MALDIVES FISCAL RISK STATEMENT

2021

Ministry of Finance

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Maldives Fiscal Risk Statement 2021

1 Introduction

Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts. These factors comprise potential shocks to government revenues, expenditures, assets, or liabilities, which are not reflected in the government's fiscal forecasts or reports. The sources of risks may be macroeconomic risks that may have implications for government revenues as well as expenditures, as well as specific fiscal risks that arises from the realization of contingent liabilities or other uncertain events. A comprehensive disclosure and analysis of fiscal risks can help the government to ensure that fiscal policy can respond to potential future economic and fiscal shocks, that specific risks are actively monitored and managed, and that abrupt and disruptive changes in policy are avoided when risks materialize.

Taking measures necessary to contain fiscal risks in the context of changing economic realities is one of the tenants of the fiscal policy established in the Fiscal Responsibility Law of Maldives (No.7/2013) (FRL). As such the Ministry of Finance regularly analyses and disclose fiscal risks in the reports submitted to the People's Majlis under the FRL, including the Fiscal Strategy Statement, Budget Position Report and the Debt Strategy Report, in addition to the Annual Government Budget Report. With the publication of this inaugural Fiscal Risk Statement this is the first step towards a more comprehensive and focused analysis of fiscal risks for Maldives.

This Statement is published in the context of an unprecedented global pandemic and economic crisis. The crisis has exposed the vulnerability of Maldives to global macroeconomic shocks and has brought forward the underlying fiscal risks and vulnerabilities. Due to the pandemic tourism arrivals plummeted by 67% while the economy contracted by an estimated 32% in 20202. Government revenue fell by 35%, while the government had to support additional unplanned spending on the health response, welfare for workers and families and support for businesses and state-owned enterprises. The additional financing to manage the budget has partly resulted in the accumulation of further debt in 2020. As the world moves into the second year of the pandemic the uncertainties remain high, and the importance of being aware of the risks and undertaking the necessary mitigation measures for potential fiscal risk remains ever more critical.

Maldives Fiscal Risk Statement 2021 identifies the fiscal risks in the implementation of the Approved Budget 2021. The Statement will look into macroeconomic risks and specific fiscal risks that are pertinent to the implementation of 2021 Budget. The Statement includes sections on:

- Macroeconomic Risks
- Revenue Risks
- Expenditure Risks
- Risks stemming from major projects
- Natural Disasters and Emergencies Risks
- Public Debt Risks
- Fiscal Risks stemming from State Owned Enterprises
- Fiscal Risks stemming from the Financial Sector.

While this initial Fiscal Risk Statement is a standalone publication, the Ministry of Finance will in the future publish the Statement as part of the Annual Government Budget Report.

The Ministry of Finance acknowledge and appreciate the contribution of the Ministry of Finance Departments as well as external stakeholders in drafting this Statement. Contributions to the Statement were made by the Fiscal Affairs Department, Resource Mobilization and Debt Management Department and the Secretariat of the Privatization and Corporatization Board, within the Ministry of Finance. The Ministry also notes the invaluable contributions made by Maldives Monetary Authority and Maldives Inland Revenue Authority to the Statement. The Ministry also notes the technical support provided by the World Bank in producing the Statement.

2 Macroeconomic Risks

2.1 Global macroeconomic shocks

The economy of the Maldives is highly dependent on tourism; with over a quarter of its GDP consisting of the tourism sector, it is very sensitive to global shocks. With the COVID-19 pandemic escalating in 2020, the Maldivian economy is estimated to have contracted by 32% in 2020 while the tourist arrivals and bed-nights decreased drastically by 67% and 63% respectively last year, hitting an all-time low. Tourism is the single largest source of earning to the country, shocks to tourism impacts major taxes such as TGST and Green Tax. Global shocks will also have trickle-down effects into various sectors of the economy, exacerbating the impact on revenues.

Figure 1: Real GDP Growth

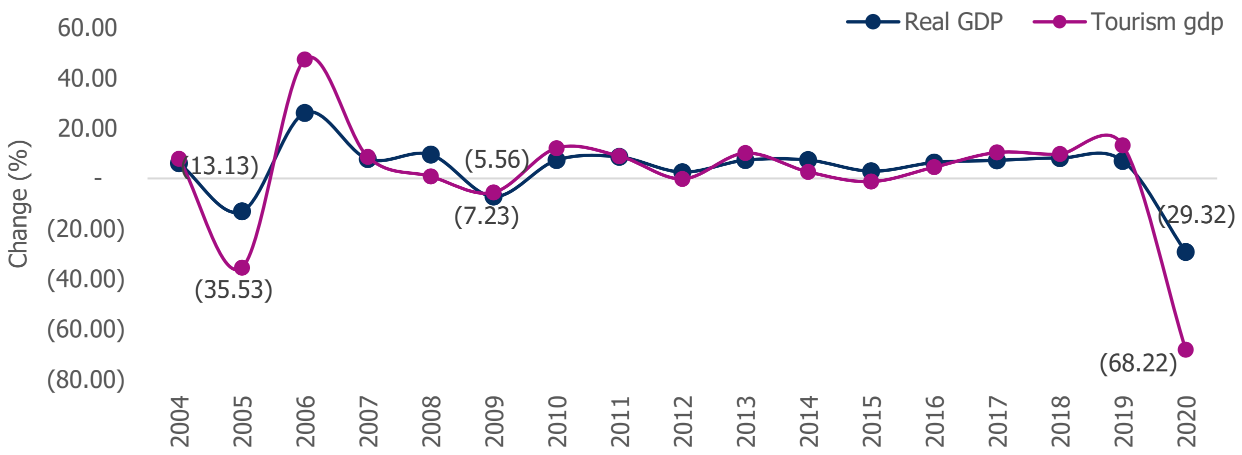
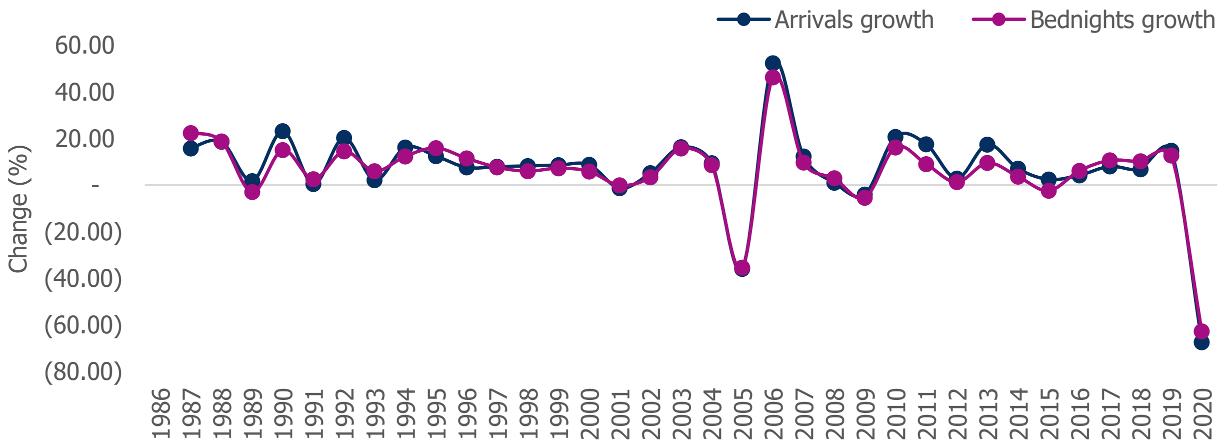


Figure 2 : Tourism Indicators



Even though the likelihood of this risk occurring is viewed as moderate to low, a slower recovery of the pandemic will have severe repercussions as experienced in the past during the 2004 Indian Ocean Tsunami and the Global Financial Crisis. The worsening of the pandemic may pose a huge risk to the number of tourist arrivals. The decline in tourist arrivals will impact revenue by directly reducing tourism-related revenues and indirectly impacting other revenues. Moreover, it will put pressure on the expenditure of the government in terms of income support and economic stimulus expenditure. Furthermore, the worsening of the pandemic will cause an increase in spending on the health sector by the government. Higher expenditure and shortage of revenue may ultimately force the government to borrow more, pushing up the debt-to-GDP ratio. The high debt-to-GDP ratio may in turn raise the risks of difficulties in accessing financing.

Over the years, demand for foreign currency has been on an increasing trend. A shortage of revenue especially foreign currency revenue will indirectly put pressure on the exchange rate, causing the domestic market rates in the parallel market to increase.

In order to mitigate the risk, the short-term solutions include controlling the community spread of Covid-19, speeding up the vaccination process and widening the coverage of vaccines in terms of the share of people vaccinated. In the long-term, the government is making an effort to diversify the economy so that tourism does not remain the single largest source of production and revenue in the economy. The 2021 Approved Budget contains investments in enhancing fish processing and value added capacity, commercialization of the agricultural sector, development of the Maldives International Container Port and in renewable energy.

2.2 Inflation risk

In the Maldives, the majority of the CPI basket consists of imported goods. This supports the argument that an increase in the global commodity prices may pose risks to the domestic economy. Considering that the highest weight in the consumption basket has been assigned to 'housing, water, electricity, gas and other fuels' and 'food and beverages including fish' with a weight of 23.42 and 21.97 respectively, changes in international crude oil prices and food prices would have some pass-through impact to the CPI.

Concurrently, an increase in the prices of imports may further add pressure to the exchange rate. With the main objective of the Maldives Monetary Authority (MMA) being price stability to maintain the exchange rate, the central bank will utilize its operating target to increase the foreign exchange intervention. At present, a large portion of the foreign currency leakages consists of payments to oil imports.

Inflation risk is an external risk that arises due to global increase in commodity prices. While the possibility of the risk is regarded as moderate, the occurrence of the said risk would impact the budget both on the revenue and expenditure side. Higher import prices would increase the revenues collected via an increased collection of import duties. Nevertheless, this would also pose an additional burden to the government concerning spending on subsidies to control the prices. The expenditure on electricity subsidies and fuel subsidies will increase as a consequence of higher fuel prices. In 2019, more than 60% of the price of staples (rice, sugar, flour) was covered by the government. Therefore, if there is an increase in commodity prices the burden on the government will increase on food subsidies as well.

Furthermore, in order to carry out the central banks' operating target smoothly, the government will consider ways to boost the reserve assets in the long run. In addition, the MMA and the government also plans to bring reforms to the foreign exchange market to address structural issues, which would also support exchange rate and price stability.

