorts, the local economy cannot be sustained by fishing, agriculture, and retail trade. Thus, the outer and smaller islands rely heavily on government employment as a source of income. Data from the 2009 Household Income and Expenditure Survey indicate that civil servants comprised 70% of the employed work force of small islands, while atoll capitals and more populated islands had much lower shares. Similarly, incomes of people living or working in larger atolls and islands were higher due in part to tourism and tourism-related services. Figure 4.6 gives employment data for a representative small island and a larger island that is an atoll capital.

The 2009 Article IV Consultation for the Maldives highlighted that public employment and the wage bill were very high by international standards (IMF 2010a). Approximately 11% of the Maldivian population was employed by the civil service, a very high percentage compared to countries within and outside the subregion (Figures 4.7 and 4.8).

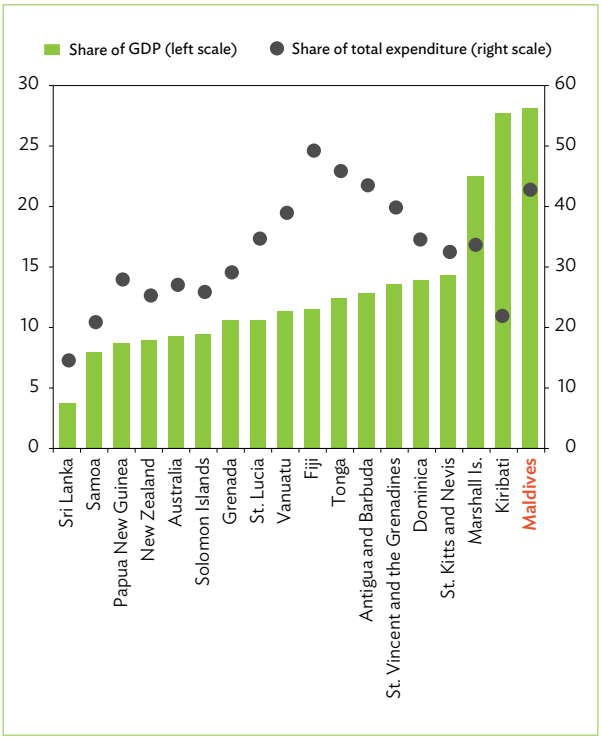
Current government expenditure was about 32% of GDP in 2012—well below that of some smaller Pacific islands (Figure 4.9). Nonetheless, there has been concern about the rising fiscal deficit driven primarily by the significant increase in current government expenditures, in particular the rapid increase in the salaries and emoluments of civil service staff starting in 2008 (Figure 4.10). Compensation or salaries constitute about 60% of total current government expenditures versus only 29% for Seychelles and 36% for Mauritius (Figure 4.11). This has prompted the government to initiate emergency reforms that were supported by the Asian Development Bank, International Monetary Fund, and World Bank, to work toward fiscal consolidation. The measures include reducing public spending to bring the public finances back to a sustainable level by restructuring

Figure 4.6: Employment, by Sector, 2010



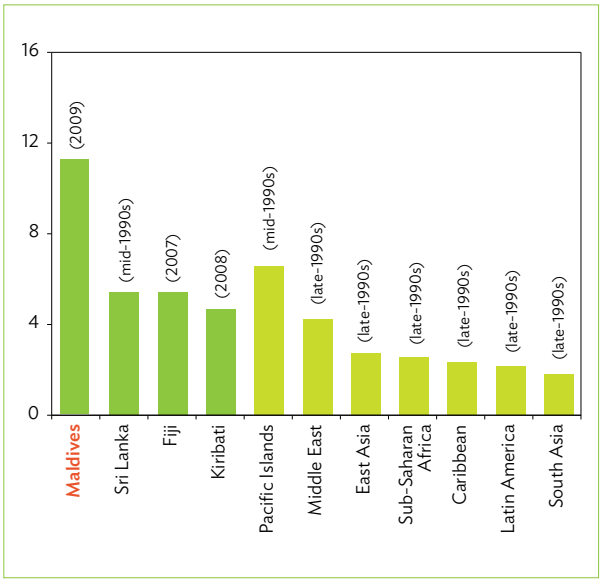
Note: "No permanent location" refers mostly to street vendors.
Source: Calculations on based DNP (2012a).

Figure 4.7: Percentage of Wage Bill in GDP and Total Expenditure



GDP = gross domestic product
Source: IMF (2010a).

Figure 4.8: Ratio of Public Sector Employees to Population



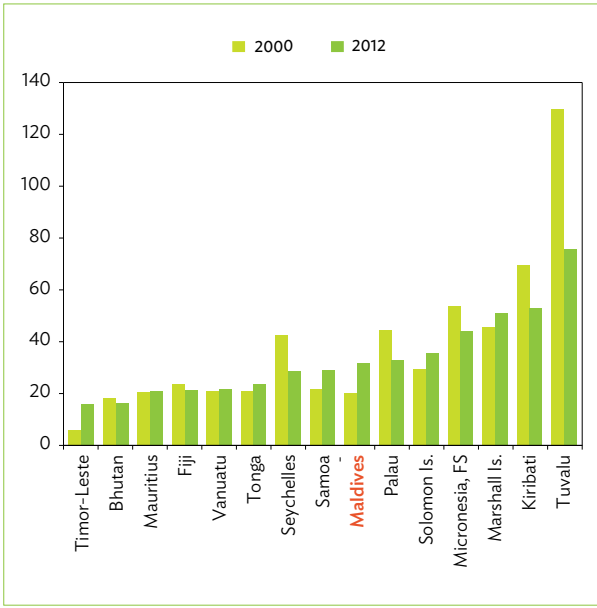
Note: Latest year available indicated in the parenthesis
Source: IMF (2010a).

wages, allowances, and other benefits and cutting other expenses.

