

2005, the proportion of the island population with income less than Rf.15 per day fell from over 30 percent to around 20 percent. Nevertheless, the same analysis reveals that of the 21 percent living in poverty in the atolls in 2005, only 7 percent has been consistently poor, while the rest are newly poor.

Table 1: Cross-country comparison of poverty and inequality in South Asia

	Gini index of inequality of expenditures	Poverty headcount ratio at national poverty line (% of population)	Year
India	33	29	2000
Pakistan	33	33	1999
Nepal	37	42	1996
Bangladesh	32	50	2000
Sri Lanka	47	23	2002
Maldives	43	19	2004

Source: World Development Indicators (except for Maldives, where Bank staff estimates are used)

18. ***Maldives has lower poverty but high inequality relative to South Asia.*** Unlike other countries in the region, Maldives experienced a spectacular growth performance and was therefore able to reduce poverty despite increasing inequality. Nonetheless, high inequality in the atolls remains a source of concern.

19. ***Finally, with two exceptions, Maldives has achieved all of its MDG target indicators.*** The gender gap in school enrollment and literacy among those aged 15 years to 24 years is virtually non-existent.⁷ The proportion of births not attended by skilled health personnel has been reduced by three-quarters.⁸ The two exceptions are for gender equality and management of the environment. Given the nation's social, economic and cultural traditions, women are at a disadvantage to men, even if as a group they are more equal than in other countries in the region. Current efforts to achieve the environmental goal are inadequate and under-funded, as discussed in a later section of this strategy.

II. KEY DEVELOPMENT CHALLENGES AND MEDIUM TERM PROSPECTS

20. The recently finalized 7NDP covers a broad range of the development needs and goals through 2010. This section attempts to highlight a critical subset that targets the strategic challenges facing the country over the short to medium-term, in particular: restoring macroeconomic and fiscal balance, improving the investment climate, consolidating human and social development, building institutional capacity, and sustaining the natural resource base.

A. RESTORING MACROECONOMIC AND FISCAL BALANCE

21. ***Overshadowing the strong economic performance is the substantial weakening of fiscal policy over the past three years, which is the main policy lever for affecting outcomes in the Maldives.*** This is the key source of risk facing the Maldives in the short-term. The fiscal outturns for 2006 showed an overall deficit exceeding 7 percent of GDP, mostly for non-tsunami related spending (Table 2). Although the 2007 budget anticipated a deficit equivalent to 28 percent of GDP, driven by

⁷ VPA-2

⁸ Annual Reports of Ministry of Health.

substantially increased spending from the already high levels of 2006, the overall deficit is likely to be less than half the budgeted level. Fiscal data for the 10 months through October 2007 suggest that domestic revenue and expenditure are both below budget, resulting in a domestic deficit running at about 2.6 percent of GDP. Much of the foreign loan financed investment also was not realized. The less expansionary results so far in 2007 reflect implementation capacity constraints rather than a strengthening of the fiscal policy stance, and the envisaged path of deficit financing over the medium-term in the PRSP remains a concern for macroeconomic stability. The main challenge is to ensure that highly expansionary fiscal policy does not undermine otherwise favorable growth prospects. It is worth noting that the sustainability of elevated revenues depends in large part on a rapid schedule of resort development that may be difficult to achieve. Spending needs to be kept within a realistic resource envelope, lest deficits pose major challenges for the country, with repercussions for inflation, private investment, growth, and external vulnerabilities.

Table 2: Summary of Central Government Finances

	2001	2002	2003	2004	2005	2006	2007
						Prov.	Budget
	<i>(Percent of GDP)</i>						
Total revenue and grants	33.0	33.1	34.8	34.2	48.0	62.9	61.8
Expenditure and net lending	37.7	38.0	38.2	36.0	58.9	70.2	90.1
Overall balance including grants	-4.7	-4.9	-3.4	-1.9	-10.9	-7.3	-28.3
Memo: Nominal GDP (millions of rufiyaa)	7650.8	8201.0	8863.2	9939.2	9607.7	11608.3	13104.1

Source: Government of Maldives. Note: presentation is Government of Maldives budget format.

22. *While expenditures as a share of GDP were comparable to other small island economies in previous years, they have reached very high levels since 2005, and appear to have risen still further in 2007 (despite being below budget).* A period of some increase is to be expected following a natural disaster, but expenditure trends in the Maldives have become far out of line with the experience of other similar countries, with allocations unrelated to the tsunami, as noted above.

