MINISTRY OF FINANCE AND TREASURY

FISCAL AND DEBT STRATEGY

PREFACE

The Fiscal Responsibility Act (Law Number 7/2013) obligates the Government to submit a Medium Term Fiscal Strategy Statement and a Medium Term Debt Strategy Statement to the People's Majlis before the end of July every fiscal year. The Ministry of Finance and Treasury has accordingly submitted these statements to the Majlis since the entry into force of the Fiscal Responsibility Act. The Ministry believes that these strategy statements, as important policy documents, requires a broader audience. As such the 2018 statements would be the first to be published on the Ministry's website and made accessible to the general public.

This document combines the Fiscal Strategy and the Debt Strategy submitted to the People's Majlis in July 2018. The documents are drafted to meet the guidelines specified in the Fiscal Responsibility Act. Furthermore, these strategies are also drafted as guiding documents to the policy makers from both the executive and the legislative branch of the Government to gauge the fiscal performance during the year, the debt conditions and the potential fiscal and debt strategy options to meet fiscal targets set under the Fiscal Responsibility Act.

As a document submitted in July, the reference period for the document is January to June 2018. As such the policy analysis and proposals are based on the best information available up to this period. The documents are presented to the reader as submitted to the People's Majlis in July 2018, with some corrections for data errors. The readers should also be aware that the budget numbers presented here for future years are forecasts produced by the Ministry in July 2018 and does not constitute approved figures by the People's Majlis. Similarly, figures for the ongoing year has been revised in July and are subject to further change when Budget 2019 is submitted to the Majilis. The annual budget would be submitted to the People's Majlis by the end of October to be approved by the Majlis before the commencement of the fiscal year in 2019.

The document is broken down into three main areas.

1. Economic and Fiscal Developments - looks at the macroeconomic developments during the first half of the year and the economic prospects for the rest of the year. The section also looks at the realization of the approved budget for 2018 in the first six months of the year.

2. Medium Term Fiscal Strategy 2019-2021 – this section looks at the fiscal strategy objectives of the Government and highlights measures to ensure the effective implementation of the fiscal strategies of the Government. The section also looks at the revised budget for 2018, the baselines budget estimates for 2019 and the medium term budget estimates.

3. Medium Term Debt Management Strategy 2019-2021 – this section details the position of the debt portfolio at the end of 2017, the estimated debt position at the end of 2018, and the strategy for debt management for the period 2019-2021.

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Economic and Fiscal Developments

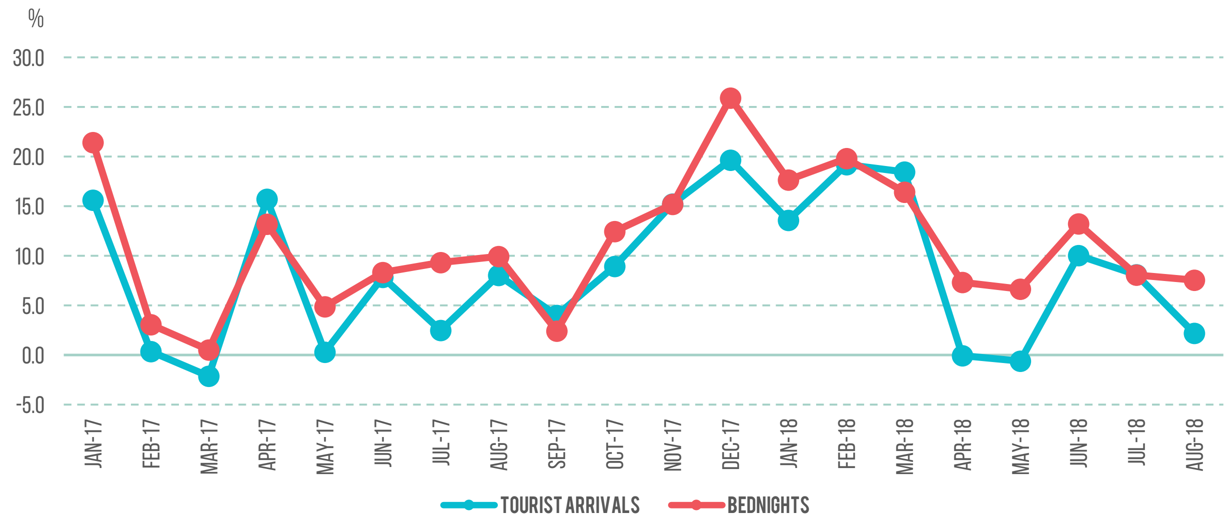
Economic and Fiscal Developments

Macroeconomic Situation

Output

According to high frequency indicators, real GDP growth is anticipated to be in line with the projections made for the budget in October 2017 – growth was forecast at 6.0 percent for 2018, down from 6.9 percent in 2017. This is despite the travel advisories issued by key tourism markets following the declaration of state of emergency in February 2018, which prompted fears of a marked decline in tourist arrivals. However the data did not show an immediate impact, recording a growth in arrivals of 19.2 percent in February 2018 and 18.5 percent in March 2018. After registering slight slowdown in growth in April and May 2018, tourist arrivals and bed nights has remained strong in the months that followed, helped by the remedial measures taken by the tourism industry following booking cancellations caused by the travel advisories. During the January-June 2018 period, arrivals from key European markets remained rather resilient, with the region as a whole registering positive growth rates, although arrivals from China, the largest source market, posted large

