



Maldives Public Finance – Issues and Challenges

Maldives Finance Forum 2013

May 13, 2013

Kurumba, Maldives

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Presentation Outline

- Maldives Public Finance
Performance: Recent History
- Current Challenges/Risks
- Way Forward



Recent History of Public Finance Performance

Public Finances were relatively well managed until the Tsunami of December 2004.

- Revenue has been strong – supported by the tourism sector. Tax base was shallow but sustained robust tourism ensured sufficient revenues through non-tax sources.
- Expenditures were high with a considerable share of public investment expenditure that supported economic growth.
- Fiscal deficits (after grants) were well below 5 percent of GDP through much of 1990's and into early 2000. The average deficit over 1994-2004 was just 3.8%.
- Financing of these modest deficits posed no problems for the government – which also received generous support from external donors. As such, recourse to domestic borrowing was minimal.
- Within this backdrop debt levels was well within manageable levels. Debt/GDP was 44% in 1994 dropped to 31.6% of GDP by 2004.



Recent History of Public Finance Performance (contd)

What happened afterwards was a gradual slide that left government in an extremely fragile fiscal situation.

- The Tsunami impacted drastically on tourism. Revenue from tourism dropped 16 percent in 2005. Further urgent (and largely unplanned) expenditures were needed to respond to the catastrophe.
- Budget deficit rose to 8.2 percent of GDP in 2005 from 1.1 percent of GDP in 2004. This was the highest the Maldives has ever recorded upto that period.
- In 2005, domestic financing provided 80 percent of overall deficit financing.



Recent History of Public Finance Performance (contd)

- Post-Tsunami public spending rose, initially on Tsunami related reconstruction and rehabilitation activities but then increasingly on areas not related to the Tsunami.
- Public sector remuneration was one such source which increased rapidly. Successive increases in public sector pay, promotions as well as adopting new salary structures were primarily responsible for sharp increases in wage costs (2005-early 2009). Public sector work force also grew during this period.
- Subsidy payments and untargeted social protection schemes were other sources of increased spending.
- Combined, these underpinned the fiscal slippage that put Maldives public finances in a very difficult situation.



Recent History of Public Finance Performance (contd)

How exactly did the crisis precipitate?

- Despite rise in expenditure, overall finances initially (2006-7) were still under control because of strong revenue – mainly from non-tax sources.
- A large source of this revenue was from new resort lease grants. A large number of new lease licenses issued over 2005-8 reaped government substantial (non-tax) revenue.
- However, with the lack of a strong tax effort, the revenue system was always under much vulnerability.

