Ministry of Finance
Male' Maldives

MEDIUM-TERM FISCAL STRATEGY

2024-2026

31 July 2023

Content

1. Introduction

This is the statement informing the Government's Medium-Term Fiscal Strategy to be submitted to the Finance Committee of the Parliament under Article 10 of Act No. 2013/7 (Fiscal Responsibility Act).

At the time of the presentation of this Fiscal Strategy, the Maldives have overcome the economic impacts of Covid-19. However, we are now faced with new fiscal risks as a result of the rising costs of energy and other commodities in the international markets, along with the increasing interest rates of the global financial markets. Government revenues are expected to be higher than the estimated figures due to a strong performance of the economy this year and, the revision of GST rates at the beginning of the year. On the other hand, government expenditures are expected to be higher than the budget. Major contributors to this include the increased expenditures on subsidies and the domestic components of the Public Sector Investment Program (PSIP) projects. Furthermore, financing the budget has become more challenging due to rising global interest rates and the widening of the fiscal deficit. As such, this Fiscal Strategy aims to formulate fiscal policies that address these risks, as well as ensure the fiscal and debt sustainability in the medium-term. Reform policies to ensure the sustainability of public spending are detailed in this Fiscal Strategy. The Government Annual Budget 2024 as well as the medium-term budgets will be formulated based on this strategy.

This statement includes a detailed comparison of the estimates presented in past Fiscal Strategies and Budget 2023; actual figures for 2022, along with revised estimates for Budget 2023. The focus is on the medium-term fiscal strategy and the medium-term budget, together with a demonstration of the adherence to the Fiscal Responsibility Act. A summary of fiscal risks and the activities carried out in the area of Public Finance Management Reform is also presented. The statement is prepared using the "Medium Term Fiscal Framework" developed by the Ministry of Finance, based on data available as at 31 May 2023.

2. Economic Condition and Outlook

The economic developments and outlook of the Maldives and global economy are key determinants considered when formulating fiscal policy. This section highlights the economic developments in 2022 and the economic outlook for 2023 and the medium term.

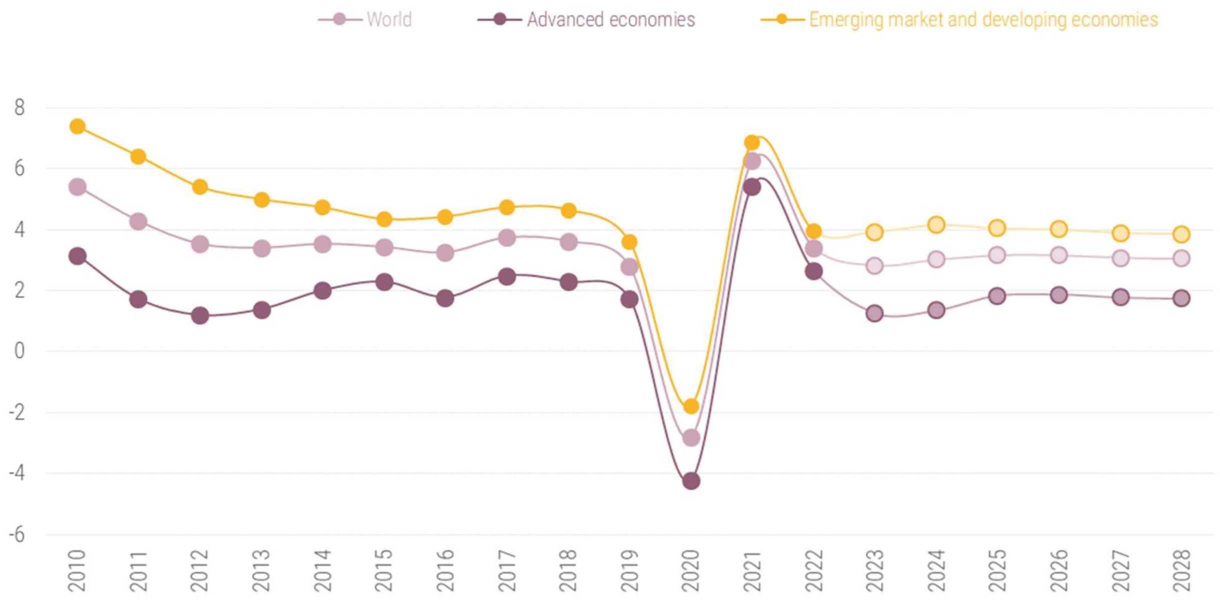
The source of information presented in this section pertaining to global economic growth and inflation is the International Monetary Fund (IMF). The estimates for economic growth till the year 2022 are from Maldives Bureau of Statistics, while the forecasts for 2023 and the medium-term are estimates by the Ministry of Finance and the Maldives Monetary Authority (MMA). Given the uncertainties in the global and domestic economies following the Covid-19 pandemic, economic growth forecasts comprise of three scenarios, namely the best case, moderate case, and worst case. The baseline estimates used in this strategy are forecasts from the moderate case scenario. In addition to economic growth, this report will encompass details on recent developments and outlook on inflation and balance of payments of the Maldives.

In the event of changes in the global or domestic economy that result in deviations between the economic forecasts and realized outcomes, there is a likelihood of adjustments to government revenue and expenditure estimates. Therefore, this statement also offers a summary of the potential impacts on government revenue and expenditure resulting from the risks to the global economy and the economy of the Maldives.

2.1 Global Economic Condition

According to the IMF's World Economic Outlook April 2023, global economic growth is projected to decelerate to 2.8 percent in 2023, following a growth of 3.4 percent in the preceding year. Furthermore, global economic growth for the year 2024 is forecasted to be 3.0 percent by IMF. The Fund has identified financial sector risks with plausible passthrough to the global economy as a result of the failure of two US banks and collapse of confidence in prominent European Bank, Credit Suisse. In a plausible alternate scenario proposed by the IMF, the growth forecast for 2023 may be revised down to 2.5 percent. Additionally, the IMF also forecasted that economies of some of the largest tourist source markets may experience economic recessions. Chart 1 illustrates the trajectory of the global economy and economic growth of developed and developing economies.

Chart 1: Economic growth of developed and developing economies (in percent)



Source: International Monetary Fund

Global inflation for the year 2022 is estimated to be at 8.7 percent reflecting the rise in fuel and commodity prices and higher economic activity post-Covid-19 amid the recovery. The IMF forecasts inflation to fall to 7.0 percent in 2023, however, this figure remains notably higher than the pre-pandemic level. Despite a marginal deceleration in inflation this year, the price level will continue to be higher than the price levels of two years prior, as a significant price increase is expected on top of the price hike in 2022. The IMF posits that inflation rate will revert to pre-pandemic levels by 2025, despite the decline in inflation rate in the next two years.

2.2 Tourism

The tourism sector in the Maldives has exhibited faster growth than previously estimated, nearly reaching pre-pandemic levels in terms of tourist arrivals while total number of tourist bed nights tourists surpassed 2019 level. The year 2021 witnessed a positive trajectory for the tourism industry as it began to recover from the Covid-19 pandemic's adverse effects. This positive momentum continued into 2022, with the sector experiencing a rapid recovery. During the budget preparation for 2022, tourist arrivals were projected at 1.63 million tourists and the number of bed nights was forecasted at 10.4 million. However, by the end of the year, the Maldives welcomed 1.68 million tourists, and the number of bed nights surpassed 12.3 million. Key factors contributing to the fast recovery of tourism sector in 2022 are the country's successful recovery from the Covid-19 crisis, the reopening of borders of more countries, and the inauguration of the new runway at Velana International Airport.

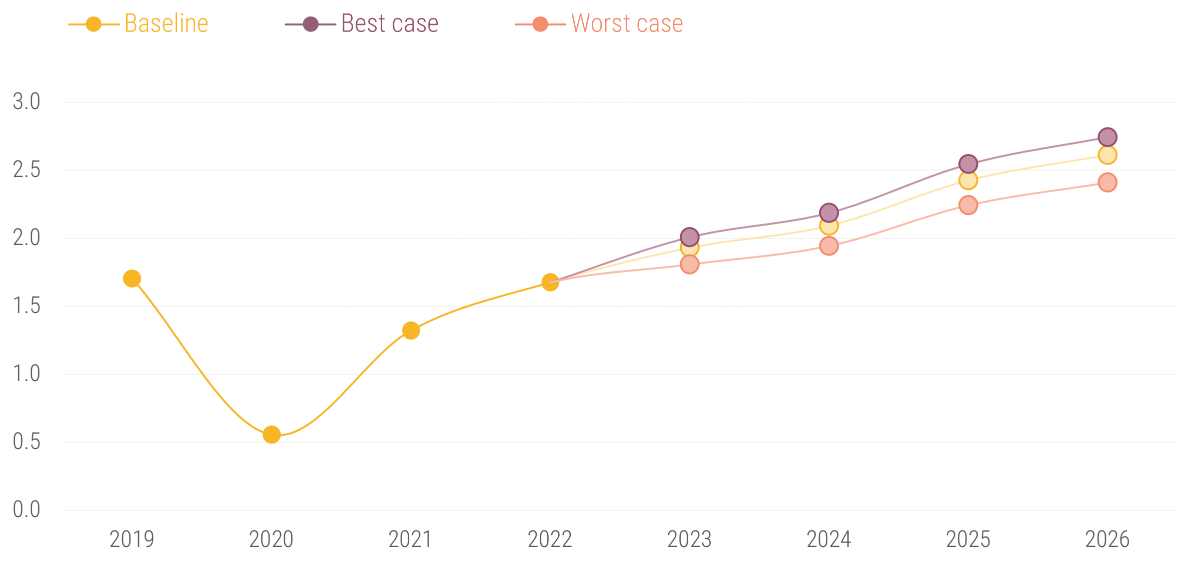
Despite the overall growth in 2022, tourist arrivals during that year were 1.6 percent lower than in 2019. Several factors contributed to the slightly lower number, such as market slowdowns due to the Russian-Ukrainian war, escalating oil and commodity prices, and the continued closure of China's border. On the other hand, bed nights increased by 14.7 percent from the pre-pandemic level, primarily driven by an increase in the average number of nights spent by tourists visiting the Maldives following the pandemic outbreak.

Tourism activity in the first quarter of 2023 has shown a remarkable increase, largely due to the opening of China's borders and the resumption of Chinese market in January 2022. In the first quarter of 2023, 523,928 tourists visited the Maldives, marking a 21.4 percent increase compared to the same period in 2022 and an 8.5 percent increase compared to the first quarter of 2019. Similarly, 3.9 million bed nights were recorded during the first quarter of 2023, reflecting a 15.0 percent increase from 2022 and an impressive 28.8 percent increase compared to 2019. The opening of China's borders on January 18, 2023, played a crucial role in driving this growth. Although Chinese arrivals remained 76.9 percent lower compared to the first quarter of 2019, the ongoing recovery of Chinese outbound tourism and an expected increase in direct flights to the Maldives in the year 2023, is likely to increase tourist arrivals from China during the year.

Considering the vulnerability of the tourism sector to global economic shocks, the estimates for tourist arrivals and bed nights are based on three scenarios: the baseline or moderate case scenario, the best-case scenario, and the worst-case scenario. The macroeconomic estimates for moderate case scenario have been used in deriving the fiscal estimates for this strategy. As such, tourist arrivals are expected to be between 1.8 million and 2.0 million in 2023. In the baseline scenario, tourist arrivals are projected to surpass pre-pandemic levels, reaching 1.9 million in 2023. Moreover, bed nights are expected to reach a record high of 14 million in 2023. In the medium term, tourist arrivals are anticipated to grow by 8.3 percent in 2024, while bed nights are expected to grow by 7.4 percent. Additionally, the completion of the new terminal at Velana International Airport in 2025 is expected to further augment both tourist arrivals and bed nights growth, as the new terminal will enable more flights to be scheduled to the airport.

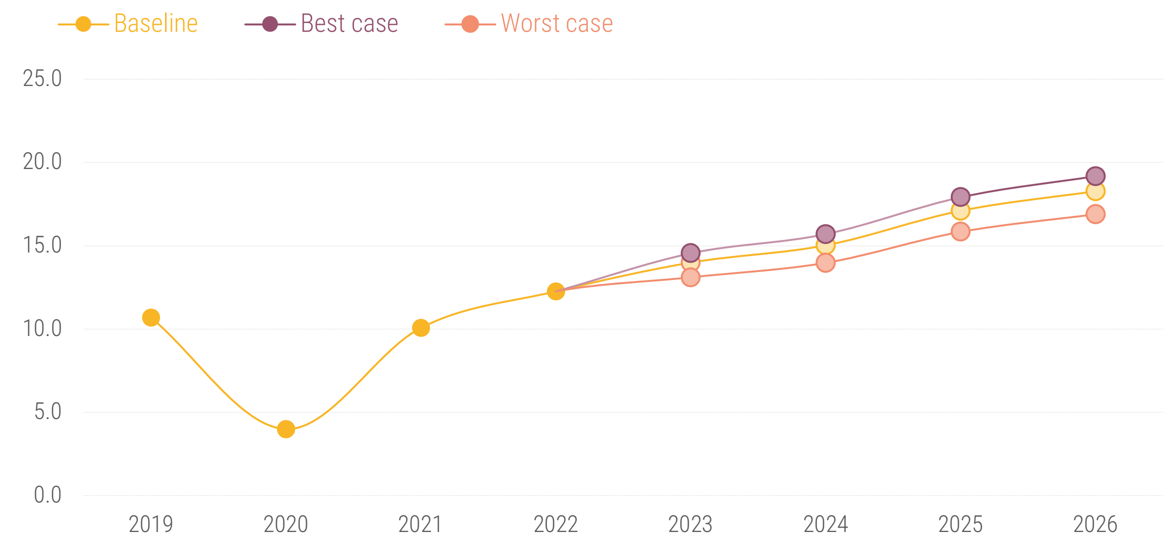
The forecasts for tourist arrivals and tourist bed nights can be seen in Chart 2 and Chart 3, respectively.

Chart 2: Tourist Arrivals (in millions)



Source: Ministry of Tourism, MMA

Chart 3: Tourist Bed nights (in millions)



Source: Ministry of Tourism, MMA

2.3 GDP

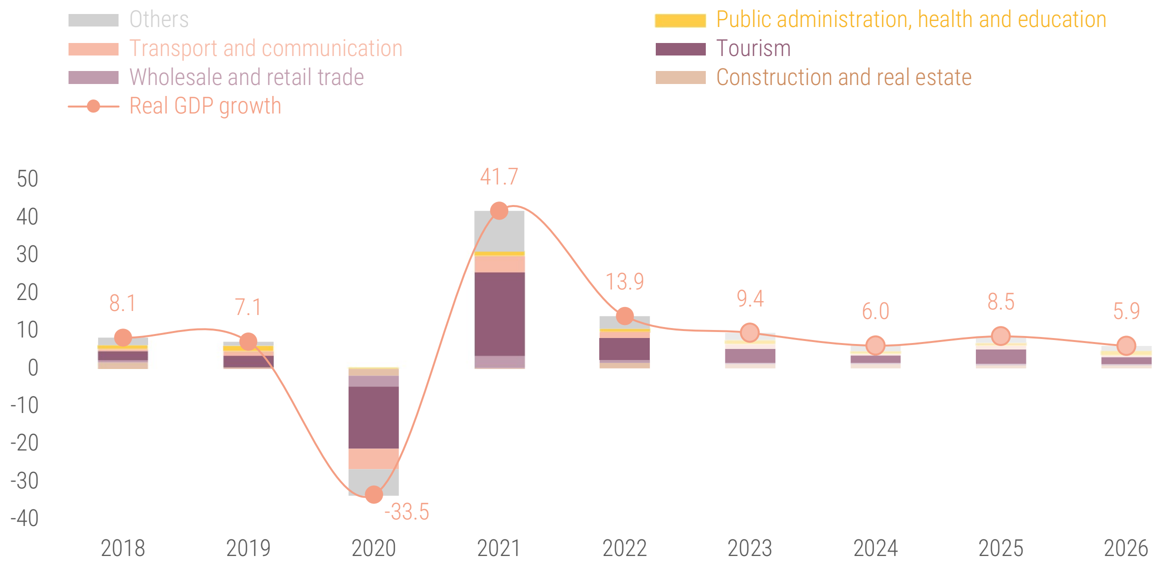
The GDP growth in 2022 is now expected to exceed previous estimates, with updated projections indicating a growth of 13.9 percent. This growth is 1.6 percentage points higher than the GDP growth estimate for the budget 2023. Given this, the economy has returned to its pre-pandemic levels by the end of the year. Despite the initially anticipated economic shocks from the Russian-Ukrainian war, which commenced in February 2022, the actual impact of the war on the economic growth was less pronounced than previously expected.

The increase in productivity in 2022, surpassing previous estimates, is primarily attributed to the robust growth of the tourism sector. In 2022, the tourism sector is projected to expand by 22.4 percent, which is 5.2 percentage points higher than previous estimates, despite no tourists from China, which is one of the largest source markets to Maldives. The tourism sector is forecasted to register an average annual growth of 8.8 percent in the medium term. In addition, with the completion of the new terminal at Velana International Airport and the ongoing development of airports in Hanimaadhoo and Gan, growth of tourism sector is expected to double, propelling the tourism sector's growth to 13.2 percent in the year 2025. Alongside the tourism sector, several other sectors are also expected to grow at a faster pace than previously forecasted in 2022.

The forecast for the construction and real estate sector's growth in 2022 was 23.3 percent, nevertheless, sectors' growth was lower at 11.8 percent. This difference in growth rate arises from the sector's decelerated growth during the last quarter of 2022 in comparison to the initial months. During the latter months of 2022, construction activity and the trade of construction materials slowed down across the globe. Nevertheless, the sector's growth forecast, initially estimated at 8.1 percent for 2023, has now been revised to 9.5 percent, as the global market is expected to recover from the supply chain bottlenecks. In the medium-term (from 2024-2026) the sectors are forecasted to grow at 7.7 percent as a result of government infrastructure projects, private sector residential initiatives, as well as the construction of new tourism establishments.

