بسم الله الرحمن الرحيم

Ministry of Finance
Male', Maldives

Translation of the report submitted to the People's Majlis

Medium Term Fiscal Strategy 2023-2025

31 July 2022

Abbreviations and Acronyms

ADF	Airport Development Fee
ASC	Airport Service Charge
CPI	Consumer Price Index
FRL	Fiscal Responsibility Law (Act No.7/2013)
GDP	Gross Domestic Product
GIR	Gross International Reserves
GGST	General Goods and Services Tax
HDC	Housing Development Corporation
IFI	International Financial Institutions
IMF	International Monetary Fund
MFMC	Maldives Fund Management Corporation
MIFCO	Maldives Industrial Fisheries Company
MNDF	Maldives National Defense Force
MMA	Maldives Monetary Authority
MPS	Maldives Police Services
MRPS	Maldives Retirement Pension Schemes
MTRS	Medium Term Revenue Strategy
MVR	Maldivian rufiyaa
NPI	New Policy Initiatives
NRM	New Revenue Measures
PBA	Public Bank Account
PFM	Public Financial Management

PPP	Public Private Partnership
PSIP	Public Sector Investment Program
RACL	Regional Airports Company Limited
SAP	Strategic Action Plan 2019-2023
SDF	Sovereign Development Fund
SDFC	SME Development Finance Corporation
SDR	Special Drawing Rights
SIFCO	Sifainge Co-operative
SOE	State Owned Enterprise
T-Bill	Treasury Bill
TGST	Tourism Goods and Services Tax
USD	United States dollars
VIA	Velana International Airport

Contents

1. Introduction

This statement is submitted to the Public Accounts Committee of the People's Majlis, as required under article 10 of the Fiscal Responsibility Law (7/2013) (FRL), disclosing the medium-term fiscal strategy of the Government.

This fiscal strategy is being submitted at a time of heightened economic uncertainty. With the world economy not fully recovered from the shock of the Covid-19 pandemic, Russian invasion of Ukraine and the ensuing spike in oil and commodity prices has further slowed down global growth. At a time when higher oil prices has increased government expenditures, the avenues for budget financing have narrowed significantly as advanced economies have sharply tightened monetary policy. This fiscal strategy is based on managing these fiscal risks and formulating a sustainable fiscal policy in the medium term. The 2023 and medium term budget will be based on this strategy.

This statement will analyze the difference between the previous Fiscal Strategies and the approved Budget. It will also include a review of the 2022 Budget, reflecting the developments so far in 2022. The report will then look into the medium-term fiscal policy objectives and policy proposals to meet these objectives. As such the report will look into the required changes to the revenue and expenditure policies, to meet the medium term targets for fiscal balances and public debt. This Strategy is based on "Medium-term Fiscal Framework" and baseline estimates of income and expenditure produced by the Ministry of Finance.

2. Comparison of Fiscal Strategies proposed in 2020 and 2021, and the Approved Budget 2022

This section examines variations in the estimates of the Fiscal Strategy 2021-2023 (Fiscal Strategy 2021), the Fiscal Strategy 2022-2024 (Fiscal Strategy 2022), and the Approved Budget 2022-2024 (Budget 2022).

The estimates of total revenue and grants has seen upward revisions from the Fiscal Strategy 2021, the Fiscal Strategy 2022 and the Budget 2022. These revisions are mainly due to the changes in tourism and economic estimates. When the Fiscal Strategy 2021 was presented to People's Majlis in July 2020, there was a lot of uncertainty in relation to the spread of the Covid-19 pandemic and the economic trajectory in the short and medium term. The Fiscal Strategy 2021 estimates were prepared taking into account the adverse impact of Covid-19 pandemic, border closures and lockdowns on the Maldives economy and fiscal balances. At the time, the economic recovery in the medium-term was expected to be U-shaped; meaning that it would take a number of years for the tourism industry and the Maldives economy to recover from the economic shock and revert to pre-Covid levels. However, the quick re-opening of Maldives borders, the reopening of tourist facilities under "new normal" conditions, and the discovery of a Covid-19 vaccine in late 2020, enabled the recovery of the tourism sector and the economic activities to resume slowly. Since the tourism recovery in 2020 and 2021 were faster than anticipated, tourism and economic forecasts were raised in the Fiscal Strategy 2022 and Budget 2022. With this, the forecasts for tax revenues, particularly from the tourism sector were revised upwards. Additionally, the Fiscal Strategy 2021 and 2022, assumes the implementation of the New Revenue Measures proposed in 2020, which were delayed due to the Covid-19 pandemic, over the medium term.

Table 1: Estimates of Fiscal Strategies proposed in 2020 and 2021 and the Approved Budget 2022

	Fiscal Strategy 2021		Fiscal Strategy 2022			Budget 2022		
MVR millions	2022	2023	2022	2023	2024	2022	2023	2024
Revenue and Grants	21,076.5	25,314.1	23,666.1	26,703.8	27,372.3	24,279.9	27,977.5	27,310.8
Budget	38,157.8	34,783.2	37,040.2	37,454.5	37,916.1	36,999.2	41,094.4	40,108.3
Expenditure	31,707.3	32,080.8	33,848.8	35,035.1	35,657.4	34,101.8	36,125.8	37,594.2
Overall Balance	(10,630.8)	(6,766.7)	(10,182.6)	(8,331.2)	(8,285.1)	(9,821.9)	(8,148.3)	(10,283.5)
Primary Balance	(6,896.1)	(2,659.2)	(6,896.5)	(4,638.4)	(4,207.2)	(6,906.7)	(4,841.2)	(6,682.6)
Economic Assumptions								
Nominal GDP	92,410.9	99,991.8	82,003.9	93,358.6	104,037.9	87,498.2	96,646.1	105,413.5
Real GDP Growth (%)	19.6%	6.7%	12.0%	11.5%	9.2%	12.0%	8.7%	7.4%
Tourist Bednights	9,468,538	11,092,512	9,673,759	11,550,621	13,191,630	10,434,747	11,268,891	12,167,818

For grants, the Fiscal Strategy 2021 and 2022 forecasted cash grants of USD100 million per year. However, the Budget 2022 revised up the cash grants projection to USD150 million per year. The estimated receipts from project grants has also been revised upwards in line with the projected acceleration in implementation of large infrastructure projects. In the Budget 2022, the estimated amount of grants for 2023 include the conversion of the USD 150 million in treasury bills invested by Government of India in 2019 to a grant.

Looking into the Government expenditures, the forecasts in Fiscal Strategy 2021 are lower than the expenditure estimates in Fiscal Strategy 2022 and Budget 2022. It was assumed in Fiscal Strategy 2021 that expenditure reduction measures implemented in 2020 to accommodate budget space for the increase in expenditure for Covid-19 pandemic management will be maintained in the medium term. However, expenditure estimates in Fiscal Strategy 2022 and Budget 2022 were revised upwards as general government expenditures were expected to return to pre-Covid levels with the removal of Covid-19 restrictions, and due to delays in the implementation of planned expenditure reduction measures. In addition, with the upward revision of revenue forecasts, the estimates for the expenditure on block grants to local councils has also been increased from one statement to another. Additionally, estimates of PSIP expenditures has been raised with each statement as public infrastructure projects, particularly the large-scale infrastructure projects have commenced physical work and are projected to progress over the medium term.

The change in the medium term plans for debt repayment, especially the repayment plan for the USD 250 million sovereign bond, was a major factor in the revisions of the total budget figures from one statement to another. Initially the Fiscal Strategy 2021 assumed a full repayment of USD 250 million, at maturity in 2022. However, as part of the liability management exercise carried out in 2021, the majority of this bond was repaid in 2021 and the remainder was planned to be repaid at maturity in 2022. This distributed the bond repayment allocation across 2021 and 2022 and changed the total budget estimates in Fiscal Strategy 2022 and Budget 2022.

From the Fiscal Strategy 2021 to the Budget 2022, the estimate for the overall deficit for 2022 has been reduced. Although the expenditure forecasts were raised from one statement to another, the estimates of total revenue and grants were raised incrementally, particularly due to improved macroeconomic projects. In contrast, for 2023, the overall deficit forecast in Fiscal Strategy 2022 and Budget 2022 is higher than the forecast in Fiscal Strategy 2021. This is because the subsequent statements assumed a faster growth in expenditure than revenue. Similarly, the forecast for overall deficit for 2024 were also raised in the most recent statements.

Unlike previous years' fiscal strategy statements, Fiscal Strategy 2022 sets out "fiscal anchors" for achieving medium-term fiscal policy objectives of the Government. They were;

(1) Reduce the public debt (excluding guarantees) to 105 percent of GDP by end of 2023

(2) Reduce the primary budget deficit to 5 percent of GDP by 2023

(3) Maintaining a year on year declining trajectory for budget deficit and public debt as a percentage of GDP

The approved Budget for 2022 proposed a fiscal trajectory which enabled public debt (excluding guarantees) to come down to 105 percent of GDP by the end of 2023, in line with the fiscal anchor (1). This is because of the projected decline in debt financing, as deficit declined with the improvement in revenue estimates, in addition to higher nominal GDP estimates. The approved Budget for 2022 also proposed a trajectory where the primary budget deficit will be reduced to 5 percent of GDP in 2023, in line with the fiscal anchor (2). However, the fiscal anchor (3) to maintain a year on year declining trajectory for the budget deficit and debt as a proportion of GDP in the medium term was not maintained in the approved Budget for 2022, as the deficit as a percent of GDP were projected to increase from 2023 to 2024. The main reason for this is that the Budget 2022 assumed that treasury bills of USD 150 million issued to the State Bank of India in 2019 was to be converted into a grant in 2023, with its repayment by the Government of India during the year. This increased total grants estimate for 2023 thereby leading to a lower deficit estimate in the year. Since this transaction is one-off, there does not appear to be a structural problem with maintaining this anchor. Furthermore, Budget 2022 estimates that a downward trajectory for the public debt and deficit as a percentage of GDP will be maintained over the medium term, as stated in the fiscal anchor (3), with the exception of 2023-2024.

3. 2021 Actuals and 2022 Revised

This section covers the 2021 and 2022 economic situation, revenues and expenditures as of June 2022, and revised revenue and expenditure estimates for 2022.

3.1 Economic developments for 2021 and 2022 and revised forecasts

3.1.1 Tourism

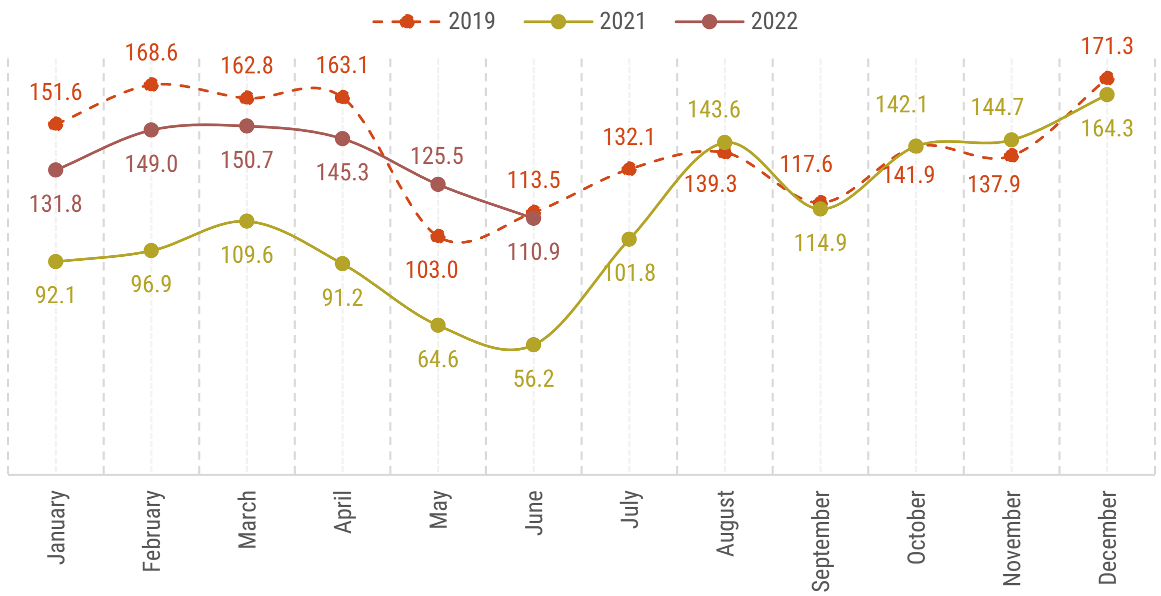
The recovery of tourism sector from the Covid-19 pandemic has been stronger than previously forecasted. As such, tourist arrivals and tourist bed nights was higher than the estimates forecasted in 2021. By the end of 2021, 1,321,937 tourists visited the Maldives, which is close to the best-case scenario estimate of tourist arrivals scenarios forecasted for the Budget 2022, in October 2021. In addition, the average duration of stay was higher than pre-pandemic levels, resulting in higher bed nights. Thus, tourist bed nights at the end of 2021 was 10,073,404. One of the factors that contributed to the higher than expected tourist arrival, was the re-opening of the borders of the Maldives while the borders of other similar destinations were closed with strict Covid-19 restrictions maintained for extended periods. Furthermore with the re-opening of border allowed many airlines to resume flights to the Maldives. Tourist establishments were also re-opened to tourists under “new normal” conditions, and bed capacity was quickly ramped up. The successful Covid-19 vaccination campaign, with a significant proportion of the vaccine eligible population being vaccinated in a short period of time, was also an important factor. In addition, the financial assistance provided by the government to sustain and resume economic activities and employment was also significant.

In 2021, the tourism growth was the highest during the last five months of the year. As shown in Chart 1, total tourist arrival from August to December 2021 were almost at par with the tourist arrivals recorded for the corresponding period of 2019. In fact during some months of the latter part of 2021, tourist arrivals were higher than tourist arrivals recorded in the same month in 2019. December 2021, saw the highest number of tourist arrivals being recorded since the beginning of the pandemic.

There was some slowdown in tourist arrivals in late 2021 into early 2022, due to the rapid spread of Omicron variant of Covid-19 across the world. Thus, in January 2022, the number of tourist arrivals, especially from India, declined significantly. Arrivals were buoyed by the strong performance of the

Russian market, with the highest arrivals in January and February 2022, being recorded from that market.

Chart 1: Tourist arrivals compared to 2019 (in thousands)



*Information available as of 30th June 2022

Source: Ministry of Tourism, Maldives Immigration

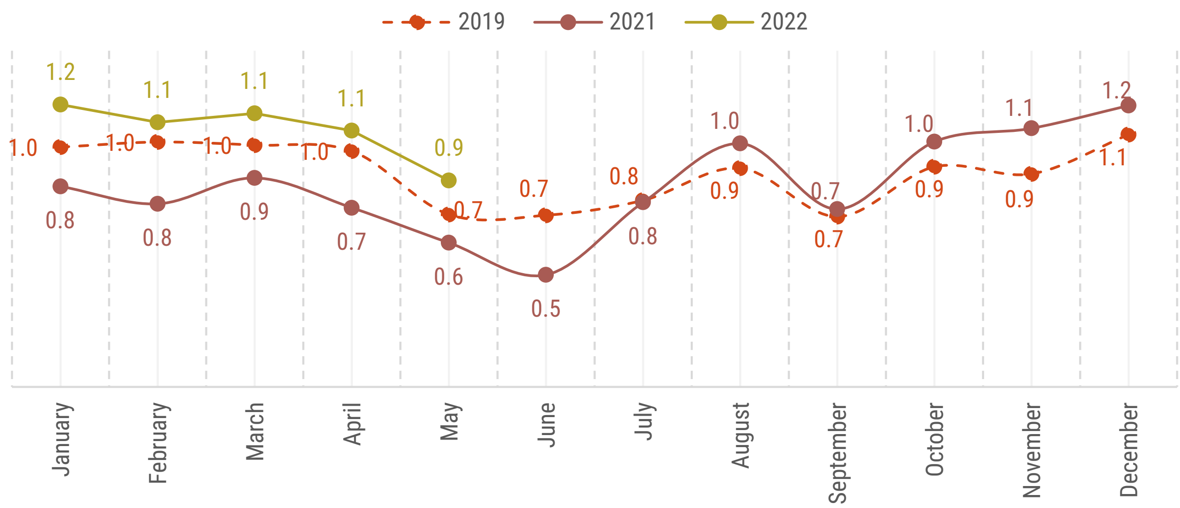
Since the Covid-19 pandemic, Russia has become the second largest tourist source market for Maldives tourism. In 2021, tourist arrivals from Russia and Ukraine accounted for about one-fifth of the total tourist arrivals to Maldives. Therefore, these two markets were expected to play an important role in Maldives's tourism in 2022 as well. However, the invasion of Ukraine by Russia on 24th February adversely impacted the country's tourism sector. Russian tourist arrivals fell 80 percent in March and April compared to the previous two months after the services of Aeroflot, the national airline of Russia with direct connections from Russia to Maldives, was temporarily halted in March 2022. As a result of the war in Ukraine, tourist arrivals from Ukraine came to a complete halt from March 2022 onwards.

While tourist arrivals from Russia and Ukraine declined, arrivals from other source markets saw higher than expected growth in March and April 2022. The increase in tourists from other markets enabled to offset the negative impact of the Russia-Ukraine war on tourist arrivals. Tourist arrivals from Western European countries, especially the United Kingdom, increased in March and April. Additionally, arrivals from India increased in May 2022 compared to previous years. The tourist arrivals from Russia have also started to increase with the resumption of Aeroflot flights on 15th May 2022.

As of June 2022, 813,211 tourists have visited the Maldives. This is an increase of 59.3 percent compared to the same period of 2021, while this is 5.7 percent lower compared to the same period of 2019. The tourist arrivals were lower in the first four months of 2022 compared to the same period in

2019. In contrast, tourist arrivals in May 2022 was 21.8 percent higher than May 2019. This is, to date, the highest number of tourist arrivals in the month of May. The tourist bed nights is higher in 2022 as the average number of nights spent by tourists in the Maldives has increased since the Covid-19 pandemic. Bed nights as of June 2022 was higher than the bednights recorded for the corresponding period of 2019.

