

THE ROLE OF FOREIGN AID FOR A GRADUATING LDC – THE MALDIVES

Outline of presentation

- ◉ Macro-economic challenges
- ◉ Levels and trends of foreign aid to the Maldives
- ◉ Aid effectiveness
- ◉ Policy directions and priorities
- ◉ Approaching donors

Challenges

- Maldives is set to graduate from LDC Status by 1 January 2011
- This amidst huge challenges
- Political challenges
- Economic challenges (perhaps most relevant for the present topic)
- Demographic challenges
- Social challenges

- Macro-economic Challenges
 - Overcoming the impact of the Global Financial Crisis
 - Fiscal Problems
 - Financial Sector Risks and Reform
 - Structural Problems with the Economy
 - Infrastructure and addressing inequality

Global Financial Crisis

- Net Cumulative Impact of the GFC is estimated at approximately USD309 million or 24.5% of GDP according to the IMF. As such, GDP growth rate is expected to shrink by 4%

Fiscal Imbalances

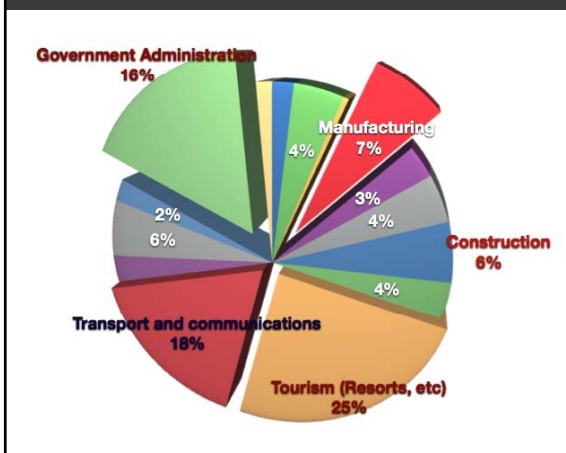
- Since 2004 – significant fiscal expansion, most notably a steep wage bill increase, pushed public expenditure to 63% of GDP in 2008.
- The fiscal deficit rose to 13.75% of GDP in 2008, and without the corrective action currently undertaken by the Govt, this was expected to hit 33% of GDP in 2009.

Narrow Financial Base – Reliance on Tourism for Strength of Financial Sector



- 61% of all loans to Tourism Sector
- Concentrated to a few borrowers with signs of non-performing
- Overall financial sector is also vulnerable to a decreased dollar liquidity shock through:
 - Large exposure to short-term external financing
 - High loan-to-deposit ratio in foreign currencies
 - Large negative net foreign asset position

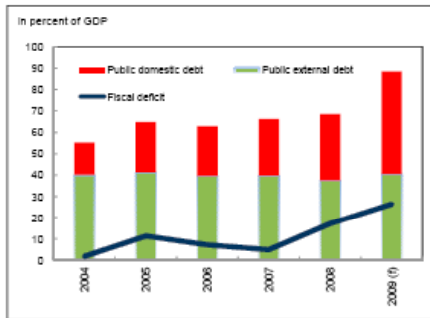
Structural Problems



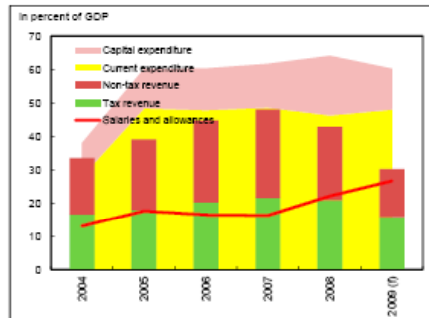
- ▶ Narrow Economic Base – Tourism 25% of GDP but this actually understates its importance.
- ▶ Narrow from a geographic (predominantly European) and product basis (high end tourism only).
- ▶ Tourism sector is relatively strong when rebounding to shocks (Tsunami and Gulf War) but in this case, the deteriorated fiscal and monetary situation put undue stress on the economy.