Climate change and disaster risks are costly and difficult to manage. The most devastating natural disaster that affected the Maldives was the 2004 tsunami. Based on the EM DAT data, this resulted in 102 deaths, about 27,000 people affected, and damage estimated at $470 million.[89] In 2007, a series of swell tides of 3 to 4 1/2 meters high hit 68 islands and displaced 1,600 people. Providing coastal protection

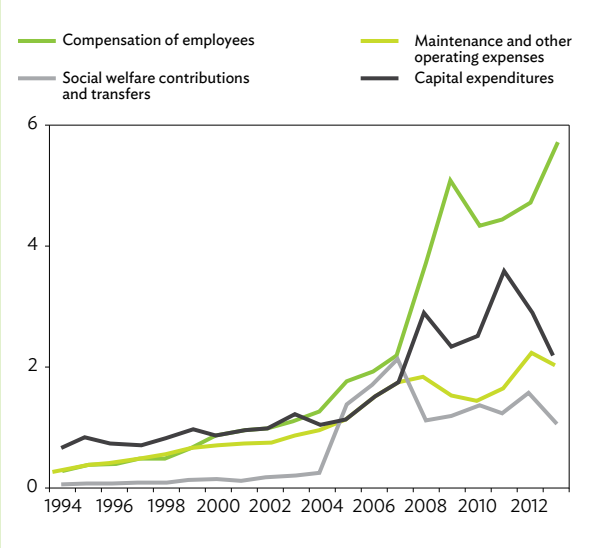
[89] EM DAT database accessed in March 2015.

Figure 4.9: Current Government Expenditure, 2000 and 2012 (% of GDP)



Sources: For Mauritius and Seychelles, World Bank, World Development Indicators (accessed April 2015); for other countries ADB (2014b)

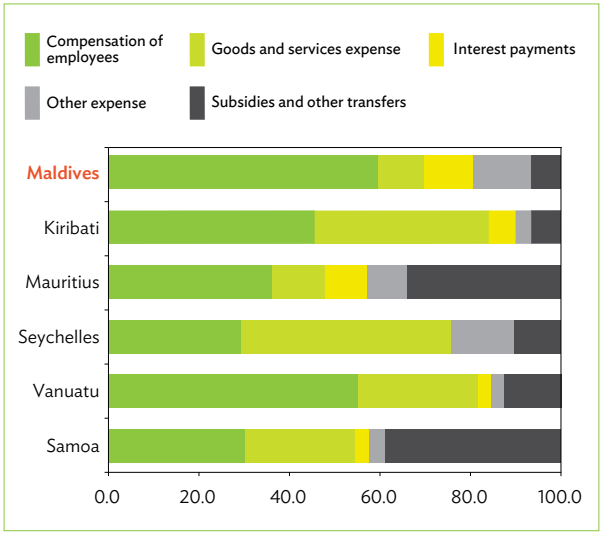
Figure 4.10: Government Expenditures, 1994–2013 (Rf billion)



Source: DNP (various years).

against erosion and flooding, and disaster risk mitigation facilities in all inhabited islands, will be very costly. The cost of coastal protection alone has been estimated at $1.8 billion in 2004 prices, which is a large amount for small economy (Shaig 2009).

Figure 4.11: Current Government Expenditure Components, 2012 (% of total)



Note: Social contribution is included in the compensation of employees while social benefits and transfers are in subsidies and other transfers. Goods and services expense is equivalent to maintenance and other operating expenses.
Sources: For Maldives, MMA (2013);. for Vanuatu, Vanuatu National Statistics Office, National Accounts of Vanuatu, 2012 Annual Report; for others, World Bank, World Development Indicators (accessed May 2015).

The global average surface temperature is forecast to rise significantly during this century, and sea surface temperature has been increasing in the Maldives. Corals are sensitive to changes in temperature, and an increase in global temperature may cause extensive coral bleaching. Coral reefs in the Maldives have multiple functions. They protect coastlines from large waves by acting as buffers, and they are home to live bait that fishermen use to catch tuna, a significant contributor to the country's exports. They are also a major attraction for tourists. The country's corals are also threatened by increased human activity within the Maldives, such as land reclamation, dredging, and garbage dumping, coupled with increasing global temperatures.

The Maldives has long taken a stance against carbon emissions, as a cause of rising sea levels. Over 80% of the country's landmass is less than 1 meter above mean sea level, and with the highest point only about 2.4 meters above mean sea level, the country could disappear over time as climate change causes sea levels to rise. In the last century, the global sea level rose by 1–2 millimeters yearly. The Intergovernmental Panel on Climate Change has projected a global rise

of 9–88 centimeters in sea levels between 1990 and 2100; in the worst-case scenario, this would entirely submerge the Maldives.[90] Extreme weather conditions such as droughts and floods are projected, along with increased intensity of tropical cyclones. Storm surge heights are expected to increase and potentially inundate even the largest island in the Maldives. Most, if not all, human settlement structures are near the coastline due to the small size of the islands. Rising sea levels, severe weather events, and storm surges could inundate housing and critical infrastructure.

With extreme climatic events expected to occur more frequently, it is critical for small island economies such as the Maldives to address this vulnerability and plan and invest in mitigation and adaptation measures to avert damage to property, infrastructure, and the domestic economy, and, most importantly, prevent the loss of more lives.

Environmental degradation has been increasing with the Maldives' pursuit of economic development. In the early stages of Maldivians' economic development, their lifestyle was simple and had a negligible impact on the environment. However, recent socioeconomic developments and growing population have led to a marked deterioration in the country's environment. With a very fragile and delicate ecosystem as well as vulnerability to the threat of global warming and sea level rise, the need for environmental management and planning has been acknowledged.