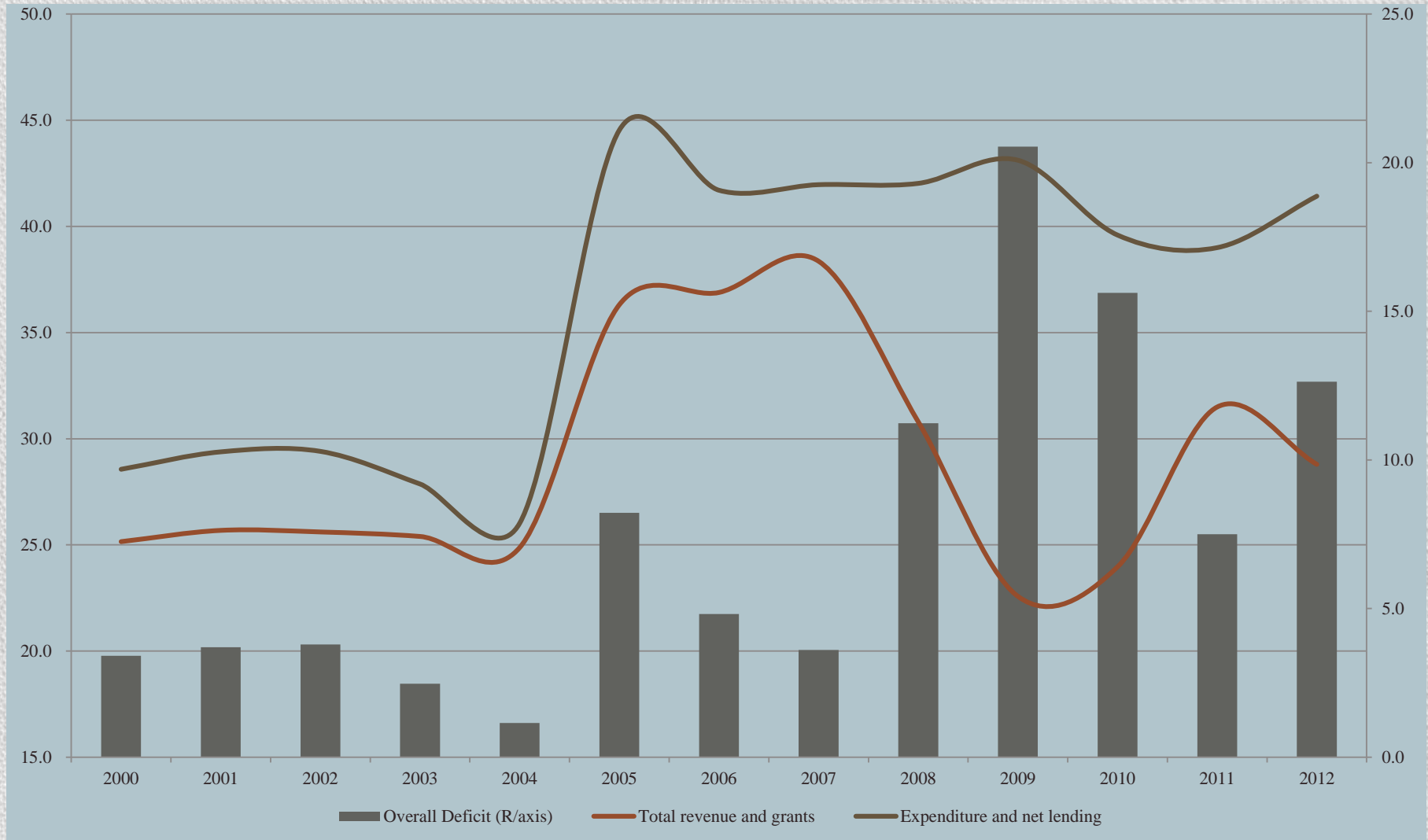


Recent History of Public Finance Performance (contd)

- The turning point came with the global financial crisis in 2008/9. Revenues dropped –tourism slumped, imports slumped, and grants were cut.
- But high expenditures remained mainly because of the wage bill: fiscal deficit rose to 20.5 percent in 2009 despite some adjustment towards end of the year.
- The fiscal situation has not recovered since then.



The Fiscal Story





Recent History of Public Finance Performance (contd)

- In 2009 the government undertook a difficult adjustment program supported by the multilateral development partners.
- However, the program had only limited success. Expenditure restraint measures either could not get off the ground or were reversed soon afterwards.
- With expenditure led adjustments not proving successful focus then turned to revenue measures. New taxes were introduced through legislation passed in 2010 and implemented over 2011/12 (TGST, GGST, BPT).
- This strengthened the revenue base – but not sufficient to consolidate the fiscal position as necessary expenditure measures were not enforced. Also some measures taken to cushion the price impact of GGST (such as broad based duty rate reductions) limited the impact of revenue enhancement measures.



The Current Situation

- Managing the fiscal position has become increasingly challenging.
- The actual deficit for 2012 (12.5% of GDP) exceeded planned levels (9% of GDP). However, deficit is likely to have been bigger given the payment arrears position.
- The 2013 fiscal outcome may also be similar to that of 2012 (although anticipated budget deficit is a very low 4% of GDP) despite laudable budget measures to raise revenue and cut expenditure.

REASONS:

- No specific policy measures to implement budgetary provisions (such as for example lower electricity subsidies and other lowering of recurrent expenditure).
- Laws require Majlis to pass separately (budget) revenue measures despite the budget having been passed.
 - Approval for increase in Airport Departure Tax suffered early snags but implementation of this together with the increase in TGST (also proposed in the budget) would be essential to meet planned revenue targets
- Also offsetting the consolidation measures were several revenue compromising and expenditure enhancing measures – such as removal of bed tax from July 2013 and increased outlay on capital expenditure. The latter is likely to be compromised in wake of recent developments.



The Current Situation (contd...)

