بسم الله الرحمن الرحيم

Ministry of Finance
Male', Maldives

Medium-Term Fiscal Strategy 2021-2023

31 July 2020

Revised on 06 October 2020 based on macroeconomic developments as of 15th September 2020

Contents

1. Introduction

The Fiscal Responsibility Act (Law Number 7/2013) Chapter 10 requires the Government to submit a Medium-Term Fiscal Strategy Statement to the Public Accounts Committee of the People's Majlis.

This Fiscal Strategy is presented at a time when unprecedented changes are occurring to the Maldivian economy and financial position of the country. To account for the present circumstances, the direction of the fiscal policy must be changed. As such, this Fiscal Strategy focuses on formulating sustainable medium-term policies that will assist in economic recovery. This will also be the basis of which the annual budget 2021 and medium-term budgets are formulated on.

This statement includes a comparison of the previous Fiscal Strategy and the approved 2020 budget, the revised estimates for 2020 budget to reflect the current circumstances, and medium-term fiscal policy goals and policy implementation. The paper also outlines proposed changes to the revenue and expenditure structure based on medium-term fiscal balance and debt sustainability, and the fiscal space (budget available for new policy initiatives). This Fiscal Strategy is based on the "Medium-Term Fiscal Framework" and baseline budget estimates for revenue and expenditure estimations.

2. Comparison of 2019 Fiscal Strategy and Approved budget of 2020

The comparison of difference between estimates for 2020-2022 given in Fiscal Strategy 2019 submitted to People's Majlis and values approved by for Budget 2020-2022 are illustrated in the table below.

Table 1: 2020-2022 Fiscal Strategy and 2020-2022 Approved Budget Forecast

	Fiscal Strategy Forecast			Approved Budget Forecast		
(millions of MVR)	2020	2021	2022	2020	2021	2022
Total Revenues and Grants	30,731.5	29,788.2	31,881.8	29,921.6	29,675.2	31,154.6
Tax Revenues	19,542.5	20,898.2	22,597.0	17,852.3	20,612.6	21,903.9
Non-Tax Revenues	7,173.4	7,177.6	7,569.1	6,854.4	6,917.1	7,114.8
Grants	4,015.5	1,712.4	1,715.7	5,214.9	2,145.5	2,136.0
Total Budget	39,552.7	41,665.0	45,663.6	37,871.3	42,749.5	42,657.2
Loan Repayment	2,491.0	2,938.2	7,033.7	1,883.7	3,017.7	6,163.5
Total Expenditure	37,040.0	38,704.9	38,607.7	35,966.4	39,710.5	36,472.4
Total Baseline Budget	32,201.3	35,184.1	40,044.0	30,902.8	40,980.4	40,332.4
Recurrent Expenditure	20,427.6	21,421.7	21,990.2	20,241.5	21,011.2	20,854.7
Capital Expenditure	11,773.7	13,762.4	18,053.8	10,661.3	19,969.2	19,477.7
PSIP	5,690.0	7,190.0	7,190.0	5,582.6	13,632.6	9,938.2

New Policy Initiatives	5,500.0	4,500.0	3,500.0	5,353.5	1.7	-
Council Block Grant	1,851.3	1,980.9	2,119.6	1,615.0	1,767.3	1,963.7
Overall Balance	(6,308.5)	(8,916.7)	(6,725.9)	(6,044.8)	(10,035.3)	(5,317.8)
Primary Balance	(4,018.6)	(6,196.2)	(3,905.1)	(4,201.1)	(7,902.6)	(3,148.6)

When comparing the estimates in Fiscal Strategy 2020-2022 and approved Budget 2020-2022, it is noteworthy that approximately the same fiscal deficit was maintained. The comparison also shows that in the same manner the approved budget revenue was comparatively lower to the revenue figure in Fiscal Strategy, the approved expenditure estimate was equally lower.

The main reason for lower revenue estimates in Budget 2020-2022 compared to Fiscal Strategy 2020-2022 was due to the revision of revenue estimates in light of new analysis conducted for the Budget 2020-2022. In addition, revenue estimates decreased because of the revisions to the medium-term economic forecasts.

Although the Fiscal Strategy 2020-2022 was formulated before the publication of the Strategic Action Plan, the objectives outlined in the Strategic Action Plan were prioritised in the preparation of the 2020-2022 budget as they detailed the targets and objectives the Government aimed to achieve in the years 2019 to 2023.

Expenditure estimates given in Budget 2020-2022 was lower than estimates given in Fiscal Strategy 2020-2022 because of relatively lower recurrent and capital expenditures following that expenditure on debt servicing and debt repayment for domestic debt was lower than previously estimated in the Fiscal Strategy 2020-2022. Furthermore, when the Decentralization Act was passed, the value of block grant for local councils was lower. The Act outlined that the value of the council grant is a proportion of total revenue- earned instead of a percentage of the total budget as previously estimated. This change in the legislature lowered the previously estimated value of grant for local councils given in Fiscal Strategy 2020-2022.

Major infrastructure projects that were planned to be commenced in the year 2020 were included in the Budget 2020-2022. Commitments to the projects started in 2019 as work was conducted early to ensure the commencement of the projects in 2020. The estimated expenditures for the continuation of these projects are forecasted to be higher for the year 2021 and 2022 compared to the initial forecast in Fiscal Strategy 2020-2022.

3. Revised Estimates For 2020

This section covers the Government revenue received and expenditure incurred until June 2020, revised estimates of the 2020 economy, and revised estimates for revenue and expenditure.

3.1.1 Tourism sector

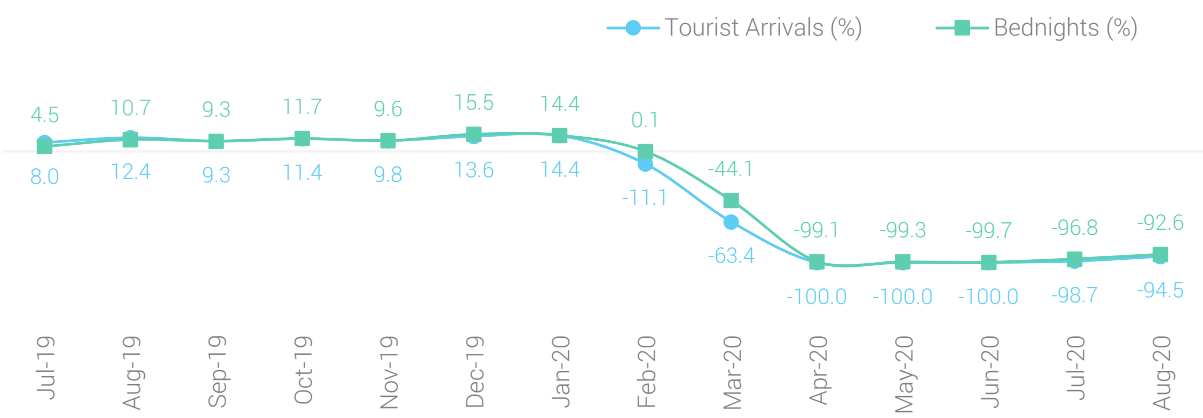
In light of the rapid spread of Covid-19, Maldives took an immediate precautionary measure of halting direct flights from China in February to prevent the spread of Covid-19 in the Maldives. Subsequently flights from Italy were stopped in March and soon after other high-risk countries where Covid-19 positive cases were surging. Once the first positive case was found domestically on 7th March, preventive measures were strengthened and a State of Public Health Emergency was declared on 12th March. In order to prevent the spread of the virus, tourists were not permitted to check-in to guest houses and tourists in resorts were not allowed to travel out of resorts. On-arrival tourist visa was also temporarily suspended from 27th March 2020 onwards.

When the borders reopened on 15th July, tourist resorts and safari vessels were given the permission to resume operations subject to public health guidelines. However, the reopening of guesthouses and city hotels on inhabited islands have been delayed until October, with the exception of the Greater Male' area. Similarly, the hotels and guesthouses in the Male area are set to resume operations in November. Despite the reopening of international borders in the Maldives, several countries have extended their border closures. The increase in flight operations have been gradual and is expected to take longer than expected. As a result, several tourist resorts have remained closed.

Although tourist arrivals in January 2020 was 14.4 percent higher than January 2019, tourist arrivals were impacted once the spread of Covid-19 was declared as a global pandemic. As a result, tourist arrival in February 2020 was 11.1 percent lower than the same period last year and even lower in March 2020 with a decline of 63.4 percent. There were no tourist arrivals from April until borders opened in July 2020. Likewise, while bed nights for January 2020 registered a growth of 14.4 percent compared to January 2019, bed nights declined by 0.1 percent and 44.1 percent in February and March respectively compared to same period last year and bed nights registered a 99.0 percent decline in April 2020.

With the reopening of the international borders on 15th July 2020, the month of July registered tourist arrivals of 1,752. This number increased to 7,628 during the month of August. Tourist bednights in July 2020 declined by 96.8 percent while the bednights declined by 92.6 percent in August 2020, compared to the corresponding months in 2019. These numbers are much lower than the initial forecasts. With reference to this, tourist arrivals for the year 2020 is now expected to decline by 72.7 percent due to the repercussions of Covid-19 pandemic.

Chart 1: Year-on-Year Growth in Tourism Arrivals and Bednights

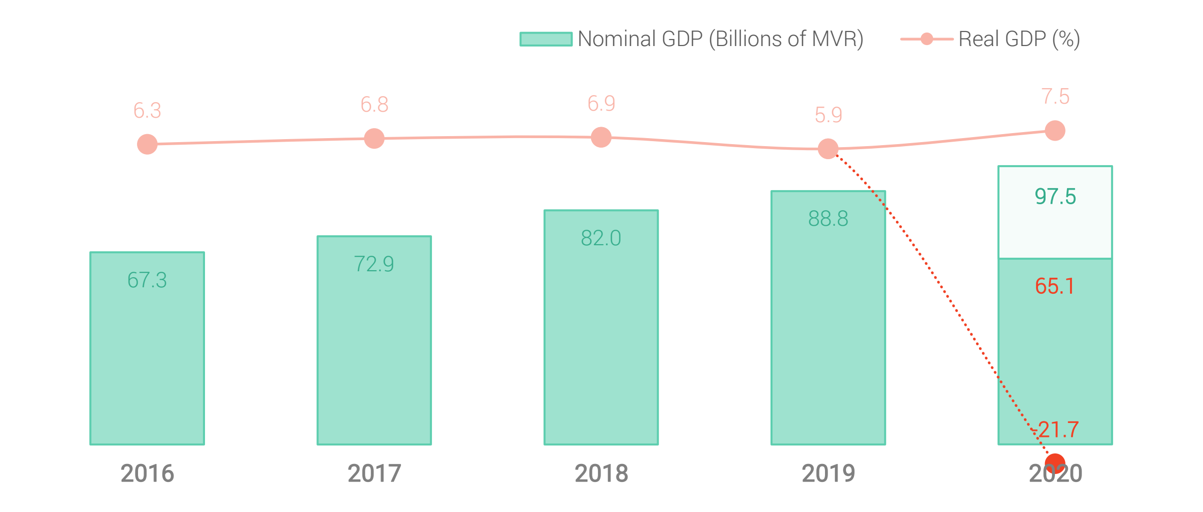


Source: Ministry of Tourism

3.1.2 GDP

While the tourism sector directly contributes 25 percent to the GDP, the indirect contribution to GDP is likely to be even higher. Thus, GDP growth is forecasted to decline with the expectation that tourism arrivals will be drastically lower. Moreover, the nationwide lockdown to prevent the spread of Covid-19 in the Maldives will negatively affect the economic growth of sectors such as construction, trade, transport and communication in 2020. While GDP was forecasted to grow 7.5 percent during the Annual Budget preparation in 2019, it is now forecasted that it will decline by 21.7 percent. Similarly, nominal GDP was previously estimated to be MVR 97.5 billion in 2020 but it is now forecasted to drop down to MVR 65.1 billion in 2020.