Chart 2: Tourist bed nights compared to 2019 (in millions)



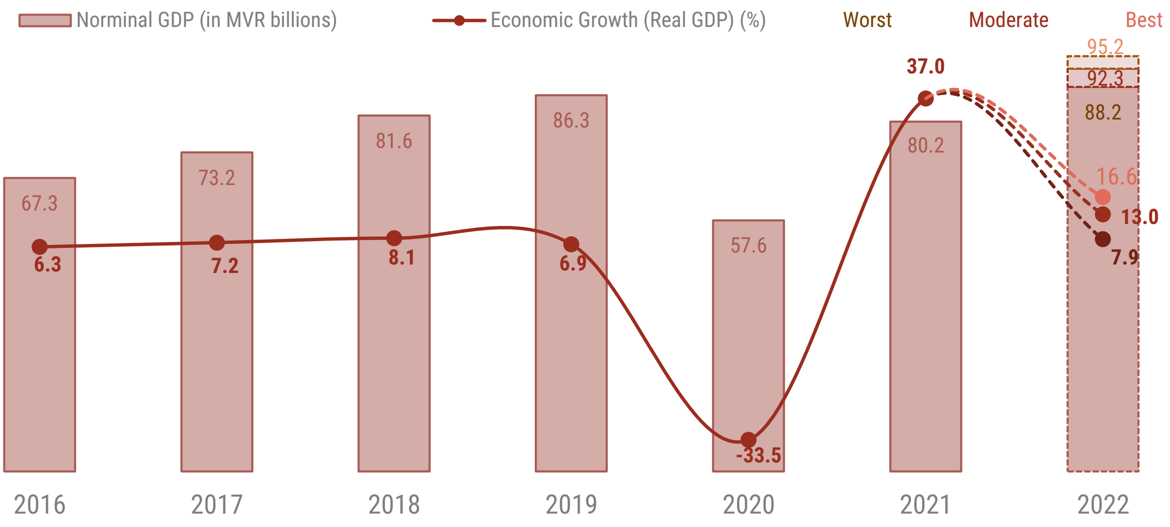
Source: Ministry of Tourism

3.1.2 GDP

While the recovery of the Maldives economy was expected to be a U-shape or long-term recovery in 2020, the Maldivian economy experienced a rapid recovery in 2021. Following the 33.5 percent contraction in 2020, the Maldivian economy bounced back strongly with an estimated GDP growth of 37.0 percent in 2021. Although this is a significant recovery, GDP in 2021 was at 92.9 percent of 2019 GDP.

After a strong recovery of the economy since the latter half of 2021, the economy has faced a major shock with the Russian invasion of Ukraine in February 2022. However, the negative impact of the war on Maldives tourism was ameliorated, by stronger than expected tourist arrivals from Europe and India, which compensated for the reduction in arrivals from Russia and Ukraine. Therefore, it is now forecasted that the Maldivian economy will grow between 7.9 percent and 16.6 percent in 2022. The economy is now expected to reach pre-Covid levels even in the worst-case scenario. Tourism sector and tourism related sectors, as well as the construction sector are expected to grow in 2022. Despite the positive growth outlook, the economy faces elevated risks from higher global fuel and commodity prices due to the Russian invasion of Ukraine.

Chart 3: Nominal GDP and Real GDP Growth



Source: Maldives Bureau of Statistics / Ministry of Finance / Maldives Monetary Authority

3.1.3 Labour Market

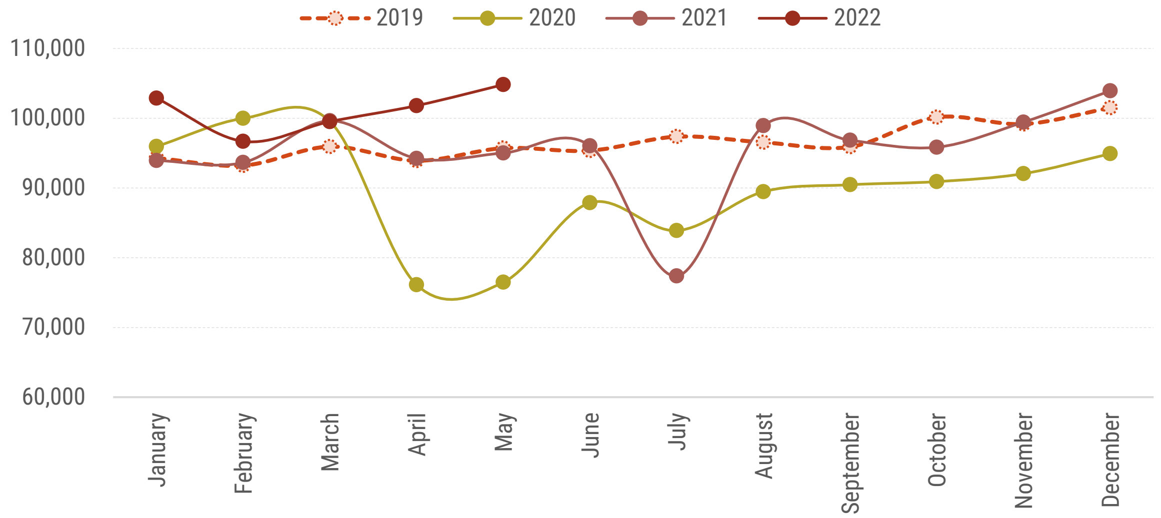
Official statistics on employment and unemployment are currently not available for Maldives on higher frequency basis. Therefore, it is difficult to accurately estimate the impact of economic shocks such as the Covid-19 pandemic or the economic recovery on the labor market in Maldives. The number of employees registered in the Maldives Retirement Pension Schemes (MRPS) is currently one of the high frequency indicators of the labor market that is available. However, the statistics of the Pension Office mainly include formal employment of Maldivians. Therefore, this data does not reflect the changes in the labor market of foreigners, self-employed workers and those working in the informal sector.

Chart 4 shows that the labour market was severely affected by the pandemic in 2020 and 2021. The number of employees registered in the MRPS declined significantly in 2020. Even though labour market started recovering in 2021, formal employment did not reach the pre-pandemic level in 2021. In July 2021, the number of employees registered in the MRPS declined, possibly due to the spread of the Delta variant of Covid-19 and the measures taken to curb the spread of the disease. Following the peak of the Delta wave, with the Covid-19 pandemic controlled and a large portion of the eligible population vaccinated, the economic recovery gathering strength with many sectors registering high growth, positive movements in the labor market started to show. In fact, the number of employees registered in the MRPS in November and December 2021 was higher than the number of employees registered in the same period in 2019.

In the first five months of 2022, the number of employees registered in the MRPS was higher than 2019 for all the months. Even though the number of registered employees in the tourism sector increased month by month, it surpassed 2019 levels in May 2022. Based on the expected growth of the tourism sector for the year, tourism sector employment is expected to surpass pre-pandemic level for the remaining months of 2022 as well.

Forty percent of the employees registered in the MRPS are employed in the public sector. The number of public sector employees increased in 2020 because of the increase in health sector employment in the public sector. In 2022, the highest growth in formal employment has come from sectors other than public sector and tourism sector.

Chart 4: Number of employees registered with the Pension Office



Source: Pension Office

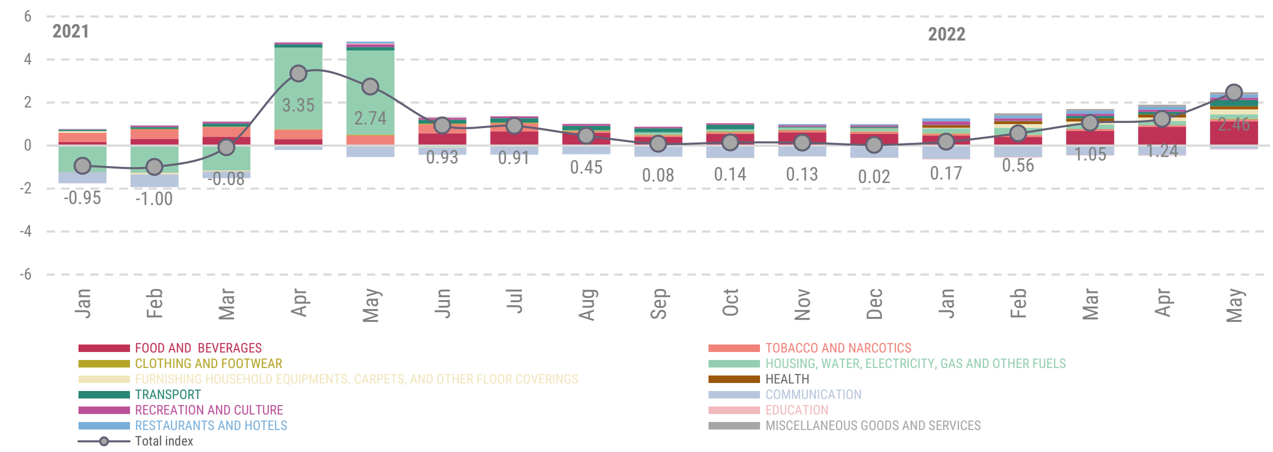
3.1.4 Inflation

After a period of average decline in consumer prices in 2020, due to the slowdown in demand with the Covid-19 pandemic, fall in commodity prices in the global market, and discounts on services provided by the government and private sector during the lockdown, the prices of goods and services started to increase in 2021. In 2021 consumer prices rose by 0.5 percent compared to 2020. Chart 5 shows the changes in prices of various parts of the consumer basket compared to the previous year. Food prices is one segment of the consumer basket that has increased consistently in 2021. In this regard, food prices has increased by 1.8 percent in 2021, which primarily reflects the rising food prices in the world market. Since most of the food items consumed in Maldives are imported, changes in international prices are reflected in consumer prices. The prices of commodities in the international market have also increased due to the disruption to the global supply chain and shipping system due to the Covid-19 pandemic.

In the first four months of 2022, consumer prices rose sharply, with the highest increases coming from food items. Food prices rose by 3.7 percent in April this year. Globally, food prices have risen to their highest level in 20 years following Russia's invasion of Ukraine in February. Despite high food prices, on average prices has not increased at the same rate as the increase in food prices, due to the base-effect from the reduction in telecommunications prices in late 2021. Furthermore, as the housing stock in Male' city has increased in recent months, rent increases have also been contained.

Looking into the inflation outlook for rest of 2022, Maldives Monetary Authority estimates that the annual inflation rate will be 3 percent by the end of the year. This is an upward revision from earlier estimates. This is mainly the impact of the Russia-Ukraine war, which has pushed global oil and food prices to levels which has not been seen in 20 years. Oil and food prices are expected to remain high in the coming months of this year. Therefore, as an import dependent country, imported inflation will cause prices to rise. In addition to this, with the base effect of the reduction in the price of communication services in 2021, dissipating in the coming months, the inflation rate measured on a year on year basis will increase.

Chart 5: Maldives's Inflation Rate (%) - January 2021 to April 2022



Source: Maldives Bureau of Statistics

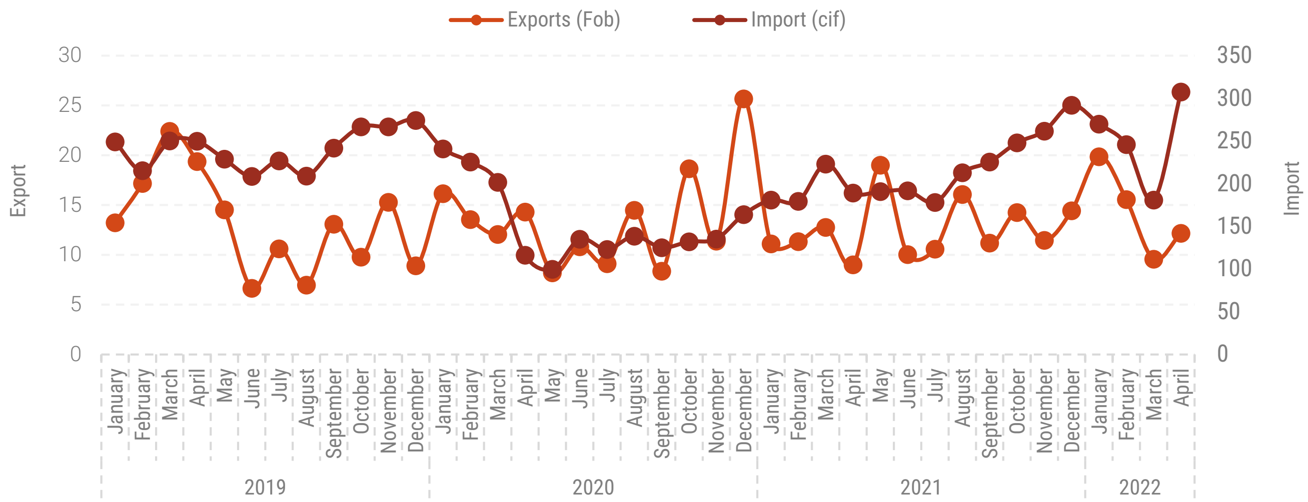
As revenue declined due to Covid-19, in order to finance the Government budget, the People's Majlis granted a temporary exception to certain terms of the Fiscal Responsibility Law, which enabled the Government to overdraw on the Public Bank Account (PBA). Although this step comes with risks, it has to be acknowledged that this was a necessity given the circumstances at the time. Concerns has been raised that overdrawing on the PBA to finance the budget would increase the money supply and lead to higher inflation. However, empirically this does not seem to have happened so far. Firstly, the inflationary pressure for Maldives over the past two years has come mainly from changes in global market prices and shipping costs. Secondly, although the money has been created, the circulation of this money still remains largely controlled.

3.1.5 External Sector

Maldives is a trade dependent open economy. Majority of consumer goods as well as intermediate goods that are used for production are imported from abroad. Tourism services are the main export and the main source of foreign currency.

Expenditure on imports decreased significantly in 2020 due to the economic shock from the Covid-19 pandemic. Tourist arrivals slumped, as the tourism sector came to a total halt for three months during border closures, and operations resumed slowly following border reopening. As such the demand for imports from the tourism sector fell sharply in 2020. Furthermore, measures taken to control the spread of Covid-19, including lockdowns and movement restrictions, caused a sharp slowdown in construction activities, which has been responsible for a large share of imported goods in recent years. Additionally, the expenditure on oil imports declined due to the drop in global oil prices.

Chart 6: Imports and Exports (in Million USD)

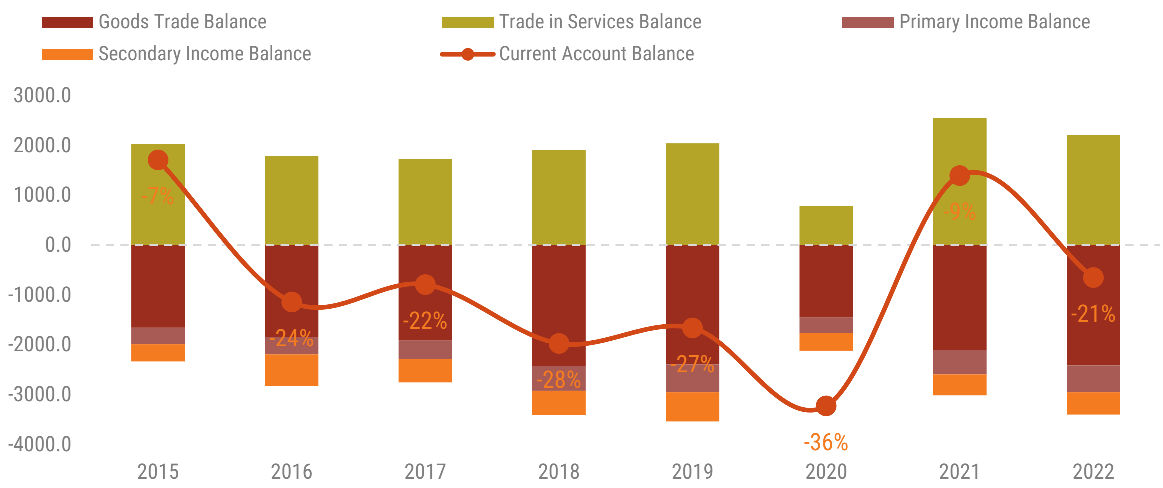


Source: Maldives Customs Service

Although the expenditure on imports declined in 2020, with the growth of the economy in 2021, expenditure on imports started to increase. Furthermore, the expenditure on imports also increased due to rising oil and food prices in the global market by the end of 2021. The Russia-Ukraine war, which began in early 2022, has led to further hikes in oil and food prices in the global market. Therefore, the expenditure on imports so far into 2022, has increased substantially compared to last year.

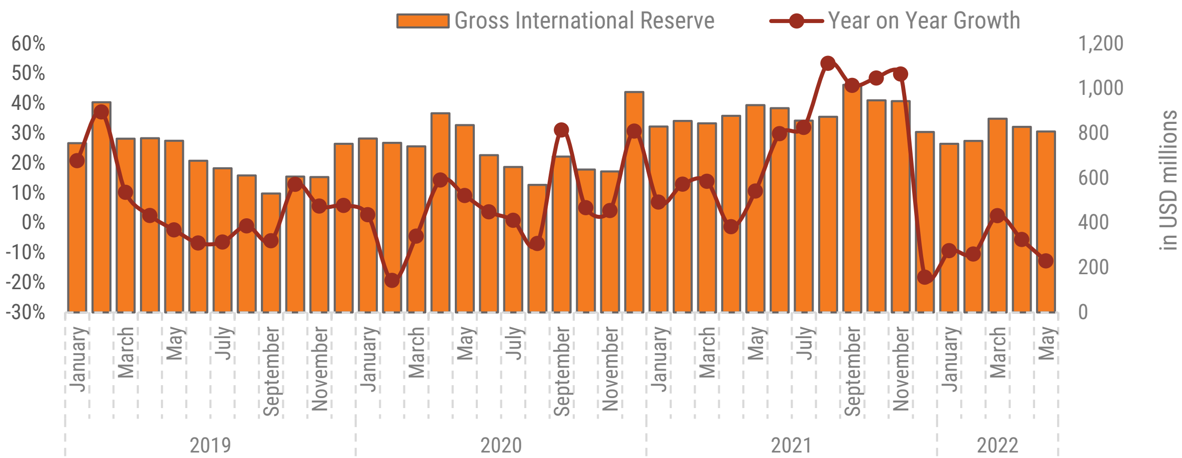
The foreign exchange required to fund the imports comes primarily from the earnings from export of goods and services. In 2020, with the slowdown of the economy due to Covid-19, exports of goods declined. Additionally, the slowdown in the tourism sector, which is responsible for a majority of export earnings, led to a decline in exports and a worsening of the current account deficit as a percentage of GDP. However, by 2021, the current account deficit as a percentage of GDP has improved due to the increase in foreign exchange earnings from the tourism, as the sector posted a strong recovery. Although the tourism earnings are estimated to increase during 2022, the current account deficit for 2022 is expected to increase compared to 2021 due to higher spending on imports in 2022, due to the spike in global oil prices.

Chart 7: Current Account Balance (as a proportion of GDP (%) ; USD)



Source: Maldives Monetary Authority

Chart 8: Foreign exchange reserves



Source: Maldives Monetary Authority

In 2020 as foreign reserves declined, and as speculation increased in the foreign exchange market, the foreign currency swap facility issued by the Reserve Bank of India (RBI) was utilized, to maintain foreign exchange levels in the market and to improve market confidence. The swap facility with RBI was fully wound down in December 2021. Foreign reserves at the end of 2021 was lower than the levels in 2020 due to the winding down of the swap facility. Furthermore, reserves are likely to decline further in 2022, as the expenditure on import of fuel and food continues to rise as global commodity prices continue to rise. However, the negative impact of the global oil and commodity price shock on reserves has been somewhat mitigated by to the strong growth of the tourism sector and thus foreign exchange earnings, and due to the measures being taken to manage foreign reserves .