- Financing of cash flow deficit has become a major issue.
- Tbill subscriptions have been moderating despite increase in rates.
- Under this context the government has been forced into 3 less desirable means of financing the budget:
 - Accumulation of Arrears Payments
 - Monetization
 - Ad-hoc borrowings
- The public debt situation is alarming. Public debt to GDP well over 80 percent of GDP and rising. External debt situation is also getting serious.
- Last Debt Sustainability Assessment (DSA) places Maldives in high risk of debt distress. Thus MDV just receives grants from the World Bank.
- Increased recourse to monetization will have a telling impact on the external balance and stability. High fiscal deficits are feeding into external imbalances
→ Maldives faced with 'twin deficits' – a large external current account deficit in addition to the fiscal deficit.



Factors contributing to difficult Public Finance situation in Maldives

- High Public Sector Remuneration
- Untargeted Subsidy and social protection programs
 - Electricity Subsidy
 - Aasandha
 - Food Subsidies

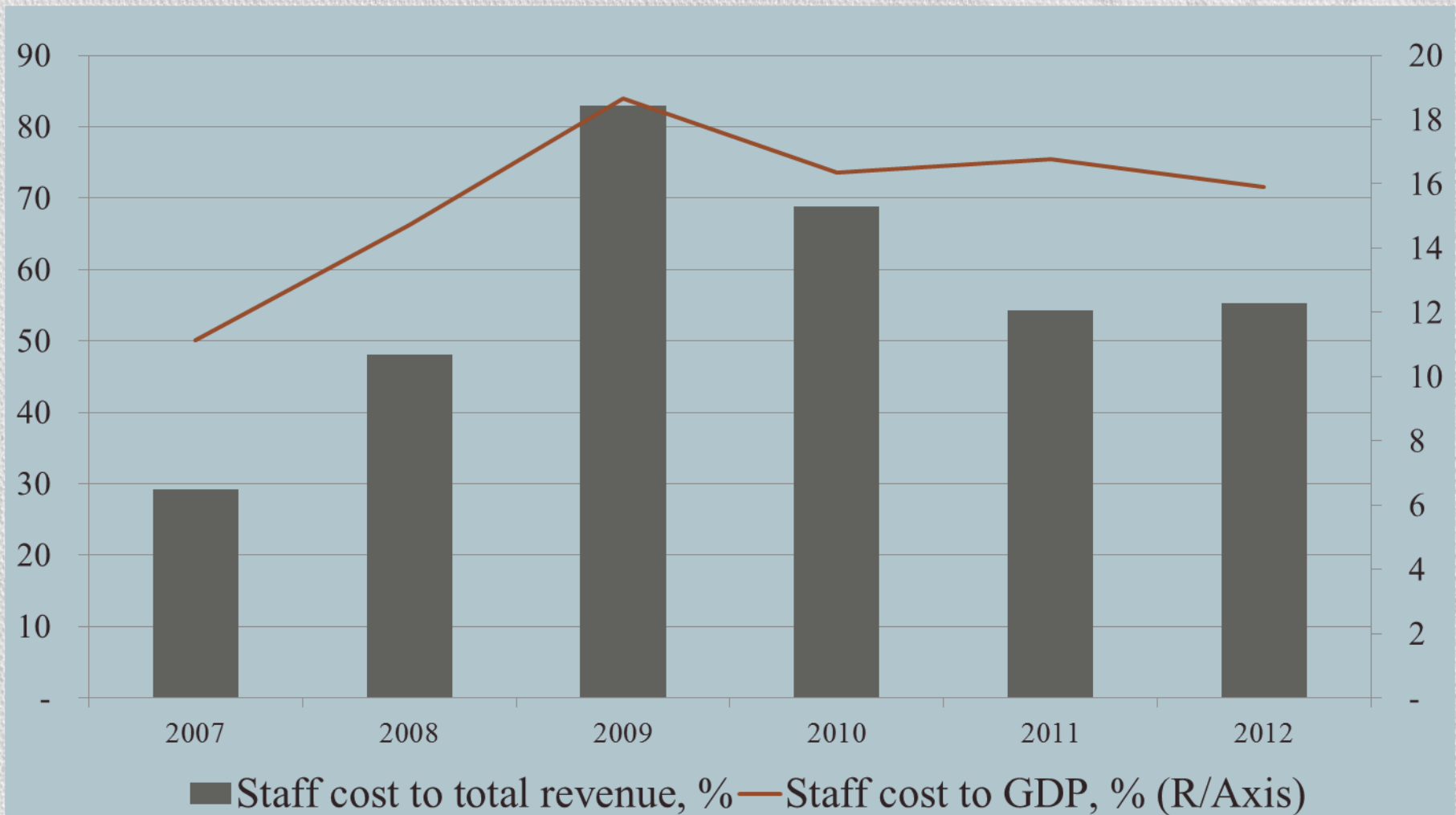


The Public Sector is Oversized

- MDV Public Sector work force accounts for over 50 per cent of formal employment.
- Wage bill in 2012 was:
 - 16 percent of GDP, and
 - 55 percent of revenues.
- High wage bill mainly because of growth in wages over the years rather than increase in employment.

