MALDIVES DEVELOPMENT UPDATE

SEEKING STABILITY IN TURBULENT TIMES

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Preface

The Maldives Development Update (MDU) has two main goals. First, it takes the pulse of the Maldivian economy by outlining key developments over the past 12 months. Placing these in a global context, and based on these recent developments, the MDU then analyzes the outlook over the medium term. Second, every other edition of the MDU provides a more in-depth investigation of selected economic and policy issues. It has a wide audience including policymakers, policy analysts from think tanks or non-governmental organizations, and business and financial sector professionals interested in Maldives' economic development.

The MDU was prepared by Ruijie Cheng, Erdem Atas, Richard Walker, Arvind Nair *(Macroeconomics, Public Sector, Trade and Investment, South Asia Region),* and Gregory Smith (Equitable Finance and Institutions). The special focus topic (Part B) on climate and development priorities was written by Martin Heger (Environment, South Asia Region) and Sebastian Forsch *((Infrastructure Resilience Policy and Finance, South Asia Region).* The team is grateful to Cristian Lucas *(Macroeconomics, Public Sector, Trade and Investment, South Asia Region),* Nandini Krishnan, Marta Schoch, and Tiloka de Silva *(Poverty),* Tatsiana Kliatskova and Ghiles Elkadi *(Finance, Competitiveness, and Innovation),* Zoe Leiyu Xie, Juan Felipe Serrano Ariza, and Patrick Alexander Kirby *(Macroeconomics, Trade and Investment, Prospects Group)* for their inputs to the publication. The team thanks Mathew Verghis *(Director, Equitable Growth, Finance and Institutions – EFI, South Asia Region),* David Sislen (Country Director for Maldives, Nepal, and Sri Lanka), Gevorg Sargsyan *(Country Manager, Maldives and Sri Lanka),* and Shabih Ali Mohib *(Practice Manager, Macroeconomics, Public Sector, Trade and Investment)* for their guidance. Yasindu Amarasinghe and Tracey Ann Plunkett provided valuable administrative support and helped with the format and layout of the report, while Ali Naafiz led the dissemination efforts.

The report was prepared based on published data available on or before September 12, 2024. Data sources include the World Bank, International Monetary Fund, Ministry of Finance, Maldives Monetary Authority, Maldives Bureau of Statistics, Ministry of Tourism, and press reports.

Previous report editions:

- May 2024: Maldives Development Update: Scaling Back and Rebuilding Buffers
  https://openknowledge.worldbank.org/entities/publication/acbc24eb-8fc1-4b94-8492-a41e4e41dd2f
- October 2023: Maldives Development Update: Batten Down the Hatches
  https://openknowledge.worldbank.org/server/api/core/bitstreams/4fdca0d7-c521-4bf0-900b-88fad30ad00e/content
- April 2023: Maldives Development Update: Navigating A Tight Line
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Abbreviations

BML	Bank of Maldives
CAD	Current Account Deficit
CAM	Communication Authority of Maldives
CAR	Capital Adequacy Ratio
CCDR	Country Climate and Development Report
COVID-19	Coronavirus Disease 2019
CPI	Consumer Price Index
DAPPs	Dynamic Adaptive Policy Pathways
DHS	Demographic and Health Survey
EMDEs	Emerging Markets and Developing Economies
EWSs	Early Warning Systems
FCCL	Fiscal Commitments and Contingent Liabilities
FDI	Foreign Direct Investment
FRA	Fiscal Responsibility Act
G2G	Government-to-government
GDP	Gross Domestic Product
GGST	General Goods and Services Tax
GHG	Greenhouse Gases
GoM	Government of Maldives
HIES	Household Income and Expenditure Survey
MNACI	Maldives National Association of Construction Industry
MDU	Maldives Development Update
MIFCO	Maldives Industries Fisheries Company Ltd
MMA	Maldives Monetary Authority
MoF	Ministry of Finance
MoT	Ministry of Tourism
MPAs	Marine Protected Areas
MPI	Multidimensional Poverty Index
MRR	Minimum Reserve Requirement
MTRS	Mid-Term Revenue Strategy
MUDRP	Maldives Urban Development Resilient Program
MVR	Maldivian Rufiyaa
NAP	National Adaptation Plan
NBS	National Bureau of Statistics
NbS	Nature-based Solutions
NDA	Net Domestic Assets
NDC	Nationally Determined Contribution
NFA	Net Foreign Assets
NPL	Non-performing Loan
ODF	Overnight Deposit Facility
OLF	Overnight Lombard Facility
OMO	Open Market Operations
PIM	Public Investment Management
PPG	Public and Publicly Guaranteed
PPP	Public Private Partnership

Abbreviations

PSIP	Public Sector Investment Program
PSPH	Public Sector Pay Harmonization
RBI	Reserve Bank of India
RE	Renewable Energy
SDF	Sovereign Development Fund
SDG	Sustainable Development Goals
SIDS	Small Island Developing State
SLR	Sea Level Rise
SOE	State-Owned Enterprise
STO	State Trading Organization
TGST	Tourism Goods and Services Tax
US$	United States Dollar
y-o-y	year on year

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Executive Summary

A. Economic Update, Outlook, and Risks

Economic growth picked up in early 2024 driven by rising tourist arrivals. Real Gross Domestic Product (GDP) grew by 9.8 percent (y-o-y) in 2024Q1, driven by robust tourism performance (9.3 percent growth in 2024Q1) translating into stronger growth in transportation, communication, and domestic trade. Tourist arrivals picked up by 15.3 percent in 2024Q1 and continued to improve in subsequent quarters, leading to a 10.5 percent y-o-y increase as of end-August, while the average duration of stay remained steady, and spending per-tourist fell.

Headline inflation declined in 2024H1, but food inflation remained elevated. Consumer price inflation declined to an average of 0.5 percent in 2024H1, from 2.9 percent in 2023, as the impact of past Goods and Services Tax (GST) rate increases eased, along with softer global commodity prices. However, food prices experienced a sharp increase, reaching an average of 6.7 percent (y-o-y) in 2024H1 from 5.9 percent at end-2023. The continued provision of blanket subsidies helped contain pressures on housing, utility, and transportation prices.

The fiscal deficit narrowed in cash terms but was accompanied by an increase in arrears. The overall fiscal deficit in 2024Q1 narrowed to MVR 677 million (US$44 million or 0.6 percent of GDP) compared to MVR 2.9 billion (US$188.5 million or 2.9 percent of GDP) in the same period of 2023.[1] Revenues increased from 9.3 percent of GDP in 2023Q1 to 9.5 percent of GDP in 2024Q1, driven by an 8.4 percent (y-o-y) increase in Tourism Goods and Services Tax (TGST) collections. Total expenditure declined by 11 percent (y-o-y) in 2024Q1, as a slight increase in recurrent spending by 6.5 percent (y-o-y) was offset by a sharp decline in capital expenditure by 44.6 percent (y-o-y) on a cash basis.

However, expenditure cuts have been accompanied by a build-up in arrears. Concerns over delayed disbursements and unpaid obligations have been raised by government contractors, the fishing industry, and private hospitals. Previously planned and budgeted subsidy reforms for fuel, electricity, food, and sanitation – that aimed to reduce expenditure by 2 percent of GDP in 2024 – are yet to be implemented.

The current account deficit (CAD) is expected to narrow slightly in 2024, but remain elevated, as widening trade deficits are offset by tourism. The trade deficit widened to US$1.5 billion (22.0 percent of GDP) in 2024H1 from US$1.4 billion (21.6 percent of GDP) in 2023H1. This was driven by imports growing 6.4 percent (y-o-y) in 2024H1, despite capital expenditure cuts that ensured merchandise imports remained flat in 2024H1 compared to 2023H1. Travel sector receipts, which account for 95 percent of services exports, experienced a robust growth of 24 percent from January to May 2024 (y-o-y). As a result, the CAD is expected to remain elevated but narrow to 16 percent of GDP in 2024 from 21.2 percent of GDP in 2023.

Foreign exchange reserves have declined to critically low levels, with rising liquidity risks, driven by an elevated CAD and increasing external debt repayments while the Maldives Monetary Authority (MMA) has been introducing new measures to ease the pressures. Official reserves fell from US$590.5 million at end-2023 to US$ 443.9 million at end-August 2024, due to rising debt repayment obligations and high import needs. Official reserves are at their lowest level since 2017, sufficient to cover only 1 month of imports, down from 1.4 months of coverage at end-2023. Usable reserves declined from US$179 million to US$61.2 million in the same period. In response to this, the MMA introduced several new regulations with an aim to increase the FX liquidity in the financial system. Citing rising liquidity pressures and an increase in the default risk, Fitch Ratings downgraded the Maldives in June and August and Moody's downgraded in September. Sukuk yields rose to 32 percent in early September from 17 percent at end-2023.

[1] Since June 20, the authorities have not released the fiscal statistics due to ongoing reconciliation works, leading to transparency concerns on the overall economic situation.

Commercial banks' exposure to the sovereign have increased further. Exposure of the domestic financial sector to the sovereign and state-owned enterprises (SOE) debt increased by 9 percent (y-o-y) in June 2024, reaching approximately US$ 4.49 billion (63.9 percent of GDP). Banks' exposure to the sovereign amounted to 36 percent of total assets, up from 30 percent as of end-2023. Meanwhile the MMA's exposure amounted to 61 percent of total assets, up slightly from 59.6 percent as of end-2023. Credit to the private sector accelerated by 12 percent (y-o-y) in July 2024, with growth observed in personal loans and the construction sector. Deposit growth decelerated over the same period, with deposits in local currency only growing by 4 percent (y-o-y) in July 2024, compared to 8 percent at end-2023, and deposits in foreign currency declining for the past four months, which contributed to increasingly tight foreign exchange liquidity.

Total public and publicly guaranteed (PPG) debt remained elevated and rose further in early 2024. Total PPG debt reached US$8.2 billion or an estimated 115.7 percent of GDP in 2024Q1,[2] compared to US$7.2 billion or 109.7 percent of GDP in 2023Q1. Domestic debt increased to 68.4 percent of GDP in 2024Q1,[3] from 62.9 percent of GDP in 2023Q1, as tighter global financial conditions compelled the government to depend more on domestic sources. External and externally guaranteed debt accounted for the remainder of the stock (47.4 percent of GDP) in 2024Q1.

Growth is expected to pick up marginally over the medium term, supported by increased tourist arrivals due to the completion of the new terminal at the Velana International Airport. Real GDP growth is projected to rise marginally from 4.1 percent of GDP in 2023 to 4.6 percent in 2026. The baseline projections for the medium term are, however, slightly lower than the forecasts in April 2024, reflecting: (i) a delay in the completion of the new terminal at the airport, shifting some growth from 2025 to 2026; (ii) an expected fiscal adjustment, including the negative impact on real household incomes from the planned subsidy reforms and reduction in government consumption and investments; and (iii) a moderation in spending per tourist.

Inflation is projected to rise significantly over the medium term, which could increase poverty unless targeted cash transfers are introduced. Inflation is projected to increase from 2.3 percent in 2024 to 7.8 percent in 2025 before moderating to 4.5 percent in 2026 driven by the proposed removal of blanket subsidies for fuel, food, electricity, sanitation, and transport. In the absence of targeted cash transfers to mitigate a withdrawal of subsidies, the poverty rate is projected to increase from 2.5 percent to 4.6 percent nationally and from 4.8 percent to 8.3 percent in the atolls.

The fiscal deficit is likely to moderate, reducing the public debt stock marginally, although debt service costs are expected to increase significantly. The fiscal deficit is projected to narrow from 9.1 percent of GDP in 2024 to 6.1 percent in 2026 due to lower subsidies, health sector reforms, and a reduction in Public Sector Investment Program (PSIP) spending. As a result, public debt is forecast to decline from 119.3 percent of GDP in 2024 to 111.4 percent of GDP in 2026. At the same time, debt service costs are expected to increase significantly, from a projected US$408.3 million in 2024 to about US$615.6 million in 2025, and then spiking to US$1.07 billion in 2026. This includes the bullet repayment on the US$500 million Sukuk and a US$100 million private bond placement due in 2026.

Downside risks are significant, given heightened external and fiscal vulnerabilities, and limited buffers. Elevated external and fiscal imbalances, together with high external debt service payments, continue to pose significant liquidity risks. Recent downgrades by rating agencies and elevated yields have reduced access and increased the cost of financing. Despite government efforts to transfer a portion of revenues to the Sovereign Development Fund (SDF), which was designed to pay off some of the maturing debt in 2026, the fund's available balance of US$65 million at end-August 2024[4] falls short of external debt servicing needs. Additional fiscal risks – from guaranteed and on-lent loans, as well as trade payables, subsidies, and capital injections to SOEs – remain and were estimated at US$2.5 billion or 45 percent of GDP in 2019.[5]

[2] Based on World Bank's latest macroeconomic forecasts.
[3] Based on World Bank's latest macroeconomic forecasts.
[4] https://en.sun.mv/88684.
[5] World Bank 2022.

A large fiscal consolidation is urgently required to regain fiscal and debt sustainability and ease liquidity pressures. Despite the government's announcement of a homegrown fiscal reform agenda in February 2024, the policies are yet to be endorsed and implemented. Implementing these reforms is key to easing current liquidity pressures and bringing the budget closer to balance. They should also be accompanied by candid and timely communication with the public. Key reforms include expenditure reduction measures such as: (i) phasing out existing subsidies and replacing them with a targeted cash transfer scheme; (ii) improving efficiency in the health insurance scheme (Aasandha); (iii) reforms to SOEs including improvements in their corporate governance and financial viability; and (iv) a sharp cut in capital spending, accompanied by changes in the PSIP regulatory framework. On the revenue side, key reforms – as announced in the recent Medium-Term Revenue Strategy[6] – include revisions to the Goods and Service Tax (GST) and Income Tax, revisions to import duties and airport taxes and charges, introduction of an excise tax regime, and raising the Green Tax.

B. Policy priorities to address climate and development challenges[7]

The special topic summarizes the main findings from the World Bank Group's September 2024 Country Climate and Development Report (CCDR). It discusses key dimensions of climate resilience and identifies recommendations to support the country in facilitating critical climate resilience and green transitions within the context of the current macroeconomic vulnerabilities.

Sea-level rise (SLR) and related flooding is a major climate change concern with significant economic impacts. Projections suggest a potential rise of anywhere from 0.5 to 0.9 meters by 2100. Without adaptation, coastal flooding could damage up to 3.3 percent of total assets by 2050 during typical 10-year floods. At the macroeconomic level, it is estimated that SLR and flooding would cause an almost 11 percentage point reduction of GDP by 2050 in a high-emission scenario.[8] This impact, however, can be reduced to less than 6 percentage points of GDP with sustained reconstruction and adaptation investments. In addition, fiscal consolidation could help create the necessary fiscal space for reconstruction and adaptation investments. This could contribute to a pick-up in growth and a reduction in the debt ratio in the long term under a high-emission scenario. This shows that strategic investments in climate change adaptation pay off.