Chart 2: Forecasted Change to GDP



Source: Ministry of Finance / Maldives Monetary Authority

3.1.3 Employment

The repercussions of Covid-19 were detrimental to the job market, particularly due to the complete halt of the tourism industry for the majority of the year which left workers in the industry unemployed or without pay. A Rapid Impact Assessment conducted by UNDP indicates that at least 45,000 workers were affected by the economic impacts of Covid-19. Out of this, about 22,000 are local employees. In addition, workers in the guesthouse industry and workers in supplementary businesses for resorts and tourists were also affected. Furthermore, workers in the construction industry, small and medium enterprises, and freelance workers were affected by the Covid-19 pandemic.

During the period from April 2020 to September 2020, 74,492 applications were submitted to the JobCenter for the Income Support Allowance, which is an allowance given to workers whose employment status or salary were affected due to the Covid-19 pandemic. As of 1st October, a total of MVR 96.4 million was spent on 22,751 payments of Income Support Allowances of 8,648 individuals. As employment related statistics are not regularly maintained in the Maldives, it is difficult to accurately estimate the impact of Covid-19 on the unemployment rate. Nevertheless, the number people unemployed or terminated is expected to increase. According to the data from the National Bureau of Statistics, unemployment rate was 5.3 percent in 2019, however it can be inferred that unemployment rate will now be higher than 5.2 percent considering the number of complaints and other information from the JobCenter due to Covid-19.

Table 2: Breakdown of Applications Made to the Job Centre as of September 2020

Whole Salary Affected	130
Portion of Salary Affected	516
On No Pay Leave	15,981
Salary Deducted	10,896
Suspended	775
Unemployed	9,386
Self-employed (Earnings affected)	35,295
Others	1,513
Total	**74,492**

Source: Ministry of Economic Development

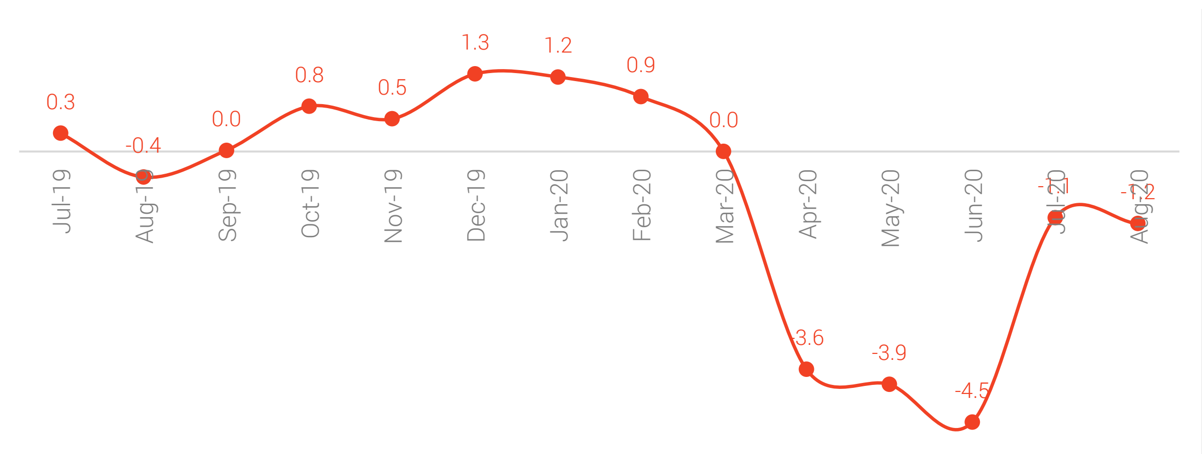
3.1.4 Inflation

Prices were initially anticipated to increase as supply chains were heavily affected by the impacts of Covid-19. However, the average inflation rate for the first 8 months of the year in the Maldives was negative, meaning that the prices have decreased as a whole compared to the previous year. This is due to price controls imposed on staple and necessary food items, and discounts on utility bills for water and electricity, and the reduction of housing rents to some extent due to the debt moratoriums on housing loans.

Price of fuel in the global market has decreased significantly with the onset of Covid-19. At the beginning of 2020, price of crude oil stood at around USD 60 per barrel. Price per barrel of crude oil dropped to USD 20 during the year, and this was the lowest price registered during the year. The price of crude oil at present is USD 40 per barrel.

Since inflation rate of Maldives is mainly derived from the price of imported goods, or rather an "imported inflation", it is important that the exchange rate is maintained to control the rate of inflation. It is also important to ensure the sufficient inflow of foreign currency in a period where its inflow is low, in order to control the imported prices of food items and other consumer goods.

Chart 3: National Inflation Rate from July 2019 to August 2020



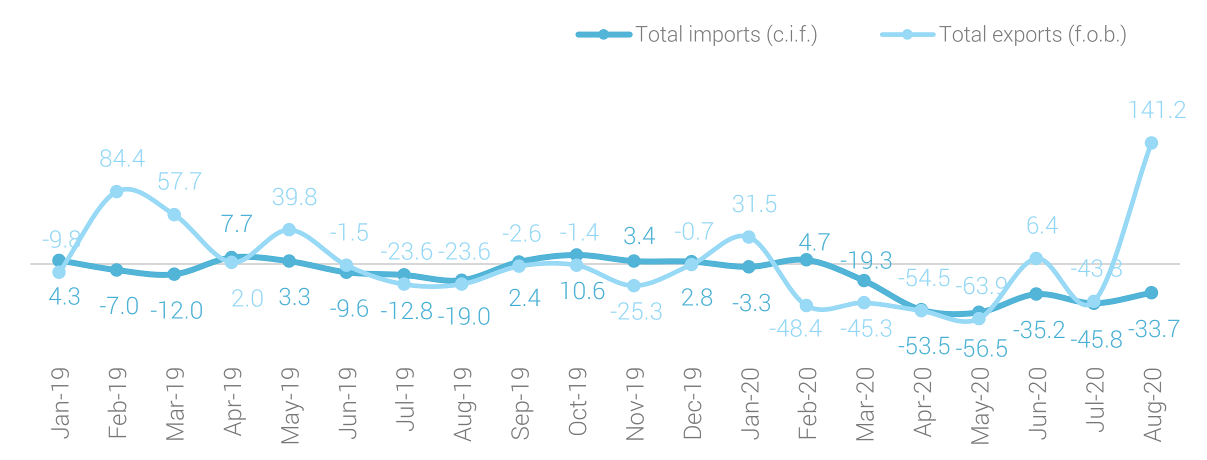
Source: National Bureau of Statistics

3.1.5 External sector

Foreign currency earnings of the Maldives are primarily from the tourism sector. Foreign currency earnings from the tourism sector halted as Covid-19 spread across the globe, global tourism came to a standstill with flight operations halted and Maldives closing its borders to visitors. Furthermore, despite the reopening of the borders in July, foreign currency inflow has been low and is expected to remain low at the end of the year.

In addition to tourism, fish exports have been the secondary source of foreign currency income. Moreover, disruptions in transportation caused interruptions in the supply chain, and the lockdowns imposed in the fish exporting European markets due to Covid-19, resulted in the fall in global fish prices and the volume of fish exports. Even though travel restrictions and lockdowns eased in the European market helped inflate the prices of fish, foreign currency earnings from fish exports is also expected to be much lower this year.

Chart 4: Month-on-Month Growth in Import and Export (%)

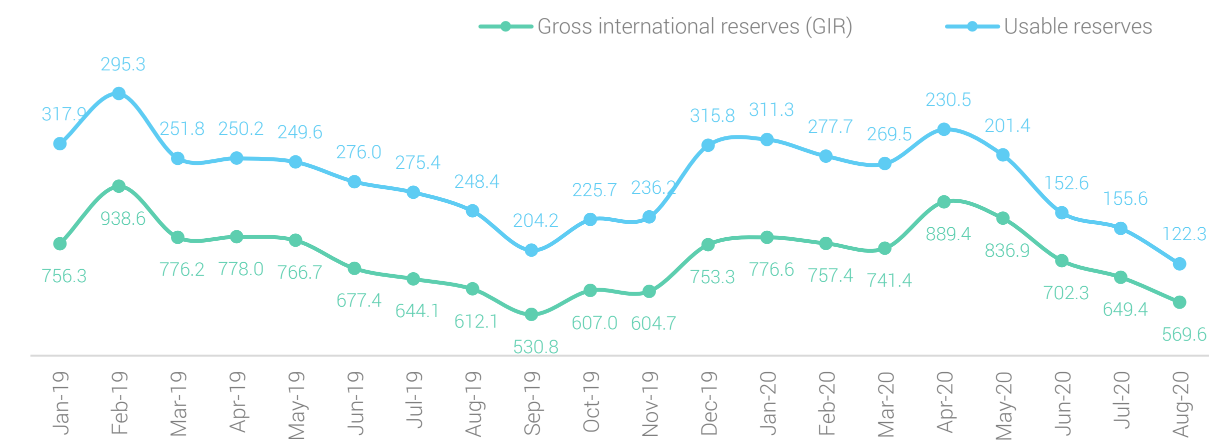


Source: Maldives Customs Service

While foreign currency earning has reduced due to reduced exports, foreign currency expenditure on imports is also expected to decline. Imports for the tourism sector is estimated to be lower as the tourism sector is at a standstill and tourist arrivals for the year are also expected to be low. Furthermore, importation of building materials is also projected to be lower as construction projects are being temporarily stopped due to supply chain disruptions. Although total imports in the period January to August 2019 was equivalent to USD 1,838.1 million, value of imports in the same period in 2020 was USD 1,280.9 million, corresponding to a 30.3 percent decline. However, the decrease in imports is generally expected to be lower than the decrease in foreign currency earnings.

Foreign exchange reserve is likely to decrease as it was depleted to maintain the exchange rate. By the end of August 2020, official reserve was at USD 569.6 million which equivalent to 2.9 months of imports. Nevertheless, pressure on foreign currency reserves can be temporarily reduced by taking countermeasures using available instruments.

Chart 5: Gross International Reserve (millions of USD)



Source: Maldives Monetary Authority

3.1.6 International Economic Forecasts

International organizations state that Covid-19 economic crisis is unlike any other economic crisis in the past. The rapidly evolving nature of the crisis is alarming and recovery is likely to be challenging.

According to IMF's World Economic Outlook published in June 2020, the COVID-19 pandemic has had more negative impact on economic activity than anticipated. The update of June 2020 shows that global growth is projected to decline by 4.9 percent in 2020. Economic growth of Advanced Economies is forecasted to decline by 8.0 percent while economic growth of Emerging Markets and Developing nation is forecasted to decline by 3.0 percent. And, the economic growth of Small Island Developing States (SIDS) is projected to decline by 3.6 percent.

IMF report also states that recovery is projected to be more gradual than previously forecasted. The impact of the travel bans and the adverse effects to the transport sector are felt globally. Most nations are not able to achieve their economic targets as measures taken to curb the spread of the infection have exacerbated expenditure on human capital. Moreover, the report highlights that economic recovery will be challenging and slower than anticipated.

Global economic growth is projected at 5.4 percent in 2021. This projection is 3.4 percentage points lower than in the pre-COVID-19 projections.

3.2 Government Revenue and Expenditure as of June 2020

Table 3: Revenue and Expenditure from January to end of June

	End of June	
(millions of MVR)	2019	2020
Total Revenues and Grants	11,624.5	6,712.9
Tax Revenues	8,652.6	5,269.8
Non-Tax Revenues	2,494.5	1,415.6
Grants	477.5	27.5
Total Budget	13,092.0	13,064.1
Loan Repayment	527.8	535.9
Total Expenditure	12,557.4	12,521.6
Recurrent Expenditure	9,220.3	8,929.2
Capital Expenditure	3,337.1	3,592.4
PSIP	1,987.2	2,077.0

Overall Balance (Deficit)	(932.9)	(5,808.6)
Primary Balance	(239.7)	(5,432.2)

3.2.1 Revenue

Total government revenue as of June 2020 was MVR 6,712.9 million, 42.3 percent decline compared to same period of 2019.