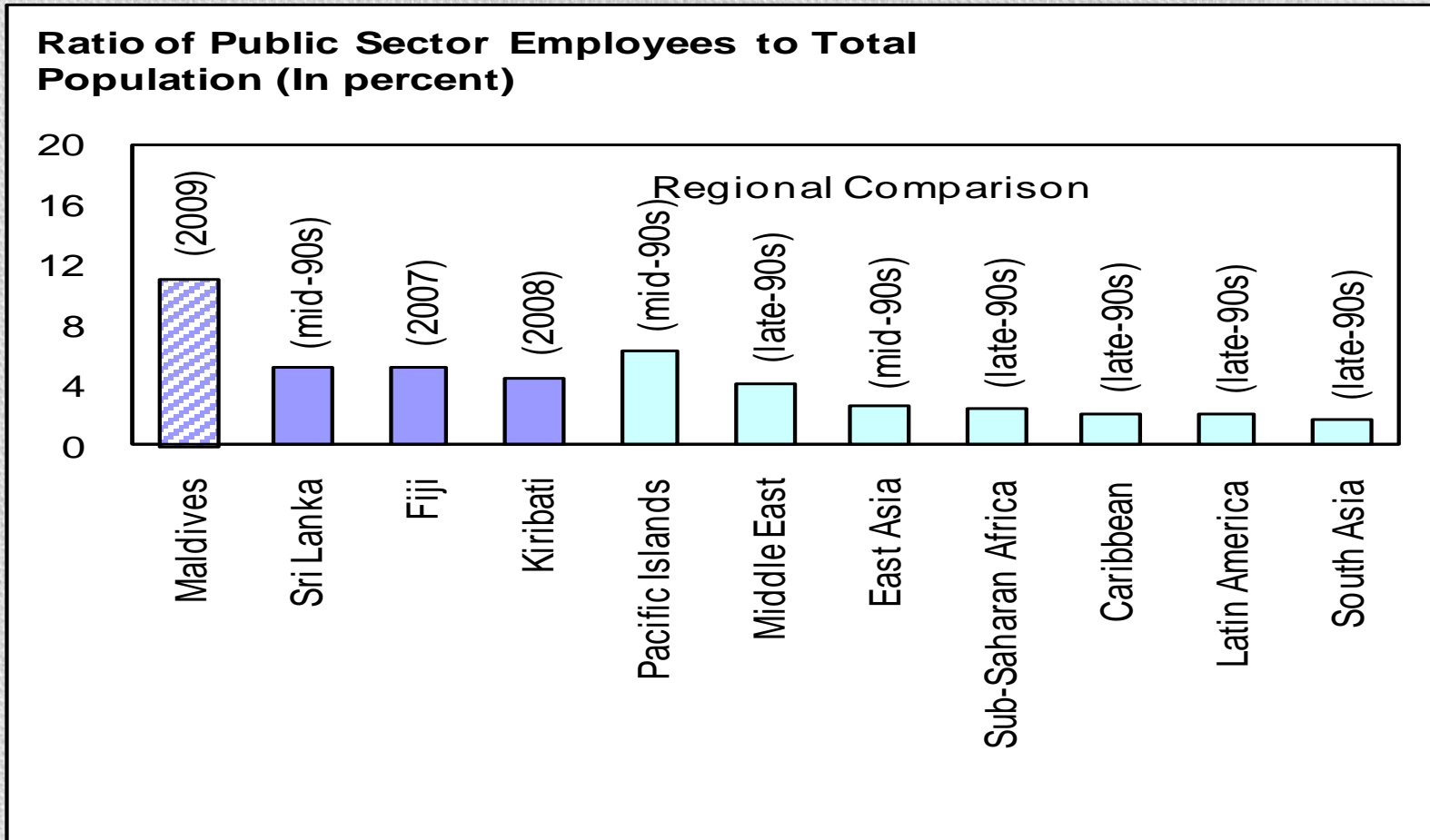


Maldives Public Sector Remunerations Cost



Sources: MMA, MoFT, IMF and WB Staff Estimates

