Maldives Public Expenditure Review

Restoring fiscal health

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Acknowledgments

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The exchange rate used throughout this report is US$1 = MVR15.4.

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CHAPTER 1

Macro-fiscal overview

Summary

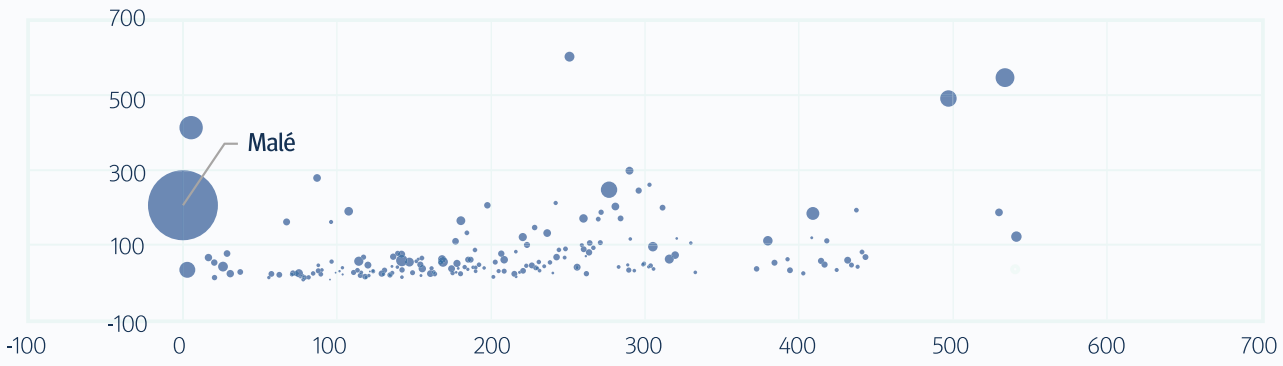
Maldives has made a remarkable recovery from the historic crisis induced by the COVID-19 pandemic, but it remains highly vulnerable to multiple external shocks and lacks the fiscal buffers to confront them. Public debt and guarantees now exceed the size of Maldives' entire economy, and are projected to remain so even if economic growth accelerates. To achieve its development goals without causing potential economic crises, Maldives needs to collect more revenues especially from domestic sources, make wiser spending decisions, and borrow more judiciously.

1.1 Maldives has made a strong recovery, but it is not yet out of the woods

Like other small island states, the Republic of Maldives (henceforth "Maldives") has unique characteristics that pose considerable development challenges. These include:

1. **A small, highly dispersed population:** With over half a million inhabitants[1] and less than 300 square kilometers of total land area, Maldives is the smallest and most densely populated country in South Asia. It is also highly geographically dispersed, with some islands located as far as 200 kilometers away from the capital, Malé (Figure 1). Over a third of the population lives in Malé and the remainder are spread across 187 other islands.[2] The lack of economies of scale drives up the cost of delivering public services across the archipelago. Costly infrastructure investments to improve connectivity or to mitigate the risks of sea-level increases are needed regardless of the size of the population or area. The small, highly dispersed population means that Maldives faces high costs of delivering basic services, as well as a limited domestic revenue base.
2. **A large public sector:** Maldives has a relatively large state, with the public wage bill at 11 percent of GDP (see Chapter 5). This is, however, not uncommon for small island developing states (SIDS), where public services need to be provided to small, dispersed populations, and where private employment opportunities are often limited. Half of all full-time workers were employed in the public sector in 2019.[3] While most jobs held by men are in the private sector, employment for females is more concentrated in the public sector.
3. **Limited near-term prospects for economic diversification:** Tourism and associated services directly account for a third of Maldives' GDP,[4] half of its revenues and the bulk of private sector jobs. While the COVID-19 pandemic has prompted the government to accelerate economic diversification, opportunities outside tourism are limited in the near-term. The scarcity of land and other natural resources constrains domestic production and leads to a heavy reliance on imports, especially for fuel and

Figure 1: Maldives is a small, but widely dispersed country
Y-axis: land area (hectares); X-axis (distance to capital city in kilometers)



Source: Statistics Maldives 2021a, staff calculations.
Note: Each bubble represents an inhabited island. Bubble size refers to population as of the 2014 Census (latest available). Excluding the Greater Malé region, only 9 inhabited islands have more than 3,000 residents.

[1] Statistics Maldives 2021a. The estimated population as of 2020 was 557,426.
[2] Ibid. According to the 2014 census. An estimated 38 percent of residents lived in Malé in 2020.
[3] Data on resort employees from Statistics Maldives (2020a); data on public sector from 2019/20 Household Income and Expenditure Survey or HIES (Statistics Maldives 2021b).
[4] The indirect contribution of tourism to the economy is much higher.

construction materials. While digital transformation could contribute more to growth, the local labor force does not yet have the requisite skills.[5] The Maldivian economy is thus expected to remain heavily reliant on tourism in the near term, and is hence susceptible to various external shocks such as global pandemics, political and economic turmoil in its main tourism markets, and heightened uncertainty.

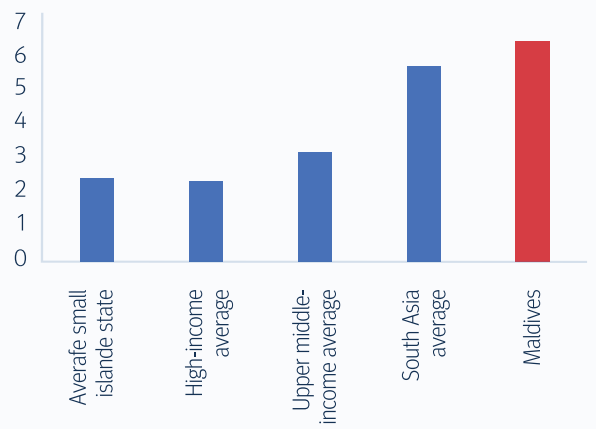
4. **Vulnerability to climate change:** Over 70 percent of Maldives' total land area is lower than 1 meter above mean sea level, and the bulk of critical tourist and other infrastructure is located within 100 meters of the country's shorelines.[6] As such, Maldives is highly vulnerable to a rise in sea levels, extreme weather events, temperature increases and floods.[7] In 2004, the Indian Ocean tsunami battered the islands and claimed approximately 100 lives; it damaged or destroyed almost 9,000 houses, and caused severe damage – estimated at US$470 million – to the physical infrastructure of many islands. While such events are rare, more than half of all inhabited islands already experience floods and freshwater shortages on an annual basis,[8] and weather events frequently disrupt the delivery of goods, services, and fuel to more remote islands. In the longer term, erosion of the coral reef could affect Maldives' comparative advantage in tourism. Changes in sea surface temperature and ocean pH would impact the fisheries sector, a key source of income and critical to livelihoods in the atolls.

5. **Despite these challenges, Maldives has managed to achieve high growth and rapid poverty reduction over the past few decades.** Endowed with a rich marine ecological system, Maldives has been able to develop a successful high-end tourism sector that has driven rapid economic growth and income convergence with richer countries.[9] Prior to the COVID-19 pandemic, real GDP grew by 6.4 percent annually on average between 2010-2019, faster than other peers (Figure 2) albeit volatile due to the high dependence on tourism (Figure 3). The unique "one island, one resort" model[10] has attracted a large amount of foreign direct investment and foreign exchange, boosting average household incomes. Poverty is low by upper middle-income standards: in 2019, only an estimated 1.7 percent of the population lived below the international poverty line of US$5.50 (PPP) per person per day.[11] Inequality, as measured by the Gini coefficient, was estimated at 29.3 points, relatively low compared to a selection of peers.[12]

6. **However, several major development gaps remain.** First, there are wide spatial disparities between Malé and the atolls. For example, only 27 and 48 percent of households residing in the atolls have access to safe drinking water[13] and improved sanitation respectively, versus nearly universal access in Malé.[14] Similar disparities persist in access to and the cost of broadband internet. The cost of transporting essential goods such as water

Figure 2: Before the pandemic, Maldives had grown faster than its peers...

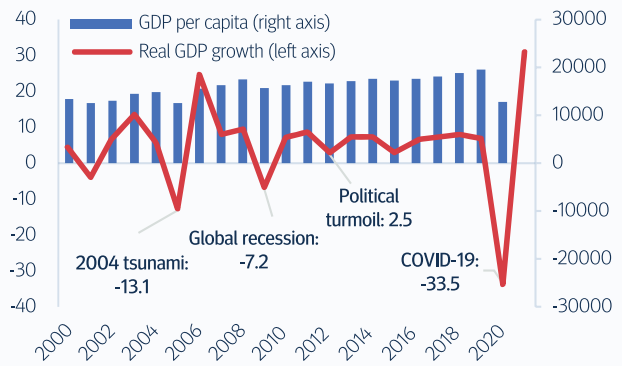
Average real GDP growth, 2010-2019, percent



Source: IMF WEO and WDI, staff calculations.

Figure 3: ...but growth has been highly volatile due to its high dependence on tourism.

Real GDP growth (%) / GDP per capita, constant 2017 US$



Source: Source: Statistics Maldives, staff calculations.

[5] World Bank 2021a. Only 13 percent of youth who are eligible to enroll in tertiary education do so. Only 5 percent of tertiary graduates pursue science, technology, engineering, and mathematics programs.

[6] Government of Maldives 2015. All four international airports are within 50m of coastline. All utilities facilities, approximately 70 percent of all fisheries infrastructure, more than 75 percent of communications infrastructure, almost all tourist accommodations are located within 100m of coastline.

[7] WBG and ADB 2021. Maldives ranks 113 out of 181 countries in the 2020 ND-GAIN Index, which assesses a country's vulnerability to climate change as well as its adaptive capacity.

[8] Ibid. There are no rivers or streams, and few wetlands or freshwater lakes in Maldives.

[9] In 1980, Maldives was among the poorest countries in the world, with a GDP per capita of US$268. Sustained and fast growth has enabled Maldives to narrow this gap, reaching upper-middle-income status in 2010.

[10] 159 islands are designated exclusively for resort tourism. Each island only has one resort.

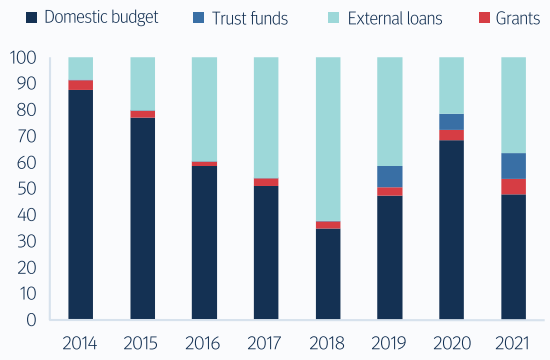
and fuel, and basic services such as health and education, to outer atolls is also extremely high. Second, a steady stream of migrants from outer atolls to Malé in search of better amenities and opportunities has driven up the cost of housing and led to overcrowding in the capital. Notwithstanding this, in 2019, the median income in Malé was twice as high as that of the atolls.[15] Third, while Maldives enjoys universal literacy, large human capital gaps persist. Only a third of the population under 19 years of age has completed higher secondary education.[16] Maldives also performs much worse than regional and small island peers in terms of secondary and tertiary education completion rates.[17]

7. **To address the housing deficit in the Greater Malé region, close development gaps between Malé and the atolls and boost economic growth, Maldives has significantly expanded public investment in recent years.** In 2015 and 2016, the government tripled spending on mega-infrastructure projects under the Public Sector Investment Program (PSIP) to help close Maldives' development gaps. Most of the funds were directed towards the construction and development of airports, harbors, water and sanitation infrastructure, and large public housing projects in the Greater Malé region (see chapter 2). Most of these projects were undertaken by state-owned enterprises (SOEs) and financed by external borrowing (Figure 4), leading to a rapid increase in guaranteed debt from 2 percent of GDP at end-2015, to 15.9 percent at end-2019.[18] As a result, the public and publicly guaranteed debt (PPG) ratio rose by some 24 percentage points of GDP over the period of four years, reaching 79 percent in 2019 (Figure 5). This ratio rose even further due to additional borrowing and the large GDP contraction during the COVID-19 pandemic in 2020 (see section 1.3).

8. **Maldives has made a remarkable comeback from the historic recession induced by the COVID-19 pandemic.** In 2020, the COVID-19 pandemic led Maldives to close its borders for three months. The sudden stop in tourism led real GDP growth to contract by 33.5 percent. However, since the reopening of borders in July 2020, Maldives' tourism recovery has been exceptionally strong, especially compared to other SIDS (Figure 6). Straightforward entry requirements, the unique "one island, one resort" concept, and a rapid COVID-19 vaccination rollout are some of the factors that have supported this strong recovery. In 2021 Maldives recorded 1.3 million arrivals, only 20 percent below the historic 2019 record (Figure 7). Resilient demand from India and Russia (which together accounted for 40 percent of all visitors in 2021) compensated for the

Figure 4: Public investment projects have been increasingly financed by external sources...

Share of PSIP spending by financing source, percent



Source: MoF, staff calculations.
Note: External loans include guarantees. Data for 2021 are preliminary

Figure 5: leading to a doubling of public debt and guarantees even before the pandemic.

Percent of GDP

Source: MoF, staff calculations.
Note: Up-to-date as of March 14, 2022.

[11] World Bank 2022c. Staff calculations using 2019-2020 HIES.
[12] Average of 40.6 for upper middle-income countries; 35.2 for South Asia (excluding India). Most small island states do not report Gini coefficients. Source: World Bank WDI data.
[13] According to Maldives' HIES 2019 methodology, safe drinking water is defined as water (including rainwater) that has been purified either by boiling, chlorinating or filtering.
[14] Statistics Maldives 2020b
[15] Statistics Maldives 2021b. The median monthly income per household is MVR 23,500 (US$1526) nationally. In Malé, it is MVR 32,575 (US$2115) per month, double the level (US$974) in the atolls.
[16] Ibid.
[17] World Bank 2021b.
[18] As long as the sovereign guarantee is not called, it does not represent an expense in the fiscal accounts. To date, no guarantee has been called in Maldives.

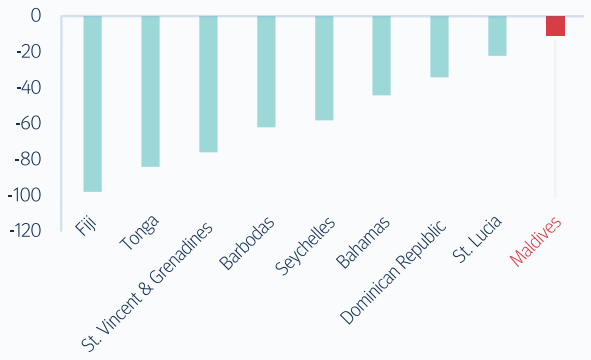
absence of tourists from China, which had accounted for a fifth of all tourists before the pandemic. Real GDP growth is thus estimated to have rebounded by 31 percent in 2021.[19]

9. **Nonetheless, the Maldivian economy is not yet out of the woods.** Even before the pandemic, Maldives had consistently recorded a budget deficit of 6.3 percent of GDP on average, nearly triple that of other upper middle-income countries and more than twice as large as other SIDS. As the next section illustrates, the deficit has been driven by a large expansion in public infrastructure investment and generous social spending. Despite a significant drop in revenues due to the COVID-19 pandemic in 2020, Maldives maintained a high level of spending as a share of GDP, leading the fiscal deficit and public debt to balloon to 24 and 150 percent of GDP in 2020 (Table 1). Despite the strong recovery, both ratios remain elevated. External financing needs are also sizeable; the current account remains at double-digit levels as a share of GDP, as import growth has accelerated to meet the demand from tourism and construction. Higher global fuel prices, induced by the ongoing Russia-Ukraine war, have also driven up the fuel import bill by an estimated 0.4-0.7 percent of GDP (World Bank 2022b). Usable reserves (netting out short-term liabilities) stood at US$405 million at end-March 2022, equivalent to only 1.9 months of goods imports. Moreover, with a fixed exchange rate, Maldives has limited policy instruments to cope with future shocks.

10. **To reduce these imbalances, Maldives can undertake three sets of reforms.** It can (i) **raise more revenues** from both international and domestic sources; (ii) c**urtail the high growth of public expenditures** by making spending more targeted and efficient; and (iii) **improve the management of public debt and guarantees**. For (ii), this would require more efficient and targeted spending

Figure 6: Maldives' tourism recovery has been exceptional compared to other small island states...

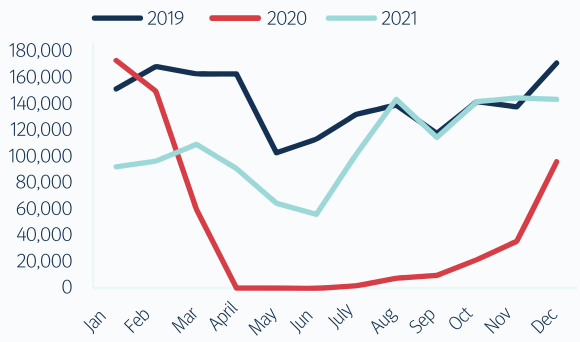
Change in real tourism receipts, 2021 vs 2019



Source: MoF, staff calculations.
Note: External loans include guarantees. Data for 2021 are preliminary

Figure 7: with tourist arrivals rebounding to pre-pandemic levels since H2 2021.

Number of tourist arrivals



Source: MoF, staff calculations.
Note: Up-to-date as of March 14, 2022.

Table 1: Key macroeconomic indicators, 2016-2021 (as a share of GDP, unless otherwise stated)

	2016	2017	2018	2019	2020	2021
Real GDP growth (year-on-year, %)	6.3	7.2	8.1	6.9	-33.5	31.0
Exchange Rate (MVR/US$)	15.4	15.4	15.4	15.4	15.4	15.4
Inflation, consumer prices (period average)	0.5	2.8	-0.1	0.2	-1.4	0.5
Current account balance	-23.5	-21.6	-28.4	-26.6	-35.5	-35.5
Total revenues	27.6	27.7	27.2	26.9	26.4	25.8
Total expenditures	37.6	30.8	32.5	33.6	49.9	43.4
Primary Balance	-8.2	-1.6	-3.5	-4.9	-20.7	-14.0
Overall Balance	-10.0	-3.1	-5.3	-6.7	-23.5	-17.7
Public and publicly guaranteed debt	58.5	64.5	73.9	78.8	150.3	125.2

Source: MoF and Statistics Maldives for 2016-2020; staff projections for 2021. Current as of April 1, 2022.

[19] 2021 real GDP growth was revised to 37 percent in June 2022, after the cut-off date for this publication.

on infrastructure and health (see Chapter 2), more transparent and equitable public wage bill management (see Chapter 5), and reformsto reduce duplications in the public pensions system (see Chapter 6). For (iii), it could reduce fiscal risks from SOEs (see Chapter 3), and reduce reliance on costly external financing for public housing (see Chapter 4). As the remainder of this chapter will show, action is needed in all three areas to restore Maldives' public finances back to a sustainable path.

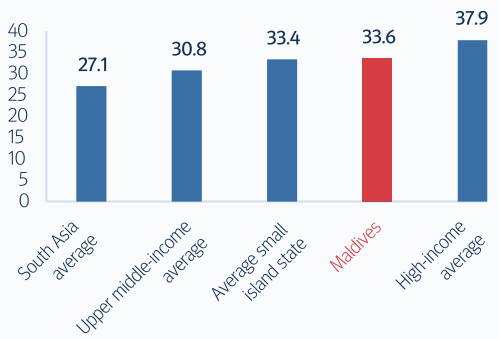
11. **Such reforms will involve some trade-offs, but acting now will help Maldives achieve faster, more resilient growth over the medium and long term.** Although the government has outlined an ambitious Strategic Action Plan (2019-2023) to close development gaps,[20] Maldives lacks adequate resources to finance this plan. While Maldives can continue to borrow to finance its spending needs, the global environment is currently highly uncertain, with every indication of tighter financing conditions over the medium term. Any sudden stop in external financing and/or a materialization of other fiscal risks could quickly wipe out hard-earned gains in growth and development. As many countries' experiences show, the rapid accumulation of debt is often associated with the increased risk of financial crises, sovereign debt defaults, and banking crises that are economically and socially costly (IMF 2016; Kose et al 2019). To avoid such a situation, Maldives needs to spend more wisely and find ways to raise additional revenues – including from domestic sources.

1.2 Expenditures have been increasing, with limited impact on near-term growth

12. **Like other SIDS, Maldives is a big spender.** Prior to the COVID-19 pandemic, public expenditures in Maldives amounted to about a third of nominal GDP, slightly ahead of other upper middle-income countries but on par with the average SIDS (Figure 8). High spending was initially driven by post-disaster reconstruction works after the 2004 Indian Ocean tsunami, but later by an expansion of the public sector under the 2008 constitution,[21] the public sector wage bill, generous social spending, and substantial increases in capital spending. The spending-to-GDP ratio remained relatively constant at around 30 percent from 2010-2014, then rose to an average of 34 percent between 2015-2019 and spiked to 50 percent in 2020 due to the deep economic contraction. Spending has remained high at 43 percent of GDP in 2021 despite the recovery.

Figure 8: Maldives spends more than the average upper middle-income country, but on par with other SIDS

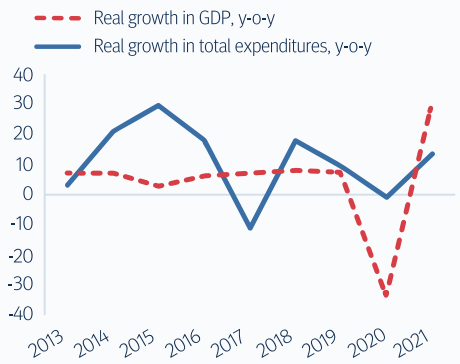
Average public expenditure 2010-2019, percent of GDP



Source: IMF Fiscal Affairs Database, October 2021

Figure 9: Growth in public spending has outpaced that of GDP since 2014...

Average public expenditure 2010-2019, percent of GDP



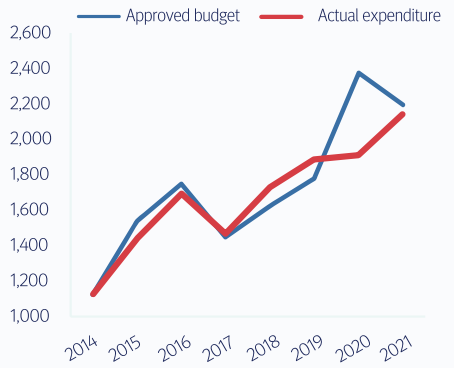
Source: IMF Fiscal Affairs Database, October 2021

[20] The plan has been scaled down and renamed as the "National Resilience and Recovery Plan" since the COVID-19 pandemic, but it remains ambitious relative to the country's domestic financing capacity.

[21] Under Maldives' Constitution of 2008, the public sector was further expanded by establishing new independent commissions and offices as well as administrative decentralization, which contributed towards higher public spending.

Figure 10: Approved budget ceilings have grown at an unsustainable pace...

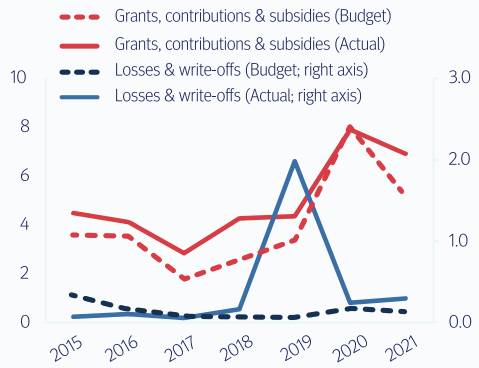
US$ millions, real terms



Source: MoF, staff calculations

Figure 11: ...and the government tends to overspend on subsidies, losses and write-offs.

Percent of GDP



Source: MoF, staff calculations

13. **The pace of public spending has picked up significantly in recent years.** Between 2014 and 2019, total public expenditures (measured in real terms) grew at a compound annual growth rate of 11.6 percent, almost double the average pace of GDP growth (6.5 percent) during the same period. Except for a one-off fiscal consolidation effort in 2017 and the large COVID-19-related rebound in 2021, total expenditures have grown faster than the economy every year (Figure 9). This, coupled with positive correlations between almost all components of public expenditures and the business cycle, suggests that public spending policies have been highly procyclical in Maldives. Like many other emerging economies, the ability of expenditure policy to act as an "automatic stabilizer" in times of economic crises is thus limited (see Frankel et al 2013; Galeano et al 2021). As Chapter 2 illustrates, the increase in public spending has mostly been driven by a rapid expansion in public investment, but also other recurrent items such as subsidies and wages.

14. **Budget ceilings have grown at an unsustainable pace.** The approved budget ceiling has steadily risen over the last several years, by an average of 11 percent per annum over 2014-2021. In 2020, prior to the pandemic, the government had approved a 32 percent increase in total expenditures. These large increases have generally been directed towards capital expenditures; however, the government typically only spends 82 percent of the capital budget allocation (see Chapter 2).

15. **While there is generally a small divergence in budget execution, the government has consistently overspent in some areas**. Budget execution has been mixed: the government underspent the overall budget in 2015-2016, while overspending it by a small margin in 2017 and by a larger amount (6-7 percent) in 2018 and 2019 (Figure 10). Nonetheless, the government tends to overspend on grants, contributions, and subsidies, as well as losses and write-offs. Between 2015 and 2021, overspending on these items amounted to 0.3 and 1 percentage point of GDP, respectively (Figure 11). Overspending was most acute in 2018 and 2019. In 2018, for example, the government spent nearly double the amount it allocated on electricity subsidies due to higher-than-expected global oil prices and a policy decision to reduce electricity prices in atolls (MoF 2019). The government also spent more than double the amount it originally budgeted on social welfare, as outstanding Aasandha arrears, of US$33 million that were not previously accounted for, were cleared. In addition, the government has spent much more than it anticipated on losses and arbitration charges to private companies over contractual disputes.[22]

16. **Higher public spending does not appear to have translated into faster economic growth so far.** While more public investment in infrastructure projects has fueled growth in the construction sector over the past few years, there is little evidence that higher public spending has had a more meaningful impact on the overall level of growth in the short-term. A preliminary estimation of the expenditure multiplier in Maldives shows that it is small (see Box 1) and consistent with what the literature predicts for a highly indebted small open economy (Ilzetzki et al 2013). One possible explanation is that PSIP projects are mostly dependent on imports of capital goods and foreign labor, and hence do not induce a large increase in domestic production. Unless such investment is accompanied by measures to improve domestic productive capacity, Maldives' infrastructure investment push may have a limited impact on medium- and long-term growth. Cross-country studies show that the welfare effects of public

[22] In 2019 alone, the Government paid US$68 million to several companies for unlawful termination of contracts by the previous administration, notably Noomadi Resorts (US$55 million). More recently, in 2021, a Malaysian construction and property developer sued the government of Maldives over unpaid dues of US$23 million from HDC. The latter payment was made off budget.

infrastructure investment are highly dependent on the productivity and effectiveness of spending (Bom and Ligthart 2014 and Ganelli and Tervala 2015).

17. **There is little room to reallocate resources across categories of spending during the fiscal year.** While there is no standard methodology to define expenditure rigidity, these are generally understood as spending items that are not subject to the discretion of the authorities during the fiscal year. In Maldives, "high rigidity" expenses comprise salaries and wages, interest payments, capital expenditure financed by external loans and grants, and arbitration losses; while "medium-rigidity" expenses comprise allowances, pensions, social transfers, and some domestically financed capital expenditures by the Green Fund, which are earmarked for environmental projects. As shown by Table 2, nearly two-thirds of Maldives' budget is comprised of these high and medium rigidity expenses, a share that has not changed much over time. International experience indicates that relatively high shares of rigid components of public spending are a constraint for fiscal consolidation (Munoz and Olaberria 2019). This occurs especially when wages, pensions, and interest payments are above what economic fundamentals would suggest.

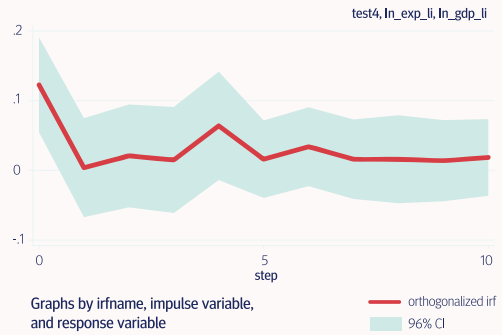
Box 1: Estimating the fiscal multiplier in Maldives

A fiscal multiplier measures how much an economy's GDP changes in response to a public spending or tax policy shock. Estimating the fiscal multiplier in Maldives is tricky given that historical fiscal data is not available for a long period of time. Nonetheless, as a first pass, quarterly expenditure and GDP data from 2013Q1 to 2021Q1 are used to estimate the fiscal multiplier. The data are log-transformed, de-seasonalized and deflated, and then linearly detrended to remove underlying trends. Following Blanchard and Perotti (2002), it is assumed that output does not have a contemporaneous effect on fiscal policy variables, i.e., total government expenditure is not affected by shocks to GDP within the same quarter. A two-variable Structural Vector Autoregressive (SVAR) model is used to identify expenditure shocks.

Estimates suggest that the impact of higher public spending on economic activity has been very limited. The econometric analysis confirms that output grows as government expenditure increases; however, this multiplier effect is very small and short-lived. A one percent increase in total spending leads to an immediate increase in GDP by 0.12 percent (significant at the 5 percent level) in the same quarter, but the multiplier becomes insignificant in subsequent quarters and fades to zero over the longer horizon of 10 quarters (Figure 12). These estimates are far below unity, indicating that the increase in GDP is much lower than the initial increase in spending. The analysis is, however, limited by the relatively short period of available economic and fiscal data in Maldives. As a further examination, we differentiated government consumption and investment spending. The impulse response for government consumption shock looks very similar to Figure 12 with a similar magnitude. However, the impulse response for investment shock is not significant at all, indicating that this multiplier effect for investment spending could be limited due to the high import-content of infrastructure spending.

Figure 12: The growth impact of higher public spending appears to be limited in Maldives

Y-axis: percent, X-axis: number of quarters



Source: World Bank staff estimates.

Source: World Bank staff estimates based on data from Ministry of Finance and Statistics Maldives.

Table 2: 60-70 percent of Maldives' budget can be considered rigid

	2014	2015	2016	2017	2018	2019	2020	2021R
High rigidity	**28**	**28**	**32**	**35**	**39**	**34**	**26**	**30**
Salaries and wages	21	18	16	18	16	16	15	14
Interest payments	6	6	5	5	5	5	6	8
Externally-financed capital expenditures	1	3	12	13	17	7	4	7
Losses and write-offs	-	-	-	-	0	5	1	1
Medium rigidity	**41**	**34**	**28**	**29**	**32**	**32**	**35**	**35**
Allowances	15	13	11	13	13	13	13	12
Pensions	8	7	6	6	6	5	5	5
Trust-funded capital expenditures	0	0	0	0	0	1	1	2
Grants, contributions and subsidies	18	13	11	9	13	13	16	16
Low rigidity	**31**	**38**	**40**	**36**	**30**	**34**	**39**	**36**
Goods and services	17	20	15	15	15	16	15	18
Domestically-financed CAPEX	14	19	25	21	14	18	25	18

Source: MoF, staff estimates. 2021 refers to revised budget estimates.

1.3 Debt vulnerabilities have increased significantly in recent years

18. **Debt is at unprecedented levels, exceeding the size of Maldives' entire economy.** Total public and publicly guaranteed debt stood at US$6.1 billion or an estimated 125 percent of GDP as at end-2021.[23] Domestic and domestically-guaranteed debt account for the bulk of total debt (65 percent of GDP), while external and externally-guaranteed[24] debt account for the remainder (60 percent of GDP). Even excluding guarantees, central government direct debt stood at US$5.2 billion or 107 percent of 2021 GDP (see Table 3). These figures do not include advances from the central bank, which has occurred since the suspension of the Fiscal Responsibility Act (FRA) in April 2020.[25] Moreover, fiscal risks – mostly stemming from guaranteed and on-lent loans, as well as trade payables, subsidies and capital injections to SOEs – are estimated at about US$2.5 billion or 45 percent

Table 3: Even before the pandemic, Maldives' debt was already high

	in US$ millions				as share of GDP			
	2018	2019	2020	2021	2018	2019	2020	2021
Domestic direct debt	**1,907**	**2,156**	**2,760**	**3,188**	**36.0**	**38.5**	**73.8**	**65.3**
Short-term	975	1,231	1,564	1,975	18.4	22.0	41.8	40.5
Long-term	821	861	1,139	1,172	15.5	15.4	30.5	24.0
MMA Bond	400	395	390	385	7.6	7.1	10.4	7.9
Pension recognition bond	223	230	236	243	4.2	4.1	6.3	5.0
MVR Treasury Bond	198	223	246	265	3.7	4.0	6.6	5.4
US$ Treasury Bond	-	13	266	279	-	0.2	7.1	5.7
Domestic guaranteed debt	**110**	**64**	**56**	**41**	**2.1**	**1.1**	**1.5**	**0.8**
External direct debt	**1,336**	**1,432**	**1,621**	**2,046**	**25.2**	**25.6**	**43.4**	**41.9**
External guaranteed debt	**672**	**827**	**1,239**	**876**	**12.7**	**14.8**	**33.1**	**17.9**
Public and publicly guaranteed debt	**3,915**	**4,415**	**5,619**	**6,110**	**73.9**	**78.8**	**150.3**	**125.2**

Note: 2021 real GDP growth was revised to 37 percent in June 2022, after the cut-off date for this publication.

[23] Estimate current as of end March 2022.
[24] Domestic guaranteed debt accounts for only 1 percent of GDP while a large portion of domestic PPG debt is direct borrowing of the government.
[25] As at end-March 2022, advances to the government from the Maldives Monetary Authority (MMA) were at US$118.5 million. In April 2020, the Parliament had approved a one-year suspension of certain clauses of the FRA to enable the government to borrow more from the central bank. In November 2021, Parliament approved the government's request to extend the FRA suspension until December 2023.

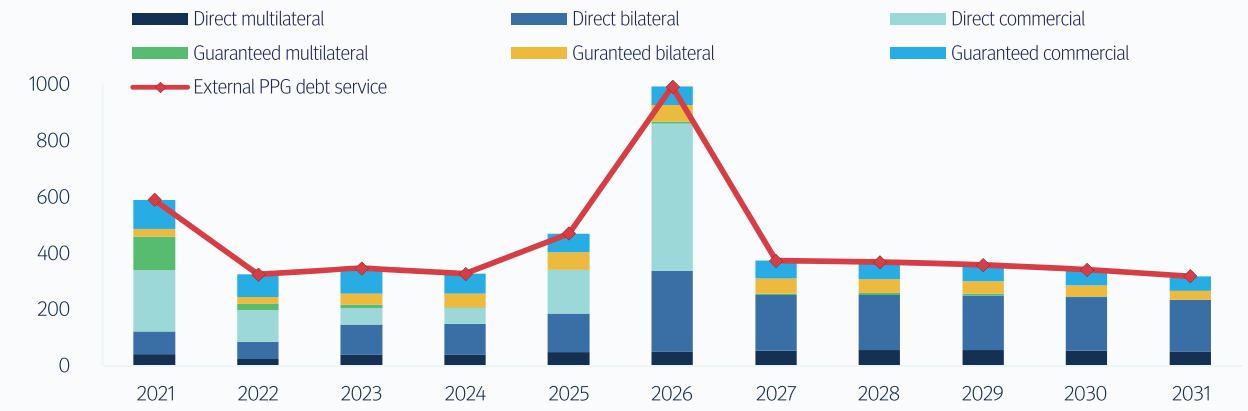
of 2019 GDP (see Chapter 3). While such risks have not materialized, Maldives lacks the fiscal space to address any potential fallout to public finances, should they occur.

19. **Not all new borrowing during the pandemic was directed towards short-term needs.** Although Maldives' debt was already high prior to the pandemic, a sharp increase in borrowing occurred in 2020-2021 as the government contracted new loans and guarantees to cope with the revenue shortfall that occurred due to the COVID-19 pandemic. Notably, these included a five-year US$500 million sukuk (accompanied by a liability management operation)[26] and US$250 million from the Government of India (channeled as domestic debt – see US$ treasury bonds in Table 3).[27] However, the bulk of new commitments contracted during this period was directed towards infrastructure projects. The government signed several lines of credit with the Export-Import Bank of India (EXIM India) for the Greater Malé Connectivity Project (US$400 million), defense projects (US$50 million) and sports infrastructure (US$40 million), and obtained guarantees worth US$246 million for the development of social housing and roads in Hulhumalé. Most of these projects began to be disbursed in 2021.

20. **Maldives is at high risk of external and overall debt distress.** In the latest published Joint World Bank-IMF Debt Sustainability Analysis (April 2020), all indicators except the debt-to-exports ratio breach their respective thresholds under the baseline scenario. Debt was assessed to be sustainable on the strong assumption that capital spending would be reduced, but this has not occurred. Rather, the government has maintained a high level of capital spending.[28] While the sukuk issuance and the associated liability management operation reduced short-term rollover risks (from the US$250 million Eurobond due in 2022), it has contributed to a huge bunching of repayments in 2026, when the US$100 million sovereign bond (placed in Abu Dhabi and initially due in 2023), in addition to the US$500 million sukuk come due. Total debt service costs on existing debt are expected to jump to US$900 million in 2026 (Figure 13) – equivalent to an estimated 16 percent of 2019 GDP or 60 percent of 2019 revenues. Although the Sovereign Development Fund could partially finance some of these repayments, these revenues are unlikely to be sufficient to repay external debt service costs.[29]

21. **Debt transparency and debt management have improved, but have failed to curtail large increases in public debt.** In recent years, Maldives has made several improvements in debt transparency: it began to publish a Medium-Term Debt Strategy, semi-annual Public Debt Bulletins, quarterly debt statistics, audited public debt and guarantee statements, and information on PSIP projects financed by sovereign guarantees. It also published its first fiscal risk statement in 2021 (MoF 2021a). As a result, Maldives is among the best performers in the South Asia region and among small island states in terms of debt reporting (World Bank 2021c). Moreover, the government has now centralized the issuance of domestic securities within MoF's Debt Management Department (DMD). Nevertheless, there is room for improvement in both debt transparency and debt management (see section 1.5). This is evidenced by the fact that Maldives has not adhered to the legal limit for public debt of 60 percent of GDP, as stipulated by the Fiscal Responsibility Act (FRA).

Figure 13: External debt service costs on existing borrowing are projected to reach nearly US$1 billion in 2026
US$ millions



Source: Data obtained from MoF, staff calculations.

[26] In March 2021, the Government of Maldives issued a five-year US$200 million sukuk (profit rate: 10.5%). A further US$100 million was raised through a tap issuance in April 2021. Proceeds of the sukuk were mainly used to roll over 76 percent of the US$250 million Eurobond due in 2022, with the remainder going towards budget financing. In September 2021, the government tapped the existing sukuk to raise US$200 million at 10.5%.
[27] This was done through a branch of the State Bank of India in Malé.
[28] In 2020, the government postponed PSIP projects that had not yet been awarded due to the pandemic, but proceeded with ongoing projects.
[29] Proceeds from the Airport Development Fee and dividends from the state-owned airport operator, MACL, are transferred into the SDF and earmarked for debt repayment. As of early June 2022, the SDF Fund amounted to USD 264.8 million, of which USD72.1 million consists of long-term investments. The remainder of the SDF is included in Maldives' foreign reserves (source).

1.4 Revenue collection on par with peers, but overly reliant on external sources and plateaued pre-pandemic

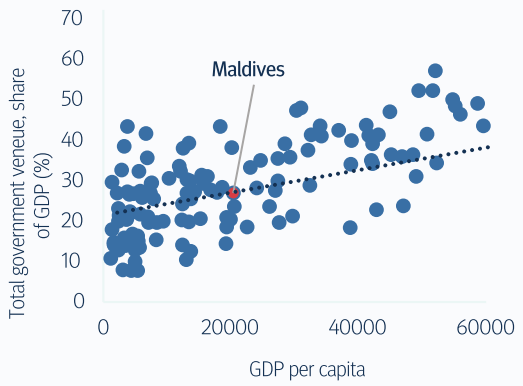
22. **Maldives collects an average amount of revenues compared to most of its peers.** Prior to the pandemic, between 2017 and 2019, Maldives' revenue-to-GDP ratio[30] averaged 27.3 percent – higher than the South Asia average, but comparable to other small island states and upper middle-income countries (Figure 14). Tax revenues make up the bulk of total revenues and grants, averaging 19.6 percent of GDP. Maldives collects a comparable amount of domestic revenues, but it is relatively less dependent on grants compared to other SIDS (Figure 15). It also collects a more substantial amount of non-tax revenue (mostly resort and land rent, and dividends from SOEs)[31] compared to its income and regional peers.

23. **Heavily dependent on international tourism, revenues are extremely vulnerable to external shocks.** Tourism-linked revenues directly contribute about half of total revenues (including grants) in Maldives. Indirectly, this proportion is likely to be even higher, as tourism is the main driver of economic growth. Most tourism-linked revenues (80 percent) are taxes, comprising the tourism Goods and Services Tax (GST), an Airport Service Charge, a per-night Green Tax[32] and a portion of import duties.[33] Non-tax tourism revenues are collected through an Airport Development Fee and on rents from resorts. Looking solely at tax revenues, tourism GST accounts for more than a third of the total (Figure 16).[34] This is not surprising as the tourism GST rate is twice the non-tourism GST rate (12 versus 6 percent respectively). Like other SIDS, trade taxes account for about 19 percent of Maldives' total tax revenues. These are mostly paid by tourists, since import duties on alcohol, animal products and other luxury goods are high and predominantly consumed by resorts. All in all, this high dependence on tourism revenues means that Maldives has few buffers in the event of external shocks, as evidenced by the COVID-19 crisis.

24. **Compared to peers, Maldives collects relatively little direct tax on income, profits and capital gains from local firms and households.** Prior to the introduction of the Personal Income Tax (PIT) beginning January 2020, Maldives did not collect any direct tax revenues from households (Figure 17), unlike most of its income, regional and even small island peers. Even in 2020 and 2021, PIT accounted for only 0.1 and 0.3 percent of 2019 GDP, respectively. This is far below the level collected in other tourism-dependent SIDS such as Fiji (2 percent of GDP), Jamaica (3.3 percent), Cabo Verde (3.8 percent) and Seychelles (5.9 percent).[35] Analyses by the World Bank and IMF suggest that the income tax threshold is too high to be a meaningful source of income – at MVR 720,000 (US$46,753 or nearly five times per capita income), many

Figure 14: Maldives' revenue ratio is comparable to countries of a similar per capita income level...

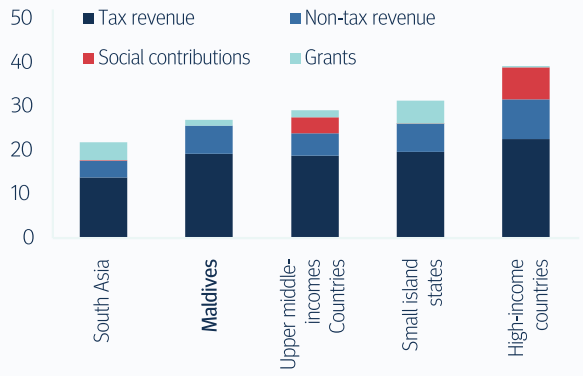
Y-axis: percent of GDP; X-axis: GDP per capita



Note: Data refer to 2019.
Source: IMF WEO data, World Bank WDI, staff calculations

Figure 15: ...but less dependent on grants compared to other SIDS.

Percent of GDP



Note: Simple average for groups. Data refers to 2019 when available, otherwise 2018. Countries with no information on 2018 were dropped from the sample.
Source: UNU-WIDER Government Revenue Dataset Version 2021, staff calculations

[30] Revenue numbers reported in this section include grants unless otherwise specified.
[31] Non-tax revenues have been variable over time, averaging 6.6 percent of GDP over the past decade. Roughly one-third of these revenues comes from rent from resorts. Dividends from SOEs also make up a sizeable portion of non-tax revenues (17 percent on average between 2012 and 2020) and are a significant source of revenue variability. The remainder of non-tax revenues consists of fees, charges, fines, and penalties.
[32] The Green Tax is payable by tourists who stay in tourist resorts, hotels, vessels, and guesthouses. It is payable at the rate of US$6 per day of stay in tourist resorts, hotels, and vessels (effective November 2015); and US$3 per day of stay in tourist guesthouses (effective October 2016). Green Tax receipts are earmarked for renewable energy, coastal protection and other environmental protection projects.
[33] Import duties on alcohol and selected food items are high, which are predominantly consumed by resorts.
[34] RHalf of Maldives' tax revenue is generated through the GST, of which more than 65 percent is based on tourism.
[35] Data are from UNU-WIDER and refer to 2018-2019.

Figure 16: The bulk of tax revenues comes from indirect taxation of tourists...

Breakdown of tax revenues, percent of GDP

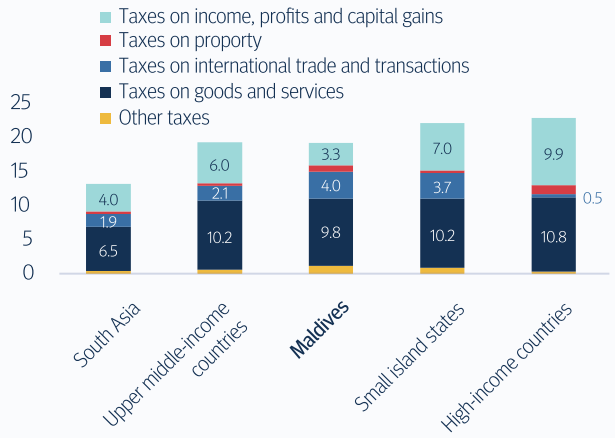
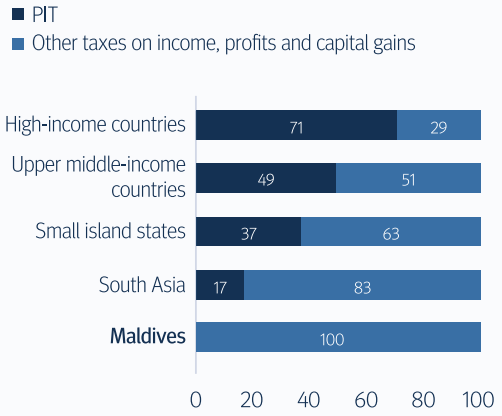


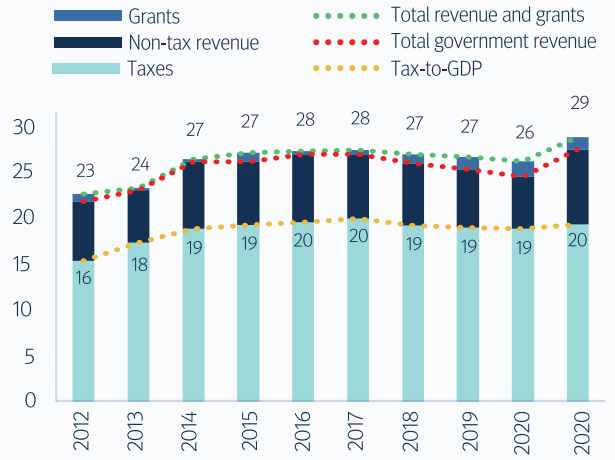
Figure 17: ...and Maldives did not collect any Personal Income Tax prior to 2020.