3.1.6 Global Economic Outlook

The Russia-Ukraine war, which began just as the global economic recovery from the slump caused by the Covid-19 pandemic was gaining momentum, has created additional economic challenges and uncertainties. Thus, the outlook for the global economy in 2022 and the medium term will depend to a great extent on the trajectory of the Russia-Ukraine war and its broader spillovers.

In the April 2022 World Economic Outlook, the International Monetary Fund (IMF) lowered its global economic growth forecast for 2022, compared to their January 2022 forecasts. IMF now expects global growth to slow down to 3.6 percent in 2022, following the strong growth of 6.1 percent recorded in 2021. This is a 0.8 percent downgrade from the January 2022 forecast.

The IMF expects global economic growth to slow down and inflation to rise in 2022 and the medium term. Global inflation was on the rise in major economies even before the Russia-Ukraine war, due to ongoing imbalances in supply and demand, due to the disruptions of the Covid-19 pandemic. The Russia-Ukraine war has further exacerbated inflationary pressures, as global oil and commodity prices has surged significantly since the war. The IMF forecasts inflation rate for developed economies to rise to 5.7 percent, and inflation rate for developing economies to rise to 8.7 percent in 2022.

Russia-Ukraine war and rising commodity prices has affected countries at varying degrees. Developing and emerging economies are expected to be particularly affected by the rising commodity prices. The burden of rising prices will disproportionately impact low-income and vulnerable populations in these countries. The polices implemented by many economies in response to the economic slowdown caused by the Covid-19 pandemic, particularly on the fiscal side, has greatly limited the scope for additional fiscal stimulus policies to counter the impact of the global price shocks. Many economies have also come out of the Covid-19 crisis, with higher debt burdens.

The IMF recommends governments to take measures to counter the impact of the ongoing economic shocks, proportionate to the impact of war and their existing scope for macroeconomic management. The IMF recommends economies undergoing severe shocks due to war to pursue additional fiscal stimulus policies. IMF also recommends countries with high debt burden and limited fiscal space to reduce public expenditures, and to counter the inflationary pressures through monetary policy instruments. However, the policy measures should ensure that the poorest populations and vulnerable groups are supported and protected.

3.2 Revenue and Expenditure for 2021

Table 2: Revenue and Expenditure for 2021

MVR millions	Fiscal Strategy		Budget		Actual
	Initial	Revised	Approved	Revised	
Total Revenue and Grants	**17,523.70**	**20,743.80**	**21,128.50**	**19,678.60**	**21,353.40**
Tax Revenues	10,102.00	13,152.40	10,895.40	13,916.90	14,681.60
Non-Tax Revenues	4,569.90	6,079.30	4,758.20	4,604.40	5,640.00
Grants	1,992.20	1,512.10	2,211.50	1,153.90	1,031.90
New Revenue Measures	859.70	na	3,263.40	na	na
Total Budget	**36,167.40**	**36,917.40**	**37,167.70**	**37,167.70**	**37,091.90**
Loan Repayment	2,257.60	4,579.20	3,714.90	4,559.20	4,285.70
Total Expenditure	**33,888.40**	**32,328.10**	**33,431.50**	**32,501.30**	**32,806.20**
Recurrent Expenditure	19,673.30	20,013.60	21,638.10	24,295.10	22,549.00
Capital Expenditure	14,215.10	12,314.50	11,793.40	8,206.20	10,257.20
PSIP	5,500.00	.6610.0	8,441.50	5,229.20	5,363.20
New Policy Initiatives	4500	na	861.8	na	na
Overall Balance (Deficit)	**(16,364.6)**	**(11,584.3)**	**(12,303.0)**	**(12,822.7)**	**(11,452.7)**
Primary balance	**(13,446.9)**	**(8,936.3)**	**(9,834.6)**	**(10,135.7)**	**(9,348.3)**
Overall Balance to GDP	-21.6	-16.1	-18.5	-16.6	-14.3
GDP	75,721.60	72,432.70	66,371.90	77,013.20	80,214.50

Note: With the exception of initial estimates of the Fiscal Strategy, the figures for New Revenue Measures and New Policy Initiatives are included in the Revenue and Expenditure figures, respectively. A MVR 2,245.0 million supplement to the 2021 Budget, to accommodate the repayment of the Sunnyside Eurobond, was submitted and approved with the 2022 Budget.

3.2.1 Revenue

The total revenue and grants for the year 2021 was MVR 21,353.4 million. This is an increment of 1.1 percent compared to the approved budget number for 2021 and an increment of 8.5 percent compared to the revised number for 2021. Despite the inclusion of several new revenue measures in the approved budget for 2021, many of these were delayed due to the emergence of new waves of the Covid-19 pandemic, and the expected revenue from new revenue measures were subsequently revised down significantly.

As the tourism sector recovered strongly in 2021, tourism related revenues such as TGST, Green Tax, Airport Service Charge and Airport Development Fee grew more than the initial and revised forecasts. Additionally, income from resort lease rent increased, as the rent that was deferred in 2020 was paid back in installments starting from June 2021. Revenues also grew as non-tourism economic activities also gathered pace, on the back of a strong tourism recovery and with the easing of Covid-19 restrictions. As such, due to the growth of wholesale and retail sector activities, income from GGST and import duties increased in 2021.

In 2021 total grants received was MVR 1,031.9 million. This is a decline of 53.3 percent compared to the approved figure and a decline of 10.6 percent compared to revised figure. However, compared to the previous year the total grants increased, as project grants increased during the year.

3.2.2 Expenditure

At the end of 2021, total government budget stood at MVR 37,091.9 million. This is 0.2 percent lower than the revised budget for 2021. At the end of 2021, total government expenditure stood at MVR 32,806.2 million, which is 1.9 percent lower than the approved expenditure for 2021, but 0.9 percent higher than the revised estimate for 2021.

Based on the implementation of the 2021 budget, and the repayment of the Sunnyside Eurobond in 2021, which was not included in the approved budget, the 2021 budget figure was supplemented by MVR 2,245.0 million, and approved with the 2022 budget.

While MVR 21,638.1 million was budgeted for recurrent expenditures in 2021, MVR 23,983.3 million was expended by the end of the year. Recurrent expenditures grew in 2021, as operational expenditure grew as Covid-19 restrictions were eased and some of the budget controls were removed. Thus, recurrent expenditure increased in 2021 across most areas. These includes the expenditure on goods and services required for operations, transportation and repair and maintenance expenditures. The emergence of additional waves of the Covid-19 pandemic during 2021 also increased the recurrent expenditures on the health response to the pandemic. As such the expenditure on medical consumables and frontline allowances exceeded initial forecasts.

While the approved budget for 2021 allocated MVR 8,441.5 million for PSIP expenditure, MVR 5,363.2 million was disbursed by the end of 2021. The disbursement on PSIP projects fell short of initial forecasts, due to the disrupted supply of construction materials resulting from global supply-chain shocks, and delays in the implementation of some of the large infrastructure projects included in the budget. In addition to PSIP, the largest allocation within the capital budget is for debt repayment expenditures. In 2021, the expenditure on debt repayment includes the repayment on the Sunnyside Eurobond issued to the international financial market in 2017.

In 2021, 99.8 percent of the revised budget for 2021 was fully utilized.

3.2.3 Budget Balance

Overall budget balance for 2021 was a deficit of MVR 11,452.7 million. This is 14.3 percent of nominal GDP. Primary balance was a deficit of MVR 9,348.3 million. Since actual revenue was higher than the revised estimates and actual expenditure was less than the revised forecasts, deficit was less than the revised estimates.

3.3 Revenue and Expenditure from 1st January to 30th June 2022

Table 3: Details of income and expenditure for the period 1st January to 30th June 2022

MVR millions	As of 30th June 2021	2022
Revenue and Grants	**10,008.8**	**13,120.9**
Tax Revenues	7,245.4	9,578.9
Non-Tax Revenues	2,345.3	3,344.3
Grants	418.1	197.7
Total Budget	**18,208.5**	**19,878.3**
Loan Repayment	3,497.6	2,020.7
Total Expenditure	**14,704.3**	**17,839.1**
Recurrent Expenditure	11,255.8	13,547.9
Capital Expenditure	3,448.5	4,291.1
PSIP	1,835.1	2,911.2
Overall Balance (Deficit)	**(4,695.5)**	**(4,718.2)**
Primary balance	**(3,725.6)**	**(2,940.8)**

3.3.1 Revenue

Total revenue and grants received between 1st January and 30th June was MVR 13,120.9 million. This is an increase of 31.1 percent compared to revenue and grants received during the same period in 2021.

As the economy recovered in 2021, Government revenue also recovered. The growth in revenue has gained momentum in 2022 as tax revenues has increased significantly, particularly TGST. Collections of TGST has increased in 2022 due to the increase in tourist arrivals and bed nights during the year. In addition, TGST increased due to increased compliance and clearance of tax arrears increased TGST collections in 2022. As the tourism sector improved, other direct taxes from tourism sector (including Airport Service Charge and Green Taxes) has grown compared to 2021. Overall, as economic activities have grown during the year GGST revenue has also increased, surpassing the collection for the equivalent period of 2020. Import duty revenue has also increased in 2022 as volume of imports as well as import prices has increased.

As for income tax, collection was lower in 2022 compared to the corresponding period of 2021. This is mainly due to a transitory increase in tax collections in 2021, due to the shift in income tax regimes, and higher clearance of tax dues. In addition, as the losses incurred by businesses in 2020 will be deducted from the profits of future years, this has also affected income tax collections. However, personal income taxes has increased in 2022, as employment and wages has improved.

In terms of non-tax revenues, with the increase in tourist arrivals and the changes to the Airport Development Fee rates coming into effect in 2022, has increase collections from the ADF. The collection of revenue fees have increased in 2022 as the volume and prices of imported goods has increased during the year. Dividends paid by state owned enterprises so far have also increased compared to the same period of last year. In addition, the collection of resort lease rents have grown, as part of the deferred rent from 2020 was received in the first quarter of 2022.

Total grants received so far in 2022 is MVR197.7 million. This is a decline of 52.7 percent compared to the same period of 2021.

3.3.2 Expenditure

Total Government expenditure between 1st January and 30th June 2022 was MVR 17,839.1 million. This is an increase of 21.3 percent compared to the same period of the last year. Compared to the same period of last year, both recurrent and capital expenditure has increased in 2022.

The biggest recurrent expenditure is the expenditure on personal emoluments. Expenditure on personal emoluments has increased, due to the payment of unpaid Covid-19 frontline allowances, the implementation of minimum wage, increase in staff at Maldives Police Service (MPS), Maldives National Defense Force (MNDF) and education sector, as well as the implementation of a new salary structure for education sector employees under the public sector pay harmonization process.

Over the first half of 2022, MVR 1,777.3 million has been spent on the payment of interest on public debt. This includes MVR 935.0 million as coupon and interest payments on external debt.

The Government expenditure on grants, contributions and subsidies has grown significantly. The expenditure on Aasandha Health Insurance Scheme stood at MVR 874.6 million, which is MVR 116.8 million above the amount spent on Aasandha for the same period of last year. Additionally, a total of MVR 1,738.2 million has been spent as indirect subsidies over this period. A large share of this has gone towards the payment of fuel subsidy, paid to STO to sell the diesel required for electricity production by FENAKA and STELCO at discount prices. As global oil prices have spiked in 2022 due to the Russian invasion of Ukraine, the import price of diesel has also increased for Maldives, leading to higher expenditure on the fuel subsidy. A total of MVR 977.5 million has been spent on the fuel subsidy in the first half of the year.

In terms of capital expenditure, between 1st January and 30th June 2022, the largest expenditure was incurred on PSIP. Major spending projects include, Greater Male' Connectivity Project, Velana International Airport (Terminal) Development Project, Greater Male' Waste to Energy Project as well as the SIFCO Housing Project. Overall in 2022, the expenditure on PSIP has increased during the year as the implementation of project has gathered pace during the year.

In the first half of 2022, MVR 938.1 million was spent on capital contributions to state owned enterprises. This includes capital contributions to the RACL, HDC, MFMC and SDFC. The largest capital contribution so far has gone to HDC, which includes MVR 453.9 million allocated to meet the cash flow required to repay the sovereign guaranteed loans for the implementation of the Hiyaa Housing projects and MVR 201.9 million required for the repayment of the loan for the construction of a 25-storey office building in the second phase of Hulhumale'. Moreover, Ocean Connect Maldives, a subsidiary of MFMC, has been allocated MVR 69.4 million for the installation of a submarine cable to Maldives in collaboration with and Reliance Jio Infocomm Limited, of India. Additionally, MVR 66.4 million has so far been allocated to RACL as capital contributions.

3.3.3 Budget Balance

In the first six months of 2022, government revenue as well as government expenditure has increased compared to the same period of last year. Therefore, the budget deficit has increased compared to last year. However, the primary deficit has declined compared to same period of 2021.

The overall deficit stood at MVR 4,718.2 million during the period, while the primary deficit stood at MVR 2,940.8 million during the period.

3.4 Updated Revenue and Expenditure Forecasts for 2022

The updated budget forecasts for 2022 are based on the performance of government revenue and expenditure so far in the year and updated macroeconomic forecasts. Based on these revenue and expenditure estimates, this section will provide updates of the budget deficit for the year and as well as updated financing plans for the budget. The table below summarizes the fiscal numbers for 2022, comparing the fiscal strategy submitted in 2021, the approved budget for 2022 and the updated estimates from this Strategy.

Table 4: Comparison of budget for 2022

MVR millions	Fiscal Strategy	Approved	Updated
Total Revenue and Grants	**23,666.1**	**24,279.9**	**24,947.8**
Tax Revenue	14,854.7	15,355.0	17,829.4
Non-tax Revenue	6,572.5	6,013.1	6,092.4
Grants	2,238.9	2,911.8	1,026.0
Total Budget	**37,040.2**	**36,999.3**	**42,807.9**
Loan Repayment	3,181.2	2,861.7	3,005.5
Total Expenditure	**33,848.8**	**34,101.8**	**39,730.7**
Recurrent Expenditure	22,494.4	24,283.3	27,555.7
Capital Expenditure	11,354.4	9,278.5	12,175.0
PSIP (including NPI)	7,652.2	6,330.4	7,427.5
Overall Balance (deficit)	**(10,182.6)**	**(9,821.9)**	**(14,782.9)**
Primary Balance	**(6,896.5)**	**(6,906.7)**	**(11,733.5)**

3.4.1 Revenue and Grants

Based on the revenue and grants received so far in the year and the revised economic projections, the Government is now expected to receive MVR 24,947.8 million in total revenue and grants. This is a 2.8 percent increase compared to the revenue and grants estimated in the 2022 approved budget, and a 5.4 percent increase compared to the numbers from the Fiscal Strategy 2022.

With the Maldives economy, particularly the tourism sector recovering stronger from the impact of the Covid-19 than previously expected, tax revenues are now expected to exceed budget forecasts. Particularly, tourism taxes are expected to perform better as tourist arrivals and bednights are now expected to be higher than previously estimated and as tax compliance of the tourism industry has improved during the year. The current estimates of TGST revenue are significantly higher than the Fiscal Strategy 2022 and the Approved Budget 2022 estimates. As of May 2022, 73.9 percent of the projected TGST revenue for the year has been realized.

While tourism revenues has improved on the back of a strong recovery of the industry, GGST and import duty revenues are expected to be around the same level as the estimates in the 2022 budget. As the growth rate of industries other than tourism are projected to be in line with the Budget 2022 forecast, the GGST revenue forecasts are maintained at the budget levels. While higher volumes and value of imports has contributed to higher import duty revenues, it is not expected to return to 2019 levels, due to changes brought to the import duty regime in 2020.

The income tax revenue for 2022 is mainly based on income earned by individuals and businesses in 2021. Looking at the performance of the business profit tax, the tax paid in 2022 for the second interim payment for 2021 are below Budget 2022 forecasts. However, with the growth in the tourism industry this year, the first interim of 2022 is expected to be higher than previously forecasted. Therefore overall revenue from business profit tax is now expected to be maintained at about a similar level as forecasted in the Fiscal Strategy 2022 and the Budget 2022. The revenue from employee withholding tax are now expected to exceed the Budget 2022 and Fiscal Strategy 2022 estimates, as wages received by individuals and employees registered for employee withholding tax has increased.

In other non-tax revenues, Airport Development Fees are now expected to be higher than previous forecasts as tourist arrivals forecasts has been revised upwards. Additionally, collections from revenue fee is now expected to be higher than previously estimated, due to higher import prices due to global increase in commodity prices. However, the dividend income is now expected to decline as state owned enterprises are expected to face difficulties in managing cash flows.

Among the New Revenue Measures included in the Approved Budget for 2022, most of the measures are not expected to generate revenue this year. In addition, non-tax revenues are also expected to fall short of the forecasts from the Fiscal Strategy 2022 and Budget 2022. Furthermore, from the amount projected to be received from grants in 2022, MVR 1.0 billion is expected to be realized during the year. This includes the, USD 37.5 million in cash grants committed by the Abu Dhabi Fund for Development.

Appendix 1 of this paper provides details of the updated forecasts for revenue and grants for 2022.

3.4.2 Expenditure

Based on the expenditure so far into 2022, and the revised global and domestic macroeconomic projections, total Government budget for 2022 is expected to stand at MVR 42,807.9 million. Of this total expenditure is now expected to stand at MVR 39,730.7 million by in 2022. This is an increase of 16.5 percent from the Budget 2022 estimated. A supplementary budget will be submitted for the year to accommodate the projected increase in expenditure. Maintaining expenditure within the approved level would require substantial reductions in expenditure programs.

The increase in government expenditure in 2022 has come from a number of factors. This includes changes to government policies after the approval of the budget, higher oil prices in the global market due to the Russian-Ukrainian conflict, delays in the implementation of expenditure consolidation measures envisions in the Budget, and additional capital contributions to SOEs beyond the amount estimated in the Approved Budget .

In 2022, Government expenditure is expected to grow most significantly in the expenditure on subsidies, contributions and grants. Of this the most notable increase has come from fuel subsidies. While MVR 341.5 million was budgeted in 2022 for the fuel subsidy, MVR9 77.5 million has been spent on the subsidy as of the end of June. With the surge in global oil prices, and with the assumption that global oil prices will remain elevated for the rest of the year, the Government expenditure on the fuel subsidy is now expected to rise to MVR1.9 billion by the end of the year, with the existing subsidy mechanism maintained. The increase in expenditure on the fuel subsidy is due to the sharp rise in oil prices in the global market. Additionally, as the electricity consumption is now expected to exceed budget projection the spending on electricity subsidies- paid to utilities for revenue loss due to tariff harmonization- is also expected to be higher than the budgeted amount for 2022.