Debt and Revenue 2004-09

Debts



Revenue



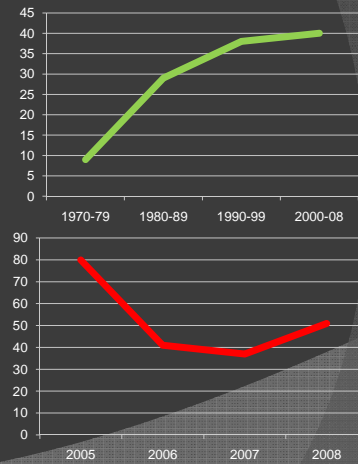
Levels and trends of foreign aid to the Maldives

Recent trends in foreign assistance receipts in the Maldives

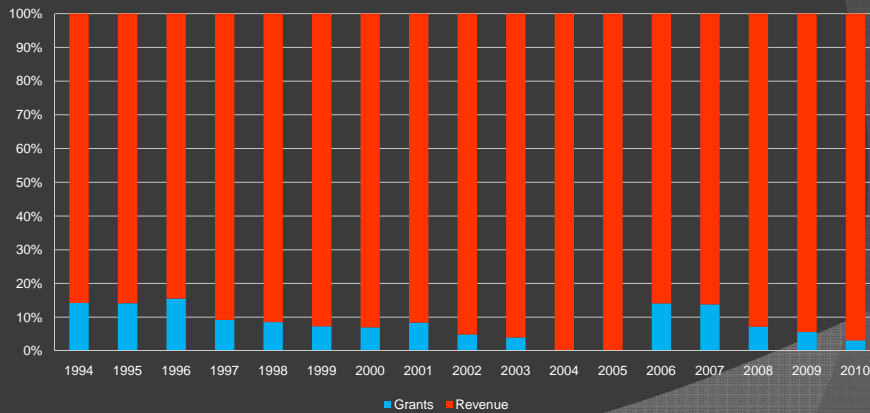
It is difficult to estimate the exact amount of pledged foreign assistance to Maldives since there is no comprehensive record of all types of assistance including DEX and NEX projects especially following the Tsunami