In addition, the government is currently making major investments in renewable resources which will substantially reduce the dependency on imports for oil thereby reducing the risk of exposure to changes in global fuel prices. While the government has little control over the global prices of tradable goods in the typical consumer spending basket, the government is proactively taking measures to reduce prices for non-tradable consumer services, such as internet and telecommunication, and housing. The recent reduction in internet prices negotiated with service providers will benefit the average consumer with lower communication spending. The government is also making investments in housing and increasing the supply of housing stocks, which will in the medium term reduce the price and rental pressures in the housing market.

2.3 Weak export prices risk

Export of services, particularly travel services is the main source of exports for Maldives. A fall in the export prices will lead to a huge fall in the revenue received. In theory, higher bed-nights and higher arrivals should yield higher revenue. However, in some instances, the country has seen that an increase in bed-nights or arrivals does not necessarily increase the revenue in the same proportion.

A proportionately lesser increase in revenue when compared to the bed-nights indicate that the bed-nights may be higher in low-end markets. Even though there is an increase in arrivals, if these arrivals are more towards the low-end markets where the average daily rate is lower, a low revenue risk will persist. Furthermore, if arrivals are more from markets where the average stay is shorter it will possibly push the revenue collection down. Nevertheless, post border reopening, there were high sales in high-end resorts with higher average daily rates. Therefore, the overall industry sales improved largely and the TGST recovery was much stronger. The change in the dynamics of the dominant market structure caused the average stay to increase, leading to a better revenue collection. It is uncertain as to when the dynamics may change again.

This risk may translate into the budget by possible overestimation in the revenue forecasts. As such, some of the forecasts for revenue are based on the forecast of bed-nights. Although the incidence of this risk is moderate to low, proper planning and changes in the policies will enable the mitigation of the risk in the event it persists in the future.

In order to reduce the risk of over estimating revenues due to weaker export prices, the government does consider potential discounting and prices reduction in forecasting conservative revenue estimates.

To improve tourism yield and improve prices, one of the main areas that the government contributes is through tourism promotion and marketing. Despite the ongoing pandemic the government budget has maintained allocations to the Maldives Marketing and Public Relation Corporation for tourism promotion at 2019 levels.

To improve the efficiency and yield of taxes government has also proposed amendments to Laws to charge Airport Service Charge and Airport Development Fee based on ticket classes of passengers.

2.4 Scenario Analysis 1: Fiscal impact of tourism shocks

Tourist arrivals and tourist bed-nights directly impacts the revenue outturn on tax revenues such as the Tourism Goods and Services Tax (TGST), Green Tax, Airport Service Charge, as well as non-tax revenues such as the Airport Development Fee. Furthermore, through the demand on imports created by the tourism sector, shifts in arrivals have been shown to impact imports and imports duty collections as well.

This scenario analysis looks at the revenue impact of a 20% shock above and below the tourist arrivals baseline of 1 million in the approved budget for 2021. It should be noted that this is a static analysis and does not look into the secondary impacts of a tourism arrivals shock on other indicators such as GDP and thus on revenue through these channels.

Table 1: Scenario analysis of tourism shock

	Baseline	**20% below baseline**	**20% above baseline**
Arrivals	1,000,000	800,000	1,200,000
Average Duration	7.5	7.5	7.5
Bed nights	6,000,000	7,500,000	9,000,000
	in million MVR		
TGST	2,640.2	1,932.6	2,840.8
Green Tax	616.56	445.2	656.0
Airport Service Charge	531.1	427.0	635.2
Airport Development Fee	529.2	425.5	633
Import Duties	2,985.3	2,585.2	3,385.3
Total	**7,302.2**	**5,815.4**	**8,150.30**
Revenue	21,128.5	19,641.7	21,976
Expenditure	33,431.5	33,431.5	33,431.5
Overall Balance	(12,303.0)	(13,789.8)	(11,455.1)

3 Revenue Risks

Historically, revenue shocks to the budget have been significant, and the difference between the projected revenues and actual revenues has been consistently positive.

Revenues are particularly correlated with macroeconomic conditions; hence negative macroeconomic shocks adversely impact revenues. The macroeconomic shock to revenue is analyzed in Section 2.

With regards to specific revenue risks three factors are identified here that affects revenues: (i) the non-realization of new revenue measures, (ii) deferment or changes to non-tax revenue policies, and (iii) non-compliance of tax and non-tax revenues.

3.1 Non-realization of new revenue measures

Figure 3 compares the budgeted revenue with the actual revenue. Figure 4 shows the new revenue measures (NRM) budgeted over the recent years and its share in total revenue. As seen in Figure 3 and Figure 4, in 2015 and 2016 when substantial NRMs was budgeted the non-realization of these NRMs led to a shortfall in revenue of around 20%. The value of NRMs proposed in the 2021 budget is similar in value and magnitude to these two years.

Figure 3: Budgeted vs Actual Revenue

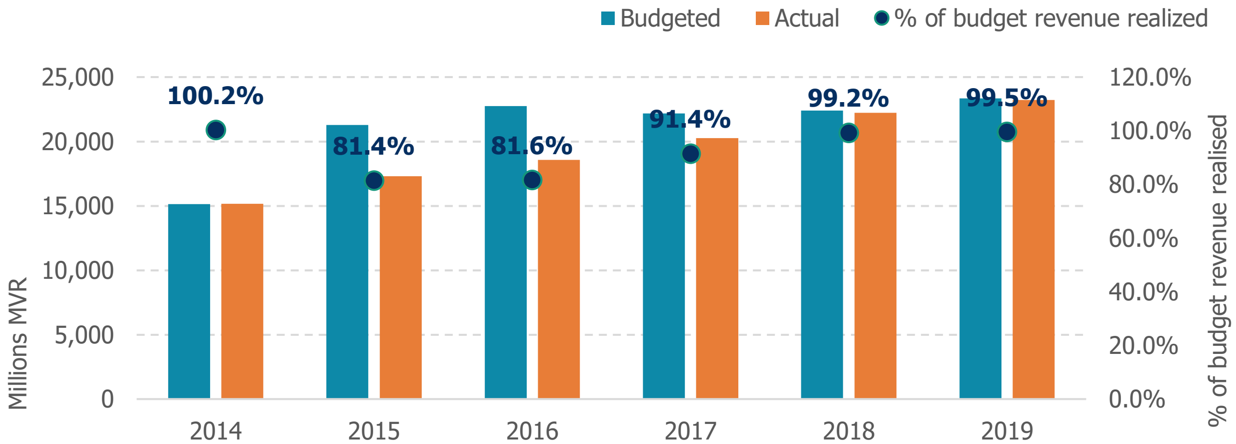
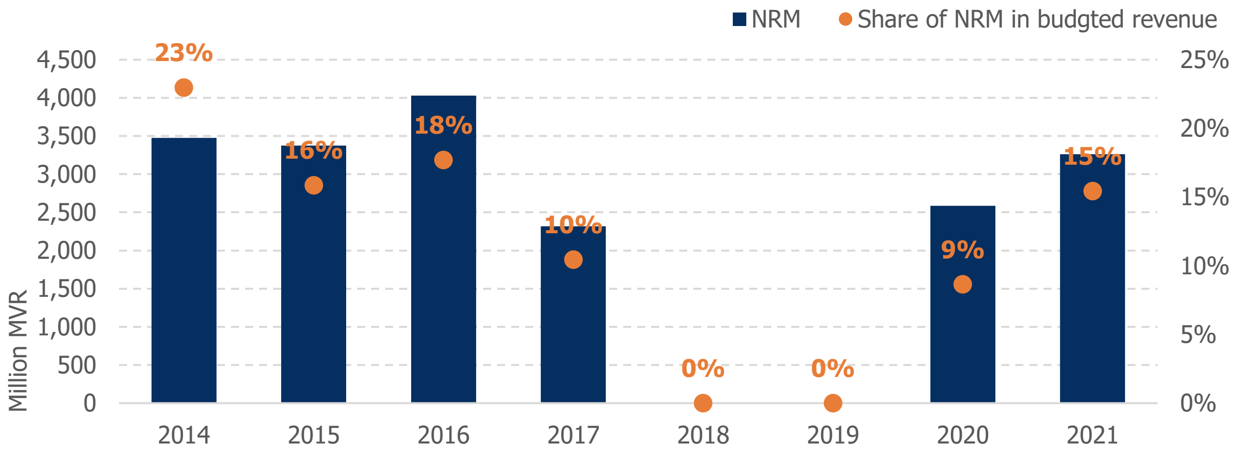


Figure 4: Proportion of New Revenue Measures in approved revenue



In 2020, many of the proposed NRMs could not be implemented due to the COVID-19 pandemic. Only the income tax and changes to import duties and other customs fees were implemented. Therefore, the remaining NRMs that were postponed to 2021 have been included in the revenue forecasts for budget 2021. The proceeds from all NRMs included in the approved budget for 2021 are expected to generate MVR 3,263.4 million.

Considering the current status and efforts it is likely that a significant portion of the NRMs propose for 2021 will not be realized, as such to mitigate these risks, the government continues to engage with implementing agencies to expedite the implementation of the NRMs and address any obstacles.

In the medium term to mitigate the risk of non-realization of NRMs, measures must be taken to ensure the timeliness and ability to implement the proposed NRMs for the year. In this regard, the following steps are being taken:

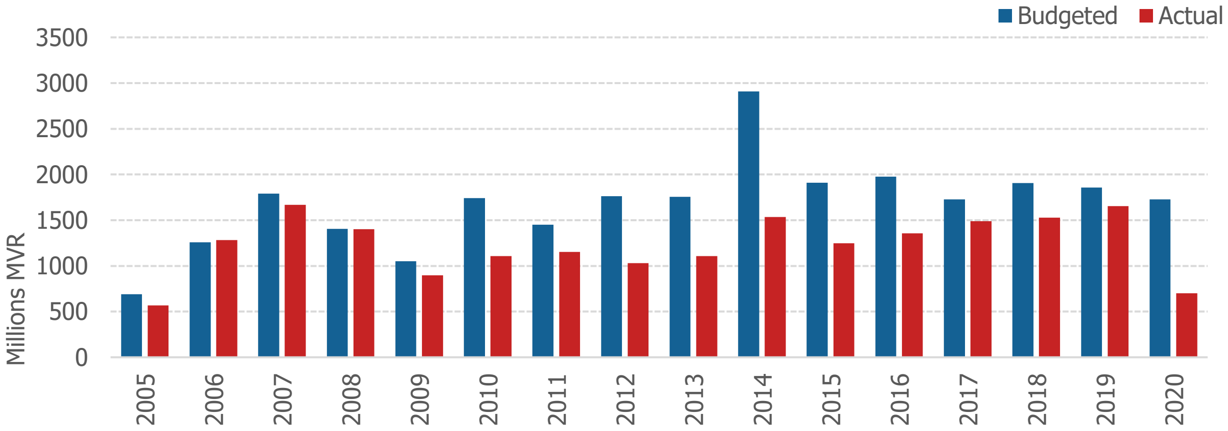
- **Obtain proposals for new revenue measures from relevant implementing agencies.** The proposals for new revenue measures generally come from the Ministry of Finance and the People's Majlis. The involvement of relevant implementing agencies in the process is currently lacking. To address this an institutional arrangement has introduced a new mechanism where annual proposals for NRMs are put forth early in the year by implementing agencies and are evaluated by Ministry. This has been introduced for the first time in the Budget Call Circular 1 for the 2022 budget. This would assist in gauging the capacity and willingness of the relevant agencies in implementing the proposed NRMs for the year.