The expenditure on Aasandha is now expected to be at MVR1.6 billion by the end of the year, with MVR 874.6 million expended by the end of June. Aasandha expenditure is expected to exceed the budgeted figure by a significant level, as some of the measures planned for the year, to bring down the cost of the Aasandha scheme (such as setting the maximum retail price) has been delayed, and the envisioned cost reductions are now not expected to materialize during the year.

Higher expenditure on capital contribution to SOEs is also responsible for the increase in Government expenditure in 2022. So far in 2022, capital contributions have been made to two SOEs, which was not envisioned in the approved Budget for 2022. Following the decision in February 2022 to raise the purchase price of fish by MIFCO from fishermen, an injection of MVR 650 million is expected to be made from the Government budget in 2022 to manage the company’s cash flows. Capital contributions were also given to HDC to support the cash flow of the company to make the repayment on loans for the Hiyaa housing project. As of May 2022, capital contributions of MVR 655.8 million has been made to HDC, with a total of MVR 1.2 billion expected to be spent on capital contributions to HDC by the end of 2022.

Furthermore, although not included in the approved Budget, it is now estimated that MVR 545.2 million will be disbursed to SIFCO, for the treasury loan issue to SIFCO to accelerate work on their housing project.

Additionally, the expenditure on PSIP is now expected to exceed the budgeted amount. This is primarily due to the faster than projected implementation of large loan funder infrastructure development projects during the year. The tendering of additional projects during the year, as well as the faster implementation of previously stalled projects are also expected to contribute to increase in expenditure on PSIP.

Appendix 1 of this paper details the updated projections for Government expenditure for 2022

3.4.3 Budget Balance

Although the government revenue and grants are expected to exceed prior forecast, government expenditure is expected to grow faster. Therefore, the budget deficit for 2022 is now expected to be at MVR 14,782.9 million by the end of 2022. This is 16.0 percent of GDP, using the updated GDP forecast for the year. Primary deficit for 2022 is now estimated at MVR 11,733.5 million, which is 12.7 percent of GDP.

3.4.4 Financing

MVR 17,084.1 million is now expected to be raised to finance and implement the 2022 budget. Of this, MVR 3,621.9 million will go towards the implementation of the external loan funded infrastructure development projects. Disbursement on external loan funded infrastructure projects are expected to increase in 2022, as physical work on some of the major projects has now commenced, and project implementation has accelerated.

In addition to the project financing, financing for 2022 includes external financing raised through the issuance of loans and bonds for budget support. The Government has already raised USD100 million this year for budget financing, and an additional USD100 million is planned to be raised later in the year. This will bring total external financing in 2022 to MVR 6,705.9 million.

MVR 10,221.3 million is now expected to be raised in domestic financing in 2022. The PBA overdraft limit of MVR 4.4 billion, approved by the People's Majlis, is expected to be fully utilized in 2022. An additional of MVR 8,919.8 million is expected to be raised from the issuance of treasury bills and bonds in 2022. This includes MVR 2.5 billion securitized from the PBA overdraft amount as at 31st December 2021.

The financing plan for 2022, also includes the financing of the payment on the remaining amount of principal due on the Sunnyside Eurobond through the Sovereign Development Fund. Additionally MVR 594.5 million is expected to be received for budget financing through the IMF's Special Drawing Rights (SDR).

As of May 2022, 73 percent of the financing required for this year has been secured.

4. Fiscal Policy

4.1 Medium Term Fiscal Policy Objectives

A significant fiscal burden had to be undertaken over the past two years due to heightened expenses to control the Covid-19 pandemic and to mitigate its negative impact on the economy. These were expenses that were essential to ensure the safety of the people and to facilitate the quick recovery of economic activity after the crisis. Despite significant expenditure consolidation measures, an increase in Covid-19 related expenses over the period led to an increase in overall expenditure. Coupled with a sharp reduction in government revenue, reflecting the slowdown in economic activity, the financing requirement of the government widened drastically compared to initial expectations. Ultimately, this led to a heavy recourse to debt financing over the past two years.

The results of the measures taken began materializing in 2021. With the pandemic mostly under control and the beginning of the economic recovery, the fiscal strategy formulated last year and the approved budget for 2022 prioritized addressing vulnerabilities and maintaining fiscal and debt sustainability. The macro-fiscal risks that have risen due to the Russia-Ukraine war have increased the need to make more concerted efforts along this front. Therefore, the main objective of the Fiscal Strategy 2023 - 2025 is also improving the fiscal position of the government, and ensuring fiscal and debt sustainability. In addition, the past few years has seen large scale investments in projects that have the potential to increase the productive capacity of the economy such as the development of the Velana International Airport and the development of infrastructure to upgrade the domestic transport network. Therefore, executing these projects to completion as soon as possible to ensure the economy starts benefiting from these assets is also an objective.

Four “fiscal anchors” have been identified for the medium term to measure the extent to which these objectives are achieved and to concretely guide policy. These anchors are:

1. Reduce public debt (excluding guarantees) to less than 100 percent of GDP by 2025.
2. Reduce the primary budget deficit to less than 5 percent of GDP by 2023, and maintain it below this threshold over the medium term.
3. Maintain public debt as a percentage of GDP on a downward trend.
4. Reduce recurrent expenditure to levels that do not exceed government revenue (excluding grants) by 2023, and maintain this threshold going forward.

These anchors were set factoring in the global and domestic economic outlook, the current fiscal and debt situation, and the degree to which revenue and expenditure reforms are expected to be implemented over the medium term. The extent to which financing can be secured given current and expected financial market conditions is also taken into account.

The Fiscal Strategy 2022, formulated in 2021 aimed to reduce the government's direct debt to 105 percent of GDP by 2023. Since this target is now expected to be achieved, the first fiscal anchor sets a new medium-term direct debt target. Meanwhile, a new fiscal anchor introduced in this strategy is the cap on government recurrent expenditure in relation to revenue. In almost all years prior to the Covid-

19 pandemic, fiscal policy was geared such that recurrent expenditure was covered from government revenue. Therefore, the goal set by the fourth anchor promotes the normalization of fiscal policy after the economic crisis caused by the pandemic.

The primary reason for the sharp decline in government revenue during the pandemic was the high contribution of tourism to the Maldivian economy and government revenue. This sector is directly affected by global economic conditions, and therefore external shocks currently have a significant impact on government revenue. Therefore, in order to reduce the magnitude of the impact of potential external shocks going forward, revenue reforms are being proposed for the medium term. These reforms involve changing the rates and structures of existing taxes, and seek to expand the tax base and increase the reliance of government revenue on domestic consumption. If the positive relationship between government revenue and domestic consumption can be strengthened, it would contribute towards reducing the volatility of the fiscal situation year by year, and make it easier to implement fiscal policy as planned. In addition, lower macro-fiscal volatility is also considered by the rating agencies as a credit positive, and so this is also expected to facilitate the improvement of the country’s fiscal and economic conditions over the medium term.

In addition to revenue mobilization, expenditure consolidation is also critical to reduce and maintain the fiscal deficit at sustainable levels over the medium term. As such, measures are being taken to reduce expenditure in areas where there has been significant growth in recent years, with a focus on consolidating recurrent expenses. These include reforming existing indirect subsidies to make them more targeted, reforming the Aasandha health care coverage mechanism, and taking steps facilitate access to drugs and medical consumables that are imported and made available through Aasandha at lower, fair prices.

Looking at capital expenditure, the main focus is on completing ongoing projects as soon as possible to begin reaping the benefits of those investments. Also, in order to maintain the government's financing requirement at sustainable levels, priority will be given to projects to be implemented with concessional loan financing. Although there are plans to reduce the number of new projects which rely on the domestic budget to reach the targets set by the fiscal anchors, there is potential of implementing some infrastructure projects through public-private partnerships.

The policy objectives for the year 2023 and the medium term are:

- Improving the debt situation worsened by the Covid-19 and other external shocks during the past few years, and ensuring fiscal and debt sustainability.
- Increasing government revenue, and strengthening the reliance on domestic consumption for taxation.

- Increasing the efficiency of public expenditure to control the rate of increase in expenses at sustainable levels.
- Diversifying and increasing the resilience of the Maldivian economy.
- Enhancing the quality of basic services provided by the government.
- Promoting service delivery through decentralization, with a focus on regional development.
- Increase the standard of living in the Maldives, while targeting existing subsidy and social welfare mechanisms to protect the most vulnerable segments of the population.
- Improving the budget formulation process and maintaining budget credibility.
- Reducing the risks to public finances arising from external shocks.

5. Medium Term Estimates

This section presents the budget and economic estimates for the medium-term to achieve policy objectives given in section 4 of this strategy.

5.1 Medium-term Tourism and GDP Forecasts

After a very fast-paced growth in the first two months of 2022, the Russia-Ukraine war has impacted the tourism sector. According to the data available until June 2022, the war is expected to affect the tourism sector for the rest of the year as well. While the country has overcome the pandemic and overcome the uncertainties surrounding the outbreak, the Russia-Ukraine war has once again brought forth new uncertainties in growth of the economy. Therefore, as in the previous two years, the estimated medium-term GDP growth for this fiscal strategy is modeled based on three scenarios.

Table 5: Tourist arrivals forecasts and scenarios

	Best Case	Moderate Case	Worst Case
2022	1,835,047	1,632,432	1,520,060
2023	2,035,742	1,793,615	1,660,374
2024	2,258,901	1,970,321	1,812,809
2025	2,507,091	2,164,007	1,978,332

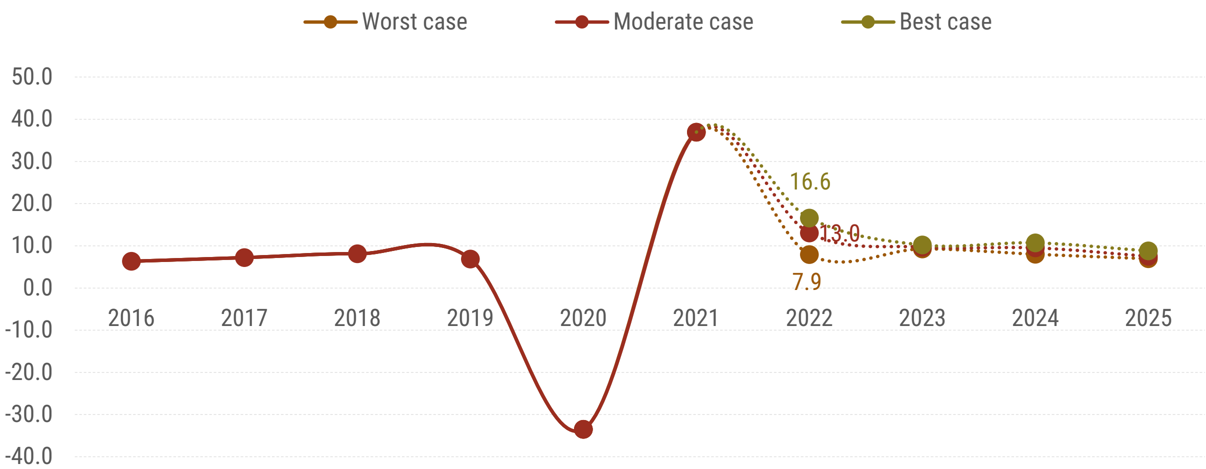
Source: Maldives Monetary Authority

The Russian and Ukrainian markets are among the top source markets that have brought in the most tourists to the Maldives since the pandemic. Therefore, the decrease in number of tourists visiting Maldives from these two countries in 2022, will have a negative impact on the tourism sector. Hence, the three scenarios used in the formulation of the medium-term forecasts uses different rates of recovery of Russian and Ukrainian market, compared to 2021 levels. Table 5 shows the three tourist arrival scenarios for 2022 and the medium term. The Moderate case scenario is used as the baseline for this Fiscal Strategy.

Tourist arrivals in 2022 is currently forecasted to be between 1,520,060 and 1,835,047. It is also forecasted that the number of tourist arrivals in 2022 will exceed pre-pandemic levels in the best-case scenario. It is assumed in the best-case scenario that Russian and Ukrainian markets will return to pre-war levels by mid-year or the number of tourists from other countries will increase to compensate for the loss in tourist arrivals from Russia and Ukraine.

Tourism sector is the largest contributor to the economy of Maldives, and it is linked to the production of many other sectors of the economy. Therefore, as tourism sector value added returns to pre-pandemic levels by 2022, the economy is likely to reach pre-pandemic levels. The economy is expected to grow between 7.9 percent and 16.6 percent in 2022 and between 9.3 percent and 10.2 percent in 2023. Economic growth is expected to remain between 9-10 percent in the medium term. However, it is important to acknowledge the potential risks to the tourism sector and economic growth in the medium term. A comprehensive review of the macroeconomic risks are provided in Section 8 of this report.

Chart 9: Medium-term GDP growth rate (%)



Source: 2016-2021 Maldives Bureau of Statistics, 2022-2025 Maldives Monetary Authority / Ministry of Finance

5.1.1 Medium-term GDP growth for tourism sector and other economic sectors

The tourism industry of the Maldives is highly sensitive to external shocks. The tourism sector also has a significant impact on the economy, both directly and indirectly. As tourism industry was the most negatively impacted industry by the pandemic, the impact on tourism was greater than other sectors. Given the sharp decline in tourism sector in 2020 and the rapid recovery in 2021, the value added growth for the tourism sector in 2021 was substantial. Similarly, in 2022, the recovery of the tourism sector is expected to outpace other sectors. After a relative deceleration in 2023, the tourism sector growth is expected to pick up again in 2024 and growth is expected to outpace other sectors. This is expected to come primarily from the projected completion of the Velana International Airport upgrading project, with the new runway and terminal expected to go into operation by the end of 2023, which is expected to substantially boost the tourist arrival capacity.

Table 6: Medium-term GDP growth by sector (in percentage)

	Tourism sector			Other sectors		
	Best case	Moderate case	Worst case	Best case	Moderate case	Worst case
2022	26.0	17.8	8.3	13.4	11.5	7.8
2023	9.4	9.3	11.5	10.5	9.8	8.5
2024	14.7	13.9	11.8	9.2	8.0	6.7
2025	12.8	12.2	11.7	7.3	5.8	5.2

Source: Maldives Monetary Authority / Ministry of Finance

5.1.2 Comparison with other medium term forecasts

Table 7 compares the revised medium-term GDP forecasts used in this Fiscal Strategy with the GDP forecasts from the Budget 2022, which was compiled in October 2021. At the end of 2021, tourist arrivals was higher than the moderate case estimates forecasted in October 2021. Additionally, higher average duration of stay saw tourist total bed nights for 2021 also surpass the October 2021 forecasts. Based on strong performance of tourist arrivals and bed nights in 2021 and the first half of 2022, stronger growth is projected for the tourism sector. With strong growth also projected for the non-tourism sector, economic growth in 2022 and in the medium-term has been revised upwards from the Budget 2022 forecasts.

Table 7: Medium-term GDP growth rates (in percentage)

	Budget 2022	Fiscal Strategy 2023
2022	12.0	13.0
2023	8.7	9.7
2024	7.4	9.5
2025	5.7	7.5

Source: Maldives Monetary Authority / Ministry of Finance

International agencies acknowledge the challenges in preparing economic forecasts given the heighted uncertainties from the Covid-19 pandemic. Just as countries across the world were recovering from the pandemic related economic downturns, the Russia-Ukraine war that began earlier this year has exacerbated economic uncertainties. It is highly likely that the forecasts produced during high level of uncertainties and high level of risks will be subject to substantial revisions. As such, international financial agencies have also revised their forecasts owing to these new developments.

Table 8 compares the latest GDP forecasts of Maldives with the GDP forecast of IFIs. The IFIs have revised down economic growth forecasts for 2022 compared to their forecasts from late 2021. The latest economic forecasts by IFIs were prepared close to the outbreak of the Russia-Ukraine war, with assumptions of a major impact on Maldives's tourism sector from the war. This is one of the main reasons for the downgrade of Maldives forecast by IFIs in 2022. Nevertheless, the negative impact of the war on Maldives's tourism sector is expected to be less than previously projected as tourist arrivals from other countries has increased since the war, compensating for the decline in tourist arrivals from Russia and Ukraine. IFI forecasts were also downgraded in 2022 due to base effect, as the Maldives economic growth for 2021 was stronger than previously projected.

Medium-term economic growth forecasts for this Strategy is higher than the forecasts of IFIs. This Strategy assume a major structural shift in the economy in the medium term as a result of the Velana International Airport expansion project, which is expected to boost arrivals and tourist sector growth. As the details of the assumptions used by IFIs to forecast economic estimates for Maldives are not available, it is likely that the IFI estimates does not include changes to economic growth as a result of this structural change.

Table 8: Comparison of medium-term GDP growth forecasts of Maldives and IFIs (in percentage)

	Maldives	IMF		World Bank		ADB	
	Fiscal Strategy 2023	October 2021	April 2022	October 2021	April 2022	September 2021	April 2022
2022	13.0	13.2	6.1	11.0	7.6	15.0	11.0
2023	9.7	12.1	8.9	12.0	10.2	-	12.0
2024	9.5	6.1	6.6	-	7.1	-	-
2025	7.5	5.4	5.6	-	-	-	-

5.2 Revenue Forecasts

5.2.1 Baseline forecasts of Revenue

From New Revenue Measures proposed for 2022, only measures that are now likely to be implemented during the year are included in the baseline of the medium-term revenue projections. Of the New Revenue Measures proposed prior to 2022 those that have been implemented to date are included in the baseline revenue.

Compared to 2022, baseline revenue for 2023 is expected to grow by 5.8 percent. Major factors behind this positive outlook are the projected acceleration in economic growth rate and the projected increase in tourist arrivals and bed nights with the developments in the tourism industry.

Baseline revenue for the medium term mainly depends on the recovery rate of domestic economy from the Covid-19 crisis and the growth of the tourism industry. Based on the current trajectory of the economic recovery, the domestic economy is expected to reach pre-pandemic levels by the end of this year. Revenue from GGST and import duties are expected to grow over the medium term in line with the forecasted economic growth.

The main factor behind the projected increase in medium term government revenue is the positive outlook for the tourism industry. As the Velana International Airport (VIA) new passenger terminal project is expected to be completed by the end of 2023, and the new runway and terminal are expected to go into full operation, it will help resolve the capacity limitation at VIA, and is expected to significantly contribute towards expanding the number of tourist arrivals to Maldives in the medium term. This will in turn increase revenues directly generated from the tourism industry, namely, TGST and Green Tax. Moreover, with the completion of the VIA development project, as passenger numbers are also expected to increase, it will contribute to higher revenues from Airport Taxes and Fees. However, it should be noted that the positive outlook for government revenue is highly dependent on the completion of VIA development project within the current time frame. Therefore, any challenge to the timely completion of this project will have a significant impact on the revenue forecasts, especially in the outer years of the forecasts. In addition, if the bed capacity of tourism industry is not raised at par with the level of increase in tourist arrivals, medium term revenue forecasts will be affected.

Baseline revenue and grants are expected to increase by 9.5 percent in 2024 and 8.5 percent in 2025.