FIGURE 1 GROWTH IN TOURIST ARRIVALS AND BEDNIGHTS



SOURCE: MINISTRY OF TOURISM

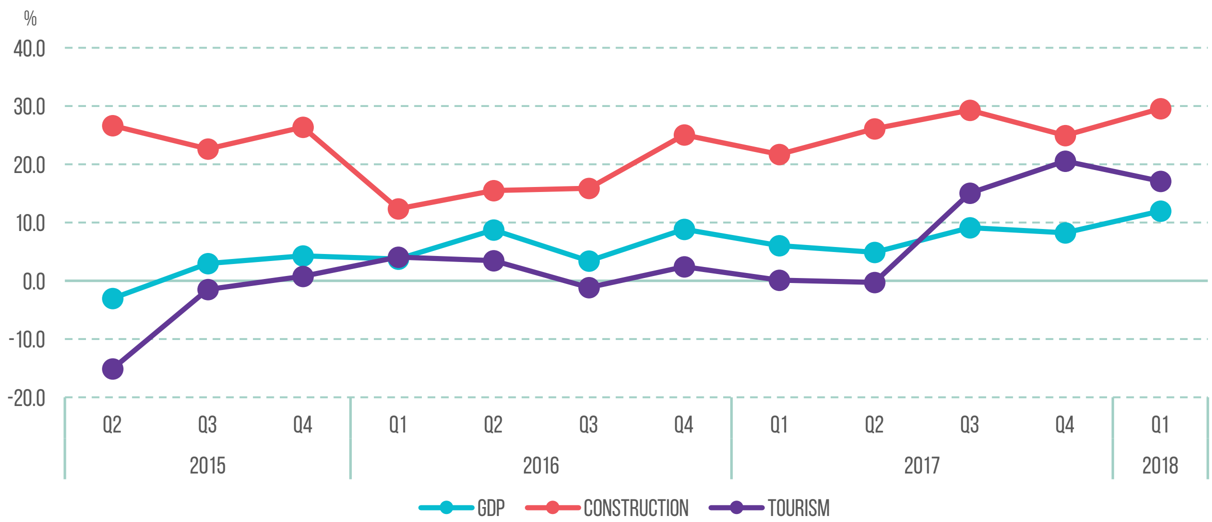
declines. It should also be noted that the Chinese market has observed major declines in 2016 and 2017 as well. Reflecting the buoyant arrivals growth, total tourism receipts also strengthened by 18 percent in the first six months of the year.

Meanwhile, according to the first estimates of the quarterly national accounts for Q1-2018, released by National Bureau of Statistics in July 2018, the economy grew by 12.0 percent in Q1-2018, compared to the 8.2 percent growth recorded in Q4-2017. In Q1-2018 growth was mainly driven by significant growth contributions from tourism, followed by construction and; transportation and communication sectors. The construction sector has been one of the major contributors to GDP growth starting from 2014 and is expected to provide a major impetus to growth in 2018. Gross value added of the construction sector grew by 29.5 percent in Q1-2018 largely driven by the mega infrastructure projects, namely the projects related to China Maldives Friendship bridge, the Velana International Airport runway expansion, Dharumavantha Hospital, Hulhumale' Phase II development and several private and public sector housing projects. Most of these projects are scheduled to be completed this year.

Inflation

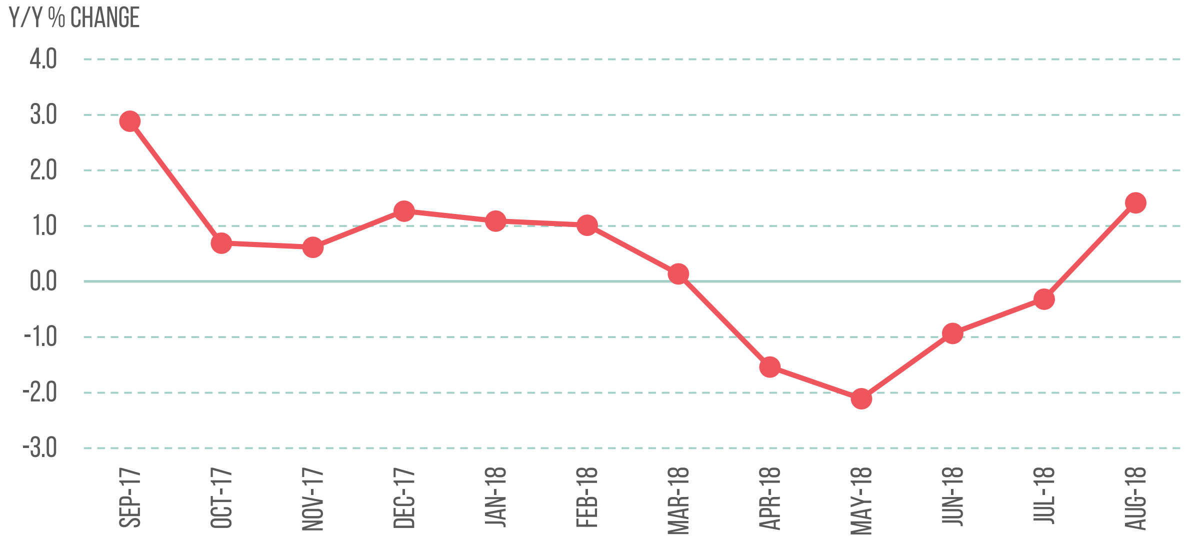
Price developments during the first half of the year remained subdued as anticipated in the projections made in October 2017. The rate of inflation, as measured by the year on year percent change in the national CPI, further decelerated and turned negative in April 2018 to register - 0.9 percent in June 2018, down from 1.3 percent in December 2017. This was

FIGURE 2 QUARTERLY GDP GROWTH



SOURCE: NATIONAL BUREAU OF STATISTICS

FIGURE 3 INFLATION RATE - NATIONAL

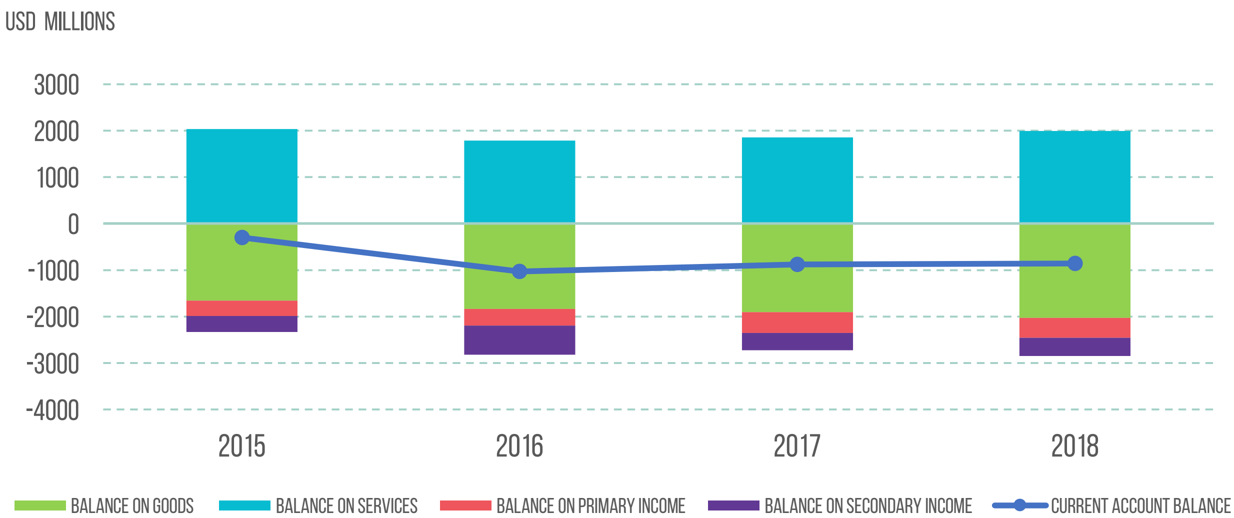


SOURCE: NATIONAL BUREAU OF STATISTICS

largely contributed by the decline food prices and electricity prices.