Table 3: Expenditure as share of GDP – international comparison

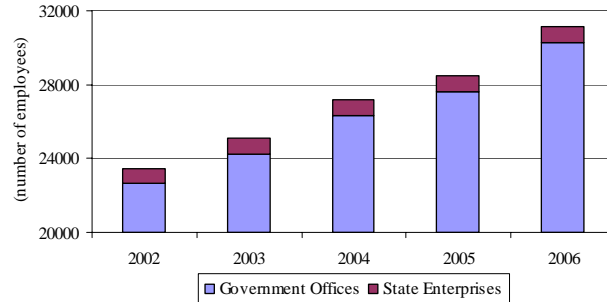
	2000	2002	2004	2005	2006 ^{1/}
Barbados	34.5	40.5	35.6	35.7	35.3
Fiji	26.3	28.6	28.4	27.5	27.5
Maldives	36.7	38.0	36.0	58.9	70.2
Mauritius	22.5	23.1	23.8	23.1	24.5
Samoa	34.3	33.4	47.6	33.4	38.3
Tonga	27.1	27.8	25.0	25.1	25.1
Vanuatu	29.0	25.6	20.2	19.8	23.1

Source: 1/ IMF staff estimates

23. *Recurrent costs are also rising.* While much of the growth in expenditures is projected to come from elevated capital spending, line ministries may be facing greater capacity constraints implementing the capital part of their budgets. With budget allocations increasingly dictated by implementation capacity, rather than strategic direction, allocative efficiency appears to be weakening, potentially introducing structural shifts in spending that will be felt for some time. For example, the civil service expanded by about 9 percent in 2006 (Figure 3), which, given the general difficulty associated with civil service retrenchment, may be having a ratcheting effect that will be felt over the medium-term. Combined with promotions and an announced pay increase to be implemented starting

January 1, 2008, a growing share of the budget is likely to be absorbed by pay and allowances, straining public finances.

Figure 3: Government employees



Source: Government of Maldives

24. ***There is a continuing need to limit recourse to domestic financing.*** Although the fiscal outturns for the first ten months of 2007 suggest that the domestic budget will be close to balance for the year as a whole, this follows two years, 2005 and 2006, when domestic financing amounted to 11.5 percent of GDP, and the 7NDP points to substantial further recourse to domestic financing over the plan period to 2010. In order to mitigate vulnerability and reduce risk, the Bank and other partners have encouraged the GoM to pursue explicitly strengthened fiscal policy, link its development programs with more realistic estimates of available financial resources, and restore the usefulness of the budget as a tool for setting strategic fiscal policy.

25. The IMF Article IV consultations, concluded in April 2007, presented two medium-term scenarios:⁹

- **Base case:** spending remains high with continued large overall fiscal deficits crowding out the private sector, lowering growth over the medium-term, increasing inflation, widening the current account deficit, raising debt to almost 80 percent of GDP, and inducing a fall in reserves to about 1.5 months of imports of goods and non-factor services (a level that induced a devaluation of the rufiyaa in 2001).
- **Alternative policy:** spending is controlled, raising growth, containing inflationary pressures, lowering external imbalances, and inducing a build in reserves to about three months of imports of goods and non-factor services.

⁹ The medium-term scenarios of the IMF Article IV for overall balance including grants in 2007 is different than the budget figures presented in Table 2 above, as the scenarios foresaw implementation capacity constraints limiting the envisaged spending to below budget, while the alternative policy scenario reflects renewed fiscal restraint. Partial year data confirm that spending is indeed running substantially below the levels envisaged in the budget, but the information available is presently insufficient to revise the macroeconomic framework.

Table 4: Macroeconomic outlook

	2005	2006	Proj.					
			2007	2008	2009	2010	2011	2012
			<i>Base Case</i>					
Real GDP growth (% change)	-4.5	19.1	5.5	4.5	4.0	4.0	3.5	3.5
Consumer prices (% change)	3.3	3.7	7.0	6.0	6.0	6.0	6.0	6.0
Overall balance, incl. grants (% of GDP)	-10.9	-7.3	-23.9	-15.4	-7.1	-1.0	-0.6	0.0
Total public sector debt (% of GDP)	52.6	51.7	69.7	78.3	78.1	71.9	66.1	60.2
Current account balance (% of GDP)	-35.8	-40.7	-40.5	-36.3	-19.5	-12.5	-8.3	-6.4
Gross official reserves (months of imports of GNFS)	2.1	2.4	2.1	1.8	1.7	1.5	1.5	1.5
			<i>Alternative Policy</i>					
Real GDP growth (% change)	-4.5	19.1	7.5	7.0	7.0	7.0	6.5	6.5
Consumer prices (% change)	3.3	3.7	3.0	3.0	2.5	2.5	2.5	2.5
Overall balance, incl. grants (% of GDP)	-10.9	-7.3	-15.2	-11.2	-4.0	1.8	1.8	1.6
Total public sector debt (% of GDP)	52.6	51.7	61.9	67.3	65.4	57.8	51.2	45.3
Current account balance (% of GDP)	-35.8	-40.7	-45.0	-40.6	-22.3	-11.8	-4.0	-1.9
Gross official reserves (months of imports of GNFS)	2.1	2.3	2.5	2.5	2.7	2.6	2.6	3.0

Source: IMF staff estimates.