The spread of Covid-19, both globally and domestically, is a major shock to government revenue. The revenue from tourism sector (TGST, airport service charge, airport development fee and green tax) has plummeted significantly owing to border closure in the period between 27th March to 15th July 2020. As a result, majority of resorts in the Maldives were temporarily closed and faced financial difficulties which caused revenue from resort land rent to decline. GST and import duty have decreased because of the public health measures taken by the Government. Even though the economic shock of Covid-19 was felt by businesses after the second interim payment deadline, most business faced cashflow issues and hence, BPT was also lower in same period of 2020 compared to 2019.

Moreover, low tax collections following the closure of Government revenue collection authorities during the payment deadlines (as a precautionary health measure) resulted in lower tax and non-tax revenues.

Revenue from grants stood at MVR 27.5 million as of June 2020 and in-kind grants have increased as a result of Covid-19 crisis.

3.2.2 Expenditure

The total expenditure for the first six months of 2020 is MVR 12,521.6 million. This is 0.3 percent lower than the amount for the same period in 2019.

Although recurrent expenditure declined during this period, capital expenditures have increased. While recurrent expenditure such as administrative expenses of government offices and travel expenses declined since government offices were closed and work from home was practiced, remuneration for front-line workers and expenditure on health sector increased as salaries for front-line workers and expenditure on PPE and other medical consumables were higher. Furthermore, expenditure on social security benefits were also higher. Expenditure on social security stood at MVR 549.5 million during the first half of the year. Apart from social security, expenditure on electricity and water subsidies increased as a result of Covid-19 relief discounts given on utility bills. The expenditure of the breakfast program was also higher during 2020.

With regards to capital expenditure during the first half of the year, PSIP expenditure was MVR 2,077.0 million as of June 2020 and major projects included Male'-Gulhifalhu port project and land acquisition for the diplomatic enclave. Capital contribution to SOEs stood at MVR 1,020.8 million as at June 2020. Capital contributions for SOEs were given for necessary Covid-19 related expenses and for the continuation of essential public services provided by SOEs. MVR 360.0 million from the Government budget was allocated to provide express loans to aid those with dire financial conditions. Upsurge in capital expenditure was also driven by the expenditure on capital equipment such as machinery and equipment needed by facilities designated for Covid-19.

3.2.3 Budget Balance

Despite the significant decrease in government revenue, the Government was inclined to raise expenditure on health and social sectors to combat the adverse effects of Covid-19 on the Maldivian economy. As a result, the Government registered a deficit of MVR 5,808.6 million on the overall balance and a primary balance deficit of MVR 5,432.2 million in the first half of 2020.

3.3 Revised Forecast of Government Revenue and Expenditures for 2020

The revised budget for 2020 was formulated accounting for the availability of alternative financing as government revenue is expected to significantly decline due to the negative impacts of Covid-19. Therefore, the budget is compiled to enable fiscal space for necessary expenditure to curb the pandemic by reducing other government spending.

Table 4: 2020 Budget Breakdown

(millions of MVR)	Approved 2020	Revised 2020
Total Revenues and Grants	29,921.6	13,734.3
Tax Revenues	17,852.3	9,812.1
Non-Tax Revenues	6,854.4	2,264.9
Grants	5,214.9	1,657.2
Total Budget	37,871.3	31,200.5
Loan Repayment	1,883.7	1,129.2
Total Expenditure	35,966.4	30,050.1
Recurrent Expenditure	22,337.9	20,169.1
Capital Expenditure	13,628.5	9,880.9
PSIP	10,454.8	5,491.1
Overall Balance (Deficit)	(6,044.8)	(16,315.8)
Primary Balance	(4,201.1)	(14,607.8)

3.3.1 Revenue

Considering the revenue and grants received to date and the adverse impact of the pandemic on the tourism sector and other related sectors, the total revenue and grants for the year 2020 is estimated to be MVR 13,734.3 million. This is a 40.7 percent decline compared to the initial estimate in the 2020 approved budget.

The severe adverse impact of the temporary shutdown of the tourism sector owing to Covid-19 is likely to reduce tourism tax revenue sharply. As the transportation sector, trade sector and other industries are heavily dependent on the tourism sector, BPT and GGST are expected to be heavily affected. Similarly, bank profit tax is forecasted to be low resulting from poor profits of the banking sector and revenue from import duty is also forecasted to be less as business activities have slowed down.

The shock to the tourism sector is likely to drive down revenue from airport development fees. Furthermore, anticipated dividends from SOEs are not likely to be realized owing to the cash flow difficulties faced by the SOEs. Total revenue from land rent of resorts will also not be realized as a result of concessions on resort land rent for the period June 2020 to December 2020. Moreover, the securing of USD 75.0 million is in progress in line with the forecasted grants for 2020. In-kind grants received this year has increased.

Further details of expected revenue for 2020 are presented in the Appendix 1 of this statement.

3.3.2 Expenditure

Since government revenue is expected to decline sharply, budgeted expenditure for the rest of the year must be rationalized and reduced significantly to ensure that the deficit is financed and to maintain budget deficit at a sustainable level. While preventive measures taken currently are to be continued, new measures may be required too.

Despite the decline in government revenue, there is an unprecedented increase in government expenditure in 2020, primarily on health sector, disaster management and social protection. Meanwhile, government expenditure will be higher as spending is increased to prevent negative impacts to the economy and businesses. Furthermore, government expenditure will also be higher as government provides assistance to SOEs for cash flow management to ensure that public services provided by SOEs are not disrupted.

The revised budget for the year 2020 was compiled by accounting for the fiscal space available for the increase in expenditure for health sector and economic recovery of Covid-19, and taking into account the possible reductions in administrative expenditure. The revised budget for the year 2020 is MVR 31,200.5 million, of which MVR 30,050.1 million accounts for total expenditure.

Further details of the revised total expenditure for 2020 are presented in the Appendix 1 of this statement.

3.3.3 Budget Balance

The 2020 budget deficit is now forecasted to be MVR 16,315.8 million which is 25.1 percent of nominal GDP. The revised primary balance for 2020 is estimated to be an MVR 14,607.8 million deficit, which is 22.4 percent of nominal GDP.

4. Fiscal policy

4.1 Medium-term Fiscal Policy

The medium-term budget aims to facilitate a structural shift to the economy, mitigate economic and social losses arising from Covid-19 pandemic, and to improve the quality of services provided for the people, while maintaining the fiscal deficit at sustainable levels.

As the economic fallout of Covid-19 has driven a steep contraction in fiscal revenues, fiscal policy must aim to promote economic resilience and stimulate economic recovery. Thus, budget 2021 must include economic recovery measures that facilitate rapid economic growth. The increase in debt of the Government must translate to higher GDP and economic development. This is to ensure debt sustainability for future budgets and to promote fiscal revenues in the future.

Policy focus will shift towards facilitating economic recovery from Covid-19 shock by re-programming expenditure. This will also aid in formulating an achievable budget financing strategy. Therefore, the medium-term budget must aim to promote expenditure reduction and efficiency in spending. Fiscal space available from these measures must be used to diversify the economy, facilitate Covid-19 recovery, improve quality of public services, and promote regional development.

To prepare for future health, economic and social crises similar to Covid-19, it is vital to embed resilient measures for crisis prevention in the medium-term budget and for the strengthening of monetary reserves.

The targets of the 2020 and the medium-term budgets are:

- Recovery from Covid-19 related impacts to health, social and economic sectors
- Develop more sectors to improve economic diversification and resilience
- Reduce financing via debt and promote efficient spending
- Facilitate decentralization and regional development
- Improve quality of essential and social services provided by the Government
- Improve standard of living
- Increase fiscal preparedness to combat crises

4.2 Proposed Measures to Achieve Fiscal Policy Targets

The measures to be taken to achieve medium-term fiscal policy targets are given below

- Increase the capacity of health sector and increase expenditure on Covid-19 related measures such as the facilitation of living in the 'new normal'. While Covid-19 is the primary cause for contractions in economic activity and fiscal revenue, these new measures will improve the capacity of the health sector in curbing health impacts of Covid-19 and instilling trust for the safe participation in the economic system in the 'new normal'.
- *Economic Response Package* targeted for households, businesses and workers to overcome the adverse impacts of Covid-19 must be better structured in the future. Even though the current economic response package focuses on economic relief, the package must be restructured to focus more on recovery and re-orientation to promote economic growth, resilience and diversification.
- Spending on public investment is needed to promote economic diversification and to improve productivity. Mega investment projects such as the development of Velana International Airport and Gulhifalhu Ports Project will improve foreign currency earnings and promote economic growth and diversification. Likewise, import substitution for products that can be efficiently produced in the country can be facilitated which will lead to an increase in exports.
- The Government must strive to improve quality of services and reduce expenditure to overcome the inefficiencies in government administration and the provision of social services. This can be achieved by identifying areas where fiscal space can be created in the short-term and long-term, and implementing these measures. The Government must ensure that overall expenditure and debt are at a sustainable level and financing via debt must be used for productive expenditure as much as possible.
- As a result of the decline in government revenue, public investment projects must be restructured and measures to improve economic growth and quality of life must be prioritized. Using grants and concessional loans to finance existing projects will help to cushion the impact on government budget.
- The Government is to facilitate development of five regional urban centres as directed by the Strategic Action Plan and the Special Development Plan to support decentralization of services. To reduce congestion in Male' region, investments need to be facilitated to promote regional development and economic diversification.
- The Government needs to take measures to improve foreign currency reserve and reduce the outflow of foreign currency. Most crucial measures to cushion fiscal revenue from medium-term shocks include maintaining a balanced budget, reducing expenditure in areas where demand for foreign currency is high and creating and expanding a fiscal reserve from budget surplus.
- As the youth population is growing, the Government must include spending on training youth for the job market in the medium-term budget. Likewise, expenditure on higher education and technical skill development must be a component of the budget. The issue of increased foreign labour can be resolved by encouraging more Maldivian youth employment in the labour market.
- With the decline in revenue, the medium-term budget must be sustained using an attainable financing plan. Hence government revenue must not be overestimated, and financing plans must be based on guaranteed revenues.

5. Medium-Term Budget

To achieve the fiscal policy goals, spending must be made more efficient, while mitigating adverse effects of Covid-19 by increasing health, social and economic expenditure. Since the financing gap is widening, expenditure financed via debt must be spent on productive areas to maintain budget deficit at sustainable levels. Increase in expenditure must be offset by an increase in revenue and an achievable financing plan must be formulated.

The medium-term budget formulated to achieve the abovementioned targets and economic outlook are given below.

5.1 Medium-Term Economic Forecasts

It is challenging to formulate valid medium-term economic estimates in light of the continued spread of Covid-19 as a result of the uncertain future it presents. However, 3 scenarios have been modelled to estimate the recovery of the economy and the tourism sector in 2020 and in the medium-term. The main difference between the three scenarios is the date at which dates on when tourism is re-opened in the country. In the best-case scenario, tourism sector is re-opened in July 2020 and the moderate-case scenario assumes that tourism sector will be re-opened by September the end of 2020. The worst-case scenario assumes that operation of tourism sector will not resume in 2020. Even though Maldivian borders have been reopened on July 15th, allowing resorts, safaris and some hotel to operate, tourist arrivals have still been lower than the moderate case scenario estimates. Therefore, tourist arrivals by end of year are estimated to be between the moderate case and worst-case scenarios.

Presently, it has been forecasted that the Maldivian GDP will decrease by 21.7 percent. Moreover, the medium-term forecasts show that tourism arrivals to the Maldives follow a "U-shaped" recovery. This imply that it may take a number of years for the economy to reach 2019 levels. According to the estimates, the economy will reach pre-Covid-19 level in 2022.