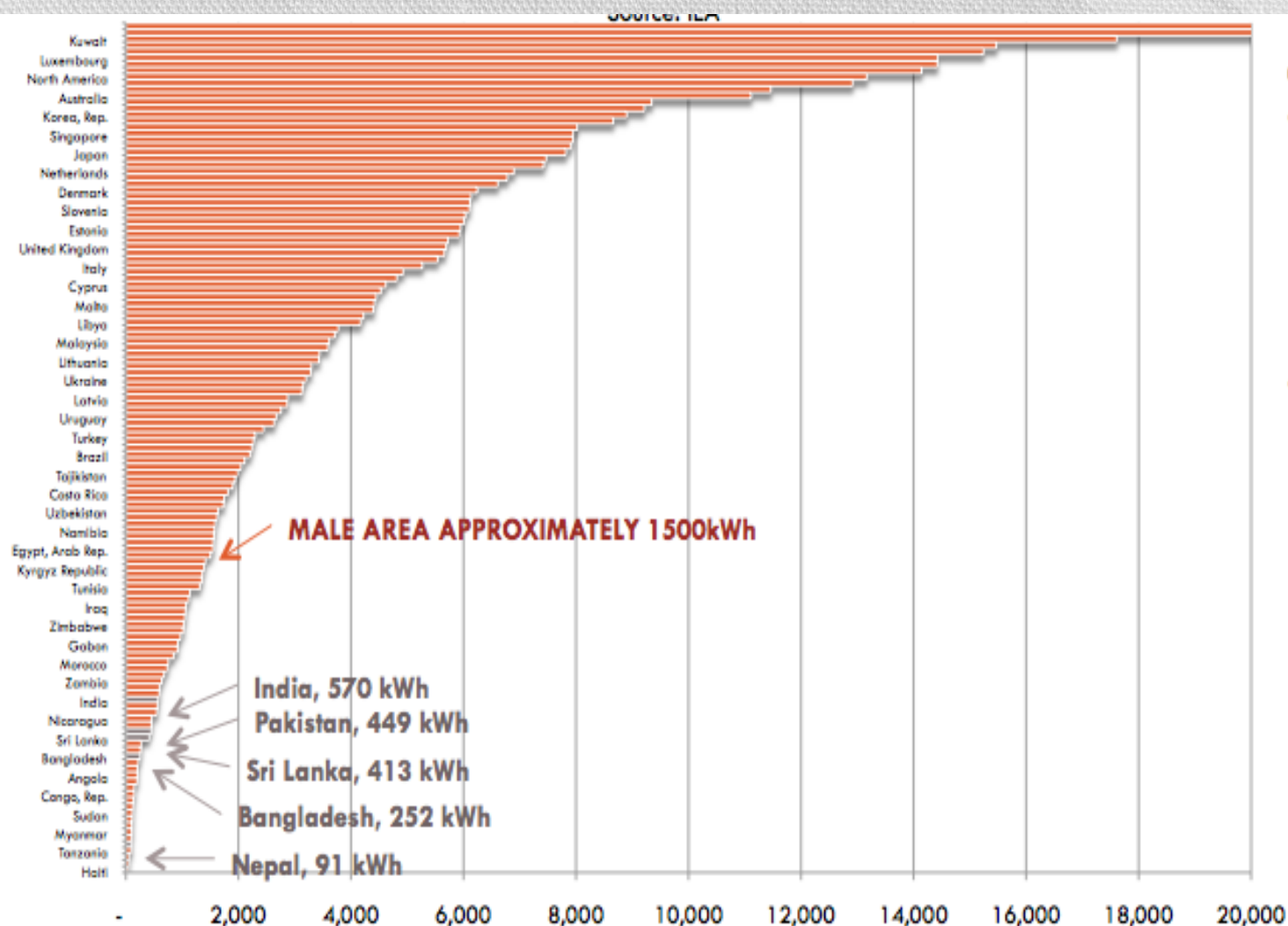
MDV public sector oversized compared to similar countries in terms of number of employees.