26. *This exercise underlines the need for sound budgeting and explicit fiscal restraint over the next few years, including through the planned democratic transition in 2008 and 2009, in order to ensure sustainability and mitigate risks.* Indeed, generating fiscal surpluses and limiting borrowing is also an important mechanism for mitigating vulnerability to external shocks (including environmental shocks). Addressing the short-term fiscal issues and restoring the role of the budget as one of the strongest policy levers available to the government will be central to the government’s ability to meeting the medium- to long-term development challenges faced by the Maldives.

Medium-term outlook

27. *Provided the GoM is able to strengthen its fiscal policy stance and adverse macroeconomic possibilities are not realized, the medium-term outlook in the Maldives is favorable, underpinned by the vibrant tourism sector and continued investment in human development.* Improving economic management and other arrangements that underpin growth hinge on renewed political will to constrain expenditures. In addition, it will require strengthening institutions, and capacity, such as the recent moves towards greater central bank independence or training activities in Public Expenditure Management (PEM). Increasing value added in diverse activities will also depend on generating economies of scale through greater connectivity and population consolidation. In addition to these cross cutting strategies, ensuring an appropriate skills mix in the labor force and improving the investment climate will be important to deepen links between tourism and the rest of the economy, and increasing domestic value added in sectors such as fisheries. Finally, safeguarding the environment is essential for the continued success of both the tourism and fisheries industries, as well as mitigating risks associated with global warming and other natural disasters, such as tidal surges.

B. IMPROVING THE INVESTMENT CLIMATE

28. *Achieving the government’s goal of diversifying the economy—and diversifying the ownership of the economy—requires continued improvements to the investment climate.* The World Bank’s Doing Business surveys¹⁰ find that the Maldives is a relatively good place to start a business, pay taxes and employ workers, but a difficult place to get credit, export goods, enforce contracts, and close a business. The recently completed Investment Climate Assessment¹¹ (ICA) highlights access to

¹⁰ www.doingbusiness.org

¹¹ “The Maldives: Sustaining Growth and Improving the Investment Climate”, the World Bank, April 2006 (ICA)

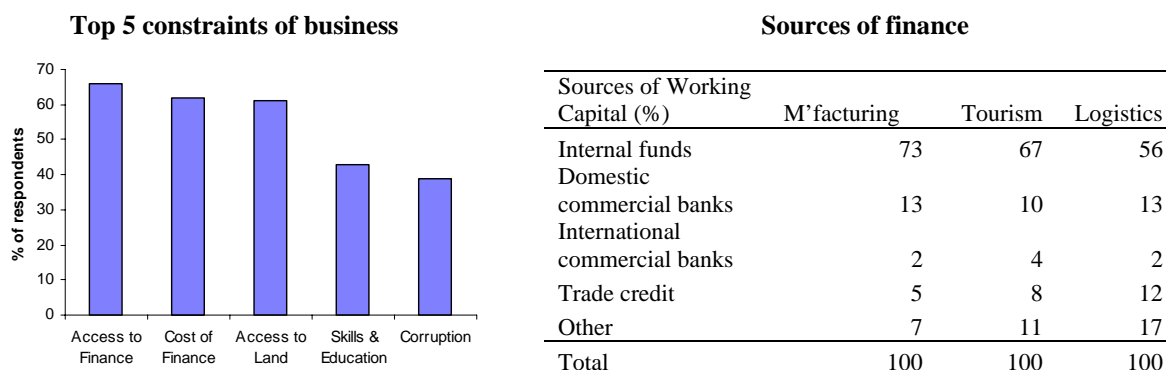
finance, the cost of finance, access to land, and corruption as being the most important obstacles to investment (Figure 4).

29. **Tourism and fishing will remain the mainstays of the economy but will exert increasingly demanding standards for environmental management.** The tourism industry draws directly on the maintenance of a pristine environment, giving the resorts an incentive to maintain very high environmental standards, as required by the government. As surrounding inhabited islands become more populous and exert greater pressure on the environment, it will be necessary to strengthen environmental practices (for example, ensuring more careful treatment of solid waste to keep the reefs free from debris). Sustaining economic activity in higher value added fishery products will also depend on sound environmental management practices, continuing with the sustainable tuna fishing practices, while improving the capacity to monitor the extended economic zone (EEZ) and limit overall yields to sustainable levels. Finally, careful management of the coastal environment also helps mitigate the negative effects of periodic tidal surges and flooding.

