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Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 04-Mar-2019 | Report No: PIDA24056

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Maldives	P163966	Maldives First Fiscal Sustainability and Budget Credibility Development Policy Financing Operation (P163966)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
SOUTH ASIA	25-Jun-2019	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Ministry of Finance	Ministry of Finance, National Social Protection Agency		

Proposed Development Objective(s)

The Fiscal Sustainability and Budget Credibility Development Policy Financing operation supports the government's efforts to:
(1) improve the policy framework to enhance sustainability of the public finances; and
(2) strengthen the policy framework to increase credibility of the budget

Financing (in US$, Millions)

SUMMARY

Total Financing	20.00

DETAILS

Total World Bank Group Financing	20.00
World Bank Lending	20.00

Decision
The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

The proposed programmatic DPF series supports the Government of Maldives' (GoM) efforts to improve the policy framework to (i) enhance sustainability of public finances; and (ii) increase the credibility of the budget. The Maldives are a small-island economy whose development model depends on a high-end tourism sector. This sector has contributed to sustained growth rates and significant poverty reduction. Not long ago, in the early 1980s, Maldives was one of the world's 20 poorest countries. Today, its inhabitants enjoy the same levels of GDP per capita and human development outcomes as a middle-income country. However, similar to other island economies, the Maldives' development model creates significant fiscal pressures. The high-end, private-sector tourism enclave model has limited forward and backward linkages to the rest of the economy. In addition, geographical and population dispersion prevent achieving economies of scale, yet imposing high costs of service delivery, with clear implications to public finances. Over time, the significant capital investments –to ensure service delivery throughout the country, support tourism and enhance the country's resiliency to climate change and natural disasters— have contributed to fiscal deficits and an overall high level of indebtedness. Especially natural disasters have had severe fiscal implications with, for instance, the tsunami that affected the Maldives in December 2004 causing total damages of about 62 percent of GDP.

Maldives' economic performance has been strong in recent years, but the country remains at high risk of debt distress. Real GDP growth averaged 6.3 percent between 2013-17 and stood at 6.1 percent in 2018, on the back of strong performances of the tourism and construction sectors. Tourist arrivals and bed nights increased by 6.8 percent and 10.2 percent respectively y/y, supported by infrastructure investments on the international airport, the opening of new resorts, and expansion in the guest houses' sector. On the external front, the Maldives is experiencing a comparatively large current account deficit, estimated at 24.1 percent of GDP in 2018, which is driven by high growth in goods imports for investment projects. The current account deficit was financed mainly through debt flows and direct investment. On the fiscal side, the fiscal deficit stood at 4.7 percent of GDP in 2018. This followed an extraordinary consolidation effort in 2017 that reduced the overall fiscal deficit by 7.2 percentage points to 3 percent of GDP through a containment of recurrent spending and revenue-generating policy measured. Public and publicly guaranteed debt stood at 72 percent of GDP in 2018, composing of domestic debt (33.5 percent of GDP), external liabilities (24.6 percent of GDP) and public guarantees. According to the 2019 World Bank-IMF Debt Sustainability Analysis, the debt dynamics and substantial debt burden means that the Maldives remain at high risk of external debt distress.

The measures supported by this operation are complemented by a Disaster-Risk Management DPF and the Urban Development and Resilience Project which contribute to an adequate macroeconomic framework for the DPF. Despite a high risk of debt distress, the presence of multiple mitigating factors means that the macroeconomic framework is considered adequate for this operation. First, strong growth, supported by crucial public infrastructure investments, is expected to benefit the country's debt dynamics. Second, the winding down of large infrastructure projects in the medium-term is also expected to lead to an improvement of the fiscal situation. Third, the GoM has earmarked the proceeds from the airport development fee (ADF) and dividends from the state-owned airport operator, MACL, for debt repayment. Fourth, this DPF is complemented by a Disaster Risk Management DPF with Catastrophe Deferred Drawdown Option (Cat-DDO) and Pandemic Emergency Financing Facility (PEF) as well as the Urban Development and Resilience Project which are expected to mitigate the fiscal impact of future shocks.