Source IMF (2010)



Electricity consumption at around 1,500 kWh per capita per year is one of the highest in the region partly due to relatively low tariff



Comments

- Based on data reported by utilities, consumption per capita, per capita consumption in the Maldives in 2009 is around 1500 kWh
- This is comparable to consumption in Egypt and Armenia. And one of the highest in the South Asia region

Notes:

- IEA estimates not available for Afghanistan, Bhutan, or the Maldives
- Maldives consumption figures based on consumption through utilities only i.e. don't include island resort consumption



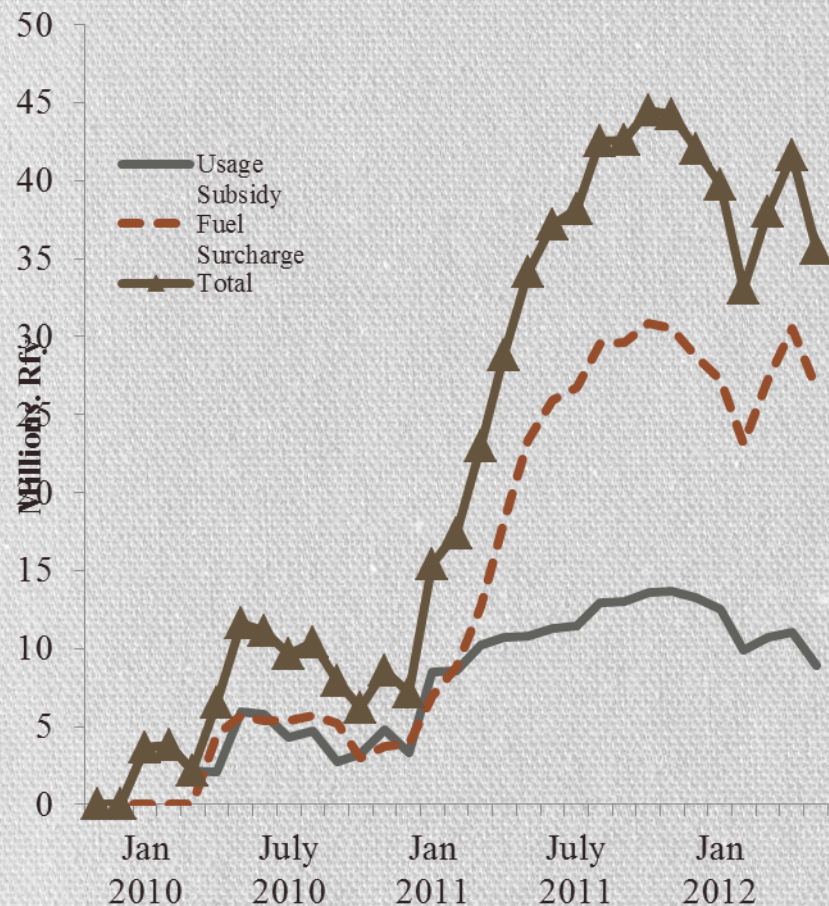
High cost of electricity in the Maldives

- With a strong dependence on diesel for generation, the cost of electricity supply in the Maldives is high.
- Electricity supply cost was MRF 3.5 Per KWH in March 2010 in Male, which is
 - 2.5 times higher than the cost of generation in Pakistan (MRF 1.4 per kWh),
 - 3.3 times more than in India (MRF 1/kWh);
 - 5 times more than in Bangladesh (MRF 0.7 per kWh)