- **Inclusion of identified and agreed new revenue measures with the medium-term fiscal strategy**. NRMs were included in the Medium-term Fiscal Strategy 2021-23. As the Medium-term Fiscal Strategy is prepared before the annual budget, the inclusion of NRMs in the Strategy ensures that NRMs are identified and discussed among policymakers well before the preparation of the Budget. Hence, it offers time for the relevant implementing agencies to plan and take necessary actions to implement the measure in the following year. Since the Fiscal Strategy is submitted to the People's Majlis, the inclusion of NRMs also gives a forward indication to lawmakers of government revenue policy as well. There is currently a mismatch between the NRMs in the agreed Fiscal Strategy and Proposed Budget. Over time as the budget process is improved and streamlines these mismatch between the Fiscal Strategy and Budget are likely to be resolved.

3.2 Deferment of non-tax revenues: Tourism land rent

Tourism land rent is the largest source of non-tax revenue, making up 8-9% of the total projected revenues for the government in the past 5 years. It has regularly been subject to negative shocks in the past and is likely to be subject to negative shocks in the future as well. In the past, the main reasons for the under-realization of budgeted tourism land rent revenues were due to changes in government policies and changes in legislation and non-compliance.

Figure 5: Budgeted and Actual Tourism Land Rent



In 2020, 59% of the projected revenues for resort rent were not realized, which accounted for 3.4% of the total projected revenues for the year. This was due to the government's decision to defer resort land rents following the negative impact of COVID-19 on the tourism sector. In a normal year, however, resorts under construction can request to extend the construction period (in which they are not required to pay rent) paying a construction period extension fee. Hence the risk normally arises from delays in construction of resorts and non-compliance.

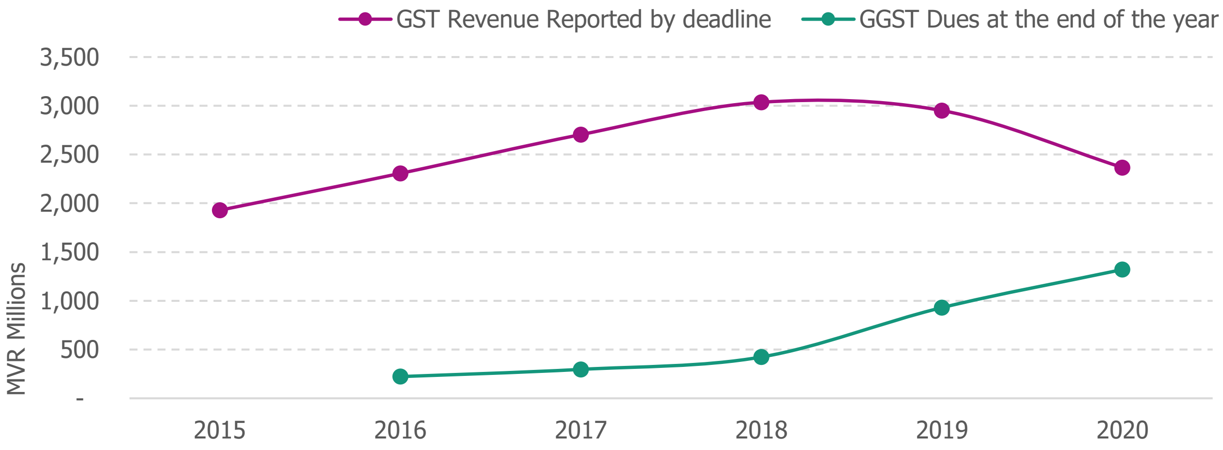
Non-compliance by resorts also poses a risk to the realization of revenue from resort rents. A significant portion of government non-tax revenues is being collected and enforced by MIRA. Lease rent payments are made under lease agreements made between line ministries and private parties. The responsibility for the implementation of said agreements lies with the contracting ministries, while the collection of rent and other fees is carried out by MIRA.

In 2021, the risk of undershooting the budgeted target for resort rent revenues is regarded as low. The measures that are being taken to mitigate this include, implementation of policies by the Tourism Ministry that incentivize resorts to reduce construction period by making deferrals and exemptions conditional on the early opening of the resort. Furthermore, support provided to resorts through COVID-19 Relief Loans and the Economic Stimulus Loans, as well as the relatively strong rebound in tourist arrivals has further improved the financial circumstance of the resorts. The risks related to non-compliance will also be mitigated by improving coordination between line ministries and strengthening collection and enforcement procedures for non-tax revenues.

3.3 Increased Non-Compliance of Taxpayers

The leniencies granted in the government's efforts to promote ease of doing business and voluntary compliance, in addition to the shock of COVID-19, have increased non-compliance in recent years.

Figure 6: GST collection, reported GST and arrears at end of the year



Non-compliance increased from 14% in 2018 to 32% in 2019. It is important to note that while a 10% provision for non-payment is included in the forecast of general GST revenues in 2019, the actual non-compliance was higher. In 2020, to cater for the adverse impact on taxpayers' cash flow due to COVID-19, additional leniencies were granted resulting in accumulated arrears increasing to MVR 1.3 billion.

The following measures are being undertaken to mitigate this risk.

- **Increasing taxpayer facilitation**. Steps have been taken by the MIRA to further enhance taxpayer facilitation. In this regard, increased activities relating to taxpayer education and awareness and targeted compliance improvement programs have been planned. Furthermore, additional mediums to ease taxpayers' to fulfilling obligations such as online filing and payment mechanisms have been planned to be implemented. Furthermore, increasing compliance monitoring activities to encourage taxpayers to correct issues before they become a sustained problem will improve compliance in the future.

- **Carrying out a taxpayer perception survey.** The government is planning to carry out its first taxpayer perception survey in 2021. The survey is expected to increase the involvement of the public in formulating and refining government policies, as well as encourage compliance and help the tax administrator in improving its performance relating to interactions with taxpayers.

- **Strengthening enforcement policies.** The government will undertake a review of the current enforcement policies and evaluate their effectiveness and ensure that policies strike a good balance between voluntary and enforced compliance.

3.4 Scenario Analysis 2: Fiscal Impact of revenue shortfall

From the revenue risk highlighted, this section will evaluate the fiscal risks of the non-realization of New Revenue Measures (NRM). To estimate the magnitude of the non-realization of NRM we look at the realization of NRM in the recent past.

The analysis below looks at two scenarios, the non-realization of all NRMs, and a scenario where half of the NRMs is realized.

Table 2: Scenario Analysis of NRM

In million MVR	Baseline	Non-realization of all of NRM	Non-realization of half of NRM
NRM	3,263.4	0	1,631.7
Other Revenue	17,865.1	17,865.1	17,865.1
Total Revenue	**21,128.5**	**17,865.10**	**19,496.80**
Total Expenditure	**33,431.5**	**33,431.5**	**33,431.5**
Overall Balance	**(12,303.0)**	**(15,566.4)**	**(13,934.7)**

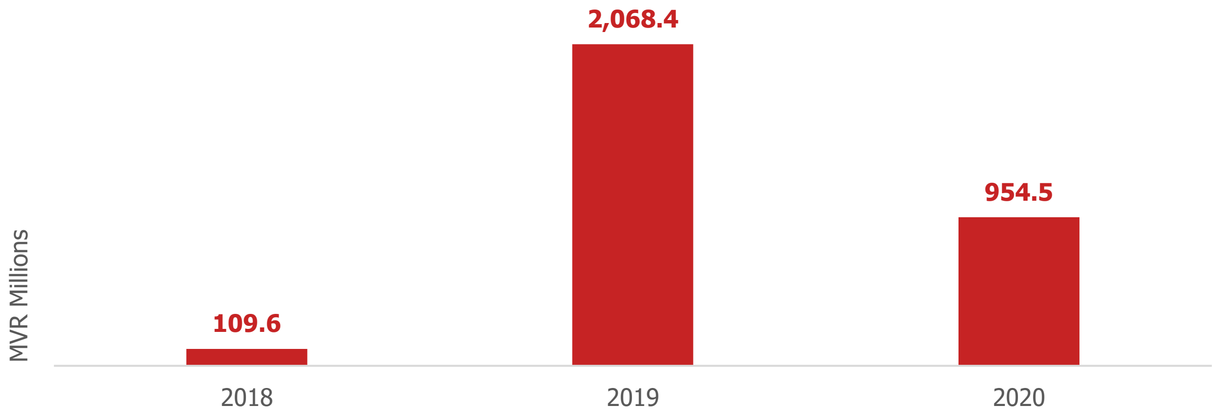
4 Expenditure Risks

With regards to specific expenditure risks three factors are identified here that affects expenditure: (i) pending bills, (ii) changes to legislations and policies, and (iii) losses and write-offs due to litigations.

4.1 Pending Bills

The issue of pending bills is a recurrent issue in budget implementation. This is mainly because some government agencies commit expenditure beyond the approved ceiling, creating unrecorded bills. The need to pay such pending bills from past budget years creates pressures on cash flows, and hinders the implementation of the budget in a given year. It also creates unplanned additional expenditures that ultimately contribute to the widening of the fiscal deficit.

Figure 7: Pending bills at the end of year



These risks will be minimized by the proper recording and implementation of the budget at the agency level as per the public finance laws. On the recording side one of the mitigation measures that has been taken in recent years has been to roll out the "Material Management Module" in the SAP (public accounting system). With the Module in place government agencies are required to raise purchase orders to raise a commitment, based on which expenditure can be planned more carefully. Furthermore, the Ministry continues to strengthen public finance regulations and institutions to make government agencies and responsible staff more accountable in budget implementation.

4.2 Changes to legislation and policies

Changes in existing policies and legislations, or the introduction of new policies and legislations during the fiscal year can lead to unintended changes in the government expenditures that affect the budget implementation. Such changes are enacted for the betterment of the society, but often exerts additional, unplanned expenditures.