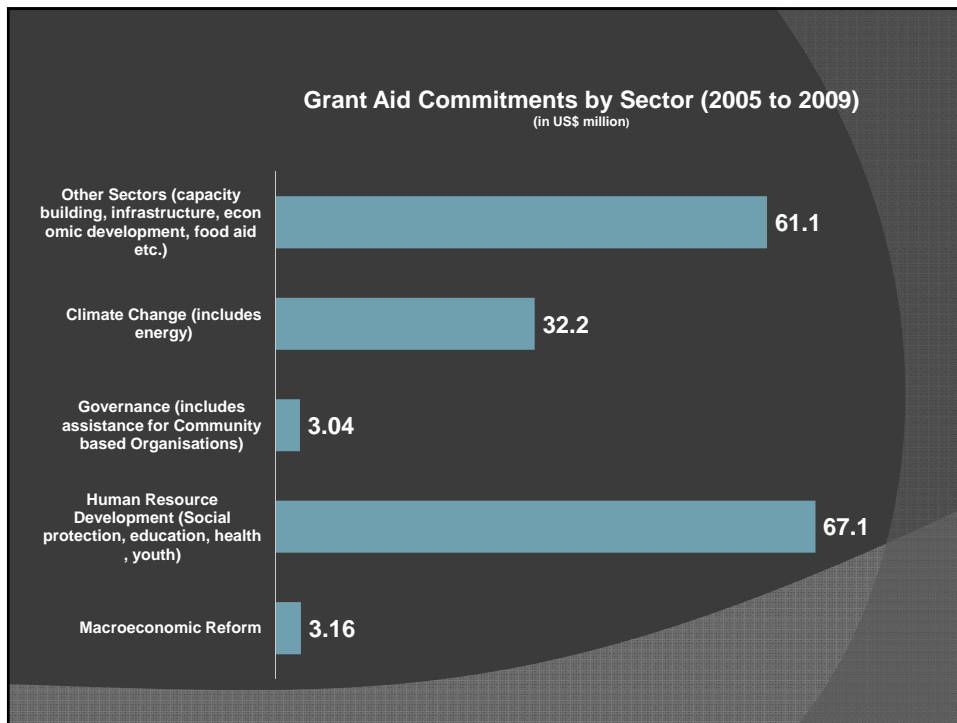
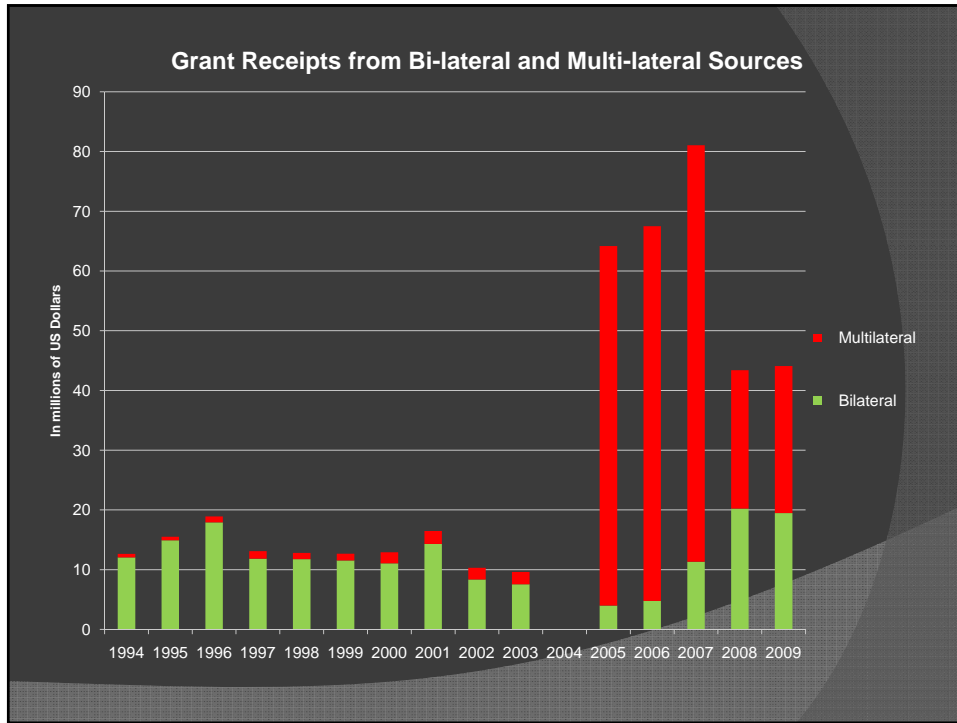
During 2005-2008 Maldives, similar to other tsunami affected regions, achieved significant growth due to the relatively large influx of ODA.