The Maldives' environment comprises a delicate and complex series of ecosystems that are unique. It has rich biodiversity and the coral reef ecosystem is one of the most productive ecosystems, ranging from microscopic plankton to large sea mammals. However, the country's small land area and population size, and the virtual isolation of a majority of its islands make their ecosystems, both on land and the sea, fragile. Current environmental issues have arisen due to the high population density and its concentration in a few islands, compounded by the increasing number of tourist resorts, making environmental management more difficult.

[90] Past readings show a rise of 1.7 millimeters per year in Hulhule' while the maximum hourly sea level has been increasing by approximately 7 millimeters yearly (Ministry of Environment and Energy 2011).

The more critical environmental issues identified include (1) beach erosion—severe cases have been reported in 57 inhabited islands and several resort islands; (2) coral mining, increasing the possibility of storm-induced erosion and flooding; (3) dredging that has damaged coral reefs and habitats of sea creatures; (4) land reclamation that increased the islands' susceptibility to flooding; (5) increased consumption patterns, including a major increase in vehicle numbers, which has contributed to significant compaction of road surfaces and consequent reduction in natural aquifer recharge; (6) lack of sustainable solid waste, sewage, and oil disposal systems, which are needed because these wastes, if not disposed of properly, can contaminate groundwater resources and destroy the Maldives' marine habitat; (7) fresh water aquifers that are being overused by the increasing population—currently, freshwater resources are at critical levels and, even with the installation of desalination plants to supply drinking water, the aquifers will be exhausted in the next few years; (9) soil degradation, a growing concern as the continuous removal of leaf litter and dumping or destruction by burning interrupts the recharge of nutrients (Khaleel and Saeed 1997).

The narrow financial sector limits mobilization of financial resources. Financial markets in most SIDS countries, including the Maldives, are relatively undeveloped. With a weak domestic financial market, the Maldives continues to face challenges in mobilizing financing effectively, both domestically and internationally.

Currently, the Maldives' banking sector lacks the capacity to provide the finance necessary to cater to the various facets of development. Historically, most of the credit in the Maldives has been channeled to large businesses and the tourism industry. Medium and small enterprises as well as low- and middle-income households lack access to long-term finance either for capital investment or permanent working capital needs. Micro, small, and medium enterprises, which are mostly engaged in retail trade, continue to face challenges in tapping financial institutions because of the lack of an enabling environment for accessing available financing. A key reason for the difficulty of access is the absence of institutionally organized credit information, which causes the financial institutions

to be conservative in their lending, charge very high interest rates, and base their lending decisions on collateral instead of cash flow. Chapters 2 and 3 discuss in detail the financial sector, including the challenges to accessing finance in the Maldives.

4.4. Conclusions and Way Forward

The Maldives has achieved remarkable growth in the last 2 decades. Tourism has been and continues to be the lifeblood of the economy. Following the tsunami and the global economic crisis, the country has had to rebuild and at the same time search for alternative growth drivers to support the economy when tourism receipts are severely affected. The macroeconomic challenges—persistent fiscal deficit and increasing current account and public debt—are compounded by the constraints of the Maldives' inherent geographical make up and low population density.

For the Maldives to address the economic and environmental vulnerability it confronts, it has to undertake policy measures to raise and sustain its growth and enhance its resilience to withstand external as well as internal shocks.

On the macroeconomic side, the government has to continue fiscal consolidation toward creating adequate fiscal space. One of the most effective ways to do this is to improve and change the composition of government expenditure; curb current spending, in particular transfers, subsidies, and wages; and maintain a level of capital spending adequate for development purpose. Such a strategy requires appropriate social safety nets to be put in place, targeted at the most vulnerable, as reducing current expenditure on public goods and services affects this group the most. While it may not be possible for SIDSs such as the Maldives to raise government revenues to the levels of other developing economies, it is important to strengthen domestic revenue mobilization efforts, including streamlining and simplifying tax administration and customs procedures, to help create fiscal space to support more development-related spending.

It is also important to improve the capacity of government institutions to plan and implement policies and programs to improve the quality of public service delivery (Cas and Ota 2008). Measures to enhance policy credibility (such as improving transparency; having credible and updated economic, social, and other data; and regularly conducting capacity building programs in planning, programming, and implementing programs) can help raise overall government effectiveness.

Establishing sound structural policies that can enhance long-term resilience to shocks while boosting growth potential is important. Implementing policies to enhance the business environment can increase private sector confidence to invest in the country. A good place to start is for policy makers to think of ways of improving the regulatory environment for business. Financial deepening and financial inclusion initiatives can also help private sector development and encourage micro and small enterprises, which can help address the inclusive aspect of growth.

The Maldives' narrow resource base and the associated high cost structure make exports less competitive in the international market. Although the provision of economic rents[91] can help, such a strategy may not be sustainable given the fiscal situation. One way to expand is to look for niche markets.[92] However, these markets, by their nature, can be short lived if not handled properly. The success of niche market activity hinges on appropriate trade and firm-level policies, and on the timely flow of information and efficient international market linkages. This would require a well-established and efficient information and communication technology and marketing network to facilitate the transactions.

[91] Economic rent is the positive difference between the actual payment made for a factor of production (such as land, labor, or capital) to its owner and the payment level expected by the owner, due to its exclusivity or scarcity. Economic rent arises due to market imperfections; it would not exist if markets were perfect, since competitive pressures would drive down prices.

[92] Fiji, for example, has been successful in exporting water—Fiji Water—a product for which developed countries pay a premium price.

Small island states such as the Maldives should consider a subregional approach to help mitigate the challenges associated with size and dispersed land area. Although it will require commitment and effort, subregional cooperation can help address the diseconomies of scale. For example, alignment of regulations and laws within the Maldives' subregion can lower transaction costs and reduce the need for instituting country-specific regulatory approaches. Promoting subregional integration can enhance exchange of knowledge and experience, which in turn can bring about subregional solutions for common issues small island states face.