Legislation related risks: In the recent past, new legislations have led to the creation of new bodies and changes to mandates of existing institutions. These specialized bodies usually need additional resources (e.g. office space, new personnel) to carry out their responsibilities. Since legislations require entities to be fully functioning within a specific duration, usually within 3 months after it is gazetted, these expenses need to be catered for within the on-going year.

Policy related risks: Policy changes becomes a risk when high-priority programs or projects are under budgeted or over budgeted. When they are under budgeted, resources from other programs or projects are affected. When they are over budgeted, resources get tied up which could have otherwise been spent elsewhere. The most major risks are related to PSIP projects. Once the budget is passed by the People's Majlis, such projects are not removed even if they no longer are priority projects due to a change of policy. Furthermore, policy changes that arise after the finalization of the budget also pose fiscal risks. One such risk in 2020 was the increase in expenditure as a result of the welfare policies to provide discounts on electricity and water bills for households. These discounts were provided to households as a welfare payment of COVID-19 pandemic. Unplanned policies are likely to arise from time to time in response to specific issues.

To mitigate legislation related risks before they occur, a better coordination has been established with the Attorney General's Office, for Ministry of Finance to be informed on bills being drafted to identify and ascertain the additional expenditure as well as savings that could be created if a proposed bill becomes effective during the year. Hence Ministry of Finance is now in a position to comment on bills at drafting stage, before they are submitted to the People's Majlis. This process is progressively being strengthened.

To mitigate risks related to policy changes, Ministry of Finance will be monitoring on-going projects at least quarterly and build in-house models to estimate expenditure for policy related programs to ensure sufficient budget allocation are made.

In cases new budget allocations need to be made to new institutions or existing institutions with broader mandates, Ministry of Finance collaborates with the heads of the these institutions to estimate a reasonable budget to support the operations for the ongoing year.

Furthermore, additional expenditures are financed through the budget contingency as well as expenditure re-allocations. Ministry of Finance also monitors the implementation of the budget and performance in making revised budget estimates for the ongoing year.

Table 3: Fiscal costs of changes in policy and new institutions

	2018	2019	2020
New institutions or mandate change			MVR 7.2 million
Change in policy	MVR 231.7 million	MVR 287.5 million	

4.3 Litigations resulting in losses above budgeted amount

The fiscal impacts of litigations between the government and its contractors (mostly private parties) are felt most profoundly on the expenditure side as losses and write-offs. This risk gets transmitted through the court systems where the disputes are ruled on and compensations are awarded. These disputes increase the likelihood of using contingency budget, supplementary budget or the consolidated revenue fund, to pay for compensations by the state to the contractors.

Table 4 below shows approved versus actual spending on losses and write-offs in recent years. The fiscal impact of such cases vary across years and substantial hikes were observed after election years: 2013 and 2018. In 2019, these expenditures greatly exceeded the budgeted amount, becoming a major driver of the widening of the fiscal deficit that year.

Table 4: Losses and Write-offs (Budgeted vs Actuals)

	Approved	Actuals	Revised
2013*	-	45,549,070	
2014	-	375,130,461	
2015	214,387,127	52,760,735	
2016	105,764,984	77,632,578	
2017	51,650,000	43,684,989	
2018*	56,313,072	123,988,329	
2019	50,350,000	1,490,269,999	
2020	-	103,099,109	93,929,042
2021	100,200,000	-	

** Election years*

It is challenging to ascertain the timing of such payments, as a party can decide at any point during the fiscal year to file for litigations against losses and damages, and as court cases tend to go through a lengthy process of litigations and appeals. These cases can range from several months to several years.

Disputes generally arise from poor project planning, in that the scope, scale, timing and the quality of the service or product delivered are not well understood between parties. Weak and non-standardized contracts also exacerbate risks. Additionally, shortcomings in contract implementation, monitoring and enforcements also contributes to this risk. As noted above, contracts awarded to private parties often become litigious after a change in administration.

To mitigate the risk in the short run, to improve the budget forecasting for losses and write offs the Ministry of Finance is gathering information to conduct an analysis into the ongoing litigations to better estimate potential future expenditures on losses and write offs.

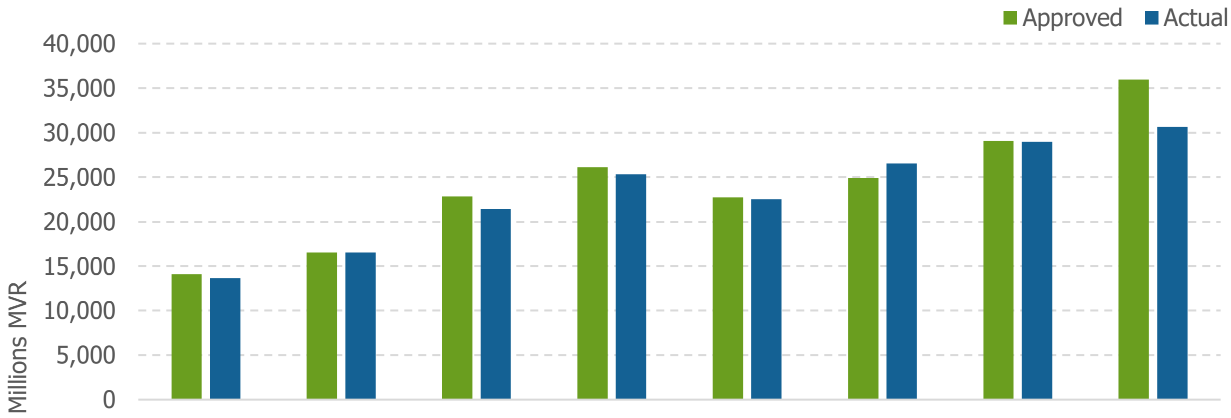
The Ministry of Finance also has plans to proactively monitor contract implementation, to reduce the probability of disputes or contract cancellation, and to ensure that contracts are cancelled with a strong legal basis for cancellation

In the long-term improvement in the planning process of projects (such as determination of the needs, scope, scale, deadlines for delivery and standards of quality) will reduce the likelihood of disputes.

4.4 Scenario Analysis 3: Fiscal Impact of expenditure shock

In the recent past the government has managed expenditure shocks, through the budget contingency, reallocations, expenditure cuts and controls and budget supplements. Figure 8 below shows the approved and actual expenditure in recent years.

Figure 8: Approved and actual expenditures



In recent years the budget has been supplemented on two occasions: in 2017 with a supplement of 2% of the approved expenditure and in 2019 with a 6% of the approved expenditure. The actual expenditure exceeded the approved budget in in 2018, at 7% over the approved expenditure

Based on recent history, for this simulation we simulate budget supplements of 6% of expenditure and 2% of expenditure in 2021, with the assumption of additional expenditure funding through debt.

Table 5 : Expenditure Scenario Analysis

in million MVR	Baseline	2% supplement	6% supplement
Total Revenue	21,128.5	21,128.5	21,128.5
Total Expenditure	33,431.5	34,100.1	35,437.5
Overall Balance	(12,303.0)	(12,971.6)	(14,309.0)

5 Major projects

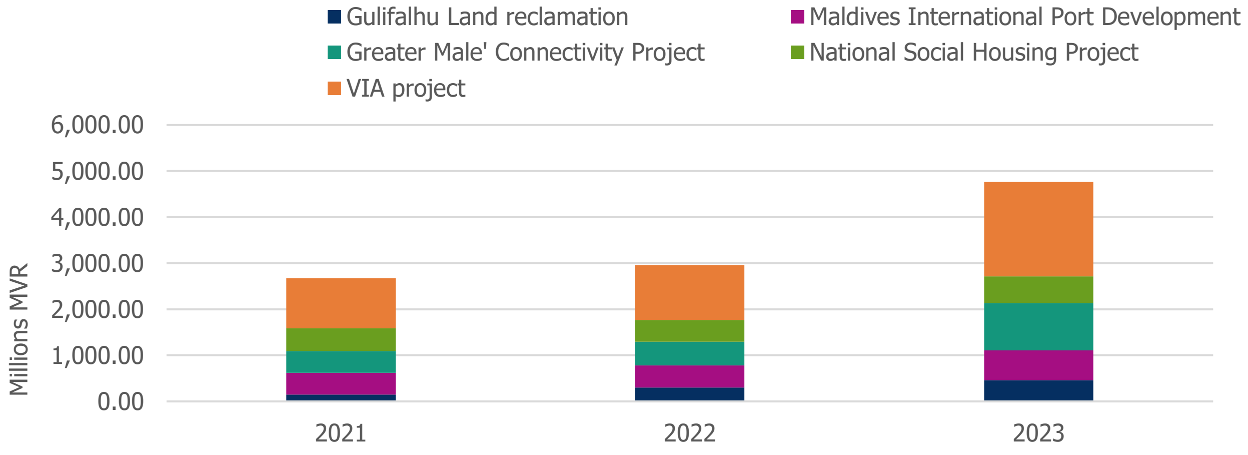
In recent years, substantial budget allocations have been made for the Public Sector Investment Program (PSIP). The bulk of the budget goes to "megaprojects", i.e., multi-year infrastructure development projects of significant size and investment value. The size of these investments and the substantial budget allocations naturally imposes fiscal risks across various dimensions, with delays in the implementation and over-optimism on the speed of project delivery being the primary sources of risk.

Table 6 below presents the PSIP budget for the medium term (2021-2023). Over this period the PSIP accounts for between 24-32% of the total budget. Of these, five projects, highlighted in Figure 9, collectively account for between 22-36% of the yearly PSIP budget.

Table 6: PSIP budget for the medium term

	Total Budget (MVR)	PSIP Budget (MVR)	Budget for mega projects (MVR)	PSIP share of total budget	Mega projects share of PSIP budget
2021	34,922,716,599	8,441,502,879	2,179,405,083	24%	32%
2022	44,977,923,779	13,559,432,445	2,481,676,789	30%	22%
2023	40,846,113,018	13,076,370,609	4,194,639,378	32%	36%

Figure 9: approved budget for mega projects in 2021-2023 budget



5.1 Sources of risks related to mega projects

One main source of risk with regards to mega projects is the optimism regarding the pace of project execution. In recent years, the realized value of PSIP has come in substantially below the budget forecasts, as seen in Figure 10. The realized share of the PSIP budget range between 49% to 96% over the period.

Another related source of risk is delays in project implementation. PSIP projects, including mega projects can get delayed for a variety of reasons, including supply chain issues, contractor issues, environmental issue or delays in contingent projects. Figure 11 below looks at the proposed budget allocations for the Velana International Airport (VIA) terminal development project in all the approved budgets from 2016 to 2021 budgets. The project, which was initially proposed with a completion date of 2020, is now expected to have disbursements into 2023.