Relationship to CPF

The proposed operation is aligned with the Country Partnership Framework (CPF) FY 16-19 and the Maldives Performance and Learning Review (PLR) of the CPF. With the increased efforts of the government to promote fiscal sustainability and better financial management, the WBG, through the PLR, updated the CPF objectives and adjusted its focus areas as follows: Focus Area 1 - promoting economic opportunities for Maldivians; Focus Area 2 - building resilience to climate change and other exogenous shocks, and Focus Area 3 - strengthening fiscal sustainability. The CPF proposes an integrated set of operations that would strengthen Maldives' fiscal sustainability, preparedness and resilience to natural disasters (financially and physically), and human capital, which includes the DPF series, the CAT-DDO combined with a PEF and the urban resilience project.

C. Proposed Development Objective(s)

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Key Results

The proposed operation supports policy measures that aim at five broad results. First, it intends to increase the *efficiency of spending* through reforms to drug reimbursement and overseas care under Aasandha, and the establishment of a green fund. Second, the operations supports measures aimed *at strengthening the revenue base* through tax and non-tax measures. Third, through public financial management reforms the DPF supports measures aimed at *budget credibility and the reduction of expenditure arrears*. Fourth, through the support of a medium-term debt strategy this operation is expected to contribute to the *development of the domestic debt markets and improved debt reporting*. Finally, the DPF supports measures aimed at *enhancing governance and performance of SOEs*.

D. Project Description

The operation's development policy objectives are to (1) improve the policy framework to enhance sustainability of the public finances; and (2) strengthen the policy framework to increase the credibility of the budget. This first proposed Development Policy Financing operation - the first in a series of two operations - is in the amount of USD 20 million on IDA terms for small states. Reforms supported under the first pillar include efficiency improvements to expenditure under Aasandha, the state-run health insurance, by harmonizing drug reimbursement prices for pharmacies and engaging a third-party administrator (TPA) for overseas care to improve expenditure oversight and enhance negotiation power. An indicative trigger for the next operation envisions supporting the engagement of an international wholesaler to reduce drug procurement costs and the hiring of a TPA. The first pillar further supports the establishment of a green fund, aimed at financing investments that protect the environment and support renewable energy, and revenue measures that increase import duties for energy drinks and cigarettes as well as introduce an Airport Development Fee for departing travelers. Indicative triggers aimed at enhancing revenue include the introduction of a personal income tax in 2020 and a further increase in departure fees. Prior actions supported under the second pillar include public financial management reforms that specify the level of budget appropriations, protect the capital budget and regulate virements. In addition, the operation supports the adoption of the Materials Management module of SAP and a new procurement platform to prevent the accumulation of expenditure arrears. The operation further supports the creation of a medium-term debt strategy and the adoption of a corporate governance code for SOEs. These changes are supported by triggers that include amendments in public finance laws to further cement such reforms.

The reforms supported by this operation are aligned with the country's priorities. The "Coalition Manifesto" of the government elected in late 2018 calls for reforms to increase state revenues, control state debt, improve the efficiency of public spending and increased accountability of state institutions. It highlights the importance of providing state services while minimizing the reliance on debt accumulation. In particular, it points to the need to enact Aasandha reforms aimed at reducing the burden of the program on the budget. The 2019 Presidential address to the People's Majlis also underscores the importance of raising more revenues and more sustainable public finances. In addition, environmental protection features prominently in both Manifesto and 2019 Presidential address. These areas are supported by policy actions under Pillar 1 of this operation. Good governance, accountability, and transparency of the public sector also represent key priorities for the new administration. In addition, improving the efficiency of state-owned enterprises was among the pledges for the first 100 days of the new administration. These areas are supported by policy actions under Pillar 2 of this operation.