In addition to tourism, the sectors contributing the most to the economic growth of 2022 include transportation and communications, as well as construction and real estate. Transportation and communications are forecasted to register a growth of 17.1 percent in 2022, while wholesale and retail trade are expected to grow by 11.5 percent. Public administration, health, and education have registered growth at a rate of 4.2 percent in the year 2022. Chart 4 illustrates the economy's growth rate and the respective contributions of different sectors to economic growth.

Chart 4: GDP Composition by sector (in percentage)



Source: Ministry of Finance, MMA, Maldives Bureau of Statistics

The forecast for GDP growth in 2023, initially estimated at 7.6 percent, has now been revised to 9.4 percent. The medium-term average annual growth was previously forecasted at 6.3, while the average annual economic growth is currently revised upwards to 6.8 percent. The primary driver behind the upward revision of medium-term average economic growth is expected growth in economic activity due to the completion of the new terminal at Velana International Airport and the development of Addu and Hanimaadhoo airports in 2025. These advancements are expected to significantly boost the tourism sector and other segments of the economy.

2.4 Inflation

While several countries experienced significant price increases in 2022, the Maldives registered a modest overall inflation of 2.3 percent. Inflation for the first quarter of 2022 was recorded below 1.1 percent. However, starting from May, inflation has consistently surpassed 2.5 percent. Various factors contribute to the heightened inflation rate in 2022. One of these factors is the cessation of the base effect caused by discounts provided by the government in 2021. Furthermore, escalated global food prices have led to elevated prices for imported food items.

Additionally, increased transportation costs are also playing a role in the escalation of prices. Despite these contributing factors, the growth in price level was reduced as a result of lower telecommunications prices compared to the previous year. Notably, the inflation rate in the Maldives remains unaffected by the surge in global oil prices since government has fixed electricity prices using electricity and fuel subsidies.

Projections indicate that inflation will be recorded at 3.4 percent in 2023. This marks a reduction from 5.4 percent, the initial inflation forecast during the preparation of this year's budget. The inflation forecasts were revised downwards because of the delayed implementation of fuel subsidy reform and due to the downward revision of global fuel price forecasts by international agencies. In the absence of new revenue and expenditure policies, barring unforeseen economic shocks that might alter commodity prices, inflation is expected to maintain an average of 1.3 percent in the medium term.

However, the direct effect of expenditure consolidation measure of reforming subsidies to a direct transfer system outlined in this strategy is likely to increase inflation rate to 2.3 percent next year. The prices may rise further, when indirect effects are accounted for. Nonetheless, the proposed reform of the subsidy system will compensate the low-income groups through direct transfers to reduce the impact on their disposable income. Hence, it is estimated that the proportion of the population that is eligible for the subsidy will be minimally affected by the price increase due to the subsidy reform.

2.5 External Sector

The current account deficit is expected to widen to USD 1,033.1 million in 2022 (16.6 percent of GDP) from USD 455.0 million recorded in 2021 (8.4 percent of GDP). This increase in the 2022 current account deficit can be attributed to two primary factors: an increase in both the price and quantity of imported goods resulting from higher global commodity prices and expansion in economic activity respectively. Nonetheless, the current account deficit declined compared to previous estimates owing to the robust growth of tourism receipts.

Looking into other components of the current account, the balance on services, which represents net exports of services, saw a significant increase of 19.2 percent in the past year which includes 28.2 percent increase in tourism services exports. Conversely, the balance on goods escalated by 38.4 percent in 2022, resulting from a 38.6 percent increase in imports of goods. Furthermore, there was a 34.8 percent increase in outflows attributed to income from domestic investments compared to 2021. Additionally, outflows in the form of remittances from foreign workers increased by 12.3 percent, further contributing to the expansion of the current account deficit.

The central bank's outlook maintains that the current account deficit is likely to remain relatively stable, approximating USD 1,010.1 million (equivalent to 14.5 percent of GDP) in 2023. The ministry's forecasts align with this trajectory, indicating a continued contraction of the current account deficit in the medium term. This decline in deficit is expected to occur year-on-year, primarily driven by the anticipated growth in tourism earnings that are forecasted to exceed outflows through imports and remittances.

3. Comparison of Fiscal Strategy proposed in 2021 and 2022, with the Approved Budget for 2023

This section compares the differences in estimates for the Approved Budget 2023 with those in Fiscal Strategy 2022 (prepared for the period 2022 to 2024) and Fiscal Strategy 2023 (prepared for the period 2023 to 2025).

Table 1: Estimates for the Budget 2023 and Fiscal Strategies 2022 and 2023

	Fiscal Strategy 2022		Fiscal Strategy 2023			Budget 2023		
MVR millions	2023	2024	2023	2024	2025	2023	2024	2025
Revenue and Grants	26,703.8	27,372.3	30,792.5	32,349.7	35,032.6	32,098.3	34,449.3	35,254.9
Total Revenue	24,553.3	25,934.7	28,458.5	31,479.7	34,159.1	29,628.9	31,978.2	34,842.7
Total Grants	2,150.5	1,437.6	2,334.0	870.1	873.5	2,469.4	2,471.1	412.2
Budget	37,454.5	37,916.1	41,533.4	43,678.7	49,997.9	42,840.8	46,849.1	45,434.1
Expenditure	35,035.1	35,657.4	39,042.1	41,363.0	41,568.8	40,718.3	44,224.4	40,594.6
Overall Balance	(8,331.2)	(8,285.1)	(8,249.6)	(9,013.2)	(6,536.3)	(8,620.0)	(9,775.2)	(5,339.7)
Primary Balance	(4,638.4)	(4,207.2)	(4,503.8)	(4,874.0)	(2,247.7)	(5,183.1)	(5,946.9)	(1,258.3)
Economic Assumptions								
Nominal GDP	93,358.6	104.037.9	103,080.7	114,897.9	125,744.4	104,389.7	112,846.8	123,829.4
Real GDP Growth (%)	11.5	9.2	9.7	9.5	7.5	7.6	6.0	7.6
Tourist Bed nights	11,550,621	13,191,630	12,518,543	14,369,842	16,352,586	12,997,948	13,947,217	15,846,254

Source: Ministry of Finance, Maldives Monetary Authority

Between Fiscal Strategy 2022 and Fiscal Strategy 2023, as well as the Budget 2023, forecasted revenue and grant estimates have been revised upward. The revenue estimates initially formulated for Fiscal Strategy 2022 was based on the information available as at May 2021, economic recovery from the pandemic was then expected to be slower. Notably, the projected revenue estimates did not incorporate the GST rate change for the year 2023.

Given the faster than expected economic recovery from the Covid-19 pandemic in the years 2021 and 2022, revenue estimates for the Fiscal Strategy 2023 and Budget 2023 have been revised upwards. Additionally, the revenue estimates for Budget 2023 takes into consideration the implementation GST rate change from January 2023, as proposed in the Fiscal Strategy for 2023.

Similar to revenue projections, expenditure estimates have been revised upwards between Fiscal Strategy 2022 and Fiscal Strategy 2023, as well as the Budget 2023. Expenditure estimates for 2023 in the Fiscal Strategy 2022 was estimated 2023 based on the assumption that global oil prices would remain at pre-pandemic levels. In addition, it was anticipated that the pace of PSIP implementation would slow due to the disruptions caused by the Covid-19 pandemic. However, the commencement of the Russia-Ukraine war in February 2022, and the subsequent hike in global fuel prices, contributed to the increase in spending on fuel subsidies. The increase in fuel subsidies has been one of the main drivers for the higher expenditure compared to estimates for Fiscal Strategy 2023 and Budget 2023. Additionally, the outlay for the expenditure on Public Sector Investment Program (PSIP) has surpassed previous estimations, due to the fast pace of implementation infrastructure projects as the economy recovered from the Covid-19 pandemic. The increase in council block grants is also a contributor of higher than estimated expenditure compared to the Fiscal Strategy 2023 and Budget 2023 estimates, driven by the robust economic recovery. As a result, the estimated budget deficit for 2023 outlined in Budget 2023 exceeds the deficit forecast in the Fiscal Strategy 2023.

4. Comparison of Revenue and Expenditure of 2022 with Revised Figures for 2023

This section includes details on actual revenue and expenditure for the year 2022, revenue and expenditure as of May 2023 and, the revised estimates for 2023.

Table 2: Details of actual revenue and expenditure 2022

	Fiscal Strategy		Budget Estimates		
MVR millions	2021	2022	Approved	Revised	Actual
Revenue and Grants	23,661.1	24,947.8	24,279.9	26,361.1	29,053.0
Tax Revenues	14,710.2	17,829.4	15,355.0	18,979.7	19,528.5
Non-Tax Revenues	5,426.8	6,249.4	6,418.4	6,789.2	482.8
Grants	2,238.9	1,026.0	2,911.8	592.3	1,041.7
New Revenue Measures	1,394.6	-	-	-	-
Total Budget	37,040.2	42,807.9	42,847.2	42,847.2	42,824.4
Recurrent Expenditure	21,121.9	27,555.7	28,144.5	27,894.5	28,090.8
Capital Expenditure	14,045.8	15,252.3	14,702.6	14,952.6	14,737.6
PSIP	7152.2	7,427.5	7,334.8	8,958.7	8,733.1
Loan Repayment	3,181.2	3,005.5	2,861.7	2,754.7	2,693.1
New Policy Initiatives	500.0	-	1,401.8	-	-
Total Expenditure	33,848.8	39,730.7	39,949.7	39,992.2	40,060.0

Overall Balance (Deficit)	10,182.6	14,782.9	15,669.8	13,631.1	11,007.1
Primary Balance	6,896.5	11,733.5	12,754.6	10,396.7	7,554.6
Overall Balance as a share of GDP (%)	-12.4	-16.0	-17.9	-14.3	-11.4
GDP	82,003.9	92,343.1	87,498.2	95,241.1	96,131.7

Source: Ministry of Finance

Notes:

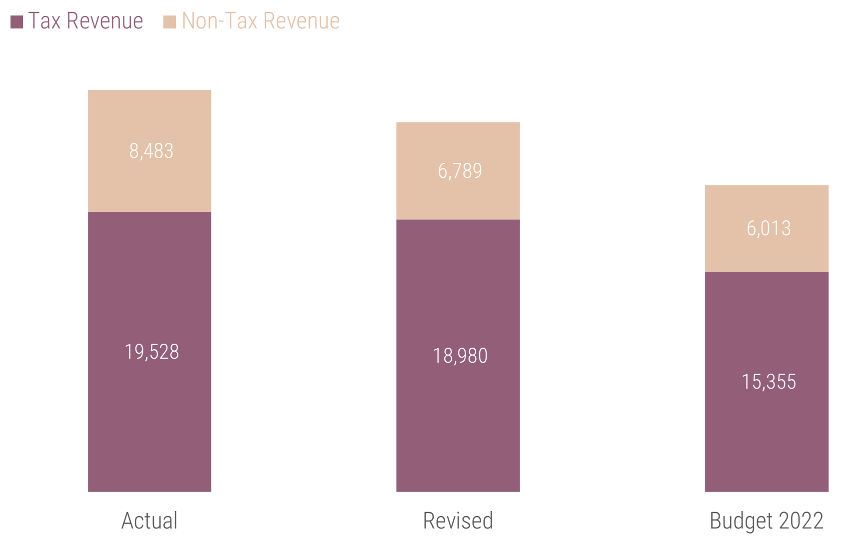
- Fiscal Strategy estimates indicate the initial estimates for 2022 submitted in Fiscal Strategy 2022 (prepared in 2021) along with the revised estimates in the Fiscal Strategy 2023 (prepared in 2022)
- Approved budget figures for 2022 indicate the estimates included in the Approved Budget 2022, along with the revisions submitted with the Approved Budget 2023
- New Revenue Measures and New Policy Initiatives are included in the figures, except for the initial proposal

4.1 Actual Revenue and Expenditure 2022

4.1.1 Revenue

Total revenue received by the Government during the year 2022 sums up to MVR 29,053.0 million, which is 19.7 percent higher than revenue estimates included in the approved budget for the year, and 10.2 percent higher than the revised revenue for 2022, published in the approved budget 2023. As the economy started to recover in the year 2021, government revenue reached pre-pandemic levels during the year 2022.

Chart 5: Tax and non-tax Revenue as a share of Total revenue – 2022 (in millions MVR)



Source: Ministry of Finance

By the end of 2022, government revenue surpassed pre-pandemic levels, and in comparison to 2019, total government revenue increased by 26.5 percent. Tax revenue collections for the year 2019 totaled MVR 16,530.5 million, whereas total tax revenue received was MVR 19,528.5 million during 2022. Additionally, non-tax revenue collection for the years 2019 and 2022 totaled MVR 5,610.0 million and MVR 8,482.8 million, respectively.

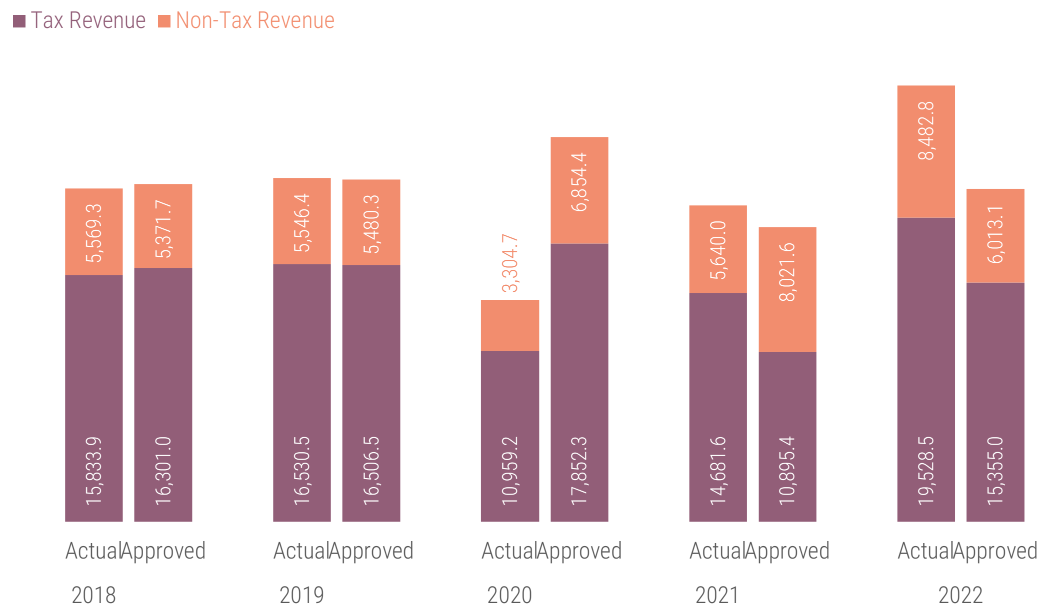
One of the main reasons for the increase in the government revenue in 2022 is the growth in the tourism sector during the year. As such, actual TGST revenue collection for the year increased by 36.8 percent in comparison to the forecasts included in the approved budget for 2022. Furthermore, while green tax collection increased by 18.1 percent compared to the approved budget 2022 forecasts, the collection of airport taxes and fees increased by 9.2 percent.

The number of tourist arrivals increased by 6.3 percent and bednights increased by 3.4 percent compared to revised forecasts for the year 2022. Thus, among tax revenue directly linked to tourism sector, revenue received as TGST, and airport taxes and fees was higher than the revised revenue for the year 2022. As such, TGST revenue was 2.9 percent higher, and airport taxes and fees were 8.5 percent higher than the revised forecasts for the year. However, due to the 11th amendment to Act Number 2/99 (The Maldives Tourism Act), the collection of green tax was halted for approximately three months. Regardless, the green tax receipts increased by 18.1 percent compared to the forecasts included in the approved budget 2022, although a decline of 1.4 percent was observed compared to the revised estimates for the year 2022, included in the approved budget 2023.

In addition to the growth in the tourism sector, wholesale and retail sector has expanded with the boost in the country's economy, resulting in the actual GGST collection being higher than the forecast included in approved budget 2022—10.7 percent. This GGST collection of MVR 3,184.1 million for the year 2022 is 3.7 percent higher than the revised projections for 2022.

Grants received by the government during the year 2022 amount to MVR 1,041.7, which is 64.2 percent lower than the estimated revenue included in the approved budget 2022. However, based on the ratio of grants received by the government, the figure was revised during the formulation of the budget for 2023. As such, revenue received from grants by the end of 2022 was 75.9 percent higher, compared to the revised projections for 2022.

Chart 6: Tax and Non-Tax Revenue 2018 – 2022 (in millions MVR)

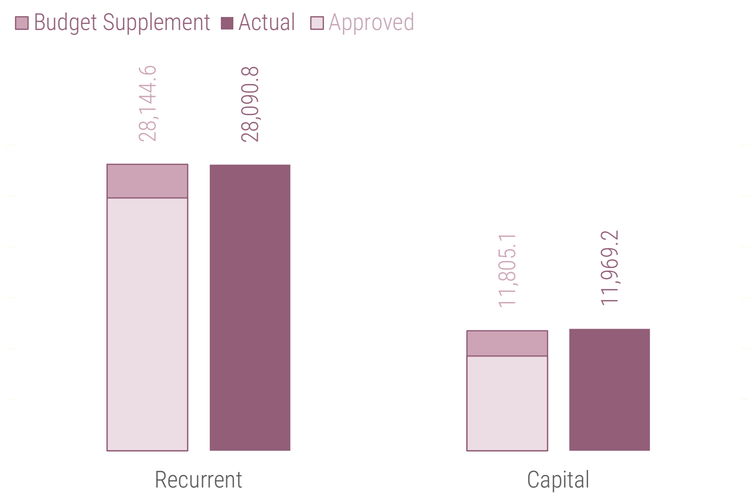


Source: Ministry of Finance

4.1.2 Expenditure

The actual expenditure for 2022 stands at MVR 40,060.0 million, which is an increase of MVR 67.8 million compared to the revised expenditure estimates prepared for 2022. The actual figure incorporates the budget supplement of MVR 5,847.9 million approved by People's Majlis in November. The supplementary budget was intended to allocate additional funds to various areas, including capital contribution to SOEs, Aasandha, fuel subsidy, and the Greater Male' Connectivity Project (Chart 7).