As per projections made in October 2017, the average rate of inflation is forecast to decelerate to 3.1 percent in 2018, down from 3.4 percent in 2017. The expected fall in inflation in 2018 reflects the dissipation of the base effect stemming from certain policy changes which kept inflation at elevated levels during most of 2017. These include the upward revisions to import duties of cigarettes and selected drinks in early 2017, as well as reduction in the food subsidy on staple food items in late 2016.

FIGURE 4 CURRENT ACCOUNT BALANCE



SOURCE: MALDIVES MONETARY AUTHORITY

External Developments

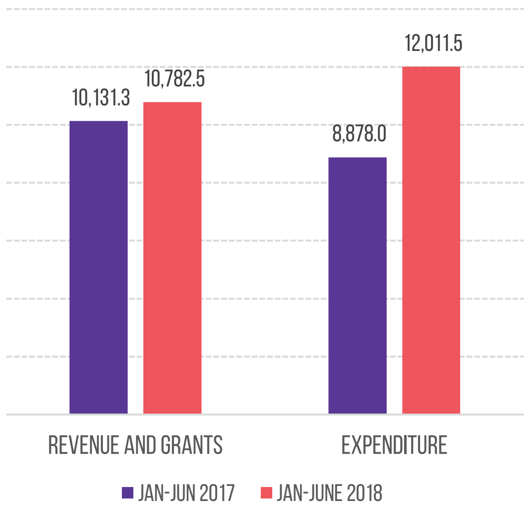
The external current account deficit continues to remain high reflecting the strong import growth driven by the mega infrastructure projects, offsetting the robust growth in tourism receipts. According to revised estimates of April 2018, the current account deficit is expected to narrow to 17.1 percent of GDP in 2018, down from 18.9 percent in 2017. This is slightly lower than the forecasts of October 2017. As in the past years, current account deficit is expected to be financed mainly by foreign direct investment inflows and foreign borrowings of both the private and public sectors. With the large increase in net financial inflows to the country during the year, the surplus of the overall balance of balance of payments is expected to increase in 2018. As a result, gross international reserves (GIR) are estimated to increase by US$141.8 USD to USD 727.9 million (3.7 months of imports) in 2018. As at end June 2018, GIR reached USD 773.3 million, while usable reserves increased to USD 288.0 million.

Fiscal Developments - January to June 2018

Total Revenue and Expenditure - January to June 2018

Total revenue including grants received from January to June of 2018 is MVR 10,782.5 million. This constitutes 48.1 percent of the forecasted amount of total revenue and grants for the year 2018. Although new revenue measures through proposed amendments to the Business Profit Tax (BPT) and Goods and Services Tax (GST) Acts did not materialize, biannual revenue figures show a strong growth as the tourism industry, which contribute to the largest share of Government revenue, performed better than forecasted. Consequently, major revenues from the tourism sector such as, Tourism Goods and Services Tax (TGST), Green Tax, Airport Service Charge and Airport Development Fee

FIGURE 5 REVENUE EXPENDITURE, JAN-JUNE 2017 - 2018 (MVR MILLIONS)



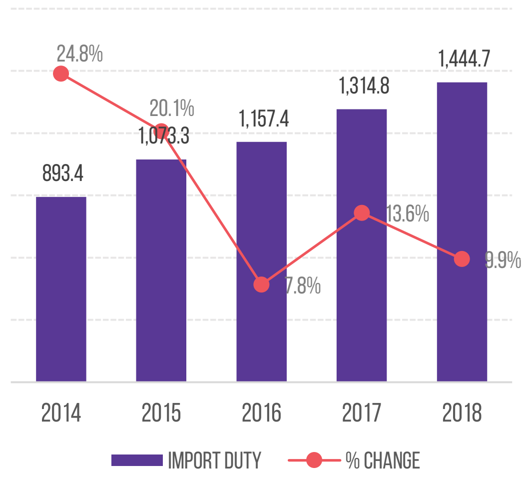
SOURCE: MINISTRY OF FINANCE AND TREASURY

collections has shown marked increases during this period compared to forecasts.

The approved budget for 2018 is MVR 27,966.3 million, of which, MVR 24,894.6 million is expenditure. The approved budget and expenditure show a respective 10.6 percent and 10.7 percent increment from the actual spending in 2017. Government expenditure during the fiscal year 2018 were expected to be high as it was formulated with the objectives of completing many of the ongoing infrastructure projects, so that their benefits will be realized to the general public during the year. The budget was also formulated to invest in new projects that would be economically beneficial to the people. In addition, unlike previous years, New Policy Initiatives (NPIs) [which now includes Public Sector Investment Programs (PSIPs) **and** recurrent activities] to be carried out by Government institutions were also approved and incorporated into the budget, separately from their baseline budgets.

A total of MVR 13,753.9 million or 49.2 percent of the approved budget was spent in January to June 2018, of which, MVR 8,253.9 million was spent on recurrent expenditures and MVR 5,500.0 million was spent on capital expenditures (including loan repayment, subscriptions to multilateral agencies and transfers to Sovereign Development Fund). While 51.4 percent of the approved recurrent expenditure was utilized from January to June, only 42.6 percent of the approved capital expenditure was spent during the same period.