The International Air Transport Association (IATA) estimates that the recovery of air transport industry is going to be slower than the recovery of World GDP. Despite the estimated rise in passenger traffic in 2021, the passenger traffic is estimated to reach pre-Covid-19 level in 2023. The main reasons for the slow recovery are the uncertainty of the availability of a vaccine or cure, limited operations of airlines due to financial difficulties and decline in consumer income owing to the economic slowdown. It is estimated that consumer demand for short-haul flights will increase when air travel is resumed.

The Maldivian medium-term economic recovery is dependent on global consumer confidence and the stabilization rate of the travel industry. If the available human capital and infrastructure resources are efficiently utilised and if more infrastructure development is created, recovery can be accelerated.
Medium-term economic forecasts used in the budget formulation are given in Appendix 2 of this statement.

Chart 6: Medium-term Forecast of Tourism Arrivals (in thousands)

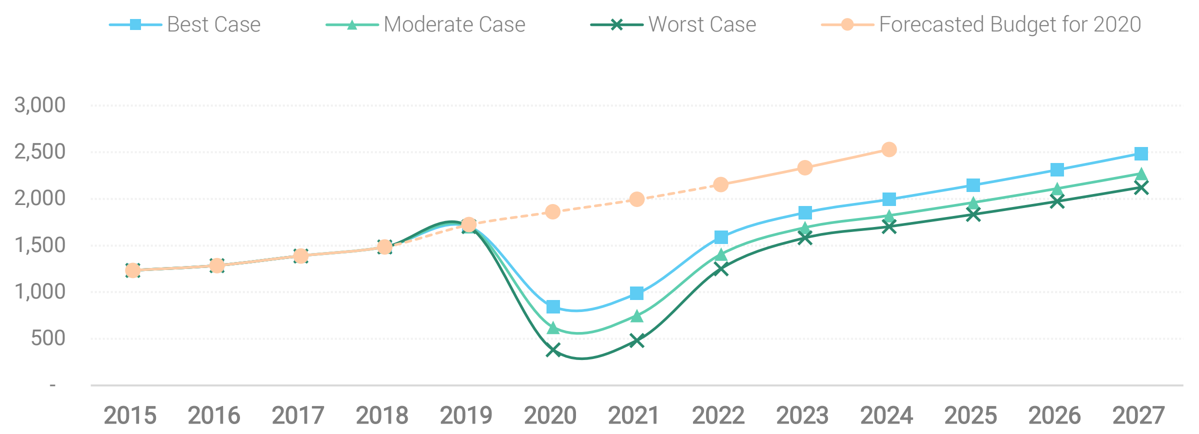


Chart 7: Medium-term Forecast of GDP (in millions of MVR)

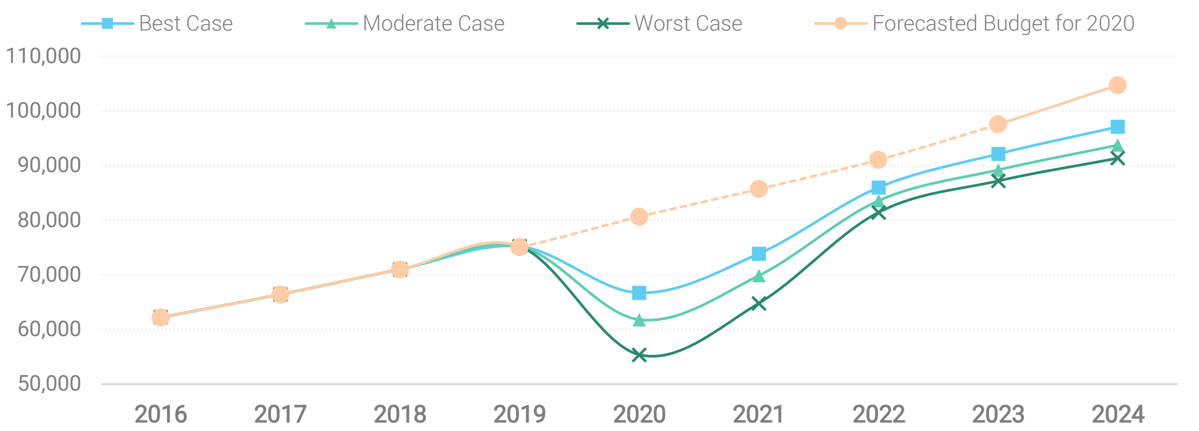
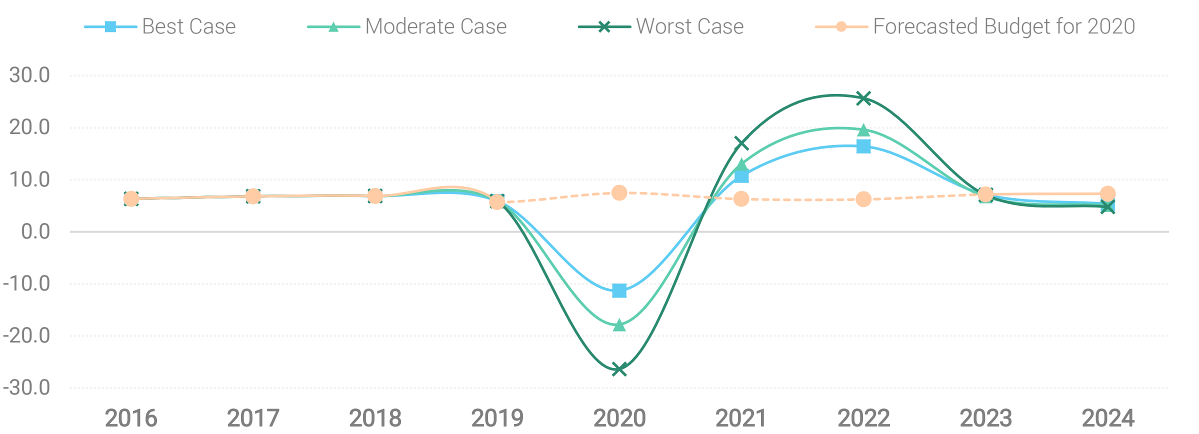


Chart 8: Medium-term Forecast of GDP Growth (%)



5.2 Revenue Forecasts

5.2.1 Medium-term Baseline Revenue Forecasts

Medium-term baseline revenue forecasts are estimates of forecasted revenues without including new revenue measures proposed in 2020 that were not implemented and proposed new medium-term revenue measures in this statement. Among new revenue measures proposed in 2020, baseline revenue estimates for 2020 only includes income tax as this measure has already been implemented. Revenue that may be received as cash grants is also not included in the baseline estimates.

The improvement in baseline medium-term revenues depend on the rate at which other economies recover. Even though revenue in 2021 is forecasted to have a sharp growth compared to this year, it will still be 36.1 percent lower than fiscal revenue of 2019. It is likely that the tourism sector and other businesses will take time to bounce-back from the economic shock of Covid-19. However, growth in revenue is estimated to be maintained and fiscal revenue in 2023 is forecasted to be higher than 2019.

Average annual growth of total government revenue (excluding new revenue measures and cash grants) is estimated to be 5.6 percent per annum and total government revenue is forecasted to be MVR 25,329.3 million in 2025.

5.2.2 Grant Revenue Forecasts

As stated in the Fiscal Strategy of 2019, the Government will attempt to secure USD 100 million per year as grants in the medium-term. Moreover, on average MVR 466.1million per year is forecasted to be received as project and other grants in the medium-term.

5.2.3. Revenue Forecasts from New Revenue Measures

With the surge in government spending, instead of relying on financing via debt or revenue from grants, the Government needs to strive to increase revenue using new and different revenue measures to achieve fiscal sustainability. To gain additional revenue, existing tax and non-tax rates can be increased or targeted to a broader base and new taxes or non-tax revenue measures can be introduced.

MVR 2,586.8 million was expected to be received from new revenue measures proposed in 2020. At the time of writing, the personal income tax, the tax regime, and changes to duties and customs fees have been implemented in 2020. Among the proposed amendments to applicable laws regarding new revenue measures, changes to the resident permit rate and the introduction of a quota fee for foreign workers have been approved by the parliament and the implementation has begun. In addition, the proposed changes to the airport service charge and development fee have been submitted to the Parliament.

To reduce the burden on business during an economic shock, proposed new taxes have been postponed and are planned to be implemented in 2021. Thus, airport service charge and airport development fees will have to be implemented in July 2021 to reduce the added burden on airlines.

If the proposed new revenue measures are implemented in 2021, it is estimated that government revenue will increase by MVR 855.0 million in the year.

Table 5: Details of New Revenue Measures Proposed for 2020

<table>
<tr><th>New Revenue Measures</th><th>Details</th></tr>
<tr><td>Changes to ASC/ ADF</td><td><table><tr><th>Class</th><th>Maldivians (USD)</th><th>Internationals (USD)</th></tr><tr><td>Economy</td><td>12</td><td>30</td></tr><tr><td>Business</td><td>60</td><td>60</td></tr><tr><td>First</td><td>90</td><td>90</td></tr><tr><td>Private Jet</td><td>120</td><td>120</td></tr></table></td></tr>
<tr><td>Proposed amendments to the Import and Export Act</td><td>Increase/ change duty on goods that are harmful to health and the environment, decrease/ eliminate duty on goods used to develop industries and day-to-day necessities. Introduction of a revenue fee (MVR 1 for every MVR 100).</td></tr>
<tr><td>Expatriate Quota Fee</td><td>MVR 2,000 annually</td></tr>
<tr><td>Increased Resident Permit Fee Rate</td><td>Increase MVR 250 to MVR 350</td></tr>
</table>

Despite the new revenue measures proposed for 2020, other measures must be taken to improve revenue in the medium-term. The impact of economic crisis of 2020 has deepened the deficit and debt of the Government, and hence the new revenue measures must be implemented in the medium-term to increase debt repayment capacity. The Government must conduct research and facilitate broad discussions with industry experts to propose new revenue measures such as higher tax rates and broadening tax base and must also plan to implement these new revenue measures. Such possible new revenue measures that may be implemented are outlined in Appendix 4.

5.2.4 Total Revenue and Grants

Total baseline revenue and grants including proposed new revenue measures and cash grants is forecasted to be MVR 17,523.7 million in 2021. The average annual growth rate of revenue and grants is estimated to be 16.2 percent per annum and total revenue and grants is forecasted to reach MVR 28,662.1 million by 2025.

Details of medium-term revenue forecasts are given in Appendix 3.

Table 6: Medium-term Revenues and Grants

(millions of MVR)	Forecast 2021	2022	2023
Total Revenue and Grants	17,523.7	21,076.5	25,314.1
Baseline Revenue	14,671.9	17,753.0	21,948.8
Tax Revenue	10,102.0	13,337.7	16,810.8
Import Duty	2,438.2	3,219.9	3,590.3
Income Tax and Withholding Tax	1,630.6	1,742.2	1,747.4
Bank Profit Tax	489.5	553.1	658.2
GGST	2,442.2	2,674.6	3,246.3
TGST	2,326.1	3,839.6	5,948.6
Airport Service Charge	308.8	512.6	671.2
Green Tax	422.1	750.2	902.8
Non-Tax Revenue	4,569.9	4,415.5	5,138.0
Airport Development Fee	308.8	512.6	671.2
Property Income	1,663.1	1,520.6	1,954.0
Interest, Profit & Dividends	902.3	987.0	1,085.7
Grants	1,992.2	2,051.8	1,980.3
New Revenue Measures	859.7	1,271.7	1,384.9

5.3 Expenditure Forecasts

5.3.1 Budget 2021 and Medium-Term Baseline Forecasts

Budget 2021 must aim to maintain fiscal deficit and debt at sustainable levels, boost economic and social recovery from Covid-19 crisis, provide high quality services and change economic direction. Therefore, the baseline estimates of expenditure are forecasted assuming that the on-going infrastructure projects and recurrent expenditure will continue for the next few years.

Baseline recurrent expenditure for 2021 is projected to be MVR 19,706.6 million and baseline capital expenditure is MVR 10,757.8 million. These estimates take into account the measures taken to reduce expenditure will continue to be implemented in 2021 and in the medium-term.