Chart 7: Comparison of the approved budget 2022 with actuals (in millions MVR)



Source: Ministry of Finance

In comparison to previous years, significant budgetary challenges were posed in 2022. This was mainly due to factors such as rising global oil prices, delays in implementation of rationalization measures and the accelerated pace of infrastructure projects as the economy rebounded from the impacts of the Covid-19 pandemic.

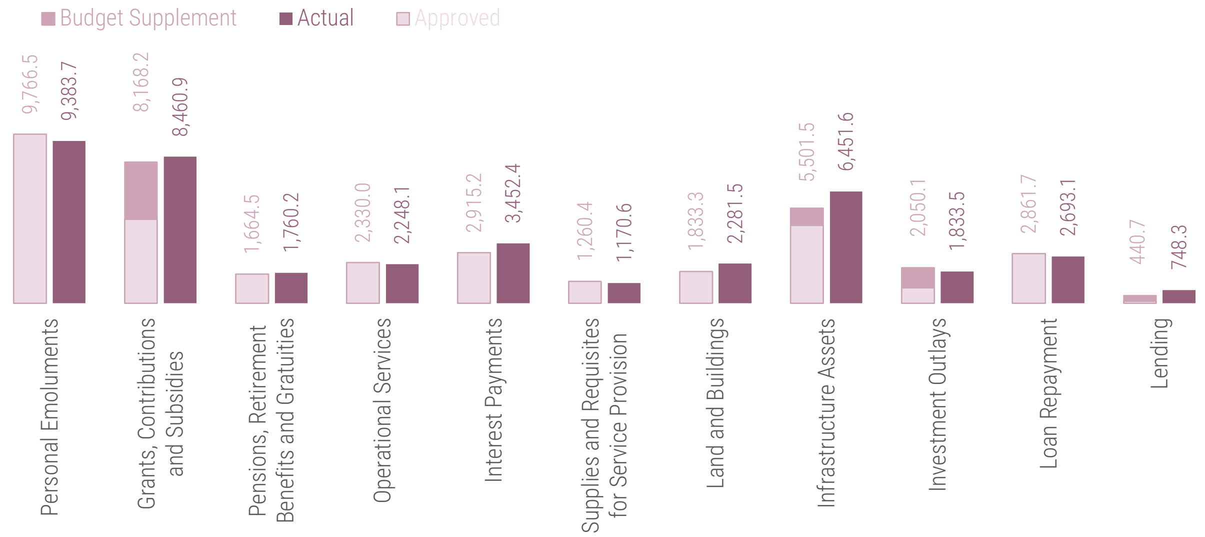
In 2022, recurrent expenditure saw a notable hike primarily driven by increased spending on fuel subsidies as a result of higher global oil prices. Additionally, the spending on electricity subsidies was higher due to advance payments FENAKA to support their expenses and cashflow requirements. Another contributing factor was the higher expenditure on the Aasandha scheme. While measures were initially planned to reduce Aasandha costs, implementation delays and increased service utilization resulted in an additional MVR 906.7 million being supplemented to the scheme. As a result, the total expenditure for Aasandha reached MVR 1,843.0 million by the end of the year. These expenditures were not accounted for at the time of formulation of the budget 2022, driving the need for a budget supplement.

The recurrent expenditure on salaries and pensions of employees saw an increase compared to the previous year, primarily due to the implementation of minimum wage and pay harmonization. This adjustment was mainly driven by the changes to the salaries of the education sector professionals due to pay harmonization. Despite these changes, the expenditures on personal emoluments were managed within the allocated budget for the year. Furthermore, transport subsidy was newly introduced, amounting to MVR 209.1 million, aimed at facilitating transportation and expanding Raajje Transport Link (RTL) services at a low cost to the public. While travel expenditure exceeded the approved budget by 20.1 percent, other categories such as repairs and maintenance, administrative supplies and requisites, training, and compensation for losses remained below the approved budget level.

In 2022, there was a notable increase in capital expenditure, especially on investment outlays and loans provided to SOEs. Additional capital had to be allocated to the Housing Development Corporation (HDC) and loans were extended to support the implementation of SIFCO housing project during the fiscal year. These additional expenditures were approved through budget supplementation.

In addition, there were significant increases in spending on PSIP, driven by the acceleration of the implementation of PSIP projects and the completion of the tender process for major projects. Notably, the Greater Male' Connectivity Project required more funds than initially estimated, and this additional expenditure was included in the Supplementary Budget. Moreover, during 2022, many projects were well underway, leading to higher expenditures compared to previous years.

Chart 8: Breakdowns of the approved budget 2022 with actuals (in millions MVR)



Source: Ministry of Finance

4.1.3 Budget Balance

By the end of 2022, the overall balance amounted to a deficit of MVR 11,007.1 million, equivalent to 11.4 percent of the GDP. The primary balance deficit was recorded at MVR 7,554.6 million. The realized revenues and actual expenditures were lower than the revised estimates, resulting in a lower deficit than the revised estimates as well.

4.2 Revenue and Expenditure from 1st January 2023 to 31st May 2023

Table 3: Revenues and Expenditures as at 31st May 2023

	As of 31st May 2023	
MVR millions	2022	2023
Revenue and Grants	11,568.8	14,172.7
Tax Revenues	8,496.4	10,754.4
Non-Tax Revenues	2,791.1	3,219.1
Grants	428.5	202.9
Total Budget	17,255.4	20,270.8
Recurrent Expenditure	11,285.9	13,165.1
Capital Expenditure	5,969.4	7,105.7
Loan Repayment	2,832.7	4,814.9
PSIP	1,688.3	1,022.3
Total Expenditure	15,549.8	19,166.2

Overall Balance (Deficit)	(3,962.9)	(4,993.5)
Primary Balance	(2,312.8)	(3,034.8)

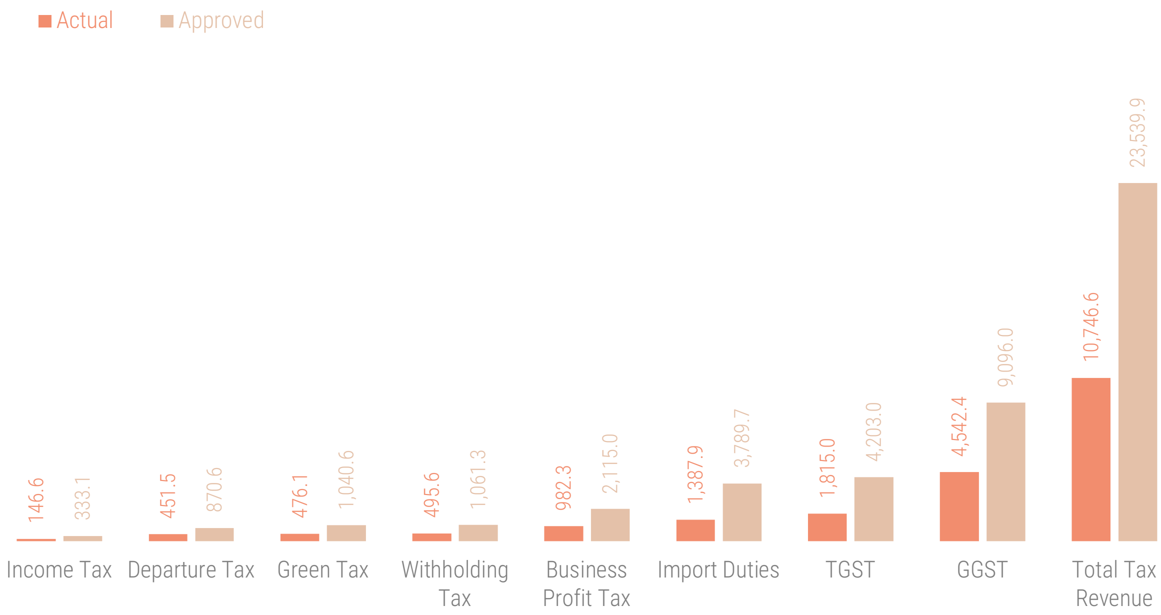
Source: Ministry of Finance

4.2.1 Revenue

By the end of 2022, the national economy was recovering after the downturn caused by the Covid-19 pandemic. As such, an increment of 3.5 percent was observed in government revenue for the period of January 2023 to May 2023, compared to the previous forecasts. MVR 14,118.2 million was recorded as total government revenue and grants for the period, which is 21.3 percent higher, compared to the total revenue and grants received during the corresponding period of 2022.

By the end of May 2023, the government's tax revenue amounted to MVR 10,746.6 million, whereas non-tax revenue for the same period stood at MVR 3,180.3 million. This indicates an increment of 26.5 percent in tax revenue, and 17.3 percent in non-tax revenue in contrast to the corresponding period of the previous year. Additionally, tax revenue and non-tax revenue was 0.5 percent and 66.3 percent higher compared to the forecasted amount for this period, respectively.

Chart 9: Total tax revenue and major components of the tax revenue – January to May 2023 (in millions MVR)



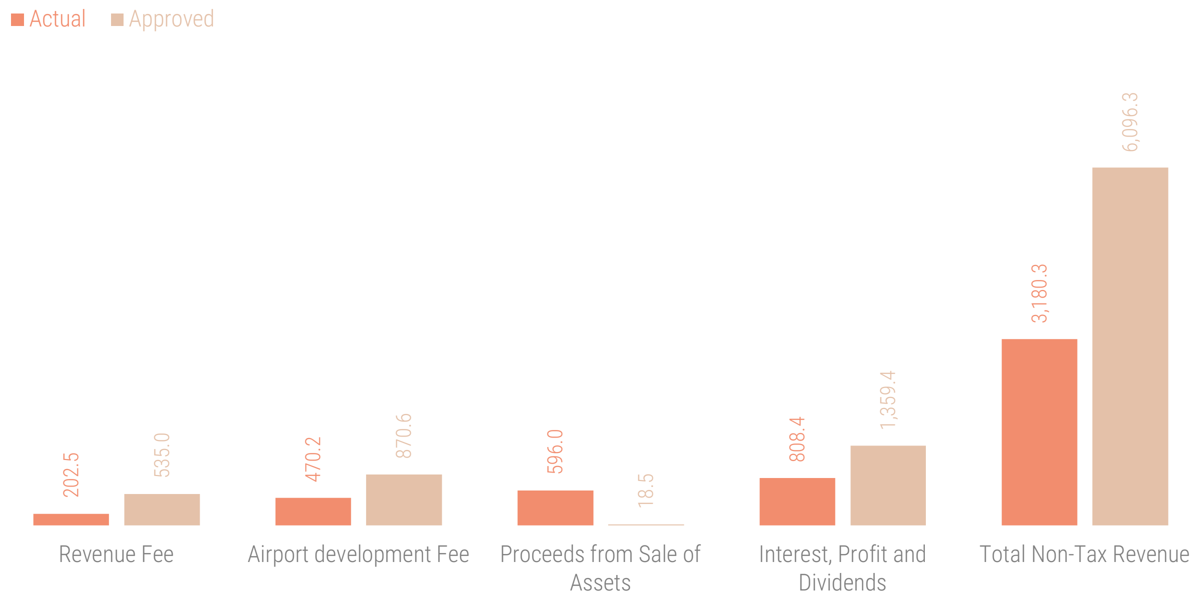
Source: Ministry of Finance

By the end of May 2023, the predominant portion of the revenue emanates from Goods and Services Tax (GST), constituting 59.2 percent (MVR 6,357.5 million) of the total tax revenue of the government. This is an increment of 29.2 percent, compared to the corresponding period of the previous year. The surge in GST revenue during the mentioned timeframe is due to the revision of GST rates, specifically, increase of TGST rate to 16% and GGST rate to 8%, from 01 January 2023 onwards. Despite these adjustments in GST rates being incorporated into the government's revenue forecast, the issuance of invoices in December 2022, with the strategic intent of capitalizing on the lower tax rate by specific taxpayers, led to a higher-than-anticipated GST collection in January 2023. Meanwhile, encompassing TGST, the revenue derived from taxes directly related to the tourism sector (including TGST, Green Tax, Departure Tax) increased by 23.6 percent in comparison to the corresponding period of the previous year. This surge is attributed to the rise in tourist arrivals and bednights, compared to the same period of the prior year.

Furthermore, revenue received as import duty during this period of 2023 (MVR 1,387.9 million) was higher than the import duty revenue received during the corresponding period of previous year. This is an increment of 1.5 percent compared to import duty revenue received during the same period of 2022. The primary reason behind this surge was the significant increase in imports over the course of the year, due to the improvements in economic performance.

The income tax, corporate income tax collection stood at MVR 982.3 million by the end of May 2023. Along with the economic growth observed, revenue received as corporate income tax has increased by 97.7 percent compared to revenue collected during the corresponding period of 2022. Consequently, revenue received during the second interim of 2022 increased by 80.0 percent compared to the second interim payment of 2021. Similarly, an increment of 0.8 percent was observed in this revenue component, compared to the initial forecast. Moreover, with the growth in economic activities and labor market, Non-Resident Withholding Tax and Individual Income Tax collection during the period of January 2023 to May 2023 increased by 29.9 percent, and 12.5 percent, respectively, compared to the same period of the previous year. In addition, while Bank Profit Tax collection by the end of May 2023 stood at MVR 393.6 million, this is an increment of 23.9 percent compared to the same period of last year. This increase was observed due to the improvement in the performance and profitability of banks during the fiscal year 2022, after the economic slowdown caused by Covid-19.

Chart 10: Total non-tax revenue and major components of non-tax revenue – January to May 2023 (in millions MVR)



Source: Ministry of Finance

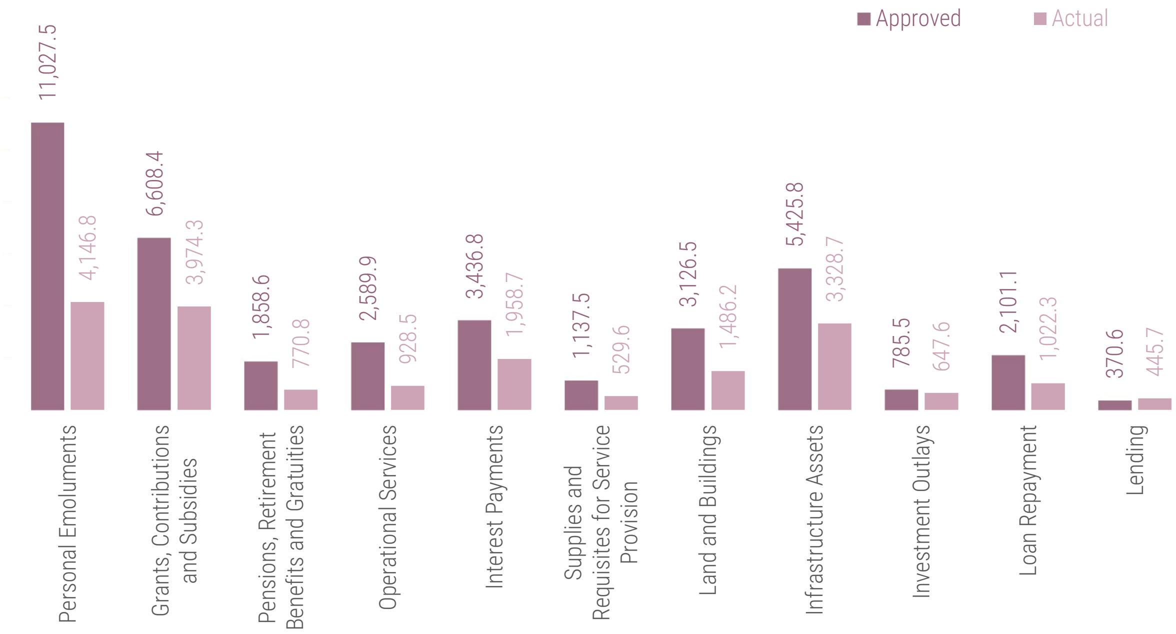
From the main components of non-tax revenue, revenue received as airport development fee for the period of January - May 2023 increased by 30.4 percent, due to the growth in tourism sector, compared to the corresponding period in 2022. However, in comparison to the revenue received as resort lease rent for the period of January - May 2022, a decline of 27.7 percent was observed during the same period of this year. It should be noted that part of the resort lease rent deferred due to Covid-19 was received during the first half of 2022.

By the end of May 2023, revenue received as grants was at MVR 191.3 million, which is an increment of 55.4 percent compared to the corresponding period of the year 2022.

4.2.2 Expenditure

As of May 2023, a cumulative expenditure of MVR 19,166.2 million has been incurred, representing a significant increase of 23.3 percent from the corresponding period in the previous year. Both recurrent and capital expenditures have increased compared to the same period in the previous year. (Chart 11)

Chart 11: Breakdown of the approved and actual expenditures – January to May 2023 (in millions MVR)



Source: Ministry of Finance

To achieve salary parity among public servants, adjustments have been made to the compensation of education workers. Similarly, pay harmonization for public health sector employees was implemented in May 2023. Further, special duty allowances were given to employees of those Government offices who were previously not receiving this allowance. Therefore, the outlay for salaries and allowances of public servants has registered a 7.1 percent increase thus far this year, compared to the same period in the previous year.