FIGURE 6 IMPORT DUTY, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

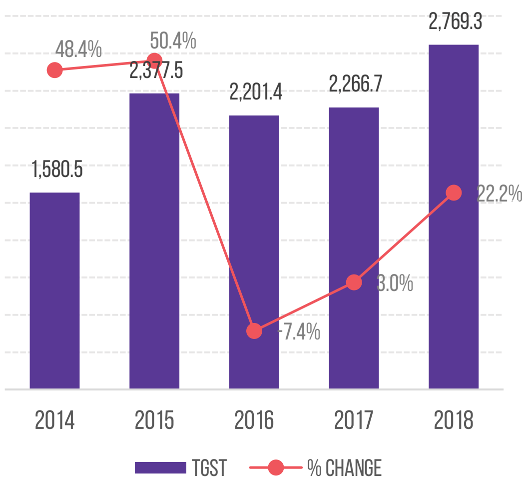
Recurrent expenditures are progressing higher than the budgeted amount because the expenditures on personal emoluments, Aasandha and subsidies are higher than initial forecasts. The capital expenditures are progressing lower than budgeted due to the slow progression of the PSIPs, as is the case in most years, however overall the capital expenditure disbursement is relatively higher than in previous years.

Revenues and Grants - January to June 2018

Import Duty

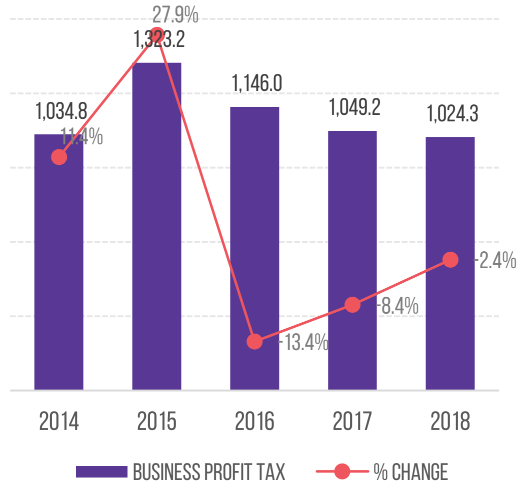
Import Duties were initially forecasted to contribute MVR 3,029.6 million to the total approved tax revenue for the fiscal year 2018. This is 8.2 percent higher than the amount received in import duties in 2017. This year's import duties are forecasted to increase as the

FIGURE 7 TOURISM GOODS AND SERVICES TAX, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

FIGURE 8 BUSINESS PROFIT TAX, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

increment on the import duties on cigarettes, fizzy and energy drink imports made during 2017 will be realized for the full year in 2018. A total sum of MVR 1,444.7 million was received in import duties from January to June 2018. This is a 9.9 percent increase from import duties collected during the same period in 2017. The main reasons for this increase is because the increment brought to the import duties on cigarettes, fizzy and energy drinks in March 2017 were realized for the full first 6 months of 2018, and quantity and price of imports increased during this period.

Tourism Goods and Services Tax

The approved budget for 2018 forecasts Tourism Goods and Services Tax (TGST) receipts of MVR 4,311.3 million. This is a 2.7 percent increase from the amount received in 2017, as tourist arrivals were forecasted to increase by 6.8 percent and bed nights to increase by 4.1 percent in the year 2018. A total sum of MVR 2,769.3 million was collected as TGST from January to June 2018, resulting in a 22.2 percent increase from the amount received in the same period of 2017. This is because the tourism industry grew faster during the first 6 months of 2018 than was initially forecasted. Tourist arrivals between January to June 2018 increased by 10.5 percent while bed nights increased by 13.9 percent when compared to the same period of 2017.

Business Profit Tax

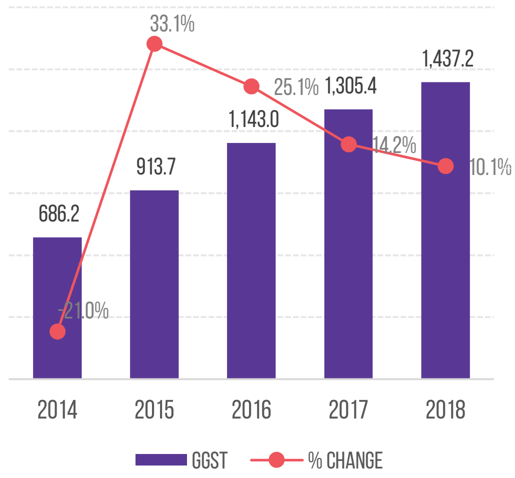
A total sum of MVR 2,962.5 million was initially expected to be collected as Business Profit Tax (BPT) in 2018. The majority of BPT collection for the year 2018 is based on profits earned in 2017. BPT forecasts for 2018 indicated an increase as the economy was expected to grow faster in 2017 compared to previous years. The forecasts also take into account higher collections due to the additional taxes from the proposed amendment to the BPT Act. However, the amendments proposed to BPT is unlikely to be implemented in 2018, BPT collections are expected to be lower than the initial forecasted amount.

The largest collection from BPT received in the first 6 months period corresponds to the second interim payment of the previous year – which is based on profits of the year before. In this regard, tax revenue collected as BPT from January to June 2018 is 2.4 percent lower than the same period of 2017 as second interim payment of 2017 was less than the second interim payment of 2016. This is because profits of businesses declined in 2016 compared to 2015.

General Goods and Services Tax

General Goods and Services Tax (GGST) forecasted for the year 2018 was MVR 3,148.0 million. This is a 17.3 percent increase from the amount collected in 2017. An increment of this magnitude was forecasted due to the expected increase in the nominal GDP growth by 8.0 percent in 2018 and the additional revenue from proposed amendment to the GST Act in 2018. Although this amendment is now not expected to be come through in 2018, an increase of 10.1 percent was still realized in the tax revenues collected as GGST from January to June 2018, compared to the same period of last year. GGST collection deadlines for the year 2017 were pushed to July as Eid holidays coincided with the original deadlines of the month, resulting in tax collections lower than usual tax collections during this period of 2017.