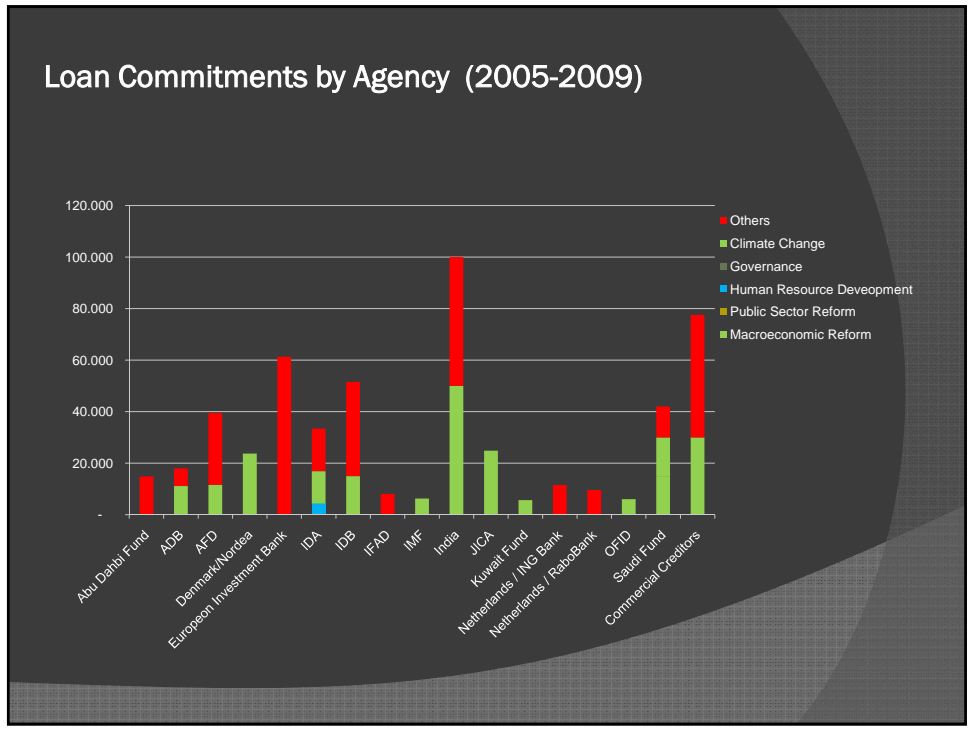
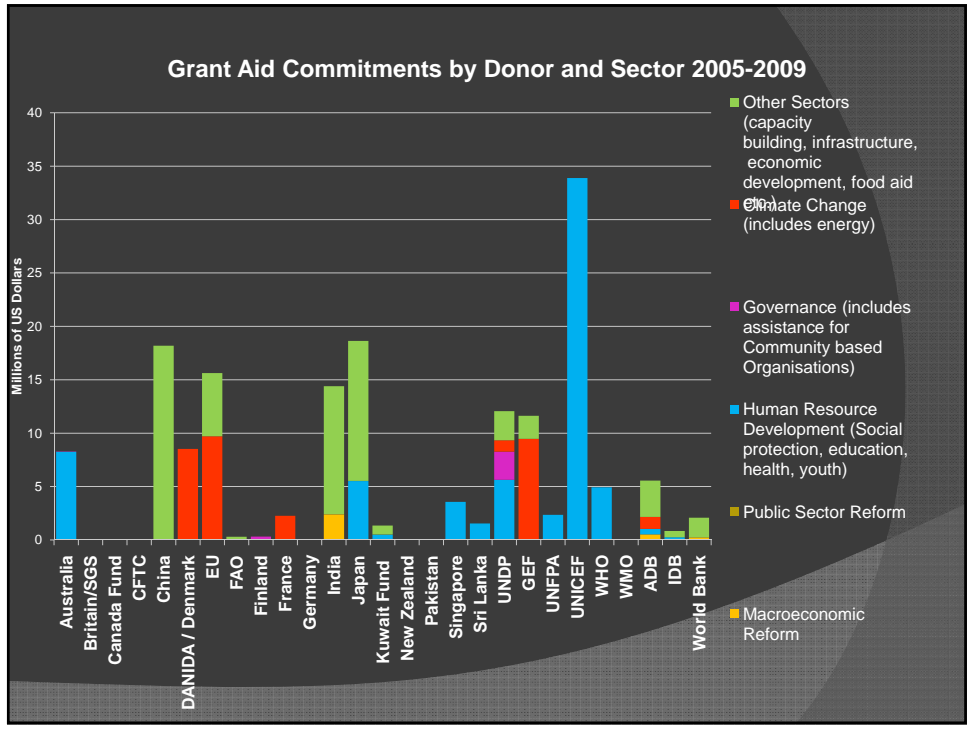
ODA to Maldives
USD million, 2007 prices and exchange rates, net
ODA receipts - Source OECD