5.2.2 New Revenue Measures

As in recent years, the 2022 Approved Budget also included proposals for New Revenue Measures to be introduced in the year to raise revenue to the Government. However, the implementation of some of these measure has been held off or delayed for various reasons. Therefore, collections from NRMs are now expected to be lower than the estimates in the 2022 Approved Budget. As it has proven in recent years, implementing New Revenue Measures in a short time poses challenges in implementation. Therefore the Ministry is currently developing a Medium-Term Revenue Strategy (MTRS) to bring a medium term perspective of the revenue needs for the Budget to achieve the spending goals of the Government.

Table 9 below shows NRMs proposed for the year 2022 and their progress.

Table 9 : Details of New Revenue Measures proposed

New Revenue Measure	Status
Plastic Bag Tax	This tax is to be introduced under the Waste Management Bill, which has been submitted to the parliament
Land lease for tourism purposes	Bidding process completed
Real Estate Tourism	Maldives Funds Management Corporation is working on formulating the respective regulations
Sale of Land	Ministry of National Planning Housing and Infrastructure is working on amending the Land Bill

Due to the global commodity and oil price shocks, the increase in government debt servicing expenditures, and the general increase in cost of government operations; the total government expenditure is currently growing at a faster pace than the growth of economic activities and government revenue. To restore fiscal normality, to manage recurrent expenditures within government revenue, changes to revenue policies are needed.

Planned amendments to revenue policies in the medium-term includes changing the Goods and Service tax rates (GGST and TGST rates) in 2023. In addition, the current GST Act is also planned to be reviewed and amended in the medium term, numerous legislative changes have been identified. Revenue sources are also to be further reviewed in the medium term, to increase revenue generated from tax as well as non-tax sources and through improvement in the efficiency of revenue administration along with enhancing effectiveness of compliance.

Unlike the past years, changes to revenue policies in the medium term will be introduced according to a MTRS, which is expected to be formulated in 2022. The MTRS will be introduced and implemented in such a way that the impact on taxpayers are minimized. Moreover, the revenue policies for the medium term will be formulated with stakeholder input, including the general public. The Strategy will also be a useful tool to identify revenue policy changes that are to be implemented in the medium term, to achieve the spending goals of the Government. With the MTRS the public will be informed of revenue policies ahead of time and the impact of such policy changes on businesses and public can be estimated prior to policy changes. The MTRS will immensely contribute towards sustainable and effective revenue management policies.

From the New Revenue Measures proposed for the medium term, only the revenue impact from GST rate changes are included in the medium-term revenue projections for this Fiscal Strategy. As such, revenue impact from changing GGST rate to 8 percent and TGST to 16 percent, from 1st January 2023 onwards is included in these estimates.

The table below details out the revenue impact from GST rate changes.

Table 10: Estimated revenue increment due to GST rate change from January 2023 onwards

MVR millions	2023	2024	2025	2026	2027
Total increase in revenue	3,144.4	3,760.9	4,077.3	4,391.8	4,734.2
Revenue increment if GGST rate is 8%	974.6	1,159.9	1,225.2	1,304.5	1,409.6
Revenue increment if TGST rate is 16%	2,169.8	2,601.0	2,852.1	3,087.3	3,324.6

With the formulation of the MTRS, revenue policies will be formulated and implemented according to the MTRS. With the MTRS, New Revenue Measures to be included in the Budget will be announced and planned in advance. Therefore, it is expected that implementation of New Revenue Measures will be improved and the policy objectives of the measures are achieved more effectively.

Table 11: Details of medium-term revenue and grants

MVR millions	Estimates 2023	2024	2025
Total Revenue and Grants	**30,792.5**	**32,349.7**	**35,032.6**
Baseline Revenue	**25,314.2**	**27,718.8**	**30,081.7**
Tax Revenue	19.641.9	21,631.3	23,635.9
Import duty	3,633.5	4,050.1	4,432.4
Business Profit Tax and Withholding Tax	2,381.7	2,765.0	3,029.0
Bank Profit Tax	666.1	687.6	705.7
Individual Income Tax	386.8	444.3	476.1
GGST	4,206.4	4,639.7	4,901.0
TGST	9,383.1	10,404.0	11,408.4
Departure Tax	943.6	1,111.2	1,304.9
Green Tax	1,078.6	1,183.2	1,347.4
Non-Tax Revenue	5,768.9	6,185.1	6,544,4
Airport Development Fee	953.0	1,122.3	1,318.0
Property Income	1,569.9	1,588.2	1,682.2
Interest and Dividends	838.1	914.5	975.6
Grants	**2,334.0**	**870.1**	**873.5**
New Revenue Measures	**3,144.4**	**3,760.9**	**4,077.3**

5.2.3 Grants

It is estimated that MVR 2,334.0 million will be received as grants in 2023. This includes MVR 455.7 million that is expected to be received as Project Grants and MVR 336.3 million expected to be received as Cash Grants. Government also has plans to secure additional USD 100 million as grants in 2023.

For the period of 2024 – 2027, it is estimated that an average of MVR 867.6 million will be received as grants.

5.2.4 Total Revenue and Grants

Total revenue and grants, including the baseline revenue grants income and the increment from New Revenue Measures, is estimated to be MVR 30,792.5 million in 2023. Considering the medium term economic growth rate projections and envisioned changes to government revenue policies, it is expected that government revenue will increase in the next five years at an average rate of 10.1 percent.

5.3 Expenditure Forecasts

Expenditure policy objective of the Fiscal Strategy 2023-2025 is to improve the fiscal and debt position of the government and to ensure fiscal and debt sustainability, taking into account the impact of the Covid-19 pandemic on fiscal balances and recent developments in the global economy. Thus, in this strategy government expenditures policy is proposed in a way that recurrent expenditures will be managed within government revenue. This strategy has also given priority to maintain the growth of government expenditure below the growth of government revenue and grants, to maintain a declining path for overall deficit, in the medium term.

5.3.1 Medium-term Expenditure (Business as usual)

The main reasons for the projected increase in medium-term public expenditure, in the business as usual scenario, include the sharp rise in global commodity prices, the additional expenditure required to implement government policies and the failure to implement planned expenditure reduction measures. Following are the main expenditure drivers in the medium term under the business as usual scenario.

Fuel Subsidy: If no measures are taken to mitigate the negative impact of rising commodity prices on public expenditure, government expenses on the procurement of goods will increase overall. Particularly with the sharp rise in oil prices in the international market, government expenditure on fuel subsidy - spent to reduce the price of diesel used for electricity generation - will grow to unsustainable levels. According to IMF forecasts, crude oil prices are not expected to return to 2019 levels within the next five years. In 2023, oil prices are expected to average at USD 93 per barrel. If no steps are taken to rationalize fuel subsidy and the current selling price of MVR 7.60 per liter of diesel is maintained, the subsidy is expected to cost MVR 1.6 billion in 2023. Over the medium term under the business as usual scenario, spending on fuel subsidy is expected to be over MVR 1 billion per year.

Fuel subsidy is an indirect subsidy. The purpose of the subsidy is to provide affordable electricity to all electricity consumers and protect consumers from fluctuations in oil prices in the world market. Therefore, the benefit of this subsidy is available to all electricity customers including households, businesses and government agencies.

Aasandha Health Insurance Scheme: The government's expenditure on Aasandha Health Insurance Scheme is also expected grow over the medium term. Over the years, spending on Aasandha has grown due to the broadening of coverage and increasing prices of prescription drugs. Prescription drugs account for the highest proportion of spending in Aasandha. The prices of prescription drugs are relatively high in Maldives, due to higher import prices. The relatively low volume of medicines required for Maldives on a global scale, prevent the country from enjoying scale economies in purchasing. Furthermore, the prices of medicine are high in Maldives due to lack of controls on excessive profits passed through to Aasandha by businesses. Additionally, the cost of Aasandha has increased due to delays in the implementation of measures to contain the cost of the scheme. If the measures planned to reduce expenditure on Aasandha are not implemented in the medium term, the expenditure on Aasandha is expected to average MVR 1.4 billion per year in the medium term.

Pay Harmonization: The pay framework of education sector employees has been harmonized under the pay harmonization policy introduced this year. The pay framework for all remaining government employees are planned to be harmonized by 2023. If pay harmonization is rolled out to all government offices from the beginning of 2023, an additional MVR 2.0 billion per annum is expected to be spent on personal emoluments in 2023 and the medium term.

Medical Consumables: Numerous efforts have been made to expand the health services provided by the state. In this regard, hospitals have been established in five regions of the country that would provide tertiary health services. Efforts have also been made to expand the services available at other centers. Furthermore, the completion and commencement of operations of the Dharumavantha and Addu Equatorial hospitals has increased the government's requirement of and thereby the spending on medical consumables. Furthermore, in addition to the general rise in price of medical consumables in the global market, the relatively low volume required for Maldives on a global scale contributes to the high prices of medical consumables available for import. For these reasons, spending on medical consumables is not expected to return to pre-2019 levels despite the recovery from the Covid-19 pandemic. Therefore, if no measures are taken to cut down on the cost of medical consumables, the overall expenditure on consumables is expected to remain at an average of MVR 1.1 billion per year in the medium term.

Electricity Subsidy: Electricity subsidy is given to compensate for the revenue loss of electricity providers due to the harmonization the domestic category tariff rates of Atolls with Male', and the business category tariffs of Atolls with Addu and Fuvahmulah cities. As the main electricity provider in Atolls, the largest portion of the subsidy goes to FENAKA. Spending on the subsidy has increased year by year due to the inefficiencies in the policies set to give the subsidy and the increased electricity consumption year by year. Thus, if cost reduction measures are not taken in the medium term, the average annual electricity subsidy is estimated at MVR 809.3 million.

If no measures are taken in the medium term to reduce government spending, the total budget for 2023 is estimated at MVR 45,572.6 million. The total expenditure is estimated at MVR 42,464.5 million. The total budget is estimated at MVR 47,442.7 billion in 2024 and MVR 49,769.5 million in 2025.

5.3.2 Medium-term expenditure consolidation

Recent developments in the world economy had further deteriorated the Maldives's fiscal situation. Hence, to mitigate the adverse impact on the country's fiscal situation, measures must be taken to consolidate government spending. Below are measures planned to cut down on government expenditure and the estimates of savings from these measures.

Fuel subsidy: The expenditure on fuel subsidies is reaching unsustainable levels this year itself, with the sharp rise in global fuel prices. Therefore, measures are planned to be implemented this year to reduce spending on fuel subsidy. Even though the purpose of proving the fuel subsidy by the state is to ensure that the people have access to affordable electricity, since the consumers are insulated from the fluctuations in fuel prices, it does not instill the behavioral response required to manage consumption during price hikes. To ensure that spending on fuel subsidy can be sustained within the budget, the purchasing price of fuel by electricity providers would be raised. This will resume the fuel surcharge from customers' bills. Thus, if the fuel purchase price exceeds MVR 8 per liter, the fuel surcharge will be charged at 3 Laari for every 10 Laari increase. The fuel surcharge has been in force since 2009. However, the surcharge has not kicked in since 2017 as the state has artificially maintained the price of fuel to electricity providers below MVR 8 per liter, with the state taking on the burden of price fluctuations in oil prices.

The propose change in fuel subsidy policy, with partial pass through of fuel prices, will increase the price of electricity, which could hinder access to electricity by poor and vulnerable segments of society. To address this issue, a direct subsidy on fuel surcharges is planned to be rolled out and is to be targeted at the poorest households.

Aasandha Health Insurance Scheme: About 60 percent of expenditure under Aasandha is spent on prescription drugs. Therefore, the highest priority has been given to implement policies to cut down spending on prescription drugs. Thus, work is underway to set a pooled procurement arrangement in which the medical consumables requirement of the Maldives is added with another country's requirement or the requirement of an international organization which carries out such arrangements. This is expected to reduce the purchasing price of prescription drugs and thereby the spending on prescription drugs through Aasandha. In addition, the baseline price of prescription drugs covered by Aasandha is being determined to reduce the cost of Aasandha. Although there has been discussions previously to set a maximum retail price for all prescription drugs sold in Maldives, with consideration to the current capacity, the priority is to review the baseline prices covered under Aasandha.

Pay Harmonization: The pay framework for all employees working in public offices will be harmonized and fully implemented in 2023. In 2023, the pay framework of government employees in the health sector and other government offices will be harmonized. With consideration to Government revenue and other government expenses and the available fiscal space, in this strategy, this policy has been planned to be rolled out in phases in 2023.

Electricity Subsidy: The biggest proportion of this subsidy goes to FENAKA. This money is mainly used to cover FENAKA's operational expenses. However, the Ministry has identified that FENAKA has started using these funds on capital expenditure in addition to operational expenses. At the same time, as the current disbursements in electricity subsidy does not cover its expenses, payments have been made to FENAKA in advance from the electricity subsidy to be paid in the coming months during the year. There are also a significant amount payables accrued to STO for diesel sold to FENAKA in recent years. Efforts must be made to reduce the impact of FENAKA on the state budget. Therefore, the strategy includes a subsidy of up to MVR 600.0 million per annum to cover the operational costs and to continue the capital work of FENAKA already started without interruption. The additional cash flow required by FENAKA is planned to be met by cutting down on the company's expenses and through additional financing sought through the banking system. FENAKA's future capital expansion plan will be implemented taking into account its financial constraints.

Medical Consumables: The arrangement to procure the medical consumables for all Government run hospitals under a pooled procurement system will be established during the year. It is estimated that this pooled procurement of consumables will achieve economies of scale and reduce the purchase price of medical consumables. This is expected to reduce spending on medical consumables in the medium term.

Further analyses of the above mentioned measures are currently being prepared by the Ministry of Finance. These and other similar measures will be implemented in the medium term based on the relevant policy papers.

The table below shows the expenditure incurred by the main components of expenditure identified above at business as usual and the savings achieved by implementing the expenditure reduction measures mentioned above.

Table 12: Main cost drivers (business as usual and potential cost savings)

MVR millions	2023	2024	2025
Fuel Subsidy*	**586.2**	**330.8**	**481.3**
Business as Usual	1,589.5	1,396.9	1,280.9
Saving	(1,003.3)	(1,066.1)	(799.7)
Aasandha	**1,000.0**	**913.1**	**951.9**
Business as Usual	1,505.7	1,418.8	1,357.6
Saving	(505.7)	(505.7)	(505.7)
Pay Harmonization	**500.0**	**1,750.0**	**2,000.0**
Business as Usual	2,000.0	2,000.0	2,000.0
Saving	(1,500.0)	(250.0)	-
Electricity subsidy	**593.9**	**610.8**	**607.4**
Business as Usual	744.1	807.5	876.3
Saving	(150.2)	(196.7)	(269.0)
Consumables	**984.5**	**983.5**	**1,007.4**
Business as Usual	1,181.4	1,180.2	1,208.8
Saving	(196.9)	(196.7)	(201.5)

* Net savings are MVR 799.9 million in 2023, MVR 858.3 million in 2024 and MVR 598.2 million in 2025 as the electricity bills of government offices will also increase with the removal of fuel subsidy.

5.3.3 Medium-term Baseline Budget

The medium-term baseline budget is a set of estimates that take into account current spending trends and developments in the global economy, and that incorporate savings expected from expenditure reduction policies planned to reach the fiscal anchors identified in this strategy. This baseline budget will also include the block grant issued to local councils.

The largest component of the baseline recurrent expenditure consists of personal emoluments. Personal emoluments are expected to increase significantly with the implementation of pay harmonization in the medium term. The next largest expenditure is expected to be on grants and subsidies. Savings from cost reduction measures have been included in the baseline expenses to maintain spending on grants and subsidies at sustainable levels. Grants and subsidies now also include subsidies given to reduce the rent of HDC’s social housing schemes and to raise the purchasing price of fish by MIFCO, which was previously recorded under capital contributions.

The block grant to councils is estimated based on the baseline government revenue forecasts. Councils are allocated 5 percent of the baseline revenue of government offices and 40 percent of the revenue received as land rent. Based on the fiscal formula, the total amount of block grant to councils in 2023 is estimated at MVR 1,714.1 million. The amount is expected to increase in the medium term with the growth in revenue. Therefore, this figure is expected to increase by an average of 9.5 percent in the medium term.

In addition, the baseline expenditure is set at a level that can ensure continuity of public services and the efficient operation of government agencies. A significant portion of the medium-term recurrent expenditure consists of interest paid on the debt. Interest expense has increased with the rise in debt, to cover the budget deficit and funding for various development projects. The interest rates on debt raised has also increased, contributing to the rise in spending on interest expenses. However, it should be noted that, on average, the interest rate on Maldives's debt is very concessional.

The largest share of baseline capital expenditure is spent on PSIP. Spending on PSIPs are expected to rise in the medium term. In this regard, the work of major infrastructure development projects carried out by the government is expected to accelerate in the medium term. More specifically, work of the loan funded large scale infrastructure projects is expected to speed up in the medium term, increasing the loan disbursements of these projects and thereby expenditure on PSIPs. In addition, support given to SOEs through the government budget will continue to be provided in the medium term, however scaled back from the pandemic levels. Debt repayment costs will also increase in the medium term primarily on foreign debt.

The total baseline budget for 2023 is MVR 41,533.4 million. The total expenditure is estimated at MVR 39,042.1 million. In 2024, baseline expenditure is expected to grow by 4.7 percent.

5.3.4 New Policy Initiatives

As the baseline expenditure has increased for, and the expenditure policies have been structured to achieve the fiscal anchors set in this strategy, no budget space has been allocated for new projects or recurrent programs, under the New Policy Initiatives, in 2023.

5.3.5 Total Budget and Expenditure

Based on the above policies, the total budget estimate for 2023 is MVR 41,533.4 million. The total expenditure is expected to be MVR 39,042.1 million. The total budget for 2024 and 2025 is estimated at MVR 43,678.7 million and MVR 49,997.9 million respectively.

Medium-term budget estimates are provided in Annex 3.