Maldivian islands have adapted to SLR naturally in the past, but climate change potentially makes their future natural adaptation highly uncertain. Despite an SLR of 3–4 mm per year in recent decades, only 3 percent of the islands experienced net land loss from 2004 to 2016, owing to natural accretion and strategic land reclamation. However, the degradation of coral reefs compromises the islands' ability to sustain critical ecosystem services including sand production. The flood protection service of coral reefs alone is valued at US$442 million or 8 percent of GDP per year.

Almost all coral cover among reefs could be lost if global temperatures exceed 2°C under a high-emission scenario. Under a lower warming scenario, however, reefs will retain substantial coral cover. Lowering global emissions and reducing impacts from local stressors, such as coastal development and pollution will be key to preserving the country's vital coral reefs.

Severe climate-induced impacts are expected to begin in the second part of this century. Up until mid-century the negative impacts are expected to be incremental only. However, by around 2050, negative impacts are expected to escalate quickly, especially under the moderate to high-emission scenarios. Ocean heating, for instance, could cause an almost entire collapse of coral reefs and fish stocks. It is critical to use the next decades to plan and build adaptative capacity and prevent the most severe scenarios to the extent possible.

Tourism and fisheries, both reliant on the country's natural capital, have been instrumental in Maldives' economic transition. Tourism and fisheries account directly for about half of the value added to GDP and

[6] Ministry of Finance, Medium Term Revenue Strategy 2024-2028.
[7] The analysis in this section is based on and summarizes key insights from World Bank 2024a.
[8] The analysis in this section considers three climate scenarios: a low greenhouse gas (GHG) emissions scenario (Shared Socioeconomic Pathway [SSP]1–2.6), a medium GHG emissions scenario (SSP2-4.5), and a high GHG emissions scenario (SSP5–8.5).

jobs. Their success is intimately linked to the country's green and blue natural capital, which is under threat from climate change impacts.

The tourism sector urgently requires accelerated climate adaptation efforts across its resort islands and guesthouses. A survey across 55 resorts indicates that over 90 percent are grappling with moderate to severe beach erosion, while around 60 percent report considerable infrastructure damage due to climate-related events. To enhance the climate resilience of the tourism sector, the regulatory framework needs to be strengthened to ensure that new resorts and guesthouses are being developed using climate-resilient and green infrastructure, among other measures.

Climate change is also anticipated to have a severe impact on the fisheries sector. Analysis projects a dramatic decrease in fish catch potential of almost 100 percent by the end of the twenty-first century under a high-emission scenario. If no adaptation action is taken, such impacts could translate to an almost 100 percent revenue reduction from fisheries. In response, alternative livelihood opportunities need to be assessed such as diversification of deep-sea fisheries and mariculture development. Further research also needs to be conducted on climate change impacts on pelagic and reef fish migration to inform fisheries planning.

Gray infrastructure such as seawalls can have tangible coastal protection benefits in some cases, but also detriments in others. Depending on the island type, coastal protection with gray infrastructure may be the right-fit approach to protection. That said, there are also maladaptive examples, e.g., islands locked into hard protection pathways lead to the destruction of protective coral reefs. This has negative impacts on the tourism and fisheries sectors that rely on healthy coral ecosystems, calling for a nuanced approach that combines engineered and nature-based measures.

Enhancing social protection and skills development is crucial for building the resilience of people and communities and fostering sustainable growth. Poor and vulnerable households in Maldives report higher incidences of floods and droughts. Existing social and social protection programs must be more adaptive, scalable, and targeted to reach the poorest households. Skill development and unemployment insurance could help mitigate risks from green transition policies.

It **is estimated that the financing requirements for Maldives' climate change adaptation to SLR and flooding alone range between US$2 billion and US$4 billion.** This estimate is based on selecting bespoke coastal protection solutions to cater to the physical characteristics of each island. It does not include climate change mitigation (estimated at US$1 billion) or other adaptation costs such as those related to ocean warming.

The government faces several financing and institutional challenges in addressing climate change. The vulnerabilities in fiscal and external sectors have led to an erosion in macroeconomic buffers. As a result, Maldives is at a high risk of external and overall debt distress and faces significant constraints to financing climate and other strategic investments in the short to medium term. Although a comprehensive policy framework to address climate change has been established, implementation is hampered by inadequate inter-agency coordination, translation of policies into action, and tracking of commitments.

Restoring fiscal space, building external buffers, and ensuring macroeconomic stability will be a prerequisite to mobilize the required financing for climate action. As discussed in Section A, major policy reforms are urgently needed, including significant expenditure adjustments via reforms in areas such as subsidies, healthcare, public investments, asset and debt management, and state-owned enterprises. Revenue-side measures such as the Green Tax, Airport Development Fees, and Departure Tax could be further increased to finance urgently needed climate action. In addition, structural reforms are needed to diversify the economy and mitigate the presence of state-owned enterprises in the economy over the longer term.

A green transition in the energy sector can also help reduce fiscal spending and reap other development benefits. The country is heavily dependent on imported diesel fuel for electricity production which accounts for over 90 percent of its energy needs. The fuel import bill was US$507 million (8 percent of GDP) in 2022 for the public sector alone, with US$61 million paid in subsidies. The potential fiscal and foreign exchange savings from switching to cheaper solar energy could help facilitate investments in climate resilience and other development objectives over the medium to long term.

The required financing for climate actions cannot be met by existing resources, and reforms are needed to improve access to finance. In addition to grants and established concessional financing instruments, new sources of concessional funds and other debt-neutral instruments should be explored. The country can also tap into carbon markets and develop climate-related risk management financial products. Further, Maldives needs an updated public investment management framework and could expand public-private partnerships to mobilize green finance.

A1. Economic Update

1. Growth picked up in early 2024, while broad inflationary pressures have eased

Economic growth picked up in early 2024 supported by tourism

The economy grew by 9.8 percent (y-o-y) in the first quarter of 2024 (2024Q1), primarily driven by strong activity in the tourism sector, which directly accounts for a quarter of the economy. Tourism's expansion of 9.3 percent in Q1, translated into stronger growth in transportation, communication, and the domestic trade subsectors (Figure A.1). Fisheries, though a small sector of the economy, declined by 0.9 percent (y-o-y) in 2024Q1,[9] which could lead to income and welfare losses for people whose livelihoods depend on the sector.

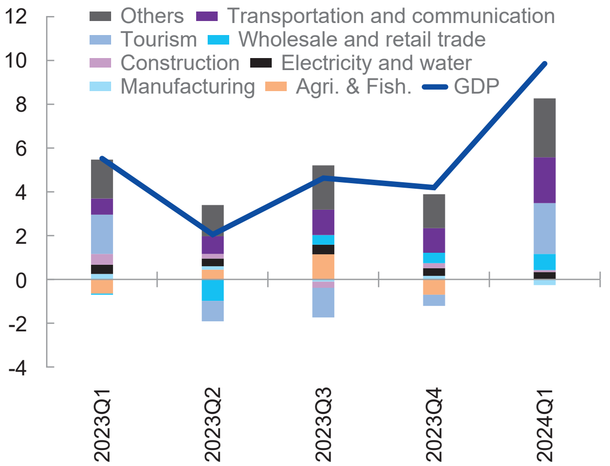
Tourism growth was driven by increased arrivals from China and sustained arrivals from Russia, Europe, and new markets

Tourist arrivals continued to increase in 2024 following a historical high of 1.88 million in 2023. As of end-August, 1.36 million tourists had visited the Maldives, a 10.5 percent increase when compared to the same period in 2023. The average duration of stay remained unchanged at 7.7 days in 2024, compared to the same period last year, albeit lower than the 8.1 days recorded in 2022. However, per tourist spending fell further by 7 percent (y-o-y) in 2024H1 compared to 2023H1 (Figure A.2). Chinese arrivals lead the market, contributing 14.6 percent of total visitors so far in 2024. Meanwhile, arrivals from India, which was the top market in 2023, have declined sharply from 11 percent of total visitors in 2023 to only 6 percent in 2024, ranking 6th on the list. Arrivals from Russia, Western Europe, and new markets such as the USA were sustained.

[9] Maldives fish exports have dropped to a record low, with a 48 percent (y-o-y) decrease in 2024H1. This was driven initially by the government's hike of the price it pays for fish in the local market in 2023, which had a negative impact on private sector exporters who were unable to compete at that price. However, due to payment arrears, fishermen have been limiting sales to the publicly owned fish company Maldives Industries Fisheries Company Ltd (MIFCO).

Figure A.1: Real GDP gained momentum in 2024Q1…

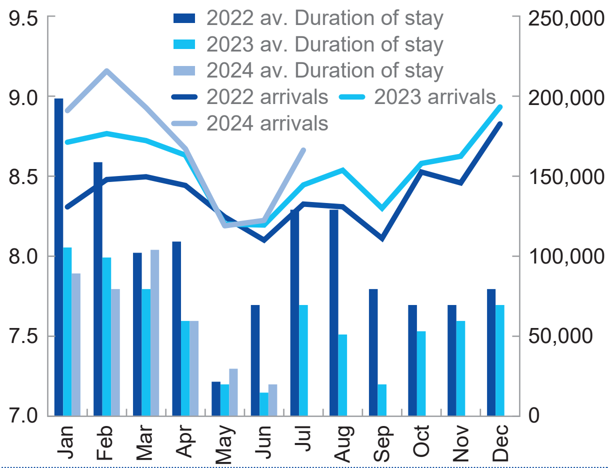
Contribution to growth, percentage points



Source: National Bureau of Statistics Maldives (NBS), WB calculations.
Note: Others include financial services, real estate, professional, scientific, and technical activities, public administration, education, human health and social work activities, entertainment and recreation.

Figure A.2: … as tourist arrivals increased, but the average duration of stay remains below 2022 levels

Number of tourist arrivals (rhs, lines), Days of stay (lhs, columns)



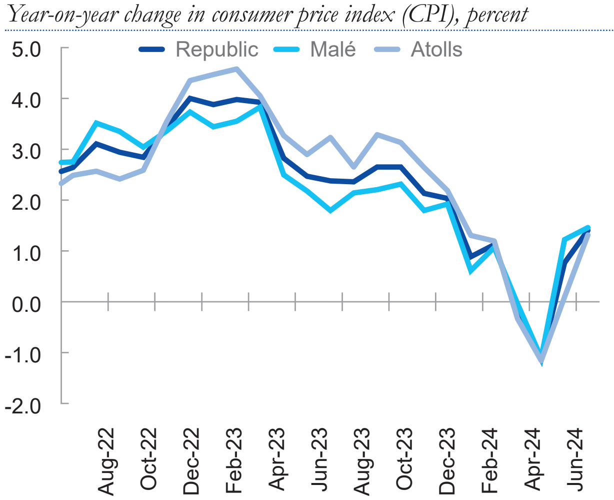
Source: Ministry of Tourism (MoT), WB calculations.

Headline inflation was contained, but food inflation remained elevated

Consumer price inflation declined to an average of 0.5 percent in 2024H1, close to the historical average, from 2.9 percent in 2023, following impacts of past increases to the Goods and Services Tax (GST) easing, along with softer global commodity prices. Inflation started easing from 2023Q4, with the moderation in global commodity prices, and fell further in 2024Q1 as price increases slowed in almost all sectors. This decline was more pronounced in the atolls (0.4 percent) than in Malé (0.5 percent). However, food prices experienced a sharp increase, reaching an average of 6.7 percent (y-o-y) in 2024H1 (Figures A.3 and A.4). Other prices, such as for housing, utilities, and transportation, remained controlled due to the continued provision of blanket subsidies provided by SOEs.

Figure A.3: Headline inflation was subdued in 2024H1…

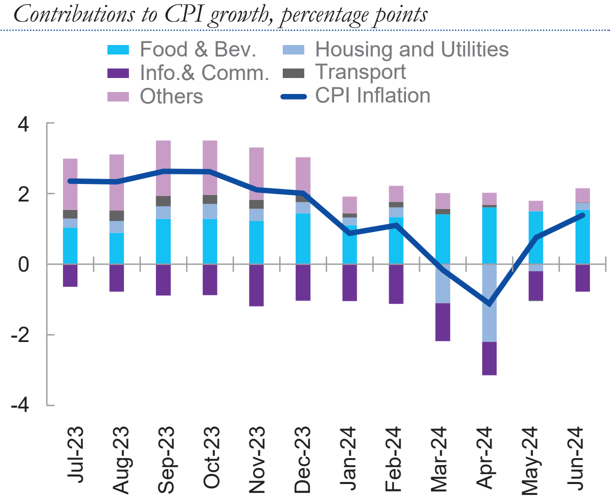
Year-on-year change in consumer price index (CPI), percent



Source: NBS, WB calculations.

Figure A.4: … although price increases were acute in food and beverages

Contributions to CPI growth, percentage points



Source: NBS, WB calculations.
Note: Others include furnishing, health, education, restaurants, and accommodation.

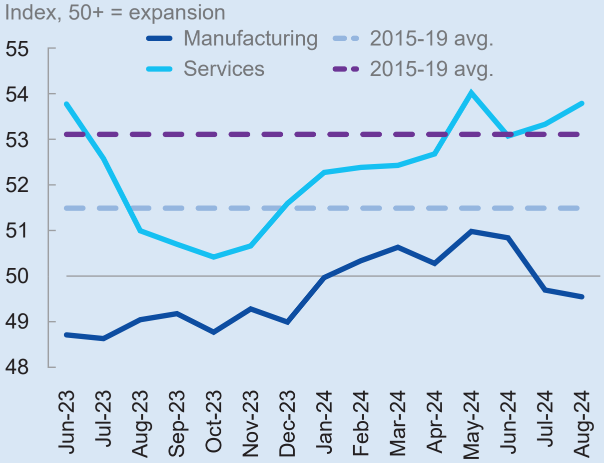
Box 1: Global economic developments

Global growth surprised on the upside over the past six months, but signs of weakness emerged in mid-2024. Global manufacturing activity contracted unexpectedly in July 2024, but the faltering was mitigated by a continued solid expansion in global services (Figure A.5). Activity in EMDEs appears to be firming, except in China, where growth has slowed unexpectedly since June 2024. In the United States and the euro area, growth is set to exceed earlier expectations.

China's growth is moderating, reflecting softening domestic consumption, but solid external demand is supporting exports. The central bank lowered its policy interest rate in July 2024 and reportedly plans to boost consumption by lowering effective lending rates for small loans and easing mortgage lending requirements. Consumption moderation in China poses downside risks for tourist arrivals in Maldives.

Figure A.5: Global growth in 2023 was better than expected

Percent



Source: Haver Analytics.
Note: Readings above (below) 50 indicate expansion (contraction). The last observation was in July 2024.

In the United States, growth in 2024 is widely expected to be stronger than anticipated six months ago but is projected to slow from its 2023 rate. Moderating inflation and signs of a cooling labor market are expected to allow the US Federal Reserve to cut the monetary policy rate in the third quarter of 2024. Economic activity in the euro area has recovered steadily, led by the services sector. Although the manufacturing sector continues to stagnate with subdued growth in investment and exports, euro area growth for the year is expected to exceed earlier expectations. Given the better projected performance in the US and euro area, this could provide a boost in tourist arrivals for Maldives.