Natural disasters take lives and damage property and infrastructure; they also disrupt economic activities and cause economies to contract. Preparedness for disaster risk mitigation and responsiveness in the event of natural disasters is important. Fostering resilience requires integrating such preparedness into the macroeconomic framework to enable the government to plan and provide for the spending requirements in times of need while at the same time ensuring fiscal prudence. The coordination for disaster preparation among government, donor partners, civil society, and the private sector must be strengthened, especially if funding is limited, the administrative capacity is relatively weak, and an institutional framework to respond to such events is poor.

Achieving and sustaining development in the Maldives and in other SIDSs is a complex and demanding task. It is important to understand the roles played by domestic and external factors in order to determine how to address the challenges. Economic resilience must be built by enhancing the country's economic base through sustained investment efforts to diversify its productive capacities, preferably in products that have niche markets, services, or activities that have greater value added and knowledge content.

Chapter 5
Policy Recommendations

The Maldives has been able to weather a major natural disaster and a global economic crisis and achieve respectable growth rates during 2005–2012. It has undergone considerable transformation from a subsistence-level economy dependent on fisheries to a low middle-income country with a growing services sector. A strong commitment to provide a conducive business environment for tourism development has propelled the country's growth performance. However, the benefits of growth have been spread unevenly across sectors and segments of the population. Many atolls, particularly in remote areas, continue to be marginalized. Employment generation has also been minimal. The key economic concerns facing the government are how best to (1) diversify the economy away from its heavy dependence on tourism, and (2) make the process of growth more inclusive. The current pattern of reliance on foreign direct investment in tourism and foreign labor for tourism and other services and professional activities has not spread the gains of growth to the less-skilled and less-educated population and to people living in the more remote atolls.

The policy choices facing the Maldives need to be understood with an appreciation of how the country's geography impacts its economy. The country's geography plays a major role in determining the constraints and growth possibilities open to the Maldivian economy. The country's archipelagic and environmentally vulnerable nature, combined with a small population dispersed across many islands, has compounded the problem of how to ensure that growth will be inclusive and sustainable. A shortage of skills, the impossibility of developing agriculture, the lack of connectivity, and high transport costs all make it difficult to diversify the economy and develop alternative exports to tourism and fisheries. The need for heavy expenditure to protect against climate vulnerability and to improve water transport links places pressure on the government capital budget. Furthermore, the need to rely on importing petroleum products at a time of rising world oil prices and the pressure to protect consumers from the most severe effects of these rises has created a continued demand for energy subsidies, putting further pressure on a tight government budget. In combination, these effects have contributed to a significant budget deficit that has been a nagging problem for the last 5–6 years. Funding this deficit has in turn affected both the cost of borrowing for the private sector and the availability of finance especially for micro, small, and medium enterprises (MSMEs) to generate employment and income.

5.1. Removing Critical Constraints to Inclusive Growth

The study uses a diagnostic approach to identify the most critical constraints to economic growth and to the reduction of poverty and income inequality in the Maldives. Of the many problems facing an economy, not all will be critical constraints, in the sense

that sustained growth cannot occur without their resolution. Given the Maldives' unique geographic features, the critical constraints on its inclusive growth relate directly to the dispersal of the relatively small national population across a series of poorly connected islands. This means that transport links are inefficient, costly, or unavailable, which in turn also makes it difficult to organize education and training, integrate the remoter communities into the national economy, and establish and develop sectors that can support economic activities even at the local level. Further, the need for investment to protect against and rehabilitate after adverse climatic events has contributed to a serious strain on government finances. Past methods of funding the budget deficit have in turn contributed to the problems of modernizing the financial sector to improve the system of financial intermediation. Based on these concerns, this report identifies the following key constraints to achieving sustainable and inclusive growth:

(1) **Inadequate and poor quality maritime infrastructure.** Without a considerably more effective transport infrastructure, private investment will not flourish because the cost of business operations will remain high, which in turn lowers returns to investment and thus holds back employment growth. At the same time, poor connectivity between outer islands and economic centers hinders access to basic social services.

(2) **Lack of professionals and highly skilled human resources.** The poor quality of and unequal access to higher secondary, tertiary, and vocational and technical education limits opportunities for productive and decent employment, particularly across atolls.

(3) **Weak macroeconomic management.** The fiscal debt is chronic and unsustainable and the public debt is increasing.

(4) **Poor and limited access to finance and other productive assets.** This is especially a problem for MSMEs.

Additional challenges must also be addressed in the medium term if growth is to continue at present rates.

(1) **Institutional and governance-related challenges.** Government effectiveness in managing resources and delivering public services, the rule of law, political uncertainty due to changes in government, and presence of irregularities in government-related transactions require attention.

(2) **Infrastructure-related issues.** Problems such as high electricity tariffs, the need to explore other sources of electricity supply, and availability of adequate water supply and sanitation systems need addressing.

In any economy, but particularly in developing countries, these two aspects can affect economic growth prospects. If the key economic imperative in the longer run is to diversify the economic base, this will require a more skilled workforce, an infrastructure system that delivers good connectivity in all senses, adequate funding for local investment, a stable macroeconomic situation, and an institutional base that can create an internationally competitive investment climate. The policy recommendations set out here are designed to address the short-, medium-, and long-run constraints that are imposed on the economy by its geographical position as well as emerging risks to macroeconomic management and institutional quality.

5.2. Achieving Inclusive Growth

5.2.1. Provide an Adequate Maritime Transport Network

Efficient maritime transport infrastructure is critical for archipelagic countries such as the Maldives; without improving its marine transport, the current rate of economic growth is unlikely to be maintained. Poor connectivity also hinders inclusivity by contributing to uneven growth in incomes and rising inequality between the atolls and Malé, and creates difficulties in accessing regional and global markets. Transport costs are high because of the long distances between islands and atolls; and the low volume of trading activity in small islands reduces profitability of the ferry service and has resulted in underinvestment in critical sea transport infrastructure.