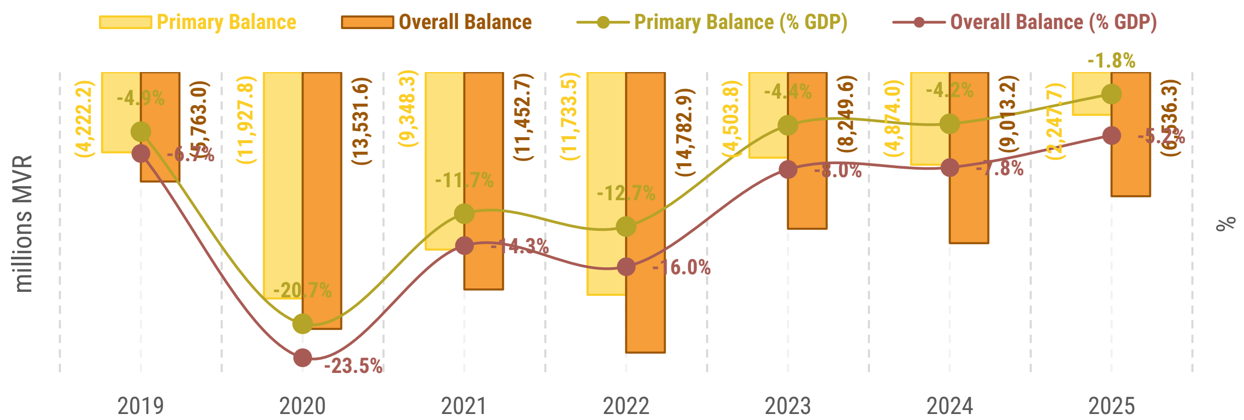
Table 13: Medium Term Budget Details

MVR millions	2023	2024	Estimate 2025
Total Budget	**41,533.4**	**43,678.7**	**49,997.9**
Total Expenditure	**39,042.1**	**41,363.0**	**41,568.8**
Baseline budget	**41,533.4**	**43,178.7**	**47,997.9**
Recurrent expenditure	**28,458.5**	**29,868.6**	**30,360.0**
Personal Emoluments (including pensions)	12,785.3	14,123.4	14,455.7
Goods and services	5,023.1	4,996.8	5,026.9
Grants, Contributions and Subsidies	5,040.1	4,562.0	4,379.3
Council Block Grant	1,714.1	1,895.4	2,056.4
Other Recurrent Costs	3,895.8	4,291.1	4,441.6
Capital expenditure	**13,074.9**	**13,310.1**	**17,637.9**
Public Sector Investment Program	7,430.4	8,017.2	6,189.1
Capital Equipment, Investment and Loan Outlays	1,670.3	1,431.9	1,438.0
Loan Repayments	2,463.6	2,300.4	8,413.8
Contingency	1,462.0	1,526.7	1,563.2
Other Capital Expenditure	48.6	33.9	33.9
New Policy Initiatives	-	**500.0**	**2,000.0**

5.4 Medium-term Budget Balance

With the proposed policy changes for 2023, the overall balance of the government budget is estimated at MVR 8,249.6 million. This is 8.0 percent of GDP. The primary balance of the budget is expected to be MVR 4,503.8 million. This is 4.4 percent of GDP.

Chart 10: Medium-Term Budget Balance



Taking into account the proposed changes in revenue and expenditure policies and the growth of baseline revenue and expenditure, the budget deficit as a percent of GDP is expected to decline year by year. Similarly, the primary deficit as a percentage of GDP is expected to decline year on year and reach a primary surplus by 2027.

6. Medium Term Budget Financing and Debt

Reflecting the revenue reforms and expenditure consolidation measures, the growth rate of public debt over the medium term is expected to remain below the growth rate of nominal GDP, implying a downward trajectory of the public debt to GDP ratio. On the financing side, controlling the rate of increase in government expenditure will be supported by prioritizing concessional loans and project financing as a means to maintain the increase in interest payments at a sustainable level in the future.

Looking at the medium term, the total financing requirement of the government is expected to be MVR 11,721.6 million in 2023 and MVR 12,466.5 million in 2024. Given that the repayment of the USD 100 million foreign loan facility availed this year is due for repayment in 2025 which also aligns with the beginning of the repayment of the principle of the line of credit facility from the Indian EXIM, the financing requirement for that year is expected to increase to MVR 16,298.5 million.

Similar to what is materializing in 2022, large infrastructure projects financed through foreign concessional loans are expected to progress at a fast pace over the medium term, leading to an increase in the expected disbursement of these facilities. However, as these are primarily low cost financing facilities, the increase in the debt service burden arising from this is not expected to be significant. Also, as these facilities are already secured with the disbursements tied to the project progress, an increase in expenditure due to faster than expected implementation of these projects will not lead to an increase in the financing gap of the government.

As the cost of issuing debt on the debt capital market is expected to be high in this environment of increasing policy rates by central banks of advanced economies, the revised financing strategy does not include significant issuances to the international market prior to 2025. The next significant issuance, amounting to USD 200.0 million, is expected to go forward in 2025 by issuing either a conventional bond or a sukuk. Between now and then, the strategy to obtain foreign financing is to rely primarily on concessional financing from bilateral or multilateral sources. As such, it is planned to raise USD 100.0 million per annum in concessional foreign financing over the next three years.

Looking at domestic financing, the government will continue to actively issue treasury bonds and bills to the domestic market as outlined in Table 13. The total amount expected to be raised from the domestic financial market in 2023 and 2024 are MVR 10,181.8 million and MVR 5,313.2 million respectively. As the total financing requirement of the government is expected to increase in 2025, the recourse to domestic financing through the issuance of treasury securities is also expected to increase that year to MVR 7,295.2 million.

The approved budget for 2022 included raising MVR 771.0 million during this year and the next through the privatization of state owned enterprises. However, the privatization strategy has now been modified, and these receipts will not materialize as planned. Under the revised plans, MVR 771.0 million is expected to be realized in both 2024 and 2025.

Due to the economic crisis following the Covid-19 pandemic, the Parliament has exempted Article 32 (a), (d) and (e) of the Fiscal Responsibility Act until the end of 2023. Under this exemption, the public bank account can be overdrawn up to a maximum of MVR 4,400 million, and the government will continue to access the overdraw facility to manage its cash flow and meet a part of its financing requirement in 2022 and 2023.

Table 14: Planned budget financing in the medium term

	Estimate			
MVR millions	2022	2023	2024	2025
Financing requirement	17,084.1	11,721.6	12,466.5	16,298.5
Budget deficit	14,782.9	8,249.6	9,013.2	6,536.2
Loan repayment	3,005.5	2,463.6	2,300.4	8,413.8
Transfers to the Sovereign Development Fund	809.4	980.7	1,137.6	1,333.2
Pending payments	(1,585.3)	-	-	-
Other	71.8	27.7	15.3	15.3
Sources of financing	17,084.1	11,721.6	12,466.5	16,298.5
Foreign loans	3,621.9	4,287.5	4,730.8	3,488.6
Bonds, sukuk and other foreign financing	3,084.0	-	-	3,084.0
Multilateral/bilateral budget support	-	1,542.0	1,542.0	1,542.0
Domestic treasury securities	6,419.8	10,181.8	5,313.2	7,298.2
PBA overdraw securitization	2,500.0	-	-	-
Change in the PBA	710.0	(4,400.0)	-	-
Privatization receipts	-	-	771.0	771.0
Other	748.4	110.3	109.6	114.7

If the overall deficit is maintained over the medium term as proposed, nominal GDP growth will outpace the growth rate of public debt, and the debt to GDP ratio will come down. In this regard, the debt to GDP ratio is expected to decline to 105.6 percent by the end of 2025, down from 117.8 percent at the end of 2021. The medium term debt strategy provides details of the debt management strategies of the government.

Chart 11: Medium-term financing plans

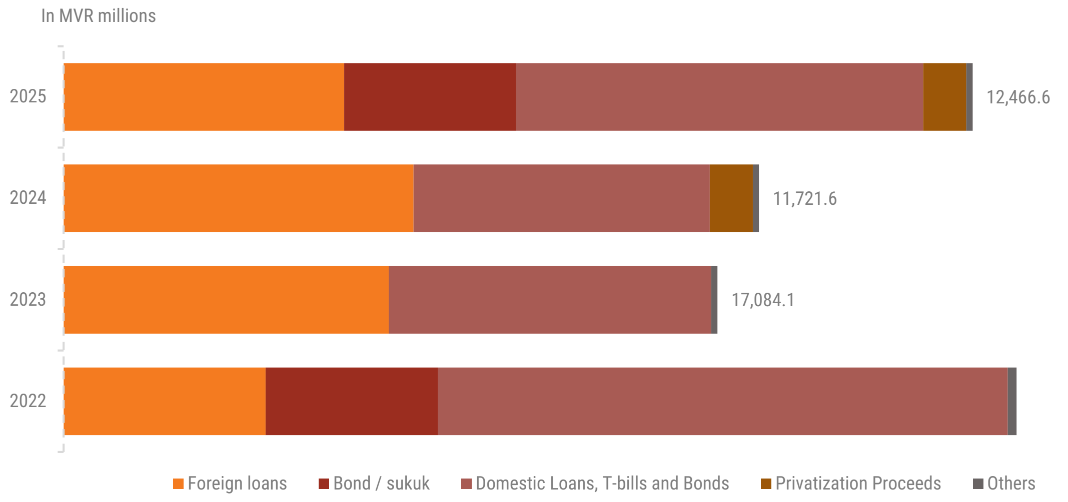


Chart 12: Medium-term debt estimates

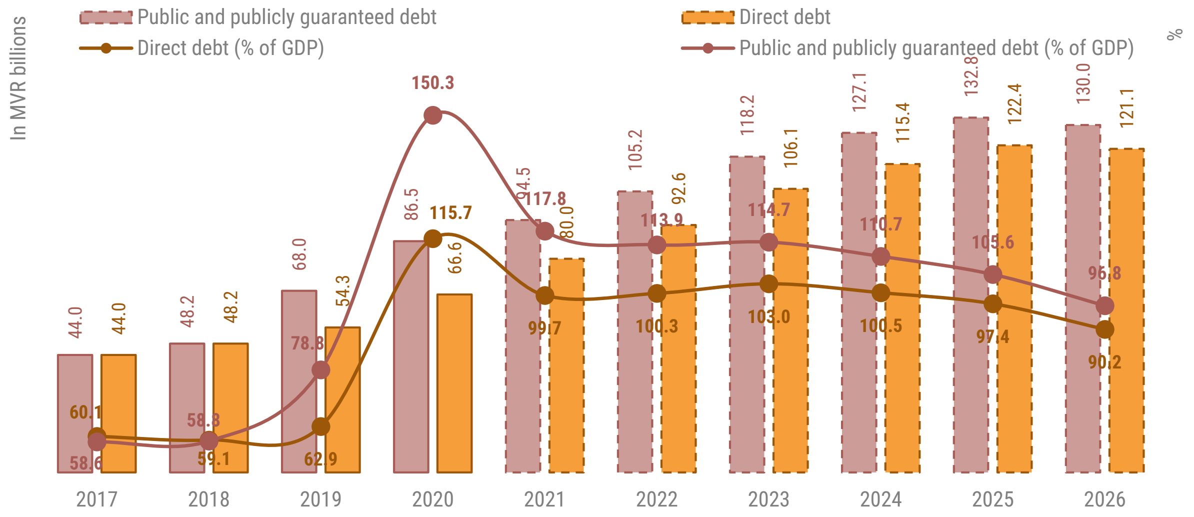
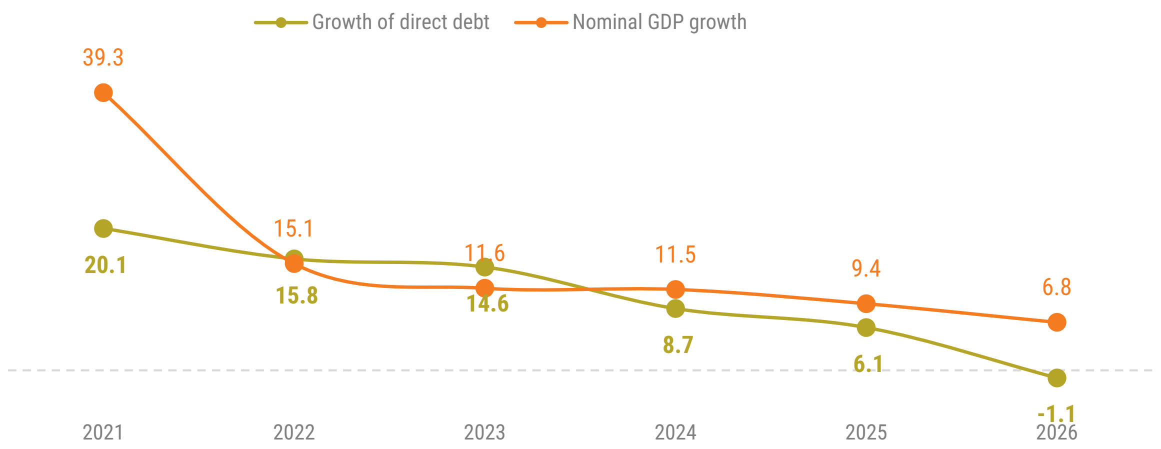
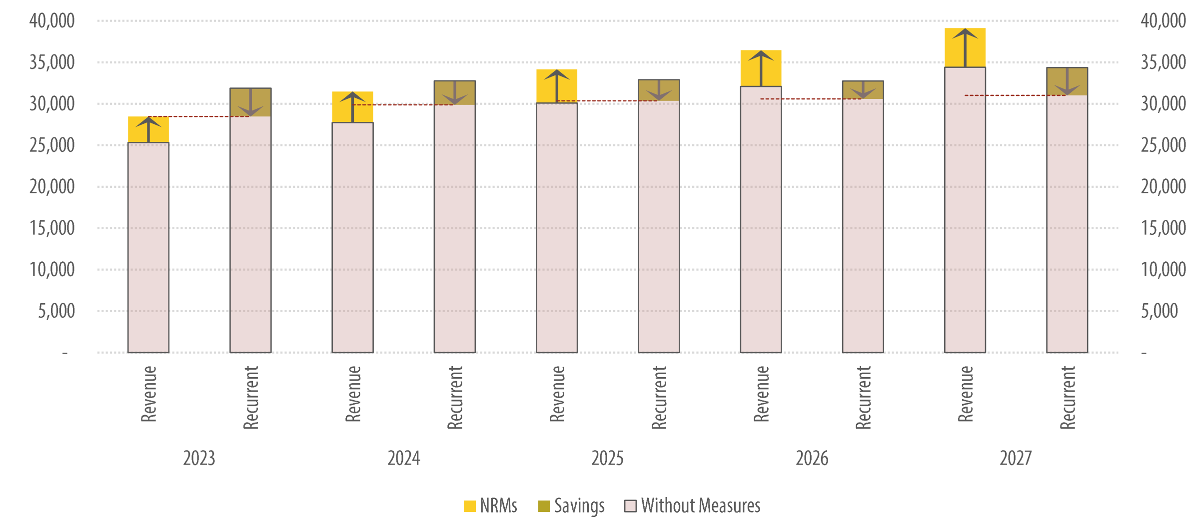


Chart 13: Growth rate of nominal GDP and debt

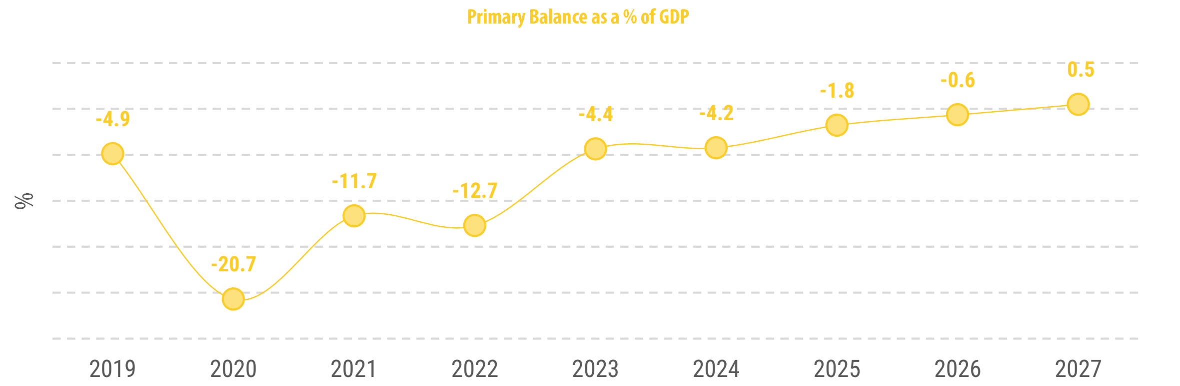


Fiscal Anchors Achieved Through the Fiscal Strategy 2023-2025

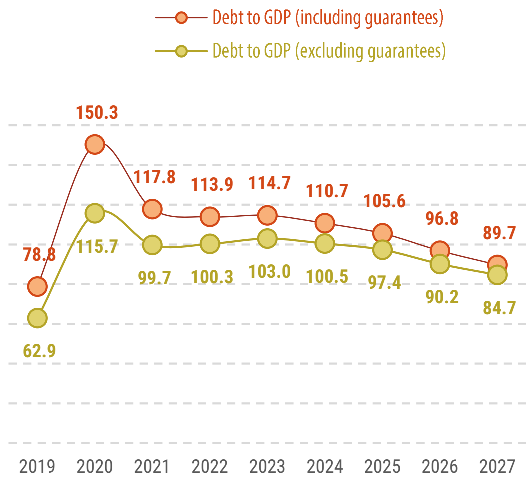
Reduce recurrent expenditure to levels that do not exceed revenue (excluding grants) by 2023, and maintain this threshold going forward



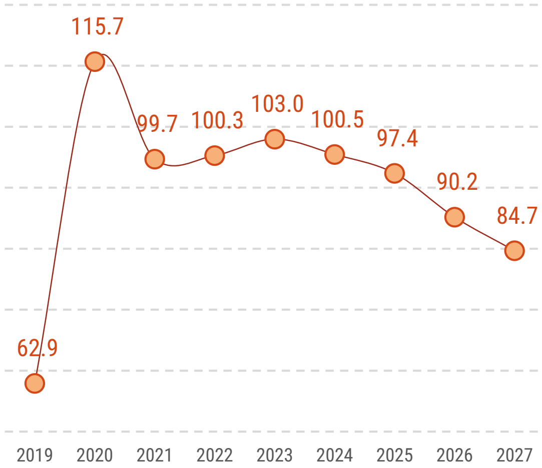
Reduce the primary budget deficit to less than 5 percent of GDP by 2023, and maintain it below this threshold over the medium term



Maintain public debt as a percentage of GDP on a downward trend



Reduce public debt (excluding guarantees) to less than 100 percent of GDP by 2025



7. Sensitivity Analysis

This section highlights the impact on budget deficit and public debt based on scenarios where government revenue and expenditure deviates from the baseline projections used in this Strategy. The revenue and expenditure estimates presented above are used as the baseline for this analysis.

Sensitivity analysis comprises of three segments; changes to tourism, revenue and expenditure. In each scenario, the impact of a deviation from the baseline scenario on budget deficit and budget financing are estimated.

Table 15: Assumptions of scenarios for sensitivity analysis

	Variable
Scenario 1	Tourist arrivals and bednights
Scenario 2	Expenditure consolidation measures
Scenario 3	New Revenue Measures

7.1.1 Scenario 1: tourist arrivals and bed nights

Tourist arrivals and bed nights have a significant impact on the government revenue directly and indirectly. Therefore, a deviation in estimates of tourist arrivals and bed nights compared to the baseline estimates will impact forecasts for government revenue in the medium-term.