30. **The Government is exploring other growth avenues such as transport and logistic centers.** The government is actively promoting the possibility of creating a container transshipment port in the north of the county, adjacent to the major shipping lane between Europe and South and East Asia. In order to broaden the ownership base which is currently concentrated narrowly on a small number of families, the 7NDP emphasizes the need to encourage more SMEs, and with this same objective, has recently created a publicly owned company—the Maldives Tourist Development Corporation—the shares of which it is proposing to sell to small investors.

31. **Connectivity is improving.** The provision of good international and internal transport services is critical for the development of the Maldives. The country’s major port is in Male’ but this is nearing capacity. There is currently a single international airport in Male’ which is beginning to show signs of strain, and capacity enhancements are required. However, a second airport in the southern Addu atoll has recently been opened, which will spur tourism in the south. Telecommunications in the Maldives have improved dramatically in the last decade. Mobile phones are already ubiquitous with more than 260,000 mobile subscribers (compared to a total population of 300,000 plus 50,000 immigrant workers). There is still a need to increase access to the internet, and broadband systems are rapidly spreading out into the atolls.

Figure 4: Finance emerges as the key constraint to business



Source: World Bank ICA

32. ***Encouraging linkages between the domestic SME sector and resorts is critical.*** Helping to facilitate the financing of SMEs, as well as addressing other constraints of the vibrant SME sector will also be important to deepening the links between the resorts and the local economy. At present tourist firms source only about 30 percent of their material inputs and supplies from the domestic sector. Manufacturing is slightly higher at 37 percent and logistics and transport is at 41 percent. There is concern that outside Male', few jobs are being created beyond the new resorts. The agglomeration of economic activity in regional growth centers is crucial to move away from the quasi-subsistence activities of artisanal fishing and farming, towards more productive activities connected with modern service industries or tourism.

33. ***Education and vocational training will contribute to preparing new school leavers.*** The government must continue to use revenue generated in tourism to maintain large investments in education and vocational training, in order to ensure that the labor force possesses an appropriate skills mix to sustain robust development in a middle income economy. This is central to employment generation, especially for growing cohorts of school leavers, expanding employment opportunities for Maldivians in higher level positions in resorts, for example, and also playing an important role in deepening the linkages between the resorts and the local economy.

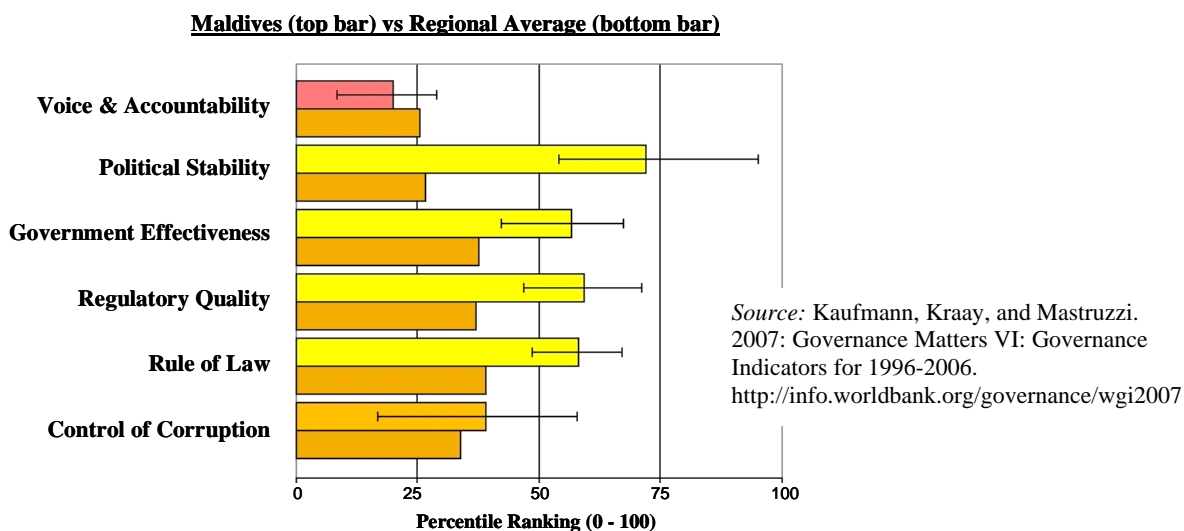
C. BUILDING INSTITUTIONAL CAPACITY

34. ***The Maldives is currently undergoing a rapid—although largely peaceful—governance transition.***¹² As highlighted in the 7NDP, impressive socio-economic gains over the last three decades have outpaced the development of accountable, transparent and effective governance institutions. The program of reforms described above aim to correct this imbalance. In particular they are targeting overhaul of the country's oversight and justice sector institutions. However, in parallel the government is seeking to strengthen the capacity, effectiveness and transparency of executive branch agencies. These reforms will be the critical underpinning for sustained growth, macro-economic stability and improved human development.