Figure 10: PSIP budgeted vs. actual

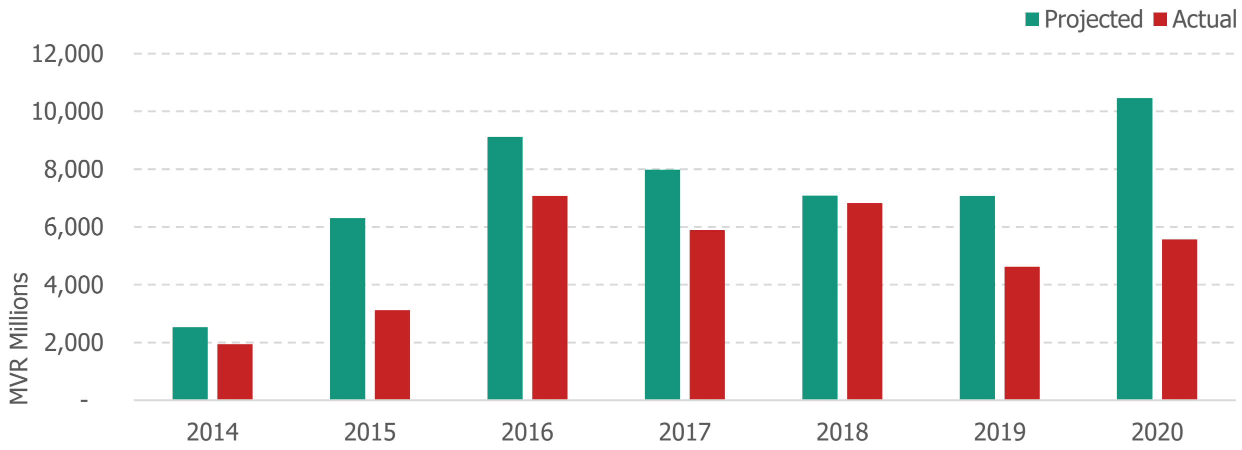
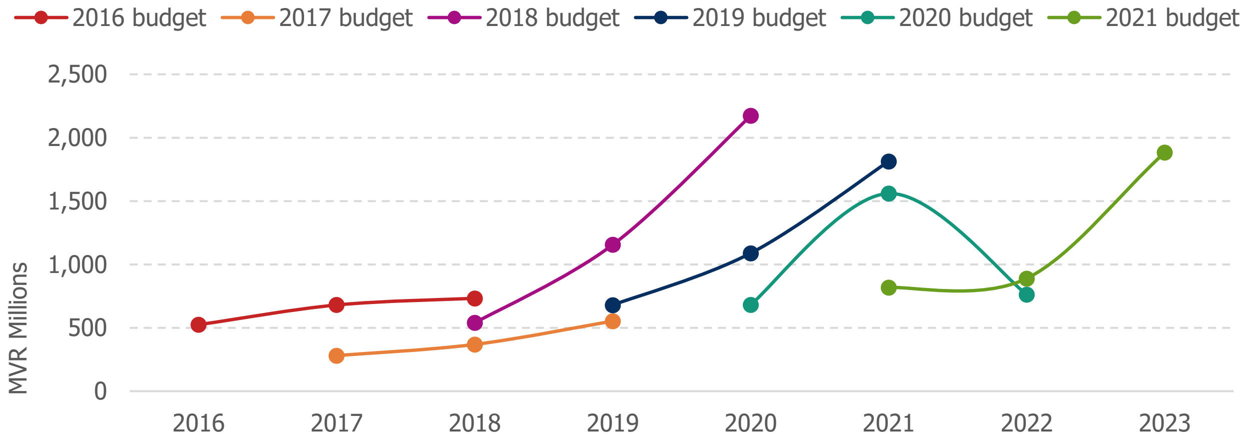


Figure 11: Delays in VIA terminal project



5.2 Impact on the budget

The impact of the realization of these risks on the budget could also be multifaceted. These include:

- **Expenditure:** Mega-projects take substantial budget space, thereby reducing space for other expenses, including infrastructure projects, welfare programs and social programs that are potentially high yielding. Hence opportunity cost of delays or over-estimation of expenditure on mega-projects is substantially high. Furthermore, delays in the implementation of investment projects increase exposure to shifts in global commodity prices and potential cost overruns.

- **Borrowing and Debt:** As most of the mega-projects are debt funded, delays in project completion would lead to a slower disbursement of the debt. This can have an unintended consequence of smoothing out the debt profile. However, the reliance on debt financing for mega projects especially has elevated the public debt risk in recent years.
- **Revenue and Grants:** Similar to debt, slow project implementation would delay disbursement on grant-funded elements of a project. In the medium term delays in project completion can also lead to delays in the realization of revenue from the asset being created.

5.3 Risk Mitigation

The risks related to project delays and overestimation of costs can be addressed through improved public investment formulation and management. The latest Public Investment Management Assessment (PIMA) for Maldives, conducted by the IMF in 2016 highlights the areas of weaknesses in the public sector investment management institutions and recommendations for improving the intuitions. The findings and recommendation of the PIMA, as well as other assessments such as the recently completed Public Expenditure and Financial Accountability (PEFA) will be incorporated in to the formulation of the PFM reform agenda for Maldives currently being compiled.

Recent PFM reforms to strengthen Public Investment Management include the reforms to capital budgeting with the screening of New Policy Initiatives, including infrastructure projects. With the support of the USAID the Ministry is also seeking to further improve project appraisal and project pipeline development.

Within the existing public investment framework, the risk of over-estimation is addressed in the budget formulation process, by revising down the project disbursal estimates based on historical precedence. This could, however, lead to potential under budgeting if the projects progress faster than expected. However, if this materializes, a supplementary budget can be introduced during the fiscal year.

Finally, what is clearly evident is that many of the recent and ongoing mega projects are financed through debt. While there are risks associated with debt financed infrastructure development, this is in itself a risk mitigation measure, because when large projects are financed, it ensures that project does not dry-up during the implementation phase. Furthermore external financing of large projects, are also necessary to mitigate foreign exchange pressures that could otherwise arise from implementing such large projects.

The government also continues to consider and develop institutions to bring in alternative financing arrangements, including forms of Public Private Partnerships (PPP) to address the infrastructure gaps. USAID PFM project is currently supporting the government in establishing a PPP framework.

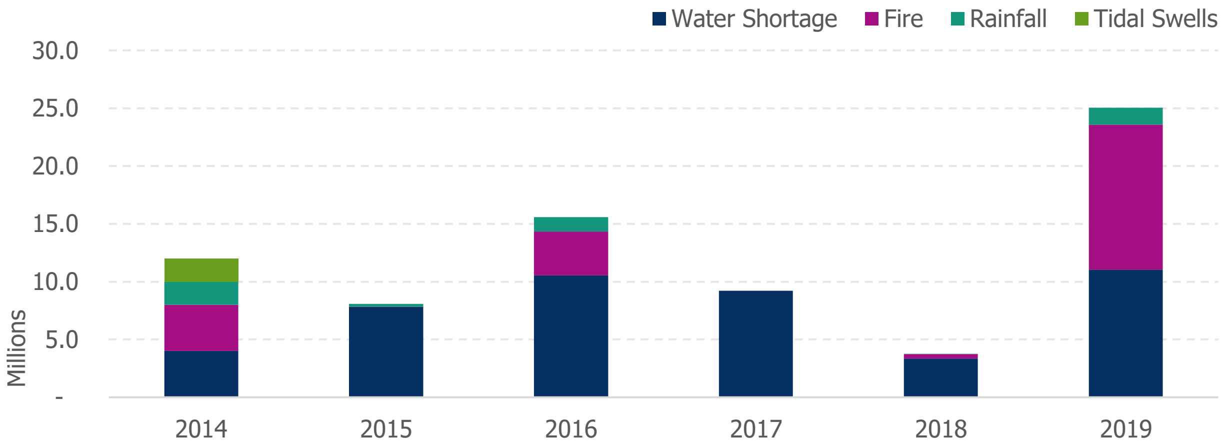
6 Natural Disasters and Emergencies Risk

The Maldives is highly vulnerable to natural disasters such as tsunamis, droughts, freshwater contamination, tidal swells, heavy rainfall, coastal erosion, as well as pandemics[1.] Among human-induced hazards, fire and oil spills are noteworthy risks[2]. Historically these disasters have had either a significant impact on the economy or translated into budgetary shocks following a government response. Major disasters such as the Indian Ocean Tsunami of 2004 and the current COVID-19 pandemic deteriorated the annual overall fiscal balance by 562 % in 2005 and by 177% in 2020, respectively. In recent years, expenditure on disasters indicates water shortages and fires as the most frequently occurring and costly disasters (Figure 12).

[1] https://www.preventionweb.net/files/68254_682304maldivesdrmstatusreport.pdf

[2] The former is the most frequently occurring hazard and the latter risk has not materialized to date.

Figure 12: Expenditure on Disaster between 2014 and 2019



Source: National Disaster Management Authority (NDMA), Ministry of Environment (MoE)

The variance between the budgeted figures and the actual expenditures illustrates a significant fiscal risk of underestimating the fiscal impact of these hazards (Table 7).

Table 7: Comparison of Budget and Total Expenditure in Indemnities & Relief Against Natural Calamities

	2014	2015	2016	2017	2018	2019
Budget	**52,200.0**	**2,068,700.0**	**6,326,069.0**	**17,203,929.0**	**11,500,000.0**	**11,038,700.0**
Total Expenditure	**5,883,266.1**	**9,153,693.6**	**15,114,222.7**	**9,899,582.3**	**5,744,086.4**	**14,227,942.1**
NDMA	5,847,791.1	9,111,768.6	12,366,332.7	651,995.6	2,359,877.1	3,106,297.4
Ministry of Environment	-	-	89,040.0	9,208,886.7	3,345,509.2	11,043,280.7
Special Budget	-	-	2,620,150.0	-	-	-
Other	**35,475.0**	**41,925.0**	**38,700.0**	**38,700.0**	**38,700.0**	**78,364.0**
Variance	**(5,831,066.1)**	**(7,084,993.6)**	**(8,788,153.7)**	**7,304,346.7**	**5,755,913.7**	**(3,189,242.1)**

Note: The budget for 2017 and 2018 increased as the Ministry of Environment began accounting for water scarcity relief.

6.1 Fire risk

Fires, especially in residential areas in Male', are a source of fiscal risk in the medium-term. In 2019, the government strengthened the regulation on storing chemicals (e.g., banning chemical storage in residential areas) and commenced the relocation of hazardous chemicals to Thilafushi. The Building Code gazette in 2019 also included functional requirements related to fire hazards in buildings[3]. Despite these developments, the risk persists due to a lack of capacity in conducting inspections and enforcing these regulations. Moreover, with the resident population in Greater Male' Region projected to grow by approximately 20%[4] in the next decade, the number of potential victims in need of relief can be expected to be relatively higher than before.