Global inflation continues to slow but remains above pre-pandemic averages amid broadly stable commodity prices. Slowing inflation has allowed central banks in some EMDEs to ease monetary policy and is anticipated to lead to monetary easing in major advanced economies by late 2024. The latter is expected to ease pressures and lower financing costs for many EMDEs. However, given the current erosion in investor confidence in Maldives, the impact of lower global financing costs is likely to be limited for Maldives.

After a brief expansion in April and May 2024, global trade flows returned to their contractionary trends, driven by shrinking goods exports as countries struggled with conflicts and the rise of trade-restricting measures. Services exports continued to expand, albeit at a decelerating pace, which was positive for Maldives's tourism sector. Global trade growth is expected to accelerate in 2025 but remains below the 2015–19 average.[10] This growth is set to be driven increasingly by trade among countries that are aligned on foreign policy.

Source: World Bank SARCE team.

[10] World Bank 2024.

2. Fiscal deficit narrowed in cash terms but was accompanied by rising expenditure arrears

Fiscal deficit narrowed in early 2024

The overall reported fiscal deficit in 2024Q1 narrowed to MVR 677 million (US$44 million) or 0.6 percent of GDP, compared to MVR 2.9 billion (US$188.5 million) or 2.9 percent of GDP in the same period of 2023. Total expenditure declined in this period by 11 percent (y-o-y) to 10.1 percent of GDP, whilst revenue collection increased by 9.1 percent (y-o-y) to 9.5 percent of GDP in 2024Q1.

Revenue collection increased due to robust tourism-related tax collections

The revenue increase in 2024Q1 came largely from Tourism Goods and Services Tax (TGST) and business and property tax collections, linked to more robust business activity in this period (Figure A.6). In addition, the government unveiled its Medium-Term Revenue Strategy (MTRS), which includes revisions to the Goods and Service Tax[11] and Income Tax, revisions to import duties and airport taxes and charges, and the introduction of an excise tax regime. The government also announced plans to raise the Airport Development Fee, Departure Tax, and Green Tax. The announced measures, including those in the MTRS, are yet to be implemented and have not yet impacted revenue collection.

Expenditure was cut on a cash basis, driven by liquidity constraints…

Recurrent expenditure grew by 6.5 percent (y-o-y), while capital expenditure declined sharply by 44.6 percent (y-o-y) over the same period (Figure A.7). Interest payments continued to be substantial in 2024Q1, totaling MVR1.4 billion (US$91.2 million), compared to MVR1.1 billion (US$71.5 million) during the same period in 2023. Expenditure cuts were necessitated by cash-flow constraints linked to limited domestic and external financing.

…which has been accompanied by a build-up of arrears

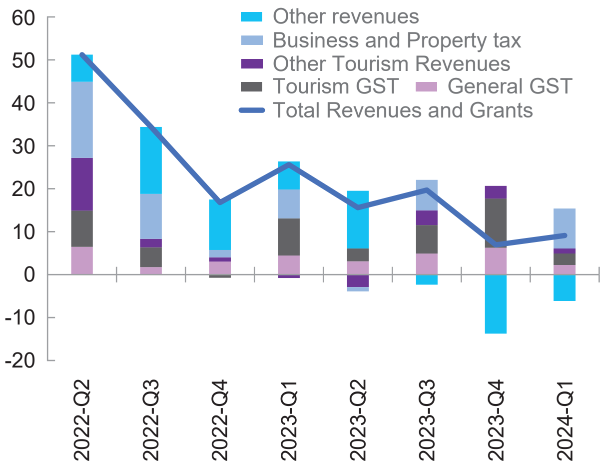
Expenditure cuts have been made on a cash basis, and not on a commitment basis, creating a significant buildup of expenditure arrears. The Maldives National Association of Construction Industry (MNACI) has been in discussions with the government due to delays in fund disbursements under the Public Sector Investment Program (PSIP). MNACI reported significant delays in payments to contractors for developmental projects across local atolls.[12] Furthermore, due to payment arrears in the fisheries sector, fishermen have limited their sales to the publicly owned fish company Maldives Industries Fisheries Company Ltd (MIFCO).[13] As part of the fiscal reform agenda, the government decided in June to purchase fish from local fishermen at global market prices, aiming to improve MIFCO's financial situation and address the expenditure arrears in the fisheries sector. Private hospitals have also recently raised concerns regarding their financial strain due to unpaid government dues.[14]

Planned fiscal reforms have been delayed

Previously planned and budgeted subsidy reforms (as part of the government's home-grown fiscal reform agenda) for fuel, electricity, food, and sanitation – that aimed to reduce expenditures by 2 percent of GDP in 2024 – have not been implemented.

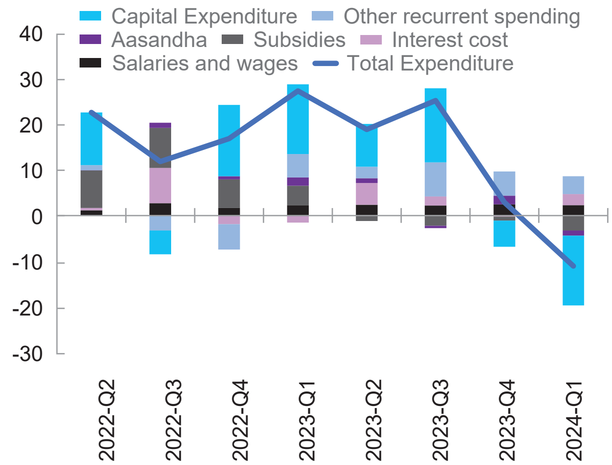
[11] The government proposes a comprehensive review of the Goods and Service Tax Act, along with the introduction of new legislation aimed at increasing the tax base. See Box 2 for a detailed analysis of How to tax Maldivian value from offshore booking platform.
[12] https://en.sun.mv/90381
[13] https://corporatemaldives.com/decline-in-fishing-activity-leads-to-shortage-of-fish-products-in-retail-stores/
[14] https://edition.mv/celebrities/35151

Figure A.6: Growth in revenues driven by robust tourism activity
y-o-y change, in percent



Source: MoF, World Bank calculations.
Note: Other Tourism Revenues consist of import duties, green tax, airport service charges/departure tax, airport development fees, and resort rents.

Figure A.7: Expenditure declined on a cash basis, due largely to capital investment cuts and lower subsidies
y-o-y change, in percent



Source: MoF, World Bank calculations.

3. Public debt and external debt servicing increased in 2024

Public debt increased further and remains elevated

Total public and publicly guaranteed (PPG) debt rose to US$8.2 billion or an estimated 115.7 percent of GDP in 2024Q1, compared to US$7.2 billion or 109.7 percent of GDP in 2023Q1, due to elevated borrowing to finance the fiscal deficit and infrastructure projects (Figure A.8). Domestic debt increased to 68.4 percent of GDP in 2024Q1, from 62.9 percent of GDP in 2023Q1, as tighter global financial conditions compelled the government to depend more on domestic finances. As a result, outstanding external debt only grew by 8.6 percent (y-o-y) in 2024Q1 to US$3.4 billion or 47.4 percent of GDP (Figure A.9).[15] In May 2024, the government signed agreements with the Saudi Fund for Development for a total of US$150 million in loans to expedite the construction of the new terminal at the Velana International Airport and to support the development of hospitals in three islands, which will lead to a further rise in the debt stock.

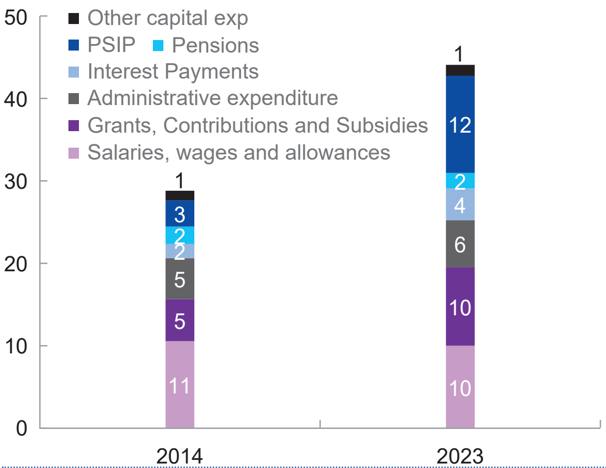
External debt service needs increased, and financing options became more limited in 2024

Debt service costs increased by 13.3 percent (y-o-y) to US$408.3 million in 2024 from US$360.3 million in 2023 (See Figure A.23). Upon Maldives' request, India has agreed in 2024 to extend the maturities of one-year US dollar treasury bonds by one year, issued through the State Bank of India Male branch. In addition, negotiations are underway to defer the repayment of other loans from China and the UAE. Credit rating downgrades by Fitch in June and August and by Moody's in September have further constrained the ability to access markets for new financing, as yields on the US dollar Sukuk increased to 32 percent in early September as compared to 17 percent at end-2023.

[15] Based on Quarterly Debt Bulletin published by the Ministry of Finance.

Figure A.8: Public infrastructure projects and subsidies have driven up spending over the last decade…

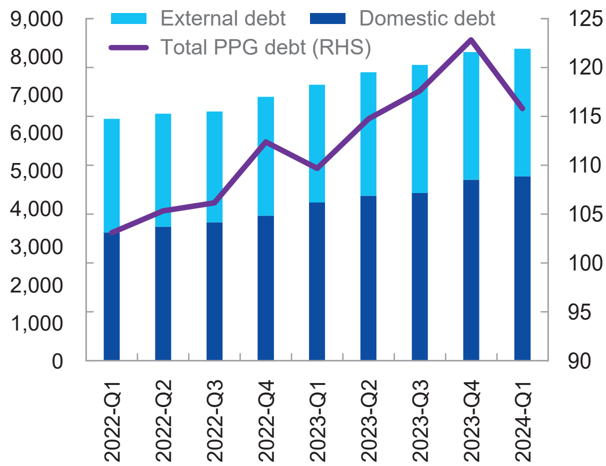
Public expenditure as a share of GDP



Source: MoF, World Bank calculations.

Figure A.9: …which has led to a sharp increase in the debt stock

PPG in US$ millions and percent of GDP (rhs)



Source: MoF, World Bank calculations.

Box 2: Capturing and taxing the value created in the Maldives from offshore booking platforms

Currently, a significant share of the value of tourism-related goods and services delivered and rendered in the Maldives escapes taxation in the country. Non-resident online platforms sell vacation packages in the Maldives (accommodation, transportation, food and beverages, and leisure activities) to tourists abroad at market prices, while only a portion of these services and goods are taxed domestically. The offshore booking transaction between the tourist and the foreign platform is, at least at first sight, off-limits for the Maldives Inland Revenue Authority (MIRA), since it takes place outside the country between two non-resident parties, and it does not involve real estate located in the Maldives, but instead, goods and services delivered and rendered therein. Furthermore, MIRA has neither legal right nor means to access the offshore booking transaction information (price, terms and conditions, parties, payment). Hence, the value of such goods and services is not being taxed in the Maldives currently. The question is, what could be done to capture and tax in the Maldives the value created therein, but sold offshore?

There are different options to address this tax avoidance scheme, but it is necessary to correctly delineate the transactions targeted. OECD´s Base Erosion and Profit Shifting (BEPS) Project aims to ensure that profits are taxed where economic activity and value creation take place. In 2017, the Maldives joined the Inclusive Framework for the global implementation of the BEPS Project, including the Two-Pillar Solution. Theoretically, from preliminary analysis, for direct taxation (income) purposes, the offshore online booking scheme could be tackled through different mechanisms: (i) addressing the tax challenges of the digital economy *(BEPS Action 1 and Pillar One´s Amount A)*, (ii) preventing the artificial avoidance of permanent establishment status (BEPS Action 7), or (iii) aligning transfer pricing outcomes with value creation *(BEPS Actions 8-10 and Pillar One´s Amount B)*. As refers to indirect taxation (consumption) purposes, it is notable that the Maldivian GST is based on the origin (rather than destination) principle. As a result of this, a supply of services by a person outside the Maldives (without a physical presence in the country) is not a supply of services in the Maldives and, therefore, is not subject to GST.

The main challenge is to establish a nexus with the offshore booking platforms. The key questions are: (i) whether MIRA has the right to tax an offshore transaction whose value is mostly attributable to goods and services delivered and rendered in the Maldives, and (ii) how such value is to be determined as different from the value of the booking service itself (mainly, getting customers). Also, as we have seen, if the foreign booking platform has no physical presence in the Maldives, then such a transaction is not a supply of services in the Maldives for GST purposes.

Box 2: Capturing and taxing the value created in the Maldives from offshore booking platforms

- Consequently, a *first* option would be finding a way to establish a nexus between the offshore platforms and the Maldives to claim direct (and indirect) taxing rights over the value of such booking transactions, though this may prove challenging. To begin with, such offshore booking transactions do not involve Maldivian resident customers, so, even if conducted online, Amount A under Pillar One would not capture these transactions, and neither would a turnover-based digital service tax (DST). Both taxes are aimed at taxing income (or revenue) from online transactions conducted without any physical presence in the market country by the non-resident providers (booking platforms) with domestic clients located in the market jurisdiction (the Maldives), which is not the case here since most customers/tourists are non-residents who are located abroad.

- A *second* option would require establishing that the Maldives-related booking activity of offshore platforms constitutes a permanent establishment of those platforms in the Maldives, which may also be hard to defend as they do not meet the minimum threshold of business presence in the Maldivian territory, not even in terms of digital presence because their customer base is abroad. Therefore, it seems challenging to create a nexus that would justify taxing those foreign platforms, either from a direct or indirect perspective.

In this regard, although taxing the digital economy in the Maldives would be highly recommended, especially the introduction of the GST on digital services, such tax policy measures would not help address the case at hand. Neither would extending the GST base to include imports help in implementing the destination principle, as this would increase prices for residents but not capture the value from offshore bookings because clients are located abroad.

Therefore, the only viable alternative is to properly assess the price to be charged by the Maldivian providers. Since the taxing scope of MIRA does not cover such offshore transactions, then the focus must shift to the value of the Maldivian domestic transactions between the Maldivian companies (resorts, travel agencies, tourist service providers) and the offshore booking platforms, assuming those transactions exist. It is logical that Maldivian companies must be properly compensated for the goods and services offered to their clients (tourists and visitors in the Maldives). In normal circumstances, such compensation should be determined according to the market value agreed between independent parties (also known as arm´s length principle, ALP), which should not differ significantly across providers, irrespective of the booking platform, either local or foreign. Still, this is not the case, and most value is shifted abroad, probably due to better tax conditions (lower taxation) and the ability of multinationals to control and incur mispricing. If the parties (Maldivian company and offshore platform) are related, then the transfer pricing regime (TP) and the ALP should be applied, and income adjustments should be made to fully tax the value created in the Maldives. Also, corresponding adjustments should be made for GST purposes. This requires a strong TP team at MIRA to conduct TP-focused audits and advanced technical skills to negotiate advance pricing arrangements (APAs) to expedite revenue collections and minimize litigation.