FIGURE 8 GENERAL GOODS AND SERVICES TAX, JAN-JUN (MVR MILLIONS)

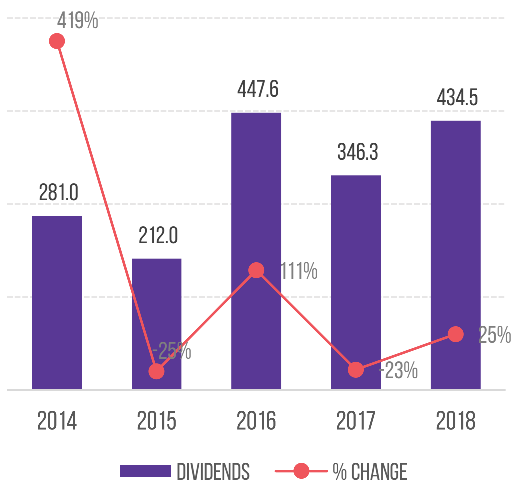


SOURCE: MINISTRY OF FINANCE AND TREASURY

Interest, Profit and Dividends

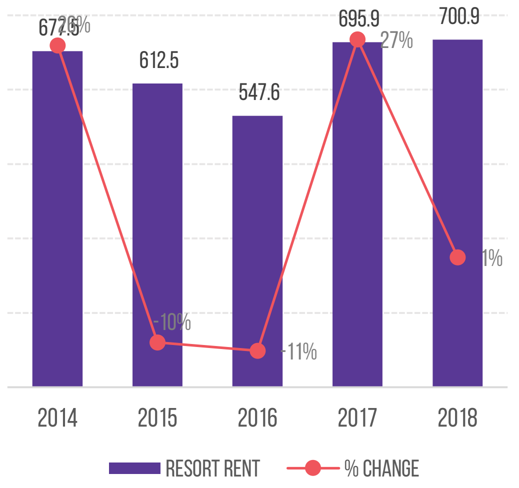
Dividends are one of the most significant contributors to the Government's non-tax revenue. Although dividends from State Owned Enterprises were forecasted as MVR 1,286.9 million, actual amounts are likely to be lower as large dividend receipts are no longer expected to be realized during the year. The amount of revenue collected as interests, profits and dividends from January to June 2018 increased by 25.4 percent compared to the same period in 2017. This is because State Owned Enterprises has been recorded

FIGURE 9 DIVIDENDS, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

FIGURE 10 TOURISM LEASE RENT, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

as paying more in dividends as they began adjusting the dividends payable with the receivables from the Government.

Tourism Land Rent

Initial estimates for tourism land rent was MVR 1,905.1 million in 2018. This is 28 percent higher than the amount received in 2017. Resort lease rent received from January to June 2018 was 0.7 percent higher than the amount received for the same period of last year. One of the reasons for a higher resort land rent receipts is the opening of new resorts in the year.

Grants

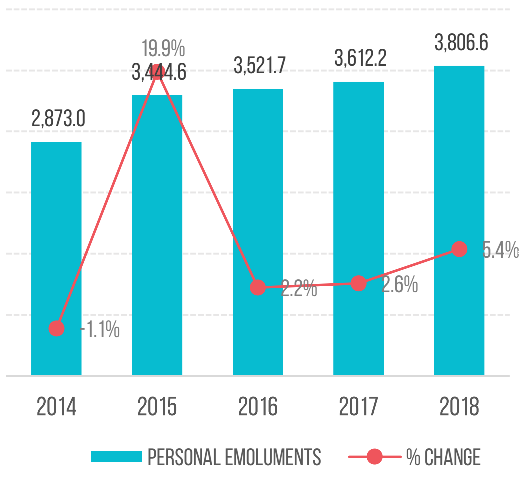
The 2018 budget estimates include grants of MVR 733.7 million, which includes MVR 700.3 million in project grants and MVR 33.4 million in cash grants. Of this estimated amount, MVR 207.4 million in grants has been received from January to June 2018. This amount is 35.5 percent higher than the same period of last year.

Expenditure-January to June 2018

Personal Emoluments

Personal emoluments accounts for 27.0 percent of the approved budget for 2018. The approved budget for personal emoluments for 2018 of MVR 7,558.0 is an 8.4 percent increment from the actual expenditure for the category in 2017. The expenditure on this item from January to June of 2018 was recorded as MVR 3,806.6 million, which is a 5.4 percent increase compared to the same period of last year. The main reason for this increase is the changes made to the salary structures of different institutions and the introduction

FIGURE 11 PERSONAL EMOLUMENTS, JAN-JUN (MVR MILLIONS)



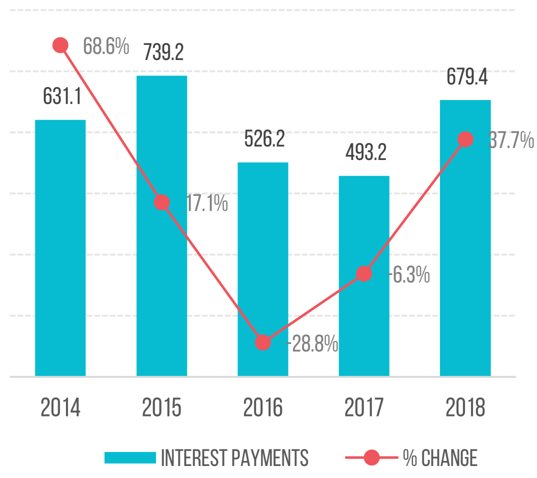
SOURCE: MINISTRY OF FINANCE AND TREASURY

of the technical core and supporting core allowance in February of 2018.

Debt service

In the approved budget for 2018, 8.9 percent of the recurrent expenditures are allocated to debt servicing. This amounted to MVR 1,436.5 million, which is an increase of 31 percent compared to the actual figured for 2017. From January to June of 2018 expenditure on debt servicing was recorded as MVR 679.4 million. The expenditure incurred for the same period of 2017 was 37.7 percent lower, at MVR 493.2 million. The main reason for this increase in 2018 is the increase in interest expenses on externally funded loans, t-bills and t-bonds.