The major contributors to baseline recurrent expenditure is estimated to be wages and salaries, and administrative expenses. Estimated baseline recurrent expenditure takes into account the expenditure needed for the continuance of public services provided by the Government and sustaining current employees of the Government institutions for efficient use of resources. Similarly, baseline capital expenditure primarily includes ongoing projects, capital contribution to SOEs, providing loans and loan repayment expenditure.

Given that PSIP expenditure is a primary contributor to capital expenditure, MVR 2,500 from domestic budget and trust funds is expected to be spent on PSIP projects. Value of PSIP from loans and grant budget is expected to be MVR 3,000 million. Therefore, total PSIP expenditure forecasted for ongoing projects is MVR 5,500 million.

Total baseline budget for 2021 is forecasted to be MVR 30,464.4 million. Total expenditure included in this figure is estimated to be MVR 28,098.8 million. To repay the additional deficit and debt due to the increase in expenditure related to Covid-19, government expenditure must be better controlled. The repayment of USD 250 million bond issued in 2022, will begin this year and is likely to further increase baseline budget.

5.3.2 New Policy Initiatives and Recurrent Expenditure

The value of New Policy Initiatives aimed to reduce the social and economic impact of Covid-19, improve quality of public services and to diversify the economy is estimated to be MVR 4.5 billion. The new initiatives proposed are based on the Strategic Action Plan of the Government and the initiatives will also include the implementation of minimum wage from 2021 onwards. Furthermore, these new policy initiatives also include medium-term expenses needed for recovery from Covid-19 crisis.

5.3.3 Council Grant

According to the amendment to the Decentralization Law of the Maldives in 2019, Council Grant to local councils were disbursed and the PSIP projects less than MVR 5 million were authorized to be implemented by local councils.

The amount for local council grant is based on the forecasted baseline revenue of the Government. The council grant is equivalent to 5 percent of total baseline revenue earned and 40.0 percent of land (including shores, reef and lagoon) rents. Council grant for 2021 is forecasted to be 1,289.6 MVR million and is projected to increase by 19.3 percent in the medium-term.

5.3.4 Total Budget and Expenditure

Total government budget is expected to be MVR 36,254.0 million when expenditure on new policy initiatives and council grants are added to the baseline budget estimates. Total expenditure is projected to be MVR 33,888.4 million. Even though sovereign bond repayment is realized in 2022, the expenditure on new policy initiatives will be reduced to maintain total expenditure at the same level in the medium-term.

Medium-term budget estimates are outlined in Appendix 3 of this statement.

Table 7: Medium-term Budget

(millions of MVR)	2021	Forecast 2022	2023
Total Budget	36,254.0	38,157.8	34,783.2
Total Expenditure	33,888.4	31,707.3	32,080.8
Baseline Budget	30,464.4	33,465.1	28,310.9
Recurrent Expenditure	19,706.6	21,224.2	21,786.1
Personal Emoluments (incl. Pensions)	9,602.6	10,208.0	10,304.5
Goods & Services	4,254.6	4,310.5	4,360.6
Grants, Contributions & Subsidies	2,816.5	2,846.7	2,876,6
Other Recurrent Expenditures	3,032.8	3,859.0	4,244.4
Capital Expenditure	10,757.8	12,240.9	6,524.8
Public Sector Investment Program	5,500.0	2,750.0	1,000.0
Property, Investment & Lending	1,383.9	1,398.2	1,412.4
Budget Contingency	1,514.6	1,648.6	1,416.5
Debt Amortization	2,344.2	6,428.8	2,680.5
Other Capital Expenditures	15.1	15.3	15.4
New Policy Initiatives	4,500.0	3,500.0	5,000.0
Council Block Grant	1,289.6	1,192.7	1,472.3

5.3.5 Reducing Expenditure in The Medium-term

As a result of the shock to the fiscal revenues in 2020, expenditure reduction measures have been taken from the onset of Covid-19. Since recovery from this crisis may take several years, expenditure reduction measures are likely to help to achieve budget objectives. Budget financing gap is estimated to widen in the year 2021, and debt accumulation will be prevented by reducing expenditure and improving efficiency of spending.

A crisis provides the most pertinent opportunity for structural reform. At times of crisis, it is paramount that the Government expenditure on different sectors is evaluated. It is also important to monitor the objectives achieved by the Government spending and to bring reforms where needed.

In compiling the Government expenditure estimates provided in this Fiscal Strategy, it is assumed that government expenditure can be efficiently reduced in the medium-term. Measures to reduce expenditure are required for different sectors and Ministry of Finance is currently undertaking research to identify the measures that can be taken to reduce expenditure. Policy papers will be formulated for these measures and new measures will also be implemented in the medium-term.

Possible measures to reduce expenditure are outlined in Appendix 5.

5.4 Medium-Term Budget Balance

Given that revenue recovery will be slow after the economic slowdown of Covid-19, measures taken to reduce expenditure will be continue into 2021. The overall budget balance is calculated using baseline revenue with new revenue measures and cash grants, and using baseline expenditure with new policy initiatives and council grants. The overall budget balance for the year 2021 is projected to be MVR 16,364.6 million, equivalent to - 21.6 percent of GDP. Primary balance is forecasted to be MVR 13,446.9 million which corresponds to - 17.8 percent of GDP. Overall deficit and primary deficit are estimated to lessen in the medium-term from 2022 onwards if new revenue measures are implemented and expenditure is maintained at the same level.

Table 8: Medium-term Budget Forecast

	Forecast		
(millions of MVR)	2021	2022	2023
Total Revenue and Grants	17,523.7	21,076.5	25,314.1
Tax Revenue	10,102.0	13,337.7	16,810.8
Non-Tax Revenue	4,569.9	4,415.5	5,138.0
Grants	1,992.2	2,051.8	1,980.3
New Revenue Measures	859.7	1,271.7	1,384.9
Total Budget	36,254.0	38,157.8	34,783.2
Total Expenditure	33,888.4	31,707.3	32,080.8
Baseline Budget	30,464.4	33,465.1	28,310.9
Recurrent Expenditure	19,706.6	21,224.2	21,786.1
Capital Expenditure	10,757.8	12,240.9	6,524.8
PSIP	5,500.0	2,750.0	1,000.0
Budget Contingency	1,514.6	1,648.6	1,416.5
New Policy Initiatives	4,500.0	3,500.0	5,000.0
Council Block Grant	1,289.6	1,192.7	1,472.3
Overall Balance (Deficit)	(16,364.6)	(10,630.8)	(6,766.7)
Primary Balance	(13,446.9)	(6,896.1)	(2,659.2)

6. Budget Financing and Debt

Due to Covid-19 the current estimated government revenue for 2020 marks a sharp decline compared to the previous forecast. It is estimated that the economy will recover and will return to pre-Covid-19 GDP levels in 2022. As a result, medium-term fiscal revenue is estimated to be lower than earlier forecasts. Even though measures are taken to reduce expenditure, financing cost of deficit and debt repayment is likely to be significantly higher.

In 2020, MVR 17.7 billion will have to be spent on budget financing. To finance this, the Government is preparing to issue a bond of USD 400.0 million and to secure an additional USD 50.0 million in concessional loans from multilateral financial institutions. In addition, MVR 6.1 billion must be financed through T-bills and other avenues from the domestic market. MVR 3.9 billion of this figure has been secured by the Government of India with a USD 250.0 million loan through a domestic financial institution. In light of the Covid-19 crisis, parliament has authorized exemptions for the laws exercising limits on overdrawing from the public bank account, Article 32a, 32d, 32e of Fiscal Responsibility Act, for a one-year period. It is estimated that this will enable the Government to overdraw MVR 3.8 billion for the year 2020.

With regards to the medium-term, the financing requirement of the Government in the next two years is estimated to be maintained at the same level. The financing requirement for the year 2021 is estimated to be MVR 19.0 billion while MVR 17.6 billion will be needed for the year 2022. While the repayment of overdrawing from the public bank account is included in the estimates for 2021, the financing requirement estimates of 2022 are higher due to the repayment of bond of USD 250 million issued in 2017.

The Government is considering privatization of State-Owned Enterprises to enhance efficiency by operating in a market structure. The Government is exploring avenues for privatization such as public listing of SOEs such as State Electric Company Ltd (STELCO), Island Aviation Services Ltd, FENAKA Ltd, Maldives Industrial Fisheries Company Ltd (MIFCO) or any other model for privatization. It is forecasted that MVR 1.5 billion will be received from privatization in the year 2021 and 2022.

The Government also plans to issue bonds in the international market in the next three years. As such, government plans to issue bonds or sukuk equivalent to USD 600 million in 2021, USD 400 million in 2022 and USD 150 million in 2023. Table 3 shows the details of financing from domestic market via T-bills and other instruments.

Table 9: Medium-term Budget Financing Plan

	Forecast			
(millions of MVR)	2020	2021	2022	2023
Total Financing Requirement	17,733.6	19,017.6	17,572.3	10,118.4
Total Debt	17,740.5	17,364.1	14,381.7	10,016.1
Foreign Loans	1,677.4	4,542.0	3,771.0	3,771.0
Bond/ Sukuk	6,168.0	9,252.0	6,168.0	2,313.0
Public Bank Account Overdraw	3,840.1	(3,840.1)	-	-
Sovereign Development Fund	-	-	1,542.0	-
Domestic Market: T-Bill, T-Bond and Other Instruments	6,055.0	7,410.2	4,442.7	3,932.1
Privatization	-	1,542.0	1,542.0	-
Other Instruments/ Methods	(6.9)	111.4	106.5	102.3

One of the major hindrances to budget financing is the challenge in issuing a bond or a sukuk in the international market given the ongoing Covid-19 pandemic. Given the credit rating for Maldives has been downgraded due to the adverse impacts of Covid-19 to the economy, the yield for the bonds listed in the secondary market is over 20 percent. Thus, the coupon rate of bonds that are issued in the market will increase and make it difficult to attract investors. As issuing bonds under private placement is considered the most cost-effective option, the Government is working towards issuing bonds under private placement.

If the budget deficit is sustained at aforementioned levels, direct debt of 2020 is forecasted to be 101.9 percent of GDP and 121.8 percent including government guaranteed debts. Although debt as a percentage of GDP is estimated to increase in 2021, government debt ratio is forecasted to decline in 2022 as the growth rate of GDP is estimated to be higher than the growth of debt.