Note: Simple average for groups. Data refers to 2019 when available, otherwise 2018. Countries with no information for 2018 were dropped from the sample.
Source: UNU-WIDER Government Revenue Dataset Version 2021, staff calculations

Figure 18: The revenue-to-GDP ratio plateaued even before COVID-19...

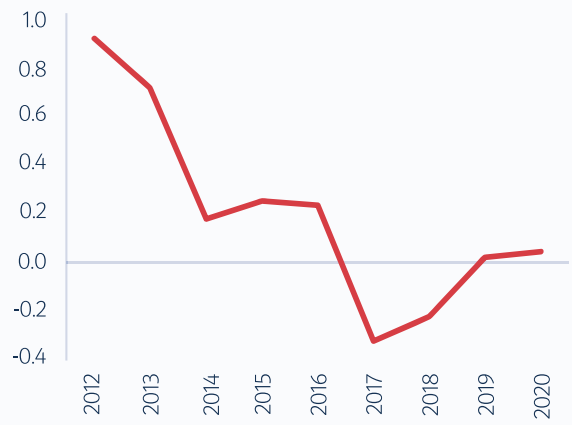
Percent of GDP



Source: Data obtained from MoF, staff calculations.

Figure 19: ...and tax revenues are not very sensitive to changes in output.

Tax revenue multiples of a percent change in GDP



Source: : MoF, staff calculations.

high-earning individuals are outside the tax net. Moreover, the top marginal tax rate of 15 percent only applies to incomes above MVR 2.4 million (US$155,844 or 17 times per capita income).

25. **Even before the COVID-19 pandemic, revenues had** been plateauing. Revenue as a share of GDP had steadily increased up until 2018-2019, when it subsequently declined to 27 percent of GDP (Figure 18). This was driven by a plateauing of tax revenue at around 19 percent of GDP in these years, which is surprising given the historic record of 1.7 million international tourists in 2019. The revenue ratio rose again in 2021, but this was driven by a repayment of resort rent income and other dues that were postponed from 2020 due to the pandemic. All in all, Maldives' revenue performance reflects the need to modernize tax policy and administration and to diversify revenue collection away from tourism-related activities. In addition, tax revenue has a low and declining responsiveness to economic growth, illustrated by a tax buoyancy[36] below one (Figure 19). This suggests tax mobilization is behind increases in economic activity, putting pressure on Maldives' fiscal sustainability in the long run. If domestic revenues do not move in tandem with output in the economy, this reduces predictability and complicates budget planning and fiscal forecasting. Similarly, in the short run, low buoyancy means that the tax system cannot stabilize output (e.g. reduce fluctuations in the business cycle and the burden on households/firms in a recession) by managing or stimulating aggregate demand (Dudine and Jalles 2017).

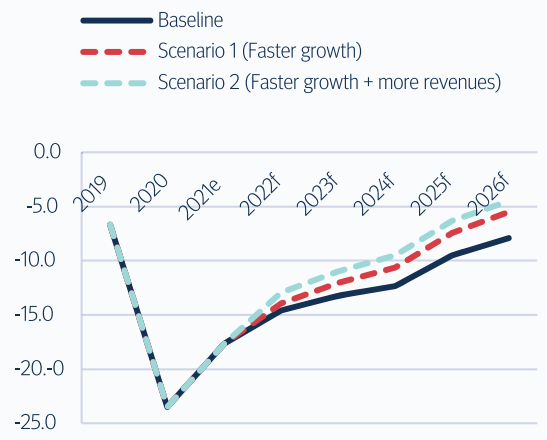
[36] Tax buoyancy measures how tax revenues vary with changes in output. A buoyancy of one means that an additional 1 percent of GDP would increase tax revenue also by 1 percent, leaving the tax-to-GDP ratio unchanged.

26. **Maldives has made laudable progress in improving tax policy in recent years, but recent reforms have not yet yielded significant increases in revenue.** Notable improvements in tax policy include: (i) establishing a Tax Policy Unit in MoF; (ii) introducing a PIT in 2020; (iii) abolishing a preferential tax regime; and (iv) abolishing all tax exemptions and incentives under the Foreign Investment Act.[37] Maldives has also implemented other tax revenue increases, such as: (i) introducing the Airport Development Fee in 2017; (ii) increasing import duties on selected beverages and cigarettes; and (iii) increasing Airport Departure Taxes and Airport Service Charges beginning January 2022. The latter is expected to increase revenues by about US$37 million in 2022 (0.7 percentage points of 2019 GDP).[38] Overall, however, it is too soon to assess the impact of most of these recent reforms: realizing the full potential from a new tax measure can typically take three to four years as the revenue authority focuses on encouraging employers to register employees, and identifies and addresses non-compliance. Recent reforms should therefore be rigorously evaluated as soon as data becomes available.

1.5 How can Maldives increase fiscal space and still achieve its development goals?

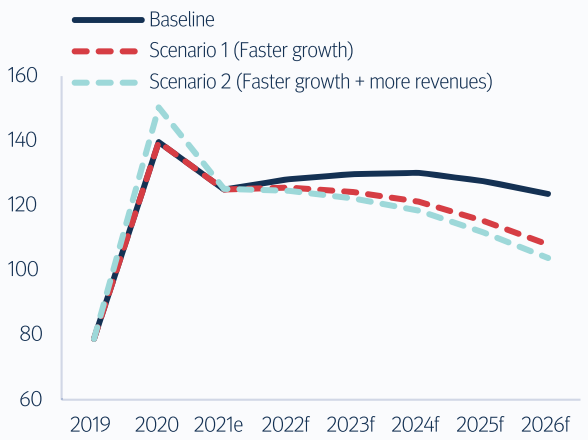
27. **To sustainably fund its large spending needs, Maldives needs to mobilize additional revenues**. The World Bank's medium-term forecasts indicate that Maldives' fiscal imbalances are expected to remain large, and potentially destabilizing, even in a context of robust economic growth. In the baseline scenario – which assumes that Maldives grows at 7.3 percent per annum over the forecast horizon of 2022-2026 (slightly higher than its pre-pandemic average of 7.1 percent) – the fiscal deficit and public & publicly guaranteed debt are expected to remain elevated relative to GDP, at 7.9 and 124 percent of GDP by 2026 (Figure 20). These ratios will remain high even under a more optimistic scenario: assuming faster average growth of 9.3 percent over the forecast horizon, the deficit and debt would still be 5.5 and 108 percent of GDP, respectively, in 2026. Only if, in addition to faster economic growth, policy measures could deliver additional government revenues of 0.6 percent of GDP per annum over 2022-2026 (an additional US$149 million annually on average), would the deficit and debt fall to 4.5 and 103 percent of GDP by 2026 (Figure 21). These scenarios assume ceteris paribus conditions for the exchange rate and inflation.

Figure 20: The fiscal deficit is expected to remain high even with faster growth
Percent of GDP



Source: World Bank staff simulations.

Figure 21: ...and tax revenues are not very sensitive to changes in output.
Tax revenue multiples of a percent change in GDP



Source: World Bank staff simulations.

[37] Additional measures include introducing transfer pricing rules and limiting interest deductions, and introducing a cross-border withholding tax on all sources of capital income and technical and management fees.
[38] Maldives previously charged a per-passenger airport service charge (ASC) of US$12 for Maldivians and US$25 for foreigners departing the country and an airport development fee (ADF) of the same magnitude. Starting January 1, 2022, the ASC was repealed and replaced with a new departure tax ranging from US$12-US$120 for Maldivians and US$30-US$120 for foreigners, depending on the class of travel. The ADF was also increased to the same amounts.

28. **Achieving such an increase in revenue is feasible if Maldives diversifies the tax base by mobilizing more domestic sources of revenue.** Raising more revenues from domestic sources could broaden the tax base and reduce Maldives' heavy reliance on external sources, which are subject to a range of conditions beyond its control. Taxing the domestic economy could reduce the procyclicality of fiscal policy and maintain the competitiveness of the tourism industry. To do so, Maldives could consider the following actions:

    i. **Lower the tax brackets for PIT**: Reducing the threshold would increase the tax base, result in more revenues, and make the tax system more progressive. World Bank simulations indicate that halving the threshold to MVR 300,000 (US$19480), for example, would increase PIT collections fivefold to US$28 million annually, equivalent to 0.5 percent of 2019 GDP. This would still be below the recommended level of 1 percent of GDP (IMF 2019a).

    ii. **Introduce a presumptive regime for businesses below the GST threshold.** At present, many small businesses do not pay business profit taxes as they generate below MVR 500,000 (US$32,467) annually. A uniform presumptive tax, for example at a rate of 2 or 3 percent of turnover, for these businesses would generate additional revenues of 0.2 percent of GDP, reduce compliance burdens, and lower administrative costs.

    iii. **Make adjustments to the GST.** Immediate term policy recommendations for the GST include: i) abstaining from introducing new tax incentives; ii) reviewing and rationalizing exemptions and zero-ratings; iii) imposing GST on imported goods and services; and iv) extending GST to digital services and offshore booking accounts. These measures are relatively low hanging fruit and could yield an additional 2 percent of GDP in revenue in the short term. In the medium term, once inflationary pressures abate, Maldives could consider gradual increases to both the general GST (to 8-10 percent) and tourism GST rates (to 14-15 percent). This could result in an additional 2-3 percent of GDP in revenue (IMF 2022a).

29. All in all, it is estimated that these measures could raise central government revenues by at least 2.7 percent of GDP in the short term, and a further 2-3 percent of GDP in the medium term.[39] This is a significant amount and represents the upper bound of revenue potential, as the average upper middle-income country only managed to increase its tax-to-GDP ratio by 0.1 percentage points of GDP per year between 2010 and 2019. The only countries that managed to increase tax revenues by more than a cumulative six percentage points of GDP during the period were Tonga and Guyana.[40]

30. **Maximizing revenue potential will require parallel investments in tax morale and tax equity.** The success of revenue reforms will be heavily dependent on political support. Tax reforms only yield their revenue potential if, besides effective enforcement and facilitation measures, taxpayers have "nonpecuniary motivations for tax compliance" (Dom et al 2022). In other words, whether Maldives can successfully raise revenues depends on how well citizens believe their taxes are being spent, whether they feel they are treated fairly by tax officials, how well tax laws and decisions are communicated, and how equitable the tax system is. These dimensions of reciprocity, fairness, equity, and accountability will need to be central in the Maldives Inland Revenue Authority's (MIRA) compliance strategies to help build trust in the tax system and expand the domestic tax base.

31. **Several non-tax revenue reforms could also yield additional revenue.** The 2020 and 2021 Budget documents had indicated new measures to raise non-tax revenues: requiring dividends from real estate tourism, imposing expatriate quota fees, increasing resident permit fees, land sales, introducing a spectrum charge, and imposing congestion charges/parking fees in the capital. Together, these measures were estimated to raise US$56 million annually on average in additional revenues over 2022-2024, or about 1 percent of 2019 GDP annually. Most of these measures, however, have yet to be implemented at the time of writing.

32. **In addition to raising revenues, Maldives needs to implement expenditure policy and debt management reforms to return to a more sustainable fiscal and debt path.** While the remainder of the report will delve into specific policy actions related to the key drivers of spending, this chapter concludes with three broad recommendations for overall fiscal and debt policy:

    i. **The Fiscal Responsibility Act needs to be revamped urgently.** The FRA, which came into effect in 2013, stipulated overly ambitious numerical targets that were never adhered to: a maximum PPG debt target of 60 percent of GDP, a budget balance of 3.5 percent of GDP, and a primary balance rule requiring a primary surplus starting at end-2016. There were no penalties for non-compliance with these targets. To make the FRA more effective and credible, the World Bank (2015) and the IMF (2022b) recommend moving away from a rules-based towards a principles-based FRA. This approach, while

[39] Estimates based on IMF 2019b.
[40] Based on a sample of 37 upper middle-income countries. Source: UNU-WIDER Government Revenue Dataset Version 2021, staff calculations.

more flexible (as the numerical targets are included in a government document, rather than a law), would require strong accountability and transparency mechanisms to ensure that any proposed changes in fiscal targets are justified by the Minister of Finance and/or approved by Parliament. Maldives' 2022-2024 Medium-Term Fiscal Strategy already sets two numerical anchors that could serve as the fiscal targets,[41] but (i) guarantees are not included in the debt limit, consistent with the FRA, and (ii) these do not seem to be realistic given the current fiscal scenario. It would be important for the new FRA to include a limit on government guarantees, given the large fiscal risks they pose to public finances (see Chapter 3).

ii. **Improving debt management could promote a more judicious use of external loans and guarantees.** How much a country decides to borrow and for what purpose is a sovereign decision. In Maldives' case, however, the large increase in public debt and guarantees in recent years is cause for concern, as the country lacks buffers to cope with potential future shocks. Greater scrutiny on the use of external loans and guarantees to fund state expenditures is therefore warranted. To start, MoF could ensure that the Public Debt Law clearly articulates the overarching objectives of debt management, clarifies the delegation of authority to borrow and lend public resources, and guarantees and empowers the DMD. It could also revamp the FRA and other necessary legislation to mandate the inclusion of government guarantees in the medium-term debt and fiscal strategies. Finally, it could publish a borrowing plan to improve cash management and domestic market development. This plan could help to mitigate large refinancing risks from the reliance of domestic debt on Treasury Bills.

iii. **There is still room for improvement on debt transparency.** The semi-annual debt bulletins typically contain information on: (i) disbursed outstanding debt; (ii) external debt, disaggregated by creditor, currency composition, disbursement, and debt service; (iii) domestic debt disaggregated by short-term and long-term, and debt service; (iv) institutional developments in debt management; and (v) debt risk indicators. However, there is limited information on the terms of contracted loans and guarantees, and coverage is not consistent across publications (the June 2021 bulletin, for example, does not include detailed information on government guaranteed and on-lent debt that was included in previous editions). More comprehensive reporting of government debt and guarantees are an important next step towards more accountability.

33. **The government of Maldives is well-placed to take these measures and has already begun to work on several key reforms**. The Ministry of Finance has made important changes to strengthen the institutional structure of debt management, following the recommendations of the 2018 World Bank Debt Management Performance Assessment (DeMPA). It is currently working with the World Bank, the IMF and other development partners to revamp the FRA, formulate a medium-term revenue strategy, draft a Public Debt Law, and to refine the sovereign guarantee policy and the public financial management reform strategy. However, communication at the highest political levels on the importance of fiscal and debt sustainability are important to secure buy-in for the necessary reforms from the whole of government and from the public. To avoid succumbing to multiple pressures to increase public expenditures, the government needs to articulate clear strategies for achieving its development objectives without jeopardizing macroeconomic and fiscal stability. The highest levels of political leadership need to visibly commit to restoring Maldives back to the path of fiscal discipline and carefully communicate the urgent need to do so. This goal can be achieved by raising additional revenues in a progressive and transparent manner, by making expenditures more efficient and well-targeted, and by reducing reliance on costly external debt and guarantees.

[41] These are to reduce the budgetary central government debt to GDP ratio to 105 percent by 2023 and to reduce the primary budget deficit to GDP ratio to 5 percent by the same year. The third, non-numeric anchor is to "maintain a reducing path over the medium term for budget deficit and debt." Source: MoF 2021.

CHAPTER 2

Public Spending

Summary

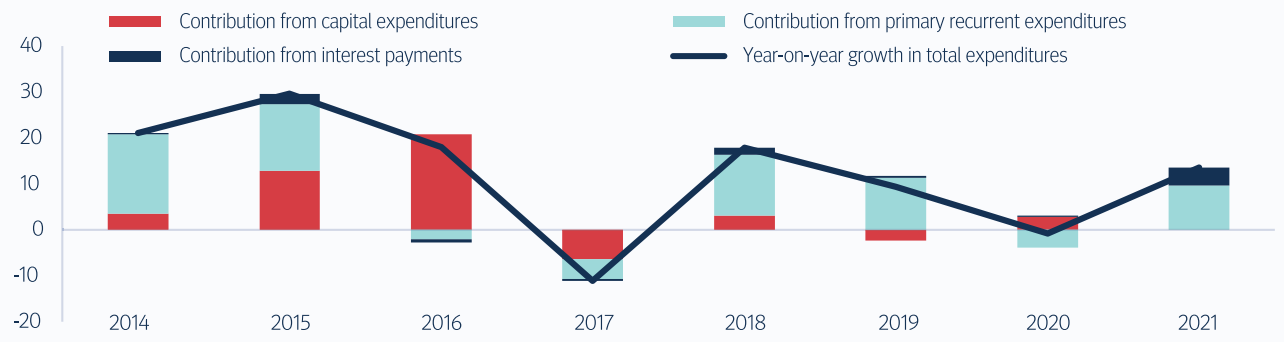
This chapter examines how the Government of Maldives has spent public resources in recent years.[42] *The first section looks at trends in spending by economic and functional classification. Maldives spends a third of its budget on capital, much higher than many of its peers. It spends another third on public wages, in line with other small island states. Spending on social sectors takes up nearly half the budget, as Maldives spends much more than peers on public health. The second section examines the quality of public spending in health and infrastructure. While available evidence is limited, the analysis suggests room for improvement. In health specifically, it can reduce the prices of drugs, leverage digital technology to provide health services, strengthen strategic purchasing and hospital management. In infrastructure, Maldives can improve the efficiency of budget execution and enact public investment management reforms. Overall, Maldives needs to collect more and better data to better monitor and evaluate the results of public spending and improve the strategic allocation of resources through medium-term expenditure or budget frameworks.*

2.1 How can Maldives increase fiscal space and still achieve its development goals?

2.1.1 Spending by economic classification

34. **The bulk of Maldives' budget goes to capital spending (one-third of total expenditures) and public sector wages (another third of total expenditures).** As established in Chapter 1, Maldives' total public spending has grown rapidly over the past decade, outpacing GDP growth. In the earlier part of this period, the increase was primarily driven by a significant ramp-up in capital spending, specifically the Public Sector Investment Program (PSIP) which accounts for about 80 percent of the total (Figure 22). Due to an ambitious push by the government, spending on PSIP leapt from an average of US$123 million in 2013-2014 to an average of US$357 million over 2015-2019. Despite the large economic contraction induced by the COVID-19 pandemic, PSIP spending remained high at an estimated US$320-US$340 million in 2020-2021. While Maldives used to spend only a fifth of the budget, or 6 percent of GDP, on capital spending in 2010-2014, it has – on average – spent a third of its budget, or 11 percent of annual GDP, on capital spending between 2015 and 2021 (Figure 23 and Figure 24).

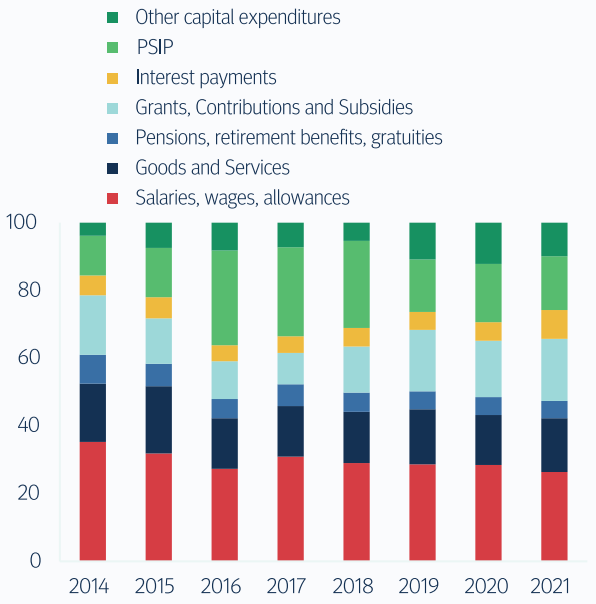
Figure 22: Capital investments drove increases in overall spending in 2015-2016, and have remained high ever since
Contribution to growth of total spending, percentage points



Source: MoF, staff calculations. Primary recurrent expenditures comprise spending on salaries, wages and allowances, goods and services, pensions, retirement benefits, gratuities, grants contributions, and subsidies.

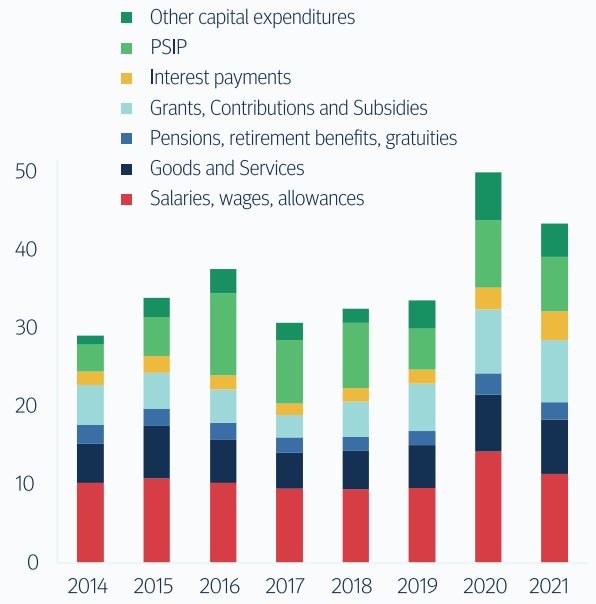
[42] Most analysis in this chapter focuses on the period 2014-2021. Data prior to 2014 was not always reported in a comparable format. Data for 2021 is preliminary and current as of March 31, 2022. All fiscal data refers to central government, as data on local council finances is incipient and not published.

Figure 23: Capital spending averages about half a billion dollars annually or a third of total spending...
Share of total expenditures, percent



Source: MoF, staff calculations.
Note: Capital expenditure excludes net lending. Other capital expenditures encompasses furniture, machinery, equipment, vehicles, investment in public enterprises, and other investments.

Figure 24: ...thanks to a large increase in PSIP spending in 2015-2016.
Share of GDP, percent



Source: MoF, staff calculations.
Note: Capital expenditure excludes net lending. 2020 ratios are affected by the large contraction of over 30 percent in the denominator.

35. **As a result of higher capital spending, Maldives now has a level of public capital stock per person that is far ahead of its peers and almost on par with advanced economies.** Even before the recent expansion of PSIP, in 2015, Maldives' level of general government capital stock per person[43] was already estimated at US$18,766. This was 78 and 40 percent higher than the average upper middle-income country and small island developing state, respectively, and far ahead of the South Asia region.[44] By 2019, Maldives' public capital stock had risen to US$27,817 per person – twice as high as its income and small island peers, and on par with the average high-income country (Figure 25). Maldives' growth in public investment per capita in recent years has almost been on par with that of China and much higher than other small island states such as Fiji, Cabo Verde, and the Seychelles (Figure 26). While the expansion in capital spending led to high growth in the construction sector between 2016-2019, it is unclear whether more public investment will translate into longer-term improvements in economic growth and poverty

Figure 25: Maldives' public capital stock per person is now almost on par with advanced economies
Public capital stock per capita, constant 2017 international US$

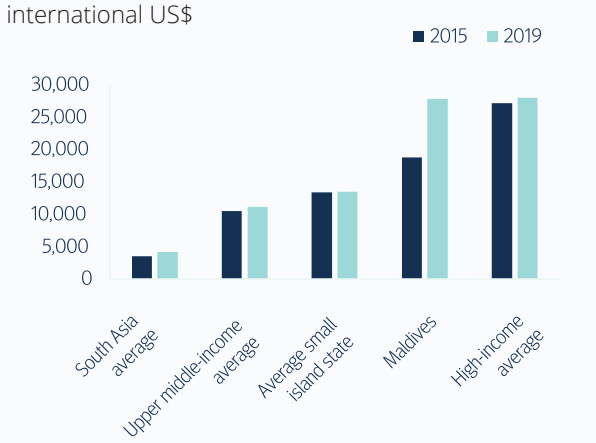
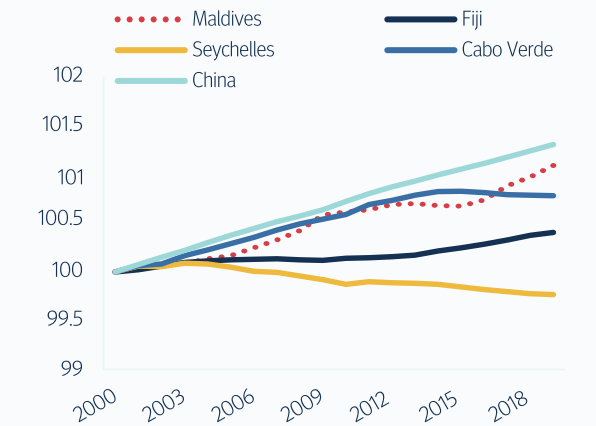


Figure 26: Growth in public investment per capita has been on par with China in recent years
Index of public capital stock per capita (2000=100)



Source: IMF Investment and Capital Stock Database (May 2021 vintage) and World Bank WDI, staff calculations.
Note: Figure 28 assumes that all countries start at the same level of capital stock in 2000

[43] Estimated by the IMF (Investment and Capital Stock database, May 2021) based on general government investment flows.
[44] Ibid.

reduction in Maldives. This is illustrated by the estimates of the fiscal multiplier in Box 1 and the findings of the IMF (2019b) Public Investment Management Assessment (PIMA) report at the end of this chapter.

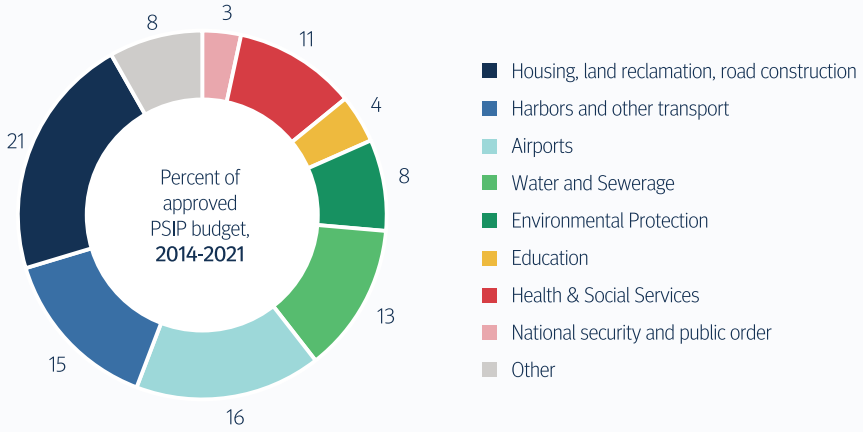
36. **About half of all PSIP spending has gone towards 'mega' infrastructure projects in transport and housing development**. Over 2014-2021, a third of the approved PSIP budget has gone towards transport infrastructure (mainly airports, but also harbors and bridges). 22 percent of the total has gone towards housing and associated land reclamation and road construction works (Figure 27). While over 1,000 PSIP projects are announced annually in the budget, most PSIP spending is directed towards a few large infrastructure projects such as large-scale housing developments, the construction of a new terminal and runway expansion at Velana International Airport (VIA), the country's main gateway, and most recently, Greater Malé Connectivity Project (comprising land reclamation works on Gulhifalhu island, the construction of Gulhifalhu port, and the Malé-Thilafushi Bridge). These mega projects are financed externally, mostly with non-concessional external loans[45] (see Annex 1). As elaborated on in Chapter 1, the overall expansion in PSIP has been enabled by increased reliance on external financing, especially loans, which has led to a large increase in the country's debt vulnerabilities.

While external sources of funding only comprised 12 percent of the total PSIP budget in 2014, this figure rose to 50 percent on average between 2016-2021. Almost all PSIP spending is executed by the Ministry of National Planning, Housing, and Infrastructure (MNPHI) and the Ministry of Finance under the Special Budget.[46]

37. **'Green' public infrastructure investments have not been allocated a large share of the budget in the past, but this is poised to change over 2022-2024 (Figure 28).** In the past, the share of annual PSIP financing dedicated to environmental protection has been relatively low, accounting for 8 percent of the total budget or US$39 million annually between 2014-2021.[47] Despite Maldives' vulnerability to sea level rise, less than half of these funds were dedicated specifically to coastal protection works. Over 2022-2024, however, the allocation for environmental protection projects has doubled to 16 percent of the total or US$77 million annually, financed mostly by grants and trust funds. Assuming all water and sewerage projects and harbor construction works also contribute to strengthening climate resilience, 36 percent of PSIP funds (US$522 million in total) over 2022-2024 will be directed towards projects that could help Maldives achieve its climate adaptation goals by 2030. While this is a positive development, the absence of a systematic budget

Figure 27: Most PSIP funding has been allocated to transport and housing infrastructure

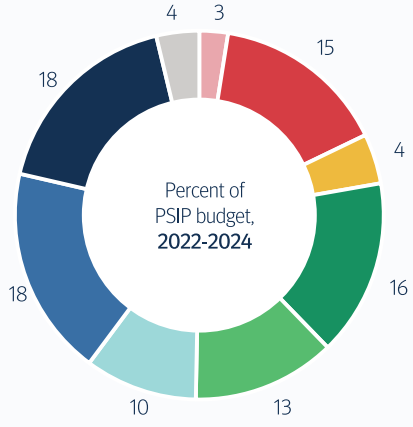
Percent of approved PSIP budget, 2014-2021



Source: MoF, staff calculations.
Note: Other encompasses general administration, mosques, fisheries and agriculture.

Figure 28: The share of PSIP funds dedicated to health and environmental protection is expected to increase

Percent of PSIP budget, 2022-2024



Source: Source: MoF, staff calculations
Note: 2022 refers to Approved Budget, 2023-2024 are Proposed Budget estimates.

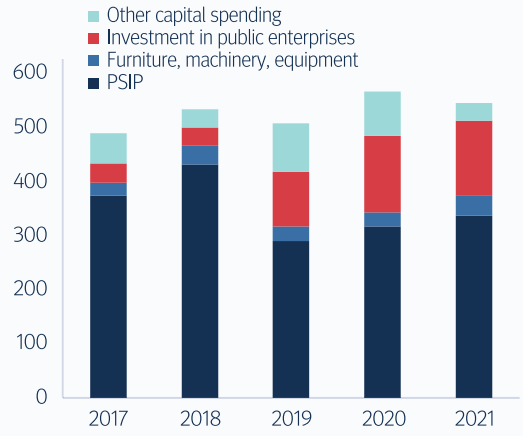
[45] Concessional finance refers to below market-rate finance provided by select financial institutions (such as development banks and multilateral organizations) to developing countries to accelerate development objectives. The World Bank defines concessional loans as having a grant element of 35 percent or more.
[46] This mostly consists of funding for mega infrastructure projects such as the VIA expansion. These funds are mostly on-lent to SOEs..
[47] This includes spending of Green Tax revenues that are earmarked for environmental projects

tagging system for climate-relevant public investments and expenditures[48] makes it difficult to ascertain how much of the PSIP addresses climate mitigation and adaptation. Establishing such a system could help Maldives further prioritize green infrastructure investments, which are important to strengthen its buffers against climate-related shocks, and could potentially attract additional climate financing. Simulations indicate that investing in adaptation infrastructure would help Maldives minimize output losses in the cases of either a natural disaster shock or slow onset climate-related events (Melina and Santoro 2021).

38. **Capital investments in health are also set to increase.** The government intends to increase the share of PSIP funds for the health sector from 11 percent in the past to 15 percent over 2022-2024, or US$76 million annually (Figure 28). About half of these funds will go towards constructing new hospital buildings in 13 islands, as well as towards ongoing efforts to build a cancer hospital and a tertiary hospital in Gan. These projects are to be financed mainly using non-concessional external loans.[49] Given that the disbursement of these loans would increase Maldives' already high external debt and that the projects will involve an increase in recurrent costs (from staffing and purchases of equipment and materials), a careful sequencing of these investments is needed to ensure that they do not exacerbate Maldives' fiscal vulnerabilities.

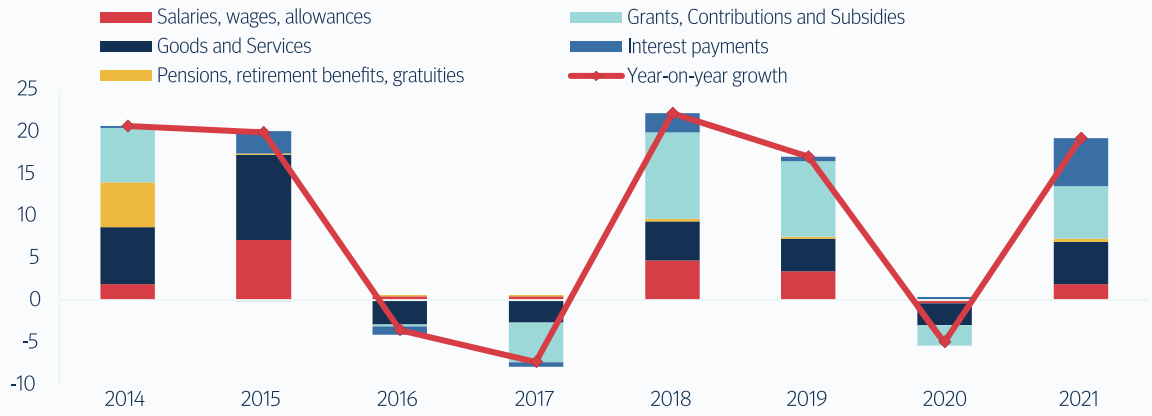
39. **Capital injections to SOEs have risen in recent years.** While PSIP accounts for the bulk of capital spending, transfers to SOEs have become more prominent in 2019 and 2020 (Figure 29). Spending on capital contributions to SOEs tripled from US$33-36 million annually in 2017-2018 to US$102 million in 2019 as the government tripled capital injections to the State Trading Organization, the Housing Development Corporation (HDC), and the Aasandha health insurance scheme. In 2020 and 2021, transfers to SOEs further increased to US$143 million and US$139 million respectively, reflecting the impact of the COVID-19 pandemic especially on HDC, the State Electric Company, and Island Aviation Services. The creation of the SME Development Finance Corporation and the Fahi Dhiriulhun Corporation in 2019 also added to the increase in SOE support. Chapters 3 and 4 show that SOEs, particularly HDC and FDC, are posing a fiscal risk to the sustainability of Maldives' public finances.

Figure 29: The government has injected more funds in SOEs in recent years
US$ millions



Source: MoF, staff calculations.
Note: "Other" comprises vehicles, construction, renovation & improvements, and other investments.

Figure 30: Recurrent spending growth has mostly been driven by grants, contributions and subsidies in recent years, but the contribution of interest payments to growth rose sharply in 2021
Contribution to total recurrent spending growth, percentage points



Source: MoF, staff calculations

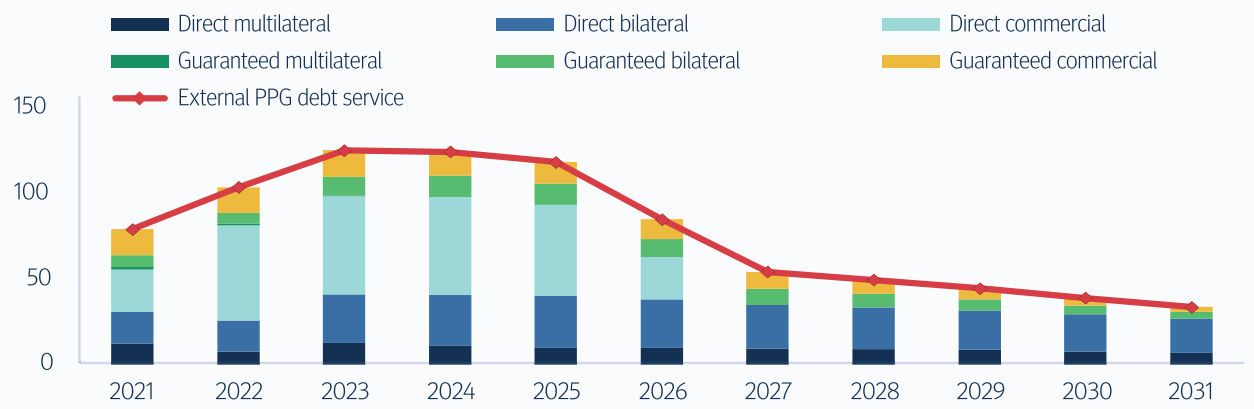
[48] Approximately US$4.6 billion or 2.4 percent of GDP was spent on climate finance in 2017. Of this, only 0.8 percent of GDP came directly from the national budget. Source: MoE 2020, page 76.
[49] According to MoF Budget in Statistics (2022), 16 new hospital constructions are to be financed by EXIM India and Kuwait Fund, while two hospitals are in pre-tendering stage and to be financed by Deutsche Bank.

40. **Recurrent spending on grants, contributions and subsidies have started to place upward pressure on the budget.** While capital spending has remained high both as a share of the budget and of GDP, recurrent spending has started to drive expenditure growth in recent years (see Figure 22). In 2018-2019 and again in 2021, higher spending on grants, contributions, and subsidies drove overall recurrent spending growth (Figure 30). This was initially due to the payment of arrears related to the Aasandha (see Chapter 1) and subsequently the inauguration of block grants for local councils (Box 2). A temporary Income Support Allowance for those affected by the COVID-19 pandemic was also introduced in 2020 (see Box 3).

41. **Pressures are mounting from the public wage bill and interest payments.** As shown in Figure 23, a third of Maldives' total expenditures or about 11 percent of GDP goes towards the payment of salaries, wages, and allowances of public sector employees. Most of the spending on salaries and wages is executed by the Ministry of Education (25 percent of the total), the Ministry of Health and Malé Group of Hospitals (20 percent) and the Maldives Police Services (8 percent). While Maldives' public sector wage bill is not unusually large compared to its peers as a share of GDP (see Figure 71), recent pressure for higher wages,[50] the mandatory implementation of the minimum wage starting January 2022, salary increments for education civil servants starting May 2022,[51] and the new public service pay framework are likely to lead to rising wage bill costs over the short term (see Chapter 5).

42. **Interest payments are a small fraction of the budget, but have grown significantly and are projected to remain high over the medium-term**. Between 2014-2020, the government spent US$85 million annually on average in interest payments. While this is a relatively small amount relative to the total budget (5.4 percent) and of GDP (2 percent), interest payments have registered faster year-on-year growth than any other recurrent spending item over the period, growing at a compound annual growth rate (CAGR) of 8.6 percent on average. The interest burden rose from US$104 million in 2020 to an estimated US$137 million (2.8 percent of GDP) in 2021, due to a large increase in domestic interest payments. Overall, the interest burden is expected to remain elevated over the medium term due to the high cost of the US$500 million sukuk issuance in 2021. From 2022-2026, Maldives is anticipated to pay an average of US$112 million on foreign interest payments alone (Figure 31). About half of this is due to the interest burden of commercial debt, mainly the sukuk.

Figure 31: Foreign interest payments are expected to rise in the coming years



Source: Data from MoF, staff calculations.

[50] In September 2021, civil servants held silent protests on low wage concerns (https://en.sun.mv/69226), and an emergency motion was submitted to Parliament calling for higher civil servant salaries (https://www.sun.com.mv/69253).
[51] Source: https://presidency.gov.mv/Press/Article/26221

Box 2: Grants to local councils are set to increase as Maldives pursues decentralization

As stipulated by the 8th amendment to the Decentralization Act (7/2010), which was ratified in 2019, all elected atoll, island and city councils in Maldives began to receive grants from the central government according to a pre-determined formula in 2020. The total block grant allocation is supposed to be equivalent to the sum of (i) 5 percent of total state revenue and (ii) 40 percent of rental and lease rent received from land, reefs and lagoons that are not under the jurisdiction of councils. In 2020, the approved budget allocated US$105 million to councils, but only 60 percent of this was transferred due to the onset of the COVID-19 pandemic and the automatic adjustment in revenues. In 2021, preliminary estimates indicate that the full budget for such grants (US$85 million) was transferred to councils.

While these grants only make up 5 percent of total expenditures at present, improved monitoring of council finances and performance is critical to ensure that resources are being utilized effectively. At present, there is little accountability and transparency, as local councils are not required to report their finances publicly. They are, however, required to submit financial statements to the Auditor General. The MoF, together with the Local Government Authority, aims to bring local council finances online through a new system, but much work remains to be done to set up local financial and budgeting systems.

To ensure that decentralization delivers better services to Maldivians, the government could explore increasing the weight of the "local council performance" in the grant allocation formula and ensure that this is objectively and transparently measured. Currently, council performance only makes up 5 percent of the formula determining the size of the block grant by island, which is mainly determined by resident population size (75 percent) and other fixed factors. The incentive is therefore insufficient to encourage better performance of councils in service delivery.

Source: Authors, based on MoF (2021b)

Box 3: How did Maldives allocate public resources to tackle the COVID-19 pandemic?

In 2020 and 2021, the Government of Maldives spent significant fiscal resources to tackle the COVID-19 pandemic. According to MoF weekly COVID-19 spending reports, the government spent US$188 million or 5 percent of GDP on its COVID-19 policy response in 2020, higher than most South Asia peers. In 2021, Maldives spent an additional US$74 million. Of the total amount spent in 2020-2021 to tackle the pandemic, about half was directed towards health and social spending, whereas the remainder was directed towards economic support for households and firms.

The bulk of health and social spending went towards procuring medical supplies and expanding the capacity of the health system. By the end of 2021, Maldives had spent US$74 million on acquiring medical consumables, test kits and Personal Protective Equipment; and US$25 million on purchasing diagnostic and medical equipment, and constructing medical and quarantine facilities – including Intensive Care Units (ICU) in eight Atolls and a 300-bed ICU facility in Hulhumalé. Additionally, the government disbursed US$17 million to over 13,000 medical and front-line workers. Most of these expenses were incurred by the Ministry of Health and the National Disaster Management Authority.

Most of the economic support was directed towards firms rather than households. 65 percent of economic response spending or US$78 million was directed towards supporting businesses, as the Bank of Maldives (BML) and the SME Development Finance Corporation (SDFC) provided favorable financing facilities to large businesses, SMEs, self-employed individuals, and freelancers whose business operations were impacted by the pandemic. By the end of 2021, the scheme had disbursed loans to nearly 2,800 businesses and individuals. COVID-19 relief loans to firms were conditional on the retention of workers for three months. In addition, starting April 2020, the government introduced an Income Support Allowance for Maldivian citizens who had lost their jobs or faced salary reductions due to the pandemic. The scheme provided monthly income benefits of up to MVR 5,000 (US$324) per eligible individual up until end-December 2020 and paid over US$27 million to more than 22,000 individuals. Finally, the government also spent US$14 million on electricity and water bill discounts in April-May 2020 and in June 2021.

Source: : Ministry of Finance weekly COVID-19 spending reports.

2.1.2 Spending by functional classification

43. **Nearly half of all public expenditures goes towards social sectors.** Estimates[52] indicate that Maldives has always spent generously on social sectors (Figure 32). From 2014-2021, the government spent an average of 42 percent of its annual budget[53] on three sectors: health (14 percent),[54] social protection (15 percent), and education (13 percent). Together, this amounted to about 14 percent of annual GDP. The second largest category of spending is public services (general public services, defense, public order and safety and environmental protection), which make up another third of the budget or 10 percent of GDP on average. Finally, economic affairs took up about a fifth of the budget or 7 percent of GDP between 2014-2021. This mostly consists of spending on large transport projects, transfers to public enterprises, and arbitration charges. Over time, spending on economic affairs has increased significantly, while spending on public services (except for defense and environmental protection) has declined (Figure 33).

44. **Maldives' public expenditure on health far exceeds its peers.** Looking at the pre-pandemic period of 2017-2019, Maldives' average public health expenditure was 14.4 percent of the budget or 4.4 percent of GDP. As a share of the budget, this was on par with several high-income OECD countries such as Portugal, Estonia, and Italy (Figure 34), and higher than the average upper middle-income country and SIDS, which spent 12 and 10 percent of their budgets on health respectively over the same period. Including expenses related to Aasandha, the health insurance scheme,[55] and total health-related spending is even higher: all in all, Maldives spends a fifth of its budget or 7 percent of GDP on health – significantly higher than the average high-income economy, which spends 14 and 5.5 percent of GDP respectively.

45. **By contrast, public spending on education appears to lag slightly behind peers**. Maldives' spending on education from 2017-2019 averaged 13.1 percent of the budget or 4 percent of GDP. As a share of GDP, Maldives' spending on education surpasses the average South Asian country (3.6 percent) but is less than the average upper middle-income country (4.7 percent) and SIDS (4.9 percent) (Figure 35). The biggest component of education spending is on the salaries, allowances, and pensions of education staff, which collectively take up about 60 percent of the total. While the biggest share of the education budget is spent on basic education, tertiary education has absorbed an increasing share of the education budget in recent years. A fifth of the budget is now spent on tertiary education, almost double the share in 2017. Much of this is due to the government's pledge to provide free tertiary education to every qualified Maldivian.

Figure 32: Social sectors take up 42 percent of total expenditures on average

Percent of total

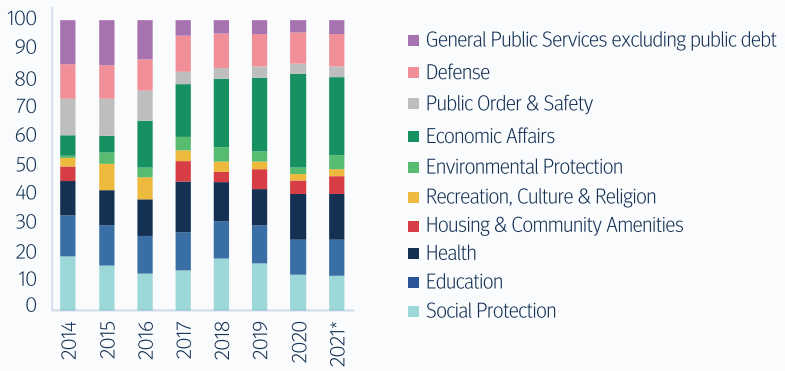
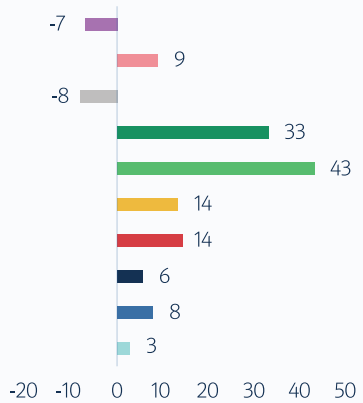


Figure 33: Spending on economic affairs and environmental protection have increased significantly

Compound average annual growth, 2014-2021



Source: MoF, staff calculations

Note: 2021 refers to revised estimates. Data prior to 2017 is estimated and may not be directly comparable for all categories.