35. ***The 2004 tsunami underlined the need to strengthen the country's institutional base in line with the needs of an increasingly sophisticated economy.*** The economic gains to date have been facilitated by a far-sighted domestic elite that has relied on informal rules and cohesive networks to implement a set of pragmatic private-sector oriented policies, while abiding to a measure of self discipline in terms of sound macro-economic management, as well as consistency and stability in policies. The sophistication and maturity of the Maldivian economy, however, depend increasingly on establishing a more formal rule-based environment based on accountable and effective institutions. An educated middle class has grown in size, become more globally integrated, and is demanding greater accountability and transparency. The domestic private sector and foreign investors also require transparent and efficient regulatory institutions that create a level playing field as well as a judicial system that ensures the rule of law and the enforcement of contracts.

¹² Two recent incidents have threatened this record. On September 29, 2007 a small homemade bomb was detonated in Male', injuring 12 tourists. This is the first instance of such violence since a coup attempt in the late 1980s. In early October 2007, 90 armed members of a radical congregation held a Maldives security service officer hostage inside a mosque in a remote island for three days before a resolution was found. Government ministers had previously expressed concern about radical religious/political influences in a country with a long tradition of religious moderation.

Figure 5: Maldives Governance Indicators and the South Asia region



36. *The Maldives outperforms the region and its income category peer group on most governance indicators, but underperforms in the area of voice and accountability* (see Figure 5).¹³ This is consistent with rising political and social tension: an increasingly vocal opposition has formed; the ruling party faces internal splits (several important cabinet members left the party during 2007 to establish alternative political bases); and there have been several large demonstrations, as Maldivians seek effective channels of representation.

37. *Strengthening the capacity of the civil service will be critical if the country is to provide public services at a level consistent with its upper-middle income aspirations.* Despite a gradual improvement in the education and skills of senior civil servants, the civil service still lacks policy, implementation, and administrative capability. Over half of the civil service is concentrated in three ministries: education, health and defense services. The remaining employees are spread over 18 other ministries and 12 presidential authorities. There is a need to strengthen transparency, effective performance management, career structure, and human resources in the system. Ad hoc allowances have become increasingly significant, often amounting to as much as one half of total take home pay. Average salaries are low relative to the private sector; although civil servants need work only a six hour day, and secondary employment to supplement incomes is legal and common.

38. *Public expenditure management, public financial management and public financial accountability are emerging as increasingly important issues where institutional arrangements and capacity are significant constraints.* The Majlis passed the Public Finance Act in 2005, establishing ‘the principles and procedures for control and management of the finances and property of the state.’ This is an important step but its implementation will face considerable challenges.¹⁴ The law is proposing to make substantial changes to the public financial management architecture. It lays down the framework for preparation of the annual state budget including its passage by the parliament, consolidation of public moneys in a single public treasury account, and requires the government to maintain proper accounts including preparation of annual financial statements. To complete the accountability chain, the law also requires a timely audit (within five months of the end of the fiscal

¹³ Transparency International has begun to include the Maldives in their Perceptions of Corruption index. The country scored 3.3, below India’s score of 3.5 but above Sri Lanka (3.2), Nepal (2.5) and Pakistan (2.4).

¹⁴ The law has not yet been notified, and therefore has yet to come into force. The law allows the President to defer any of its provisions coming into effect for up to three years after the Act has come into force.

year) from the auditor general and the tabling of the report in the parliament through the office of the president.

39. ***Initiatives to control corruption should be strongly supported.*** As in other small island economies the risk of patronage, corruption or conflicts of interest is high. The Maldives scores better than other South Asian countries on control of corruption indicators. However, corruption emerged from the ICA as a significant obstacle to investment. The government has committed itself to several promising initiatives. A new Public Accounting System (PAS) will be fully implemented over the next three years. The Audit Act was passed in April 2007, which allows the Audit Office to act independently with direct interactions with parliament. Until this point there was no legal framework to ensure the independence of the auditor general and to allow for audit findings being made public. Although the Audit Office is required to audit the government's accounts, its staff capacity has, to date, been limited, resulting in inadequate coverage. There is also a need to strengthen the Anti Corruption Board, which was established in 1991 but has had limited resources at its disposal.