This operation has been prepared in collaboration with other development partners and complements other World Bank projects under preparation. The World Bank has consulted with the IMF, since there are many common areas of support through the Bank's PFM project and the IMF's South Asia Regional Training and Technical Assistance Center (SARTTAC). The World Bank and the IMF also collaborate on macroeconomic monitoring and the LIC-DSF. The 2014 PEFA report which informs a number of prior actions was prepared jointly with the IMF. In addition, the World Bank and ADB have been collaborating on related topics, such as non-concessional borrowing and technical support to MoF. This DPF is further complemented by a Disaster Risk Management DPF with Catastrophe Deferred Drawdown Option (Cat-DDO) and Pandemic Emergency Financing Facility (PEF) and the Urban Development and Resilience Project, under preparation concurrently. The DPF with Cat-DDO and PEF will support the Government's capacity to manage the human, physical and fiscal impact of climate change and natural disasters including disease outbreaks through the PEF. Improved disaster preparedness will in turn contribute to budget credibility and fiscal sustainability. The Maldives Urban Development and Resilience Project will support enhancing services and strengthening resilience in the Greater Male Region.

E. Implementation

Institutional and Implementation Arrangements

The Ministry of Finance is responsible for the monitoring and evaluation of the program supported by this DPF series. As the main implementing agency, it will coordinate with NSPA and other agencies and ministries to collect the necessary data to assess implementation, monitor progress and evaluate results. The monitoring and evaluations systems are deemed adequate.

F. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

Actions supported by the proposed operation are expected to have either a positive or neutral poverty and social effects. The harmonization of drug reimbursement prices and contracting of TPAs to handle overseas-based hospitals (prior action 1) are expected to contribute to fiscal savings without negatively impacting the quality of the drugs and services provided. These actions are unlikely to have a direct effect on the population, since it will only affect the prices reimbursed by Aasandha to the pharmacies, rather than retail prices paid by the population for over-the-counter medicine. The implementation of a Green Fund is expected to have a positive impact on government finances, however, the poverty and social impacts depend on how the green tax will be used and redistributed. To the extent that this is used for renewable energy projects, it will potentially free up resources (subsidies and transfers related to the use of diesel) that could be allocated to other social spending. The potential negative effects on poor Maldivians' expenditure as a result of price increases due to increased import duties, are likely to be offset by increased health benefits and reduced expenditures on health. Introducing an Airport Development Fee will likely have a neutral effect on the poor given the low share of poor households with expenses on travel abroad. Finally, the adoption of a policy guiding the legal framework of public financial management, debt management and SOE governance are likely to have no adverse or positive effects on the poor or most vulnerable.

Environmental Aspects

The prior actions supported by this operation are expected to have either neutral or potential positive effects on natural resources and environment. The creation of the Green Fund supports climate change adaptation and mitigation measures; and could have positive effects on the environment. With sea levels expected to rise and extreme weather events likely to increase in frequency and intensity, the Maldives is considered one of the world's most vulnerable countries. As coastal erosion, sea level rise, and pressure on scarce land resources increase, the physical vulnerability of island populations, infrastructure, and livelihood assets will increase as well. Positive effects on the environment are expected from the creation of the Maldives Green Fund, which is expected to finance renewable energy and other environment-related projects (waste disposal, coastal protection, among others), resulting in more sustainable used of water resources and more reliance on renewables in the electricity generation matrix.

The environment-related provisions of the Code on Corporate Governance of State-owned Enterprises can also positively contribute to the environment. The code includes provisions on SOE's corporate responsibility, including (i) annual or more frequent reporting on company policies and practices with regard to the environment; (ii) active involvement of the companies in managing their activities so as to minimize any negative impact on the environment; (iii) development of environment policies and practices to comply with existing legislative and regulatory frameworks, (iv) inclusion in Annual Reports information on the company's contribution to securing economic stability, social welfare and environmental safety.

G. Risks and Mitigation

The risks associated with the proposed operation are assessed as high. While the new administration is committed to macroeconomic stability and an ambitious reform agenda, there are downside risks that could delay or complicate the implementation of the reforms. This reflects, amongst others, high political and governance risks, and macroeconomic and institutional capacity risks. These risks may limit the ability to conduct the necessary reforms, while fiscal and external risks impact the macroeconomic framework. The proposed operation supports the government's critical efforts to improve fiscal sustainability and budget credibility, which can strengthen the overall policy framework and institutional capacity within GoM. The risk, therefore, of not engaging is higher and outweighs the risks to the DPF. One additional mitigating factor is the Bank's long-standing relationship and frequent interactions with the MoF, acting as a trusted partner in many just-in-time requests.

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APPROVAL

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