6.2 Water Shortage Risk

Shortage of fresh water is a recurring hazard in outer islands due to droughts and saltwater intrusion into groundwater. In these events, the demand for bottled and desalinated water is met by the government's emergency water distribution initiatives. Between 2012 and 2016, expenditure on emergency water distribution accounted for 57% (MVR 28.5 million) of all expenditures on disasters by the NDMA.

Allocating resources to guarantee the provision of water in all islands is challenging due to key uncertainties, e.g. changes in weather patterns due to climate change and fuel price volatility.

6.3 Mitigation Policies and Measures

The National Disaster Management Authority (NDMA) is mandated to formulate strategies focused on disaster mitigation, preparedness, and emergency relief and response. With the continued work under this mandate, the fiscal risk borne by disasters and emergencies may be reduced.

[3] https://www.gazette.gov.mv/gazette/download/5510

[4] http://statisticsmaldives.gov.mv/nbs/wp-content/uploads/2018/07/Maldives-Population-Projections-2014-2054.pdf

Additionally, there are other measures in place to alleviate pressures from the budget in case of a disaster. This includes drawing from the National Disaster Fund and the contingency budget.

To minimize the damage from fires, the Maldives National Defense Force (MNDF)'s Fire and Rescue Services have increased firefighting capacity with additional vehicles and equipment, and the installation of fire hydrants in Male' City. Between the end of 2019 and early 2020, MNDF undertook large-scale monitoring and inspection of chemical storage facilities in Male' City. To ensure frequent monitoring of chemicals in warehouses, permits for chemical storage are only valid for one year. An inspection is required to renew the permit for another year.

In addition to measures that mitigate the risk of occurrence of fire incidents, fiscal risks can also be reduced through further risk sharing with the private sector. In 2016 NDMA in collaboration with the Bank of Maldives introduced the Disaster Relief Loan scheme, a low interest long maturity loan scheme to support those affected by disasters. Additionally there are insurance products available in the market to protect homes and businesses and other natural disasters.

Significant progress has been made in tackling water scarcity. To eliminate this risk, there are rainwater harvesting projects undertaken in the recent years. These projects store rainwater and dispense from various areas of the island. Multiple infrastructure projects are also currently underway to deliver on the pledge of the current administration to provide water and sanitation facilities to all islands in Maldives by 2023.

7 Public Debt

7.1 Size and composition of Public and Publicly Guaranteed Debt

The Government's debt position, although sustainable, remains vulnerable to significant risks in the medium term. Total public debt rose steadily from 78 percent of GDP (MVR 67,957 million) in 2019 to 149 percent of GDP (MVR 86,544 million) by the end of 2020. This increment was mainly due to additional borrowings incurred as a result of the massive shortfall in government revenues due to negative impact of COVID-19 pandemic. Additionally, the downward revision of nominal GDP given the massive economic contraction is also attributable to the significant deterioration in Debt to GDP levels. Total domestic debt stood at MVR 42,511 million or (49.1 percent of GDP), at the end of December 2020. This is an increase of MVR 9,304 million when compared to total domestic debt outstanding at the end of December 2019. This was mainly driven by the increment in direct domestic borrowings by the central government, including the issuance of a USD 250 million bond to the State Bank of India, Male' Branch.

Total external debt stock at the end of 2020 stood at MVR 44,033 million (76 percent of GDP), an increase of MVR 9,283 million when compared to December 2019. In terms of composition of external debt as of December 2020, buyer's credit comprised of 28 percent, multilateral loans constituted 25 percent, bilateral loans constituted of 21 percent and commercial facilities made up the remaining 15 percent.

Table 8: Size and Composition of Public and Publicly Guaranteed Debt (PPG)

	2018	2019	2020
Total Outstanding Debt (MVR millions)	**60,260**	**67,957**	**86,544**
External Debt	20,548	22,021	24,921
Domestic Debt	27,665	32,227	41,628
Publicly Guaranteed External Debt	10,347	12,728	19,112
Publicly Guaranteed Domestic Debt	1700	980	883
Public Debt as a % of GDP	**73%**	**78%**	**149%**
External Debt as a % of GDP	25%	25%	43%
Domestic Debt as a % of GDP	34%	37%	72%
Publicly Guaranteed External Debt as a % of GDP	13%	15%	33%
Publicly Guaranteed Domestic Debt as a% of GDP	2%	1%	2%
Debt Maturing in One Year	**23,885**	**25,231**	**35,435**
Domestic Debt	16,462	19,944.55	25,409
External Debt	939	822	1,459
Guaranteed Debt	6,484	4,465	8,567

7.2 Risks in Debt Portfolio

In terms of risk assessment, the exposure of the current debt portfolio to refinancing risk[5], interest rate risk[6] and exchange rate risk[7] were measured. These key parameters assist the Government in adopting strategies that will provide optimal combination of lowest possible cost and risk.

Table 9: PPG Debt Risk Indicators

	2018	2019	2020
Total Debt to GDP	73%	78%	149%
BCG Debt to GDP	59%	63%	115%
Guaranteed Debt to GDP	15%	16%	34%
Refinancing Risk			
Debt maturing in One Year (% of total)	40%	37%	41%
Debt maturing in 1yr (% of GDP)	19%	25%	59%
ATM External Portfolio (years)	7	7	8
ATM Domestic Portfolio (years)	9	8	7
ATM Total Portfolio (years)	8	8	8
Interest Rate Risk			
ATR (years)	8	7	7
Debt re-fixing in 1yr (% of total)	34%	35%	41%
Fixed rate debt (% of total)	79%	81%	79%
Weighted Average Interest Rate (%)	4%	4%	3%
Exchange Risk			
FX debt as % of total	44%	56%	60%
ST FX debt as % of Gross International Reserve	55%	43%	63%

[5] Risk refers to the uncertainty that debt may have to be rolled over at an unusually high interest cost or cannot be rolled over at all.

[6] Risk of increase in debt servicing cost due to unfavorable changes in the interest rates.

[7] Risk of increasing debt outstanding and servicing cost due to fluctuations in exchange rate.

7.2.1 Refinancing Risk

As depicted from the chart below, the redemption profile of the Government indicates that a large portion of the total debt portfolio equivalent to 41 percent will mature in 2021. It is worth noting that a significant portion of this debt (72 percent) maturing in the next 12 months are treasury bills issued in the domestic market.

However, with the exception of spike in redemption payments in 2026, the maturity profile is relatively smooth. This is also evident from the Average Time to Maturity (ATM) of the government's debt portfolio. As such, ATM for total PPG debt and external portfolio has sustained around 8.1 years in the past three years.

Figure 13: Maturity profile of PPG debt as at end of April 2021

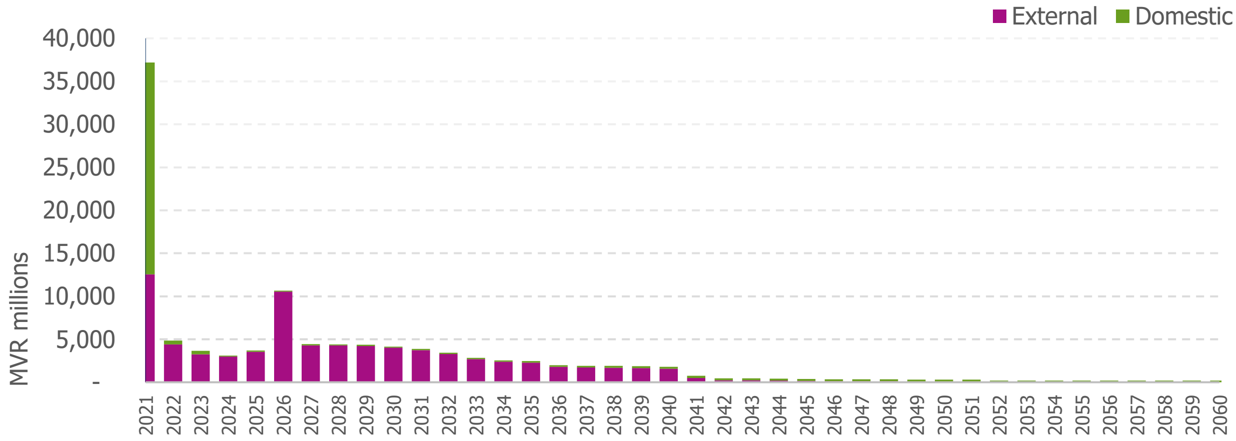
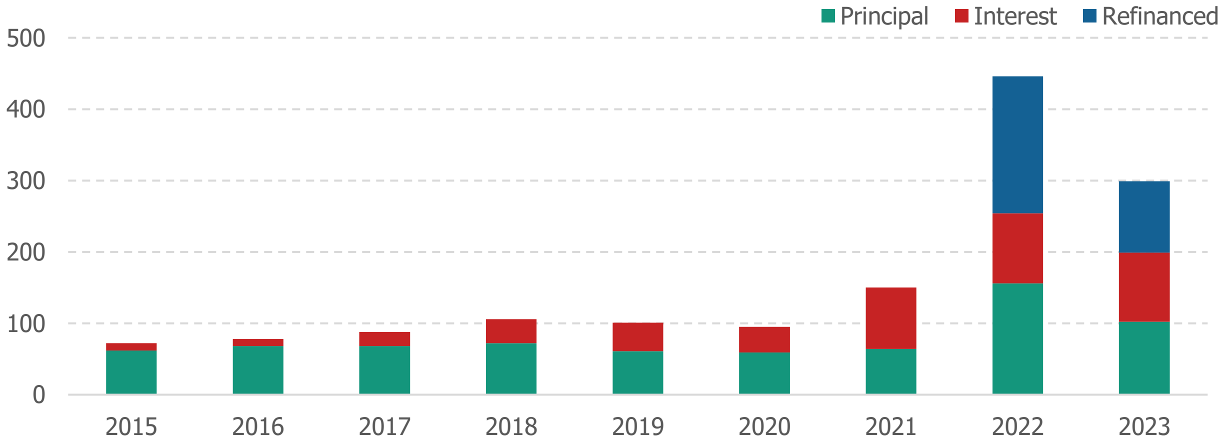


Figure 14: External Debt Repayment History and Profile (2015-2022)



Key Measures to mitigate Refinancing risks;

One of the major risks in the debt portfolio which accounted to refinancing risk was the $250m Eurobond maturing in mid-2022. As a proactive measure to address the refinancing risk ahead, Government carried a Liability Management Exercise through a tender offer. 76 percent of the Eurobond was tendered and settled from a 5-year Sukuk issued under a Sukuk Issuance Program. Additionally, the maturity period of the USD 100 million bond subscribed by Abu Dhabi Fund for Development (ADFD) with original maturity in 2023 has been extended by 3 years.