An interim ad hoc turnover-based presumptive levy targeting mispricing from offshore bookings could be introduced. In the meantime, until TP and APA capacity are fully developed in MIRA, an *interim* tax measure to capture the Maldivian value from offshore booking platforms could be introduced temporarily. It would consist of an *ad hoc* turnover-based presumptive levy on room occupancy referenced to the gap between local pricing and price quotes in offshore platforms for each specific Maldivian tourist resort, hotel, vessel, and guesthouse. It would bear some resemblance to the Green Tax, but it would be paid by the Maldivian companies, not by the tourists. It would be assessed by multiplying the difference between the price charged by the Maldivian company and the online room price charged by the offshore platform, times the occupancy rate, and times the tax rate (suggested at around 3 percent on differential turnover, as it would be assessed on turnover accrued by a non-resident third party but imposed on and paid by the Maldivian company, which has not realized such additional turnover). As an example, if a Maldivian resort charges 100 USD and the same room is commercialized at 300 USD through an offshore platform, the difference of 200 USD would be multiplied by the number of nights that the room was occupied during the year and then the tax rate would be applied. This presumptive tax would be a standalone levy on gross differential turnover that would be creditable against any future TP adjustment for the same period, and repealed once the TP unit has sufficient capacity and benchmarking to implement a reliable risk-based TP audit selection system and an APA negotiation team. This *interim* measure would compensate for the tax loss from transfer mispricing and would encourage Maldivian companies to commercialize their vacation packages directly B2C instead of doing it B2B through (related or not) offshore companies operating booking platforms. If 100 percent B2C were not an option, at least B2B pricing should be adjusted upwards to capture the real value. In addition, given the recent Minister's announcement,[16] this levy could be collected in USD.

4. Household welfare may be affected due to potential austerity measures

Fiscal reforms to address the looming macroeconomic challenges may negatively affect household welfare

The Maldivian economy is heavily reliant on international tourism with the revenues being redistributed to the population via a strong redistributive system, including significantly subsidized access to healthcare and education, public sector employment, price controls and subsidies, and income support programs. Given the planned reforms to the healthcare system and subsidy reforms, households may face significant welfare losses given these austerity measures and the higher prices that are likely to follow. Overnight subsidy removal is estimated to increase poverty from 2.5 to 4.6 percent nationally and from 4.8 to 8.3 percent in the atolls, if not compensated with targeted cash transfers. The poverty rate could nearly double among households with more than three children and single-parent households.

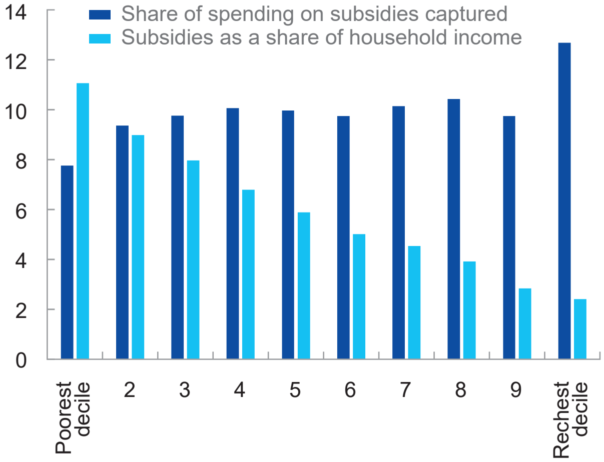
Targeted assistance to poorer households will be crucial for mitigating the impacts of these reforms

Despite indirect subsidies being more important for poor and vulnerable households as a share of household income, high-income households capture a larger share of spending on subsidies. For instance, the richest and poorest income deciles benefit from 13 and 8 percent, respectively, of the total spending on subsidies, but these subsidies account for 2 and 11 percent, respectively, of household income in these two deciles (Figure A.10). Moreover, 43 percent of subsidy spending (equivalent to 4.1 percent of the 2023 budget) is going to the richest 40 percent of the population. Subsidy removal, therefore, creates an opportunity to move towards a more targeted, fiscally sustainable, and pro-poor means of allocating public spending. The poverty impacts of blanket subsidy removal could be offset if the removal of subsidies is accompanied by an income-targeted cash transfer. Assuming an overall budget of MVR1.2 billion, estimates suggest that such a targeted transfer could be effective to offset the poverty increase from subsidy removal if a flat transfer of the same amount is provided to everyone in the targeted bottom 60 percent of the population. The impact will be greater if payments are higher for the bottom 20 percent of the population as compared to the population in the 20th to 60th percentile of the population (Figure A.11). Implementing a targeted transfer will require shifting to a new targeting framework, underpinned by a proxy means test (PMT) to identify eligible beneficiaries.

[16] MIRA 2024.

Figure A.10: Richer households capture more of the spending on indirect subsidies, which are more important for the poor in relative terms

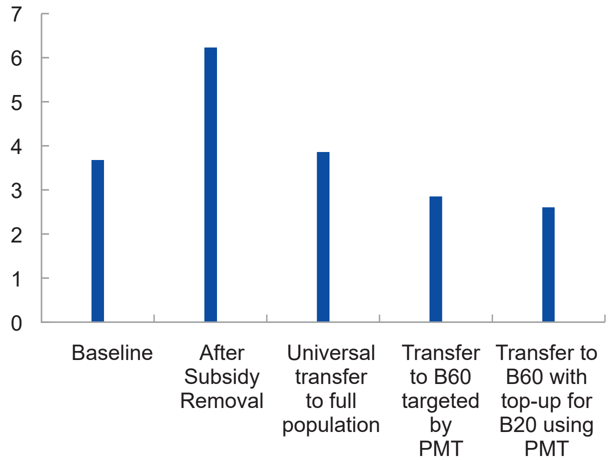
Percentage



Source: HIES 2019, WB calculations.

Figure A.11: Targeted cash transfers to poor and vulnerable households can offset the expected poverty increases following the subsidy removal

Poverty headcount rates based on the national poverty line



Source: HIES 2019, WB calculations.

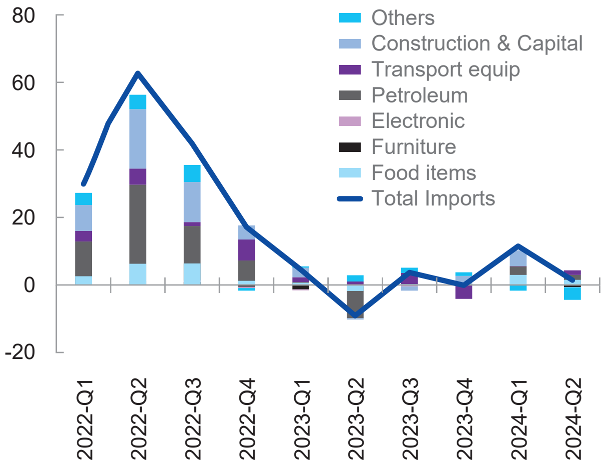
Note: B20 (B60) refers to the share of the population living in the bottom two (six) deciles.

5. Mounting external pressures have led to a sharp deterioration in FX reserves

The trade deficit widened further in early 2024 and the CAD is expected to remain at elevated levels

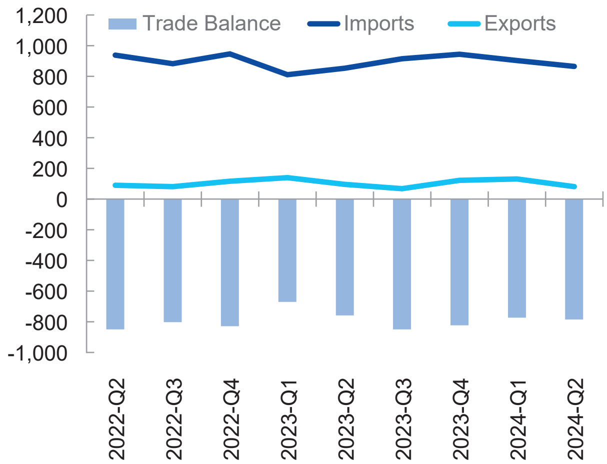
The current account deficit remained elevated at US$1.4 billion (or 21.2 percent of GDP) in 2023, largely financed by foreign direct investment (FDI). Net FDI grew by an estimated 4 percent (y-o-y) to US$761.5 million (or 11.5 percent of GDP) covering 54.4 percent of the current account deficit in 2023 (Figure A.14). The trade deficit widened to US$1.5 billion in 2024H1 from US$1.4 billion in H12023 driven by a sharp decline in fish exports of 45.5 percent (y-o-y) and growth in goods imports of 6.6 percent (y-o-y) despite a reduction of capital expenditure (Figure A.13). Merchandise imports remained elevated at US$1.8 billion in 2024H1, up marginally from US$ 1.7 billion in 2023H1, but merchandise import growth showed signs of slowing down due to the reduction of construction-related imports since 2024Q2 (Figure A.12). Travel sector receipts, which account for 95 percent of services exports, experienced a robust growth of 24 percent from January to May 2024 (y-o-y) compared to the same period in 2023. Driven by these services exports, the current account deficit is expected to narrow marginally, but remain elevated at 16 percent of GDP, in 2024.

Figure A.12: While import growth slowed…
Contribution to import growth, in percent



Source: MMA, World Bank calculations.

Figure A.13: …the trade deficit remains large
US$ million

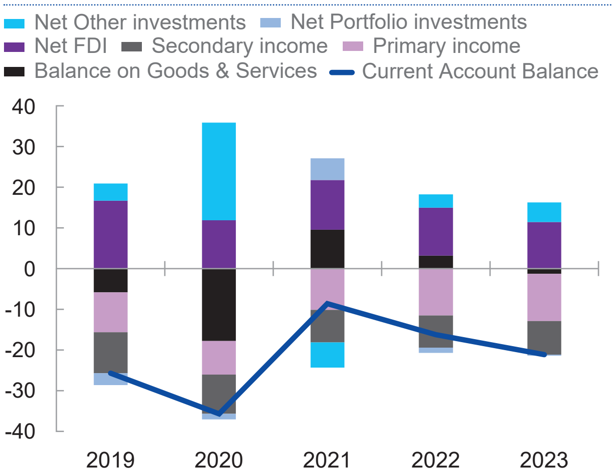


Source: MMA, World Bank calculations.

Official reserves have declined to critically low levels, increasing vulnerabilities

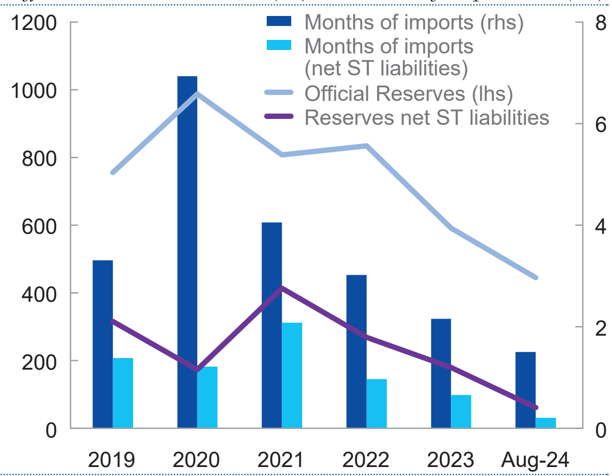
Elevated current account deficits, and rising external debt repayment obligations, led to a decline in official reserves from US$590.5 million at end-2023 to US$ 443.9 million as of end-August 2024. This is sufficient to cover only 1 month of imports. Although short-term liabilities (i.e., coming due within the next 12 months) declined to US$382.7 million in August 2024 from US$543.5 million a year earlier, usable reserves dropped to a low level of US$61.2 million or 0.1 months of import cover. (Figure A.15).

Figure A.14: CAD somewhat financed by FDI…
Percent of GDP



Source: MMA, World Bank calculations.
Note: 2023 figures are based on World Bank GDP estimations

Figure A.15: …as reserves declined to critically low levels
Official reserves US$ million (lhs) and months of import cover (rhs)



Source: MMA, World Bank calculations.

6. MMA and banking sector exposure to the sovereign remains high

Monetary policy has been unchanged since October 2022

The MMA kept policy rates and minimum reserve requirements unchanged.[17] Broad money (M2) remained stable, with a growth of one percent (y-o-y) in July 2024 (Figure A.16). Broad money growth was mostly driven by the increase in net domestic assets, while net foreign assets declined. The dollarization of the economy remained relatively stable but high at 45 percent in July 2024 compared to 46 percent in July 2023.

Foreign exchange pressures have led to declining reserves

The official exchange rate is currently pegged at MVR 15.42 per USD, however on account of FX shortages a parallel FX market persists. The decision and reversal by the country's largest commercial bank to limit foreign transactions on August 25 were accompanied by significant volatility in the parallel exchange rate market where rates have been 15-20 percent higher than the official market.[18] This underscored the severity of foreign exchange liquidity challenges in the financial sector.

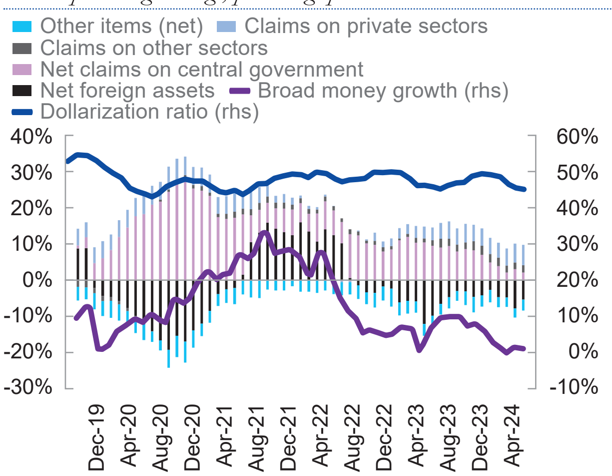
The MMA has introduced new measures to improve FX liquidity challenges in the financial system

On Oct 1, 2024, MMA introduced regulations requiring hotels and guesthouses to register with the MMA and deposit a certain amount of USD per tourist ($500 for hotels per tourist and $25 for guesthouses per tourist) in the domestic banking system, with an aim to improve FX liquidity in the banking system. The MMA anticipates to generate US$750 m additional yearly FX inflows into the banking system.

Given constrained access to external financing, rising public sector borrowing was

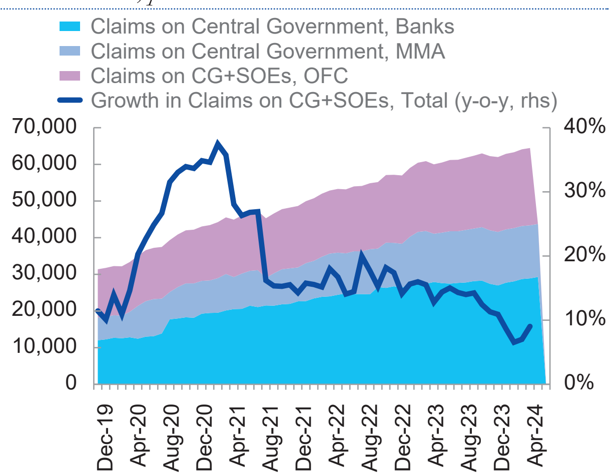
Exposure of the domestic financial sector to the sovereign and SOE debt continued to increase, amounting to MVR 63,795 million in sovereign securities and MVR 5,981 million in SOE debt in June 2024. While the growth rate of sovereign and SOE debt accumulation on the financial sectors' balance sheets slightly moderated, it remained high at 9 percent (y-o-y) in June 2024 (Figure A.17). Banks, other financial

Figure A.16: Growth in net domestic assets contributed to broad money growth…
annual percentage change, percentage point contribution



Source: MMA, World Bank calculations.