In addition to the baseline estimates for tourist arrivals and bed nights, estimate under the best-case and worst-case scenarios are considered in this analysis. TGST, Green Tax, Departure Tax and Airport Development Fee are the revenues that will be directly affected by any deviation in tourist arrivals and bednights. As tourism sector is the main driver of economic growth for the Maldives, revenues that are reliant on economic growth will also be affected indirectly by tourist arrivals and bed nights. The revenue that will be indirectly affected by the tourism outturn are GGST and business and property taxes. These revenue categories account for more than 50 percent of the baseline revenue in 2022. Therefore, any change in the expected levels of tourist arrivals and bed nights will have a significant impact on total revenue.

In this scenario, the impact on total revenue and budget balance due to tourist arrivals and bed nights being higher than the baseline estimates (best case) and tourist arrivals and bed nights being lower that the baseline estimates (worst case) are estimated, holding government expenditure constant. Table 16 shows a detailed analysis of revenue, budget balance and debt in 2023 under the three tourism scenarios.

Table 16: Impact of changes in tourist arrivals on revenue and budget balance in 2023

	Baseline	Best Case	Worst Case
Tourist Arrivals	1,865,519	1,984,446	1,740,587
Average Duration of Stay	6.7	6.8	6.7
Bednights	12,518,544	13,409,091	11,674,524
		MVR millions	
TGST	9,383.1	10,084.5	8,696.4
Green Tax	1,078.6	1,159.7	999.0
Airport Service Charge	943.6	1,006.7	875.2
Airport Development Fee	953.0	1,016.7	884.0
GGST	4,206.4	4,430.5	4,204.9
Business and Property Tax	3,455.5	3,470.1	3,413.3
TOTAL	20,009.1	21,168.2	19,072.8
Revenue and Grants	30,792.5	31,951.6	29,856.3
Expenditure	39,042.1	39,042.1	39,042.1
Budget deficit	-8,249.6	-7,090.5	-9,185.9
Debt (% of GDP)	103.0	97.5	109.8
Financing gap	0.0	-1,159.1	936.2

7.1.2 Scenario 2: Expenditure Consolidation measures

Expenditure estimates included in 2023 baseline figures includes savings from expenditure consolidation measures proposed by the government. However there are risks of delays in implementation of these measures, as well as some policy measures not being implemented at all. This scenario illustrates the impact on total expenditure, revenue, debt and financing if there is a delay in implementation of proposed measures by 3 months and by 6 months.

Table 17: Impact on changes in implementation of expenditure consolidation measures

MVR millions	Baseline	Delay implementation by 3 months	Delay implementation by 6 months
Revenue and Grants	30,792.5	30,792.5	30,792.5
Expenditure	39,042.1	39,897.7	40,753.3
Savings from expenditure consolidation measures	3,422.4	2,566.8	1,711.2
Budget Deficit	-8,249.6	-9,105.2	-9,960.8
Financing gap	-	855.6	1,711.2

7.1.3 Scenario 3: New Revenue Measurements

Of the estimated revenue and grants for 2023, MVR 3,144.37 million is expected to be raised from the increase in GST rates from 1st January 2023 onwards. In the past, the realization of NRMs has often been below forecasts due to implementation delays caused by adverse economic conditions, administrative delays and improper planning. The delays in implementation of new revenue measures affect the realization rate of total revenue estimated for a given year. Therefore, this scenario illustrates the impact on if the proposed increase in GST rates is delayed by 3 months and 6 months.

Table 18: Impact of change in implementation of New Revenue Measures

MVR millions	Baseline	Delay implementation by 3 months	Delay implementation by 6 months
New revenue measures	3,144.4	2,071.9	1,352.2
Revenue and Grants	30,792.5	29,720.0	29,000.3
Expenditure	39,042.1	39,042.1	39,042.1
Budget deficit	- 8,249.6	-9,322.2	-10,041.8
Financing gap	-	1,072.5	1,792.2

8. Fiscal Risks

Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts. The sources of risks may be macroeconomic risks that may have implications for government revenues and expenditures, as well as specific fiscal risks that arise from the realization of contingent liabilities or other uncertain events.

This section looks at the major risks to the implementation of this medium-term fiscal strategy and the measures being taken or measures that will be taken in the future to address these risks. The section will look into macroeconomic risks, revenue risks, expenditure risks and financing and debt risks. A Fiscal Risk Statement, with detailed assessment of the risks to the implementation of the medium-term budget will be published later in the year along with the proposed budget for 2023-2025.

8.1 Macroeconomic Risks

8.1.1 Russian invasion of Ukraine

Risk: As a trade dependent small open economy, Maldives is highly vulnerable to global shocks. In the medium term one of the greatest uncertainties to the global economy is the ongoing Russia-Ukraine war and the spillover effects of the war. With the war already impacting the global economy, with a sharp slowdown in economic growth and massive hikes in global prices of commodities, there remains great uncertainties on the future direction of the war, the duration of the war, the potential for escalation of the war, and the extent of the spillover effects of the war to the regional economies, Europe and the world in general.

Since the Maldives borders were reopened in July 2020, the second highest arrivals to the country was from Russia. In fact prior to the invasion, in the first two months of 2022, Russia was the top market for Maldives tourism. Additionally, Ukraine has also been an important tourism market since border reopening. In the months since the Russian invasion of Ukraine, tourist arrivals from Russia have come down substantially, while arrivals from Ukraine have stopped altogether. With the recommencement of direct flight operation to Maldives by Russian flag carrier, Aeroflot in May 2022, after a brief interlude, arrivals from Russia has slowly been increasing. However, given the weight of the economic sanctions imposed on Russia by Europe and other major economies, tourist demand from Russia is not expected to recover to pre-invasion levels in 2022 and the medium term. Given the significance of the Russian tourism market in the post-Covid tourism market for Maldives and the uncertainties over the war, the potential impact of the war on the Russian tourism market in 2022 and the medium term is a macroeconomic risk with potential fiscal implications. Furthermore since the Russian tourism market is a high spending market with longer average duration of stay, even if other markets are able to make up for the loss in Russian arrivals, the yield from these other markets may not be at the same as the Russian market. This could result in lower tourism revenues, even if the arrivals target for the medium term are met.

The Russia-Ukraine war and the ensuing sanctions have had negative spillovers on its neighborhood as well, including other Eastern European economies, Central Asian economies and even some countries in Western Europe. Eastern European and Central Asian market which has gained a larger share of the post-Covid tourism market in Maldives are facing a prospects for a prolonged recession due to the war. Major Western European economies that are dependent on Russia on fuel, such as Germany, are also at risk of further economic slowdown. Therefore the future trajectory of the war and spillovers from the war may have further economic impact on these countries, their consumer demand and thus on the tourism demand for Maldives.

Probability of realization of risk: High

Impact of risk: (Large) Impact tourism related tax revenues

Measures to alleviate risk: Maintain the tourism promotion budget, intensify and broaden tourism promotion activities. Accelerate the completion of the Velana International Airport Upgrading project, and bring into operation components of the project as completed. Complete the airport upgrading projects in the North and South of the country as scheduled. Facilitate the development of additional tourist beds.

8.1.2 Stagflation

Risk: In the short run there is an inverse correlation between inflation and unemployment. The main exemption to this relationship in the post war period was the stagflation of 1970s, when high inflation and high unemployment persisted for a number of years due to two major oil price shocks.

Global inflation has risen sharply since mid-2020, due to tighter demand, supply chain bottlenecks, and soaring food and energy prices, especially since Russia's invasion of Ukraine, with many emerging and developed economies facing the highest inflation levels in decades. Rising inflation has led to sharper monetary policy tightening in developed economies. Overall in 2022 world economy is expected to experience a sharp deceleration in growth, with many countries facing prospects for a recession in the medium term. Rising inflation and slowing growth has raised concerns that the global economy is entering a period of stagflation reminiscent of the 1970s.

Rising prices and an economic slowdown will affect the disposable income of consumers in these countries. This is likely to reduce spending on travel and transport, which could impact demand for Maldives tourism and the average spending of tourists that visit the country. In the past, tourism demand to Maldives has been observed to be highly correlated with the macroeconomic situation of the tourism source markets.

Maldives is a country that has to import many of the goods that are consumed in the country. If prices rise in the world market, these are reflected in the prices in Maldives. However, the current subsidy system is designed to control the price of some essential items in the market, which insulates the consumers from global prices shocks, but are detrimental to public finances. Therefore, the rise in world prices will affect both the consumers as well as public finances.

Probability of realization of risk: High

Impact of risk: (Large) Increase in Government expenditure on fuel subsidies. Higher global prices leading to higher cost of government operating expenditures and capital expenditures. Although revenue from GGST and import duties will increase in nominal terms due to higher prices, if demand for Maldives tourism declines, Government revenue will decline.

Measures to alleviate risk: Review existing subsidies, and reform subsidies to reduce the risk on government budget due to global price increases. This could be achieved by passing through some or all of the cost increases directly to the consumers, while at the same time ensuring that the Government assistance is targeted to the most vulnerable members of society. Reduce cost of freight and shipping through Maldives State Shipping Company. Resolve the capacity constraints in the Male' Commercial Harbor by developing the Maldives International Sea Port in Gulhifalhu, which will reduce the cost of importing goods to Maldives. Maintain tourism promotion expenditures and complete the ongoing airport development projects. Formulate a sustainable fiscal strategy while ensuring that productive investments can be made from the Government budget.

8.1.3 Decline in export prices

Risk: Countries across the world closed their borders in 2020, due to the Covid-19 pandemic, and these Covid-19 restrictions largely remained in place into 2021. These include major tourism destinations. However, Maldives was among the first countries in the world to open its border and open for tourism, and remained one of the few tourism destinations to remain continuously open for most of the last two years. This helped to jumpstart the recovery of the Maldivian economy. However, as Covid-19 vaccinations have rolled out across the world, more countries have opened their borders in 2022. This has increased competition among tourism destinations. If this competition leads to major price discounts, this will reduce the average revenue per visitor.

Probability of realization of risk: Moderate

Impact of risk: (Moderate) Decrease in tax revenue related to the tourist sector.

Measures to alleviate risk: Maintain tourism marketing spending. Make necessary investments in public infrastructure and tourist beds to increase the number of tourists visiting Maldives.

8.2 Revenue Risks

8.2.1 Delay in implementation of new revenue measures

Risk: In recent years, many of the new revenue policies proposed with the government budget have not been implemented in a timely manner, while some have been delayed beyond the budget year. Therefore, the failure to implement the proposed new revenue policies for the coming year is a major fiscal risk. The most important new revenue measure proposed for the medium terms budget is the revision to GST rates, to be effective from the 1st of January 2023.

Probability of realization of risk: Moderate

Impact of risk: (Large) Delays in the implementation of the new revenue measures will reduce total revenue for the year. As a result, the fiscal anchors set out in this strategy will not be achieved. If revenue declines, more drastic measures will have to be taken to reduce expenditure or this shortfall will need to be financed. However, in the medium term there a major challenges in raising finance, especially from international capital markets.

Measures to alleviate risk: Conduct consultations with industries and general public to explain the rationale for the policy changes. Preparing a Medium Term Revenue Strategy, and proactively communicating the medium terms changes to revenue policies. Complete the implementation of the New Revenue Measures identified in the approved budget for 2022. Improve tax compliance through a strategy to improve compliance over the medium term. Regular updating of tax laws and regulations to reflect latest developments. Proactively identify measures to cut costs if the proposed revenue measure are not realized.

8.2.2 Lower than expected realization of grants

Risk: Over the past years, the budgeted amount for grants, especially cash grants from abroad has not been realized as planned in the budget. This strategy also includes a proposal to raise USD 100 million in cash grants in 2023. If this grant is not realized as expected, this will increase the deficit and the financing need, or require even further tightening of expenditures.

Probability of realization of risk: Moderate

Impact of risk: (Large) Although the estimated amount of grants is relatively small in proportion to total revenue, if this risk is realized, this would lead to an increase in deficit and financing need. With the limited fiscal space and tightening financing conditions, any measure that would increase the deficit will worsen the fiscal situation of the Government. If the decline in grants are to be managed without increasing budget financing, the expenditure reduction measures will have to be further tightened.

Measures to alleviate risk: Proactive engagements with bilateral partners to access cash grants. Identify cost-cutting measures in advance if the proposed grant amount is not realized.

8.3 Expenditure Risks

8.3.1 Delays or failure to implement expenditure consolidation measures

Risk : Government expenditure is growing faster than government revenue. Therefore, in a business as usual scenario government revenue will not be able to cover recurrent expenditures. Hence, this Fiscal Strategy proposes expenditure consolidation measures to reduce and maintain recurrent expenditure at or below total revenue. However in the past, various expenditure consolidation and efficiency improvement measures that were proposed in the Government Budget has failed to be implemented. Nevertheless, to achieve the fiscal anchor of maintaining recurrent expenditures within total revenue, implementing the expenditure reduction measures has become imperative. Thus, delays in implementation of these measures or a failure to implement the measures altogether will pose a major fiscal risk.

Probability of realization of risk: Moderate

Impact of risk: (Large) with higher expenditures, the fiscal anchors stated in this strategy will not be achievable. Higher expenditures will increase the budget deficit and the financing need, at a time when the avenues for financing are highly constrained.

Measures to alleviate risk: Take immediate actions to start implementation of expenditure policies that can be implemented in the immediate term. Complete the background work to formulate policies and prepare for implementation with the 2023 Budget.

8.3.2 Additional expenditures due to changes in policies or legislative changes

Risk: The budget for the upcoming year is approved by the People's Majlis November of the ongoing year. Government expenditure for the upcoming year should be based on the policies and programs approved in the budget. However, in the past, after the budget is approved by the Majlis, new laws are passed or policy changes are brought which adds new expenditures during the year.

Probability of realization of risk: Moderate

Impact of risk: (Moderate) Increase in recurrent expenditure due to policy changes. Will need to allocate budget space for new expenditures through the contingency budget or by reprioritizing existing budget programs. New expenditures may also increase the financing need for the budget.

Measures to alleviate risk: As much as possible identifying new expenditure programs in the budget formulation process, under the New Policy Initiatives framework. If there is an increase in expenditure that need to be accommodated during the year, determining whether the budget space is available or identifying in advance the existing expenditure programs to be reprioritized to accommodate the expenditure. Determining a contingency budget and utilizing the contingency to accommodate actual fiscal surprises. Educating and familiarizing Government agencies and staff on the budget formulation process, including the New Policy Initiatives framework. Over the medium term, prioritizing budget programs through the ongoing roll out of the program and performance based budgeting framework.

8.3.3 Faster than expected implementation of PSIP projects

Risk: Due to supply chain constraints and Covid-19 restrictions the implementation of infrastructure projects were delayed in 2020 and 2021. However, as the economy has recovered and restrictions have been eased the implementation of projects has accelerated. Furthermore many of the projects that were in the planning stages in 2019 and 2020 has commenced physical work since 2021.As such the expenditure on PSIP in 2022 is expected to exceed the budgeted amounts in 2022. The medium term fiscal projections assumes an acceleration in project implementation, however the pace of implementation may well be beyond these projections, which will have fiscal implications.

Probability of realization of risk: Moderate

Impact of risk :(Moderate) This will increase capital expenditures in the Government Budget. If the increase is coming from financed project, there is no financing risk. However, if the cost of projects from domestically financed projects exceed the budgeted amount, this would increase the financing need. However, the avenues for additional financing in the medium term are highly constrained.

Measures to alleviate risk: Seek concessional financing for large projects. Strengthen the PPP framework in Maldives and increase private sector participation in public infrastructure projects.

8.3.4 Underfunding of programs

Risk: The current layout of the Government Budget is highly rigid, with limited expenditure space at the discretion of policy makers. Meaning that most of the budget expenditures are for commitments. These include employee salaries and pensions, government transfers and subsidies as well as contracted and ongoing projects. In the past, the limited discretionary budget space available was used to control expenditures. One such expenditure is cost of repairs and maintenance. However, reducing repair and maintenance expenditures may lead to higher costs in the future for replacing property and infrastructure.

Furthermore if expenditure consolidation prioritizes expedience over more holistic reforms over the medium term horizon, the budget may end up under funding programs to achieve the development objectives of the government or expenditures to improve the quality of public services.

Probability of realization of risk: Moderate

Impact of risk: (Moderate) Damage to property and infrastructure leading to higher expenditures on replacements. Underfunding of priority programs of the government and programs to improve the quality of public services.

Measures to alleviate risk: Medium term planning of revenue and expenditure policies of the Government. Formulate a Medium Term Revenue Strategy (MTRS) to identify medium-term expenditure priorities and the strategies to raise revenue to fund these expenditures. The Ministry of Finance is currently working on a MTRS for Maldives. Managing the funding required for repair and maintenance of fixed assets and public infrastructure through user fees. Strengthen the management of public assets. Explore avenues for managing public assets through Public Private Partnerships. Ensure adequate funding is allocated to economically beneficial public investment projects, despite expenditure rationalization in the medium term.

8.3.5 Unbudgeted expenditures on state owned enterprises

Risk: In recent years, the assistance to state-owned enterprises from the Government Budget in the form of capital contributions, subsidies and treasury loans, has increased substantially. Specifically in 2020, as state-owned enterprises themselves faced major downturn in their revenue due to the Covid-19 pandemic, the Government had to expand the support. However, budget support to state owned enterprises cannot be maintained at this level over the medium term. Therefore, if the dependence of the government budget cannot be scaled back through operational efficiencies there is a risk of further budgetary support for state owned enterprises.

Probability of realization of risk: Moderate

Impact of risk: (Large) Additional expenditure to support state owned enterprises to manage cash flows. This will increase budget financing need or will require tighter expenditure consolidation measures.

Measures to alleviate risk: Study the cost structures and inefficiencies of state owned enterprises supported by the Government Budget, and restructure such enterprises. Developing action plans for Budget dependent state owned enterprises to reduce expenditures and dependence. Holding the board of directors and management of companies accountable for the financial sustainability of the company. Privatize state owned enterprise in the medium term and improve corporate governance with the participation of external shareholders. State owned enterprises to step away from the provision of public services over the medium term.

8.4 Debt and Financing Risks

8.4.1 Global monetary policy tightening and rising interest rates

Risk: As inflation has risen around the world, central banks have sharply tightened monetary policy and raised interest rates. As of the end of June, the US Federal Reserve has raised interest rates three times during the year, and are expected to raise interest rates further during the year. Similarly, central banks of other developed country and emerging market are raising interest rates to tackle inflation. The steep increase in interest rates in developed economies has shifted liquidity from emerging and developing markets to developed economies. Furthermore, greater uncertainty on the global economic prospects have reduced the appetite for investors to invest in developing and emerging markets. This will create challenges to raise funding from the market for small island developing countries such as the Maldives. If the Government was to tap into the international financial market currently, it would come at high interest costs, and unfavorable conditions.

Probability of realization of risk: High

Impact of risk: (Large) Reduced avenues to raise market based financing from the international money markets for the next two to three years. Tapping into the international financial market at a high cost which could deteriorate the sustainability of public debt.

Measures to alleviate risk: Formulating medium term government expenditure, revenue and financing policies in a way that does not require funding from international financial market in 2023 and 2024. Prioritizing domestic financing and concessional external financing for budget financing.