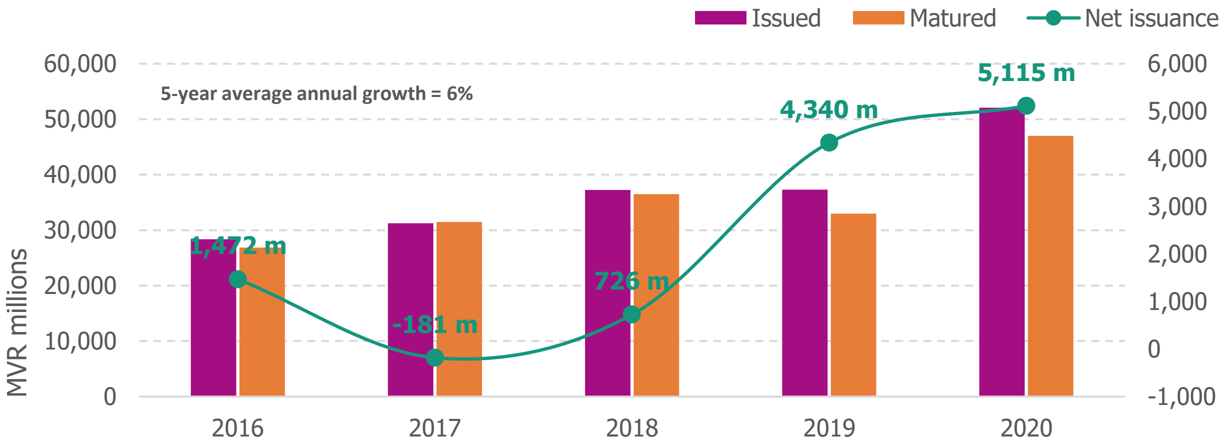
Furthermore, to maintain an optimal maturity structure of the debt portfolio and minimize refinancing risk, Government is exploring the potential for issuing treasury bonds with tenures between 8 and 20 years both in the domestic and international debt capital markets

7.2.2 Interest Rate Risk

The interest rate risk reflects the volatility in various interest rates structures in Government's debt portfolio. The key indicators used to measure interest rate risk are; Average Time to Refixing (ATR), Debt refixing in 1 year, split between fixed and variable rate debt and Weighted Average Interest Rate (WAIR).

The ATR describes time taken in years to fix the interest rates; therefore, a shorter ATR implies that the portfolio is more exposed to variable interest rate shocks. When looking at the Government total debt portfolio, the ATR as at 31 December 2020 was 7 years. The above table also indicates that 41 percent of total debt portfolio is subject to interest rate refixing in less than a year. However, around 70 percent of debt subject to refixing represents fixed rate treasury bills issued to domestic market. Hence, considering the growing demand for treasury bills as observed from the chart below, risk of interest rate refixing remains minimal.

Figure 15: Net Issuance of Treasury Bills, 2016-2020



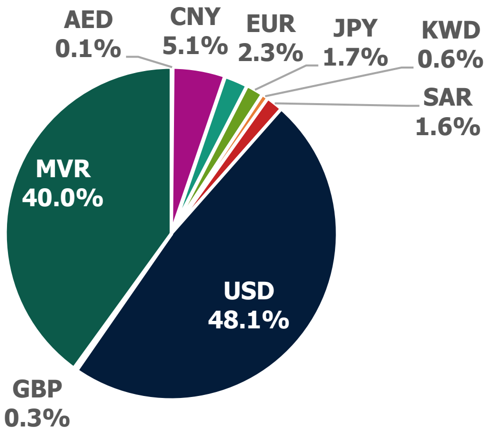
In terms of average interest rate, the WAIR is relatively low at 3 percent for the total debt portfolio as at 31 December 2020. This indicates a 1 percent drop when compared to end of December 2019. This is mainly due to increased concessional borrowings obtained through multilateral and bilateral partners in 2020. In addition to this, at the end of 2020, the debt portfolio's mix between fixed and variable interest rates were 79 percent and 21 percent, respectively. It is estimated that with a 100 basis point increment of WAIR, the debt service cost associated with variable debt instruments could increase by 33% in 2021, which is equivalent to 0.29 percent of GDP.

Given the above, risk of higher debt service cost due to adverse shocks in interest rates remain low.

7.2.3 Exchange Rate Risk

In terms of exposure to foreign exchange risk, at the end of December 2020, 60 percent of the total PPG debt is denominated in foreign currency, an increase in 4 percent when compared to end of 2019. As depicted in the above chart, total PPG debt comprises of 48 percent in United States Dollars, while 40 percent of the portfolio is denominated in Maldivian Rufiyaa (MVR). The remaining 11.8 percent of the portfolio comprises of various currencies including Chinese Yuan (CNY), Euro (EUR), Japanese Yen (JPY), Saudi Riyal (SAR), Kuwaiti Dinar (KWD) and United Arab Emirates Dirham (AED).

Figure 16: Currency Composition of PPG



The portfolio's exposure to foreign currency denominated debt has grown significantly in 2020 with an approximation of 27 percent increase recorded in 2020 when compared to 2019. However, it is worth noting that the risk associated with exchange rate fluctuation remains minimal since the local currency is pegged to USD.

Nonetheless, the increasing reliance on foreign currency denominated debt presents challenges in debt management. For instance, in a scenario whereby MVR depreciate against the USD by 5 percent, the PPG DOD will increase by MVR 2.5 billion and vice versa if it were to appreciate. In such a scenario, the debt to GDP will increase to 154 percent, and 145 percent, respectively. Moreover, as depicted in the above table, the debt service to revenue ratio for foreign currency denominated debt is estimated to increase by 4 percent if MVR depreciate against USD by 5 percent and vice versa if it were to appreciate in 2021.

Table 10: Exchange Rate Risk

PPG External Debt Debt service (in MVR Millions)	**2021 Proj**	**2022 Proj**	**2023 Proj**
Principal (A)	14,394	4,544	3,406
Interest and other Payments (B)	1,554	1,830	1,813
Baseline: Total Debt service (A+B)	**15,949**[8]	**6,374**	**5,219**
Baseline: PPG External Debt service as a % of Total GOM's Revenues	**75%**	**28%**	**19%**
Scenario 1:MVR Depreciate by 5%			
Revised PPG External Debt Service	16,746	6,693	5,480
PPG external Debt service as a % of Total GOM's Revenues	79%	29%	20%
Scenario 2: MVR appreciate by 5%			
Revised PPG External Debt Service	15,151	6,056	4,958
PPG external Debt service as a % of Total GOM's Revenues	72%	26%	18%

Key Measures to mitigate Exchange rate risks;

A key priority of Government is to develop the domestic Government Securities Market and introduce new instruments such as new local currency Islamic financial instruments as a measure to mitigate the risk associated with foreign currency denominated debt. It is evident that investors' demand for Islamic treasury instruments have been increasing in recent years. However, despite the growing demand, there have been limited instruments that are available in the domestic market to date, and have only been used to provide financing for SOEs. Therefore, to further develop the domestic securities market and minimize the exposure to external debt, the Government has developed new Islamic financial instruments and is expected to introduce to the market before end of 2021.

[8] The total debt service figure is based on the assumption that RBI swap of USD 400 million guaranteed by the GOM will be repaid in 2021.

7.2.4 Operational Risk

Operational risk refers to a wide variety of risks faced by the Debt Management Office (DMO) that can disrupt debt service and debt management operations. In this regard, several operational gaps were identified in the DeMPA carried out in 2019 by the World Bank. For instance, the need to further strengthen the institutional structure within the Ministry of Finance for debt management and to implement the front, middle and back offices (FO/MO/BO) with enhance staff capacity; the internal procedures, distribution of staff needs were identified as key operational reform tasks. Additionally, the current domestic securities issuance operation involves several manual processes which are prone to operations risks.

Key Measures to mitigate operational risks;

Based on the recommendations from DeMPA 2019, the Ministry has implemented the traditional FO/MO/BO model with enhanced FO capabilities. The Ministry has also set out internal procedures and guidelines for DMO operations with appropriate distribution of staff roles. Moreover, in order to build capacity and enable DMD staff to execute their new functions, the Ministry has created annual training plans.

As a part of the Government's legislative agenda Drafting of the Public Debt law and reviewing of the existing Public Finance Regulation and Fiscal Responsibility Act in order to align to the international best practices on debt management to country context. This would further strengthen the legal framework for debt management.

The Government is working towards procuring the Commonwealth Secretariat's Meridian Software which is the latest version of the Commonwealth Secretariat's Debt Recording and Management System (CSDRMS), this will better equip the debt department with the most up to date tools to manage and analyze the debt portfolio. As a result, this will reduce the operational risks associated with debt recording and reporting. Furthermore, to mitigate operational risks associated with domestic government securities operations, the Government is currently working with the MMA to bring the necessary automation and integration into the process. In this regard, establishment of an electronic trading platform and a central securities depository that integrated to payment system is currently underway. The successful implementation of this project will ensure that the government securities operations are carried out prudently and in line with the international best practice

7.2.5 Contingent Liabilities

Government's contingent liabilities include, government guaranteed debt of State-owned entities, statutory authorities' debt and guaranteed debt of private companies where sovereign guarantees are granted for their borrowings. As such, total guaranteed debt at the end of 2020 stood at MVR 19,994 million which represents 35 percent of total PPG debt. This poses significant risks for the government if a beneficiary of guaranteed debt defaults and a call on the guarantee is made by the lender resulting a settlement to be made by the Government to avoid any sovereign default.

Key Measures to mitigate risks associated with contingent liabilities include;

The Government is currently reviewing the existing "Guarantee Issuance Policy" to strengthen the quality and requirements for analyzing loan guarantee proposals. In particular, a strong emphasis would be given on clearly defining eligibility criteria, strengthening risk assessment process, monitoring and recording mechanism, and auditing requirements

Strengthen the credit risk assessment of Sovereign guarantee applicants. Further, efforts are ongoing to strengthen the capacity of the debt department to undertake such risk assessments.

8 State-owned enterprises

State Owned Enterprises (SOEs) consist of mainly three groups; state-owned enterprises, state controlling enterprises and state minority shareholding enterprises. There are a total of 31 SOEs, of which five are publicly listed, with a predominant share in providing public goods. The main drivers of fiscal risks from non-financial SOEs in the Maldives are excessive reliance on government subsidies, the extent of uncompensated non-commercial obligations, SOE budget constraints, and weak corporate governance.