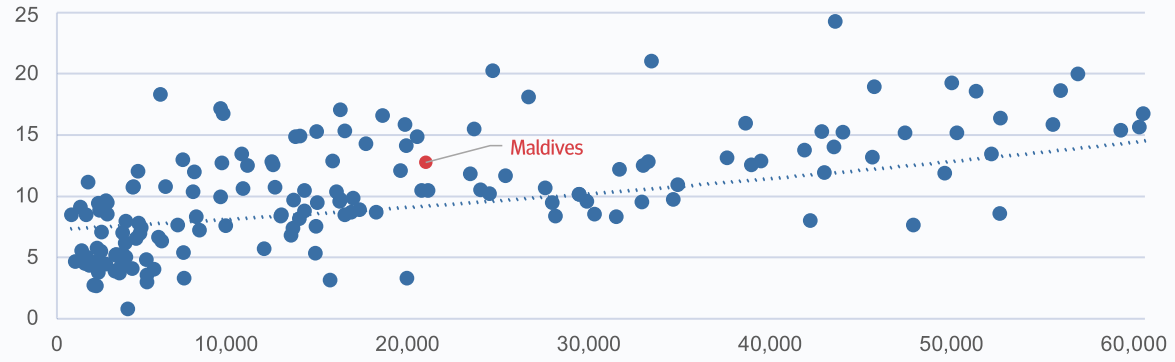
[52] Data on the spending by functional classification prior to 2017 (see data here) did not follow the standard COFOG classification (i.e., social protection and housing and community amenities were not recorded as separate functions, but instead were included as "social security and welfare" and "community programs" under the social services function. Other than these two functions, however, it is assumed that there are no significant differences between the sectors.

[53] This excludes public debt transactions.

[54] This does not include expenses related to the Aasandha, which are classified under social protection.

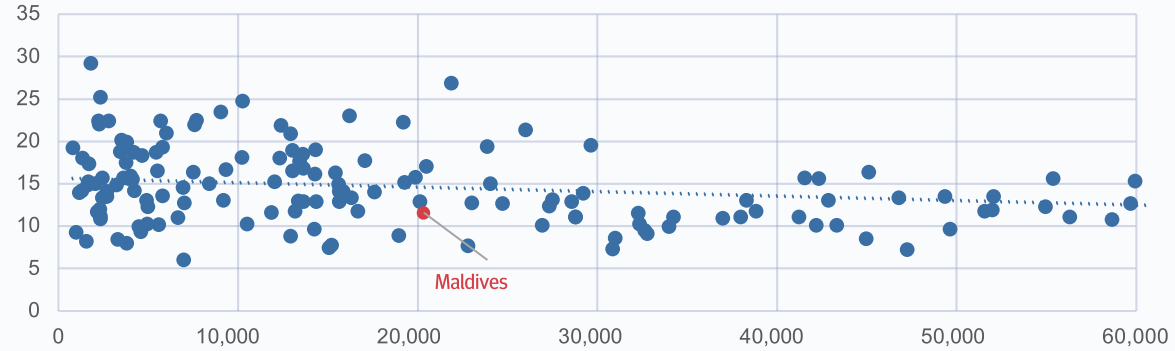
[55] Maldives classifies Aasandha expenses as social protection. If Aasandha is included as health spending rather than social protection, then Maldives' spending on social protection is on par with other upper middle-income countries and SIDS.

Figure 34: Maldives spends far more on health than its peers...
Y-axis: Domestic general government health expenditure as a share of total expenditure (2017-2019 average, percent); X-axis: GDP per capita, PPP (current international $)



Source: WHO Global Health Expenditure Database and WDI, staff calculations

Figure 35: ...but less than most of its peers on education.
Y-axis: Share of total expenditure, percent; X-axis: GDP per capita, PPP (current international $)



Source: World Bank WDI, staff calculations.

2.2 How well are public resources being spent?

46. **Assessing the quality of public spending typically involves discussions of efficiency and effectiveness:**

- Allocative efficiency refers to using the optimal combination of inputs (public spending) to maximize growth and productivity. At an aggregate level, this could refer to decisions on how to allocate spending across different functions, areas of the country or levels of government.

- Technical efficiency refers to maximizing value for money by reducing 'waste' or leakage of resources, or by getting more outputs given a fixed level of inputs. In the health sector, for example, technical inefficiencies could occur if the price of medicines is overly high or if average hospital stays are overly long. In infrastructure, technical inefficiencies often arise from cost overruns and delays.

- Spending effectiveness is assessed based on the relationship between outputs and outcome. For example, has the increase in public capital stock improved access to basic services and infrastructure? Are Maldivians healthier than before given higher public spending on health? Effectiveness also includes considerations of equity: are public resources being directed to the neediest households?

47. **To conduct a thorough analysis of efficiency and effectiveness, data on inputs (public expenditure), outputs and outcomes, both at the sectoral and aggregate level, are needed.** Unfortunately, while reasonably granular data on public expenditure is available at the national level, information on outputs, outcomes and activities of ministries and agencies are not published on a regular basis in Maldives (GoM and

WBG 2021). It is unclear whether such data is collected, as ministries are not required to periodically evaluate the efficiency and effectiveness of their services. Due to the lack of data, Maldives scores a "D" on most sub-dimensions of the "performance information for service delivery" indicator in the Public Expenditure and Financial Accountability (PEFA) assessment (GoM and WBG 2021). In the absence of such granular data, this section draws on selected examples from the health and infrastructure sectors to provide a partial view of public spending quality. More comprehensive, sector by sector spending reviews are needed to assess whether resources are sufficient and well spent in other key sectors, such as education.

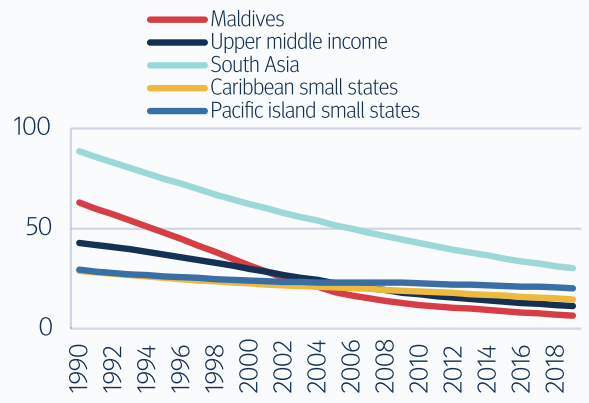
2.2.1 Efficiency and effectiveness of public spending on health

48. **Maldives has the best health outcomes in the South Asia region and among income peers.** Life expectancy at birth was recorded at 78.9 years in 2019, ahead of the average upper middle-income country (75.9 years) and the region (70.6 years). Health-related Millennium Development Goals (MDGs) and mortality-based Sustainable Development Goals (SDGs) have been achieved ahead of time: infant and under-five mortality declined by approximately 90 percent between 1990 and 2019, while maternal mortality halved between 2000 and 2017 (Figure 36 and Figure 37). Maldives also enjoys the best nutrition outcomes of any country in South Asia: only 15 percent of children under-five were stunted in 2017, half the regional average.[56] As in other upper middle-income countries, the key health challenge relates to non-communicable diseases, which account for 73 percent of the disease burden and 80 percent of all deaths.[57]

49. **While these achievements are laudable, some gaps remain.** Maldives' infant mortality ratio improved by 2.8 percentage points over 2014-2019 and maternal mortality improved by 3 percentage points over 2017-2019. The magnitude of these improvements was, however, identical to that of the average upper middle-income country. Given that Maldives spends significantly more on health than peer countries (as discussed in section 2.1.2), this suggests that it may be spending far more than it needs in order to achieve similar health outcomes. One possible reason is the inadequate local supply of trained human resources in health, which means that Maldives depends heavily on more expensive expatriate staff: 64 percent of medical doctors and 42 percent of nurses were expatriates in 2019.[58] Moreover, geographic disparities in health outcomes persist. Stunting rates vary between 11 percent in the Central Region and 20 percent in the North

Figure 36: Maldives has significantly reduced infant mortality over the past three decades...

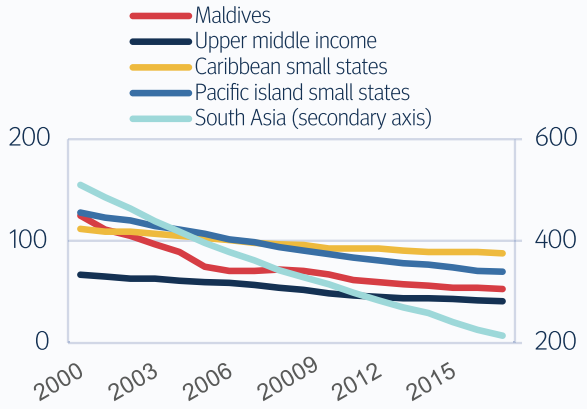
Mortality rate, infant (per 1,000 live births)



Source: : World Bank WDI, staff calculations
Note: South Asia average excludes Maldives.

Figure 37: ...as well as maternal mortality over 2000-2017.

Maternal mortality ratio (per 100,000 live births

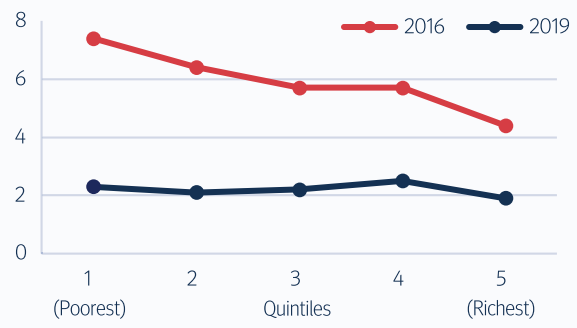


Source: : World Bank WDI, staff calculations
Note: South Asia average excludes Maldives.

[56] Prevalence of stunting is the percentage of children under age 5 whose height for age is more than two standard deviations below the median for the international reference population ages 0-59 months. Source: World Bank WDI.
[57] IHME 2022.
[58] Maldives MoH 2020.

Figure 38: Out-of-pocket health spending declined, especially for poorer households

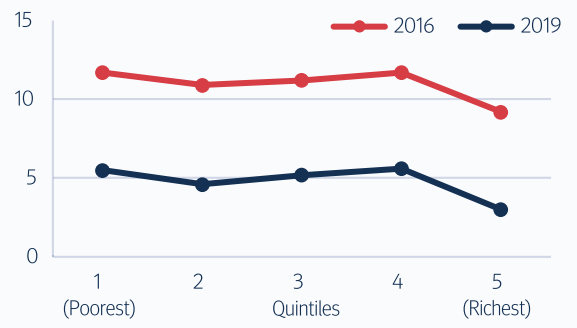
OOP spending as a share of total household expenditure, percent



Source: : Statistics Maldives 2016; Statistics Maldives 2021b, staff calculations.

Figure 39: Catastrophic OOP spending for health also declined across the board

Incidence of catastrophic OOP, percent of households



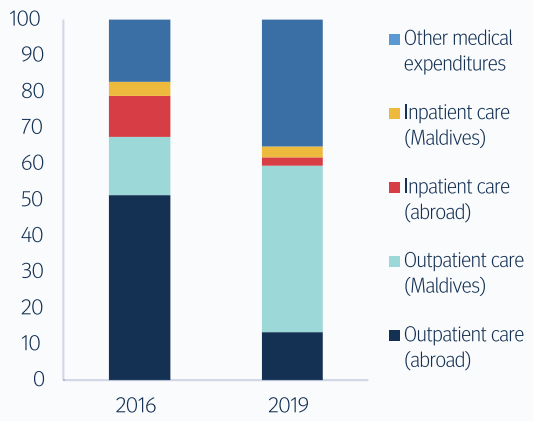
Source: : Statistics Maldives 2016; Statistics Maldives 2021b, staff calculations.

Central Region. As previously noted in section 2.1, the government is trying to address shortcomings in healthcare provision by building new hospitals in the outer atolls (see projects in Annex 1). However, this strategy implies a further increase in healthcare spending in the medium term, as these new facilities would require expanding headcount and additional purchases of medical consumables.

50. **The introduction of the Aasandha health insurance scheme has helped to shield households against unpredictable health shocks.** Data from household income and expenditure surveys indicate that over the past decade, household out-of-pocket (OOP) spending on health has declined significantly. In 2009-2010, health accounted for an average of 9 percent of total household spending, but this fell to 6.5 percent in 2016 and further to 2.2 percent in 2019. The largest reduction in the OOP share has been for lower-income households, resulting in a more equal distribution of public health spending across income groups in 2019 (Figure 38). A key reason for lower OOP spending is the introduction of Aasandha in 2014, which provides coverage for previously uncovered costs such as overseas care, pharmaceuticals, and private medical visits. The incidence of "catastrophic OOP"[59] – an SDG indicator – also declined by at least half among all quintiles between 2016 and 2019 (Figure 39).

Figure 40: Patients are more likely to seek care domestically than abroad

Share of total OOP spending on health, percent



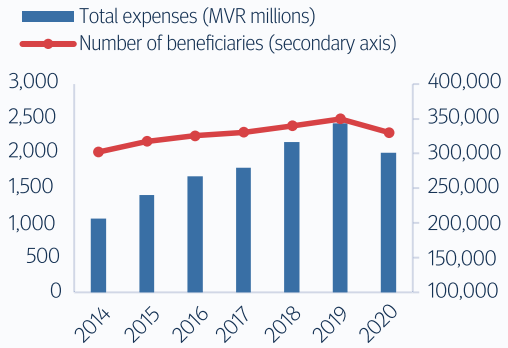
Source: : Statistics Maldives 2016; Statistics Maldives 2021b, staff calculations.

51. **Investments in domestic healthcare capacity have had some positive implications for efficiency and equity.** Analysis of HIES data suggests a sharp decline in OOP spending for overseas care between 2016 and 2019 (Figure 40). The share of households with at least one overseas outpatient visit in 30 days almost halved from 6.2 percent in 2016 to 3.3 percent in 2019. At the same time, domestic outpatient visits increased from 48 percent in 2016 to 55 percent in 2019. This shift from overseas to domestic care-seeking may be explained by multiple factors, including the enhanced capacity of domestic health care (e.g., the number of local general doctors increased from 97 in 2016 to 254 in 2019)[60] and expanding coverage of Aasandha, which has improved access to local high-end private health care. This shift has positive implications on both efficiency (as overseas care was more expensive to reimburse) and equity (because overseas care was less common among poorer households) of health spending.

52. **However, there is scope to improve the efficiency of spending on Aasandha.** Spending on the Aasandha health insurance scheme grew at a compound annual average growth rate of 18 percent

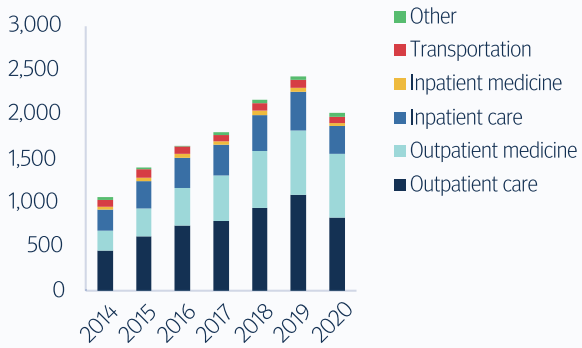
[59] Defined as OOP exceeding 10% of total household expenditure.
[60] Maldives MoH 2021.

Figure 41: Rising Aasandha costs have not been driven by an increase in beneficiaries...
MVR millions and number of beneficiaries



Source: : Statistics Maldives, staff calculations

Figure 42: ...but rather an increase in outpatient care and medication costs
Aasandha expenditure by services, MVR millions



Source: : Statistics Maldives, staff calculations

per annum between 2014 and 2019. Such rapid growth in Aasandha expenses has not been due to an increase in beneficiaries, which only increased by about 3 percent per annum over the period (Figure 41), but due to the rising costs of outpatient medication and care (Figure 42). A comparative World Bank (2018) study of drug prices showed that average drug prices were 15 to 75 times higher than international benchmarks, reflecting the absence of robust procurement and purchasing approaches. Spending on drugs and medical consumables grew further by 24 percent annually on average between 2017 and 2019. Most public health spending is executed by MoH (45 percent) and the Malé Group of Hospitals (27 percent). The government's plan to impose a maximum retail price for reimbursements of pharmaceutical drugs to pharmacies by Aasandha is a welcome measure, as this is expected to reduce fiscal pressure, but its implementation has been postponed as of April 2022. Similarly, the government is exploring the bulk procurement of major drugs to generate cost savings.

2.2.2 Efficiency and effectiveness of public spending on infrastructure

53. **Even before the public investment boom, Maldives already outperformed most of its peers on measures of access to infrastructure.** Although Maldives does not feature in many internationally comparable datasets of access and quality of infrastructure,[61] available data indicate that it generally outperforms regional and small island peers and is on par with other upper middle-income countries when it comes to access to basic infrastructure. Maldives has enjoyed universal access to electricity since 2009, has a high share of internet users and widespread mobile access, and has a relatively low rate of road traffic mortalities (Table 4). It also ranked higher than its income and regional peers on the 2018 World Bank Logistics Performance Index (Figure 43) and has the most well-connected

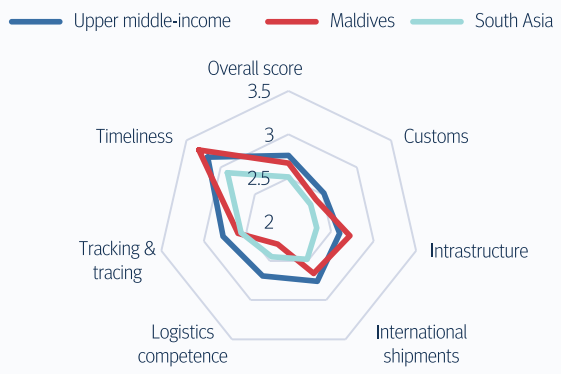
Table 4: Maldives outperforms its peers on key indicators of connective and social infrastructure

	Maldives	Average South Asia	Upper middle-income	Small island state
Access to electricity, % of population	100	93.1	96.2	93.6
Internet users, % of population	63.2	17.0	61.3	56.0
Mobile cellular subscriptions, per 100 people	144	99.2	116.3	113.3
Hospital beds, per 1000 people	4.1	1.4	3.1	2.8
Pupil-teacher ratio, secondary level	5.0	24.7	14.0	12.4

Source: World Bank WDI and Maldives MoH 2021. Data on internet users are from 2017 (last available year for Maldives); data on broadband subscriptions are from 2019.

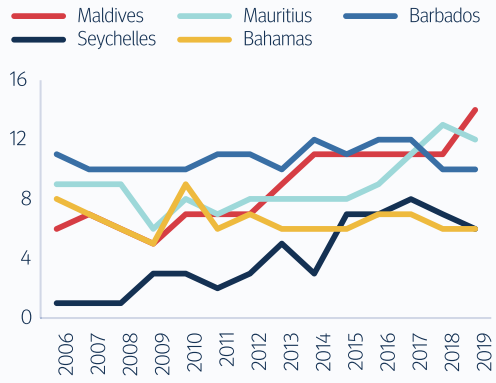
[61] Data on perceptions of the quality of infrastructure, for example, which are typically available from the World Economic Forum or the World Bank Enterprise Survey, do not exist for Maldives.

Figure 43: Maldives outperforms its regional peers on the Logistics Performance Index...
Score



Source: World Bank.
Note: Data refer to 2018.

Figure 44: ...and is the most internationally well-connected destination among small island states
Number of countries connected to via air transport



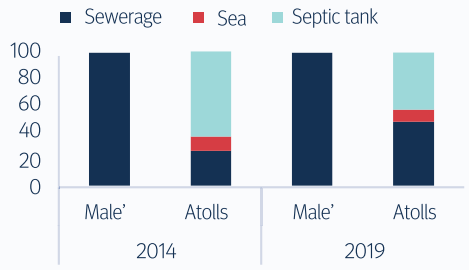
Source: Cirium.

international airport among small island states, with direct air connections to 14 countries (Figure 44).[62] As for health and education infrastructure, national data indicate a more than adequate number of hospital beds per capita and a relatively low pupil-teacher ratio on average compared to peers, indicating possible over-spending on infrastructure in these areas.

54. **Access to some types of infrastructure has further improved in recent years, but not sufficiently to close the gap between Malé and the atolls.** According to national census and household survey data, there have been several improvements in access to basic infrastructure since the expansion of PSIP, especially in the atolls. For instance, the share of households in atolls with a toilet facility connected to sewerage networks has doubled to 48 percent between 2014-2019 (Figure 45). Reliance on rainwater[63] as a drinking water source has declined (Figure 46) and the share of households in atolls properly disposing of their waste has increased from 87 percent to 95 percent over 2016-2019. Despite these improvements, spatial disparities remain. On average, only half of all households residing in atolls are connected to the sewerage system, versus all households in Malé. Piped water connections also remain much lower in the atolls than in Malé. Moreover, households in atolls have increasingly shifted to drinking bottled water, which is costly and unsustainable.[64] Several ongoing PSIP projects focus on improving access to water and sewerage facilities in all islands, a key pledge of the current administration.

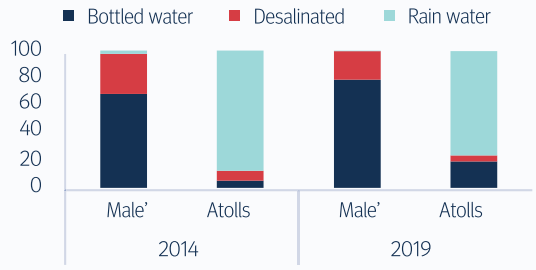
55. **There are signs that infrastructure spending efficiency can be improved.** The lack of data on outputs and outcomes at the project level and the relatively short period of time that has passed since the expansion of PSIP in 2016 make it difficult to

Figure 45: The disparity in sewerage connections between Malé and atolls persists
Share of households residing in atolls by type of toilet connection, percent



Source: Statistics Maldives

Figure 46: Bottled water usage has increased in both Malé and the atolls
Share of households by drinking water source, Malé and atolls, percent



Source: Statistics Maldives.

[62] World Bank INFRASAP diagnostic, Phase 1. Unpublished.
[63] Rainwater is not considered a safe drinking water source without additional treatment.
[64] Maldives is currently phasing out single-use plastics, including a ban on imported bottled water under 500ml from June 1, 2022.

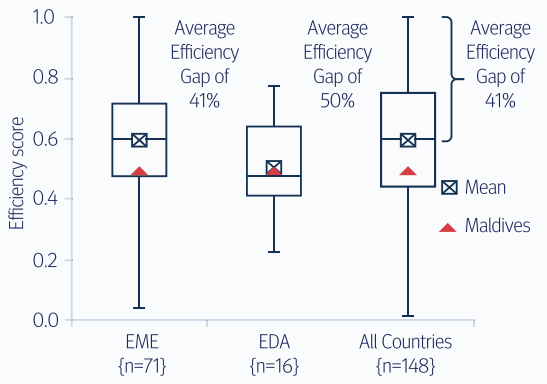
Table 5: Actual versus budgeted spending on PSIP by function, percent

	2019	2020	2021*
National Security & Public Order	182%	41%	27%
Health & Social Services	61%	78%	47%
Education	34%	22%	64%
Environmental Protection	29%	13%	55%
Water and Sewerage	61%	40%	89%
Transport	66%	63%	60%
General Administration	111%	21%	63%
Housing & Infrastructure	143%	14%	23%
Mosques	64%	53%	77%
Land Reclamation & Road Construction	57%	64%	86%
Fisheries & Agriculture	91%	48%	69%
Other	47%	49%	15%
Overall PSIP budget execution	**65%**	**47%**	**62%**

Source: MoF, staff calculations. Note: 2019 and 2020 refer to actual spending versus Approved Budget spending. 2021* refers to preliminary (Revised Budget) estimates versus Approved Budget spending.

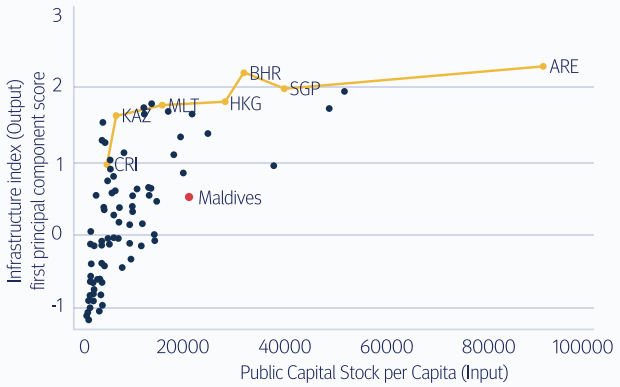
assess the impact of infrastructure spending on Maldives' aggregate welfare. However, available evidence indicates that there is room to improve the technical efficiency of spending. While the government allocates a large amount of resources to PSIP, only three quarters of it is spent. On average, from 2014 to 2019, the government only spent 82 percent of the approved capital budget. This has mainly been due to under execution of the PSIP, as well as underspending on land and buildings and other investments. PSIP execution improved from an average of 53.1 percent in 2015-2016 to 96.3 percent in 2018, but fell again in 2019-2020. Underspending of PSIP was particularly acute in transport, water and sewerage, education, and environmental protection in 2019-2020 (Table 5). It is also particularly acute for foreign-funded PSIP projects, in part due to optimistic expectations of project progress (IMF, 2019a). Even in 2019, only 48 and 80 percent of the annual PSIP budgets for the VIA terminal and runway development projects were executed, respectively. The adoption of a Virements and Appropriation Procedure in mid-2019 to protect the PSIP budget should have led to improvements in capital budget execution, but its implementation has been delayed due to the pandemic.

Figure 47: Maldives already had a large infrastructure spending efficiency gap...
Input efficiency scores, spending on infrastructure



Source: IMF PIMA
Note: EME = emerging market economies, EDA = emerging and developing Asia.

Figure 48: ...which seems to have persisted after the most recent expansion of PSIP spending.
Y-axis: infrastructure index; X-axis: public capital stock per capita.



Source: World Bank staff estimates using data from WDI and IMF.
Note: Data envelopment analysis methodology follows Herrera and Ouedraogo (2018).

56. **International benchmarking also indicates that Maldives has room to improve the efficiency of infrastructure spending.** The Public Investment Management Assessment undertaken in 2016-2017 (IMF 2019a) found that Maldives' infrastructure spending was only half as efficient as the most efficient spender (Figure 47). The gap was comparable to other developing Asian economies, but larger than the average gap for emerging and developing economies worldwide. An update of this analysis using more recent data from 2010-2019[65] and the data envelopment analysis technique specified in Herrera and Ouedragogo (2018) suggests that after increasing spending on PSIP, Maldives is still far from the spending efficiency frontier (Figure 48). In other words, Maldives can find ways to rationalize infrastructure spending without jeopardizing service delivery.

57. **Some reasons driving the low efficiency of investment are:**[66]
    - No costing of national strategies and plans: The SAP 2019-2023 lays out Maldives' development vision and mission, with clear targets, goals, actors responsible, and timelines. However, aside from a one-off attempt to estimate the cost of SAP implementation in 2020,[67] there is no accompanying document that estimates the costs of achieving these targets and goals, which could be used to inform multiannual PSIP allocations. Medium-term strategic plans are prepared for some ministries, but none are costed. As a result, there is a disconnect between budgeting, planning, financing, and implementation of public infrastructure investments.
    - Absence of costing over the project life cycle: Annual budget publications contain approved and estimated allocations for PSIP projects in their respective year and the following two years. For projects extending beyond three years, however, the total fiscal obligations of multiannual investment projects are not disclosed. Moreover, the projected recurrent costs of major infrastructure projects and carryovers from previous years are not included in the budget. Since lifecycle costing is not carried out, policymakers do not have a full picture of the total cost of each investment project at the onset. Costs for maintenance and operations are also not factored in.
    - Lack of robust and transparent selection criteria: There is very little public information available on how PSIP projects are selected to be included in the Budget. While MoF and the President's Office review and prioritize all projects based on standard criteria, these criteria are not published.
    - Lack of a standard published methodology for project appraisal: While MoF collects information on project appraisal, including feasibility studies and cost-benefit analyses of potential PSIP projects, these documents are rarely published. Internal capacity to perform and review cost-benefit analyses is limited, and there are significant data constraints in conducting such assessments.
    - Weak incentives for SOEs tasked with service delivery. As Chapter 3 shows, improving the governance of and central oversight over SOEs is key to improving the efficiency of public infrastructure spending in Maldives.

2.3 How can Maldives improve the quality of public spending?

58. **To improve the overall efficiency and effectiveness of public spending, Maldives could consider:**
    - Strengthening the monitoring and evaluation function within ministries and agencies. Decisions over how to improve the targeting, design or quality of state interventions can be better informed by periodic evaluations of which programs and projects are delivering, and which are not. To do so, ministries and agencies need to collect more and better data on sectoral outputs and outcomes. This also applies to the subnational level; however, data on public spending in a particular sector by atoll and island are not yet available.
    - Improving the strategic allocation of resources through medium-term expenditure or budget frameworks. To ensure that available resources are more closely linked to government priorities, the government could prepare bottom-up estimates of the financing that would be needed to achieve

[65] The infrastructure index consists of three indicators, selected based on data availability for the full sample of emerging and developing economies: (i) share of the population with access to electricity; (ii) share of population using the Internet; and (iii) trained teachers in secondary education (share of total teachers).
[66] This section draws heavily on IMF 2019b, 2021 and GoM and WBG 2021.
[67] MoF (2021b) provided some top-down estimates of how the yearly budget from 2020-2022 would be allocated towards the five areas of the SAP (p. 94), but these were not based on detailed investment plans.

targets in the SAP. As capacity improves in MoF and line ministries, the government could also bring medium-term budget planning more in line with international best practice, which would involve integrating the budget preparation process for current and capital spending, and carrying forward spending from one year to the next with well-defined restrictions (IMF, 2021). In this regard, the government's plans to move towards results-based budgeting would be a step in the right direction.

59. **On health, Maldives has room to reduce both current and capital costs without jeopardizing outcomes**. To ensure the sustainability of public health financing, the government could explore various opportunities to achieve better value for its health spending:

- **Reduce the price of drugs:** The government had proposed maximum retail prices for drugs reimbursed by Aasandha starting March 2022, which would cap the mark-up to 100 percent of free-on-board prices. The government had estimated that these maximum retail prices would reduce the drug spending in the country by US$13 million (0.7 percent of total expenditures in 2021) annually; however, the implementation of this measure has been postponed. The government's plans to explore bulk procurement to reduce drug prices could also result in some cost savings.

- **Reduce transport costs**, including through the use of digital technology: Rather than over-investing in specialized tertiary care in atolls, the government could help reduce transport costs of atoll residents to Malé by improving staffing at atoll hospitals and health centers. It could also increase the use of digital technology in health services, for example telemedicine, to reduce the need for patients to seek care in Malé or abroad.

- **Strengthen strategic purchasing by Aasandha**. Currently, hospitals are reimbursed largely via an inefficient fee-for-service payment method whereby all itemized expenses are paid by Aasandha. However, the global norm is to adopt a case-based approach, such as diagnosis-related groups, which would imply sharing of financial risk with the provider. Moving to such an approach would help to incentivize more judicious use of Aasandha resources. In addition, Aasandha could also benefit from a well-defined and costed benefit package of services.

- Improve hospital management: Finally, there is also room to improve hospital management practices at major government hospitals. Strengthened approaches to patient classification, cost accounting, quality improvement and human resources could all reap dividends.

60. **Maldives does not need to spend more on infrastructure, since public capital stock per capita is already almost on par with advanced economies.** Instead, to close infrastructure gaps between Malé and the atolls, it needs to find ways to improve the efficiency of budget execution and avenues to improve technical efficiency. It also needs to ensure that ongoing public investment projects are closing gaps in spatial welfare between Malé and the atolls, and increasing Maldives' potential output and productivity. To that end, the government can consider the following measures:

- **Publish the criteria and methodology for selecting and appraising PSIP projects**. While the government has started to develop a standard vetting process to screen potential PSIP projects, these guidelines and methodology are not divulged publicly. As a result, investment projects are not necessarily driven by local needs nor project readiness. Publishing the criteria and methodology for project selection and appraisal could help ensure that public resources are directed towards the most impactful investment projects.

- **Review whether sufficient funds are dedicated to rehabilitating and maintaining infrastructure assets.** Budgeting for recurrent costs associated with new and ongoing capital projects can help the government have a more realistic picture of the full costs over the project's life cycle. For instance, how much more will the government have to budget for health care staffing over the medium term given the envisioned construction of new hospitals and health centers, especially in the atolls? Are there sufficient funds for operations and maintenance of new harbors? Moreover, as previously mentioned, establishing a climate budget tagging system over the medium to long term could also help Maldives assess whether adequate PSIP resources are dedicated towards climate adaptation needs. Such a system would take time and resources to prepare, but Maldives could begin to lay the groundwork.

- **Improve systems to monitor and manage the implementation of public investment projects, both at the central and local levels.** In 2021, the government populated the Isles portal with comprehensive information on the financing and status of PSIP projects. This is an important step to improve transparency, accountability, and capital budget execution. Ensuring that there are sufficient resources to regularly maintain and update the portal, verify the information reported, and improve supervision and reporting will enable policymakers to take swifter action in the case of delays. This will be particularly important as the central government hands over the implementation of smaller PSIP projects to city, atoll, and island councils.

- **Establish a clear legal framework for public-private partnerships (PPPs)**.[68] PPPs can help Maldives leverage more private sector financing for planning, executing, and maintaining infrastructure projects, and therefore improve 'value for money'. However, there is currently no legal framework to regulate PPPs in Maldives. Without such a framework and the requisite oversight mechanisms, PPPs could become a significant source of fiscal risk to the government.[69] PPPs are not 'free money', but rather need to be repaid over the long term. Failure to monitor and adequately account for such risks could lead Maldives to engage in highly risky and costly infrastructure PPPs, as evidenced by its experience with India's GMR group in 2015.[70] This is especially the case as local councils are legally allowed to enter into PPPs on their own.

[68] PPPs refer to long-term contracts between a private party and a government entity for providing public assets or services, in which the private party bears significant risk, and where management responsibility and remuneration is linked to performance. See World Bank PPP Knowledge Lab for more.
[69] Bova et al (2016) analyzed 80 countries between 1990 and 2014 and found that PPP contingent liabilities that had materialized had amounted to 1.2 percent of GDP, on average.
[70] In 2010, the Indian firm GMR had signed an agreement with Maldives Airports Company Limited and MoF to expand, modernize, and operate Velana International Airport; however, a change in government led to the termination of the contract in 2012. Maldives had to pay US$270 million as compensation for wrongful termination.

CHAPTER 3

Fiscal risks from state-owned enterprises

Summary

Despite playing a critical role in Maldives, SOEs are not very profitable and pose large risks to public finances. To illustrate the importance of mitigating these risks, the chapter simulates the health of major SOEs' balance sheets under alternative economic scenarios. The analysis finds that: (i) faster economic growth will not improve the poor financial performance of SOEs; (ii) elevated oil prices will further exacerbate losses and increase corporate debt for most SOEs; and (iii) eliminating all government support to SOEs is not a viable option in the short term. Rather, the government needs to: (i) undertake major operational and institutional reforms to improve oversight of SOEs; (ii) rationalize support to SOEs; and (iii) promote more regular and detailed monitoring of SOE finances.

3.1 Introduction

61. **State-owned enterprises (SOEs) are a major source of fiscal risks.**[71] Fiscal risks refer to events that can result in unexpected deviations of fiscal outturns from their projected outcomes. They comprise both explicit legal obligations ("direct risks") and implicit burdens placed on the government by public expectations ("contingent risks"). SOEs can pose significant risks to public finances in two main ways:

    - Impact on government cash flows: Both sides of the government's cash flows may be adversely impacted by higher-than-anticipated outflows to SOEs (e.g., additional expenses from subsidies, capital injections, or payments of SOE debt service) and/or by lower-than-anticipated SOE inflows (e.g., profits, dividends, and tax revenues) to the state. During the COVID-19 pandemic, both of these effects occurred simultaneously in many countries.

    - Impact on government balance sheet: Downside risks related to SOEs can impact both sides of the public sector balance sheet, leading to higher-than-anticipated levels of public debt (e.g., when guarantees provided to SOEs are called) or a lower-than-anticipated stock of assets (e.g., erosion of value of equity stakes in a SOE facing bankruptcy). Such events may undermine the government's creditworthiness, resulting in a higher cost of borrowing.

62. **Such fiscal risks can be explained by the existence of non-commercial objectives and soft budget constraints.** SOEs operate in many sectors that are not commercially viable for private enterprises, often undertaking "quasi-fiscal activities"[72] that limit their profitability. SOEs also face a soft budget constraint, as governments cannot credibly commit not to bail out enterprises of which it has sole or controlling ownership. Because SOEs are often not allowed to fail, they benefit from explicit and implicit subsidies and preferential access to domestic and external credit. Governments may borrow on SOEs' behalfs or provide guarantees for SOEs, which can reduce incentives for efficiency and profitability, and ultimately spark financial crises.

63. **This chapter urges the government to take policy actions that mitigate the fiscal risks that SOEs pose to the Maldivian economy.** Following a brief discussion of SOEs' economic importance, the main mechanisms through which SOEs pose fiscal risks are discussed and quantified. The chapter then presents the results of stress tests on the balance sheets of SOEs in different potential economic scenarios and concludes with some suggestions on how fiscal risks from SOEs can be mitigated.

[71] Using a sample of 80 advanced and emerging market countries, Bova et al (2016) find that fiscal costs from SOEs bailouts averaged 3 percent of GDP over 1990-2014, but reached as much as 15 percent of GDP in the most extreme case. Realized liabilities from SOEs constituted the fourth largest source of fiscal risks.

[72] These are sectors where the government mandates activities, prices, labor and other regulations that often result in losses for the SOEs. QFAs tend to lead to underinvestment and/or excess borrowing. Ultimately, the government has to step in to bail out these enterprises through transfers, capital/equity injections and even debt restructuring.

3.2 Overview of SOEs in Maldives

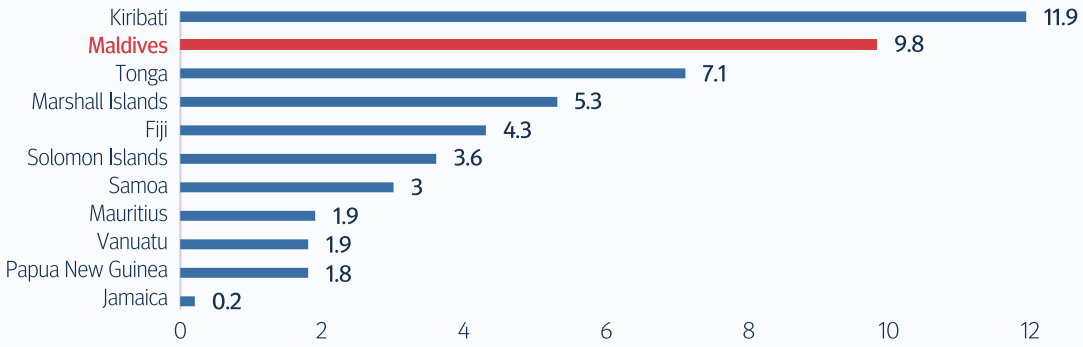
List of Maldivian SOEs frequently used in this chapter

AIA	AIA Addu International Airport
BML	BML Bank of Maldives
FDC	FDC Fahi Dhiriulhun Corporation
HDC	HDC Housing Development Corporation
HDFC	HDFC – Housing Development Finance Corporation
MACL	MACL – Maldives Airport Company Ltd
MIB	MIB – Maldives Islamic Bank
MIFCO	MIFCO – Maldives Industrial Fisheries Company
MTCC	MTCC – Maldives Transport and Contracting Company Plc
MTDC	MTDC – Maldives Tourism Development Corporation
MWSC	MWSC – Malé Water and Sewerage Company
SDFC	SDFC – SME Development Fund Corporation
STELCO	STELCO – State Electric Company
STO	STO – State Trading Organization
WAMCO	WAMCO – Waste Management Corporation Ltd

64. **SOEs play a critical role in the Maldivian economy.** While SOEs tend to be dominant in small island developing states, Maldives stands out, accounting for nearly 10 percent of GDP – much higher than its small island peers(Figure 49).[73] The government is the majority stakeholder in most SOEs, fully owning 22 out of the country's 32 SOEs.[74] SOEs are important sources of job and revenue creation: they employ an estimated 21,000 Maldivians or about 12 percent of employees outside resorts[75] and account for about a fifth of total non-tax revenues (4 percent of total revenues).

65. **The main reason driving the outsized role of SOEs in Maldives is their mandate to deliver public infrastructure.** As at end-2020 (latest available data), Maldives' SOEs held US$8.3 billion in total unconsolidated assets. The bulk of these assets (57 percent) was held by majority government-owned SOEs that are involved in delivering public housing, transportation and utilities (Figure 50), mainly the Housing Development Corporation (HDC) and the Maldives Airports Company Limited (MACL). The

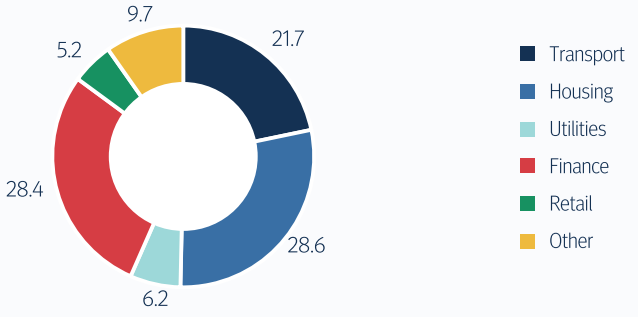
Figure 49: SOEs play a critical role in Maldives, even more so than in other small island developing states
Sum of operating profits, wages, and salaries as a share of GDP, percent



Source: Based on ADB (2016). Maldives' data is an average of 2014–2018; other countries' data refer to 2014.

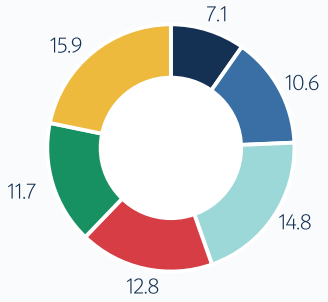
[73] This is calculated as the sum of operating profits and wages and salaries as a share of GDP. In 2020, the share increased to 16 percent due to the contraction in the denominator. An alternative metric is SOE density (number of SOEs per 100,000 inhabitants). According to the World Bank Global SOE Database (World Bank, 2022d, forthcoming), Maldives' SOE density is 70, compared to just 32 in Seychelles.
[74] See https://www.finance.gov.mv/public-finance/public-enterprises. These include FDC and HDC, the major entities responsible for public housing development (see Chapter 4), Aasandha, the health insurance provider, STELCO and FENAKA, the country's major electricity providers, and the MACL, the airport management company.
[75] According to PCB in November 2021. As noted in Chapter 1, half of all full-time workers (outside those working in resorts) were employed in the public sector in 2019.

Figure 50: SOEs in transport, housing and utilities hold over half of total assets...
Share of total, percent



Source: MoF 2021b, staff calculations

Figure 51: ...but only account for about a third of revenues.
Share of total, percent



Source: MoF 2021b, staff calculations

prominence of SOEs in infrastructure provision is not unusual for small island developing states and emerging market economies such as Maldives, where delivering essential public goods and services to a widely dispersed population (see Chapter 1) is costly and challenging. However, Maldives' infrastructure SOEs are not very profitable, accounting for only about a third of the total revenues and net profits generated by a sample of SOEs at end-2020 (Figure 51).[76] This poor financial performance was not solely a consequence of the effects of the COVID-19 pandemic: even in 2019, infrastructure SOEs only generated 40 percent of total revenues and net profits of the largest SOEs.[77] As shown later, most infrastructure SOEs are heavily reliant on government budget support, external loans and guarantees.

66. **Even before the COVID-19 pandemic, the financial performance of SOEs[78] was highly uneven.** In 2019, listed SOEs generated three times more revenue on average than unlisted SOEs (Figure 52), and twice as much in net profits (Figure 53). In 2020, the average net profit from listed SOEs even increased slightly despite the pandemic, while that of unlisted

Figure 52: The average listed SOE generates more revenues than the average unlisted SOE...
Total revenues, US$ million

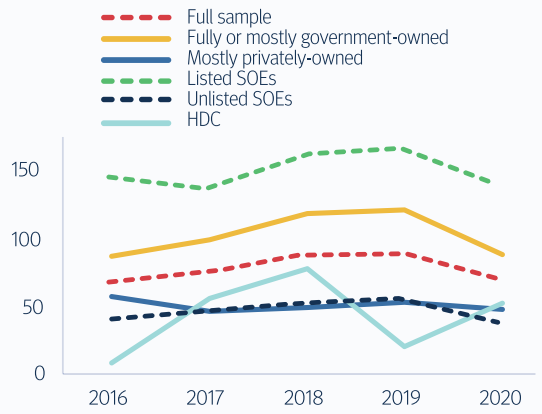
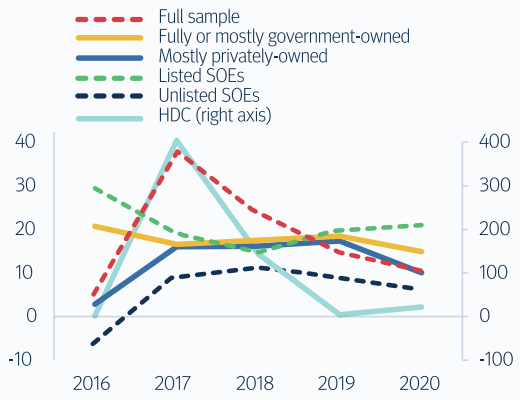


Figure 53: ...as well as higher net profits.
Total net profits, US$ million



Source: PCB annual reviews (2017-2020) and HDC 2018, staff calculations
Note: HDC is shown separately due to the large increase in net profits in 2017. This was prompted by a change in policy at end-2017 to recognize all investment properties at fair value.

[76] Total revenues of selected SOEs whose financial information is reported in the FY2020 PCB Annual Review amounted to US$1.4 billion and US$199 million at end-2020, respectively. See Annex 3.
[77] Total revenues of selected SOEs whose financial information is reported in the FY2020 PCB Annual Review amounted to US$1.7 billion and US$275 million at end-2019, respectively. See Annex 3.
[78] This would ideally be measured by return on equity and return on assets, but such information is available for only a small group of SOEs in PCB's latest (FY2020) Annual Review. Using data available for AIA, FDC, BML, Dhiraagu, MACL, MIB, HDC, MWSC, MTDC, STELCO and STO, the average RoE was negative (-7 percent) in 2019, worsening to -17 percent in 2020. This indicator was mostly driven by large negative RoEs for AIA and FDC, the newly-established social housing SOE (see chapter 4).