Grants, contributions and subsidies are the largest recurrent expenditure, with 3,974.3 million spent as at May 2023, a 20.9 percent increase from the same period of the previous year. Energy subsidies have also increased by 28.2 percent during this period, primarily due to rising global oil prices. The cost of fuel subsidies began to increase significantly towards the end of the first quarter of 2022, coinciding with the rise in oil prices caused by the Russia-Ukraine war. The increase in electricity subsidy spending can be attributed to the early disbursement of electricity subsidies, for the management of operational expenses and cash flow management of the relevant SOEs. Furthermore, Aasandha expenditure has increased by 29.6 percent from the corresponding period in the previous year. As of May 2023, 94.9 percent of the allocated budget has already been utilized. The increase in Aasandha expenditure is attributed to higher costs and increased utilization of services by select health service providers in the Maldives.

Recurrent expenditures allocated for losses and write-offs to various entities was exhausted by the end of May 2023. These expenditures include sums owed by the state to various entities in relation to court orders, as well as amounts owed as a result of the arbitration processes related to development projects. In addition, there has been a significant increase in expenditures on operational requisites and consumables as of May 2023, registering a 48.6 percent increase from the corresponding period in the previous year. This increase is primarily attributed to higher spending on meals and beverages for security personnel. Additionally, an expenditure of MVR 958.7 million was incurred on financing and interest costs at the end of May 2023.

PSIP constitutes the most significant portion of capital expenditure. As such, the outlay for PSIP during the first five months of the current year has increased from the corresponding timeframe of the previous year. While the majority of this increase is attributed to projects executed through domestic funding, the escalation in PSIP expenditure is primarily attributed to the accelerated pace of project implementation. The Male'-Thilafushi Bridge project, the Hanimaadhoo Airport Development project, and the road development and land reclamation projects in Addu City are the largest expenditures in the PSIP.

While capital contributions to SOEs have decreased from the previous year, MVR 565.3 million has been disbursed to several SOEs by the end of May 2023. This includes MVR 115.6 million for equity infusion in the K. Giraavaru Lagoon Development Project through the Maldives Fund Management Corporation (MFMC), and MVR 75.0 million for the SME Development Finance Corporation (SDFC). In addition to capital contributions, treasury loans sanctioned to SOEs in this period include MVR 213.3 million for FENAKA Corporation Ltd., MVR 60.0 million for the Road Development Corporation to acquire machinery and equipment, and MVR 75.5 million for SIFCO's housing project. Debt amortization has also been a significant portion of capital expenditure, with MVR 1,022.3 million spent as of May 2023. A notable proportion of this outlay has been directed towards the repayment of foreign debts.

4.2.3 Budget Balance

Between 01 January 2023, and 31 May 2023, government revenue grew compared to the corresponding period the previous year, but expenditure also increased. As a result, the budget deficits, both overall and primary, for the year 2023, have expanded as the expenditure growth was higher than revenue growth. The overall budget deficit reached MVR 4,993.5 million, while the primary budget deficit amounted to MVR 3,034.8 million.

4.3 Revised Revenue and Expenditure Forecasts for 2023

Revised revenue and expenditure forecasts for the year 2023 are based on the actual revenue collection and expenditure incurred till the month of May 2023. This section details the estimated budget deficit and the proposed changes to the financing plan, based on the revised revenue and expenditure projections. Table 4 presents a summary of forecasts included in Fiscal Strategy 2023-2025, approved budget 2023, and revised projections of revenue and expenditure for 2023.

Table 4: Details of approved and revised budget for 2023

MVR millions	Fiscal Strategy 2023-2025	Approved	Revised
Total Revenue and Grants	30,792.5	32,098.3	33,951.2
Tax Revenue	22,786.2	23,539.9	26,096.2
Non-tax Revenue	5,672.3	6,096.3	6,664.8
Grants	2,334.0	2,469.4	1,190.2
Total Budget	41,533.4	42,840.8	48,137.3
Recurrent Expenditure	28,458.5	28,636.8	30,795.1
Capital Expenditure	13,074.9	14,204.0	15,511.8
PSIP (Including NPI)	7,430.4	8,552.3	9,966.4
Loan Repayment	2,463.6	2,101.1	2,554.4
Total Expenditure	39,042.1	40,718.3	45,495.3
Overall Balance (Deficit)	(8,249.6)	(8,620.0)	(11,544.1)
Primary Balance (Deficit)	(4,503.8)	(5,183.1)	(6,832.9)

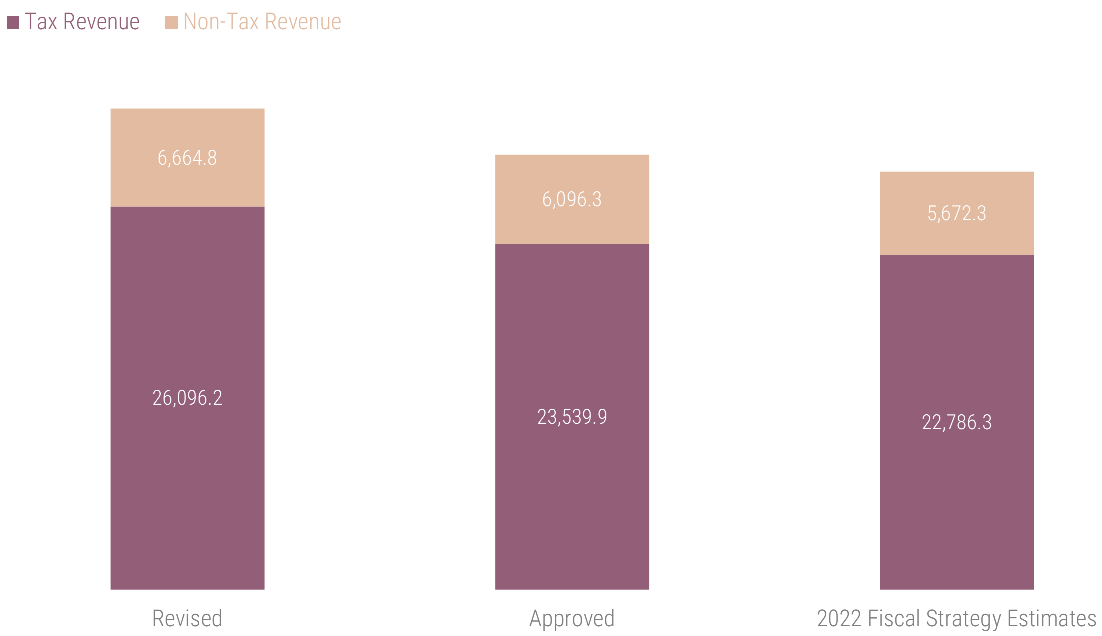
Source: Ministry of Finance

4.3.1 Revenue

Considering the total revenue and grants received by the end of May 2023, and accounting for the revisions to macroeconomic estimates of the changes in both the national and global economy, total revenue and grants for the year is estimated to be at MVR 33,951.2 million, which is 31.7 percent of the estimated nominal GDP for the year. Moreover, this is an increase of 10.3 percent compared to the estimate included in Fiscal Strategy 2023-2025, and a 5.8 percent increment compared to the forecasts included in the approved budget 2023. Even though the total revenue and grants are estimated to increase, compared to the estimates in the previous Fiscal Strategy and the approved budget for this year, it is important to note that the revised forecast for grants is lower than the forecasts included in the approved budget 2023.

Similar to the year 2022, main reasons for the higher-than-expected increase in government revenue this year include faster than expected growth in domestic productivity and the rapid growth of tourism, which is the largest contributor to the country's economic growth. As such, revised tax revenue for the year 2023 is 14.5 percent higher compared to the forecasts included in Fiscal Strategy 2023-2025, and 10.9 percent higher than the estimates included in approved budget 2023.

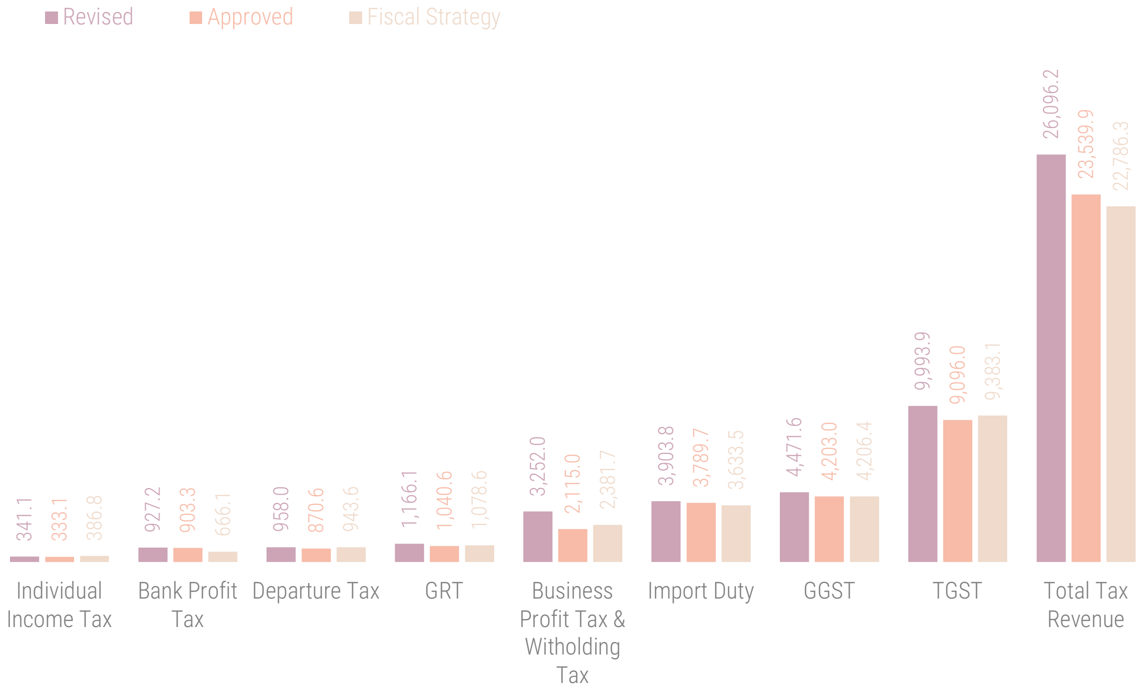
Chart 12: Revised tax and non-tax revenue 2023 (in millions MVR)



Source: Ministry of Finance

Revenue received from tourism industry is anticipated to increase, as it is estimated that tourist arrivals will reach 1.9 million and bednights will increase to 14.0 million this year. While Green Tax is expected to increase by 8.1 percent and 12.1 percent compared to the forecasts included in Fiscal Strategy 2023-2025 and the approved budget for 2023, respectively, it is expected that TGST revenue will increase by 6.5 percent and 9.9 percent compared to the estimates in the Fiscal Strategy published last year and the approved budget for 2023, respectively. Moreover, revenue received as Departure Tax is expected to reach MVR 958.0 million this year, which accounts for an increment of 10.0 percent compared to the estimates in approved budget 2023 and an increment of 1.5 percent compared to the Fiscal Strategy 2023-2025.

Chart 13: Revised total tax revenue and major components of tax revenue (in millions MVR)

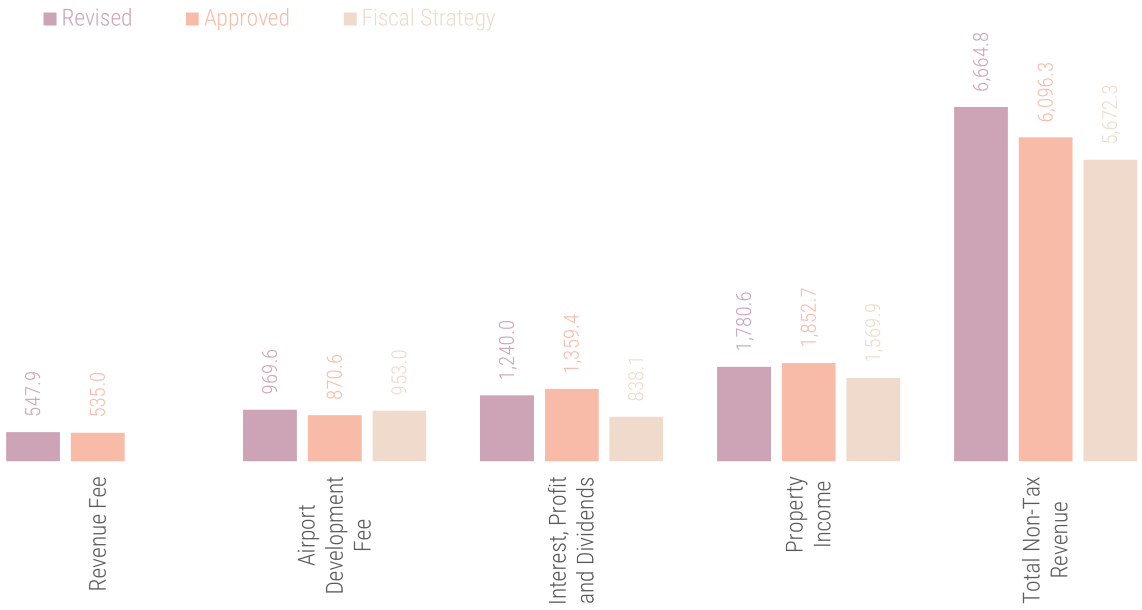


Source: Ministry of Finance

As the productivity of all economic industries is now expected to be higher than pre-pandemic levels, similar to TGST, GGST revenue collection is also expected to increase significantly compared to the previous estimates and is forecasted to reach MVR 4,471.6 million by the end of the year 2023. As such, the revised estimates for GGST revenue is 6.3 percent and 6.4 percent higher compared to the estimates included in the Fiscal Strategy 2023-2025 and approved budget 2023, respectively. Moreover, Import Duty revenue is also expected to increase compared to the previous estimates, as the volume of imports is increasing year on year. Revised Import Duty revenue (MVR 3,903.8 million) for the year 2023 is an increment of 7.4 percent compared to the forecasts included in the fiscal strategy published last year. This is also an increment of 3.0 percent compared to the projected revenue included in approved budget 2023.

Withholding tax revenue and corporate income tax revenue are expected to increase by 36.5 percent compared to Fiscal Strategy 2023-2025 and 53.8 percent compared to the approved budget, due to economic growth and increased consumer and business confidence. Simultaneously, Bank Profit Tax is expected to increase by 39.2 percent compared to forecasts included in the Fiscal Strategy formulated last year, as the performance of banks has also exceeded the previous projections. As such, revised Bank Profit Tax revenue is expected to increase by 2.6 percent compared to the estimates included in the approved budget 2023. Similarly, with the economic growth, Personal Income Tax is expected to increase by 2.4 percent compared to the initial estimates published in the approved budget 2023.

Chart 14: Revised total non- tax revenue and major components of non-tax revenue (in millions MVR)



Source: Ministry of Finance

Similar to tax revenue, non-tax revenue is also expected to increase by the end of this year compared to previous estimates. As tourist arrivals and bednights are now projected to be higher than the previous estimates, revenue received as Airport Development Fee is expected to increase by 11.4 percent compared to forecasts included in the approved budget 2023. In addition, with the increase in volume of imports, Revenue Fee collection is expected to increase by 2.4 percent compared to initial forecasts published in the approved budget 2023.

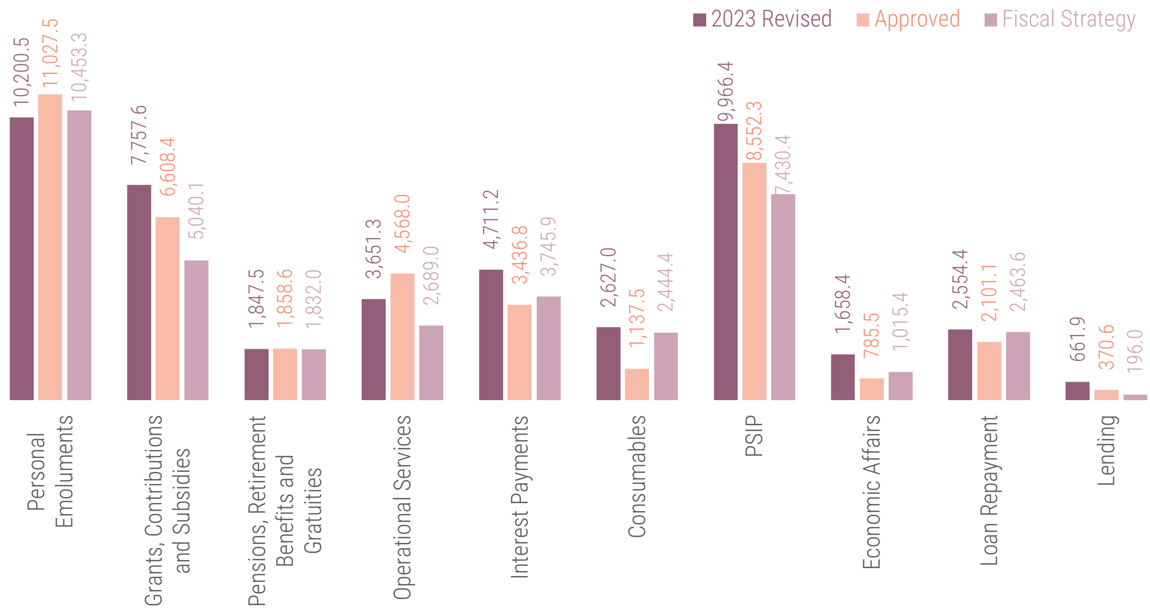
Though the policy on Quota Fee of foreign workers was expected to be implemented from 01 January 2023 onwards, the delay in implementation to 12 March 2023 has led to a downward revision of the revenue received from this policy measure, by 18.6 percent, compared to previous estimates. In addition, though the current estimates for revenue from Interest Profit and Dividends is 47.9 percent higher, compared to the projections in Fiscal Strategy 2023-2025, it is expected to decline by 8.8 percent compared to the estimates included in the approved budget 2023. This downward revision to Interest Profit and Dividends is due to government not realizing revenue from this component, as per the formulated schedules. Nevertheless, it should be noted that revenue from Interest Profit and Dividends can reach the previous projections, if the government receives expected revenue during the rest of the year. Revised estimate of revenue from Property Income for 2023 is 13.4 percent higher compared to the forecast included in the Fiscal Strategy formulated last year.