40. ***Reform of the government's public procurement system is necessary.*** Currently the system lacks a legal framework as there are no consolidated national public procurement instructions, resulting in the various agencies adopting ad-hoc approaches to this function. Government is aware of the need for these reforms and is giving their introduction priority, including the provision of capacity development to enable institutions and its civil servants to understand and properly apply such instructions. The system also lacks an effective independent procurement grievance mechanism, which can act as an oversight function to proper implementation of procurement rules and, hence, a deterrent to corruption practices.

41. ***In general, the direction of governance reforms is positive, yet the scope and pace are ambitious for a small country.*** New institutions such as an independent Supreme Court and Judicial Services Commission are being created that will require staffing and financing. Reforms of such a fundamental nature require due deliberation and adequate country wide public consultations before they are enacted into law. Yet the timetable established is extremely tight, driven as it is by a June 2008 deadline. A heavy responsibility will fall on the first set of elected officials in 2008. Much will also depend on how effectively the media and civil society use their newly won freedoms to enhance public voice and accountability, while at the same time not provoking a backlash from interest groups who may lose out from political liberalization.

D. CONSOLIDATING HUMAN AND SOCIAL DEVELOPMENT

42. ***The Maldives is seeking to consolidate human development gains while also responding to new challenges.*** Rapid economic growth and broad access to basic services have enabled the Maldives to rapidly reduce poverty, improve health care and education standards, and meet most of the MDGs. At this stage in its development path, the country is consolidating these gains and seeking to increase the quality of its service provision to a standard commensurate with the country's income levels. In addition, the country faces new challenges such as vulnerability, malnutrition, fertility, and youth unemployment which represent significant implications for other aspects of social and human development, including education and economic productivity.

43. ***Common to all sectors in the Maldives is the additional challenge of scale.*** Supporting the government's population consolidation policy and developing capacity in the government agencies are two essential cross-cutting areas for all donors in the country.

Table 5: Progress in basic social indicators: 1995-2006

Basic Social Indicators	1995	1999	2002	2004	2006
Male Life Expectancy	70	72	70	71	72
Infant Mortality Rate (per '000 live births)	32	20	18	15	16
Student Teacher Ratio	31	23	19	20	15
GDP per capita	\$1,630	\$2,214	\$2,284	\$2,682	\$3,090

Source: Government of Maldives

Education

44. ***Maldives needs a population with good quality education, including higher education, to provide the managerial and technical skills necessary to sustain economic growth and to be globally competitive.*** The school system is not producing enough quality people and the private sector is heavily reliant on foreign workers for all types of work. The public education and health systems are also heavily staffed by foreign workers outside of Greater Male'. The challenge for Maldives is to provide quality education, particularly higher secondary and tertiary, in a cost-effective manner.

45. ***Access to education has risen but quality remains uneven.*** Maldives has successfully addressed the basic challenges of school access particularly at the primary level. However, while literacy is almost total, the quality of education is uneven and learning achievements are mixed. Only a small proportion of the children leave school with a qualification, and "O level" pass rates are low even for the minority who enter for the examination.

46. ***Achieving quality improvements will inevitably increase costs.*** Both rising expectations and the recent declines in fertility (meaning that smaller numbers will need to be enrolled at the lower level but more at the higher levels) will put pressure on costs. The government may not be able to offer quality education without consolidating the population. Today, primary school education (Grades 1 to 7) is universal, lower secondary schools (up to grade 10) are located on 138 islands and it is the government's intention to make 10 years of education available to all before 2010. But the cost of doing these on 138 islands is prohibitive and the government is seeking ways to tackle the issue, with help from the World Bank Group through the Integrated Human Development Project (IHDP).

47. ***Access to higher secondary schools (Grades 11 and 12) is more limited and schools are located on a much smaller number of islands: 14 in July 2007.*** An even smaller proportion of young people have access to tertiary education. Whereas for primary and lower secondary schools there is not gender bias in admissions, for upper secondary and tertiary education there is a bias in favor of boys. This is thought to be due to the social pressures not to leave home to continue their studies. Increasing access to upper secondary schools will be much easier when a larger proportion of the population live on a small number of larger islands.

Health Care

48. ***In one generation, the public health landscape of Maldives has transitioned from that of a poor country to that of a typical middle income country.*** The health MDGs were reached - communicable diseases were brought under control, and infant mortality fell to just 12 per thousand births, a decline of two-thirds from 1990 to 2005. Longevity grew, and a Maldivian born today can expect to live to age 72, a gain of 24 years since 1978. These results have been made possible by a major expansion in public investment and an influx of expatriate doctors – both of which have increased access to healthcare. This expansion continues: the total number of atoll hospitals, health centers and health posts has more than doubled since 2001. As with other basic services, it will not be

possible to provide a consistent level of quality care on all islands in a fiscally sustainable manner without some population consolidation.