SOEs declined. Out of the seven listed SOEs, the government only owns a majority stake in three, i.e., STO, MTCC and BML. Minority government-owned SOEs posted slightly higher net profits especially in 2020, compared to the majority of government-owned SOEs.[79] Importantly, the 'true' averages for majority government-owned SOEs are likely much lower, as data from audited financial statements was not available for Aasandha, Island Aviation Services, the Waste Management Corporation (WAMCO) and FENAKA for most of the 2016-2020 period. Although all SOEs are required to submit audited financial statements within three months after the end of each financial year, this is not currently practiced by most companies (GoM and WBG 2021).[80]

67. **To some extent, the poor financial performance of unlisted, majority-government owned SOEs reflects their public service obligations, which have kept profits below their potential.** Public service obligations impact SOEs' financial performance, as ensuring service delivery across Maldives' widely dispersed population is costly and presents a considerable challenge. For example, the State Electric Company (STELCO), which is required to provide electricity to over 30 islands, has high fixed costs and is not able to achieve economies of scale. Similarly, FENAKA cannot set tariff prices freely and thus does not make a profit from its operations on any island. MTCC is mandated to provide regular low-cost ferry services to ensure connectivity between islands, including on unprofitable routes. In other cases, SOE profitability has been impacted by government mandates to enter an unrelated and often unprofitable business line, such as the case of STO absorbing MIFCO.[81]

68. **SOEs have also played a major role in delivering fiscal stimulus during the COVID-19 pandemic, to the further detriment of their balance sheets.** In April 2020, the government – acting largely through SOEs – delivered a series of stimulus measures to support households and firms' liquidity during the crisis (see Box 3 in Chapter 2). These included: (i) temporary discounts on utility bills (STELCO, FENAKA, MWSC); (ii) price controls on food staples (STO); (iii) a moratorium on repayments for selected business and personal loans (BML, MIB and HDFC); (iv) deferment of housing rent and resort lease rent payments; and (v) extension of special financing facilities totaling US$75 million to businesses through BML and the SME Development Fund Corporation (SDFC). Although SOEs were already not very profitable before the pandemic, some of these measures have further affected their balance sheets.

3.3 How do SOEs pose fiscal risks to the Government of Maldives?

69. **Fiscal risks from SOEs amount to an estimated US$2.5 billion or 45 percent of 2019 GDP.** SOEs pose both explicit and implicit fiscal risks to the government. "Explicit" fiscal risks emerge from liabilities owed by SOEs to the government (e.g., loans and on-lending, tax and dividend arrears), as well as debts owed by SOEs to third parties that are explicitly guaranteed by the government (e.g., external loans carrying sovereign guarantees). "Implicit" fiscal risks result from financial assistance provided by the government that does not create a repayment obligation for the SOEs (e.g., subsidies and capital injections), as well as debts owed by SOEs to third parties that do not carry a formal guarantee but are expected to be borne by the government if SOEs run into distress. Table 6 presents the main sources of fiscal risks to the government from SOEs, with estimates of their magnitude as at end-2020 (latest data available). Explicit risks are estimated at US$1.6 billion or 30 percent of 2019 GDP[82] and mostly stem from guaranteed and on-lent debt to SOEs. Implicit risks amount to an estimated US$859 million or 15 percent of 2019 GDP and mostly consist of trade payables.

70. **From the table, the main three sources of fiscal risks from SOEs are as follows: First, the government supports SOEs through the issuance of loan guarantees and on-lent loans.** As noted in Chapters 1 and 2, SOEs tasked with delivering PSIP projects have been the main driver of the increase in

[79] Majority government-owned SOEs had higher revenues on average, presumably because they receive capital contributions from the government.
[80] For financial year 2018, for example, most companies took more than 9 months to submit their annual financial statement to the Privatization and Corporation Board, PCB (World Bank, 2021).
[81] For example, the Maldives Port Company has been required to provide bus and ferry services; STELCO is required to provide water and sewerage services where they have existing electrical plants. STO's profitability was also impacted by subsuming the loss-making MIFCO as a subsidiary.

Table 6: Sources and Magnitude of Fiscal Risks to Government from SOEs (end-2020)

Source of fiscal risk related to SOEs	Risk exposure (US$ millions)	% of 2019 GDP
SOE debt guaranteed by govt	780	14
Govt. on-lending to SOEs	567	10
Direct Treasury lending to SOEs	131	2.3
Dividend arrears	129	2.3
Tax arrears	37	0.7
Total explicit risks	**1645**	**29.9**
SOE trade payables	636	11
Subsidies to SOEs	81	1
Capital injections	143	3
SOE contingent liabilities	N/A	N/A
SOE non-financial assets exposed to damage from disasters	N/A	N/A
Other	859	15
Overall PSIP budget execution	**2504**	**44.9**

Source: Staff estimates, adapted from IMF (2020) based on information from MoF Public Debt Bulletin (December 2020) and Budget in Statistics (2021).

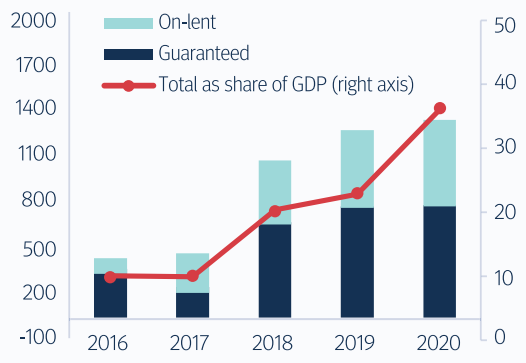
Maldives' public debt. To finance these projects, the government has guaranteed US$780 million worth of debt and on-lent a further US$567 million to SOEs (Figure 54), for a total of US$1.3 billion or 35 percent of 2020 GDP. HDC is the biggest beneficiary of sovereign guarantees and MACL is the biggest beneficiary of on-lent debt, accounting for 71-73 percent of their respective totals[83] (Figure 55). These guarantees were mainly given on loans related to the expansion of the VIA and Hulhumalé Phase II. Most guarantees were provided for loans contracted at non-concessional rates from external sources, including ICBC and EXIM China. Almost all guaranteed debt is denominated in US dollars and carries floating interest rates, posing a risk to government finances. Again, it is important to note that SOEs were already highly indebted before the pandemic; in 2019 Addu International Airport (AIA) had a gearing ratio[84] of 201 percent, whereas STELCO, STO and MACL had gearing ratios exceeding 50 percent. Except AIA, whose gearing ratio has doubled, the ratios of other companies have moderated slightly – but remain high – in 2020. All in all, SOEs' liabilities amounted to US$4.8 billion at end-2020 (see Annex 2). Such high levels of SOE debt could impact the central government's ability to borrow.

71. **Second, the government supports SOEs extensively through subsidies to cap the prices of certain goods and public services.** From 2018-2021, the government spent an average of US$79 million or about 2 percent of GDP per annum on subsidies to SOEs. These include: (i) food subsidies to STO to reimburse it for the cost of selling staple foods (rice, sugar and floor) at controlled prices, which are below market prices; (ii) fuel subsidies to STO to reimburse it for the cost of fuel used by electricity producing companies; (iii) electricity subsidies to FENAKA and STELCO to compensate them for the loss in revenue from selling a unit of electricity below a cost recoverable unit price;[85] (iv) waste management subsidies to WAMCO reduce the price of waste disposal services; and (e) public ferry operation subsidies to MTCC.[86]

72. **The government also provides capital injections to SOEs to meet their operational and capital expenses, and thus support their overall financial position.** As SOEs often provide essential services mandated by the government, capital contributions are being provided from the government budget every year to minimize disruptions to their operations

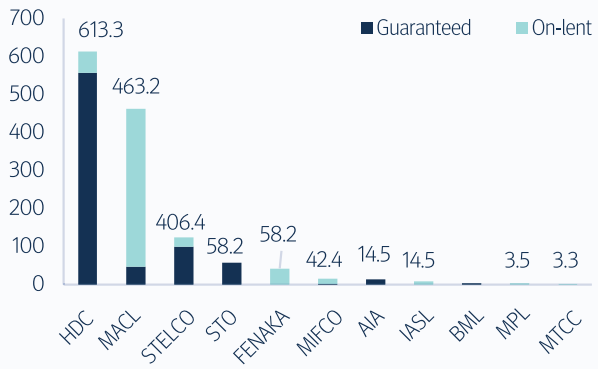
[82] 2019 GDP is used since the economy suffered a large contraction in 2020.
[83] Excludes US$400 million to MMA (RBI swap).
[84] Total loans and borrowings over capital employed.
[85] The tariff rate approved by the Maldives Energy Authority is lower than the cost of producing a unit of electricity. As a result, the government provides STELCO, FENAKA and MWSC subsidies in the form of revenue loss recovery.
[86] MTCC has been operating the public ferry system at a loss and has also recently had to cater for additional regions where private ferry operators have ceased their operations. Hence, to compensate for the loss in its operation in the year 2020, the government will grant MTCC a subsidy of MVR 102 million.

Figure 54: Government guaranteed and on-lent debt to SOEs reached US$1.3 billion at end-2020
Left: US$ millions, right: share of GDP, percent



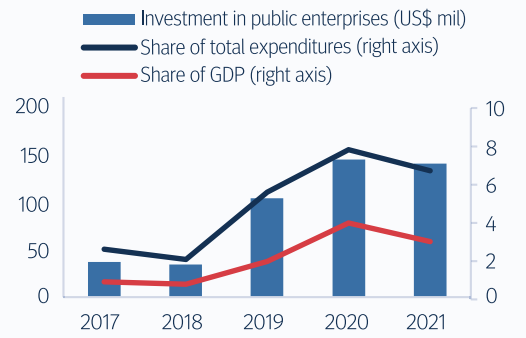
Source: MoF public debt bulletins, 2016-2020.
Note: The December 2021 debt bulletin does not include this breakdown. Excludes the US$400 million MMA swap with RBI and a US$121 million guarantee to Ahmed Siyam Holding, a private entity.

Figure 55: HDC and MACL are the biggest beneficiaries of guaranteed and on-lent debt, respectively
US$ millions



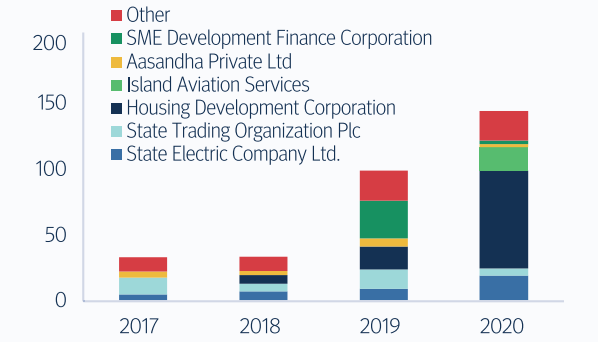
Source: MoF December 2020 Public Debt Bulletin.
Note: The December 2021 debt bulletin does not include this breakdown. Excludes the US$400 million MMA swap with RBI and a US$121 million guarantee to Ahmed Siyam Holding, a private entity.

Figure 56: The government supports SOEs through capital injections...
Transfers to SOEs, US$ millions (left axis) and share, percent (right axis)



Source: MoF, staff calculations

Figure 57: ...of which HDC is the main beneficiary.
Transfers to SOEs, US$ millions



Source: MoF
Note: Latest data available.

and service delivery. As noted in Chapter 2, spending on capital contributions to SOEs tripled from US$33-36 million annually in 2017-2018 to US$102 million in 2019 as the government tripled capital injections to STO, HDC and Aasandha (Figure 56). In 2020 and 2021, transfers to SOEs further increased to US$143 million and US$139 million respectively, reflecting the impact of the COVID-19 pandemic especially on HDC (Figure 57), STELCO and Island Aviation Services. New SOEs such as FDC (housing) and the SDFC (SME finance) were also established. Chapter 4 elaborates on the fiscal risks from HDC and FDC.

73. **Such subsidies and capital injections heavily support SOEs' financial performance.** In 2020, total net profits of a sample of 20 Maldivian SOEs reached US$275 million. However, subsidies and capital injections from the government to SOEs accounted for the bulk of their net profits, amounting to US$224 million or 81 percent of total net profit.

74. **Third, SOEs make limited and lower-than-expected contributions to state revenues.** Even before the COVID-19 pandemic, only six out of Maldives' 32 SOEs paid any kind of dividend to the government in 2019 (Dhiraagu, MWSC, HDFC, BML, STO and MACL). On

[87] Differs from the number reported in Figure 5 because it includes Aasandha, which reported audited financial information in 2019 and 2020. Figure 5 excludes Aasandha because this information was unavailable in PCB annual reports from 2016-2018.
[88] MoF 2021a.
[89] Ibid. In 2020 dividends amounted to US$27.5 million (net of MMA) while subsidies and capital injections reached US$224 million.

Figure 58: Half of all dividends come from Dhiraagu, the mostly privately-owned SOE

US$ millions

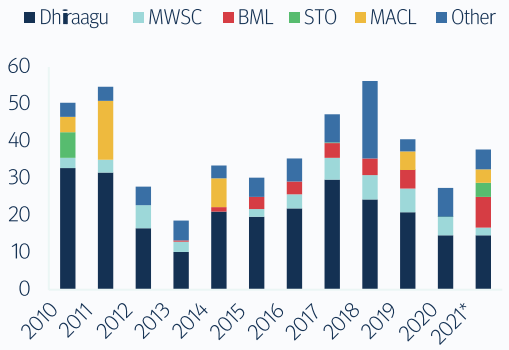
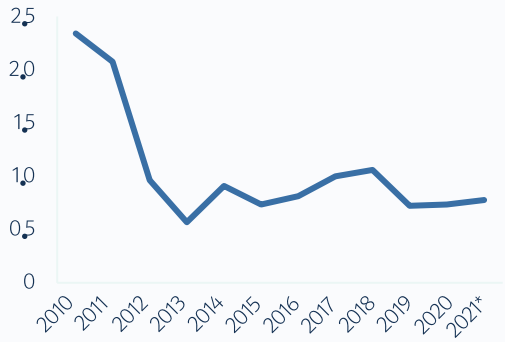


Figure 59: SOE dividends only contribute 1 percent of GDP to state revenues

Percent of GDP



Source: MoF, 2021. Budget in Statistics and 2019 Annual Financial Review, PCB. Total dividends exclude MMA

average, about half of all dividends come from the telecommunications company, Dhiraagu, in which the state owns a minority share (Figure 58). The aggregate size of SOE dividends fell from an average of 1.8 percent of GDP between 2010-2012 to 0.8 percent of GDP between 2013-2021 (Figure 59). This significant fall in SOE dividends can mainly be explained by MACL, which has stopped providing dividends due to the expansion of VIA. In addition, as a result of higher inter-SOE arrears and unpaid bills owed by the government itself to some SOEs (e.g., STO, MWSC, STELCO) during the onset of the COVID-19 pandemic, SOEs have withheld an increasing share of dividends owed to the government. Dividend arrears by SOEs were estimated at US$129 million or 2 percent of GDP at end-2020.

75. **Not all SOEs make tax payments.** While the Maldives Inland Revenue Authority (MIRA) has made substantial progress in updating its systems by tracking tax receipts for large companies (Maldives' primary tax contributors) and improving accountability, comprehensive data is currently not yet available for the entire SOE portfolio. According to information available at the time of writing, SOE tax arrears include US$34 million in Business Profit Tax and US$3.4 million in withholding taxes.

76. **The above assessment only provides a partial view of the overall net effect of SOE operations on the government budget.** Without comprehensive data on SOE tax payments, the net impact of SOEs on government finances can currently only be partially estimated. Based on MoF information, it is estimated that SOEs had a negative net impact of US$197 million at end-2020 (equivalent to 3.5 percent of 2019 GDP), excluding tax payments. However, inter-SOE transactions render the assessment of individual SOEs' financial performance and fiscal risks from SOEs more complex. More comprehensive information on the pricing of transactions between SOEs, and the business relationships between specific entities, is needed to make a full assessment of fiscal risks from SOEs.

3.4 Stress-testing Maldives' SOEs

77. **To illustrate the importance of mitigating fiscal risks from SOEs, this section presents simulation results on the health of SOEs' balance sheets under alternative scenarios, including shocks to the Maldivian economy.** The section uses an integrated macro-micro model to link macroeconomic indicators to corporate finance indicators by postulating accounting conventions and elasticities (see Annex 3a for the methodology and Annex 3b for the results). The model assesses the performance of six major SOEs (STO, MACL, STELCO, FENAKA, MTCC and HDC)[90] in 2022-2024 under four illustrative scenarios (Table 7):

    i. **Baseline scenario:** Uses the economic growth and inflation forecasts of the baseline scenario reported in the conclusion of Chapter 1. It assumes the Brent oil price decreases from US$95 per barrel in 2022 to US$80 per barrel in 2024.[91] Annual government subsidies to SOEs are maintained at the levels observed in 2020 throughout the 2022-2024 period.

    ii. **Higher economic growth scenario:** Uses the higher growth scenario in Chapter 1.

    iii. **Higher oil price scenario:** Assumes that the Brent oil price peaks at US$105 per barrel in 2022 and decreases to US$85 per barrel by 2024.

    iv. **No subsidy scenario:** Assumes no government subsidies are provided to SOEs in 2022-2024 (as a result of, for example, an economic shock or a policy reform).

78. **Poor financial performance of STELCO, FENAKA, MTCC and HDC is expected to continue even if the Maldivian economy recovers.** In the baseline scenario, these four SOEs are projected to run operating losses in 2022-2024, and thus require government subsidies and other types of financial assistance.[92] Their corporate debt will increase further in view of persistent financing needs associated to those losses and ongoing investment plans. STO is expected to maintain very limited operating profits and slightly reduce its corporate debt. On the other hand, MACL will generate significant operating profits, while accumulating corporate debt to fund large capital expenditures related to the expansion of VIA.

79. **Under the baseline outlook, the SOEs' demand for budget subsidies, direct loans, and sovereign guarantees is likely to continue unabated in the next few years.** Subsidies to SOEs, especially for fuel, are expected to continue as long as a partial pass-through of international oil and commodity prices to domestic retail prices and power tariffs remain in place. Cross-subsidization between operational loss-making companies and operational profit-making ones – most notably, MACL – is not an option since the latter requires those profits to support their (debt-financed) capital investment programs.

80. **Given the baseline outlook and in the absence of major reforms to the SOE sector, aggregate operating losses for STELCO, FENAKA, MTCC, and HDC are expected to reach about MVR 900 million (US$58 million) per year, on average, between 2022 and 2024.** This aggregate loss is equivalent to 1 percent of 2019 GDP and even exceeds the MVR 550 million (US$36 million) combined loss recorded in 2019 for the four companies. Corporate debt for these companies will increase further, from MVR 14.8 billion (US$961 million) in 2021 to an estimated MVR 20.4 billion (US$1.3 billion) by 2024.

Table 7: Scenarios for simulations of selected Maldivian SOEs' balance sheets

	Real GDP Growth (%, annual average 2022-2024)	Brent Oil Price (US$/barrel, average 2022-2024)	Subsidies to SOEs (MVR million, annual average 2022-2024)
Baseline Scenario	8.3	87	1,442
Faster economic growth	10.3	87	1,442
Higher oil prices	8.3	93	1,442
No subsidies to SOEs	8.3	87	0

Source: World Bank projections.

[90] The selection was based on the fact that these are fully government-owned SOEs that are instrumental in delivering key public infrastructure and services.
[91] World Bank commodity price assumptions as of March 2022.
[92] Projections of SOEs' gross income are rather challenging in the current juncture; for instance, HDC's future sales of land, residential and commercial properties face volatile prices and uncertain construction completion dates and market demand.

81. **The second scenario – faster economic growth over 2022–2024 – would only marginally improve financial performance of the SOE sector.** In the higher growth scenario, the operating losses (or profits) and corporate debt of the six SOEs in 2022–2024 are similar to the baseline case. This is because a company's sales and costs increase pari passu with a stronger economic recovery, while the unitary operating margins are not affected, i.e., unitary operating margins would still remain at a loss for STELCO, FENAKA, MTCC and HDC, and at a profit for STO and MACL. In all six companies, the financing needs emerging from operating losses, investment programs, or both, are also unaffected.

82. **A faster-than-expected economic recovery is insufficient to mitigate the fiscal risks posed by the SOE sector.** In the higher growth scenario, the aggregate operating losses for STELCO, FENAKA, MTCC and HDC are projected to be MVR 940 million (US$61 million) per year, on average, between 2022 and 2024 – in view of their unitary operating margins exhibiting a loss. Their corporate debt will be on a rising path similar to the baseline case. Hence, faster economic growth in Maldives cannot restore the financial viability of these companies by itself.

83. **In the third scenario, elevated oil prices are expected to significantly worsen the financial performance of the SOE sector.** In the high oil price scenario, the unitary operating margins worsen for most companies; thus, their operating losses widen, or the operating profits narrow. Such deterioration is more significant in STO, MACL, STELCO, and FENAKA, in view of the intensive imports of oil required for their productive activities. In most companies, the financing needs resulting from higher operating losses – or lower operating profits – lead to higher levels of corporate debt.

84. **Higher-than-expected oil prices will further exacerbate fiscal risks emerging from SOEs.** In the scenario with higher global energy prices, the aggregate operating losses for STELCO, FENAKA, MTCC and HDC are expected to reach MVR 1.2 billion (US$78 million) per year, on average, between 2022 and 2024 – as a consequence of their unitary operating margins exhibiting a loss larger than in the baseline case. Corporate debt will increase even further, reaching MVR 21.4 billion (US$1.4 billion) by 2024. Even if the government provides more subsidies, aggregate corporate debt would still rise to about MVR 21.2 billion by 2024. (For STO and MACL, the aggregate operating profits would be reduced by 15 percent relative to the baseline case, thus weakening their financial standing and borrowing conditions).

85. **The higher oil price scenario is relevant to the current global context and would have the most damaging impact on Maldivian SOEs.** More expensive oil imports – which are often accompanied with higher prices for other commodities also imported to the Maldivian economy – will further lead to a deterioration in SOEs' financial viability and increase their demand for government support. SOEs' demand for budget subsidies, direct loans, and sovereign guarantees would also increase in a context of sustained high prices of oil and commodities.

86. **In the final and fourth scenario, eliminating all government subsidies to SOEs would significantly weaken their financial position and creditworthiness in the short-term.** In the no subsidy scenario, most companies are expected to run significant losses, face larger financing needs, and accumulate corporate debt to unprecedented levels. For instance, aggregate corporate debt of STELCO, FENAKA, MTCC and HDC would increase from MVR 14.8 billion (US$961 million) in 2021 to MVR 23.4 billion (US$1.5 billion) by 2024. For STO and MACL, aggregate corporate debt would rise by 8 percent relative to the baseline case. This scenario illustrates the dependence of SOEs on government support.

87. **To rationalize government support to SOEs and avoid further deteriorations in their (already weak) financial performance and creditworthiness, major operational and organizational reforms in the SOE sector are essential.** The scenarios described above suggest that the government should not rely solely on economic recovery as a solution for SOEs' structurally weak performance. More importantly, even if the government seeks to impose more fiscal discipline and restore public debt sustainably, it cannot just withdraw long-standing financial support to SOEs because many will eventually experience additional financial distress and undermine the overall credit standing of the public sector as a whole. Hence, subsidy rationalization should be an integral part of a comprehensive SOE reform program. Some policy recommendations are put forward in the remainder of this chapter.

3.5 How can Maldives manage and mitigate fiscal risks from SOEs?

88. To better manage and mitigate the fiscal risks from SOEs, it is recommended that the government: (i) strengthen the institutional arrangement for SOEs fiscal risk oversight; (ii) rationalize government support to SOEs; and (iii) enhance transparency in monitoring and reporting.

Strengthen the institutional framework for SOEs' fiscal risk oversight

89. **First, Maldives needs to either liquidate or privatize SOEs that are highly dependent on the government budget or introduce a different set of rules that restricts their autonomy compared to commercially-oriented SOEs.** As a first step, MoF could identify commercially-viable SOEs versus SOEs that exist to serve a policy purpose. Commercial SOEs should adopt regimes for subsidies based on management performance, and alternative ownership arrangements should be explored – e.g., partial public listing or sales of minority stakes. On the other hand, the government could enhance the corporate governance of SOEs seeking to achieve a policy purpose, e.g., separating accounting for costing their non-commercial obligations; redesigning obligations and funding from government budget under explicit service agreements; and eliminating cross-SOE arrears.

90. **Second, Maldives needs to develop a clear and rational policy for creating new SOEs, which should be created only in the absence of viable alternatives.** While the prominence of SOEs in a small island state is not unusual, the omnipresence of SOEs in Maldives is crowding out the private sector. To ensure that SOEs only play a role where the market cannot, the government could more strictly enforce the provisions of the Privatization and Corporatization Act[93] and apply greater scrutiny to the establishment of new SOEs. It is unclear, for example, why FDC was created to take over the public housing mandate from HDC (see Chapter 4). Ideally, any new SOE should have a clear mandate and accountability, be restricted to invest in well-defined business lines, subsidiaries, or joint ventures, and have a limited capacity to expand unprofitable activities without explicit government approval. To complement the current Corporate Governance code, MoF could set a Statement of Corporate Intent that defines and limits SOEs' scope of activities.

91. Third, a public sector obligation (or agreement) system could be introduced for subsidized activities. The cost of subsidized activities must be accounted for separately and subject to comprehensive auditing. To do so, Maldives could create a holding company or specialized entity for SOE oversight and ownership, following the model adopted in Bhutan, Kazakhstan, Malaysia, and Singapore. Such a holding company could enhance the monitoring of SOEs' subsidized activities through the design, execution and follow-up of public sector obligations (agreements) between each SOE and the holding entity. These public sector obligations would impose certain targets in terms of operation and subsidy rationalization. Although not without its risks, the holding company model could improve SOE performance and mitigate political interference if there is commitment to a set of commercial targets at the highest levels of leadership. Another option is to establish an agency or commission within the government, which is administratively more straightforward (e.g., the model used in Korea and Philippines).

92. **Fourth, the role of PCB could be further enhanced to incentivize better SOE performance and to monitor fiscal risks from SOEs.** In recent years, PCB has strengthened its monitoring and guidance function. In May 2019, for example, PCB issued a corporate governance code for SOEs to strengthen the staffing and functioning of SOE Boards, improve risk assessment and management, and strengthen the transparency and disclosure of the SOEs. However, a recent review (MoF PCB 2021) indicates that compliance with the code is poor – few companies have a proper internal audit function and only half had formulated a Board-approved strategic plan. Given that the legal mandate of PCB is more focused on privatization, PCB lacks stronger mechanisms to enforce the code (see Box 4). Similarly, while PCB has strengthened its monitoring function by collecting, analyzing, and publishing financial information of individual SOEs on a quarterly basis, PCB staff lack specific skills in financial and risk analysis, which severely impedes its effectiveness to monitor fiscal risks. It is also understaffed.

[93] As stipulated by the Act, PCB is supposed to evaluate the fiscal status and budget analysis, the use of the capital allotted by the government, maintain the accounts and implement the procedures for the distribution of annual profits, determine the actions to be taken against companies that do not generate a profit, discuss with the relevant authorities about what to do about entities that fail to produce a profit even after taking action against them except the places that are run for community services by SOEs.

Box 4: Enhancing the role of PCB

To oversee and monitor SOEs, the "Public Enterprises Monitoring Unit" (PEMU) was formed as a part of the Ministry of Finance on 1 March 1995 (later renamed to "Public Enterprise Monitoring and Evaluation Board, PEMEB). With the adoption of the Privatization and Corporatization Act in 2013, a Privatization and Corporatization Board was formed, and PEMEB served as the secretariat. The Board consists of seven members appointed by the President of Maldives. In 2019, the name of the unit was changed to "Secretariat of Privatization and Corporatization Board" (PCB).

The PCB was originally established to facilitate privatization. However, this agenda has not progressed, with hardly any SOEs being privatized. The mandate of the PCB therefore needs to be revised. Currently, the Act overemphasizes privatization and does not say much on monitoring and enforcing actions against underperforming SOEs. The Act is also silent on the role of the MoF, which is the legal shareholder and representative at SOE boards. Amending the Act to have a greater emphasis on monitoring and oversight, and to restore the role of the MoF in SOE monitoring, would give PCB greater weight in policymaking on SOEs.

Source: Adapted from World Bank 2019; GoM & WBG 2021.

Rationalize government support to SOEs

93. **Fifth, the government could strengthen scrutiny of subsidies to SOEs and their capital expenditure proposals, and improve SOE budget planning.** Comprehensive budget guidelines could be developed to assess subsidies and financial assistance to SOEs. As highlighted in Chapter 2, affordability analyses should be conducted for major capital projects – on top of financial and economic assessments – to improve the effectiveness of SOE public investment and the sustainability of public finances (IMF 2019b). While current quarterly reports on SOEs are good practice, additional analysis on SOEs' operational and financial performance could be included. For example, to better understand the net impact of SOEs on the Maldivian economy, it would be necessary for PCB to collect detailed information on inter-SOE arrears and reciprocal SOE-government arrears; operating subsidies paid by the government for the costs of specific activities conducted by SOEs, or to compensate for operating losses; taxes and royalties paid by SOE; cross-trade credits and payables; and write-offs of SOE debt.

94. **Sixth, there is room to improve the management of sovereign guarantees and to discontinue Treasury Loans to SOEs.** While the Debt Management Department of MoF has made much progress, it could further enhance technical evaluation and monitoring of sovereign guarantees supporting SOEs' major capital investment, including the analysis of fiscal risks. To mitigate these specific risks, the draft Debt Law and guarantee guidelines could contemplate the charging of risk-based fees, the establishment of a guarantee fund, and the introduction of quantitative limits on the value of new guarantees granted every year. Furthermore, Maldives could require any state budget funding to SOEs to be approved by Parliament, with a limited/pre-specified scope in terms of equity, subsidies, and/or government contracts (IMF 2021).

Promote transparency in monitoring and reporting of SOE financial information

95. **Seventh, the government could enhance the SOE monitoring framework to become more policy-based, risk-based, and forward looking.** This requires setting up a centralized database of core corporate finance information, including subsidies and capital contributions, quasi-fiscal activities, and risk indicators. Ideally, the database would contain information of the full capital costs and future recurrent costs of current and planned public investment projects. Individual SOE profiles can be formulated using this database, and the government could consider establishing a "SOE report card" system, as done in Grenada, to track key performance indicators. Moreover, the PFM legal framework could require more comprehensive requirements on SOEs' budgeting, reporting, transparency, and performance. The government has taken a first step towards greater transparency of some SOEs by updating information on public infrastructure projects on the Isles portal, and is working on developing a "SOE Gateway", a portal that monitors the financial situation of SOEs.

96. **Finally, the fiscal risk statement could be strengthened to include a more in-depth discussion and estimation of risks stemming from SOEs.** In the latest PEFA assessment (GoM and WBG 2021), Maldives scored a D+ on the indicator "PI-10: Fiscal risk reporting", in part because most major

SOEs did not submit audited financial statements to PCB within nine months. Since the assessment was finalized, Maldives has published its first fiscal risk statement, a welcome step towards greater fiscal and debt transparency. While the publication discusses SOE-related fiscal risks, it could go a step further and quantify potential additional expenditures if any of the risks or contingent liabilities materialize. To do this, establishing the centralized monitoring system of SOEs, improving the periodicity of regular reporting, and strengthening the capacity/resources of PCB to collect such data will be essential.

CHAPTER 4

Affordable Housing

Summary

Maldives has contracted a billion dollars in external loans and guarantees to finance large-scale public housing projects. While small island states face constraints that drive up the costs, this chapter shows that spending more on public housing may not necessarily help the government solve affordable housing issues. Although the Rent-to-Own programs have increased the supply of housing units, they are of poor quality, are not well-targeted towards the neediest Maldivians, and have incurred high costs for the government. An institutional overhaul, a housing data management system, better monitoring and evaluation of housing projects, and reforms to leverage private sector participation – including through PPPs – are needed to meet the government's ambition of adequate, safe, and affordable housing for all Maldivians.

4.1 How can Maldives manage and mitigate fiscal risks from SOEs?

97. **As a small island state, Maldives faces unique housing constraints.** Over a third of the population is concentrated in the capital, Malé, drawn there by the educational and employment opportunities. Internal migration to Malé has led to overcrowding, while unplanned growth has resulted in traffic congestion and air pollution in the city. The wide dispersion of the rest of the population and the lack of economies of scale make it difficult to provide even service coverage, leading to wide disparities in access to public services between Malé and atolls. As noted in Chapter 1, Maldives is highly vulnerable to natural hazards and extreme climatic events, which necessitates considerable investments in climate adaptation and resilience. As coastal erosion and pressures on scarce land increase, the physical vulnerability of housing and other infrastructure will increase, potentially eroding their market value and putting people at risk.

98. **Housing construction costs are high due to the scarcity of land, lack of technical expertise, and heavy reliance on imports. Land is a scarce resource in Maldives.**[94] The government has initiated land reclamation projects to address this challenge, notably on the neighboring island of Hulhumalé,[95] but such undertakings are costly. Moreover, as Maldives lacks natural resources and a domestic production base, all construction materials are imported, weighing on the trade balance and external financing needs. Developers also often rely on foreign technical assistance and labor.[96]

99. Government initiatives to improve access to land have not yielded an increase in home ownership. The government has allocated land for free to households to increase the supply of housing in the atolls. However, without proper targeting and technical assistance, this strategy has not resulted in an increase of housing units. Most households who own plots of land have been unable to build housing due to lack of financial resources and knowledge. In addition to incentives to migrate to Malé, the absence of technical support and guidelines for self-built housing has also resulted in parcels that are left undeveloped, unfinished, or poorly finished.

100. **Private sector participation in new housing construction is low.** New affordable housing provision is overwhelmingly led by the government. Private construction is limited to large-scale infrastructure development, such as high-end residential and commercial buildings, hotels and resorts, and owner-driven residential developments for investment and the rental market. The high cost of construction finance and the lack of access to domestic financing for construction are two factors that preclude more private participation in housing construction.

101. **In part due to these constraints, housing ownership is unaffordable for most Maldivians, especially in the Greater Malé region.** According to World Bank estimates, a household would need to have a monthly income of around MVR 46,000 (US$3,000) to be able to afford the most inexpensive available 2-bedroom flat in the market,[97] which is estimated to

[94] The total land area is less than 300 square kilometers.
[95] A manmade island built starting in 1997 to relieve the lack of housing and overcrowding conditions in Malé.
[96] Some 89 percent of the workforce in the construction industry are expatriates. MNACI 2020.
[97] Assumed to be a 650 square-foot, two-bedroom apartment that can accommodate an average family of five.

be priced at MVR 1.8 million (US$117,000).[98] Currently, only the richest (top 20th percentile) of Maldivian households, who have average monthly incomes of MVR 57,000 (US$3,700), would be able to take out a bank loan to make this purchase.[99] As a result, most households living in the Greater Malé region cannot afford to purchase a home, but instead rent their accommodation. According to the 2019/20 HIES (Statistics Maldives, 2021b), 74 percent of households living in Malé rented their homes in 2019, an increase from 64 percent in 2016.

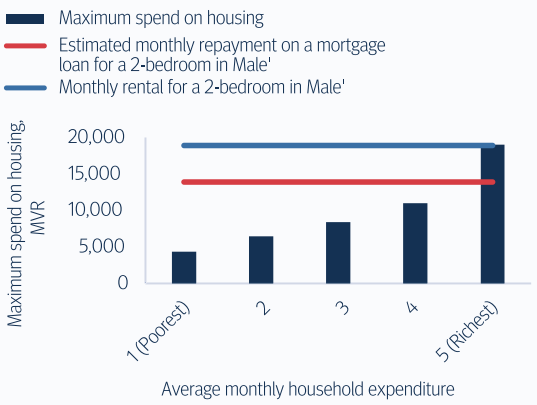
102. **Rental prices are also out of reach for many households, leading multiple families to co-inhabit the same unit.** Overcrowding of homes is also an issue in the Greater Malé region, affecting about 12 percent of households. This is related to the fact that housing rental prices are also out of reach for many families. Assuming the cheapest available two-bedroom flat costs MVR 18,900 or US$1,227 to rent per month in Malé, households in the bottom 60 percent of the distribution would have to pool their incomes to be able to afford the rent. Assuming that households do not spend more than a third of their income on rent, this means that 2-4 families have to share the same apartment, hence leading to overcrowding (Figure 60).[100]

103. **Regardless of whether they own or rent homes, most Maldivians are unsatisfied with their current housing conditions.** According to the WB MUDRP survey,[101] in 2020/2021 about 56 percent of respondents in Malé and 51 percent of respondents in atolls are unsatisfied with their current housing conditions (Figure 61). Almost all respondents pointed to the lack of space as the key driver of their dissatisfaction. Overcrowding affects about 12 percent of households in Malé (Statistics Maldives 2021b), and disproportionately affects lower-income households. Despite their high dissatisfaction with current housing conditions, survey respondents were hesitant to move elsewhere due to the lack of alternatives.

104. **The undeveloped housing finance market has curtailed access to affordable housing.** As in most small island states, Maldives' financial sector is under-developed, with limited access to long-term finance and housing finance. The mortgage market is small, with outstanding loans at 7 percent of GDP – half the expected size for a country with Maldives' level of income. Only three banks (mostly the Bank of Maldives or BML, but also the Maldives Islamic Bank and the Housing Development Finance Corporation, HDFC) actively lend in the housing sector. There are only eight housing finance products, most of which

Figure 60: Purchasing a home is out of the question for many Maldivians

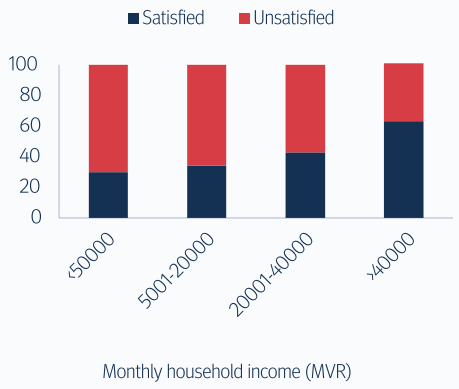
MVR



Source: Staff calculations based on Statistics Maldives 2021b and WB MUDRP study 2020/2021.
Note: Flat price is assumed to be MVR 1.8 million. Monthly rent is assumed to be MVR 18,900.

Figure 61: Most Maldivians are dissatisfied with their current housing situation

Share of survey respondents, percent



Source: WB MUDRP study 2020/2021.

[98] Source: Market research conducted by the Affordable Housing Institute (AHI) and Riyan for the World Bank Maldives Urban Resilience and Development Project in December 2020 and January 2021 (hereby referred to as WB MUDRP study 2020/2021).
[99] Assumes that households spend no more than a third of their income on housing. The terms of the loan are assumed to be 10 percent at a 20-year maturity. Down payment is assumed to be 20 percent.
[100] Calculations based on survey data collected by AHI as part of the WB MUDRP study. The rent-to-household-income ratio is calculated for each quintile in Figure 64. Where the ratio exceeds the benchmark of 30 percent, households must combine their budget to pay for rental.
[101] This was a nationally representative sample of 2,015 respondents in 19 islands.

are out of reach for lower-income households. Housing finance is largely inaccessible to them for three reasons:

- **Mortgage loans require a 20 percent down payment; building such equity is very difficult for most low-income households.** BML, which represents almost 70 percent of the mortgage sector, requires a 20 percent down payment, on par with international prudential measures for residential mortgage loans. Lower-income households cannot easily save for a down-payment, and at present there are almost no demand-side government subsidies to address the affordability gap between commercial mortgage loan products and the high savings requirement.[102]

- **Most local financial institutions do not offer long-term housing finance products. Except the Bank of Maldives, which offers mortgages with fixed interest rate for up to 20 years, most financial institutions either do not offer housing loans or do not offer housing loans with maturities above 10 years**. This limits the access and affordability of housing finance for low-income borrowers. In addition, most financial institutions do not offer mortgage insurance products such as credit risk protection for lenders.

- **The foreclosure process is highly undeveloped. If a bank decides to foreclose on a borrower, they must carry their claim to the courts to be adjudicated.** However, there are delays in the court process that extend foreclosure for up to 7-8 years, posing risks to banks in recouping non-performing loans (NPLs). Inadequate regulations and the small size of the market discourage banks from entering the market or creating new products.

4.2 Public spending and fiscal risks associated with the housing sector

105. **The government's exposure from external loans and guarantees associated with public housing is estimated at nearly US$1 billion or a fifth of Maldives' GDP.** In the past decade, the government has significantly ramped up public investments to address the lack of affordable housing. From 2010 to 2021, the government and the Housing Development Corporation (HDC; a 100 percent SOE) contracted 11 external loans amounting to US$1.1 billion to finance the construction of housing units, primarily in Hulhumalé (see Annex 4). The government further guaranteed US$134 million in external loans to HDC to design and construct roads and electricity systems in Hulhumalé. Most of these obligations were signed in 2017 and 2018 in the form of guarantees to HDC, leading the external guaranteed debt ratio to jump by 12 percentage points of GDP in a single year (see Chapter 1). All in all, total external debt outstanding and disbursed related to housing (including guarantees) amounted to an estimated US$739 million at end-2021, equivalent to a third of the total external public and publicly guaranteed debt or about a fifth of GDP. The bulk of this debt (86 percent) is due to Chinese lenders, in particular the Industrial and Commercial Bank of China or ICBC.

106. **The cost of housing-related debt repayments is high.** From 2021-2028, MoF estimates[103] indicate that debt service payments on existing housing-related debt amount to US$40 million annually on average, or about a third of total external debt service due over the period**.** The high cost of debt servicing reflects the expensive terms of all six guarantees HDC contracted in 2017-2018, which had short grace and maturity periods (2 and 3-13 years, respectively) and variable interest rates (33.3% plus 6-month LIBOR).

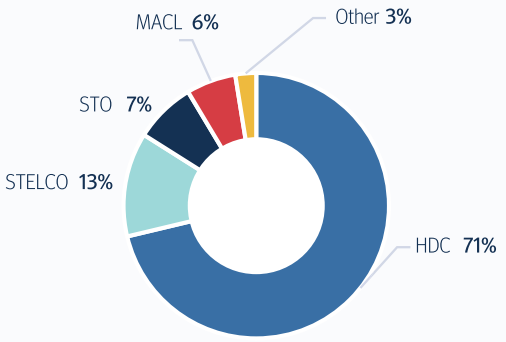
107. **Revenues from public housing projects are insufficient to cover debt service repayments and revenues.** HDC accounts for over half of external guaranteed debt (Figure 62), but its projected revenues from rental payments on public housing projects are insufficient to cover the high cost of debt servicing, which is mostly due in the short and medium term (Figure 63). In line with the social housing mandate, the government has also 'capped' monthly rental rates for Rent-to-Own program beneficiaries, tolerated high delinquency rates on loan repayments and provided lengthy repayment periods (25 years). The cost of debt service is thus a major fiscal risk that will likely have to be borne by the public sector balance sheet.

[102] Prior to 2021, the MMA Affordable Housing Loan Scheme required banks to lend at below market rate for home loans; however, the scheme was abolished as it did not successfully meet its objectives. The Maldives' Pension Retirement Scheme has had a Housing Loan Collateralization Scheme since 2016, but this is not a demand-side subsidy (see Chapter 6).

[103] Based on data received 24 February 2021. Include estimates of debt service repayments on sukuk.

Figure 62: HDC accounts for over half of guaranteed debt to SOEs

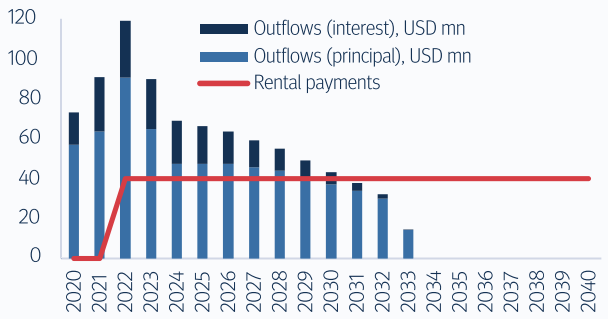
Share of total external guaranteed debt, percent



Source: MOF Public Debt Bulletin, December 2020.
Note: Excludes the US$400 million MMA swap with RBI and a US$121 million guarantee to Ahmed Siyam Holding, a private entity.

Figure 63: There is a mismatch between HDC's debt service repayments and rental payments

US$ millions



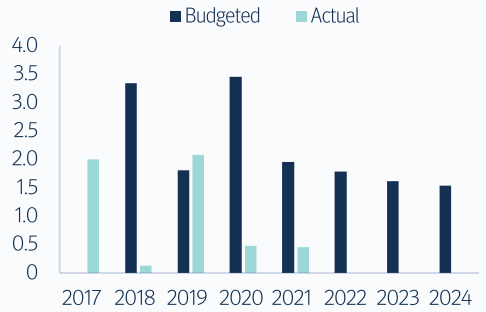
Source: World Bank analysis based on estimates from Ministry of Finance received on 24 February 2021.
Note: Rental payments assume 100% of all units are leased starting in 2022 at the monthly rate of MVR7,500.

HDC's other revenue sources such as sales of land are uncertain, as they depend on external timelines and buyers' demand. HDC itself is highly leveraged and holds more foreign currency liabilities than assets (see Chapter 3).

108. **Fiscal risks[104] from housing may become even more significant going forward. In 2021, a new housing agency, the Fahi Dhiriulhun Corporation (FDC) was established to take on the bulk of social housing development and implementation from HDC.[105]** However, FDC lacks the revenue and cross-subsidization sources that HDC has traditionally relied on, such as land leasing and sales of properties. Unlike HDC, which owns land assets and thus did not have to pay land rent on social housing projects in Hulhumalé, FDC will likely have to rent the land for all social housing projects they develop going forward, using HDC land in Hulhumalé and elsewhere. As a result, FDC is expected to be even more reliant on capital contributions from MOF than HDC. Capital expenditure and fiscal risks related to housing are thus likely to increase as FDC has begun to contract external loans to develop its pipeline of 14,200 housing units, with a total funding requirement of US$671 million (see Annex 4). Going forward, FDC is expected to face a cash flow imbalance similar or worse than that of HDC's, given its lack of revenue sources.

Figure 64: Domestically financed housing development spending is not high...

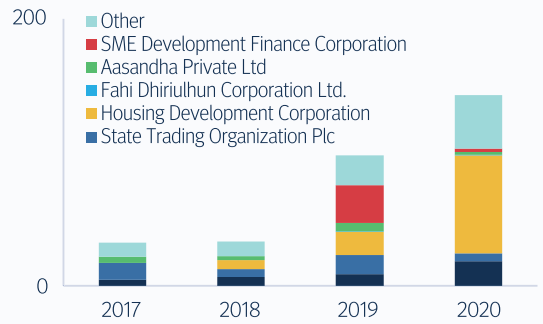
Housing development as a share of total budget, actual and budgeted expenditures (% of total)



Source: MOF Public Debt Bulletin, December 2020.
Note: 2022-2024 refer to proposed budget estimates.