FIGURE 12 DEBT SERVICE, JAN-JUN (MVR MILLIONS)

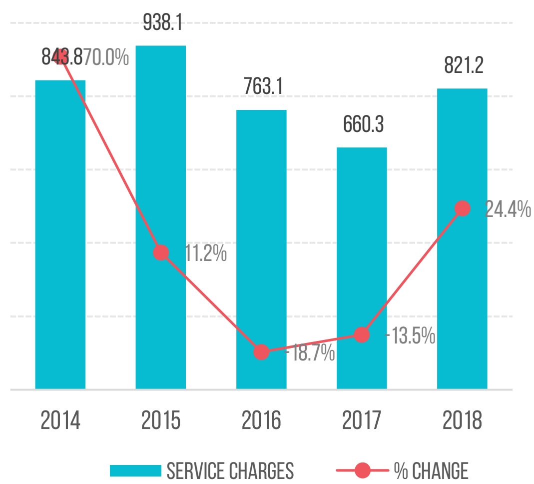


SOURCE: MINISTRY OF FINANCE AND TREASURY

Operational services

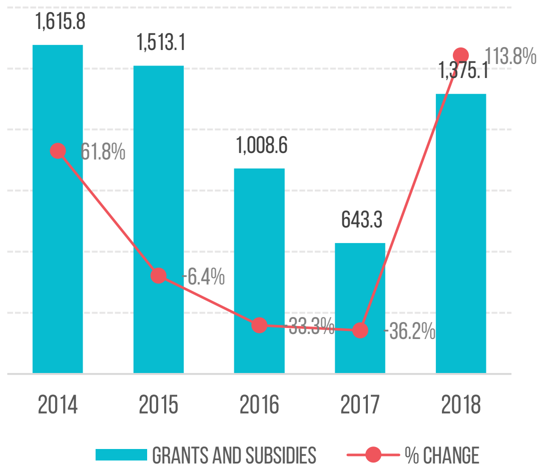
The budget allocated for operational services in the approved budget for 2018 is MVR 1,862.9 million. This is a 16.9 percent increase from the actual expenditure incurred for this category in 2017. From January to June of 2018 the expenditure incurred on this category was MVR 821.2 million, compared to MVR

FIGURE 13 OPERATIONAL SERVICES, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

FIGURE 14 GRANTS, CONTRIBUTIONS AND SUBSIDIES, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

660.3 million spent for the same period of 2017. This is the result of higher expenditure on telecommunication, electricity, water, internet and security, additional expenditure on tournaments and special occasions and an increase of 69.0 percent in other expenditure on operational services.

Grants, contributions and subsidies

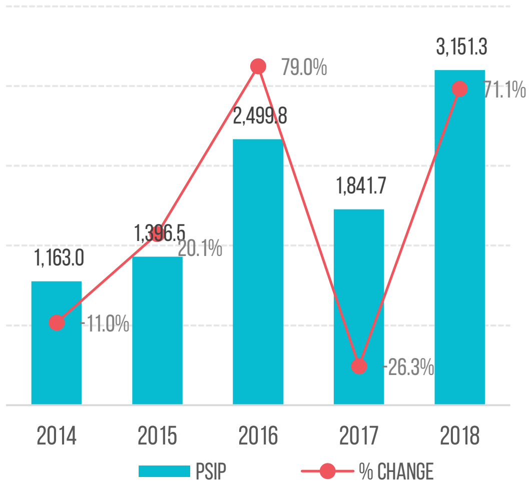
The 2018 approved budget estimates that MVR 1,992.4 million will be incurred on grants, contributions and subsidies. This is 2.1 percent lower than the actual expenditure incurred for this category in 2017. However, analyzing the expenditure recorded for this item from January to June 2018 indicates that the allocated budget would be exceeded by the end of the year, with 69 percent of the approved budget utilized in the first six months. While MVR 1,375.1 million was spent on this category from January to June of 2018, the expenditure incurred for the same period of 2017 was MVR 643.3 million, a growth of 113.8%. The 2018 expenditure has grown substantially as a result of the decision to increase subsidies paid for State-owned Enterprises to reduce the price of electricity, food and fuel. Another factor is the faster than expected acceleration in the global fuel prices, which increased the amount of fuel subsidies that has to be paid to maintain the prices. Furthermore, the reforms proposed to the Aasandha universal health insurance program has not materialized by June of 2018, resulting in a higher expenditure on this item as well.

Public Sector Investment Program

A significant portion of the budget approved for 2018 (MVR 7,087.4 million) is allocated towards the Public Sector Investment Program (PSIP). The approved PSIP budget for 2018 is 21.6 percent higher than the actual PSIP expenditure for 2017.

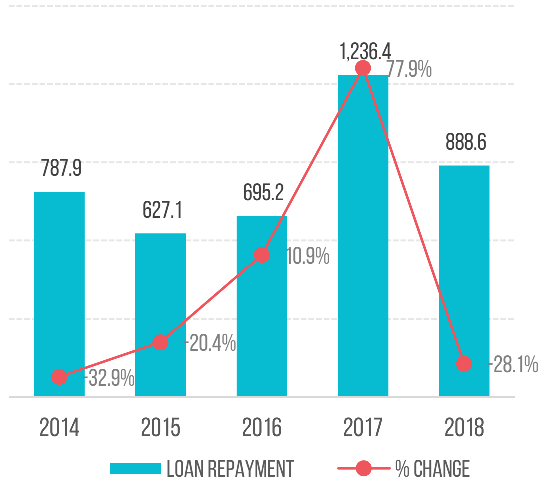
From January to June 2018, the PSIP expenditure recorded was MVR 3,151.3 million. This is an increase of 71.1 percent compared to the PSIP expenditure of MVR 1,841.7 recorded for the same period of 2017. The increase in PSIP expenditure in 2018 is the result of higher expenditure on some major projects and the overall acceleration in the pace of projects in the year.

FIGURE 15 PSIP, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

FIGURE 16 DEBT REPAYMENT, JAN-JUN (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

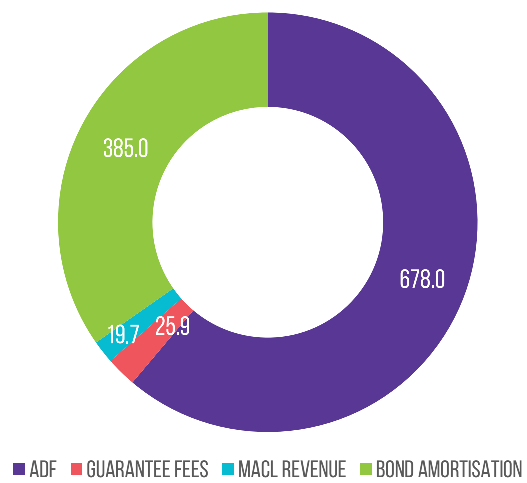
Debt Repayment

The 2018 approved budget estimates that MVR 2,183.7 million will be incurred for loans repayment. This is 9.2 percent lower than the amount incurred for 2017. This estimate is based on the assumption of lower treasury bills redemption in 2018 compared to the previous year and lower repayment of short term debt in the year. From January to June 2018 debt repayments of MVR 888.6 million has been recorded, which is 28.1 percent lower than the amount recorded for the same period of last year. This is the result of relatively higher short term debt repayments for the period in 2017.