49. *While infectious diseases are generally under control new diseases including dengue, influenza, scrub typhus, and thalassaemia, have recently emerged as significant problems.* Up to one in six Maldivians are said to be carriers of thalassaemia, which gives the country one of the highest incidences in the world.¹⁵ Looking ahead, the biggest long-run challenge to the Maldives health system is the rise of degenerative non-communicable diseases such as diabetes, heart disease and cancer which will place a great burden on the health system and on both public and private finances. The health system needs to address this by developing treatment protocols and operating procedures which can address these new challenges in a cost-effective manner. The World Bank's IHDP and WHO are working with the government to develop these systems.

Social Protection

50. *Vulnerability is outpacing the country's ability to provide safety nets.* Two particularly vulnerable groups are women and unemployed youth. Women are at risk because their rights are not fully protected by law or society. This issue is also highlighted in the 7NDP. While their position in society may be stronger than in most other South Asian countries, as a group, women still do not have the same rights as men. Worryingly, a recent survey undertaken by the government recorded high rates of gender based violence and sexual molestation. Drug abuse is a growing problem, particularly among young men. Reported cases of drug abuse have more than trebled, from around 200 every year in the late 1990s to 600-700 in 2004-05. Most drug users are young: 95 percent are 16-39 years, and 53 percent are age 16-24.

51. *Safety net programs are ad hoc and overlapping.* The government would like to develop an effective social protection system for its country that is consistent with its level of income and implementation capacity. Economic growth has been, and will continue to be, the dominant factor in the reduction of poverty in Maldives, but the concentration of poverty in the Northern atolls and among particular population groups is of considerable concern. Seeking to address these issues, the government is interested in reforming its pension system, and meeting the constitutional mandate to provide income support to the elderly. It is also interested in developing an effective safety net for the very poor, and those who may suffer poverty from catastrophic health shocks or from natural disasters. The government's priority is to establish a pension plan first for government employees, but to extend it quickly to the private sector, as the first step in developing a financially sustainable social security and safety net system. The Bank Group has supported this effort through analytical work and is considering an investment in the future.¹⁶

E. SUSTAINING THE COUNTRY'S NATURAL RESOURCE BASE

52. *The country's considerable environmental assets have been and will remain the key source of growth for the economy.*¹⁷ Nature based tourism remains the country's primary industry accounting for almost 70 percent of GDP, with fish and fish processing contributing to about 10 percent of GDP. Recognizing the economic significance of its fragile environment, sustainability has remained an important development priority in the Maldives. Indeed, the Maldives stands as a rare success story of

¹⁵ An inherited form of anemia whereby the blood cells are unable to carry a sufficient supply of oxygen for the body's needs.

¹⁶ "Social Protection in the Maldives: Options for Reforming Pensions and Safety Nets", World Bank, April 2006.

¹⁷ There is for example immense marine biodiversity: the reefs host over 1,900 species of fish, 187 coral species, and 400 crustaceans.

a resource rich country that has judiciously managed its natural capital to fuel prosperity and graduate to middle income status. But much of this is changing with rising population densities and growing aspirations.

53. ***Economic prosperity has been accompanied by a litany of pressures on the natural resource base that could jeopardize economic prospects.*** Between the resort and inhabited islands, there is a marked difference in both the quality of the environment and the interest shown in protecting it. With high population densities and affluence, the inhabited islands confront growing problems of solid waste management, sewage disposal and other effluents emanating from settlements, fish processing plants and other sources. There is inadequate treatment of waste water on most inhabited islands, including the capital Male'. Simultaneously, the amount of waste generated (estimated at about 400 tons a day) far exceeds the processing capacity of available land fills. Sewage and solid waste can foul pristine beaches, degrade sea water and damage the corals that are a magnet for tourists. This calls for a considerable improvement in environmental management with policy principles being translated into observable outcomes and an environmental infrastructure that matches the country's needs.

54. ***Over the long-term, climate change will be the most perilous environmental risk facing the country.*** Geography has rendered the Maldives especially vulnerable to climate change. Being land scarce, low lying (over 80 percent of the country is less than 1 meter above sea level) and affected by storm surges arising from cyclones from the Indian Ocean, it is exposed to the risks of intensifying weather events including damage caused by inundation, wind and flooding from storms. With the melting of polar ice caps, the country faces additional risk of sea level rise. With future sea level projected to rise within the range of 10 centimeters (cm) to 1 meter (m) by the year 2100, without investments to adapt, much of the country could be submerged in the worst-case scenario.¹⁸ Tourist resorts on low lying coral islands or located over lagoons are among the most vulnerable to sea level rise. The loss of these assets would have a devastating impact on economic prospects.