Details of revised revenue estimates for the year 2023 are included in Annex 1 of this paper.

4.3.2 Expenditure

Considering the expenditure incurred thus far and the changes to economic and fiscal conditions, the revised expenditure is anticipated to be at MVR 45,495.3 million. This is a 6.3 percent increment on the approved budget. Consequently, budget supplementation for this year has become necessary due to the unforeseen expenses in some major expenditure components. The primary reason for higher expenditures is due the increases in global commodity prices, particularly the price of crude oil driving the variations in the expenditure on subsidies. Furthermore, expenditure reduction policies not being implemented, the execution of unbudgeted policies, and the rapid pace of PSIP projects has resulted in this increase in budget consumption (Chart 15).

Chart 15: Major components of the revised total expenditure 2023 (in millions MVR)



Source: Ministry of Finance

One of the most significant areas of spending on recurrent expenditure includes grants, contributions and subsidies. Expenditures on Aasandha and other health-related services are projected to exceed the allocated budget by 16.1 percent by the end of the year. Despite cost reduction through bulk procurement of medicines were accounted for during the budget formulation, its delayed implementation of this policy is one of the main reasons for the increase in the budget overrun for Aasandha. Moreover, the increased service utilization of Aasandha along with the substantial increase in medical-related welfare expenses within the social security framework this year are additional factors contributing to the high expenditures on this component.

Likewise, amidst elevated global oil prices, the expenditure on fuel subsidies saw an increase throughout the year, mainly due to the delays in the shift from the indirect fuel subsidy to a direct subsidy regime. The fuel subsidy is projected to reach MVR 1,913.9 million by the end of the year. Similarly, electricity subsidies have increased due to advance payments to FENAKA to support their operational expenses, resulting in an estimated electricity subsidy of MVR 1,061.1 million by the end of 2023. Furthermore, the policy decision to revise the allowances for people with disabilities also contributed to the anticipated overall increase in the expenditure on this component.

Among other recurrent expenditures, the outlay for debt servicing is estimated to reach MVR 4,711.2 million by year-end. This reflects an increase of 36.5 percent compared to the previous year. The anticipated rise in interest costs can be largely attributed to the increase in treasury securities issued in the domestic market, consequently leading to increased coupon payments throughout the year. Moreover, an expenditure of MVR 231.9 million has already been spent on compensating losses and arbitration settlements to various entities within the current year. It is projected that this expenditure will grow to MVR 470.7 million by the end of the year.

Under capital expenses, the budget allocated for capital contributions to SOEs is expected to reach MVR 1,570.7 million by the end of the year. This represents an increase of 105.6 percent in comparison to the approved budget. At the budget formulation stage, the capital contribution for SOEs was accounted for based on the need for support on operational expenses, and to specifically cover those expenses. However, the budget has also been allocated to provide equity for certain projects undertaken by some SOEs. The most substantial outlays on this component for the year is projected to be directed towards financing the Hulhumale' Phase II housing project undertaken by the FahiDhiriulhun Corporation (FDC) and providing equity for the city hotel development by Addu International Airport Company. Furthermore, the budget will include projects financed through cross-subsidies as well. This includes Giraavaru Falhu development and various regional airport projects undertaken by MFMC.

The cumulative expenditure on the PSIP is projected to reach MVR 9,966.4 million by the end of the year. This is a 16.5 percent increment to the budgeted amount for PSIP in 2023. It is also anticipated that approximately 51.2 percent of the amounts allocated for PSIP projects financed domestically will be realized. PSIP expenditure is anticipated to surpass initial estimates due to the accelerated progress of numerous projects, particularly those funded from domestic sources. As such, the Thilamale' Bridge project, along with dredging and road construction initiatives, is expected to incur significant budgetary allocations by the end of the year. Additionally, the loan financed Velana International Airport terminal project is expected to incur a high expenditure this year.

Annex 1 of this paper details the current estimated expenditure for 2023.

4.3.3 Budget Balance, Financing and Debt

Even though there has been an increase in government revenue and grants when compared to the budget 2023 estimates, increases in government spending is expected to be higher. Consequently, the budget deficit for the year is now projected at MVR 11,544.1 million, equivalent to 10.8 percent of the revised nominal GDP. This amount exceeds the approved budget deficit of MVR 8,620.0 million by MVR 2,924.1 million. The revised 2023 budget estimates a primary deficit of MVR 6,832.9 million, constituting 6.4 percent of the nominal GDP.

As a result, the government will need to secure budget financing up to MVR 15,494.7 million in 2023. This includes the financing of the overall budget deficit, MVR 2,554.4 million for debt servicing, along with MVR 1,308.6 million in transfers to the SDF. As part of this year's financing plan, an anticipated disbursement of MVR 4,862.8 million is anticipated for project loans for PSIP project implementation. Additionally, budget support loans amounting to MVR 1,087.1 million are expected to be disbursed this year. As these loans have been agreed upon and are nearing disbursement, the risk of non-realization of these funds is minimal. The plan also includes financing to be raised from the domestic financial markets, including the central bank, amounting to MVR 9,432.6 million.

If the overall deficit in 2023 is maintained at the projected level, the direct debt is forecasted to reach MVR 108,276.2 million by the end of the year. This is 101.0 percent of the nominal GDP. Moreover, the total debt, including sovereign guarantees, is anticipated to reach 112.2 percent of the GDP by the end of the year.

5. Fiscal Policy

5.1 Medium Term Fiscal Policy Objectives

The timely Covid-19 health and economic response of the government and the compliance by the public resulted in a quick turnaround from the sharp pandemic induced economic downturn in 2020. The Maldivian economy was among the fastest recovering economies globally over the past two years, which resulted in real GDP recovering back to pre-pandemic levels last year. However, despite the promising developments on the macroeconomic front, the rise in global commodity, and especially oil prices and the increase in interest rates by major central banks in response to inflationary pressure have resulted in the emergence of new fiscal risks going forward.

The primary objective of the fiscal strategy 2024 – 2026 is therefore to manage these fiscal risks and to ensure that fiscal and debt sustainability is maintained over the medium-term. Although this objective remains unchanged from the fiscal strategy presented last year, given the change in the nature of risks that are now present, the mix of actions required to achieve the objective has changed. The revenue and expenditure measures proposed in this strategy aim to reduce the fiscal deficit to levels that can be realistically financed at a reasonable cost. They are also designed to increase the degree to which the most vulnerable segments of society are prioritized within the social protection framework and reduce income inequality.

Four fiscal anchors are set for the medium term to guide policy and to measure the extent to which the fiscal objectives are achieved. They are:

- Reduce direct public debt (excluding guarantees) to less 95 percent of GDP by the end of 2026.
- Maintain the primary budget deficit at levels that do not exceed 5 percent of GDP.
- Maintain public and publicly guaranteed debt as a percent of GDP on a downward trend.
- Maintain recurrent expenditure at levels that do not exceed government revenue (excluding grants).

These anchors were set accounting for the global and domestic economic outlook, the fiscal and debt situation, and the degree to which revenue and expenditure reforms are expected to be implemented over the medium-term. In addition, the extent to which financing can be secured given current and expected financial market conditions is also considered.

The fiscal strategy formulated last year aimed to reduce direct public debt to below 100 percent of GDP by the end of 2025. As this is now expected to be achieved, the first fiscal anchor presented here has been revised to set a new target for the year 2026. Although the fiscal strategy proposed in 2022 also aimed to reduce the primary budget deficit to below 5 percent of GDP by the end of 2023, it is now expected that this target will not be achieved. This is primarily because of significant overruns in expenditure this year, particularly due to the increase in spending on fuel subsidies due to the increase in global oil prices, the delay in the implementation of targeting fuel subsidies as proposed last year, and higher than anticipated expenditure on PSIP projects due to faster than expected implementation of most projects. Although the primary budget deficit related anchor cannot be achieved in 2023, this fiscal strategy maintains this anchor as a target going forward as well. The third and fourth fiscal anchors presented above remain unchanged from last year's strategy.

Its small, open nature and the high dependency on imports mean that the Maldivian economy is highly exposed to developments in the global economy. The large decline in government revenue during the pandemic as a result of the slowing of tourism sector activity, and the significant increase in subsidy related expenditure due to the increase in global commodity prices in 2022 and 2023 are both the result of external shocks. The susceptibility to these shocks and the corresponding macro-fiscal volatility this generates negatively affects the sovereign credit rating as well, which has additional implications for the access and cost of financing. Therefore, mitigating the exposure to these shocks to the extent possible given the structure of the economy is a policy priority. Work is currently ongoing to reform the existing subsidy mechanism in a way that eliminates the link between subsidy expenditure and global fuel prices. Hedging commodity price risks is also being considered as a temporary measure until structural changes such as reducing the reliance on fossil fuels can be phased in.

The primary issue driving inefficiencies in the existing social protection framework is the indirect nature of state support and the lack of targeting. A significant share of resources is currently directed towards those that do not truly require it, which results in the resources that are available for supporting the most vulnerable segments in society being constrained. Therefore, one of the main changes proposed in the fiscal strategy is to overhaul the subsidy and welfare frameworks to ensure that most of the benefits provided by the social protection framework goes to the most vulnerable, while also generating fiscal space. In this regard, it is proposed to replace the current indirect subsidy mechanisms for staple food, sanitation, fuel and electricity with means-tested, direct cash transfers. Work is also ongoing to review existing eligibility criteria and vetting mechanisms that determine access to state support for health related incidences that are not covered by Aasandha.

The spending on personal emoluments, which is the largest component of recurrent expenditure, will increase as the ongoing pay harmonization programme proceeds. However, as the compensation of government employees are brought more in line with that of the private sector, and the differences between the compensation of government employees performing similar roles are harmonized, the productivity across the government is anticipated to improve. As a result, the requirement of additional public sector employees is expected to decline over the medium term, and the standard of service provision to the public is expected to increase. With the rollout of pay harmonization, the harmonization of benefit schemes across the public sector such as retirement benefit schemes and health coverage and insurance schemes is also planned as a medium term measure. Therefore, while pay harmonization will initially result in a rise in recurrent expenditure, the efficiency gains which follow and the harmonization of other benefit schemes are expected to reduce the rate at which the spending on personal emoluments is increasing over time.

Looking at capital expenditure, the significant number of ongoing essential infrastructure developments such as water and sewerage projects, and projects that have the potential to increase the productive potential of the economy such as the development of harbors, ports and airports mean that PSIP spending will remain elevated in both 2023 and 2024. However, as these projects come to a close, PSIP spending, and especially spending on PSI projects funded through the domestic budget, is expected to decline. This fiscal strategy envisages a more gradual, prioritized PSIP pipeline for new projects, with the primary focus on the development of essential infrastructure. In addition, in order to reduce the risks arising on the fiscal and external fronts as a result of the high reliance on fossil fuels, an increase in the space allocated to renewable energy projects is also planned.

In addition to the primary fiscal objective of ensuring fiscal and debt sustainability, the following are the major policy goals of the medium-term budget:

- Increasing the efficiency of public expenditure to control the growth of expenses at sustainable levels.
- Restructuring the social protection framework to prioritize the most vulnerable segments of society, and reforming existing subsidy mechanisms.
- Mitigating the fiscal and economic risks arising due to external shocks.
- Enhancing the quality of basic services provided by the government.
- Increasing government revenue, and strengthening the reliance on domestic consumption for taxation.
- Diversifying and increasing the resilience of the Maldivian economy.
- Promoting service delivery through decentralization, with a focus on regional development.
- Formulating an adequate budget to achieve the goals and objectives of fiscal policy, and bringing in the necessary legislative and other changes required to increase budget credibility.

6. Medium Term Budget

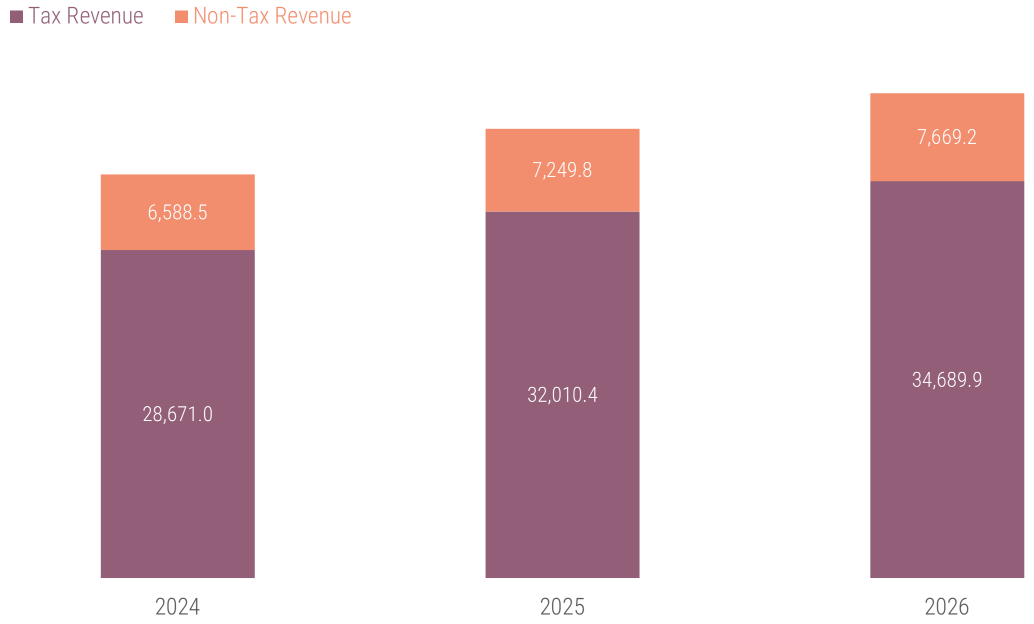
In order to achieve medium-term fiscal policy targets, it is essential to control the growth of public expenditure at sustainable levels that can realistically be financed, and expand the tax base to increase revenue mobilization. This section outlines the baseline projections for medium-term revenue and expenditure, and presents the proposed reforms to revenue and expenditure policies aimed at ensuring medium-term fiscal sustainability. The forecasted changes to revenue and expenditure with the implementation of these policies, the subsequent changes to the fiscal balance and public debt, along with the degree to which the medium-term fiscal anchors are expected to be met are also discussed.

6.1 Medium Term Revenue Forecasts

6.1.1 Medium Term Baseline Revenue

Baseline revenue forecasts for the medium term show a steady growth in revenue, driven by economic growth and planned measures to further strengthen government revenue policies. In particular, medium term revenue growth is expected to be contributed by the growth of the tourism sector and the construction industry. This year-on-year growth is expected for both tax and non-tax revenue over the medium term. It should be noted that these baseline estimates do not include the additional revenue generated from new revenue measures proposed for the period.

Chart 16: Tax and Non-Tax Revenue Forecasts for the Medium Term, MVR Millions



Source: Ministry of Finance

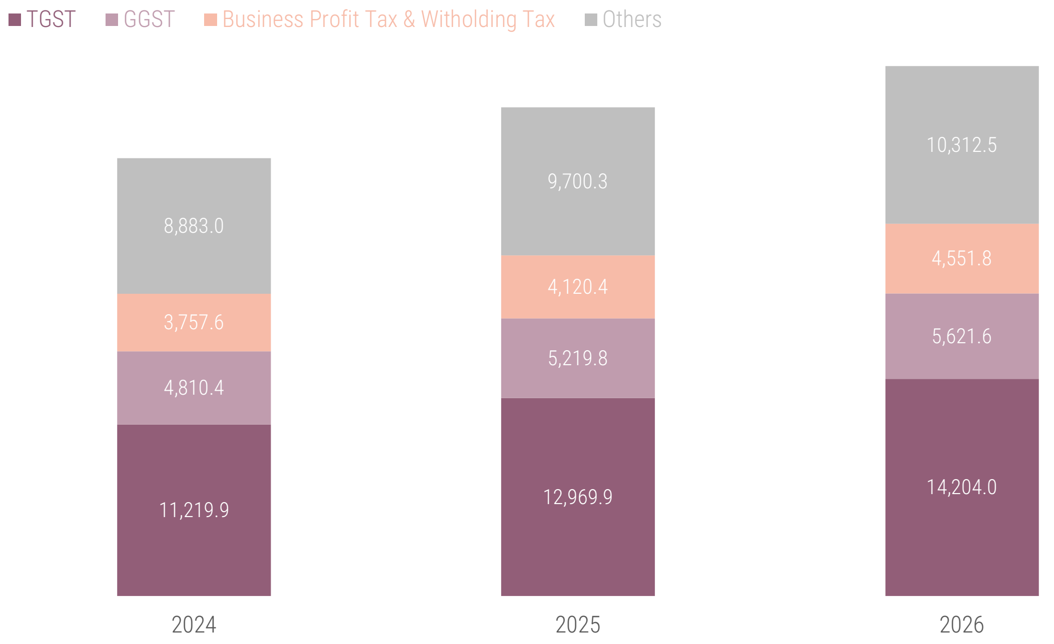
The projected baseline revenue for 2024 is MVR 35,259.5 million, equivalent to 30.5 percent of the forecasted nominal GDP for the year. Out of this, MVR 28,671.0 million (24.8 percent of GDP) is expected to be tax revenue, while non-tax revenue is estimated at MVR 6,588.5 million (5.7 percent of GDP). Furthermore, the government is expected to receive grants amounting to MVR 925.3 million in 2024.

With the completion of the Velana International Airport Development Project, and the opening of the new passenger terminal in 2025 for operation, a significant pickup in the growth of the tourism industry is anticipated.

Consequently, the year-on-year growth in government revenue is forecasted to be higher during the year. Hence, the revenue forecast for 2025 is MVR 39,260.2 million, which is 11.3 percent higher than the estimated revenue for 2024.