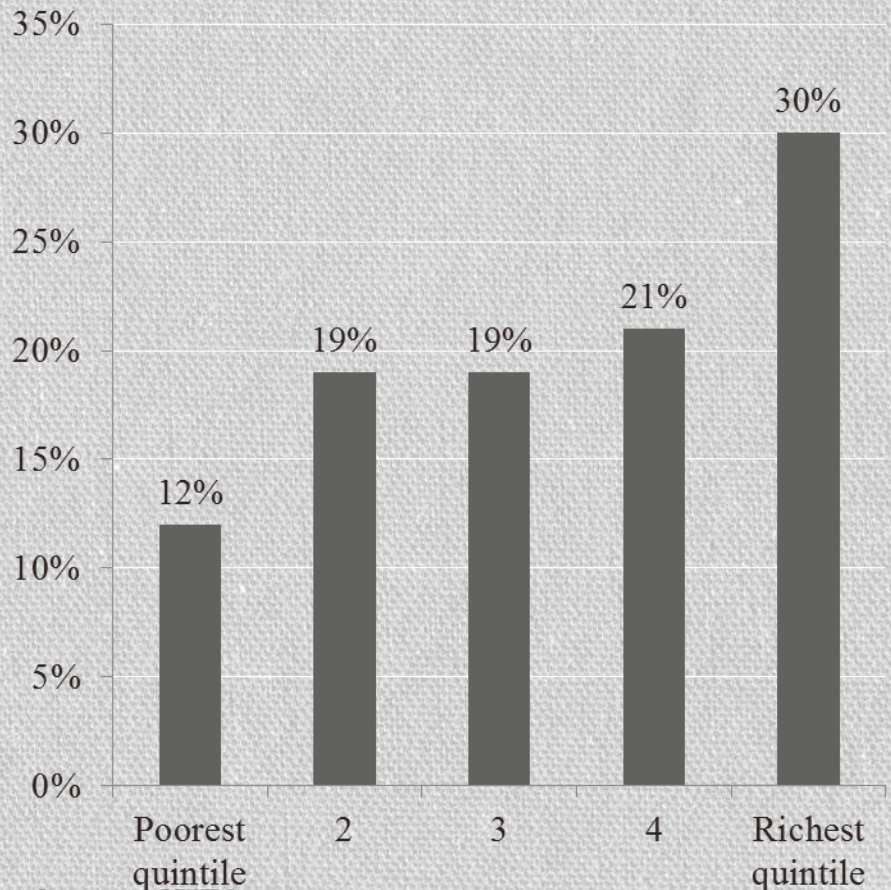


Rising electricity subsidy and skewed benefits in favor of the rich

Monthly Fiscal Cost of Electricity Subsidies



Distribution of electricity subsidy benefits





The Aasandha Scheme

- Utilization trends (as of Sept 15, 2012):
 - 299,668 people registered in Aasandha ~ 91% pop
 - 243,046 people had used Aasandha at least once ~ 74% of population, 81% of registered beneficiaries
- The Aasandha scheme's total claims for 2012 will likely surpass the 1,040 million Rfy premium payable to the Aasandha Corporation.
- The scheme in its current form is fiscally unsustainable.
- However some recent initiatives such as the introduction of co-payments etc will help consolidate the position.



Food (rice, flour & sugar) subsidy

- Rice, flour & sugar are sold at subsidized prices by STO – subsidy cost for 2012 is around MVR 300 million.
- Since 2002, the controlled prices for these commodities have not been revised and were set at around MVR 4 per kg. With an actual current trading price of around MVR 11-12 per kg, the STO's costs to deliver this assistance have increased significantly.
- Impacts of devaluation & inflation have widened the price gap.
- Subsidized food staples is available to anyone and everyone, which continues to drive growth in demand.



Way Forward

- What actions could put public finances on the path of economic development and prosperity?
- A **combination** of prudent expenditure restraint and revenue enhancement measures are needed.



Expenditure Measures

- Limited prospects of containing the wage costs in the near term. But established institutions such as the pay commission should work towards right sizing the public sector and rationalising wage costs.
- Better targeting of subsidy and social protection schemes needs to be done.
- Freezing of all non-essential (domestically financed) capital expenditures. This may come about anyway out of compulsion.



Aasandha

Short-term reform options to reduce costs

- Bulk procurement of essential and generic drugs -
Potential for savings as much as 70% of the current expenditure.
- Overseas treatment - Negotiating close-ended package rates with the overseas network of providers
- Overtime policy in public hospitals
- Performance based overtime payments



Electricity Subsidies

- A more focused targeting of electricity targeting based on consumption levels
- A long term low cost energy development plan which is also environmental friendly and cost effective – such as renewable energy.