55. ***Degradation of the reefs has increased vulnerability to climate change risks.*** Ever increasing damage to the reefs has impaired their protective functions and increased exposure to risks from storm and cyclones. One of the major stresses to reef ecology is sea surface warming, resulting in coral bleaching. Bleaching events have been recorded seven times since 1997, with the impacts being most severe in areas that are stressed by pollutants, or damaged by physical disturbance. In addition, coastal erosion poses another perennial problem for the Maldives. In their natural state the islands are highly dynamic and continually changing shape. However, there is little experience on how to manage these changes and there have been no systematic assessment of the economic consequences of erosion and cost effective remedies.¹⁹

56. ***Adapting to climate change will call for multiple approaches, guided by scientific risk management.*** It would require costly investments in protective barriers such as sea-walls and land reclamation, integrating climate risks in the planning, design and location of new assets and more aggressive stewardship of the natural protective barriers formed by coral reefs. Considerable strategic planning is necessary, to determine both the risks facing the various atolls and appropriate responses to these long term risks.

¹⁸ As an example, in Hulehule an hourly sea level of 70 cm is currently a once in 100-year event. Under "moderate" climate change scenarios it could become a once in 10-year event. However, scientists are still discussing the impact of global climate change on the Maldives with some arguing against the theory that the Maldives faces inevitable and major flooding in the near future. See N.A Mörner et al: "New Perspectives for the Future of the Maldives", *Global & Planetary Change* 2004 (177-182).

¹⁹ An expensive sea wall has been built around Male' but it is unlikely that this is an affordable solution for all islands, or a desirable solution for resorts. The issue is also closely linked to population consolidation.

57. ***Population consolidation and the creation of safer islands are part of the solution to climate change, as discussed in the 7NDP.*** The need for such a policy is widely promoted and accepted within the government, and was supported during discussions with the Bank by three out of the five registered political parties. There is a consensus that, in the long-term and as the sea level rises, it will be impossible to protect widely dispersed populations. In addition, the provision of increasingly sophisticated social services is becoming prohibitively expensive on a large number of islands with small populations. Population consolidation therefore produces benefits from lower costs of service delivery, as well as being part of a strategy for adaptation to climate change. The location of these safe islands needs to be based on detailed scientific assessments of climate risks. In the absence of scientific data, current decisions do not appear to have been guided by risk assessments.

58. ***The capacity to manage growing environmental pressures does not match the needs of a vulnerable, resource dependent economy that is transiting to middle income status.*** There is insufficient technical, financial and human capacity to either deliver the required environmental infrastructure or monitor and control environmental impacts.²⁰ There is also inadequate baseline information on the status of habitats and limited experience in scientific management methods, despite the importance of marine assets in fueling economic growth. Monitoring and enforcement of the myriad environmental regulations is uneven, particularly in remote islands where financial resources are limited. All of this suggests an urgent need to strengthen the information base of environmental management and the mechanism for implementing and enforcing environmental policies to assure sustained growth and prosperity. It is in this context that environmental sustainability has been identified as a key pillar of the Bank's assistance to Maldives.

III. THE GOVERNMENT'S DEVELOPMENT PLAN

59. ***The government has set out its vision and strategy in the 7NDP for the period 2006-2010: "Creating New Opportunities".*** This is also the strategic policy framework for achieving the objectives of Vision 2020. The national vision is to achieve upper-middle income status, ensure more equitable access to services and opportunities through urbanization and improved service delivery, facilitate economic diversification, promote gender equality, and support better environmental practices to sustain growth and adapt to global climate change.

60. ***The 7NDP was compiled through a consultative process involving the government, NGOs, and various private sector organizations and individuals.*** The broad objectives and key development opportunities and challenges outlined in the 7NDP are presented in Box 1. In short, the eight key principles underpinning the 7NDP are: (1) national ownership, (2) enhanced trust and confidence, (3) economic opportunity for all, (4) gender equality, (5) environmental sustainability, (6) human rights, (7) civil society participation, and (8) results focus. The 7NDP elaborates specific goals with performance targets across four key areas: economic, spatial, social and governance.

²⁰ As an example the Ministry of Energy, Environment and Water receive between 60-70 Environmental Impact Assessment reports each year, that need to be reviewed and cleared within a month. But with only four graduates in the Ministry, there is little capacity to evaluate and assess the reports in the desired depth and detail.