TGST, Corporate Income Tax and Withholding Tax, and GGST are anticipated to generate the majority of tax revenue in 2024. While TGST is expected to account for 39.1 percent of the forecasted tax revenue, Corporate Income Tax and Withholding Tax are estimated to form 13.1 percent of tax revenue. The major sources of tax revenue are expected to stay the same, although year-on-year growth in tax revenue is anticipated in the medium term, as depicted in Chart 17. Government tax revenue in the medium term is expected to depend on revenue streams directly related to the tourism sector, similar to past years.

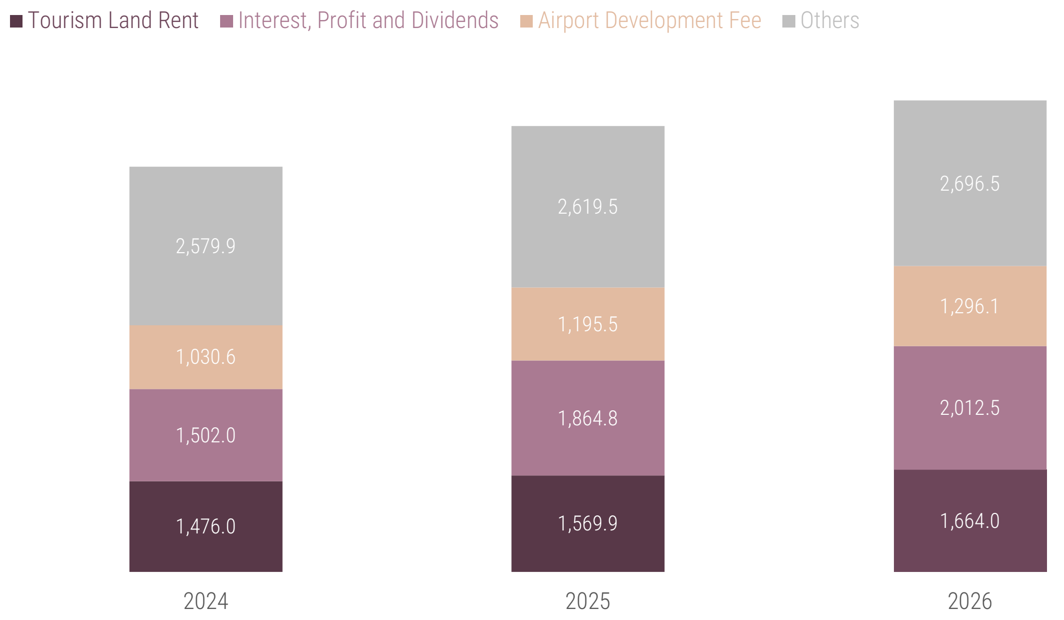
Chart 17: Main Components of Forecasted Tax Revenue, MVR Millions



Source: Ministry of Finance

Non-tax revenue is estimated to account for 18.7 percent of the total revenue forecasted for 2024. Tourism Land Rent (22.4 percent), Airport Development Fee (15.6 percent), and Interest, Profit and Dividends (22.8 percent) are the main sources of non-tax revenue. Similar to tax revenue, non-tax revenue is largely reliant on the growth of the tourism sector.

Chart 18: Main Components of Forecasted Non-Tax Revenue, MVR Millions



Source: Ministry of Finance

6.1.2 Grants

The Government has received grants of MVR 596.0 million on average over the past ten years, contributed mainly by Cash Grants and Capital Project Grants. The baseline forecast of grants for the year 2024 is MVR 925.3 million, which accounts for 2.6 percent of the total revenue and grants estimated for the year. Additionally, the baseline forecast for grants is expected to be MVR 937.5 million in 2025. Although these amounts are included in the baseline forecasts, efforts to secure additional USD 50 million in 2024 and 2025 are included in the Fiscal Strategy.

6.1.3 Revenue Forecasts from New Revenue Measures

The new revenue measure proposed in Fiscal Strategy 2023-2025 is to raise the GST rates and accordingly, the amendments to the Goods and Services Tax Act (Act no: 10/2011) to increase GST rates were implemented on 22nd November 2022. With this amendment, the TGST rate was revised upwards from 8 percent to 16 percent while the GGST rate was increased from 6 percent to 8 percent on 1st January 2023.

One of the main new revenue measures to be implemented in the upcoming year is the sale of carbon credits based on the generated credits through the sequestration of carbon from mangroves and sea grass meadows in the Maldives. Carbon credits sold by environmentally vulnerable countries like the Maldives likely have a greater chance of receiving a good price in auction markets. Discussions with two international financial institutions are underway, and a preliminary assessment indicates the credits can be taken to the market in 2024.

In addition, assuming that MFMC will start generating revenue from the Integrated Tourism Project in K.Gaafaru this year, dividend receivable from the company has been forecasted to increase in the medium term. As such, it is expected that the 14 private islands under this project are to be sold within a three-year period. Table 5 shows the estimates for the additional revenue generated from the proposed new revenue measures.

Table 5: Estimated Revenue Increment from Proposed New Revenue Measures

MVR Millions	2024	2025	2026
Total	1,326.1	2,097.1	1,326.1
Monetisation of Carbon Credits	863.5	863.5	863.5
Dividends from MFMC	462.6	1,233.6	462.6

Source: Ministry of Finance

To further strengthen revenue policies and implement them in a sustainable manner through early engagements with relevant stakeholders, the Ministry of Finance is working on developing a Medium-Term Revenue Strategy (MTRS). In addition to providing a timeline for the introduction of revenue policies, this strategy will help inform the government and the general public on the impact on policy changes beforehand and provide forward guidance. Hence, once the MTRS is formulated, revenue policies will be implemented in line with the strategy.

6.1.4 Total Revenue and Grants

Including the additional revenue generated with the implementation of new revenue measures, the total revenue and grants forecasted for 2024 is MVR 38,283.3 million. Furthermore, with most of the on-going development projects expected to complete during 2024 and 2025, which will likely further contribute to economic growth, government revenue is expected to increase at an average of 28.8 percent in the medium term.

Table 6: Details of Medium-Term Revenue and Grants

MVR Millions	Forecast		
	2024	2025	2026
Total Revenue and Grants	38,283.3	43,067.3	44,612.9
Baseline Revenue	35,259.5	39,260.2	42,359.1
Tax Revenue	28,671.0	32,010.4	34,689.9
Corporate Income Tax and Withholding Tax	3,757.6	4,120.4	4,551.8
Bank Profit Tax	953.5	975.8	995.6
Individual Income Tax	372.8	393.8	414.5
GGST	4,810.4	5,219.8	5,621.6
TGST	11,219.9	12,969.9	14,204.0

Departure Tax	1,020.4	1,183.7	1,283.3
Green Tax	1,240.8	1,409.1	1,514.9
Non-Tax Revenue	7,914.6	9,346.9	8,995.3
Airport Development Fee	1,030.6	1,195.5	1,296.1
Property Income	1,588.2	1,682.2	1,776.3
Interest, Profit and Dividends	1,964.6	3,098.4	2,475.1
Grants	1,697.8	1,710.0	927.7
New Revenue Measures	1,326.1	2,097.1	1,326.1

Source: Ministry of Finance

6.2 Medium Term Expenditure Forecasts

The expenditure policy outlined in the Fiscal Strategy for 2024-2026 aims to maintain a level of spending that can be financed at a reasonable cost, considering prevailing economic conditions and anticipated revenue. As such, the focus is on maintaining recurrent expenditure at levels that do not exceed government revenue, and gradually reducing the overall budget balance over the medium term to ensure fiscal sustainability.

6.2.1 Medium Term Baseline Expenditure

Medium-term baseline expenditure refers to expenses required to sustain ongoing activities and projects conducted by the AGAs at their current level or scope. This excludes planned new activities, projects, services and resources, as well as provisions for hiring new personnel. Additionally, these estimates do not account for the changes in expenditure that are expected to arise from the implementation of proposed policies in the Fiscal Strategy aimed at reducing spending.

Based on existing trends, the primary factors contributing to the projected increase in public expenditure in the medium term include fluctuations in global commodity prices, and the dynamics of global oil prices in particular which affect the government's spending on subsidies. Additionally, delays in the implementation of planned policy changes aimed at controlling spending further contributes to this expected increase. For the year 2024, the total baseline expenditure envisaged is MVR 48,335.4 million, of which recurrent expenditure accounts for 70.7 percent.

In the medium term, employee salaries and allowances are expected to be the most significant component of the baseline recurrent expenditure. While the outlay on employee expenses increased this year due to the partial rollout of the planned pay harmonization, it is anticipated that the baseline expenditure in this area can be maintained similar levels over the medium term. Looking at the pay harmonization efforts to date, the salaries of the education sector was successfully equalized last year, while the policy was implemented for doctors and nurses in May 2023. An increase in allowances has also been extended this year to agencies that previously did not receive non-practice allowances. Under the baseline, which assumes the current level of pay harmonization is sustained and no additional employee recruitment takes place, the projected expenditure for salaries, allowances, and pensions in 2024 is anticipated to total MVR 13,002.1 million. Over the medium term, baseline expenditures for this component are expected to increase gradually at an average of 1.2 percent per annum.

Grants, contributions and subsidies are the second largest component of baseline recurrent expenditure, which includes the spending on subsidies, Aasandha and social security. The main factors contributing to the increased spending on Aasandha include increased service utilization, shifts in service-cost dynamics, and the delayed execution of strategies aimed at mitigating Aasandha expenses. Based on current expenditure patterns, projected baseline expenditure for Aasandha in 2024 is estimated at MVR 2,491.4 million. Over the medium term, an average increase of 6.8 percent per annum in the baseline expenditure is anticipated.

The other significant component in this area is subsidies, and in particular, fuel and electricity subsidies aimed at curbing electricity prices. In the absence of measures to counteract the pass through to subsidies from elevated global fuel prices, the spending on energy subsidies is expected to remain elevated. As such, the baseline projections indicate that the fuel subsidy expenditure is will reach MVR 1,532.1 million in 2024. The key assumption for estimating this is the IMF estimates of crude oil prices, which is currently at USD 68.9 per barrel on average in 2024. It is noteworthy that, unlike previous years, the premium between crude oil and diesel prices has increased substantially. As a result, despite a decline in crude oil prices, the cost of diesel is expected to be relatively high over the medium term. This is the primary reasoning behind the high baseline expenditures on fuel subsidy. In addition, the expenditure on electricity subsidies in 2024 is projected at MVR 1,256.4 million. This estimated cost encompasses the revenue shortfall covered by the government, intended to bridge the gap between the cost and revenue associated with the provision of electricity by Fenaka and STELCO. Without proactive measures to curtail energy subsidy expenditures, there is a substantial likelihood of a significant increase in these expenses over the medium-term.

Furthermore, an additional MVR 545.4 million is anticipated for the transport subsidy, which is intended to offset the losses incurred by MTCC from the operation of RTL network in the coming year. These increased costs are attributed to the expansion of its high-speed ferry services across the Maldives. Similarly, the outlay on the recently introduced sewerage subsidy is projected to rise in the following year, in line with the anticipated completion of several sewerage projects by the end of the year.

There is also anticipation of an increase in expenses associated with debt servicing in the medium-term. This is due to the projected rise in payments for domestic debt servicing costs, coupled with increased borrowings for various development projects over the same timeframe. Additionally, an increase in the level of disability benefits is anticipated as the government has revised the assistance given to persons with disabilities (PWDs). This includes an increase in the "carer's allowance" for caregivers of PWDs and an increase in support for consumable purchases. Further, an expansion in the number of people enrolled in the disability registry is envisaged driven by these policy changes.

The allocation of block grants to local councils is a fundamental part of the state budgetary framework, as stipulated by the Decentralization Act. The total amount allocated for block grants as well as the amounts apportioned for individual councils are calculated using a fiscal formula. Based on the projected baseline revenue figures for the year 2024, the disbursement for council block grants amounts to MVR 1,857.0 million.

Looking at capital expenditure, a reduction in anticipated capital contributions to SOEs is expected over the medium-term in the baseline expenditure forecasts. This decline is due to the expectation that fewer equity contributions will be required from the government to support the projects being implemented by SOEs, with ongoing projects gradually nearing completion and the subsequent improvements in their revenue generation capacity. Forecasts indicate that the largest capital outlay in the medium term will be directed towards FDC (Fahi Dhiriulhun Corporation) in relation to the housing development projects in Huilhumale Phase II, and to the Regional Airports Company for operationalizing new airports that are currently being developed.

A large portion of the baseline capital expenditure for 2024 is earmarked for ongoing PSIP projects, including water and sanitation initiatives and the construction of schools in different parts of the Maldives, and donor-funded projects such as the Velana International Airport terminal project. With a significant part of the airport terminal complete and anticipated to be operationalized by 2025, the expenditure on the Greater Male' Connectivity Project is expected to be higher—due to its rapid progress—along with the Indian Exim-funded Addu City Development project amounting to MVR 868.9 million. In addition, the expenditure on the reclamation of Giraavaru Falhu, which aims to address the issue of congestion in Male', is expected to make up a significant part of the PSIP budget. As the baseline excludes costs pertaining to new projects, the baseline PSIP expenditure is expected to decline over the medium-term as ongoing projects approaching completion.

6.2.2 Expenditure Reduction Measures

Although the economy has recovered to pre-pandemic levels, the fiscal risks that materialized during the pandemic has been compounded by the recent increase in global commodity prices. These external shocks, together with a subsidy regime significantly linked to commodity prices, have resulted in a financing gap that is not sustainable under the baseline. Therefore, it has become necessary to take efficiency measures to reduce expenditure and establish a sustainable fiscal trajectory while still achieving the intended outcomes. The following is a summary of the reforms proposed to consolidate and reduce government expenditure, together with estimates of potential savings. In addition to expenditure reduction, increasing the efficiency and progressiveness of the subsidy regime and social protection programs to expand protection for the most vulnerable groups of society was also a priority in the formulation of the reforms.

Replacing the universal fuel, electricity, staple food and sanitation subsidies with targeted, direct cash transfers

One of the main inefficiencies of the social security system arises due to the coverage of a large number of people who do not truly require state support in the current subsidy program. This limits the resources available to those that are most disadvantaged. Fuel, electricity and sanitation subsidies are available to all residents, while the staple food subsidy benefits tourists and businesses as well. As a result, despite the government incurring expenses on these subsidies, the collective benefits they provide to the most disadvantaged segments of the population are relatively small. In 2023, the projected total expenditure on these subsidies is MVR 3,485.2 million, which is 7.7 percent of the total projected expenditure for the current fiscal year. This proportion is expected to rise in the medium-term unless corrective measures are taken.

Therefore, in order to increase the efficiency of expenditure in this area and address distributional concerns in the current system, the proposal is to replace the existing fuel, electricity, staple food and sanitation subsidies with targeted cash transfers, starting from July 2024. Only individuals who opt-in and meet predetermined criteria will receive the benefits. The annual subsidy envelope would be pre-determined as a percentage of the previous year's TGST receipts, which links subsidy expenses with the government's revenue. The change would decouple subsidy expenses from external shocks such as fluctuating commodity prices, mitigating against the fiscal risks posed by these. The prices of currently subsidized products and services will become cost reflective, and this is anticipated that to promote behavioral changes leading to reductions in fuel and electricity consumption, which also has added benefits such as reducing the foreign exchange requirement for fuel imports and carbon emission. Disadvantaged individuals and households will continue to receive direct cash transfers—enough to protect them from the increase in the cost of living due to the implementation of this policy—on a monthly basis, while also opening up the possibility to generate savings by reducing their electricity consumption.

A sum of MVR 599.6 million in direct cash transfers is projected for the final six months of 2024. Coupled with the proposed subsidy restructuring, anticipated savings of MVR 1,174.2 million and MVR 2,528.3 million are projected for 2024 and 2025 respectively.

Targeting Aasandha coverage

The Aasandha system is designed to ensure access to healthcare to all Maldivians. However, there is no distinction in the level of benefits for individuals based on their income level, and the open nature of the scheme has inadvertently led to a significant moral hazard problem and the over consumption of healthcare services and medications. Over the past two years, expenditure on Aasandha has increased by an average of 27.2 percent per year, with MVR 2,306.1 million projected for 2024. Without reforms, it is projected that Aasandha's expenditure will continue to rise, averaging 6.8% per annum over the medium-term.

To ensure the sustainability of Aasandha's expenditure, the government is considering controls from both the quantity and price sides. On the price side, the government has initiated the bulk procurement of medicines through a project with UNDP to capitalize on pricing advantages generally available to larger countries. The objective is to lower the cost of drugs and the Aasandha expenditure on drugs and pharmaceuticals—which make up the majority of Aasandha expenses.

The proposed reform targets the quantity side or consumption to address concerns of moral hazard in service utilization and pharmaceutical consumption and wastage. In particular, it is proposed to link the coverage of the Aasandha system to the targeted benefits scheme starting from July 2024. The beneficiaries of the targeted direct cash transfer (also planned for implementation in July 2024) will enjoy the Aasandha scheme without any modifications to their coverage. However, individuals that are not eligible for the targeted direct cash transfer would be required to pay a set percentage out of pocket for all medical expenses up to a maximum out of pocket threshold per year. The ceiling for out-of-pocket expenses is intended to protect individuals with genuine needs for high-cost or continuous recourse to health services. This shift is expected to reduce the incentives for wastage in healthcare service consumption, while also ensuring that individuals in need are not subjected to significant financial burdens.

The envisaged policy changes to the Aasandha system is projected to result in total savings amounting to MVR 267.9 million in 2024. The change is expected to contribute to achieving a sustainable trajectory in Aasandha expenditure over the medium term.

Strengthening screening measures for welfare assistance

The government provides assistance for various healthcare needs through the welfare system, in addition to the services covered under the Aasandha scheme. In 2019, MVR 105.0 million was spent on welfare assistance, and this expense is expected to increase to MVR 302.8 million in 2024. Support for medical expenses incurred abroad makes up a sizeable portion of this increase. However, the current system does not adequately consider the individual's financial circumstances, and there is no robust mechanism to verify the information provided by applicants. Additionally, since welfare aid is disbursed in advance in cash, there is an increasing incidence of system misuse.