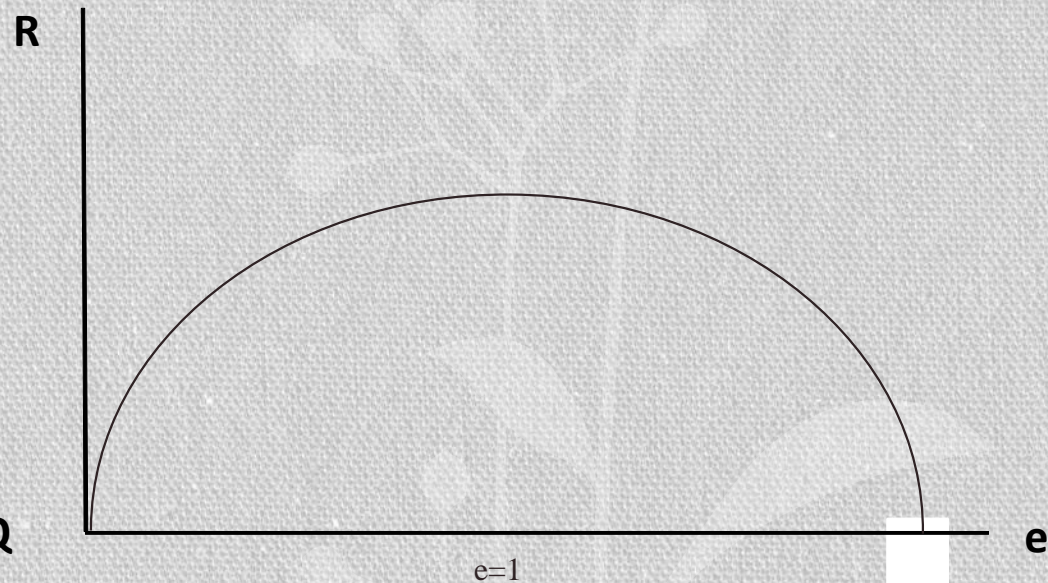
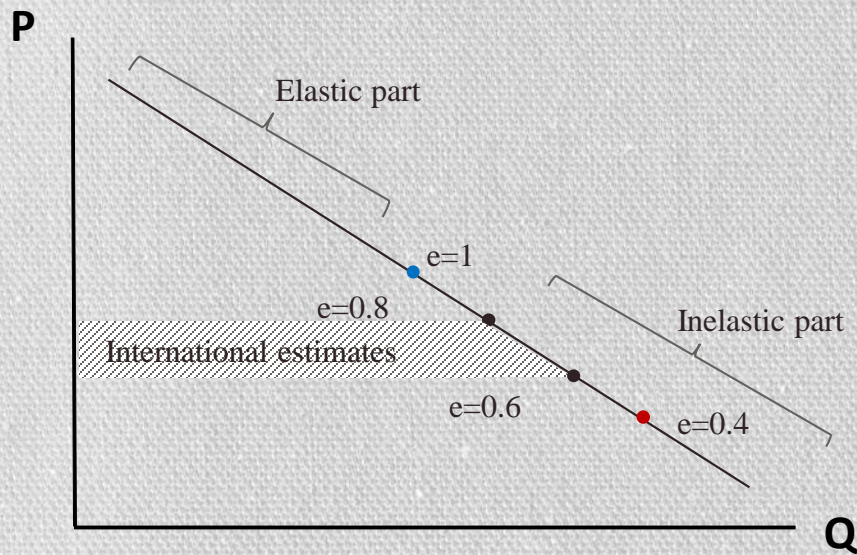
Revenue Measures

- Maldives Revenue/GDP is strong – the best in South Asia and comparable to well performing OECD countries.
- However, the problem lies in sufficiency of revenues to meet unsustainable expenditure levels.
- So if the expenditure structures remains rigid in the short to medium term (for various reasons) then necessarily revenue measures could be considered in order to stem the fiscal stress.
- Revenue enhancing measures:
 - Elasticity of demand estimate show Maldives having considerable leeway for pricing increase in the tourism sector (TGST).
 - But this needs to be pursued cautiously and progressively.
 - Import duty reductions in 2012 → huge shortfall on revenue collection. Some element of rationalisation should be considered.
 - Broadening the scope/coverage of GGST to current exempted items should also be considered.



MDV Price Elasticity of Tourism Demand

- Maldives elasticity (-0.41) is lower than international elasticity (average -0.6 to -0.8).



In theory, Maldives could increase its price up to a point where $e=1$ and obtain maximal revenue.



Implementation of needed measures will not be easy

- But not doing it or delaying/postponing them will only worsen the fiscal crisis.
- Government is already in a difficult situation.
- Management of the cash flow situation a day-to-day affair. This is not sustainable.
- Country best avoid a complete paralysis of civil administration and essential service delivery facilities (health, education defense etc) that could hurt people significantly
- *All parties in Maldives, and Maldives as a country, must come together to avoid a crisis.*



Thank you!