Figure 65: ...but the government transfers an increasing and significant amount of resources to housing SOEs

Capital contributions to SOEs, US$ millions



Source: MoF, staff calculations

[104] Fiscal risks refer to substantial deviations in fiscal outturns from budgeted projections, which may exert unexpected pressures on public resources through their impact on cash flows and balance sheets.
[105] HDC is now responsible for developing commercial housing, whereas FDC is responsible for developing and managing social housing.

109. **Housing development expenditure financed by domestic resources is not high, but housing SOEs receive significant support.** On average, only US$3 million or 2.3 percent of total expenditures is budgeted for housing development each year, which is on par with the share of budget spent for housing in several other emerging market economies.[106] Actual expenditures have come in at about half of that amount (Figure 64). These resources have generally funded the construction of social housing projects in the atolls. However, the government also makes significant capital contributions to HDC and FDC. Between 2018 and 2020, the government provided US$135.2 million in capital contributions to HDC and US$0.8 million to FDC, or approximately 60 percent of total capital contributions over the period (Figure 65).[107] HDC relies on such contributions to balance out its operational losses. Finally, the government foregoes tax revenues by providing Goods and Services tax exemptions on sales of properties classified as social housing, and by providing land for free for self-built homes and developer-led housing projects.

110. **Even though commercial banks have a low level of exposure to the housing sector, the lengthy foreclosure process could pose financial risks in the longer term.** Interest rates and household incomes are two key determinants for assessing commercial banks' exposure to real estate. While the average interest rate has been relatively stable at 11.5 percent over 2018-2021, household income has been adversely impacted by the large contraction in GDP growth in 2020 due to the COVID-19 pandemic. Nonetheless, the moratorium on housing and other loan repayments[108] cushioned the impact on loan repayments. The NPL ratio declined from 9.4 in 2019 to 7.5 percent at end-Q3 2021. Moreover, real estate represents only 7.1 percent of commercial banks' total loan portfolio and the mortgage debt-to-GDP ratio is low at 7 percent. While BML's requirement of a 20 percent down payment theoretically protects it in the case of default, the lengthy foreclosure process and the lack of foreclosure laws (see section 4.1) put BML at high risk of loss in the event of a default. Reform of the foreclosure process is needed to ensure that default rates on housing loan repayments do not become a systemic financial risk.

4.3 Is public spending on housing yielding the desired results?

111. **Affordable housing for all Maldivians has long been a key government priority.** Since the formulation of Maldives' first National Housing Strategy in 2009, national strategic plans have included large-scale housing interventions to achieve this goal. The 2019-2023 Strategic Action Plan outlines ambitious policy actions to increase the accessibility and affordability of housing, including the provision of 20,000 new social housing units, allocating MVR 1 billion (US$65 million) for the social housing loan scheme (Gedhoruveriya), and enacting a tenancy and condominium law.

112. **To meet the government's housing provision goal, public spending on housing is concentrated on supply-side strategies, namely:**

i. the Rent-to-Own program in Hulhumalé (Phase 1 and Phase 2; the latter is also called "Hiyaa");

ii. the Rent-to-Own program in the atolls; and

iii. Gedhoruveriya, which provides loans to eligible households in the atolls for housing construction and upgrades.[109]

[106] In Indonesia, for example, an estimated 2.2 percent of the budget was spent on housing in 2018. In Chile, 3.8 percent of the total budget was spent on housing and urban development in 2021. Source: World Bank staff estimates based on national budget publications.
[107] FDC is expected to receive US$4.5 million from the government annually in 2021-2022.
[108] From March 2020 to March 2021.
[109] The scheme is being implemented by HDFC on behalf of the government.

Table 8: The per unit cost of the Hiyaa public housing is extremely high

Components	Cost (MVR billion)	Cost (US$ million)
Land	2.1	133.1
Infrastructure	1.1	71.4
Construction	7.1	459
Refinancing of debt	0.2	14.9
Total cost	**10.5**	**678.5**
Cost per unit	MVR 1,554,895	US$ 100,967
Cost per unit excluding land	MVR 1,249,875	US$81,160

Source: Staff calculations from HDC report.

4.3.1 The efficiency of the Rent-to-Own Program

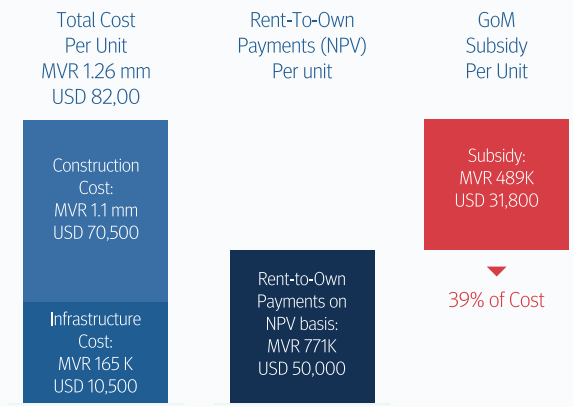
113. **The Rent-to-Own Program is the primary public housing scheme in Maldives.** Under the Hulhumalé Phase 1 project, the government built approximately 3,000 housing units (3-bedroom units of 900 square feet) in 4-story, low-rise buildings.[110] Hulhumalé Phase 2 (Hiyaa) was even more ambitious in scale: 6,720 housing units were built in 16 blocks of 25-story high-rises, but the units were smaller (2-bedroom units of 550 square feet). To purchase their flats, Phase 1 beneficiaries pay MVR 7,000 or US$455 monthly over 25 years to HDC, whereas Phase 2 beneficiaries pay MVR 7,500 or US$487 monthly[111] over the same period. This chapter focuses on the efficiency and effectiveness of this Rent-to-Own scheme in providing affordable housing, as its shortcomings are the principal driver of the high fiscal burden of public housing in Maldives.

114. **The Rent-to-Own projects have cost the government a significant amount of public resources.** The estimated combined cost for the Hiyaa project is MVR 10.5 billion or US$679 million, as laid out in Table 8 (12 percent of 2019 GDP). This works out to about MVR 1.6 million (US$101,000) per unit,[112] or MVR 1.3 million (US$82,000) per unit excluding the land cost. To finance this, HDC contracted several expensive loans from external creditors such as Credit Suisse and ICBC, as detailed in section 4.2 and in Annex 4.

115. **Overall, it is estimated that the government provides a subsidy of approximately US$31,800 for each Hiyaa unit (Figure 66).** Given the low Rent-to-Own payments (MVR 7,500 or US487 per month), the per unit economic cost of the Hiyaa is MVR 489,000 or US$31,800, accounting for 39 percent of the total combined cost of construction, infrastructure, and refinancing. If land were to be included in the total cost, the subsidy would be 69 percent of the unit cost. This subsidy calculation excludes other potential costs to the government to finish the project for livability, cash flow reduction due to the high delinquency rates, repair and maintenance costs,[113] and refinancing costs due to HDC's tight cash position.

Figure 66: The Hiyaa project effectively costs the government at least US$31,800 per unit (excluding land costs)

Per uni Cost of Hulhumale 2 Project to GoM



Source: World Bank staff estimates

[110] Of these, 2,100 remain on the HDC's books as loans, with a small portion of units kept as rental stock for employees of service providers. The remaining 900 have been fully paid and ownership has been transferred.
[111] Monthly rental was initially set at MVR 15,000 for the first five years and MVR 10,000 for the subsequent 20 years, but the rates were lowered following protests from tenants. Residents also pay a monthly maintenance fee of around MVR1,000 or US$65.
[112] The project is referred to as the 7000-unit project, although the actual final unit count is 6,720 units.
[113] HDC levies a monthly charge of between MVR 1,200-1,500 (US$78-97) for operational and maintenance costs. However, these amounts barely cover structural maintenance and do not include the cost of servicing amenities (e.g. elevators and security). To cover the full costs, this amount should be closer to MVR 2,500 (US$162) per month.

116. **Despite the high cost, Hiyaa units have not been completed to a satisfactory standard, incurring further costs for the government.** The Hiyaa project has several design weaknesses. First, the 25-story high-rises are an unusual building typology in Maldives, where households typically live in low-rises or single-family homes. Second, each of the 16 housing towers only consists of four small elevators with narrow lobby areas to serve more than 400 units, leading to congestion during peak hours. HDC incurred additional costs to extend the lift lobby areas in several towers.[114] Third, many units have also been left unfinished, with beneficiaries expected to complete the remaining work at their own cost.[115] BML provided home improvement loans up to MVR 150,000 (US$9,740) to enable households to finish and furnish their new flats, but it is unlikely that all beneficiaries will be able to afford the additional expense.[116]

117. **All in all, Hiyaa has exacerbated HDC's financial vulnerabilities.** HDC has faced cash flow shortfalls that endanger the long-term financial sustainability of the Hulhumalé Phase 2 project. In 2019, HDC took four loans totaling US$40 million to refinance the project's interest and principal repayment obligations. The pandemic has added to HDC's financial hardship, and its cash ratio has been severely constrained due to the shortfall in revenues.[117] The company is also at risk due to the long delays in project lease up (see Section 4.3.2), as HDC absorbs all risks once units are built (developers are paid upon project completion and pre-lease up). As noted in Section 4.2, there is a mismatch between the lengthy repayment period and low monthly repayments, and the high cost of servicing debt in the short and medium term.

118. **Other weaknesses in the design of the Rent-to-Own scheme have driven up its costs:**

   i. **First, the lack of income verification affects the financial sustainability of the program.** In selecting households for the Rent-to-Own scheme, MNPHI does not assess a household's repayment capacity and therefore cannot ensure that selected households will regularly pay the social housing rent. HDC is only servicing the loan and has no prerogative over households' selection. While loans are evaluated by HDFC based on information received by MNPHI, HDFC representatives interviewed for the WB MUDRP study (2020/2021) acknowledged that this information is often incorrect and/or unverified. As a result, loan delinquencies are high (between 15 to 20 percent of all loans) and are expected to trend further upwards over time. The outstanding commercial and residential delinquencies amount to about MVR 300 million (US$19.5 million). Although the law and several court decisions state that the HDC has the right to evict households who are delinquent, eviction is not enforced. Rather, HDC's short-term solution is to reschedule the payments.

   ii. **Second, significant delays in the completion and lease-up of units increase total development costs.** Housing developments built through the Rent-to-Own Program, especially those in the outer atolls, have faced lengthy delays through construction and lease up. The reasons, as highlighted by respondents to the WB MUDRP study (2020/2021), include changes in administration and project management issues leading to delays in construction completion. These delays are considerable: lease-up took two years in Addu, six years in Thinadhoo, and six to seven years in Kulhudhuffushi. The lengthy allocation process has degraded the quality of housing units, which were left vacant for years. As a result, beneficiaries were forced to pay for repair and renovation work when they moved in.

[114] Source: https://psmnews.mv/en/97347

[115] According to The Edition, June 25, 2020, "PPM's administration had initially planned to distribute the Hiyaa apartments to recipients without completing the finishing works, such as installing doors and lights, painting and tiling the walls and floors." In normal residential development, anything that is necessary to achieve a Certificate of Occupancy or its local equivalent would be considered essential, and 'finishes' would cover only: (a) amenities not necessary for the CO (e.g., a dishwasher or refrigerator); or (b) upgrades from the basic standards (for instance, a granite countertop instead of Formica or wood). Considering tiling or doors as 'finishes' is unusual (at best), and supervisory negligent at worst.

[116] As noted in the Bank of Maldives, July 2021.

[117] Based on HDC's Q1 2021 financial statement.

4.3.2 Is the Rent-to-Own program effective?

119. **Despite the government's considerable financial investment in the Rent-to-Own scheme, its effectiveness has been marred by poor targeting of beneficiaries.** To select recipients, the government scores applicants based on the number of their dependent children, current living conditions (e.g. the number of bathrooms/rooms versus the number of people residing in the household), and whether applicants already own other housing and land.[118] This eligibility criteria does not filter out higher-income earners, resulting in a huge housing application backlog (as almost everyone is eligible to apply). Moreover, confirming households' declarations of their living conditions is a costly and lengthy process that requires resources. Since the number of applications has significantly outpaced the number of available social housing units, the verification process leads to delays in the selection process.

120. **Similarly, the Hulhumalé Phase 2 (Hiyaa) project prioritizes specific demographic and job categories, rather than income.** Thirteen categories of applicants were prioritized to receive Rent-to-Own housing under the Hiyaa project. Among these groups were civil servants, married people between the ages of 18 and 35, and Malé residents which had previously experienced issues with public housing projects. Other categories that received priority were teachers, single parents, doctors, and nurses. This practice of prioritizing employment types who are generally in the highest income segment counters the social housing targeting principle to serve those most in need of government support. As a result, Hiyaa has not served the neediest households or those with limited capacity for self-built housing.

121. **Residency verification is not monitored after lease-up.** By law, beneficiaries of public Rent-to-Own units in Hulhumalé cannot sublease or resell their units until they have fully paid for their flat. However, according to several stakeholders[119] interviewed for the WB MUDRP study (2020/2021), sub-leasing social housing units at higher rental prices is a common practice in Maldives. Neither HDC nor MNPHI have created systematic monitoring processes to verify that initially identified beneficiaries are still living in the units. Due to the lack of a systematic monitoring process, the extent of subleasing is unclear. As a result, the Rent-to-Own scheme does not effectively target those who are most in need of public housing support.

122. **Furthermore, most public housing beneficiaries are dissatisfied with the outcomes.** According to the WB MUDRP study (2020/2021), 72 percent of all respondents who participate in the Rent-to-Own scheme are dissatisfied with their homes. There are several reasons for this:

   i. **The poor construction quality of many public housing units, coupled with the lack of maintenance, have led to substandard living conditions for program beneficiaries.** In focus group interviews of Rent-to-Own beneficiaries for the WB MUDRP study (2020/2021), many residents highlighted the poor construction quality of units (e.g. loose floor tiles, plumbing issues with sinks and toilets, water leaks). These issues present health and financial hazards to beneficiaries, who are often forced to relocate or use their limited funds to repair their homes. Moreover, most residents residing in these units stated that they do not know whom to approach with maintenance issues. Island councils who are responsible for managing housing units in the outer atolls do not have the full authority and budget for monitoring and maintaining the program units. There are no long-term maintenance and redevelopment plans.[120]

   ii. **Lack of minimum safety guidelines or design standards:** According to interviews for the WB MUDRP study (2020/2021), beneficiaries living in Greater Malé region have experienced theft, vandalism, and misuse of public spaces, which often lack security personnel or services. As a result, many beneficiaries reported feeling unsafe in their own homes. Similarly, in the atolls, Rent-to-Own developments have been built on reclaimed land located far from existing residential areas and lack supporting facilities, security services, or safety features such as proper lighting and surveillance of public spaces.

   iii. **Lack of consultation:** According to focus group interviews conducted for the WB MUDRP study (2020/2021), existing Rent-to-Own housing

[118] Eligibility criteria provided by MNPHI (2020).
[119] This included interviewees from HDC, participants in focus group discussions and landowners.
[120] According to some respondents from the Sinamalé flats (established in the Greater Malé region in 1990), the government promised beneficiaries new units after the development reached its useful life. However, there is no written evidence of such an agreement, nor a clear redevelopment plan.[121] Source: https://psmnews.mv/en/98881

projects do not address preferences and weather considerations regarding the design of units. This includes building orientation and window placements to avoid the impacts of high wind and rain during the monsoon season, as well as household preferences for bathroom and kitchen locations. The projects also do not adequately take climate risk considerations into account: residents from Naifaru and Kulhudhuffushi expressed concerns that public housing units in their atolls are located close to the shoreline and a wetland area, respectively. The precarious location of these housing units is exacerbated by the risk of rising tides.

4.4 Spending more will not necessarily help the government solve housing problems

123. **The Government of Maldives has directed a significant amount of resources to the challenge of delivering affordable housing, but so far fallen short of its goals.** Among the key constraints that hinder the efficient and effective delivery of government housing expenditures are:

i. **Weak institutional arrangements and capacity:** HDC, FDC and local councils do not have the adequate ability to plan, design, source funding, target, implement and monitor social housing projects. Starting from 2021, FDC was supposed to replace HDC in social housing provisioning. As a new institution, FDC lacks the capacity for housing development and management which HDC has built up over the last 20 years of operations. Further, the risk of duplications and administrative overlap between HDC and FDC is still present, especially in Hulhumalé. Ultimately, the poor coordination and weak technical development and implementation capacity of the key housing stakeholders will remain key challenges that will impact the performance and results of social housing programs.

ii. **Lack of an integrated housing project data system:** The basic data and information on public housing projects such as construction start/completion date, target units/completed units, budget versus actuals, construction costs, monitoring and evaluation data are not centralized nor easily accessible across the different key housing stakeholders (i.e., MNPHI, MoF, HDC, FDC, HDFC, island councils, etc). The absence of data consolidation on a project-by-project basis precludes the government's ability to assess: (i) the inherent cost of the project; (ii) the level of subsidy/support per project, per unit, and by income segmentation; and (iii) the performance of the project and how to improve. A transparent monitoring process of public housing programs could lead to more timely adjustments to improve program implementation.

iii. **One-size fits all housing strategy:** Until recently, 90 percent of public funding in the housing sector has been directed to the Rent-to-Own Program in Hulhumalé at the expense of other housing needs. Households have diverse preferences of housing types (ownership, rental, rent-to-own, housing upgrade/expansion, etc.), locations (Greater Malé vs. other atolls), income, and employment type (low-mid-high income; salaried/non-salaried). The current administration's decentralization agenda requires a more nuanced housing policy that includes comprehensive planning for these diverse needs. The government has announced a plan to build 1,575 units in 14 atolls starting in 2022,[121] but it is unclear whether this plan is adequate to meet the housing needs in the atolls.

4.5 How can the government achieve its housing policy goals without jeopardizing fiscal and debt sustainability?

124. **The discussion has illustrated that Maldives' public housing expenditure – mostly financed through expensive external debt – has not helped the government meet the SDG goal of providing adequate, safe, and affordable housing.** Rather than take on more costly external debt to finance large-scale Rent-to-Own programs, the government could undertake three sets of reforms to address institutional and organizational gaps that significantly impact the provision of social housing in Maldives.

[121] Source: https://psmnews.mv/en/98881

These are divided into three categories: (i) policy reforms to improve the targeting of beneficiaries of affordable housing programs and land use planning/ policies; (ii) enabling environment reforms to improve the implementation of housing policies and programs; and (iii) investment and management reforms to attract more private participation in the housing sector.

Pillar 01 – Land and housing policy reforms

125. **Income-based targeting of public housing scheme beneficiaries:** Improved targeting in all social housing programs is critical to improve the efficiency and effectiveness of public spending in the housing sector. While the draft National Housing Policy (dated July 2020) provides a better definition of low-income housing and a clearer understanding of the targeted segments for future public housing (Table 9), implementing the policy would require better mechanisms for verifying income. To avoid sub-leasing of public housing and to ensure an exit strategy for households who are no longer eligible for a housing subsidy, the government could ensure that targeting and income verification occurs at the time of original purchase or rental move-in and at regular intervals. Annual home visits and income recertification would help to confirm that beneficiaries continue to reside in the unit.

126. **Legal and policy framework reform for housing:** A fair, transparent, and predictable legal and regulatory framework for housing is a critical determinant of investment decisions for both public and private sector stakeholders. Hence, improving the existing legal and regulatory framework is crucial. A set of new regulations, including a new Land Law, Building Code, and Tenancy Act have been either adopted or are being drafted, but have not yet been implemented as at the time of writing.

127. **Land rationalization:** The key to an effective and sustainable public housing policy is a successful land policy. Along with the allocation of land which has been neither strategic nor economic, the weak land data management and the lack of a secondary land market in Maldives have affected land-related decision-making processes and the development of a commercial real estate market. It is essential that MNPHI establish an improved land data management system and help improve the capacity of local councils to design and implement strategic land policy and land use plans.

Table 9: Housing programs need to be better targeted based on income

Housing typology	Monthly Rent/Loan Repayment	Property Value (MVR)	Income segment (monthly income in MVR)
Council Housing	Free or Subsidy	755,580	Below 15,000
Affordable Housing	8,600 to 13,000	1 million to 1.5 million	15,000 - 25,000
Mid-range	13,000 to 23,8000	1.5 million to 2.5 million	25.000 - 45.000

Source: MNPHI Malé Region Housing Need and Demand Assessment

Pillar 02 –Improve the enabling environment for program implementation

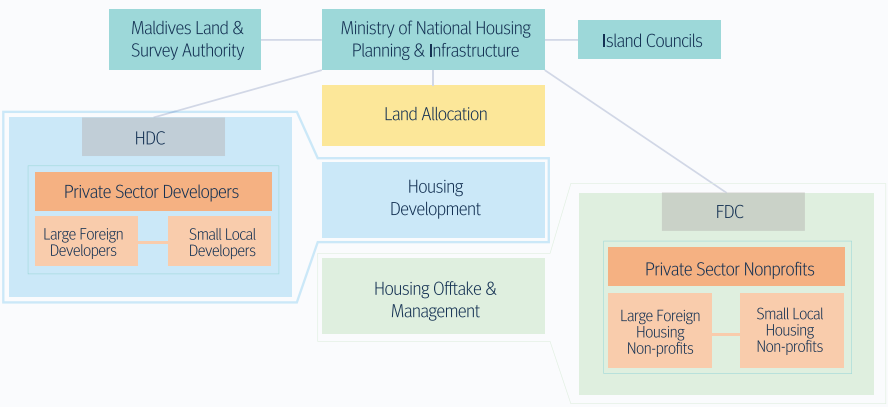
128. **Reform institutional arrangements to develop distinct mandates for HDC and FDC.** To address the institutional efficiencies described earlier, the government could establish clear mandates for key institutions in charge of housing. Rather than splitting these by housing typologies and income segments (social housing for FDC and market-priced housing for HDC), the distinction between the two state-owned agencies could be based on their roles:

- **HDC could continue as housing developer,** a role it has been playing in Hulhumalé for the past 20 years. HDC's stronger balance sheet would also enable it to better manage external debt funding and develop mixed-income and mixed-use housing, including under a public-private partnership (PPP) model.
- **FDC could take on the 'post-offtake' ownership role** and become the property manager for affordable housing projects, which would significantly improve its rental cash flows and quality of public housing assets. It could cement joint ventures with international property managers to build capacity and implementation know-how.
- **As for land use and allocation, HDC has undertaken this role for Hulhumalé and could potentially do it for the entire country,** with decentralized agencies or branches in different atoll regions or islands. HDC could support other housing agencies and/or local councils in engaging more proactively in land markets in the atolls, helping them adjust land allocation according to local development needs (e.g., releasing public land in stages, or bidding it out through an auction process to private investors).

129. **Develop an integrated housing data system for policy making and project monitoring.** A healthy housing market benefits from an integrated housing data system that allows public and private stakeholders to quickly assess market needs and find the most efficient ways to fulfill them. Such a system would include data on consumer housing needs and demand (by location, income, and employment), construction updates, home price trends, and rental data. Access to reliable and timely housing-related data can help Maldives to develop targeted regulations and policies, monitor the effectiveness of public housing programs, and accelerate private sector investments.

130. **Strengthen private sector engagement in housing.** The private sector can play a more prominent role in the development of affordable housing, both on the supply and demand sides (Figure 67). Currently, Maldives' commercial banks have limited risk appetite to provide construction financing to developers/contractors and mortgages for low-income and non-salaried workers due to their internal limiting guidelines and capital requirements. The government can explore the use of incentives and technical assistance to support banks in reaching the informal and low-income segment. These could include: (i) co-investing in mortgage (credit loss) guarantee schemes; (ii) developing alternative credit scoring for informal and low-income workers in partnership with financial technology companies to

Figure 67: Better collaboration between different actors and more engagement with the private sector could yield better results for affordable housing policies and programs



Source: World Bank

improve underwriting capacity; and (iii) exploring innovative loan products such as incremental housing loans that better meet the needs of the consumers. Moreover, addressing the lengthy foreclosure process is key to ensuring that the banking system can manage losses in the event of a default.

131. **Strengthen disaster and climate-resilient building practices, especially in the housing sector.** Despite its high vulnerability to climate change, Maldives currently lacks a comprehensive framework for resilient building practices (construction permits, code compliance monitoring and green construction guidelines and certification). While the MNPHI issued the Construction Act in 2017, much more work is needed to ensure proper compliance with regulations, standards, and procedures. For public housing specifically, the government can further collaborate with the private sector to ensure the inclusion of code-compliant and climate-smart aspects into the design structure, engineering, construction, materials, monitoring and certification of housing units. In the medium to long term, the process of 'greening' upstream land use planning, regulations, land tenure, building codes, and building approval processes would further promote resilience in housing and buildings. Alternative construction technologies that support climate-smart embedded construction materials can also be explored for the market; however, these materials may not necessarily bring down the total costs.

132. **Develop a long-term savings program, especially for low-income households.** A financial literacy program can increase Maldivian households' financial knowledge and skills, while a savings program designed specifically for homeownership can encourage households to save for a down-payment to obtain access to affordable housing.

Pillar 03 – Investment and management

133. **Optimize the implementation of the Rent-to-Own program and consider a mixed-income, mixed-use, PPP model:** As previously outlined, the Rent-to-Own model faces significant challenges, including the lack of financial sustainability, targeting issues, and weak design and implementation. Three ways to optimize this program are:

   i. **Improve capacity to manage properties:** Rental property management requires specific knowledge and processes which are currently missing from the Rent-to-Own housing program. The government could consider establishing a joint venture between FDC and an international non-profit housing entity so that FDC can learn and implement property management skills and processes. This would enable public housing assets to be better managed, including through better targeting of beneficiaries and on-time rental payments.

   ii. **Redesign the rent-to-own product:** Currently, the shorter-term capital funding for the development of rent-to-own housing units is constrained by the longer-term 15 to 25-year Rent-to-Own Program repayments. Incentives between residents and the government ought to be better aligned to improve the program's fiscal sustainability. This can be done by redesigning the criteria based on beneficiary income to enable a more progressive level of subsidy support. For example, middle-income earners can be given the option to purchase their homes with a mortgage loan and subsidy,[122] while low-income earners can progress through different rental payment levels in line with their capacity-to-pay. The government needs to reassess the targeting and eligibility criteria, and establish a comprehensive repair and maintenance plan and budget. Regarding the latter, a clear delineation of the roles and responsibilities for both government and the tenants are required.

   iii. **Use of public-private partnerships (PPP) to develop mixed-income housing:** Although not without its risks, PPPs are a mechanism that can help Maldives to engage a broader range of private sector developers in the housing sector, potentially increasing efficiency and economies of scale. New housing PPPs would create the opportunity for a proof-of-concept laboratory to develop demand-side products (loans, savings programs, down payment assistance, others) that are compatible with supply-side initiatives. The PPP model would also allow various offtake solutions within one development to increase financial viability and to promote mixed

[122] Various subsidy instruments can be considered such as down-payment assistance and interest buy-down

communities. However, PPPs are not without their fiscal risks (see Box 5) and are not a guaranteed mechanism to reduce the costs of building affordable housing in Maldives. As highlighted earlier on, establishing a legal and regulatory framework to monitor PPPs and ensure adequate risk sharing is critical to maximizing their benefits while minimizing their costs.

134. **Tailor land and housing interventions according to location.** The multiplicity of situations that exist across the atolls requires diverse strategies for land use, management, and housing development. In the Greater Malé region, large-scale housing PPPs can be considered, provided that the requisite institutions and framework to implement and monitor PPPs are set up by the central government. The central government could also partner with Malé City Council to support housing projects by developers and small owner-occupants who wish to redevelop their plot of land. In urbanizing islands,[123] the government can consider developing small housing PPPs and providing block grants to support community projects. Again, as noted in Box 5, PPPs are however not a silver bullet and would require considerable capacity building to monitor and manage fiscal risks. In smaller islands, the government could accelerate the implementation of Gedhoruveriya and provide technical assistance for self-built and housing retrofits.

135. **Reform Gedhoruveriya (self-construction housing loans in the atolls) to address the high rate of NPLs.** To improve the targeting of the program, the government could consider adopting income verification and loan underwriting guidelines and processes. To further address the risk of borrower defaults, alternative schemes such as incremental loans and community cross-guarantee schemes can be implemented. Furthermore, the government could provide technical assistance to households and contractors to ensure greener, resilient, and good quality construction. `

136. **Create permanent affordable rental stock while partnering with non-profit housing agencies for rental management.** As previously noted, many Maldivian families cannot afford to rent homes without pooling incomes in the Greater Malé region. Rather than solely promoting home ownership, the government could provide a rental subsidy to these households and create permanent rental housing. The government could also leverage domestic or international housing non-profits with the capacity to manage permanent affordable rental housing to play a more prominent role. This would enable the government to disassociate itself from the role of collection agent, reduce moral hazard, and thus reduce the currently-high delinquency rates in public housing schemes.

[123] These are regional hubs stipulated by the Maldives National Spatial Plan 2020–2040.

Box 5: Public-private partnerships can deliver affordable housing, but they are not a silver bullet

PPPs can help governments provide affordable housing without overly burdening public finances. In the housing sector, a PPP is defined as "a partnership between the public and private sectors, established through a contractual relationship which seeks to access private sector finance, design, construction, commercialization, maintenance or operational management for the delivery of affordable housing, and, in some cases, ancillary services". The public sector contribution can occur in the form of cash or equivalents such as land, development rights, revenues generated from land, infrastructure and building assets, taxation relief and/or a share in the equity generated over a fixed period. The private party's remuneration is typically linked to performance.

Where effectively used in the affordable housing sector, PPPs can help the government transition from "government as builder" to "government as enabler and regulator". PPPs can transfer risk to the most competent party, control project costs throughout the project life cycle, and harness the private sector's experience and efficiency in delivering infrastructure projects. However, PPPs in emerging economies often fail because the institutions and supporting legal and financial systems are insufficiently mature to facilitate implementation or to reduce the costs and risks for the private sector to deem them viable/profitable. Moreover, some PPPs have ended up continuing to rely heavily upon government land, subsidies or guarantees, making it questionable whether the private sector has taken its fair share of risks and whether the deal has maximized value for money.

Housing PPPs are therefore not silver bullets. Governments must first identify the key constraints in the enabling environment (policy, legal/regulatory and administrative) along the housing value chain. By removing/reducing these constraints, the market as a whole will benefit from more private sector entry/competition. Establishing the necessary institutional mechanisms to manage and monitor the implementation of PPPs, for example through the recently-established PPP unit in the Ministry of Finance, is therefore a prerequisite to embarking on such projects. In the short-term, the government can ensure that the procurement process for public housing projects allows for better transparency and screening of contract awardees and involves the community in project design.

Source: World Bank 2020c.

CHAPTER 5

Public Sector Wage Bill

Summary

Like other small island developing states, Maldives spends a lot – about half a billion dollars annually – on public sector salaries and allowances. While there is no international benchmark of the 'ideal' size of the wage bill, this component of expenditure may be crowding out other priorities as it takes up 40 percent of revenues and a third of the budget. Beyond affordability concerns, there is extreme pay variance across the public sector, especially in the distribution of allowances which make up half of total compensation. Public sector employees also earn 40 percent more than comparable private sector equivalents when looking at hourly take home pay, which may be leading to distortions for private sector job creation. Given the importance of the public wage bill – not only to fiscal sustainability but also to service delivery – the government may want to consider setting a wage bill target, strengthen wage bill controls and continue to pursue other reforms[124] to make the wage bill more equitable, transparent, and sustainable.

5.1 Introduction

137. **Public sector wage bills have come under pressure during the COVID-19 pandemic.** The large global economic shock from the COVID-19 crisis led governments to tread a difficult balance between fiscal consolidation with the need to procure additional resources to save lives. Governments have had to increase staffing and compensation for certain critical functions in health and disaster management, while decreasing them in other non-essential roles. In Maldives, the sudden stop in tourism inflows in 2020 – and the resulting deep economic contraction – forced the government to temporarily slash salaries of political appointees and employees of state-owned enterprises, while expanding expenditures on front line healthcare workers.[125] Nonetheless, pre-pandemic concerns about fairness and fiscal sustainability of the wage bill persist.

138. **This chapter illustrates several structural challenges in Maldives' central government wage bill.** The analysis uses aggregate data from official publications and a cross section of detailed micro-level payroll data provided by MoF. The microdata comprises 26,063 Malé-based public employees who were registered in the central government's central SAP payroll system as at end-November 2020, representing an estimated 54 percent of the total public sector wage bill (see Annex 5a).[126] The analysis excludes most atoll- and island-based public employees whose information was not included in the SAP at the time of writing,[127] as well as 21,000 employees of SOEs[128] whose compensation is governed separately.

139. **A broad framework is used to assess wage bill management, which is a more comprehensive concept beyond the standard recommendation to simply cut the wage bill.** Wage bill management refers to a strategic, purposeful coordination of resources to meet specific wage bill objectives. Five key principles are evaluated: (i) affordability; (ii) transparency; (iii) fairness; (iv) competitiveness; and (v) institutional coordination (Table 10). These key principles are interdependent and there may be tension among them as policies, the economy, and other circumstances change. For example, a non-transparent wage bill can affect fairness, or a non-competitive pay system can affect affordability. By emphasizing management, the focus is on addressing the underlying structural issues that contribute to inefficiencies and inequality.

[124] This chapter was completed before the introduction of a new Public Service Pay Framework in May 2022. As the team was not able to access drafts of the document, the chapter does not reflect these reforms.

[125] The cuts were on a sliding scale: (i) 25 percent reduction in wages for those earning MVR 20,000-25,000; (ii) 30 percent for those earning MVR 25,000-60,000; and (iii) 35 percent for those earning above MVR 60,000. Employees earning less than MVR 20,000 were not affected. Wages were reinstated at the end of 2020.

[126] 153 employees were removed from the analysis due to repeat or blank Personal ID Numbers.

[127] While the MoF provided some supplementary data on atoll-based public employees, it only contained information for health and education employees, and excluded the main allowances (overtime and holiday allowances).

[128] General SOE employee compensation is determined by the respective Boards of Directors. For the Managing Director and Board members, the PCB within MoF issues guidelines for their compensation.

Table 10: Wage Bill Management Framework

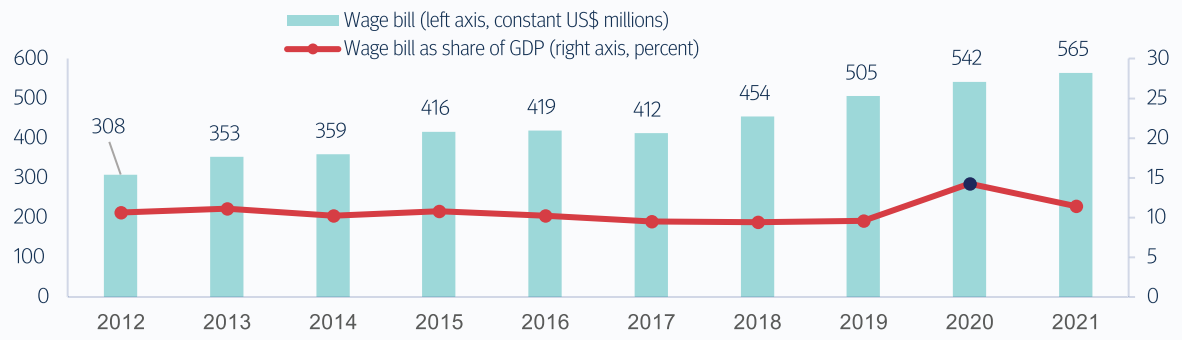
Principle	Question
Affordable	Is the wage bill affordable and sustainable, or does it crowd out other critically important expenditures?
Transparent	Is the wage bill transparent and simple? Does the base salary equal at least 80 percent of total take home pay?
Fair	Does the principle of equal pay for equal work apply?
Competitive	Is public sector compensation commensurate with private sector wages?
Institutional Coordination	Is there institutional coordination in wage bill management across the whole of government?

140. **There is also a sixth principle, performance, which is beyond the scope of this chapter.** The wage bill can be considered as an input to productivity growth, as the employees are hired to perform certain functions and deliver certain services. If the intent is to improve health outcomes, hiring more doctors and nurses – and thus increasing the health sector wage bill – may not be the best response. Rather, reviewing the distribution of health care staffing, investing in better equipment, or employing new technologies such as telemedicine may deliver a higher return (see Chapter 2). An in-depth human resource management review could shed further light on public sector performance, although better data on outputs and outcomes, especially in the atolls, would be needed (see Chapter 2 and World Bank 2021d).

5.2 Is the wage bill affordable?

141. **About a third of Maldives' annual budget – about half a billion dollars – goes to public sector salaries and allowances.** Over the past decade, Maldives spent an average of US$433 million annually on the salaries and allowances of public sector employees (Figure 68). This is equivalent to 11 percent of GDP or a third of total expenditures. The wage bill is typically the largest share of government expenditure, except between 2016-2018 when it was second to capital expenditures (Figure 69; see also Chapter 2). The large proportion of the wage bill in total public spending indicates a high level of budget rigidity, which implies that the government has little room to adjust expenditures in a crisis (see section 1.2). About 40 percent of total revenue collections (excluding grants) go towards the public sector wage bill, rising to 57 percent during the COVID-19 pandemic in 2020 (Figure 69). This means that the size and trend of the wage bill has a significant impact on the fiscal balance, public debt levels, and other indicators of macro-fiscal stability.

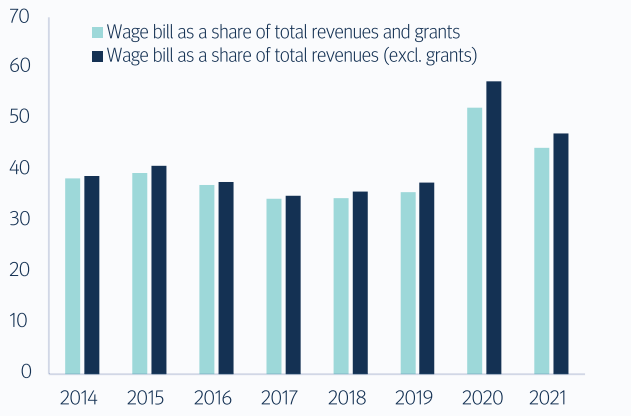
Figure 68: Maldives spends about 11 percent of GDP or half a billion dollars annually on the public wage bill
Left axis: US$ millions, right axis: share of GDP, percent



Source: MoF, staff calculations

Figure 69: About 40 percent of total revenues excluding grants goes towards the wage bill

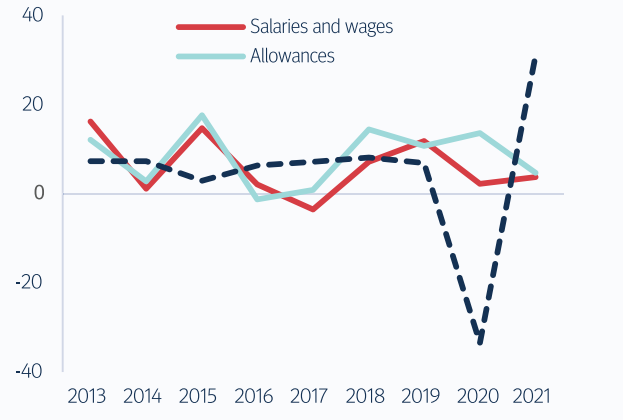
Share of total, percent



Source: : MoF, staff calculations.

Figure 70: Real growth in salaries and allowances have outpaced real GDP growth

Year-on-year growth in real terms, percent



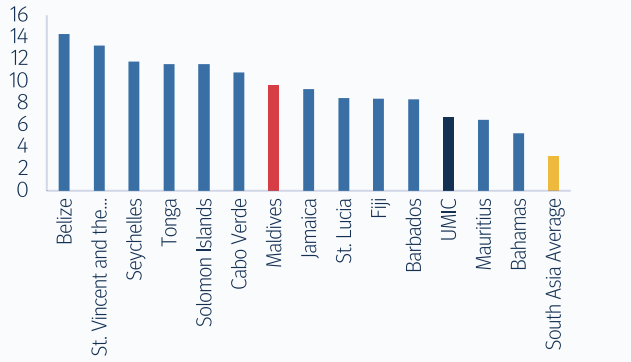
Source: MoF, staff calculations

142. **The public wage bill has grown faster than the economy.** Between 2012 and 2019 the wage bill grew at a compound average annual growth rate (CAGR) of 7.3 percent in real terms.[129] This outpaced real GDP, which expanded 6.1 percent annually on average over the same period (Figure 70). Allowances have grown faster (with a CAGR of 7.9 percent over the same period) than basic salaries (with a CAGR of 6.9 percent). While basic salaries were temporarily reduced for certain public servants in 2020 due to the pandemic, resulting in muted real growth of 2.2 percent, allowances continued to grow by double digits (14 percent). This reflected the payment of additional overtime and other compensation allowances to front line workers.[130] All in all, Maldives' wage bill has nearly doubled in real terms over the past decade.

143. **Maldives' wage bill is higher than other income and regional peers as a share of GDP, but is comparable to other small island developing states.** Looking at 2017–2019, Maldives' public wage bill as a share of GDP (9.6 percent on average) is significantly higher than the average for other upper middle-income countries and for the South Asia region; however, it is within the middle range of other SIDS (Figure 71). As noted in Chapter 1, small states are unable to benefit from economies of scale in the public sector, which provides minimum functions and basic services regardless of population size (Horscroft 2014). Basic services, such as health care and education, must be provided in all locations despite the costs. That is why most small island states, including Maldives, have relatively large public wage bills.

Figure 71: Maldives' wage bill is on par with small island peers as a share of GDP...

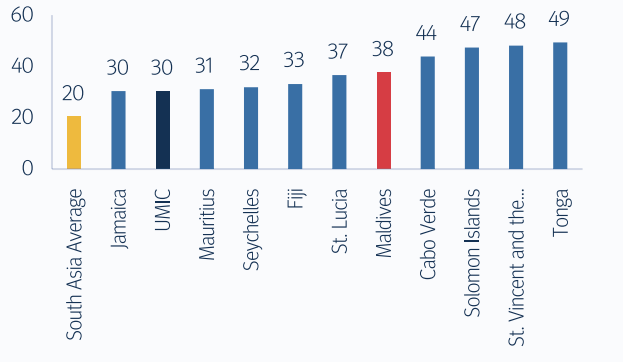
Share of GDP, percent



Source: World Bank WDI. Data refer to average of 2017-2019.
Note: Unweighted averages of upper middle-income countries and South Asia, excluding Maldives.

Figure 72: ...but higher than most peers as a share of total revenues.

Share of total revenues excluding grants, percent



Source: World Bank WDI. Data from 2017-2019.
Note: Unweighted averages of upper middle-income countries and South Asia, excluding Maldives.

[129] Deflated using the Consumer Price Index (August 2019=100).
[130] According to 20222024 Fiscal Strategy, wage expenditures increased in the first half of 2021 "as the previously discontinued frontline allowance for workers engaged in the Covid-19 response was reinstated due to the emergence of new waves of Covid-19, and due to additional staffing for MPS [Maldives Police Service], MNDF [Maldives National Defense Force] and the education sector."

144. **However, looking at wage bill as a share of revenues, Maldives' wage bill is higher than other upper middle-income and most small island peers.** The wage bill as a share of domestic revenues can often provide a better barometer on the fiscal sustainability of the public wage bill as this metric illustrates the real pressure on government finances. In this case, Maldives is significantly above the upper middle-income country average and on the higher range of SIDS. Even before the pandemic, in 2019, it spent 38 percent of total revenues (excluding grants) on the public wage bill (Figure 72).

145. **There is no ideal threshold for the size of the wage bill expressed as a share of GDP.** This cross-country comparison provides only a snapshot in time and does not on its own indicate good or bad performance, nor whether this level is sustainable.[131] Furthermore, there is no international consensus on the "right size" of the public wage bill. Countries differ by the size of their revenue base, the nature of the economy, and the effectiveness of governance, and smaller states tend to have larger governments. A large wage bill to GDP ratio could be sustainable if a country has a large revenue base, ample fiscal space or highly effective governance. Denmark, for example, regularly has a wage bill ratio exceeding 20 percent of GDP, but satisfaction with public services is among the highest in OECD countries (OECD 2019a).

146. **However, controlling the growth of the wage bill is important in the current context.** While Maldives is recovering robustly from the pandemic, several factors have exacerbated wage bill management challenges. First, the minimum wage has started to be implemented since January 2022, which is expected to lead to an increase in the public wage bill by 13 percent in 2022. Second, the government has begun to implement a new public sector pay framework starting in May 2022. The pay framework aims to harmonize public sector salaries and tackle the pay inequities highlighted in this chapter, but it is expected to result in a large, one-off increase in the wage bill. Third, the uncertain global environment and the increase in global fuel prices due to the Russia-Ukraine war has put further pressure on public finances. To prevent any additional shock from causing the wage bill to be a source of fiscal instability, Maldives needs to ensure that the wage bill is prudently managed to contain its future growth, while also addressing the underlying issues that have caused inequities and inefficiencies in public wage bill management.

5.3 Outsized role of allowances

147. **The transparency of Maldives' public wage bill system could be significantly improved.** A transparent public wage system is the basis for horizontal equity, predictability, and facilitates wage bill management and control (van Acker and Hasnain 2019). A simpler pay system with fewer allowances leads to more transparency, which in turn promotes horizontal pay equity (where public employees are paid the same amount for the same job). A simpler and more transparent wage bill system also improves the accuracy of wage bill growth forecasting, which can better inform policy decisions and trade-offs.

148. **Currently, nearly half of compensation is from allowances** (Figure 73). The share of allowances in total compensation averaged about 43 percent of total compensation between 2014 and 2019, and increased to 47 percent[132] in 2020-2021 due to higher payouts of the overtime allowance during the COVID-19 pandemic. This proportion is significantly higher than international norms. In most OECD countries, the base salary accounts for at least 80 percent of total compensation, with the remainder made up of allowances (World Bank 2020b). Basic salary is prioritized because it should capture the level of qualifications, experience, responsibility, and risk required for each job. In turn, allowances should only exist to supplement the basic salary for very specific or short-term reasons. This is not the case in Maldives, where allowances play an outsized role.

149. **There are currently 54 different allowances in Maldives, which is high by international standards.** While the number of allowances is high, only 9 allowances contribute more than 1 percent each to the total wage bill (Figure 74). The largest allowance was the Service Allowance (18 percent), followed by the Exclusive Job Allowance (8.5 percent),

[131] For example, in a sample of Europe and Central Asia countries, Eckardt and Mills (2014) found there to be a weak, but insignificant relationship between the level of wage bill spending and the fiscal balance, both measured as a share of GDP.
[132] For Malé-based employees, the proportion of allowances was even higher at 50 percent on average from 2014-2019, increasing to 54 percent of total compensation in 2020.