Figure A.17: …while exposures of the financial sector to the sovereign and SOEs remain elevated
MVR million, percent



Source: MMA, World Bank calculations.
Note: Other financial corporations include finance companies, insurance companies, and pension funds.

17 Minimum reserve requirement (MRR) has been at 10 percent of average local currency deposits since June 2021, while the MRR for foreign currency deposits has been at 10 percent since October 2022. The interest rate corridor has also been maintained in the same band, with the overnight deposit facility and overnight Lombard facility unchanged at 1.5 and 10 percent, respectively.

18 https://www.bankofmaldives.com.mv/articles/703/bank-of-maldives-announces-card-limits-for-foreign-transactions

largely absorbed by the domestic financial sector

corporations and MMA are heavily exposed to the sovereign and SOE debt that accounts for 36 percent, 68 percent, and 61 percent of their total assets, respectively, which warrants continued monitoring due to the high risk of public debt distress in Maldives.

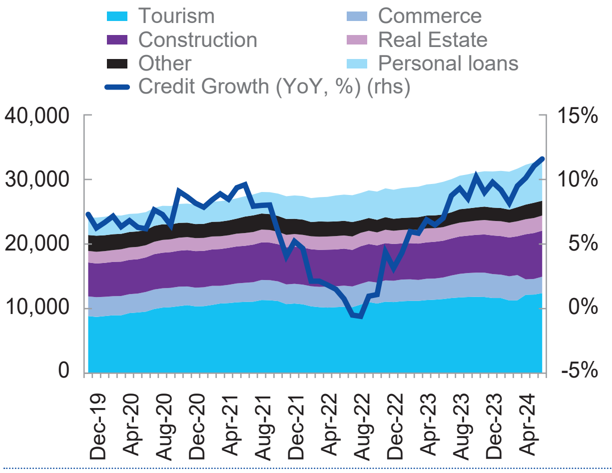
Private credit growth accelerated, while deposit growth remained subdued

Credit to private sector growth has been on an upward trend since end-2022, accelerating to 12 percent (y-o-y) in July 2024 (Figure A.18). The highest credit growth was observed in personal loans (27 percent, y-o-y), and the construction sector (25 percent, y-o-y). At the same time, deposit growth continued decelerating (Figure A.19). Deposits in local currency grew by 4 percent (y-o-y) in July 2024, as compared to 8 percent growth at end-2023. Deposits in foreign currency have been declining for the past four months, with the deceleration rate reaching 1.4 percent in July 2024 (y-o-y), which contributed to increasingly tight foreign exchange liquidity conditions. There is, however, an excess of MVR liquidity in the market, whose redistribution across banks is limited due to the lack of appropriate market mechanisms, such as active open market operations (OMOs) or standing facilities to manage systemic liquidity.

The banking sector remains stable, but vulnerabilities continue to persist due to FX shortages and heavy exposure to the sovereign

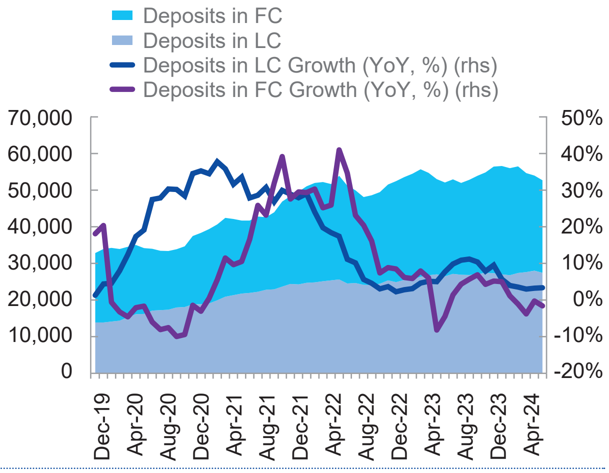
Banks remain well capitalized, with a capital adequacy ratio of 50.6 percent in 2024Q2,[19] well above the regulatory minimum of 12 percent. However, the practice of zero credit risk weighting of both local and foreign currency government exposures implies that sovereign risks are not captured. While non-performing loans (NPLs) dropped by 0.8 percentage points since end-2023, they remain elevated, amounting to 7.5 percent of total loans in 2024Q2. Provisioning for NPLs is relatively low, at 51.8 percent of NPLs. Banks' profitability slightly declined, with returns on assets of 4.9 percent in 2024Q2 (as compared to 5.1 percent at end-2023) and returns on equity of 15.3 percent (as compared to 15.4 percent) over the same period. The net open position in foreign exchange remained negative from 2022 and reached minus 11.8 percent of capital in 2024Q2, indicating increasing vulnerabilities of banks to foreign exchange risks.

Figure A.18: Private credit growth accelerated…
MVR million, percent



Source: MMA, World Bank calculations.

Figure A.19: …while deposit growth remained subdued
MVR million, percent



Source: MMA, World Bank calculations.

[19] The ratio is likely overstated due to the zero-credit risk weight applicable to all government exposures and absence of any provisions on government exposures.

A2. Outlook and Risks

7. Growth is forecast to moderate, inflation to increase, and fiscal and external balances to narrow

The expansion of the airport will help maintain the forecast rate of GDP pick-up as the airport expansion boosts tourism

Real GDP growth is projected to be 4.7 percent in 2024, followed by similar levels in 2025 and 2026 (Table A.1). This will be supported by the completion of the new terminal at Velana International Airport by mid-2025, which is expected to lead to further increases in tourist arrivals. The baseline projections for medium-term growth are, however, slightly lower than the forecasts in April 2024 (Figure A.20), reflecting the following factors: (i) a delay in completing the airport project, shifting some growth from 2025 to 2026; (ii) an expected fiscal adjustment, including the impact on real household incomes from the planned subsidy reforms as per Budget 2024 and a fall in government consumption and investments; and (iii) more moderate spending per tourist.

Table A.1: Medium-term projections

	2022	2023e	2024f	2025f	2026f
Real GDP Growth, at constant market prices	13.9	4.1	4.7	4.7	4.6
Agriculture	3.1	0.8	-7.5	3.4	2.9
Industry	25.2	7.6	2.3	1.6	0.9
Services	14.7	3.1	5.8	5.2	5.1
Inflation (Consumer Price Index)	2.3	2.9	2.3	7.8	4.5
Current Account Balance (% of GDP)	-16.3	-21.2	-15.9	-13.7	-12.1
Fiscal Balance (% of GDP)	-11.6	-12.7	-9.4	-7.8	-6.1
Primary Balance (% of GDP)	-8.0	-8.6	-4.1	-3.1	-1.5
Debt (% of GDP)	112.3	122.8	119.3	114.9	111.4

Source: World Bank estimates and forecasts as of March 2024.

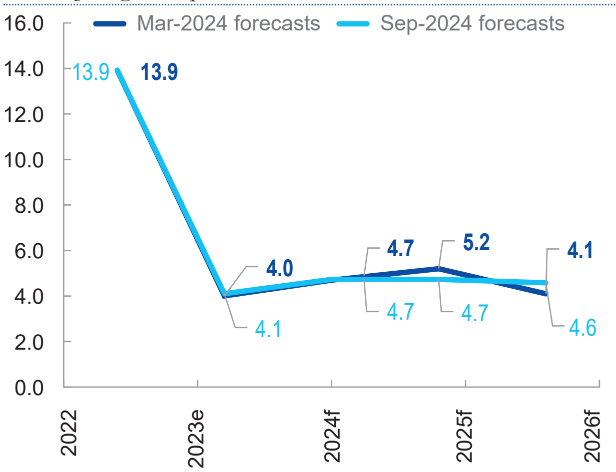
Inflation is projected to rise

Inflation is forecast to rise above the historical average over the next couple of years, due to the planned removal of blanket subsidies – expected to be implemented in December 2024 – and its spillover effects on other sectors.

The fiscal deficit is expected to narrow and public debt to decline marginally due to planned expenditure cuts

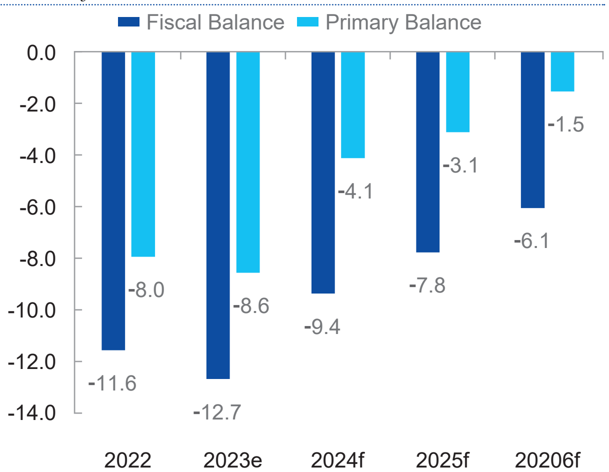
The narrowing of the fiscal deficit in 2024 (Figure A.21) is due to the scarcity of domestic and external financing, which has led to a notable reduction in capital spending. While subsidy reforms are delayed, the fiscal deficit projections also consider planned Aasandha reforms supported by the bulk procurement of medicines that are likely to decrease health spending. Assuming a timely implementation of the government's fiscal reform package, including a meaningful spending reduction, the fiscal deficit is expected to narrow from 12.7 percent of GDP in 2023 to 6.1 percent of GDP in 2026. As a result, public debt is projected to decline marginally from 122.8 percent of GDP in 2023 to 111.4 percent of GDP in 2026 (Table A.1).

Figure A.20: Real GDP growth will moderate over the medium term.
Year-on-year growth, percent



Source: Ministry of Finance and World Bank projections.

Figure A.21: Fiscal deficit is projected to narrow, with the pace depending on reform implementation
Percent of GDP



Source: Ministry of Finance and World Bank projections

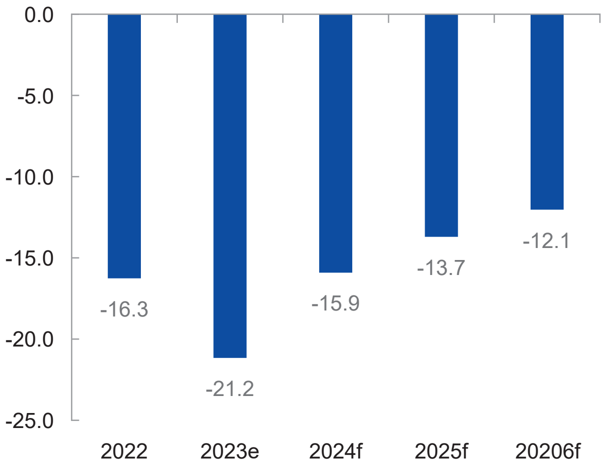
The CAD is expected to narrow over the medium term

The narrowing of the CAD from 21.2 percent of GDP in 2023 to 12.1 percent of GDP in 2026 (Table A.1) is expected to be supported by robust growth in service exports and slower growth in imports – as capital goods imports slow primarily due to the anticipated PSIP reforms (Figure A.22). High external financing needs – including significant debt servicing requirements – are expected to sustain pressure on the balance of payments and official reserves.

External debt repayment needs are expected to increase significantly

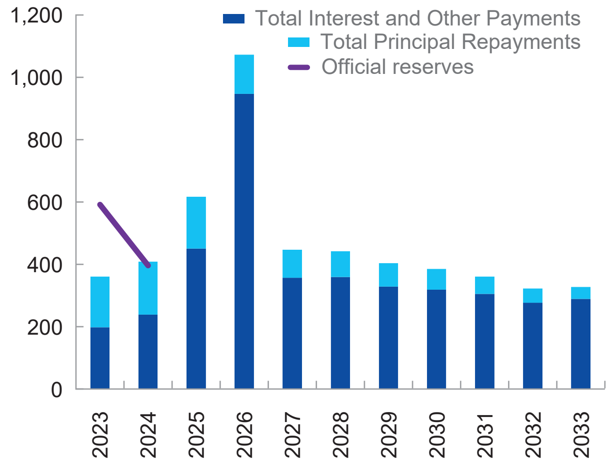
Annual average debt servicing needs are projected at US$615.6 million in 2025, followed by a spike to US$1.07 billion in 2026 (Figure A.23). This includes bullet payments for the US$500 million Sukuk and US$100 million private bond placement. Despite the government's aim to refinance US$ 500 million in 2026, this may not be possible given current market conditions. The country's ability to repay or roll over its external debt will primarily depend on building investor confidence through the implementation of a multi-year fiscal reform program, better global financing conditions, and the availability of credit enhancement measures for liquidity management or debt for nature deals.

Figure A.22: Current account deficit is expected to narrow primarily due to anticipated PSIP reforms…
Percent of GDP



Source: MMA and World Bank estimates.

Figure A.23: …but increasing external debt servicing needs will continue to exert pressures on reserves
External debt service projections for PPG debt, US$ million



Source: MoF, MMA and World Bank calculations.
Note: Data as of April 2024, do not include debt service costs of pipeline loans – neither non-concessional nor commercial. Thus, debt servicing costs of the outer years may be underestimated.

8. Risks to the outlook are heavily on the downside

Implementing reforms is key to avoiding a major economic shock

External and fiscal vulnerabilities, along with increased debt service needs, pose major downside risks to the economic outlook. Failure to implement planned fiscal reforms, while obtaining new external debt at expensive terms, could lead to a fiscal or debt sustainability shock, as the country is already at a high level of debt distress.

Maldives has very limited external buffers to meet financing needs

Despite government efforts to transfer a portion of revenues to the Sovereign Development Fund (SDF), which was designed to pay off some of the maturing debt in 2026, the fund's available balance of US$65 million (as of end-August 2024)[20] remains small in comparison to medium-term external debt servicing needs. Given the limited level of reserves and external debt service needs, the SDF is likely to remain under significant pressure to meet short-term debt repayment obligations.

Downside risks to the global economic outlook post further challenges

The global economic outlook is dimmed by slower growth, a risk of high commodity prices, and ongoing geopolitical conflicts. Major economies such as China are projected to experience an extended economic slowdown, with risks tilted towards the downside. These global uncertainties, as well as any additional global shocks, pose risks to Maldives' economic outlook, especially where there is a slowdown in countries that are key markets for tourists, such as China and Europe. Stronger tourism performance would provide some upside.

A multi-year fiscal reform program with a strong fiscal adjustment path is urgently required.