Currently, there are ongoing enhancements to the criteria of welfare eligibility and its procedures for disbursement, with the aim of preventing abuse and targeting assistance to genuinely deserving individuals. Through these revisions, the aim is to limit expenditure on welfare assistance to MVR 136.6 million in the upcoming year.

Staggering the rollout of pay harmonization

A pay harmonization initiative was launched in 2022 to set competitive remunerations to that of the private sector within the government and, eliminate the discrepancies in government salaries for employees performing similar roles to boost productivity. In the previous year, the policy was implemented for employees in the education sector, and adjustments to the compensation of health professionals were implemented in May of this year. The anticipated total impact of the pay harmonization initiative is estimated at MVR 2,953.3 million. The strategy proposes a staggered, four-year timeline for the completion of the pay harmonization initiative, contingent upon fiscal constraints.

The Ministry of Finance is currently working with relevant institutions to develop detailed analyses of the proposed cost-saving measures and to formulate implementation plans. Table 7 shows the estimated costs of these measures in the absence of the proposed rationalization measures, as well as the projected cost savings that could be achieved through their implementation.

Table 7: Expenditure under the baseline and estimated savings with reforms

MVR millions	2024	2025	2026
Subsidy[1]	2,304.3	1,199.3	1,199.3
Business as usual	3,409.3	3,580.3	3,668.7
Saving	(1,105.0)	(2,381.0)	(2,469.4)
Aasandha	2,223.5	2,410.0	2,533.8
Business as usual	2,491.4	2,680.6	2,807.1
Saving	(267.9)	(270.6)	(273.3)
Pay Harmonization[2]	250.0	1,000.0	1,421.0
Business as usual	1,421.0	2,953.3	2,953.3
Saving	(1,171.0)	(1,953.3)	(1,532.3)
Welfare	136.6	145.3	152.3
Business as usual	318.7	339.2	355.4
Saving	(182.1)	(193.8)	(203.1)

Source: Ministry of Finance

[1] This component covers food, fuel, electricity, and sewerage subsidies, along with the envisaged cash transfer system cost.

[2] In this component, the included expenditure for pay harmonization represents the estimated costs for implementing salary adjustments in sectors pending harmonization.

6.2.3 Expenditure on New and Recurrent Projects

An allocation of MVR 808.4 million has been made for new programs to be initiated in 2024. This allocation includes MVR 250.0 million for the continued rollout of pay harmonization, MVR 308.4 million for commodity risk hedging, and MVR 250.0 million for other new activities that are planned to be included in the budget. The envelope set for new projects in that year is MVR 500.0 million. An overview of cost estimates for new policy initiatives (NPIs) in the medium-term is presented in Table 8.

Table 8: Fiscal Space Allotted for NPIs in the Medium-term

MVR millions	2024	2025	2026
New Programs	808.4	1,558.4	1,979.4
Pay harmonization	250.0	1,000.0	1,421.0
Commodity Risk Hedging	308.4	308.4	308.4
Others	250.0	250.0	250.0
New Projects	500.0	800.0	1,050.0
New projects	500.0	500.0	750.0
Continuation of new projects	-	300.0	300.0

Source: Ministry of Finance

6.2.4 Total Budget and Expenditure

The total budget estimate for the year 2024 is MVR 50,679.1 million, which includes baseline expenses, allocations for new projects and programs and anticipated savings from cost-reduction measures. This is a 5.3 percent increase over the current year's budget estimate. The forecasted expenditure for the year 2024 amounts to MVR 48,094.9 million. With the anticipated implementation of the proposed cost-cutting measures, this figure is projected to decrease to MVR 44,948.8 million by the year 2025. Over the medium term, a moderate annual increase of 0.5 percent in costs is expected. (Table 9)

Table 9: Details of the Medium-term Budget

		Estimate	
MVR millions	2024	2025	2026
Total Budget	50,679.1	51,513.4	57,531.6
Total Expenditure	48,094.9	44,948.8	45,997.8
Baseline Budget	49,370.7	49,155.0	54,502.2
Recurrent expenditure	32,705.5	32,386.7	32,806.6

Personal Emoluments (including pensions)	13,002.1	13,138.9	13,309.3
Administrative supplies and services	5,532.8	5,561.7	5,669.6
Grants, contributions and subsidies	6,824.4	5,911.6	5,967.6
Councils block grant	1,926.6	2,177.4	2,298.9
Other recurrent expenses	5,419.6	5,597.1	5,561.2
Capital expenditure	14,929.8	14,850.5	20,191.9
Public Sector Investment Program	10,632.7	6,710.1	7,455.3
Capital equipment, investments and loan outlays	272.6	279.3	283.9
Debt amortization	2,571.6	6,552.0	11,521.1
Budget contingency	1,735.5	1,917.9	1,503.7
Other investments	75.0	-	-
New Policy Initiatives	1,308.4	2,358.4	3,029.4

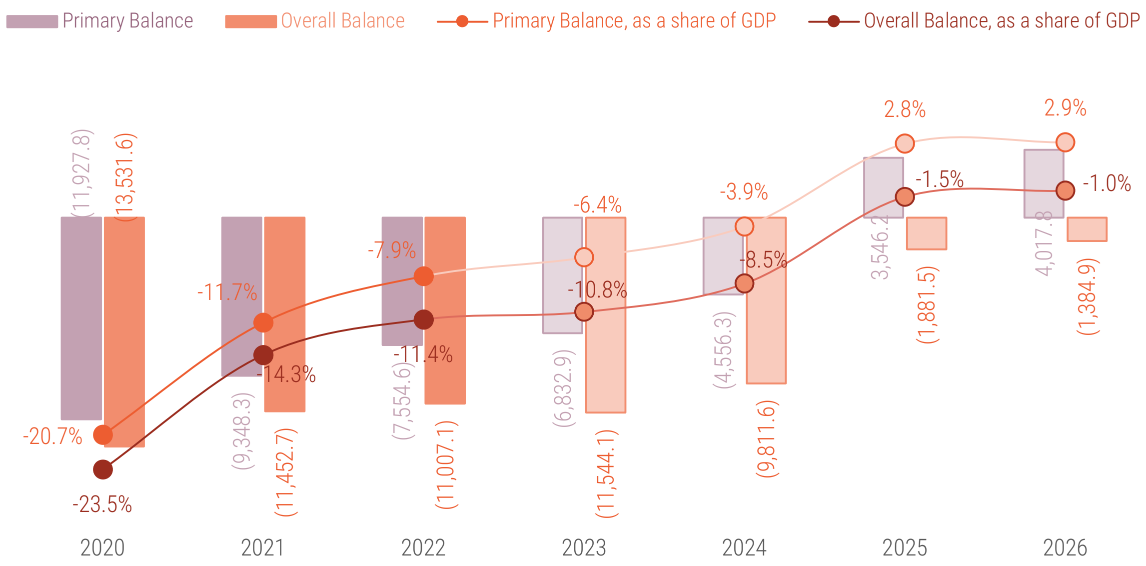
Source: Ministry of Finance

6.3 Medium Term Budget Balance

The anticipated changes in expenditure and revenue policies are projected to result in an estimated overall budget deficit of MVR 9,811.6 million for the year 2024, equivalent to 8.5 percent of GDP. The primary budget deficit is projected to be MVR 4,556.3 million, corresponding to 3.9 percent of GDP.

Over the medium term, a reduction in the overall deficit is expected, with a primary surplus expected in 2025 with the successful implementation of the proposed reforms. Therefore, these measures are pivotal to contain the growth of public debt and maintain a sustainable fiscal position over the medium term.

Chart 19: Medium-term Budget Balance (unless specified otherwise, in millions MVR)

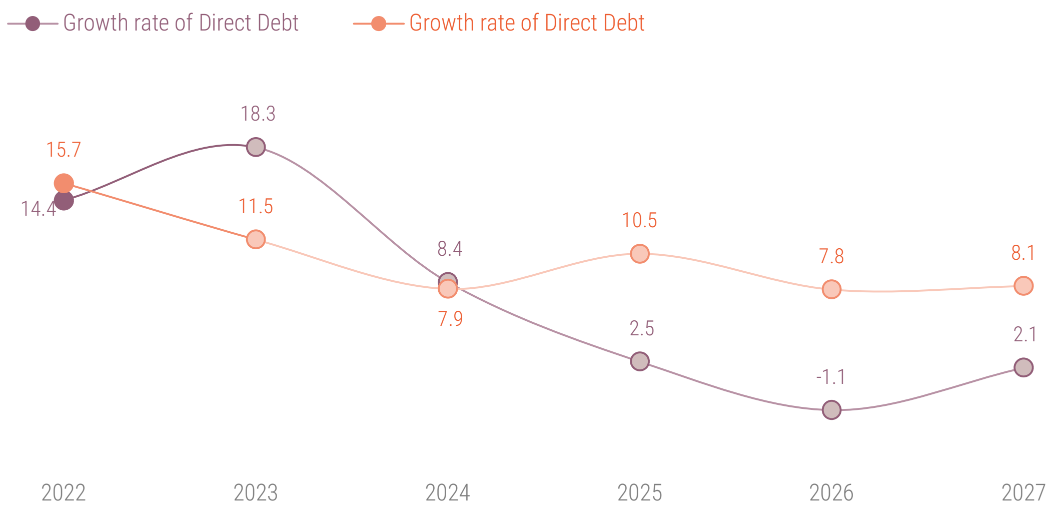


Source: Ministry of Finance

6.4 Medium Term Budget Financing and Debt

The successful implementation of revenue measures and expenditure side reforms is expected to maintain the growth rate of direct government debt below the growth rate of nominal GDP over the medium-term. The budget financing strategy prioritizes concessional borrowing in order to maintain debt servicing at a sustainable level.

Chart 20: Rate of increase in GDP and Debt (in percent)



Source: Ministry of Finance

The financing requirement for the year 2024 is estimated at MVR 13,426.4 million, followed by MVR 9,641.6 million in 2025 and MVR 14,214.8 million in 2026. Despite a decline from 2024, the financing requirement is expected to remain high in 2025 due to the scheduled repayment of the USD 100 million foreign loan borrowed in 2022, as well as the commencement of debt repayment under India's line of credit facility. The large increase anticipated in 2026 is primarily driven by the scheduled repayment of the USD 500 million sukuk that year. While debt repayment outlays for 2024 are expected to be relatively modest, the overall budget deficit for that year will exceed that of the latter years in the medium-term, which contributes to the elevated financing requirement.

The momentum of the implementation of PSIP projects is expected to be maintained in 2024 as well, with an increase in disbursements for projects funded through loans. These are mostly concessional or close to concessional loans, which do not significantly add to debt servicing in the medium-term. As these loans have already been contracted or are soon to be finalized, there are no risks of this financing not being realized.

The proposed Fiscal Strategy for 2022 and the Budget 2023 strategizes abstaining from any further issuances of government securities in the financial markets until 2024. This is due to the rise in interest rates globally, which in turn has increased the cost of financing from the international capital market. Given that conditions in financial markets are not anticipated to improve over the short term, the financing plan in this Fiscal Strategy does not include an issuance over the next two years. However, the issuance of a bond or sukuk worth USD 250 million is planned for 2026 anticipating market conditions to improve by then. The financing plan also includes securing budget support loans from international agencies and bilateral partners amounting to USD 50 million in 2024 and USD 150 million in 2025.

In addition, it is planned to raise MVR 6,171.6 million in 2024, MVR 3,882.5 million in 2025, and MVR 1,182.4 million in 2026 through the issuance of T-bonds and T-bills in the domestic market. However, depending on market liquidity, the domestic financing strategy may need to be revisited, with domestic financing possibly substituted with foreign loans.

Table 10: Medium-term budget financing

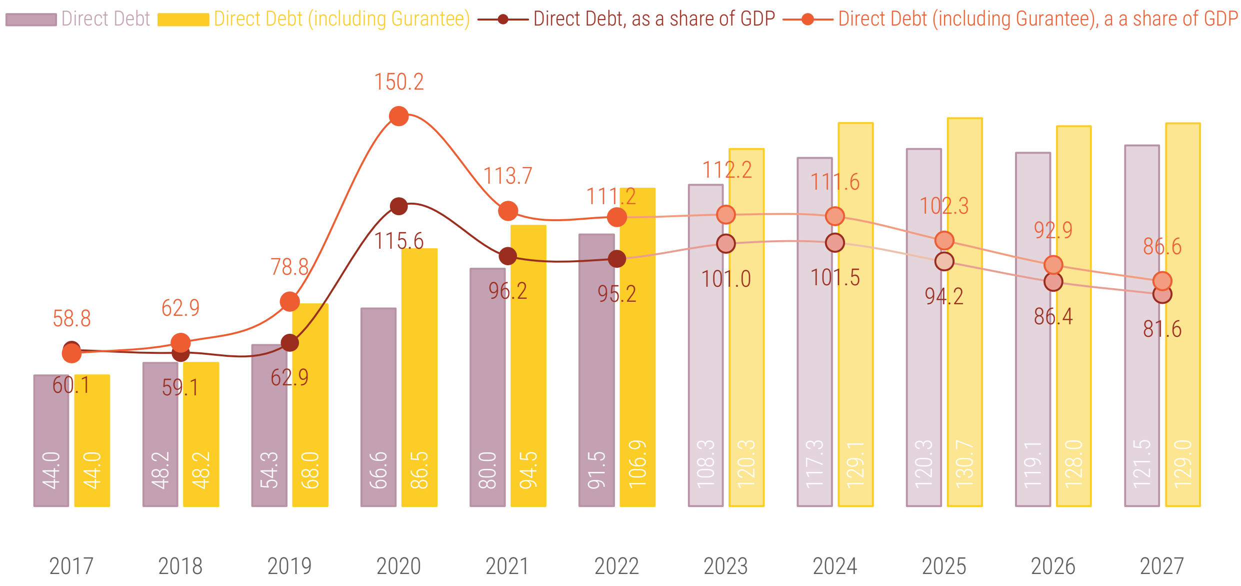
		Estimate		
MVR millions	2023	2024	2025	2026
Financing Gap	15,494.7	13,426.4	9,641.6	14,214.8
Budget Deficit	11,544.1	9,811.6	1,881.5	1,384.9
Loan Repayment	2,554.4	2,571.6	6,552.0	11,521.1
Transfers to Sovereign Development Fund	1,308.6	1,030.6	1,195.5	1,296.1
Others	87.6	12.6	12.6	12.6
Financing Gap	15,494.7	13,426.4	9,641.6	14,214.8
Foreign Loans	4,862.8	6,371.9	3,328.7	5,218.5
Bonds/Sukuk Issuance	-	-	-	3,855.0
Multilateral/Bilateral Budget Support	1,087.1	771.0	2,313.0	0.0

Domestic Securities and Loans	9,432.6	6,171.6	3,882.5	1,182.4
Sovereign Development Fund	-	-	-	3,855.0
Others	112.2	111.9	117.4	103.9

Source: Ministry of Finance

If the planned expenditure reforms and revenue measures are implemented in the medium term, and the primary budget deficit remains within the projected limits, nominal GDP growth is expected to outpace the growth rate of total public debt. As a result, the debt-to-GDP ratio is projected to decline from 111.2 percent at the end of 2022 to 92.9 percent at the end of 2026. The medium-term public debt strategy includes additional details on borrowing and debt management policies.

Chart 21: Medium-term Debt Estimates

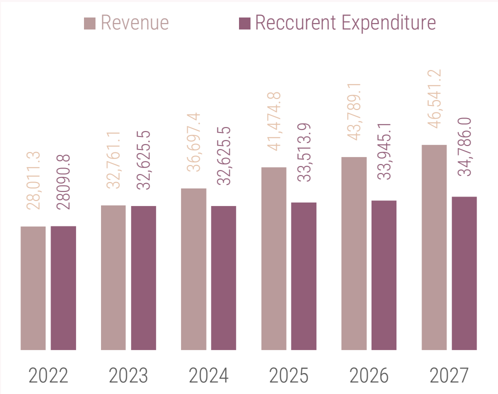


Source: Ministry of Finance

7. Compliance with Fiscal Responsibility Act

Maintain recurrent expenditure at levels that do not exceed government revenue (excluding grants)

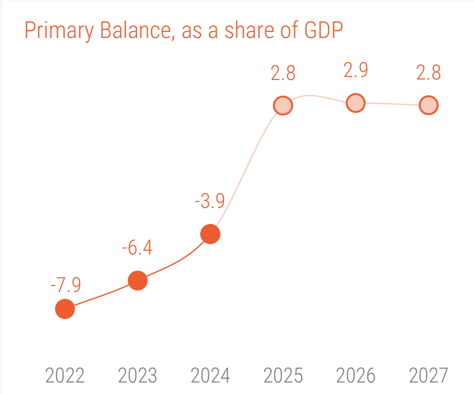
In MVR millions



Recurrent expenditure is expected to be kept below Revenue from 2023 with measures to increase revenue and reduce expenditure

Maintain the primary budget deficit at levels that do not exceed 5 percent of GDP.

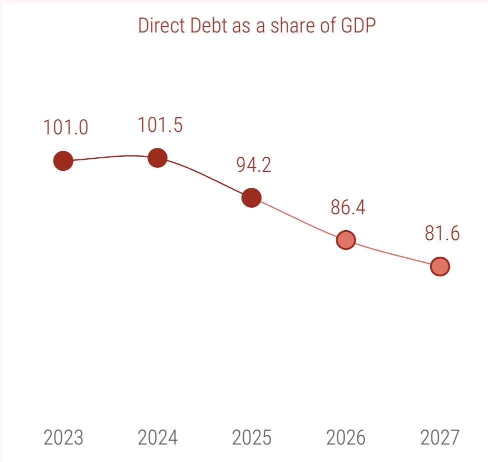
In percent



From 2024, the Primary Deficit as a percentage of GDP will be reduced to 5 percent and maintain below 5 percent in the Medium-Term

Reduce direct public debt (excluding guarantees) to less 95 percent of GDP by the end of 2026

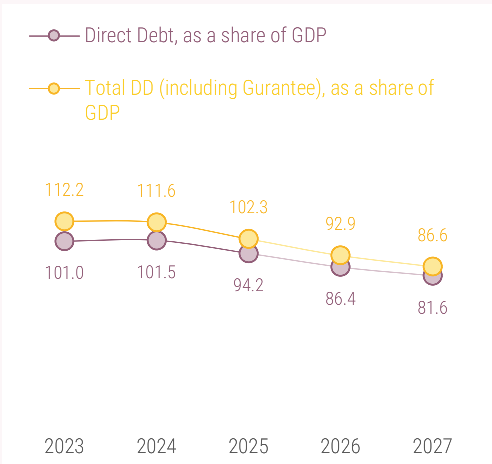
In percent



If the policies are implemented as proposed, the direct debt target is expected to be achieved by the end of 2025

Maintain public and publicly guaranteed debt as a percent of GDP on a downward trend.