Improving connectivity through adequate transport infrastructure and transport services, most importantly maritime transport, will facilitate efficient international and domestic trade, improve the population's market access, and attract private investment. The government has recognized this as a priority area to reduce disparities between Malé and other atolls. An integrated maritime transport service is one option. This has to start with improving the country's harbor infrastructure and maritime transport services, which in turn should be linked to the adopted population and development consolidation approach. The Maritime Transport Master Plan (MTMP) has already set out an important overview of the development needed. The more immediate actions for the short and medium term are listed below.

Short- to Medium-Term Measures

- Undertake a comprehensive assessment of the country's maritime transport infrastructure facilities and conduct a demand analysis and feasibility studies to prioritize implementation of high priority subprojects, especially those identified in the MTMP.
- Implement, within an agreed timetable, institutional and regulatory reforms recommended by the MTMP, such as (1) establishing a clearer and more efficient institutional arrangement for managing the sector; (2) establishing an independent and competent regulatory authority; (3) formulating a legal and institutional framework to attract private sector participation in infrastructure development and management, and transport service provision; (4) improving the capacity of institutions to formulate transport policies and to manage and regulate the sector; and (5) formulating clear guidelines on the scope for private sector participation in maritime transport (e.g. building regional port infrastructure, privatizing operation and management of ports, and providing maritime transport services).
- Prepare a plan for regular upgrading of port equipment, particularly handling facilities (harbor cranes, terminal trailers, reach stackers, and forklifts) and navigational equipment to enhance efficiency and capacity.
- Strengthen coordination among maritime transport authorities by setting up a monitoring system to improve efficiency of project implementation, i.e. by establishing a system to monitor project implementation and ensure transparency in project funds management.
- Review and institute a pricing strategy for maritime transport services that balances the objectives of financial sustainability, efficiency, and equity to encourage more private sector participation in maritime transport.

Medium- to Long-Term Measures

- Develop and implement a cost-efficient, integrated transport network covering air, road, and sea to improve the mobility of people and goods, increase and facilitate international connectivity, and ensure reliable and affordable transport services. This should take off from a comprehensive transport sector master plan that provides an assessment of the infrastructure of all modes of transport.
- Build infrastructure that will facilitate multimodal transport services, including interchange facilities for quick and efficient transfer of goods and passengers from international ships to domestic sea vessels.
- Provide continuing capacity building programs (recruiting, training, coaching, and mentoring) to enhance and develop competencies in agencies involved in the sector and extend these efforts to local maritime transport authorities.

5.2.2. Improve the Quality of and Access to Upper Secondary, Tertiary, and Vocational Education

The country has achieved universal access to basic education by rapidly expanding enrollment in primary schools. The next challenge is to provide high quality education and generate more and better qualified tertiary education and vocational graduates. The Maldives has not produced enough professionals and skilled workers for its modernizing economy.

The evidence presented in earlier sections suggests that the quality of education in the Maldives needs improvement and that this is central to improving the inclusiveness of growth. The government could now focus on improving the quality and access to education particularly at the upper secondary, tertiary, and vocational levels, which are critical for producing the professional and skilled workers required for growth. Because the education system is unable to supply the education, skills, and training demanded in the local labor market, unemployment among the youth is high as employers rely on foreign workers to fill vacancies.

Short- to Medium-Term Measures

- Prepare an investment program for upgrading and/or expanding higher secondary school infrastructure in the atolls and remote islands to improve access, especially at the secondary level.
- Expand the coverage of the scholarship program currently offered by the Ministry of Human Resources, Youth, and Sports to poor but well-qualified upper secondary and tertiary students, especially those from farther atolls. The program is for degree and nondegree courses based on approved eligibility criteria, i.e. household income, test scores, etc.
- Explore and promote innovative public–private partnerships to encourage private tertiary education providers to offer franchised education and e-learning.
- Improve the competency of teachers by providing a comprehensive teacher development program to upgrade skills especially of untrained local teachers. Provide onsite in-service teacher training and distance learning.[93]
- Regularly update and design the school and vocational and technical education curriculums to align them with international practice and respond to the skills required in the labor market.
- Develop the capacity for quality assurance of higher secondary and tertiary education by regularly conducting a national assessment of learning outcomes to monitor the performance of students at the higher secondary and tertiary levels.
- Institutionalize a system with the private sector for internship or on-the-job training programs to adequately prepare graduates for future employment and to provide them with work experience.

Medium- to Long-Term Measures

- Strengthen the technical and vocational education and training (TVET) system by establishing a TVET authority to oversee and coordinate all TVET programs, and facilitate TVET training in all regions of the country.
- Develop and implement an accreditation system for educational, vocational, and technical institutions to improve competency standards.
- Consider providing adequate incentives (monetary and nonmonetary) to attract young people to the teaching profession and to encourage them to work in the atolls (e.g. competitive salaries, housing for teachers deployed in the atolls, and opportunities for professional development).
- Explore distance learning as a means of delivering education, especially in remote islands, by using information and communications technology.

5.2.3. Macroeconomic Risks: Decrease the Fiscal Deficit and Improve Debt Management

The weak fiscal position has undermined the prudent macroeconomic management applied during 2000–2007. However, the government is committed to fiscal consolidation and to reforming its public financial management to achieve greater macroeconomic stability. As the government needs to prioritize capital expenditure to expand transport infrastructure and the provision of social services, the current structure of public finance raises questions about medium- to long-term fiscal sustainability. Higher expenditure will incur larger fiscal deficits and a higher level of public debt unless fiscal space is enhanced through more vigorous domestic revenue mobilization. The efficiency of government spending needs to be improved by prioritizing spending and reducing unnecessary increases in recurrent expenditures. On the revenue side, the government has made important progress

[93] This is suitable for the widely-dispersed islands of the Maldives as it reduces the travel cost and minimizes the absence of teachers from their schools.

in tax reform since 2011. The government should continue to explore ways to broaden the tax base and to step up efforts to improve tax administration, e.g. strict monitoring of the implementation of the Tourism Goods and Services Tax, Business Profit Tax, and General Goods and Service Tax.