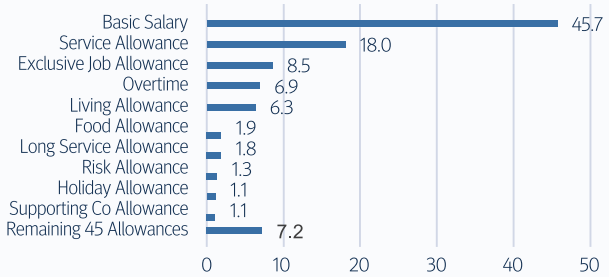
Figure 73: Allowances make up nearly half of total compensation

Share of total compensation, percent

Source: : MoF, staff calculations

Figure 74: There are 54 different allowances in Maldives

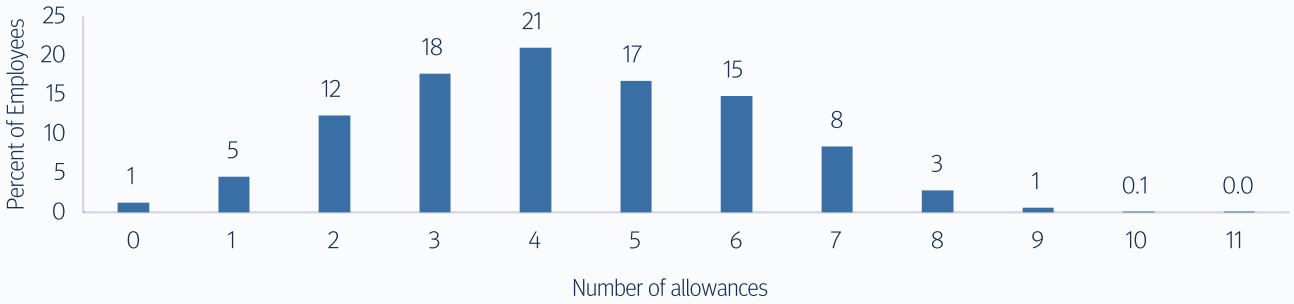
Share of the total wage bill, percent



Source: SAP Payroll database for Malé-based public employees, staff calculations

Figure 75: Allowances form part of almost every employee's compensation

Share of all employees receiving 0-11 allowances, percent



Source: SAP Payroll database for Malé-based public employees, staff calculations

Table 11: Compensation from allowances increases in tandem with basic salaries

Basic Salary (MVR)	Number of Employees	Average Allowances (MVR)
0-10000	20,333	8,479
10000-20000	3,169	12,562
20000-30000	294	13,143
30000-40000	178	14,747
40000-50000	130	31,662
50000-60000	10	27,418
70000-80000	1	0
90000-100000	1	0
Grand Total	**24,116**	**9,250**

Source: MNPHI Malé Region Housing Need and Demand Assessment

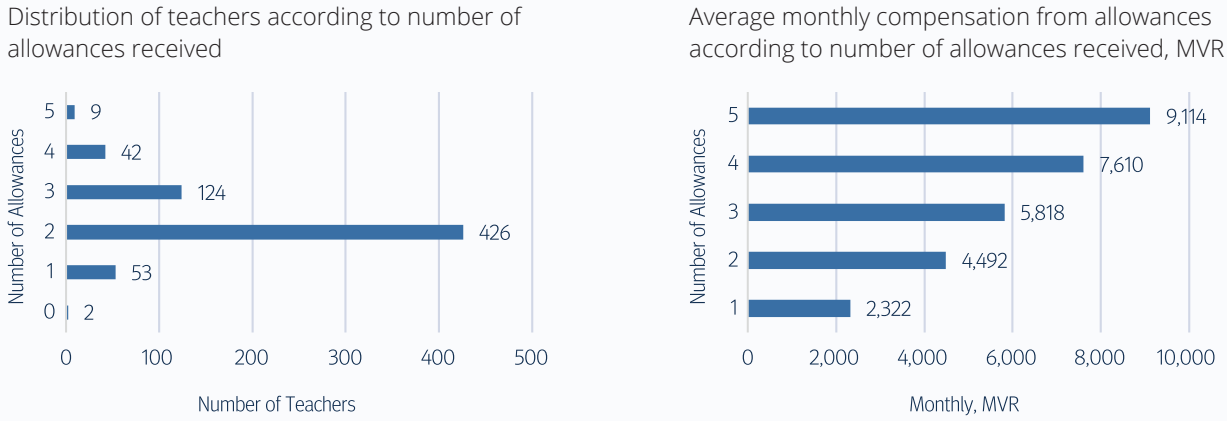
the Overtime Allowance (6.9 percent), and the Living Allowance (6.3 percent). Conversely, there are 45 allowances that collectively contribute only 7.2 percent of the wage bill, which suggest that many allowances are only received by a select few individuals. The high number of allowances contributes to pay inequities, discussed below.

150. **Allowances form part of almost every employee's compensation.** Only 1.2 percent of employees did not receive any allowance (Figure 75). Conversely, 64 percent of employees receive 4 or more allowances. One employee received 11 different allowances, which accounted for 66 percent of their total compensation. In addition, total monthly

compensation from allowances increases in step with increases in basic salary. For example, while employees who earn a monthly basic salary of MVR 10,000-20,000 (US$650-US$1300) receive an average allowance of MVR 8,402 (US$546), employees whose monthly basic salary falls in the MVR 40,000-50,000 (US$2,600-US$3,250) receive an average allowance of MVR 30,923 or US$2,008 (Table 11). Allowances also differ across payroll areas: civil servants receive an average of MVR 5,933 (US$385) per month in total allowances, whereas personnel of uniformed bodies and politicians receive double this amount.

151. **Allowances, however, are not distributed evenly.** For example, in the job title of "teacher",[133] there were 661 permanent employees[134] that averaged MVR 4,813 (US$312) in monthly allowances. Within this unique job category, three teachers received zero allowances, while nine teachers received 5 allowances that collectively averaged MVR 9,192 (US$597) additional monthly salary per employee (Figure 76). For permanent teachers in the same job title with the same job responsibilities, each additional allowance adds an average MVR 1,700 (US$110) to take home compensation. Whether this difference is warranted and fair is a question that merits further investigation.

Figure 76: The number of allowances and total allowances received by teachers vary widely



Source: SAP Payroll database for Malé-based public employees, staff calculations

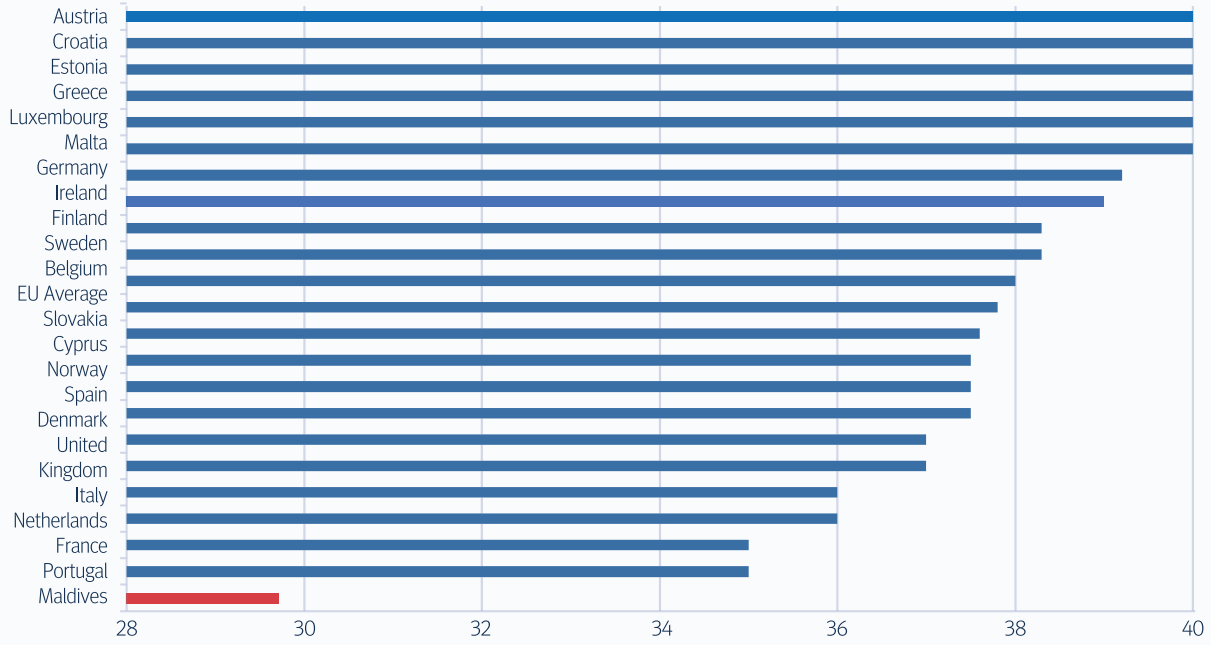
Table 12: New allowances are periodically introduced in Maldives

Year	Changes to Salaries and Allowances
2009	Sep 2009: Pay cuts introduced for 3 months due to the fiscal situation.
	Dec 2009: Pay cuts introduced in September are re-established.home pay?
2012	April: Salaries and wages that were deducted in 2010 were given back to the staff under the new administration.
2014	July: Bonus given to civil service employees that have maintained a high level of performance in 2013 as per the performance appraisal framework.
2015	November: Service Allowance and Special Duty Allowance introduced.
	July: Bonus given to civil service employees that have maintained a high level of performance as per the performance appraisal framework. Note: This is supposed to be given once every 2 years but has not been given since 2015.
2018	February: Technical Core Allowance and Supporting Core Allowance 1 and 2 introduced.
2020	January: Salaries and Allowances set for the position of Secretary General (the highest administrative position in local councils). The salaries and wages are set by the National Pay Commission.
2021	April: The Parliamentary Committee on Public Accounts approved a new pay structure for local councilors.

Source: Source: Local consultations and circulars issued by Maldives Civil Service Commission

[133] Teacher is a unique job title. There were 40 other job titles that also contained the word "teacher".
[134] For all analysis of job categories in this chapter, only permanent employees were considered. Contract, part-time, and temporary employees were omitted due to differences in terms of service and working hours.

Figure 77: The work week for public servants in Maldives is shorter than in EU/OECD countries
Number of hours worked per week



Source: World Bank.

152. **Allowances have played this prominent role in part because there is no institutional mechanism to adjust basic salary.** There is no legal requirement for the government to make annual adjustments to salaries and allowances. In practice, adjustments are made in an ad hoc manner, and are often tied to political commitments. In 2018, the government introduced two new allowances, the Technical Core Allowance for technical staff (28 percent of basic salary) and the Supporting Core Allowance for supporting staff (varies from MVR 700-1,500 or US$45-97 per month), which was the last time there was an adjustment to civil service wages.[135] The previous adjustment to salaries was made in July 2015 (Table 12). Without an objective framework to increase basic salary year-to-year, pressure will keep building to use allowances as the mechanism to increase remuneration.

153. **The outsized role of allowances has developed in part by a reduction in public sector working hours to only 30 hours per week, which is considerably low by international standards** (see Figure 77). On October 1, 2015, the official public sector working hours were reduced from 35 hours per week to 30 hours per week. The official release stated the reduction was "to provide the opportunity for government employees to spend quality time with their families, to work in the private sector apart from the government, and to facilitate youth to be more involved in sports activities, further education and technical professions."[136]

154. **This shorter work week has created upward pressure on the overtime allowance, which accounts for 7 percent of the total wage bill.** As the official working hours were reduced, the amount of work remained the same. For example, employees who work on shift base duty (such as nurses, doctors, immigration staff) still operate for 8 hours shifts, which means that they are now compensated with 2 hours at the overtime pay rate[137], an additional cost to the budget. With no cap on the overtime allowance, and with the continued need to perform official duties, 40 percent of Malé-based public employees currently receive overtime (Figure 78). For 16 percent of Malé-based employees, it accounts for more than 20 percent of their total salary. In addition, it is concentrated heavily for employees who earn a monthly basic salary less than MVR 10,000 or US$649 per month, and towards female employees where 50 percent receive overtime allowance compared to 33 percent of males (see Table 13 and Table 14).[138]

[135] The announcement was made via a Civil Service Commission circular, announcing the 6th amendment to the Civil Service Staff Allowances.
[136] https://presidency.gov.mv/Press/Article/15989
[137] The overtime allowance is 1.25 times an employee's hourly rate. For overtime performed on Fridays and Public Holidays, the overtime allowance is 1.5 times the hourly rate of an employee's salary. Source: Maldives Civil Service Regulation 2014.
[138] According to the NPC, the overtime allowance will be capped at 10 percent of the basic salary, and can only be claimed after 8 hours of work per day (while the official working duration is still set at 6 hours per day)

Figure 78: Overtime allowance plays an important role for nearly half of all public servants in Malé
Y-axis: number of employees; X-axis: overtime allowances as share of total salary, percent

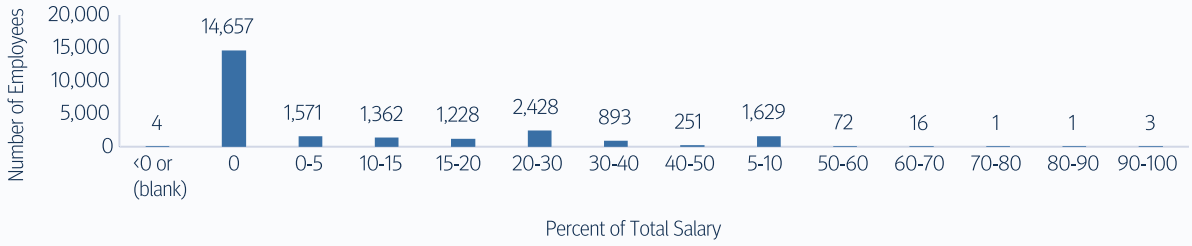


Table 13: Overtime Distribution by Basic Salary

Receive Overtime	Employees	Average Overtime (MVR)
No	**14,661**	**0**
Yes	**9,455**	**2,770**
0-10000	8,654	2,650
10000-20000	792	4,052
20000-30000	7	6,142
30000-40000	2	3,389

Table 14: Overtime Allowance by Gender

Receive Overtime	Employees	Average Overtime (MVR)
Female	**9,987**	**-**
No	4,626	0
Yes	5,361	2,739
Male	**14,129**	**-**
No	10,037	0
Yes	4,092	2,811

Source for Figure 78, Table 13 and Table 14: SAP Payroll database for Malé-based public employees, staff calculations

155. **This short working week has also potentially facilitated conflicts of interest.** According to analysis of the 2019/20 HIES, 10 percent of public employees currently have a second private sector job. Globally, most governments prohibit public sector employees from working in the private sector to avoid a potential conflict of interest that could improperly influence the performance of their official duties and responsibilities (OECD 2004). However, Maldives does not have any conflict-of-interest provisions for civil service employees as per the Civil Service Act or regulation.[139]

5.4 Same job, different pay

156. **The guiding principle of fairness is equal pay for equal work.** Equal pay represents the full range of payments and benefits, including basic salary, allowances, bonuses, and non-salary payments. Without this principle in place, it can lead to low morale, low productivity, and high rates of turnover.

157. **This principle does not hold in Maldives as more than 1 in 2 employees have a unique take-home salary.**[140] Pay variation on its own is not necessarily bad if there is an objective, merit-based system that assigns pay based on performance. However, excessive pay variation indicates that pay inequities likely exist. In the Malé-based SAP payroll database, 60 percent (15,974 of the 26,216 employees) had a unique total monthly salary. This excessive variation creates inequities among employees performing the same job, but who are not paid the same. It also makes the wage bill more difficult to control.

158. **Consequently, the pay compression ratio in Maldives is extremely high.** The pay compression is the ratio between the highest and lowest total take home pay.[141] Overall, Maldives has a pay compression

[139] The Act (Article 33) says that civil service employees should follow the code of conduct which is part of the Regulation), but the code of conduct does not have any conflict-of-interest provisions.
[140] A unique take-home salary is defined as having a total monthly salary (basic salary plus allowances) that is different from everyone else.
[141] In Maldives' case, this includes allowances.

ratio of 36 (Figure 79), significantly higher than the European average of 7.5 (Vlady 2017). While compression ratios are high across the board, except for consultants, payroll for the health and judiciary sectors, as well as the politicians and uniformed bodies, tend to have especially wide variation in monthly salaries (Figure-80).

159. **This excessive pay variation is derived from the differences in eligibility for allowances.** For example, while 94.7 percent of employees receive the Service Allowance, only 8.7 percent of employees receive the Commuting Allowance (see Annex 5a). Notably, 27 allowances are received by fewer than 100 employees, signifying more compensation inequity. Most allowances pay different amounts, which further contributes to the variation in take-home pay.

160. **The differences in allowance eligibility drive pay inequities.** For example, in the job category of Administrative Officer, 77 percent of permanent employees (953 of 1,237) had a unique take-home monthly salary (Figure 81). The difference is strongly influenced by the payroll area of the employee (see Annex 5a). Administrative Officers in Constitutional Bodies, the Judiciary, and Uniformed Bodies earn on average considerably more than Administrative Officers in the Civil Service for the same job. This difference is not primarily due to differences in the Overtime Allowance. While the Overtime Allowance does play a role, there were still 522 employees (or 42 percent of all permanent employees) receiving a unique take-home salary without including the Overtime Allowance.

161. **Similarly, for the job category of "teacher", 33 percent of permanent employees had a unique take-home monthly salary** (Figure 82). While this percentage is lower than Administrative Officer and Registered Nurse, it is still very high by international standards. If the Overtime Allowance is excluded,

Figure 79: Pay compression is extremely high in Maldives...
Pay compression ratio

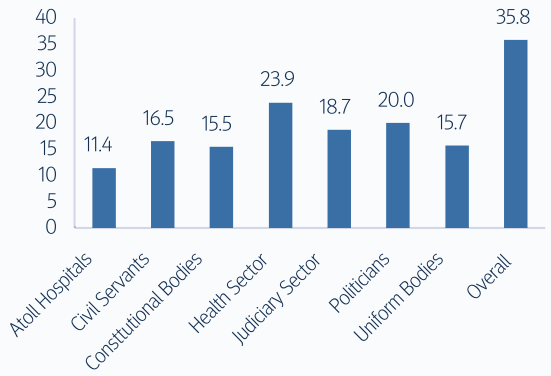
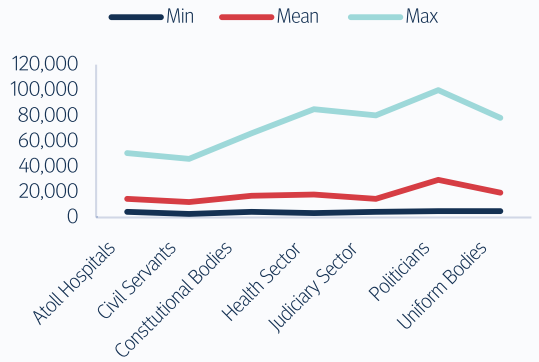
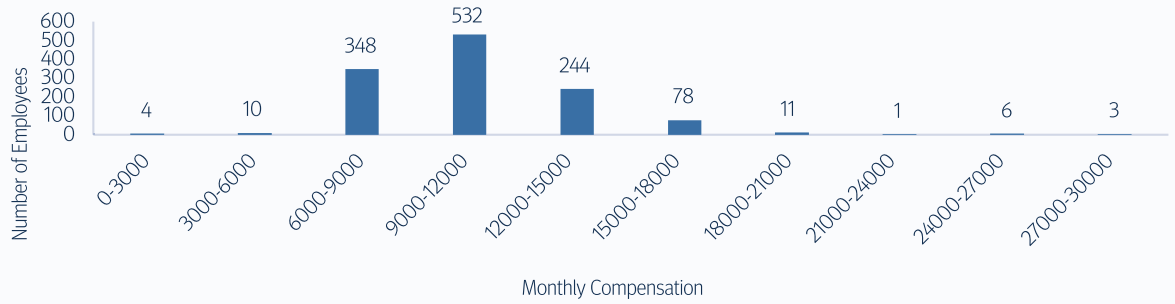


Figure 80: ...especially amongst health and judiciary workers, political appointees, and uniformed bodies
Total monthly salary by payroll area, MVR



Source: SAP Payroll database for Malé-based public employees, staff calculations
Note: Only permanent employees with a basic salary larger than zero were considered. The compression ratio was calculated by the maximum total monthly salary by the minimum total monthly salary.

Figure 81: Three-quarters of administrative officers had a unique take-home salary
Distribution of administrative officers by monthly compensation



Source: SAP Payroll database for Malé-based public employees

there were 118 unique monthly take-home salaries (18 percent). For the job category of Registered Nurse, nearly all (94 percent) of permanent employees in the Malé SAP database had a unique monthly take-home salary for the same job position (Figure 83).[142] If the Overtime Allowance is excluded, there were still 399 (or 68 percent) unique monthly take-home salaries.

162. **This trend of extreme pay variance persists across the public sector, which results in significant pay inequities.** A small degree of pay variance due to objective measures of performance to reward performance can be justified, but without a compelling or objective justification, these widespread inequities violate the principle of "equal pay for equal work", and affect employee morale, effort, and teamwork. Eliminating these inequities should be a priority for government.

Figure 82: A third of teachers had unique take-home salaries...

Distribution of teachers according to monthly compensation

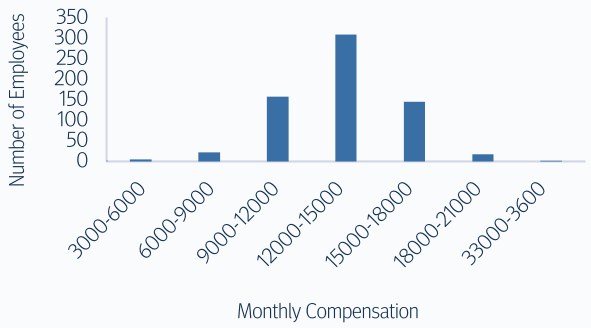
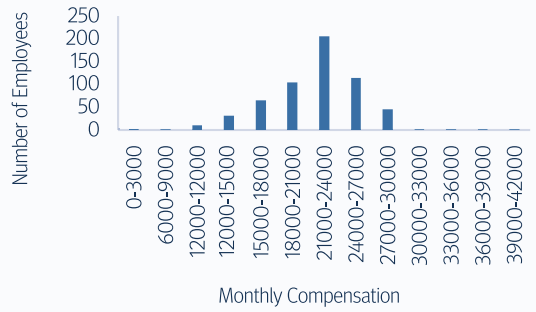


Figure 83: ...and almost all registered nurses had different salaries.

Distribution of registered nurses according to monthly compensation



Source: SAP Payroll database for Malé-based public employees

5.5 Competitiveness[143]

163. **As is typical of small island states, the public sector is the largest employer in Maldives outside of tourism.** Half of all full-time workers were employed in the public sector in 2019. Because the public sector offers job security and generous benefits, it is the employer of choice of many Maldivians, especially among youth. This strong preference to work for the public sector can distort incentives in the labor market, making it more difficult for private firms to attract top talent. The incentives to find a private sector job would be even lower if the public sector pays a premium in the form of higher compensation to similar workers.

164. **To investigate whether public employees also earn a wage premium in Maldives, and whether the size of the premium has increased over time, we use data from the Household Income and Expenditure Survey (HIES)**. The HIES is not a comprehensive labor force survey as it does not cover Maldivians working on resort islands, which were estimated at 21,000 at end-2019. However, it contains a comprehensive labor force module that includes the different components of total monthly income, including the basic salary or wage, allowances, bonuses, overtime payments, etc. The analysis is restricted to the sub-sample of 7,002 full-time workers (see Annex 5b for more details of the data and methodology and the full set of regression results).

165. **Public sector employees are indeed paid significantly more than private sector employees in Maldives.** After controlling for education, gender, age, and location, being a public sector employee results in a 28 percent increase in average total monthly take-home pay compared to a private sector employee (excluding resort employees). This premium remains positive but becomes smaller in magnitude when considering only formal sector employees.[144]

[142] Note that there is a separate job title of Senior Registered Nurse.
[143] This section is based on De Silva 2021 (a background paper for Maldives Public Expenditure Review).
[144] According to Statistics Maldives' definition, employees who do not receive social protection contributions by their employer or do not receive paid annual and paid sick leave are not considered formal sector employees.

For hourly take-home pay, the divergence is even higher considering the reduced work schedule in the public sector — public sector employees earn on average 40 percent more than private sector employees.[145] The premium is largely driven by the allowances component.[146]

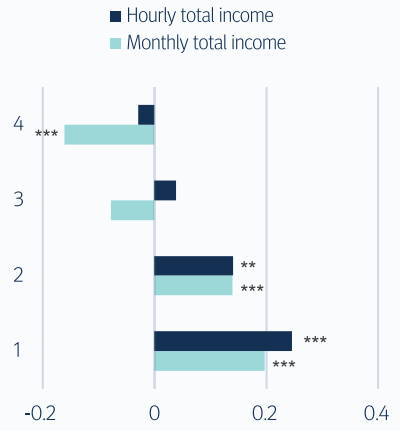
166. **The public sector premium is largest for low-skilled employees.** Lower skilled formal employees have the highest premium, earning on average 22 percent more in monthly take-home pay than their formal private sector counterparts (Figure 84). The premium is also significant and positive when looking at hourly pay. For more skilled employees, however, the premium reduces and turns negative in the case of the highest skilled workers. Managers and professionals in the public sector earn, on average, 15 percent less after controlling for personal characteristics. This finding is to be expected, as public sector pay is often capped for the highest skilled employees. These results are also consistent with estimates from quantile regressions – the public sector earnings premium decreases with total income, becoming negative at the highest quantiles of the income distribution (see Annex Table A12).

167. **The premium also benefits females and employees with fewer years of experience** (Figure 85). The analysis finds that the negative effect of being female on earnings (both total income and basic salary) are significantly smaller in the public sector. In other words, females earn closer to males when working in their public sector, compared to their private sector counterparts. Moreover, contrary to findings of a larger premium for older, more experienced workers in upper middle-income countries (Gindling et al 2019), the returns to age are significantly lower in the public sector compared to the private sector. Given that age is commonly used as a proxy for experience, these results suggest that the rewards for experience are significantly higher in the private sector.

168. **These findings suggest that pay increases are not needed for most of the public sector.** Despite the negative premium for earners in the top quintile, degree holders and highly skilled workers, employees in the public sector tend to be more highly educated (24 percent have a degree or higher qualification as opposed to 10 percent in the private sector), and the public sector tends to have a higher share of high-skilled jobs (professionals,

Figure 84: Lower-skilled public employees benefit from a larger premium...

Public sector wage premium, percent



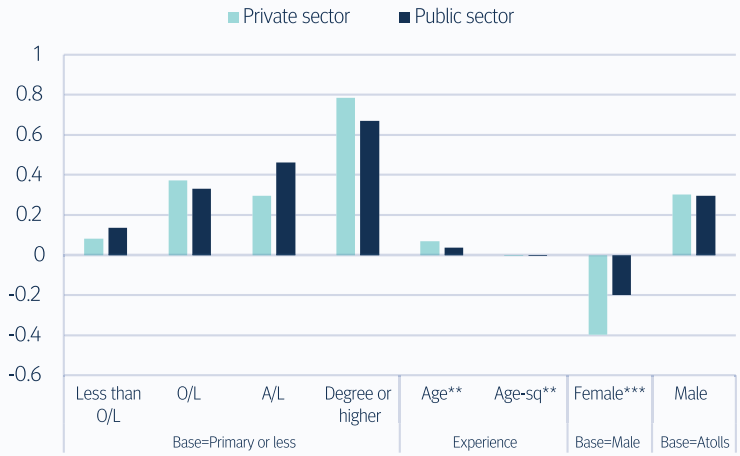
Source: De Silva 2021

Note: Asterisks refer to significance levels (p-values) of estimated premia. *** is strongly significant (1% level), ** denotes 5%, and * denotes 10%.

Skill levels 1 (low) to 4 (high) correspond to the International Standard Classification of Occupations definitions.[147]

Figure 85: ...as well as females and less experienced employees.

Estimated returns to education, age, gender and location on monthly total income for formal sector employees, percent



Source: De Silva 2021

Note: The graph plots the estimated returns to public and private sector employment obtained from a specification where each of the controls is interacted with the public sector dummy variable. *, ** and *** indicate that the difference between public and private sector returns to a given variable is significantly different from zero at 10%, 5% and 1% levels, respectively. O/L and A/L refer to O-levels and A-levels, respectively.

[145] Note that private sector employees working at resorts were not included in this analysis.

[146] When allowances are excluded, a formal public sector employee earns, on average, 15 percent less in terms of monthly basic salary than her private sector counterpart, controlling for background characteristics. There is virtually no difference in hourly basic salaries when allowances are excluded.

[147] Skill level 1 occupations correspond to simple and routine physical or manual tasks. Skill level 4 occupations, on the other hand, correspond to tasks that require complex problem-solving, decision-making, and creativity based on an extensive body of theoretical and factual knowledge in a specialized field. (ILO 2012, 12).

managers, etc). This suggests that the public sector is already able to compete with the private sector for top talent, and that degree holders are attracted to government jobs for reasons unrelated to wages. Additional wage increases therefore may crowd out more productive spending. The large public wage premium can also lead to unintended consequences; for example, it may encourage youth to queue for public sector jobs, which could cause higher rates of youth unemployment (Gindling et al 2019). There is some indication that this is occurring in Maldives (World Bank 2021b). While analysis of the HIES data shows that the size of the public sector premium has declined by 10.6 percent on monthly income between 2016 and 2019, the government may want to review potential disincentives that public sector pay creates for the growth and productivity of the private sector.

5.6 Institutional Fragmentation

169. **Wage bill management is fragmented across multiple government institutions.** This fragmentation presents coordination and harmonization challenges as the responsible institutions have different policy objectives and priorities. It could also inhibit the government's ability to contain wage bill growth.

170. **For example, there is no single institutional body that sets pay policy.** While the National Pay Policy Act (11/2016) states that the National Pay Commission (NPC), which resides within the Ministry of Finance, has the general responsibility to determine the salaries, allowances,[148] policies, standards, and benefits to public servants, they are not the final decision-makers. The NPC is chaired by the Minister of Finance, which means that budgetary and fiscal consequences are considered before a wage adjustment is proposed. Any proposed wage adjustment must first be approved by the Minister of Finance, be included in the MoF Fiscal Strategy, and subsequently submitted to the cabinet for consideration and approval. Since the budget is approved by Parliament, decisions on the public wage bill are subject to further amendments. Furthermore, the Constitution (Article 102) states that the President, Vice President, members of the Cabinet, members of Parliament (including the Speaker and Deputy Speaker), members of the Judiciary, and members of the Independent Commissions and Independent Offices shall be paid a salary and allowances as determined by the Parliament.[149]

171. **The number of filled public sector positions follows both a top-down and bottom-up process.** The top-down organizational structure is set by the Civil Service Commission (CSC). A ministry, department, or agency can, however, fill a vacancy that already exists within its organizational structure if they budget for it. Once funds are allocated, these ministries/departments/agencies are free to publicly announce and recruit for the position, without any involvement of the CSC. [150]

172. **This institutional fragmentation of wage bill policies and practices has contributed to weaknesses in affordability, transparency, and fairness.** Sustainable, corrective action to ensure a fair and affordable public wage bill will require addressing this fragmentation. To enhance wage bill control, the NPC should be setting wages for all public sector employees to ensure coherence and fairness. If policies continue to be set by different actors with different objectives, it can lead to short-term approaches that undermine the principles of wage bill management. For example, wages determined by the Parliament may be more influenced by the electoral cycle than wages determined by NPC, which is a technocratic body. Furthermore, the new public sector pay framework should be complemented with the development of a web portal and mobile application to ensure full transparency and consistency of salary structures for all jobs.

[148] While the announcements of new allowances for civil service staff are made by the Civil Service Commission (CSC), the actual decision to establish the new allowance is made by the NPC who must consult with MOF on budget availability. The MOF's role is to advise on whether the new allowance can be funded and to secure the resources. For other public entities, like independent institutions for instance, their Board can decide on the new allowance and write to MOF for the budget. MOF will consult with NPC before they decide.

[149] There is no formal written process on how these wages are decided. The current process is that the Parliament writes to MOF for advice, who in turn will consult with NPC, consider other benchmarks and give a recommendation. The final decision is with the Parliament.

[150] If a change is required in the organizational structure (for example, a new position or a new department is being established), the agency can propose it to the CSC with justification, and the Commission will decide. In some rare cases the CSC may do a full review before making a final decision.

5.7 Options for Reforming the Public Wage Bill

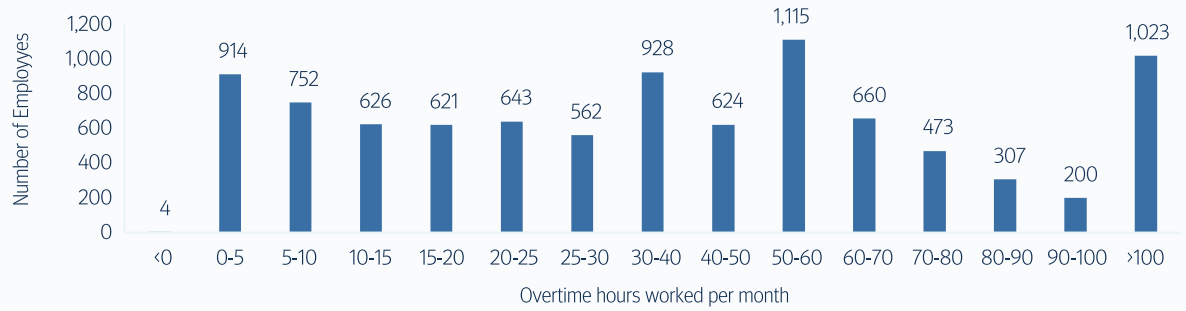
173. **Maldives' public wage bill system needs structural reform.** The fiscal shock from the global COVID-19 pandemic has exposed weaknesses that has exacerbated affordability concerns. Short-term wage cuts provided temporary savings that were reallocated to more pressing needs to tackle the pandemic, but they were ultimately reinstated and did not address existing structural issues. The main issues are extensive pay inequity, institutional fragmentation, limited transparency, and lack of wage bill controls.

174. **The government recognizes these issues and has tasked the NPC with developing a pay harmonization framework.**[151] The NPC has been tasked to develop a new public service pay framework and has completed a comprehensive job evaluation[152] to harmonize jobs across the public sector to ensure fairness and equity in compensation. The end objective is that pay is set objectively for each job, not the employee. This reform is very important: by setting pay objectively for each job, it should eliminate the pay inequities that persist across the public sector. A new, simpler, and more transparent public pay system could ensure the principle of fairness is upheld and simultaneously provide much greater wage bill control.

175. **Notwithstanding the good intentions of these reforms, the new pay framework is likely to lead to a significant increase in the public wage bill.** During a pay reform, typically there are employees who earn compensation above and below the amounts set by the new policy. If the intent is to ensure no one receives less compensation than the amount they are currently paid, then there will be a large net fiscal cost. This cost will result from the boost to compensation for employees currently earning less than the amount prescribed by the new policy. MoF (2021c) estimates an additional US$78 million or 2.1 percent of 2019 GDP would be needed to implement the new pay harmonization framework in 2022 (more recent estimates from NPC indicate that this figure is even higher, from US$162-227 million).[153] This is in addition to the costs that will already be incurred this year due to the implementation of the minimum wage (MVR 7,000 or US$455 for full-time permanent civil servants) that began on January 1, 2022.[154]

176. **It would be fiscally prudent for the government to phase-in the new pay framework over multiple years to avoid a large increase in the public wage bill.** Given the persistence of the wage bill at a third of total expenditures and 11 percent of GDP, any additional cost to the wage bill is likely to persist over the medium term and beyond. While this cost would, in principle, be a one-off expense, the absence of institutional wage bill controls in Maldives could mean that the reform may fail to address issues of pay inequity and the proliferation of unique salaries, thus leading to higher overall wage bill expenditures over the medium term. NPC also does not have the mandate to oversee SOE employee compensation. Furthermore, there is a risk that a one-off increase in wage expenditures could compromise other

Figure 86: A quarter of employees are working at least 30 hours of overtime per month
Distribution of employees according to number of overtime hours worked per month



Source: SAP Payroll database for Malé-based public employees

[151] The new Public Service Pay Framework was launched on May 1, 2022, after analysis for this report had been completed.
[152] The job evaluation used a factor analysis to assess job positions based on four key attributes: (i) skills and knowledge (45 percent); (ii) responsibility (35 percent); (iii) physical effort (10 percent); and (iv) environmental working conditions (10 percent). Across the public sector, 9 major job families were identified and the multiplier to determine the salary for each job title was obtained through regression analysis on microdata from the labor market.
[153] According to NPC, the fiscal burden would be mitigated by the fact that employees would be migrated to the new pay framework in stages. The new pay structure proposal also includes lead, lag and meet options for each profession and job matrix.
[154] The minimum wage implementation is estimated to add an additional US$26 million or 0.5 percent of 2019 GDP to the annual wage bill. MoF (2021c) had estimated US$25 million based on a minimum wage of MVR 6,700.

government priorities during this global period of slower growth and rising energy and food prices. A strong commitment not to deviate from the new pay framework would be imperative for the reform to succeed in strengthening wage bill controls.

177. **As part of this reform, the NPC could consider consolidating or eliminating most of the allowances.** The pay reform presents an opportunity to address the proliferation of allowances in the current system. Each allowance should be evaluated on whether it meets the criteria of a supplementary form of compensation beyond what has already been assessed in the job factor analysis. If not, it should be eliminated. Any allowance that remains should serve a clear, justifiable purpose, and set strict and fair eligibility criteria. Remaining allowances should also be consolidated to ensure a simpler and more cost-effective allowance system. Nonetheless, the basic salary should still form the dominant part of compensation.

178. **The overtime allowance needs to be capped and standardized.** The comparatively low working hours in the public sector has led to a large share of employees (39 percent of Malé based employees) earning overtime. A third of Malé-based employees are working at least 30 hours of overtime per month (Figure 86). This number is too high. If there is a consistent need to pay overtime, the government could consider increasing the official working hours back to its previous working schedule of 35 hours per week. If not, for most employees, this additional compensation could be captured in the basic salary under the new pay system. For example, if shift workers continue to work in 8-hour shifts, 2 hours beyond the official working day, their salary could be structured to account for this responsibility. Furthermore, the overtime allowance could be capped to ensure commitments remain within the available fiscal space.**The government could consider setting a wage bill target, both in the short run and over the medium-term.** To prevent unanticipated and large increases in wage bill growth, the government could consider setting a wage bill target, expressed as a share of domestic revenues (excluding grants).[155] This would help provide an anchor against multiple pressures that come with managing the wage bill and avoid the need for more drastic measures such as a hiring or wage growth freeze. A target could help the government to assess whether policy proposals help or hinder progress towards more sustainable wage bill management in the long term. The target could also help, over time, to reduce the wage premium for public sector jobs compared to similar jobs in the private sector. Without a target, pressures on the wage bill may be challenging to offset.

179. **A new pay system will have pension implications, which will require a simultaneous pension reform to mitigate fiscal liabilities.** Currently, the Maldives Retirement Pension Scheme (MRPS) is based on the basic salary, not total take home pay, and mandates a contribution rate of 7 percent for employers and employees (see Chapter 6). Therefore, if the new pay structure shifts most of employee compensation away from allowances and to the basic salary, by default the fiscal liabilities of pensions will increase unless additional reforms to the pension scheme are undertaken.

180. **Finally, the government could consider consolidating the institutional responsibilities of wage bill management under one body.** Centralizing this function would ensure that approaches to negotiating, planning, and budgeting pay policies are consistent across all of government. Otherwise, coordination and harmonization challenges may persist, which could lead to a scenario where reforms undertaken by NPC are subsequently not implemented or reversed, such as in the current framework where pay and allowances for certain job positions are determined by parliament. In addition, integrating wage bill controls under one institution for the entire public sector, including SOEs, would improve the government's oversight of personnel and payroll growth. This would accelerate ongoing reforms such as developing a single, digital payroll register that includes timely information on atoll- and island-based staff (GoM and WBG 2021).

181. **Ultimately, wage bill management is about having the controls, authority, and necessary information to make the best decisions going forward.** There will always be pressures to spend more and more on the wage bill. Unfortunately, spending more on the wage bill does not necessarily lead to better outputs and outcomes when the underlying system suffers from structural weaknesses. While these reforms need to be carefully sequenced as Maldives recovers from the COVID-19 pandemic, now is an opportunity to undertake reforms to recalibrate the public wage bill so it is on a more equitable and sustainable path.[156]

[155] Expressing the target as a share of GDP could cause challenges due to sudden fluctuations in output or rebasing the GDP.
[156] Pay harmonization for the education sector came into effect starting May 1, 2022.

CHAPTER 6

Pensions

Summary

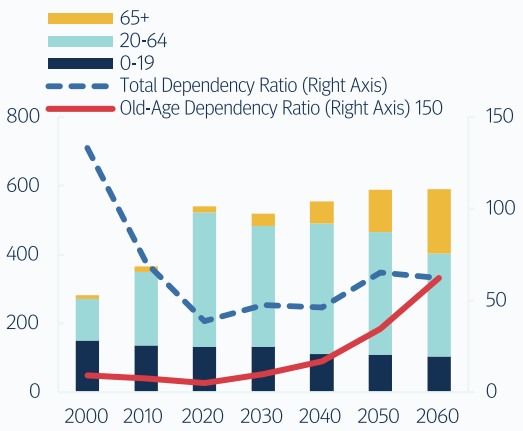
Maldives only spends an average of US$100 million or 2 percent of annual GDP on pensions, but the pension scheme faces several challenges: (i) fiscal costs are projected to increase as the population ages, largely due to the costs of the Old Age Basic Pension; (ii) it is inequitable, with select groups of civil servants receiving "double pensions"; and (iii) private sector coverage is low. Using the World Bank Pension Reform Options Simulation Toolkit (PROST), this chapter explores options to constrain the long-term costs and increase the coverage of Maldives' pensions system. These include using inflation-based indexation, prohibiting new defined-benefit schemes for select civil servants and reversing the existing "double pensions". To increase coverage, Maldives could improve compliance oversight, link the pension scheme to the proposed unemployment insurance scheme, and possibly provide additional incentives for contributions.

6.1 Introduction

182. **Maldives is undergoing a dramatic demographic transformation.** Over the next four decades, the elderly population is anticipated to increase almost ninefold, while the working age population will decline by almost a quarter (Figure 87). Maldives began an aging process in 2020 when both the total dependency ratio and the old-age dependency ratio[157] reached a low point. Prior to this, Maldives could draw upon a demographic dividend. A sharp escalation in the old-age dependency ratio is projected, doubling from 4.9 percent in 2020 to almost 10 percent in 2030 and rising to 16.8 percent by 2040. The rapid growth in the number of elderly is attributed to projected increases in life expectancy of about a 1-year increase per decade (Figure 88), along with a rapid drop in the fertility rate. This has two implications: (i) more households will need to support the elderly that are not able to work and (ii) the level of old age vulnerability could increase.

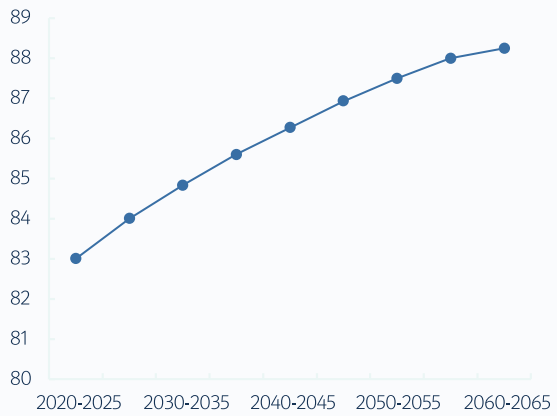
183. **Maldives will need a strong pension system, both in terms of coverage and adequacy,158 to support the aging population in the context of a shrinking workforce.** There are three main challenges with Maldives' current pension system: (i) it poses rising fiscal costs over the long term; (ii) it is inequitable: about a third of government retirees receive both a 'double pension' (an old age basic

Figure 87: The aging process has begun in Maldives...
Thousands of people; percent (right axis)



Source: World Population Projections, 2019 revision.

Figure 88: ...as Maldivians are living longer and having fewer children.
Projected life expectancy at age 65



Source: World Population Projections, 2019 revision.

[157] The total dependency ratio is the number of individuals aged 0-19 and 65 or older ("dependents") over the working-age population (defined as those between the ages of 20 and 64). The old-age dependency ratio is the number of individuals aged 65 and over per the working-age population (20-64).
[158] Coverage is defined as the share of the labor force actively contributing to pension schemes. There is no universal definition of adequacy of retirement income, but it refers to whether the total pension entitlement is sufficient (e.g. satisfying basic needs/allowing retirees to maintain the same standard of living prior to retirement). Adequacy refers to how much pension benefits serve to replace pre-retirement income and protect retirees from poverty.

pension or OABP, as well as a pension from their respective agencies); and (iii) coverage is limited to only a third of the labor force who actively contribute to the pension scheme, of which most are civil servants. Unless coverage can be increased, it is estimated that only two-thirds of the labor force will receive only the OABP benefit in spite of rapid aging. The chapter explores these challenges and potential reform directions.

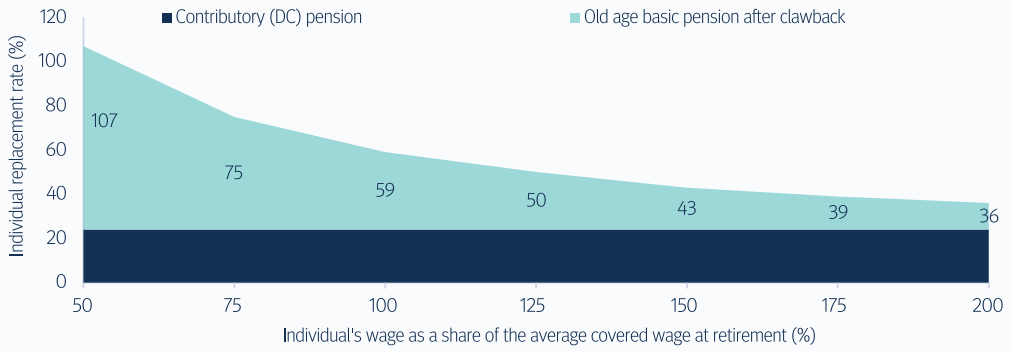
6.2 Description of the Maldives Retirement Pension Scheme (MRPS)

184. **Maldives substantially reformed its pension scheme in 2009 by establishing a mandatory defined contribution (DC) scheme for public and private sector workers.** The Maldives Retirement Pension Scheme (MRPS) was meant to replace existing civil service pension schemes and to provide a unified framework for private sector workers. State employees who were not yet of pensionable age at the time of the reform had their accrued rights deposited in their Retirement Savings Account (RSAs) as "recognition bonds" of the government. Under the MRPS, both employers and employees contribute 7 percent of basic salary (see Annex 6 for details). The retirement age is 65, but workers can retire at age 55 provided that the balance in their RSAs is sufficient.[159] The MRPS also allows for pre-retirement disbursement to pay for 80 percent of obligatory Hajj pilgrimage expenses,[160] and a Housing Loan Collateralization scheme which was established in 2016.[161]

185. **The MRPS has offered attractive returns over the past decade.** The MRPS is managed by the Maldives Pensions Administration Office (MPAO), with support from the Capital Markets Development Authority (CMDA). The MPAO is responsible for investment management, collections, accounting, data management, communications, benefit calculations and disbursement, whereas the CMDA is responsible for compliance monitoring, risk-based inspections, and overall oversight. Contributions made to the scheme are invested in asset classes stipulated under the Pension Act. Three funds are offered during retirement, and two pre-retirement investment funds are offered (the Investment Fund and the Sharia Fund). The investment fund has had an average annual return of 6.5 percent since inception, much higher than the average deposit interest rate in the banking system (3.8 percent) over the same period.