Chart 9: Debt to GDP Ratio

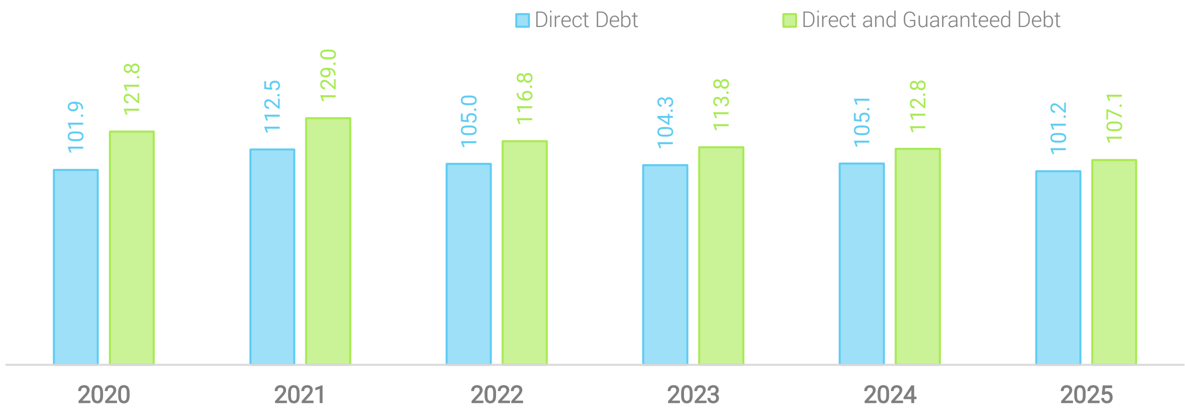
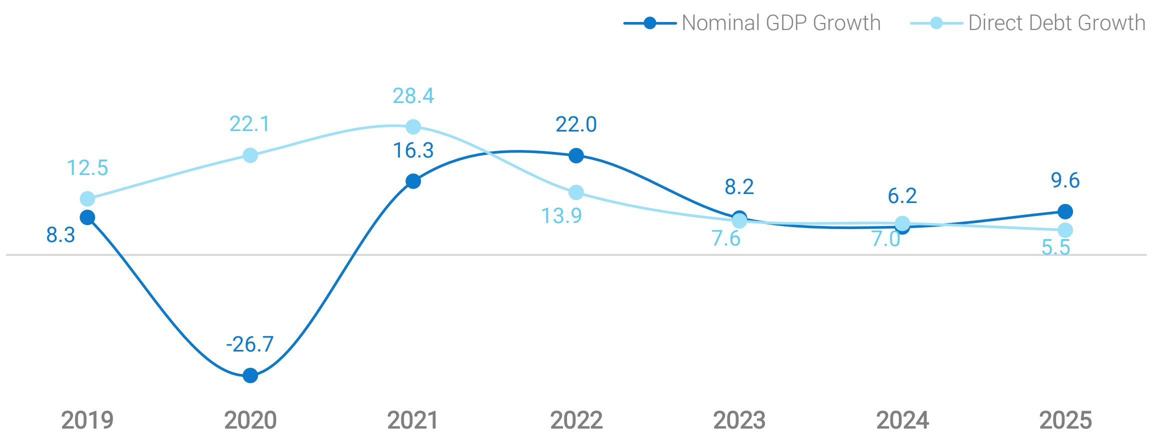


Chart 10: Nominal GDP and Debt Growth Rates



7. Sensitivity analysis

This section highlights the estimates on debt and required amount of debt financing based on scenarios where government income decreases and expenditure increases. The baseline estimates for this analysis are the aforementioned fiscal forecasts.

Three scenarios are provided in this analysis. In each scenario, an expenditure shock is introduced. Expenditure shock in Scenario 1 is considered as 5.0 percent of revised total budget, equivalent to MVR 1.8 billion. Expenditure shock considered in Scenario 2 is 10.0 percent of the total revised budget (MVR 3.6 billion) while expenditure shock is considered as 15.0 percent of total revised budget in 2021 which is MVR 5.4 billion for Scenario 3. These are proxies that can be used to estimate the change in expenditure where a surge in Covid-19 cases require strict economic and health precautionary measures over a prolonged period.

For revenue, three scenarios are based on three medium-term estimates. The first scenario provides the baseline estimates for fiscal revenue given in the best-case scenario for the economy mentioned above. In the second scenario, revenue is estimated for the moderate-case scenario for the economy, and in the third scenario, revenue is estimated for the worst-case scenario for the economy. Table 10 provides a summary of the three scenarios.

Chart 11: Forecasts for Revenues and Grants

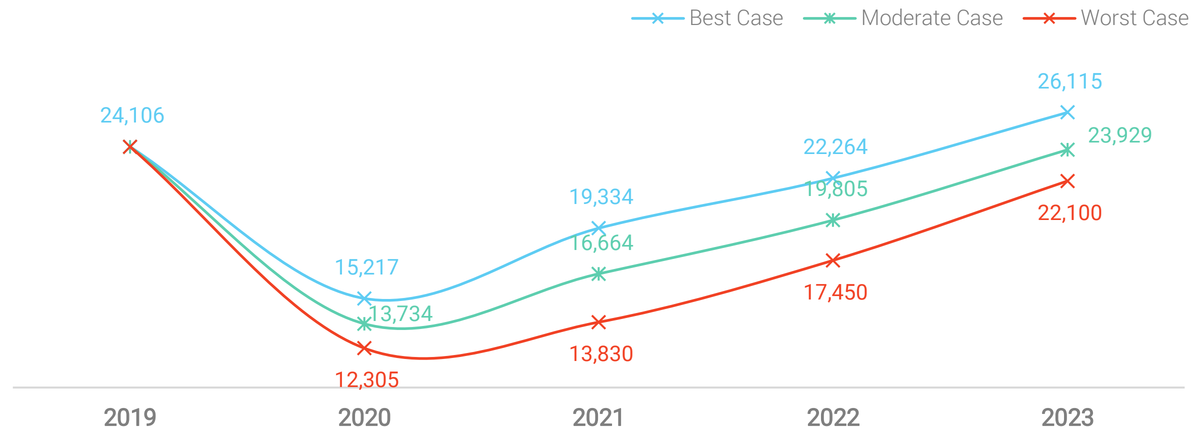


Table 10: Assumptions of Scenarios

	Sources of Revenue Estimation	Expenditure Shock (millions in MVR)
Scenario 1	Economic Best-Case Scenario	1,812.70
Scenario 2	Economic Moderate Case Scenario	3,625.40
Scenario 3	Economic Worst Case Scenario	5,438.10

The sensitivity analysis shows that budget deficit and deficit financing will be higher than the feasible limit in 2021 and 2022 for scenarios 2 and 3. The lower revenue as a result of assumptions for tourism sector re-opening dates (Scenario 2: October 2020, Scenario 3: January 2021) is the main reason for this. In these cases, public programs and infrastructure projects may need to be halted, to prioritize Covid-19 related health sector spending and other essential services provided by the Government. Therefore, the Government is preparing for these situations by introducing measures to reduce expenditure. Chart 12 and 13 show the budget deficit and financing need.

Chart 12: Overall Deficit Scenarios (in millions of MVR)

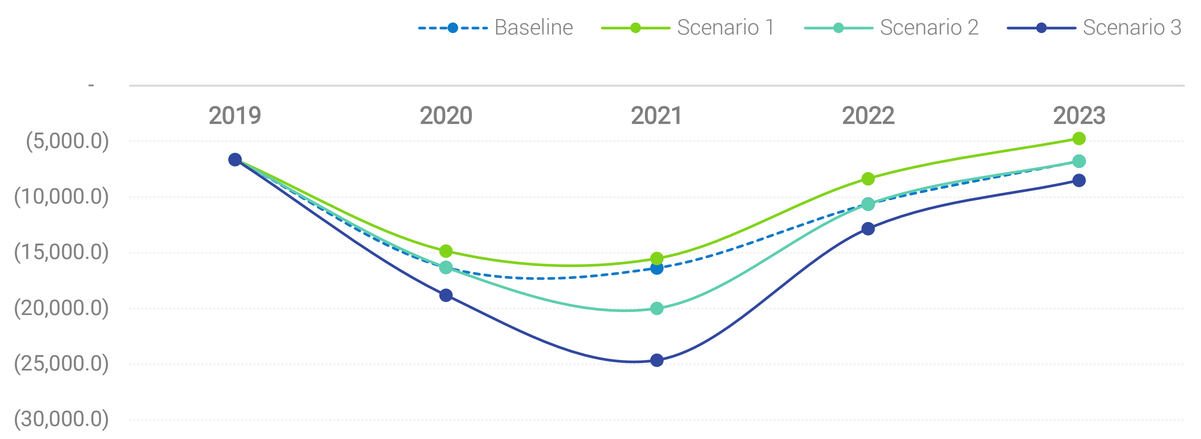
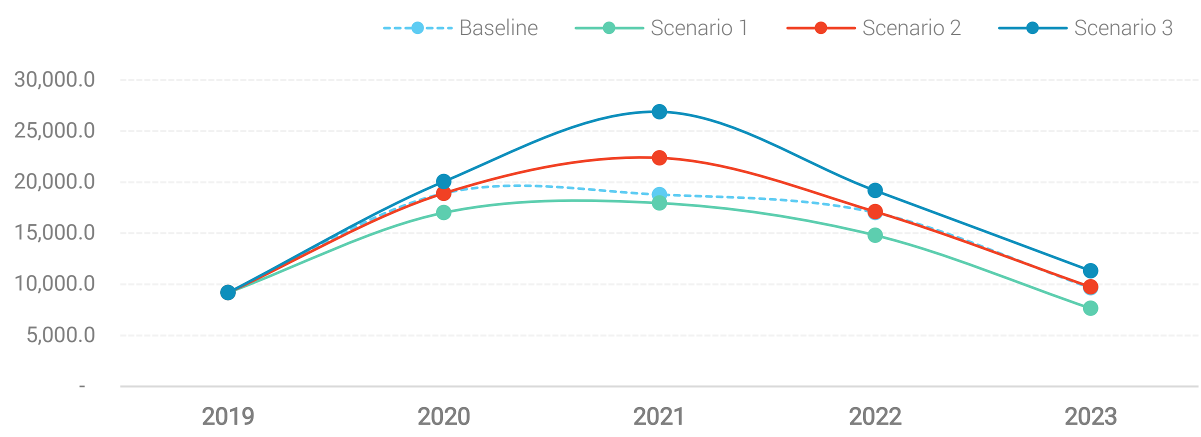


Chart 13: Budget Financing Requirements Scenarios (in millions of MVR)



Since the primary source of financing is via debt, the sharp increase in financing requirement of the Government will increase debt as a percentage of GDP, making it challenging for the Government to repay debt and also to service debt. Furthermore, nominal GDP is forecasted to decline significantly which will increase the debt to GDP ratio. In scenario 3, debt as a percentage of GDP is expected to be 155.6 percent in 2021. Given that nominal GDP growth rate is expected to be higher than the growth rate of debt after 2021, debt to GDP ratio is expected to decline. Nevertheless, as a result of expected sharp growth in government debt due to the pandemic, the Government may be required to allocate a large proportion of government budget to debt repayment and debt financing. Maldives has been considered as a nation with "High Risk of Debt Distress" according to the World Bank's Debt Sensitivity Analysis, prior to Covid-19 crisis. Hence, if Scenario 2 and Scenario 3 were to occur Maldives could go into debt distress. Overcoming challenges in preventing debt distress will also depend on the effectiveness of measures to reduce expenditure and New Revenue Measures. Chart 14 and 15 show the estimates of direct debt as a percentage of GDP and total debt (direct plus guaranteed debt) as a percentage of GDP.