The PPG debt to GDP is forecast to remain at over 118 percent (Table A.1). Such high levels of public debt, and associated refinancing risks, make the Maldivian economy vulnerable to domestic and external shocks. Low external and fiscal buffers, mean that fiscal adjustment is required to mitigate debt sustainability risks. Thus, despite somewhat robust growth prospects, prudent debt management remains a top priority to improve fiscal sustainability, lower the cost of growth-enhancing investments – especially with large debt service obligations coming due (Figure A.23) – and ensure a more resilient economy going forward.

[20] https://en.sun.mv/88684.

9. Implementing reforms, with a sharp fiscal adjustment, remains an urgent priority

A multi-year fiscal reform program with a strong fiscal adjustment path is critical, and urgently required

Reducing fiscal and external imbalances is critical to restoring fiscal and debt sustainability and managing liquidity risks. This entails the immediate implementation of the homegrown fiscal reform agenda, announced in February 2024, including: (i) phasing out existing blanket subsidies and replacing them with a targeted cash transfer scheme;[21] (ii) improving health spending efficiency by changing the coverage policy of health services and implementing measures to reduce drug costs (such as bulk procurement of medicines);[22] and (iii) prioritizing the PSIP envelope and rationalizing capital expenditure. Importantly, the reform plan needs to be accompanied by an effective mechanism to offset welfare losses among vulnerable groups, and timely and candid communication to the public. Any further delay in fiscal reforms could lead to further erosion in investor confidence and an unprecedented economic shock.

Diversification of the economy remains a long-term objective

Maldives' heavy dependence on tourism leaves the country vulnerable to external shocks, emphasizing the need for economic diversification. The government has launched recent initiatives to support diversification including establishing the Development Bank of Maldives. New tourism products, such as environmentally friendly eco-tourism options, better infrastructure, enhanced connectivity, and favorable rents for resort developments, could further enhance tourism in the Northern and Southern Atolls and support diversification within the tourism sector. Diversification beyond tourism could be supported by improved digital connectivity including an upcoming new submarine cable, and gradually reducing the government's heavy presence in the non-tourism economy through SOEs. At a sectoral level, the fisheries sector be supported by the expansion of fish processing and cold storage facilities, focusing on new export markets, and reducing the state's footprint in the sector to remove market distortions. However, any additional infrastructure investments to support diversification must be well-sequenced and consider affordability given the country's current debt vulnerabilities.

[21] According to the approved budget, this is expected to result in expenditure savings of around MVR1.5 billion or around 1.3 percent of projected GDP in 2024. To mitigate the negative welfare impacts of subsidy reforms on vulnerable groups, the government plans to provide direct cash transfers that correspond to around half of subsidy-related savings.
[22] The bulk procurement measures will lead to an estimated 0.3 percent of GDP spending reduction in 2024.

B. Policy priorities to address climate and development challenges[23]

1. Maldives faces intertwined development and climate change challenges

Resilient and green development requires a synchronized policy response.

Maldives needs to address its climate change and development challenges and opportunities in an integrated manner (see Figure B.1). The presence of a heavy public debt burden, coupled with large fiscal and external vulnerabilities, leaves little room to finance much-needed investments in climate resilience in the short to medium-term (see Section A1). Therefore, a synchronized and well-coordinated policy response is required to tackle climate change, development, and current macroeconomic challenges.

A climate-resilient development path is the most sustainable trajectory for the nation's economic and social development.

Maldives has begun to focus on resilience and seize the opportunities of a blue and green economy. However, much more needs to be done to preserve the natural capital on which its economy is based and to unlock additional areas for green, resilient, and inclusive growth. Green transitions in the energy, mobility, waste, and housing sectors can build resilience, reduce harmful climate and environmental impacts, and save fiscal space in the longer term. Clean ocean water and waste management are key for tourism, fisheries, and people. Maintaining environmental sustainability and establishing appropriate links to value chains will be critical in developing high-value products supplied to the local tourism industry or niche international markets.

The government has established a comprehensive policy framework to address climate change, but implementation is not sufficiently effective.

The lack of a detailed National Adaptation Plan (NAP) and weaknesses in project planning, preparation, and selection exacerbate effective public investments in climate adaptation. The 2020 Nationally Determined Contribution (NDC) targets a 26 percent reduction in emissions by 2030, with aspirations for net zero emissions, contingent on international support. However, policy implementation is hampered by coordination challenges among institutions with partly overlapping mandates and disjointed activities. Local island councils also struggle to manage climate impacts and disaster response, and central agencies face challenges in monitoring and forecasting.

[23] The analysis in this section is based on and summarizes key insights from World Bank. 2024a.

Figure B.1: Conceptual framework for climate change and development in Maldives

2. Climate change impacts in Maldives

Tourism and fisheries, both reliant on the country's natural capital, have been instrumental in Maldives' economic transition.

Combined, these two sectors contribute to about half of the value-added to GDP and jobs. The tourism sector alone accounts, directly, for almost 30 percent of GDP, more than 60 percent of foreign exchange receipts, and almost 50 percent of public revenues.[24] Fisheries contributes around 4.5 percent of nominal GDP and 50 percent of merchandise exports; it provides direct or indirect income to more than 20 percent of the population.[25] The tourism sector, drawing visitors for its pristine beaches and vibrant marine life, reports that 80 percent of tourists are attracted by the beaches and over 60 percent by underwater activities.[26] This demonstrates the importance of coral reef health, upon which 3 in 10 fish species depend. The fisheries sector's profitability, particularly in tuna fisheries, also hinges on the health of coral reefs and marine ecosystems. However, economic and tourism growth has not always been sustainable, and the foundational natural capital basis is under threat from climate change impacts.

Sea-level rise (SLR) and related flooding is the main climate hazard facing Maldives.

At least 80 percent of the landmass lies less than 1 m above mean sea level, and over 40 percent of the population resides within 100 m of the coastline.[27] Between 1992 and 2015, annual SLR averaged just under 4 mm. However, projections carried out by the World Bank Group's Country Climate and Development Report (CCDR)[28] suggest the rate could increase to between 6 and 12 mm per year, under severe warming scenarios, potentially leading to a rise of anywhere from 0.5 to 0.9 m by

[24] World Bank 2023.
[25] World Bank 2020.
[26] World Bank 2024b.
[27] ibid.
[28] World Bank 2024a.

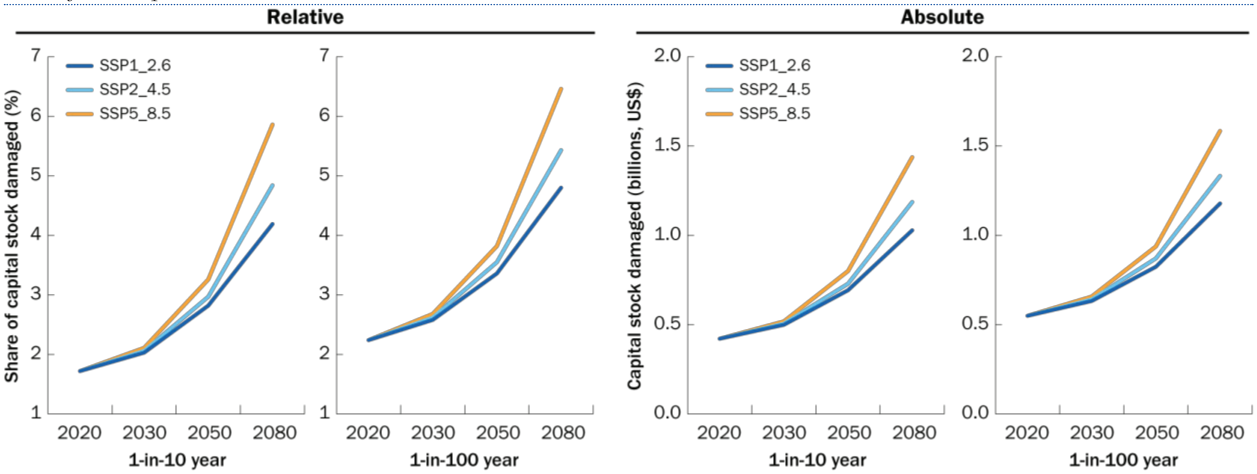
2100. Without adaptation, coastal flooding could damage up to 3.3 percent of total assets by 2050 during typical 10-year floods. For rare, more intense events, damage to natural assets could reach up to 3.8 percent (for century-level floods) and 4.4 percent (for millennium-level floods).

Without any adaptation to SLR, more valuable land and productive capital will be exposed to coastal flooding.

Depending on the climate scenarios,[29] in 2050, coastal flooding can result in damages of up to 2.8–3.3 percent of the total asset stock in a 1-in-10-year event, 3.4–3.8 percent in a 1-in-100-year event (see Figure B.2), and 3.9–4.4 percent in a 1-in-1000-year event (not shown). These damages are equivalent to US$0.7–1.1 billion or between 11.3 and 17.7 percent of GDP. Toward 2080, the damage rises as high as US$1.6 billion even under a 1-in-100-year event.

Figure B.2: Capital stock damaged from coastal flooding in relative and absolute terms under different climate change scenarios

Share of total capital stock and US$ terms



Source: World Bank 2024d.

Future natural adaptation potential of islands to SLR remains uncertain.

Maldivian islands have adapted to SLR naturally in the past, but the impacts of climate change make their future natural adaptation potential highly uncertain. The physical foundation of atoll islands largely comes from the sand produced by marine ecosystems. This has historically enabled them to adapt to SLR. Despite SLR of 3–4 mm per year in recent decades, only 3 percent of the islands experienced net land loss from 2004 to 2016, while 59 percent saw increases in land area and 38 percent remained stable, owing to natural accretion and strategic land reclamation. However, the degradation of coral reefs compromises the islands' ability to sustain this vital sand production. More than economic loss, this represents a substantial reduction in the ecosystem services that coral reefs provide. The flood protection service of coral reefs alone is valued at US$442 million or 8 percent of GDP per year.

[29] The analysis in this section considers three climate scenarios: a low greenhouse gas (GHG) emissions scenario (Shared Socioeconomic Pathway [SSP]1–2.6), a medium GHG emissions scenario (SSP2-4.5), and a high GHG emissions scenario (SSP5–8.5).

[30] This is without accounting for the expected socioeconomic growth over the decades to come, which might further increase the amount of capital and assets located in areas at risk of coastal flooding. For instance, according to NBS, the population growth is projected to reach almost 1 million by 2054, further increasing the capital stock required to serve these residents.

SLR would have a significant impact on the output…

The macroeconomic modeling exercise[31] assesses the impact of SLR on economic growth, and the debt trajectory for various scenarios with different assumptions about fiscal consolidation, reconstruction investments, and adaptation investments[32] with different protection levels. Two response scenarios were modeled to assess the impact of SLR on economic growth: (1) no fiscal consolidation, slow reconstruction,[33] and no adaptation, and (2) fiscal consolidation, fast reconstruction, and adaptation (assumed to be 50 percent financed through public debt financing between 2027 and 2039 and 50 percent financed by the private sector through higher-cost private capital). Under the second scenario, three different degrees of adaptation effectiveness (assuming 25, 50, and 75 percent damage reduction) were modeled. It estimates SLR impacts on GDP under three different emission scenarios and finds that the median impact is an 11.3 percent reduction by 2050 under the high emission scenario, 10.7 percent under the medium emission scenario, and 10.2 percent under the low emission scenario.

…however, the impact can be reduced with sustained reconstruction and adaptation investments.

GDP impacts can be significantly reduced with context-informed and fast reconstruction and adaptation action. For instance, under the worst-case emission scenario, GDP impacts can be reduced from about 11 percentage points to about 5 percentage points by 2050. Under the first response scenario (no fiscal consolidation, slow reconstruction, and no adaptation), there is a significant adverse impact on GDP with an approximate 11 percentage point reduction from the baseline by 2050 under the high emission case. However, under the second scenario with fiscal consolidation, fast and context-aware reconstruction taking effect just one year after SLR-induced flooding, and adaptation investments, the GDP decline is reduced to about 9 percentage points, assuming a protection level of 25 percent. Under the scenarios of adaptation investments with higher adaptation effectiveness (50 percent or 75 percent), investments are estimated to further cushion the negative impact to less than 7 percentage points or 5 percentage points of GDP reduction from the baseline by 2050, effectively reversing compounding negative impacts over time.[34] However, failure to implement planned fiscal reforms could lead to a potential macro-financial crisis and therefore adversely affect the country's growth and debt profile, causing delays in required asset reconstruction and climate adaptation investments (see Figure B.3).

Fiscal consolidation helps lower the debt ratio and creates necessary fiscal space for reconstruction and adaptation

The same two response scenarios were modeled to assess the impact of SLR on the debt-to-GDP ratio (see Figure B.4). Under the first scenario, GDP losses accrue under climate change, and consequently, debt as a share of GDP rises sharply. The debt-to-GDP ratio becomes almost 10 percentage points higher than the baseline by 2050. In contrast, the debt-to-GDP ratio declines substantially in the initial stage in the second scenario by more than 16 percentage points from the baseline due to a fast fiscal consolidation in three years, which provides resources to protect against future climate events. Though the debt ratio bounces back due to the partially publicly

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[31] See World Bank. 2024a.

[32] The assumptions are (a) an adaptation cost of US$2.61 billion (constant 2022 dollars) based on the midpoint estimate of the most comprehensive investment scenario; (b) the adaptation cost uniformly distributed across 13 years from 2027 to 2039; and (c) adaptation benefits start to materialize three years after the cost starts incurring and are fully realized by 2042.