To improve public financial management, the government has also taken important steps to implement some of the high-priority reforms identified as needed immediately by the 2010 Maldives: Public Financial Management—Performance Report, which was based on the 2009 Public Expenditure and Financial Accountability assessment (IMF 2010b). The following recommendations should be implemented to complete the reform program envisaged in that report.

Short- to Medium-Term Measures

- Establish a framework for monitoring and managing fiscal risks to enable the government to plan or act immediately on financial shortfalls, cost overruns, and unbudgeted costs, especially of unplanned expenditures.
- Operationalize modules under the Public Accounting System to have more accurate and timely monitoring reports on the budget, and enhance the cash flow and debt management system.
- Establish key parameters to guide government ministries in conducting their expenditure reviews to enable them to prepare a well-prioritized expenditure program.
- Consider rationalizing the granting of subsidies and cash transfers by improving the targeting mechanism to minimize leakage from the national budget.
- Consider implementing new tax measures to help broaden coverage and revenues e.g. personal income tax and excise tax on alcohol, tobacco, jet fuel, gasoline, and vehicles to raise more revenue. Explore the possibility of raising nontax revenues, e.g. increasing the import duty on selected goods and services and raising fees for selected government services.

Medium- to Long-Term Measures

- Implement the provisions of the Fiscal Responsibility Law (2014) to support longer-term fiscal goals through prudent fiscal policies that can increase accountability, mitigate fiscal risks, and support the government's fiscal consolidation efforts. This will require the government to lay out its medium-term strategy, including fiscal targets and accompanying revenue sources or measures. A medium-term strategy would also help improve budget formulation and allow for a more comprehensive assessment of the fiscal impact of new expenditure policies.
- Develop a training program for government staff to address capacity constraints in public financial management.
- Comprehensively review the government bureaucracy to determine appropriate ways to make it more responsive and efficient.[94]
- Review the overall performance of state-owned enterprises and identify those performing poorly that may be privatized.
- Periodically review the tax and nontax measures being applied as well as exemptions provided, to determine if they are responsive to the government's fiscal requirement and are reasonable to the business enterprises and the general public.

5.2.4. Enhance Access to Finance and Credit, Particularly for Micro, Small, and Medium Enterprises

Without following through with reforms undertaken in the financial sector, it is highly unlikely that the benefits of growth will be shared widely, because lack of access to finance is a key constraint on the business sector. To reduce the high cost of finance, it will be important for

[94] The government has recently implemented a scheme to streamline the bureaucracy and reduce the public sector wage bill. The Voluntary Retirement Scheme was funded from the first tranche ($16 million) of the Asian Development Bank's budget support program in 2010. Because the scheme was oversubscribed when it was first implemented in 2011, a similar program could be considered to further decrease the number of civil servants.

the government to continue with macroeconomic and financial policy reforms. Examples are bringing down the fiscal deficit and achieving fiscal consolidation; strengthening the banking system by introducing more competition; and increasing the accessibility of banking services, the lack of which significantly constrains the expansion and diversification of MSMEs. As discussed in Chapters 2 and 3, the wide dispersion of the Maldives' islands and people has been a barrier to establishing bank branches in the atolls and, while the advent of mobile banking technology promises to ease the constraint to accessibility, the appropriate legal and regulatory framework for mobile phone transactions has not been fully set up. Only the payment and the anti-money-laundering regulations are in place; consumer protection and agent network regulations are still to be issued by the Maldives Monetary Authority (World Bank 2014d). Thus, while the government implemented the Maldives Mobile Banking Project as a mechanism to make banking services more accessible, the mobile payment system was put in place but has not been operationalized (World Bank 2008). The population in remote atolls continues to use significant amounts of cash and time to travel to Malé for cash-related transactions.

As discussed in Chapter 2, the government and the Maldives Monetary Authority have recently introduced major reforms in the financial sector such as the Maldives Banking Act (2010) and the Islamic Banking Regulation, and the establishment of the Credit Information Bureau, which have served to strengthen the financial system. Financial reforms were also implemented in 2011 to manage liquidity in the market and ease the pressure on the exchange rate by allowing the central rate to fluctuate within a horizontal band of 20% on either side of a central parity. The government also enacted the Small and Medium Enterprise Act of Maldives in April 2013 to strengthen MSMEs (UNDP 2013b). On 16 July 2013 the President of the Maldives established the SME Council, which is mandated to develop a national integrated strategy to promote the MSME sector. The government also implemented the Inclusive MSME Development Project, aimed at enhancing MSMEs' access to finance by providing the Bank of Maldives with a credit line facility that pilot tested credit assistance for MSMEs in designated regions and created a central movable asset registry to facilitate the use of collateral for business financing.[95] Additional important policies are needed to ease access to credit particularly (but not exclusively) for MSMEs.

Short- to Medium-Term Measures

- Review and improve the prudential regulations (especially the regulations on single borrower limits, asset classification and loan loss provisioning, and foreign currency exposure limits) to encourage banks to provide more credit to MSMEs.
- Design effective government support systems such as credit guarantee mechanisms; insurance products; a liquidity pool; and business development services, including institutionalized support for creating and enforcing market linkages.
- Adopt a legal and regulatory framework that will allow for various modes of branchless banking such as in-store point-of-sale systems (permitting cashless payments using credit, debit, or prepaid cards); internet banking (permitting virtual connections with banks and their branches); and banking agents (outsourced bank branches). In addition, guidelines for consumer protection are needed that establish the rights, liabilities, and responsibilities of customers and financial institutions relating to such transactions.
- Review institutional arrangements governing microfinance and monitor their operations to determine if coverage can be expanded. Introduce more business development services to extend the reach of microfinance institutions by including savings associations and community and village cooperatives.
- Strengthen the Credit Information Bureau and extend its coverage to collect and facilitate sharing of information on MSMEs, improve information quality, reduce credit risk, and establish a secured transaction registry providing information on fixed and movable assets.