Chart 14: Direct Debt to GDP

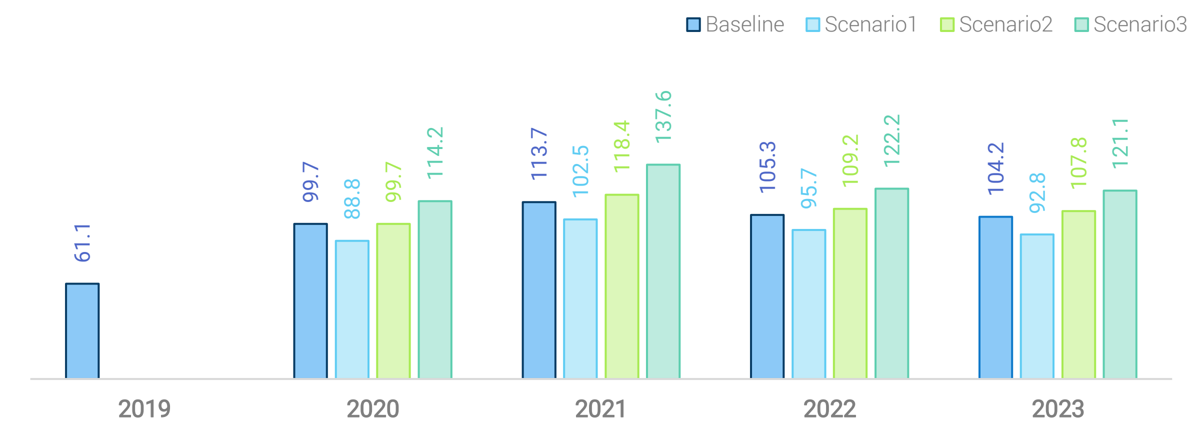
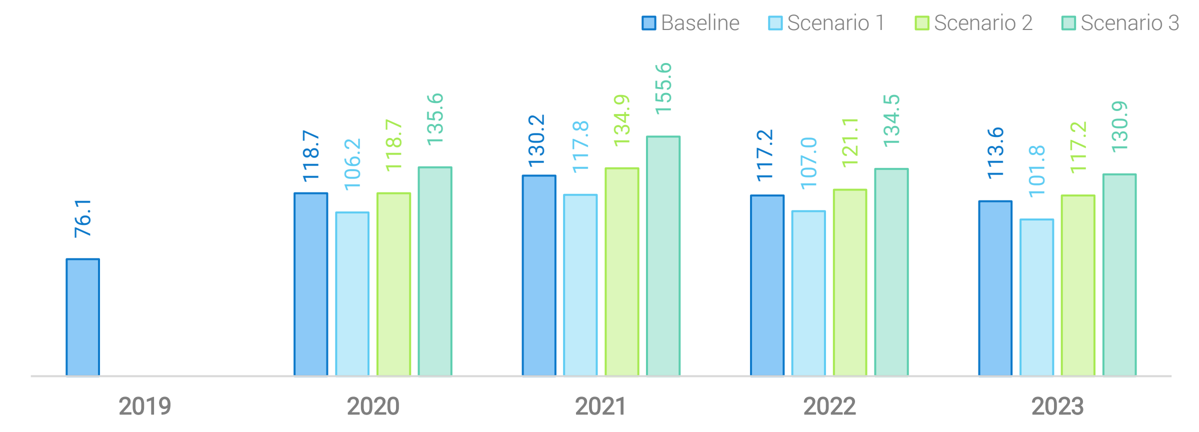


Chart 15: Direct and Guaranteed Debt to GDP



8. Challenges to Fiscal Strategy

Given below are the major challenges to medium-term fiscal strategy and the measures being undertaken or measures that will be undertaken in the future to overcome these challenges

Long Global Recovery Period

Challenge: International borders being closed for a prolonged period if global spread of Covid-19 is not controlled, leading to a slower recovery of transport sector. This will result in slower recovery of tourism sector and slower overall economic recovery in the Maldives

Measures: Taking stronger measures to prevent the spread of Covid-19 in the Maldives and to gain the confidence of tourists about the safety of Maldives as a holiday destination. Increase marketing and promotion of the tourism industry and increasing the flights operating to the Maldives.

Slower Recovery of Maldivian Economy

Challenge: Inability to spend adequately on health, social response and economic recovery because of lack of financing and as a result, recovery from Covid-19 may be prolonged.
Measures: Allocate sufficient expenditure from budget for Covid-19 response and recovery, continue working towards securing financing needed for budget, make arrangements with central bank to prevent cashflow difficulties and to facilitate payments. Facilitate loans for businesses through banking sector.

Decline in Fiscal Revenue

Challenge: Lower room rates for tourist resorts and guest houses in Maldives due to higher price competition when guest houses and resorts in Maldives try to attract the already declining number of international tourists. Hence, despite an increase in tourist arrivals, revenue earned may be relatively lower.
Measures: Commence investments to improve tourist arrivals. Complete the Velana International Airport sooner. Increase revenue by diversifying the economy to reduce dependency on tourism sector. Introduce measures to reduce expenditure when the Government experiences a slump in fiscal revenue.

Devaluation Risk

Challenge: While foreign currency earnings are falling, an increase in supply of Maldivian Rufiyaa can cause an unsustainable increase in demand for USD.
Measures: Reduce expenditure, acquire a higher portion of financing by international market in foreign currency. Improve coordination between fiscal and monetary policy.

Inflation Risk

Challenge: Raise in overall prices; devaluation risk will also cause inflation risk since primary cause of inflation in the Maldives is imported inflation.
Measures: Measures to control value of Rufiyaa, control market prices, and providing relief discounts to households

Deflation Risk

Challenge: Economic slowdown as people may delay their spending if prices are speculated to fall. For example, delaying renting places expecting a decline in rent in the future
Measures: Take measures to boost economic recovery, economic stimulus and relief

Increase in Debt to An Unsustainable Level

Challenge: As fiscal revenue has declined; expenditures are being financed via debt causing a drastic increase in debt levels in 2020 and 2021.

Measures: Reduce expenditure and increase revenue in the medium-term, develop a strategy to reduce debt to pre-Covid-19 level by repaying the additional debt of the next two years, reduce expenditure and increase saving, investing on productive activities to promote economic growth.

Underfunding

Challenge: Decline in spending to achieve government's objectives or reduction in spending on improvement of quality of public services. Spending will be prioritized to areas where short-term spending cannot be reduced when implementing measures to reduce expenditure. As a result, it will be difficult to achieve social objectives of the Government.

Measures: take measures to improve efficiency of government spending, analyse expenditure leakages and prevent those leakages, budget reprogramming, analyse the allocation of resources to public services and reallocate resources to important areas, include spending for important government objectives in the budget even though measures to reduce expenditure are being undertaken.

Debt Overhang Post-Crisis

Challenge: The reduction in expenditure coupled with higher taxes needed for debt repayment owing to the increase in debt in a crisis may lead to a possible economic slowdown. The increase in debt level will create difficulties in obtaining debt for productive activities.

Measures: A long-term plan must be devised to lower debt instead of a medium-term plan to lower debt, reduce expenditure and budget deficit, prioritize concessional financing, undertake measures according to recommendations from international financial organizations and promote close relationships with these international organizations and other nations.

9. Achieving the Targets of Fiscal Responsibly Act

According to Fiscal Responsibility Act, Article 32b, total debt (including guaranteed debt) must not exceed 60 percent of GDP by the end of three years since the passing of the Act on 01 January 2014. And, once debt is maintained at this level, the proportion of debt as a percentage of GDP must be reviewed and published every 5 years by the Ministry of Finance. However, debt as a percentage of GDP was 63.9 percent at the beginning of 2017 and did not reach the required levels thereafter. According to the current fiscal strategy mentioned above, debt is expected to be 121.8 percent of GDP by the end of 2020, thus not meeting the requirement of the Act. It is important to review the current requirement of debt level of 60 percent of GDP as this level of debt is currently being mandated by advanced countries in European Union and it may not be the most appropriate level of debt for the Maldives, particularly given the current situation.

Moreover, Article 34a of the Fiscal Responsibility Act states that a surplus budget must be achieved three years after the passing of the Act on 01 January 2014, and Article 34b requires that overall budget balance to be maintained below 3.5 percent of GDP. Given that primary balance of the budget has not been in surplus in the past three years, it is highly unlikely that this requirement can be met in the medium-term. Even though the overall balance of the budget was brought down to 3.1 percent of the budget in 2017, this requirement has not been met since then and is unlikely that this requirement will also be met in the medium-term.

During this period of economic downturn, a contractionary fiscal policy is likely to further dampen economic growth. Nevertheless, debt must be maintained at a sustainable level and in line with fiscal revenue.

10. Conclusion

As required under the Fiscal Responsibility Act, this statement includes the revised estimates for 2020, medium-term baseline estimates, budget deficit and medium-term estimates taking into account the objectives that are aimed to be achieved.

This statement has been prepared to change the direction of the economy and to maintain the quality of public services provided by the Government in response to the economic downturn caused by the Covid-19 crisis. Hence, the measures outlined in the strategy aims to reduce expenditure in the medium-term, create fiscal space to increase necessary spending, enhance resilience and economic diversification, and to improve social wellbeing of the economy. The statement also targets to reduce the budget deficit in the medium-term by lowering debt to a sustainable level given that the debt level has increased to finance measures required to curb the adverse impacts of Covid-19.

Budget 2021 will be formulated based on this statement.

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Appendix 1: Revenue and Expenditure for 2019 and 2020

	Approved 2019	Actual 2019	Approved 2020	Revised 2020
Total Revenue and Grants	24,056.60	24,106.10	29,921.60	13,734.30
Total Revenue and Grants	21,986.8	22,950.4	24,706.7	12,077.0
Import Duty	3,183.8	3,412.3	3,580.6	2,062.9
Export Duty	-	-	39.7	-
Business and Property Tax	3,451.4	3,544.1	4,027.8	3,317.6
Withholding* and Business Profit Tax	2,846.1	2,899.2	3,103.6	2,506.9
Bank Profit Tax	566.8	614.0	923.7	811.7
Goods & Services	8,038.4	7,748.3	7,954.5	3,791.3
Tourism Goods & Services Tax	5,039.5	4,903.4	5,053.5	1,878.7
General Goods & Services Tax	2,998.9	2,844.9	2,901.0	1,912.6
Other Taxes and Duties	1,752.8	1,735.5	2,105.5	775.4
Airport Service Charge	705.6	731.1	877.1	258.0
Green Tax	892.7	850.6	970.3	319.4
Fees & Charges	1,398.1	1,737.0	2,175.9	754.2
Registration & License Fees	417.5	413.4	441.0	210.1
Property Income	2,123.7	1,875.4	2,195.5	546.3
Interest, Profit & Dividends	1,180.7	1,807.3	1,670.9	575.2
New Revenue Measures	-	-	-	-
Other Revenue	440.4	677.0	515.4	205.1
Grants	2,069.8	1,155.8	5,214.9	1,657.2
Total Expenditure	29,045.5	30,716.7	35,966.4	30,050.1
Total Budget	31,954.9	31,850.2	37,871.3	31,200.5
Recurrent Expenditure	19,117.4	21,350.1	22,337.9	19,233.2
Personal Emoluments	7,966.9	8,294.2	8,716.1	8,098.8
Pensions, Retirement Benefits & Gratuities	1,565.1	1,540.8	1,562.4	1,545.7
Goods & Services	4,412.4	4,736.0	4,752.3	4,694.6
Travel Expenses	142.1	230.6	237.8	117.2
Supplies & Requisites	609.2	637.3	725.8	649.4
Operational Services	2,002.3	1,922.0	2,299.1	1,748.6
Supplies & Requisites for Service Provision	657.4	973.5	897.9	1,626.9

Training	724.0	564.4	905.7	296.7
Repairs & Maintenance	277.4	408.1	410.2	255.9
Grants, Contributions & Subsidies	3,094.8	3,748.0	2,987.7	3,092.4
Other Recurrent Expenditure	2,078.2	3,031.1	1,980.2	717.2
Council Block Grant	-	-	1,615.0	908.5
Capital Expenditure	12,837.6	10,500.1	15,533.4	11,031.4
Development Projects	7.8	12.1	51.9	15.0
Public Sector Investment Program	7,214.2	5,994.1	10,454.8	5,491.1
Property, Investment & Lending	2,070.1	3,360.4	1,547.5	3,874.8
Budget Contingency	636.0	-	1,574.3	500.0
Debt Amortization	2,887.9	1,124.5	1,883.7	1,129.2
Capital Contributions to Multilateral Organisations	21.6	8.9	21.3	21.3
Primary Balance	(2,987.3)	(5,069.7)	(4,201.1)	(14,607.8)
Overall Balance	(4,988.9)	(6,610.5)	(6,044.8)	(16,315.8)
% of GDP				
Primary Balance		(5.7)		(22.4)
Overall Balance		(7.4)		(25.1)
Direct Debt		61.1		101.9
Direct & Guaranteed Debt		76.1		121.8

* Withholding figure for 2020 includes estimates for Employee Withholding Tax

Appendix 2: Medium-term Economic Forecast

	2018	2019	2020*	2021*	2022*	2023*
Nominal GDP (in millions of MVR)	81,993.8	88,824.7	65,091.8	75,721.6	92,410.9	99,991.8
Nominal GDP Growth	12.5%	8.3%	-26.7%	16.3%	22.0%	8.2%
Real GDP (in millions of MVR, 2014 constant price)	71,025.9	75,215.8	58,880.0	69,884.5	83,586.8	89,226.6
Real GDP Growth	6.9%	5.9%	-21.7%	18.7%	19.6%	6.7%
CPI Inflation	-0.1%	0.2%	0.7%	0.8%	1.1%	1.1%
Tourism Arrivals	1,484,274.0	1,702,887.0	625,082.0	751,647.0	1,407,727.0	1,692,759.0
Tourism Arrivals Growth	6.8%	14.7%	-63.3%	20.2%	87.3%	20.2%
Bednights	9,471,778.0	10,689,248.0	4,738,723.0	5,551,474.0	9,468,538.0	11,092,512.0
Bednights Growth	10.2%	12.9%	-55.7%	17.2%	70.6%	17.2%