Government Revenue and Grants 1994-2010



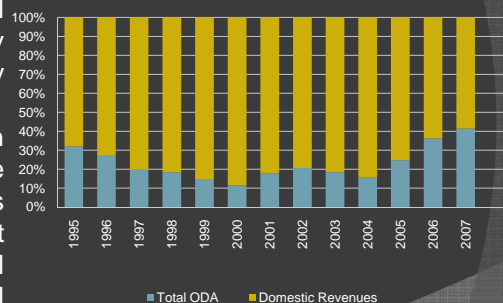




The role of foreign assistance in the Maldives

Significance of foreign aid in national budgets and fiscal policy

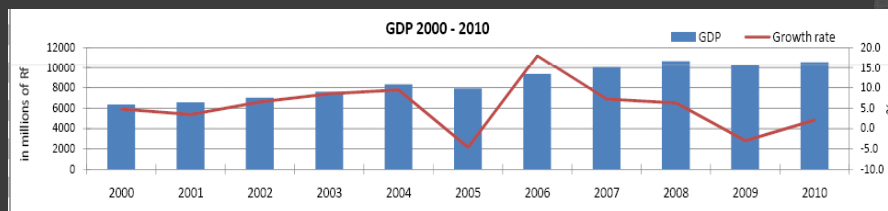
External resources account for up to 40% in 2007 budget. The bulk of external resources can be directly attributed to tsunami recovery and reconstruction, however, even when such funds are excluded, external resources continue to play an important role for the successful execution of developmental priorities of the country.



The contemporary role of foreign assistance in the Maldives

In the past, majority of the development expenditure was financed by external resources with the grant component being significantly high. This include official bilateral and multilateral aid flows and limited International NGO assistance to the Maldives.

In particular, foreign aid played a significant role in recovering from the impact of Tsunami in December 2004.



Due to the narrow economic base and related issues of economic vulnerability, environmental vulnerability of the islands and other insularity problems associated with smallness, Maldives will continue to have to rely on the international community for development assistance in the medium and long term, even after graduating from LDC status.

The domestic economy is too weak to provide sufficient resources for the high-cost economic development of the island nation.

Against the backdrop of these challenges and vulnerabilities, development financing through commercial borrowing is not a viable option for the Maldives at present.

The key opportunity costs of foreign aid

- Foreign aid is essential. However, when it comes with conditionalities, as is often the case,
- Tied aid leads to lack of ownership and community participation in development projects
- Community spirit is lost
- Local capacities are not developed
- Cost of services increased (eg. Tsunami)
- Increased expectations of people
- Unfinished business (water tanks and desalination plants) leaves huge recurrent costs to the government and the communities.

Foreign aid mobilisation is coordinated by the government through an established aid-coordination mechanism that has been agreed with development partners during the Donor Conference.

The National Planning Council, Chaired by the President and represented by key ministers (Finance, Economic Development, Housing and Environment) and representatives of the Private Sector and Social Sector decides on the projects to be submitted for donor financing.

Decisions are based on the Government Manifesto and SAP with considerations for duplication and recurrent cost to the budget.

Despite the existence of such a mechanism, the specific sectors are often dictated by donor preference. Eg. Environment and climate change being a priority area for most donors at present.

Health and education not so much of a priority for many donors at present.

Effectiveness of aid

Guiding Principles for ODA mobilization and Utilization
in the Maldives

To ensure ***national ownership***, Maldives exercise effective leadership over development policies and ODA projects and programs (NPC)

To ensure ***alignment and harmonization***, Maldives work with development partners to base their overall support to national development plans and strategies (Donor Conference).

The existing mechanisms to ensure ***predictability*** of aid to the Maldives is weak.

The government tries to negotiate its ODA requirements with donors during the annual donor conference/partnership forum.

To the extent possible, ODA funds are used to enhance government capacity to implement and execute projects and programs.

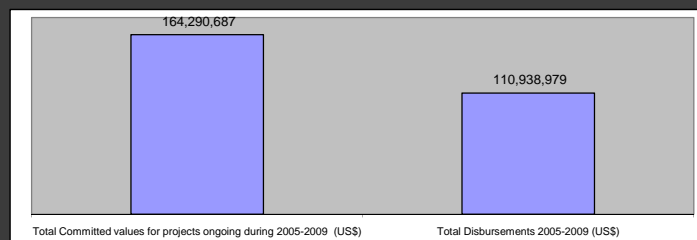
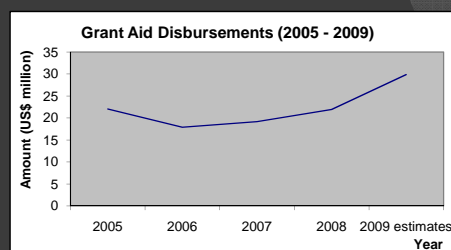
To ensure, coordination and results, utilization and mobilization of ODA funds are based on avoiding duplication and recurrent costs.

To ensure mutual accountability, development partners are encouraged to adhere to the government's processes of monitoring and evaluation.