[95] Business development centers were also established. They assist small business owners and entrepreneurs to start to grow and compete in the domestic and global markets by providing quality training, counselling, and access to resources. A cost-sharing facility designed to meet MSMEs' special needs, with additional capacity development of related government support agencies and chambers of commerce was also created. Finally, the small and medium enterprises can tap into the Cost Sharing Facility to fund their training needs: see http://bdsc.com.mv.

- Provide MSMEs with technical support services, including training on financial planning, development, and marketing of financial products.
- Implement policies to strengthen the country's land and housing markets and enhance creditors' rights and property rights to build a collateral base for entrepreneurs, especially MSMEs.
- Conduct financial literacy campaigns and training courses for MSMEs, particularly in the outer atolls, to help them with loan applications and financial planning.

Medium- to Long-Term Measures

- Continue to strengthen the Maldives Monetary Authority's overall regulatory role for the financial sector by adopting international best practice.
- Adopt regular stress testing of commercial banks' abilities to withstand shocks (interest rates, exchange rates, and nonperforming loans) to ensure consumer confidence and continuous banking services especially in times of crisis.

5.3. Managing Key Challenges

It is widely recognized that in all economies, the prospects for growth can be undermined by macroeconomic instability, a poor investment climate, and (in particular) a lack of protection for property rights. Thus, even if the critical constraints previously discussed are addressed, growth can be threatened unless emerging governance and institutional concerns are addressed.

Political changes bring about policy uncertainty. Government effectiveness deteriorates when government resources can be mismanaged or irregularities in government transactions persist. These can undermine the impact of public sector investment and increase the private sector's cost of doing business. Without a dynamic private sector it will be very difficult to achieve the objectives of economic diversification and greater inclusion. The resolve to continue with a democratic political framework has been tested by the recent political turmoil and the adherence to the rule of law and the preservation of democratic processes are to be commended. The government needs to continue the reforms it has started to improve the investment climate in the country. Strengthening the institutions and rule of law can help improve access to productive assets, facilitate effective public service delivery, and minimize negative effects from incidences of corruption and irregularities in government-related transactions.

The Maldives has initiated improvements of aspects of governance, including modernization and innovation in the delivery of public services under the Civil Service Strategic Action Plan 2011–2015, revisions and introduction of new provisions under the Anti-corruption Act, and proposals to expand the powers and role of the Anti-Corruption Commission. The government has also prioritized the strengthening of internal governance by improving its operational governance and actively engaging the community to address criminality.

5.3.1. Strengthen Governance and the Rule of Law

Short- to Medium-Term Measures

- Strengthen the technical capacity of staff in the newly formed independent legal institutions, particularly the Supreme Court, Prosecutor General's Office, Judicial Service Commission and Employment Tribunal, Police Integrity Commission, and Auditor General's Office.
- Provide additional resources to expedite processing of court cases by using modern technology and facilitating the establishment of alternative dispute resolution mechanisms.
- Create public awareness of fundamental rights and establish a unit responsible for compiling and publishing laws and disseminating judicial decisions.
- Strengthen the mechanism through which the public can file complaints in situations where they feel have been deprived of their rights.
- Introduce legislation that clearly establishes property rights, especially relating to land access, to encourage investment and allow land to be used as collateral for lending for business-related activities. Other initiatives to support

establishment of property rights include easing restrictions on the transfer of land; facilitating the process for businesses or individuals to sell, lease, bequeath, mortgage, and improve land; completing the cadastral survey; establishing a property registry to keep accurate records of ownership; and allowing fast and inexpensive land transfer to help reinforce security of property rights.

Medium- to Long-Term Measures

- Review, and if needed, revise the legal education and training institutions to strengthen the legal profession.
- Establish an effective court-based alternative dispute resolution mechanism, including arbitration, mediation, and conciliation, for matters referred to the civil and family courts.
- Explore ways to promote access to justice by developing alternative systems, such as mobile courts, that will increase the accessibility to judicial services especially in the atolls.

5.3.2. Strengthen Institutions

Short- to Medium-Term Measures

- Strengthen and improve the Civil Service Commission to include establishing and enforcing a code of conduct and requirements for qualifications and experience for members of the civil service.
- Ensure that mechanisms are in place for effective resource utilization within the civil service.
    - Periodically review remuneration provided to civil servants to ensure that it is adequate given living standards and other economic indicators.
    - Strengthen internal oversight mechanisms within the civil service, such as internal mechanisms to monitor public procurement, and ensure the Auditor General's recommendations are implemented.
    - Develop a system of regular assessments of training needs derived through a comprehensive competency framework.
- Improve the dissemination of information on government activity by upgrading websites and portals of the Civil Service Commission and all ministries, departments, and agencies.

5.3.3. Eliminate Irregularities in Government Transactions and Enhance Government Effectiveness

Short- to Medium-Term Measures

- Strengthen the Anti-Corruption Commission's independence to make it more effective in fighting corruption by providing more power to initiate investigations and prosecute on its own initiative without prior government approval (TI 2014). Provide the commission with funding to undertake its mandated functions or give it formal guarantees of financial independence.
- Review and strengthen laws and regulations on corruption following international best practice and renew commitments to international agreements and conventions, such as the United Nations Convention against Corruption.
- Enhance transparency in government decision-making, for example by using e-procurement for government transactions and by ensuring full information disclosure on tender procedures and contract awards.
- Establish accountability and reporting mechanisms to make government officials accountable for their actions by requiring all public sector officials and employees to submit declarations of their income, assets, and business interests, and make them publicly available.
- Draw up and make public comprehensive and transparent codes of conduct for all public officials and standard operating procedures for issues concerning public finances. Penalties for not complying with the code should be stated clearly and enforced.