Transfer to Sovereign Development Fund

To ensure the capacity of the state to repay the loans and debt instruments issued to finance the infrastructure scale up, the Government has established the Sovereign Development Fund (SDF) and has earmarked revenue to the fund since 2017. As such the funds transferred to the SDF in 2017 were the newly introduced Airport Development Fee, the new revenue generated from the revisions to the charges on airport services and sovereign guarantee fees. The allocations to the SDF were started

FIGURE 17 REVENUE TRANSFERED TO SDF, TILL JUN 2018 (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

beginning from November of 2017.

In 2018, in addition to the revenue earmarked to the SDF in the approved budget, the decision was made to earmark additional revenue to ensure the buildup of funds to repay the USD 250 million bond by its maturity of June 2022.

Up to June 2018, SDF transfers was recorded to be MVR 1,108.6 million (USD 71.9 million).

Deficit - January to June 2018

The approved budget for 2018 estimates a budget deficit of MVR 2,493.9 million. From January to June 2018, the overall balance recorded was a deficit of MVR 1,229.1 million. Comparing this to the same period of 2017 the overall balance stood at MVR 1,253.2 million surplus for the period. Although revenue has increased for the first half of the year in 2018, the expenditure growth outpaced the revenue growth, thereby leading to an overall deficit. To some extent this is also a result of better recorded of fiscal data in 2018.

Financing - January to June 2018

To finance the expenditure incurred from January to June 2018 MVR 4,193.9 million were raised through rufiyaa loans and other financial instruments, in addition to revenue and grants received. In addition to budget financing the cash raised would be utilized for repayment of loans, transfers to sovereign development fund, and subscriptions made to multilateral agencies. The amount of MVR 4,193.9 million includes the USD 100 million raised from the private placement of a bond with Abu Dhabi Fund for Development. The proceeds from the bond will be used to finance the development projects proposed in the 2018 budget.

Debt - January to June 2018

As of June 2018 the public debt is at MVR 43,347.4 million (debt-to-GDP ratio of 56 percent). Even though domestic debt as of June 2018 has been kept at a similar level as 2017, external debt has increased. The main reason for the increase in external debt up to June was the issuance of a USD 100 million bond privately placed with the Abu Dhabi Fund for Development. Public debt is expected to stand at MVR 49,135.7 million with a debt-to-GDP ratio of 63.5 percent by the end of 2018.

Medium Term Fiscal Strategy

Medium Term Fiscal Strategy 2019-2021

Introduction

This paper states the Government of Maldives' (GoM) Fiscal Strategy submitted to the People's Majilis as mandated by section 10 of the Fiscal Responsibility Act (Law Number 7/2013). The paper will also determine the "fiscal space" (or the budget allocation for New Policy Initiatives[1]), and the goals of the Government annual budget 2019. Furthermore, it will state the budget estimates for the medium-term (2019 to 2021).

The GoM Fiscal Strategy is based on the revenue and expenditure estimates made for the baseline budget by the Ministry of Finance and Treasury (MoFT). In addition, this paper will outline some of the issues faced in budget execution and the ways in which Government institutions should formulate their budgets in order to achieve the budget goals.

[1] Any additional project or recurrent expenditure other than the ongoing projects and programs during the budget period

Government's Fiscal Policy

The aim of the medium-term budget is to achieve a budget surplus and to reduce the country's total debt as a percentage of the total GDP. Therefore achieving an overall budget surplus by 2023 and a gradual decrease in the country's debt as a percentage of GDP would be the key success indicators of the policy.

The Fiscal Strategy for the year 2019 is to complete the ongoing infrastructure projects and initiate new infrastructure projects without exceeding the budget deficit over 5 percent of GDP. In addition to this, establishing a sufficient recurrent budget to cater for the ongoing infrastructure projects as they are being completed is also an important strategy of the budget. Furthermore, the policy intends to work on overcoming issues with cash flow management.

The medium-term budget intends to achieve the following goals:

1. Reducing the budget deficit and domestic budget financing
2. Completing the ongoing infrastructure projects

3. Initiating projects that would reap economic benefits
4. Determining a sufficient recurrent budget and taking necessary steps to maintain the recurrent expenditures during the medium-term
5. Investment in technology with the goal of reducing costs
6. Taking the necessary steps to enhance the country's debt repayment capacity

Measures to ensure effective execution of fiscal policy

There are 4 main areas that need to be improved in order to strengthen the budget to make it more credible and effective. They include maintaining the budget deficit, allocating a sufficient budget while controlling additional changes, managing cash flow and formulating a medium-term Public Sector Investment Program.

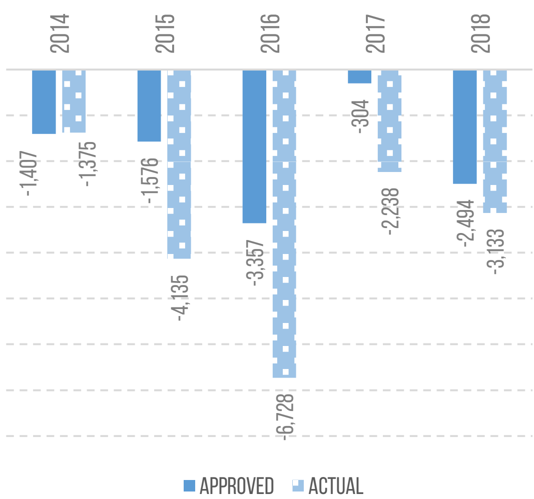
Maintaining deficit as per the Fiscal Strategy

Over the past years the actual budget deficits has tended to surpass the approved deficit for the year. The main reasons for this include the disruption of some of the main sources of Government revenue due to political instability and the failure to successfully execute new revenue measures, while the expenditures remain close to approved amounts.