Future policy priorities

Ensure that growth of economy does not suffer due to less or more expensive foreign aid.

Accelerate the disbursement of signed ODA projects to put their outputs into operation and monitor and evaluate the effectiveness of the programs.



Future policy priorities

Streamline foreign aid to address the implications of graduation from LDC by preparing effective and high quality projects that continue after 2010

Through continuous engagement with government, civil society, corporations, and development partners, effectively implement the national development strategies and achieve Millennium Development Goals.

Sectors / Areas identified for foreign aid

- 1- Macroeconomic Reform
 - 1.1 Budget Support
- 2- Public Sector Reform
 - 1.1 Civil Service Reform,
 - 1.2 Structural Reform
- 3- Social Development
 - 3.1 Social protection,
 - 3.2 Education,
 - 3.3 Health,
 - 3.4 Youth
- 4- Governance (includes assistance for Community based Organisations)
 - 4.1 Rule of Law
 - 4.2 Decentralisation
 - 4.3 Eliminating Corruption
- 5- Climate Change (includes energy)
 - 5.1 Water and Sewerage
 - 5.2 Coastal Protection
 - 5.3 Alternative Energy Sources
 - 5.4 Integration of Communities / Transport
- 5- Other Sectors (includes capacity building, infrastructure, economic development, food aid etc.)

Approaching Donors

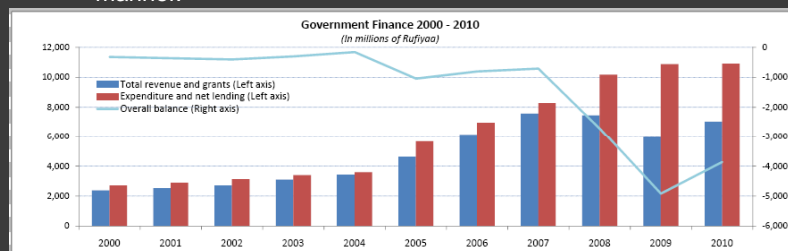
the Maldives is in the process of donor mapping exercise to identify the right kind of aid. This include exercise include the traditional donors as well as new players to the donor landscape such as China and India. Maldives is implementing the following five point approach:

- ✓ Develop a long term international cooperation strategy to identify role of development partners as donors, investment partners etc
- ✓ Enhance and streamline the role of key aid coordination institutions in the Country
- ✓ ERCC to be more active, revisit ERCC mandate
- ✓ Encourage donor presence in the country

longer term exit strategy for aid

Maldives graduation from LDC in December 2010 , brings the following challenges

1. The competitive threat faced by the fisheries industry
2. Decrease in concessionary external financing
3. Perception of development partners that Maldives has capacity to pursue development efforts in a less externally dependent manner.



As seen from the graph, in the short-term, Maldives dependence on Foreign Aid is still likely to be high.

longer term exit strategy for aid

However, active integration into the global and regional economy with the turning point of Maldives graduation from LDC in 2010 also opens up opportunities for new types of the assistance from bilateral sources International Financial Institutions.

Change in the government in 2008 also presented excellent opportunity to reformulate the way foreign assistance is being utilized in the Maldives. The current government gives high priority to privatize (through PPPs etc) most of the public services, thus reducing the demand for foreign assistance.

Government has also send key tax legislations to the parliament and once a proper tax regime on personal income, capital gains, business profits , real estate, etc. are established, more money will be available for government expenditure , which intern reduce the need for ODA.

“.... there is an emerging consensus on aid effectiveness – without far-reaching changes in how aid is delivered, it won't achieve maximum benefits.

It should no longer be conditional on recipients promising economic change like privatizing or deregulating their services, cutting health and education spending, or opening up their markets. Aid should support poor countries' and communities' own plans and paths out of poverty.

At the same time, recipient countries need to have people and policies in place so that the aid is used in an honest and transparent way. Aid will work if people dealing with it both in the north and the south are made accountable.

Aid also needs to focus better on poor people's needs. This means more aid being spent on areas such as basic health care and education”.

<http://www.oxfam.org/en/about/issues/aid-effectiveness> (downloaded on 25 July 2010)