186. **Regardless of whether they contribute to MRPS, Maldivians also receive an Old Age Basic Pension (OABP).** Since the inception of the MRPS in 2009, the government has provided an OABP to retirees with a "clawback" or reduction of 50 percent for the amount received from the MRPS and 100 percent of the amount received from any other state-funded scheme.[162] The initial OABP amount was MVR 2,000 (US$130) per month, subsequently increasing to MVR 2,300 (US$149) per month in 2012. However, from 2014–2019 the government also provided a "Senior Citizen Allowance" (SCA) to all retirees. The

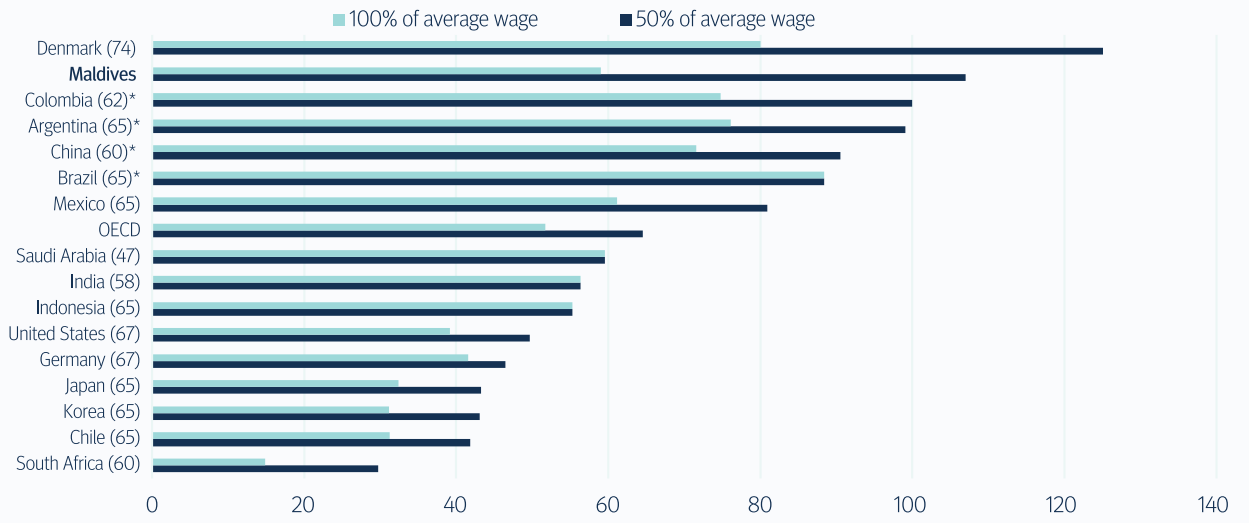
Figure 89: A Maldivian earning the average wage would receive 59 percent of their income after retirement



Source: World Bank staff calculations using the OECD Apex model.
Note: The real rate of return is assumed to be 6 percent per year.

[159] Provided a lifetime monthly payment more than twice the OABP amount prevailing at the time of retirement.
[160] Provided a member has an RSA balance sufficient to pay for an MVR 2000 monthly benefit at pension age.
[161] Under the program, individual retirement savings can be used to collateralize against the 20 percent down payment requirement for bank housing loans. The collateralized amount is used as a last resort in case of default on an individual's mortgage loan.
[162] This means that the OABP is adjusted or deducted according to the amount an individual receives from MRPS and other state pension systems.

Figure 90: Maldives' pension system is highly adequate and generous, even more than the OECD
Replacement rate, percent



Source: Adapted from OECD: Pensions at a Glance 2021, Table 4.1. Statlink: https://stat.link/b2f0ws
Note: : Retirement ages are listed in parentheses. Countries marked with * have different retirement ages/replacement rates for men and women. Gross replacement rates represent the total retirement income before deductions for taxes or social insurance as a proportion of the individual's gross income prior to retirement.

minimum combined OABP and SCA was MVR 5,000 or US$325 per month at age 65. In March 2019, the government eliminated the SCA, increased the OABP to MVR 5,000 per month, and linked the entire OABP to the clawback.

187. **The combination of the OABP, a universal basic pension and the MRPS, a contributory DC scheme, results in a generous redistributive pension benefit.** The replacement rate measures how effectively a pension system provides a retirement income to replace earnings, the main source of income before retirement (OECD 2021). In Maldives, the replacement rate for a full career worker earning the average basic wage is estimated at 59 percent (Figure 89). This is considered generous by most international metrics and higher than the OECD average of 52 percent for the average wage worker (Figure 90). These replacement rates are progressive: a worker earning only half of the average wage is estimated to receive 107 percent of such an individual worker's wage (Figure 89).[163] Only Denmark provides a higher replacement rate (125 percent) for someone earning half the average wage (Figure 90).

188. **As the defined contribution scheme is relatively new,164 there are very few new retirees from the scheme and most retirees receive the minimum MVR 5,000 (US$325) per month.** According to MPAO data in December 2020, 90 percent of male retirees and 93 percent of females retirees receive a monthly retirement benefit of MVR 5,000. The relatively high level of the OABP and the 50 percent clawback from the contributory benefit adversely affect the incentives to contribute to the MRPS scheme and to correctly report current basic wages. The effective tax rate after consideration of the clawback is substantially negative for most retirees.

189. **The OABP provides a much higher replacement rate when compared with OECD and G20 comparators.** The OABP provides a benefit equal to about 73 percent of the monthly average basic wage for workers contributing to the MRPS.[165] This is much higher than in OECD and G20 countries, where the average non-contributory basic benefit and the contributory-based basic benefit are 22 and 14 percent respectively (left panel in Figure 91). Moreover, the universality of the OABP means that almost all of the elderly are covered by a benefit that is generous by international standards, similar to OECD countries (right panel in Figure 91).

190. **The adequacy of OABP benefits are, however, lower when compared with total individual compensation in the public sector because contributions are levied only on basic salaries, not total compensation.** In Maldives, the basic salary for government employees at end-2020 made up about 57 percent of total compensation on average,

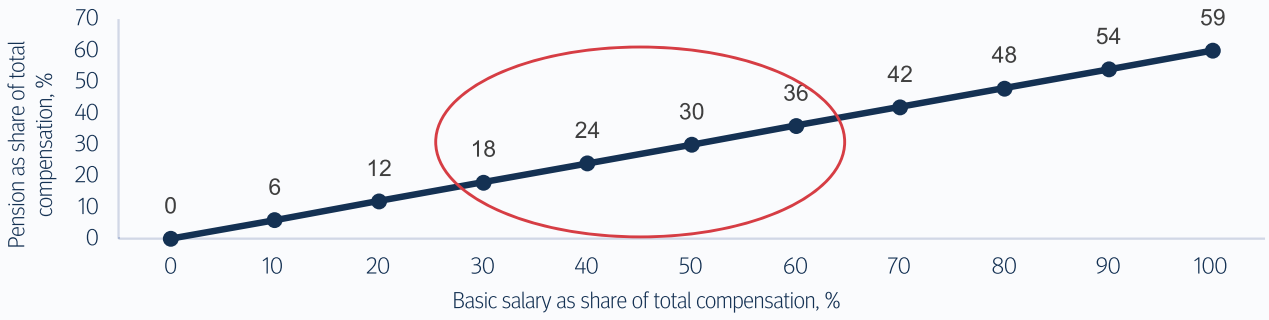
[163] In DC schemes, the annual rate of return on pension assets impacts the replacement rate at retirement. [164] Maldives did not have a mandatory contributory scheme for private sector workers until implementation of the MRPS in 2011.
[165] As of December 31, 2020. Source: MPAO.

Figure 91: Maldives' basic pension scheme is extremely generous compared to OECD countries
Share of average wage earnings / share of population aged 65+, percent

Source: World Bank staff elaboration based on OECD (2021).

while the remainder comprises non-pensionable allowances (see Chapter 5). As such, the replacement rates shown in Figure 89 would be roughly 50 percent lower in the case of about two-thirds of government retirees when compared to their total compensation including allowances at the end of 2020.[166] There is also considerable variation in the individual proportions of total compensation consisting of basic salary and allowances.[167] Even more substantial differences would apply to those with more (or fewer) allowances as a proportion of total compensation (Figure 92). For example, a civil servant whose basic salary makes up only half of total compensation would have a replacement rate of only about 30 percent, i.e., she would receive a benefit equivalent to only a third of her total take-home compensation prior to retirement.

Figure 92: As suggested by this stylized example, replacement rates could be lower or higher depending on the proportion of basic salary as share of total compensation



Source: World Bank staff simulations.

[166] The authorities do not have data on the distribution between basic wage and allowances for private sector workers, so we are not able to estimate the total replacement rate when measured against total pre-retirement compensation.
[167] One standard deviation variation was about 14.5 percent of total compensation.

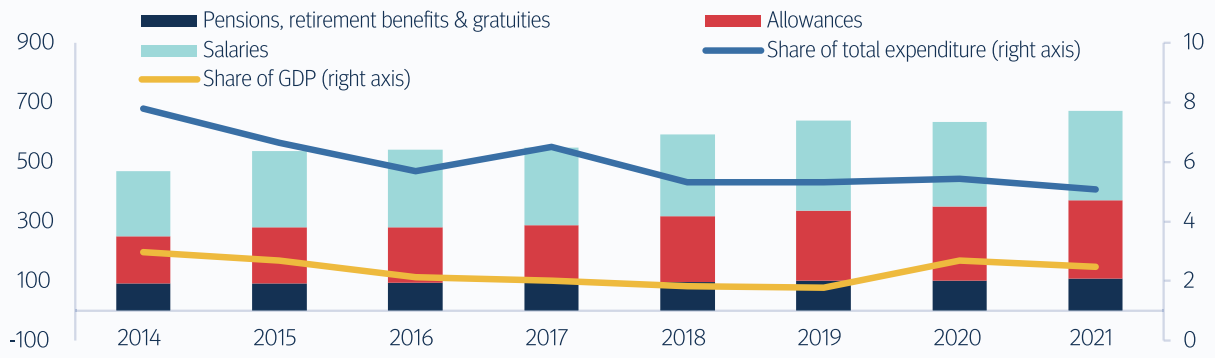
6.3 Description of the Maldives Retirement Pension Scheme (MRPS)

6.3.1 Is the Rent-to-Own program effective?

191. **Given the generosity of Maldives' OABP and the aging demographics, pension costs are projected to rise, even though the MRPS is a defined contribution scheme.** Pensions cost the state US$100 million annually on average (5.3 percent of total expenditures or 1.8 percent of GDP; see Figure 93). However, total costs of the pension system are projected to reach an average of 2.6 percent of GDP per year over the coming decade and progressively rise to over 5 percent of GDP by 2060 (Figure 94). This projection assumes OABP benefits are indexed at about half by prices and half by wages ("Swiss" indexation), even though there is no legal requirement for annual adjustments. It includes the projected fiscal costs of government contributions on behalf of civil servants, payment of civil servant defined-benefit pensions,[168] encashment of recognition bonds and payment of the OABP.[169] It does not, however, include the costs of additional civil service or uniformed services pensions which could be established in the future, nor the impact of the recent minimum wage reform.[170]

192. **The projected costs of the MRPS and especially the OABP are heavily reliant on the indexation method adopted and there is no framework for the indexation of OABP benefits.** Much of the increase in fiscal costs is attributed to the projected costs of the OABP as the number of eligible retirees grows substantially in the years ahead. This, in turn, depends on the indexation method used. The baseline projection assumes a combination of price- and wage-based indexation. Wage-based indexation alone would result in a projected escalation of costs up to 8 percent of GDP by 2060, whereas automatic adjustment of the OABP according to the growth in consumer prices would roughly stabilize the costs at under 2 percent of GDP (Figure 95). The trade-off, however, is that inflation-based indexation will gradually reduce the individual replacement rate for the old-age basic pension because wages tend to grow faster than prices, as illustrated in Figure 96.

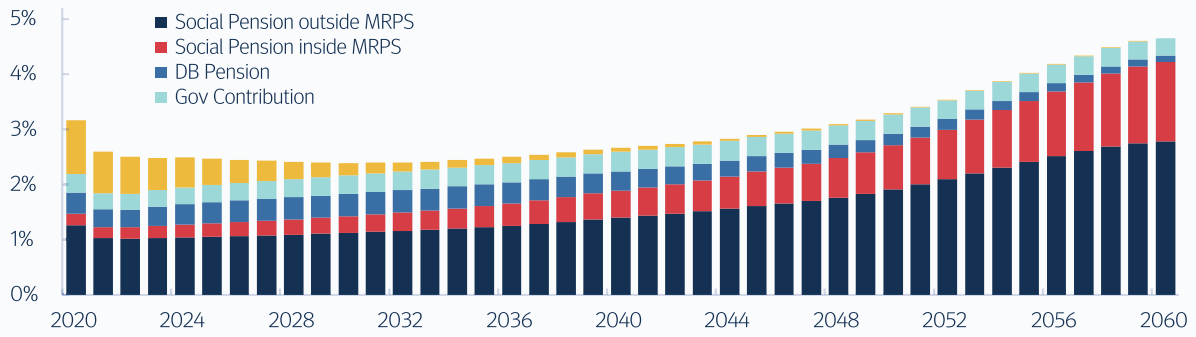
Figure 93: Pensions have not been a big fiscal burden...
US$ millions (left axis); pensions' share of total expenditure & GDP (right axis)



Source: MoF, staff calculations.

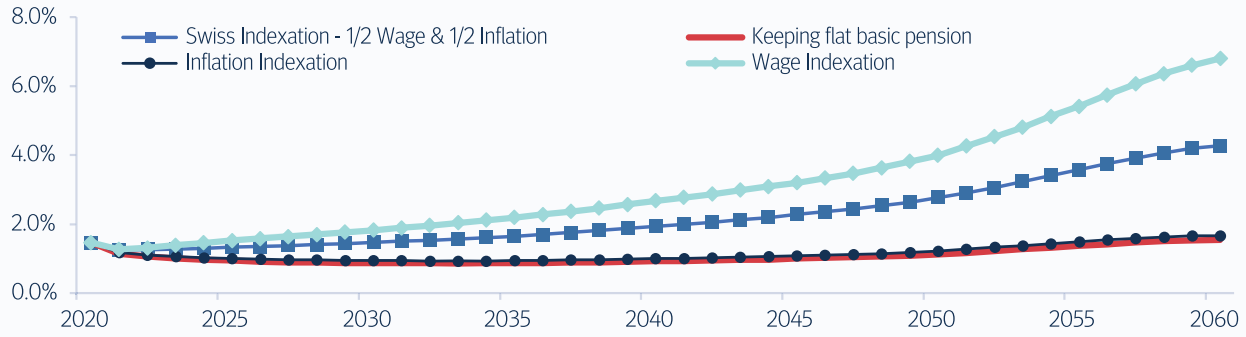
[168] This includes benefits for government retirees prior to 2009 as well as defined-benefit pensions or so-called "double pensions" for some retiring civil servants since then, discussed later in the chapter.
[169] This is based on a projection undertaken using the PROST. This does not include the costs of additional civil service or uniform services pensions which could be legislated in the meantime. Recognition bonds were established in 2009 to provide a means of pre-funding the accrued rights of civil servants which were translated into initial balances in the MRPS at that time. .
[170] The mandatory minimum wage began on January 1, 2022 (after these estimates were completed). Its impact on the long-term projected costs is not expected to be material.

Figure 94: ...but they will begin to rise over the long term.
Projected total fiscal costs for all pensions, percent of GDP



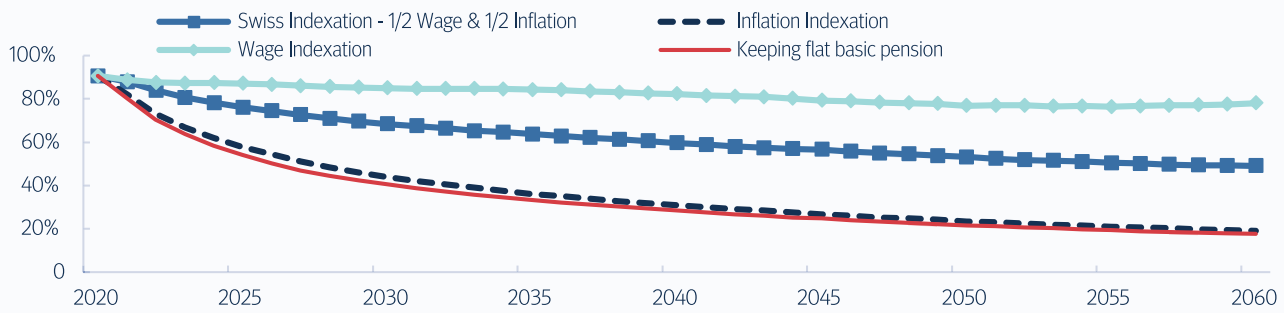
Source: World Bank PROST Projections
Note: The OABP is represented by the combination of dark and light blue bars. The projection assumes OABP benefits are indexed at half by prices and half by wages ("Swiss" indexation). "Social pension outside MRPS" refers to the OABP for those who do not contribute to the MRPS; "social pension inside MRPS" refers to the OABP provided to contributors. "DB pension" refers to existing public pensioners at the time of the 2009 reform, who received a DB pension from the old system. Government contribution refers to the payment for service prior to 2009 for public sector workers. The so-called "double pension" is not included in these projections.

Figure 95: The projected costs of OABP differ depending on the indexation method adopted
OABP replacement rate as share of average covered wage, percent



Source: World Bank staff projections using PROST (base year: 2020).
Note: Details as to the assumptions used for the projections are indicated in the Annex.

Figure 96: Inflation indexation would gradually reduce the individual replacement rate for OABP
OABP replacement rate as share of average covered wage, percent



Source: World Bank staff projections using PROST (base year: 2020).
Note: Details as to the assumptions used for the projections are indicated in the Annex.

6.3.2 Civil service pensions: double coverage and rising costs

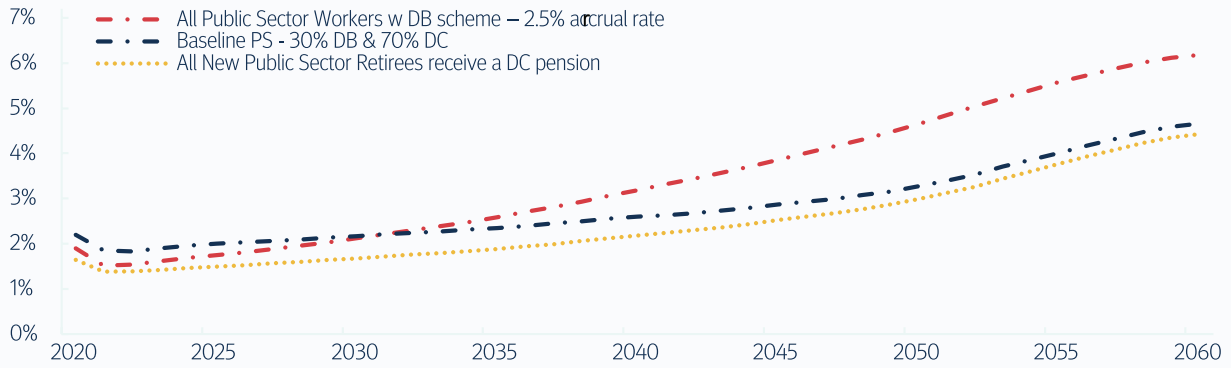
193. **About a third of government retirees receive a so-called "double pension".** Although the Maldives Pensions Act in 2009 replaced previous 'defined benefit' (DB) government pension schemes and the Government Provident Fund with the 'defined contribution' MRPS, various government institutions have subsequently established DB pension schemes alongside the MRPS (MoF 2019). In this way, about 30 percent of government retirees have received double coverage – namely, coverage both by the MRPS and by non-contributory defined-benefit schemes established after 2009. This was not supposed to occur, as MRPS intended to provide a framework for all government pensions, including recognition of pre-2009 service.[171] For most civil servants, however, the MRPS reform represented a decrease in the anticipated replacement rate when compared with the equivalent replacement rates for similar service under the earlier pay-as-you-go DB scheme.

194. **Unless the government undertakes reforms to eliminate double coverage,172 civil service pension costs are expected to increase.** To model the effect of the 'double pensions' issue, three scenarios were considered. First, the baseline scenario projected the same distribution between public sector workers receiving both MRPS benefits and public service DB pension benefits (as was observed for new retirees in 2020), i.e., about 30 percent continue to receive double pensions.[173] Second, all public sector retirees are assumed to receive double pensions (based on a 2.5 percent accrual rate).[174] Finally, the last scenario assumes all new civil servant retirees receive only MRPS DC benefits, i.e., eliminating the double pensions problem. The results (Figure 97) suggest the following:

- The "Baseline" projects an increase in pension costs from about 2 percent of GDP in 2022 to about **3 percent of GDP** over about 25 years.
- The second scenario, which assumes that all new government retirees receive double pensions, leads to an increase in costs to **6 percent of GDP** by 2060. This assumes that no fiscal costs are incurred for accrued rights or transition costs.
- The last scenario, assuming that all new government retirees only receive MRPS DC benefits, indicates a **cost reduction** of 0.3 to 0.6 percent of GDP per annum from the baseline up until 2060.

Figure 97: Civil service pension costs are expected to rise under no reform scenarios

Percent of GDP



Source: World Bank PROST projections.

Baseline – Existing & new public employees (70% of the total public sector headcount) are assumed to receive a DC pension + OABP. The remaining public employees from the old system who joined the MRPS are assumed to receive new DB + DC pensions ("double pension") + OABP. Existing public pensioners received a DB pension.

All DB – Existing and new public workers receive DB pension with pre-2009 parameters and all private-sector workers receive a DC pension + OABP.

All DC - All public employees receive only the DC benefit + OABP; all private receive DC pension + OABP.

[171] The formula for recognition of accrued rights is: Basic salary (at the time of retirement) × 93% ×14% × service period up to 30 April 2010. The pre-2009 pension parameters varied by service group. However, most retirees had effectively a 2.5 percent per year accrual rate with a replacement of final basic salary of 50 percent received and paid out with an additional 50 percent paid out after 40 years (effectively, a 100 percent accrual rate after 40 years).

[172] The new Public Service Pay Framework, introduced in May 2022, included substantial reforms to the defined benefit pension for civil servants. This analysis was completed before the reform.

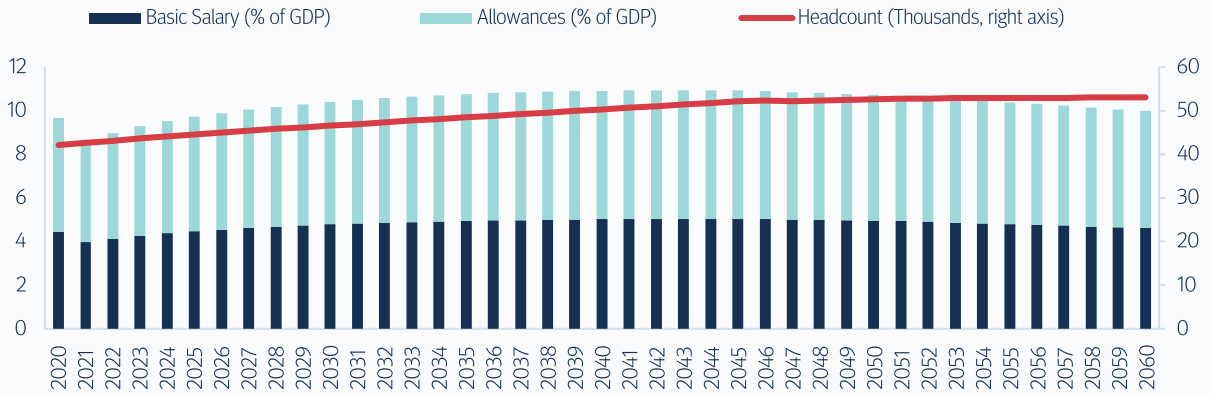
[173] About 70 percent of total public sector workers retiring in 2020 received only MRPS benefits while about 30 percent received both MRPS and additional DB benefits. As the legal documents for the double coverage pensions were not made available, the application of a 2.5 percent per year accrual rate for the entire work history of projected government retirees in addition to the projected MRPS benefits is assumed.

[174] This was a common accrual rate used in the PAYG DB schemes prior to 2009, but may not be the precise rate used for each of the schemes established since 2009.

195. **The projected costs of public sector pensions could increase further depending on growth in headcount, basic salaries and changes in the benefit formula leading to double coverage.** In a scenario where the public sector headcount remains constant as a share of the working-age population, the public sector wage bill is expected to increase marginally from about 9 percent of GDP in 2021 to about 11 percent of GDP in 2035 (Figure 98)[175] and stabilize thereafter. Should headcount increase, these costs are expected to rise, and would subsequently lead to an increase in public sector pensions.

Figure 98: Public pension costs could increase further if headcount increases

Left axis: share of GDP, percent; Right axis: Thousands of people employed in the public sector



Source: World Bank projections. Assumes salaries and allowances are a constant share of GDP.

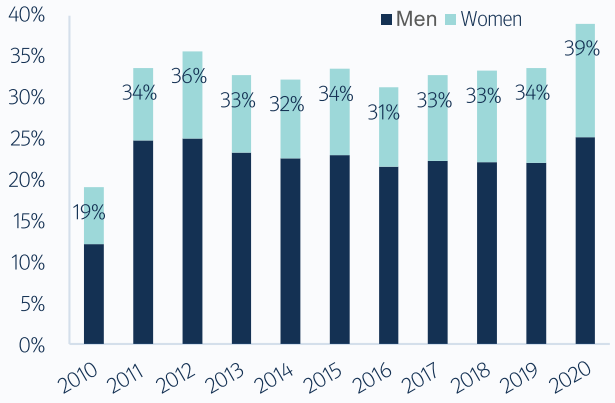
[175] The projections of salaries and allowances are heavily dependent upon the assumptions of compensation growth and changes in headcount. Growth in public sector salaries is assumed to be in accordance with the real growth of GDP per capita. The public sector headcount is assumed to remain a fixed percentage of the working-age population until 2045 when it reaches a peak; after that, we assumed that there is no net new hiring, i.e., the number of new entrants equates to the number of new retirees.

6.3.3 Coverage

196. **Only a third of the labor force actively contributes to the MRPS (Figure 99)**. About 40 percent of these are civil servants, including teachers and health workers. All employers and employees paid a salary or wage by their employer are required to contribute to the scheme. Looking at the correlation between the proportion of the working age population covered by contributions to a retirement scheme on the one hand and GDP per capita, the coverage of Maldives' pension scheme underperforms many other countries of a similar per capita income (Figure 100). Low coverage, combined with rapid aging, suggest that Maldives might need to consider measures to increase contributory coverage or alternative retirement savings arrangements.

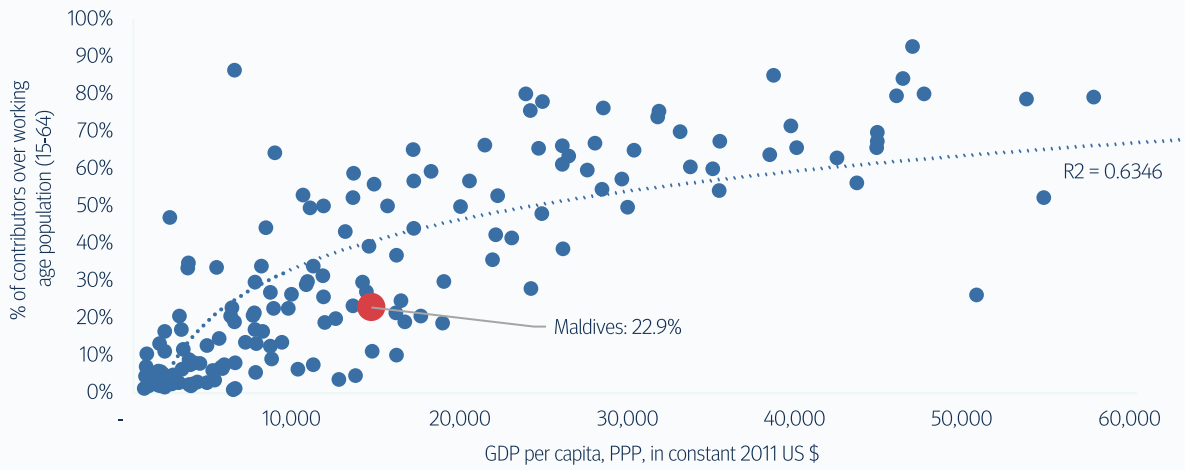
197. **All elderly Maldivians are covered by a benefit that is generous by international standards, but not many receive the DC benefit.** All elderly receive about three-quarters of the average covered basic salary – a relatively generous proportion compared to, for example, the elderly pension in Chile (Box 6). In 2020, only 7 percent of retirees received a contributory (DC) Retirement Pension in addition to the OABP. This low level of retiree coverage reflects the relative newness of the scheme; there have only been about 10 years of civil service cohorts retiring since the implementation of the MRPS in 2009. In addition, very few private sector workers had both registered and retired over this period. Disbursements to existing and new retirees under the civil servants' scheme covered 40 percent of retirees in 2020 (Figure 101).

Figure 99: MRPS coverage is low
Share of the labor force contributing to retirement pension scheme, percent



Source: Statistics Maldives 2021c and World Bank WDI.

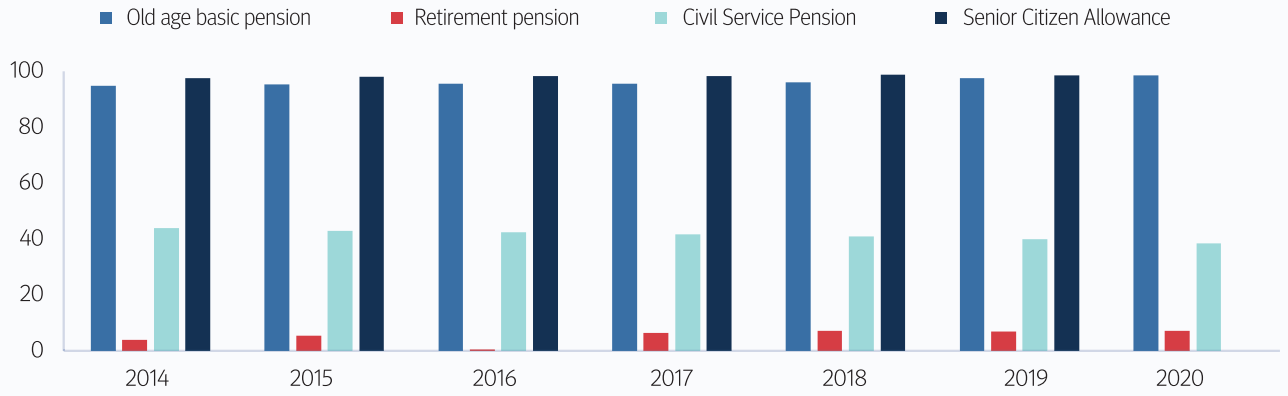
Figure 100: Coverage of the MRPS is low, compared to countries of a similar per capita income level



Note: Data from 2010-2018 (most recent available); Maldives' data from 2020.
Source: Staff calculations from World Bank WDI.

Figure 101: Virtually all retirees receive the old age basic pension (OABP), but few receive the retirement pension (MRPS)

Elderly coverage by type of pension, share of population aged 65+ (%)



Note: Data from 2010-2018 (most recent available); Maldives' data from 2020.
Source: Staff calculations from World Bank WDI.

Box 6: A Comparison of Chile's Solidarity Pension and the Maldives OABP

In July 2008, the Chilean authorities established a means-tested non-contributory basic solidarity pension known as the Basic Solidarity Pension (Pensión Básica Solidária, PBS) which was meant for individuals without any other pensions. The benefit initially covered retirees at age 65 in the bottom 40 percent of the welfare distribution of households, but was gradually extended to the bottom 60 percent by 2012. The authorities also established a supplementary pension known as a "solidarity complement" (Aporte Previsional Solidário, APS) targeted to individuals with low pensions. The means testing criteria is the same for both. The PBS was about US$157 per month in September 2018 or about 7 percent of the average wage. The APS is a benefit on a sliding scale which has a maximum of the value of the solidarity complement (US$463/month or about 21 percent of the average wage) and the PBS. The implicit tax on pension benefits is 33.7 percent up to a threshold for those who qualify for the APS benefits.

The Maldives OABP is universal to all individuals aged 65 and above and is a benefit of MVR 5,000 or US$325 per month (about 73 percent of the average reported basic salary). The implicit tax on pension benefits is 50 percent because of the clawback for private sector retirees and 100 percent because of the clawback for public sector retirees.

Three key differences are evident between the Chilean and Maldivian basic pensions:

- The Chilean benefit is allocated based on a means-testing formula to the bottom 60 percent of the welfare distribution while the Maldivian benefit is not subject to any means-testing criteria;
- Both the Chilean benefits for the elderly with no pensions (the PBS) and the benefit for those with low pensions (the APS) represent a very small proportion of the average wage. In the Maldivian case, however, the benefit is almost three-quarters of the average covered wage.
- The implicit tax through the clawback is higher in Maldives (50 percent) than in Chile (33.7 percent).

Source: World Bank 2020c.

198. **Increasing coverage of the MRPS is even more important in light of the minimum wage reform.** The establish ment of a minimum wage starting January 2022 will make compliance more costly for employers and workers to the degree to which some basic salaries are increased. To the extent that labor costs are higher, some businesses may have even less incentive to contribute to the pension scheme. Therefore, stronger compliance oversight by the authorities (particularly CMDA) will become even more important to ensure that coverage does not decline further.

199. **The distribution of covered wages in October 2021 suggests that a substantial proportion of workers may have pensionable wages which are lower than the minimum wage requirements for January 2022.** The median monthly basic salary for private sector workers was MVR 5,050 or US$328. Moreover, about 34 percent of men and 39 percent of women had pensionable wages reported which were below the MVR 4,500 (US$292) level stipulated as the minimum wage for small businesses, while more than 68 percent of men and women had pensionable wages below the MVR 7,000 (US$455) level stipulated for medium businesses.

6.4 Options for reforming Maldives' pension system

200. **Old Age Basic Pension.** The parameters of the OABP need to be changed to make the benefit more fiscally affordable and strengthen the incentives to work and save for retirement. The government may want to consider the following options (not mutually exclusive):

- **Index the benefit level to the growth in the consumer price index.** This will modestly reduce the growth in costs as wages tend to grow faster than prices. As seen in Figure 96, this would stabilize costs at about one percent of GDP for more than two decades. At the same time however, the benefit would gradually decline as a proportion of average wages, because wages tend to grow faster than prices. For example, the OABP, when measured against the average covered wage for MRPS, would fall from almost 90 percent in 2020 to 30 percent in 2040. This decline in the replacement rate is driven by the difference in the assumed real wage and price growth in the projections.

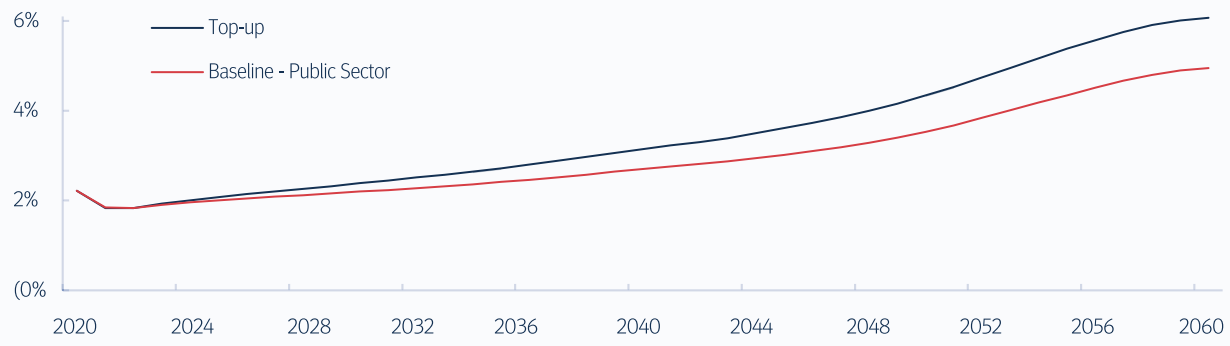
- **Freeze the benefit level at MVR 5,000 for existing and new retirees.** As and when the benefit level reaches 50 percent of median individual total expenditures (the national poverty line), begin to adjust the benefit on the basis of growth in the consumer price index. This option would bring OABP expenditures to below one percent of GDP but would also find benefits declining as a proportion of average wages at a pace even faster than for the CPI-based indexation scenario. The OABP is projected to decline somewhat more than the scenario assuming CPI-based indexation above.

- **Establish means-testing criteria limiting beneficiaries to those in households which are poor or vulnerable.** This might be perhaps the bottom 40-50 percent of the welfare distribution, although the authorities should examine the precise effects of different thresholds. This provision could be phased-in over a transition period of perhaps five years. This would target minimum benefits to the poor or vulnerable elderly and thus would be the most equitable. It could also reduce costs by as much as half, depending upon the indexation of the benefit level applied.

201. **Eliminate double pensions**. The government may want to consider revising the framework for pension benefits for those government workers who both benefit from the post-2009 MRPS as well as the additional benefits legislated since its establishment. Possible reform options are as follows:

- **Credit for pre-2009 service**. One option would be to provide credit for pre-2009 service based on the applicable benefit formula in place at the time of the 2009 reform. In this way, the pension calculation would be the combined sum of: (i) a defined-benefit pension based on pre-2009 service multiplied by the applicable accrual rate multiplied by the salary basis at retirement; and (ii) a benefit based on individual account accumulations since 2009 at retirement. In this case, none of the account accumulations made for pre-2009 service under the MRPS would be provided. This option would increase the government's pension costs when compared with the self-funded MRPS, but it would also provide for a smoother transition in the replacement rates between cohorts.

Figure 102: Impact of Establishment of a Top-up for Civil Servant Retirees
Percent of GDP



Source: World Bank staff projections using PROST (base year: 2020).

- **Government financed top-up.** Another option would be to provide a select government-financed defined-benefit top-up for service since 2009 (Figure 102). For example, this might be an accrual rate of 0.75 percent per year for this service period. This additional top-up could be applied only to select workers such as those in the uniformed forces and judiciary. A retiree under this arrangement would therefore receive: (i) a defined-benefit pension based on pre-2009 service multiplied by the applicable accrual rate multiplied by the salary basis at retirement; plus (ii) the benefit based on individual account accumulations at retirement; plus (iii) a pension based on post-2009 service multiplied by the supplemental applicable accrual rate (possibly 0.75 percent per year) multiplied by the salary basis at retirement.

- **Separate retirement eligibility conditions for special groups of government employees.** Another issue which may need to be addressed is the retirement age for select government retirees such as uniformed forces.[176] The authorities may want to permit an early retirement window for select uniformed forces based on the employment conditions and risks specific to each profession.

202. **Several policy and institutional measures will be needed to strengthen the overall incentive framework to ultimately expand coverage.** The following options are suggested for consideration:

- **Broaden the menu of individual social risks covered by the MRPS** to make participation in the scheme more attractive. These could include the following:

  i. **Unemployment insurance.** Earmark some pension contributions and/or account accumulations to the provision of unemployment insurance benefits. The government has already announced their intent to establish an unemployment insurance scheme, although at the time of publication they are still in the process of formulating the precise design and financing.

  ii. **Permanent disability.** Establish criteria for withdrawals of pension savings accumulations in the event of the certification of disability including an inability to work. Disability coverage could also include partial withdrawals for life-threatening illnesses.

  iii. **Survivorship.** In addition to withdrawal of accumulated balances, the authorities could consider evaluating the establishment of a voluntary state-sponsored life insurance program based on voluntary supplementary premiums.

  iv. Financing of mortgage down payments. The authorities may want to review the existing financing facility for home mortgages to provide additional flexibility while also ensuring that beneficiaries repay the amount withdrawn.

- **Enhance the window for voluntary contributions.** The MRPS already has in place a program of voluntary contributions for the self-employed. It may be possible to enhance this facility by enabling employers or employees to increase their benefits through supplementary contributions as well as

[176] Many government workers could retire at age 55 prior to the 2009 reform.

contributions during temporary employment. This might take the form of matching contributions such as has been proposed for informal workers in the unemployment insurance program under development. Some countries have also enhanced the incentives for voluntary contributions by segregating such contributions into separate accounts which are much more liquid – where workers can make withdrawals under much more lenient conditions. Such accounts provide a vehicle more for financial inclusion than for retirement savings per se. Contributions to a voluntary window should also be flexible both with respect to the amount and the frequency.

- **Strengthen incentives for contributions.** These might include: (a) an auto-enrollment mechanism for employees; (b) bi-monthly text reminders to registered workers who are not contributing; (c) linkages to lottery tickets for minimum recurrent contributions; and (d) small matching contributions targeted to low-income workers.

- **Measures to enhance compliance.** The CMDA is responsible for supervising the MRPS. Several measures could be explored to enhance compliance. These might include: (i) establishing a process of reconciliation between wage reporting for the purposes of corporate income tax on the one hand, and declared wages for the purposes of determining pension contributions, on the other; (ii) requiring pension registration for all companies which directly or indirectly carry out government contracts; (iii) link pension registration to business licensing and renewal; and (iv) if possible, introduce risk-based compliance monitoring which includes review of corporate bank records.

- **Investment management.** Over the medium term, the authorities may want to investigate the possibility of enabling contributors to decrease the risk of their portfolios as they get closer to retirement. Members can already choose to place their funds in the Investment Fund or the Sharia Fund, but a growth fund and an income preservation fund could provide additional choices. Another option would be to enable contributors to access the Conservative Fund or the Sharia Retirees Fund prior to retirement.

203. **This chapter has suggested that the key challenges facing the Maldives Retirement Pension Scheme are the design, level and implicit tax associated with the Old Age Basic Pension, double pensions for some government employees, and weak contributory coverage.** In response to these challenges, some options are suggested for consideration. These include inflation-based indexation for the OABP to constrain costs, prohibiting new defined-benefit schemes for select civil servants, while developing a means of reversing existing "double pensions". Several options were suggested for improving coverage, they include improving compliance oversight, linking the pension scheme to a recently-announced unemployment insurance scheme, and possibly providing additional incentives. Further analysis will be needed to refine these options into a comprehensive reform strategy, as the authorities will also need to consider the institutional implications of the measures proposed.

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Annex 1: PSIP Projects

Table A1: PSIP projects financed by external loans in 2021-2024 (projected disbursements, US$ millions)

Description	Status	Funding Source	2021B	2021B	2021B	2021B	SUM
Velana International Airport terminal expansion	Ongoing	Saudi Fund	17	8	8	13	189
		Govt. of Abu Dhabi	17	8	6	1	
		OFID	10	8	8	14	
		Kuwait Fund	9	8	8	11	
		Unspecified	0	3	5	6	
Velana International Airport terminal expansion	Completed	EXIM China	18	0	0	0	
Malé-Thilafushi Bridge (under Greater Malé Connectivity Project)	Ongoing	EXIM India	23	35	22	61	196
Gulhifalhu land reclamation	Ongoing	ING Bank	6	1	1	4	
Gulhifalhu port development	Pre-tendering	EXIM India	29	1	6	6	
Land reclamation & shore protection in Addu City	Ongoing	EXIM India	17	7	6	7	73
Developing roads in Addu City	Ongoing	EXIM India	13	7	8	8	
Water and sewerage projects on 34 islands	Ongoing	EXIM India	14	14	14	5	119
Other water, sewerage, waste management projects	Ongoing	Various, mostly OFID	26	15	12	20	
Construction of tertiary and cancer hospitals in Gan (Addu Atoll)	Ongoing/ pre-tendering	EXIM India & ING Bank	6	4	7	8	92
New hospital buildings in 13 islands	New	Kuwait Fund, EXIM India, ING	0	11	44	11	
Renewable energy projects	Ongoing	Mostly ADB & AIIB	8	14	21	40	84
Upgrading regional airports	Ongoing	EXIM India	5	4	4	9	22
Youth and sports projects	Ongoing	EXIM India	9	8	5	11	31
Housing and urban development	Ongoing	Mostly Saudi Fund	10	10	8	8	35
Other projects	Various	Various	17	7	3	9	35
		Total financed by external loans	**253**	**175**	**197**	**252**	**876**
		Total PSIP budget	**548**	**411**	**504**	**572**	**2035**

Source: Ministry of Finance Budget 2021 and Budget 2022 website.

Annex 2: Performance of Maldives' Largest SOEs

Table A2: SOE statistics (All in US$ millions, unless otherwise noted)

Name	Sector	% state ownership	Total assets	Loans and borrowings	Total liabilities	2019 net profit	2020 net profit	2019 revenue	2020 revenue
HDC	Housing	100	2,374	694	896	4	21.6	21.8	174.3
BML	Finance	50.8	2,041	59	1,585	67.5	21.1	179.9	174.3
MACL	Transport	100	1,490	502	1,120	75.3	6.3	348.3	142.2
STO**	Retail	81.6	429	110	266	19.7	23.3	605.1	468.1
STELCO**	Utilities	100	346	193	254	7	8.5	124.9	124
Greater Malé Industrial Zone	Other	100	315	-	2	2.7	31.1	8.7	6.9
MIB	Finance	28	287	-	247	5.5	4.9	13.4	16.6
Dhiraagu	Tele-communications	41.8	267	-	105	61.2	47.6	185.6	161.2
MWSC**	Utilities	80	172	9	66	20.1	21	65.6	64.1
MTCC (transport)**	Transport	64.2	161	21	86	3.4	12.1	73.8	88.3
HDFC	Housing	49	135	41	93	5.9	6.2	13.9	14.6
Maldives Ports	Transport	100	115	13	53	7.6	0.7	49.2	34.9
MTDC (tourism)	Other	47	78	-	38	1.2	1	3.7	3.7
AIA**	Transport	70	38	30	47	-3.9	-5	4.2	2.3
SDFC*	Finance	100	37	-	6	-0.1	-0.1	0.4	1.2
Maldives Hajj Corporation*	Other	100	11	-	13	-0.8	-0.1	5.2	0
Aasandha *	Health	100	2	-	2	-0.4	-0.2	0.2	1.1
FDC*	Housing	100	0	-	0	-0.2	-0.4	0	0
Maldives Centre for Islamic Finance*		100	0	-	0	-0.4	-0.3	0	0
Maldives Sports Corporation Ltd*	Other	100	0	-	0	-0.3	-0.3	0	0.6
TOTAL			**8,298**	**1,671**	**4,878**	**275**	**199**	**1,704**	**1,358**

Source: PCB FY2020 Annual Review, 2021.