8.4.2 Non realization of proposed financing plan

Risk: The implementation of the proposed medium term financing plan poses significant risks to the implementation of the budget. This fiscal strategy includes plans to raise USD 100 million through concessional budget support loans from foreign sources in 2023. Furthermore, for the upcoming two years, the strategy includes plans to raise more than MVR 5 billion in domestic financing. The non-realization of the proposed financing plans for the medium term could increase the risks for budget implementation.

Probability of realization of risk: High

Impact of risk: (Large) Will need to fill any financing shortfall through other financing sources, which are likely to be more expensive market based or non-concessional financing. Will need to more aggressively increase revenue or reduce expenditures to reduce the financing need.

Measures to alleviate risk: Proactive engagement with international agencies and bilateral partners to obtain budget support loans. Taking measures to reduce expenditure and raise revenue to ensure a sustainable fiscal policy for the medium term. Strengthen the infrastructure of the domestic T-bill market and open up the secondary market.

8.4.3 Unsustainable increase in public debt

Risk: As Government revenue fell drastically due to the Covid-19 pandemic, to cut expenditures at the same pace would have been detrimental to the welfare of the citizens and the overall health of the economy. Therefore, budget deficit has increased in the past two years, leading to higher public debt. Although the economy is expected to return to pre-Covid levels by the end of 2022 and government revenue is expected to grow, if expenditures are left to grow at business as usual, expenditure growth will outpace revenue growth. If this leads to a faster growth in deficits than GDP growth, it could lead to an unsustainable growth in public debt.

Probability of realization of risk: Moderate

Impact of risk: (Large) Increase in financing cost and reduction in avenues for concessional budget financing. Higher budget space for debt servicing, will reduce the budget space for other economically and socially beneficial programs.

Measures to alleviate risk: Structure medium-term fiscal policy to increase revenue, reduce expenditure and reduce budget financing need in the medium-term. Prioritize grants and concessional financing for financing the budget. Maintain average interest rate of the overall debt portfolio at concessional levels.

9. Compliance with Fiscal Responsibility Act

Fiscal Responsibility Act (Act No. 7/2013) stipulates 3 main fiscal rules; which are

(1) Article 32(b): To make an effort to maintain the total public debt including guarantees at a level not exceeding 60 percent of the GDP of the previous year, at the end of three years from the 1st of January 2014. Following the achievement of this target, the Minister of Finance to announce the debt to GDP target for every five year period.

(2) Article 34(a): The primary balance to be at surplus within 3 years from the 1st of January 2014

(3) Article 34(b): The overall balance to not exceed 3.5 per cent of GDP within 3 years from the 1st of January 2014

Target (1) has not been achieved since the enactment of the Act. The government debt has increased substantially since the outbreak of the Covid-19 pandemic as the government revenue declined sharply and the budget had to be financed through debt. In addition to the impact of the pandemic, debt has also increased to finance major public infrastructure projects undertaken by the Government and to finance deficit budgets. Furthermore, debt measured as a share of GDP has partly gone up due to the substantial decline in the Maldives GDP due to the Covid-19 pandemic. Therefore, it is unlikely that the target (1) can be achieved over the medium term, even for direct public debt.

Target (2) has also not been met since the enactment of the Act, as a primary deficits has been maintained in the past years. If a primary surplus is to be achieved, all expenses other than interest payment on debt will need to be covered by revenue and grants. Unless current policies are changed significantly to fund all expenditures excluding interest from revenue and grants this target is unattainable. The estimates included in the strategy show that in the medium term a primary surplus can be reached in 2027.

The only time that any of the three targets stipulated in the Act has been met, was the achievement of target (3) in 2017. In 2017, the overall balance was reduced to 3.0 percent of GDP. However in subsequent years, Government expenditures have grown faster than Government revenue. Hence, overall deficit has on average grown faster than nominal GDP over this period. The overall deficit has increased significantly since the emergence of the Covid-19 pandemic which led to a substantial slide in Government revenue. With the government expenditure and revenue plans set out in this Strategy, this target is not expected to be achieved in the medium term. However, one of the objectives of this Strategy is to maintain a trajectory in which overall deficit as a proportion of nominal GDP is reduced over the medium term.

Considering the extent to which the fiscal situation has deviated from the targets set out in the Act, the level of fiscal consolidation required to achieve these targets in the short term would be significant. Such a fiscal consolidation will require major changes in government policies, staffing and salaries, social assistance programs and infrastructure development projects. This would have substantial adverse impacts on the economy and the welfare of citizens.

Fiscal targets should be flexible and reflective of the current situation and the changing macroeconomic outlook for the economy. Fiscal responsibility laws enacted by countries in recent years have preferred to define a set of fiscal principles that should be considered in determining fiscal policy rather than prescribing numerical targets. Under such an approach, in the context of Maldives, each government can formulate a five-year Fiscal Charter, to achieve its fiscal policy objectives in accordance with the principles specified in the Act, with a set of fiscal targets to be achieved during the five year term. The Charter will need to be approved by People’s Majlis and the Government will be accountable to Majlis for the achievement of the targets set out in the Charter. In the Technical Assistance exercise conducted by the IMF to review the existing Fiscal Responsibility Act, the IMF has also recommended the Maldives to revise the Act to move from a rules-based law to a principles based law. The Ministry of Finance is currently drafting amendments to the Fiscal Responsibility Act based on the recommendations of the IMF Technical Assistance report.

10. Public Financial Management Reform

The public financial management (PFM) system encompasses all the processes of planning and managing the public finances and all the resources for planning and managing public finances. This includes the laws and regulations relating to the planning and implementing public finances, the processes and resources for estimating public revenue, expenditure and debt, and for planning fiscal policies, the processes and resources for budget implementation, as well as the processes for disclosing and presenting public finance information. In a modern PFM system in addition to the Government budget, state-owned companies, state funds, local councils are included as part of the PFM system.

The process of improving the PFM system, addressing inefficiencies and modernizing the system is a continuous process. As such the Ministry of Finance is currently undertaking a number of reforms to improve and enhance various aspects of the PFM system. The Ministry is currently receiving financial and technical assistance from the World Bank and USAID, specifically for PFM reform. Furthermore technical assistance for various aspects of PFM reform has been received by the IMF and other IFIs. A number of studies have been conducted on the Public Financial Management System of Maldives in recent years. These include:

- Public Investment Management Assessment (PIMA) assessing public infrastructure governance over the public investment cycle
- Debt Management Performance Assessment (DeMPA), a diagnostic on government debt management practices and institutions
- Fiscal Transparency Evaluation (FTE), a diagnostic of fiscal transparency practices against the first three pillars of the IMF's Fiscal Transparency Code.
- Public Expenditure and Financial Accountability Assessment (PEFA) a broad diagnostic assessment on the performance of the PFM system.

Based on these assessments, the Ministry of Finance has formulated the Public Financial Management Reform Strategy and Action Plan for 2022-2026. In line with the Strategy following are some of the PFM reform activities currently being undertaken by the Government:

- Developing the process and tools used for medium-term fiscal policy formulation
- Strengthening the government's cash flow and debt management.
- Institutionalizing program and performance based budgeting. Improving budget formulation and establishing mechanisms to measure performance of budget programs.

- Formulating new laws and regulations to strengthen the PFM system, reviewing, amending and updating existing PFM related laws and regulations.
- Publishing a Fiscal Risk Statement to disclose the risks in the implementation of the Government budget.
- Strengthening the public financial management capacity of the local councils.
- Strengthening the governance of state owned enterprises and establishing mechanisms to strengthen their accountability.
- Completing the roll out of the public accounting system for recording and maintaining public financial accounts and further automating of budget preparation and budget implementation processes.
- Strengthening public procurement systems in line with international best practice.
- Strengthening the planning, implementation and monitoring of public investment projects.
- Formulating laws and regulations to facilitate greater public-private partnership (PPP) in public investment. Establishing the systems for planning, implementation and risk assessment of PPPs.
- Establishing internal and external audit practices in line with international best practices.

11. Conclusion

As required under the Fiscal Responsibility Act, this statement presents the revised budget estimates for 2022, medium term baseline budget estimates and medium-term fiscal policy estimates, based on the fiscal objectives of the Government.

The Fiscal Strategy for the previous year was formulated with the goals of improving the fiscal situation that had deteriorated due to the Covid-19 pandemic and to ensure fiscal and debt sustainability. However, with the ongoing Russia-Ukraine conflict, macro-fiscal risks have heightened, requiring further efforts to ensure fiscal and debt sustainability in the medium term. This Strategy proposes a fiscal policy direction which would reduce budget deficits, reduce budget financing risks and ensure the public debt sustainability over the medium term.

To achieve the fiscal anchors set out in this Strategy, a fiscal consolidation of MVR 6 billion, equivalent to 6 percent of GDP has to be instituted. This strategy proposes to bring this consolidation, with 3 percent of GDP from raising revenue and 3 percent of GDP from reducing expenditures. Instituting these reforms ahead of the 2023 budget will be imperative for the medium term fiscal sustainability.

The 2023-2025 Government budget will be formulated based on this Strategy.

Annex 1: Revenue and Expenditure for 2021 and 2022

	Approved *2021	Actual 2021	Approved 2022	Revised 2022
Total Revenue and Grants	**21,128.5**	**21,353.4**	**24,279.9**	**24,947.8**
Total Revenue	**18,917.0**	**20,321.6**	**21,368.1**	**23,921.8**
Import duty	2,985.3	2,843.0	3,223.4	3,255.0
Business and Property Taxes	2,001.2	2,748.8	2,711.3	3,004.5
Withholding and business profits taxes	1,316.1	1,847.0	1,893.7	2,006.1
Bank Profit Tax	598.3	675.1	603.4	651.2
Goods and Service Tax	4,676.4	7,733.3	7,699.4	9,706.1
Tourism Goods and Services Tax	2,640.2	5,247.7	4,821.8	6,725.7
General Goods and Services Tax	2,036.2	2,485.6	2,877.5	2,980.4
Other taxes and duties	1,151.4	1,277.2	1,640.7	1,768.0
Airport Service Charge	531.1	473.4	769.2	800.9
Green Tax	616.6	802.1	823.7	967.1
Fees and Charges	1,625.0	1,379.3	1,503.5	2,024.8
Registration and License fees	679.5	722.8	740.6	730.4
Property Income	4,722.8	2,254.9	2,356.0	1,927.5
Interest, Profit and Dividends	799.4	521.4	1,237.9	913.8
New Revenue Measures	-	-	-	-
Other Revenue	194.8	840.8	255.3	591.5
Grants	2,211.5	1,031.8	2,911.8	1,026.0
Total Expenditure	**33,431.5**	**32,806.2**	**34,101.8**	**39,730.7**
Total Budget	**37,167.7**	**37,091.9**	**36,999.3**	**42,807.9**
Recurrent Expenditure	**21,638.1**	**23,938.3**	**24,823.3**	**27,555.7**
Personal Emoluments	8,416.4	8,681.5	9,766.5	9,939.8
Pensions, Retirement Benefits & Gratuities	1,592.5	1,649.9	1,664.5	1,742.5
Goods and services	5.156.4	5,538.7	5,525.3	5,403.0
Travel Expenses	172.3	183.2	203.0	206.1
Supplies and Requisites	611.8	680.7	693.9	693.2
Operational Services	2,383.9	2,258.5	2,330.0	2,433.2
Supplies and Requisites for Service Provision	1,098.3	1,538.5	1,260.4	1,374.8
Training	630.8	567.4	690.1	344.0
Repairs and Maintenance	259.4	310.3	348.4	351.7
Grants, Contributions and Subsidies	2,622.7	4,344.7	3,281.6	5,707.9

	Approved *2021	Actual 2021	Approved 2022	Revised 2022
Other Recurrent Expenses	2,568.6	2,363.6	3,019.4	3,197.1
Grants to Councils	1,281.5	1,405.0	1,565.4	1,565.4
Capital expenditure	**16,999.5**	**13,108.6**	**12,176.0**	**15,252.3**
Government expenditure on development projects	3.1	75.4	22.5	21.4
Public Sector Investment Program	8,441.5	5,363.2	6,330.4	7,427.5
Issuance of property, investments and loans	1,953.6	3,384.3	1,625.6	4,726.1
Budget contingency	1,395.3	-	1,300.0	-
Repayment of debt	3,714.9	4,047.8	2,861.7	3,005.5
Capital paid to foreign financial institutions	21.3	12.2	35.7	35.7
Other investment	-	225.7	-	36.1
Primary balance	**(9,834.6)**	**(9,348.3)**	**(6,906.7)**	**(11,733.5)**
Overall Balance	**(12,303.0)**	**(11,452.7)**	**(9,821.9)**	**(14,782.9)**
As a percentage of GDP (%)				
Primary balance		-11.7		-12.7
Overall Balance		-14.3		-16.0
Direct Debt		99.7		100.3
Direct and Guaranteed debt		117.8		113.9

*With the approved budget for 2022, MVR2,245.0 million has been supplemented to the 2021 budget.

Annex 2: Medium-term Economic Forecasts

	2020	2021	2022*	2023*	2024*	2025*
Nominal GDP (in millions)	57,568.7	80,214.5	92,343.1	103,080.7	114,897.9	125,744.4
Percentage of nominal GDP growth	-33.3%	39.3%	15.1%	11.6%	11.5%	9.4%
Real GDP (in millions, 2014 constant prices)	51,260.8	70,203.1	79,358.9	87,049.4	95,327.9	102,504.9
Percentage of real GDP change	-33.5%	37.0%	13.0%	9.7%	9.5%	7.5%
CPI inflation	-1.6%	0.5%	3.0%	-	-	-
Number of tourist visits	555,494	1,321,932	1,625,646	1,865,518	2,207,917	2,590,833
Percentage of change in tourist visits	-67.4%	138.0%	23.0%	14.8%	18.4%	17.3%
Bednights	3,984,712	10,073,4	11,354,323	12,518,543	14,369,842	16,352,586
Percentage of bednights changed	-62.7%	152.8%	12.7%	10.3%	14.8%	13.8%

* 2022 to 2027 forecasts are estimates of the moderate case scenario·

Annex 3: Revenue and Expenditure Forecast for 2023-2027

					Forecast
	2023	**2024**	**2025**	**2026**	**2027**
Total Revenue and Grants	30,792.5	32,349.7	35,032.6	37,317.9	39,999.2
Total Revenue	28,458.5	31,479.7	34,159.1	36,467.5	39,122.7
Import duty	3,633.5	4,050.1	4,432.4	4,733.8	5,237.3
Income and Property Tax	3,444.4	3,906.5	4,220.5	4,489.1	4,774.1
Withholding and business profits tax	2,381.7	2,765.0	3,029.0	3,253.6	3,487.4
Bank Profit Tax	398.0	453.7	484.9	512.3	544.4
Individual Income Tax	666.1	687. 6	705. 7	721.9	741.1
Goods and Service Taxes *	13,589.5	15,043.7	16,309.4	17,567.2	18,936.6
Tourism Goods and Services Tax	9,383.1	10,404.0	11,408.4	12,349.4	13,298.3
General Goods and Services Tax	4,206.4	4,639.7	4,901.0	5,217.8	5,638.3
Others Tax and duties	2,022.2	2,294.4	2,652.3	2,819.2	3,000.9
Airport Service Charge	943.6	1,111.2	1,304.9	1,409.5	1,509.9
Green Tax	1,078.6	1,183.2	1,347.4	1,409.7	1,491.0
Fees and Charges	1,980.9	2,237.1	2,461.9	2,602.9	2,751.2
Registration and License fee	731.8	753.6	760.6	767.9	775.1
Property Income	1,569.9	1,588.2	1,682.2	1,776.3	1,884.3
Interest, Profit and Dividends	838.1	914.5	975.6	1,024.2	1,082.9
New Revenue Measures*	0.0	0.0	0.0	0.0	0.0
Other Revenue	648.3	691.7	664.2	686.9	680.3
Grants	2,334.0	870.1	873.5	850.4	876.5
Total Expenditure	**39,042.1**	**41,363.0**	**41,568.8**	**42,363.8**	**43,240.5**
Total Budget	**41,533.4**	**43,678.7**	**49,997.9**	**55,080.2**	**46,598.0**
Recurrent expenditure	**28,458.5**	**29,868.6**	**30,360.0**	**30,589.7**	**31,011.7**
Personal Emoluments	10,938.9	10,697.9	10,444.5	10,451.7	10,453.3
Pensions, Retirement Benefits & Gratuities	2,248.0	2,130.0	2,011.2	1,921.7	1,832.0
Pay harmonization	500.0	1,750.0	2,000.0	2,000.0	2,000.0
Goods and services	5,245.9	5,132.9	5,026.9	4,996.8	5,023.1
Travel Expenses	219.3	216.9	214.5	212.3	210.3
Supplies and Requisites	731.1	723.2	715.2	717.0	709.7
Operational Services	2,478.9	2,447.8	2,416.6	2,417.5	2,444.4
Supplies and Requisites for Service Provision	1,029.7	1,018.6	1,007.4	983.5	984.5
Training	424.7	368.0	318.9	315.6	326.5

	2023	2024	2025	2026	Forecast 2027
Repairs and Maintenance	362.3	358.3	354.4	351.0	347.8
Grants, Contributions and Subsidies	4,119.3	4,107.2	4,379.3	4,562.0	5,040.1
Grants to Councils	1,714.1	1,1895.4	2,056.4	2,194.1	2,354.5
Other Recurrent Expenses	3,895.8	4,291.1	4,441.6	4,327.6	4,105.2
Capital expenditure	**13,074.9**	**13,310.1**	**17,637.9**	**21,990.5**	**12,586.3**
Development Projects	20.9	18.6	18.6	18.8	19.0
Public Sector Investment Program (Ongoing)	7,430.4	8,017.2	6,189.1	6,188.7	6,262.3
Capital Equipment, Investment & Loan Outlays	1,670.3	1,431.9	1,438.0	1,538.5	1,557.5
Budget Contingency	1,462.0	1,526.7	1,563.2	1,528.2	1,390.0
Loan Repayment	2,463.6	2,300.4	8,413.8	12,700.9	3,341.9
Capital Contributions to Multilateral Organizations	27.7	15.3	15.3	15.4	15.6
New Policy Initiatives	-	500.0	2,000.0	2,500.0	3,000.0
Primary balance	(4,503.8)	(4,874.0)	(2,247.7)	(872.3)	718.9
Overall Balance	(8,249.6)	(9,013.2)	(6,536.3)	(5,045.9)	(3,241.3)
As a percentage of GDP (%)					
Primary balance	-4.4	-4.2	-1.8	-0.6	0.5
Overall Balance	-8.0	-7.8	-5.2	-3.8	-2.2
Direct debt	103.0	100.5	97.4	90.2	84.7
Direct and Guaranteed Debt	114.7	110.7	105.6	96.8	89.7

*Goods and Services Tax estimates include additional revenue from increased GST rates (New Revenue Measures).