Medium- to Long-Term Measures

- Increase participation of business associations, including small-scale businesses, in policy dialogue on issues concerning government transactions.

- Engage the support and involvement of media, nongovernment organizations, and other civil sector groups to take a proactive role, especially in monitoring public procurement and the implementation of government projects.
- Incorporate civic education and the values of integrity and honesty in the national educational curriculum.

5.4. Addressing Challenges Typical of a Small Island Developing State

Small island developing states (SIDSs) face unique challenges in raising growth and more importantly addressing inequalities. For the SIDSs to raise and sustain their growth path and to enhance their resilience to deal with economic and environmental vulnerabilities, they have to continue building policy buffers and strengthening efforts to implement measures that can achieve inclusive economic growth.

To achieve macroeconomic resilience, adequate fiscal and external buffers are needed to withstand the external shocks. Some of the high priority initiatives include

- formulating a medium-term fiscal framework to help ensure budget is available for priority projects and protected from revenue volatility;
- strengthening domestic resource mobilization by streamlining and simplifying tax administration and customs procedures to help increase revenue collection to create more fiscal space;
- improving the composition of public spending, especially in infrastructure, education, health, and social protection, which are keys to fostering inclusive growth.
- prioritizing government expenditure and rationalizing current spending to maintain capital spending for development purposes at the current or a higher level;
- creating a contingency budget so government can respond quickly in times of shocks, disaster, etc., when public spending must increase temporarily to support the economy; and
- strengthening public financial management in the processes covering aggregate control, prioritization, accountability, and efficiency in managing public resources and delivering services, which are all critical to achieving the government's objectives.

To improve growth performance, the public sector will require strong partnership with the private sector. In order to do this, implementing policies conducive to enhancing the business environment can increase private sector confidence to invest in the country. This would require

- designing, implementing, and/or upholding laws and/or policies that protect property rights;
- ensuring that costs and procedures for starting a business are affordable, clear, and simple; and
- leveling the playing field for new entrants.

The SIDSs' narrow resource base and the associated high cost structure impact the competitiveness of their exports in the international market. To enable economic diversification and enhance competitiveness of small island economies, the following actions could be prioritized:

- Diversify in labor-intensive sectors through well-designed policies to encourage employment (beyond tourism, for example, to other subsectors such as information technology and financial services).
- Explore niche markets; provide appropriate trade and firm-level policies, including time-based incentives; and facilitate international market linkages. This requires establishing efficient information and communications technology and a marketing network to facilitate the flow of transactions.
- Ensure that structural inefficiencies (such as high transport or energy costs, labor market rigidities, etc.) are reduced or eliminated by addressing the bottlenecks.
- Carefully assess the impacts of exchange rate adjustment. Understanding the role of exchange rate policy in strengthening competitiveness is important.
- Pursue subregional trade and cooperation to help mitigate the challenges, such as diseconomies of scale. A subregional approach can encourage the alignment of regulations and laws, which can

lower transaction costs and reduce the need for country-specific regulatory approaches and can bring about subregional solutions for common issues SIDSs face. The Maldives could adopt the 2014 South Asia Sub Regional Economic Cooperation Strategy, as the country shares common trade facilitation issues with the other members of the South Asia Subregional Economic Cooperation.

Strengthening institutions and improving governance will always be a key part of a government reform agenda. To help improve public service delivery and therefore address the resulting inequality in a number of SIDSs, a high priority is conducting regular capacity building programs to improve the institutional capacity of government institutions to plan and implement policies and programs to improve the quality of public service delivery.

Natural disasters kill people and damage property and infrastructure; they also disrupt economic activities and cause economies to contract. Preparing for potential disasters through risk mitigation and planned responsiveness is important. Fostering resilience requires integrating the potential for natural disasters into the macroeconomic framework to enable the government to plan and provide for the spending required in times of need while at the same time ensuring fiscal prudence. Strengthening the coordination for disaster preparation among government, donor partners, civil society, and the private sector is essential, especially in vulnerable countries.

5.5. Conclusions

The Maldives' relatively strong economic growth has brought about a dramatic reduction in poverty and improvement in the welfare of the Maldivian people. However, the growth, which is primarily driven by the tourism sector, has been highly cyclical and vulnerable to external shocks, and unable to create adequate jobs for the growing young population. Moving forward, the Maldives needs to shift to a more broad-based, sustainable, and inclusive growth strategy given its resource endowments and small population. Transport infrastructure is critical, and improved transport will help address the country's connectivity issue and reduce the cost of doing business. An educated and skilled workforce can improve productivity and help find additional economic niche markets for the country. As with all countries, the government must remain aware of the importance of maintaining fiscal stability and an adequately functioning system of financial intermediation to enable and support both public and private investments needed in the growth process.

This study aims to provide support to the Maldivian government in formulating its high-priority policies by identifying the critical constraints to achieving inclusive growth. The report provides policy recommendations aimed at helping the government to overcome the constraints to achieving a process of growth that is both sustained and inclusive.

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Maldives: Overcoming the Challenges of a Small Island State
Country Diagnostic Study

The Maldives has propelled itself to middle-income status despite its geographic constraints and the risks it faces as a small island economy. The economy has been growing in the last 5 years, but development challenges remain formidable. How can the Maldives sustain and improve the pace of its economic growth and reduce poverty and inequality? This report identifies the critical constraints to inclusive growth and discusses policy options to overcome such constraints.

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