Note: SOEs marked with * receive capital contributions from the government; those marked with ** receive subsidies. Does not include 12 other fully government-owned SOEs: FENAKA, Island Aviation Services, Maldives Marketing & Public Relations Corporation, Kadhdhoo Airport, Maldives Integrated Tourism Development Corporation, Waste Management Corporation Ltd, Business Center Corporation Ltd, Public Service Media, Maldives Fund Management Corporation Ltd, Road Development Corporation, Maldives Post Ltd and Regional Airports Company Ltd. SDFC is partially owned (15 percent) by local councils.

Annex 3a: Methodology and Operation of the SOE Model

The SOE Model projects both gross income and operating expenses by multiplying the previous year's figure with annual changes in volumes and prices. Gross income excludes government subsidies/dividends, while operating expenses include overhead costs[177] and exclude CAPEX.

The volume change of both gross income and operating expenses depends on real GDP growth multiplied by the demand-elasticity (e.g., a sensitivity parameter, assumed to be one for STO, FENAKA, STELCO, MTCC and HDC since the demand for oil, goods and utilities tends to fluctuate with the economic cycle; and 2.1 for MACL, since tourism arrivals declined by 2.1 times the GDP downturn during 2020).

For gross income, the price change is a weighted average of variations of domestic prices (proxied by inflation rate) and import prices pass-through to the domestic market (proxied by oil price inflation and exchange rate depreciation). The table below describes the weights for each SOE.

Formula to project SOEs' Gross Income

$$GI_t = GI_{t-1}\, x \left(1 + \Delta GDP_t\, x\, E_{\frac{SV}{GDP}}\right) x \left(1 + (\Delta CPI_t\, x\, \Omega) + \left(\frac{ER_t}{ER_{t-1}} x \frac{OP_t}{OP_{t-1}} - 1\right) x\, O + \left(\frac{ER_t}{ER_{t-1}} - 1\right) x\, \mathcal{F}\right)$$

GI: Gross income (MVR million)

$E_{\frac{SV}{GDP}}$ **:** Sensitivity of sales volume to real GDP growth

ΔCPI: Consumer price index annual variation (%)

Ω: Share of domestic sales in terms of total sales (%)

ER: Exchange rate (MVR/US$)

OP: Oil prices (US$ per barrel)

O: Share of oil sales in terms of total sales (%)

$\mathcal{F}$: Share of non-oil foreign exchange sales in terms of total sales (%)

Table A3: Gross income weights for each SOE

	% sales related to domestic prices	% sales related to domestic prices	Explanation
STO	1.9	98.1	The bulk of STO sales are related to the exchange rate, mainly comprising imported fuel and lubricants, and goods such as staple foods, medical equipment, and construction materials. 61.2 percent of sales are related to oil prices, of which 59.2 percent is fuel and lubricants and 2 percent is gas. Both oil price inflation and exchange rate depreciation are passed through to utility companies and consumers.
MACL	8	92	Most sales are denominated in foreign currency and partially related to oil prices. Sales related to domestic prices are catering, room revenue, cabin handling and food and beverages. 92 percent of the sales prices are related to exchange rate, of which 50 percent are imported fuel and 42 percent are exported traffic and non-traffic services (e.g., ground handling charges, landing, navigation and parking fees, duty-frees sales, cargo income). 50 percent of the sales prices are imported fuel and hence related to oil prices.

[177] Overhead Costs correspond to management and marketing expenses and are recorded separately from the operational expenses in the Financial Statements.

MTCC	60	40	Sales are partially denominated in foreign currency. 60% of sales are related to domestic prices and mainly comprise infrastructure development (harbors, shore protection and related works, road and airport construction, water and sewerage infrastructure and electrification). 40 percent of the sales are related to exchange rate, of which 22.8 percent are imported goods and 17.2 percent are imported equipment for dredging.
MACL	100	0	All sales are domestic. There is zero oil-price inflation and exchange-rate depreciation pass-through to consumers. For the operating expenses and overhead costs, as well as for the gross income, the price change is a weighted average of variations of domestic prices (proxied by inflation rate) and import prices (proxied by oil-price inflation and exchange-rate depreciation).

Formula to project Operating Expenses and Overhead Costs

$$OE_t = OE_{t-1}\ x \left(1 + \Delta GDP_t\ x\ \mathrm{E}_{\frac{OE}{GDP}}\right)\ x\ \left(1 + (\Delta CPI_t\ x\ \mathrm{B}) + \left(\frac{ER_t}{ER_{t-1}}\ x\ \frac{OP_t}{OP_{t-1}} - 1\right)\ x\ \mathrm{K} + \left(\frac{ER_t}{ER_{t-1}} - 1\right) x\ \mathrm{X}\right)$$

OE: Operating expenses and overhead costs (MVR million)

ΔGDP : Real GDP growth (%)

$\mathrm{E}_{\frac{OE}{GDP}}$: Sensitivity of operating expenses and overhead costs to real GDP growth

ΔCPI: Consumer price index annual variation (%)

B: Share of domestic inputs costs in terms of total costs (%)

ER: Exchange rate (MVR/US$)

OP: Oil prices (US$ per barrel)

K: Share of total costs related to oil and foreign exchange (%)

X: Share of total costs related to foreign exchange and non-oil inputs (%)

Table A4: Gross income weights for each SOE

	% of input costs that are related to domestic prices	% of input costs that are related to domestic prices	Explanation
STO	14	86	The bulk of input costs are related to the exchange rate (57% imported fuel and lubricants, 16.5% imported goods, 3% imported gas and 8% purchase of fish in the domestic market). Domestic input costs comprise administrative costs (6.8%), sales and marketing costs (5.6%), and insurance services (1.6%). 60% of all input costs are related to oil prices.
MACL	57.6	42.4	Production inputs and costs are partially imported and related to oil. 57.6 percent of the input costs are related to domestic prices, mostly employee benefit and other administrative expenses. 42.4 percent of the input costs (mostly fuel) are related to the exchange rate.
MTCC	52.6	47.4	Production inputs and costs are partially imported and related to oil. Input costs related to domestic prices comprise utilities, sales and marketing expenses, and employee benefit expenses. The remaining input costs are related to the exchange rate. These comprise other imported materials and consumables, repair and maintenance expenses, and fuel.

FENAKA	43.6	56.4	Production inputs and costs are mostly imported and related to oil. 56.4 percent of the input costs are related to the exchange rate – mostly diesel and lubricant oil costs.
STELCO	19.5	80.5	Practically all production inputs are imported (mostly diesel and lubricant oil costs, also related to oil prices). Input costs related to domestic prices mostly comprise employee benefit expenses.
HDC	100	0	All production inputs are local, mainly related to employee benefit expenses, project expenses, utilities and selling and marketing expenses.

Subsidies and dividends reflect policy decisions and so are treated as exogenous variables, whose values are assumed based on figures observed in recent years (2017-2020) and sensitive to inflation. Gross income and operating expenses are more sensitive to market conditions.[178]

Capital expenses (CAPEX) are recorded separately from the operational expenses in the Financial Statements. CAPEX projections are based on companies' investment plans. CAPEX is also treated as an exogenous variable.

Taxes are estimated by an average effective Business Profit Tax (BPT) rate of 15 percent and applied to a proxy for the BPT tax base (e.g., corporate net income before taxes) of the previous year.

Interest Payments are computed by multiplying the previous year's debt stock by the implicit interest rate on outstanding debt at end-2020. Interest expenses are sensitive to interest rates on sovereign debt, a company's risk spread, and the level of corporate debt.

Profit/loss account – expressed on a cash basis – reflects selected operating, investment, and financing cash flows. The profit/loss account reflects: (i) revenues (gross income, government subsidies) and expenses from operating activities and overhead costs; (ii) CAPEX from investing activity; and (iii) interest payments from financing activities.

Debt-service flows reflect the interest and amortization obligations due and indicate the liquidity flow that must be secured from financial markets or the government to ensure smooth financing of business operations.[179] Amortization payments depend on maturities and redemption profiles. Lack of detailed information on the SOE's financial terms of major debt obligations, warrants treating debt service obligations due as exogenous variables.[180] For this reason, and for simplicity, debt service is assumed to remain constant at 2020 levels, except for MACL, STELCO and HDC whose debt stock is projected to grow significantly over the projected horizon based on the high level of projected losses.[181]

Debt service obligations due are assumed to be paid by the SOE (e.g., no default) either with own funds or with borrowed funds. Corporate profits provide the company with own (non-borrowed) funds which can be utilized for paying debt amortizations/dividends and accumulating financial assets. On the other hand, corporate losses require the company to borrow funds for financing expenses in excess of incomes, paying debt amortizations (e.g., rollover maturing liabilities), and accumulating financial assets. In the SOE Model if there is profit, it goes automatically to debt service or dividends payments; if there is a loss, SOEs need to borrow. Hence, the SOE Model abstracts from financial-asset accumulation.

Borrowing flows reflect indebtedness and sources of borrowed funds. Borrowings correspond to cash flows from financing activities and emerge from imbalances between various cash outflows and inflows (operating expenses, CAPEX, overhead, taxes, interests, and amortizations in excess of gross income and subsidies). For simplicity, the SOE Model accommodates two sources of borrowed funds: financial markets and the Central Government. It is nevertheless assumed that the five SOEs borrow from financial markets only.

Corporate debt refers to interest-bearing financial obligations and excludes other liabilities, e.g., trade

[178] The SOE Model can reverse the causality and calibrate what amount of government subsidies would be necessary for an SOE to achieve a target value for its profit/loss account. Thus, the government support is 'endogenized' and the profit/loss account is 'exogenized'

[179] In the normal operation of business, it is expected that access to financial markets will permit to rollover maturing debt obligations—thus avoiding asset liquidation and drastic adjustments to corporate's revenue and expenses.

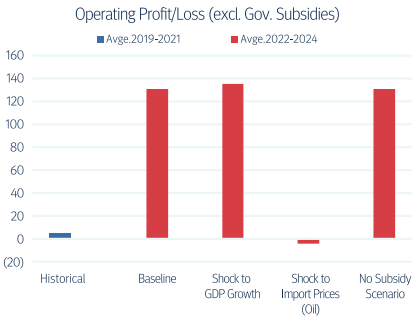
[180] The Financial Statements of a Public Corporation do not provide the full set of information that is required for projecting debt-service obligations due in the next few years.

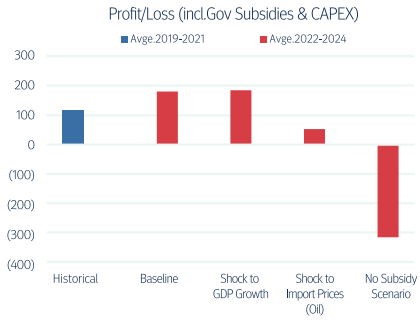
[181] For these cases amortizations are calculated as the debt stock divided by the outstanding debt maturity.

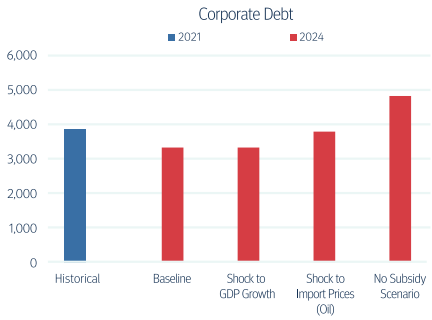
payables. Corporate debts are denominated in local and foreign currencies.[182] Corporate debt stock is computed in two ways that are complementary and deliver identical results: (i) by adding the profit/loss account and the valuation effect to the previous year's debt stock; and (ii) by adding the net borrowings (i.e., gross borrowings minus amortization payments effectuated) and the valuation effect to the previous year's debt stock. The valuation effect is computed by multiplying the previous year's foreign-currency debt stock by the absolute annual variation in the exchange rates between local and foreign currencies.

Annex 3b: Financial Performance of SOEs in Baseline and Alternative Scenarios

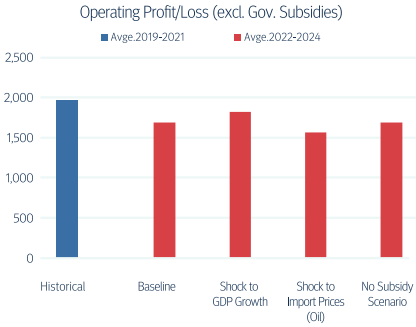
1. State Trading Organization (STO) – Financial Performance Indicators – Million MVR

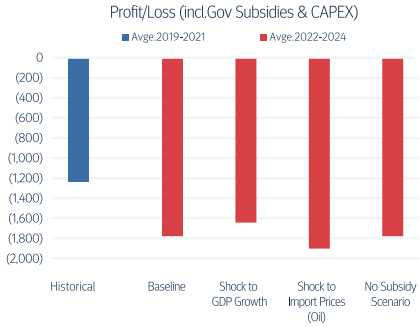


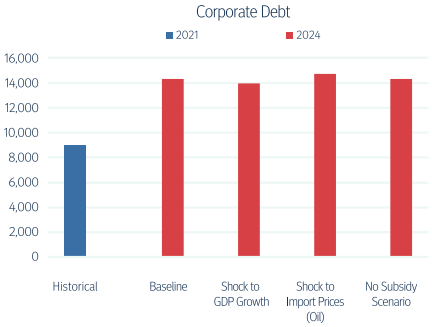




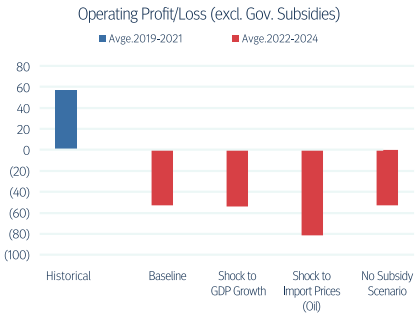
2. Maldives Airports Company Limited (MACL) –Financial Performance Indicators – Million MVR

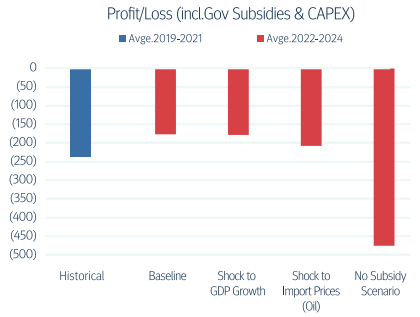


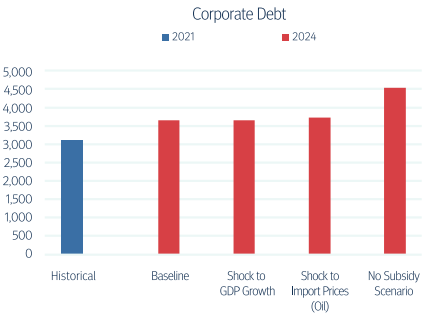




3. State Electric Company (STELCO) – Financial Performance Indicators – Million MVR

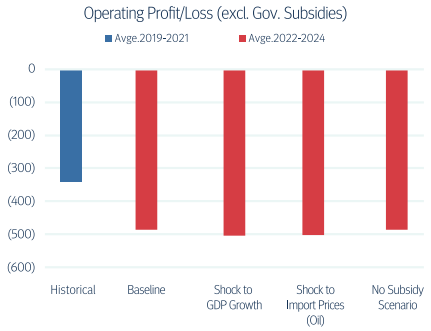


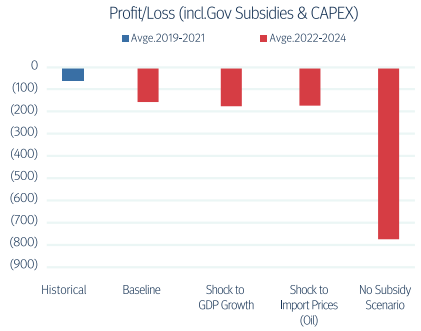


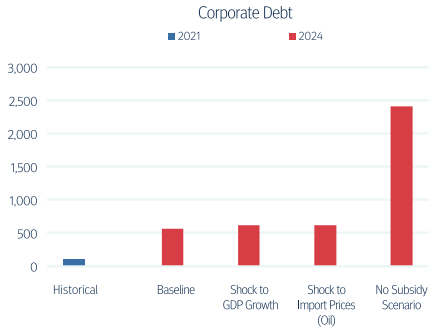


[182] For valuation purposes, they are all expressed in local currency, using the prevailing exchange rates between local and foreign currencies whenever appropriate.

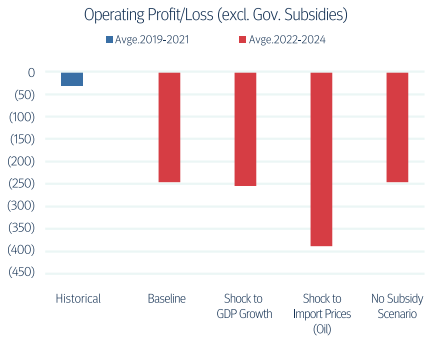
4. Fenaka Corporation – Financial Performance Indicators – Million MVR

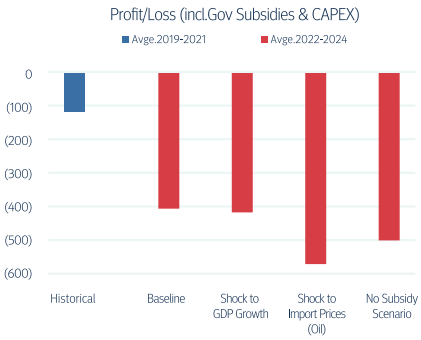


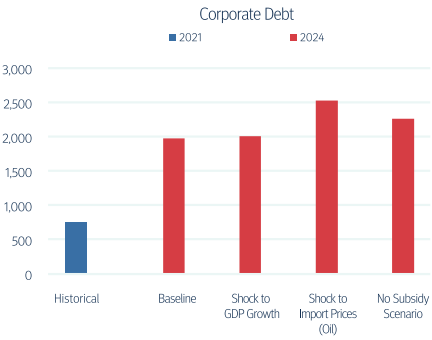




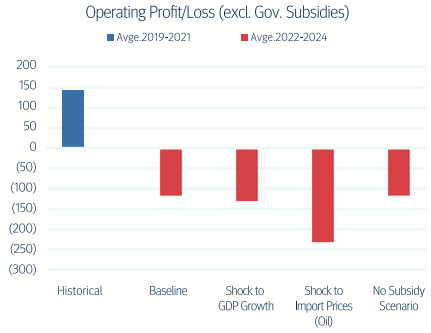
5. Maldives Transport and Contracting Company (MTCC) – Financial Performance Indicators – Million MVR

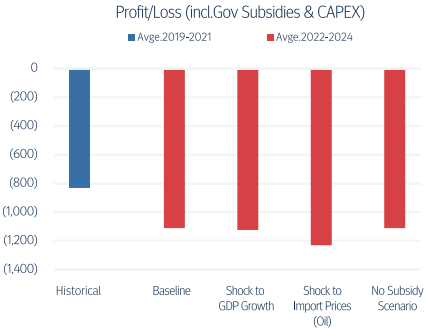


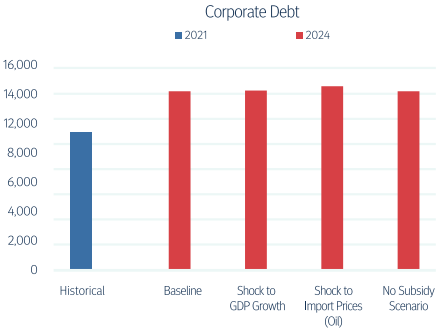




6. Housing Development Corporation (HDC) – Financial Performance Indicators – Million MVR







Annex 4: Housing

Table A5: External loans and guarantees contracted by the government to finance public housing

Year	Name of project	Amount (US$ million)		Creditor
2010	1000 Housing Units in Hulhumalé	74.4	GoM	EXIM China
2011	485 Housing Units in Maldives	40.0	GoM	EXIM India
2012	1500 Housing Units in Maldives	152.0	GoM	EXIM China
2017	7000 Housing Units Development Project	368.9	HDC	ICBC
2017	1530 Housing Units in Hulhumalé	159.0	HDC	China Development Bank
2017	1530 Housing Units in Hulhumalé Phase II	14.3	HDC	Seylan Bank Plc
2017	7000 Housing Units in Hulhumalé Phase II	65.1	HDC	Credit Suisse (Singapore)
2018	2500 Social Housing Units Project	20.0	HDC	Bank of China (London)
2020	Affordable Housing Scheme Project	25.0	GoM	Saudi Fund
2021	2000 Social Housing Units in Hulhumalé	116.5	FDC	EXIM India
2021	2000 Social Housing Units in Hulhumalé Phase II	110.5	FDC	EXIM India
	Total external loans	**1145.6**		
2016	Hulhumalé Phase II Road Development	34	HDC	EXIM India
2018	Electricity System & Open Access Network of Hulhumalé Phase II	17	HDC	Seylan Bank Plc
2018	Design & Construction of the Link Road Connecting Hulhule and Hulhumalé	31	HDC	ICBC (China)
2018	Design & Construction of Electricity System and Open Access Network of Hulhumalé Phase II	67	HDC	Browns-CMEC (China)
2020	Development of Hulhumalé Phase I Remaining Roads and Phase II Stage 2 Roads	19	HDC	EXIM India
	Total external guarantees	**169**		
	Total external loans and guarantees	**1,314**		

Source: MoF

Table A6: FDC Social Housing Pipeline (2020–2022)

Description	Typology	N° of units	Unit price (US$)	Market	Estimated funding requirements (US$ million)
Southern Atolls	3-BR	5,000	42,700	Social	213.5
Northern Atolls	3-BR	3,000	51,700	Social	155.1
Hulhumalé Phase 2	3-BR	2,100	51,700	Social	108.6
Hulhumalé Phase 2	2-BR	2,100	42,900	Social	90.1
Hulhumalé Phase 2	3-BR	2,000	51,700	Social	103.4
Mixed Housing Project	2-BR 3-BR	301 529	TBD	Mid-Range	
Mixed Housing Project	2-BR 3-BR	593 609	TBD	Social	
Sinohydro	2-BR 3-BR	680 1,020	TBD	Social	
Sinohydro	n/a	620	TBD	Social	
3,500 units	2-BR 3-BR	1,226 2,099	TBD	Social	
	TOTAL	**14,200**			**670.7**

Source: WB MURDP study (2020/2021).

Annex 5a: Methodology and Operation of the SOE Model

Table A7: FDC Social Housing Pipeline (2020–2022)

Location	Malé
Employees	26,063
Permanent	24,116
Contract	1,817
Temporary	127
Other	3
Payroll Month	November, 2020

Payroll Area	Malé
Atoll Hospitals	1,018
Civil Servants*	7,519
Constitutional Bodies	2,716
Consultants	50
Health Sector	3,270
Judiciary Sector	1,822
Non-payroll-relevant	16
Politicians	970
Uniform Bodies	8,682

*Malé-based Civil Servants includes the Education Sector.

Table A8: Number of permanent employees receiving each allowance in dataset

#	Allowance Name	Employees	#	Allowance Name	Employees
1	Service Allowance	22,843	28	Practice Allowance	98
2	Exclusive Job Allowance	13,148	29	Auxiliary Allowance	93
3	Overtime	9,455	30	Qualification Allowance	91
4	Living Allowance	7,996	31	Committee Allowance	81
5	Special Allowance	6,148	32	Legal Support Allowance	72
6	Long Service Allowance	5,387	33	Hardship Allowance	63
7	Supporting Co Allowance	5,282	34	Night Court Allowance	59
8	Mobile Phone Allowance	5,166	35	Religious Service Allowance	51
9	Holiday Allowance	4,784	36	Travel Allowance	42
10	Uniform Washing Allowance	3,715	37	Travel Food Allowance	40
11	Risk Allowance	3,268	38	Misc. Allowances	34
12	Food Allowance	2,981	39	Car Allowance	33
13	Commuting Allowance	2,105	40	Acting Allowance	32
14	Professional Allowance	1,875	41	Scholarship Allowance	30
15	Technical Allowance	1,710	42	Fixed Hardship Allowance	24
16	Shift Duty	1,679	43	Tenureship Allowance	16
17	Judiciary Allowance	1,605	44	Socks & Shoes Allowance	8
18	Technical Co Allowance	1,336	45	Toll Free Allowance	8
19	EQ Allowance	707	46	Marriage Allowance	5
20	Uniform Sewing Allowance	691	47	Delivery Service	4
21	Rent Allowance	534	48	On Call Allowance	4
22	Other Allowance	530	49	Tie & Clothes Allowance	3
23	Chit Allowance	258	50	Bank Charges & Commission	3
24	Leave Encashment	219	51	Migration Allowance	2
25	Petrol Allowance	134	52	Clothing Allowance	1
26	Special Constabulary Allowance	120	53	Social development Allowance	1
27	Administrative Support Allowance	114	54	Utilities Allowance	0

*: SAP Payroll database for Malé-based public employees, staff calculations

Table A9: Administrative Officer Average Salary by Rank and Payroll Area

Rank	Atoll Hospitals	Civil Servants	Constitutional Bodies	Health Sector	Judiciary Sector	Politicians	Uniform Bodies
AO		17,11	14,614				
CO/GR2			15,400				
CS06				14,440			
CS10							25,218
CS8							25,739
GS1			11,815				
GS2	11,067	6,662	10,150	9,993			
GS3	9,263	8,800	14,949	10,239	11,577		
GS4	8,559	8,691	13,477	11,220	13,966	11,818	
MS1		10,237	14,134	10,465	13,510	17,254	
MS2		10,858					
MS3		11,350	16,801				
OTHERS		5,020	11,237				
SPINE10			6,854				
SPINE17			8,254				
SPINE18			8,643				
SPINE19			8,773				
SPINE20			9,044				
SPINE23			9,910				
SPINE24			10,503				
SPINE25			10,532				
SPINE27			11,318				
SPINE31			13,814				
SS1	8,757						
SS3		7,375	12,313				
SS4			13,625				
Average	**9,438**	**8,791**	**10,957**	**10,376**	**12,097**	**16,711**	**25,674**

Source: SAP Payroll database for Malé-based public employees, staff calculations

Annex 5b: Estimation of the Public Sector Wage Premium

To estimate the public sector premium, we use data from the 2019/20 and 2016 Household Income and Expenditure Survey (HIES) by the Maldives National Bureau of Statistics. These surveys are representative at the level of the 20 atolls as well as the capital island Male. The HIES includes a comprehensive labour force module in the absence of a separate national labour force survey. Given that allowances and additional payments form a significant component of remuneration, particularly in the public sector, we examine determinants of both total income or take-home pay and basic salary. Moreover, to account for differences in the average hours worked in the private and public sectors, we also analyze monthly pay and hourly pay separately (where the hourly pay is calculated by scaling down monthly pay by the reported hours worked). The data from the HIES 2016 are inflated using the CPI to allow comparisons of the monetary variables over time.

While the HIES 2019 covers a sample of 9,630 individuals who report being employed, including contributing family workers and group workers, we restrict our analysis to the sub-sample of 7,002 full-time workers (defined as working 30 hours or more per week) excluding contributing family workers. This sub-sample corresponds to 75 percent of the total employed population. The HIES also collects data on primary and secondary occupations; we restrict our analysis to the primary occupation only.

Empirical strategy

To examine the public sector wage premium (or penalty), we estimate a standard Mincerian wage regression, with a dummy variable indicating whether the worker is employed in the public sector. The specification we use is:

$$\log Y_i = \beta_0 + \beta_1 \text{Public}_i + X_i \gamma + u_i$$

To examine the public sector wage premium (or penalty), we estimate a standard Mincerian wage regression, with a dummy variable indicating whether the worker is employed in the public sector. The specification we use is:

Where Y_i is monthly or hourly total income or monthly or hourly basic salary of individual i, Public_i is a dummy variable taking the value 1 if the individual is a public sector employee, and X_i is a vector of standard controls including gender, age, age-squared, level of education, and area of residence. Standard errors are adjusted for clustered survey design. The regressions only include workers reporting positive income/wages.

We do not include occupational dummies in our Mincerian regressions, following the Angrist and Pischke (2009) argument that the inclusion of this variable will result in the coefficients on education becoming biased (described as the "bad control" problem). Instead, we estimate the Mincerian regressions separately for different occupational categories (following the skill categorization of occupations provided in ILO [2012, pp. 12-13]) to examine the sensitivity of the wage premium to differences in the type of job between public and private sectors. We also estimate additional specifications that interact Public_i with all the controls in the model to explore whether returns to these variables are also different between the public and private sectors as well as quantile regressions that estimate the public sector premium at different points in the conditional earnings distribution.

Table A10: Mincerian regression results – regressions with all employees

	Monthly total income	Hourly total income	Monthly basic salary	Hourly basic salary
Public sector worker	0.249*** [8.08]	0.388*** [12.67]	-0.088** [-2.32]	0.064 [1.53]
Less than O/L	0.115** [2.58]	0.123*** [2.61]	0.170*** [3.77]	0.169*** [0.57]
O/L	0.317*** [7.05]	0.377*** [7.88]	0.416*** [7.79]	0.463*** [8.14]
A/L to certificate/diploma	0.399*** [7.42]	0.468*** [8.42]	0.501*** [9.03]	0.556*** [9.03]
	0.681*** [15.85]	0.786*** [16.76]	0.819*** [13.79]	0.914*** [15.22]
Age	0.060*** [9.79]	0.055*** [8.73]	0.043*** [4.91]	0.040*** [4.15]
Age-squared	-0.001*** [-9.87]	-0.001*** [-8.64]	-0.000*** [-3.67]	-0.000*** [-3.05]
Female	-0.409*** [-16.36]	-0.275*** [-11.01]	-0.263*** [-9.81]	-0.139*** [-5.71]
Location FE	Yes	Yes	Yes	Yes
Observations	6508	6508	4143	4143
R-squared	0.325	0.331	0.296	0.277

Source: De Silva 2021 using HIES 2019 data.
Note: t-statistics based on standard errors adjusted for clustered survey design in brackets. Significance levels: * 0.1 ** 0.05 *** 0.01

Table A11: Mincerian regression with public sector dummy interactions – regressions with formal sector employees only

	Monthly total income
Public sector worker	0.524* [1.71]
Less than O/L	0.082 [0.56]
O/L	0.372** [2.50]
A/L to certificate/diploma	0.296** [2.00]
Degree or higher	0.784*** [4.77]
Public sector*Less than O/L	0.054 [0.34]
Public sector*O/L	-0.04 [-0.24]
Public sector*A/L	0.165 [1.07]
Public sector*Degree	-0.113 [-0.61]
Age	0.068*** [5.57]
Public sector*Age	-0.032** [-2.29]
Age-squared	-0.001*** [-5.05]
Public sector*Age-squared	0.000** [2.39]
Female	-0.399*** [-6.35]
Public sector*Female	0.200*** [3.05]
Male	0.303*** [6.40]
Public sector*Male	-0.008 [-0.13]
Constant	7.474*** [26.18]
Location FE	Yes
Observations	3671
R-squared	0.319

Source: De Silva 2021 using HIES 2019 data.
Notes: t-statistics based on standard errors adjusted for clustered survey design in brackets. Significance levels: * 0.1 ** 0.05 *** 0.01

Table A12: Public sector premium estimated with quantile regression – formal sector employees only

Percentile	Monthly total income		Hourly total income	
	Coefficient	p-value	Coefficient	p-value
10th percentile	0.081	0.045	0.232	0.000
25th percentile	0.038	0.220	0.178	0.000
50th percentile	0.024	0.351	0.138	0.000
75th percentile	-0.001	0.973	0.109	0.000
90th percentile	-0.093	0.030	-0.043	0.411

Source: De Silva 2021 using HIES 2019 data.
Notes: The table reports the public sector wage premia estimated from quantile regressions at the 10th, 25th, 50th, 75th, and 90th percentiles of the monthly and hourly total earnings distributions for formal sector employees. All regressions include the full set of controls and location fixed effects. P-values are based on standard errors adjusted for clustered survey design.

Annex 6: PROST Methodology, Assumptions And Key Data

This annex summarizes key parameters, reviews trends in the underlying administrative data, and describes the key assumptions and process to establish a baseline of financial projections. The World Bank PROST model was used to project the MRPS funds flows as well as to simulate the continuation of so-called double pensions for select civil servants. PROST was also used to project costs of the OABP.

A. Key Parameters

The Maldives Pension Act (2009) establishes a two-pillar pension system which includes a mandatory defined contribution (DC) scheme for all employees, an ongoing unfunded defined benefit pension for civil servants, and a non-contributory OABP aimed at providing an income floor for all Maldivians (retirees of the MRPS and those outside the scheme) aged 65 and above. The MRPS first replaced the two pension schemes operating solely for government employees in 2009 and was extended to the entire formal sector labor force in 2011. It is also open to self-employed workers who can subscribe to MRPS voluntarily. Key parameters of the MRPS are described below.

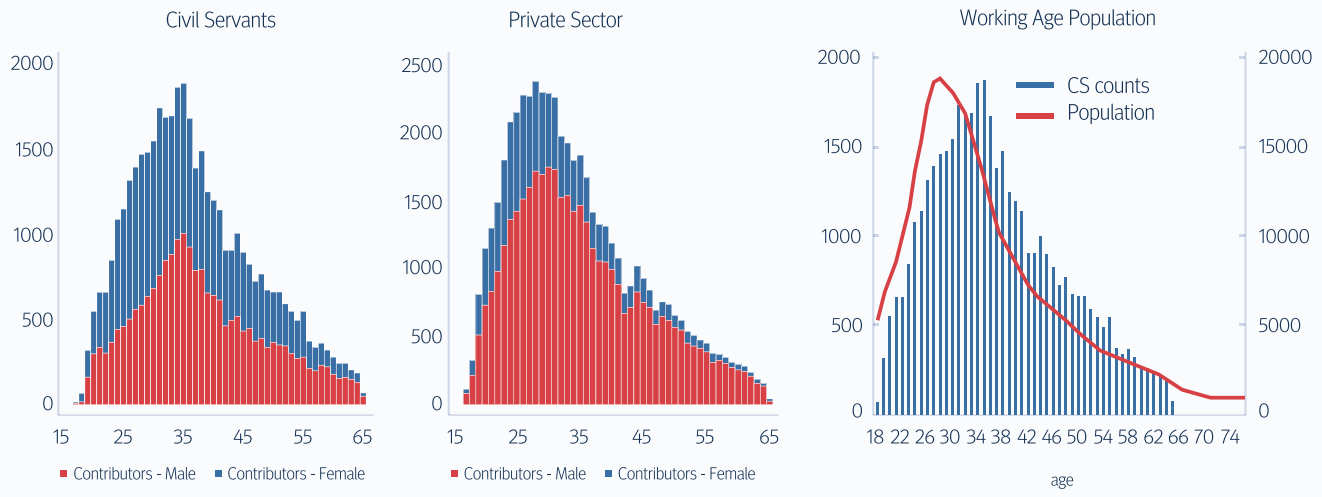
B. Profile of the working age population, contributors and retirees

The age profile of civil servants, covered private sector employees and the working age population is summarized in Figure A1. A graph of the age distribution of civil servants and private sector employees counts by age, as of 2020 (Figure A1) shows a bulge in the number of employees at ages 26 to 46, which is in line with the working-age population in Maldives.

Table A13: Maldives Retirement Pension Scheme

Basic parameters	
Contribution Rate	7% of Basic Salary for employer; 7% of Basic Salary for employee
Treatment of accrued pension rights prior to the 2009 reform	Workers in state employment in 2009 under age 65 eligible for Accrued Pension Rights: Basic salary (13/5/2019) × 93% ×14% × service period up to 30 April 2010.
Administrative fees	0.6% of Retirement Savings Account (RSA) annually
Investment options	• MRPS default Investment portfolio • MRPS Sharia portfolio • MRPS Conservative portfolio - Default Portfolio for members age 65+ • MRPS Retirees Shariah Portfolio: Age 65+
Eligibility Conditions	
Eligibility Age	65
Early retirement eligibility	Age 55+, provided the balance in the RSA is sufficient to provide a lifetime monthly payment > twice the amount of the Old Age Pension prevailing at the time of retirement.
Old Age Benefits	Balance in the member's RSA at time of retirement divided by life expectancy at that age at time of retirement.
Survivorship benefits	Lump sum distribution of RSA accumulation.
Housing Loan collateralization & Hajj disbursement	• MRPS balances can be used to collateralize housing loans according to a sliding scale by the age of the contributor. •The scheme provides for pre-retirement disbursement to pay for 80% of obligatory Hajj provided that the member has a balance necessary to pay for a MVR 2000 monthly benefit at pension age.
Old Age Basic Pension (OABP)	OABP amount is MVR 5000. For pensioners receiving pension benefits the following adjustments are made to the OABP: • 50% of the amount received from MRPS. • 100% of the amount the amount received from any other state funded pension scheme • Pensioners receiving more than double the amount of Basic Pension (MVR 10000) as a pension from the MRPS and pensioners receiving more than MVR 5000 from any state funded pension scheme are not eligible for Basic Pension

Figure A1: Age distribution of CS, Private Sector and Working Age Population



Source: MPAO administrative data and Maldives Bureau of Statistics.

C. PROST Projections

The financial projections of the pension system were made using the Pension Reform Options Simulation Toolkit (PROST). PROST is a modeling program with an Excel-based interface developed by the World Bank and licensed without cost to country client users. PROST follows the methodology depicted in the figure below for carrying out the projections and arriving at the inflows and outflows of a pension system. The base year for the analysis was 2020. The simulation period runs from 2020 to 2080 to capture the full life cycle of those currently entering the pension system.

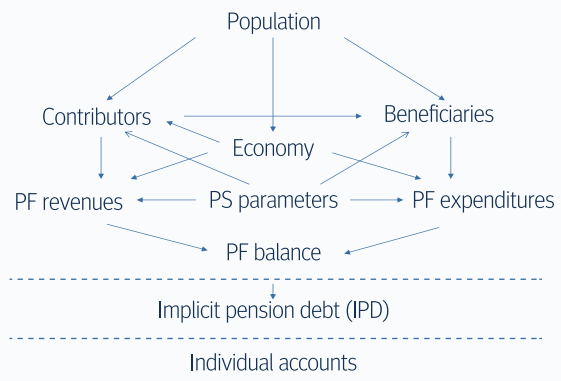
PROST projects both the profile of the covered population, existing and new retirees using the flow of contributors from the previous year. The retirement pattern is estimated from the data using the contributor age/wage/gender profile and the age/gender/benefit level distribution of existing and new pensioners.

Using projections of the population, contributors, and beneficiaries, PROST determines the cash in-flows (contribution revenues and investment income) and outflows (pension payments, miscellaneous payments). All three components are projected, the civil service defined-benefit scheme, the MRPS DC scheme, and the OABP.

Table A13 shows the most important assumptions used for the projections.

- Real GDP growth**.** World Bank projections current as of April 1, 2022 are used as the basis for the short-term real GDP growth assumptions. For the long term, it is assumed that Maldives will gradually converge on a real GDP growth rate of 3 percent per annum. This is the approach that the World Bank has used in many countries.
- Real wage growth per capita**.** Real wages are assumed to increase in line with real GDP growth assumptions, adjusted according to the projected changes in the working age population. This relationship has been validated from cross-country experience. Real wages are strongly correlated with productivity growth and thus overall economic growth.
- Real rates of return on investments. The real rates of return on investments over the long-run are assumed to be about 1.5 percent higher than real GDP growth. This is in line with what has been observed across countries.

Figure A2: PROST Projection Methodology



Inflation. Inflation assumptions are not material to the model since the key assumptions are in real terms. Inflation assumptions are used in the calculations of net present values, but this has not been done here.

Age/wage/gender profile. To estimate the Pension due at the time of retirement, PROST creates an age/wage/gender profile using (a) distribution of wages by age and gender and (b) the number of people by wage

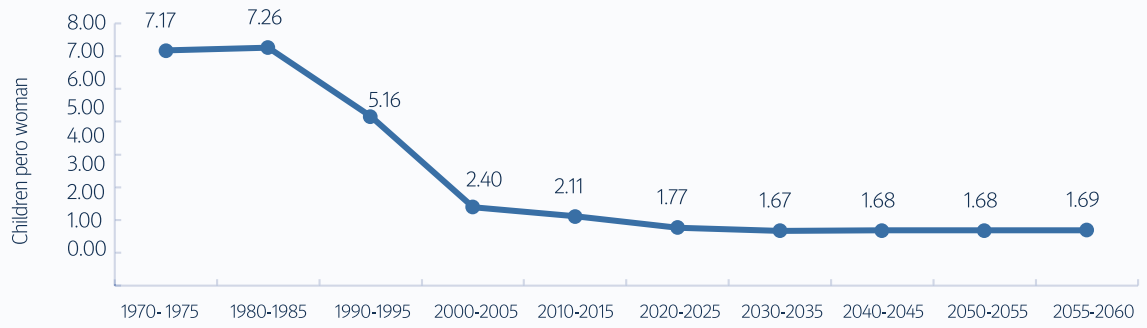
Table A14: Key Assumptions for PROST Projections

	2021	2022	2030	2040	2050	2060	2070	2080
Real GDP growth rate	31%	7.6%	5.2%	4.2%	3.8%	3.50%	3.00%	3.00%
Real wage growth per capita	29.8%	6.4%	4.4%	3.5%	3.2%	3.3%	3.2%	3.4%
Inflation rate	0.5%	3.5%	1.3%	1.0%	1.0%	1.0%	1.0%	1.0%
Real investment returns	17.3%	11.3%	6.7%	5.7%	5.3%	4.7%	4.5%	4.5%
Net rate of increase in workforce	1.2%	1.2%	0.8%	0.7%	0.6%	0.2%	-0.2%	-0.4%

Note: In the private sector, an increase consistent with a projected increase in GDP/capita is assumed. A gradual increase in line with a constant share of working-age population growth in the public sector is assumed.

[183] The wage brackets are chosen by us after looking at the distribution of wages, the minimum and maximum and dividing the brackets such that we have at least 3–7% of all individuals fall within each bracket.

Figure A5: Maldives Actual and Projected Fertility Rates
(Number of children per woman)



Source: UN Population Projections.

Table A15: Number of Covered Workers and Retirees[184]
(As at end-2020)

Contributors (base year)	Males	Females
Civil servants	21,191	20,951
Private sector	40,265	12,593
Beneficiaries (base year)		
Only DB pension	6,154	Civil servants
Only DC pension	386	Private sector
DC + DB pensions	950	Civil servants
DC + DB	15,556	Out of MRPS
OABP	2,811	Top-up in MRPS

Table A16: Distribution of Covered Wages
Monthly wage distribution (civil servants and private sector), MVR per month

	Male		Female	
MVR	**Freq.**	**%**	**Freq.**	**%**
3100	9742	16%	6252	19%
3544	5312	24%	2477	26%
4300	5751	34%	4500	39%
4950	7481	46%	2645	47%
5789	7063	58%	3070	56%
6837	6716	68%	3466	67%
8042	6077	78%	4099	79%
9620	5539	87%	4655	93%
19055	7780	100%	2385	100%

Median basic wage, MVR per month

	Male	**Female**	**Total**
Civil servants	6400	6185	6295
Private sector	5300	4700	5050
All	5500	5520	5500

brackets.[183] PROST includes age/gender profiles both for the covered population (from administrative data) and for the overall population using UN population data and demographic projections, i.e., population projections, fertility, mortality, and mortality improvement. Fertility rates in Maldives (Figure A5) show a sharp decline from 7.26 births (on average) per adult female in 1980 to about two births from 2010 which, along with life expectancy have profound implications for pension systems. Projected mortality assumptions are derived from the UN Population Projections. Mortality rates at all ages are expected to decline over the projection period, consistent with expectations of countries with similar levels of development. The combined effect of fewer births and longer life expectancy on the long-term sustainability of the pension system is that more households will have to support the elderly that are not able to work.

Headcount projections are a function of the demographic profile of the working age population and the anticipated worker coverage and contribution density during the projection period. Table A15 summarizes the headcount of workers and pensioners as at end-2020. The following are the key assumptions used in the coverage/headcount projections:

- Assumptions from UN Population Projections are used to project changes in the working-age population. The projections are developed in accordance with census data. Civil servants' headcounts are assumed to remain a fixed percentage of the working-age population until 2045, when it reaches a peak; after that, we assumed that there is no net new hiring, i.e., the number of new entrants equates with the number of new retirees.
- No change in labor force participation.

[184] Individual data on survivors was not available. Survivor pension is received as a lump sum from the individual account accumulation.

- The coverage of private sector workers is assumed to gradually converge on the relationship between GDP per capita and working age population coverage, as indicated in Figure 100.

The median monthly basic salary from the individual data was about MVR 6,300 for civil servants and MVR 5,050 for private-sector workers, and a median of MVR 5,500 for the entire covered population (Table A16).

As of 2020, the average old-age DB pension was about MVR 2700 while the average old-age DC pension was about MVR 5200. About 93 percent of all pensioners received the OABP of MVR5000.

Contribution density. The contribution density for public sector employees was about 92 percent, reflecting the relatively stable employment in the public sector. The contribution density for private sector employees is lower at 73 percent of private-sector employees who contributed throughout the whole year and 13 percent contributing six months or less.

Table A17: Pension Distribution (DB and DC pension) as at end-2020

a) DB Pension (Civil Servants)

	Male		Female	
Benefit Bracket (MVR/month)	**Retirees**	**Cumulative Percent**	**Retirees**	**Cumulative Percent**
446	356	7%	56	3%
621	430	16%	174	11%
882	481	25%	285	24%
1118	447	34%	308	39%
1478	523	45%	281	52%
1960	442	54%	274	65%
2733	478	64%	283	78%
3755	566	75%	229	89%
5583	601	87%	125	95%
14349	647	100%	113	100%

b) DC Pension (Post-2009 retirees)

	Male		Female	
Benefit Brackets (MVR/Month)	**No. Of Retirees**	**Cumulative Percent**	**No. of Retirees**	**Cumulative Percent**
5000	955	90%	249	92.6%
5204	22	91.5%	3	93.7%
5765	20	93.4%	7	96.4%
6790	22	95.5%	5	98.1%
7942	24	97.75%	3	99.2%
10946	24	100%	2	100%

Source: MPAO.

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