8.1 Performance of SOEs

Most of the SOEs have ended the year 2020 with a net loss, partly as a result of the financial impact of the COVID-19 pandemic. However, there are also loss-making SOEs, primarily engaged in the provision of basic services, that frequently requires financial support from the government for their operational expenses.

There are several SOEs that are reliant on government subsidies. Currently, the government's financial support is in the form of capital contribution, grant, subsidy or operational/capital expenditure contingency. However, the funding model for SOEs is not adequately discussed when the decision is made to establishment of a new SOE. The combination of SOE autonomy and significant reliance on the government budget creates fiscal risks.

Out of 31 SOEs, 23 are benefiting from financial support of the government. The government provides subsidies to electricity providers (STELCO, Fenaka and MWSC) to compensate for the revenue loss incurred. In addition, subsidies are also provided to STO for selling basic commodities (flour, rice and sugar) at a controlled price set by the government.

Some of the government's objectives are achieved through the SOEs. In this regard, non-commercial obligations are imposed on SOEs to fulfil specific objectives. For instance, business line cross-subsidies such as instructions to SOEs to enter an unrelated and unprofitable business to be cross-subsidized by an existing profitable business line. SOEs have significant amounts of receivables from government departments for goods or services supplied. There are also arrears of subsidies payable to SOEs from the Ministry of Finance. In addition, there are also inter-SOE arrears. These cross-areas are offset within the government and reduce revenues in terms of dividends by SOEs to the government.

Fiscal risks from SOEs arise from the changes in SOE's financial performance and financial position, which ultimately burdens the central government. A second key risk driver is non-commercial activities imposed by government to achieve government objectives of providing services to the public. Sometimes these activities weaken the financial position of SOEs as a company, although it fulfills the need of the public. Thirdly, most SOEs are provided with some form of fiscal support regardless of the significance of the services provide by them.

To mitigate the risks arising from SOEs The Privatization and Corporatization Board (PCB) reviews the financial performance of the SOEs and identifies the poor performing SOEs which needs to be liquidated based on their performance and its nature. At present 17 SOEs are in the liquidation process.

SOEs are instructed to get prior approval from Ministry of Finance before any capital projects/investments above MVR 2.5 million are undertaken.

In addition, Ministry of Finance plans to strengthen the budgeting process further by integrating the SOE budget proposals to the budget process.

The PCB is proactive in instilling good governance and enhancing the accountability of board of directors and the management of SOEs. In 2021 PCB has released a "Procurement Procedures and Guidelines for SOEs" as well as "Job Classification Framework for SOEs".

8.2 Treasury loans to SOEs

Several SOEs receive treasury loans to help meet their obligations. The outstanding amount is about MVR 1.15 billion compared to the loan amount of MVR 1.13 billion including penalty interest as at the end of December 2020. The loans are typically issued for one year at an interest rate of between 8-10 percent and a loan agreement is signed between Ministry of Finance and the SOE for repayment of the loans. Most of these loans have not been repaid, yet they continue to receive budget support. Although these SOEs failed to service their loans, no action has been taken and recovery is likely to be difficult.

For the recoverability of these loans, Ministry of Finance has been working with the SOEs to come up with new payment terms/offsetting scheme. In this regard, measures taken by Ministry of Finance include, rescheduling the loan, waive offs on penal interests, extending tenure of loan, re-scheduling cumulated interest and penal interests to pay on equal installments within the loan period.

8.3 Sovereign guarantees given to SOEs

Sovereign guarantees are governed by a legal framework. The Public Finances Law (No.3/2006 as amended) and the "Policy on the Provision of Sovereign Guarantees" spells out the conditions for issuing guarantees. Although guarantees are provided off-budget, they form part of government's debt as interpreted by the Fiscal Responsibility Act. The absence of a limit on guarantees has led to its rapid increase of guaranteed loans to SOEs.

At the end of December 2020, total of 25 loans of SOEs were guaranteed by the government with a total value of MVR 11,964 million, which is 60% of the total debt guaranteed by the government. This creates significant financial risk to the government as the government must bear the repayment and interest in time of default by the relevant SOE.

The major risk of issuing guarantee is that government having to repay the loan in times of default by the SOE. Currently, government is providing cash flow assistance to repay loans of three SOEs.

Hence, to mitigate that risk, a business risk assessment of the SOE is performed focusing on their repayment capability, cashflow status and financial stability prior to issuing any sovereign guarantee.

In addition, the Government is currently reviewing the existing "Guarantee Issuance Policy" to strengthen the quality and requirements for analyzing loan guarantee proposals. In particular, a strong emphasis would be given on clearly defining eligibility criteria, strengthening risk assessment process, monitoring and recoding mechanism, auditing requirements.

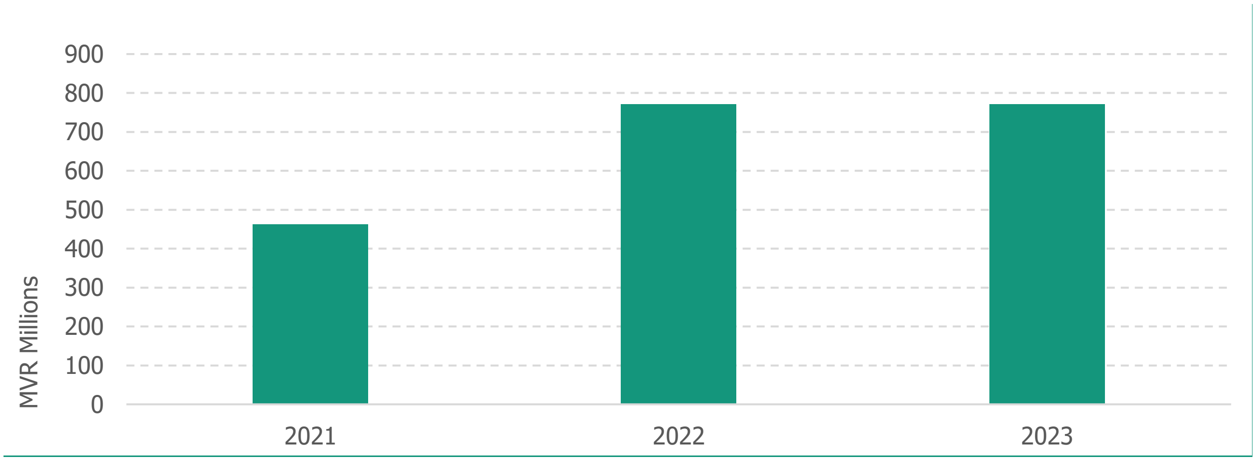
8.4 Privatization

The Maldives will initiate a medium-term privatization program in 2021. In addition to financing the budget deficit, the primary objective of the privatization program is to improve the governance and performance of SOEs, through partnerships with strategic investors and greater participation of the public in the management of SOEs through public listings. It has been shown that existing

SOEs with public listings or strategic partners tend to perform better than fully government held SOEs.

The total estimated value to be raised through privatization is estimated at MVR 2 billion between 2021 and 2023. This is between 4-7% of total financing for 2021-2023. Given the existing relatively high deficits the potential non-realization of privatization proceeds poses some risks to deficit financing.

Figure 17: Privatization proceeds



Potential risks in the implementation of the privatization program may be public misgivings and opposition to privatizing certain SOEs. Furthermore, poor planning of public offer may result in lower-than-expected demand for the offer and shallow capital markets may fail to bring in sufficient funding from domestic markets. The process may also be delayed through legal or administrative changes that may be required to attract foreign investments in the offers.

To mitigate the risks and to ensure that the government receives the proper value for the privatized assets, the privatization program will be preceded by proper assessments. The initial assessments at the Ministry level have been completed, and to ensure the success of the process government is seeking to engage advisors and experts to design the privatization program in the next stage.

To address potential public opposition to the privatization program, the program will be implemented transparently. In addition, privatization program will include public listing of stocks in SOEs, which will allow the public to not only play a more active role in the management of

SOEs, but also gives the opportunity to capitalize on potential returns from improved governance and financial performance facilitated through privatization.

9 Financial Sector Risk

The financial sector of the Maldives consists of banks, non-bank financial institutions, and payment service providers. The banking sector consists of eight commercial banks; three locally incorporated banks of which two banks are partly state-owned, four branches of foreign banks, and one subsidiary of a foreign bank. The non-bank financial institutions regulated by the MMA include five insurance companies, three finance companies, two money remittance providers, and two payment service providers.

The impact of the COVID-19 pandemic was evident in the lower annual profitability, signs of deteriorating loan quality, and USD liquidity strains. To reduce the burden on borrowers and banks due to the crisis, MMA provided regulatory leeway for banks in March 2020 by temporarily reducing the provisioning requirement for rescheduled loans and required banks to provide a minimum of 6 months' moratorium for affected borrowers. The total value of loans under moratorium at the end of 2020 accounts for 54.34% of the total value of loans in the banking sector and accounts for about 16.92% of the total number of loans. Banks remain extremely well capitalized (total risk based capital ratio at 47.46%) and have sufficient liquidity going into the crisis, therefore the MMA does not envisage any need for government financial support.

Policy measures were also taken to ease liquidity constrains on banks by reducing the Minimum Reserve Requirements (MRR) of banks, from 10% to 7.5% for local currency and 5% for foreign currency. Further to this, MMA has been making US dollar fixed deposits placement with banks. A foreign currency swap facility and short-term local currency liquidity support facility are also available if needed.

Capital of the Non-Bank Financial Sector remained strong, with total capital to risk weighted assets ratio at 44.94%, indicating high capacity for absorbing losses. Asset quality of the sector also remained strong, with a low NPL ratio of 2.66%. MMA has been monitoring the resilience of financial sector by conducting stress test and scenario analysis based on regular reporting data submitted to MMA. The stress test results conducted by MMA indicated that banks have adequate buffers to absorb extreme credit shocks and short-term liquidity constraints.

With MMA's continued commitment to strengthen the Corporate Governance framework within the financial sector, MMA has issued regulation which covers Corporate Governance requirements for Banks, Insurance Companies and Finance Companies. The purpose of this regulation is to promote sound corporate governance in Financial Institutions by stipulating a minimum standard of corporate governance principles and practices that are applicable to the Financial Institutions. Sound corporate governance practises and strong internal control processes are important for prudent management of financial institutions for longer term success and to maintain stakeholder confidence.

10 Conclusion

With this inaugural fiscal risk statement, the Ministry has analyzed and presented a broad range of the most pertinent fiscal risks for Maldives. The Ministry will continue to expand the range of risks and the breadth of the risk analysis in future publications.