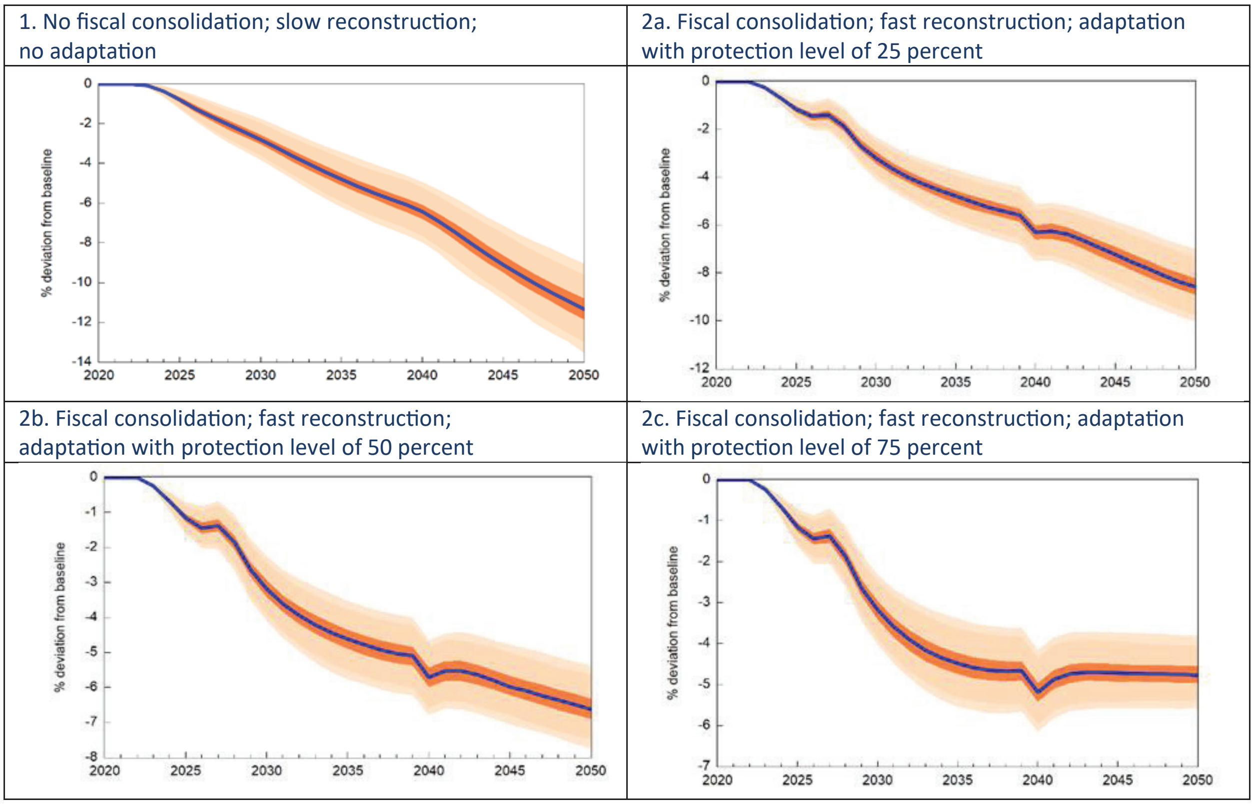
[33] Reconstruction refers to repairing damaged capital stock. The assumption is that shocks destroy capital with average productivity. Therefore, reconstruction brings higher returns (average) than other productive investments (marginal). Thus, it is assumed that reconstruction is prioritized and financed. The cost of reconstruction crowds out productive public investment. Relocation aspects are not considered due to a lack of granular data.

[34] GDP reaction is sensitive to adaptation investment intervention. Despite a general downward trend over the time horizon until 2050, GDP bounces back slightly when the adaptation investment kicks in around 2027, while accelerating to decline when the investment phases out around 2039. However, the response is temporary and returns to the trend quickly.

investments in the long term.

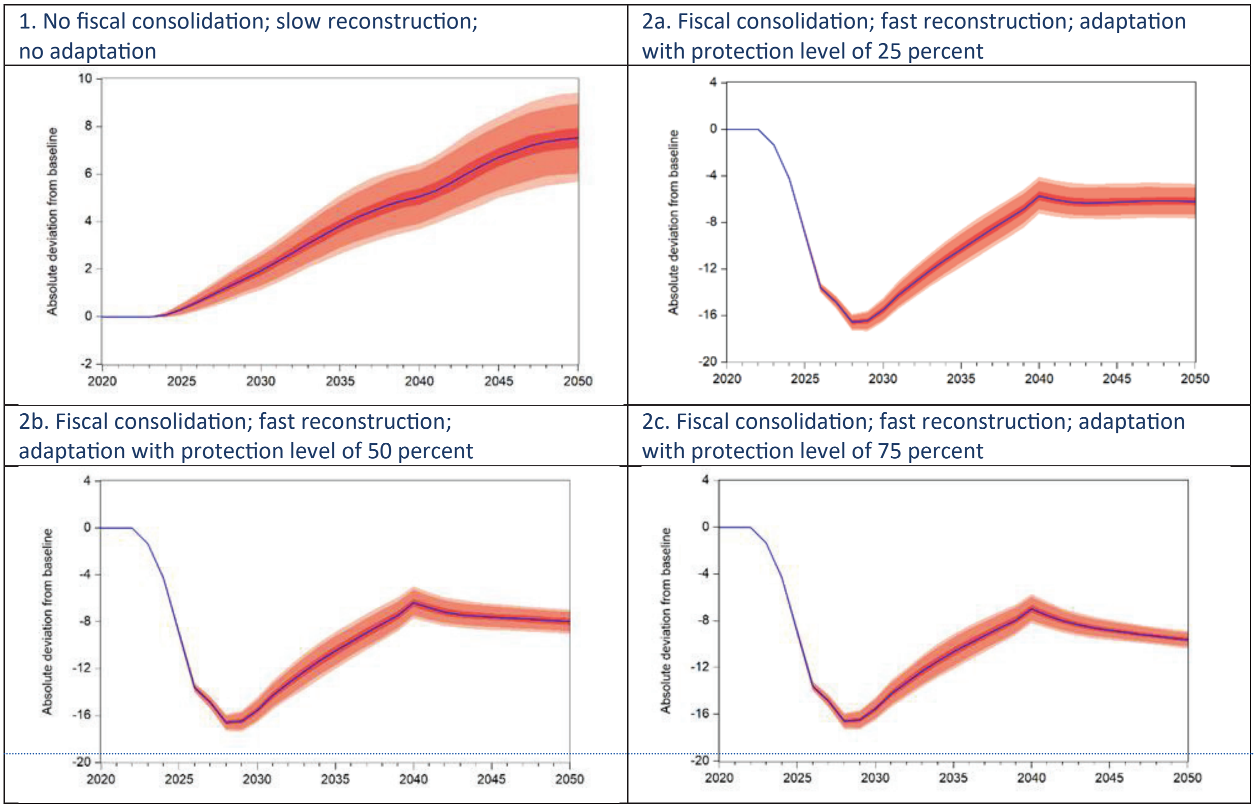
financed adaptation investments until 2040, it declines by more than 8 percent (protection level at 75 percent) and about 6 percent (protection level at 25 percent) from the baseline over a longer term until 2050. Overall, the debt ratio under a fiscal consolidation scenario stays on a downward path and is much lower compared to the scenario without a fiscal consolidation.[35]

Figure B.3: GDP impact from SLR under the high-emission scenario



[35] An important limitation of the modeling results is that only impacts from SLR are assessed while other hazards such as ocean temperature rise are not accounted for – the macroeconomic impact of all climate change threats combined would thus be significantly larger.

Figure B.4: Debt/GDP impact from SLR under the high-emission scenario



Almost all coral cover among reefs could be lost if global tem-per-atures exceed 2°C.

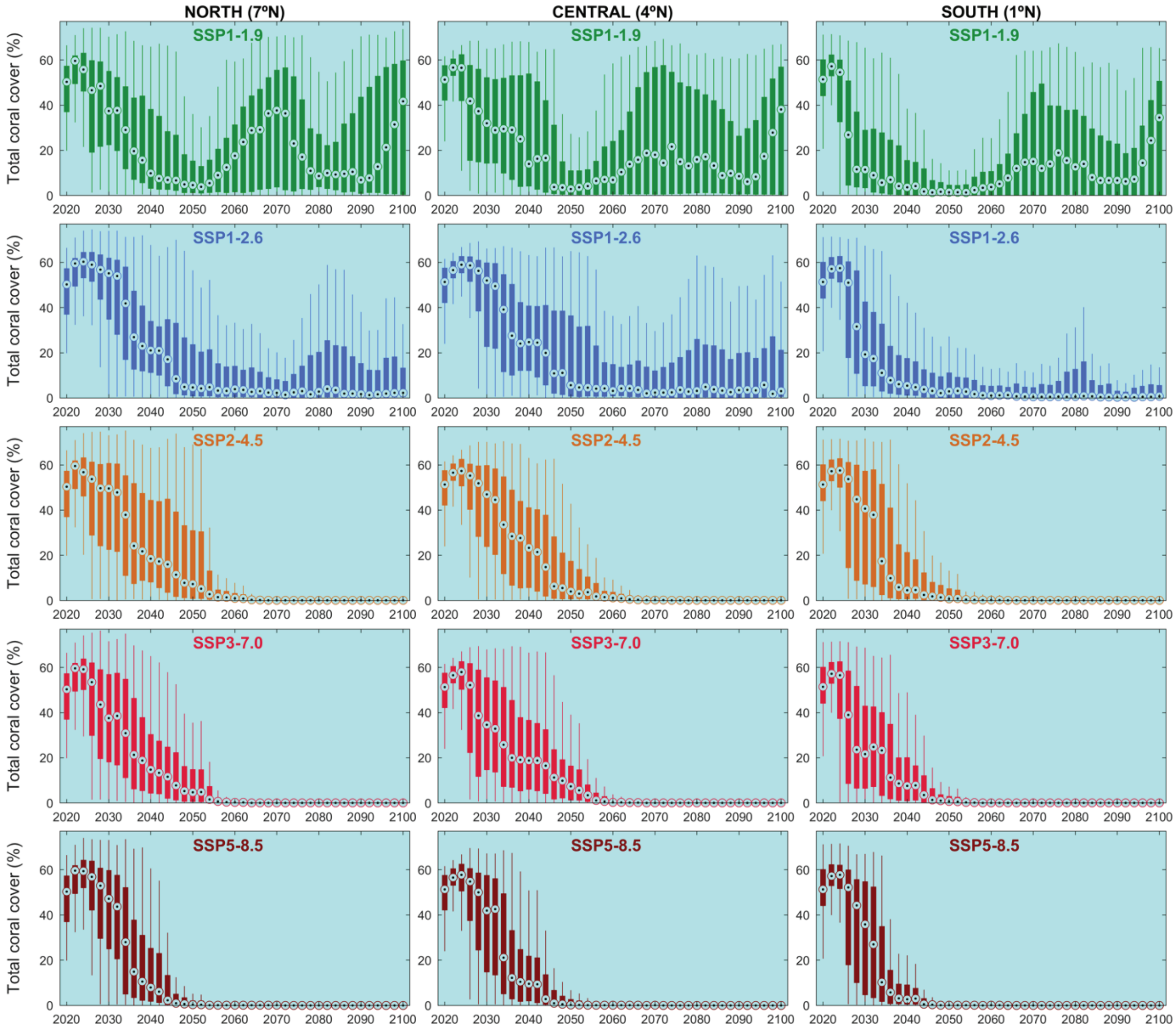
Ocean warming – resulting in coral bleaching events – is a major climate concern. Past ocean heating events in Maldives led to significant coral mortality. The severe 1998 coral bleaching event, for instance, resulted in a reduction of coral coverage from more than 70 percent to less than 10 percent. Fortunately, corals recovered to nearly pre-shock levels, until the next bleaching event occurred in 2016. Coral bleaching is cyclical, and corals can recover if they have the necessary time. However, climate change shortens the duration between ocean heatwaves and intensifies them. It is estimated that almost all coral cover among reefs could be lost if global temperatures exceed 2°C (see Figure B.5).[36] Even under a low-emission scenario, heatwave intensity will increase two to five times. Despite significant impacts, under the low-emission scenario, reefs would retain substantial coral cover.

Severe climate-in-duced impacts are expected to begin by 2050.

Projections of the climate change impacts on coral reefs, fish stocks, land, and infrastructure, all indicate that up until mid-century the negative impacts are expected to be incremental only.[37] However, by around 2050, negative impacts are expected to escalate quickly, especially under the medium to high-emission scenarios. Ocean heating, for instance, could cause an almost entire collapse of coral reefs and fish stocks. It is critical to use the decades leading up to these projected impacts to plan and build adaptative capacity for high-impact scenarios and, with the support of the international community, prevent them to the extent possible.

[36] See World Bank 2024a.
[37] ibid.

Figure B.5: Development of the distribution of coral cover among reefs till 2100 under different climate scenarios



Source: World Bank 2024a.
Note: Distribution of predicted values of total coral cover captured every two years with all geophysical coral reef mappings combined for the 'North' (left), 'Central' (middle) and 'South' regions of Maldives (right) for a model with no crown-of-thorns starfish outbreaks. For every selected year, Number (reefs) = 120 values for SSP1-1.9 and Number (reefs) = 200 values for all the other scenarios of carbon emission. The boxes show the interquartile range which visualizes the spread of reef states between the 25th and 75th percentile. From each box, whiskers are drawn up and down to 1 time the interquartile range, which covers around 85–90 percent of reef states. The central mark indicates the median.

3. Toward Climate-Resilient Islands, Infrastructure, and Ecosystems

Tourism and fisheries, both reliant on the country's natural capital, have been instrumental in Maldives' economic transition.

Given the heterogeneity of Maldivian islands, climate adaptation options must be carefully planned and tailored to the needs of each island. Specific island typology and four archetypical Dynamic Adaptive Policy Pathways (DAPPs) have been developed to guide island-level SLR adaptation strategies.[38] These generic pathways offer a starting point for developing more detailed adaptation strategies for individual islands and recommend solutions for various situations and points in time. There are five broad categories of adaptation options for making atoll islands more climate resilient,

[38] ibid.

including: (a) protection infrastructure (using hard/gray measures to reduce SLR and flooding); (b) accommodation measures (building resiliently, such as on stilts or floating); (c) nature-based solutions (NbS), using natural practices such as restoring coral reefs or planting mangroves for flood protection; (d) island raising and land reclamation; and (e) relocation and migration. Underpinning these adaptation options are climate, disaster, environmental monitoring and modeling, and early warning systems (EWSs) – all serving as crucial tools to facilitate effective implementation.

Current gray solutions can provide tangible coastal protection, but side effects need to be assessed and mitigated.

Currently, the most prevalent coastal adaptation measures in Maldives are land reclamation and hard/gray coastal protection infrastructure. While gray-engineered measures currently dominate adaptation efforts on both inhabited islands and resort islands, several resort islands have experimented with NbS. Gray infrastructure can have tangible coastal protection benefits in some cases but also detriments in other cases. This highlights the complexity of coastal protection in the face of economic imperatives such as tourism and the urgent need for a nuanced approach combining engineered and nature-based measures.

Island raising and reclamation can address risks from SLR but can also exacerbate vulnerabilities.

Hulhumalé, for instance, was designed and developed with future SLR in mind and features extensive island augmentation. The land was raised to approximately 1.8 m above mean sea level to reduce flood risks. However, land reclamation often affects lagoons and coral reefs, which are instrumental in natural island formation and growth, by disrupting natural sediment transport processes. The removal and redistribution of sand and sediment can also damage coral structures that protect against coastal erosion and flooding.

Safeguarding coral reefs is a priority.

Coral reefs provide important ecosystem services. They are an important attraction for tourists and a habitat for a range of flora and fauna underpinning the fishery industry. In addition, they prevent damage from storm surges and ensure the country's existence in the face of SLR. Coral sands represent 90 percent of the sediments of the islands whose continued supply supports the natural adapta-tion of the islands to SLR. Coral reefs prevent annual flood damage amounting to about 8 percent of GDP. Simulations of coral cover under different climate scenarios show that coral reefs are expected to be severely affected by ocean heating.[39]

4. Toward Climate-Resilient Livelihoods

The tourism sector urgently requires a d-aptation actions.

The tourism sector urgently requires accelerated climate adaptation efforts across its resort islands and guesthouses. A survey conducted across 55 resorts indicates that over 90 percent are grappling with moderate to severe beach erosion, while around 60 percent report considerable infrastructure damage due to climate-related events.[40] To enhance the climate resilience of the tourism sector, the regulatory framework needs to be strengthened to ensure that new resorts and guesthouses are being developed using climate-resilient and green infrastructure, among other measures.