In percent



If the proposed policies are implemented, the debt as a percentage of GDP is expected to decrease year by year

8. Risks to the Fiscal Strategy

The need to spend on expenditures not budgeted for the year, non-discretionary outlays exceeding estimations, and unanticipated shifts in government revenue and expenditure due to economic shocks are the primary sources of fiscal risks. Most fiscal risks to the strategy are categorized as economic, revenue-related, expenditure-related, debt, and financing risks.

The economy of Maldives is highly dependent on tourism, making it susceptible to global economic shocks. Notably, the IMF's World Economic Outlook, released in April of this year, highlighted the global economy's vulnerability stemming from the Credit Suisse crisis and the collapse of two US banks. The risk of a global slowdown has the potential to adversely affect both tourism demand and government revenue. In order to mitigate the repercussions of potential global economic upheavals transmitted through the tourism sector, efforts are currently in progress to increase the diversity of tourism source markets and foster the development of non-tourism sectors to diversify the economy.

On the revenue front, the shortfall in the realization of grants compared to estimates has been a significant constraint challenge in recent years. Funds which can be secured in the medium term through bilateral and international partners are being planned ahead along with the timelines to mitigate this risk and increase the accuracy of projections. Furthermore, gaps in the compliance with tax statutes and regulations might contribute to suboptimal revenue realization in the medium term. In order to address this concern and enhance taxpayer compliance, the Maldives Inland Revenue Authority (MIRA) has devised a Compliance Risk Management Policy, which was implemented in 2022. With unpaid tax revenue (including fines) 17.6 percent down compared to that in 2021, and dues of non-tax revenue (including fines) 3.4 percent lower, this risk appears to be contained. Meanwhile, the Maldives Customs Service is bolstering post-clearance audits to amplify adherence to statutes and regulations.

Looking at risks arising from the expenditure side, increasing global commodity, and particularly oil prices beginning in 2022 was the major driver of expenditure variations last year. Although there has been a decline in crude oil prices since then, volatility in global oil prices has been increased by the Russian-Ukrainian conflict and ongoing fluctuations in oil supply by the Organization of the Petroleum Exporting Countries. Additionally, the divergence between crude oil and diesel prices has surged to unprecedented levels, largely due to premiums that are expected to be driven by oil refining expenses. Hence, maintaining the current subsidy framework is anticipated to contribute to fiscal risks in the medium term. A central objective of the proposed subsidy reform in this strategy is to break the link between key expenditure areas and global commodity price volatilities.

Furthermore, the delayed implementation of proposed revenue and expenditure reform measures poses an obstacle to realizing the objectives outlined in this strategy. Mechanisms have been identified to execute the reforms aimed at attaining revenue and curbing expenditure. Efforts are also underway to secure financing as per the outlined plans.

Table 11 shows an overview of the fiscal risks highlighted in the "Fiscal Risk Statement" released by the Ministry of Finance in conjunction with the 2023 Budget. Details on the fiscal risks and the mitigation measures are presented in the Fiscal Risk Statement.

Table 11: Summary of fiscal risks

	Likelihood	Impact
Changes to global macroeconomic conditions	High	Low
Stagflation	High	High
Declining tourism prices	Low	Low
Non-realization of new revenue measures	Moderate	High
Non-realization of grants	High	Low
Increased non-compliance of taxpayers	Moderate	Low
Failure to implement expenditure reduction measures	High	High
Budget overruns in programs and projects	Moderate	High
Payment of pending bills of expenses incurred in previous years	High	Moderate
Underperformance of budgeted projects	High	Low
Underbudgeting for projects	Moderate	High
Low efficiency of investments	High	Moderate
Rising interest rates in the global financial markets	High	High
Failure to implement budget financing plans	High	High
Debt portfolio risk	Moderate	Moderate
Refinancing risk	Low	High
Interest rate risk	Low	Low
Exchange rate risk	Moderate	Moderate
Operational risk	Moderate	Moderate
Contingent liability risk	Low	Low
Decline in revenue from SOEs	High	High
Increased dependency of SOEs on the budget	High	High
Treasury loans and guaranteed debt of SOEs	Low	Low
Local council fiscal risks	High	High
Fire incidents	Low	Moderate
Climate risks	High	Low
Droughts	Moderate	Low
Financial sector risks	Low	Low

Legend:

Low	Moderate	High

Source: Ministry of Finance

9. Public Finance Management Reforms

In recent years, the Ministry has intensified its efforts to enhance and modernize public financial management (PFM) systems. Reviews to identify the necessary amendments to laws and regulations related to public revenue, expenditure, and debt management are currently underway, with the objective of increasing transparency by disclosing public finance related information, and align matters concerning state-owned enterprises and local councils with contemporary public finance management principles. These endeavors are being carried out in collaboration with international financial institutions and associations.

Looking at the main donor funded PFM related projects, the World Bank's "Public Financial Management Systems Strengthening Project" has successfully been closed, while support from the United States Agency for International Development and the Asian Development Bank is ongoing. Key assessments conducted on PFM and related areas include the Public Expenditure and Financial Accountability Assessment, Fiscal Transparency Evaluation, Debt Management Performance Assessment, and the Public Investment Management Assessment. These assessments play a pivotal role in determining the current state of the PFM systems, identifying necessary steps to enhance it, and benchmarking it against global standards. The following outlines some of the key ongoing and planned activities in the PFM space:

- Implementation of program and performance-based budgeting to strengthen the state budget formulation process and the monitoring of sectoral budget outcomes.
- Reviewing existing fiscal rules and processes, and the drafting of necessary amendments to the Fiscal Responsibility Act.
- Strengthening budget virement rules to facilitate budget implementation and increase budget credibility.
- Improving the process of treasury bill issuances in the primary market, and establishing the mechanism for secondary markets trading of treasury securities.
- Transition from cash basis to accrual accounting for recording transactions, in line with modern international standards.
- Improving the planning, implementation, and monitoring process of public infrastructure projects, including a planned Climate Public Investment Management Assessment to identify gaps and the linkages to climate related vulnerabilities and adaptation requirements.
- Conducting spending reviews to identify outcomes and inefficiencies in expenditure.
- Development of the Integrated National Financing Framework focusing on climate financing and the social sector.
- Developing a Medium-Term Revenue Strategy to broaden the tax base, strengthen revenue systems, and provide forward guidance on revenue policy.

- Improving the governance framework of state-owned enterprises, including the establishment of a digital platform to publish financial statements and the development of a mechanism to identify risks from contingent liabilities.
- Identifying appropriate ceilings and controls on government and local council borrowing, and improving the legislation and guidelines governing debt issuance and management.
- Developing a legislative framework for the governance of the Sovereign Development Fund.
- Establishing a Procurement Policy Board to improve public procurement practices and to align these with global standards.
- Formulating laws and regulations for formulating and implementing public-private partnership (PPP) projects, and establishing the systems required for PPP planning, implementation, and risk management.
- Increasing external and internal scrutiny of public expenditure through third-party audits.
- Strengthening the PFM capacity of local councils.
- Upgrading the existing state accounting system, SAP.
- Upgrading the state asset management system.

10. Conclusion

This statement presents revised revenue and expenditure estimates for 2023, medium-term fiscal targets, proposed measures to achieve these targets, and revised medium-term revenue and expenditure estimates as required under the Fiscal Responsibility Act.

Similar to the objective of the Fiscal Strategy developed in the previous year, this strategy is geared towards maintaining fiscal and debt sustainability in the medium term. However, recent changes in the global economic landscape and the emergence of new risks require a change to the mix of reforms to attain fiscal policy objectives. The revenue and expenditure policies outlined in this fiscal strategy aim to reduce the fiscal deficit and maintain the state's financing needs at levels that can be realistically met. These reforms also prioritize safeguarding the most vulnerable segments of society and achieving a more equitable distribution of income. Implementing the proposed reforms as planned is essential to increase revenue mobilization, reduce expenditure and subsequently ensure fiscal and debt sustainability.

The 2024-2026 government budget will be formulated based on this Strategy.

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Annex 1: Revenue and expenditure of 2022 and 2023

	Budget 2022	Actual 2022	Budget 2023	Revised 2023
Total Revenue and Grants	**24,279.9**	**29,053.0**	**32,098.3**	**33,951.2**
Total Revenue	**21,368.1**	**27,993.5**	**29,636.2**	**32,761.1**
Import Duties	3,223.4	3,497.2	3,789.7	3,903.8
Property Taxes Business and	2,711.3	4,311.0	4,416.0	5,466.2
Withholding and business profits taxes	1,232.1	2,147.9	2,115.0	3,252.0
Bank Profit Tax	603.4	901.3	903.3	927.2
Tax Goods and Service	7,699.4	9,781.2	13,299.0	14,465.6
Tourism Goods and Services Tax	4,821.8	6,597.1	9,096.0	9,993.9
General Goods and Services Tax	2,877.5	3,184.1	4,203.0	4,471.6
Other Taxes and Duties	1,640.7	1,803.6	1,911.2	2,124.0
Airport Service Charge	769.2	830.6	870.6	958.0
Green Tax	823.7	973.0	1,040.6	1,166.1
Fees and Charges	1,503.5	3,572.1	1,831.9	2,200.1
License fees Registration and	740.6	809.0	778.4	854.3
Property Income	2,356.0	2,213.5	1,852.7	1,780.6
and Dividends Interest, Profit	1,237.9	1,343.8	1,359.4	1,240.0
Other Revenue	255.3	662.2	397.9	352.4
Grants	**2,911.8**	**428.5**	**2,462.1**	**1,190.2**
Total Expenditure	**39,949.7**	**40,060.0**	**40,718.3**	**45,495.3**
Total Budget	**42,847.2**	**42,828.4**	**42,840.8**	**48,137.3**
Recurrent Expenditure	**28,144.6**	**28,090.8**	**28,636.8**	**32,625.5**
Personal Emoluments	9,766.5	9,383.7	11,027.5	10,200.5
Pensions, Retirement Benefits & Gratuities	1,664.5	1,760.2	1,858.6	1,847.5
Goods and services	5,525.8	4,988.4	5,604.3	5,807.6
Travel Expenses	203.0	243.9	210.2	236.0
Supplies and Requisites	693.9	673.2	788.0	805.1
Operational Services	2,330.0	2,248.1	2,589.9	2,627.0
Supplies and Requisites for Service Provision	1,260.4	1,170.6	1,137.5	1,260.6
Training	690.1	356.9	391.0	371.8
Repairs and Maintenance	348.4	295.6	487.6	507.1
Grants, Contributions and Subsidies	6,602.9	6808.8	4,784.1	7,757.6
Other Recurrent Expenses	3,019.4	3,497.6	3,538.0	5,218.8
Grants to Councils	1,565.4	1,652.1	1,824.3	1,793.5
Capital expenditure	**14,702.6**	**14,737.6**	**14,204.0**	**15,511.8**
Development Projects	22.5	90.1	47.3	47.6
Public Sector Investment Program	7,334.8	8,733.1	8,552.3	9,966.4
Issuance of property, investments and loans	440.7	748.3	370.6	661.9
Budget contingency	1,300.0	-	1,732.0	-
Debt amortisation	2,861.7	2,693.1	2,101.1	2,554.4

Subscription to Multilateral Agencies	35.7	27.4	21.4	12.6
Other investments	-	47.9	-	75.0
Primary Balance	**(12,754.6)**	**(7,554.6)**	**(5,183.1)**	**(6,832.9)**
Overall Balance	**(15,669.8)**	**(11,007.1)**	**(8,620.0)**	**(11,544.1)**
As a share of GDP:				
Primary balance	-14.6%	-7.9%	-5.0%	-6.4%
Overall Balance	-17.9%	-11.4%	-8.3%	-10.8%
Foreign Debt	47.0%	34.4%	38.3%	66.2%
Domestic Debt	57.4%	60.8%	59.4%	34.8%
Guaranteed debt Direct and	117.7%	111.2%	108.9%	112.2%

Annex 2: Medium-term economic forecasts

	2021	2022	2023	2024	2025	2026	2027
Nominal GDP (in millions MVR)	83,098.3	96,131.7	107,214.1	115,669.8	127,781.1	137,800.6	148,950.2
Nominal GDP Growth (%)	44.2	15.7	11.5	7.9	10.5	7.8	8.1
Real GDP (in millions MVR, 2014 constant prices)	72,812.8	82,907.0	90,688.2	96,128.0	104,299.7	110,501.4	117,288.5
Real GDP Growth (%)	41.7	13.9	9.4	6.0	8.5	5.9	6.1
CPI Inflation (%)	0.2	2.3	3.4	1.8	1.7	1.2	1.4
Number of tourist arrivals	1,321,937	1,675,303	1,930,760	2,091,237	2,426,772	2,612,973	2,813,343
Tourist arrival growth (%)	133.8	26.7	15.2	8.3	16.0	7.7	7.7
Bednights	10,073,403	12,260,009	13,986,082	15,025,817	17,101,846	18,282,490	19,543,958
Bednights growth (%)	152.8	21.7	14.1	7.4	13.8	6.9	6.9

2023 to 2027 forecasts are estimates of the moderate case scenario

Annex 3: Medium-term revenue and expenditure forecasts 2024 - 2026

		Forecast		
	2023	2024	2025	2026
Revenue and Grants Total	**33,951.2**	**38,283.3**	**43,067.3**	**44,612.9**
Total Revenue	**32,761.1**	**36,585.6**	**41,357.3**	**43,685.2**
Import duty	3,903.8	4,211.7	4,652.7	5,017.5
Business and Property Taxes	5,466.2	6,029.9	6,435.9	6,907.8
Withholding and business profits taxes	3,252.0	3,757.6	4,120.4	4,551.8
Bank Profit Tax	927.2	953.5	975.8	995.6
Goods and Service Tax	14,465.6	16,030.3	18,189.7	19,825.6
Tourism Goods and Services Tax	9,993.9	11,219.9	12,969.9	14,204.0
General Goods and Services Tax	4,471.6	4,810.4	5,219.8	5,621.6
Other taxes and duties	2,124.0	2,261.1	2,592.8	2,798.2
Airport Service Charge	958.0	1,020.4	1,183.7	1,283.3
Green Tax	1,166.1	1,240.8	1,409.1	1,514.9
Fees and Charges	2,200.1	1,952.3	2,167.4	2,317.3
Registration and License fees	854.3	909.9	921.7	930.8
Property Income	1,780.6	1,588.2	1,682.2	1,776.3
Interest, Profit and Dividends	1,240.0	1,964.6	3,098.4	2,475.1
Other Revenue	726.4	1,637.4	1,616.5	1,636.6
Grants	**1,190.2**	**1,697.8**	**1,710.0**	**927.7**
Total Expenditure	**45,495.3**	**48,094.9**	**44,948.8**	**45,997.8**
Total Budget	**48,137.3**	**50,679.1**	**51,513.4**	**57,531.6**
Recurrent Expenditure	**32,625.5**	**32,705.5**	**32,386.7**	**32,806.6**
Personal Emoluments	10,200.5	10,978.9	10,971.5	10,985.2
Pensions, Retirement Benefits & Gratuities	1,847.5	2,023.2	2,167.4	2,324.1
Goods and services	5,807.6	5,532.8	5,561.7	5,669.6
Travel Expenses	236.0	204.8	204.2	216.7
Supplies and Requisites	805.1	783.5	790.0	823.5
Operational Services	2,627.0	2,508.9	2,522.6	2,594.4
Supplies and Requisites for Service Provision	1,260.6	1,294.6	1,306.7	1,285.7
Training	371.8	386.4	396.2	403.2
Repairs and Maintenance	507.1	354.6	342.0	346.1
Grants, Contributions and Subsidies	7,757.6	6824.4	5,911.6	5,967.6
Other Recurrent Expenses	5,218.8	5,419.6	5,597.1	5,561.2
Grants to Councils	1,793.5	1,926.6	2,177.4	2,298.9
Capital Expenditure	**15,511.8**	**14,929.8**	**14,850.5**	**20,191.9**

Development projects	47.6	47.6	47.3	48.6
Public Sector Investment Program	9,966.4	10,632.7	6,710.1	7,455.3
Issuance of property, investments and loans	661.9	272.6	279.3	283.9
Budget contingency	-	1,735.5	1,917.9	1,503.7
Debt Amortisation	2,554.4	2,571.6	6,552.0	11,521.1
Subscription to Multilateral Agencies	12.6	12.6	12.6	12.6
Other investments	75.0	-	-	-
Primary Balance	**(6,832.9)**	**(4,556.3)**	**3,546.2**	**4,017.8**
Overall Balance	**(11,544.1)**	**(9,811.6)**	**(1,881.5)**	**(1,384.9)**
As a share of GDP:				
Primary balance	-6.4%	-3.9%	2.8%	2.9%
Overall Balance	-10.8%	-8.5%	-1.5%	-1.0%
Foreign Debt	34.8%	36.8%	34.5%	30.6%
Domestic Debt	66.2%	64.6%	59.6%	55.8%
Direct and Guaranteed debt	112.2%	111.6%	102.3%	92.9%