* Forecasts from 2020 to 2023 are based on the moderate case scenario forecasts

Appendix 3: Revenue and Expenditure Forecast for 2021 to 2023

	Forecast		
	2021	2022	2023
Total Revenue and Grants	17,523.7	21,076.5	25,314.1
Total Revenue and Grants	15,531.5	19,024.7	23,333.8
Import Duty	2,438.2	3,219.9	3,590.3
Income and Property Tax	2,120.1	2,295.3	2,405.6
Withholding* and Business Profit Tax	1,630.6	1,742.2	1,747.4
Bank Profit Tax	489.5	553.1	658.2
Goods & Services	4,768.2	6,514.1	9,194.9
Tourism Goods & Services Tax	2,326.1	3,839.6	5,948.6
General Goods & Services Tax	2,442.2	2,674.6	3,246.3
Other Taxes and Duties	775.4	1,308.4	1,620.0
Airport Service Charge	308.8	512.6	671.2
Green Tax	422.1	750.2	902.8
Fees & Charges	699.5	910.4	1,078.8
Registration & License Fees	398.1	414.2	415.0
Property Income	1,663.1	1,520.6	1,954.0
Interest, Profit & Dividends	902.3	987.0	1,085.7
New Revenue Measures	859.7	1,271.7	1,384.9
Other Revenue	906.8	583.1	604.4
Grants	1,992.2	2,051.8	1,980.3
Total Expenditure	33,888.4	31,707.3	33,080.8
Total Budget	36,254.0	38,157.8	34,783.2
Recurrent Expenditure	19,673.3	21,187.1	21,748.9
Personal Emoluments	8,029.8	8,610.1	8,696.2
Pensions, Retirement Benefits & Gratuities	1,572.9	1,597.9	1,608.3
Goods & Services	4,254.6	4,310.5	4,360.6
Travel Expenses	175.2	205.2	205.2
Supplies & Requisites	646.4	654.8	650.4
Operational Services	1,762.3	1,781.2	1,799.9

Supplies & Requisites for Service Provision	1,009.6	984.0	994.3
Training	439.1	461.0	484.1
Repairs & Maintenance	222.0	224.3	226.7
Grants, Contributions & Subsidies	2,816.5	2,846.7	2,876.6
Other Recurrent Expenditure	2,999.5	3,821.8	4,207.3
Capital Expenditure	8,392.2	5,790.4	3,822.4
Development Projects	15.1	15.3	15.4
Public Sector Investment Program	5,500.0	2,750.0	1,000.0
Property, Investment & Lending	1,362.5	1,376.5	1,390.5
Budget Contingency	1,514.6	1,648.6	1,416.5
Debt Amortization	2,344.2	6,428.8	2,680.5
Capital Contributions to Multilateral Organisations	21.4	21.7	21.9
New Policy Initiatives	4,500.0	3,500.0	5,000.0
Council Block Grant	1,289.6	1,192.7	1,472.3
Primary Balance	(13,446.9)	(6,896.1)	(2,659.2)
Overall Balance	(16,364.6)	(10,630.8)	(6,766.7)
% of GDP			
Primary Balance	-17.8	-7.4	-2.7
Overall Balance	-21.6	-11.5	-6.8
Direct Debt	112.5	105	104.3
Direct & Guaranteed Debt	129	116.8	113.8

* Withholding figure for 2020 includes estimates for Employee Withholding Tax

Appendix 4: Measures Proposed to Increase Revenue in the Medium-term

4.1 Frequency Spectrum Charge

Presently there is no fee charged for the use of the frequency spectrum. As a result, the use of the frequency spectrum has been inefficient. If a fee could be charged for the usage of frequency, the usage of it can be more efficiently allocated, possibly generating up to MVR 120 million per year.

4.2 Charging Property Tax

This type of tax is usually charged to generate or increase income for local government. If an income stream for councils could be set up by the central government, the dependency of councils on central government grants will decrease and councils can become financially independent. Moreover, the electorate of councils should accountable if such a tax is collected. When collecting a property tax, each council should receive the income generated from the lands and buildings in the council's jurisdiction.

Implementing a property tax requires extensive preparation by the Government. The first step of preparation would need to be establishing a registry of lands and buildings, and setting up a mechanism to maintain it. In order to begin implementing this tax, a value per square foot can be set, to be paid throughout the year. And as property value changes every year, the tax rate should be revised every year.

4.3 Changing the GST Rate or Tax Base

In order to increase income to the Government, the established GGST and TGST rates can be increased. Different rates can be applied for different industries. Additionally, GST exempt or zero-rated goods and services can be reviewed to see if the purpose of exempting and zero-rating them are fulfilled, and can be revised.

4.4 Implementing a Turnover Tax

In order to alleviate the difficulty for small and medium enterprises to follow the taxation system, a turnover tax can be implemented from them instead of GST. Additionally, the threshold for being eligible for GGST can be increased. As such, turnover tax will be charged at a rate of 4.3 percent of the total income (sales) of the business. The amount of documentation required to be maintained and submitted by those eligible for turnover tax can also be made easier. Furthermore, the duration in which turnover tax needs to be paid can be increased.

4.5 Introducing the Issuance of Long-term Resident Permits

A long-term residency permit can be requested by expatriate workers who have been living in Maldives for an extended period of time and meet set requirements. As such, long term residency permit holders will receive similar rights as citizens of Maldives (example: health insurance).

4.6 Solidarity Tax

A solidarity tax is implemented for specific purposes and for a specific period of time. As such, some countries implement solidarity tax for the following reasons:

- France: At specific rates for passengers departing on various classes of air tickets
- Germany: 5.5 percent surtax on income tax or corporate tax
- Greece: A progressive rate from total income (from 2.2 percent to 10 percent)

Similarly, such a tax can be introduced to meet the additional financing requirements that arose due to the Covid-19 pandemic. This tax will be taken for the recovery period.

4.7 Privatization

In order to increase the efficiency of the services provided by SOEs, the most profitable SOEs can be identified and privatised. As a result, the cost of the services offered may be reduced, as they shift to a profit motive, reducing the need for the Government to provide capital for them.

In 2009 and 2010, MVR 510 million and MVR 946 million were generated as a result of privatising schools and airports.

4.8 Island Lease for Tourism

In line with previous years, in the medium-term new islands can be leased for the development of resorts. A conversion fee can be collected from leasing of such islands.

Appendix 5: Possible Measures to Reduce Expenditure in the Medium-term

5.1 Reduction of Expenditures on Personal Emolument and Over-time

The following measures can be taken to reduce and maintain the budgetary expenditure on employees at a sustainable level in the medium term:

- Increase the productivity of current employees
- Developing a management plan to distribute the constitutional responsibilities of institutes with too many legal responsibilities
- Changing employees between civil service institutions based on their requirements
- Temporary halting employee recruitment for the time-being

Moreover, flexible working arrangements can be made in order to reduce overtime expenditures. As such, official working hours can be set at 8 hours, with 2 of those hours being dedicated for flexible working. Services offered by government institutions can also be centralised, while reducing administrative staff and outsourcing these services to SOEs.

5.2 Reduction of Operational Expenditures of Offices

In order to reduce operational expenditure of government offices, online working arrangements can be made in order to reduce the expenses on paper and printing. In addition, a majority of expenditure made on providing meals for employees while at work are made in defence forces. In order to reduce such expenses, avenues to reduce the rates charged for these services can be analysed and amended accordingly.

5.3 Expenditures on Medical Consumables

About 1-3 percent of total government expenditure is spent on medical consumables. Medical consumables include goods used for treatment of wounds, injections, and goods required for laboratory tests. On average, MVR 500-700 million has been spent from the national budget on medical consumables over the past years. While MVR 897.5 million was spent on medical consumables in 2019, MVR 770.7 million was budgeted for 2020. This figure has been increased based on the increase in health centres and the general increase in medical consumables over the years.

Measures that can be taken to reduce the expenditure on medical consumables are:

- Establishing an inventory and stock management system (reducing wastage and overstocking)
- Enhancing the medical consumables procurement system
- Increasing competitiveness in the medical consumables industry and eliminating monopoly power
- Establishing a system for the use of generic medication
- Bulk purchasing the most used and essential medications

- Keeping different brands of laboratory machinery in order to increase competition among the re-agent businesses for laboratory machinery

5.4 Reducing Expenditure on the Procurement of School Books

Currently, all necessary school books and stationery are provided for all students under the national budget. This service is provided in other neighbouring countries in a targeted to students who needs the assistance or are beneath the poverty line. As such, starting from 2021, the Government could reduce its expenses on school books and stationery by only providing it to students who requests this support.

5.5 Expenditure on Students' Breakfast Program

The student's breakfast program introduced in 2019 is one of the key pledges of this government. However, as the scope of this program widened with various menus being offered and the amounts being paid to multiple contractors increasing, the cost of the program has climbed significantly. For the remainder of the year, expenses on this program can be reduced if it is provided only to students in need of it, as per the advice of health professionals.

Moreover, the original menu can be re-introduced. If the program can be targeted as above, MVR 50-75 million can be reduced from budgetary expenditure.

5.6 Aasandha

3-5 percent of government expenditure is made on the national medical insurance scheme-Aasandha. Over the past years, an average of roughly MVR 1.0 billion was spent per annum from the national budget on this scheme. While MVR 1.0 billion was spent on Aasandha in 2019, MVR 950.8 million was budgeted for 2020.

Most of the expenses in this scheme is spent on reimbursement for the cost of pharmaceutical drugs, in-patient and out-patient services and for medical treatment from abroad. If the cost of the Aasandha scheme continues to increase at this rate, it cannot be sustainably continued.

Expenditure reducing measures could be:

- Changing the most frequently used medications to generic medication, and covering up to the cost of the generic medication within Aasandha
- Setting a baseline price for medications and setting a maximum retail price
- Increasing competitiveness in the medications market, and eliminating monopoly in the import of medication
- Purchasing medication through a competitive bidding process. Further in order to achieve economies of scale in procurement of medication, partnering up with another large purchaser of medication.

In order to reduce the cost of the Aasandha scheme in the medium-term, it can also be considered to redesign the scheme. In particular, amendments can be made in order to address the negative incentives present within the scheme while leads to uncontrolled increases in costs. Further, it is important for the Government to view health insurance and expenses on employee medical expenses together. As such, employees who have been registered on other health insurance schemes on government expense can be made exempt from the Aasandha scheme.

5.7: Indirect Subsidies

Relevant subsidies are given to the STO and utility companies reduce the price of food, and energy & electricity, respectively. The subsidy provided to reduce the price of food is the amount given to compensate for the losses sustained by STO for selling staple foods (wheat, flour, sugar) at government-controlled prices. The energy and electricity subsidies were provided to reduce the price of electricity. The energy subsidy was given to compensate for the losses incurred by STO for selling oil needed by utility companies to produce electricity at government-controlled prices. The electricity subsidy was provided to compensate for the losses incurred by utility companies for the Government-controlled tariff rates on electricity. The current subsidy mechanism may not be considered efficient as the subsidies are indirect and not targeted.

In order to reduce the cost of food subsidy, the control rate could be increased or the food items considered staple foods can be revised. To reduce the expenditure on energy subsidy, the price charged for oil or the tariff rate can be increased. Finally, with respect to reducing expenditure on electricity subsidy, the use of renewable energy sources, instead of diesel, can be considered.