Severe climate change impacts are anticipated in the fisheries sector.

Climate change is also anticipated to have a severe impact on the fisheries sector. The analysis projects a dramatic decrease of almost 100 percent in fish catch potential by the end of the twenty-first century under a high-emission scenario.[41] If no adaptation action is taken, such impacts could translate to almost 100 percent revenue reduction from fisheries (Figure B.6). In response, alternative livelihood opportunities for fishers

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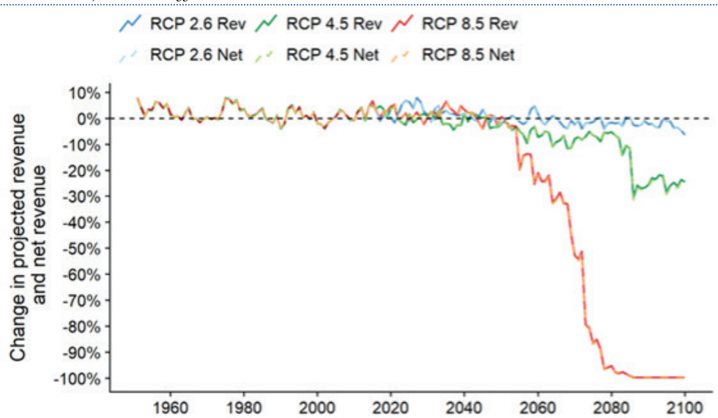
39 ibid.
40 ibid.
41 ibid.

need to be assessed – such as diversification of deep-sea fisheries and mariculture development – and further research needs to be conducted on climate change impacts on pelagic and reef fish migration to inform fisheries planning.

Figure B.6: Projected percentage change in fisheries – pelagic and reef-associated – revenue and net revenue
Relative to the base period (1990–2010) under different climate scenarios



Source: World Bank. 2024c.
Note: Solid lines indicate revenue, and dashed lines are net revenue (revenue − fishing cost).

Social protection and skills development are critical for resilient and sustainable growth.

Enhancing social protection and skills development is crucial for building the resilience of people and communities. Poor and vulnerable households in Maldives report higher incidences of floods and droughts. Remote atolls face increased risks of coastal flooding and extreme sea levels and have more difficulty accessing post-disaster support. There is a foundation for a responsive social protection delivery system, but it requires improved digital infrastructure, data, and institutional strengthening. Existing social protection programs need to be more adaptive, scalable, and targeted to reach the poorest households. Skill development and unemployment insurance could help mitigate risks from green transition policies, which must be designed carefully, as they could also further add strain to public finance. A robust social protection system, digitization, and smart policy design can shield the poor from the impacts of decarbonization reforms, such as energy subsidy removal.

5. Climate finance

Adaptation to SLR and flooding requires a significant amount of financing.

The financing requirements for Maldives' climate change adaptation to SLR and flooding alone range between US$2 billion and US$4 billion. This estimate is based on selecting bespoke coastal protection solutions to cater to the physical characteristics of each island (which contrasts with previous estimates based on the costliest measures). It does not include other adaptation costs such as those related to ocean warming, which will significantly threaten tourism and fisheries. Similarly, it also does not include the financing gap for mitigation (i.e., renewable energy investments), which has been estimated at US$1 billion through 2030.[42]

[42] Potomac Group 2023.

Addressing macroeconomic vulnerabilities will be essential for financing climate action.

Restoring fiscal space, building external buffers, and ensuring macroeconomic stability will be a prerequisite to mobilizing the required financing for climate action. As discussed, major policy reforms are urgently needed, including significant expenditure adjustments via reforms in subsidies, the health sector, public investment, asset and debt management, and state-owned enterprises (SOEs) and private sector support (see Section A1). Revenue-side measures such as the Green Tax, Airport Development Fees and Departure Tax could be further increased to finance urgently needed climate action.[43] In addition, structural reforms are needed for a more diversified and resilient economy over the longer term.

A green transition in the energy sector can help restore fiscal space and reap other development benefits.

The country is heavily dependent on imported diesel fuel for electricity production which accounts for over 90 percent of its energy needs. The fuel import bill was US$507 million (8 percent of GDP) for the public sector alone in 2022, with US$61 million paid in subsidies. The potential fiscal and foreign exchange savings from switching to cheaper solar energy could help facilitate investments in climate resilience and other development objectives over the medium to long term.[44] In addition, creating its own energy would reduce vulnerability to global energy shocks and create quality jobs for the local population.

The financing requirements cannot be met by domestic public finance alone.

A variety of external financing sources should be explored. Grants and concessional financing totaling around US$500 million have contributed to financing climate projects in the past. For adaptation investments that are not commercially viable, grants will continue to be crucial but will not be sufficient to fill the significant financing requirement. New sources of concessional funds may be tapped, which could be facilitated by establishing dedicated conservation and climate adaptation trust funds. Related to this, the government could consider other debt-neutral instruments such as debt-for-nature swaps or donor outcome-based bond structures. The country can also tap into carbon markets, including for blue carbon projects, and develop climate-related risk management financial products such as insurance and instruments for disaster risk financing.

The private sector will have to play an important role.

Maldives needs an updated public investment management (PIM) framework and could expand public-private partnerships (PPPs) to mobilize green finance. Once the existing fiscal and external vulnerabilities are addressed and the appropriate regulatory frameworks are in place, more projects can be bid out to the private sector. The small project size and lack of capacity might require the use of de-risking instruments to attract more private capital and foreign direct investment (FDI) to meet climate adaptation and mitigation financing needs. A fiscal com-mitments and contingent liabilities framework for PPP projects can help manage the associated fiscal risks and enhance coordination between institutions.

6. Recommendations

Six High-Level Objectives and related Key Recommendations

Table B.1 provides a snapshot of the Key Recommendations with those considered urgent marked with a ★ symbol.[45] The High-Level Objectives include improving macroeconomic stability and fiscal space to finance climate action, mobilizing climate finance, enhancing the climate resilience of islands, infrastructure, ecosystems, livelihoods, and unlocking the development benefits from green transitions in the

[43] From the Medium-Term Revenue Strategy 2004-2008 by Ministry of Finance. The authorities have decided to raise the mentioned rates by January 2025.

[44] This considers the costs of importing, constructing, and maintaining the materials and machinery for renewable energy.

[45] The Key Recommendations are further elaborated (including the time frame for implementation, synergies and trade-offs with other development objectives, implementation barriers, and progress indicators) in Chapter 8 of World Bank 2024a.

are vital to building climate resilience. energy, mobility, and waste sectors with an aim to develop a path to address climate and development challenges in an orderly manner.

Table B.1: High-level objectives and a snapshot of key recommendations

High-Level Objective 1: Improve macroeconomic stability and fiscal space to finance climate action	
✓	**(1.1) Reduce expenditure related to subsidies, infrastructure, expensive health care options, and SOEs to return public spending to sustainable levels; address fiscal vulnerabilities; create space for climate-related spending over the medium term; and increase private sector participation.**
✓	**(1.2) Implement revenue mobilization measures including tax reforms such as raising the Green Tax and dedicating proceeds to environmental- and climate-resilient interventions.**
✓	**(1.3) Limit the lending from the banking sector to public sector to allocate more resources to the private sector for climate adaptation investments and enhance banking regulation and supervision to ensure financial stability.**
High-Level Objective 2: Mobilize climate finance	
✓	**(2.1) Operationalize the Climate Finance Hub and develop a climate investment plan with bankable projects.**
✓	**(2.2) Set up a conservation and climate adaptation trust fund with appropriate governance structures to help attract additional concessional finance for climate adaptation and environmental protection.**
✓	**(2.3) Develop a national carbon market strategy and infrastructure and promote the development of robust carbon crediting systems to tap into finance from voluntary and compliance markets.**
✓	**(2.4) Introduce climate budget tagging to improve climate-related spending and decision-making and facilitate the engagement with green investors.**
High-Level Objective 3: Enhance the climate resilience of islands and infrastructure	
✓	**(3.1) Develop an NAP and related island/regional development plans that explicitly integrate SLR, flooding, and ocean heating scenarios to guide future spatial and development planning.**
✓	**(3.2) Develop guidelines for island raising and land reclamation to optimize their use and, when used, increase the resilience and sustainability of newly developed land and limit negative environmental impacts.**
✓	**(3.3) Systematically study the feasibility and unintended side effects of hard/gray protection infrastructure and preserve natural island processes to avoid maladaptation and lock-in effects.**
✓	**(3.4) Update building codes and practices to increase the resilience and sustainability of infrastructure.**
✓	**(3.5) Further assess the feasibility and effectiveness of NbS to support their scale-up.**
High-Level Objective 4: Enhance the climate resilience of islands and infrastructure	
✓	**(4.1) Develop a coral management and funding plan with a time horizon until 2050 to scale up coral reef restoration, including exploring emerging restoration technologies.**
✓	**(4.2) Improve waste management and coastal infrastructure development to reduce local stressors on coral reefs.**

✓	**(4.3) Systematically develop and implement marine protected areas (MPAs) to conserve high-biodiversity marine and coastal ecosystems.**
✓	**(4.4) Establish a coral reef management decision support system to guide the targeting of conservation and restoration interventions.**
High-Level Objective 5: Enhance the climate resilience of livelihoods (fisheries and tourism)	
✓	**(5.1) Research pelagic and reef fish migration and impacts under different climate scenarios to inform fisheries planning.**
✓	**(5.2) Assess alternative livelihood opportunities for fishers such as diversification of deep-sea fisheries and mariculture development to improve the resilience of fishing communities.**
✓	**(5.3) Strengthen the regulatory framework to ensure that new resorts and guesthouses are being developed using climate-resilient and green infrastructure, existing resorts and guesthouses receive advice on and support for upgrades/retrofits, and minor repair and climate resilience upgrade works can proceed without lengthy approval processes.**
High-Level Objective 6: Enhance the climate resilience of livelihoods (fisheries and tourism)	
✓	**(6.1) Phase out fossil fuel subsidies and reduce public expenditure while mitigating the impacts on poor and vulnerable households.**
✓	**(6.2) Promote risk-sharing frameworks and increased private sector participation and PPPs to increase renewable energy adoption and improve waste management.**
✓	**(6.3) Introduce a renewable energy mandate for resorts to increase the share of renewable energy.**
✓	**(6.4) Develop a strategy and action plan to promote green mobility, including non-motorized transport, e-scooters, e-buses, e-ferries, and charging infrastructure.**

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Annex 1: Balance of Payments (percent of GDP)

	2020	2021	2022	2023e
Current Account Balance	**-35.8**	**-8.6**	**-16.3**	**-21.2**
Balance on Goods and Services	**-17.9**	**9.6**	**3.2**	**-1.3**
Merchandise Trade Balance	**-39.1**	**-40.1**	**-47.3**	**-43.3**
Merchandise Exports	**7.0**	**5.4**	**6.5**	**6.6**
o/w fish exports	*4.2*	*2.7*	*2.4*	*2.3*
o/w re-exports	*3.3*	*2.6*	*3.9*	*3.9*
Merchandise Imports	**46.1**	**45.5**	**53.8**	**49.9**
o/w fuel	*7.1*	*8.6*	*13.5*	*11.4*
o/w capital and construction goods	*15.1*	*14.2*	*17.9*	*17.4*
Services Trade Balance	**21.3**	**49.7**	**50.5**	**42.1**
Service Exports	**41.3**	**70.5**	**76.2**	**67.5**
o/w travel services (tourism)	*37.7*	*66.8*	*73.0*	*64.0*
Service Exports	**20.0**	**20.8**	**25.7**	**25.4**
Primary Income, net	**-8.3**	**-10.2**	**-11.5**	**-11.7**
Secondary Income, net	**-9.7**	**-8.0**	**-7.9**	**-8.3**
o/w worker remittance outflows	*10.7*	*9.4*	*9.2*	*8.9*
Capital Account Balance	**0.0**	**0.0**	**0.0**	**0.0**
Net borrowing (balance from current and capital a/c)	**-35.8**	**-8.6**	**-16.3**	**-21.2**
Financial Account Balance (excluding reserves and related items)	**34.7**	**11.4**	**13.7**	**16.1**
Direct Investment, net	**11.9**	**12.2**	**11.9**	**11.5**
Portfolio Investment, net	**-1.3**	**5.4**	**-1.3**	**-0.3**
o/w general government debt issuance	*0.0*	*-5.9*	*0.9*	*0.0*
Other Investment, net	**24.1**	**-6.2**	**3.2**	**4.8**
Net Errors and Omissions	**6.6**	**-6.2**	**3.0**	**1.6**
OVERALL BALANCE	**5.5**	**-3.4**	**0.4**	**-3.6**
FINANCING				
Official Reserves (- increase)	**-5.5**	**3.4**	**-0.4**	**3.6**

Annex 2: Key Fiscal Indicators (percent of GDP)

	2020	2021	2022	2023e
Total Revenue and Grants	**26.7**	**26.4**	**30.6**	**33.5**
Total Revenue	**25.0**	**25.2**	**29.5**	**32.5**
Tax Revenue	**19.2**	**18.2**	**20.6**	**23.7**
o/w Import Duties	*4.0*	*3.5*	*3.7*	*3.4*
o/w Business and Property Tax	*6.4*	*3.4*	*4.5*	*5.1*
o/w Tourism Goods and Services Tax	*3.9*	*6.5*	*6.9*	*8.6*
o/w General Goods and Services Tax	*3.7*	*3.1*	*3.4*	*4.4*
o/w Airport Service Charges	*0.5*	*0.6*	*0.9*	*1.0*
o/w Green Tax	*0.6*	*1.0*	*1.0*	*1.0*
Non-Tax Revenues	**5.8**	**6.9**	**8.7**	**8.9**
o/w Airport Development Fees	*0.5*	*0.6*	*0.8*	*1.0*
o/w Property Income	*1.4*	*2.8*	*2.3*	*1.9*
Grants	**1.7**	**1.3**	**1.1**	**1.0**
Total Expenditure	**50.4**	**40.7**	**42.2**	**46.3**
Recurrent Expenditure	**35.6**	**29.8**	**29.6**	**31.8**
o/w Personal Emoluments	*14.4*	*10.7*	*9.9*	*10.0*
o/w Pensions, Retirement Benefits, and Gratuities	*2.7*	*2.0*	*1.9*	*1.9*
o/w Goods and Services	*7.7*	*6.9*	*2.5*	*8.5*
o/w Grants, Contributions, and Subsidies	*8.0*	*7.5*	*7.2*	*7.6*
o/w Interest Payments	*2.8*	*2.6*	*3.6*	*4.1*
Capital Expenditure	**14.8**	**10.9**	**12.6**	**14.5**
o/w Public Sector Investment Program	*9.1*	*6.6*	*9.2*	*11.6*
Primary Fiscal Balance	**-20.9**	**-11.6**	**-8.0**	**-8.6**
Overall Fiscal Balance	**-23.7**	**-14.2**	**-11.6**	**-12.7**