The following steps must be undertaken in order to overcome these problems:

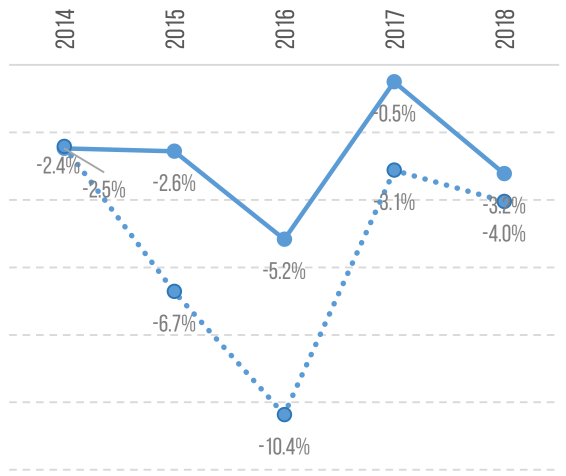
1. Ensuring that measures that do not have revenue bills prepared beforehand and are not ready for execution are not included as new revenue measures in the budget
2. Submission of the revenue bills to the People's Majlis along with the Government annual budget
3. Matching the proposed revenue measures to some of the projects proposed in the Public Sector Investment Program (PSIP). The assigned projects must not commence if revenue is not realized as planned

FIGURE 17 DEFICIT/SURPLUS, 2014-2018 (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

FIGURE 18 DEFICIT/SURPLUS AS A % OF GDP, 2014-2018



SOURCE: MINISTRY OF FINANCE AND TREASURY

4. Changing the amount given to political parties from 0.1 of total domestic budget to 0.05 percent of total tax revenue with a cap of MVR 10 million

Controlling changes (virements) to the budget

The following steps must be taken to reduce budget virements and increase the credibility of the budget.

1. Allocating a sufficient budget to sustain the total expenditures and refraining from cutting the baseline budget unless there is a policy change and the institutions are notified of these changes
2. Refraining from allowing for expenditure that were not approved in the budget for the year, and instead proposing these expenditures as “New Policy Initiatives” to be included in the following year’s budget
3. Increasing the level of budget controls
4. Increasing the modules used to manage Government revenues and expenditures by the SAP system and creating efficiencies in using the system
5. Introducing appropriation rules, as per the recommendations of the report submitted with the Government annual budget 2018 by the Peoples Majlis’s Public Accounts Committee

It also important to note that the disbursement of Public Sector Investment Program (PSIP) budget remain low. Hence, the actual expenditure for these PSIPs are lower than the approved expenditure. This is more notable in projects carried out and funded by foreign loans and grants (Table 2). As a result, there is a loss in fiscal space and reallocation of the budget initially allocated for PSIP to other components during the year.

TABLE 1 BUDGET VIREMENTS

Year	Virement no.	Virements (millions MVR)	% of approved budget
2014	34,418	16,260.3	91%
2015	35,111	14,126.7	58%
2016	22,651	17,632.8	64%
2017	19,350	11,280.2	42%

SOURCE: MINISTRY OF FINANCE AND TREASURY

TABLE 2 PSIP BUDGET (MVR MILLIONS)

Year	Total		Domestic PSIP		Donor funded PSIP	
	Approved	Actuals	Approved	Actuals	Approved	Actuals
2014	3,459.9	1,944.2	1,952.8	1,707.2	1,507.0	237.0
2015	6,259.6	3,118.2	3,189.0	2,403.5	3,070.5	714.7
2016	9,115.7	7,079.0	5,234.6	4,147.7	3,881.1	2,931.3
2017	7,989.0	5,829.5	4,368.7	3,040.4	3,620.3	2,789.1

SOURCE: MINISTRY OF FINANCE AND TREASURY

Cash flow Management

There are significant differences between the approved budget and the realization of the budget related cash flows. For example, even though the approved budget outlines the financing plans for the year a vast majority of the bills paid at the beginning of the fiscal year are from the expenditure incurred as a result of the previous year's budget. Since the revenues included in the financing plans are used to finance the previous year's expenditures, it creates a shortage of funds, requiring additional financing for the new fiscal year. Failure to meet this financing requirement would mean that they get passed on to the following fiscal year in the form of pending bills.

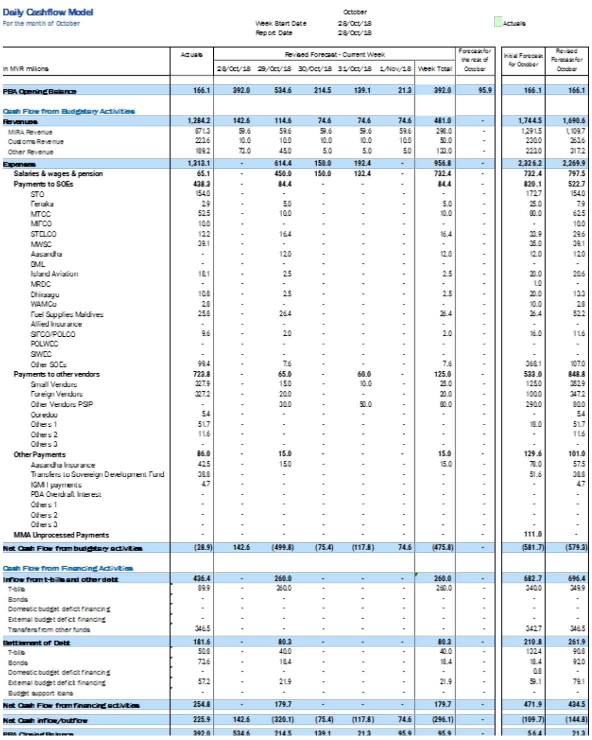
As this is a recurring issue, if the Government's cash flow is illustrated in a separate table in the Government annual budget, it would be helpful for all stakeholders at different stages of budget financing to understand the Government's plan to meet financing requirements.

It is important that the following steps are undertaken to alleviate this issue:

1. Closing the annual budget on December 31st of that year, halting the recording of any transactions of that budget beyond that point

2. Compiling a cash flow plan to be published along with the budget. The People's Majlis should also approve this plan

CASHFLOW FORECAST MODEL EXTRACT


Daily Cashflow Model
For the month of October

October
Week Start Date 28/Oct/18
Report Date 28/Oct/18

Actuals

In MVR millions	Actuals	Revised Forecast - Current Week						Forecast for the rest of October	Initial Forecast for October	Revised Forecast for October
		28/Oct/18	29/Oct/18	30/Oct/18	31/Oct/18	1/Nov/18	Week Total			
PBA Opening Balance	**166.1**	**392.0**	**534.6**	**214.5**	**139.1**	**21.3**	**392.0**	**95.9**	**166.1**	**166.1**
Cash Flow from Budgetary Activities										
Revenues	**1,284.2**	**142.6**	**114.6**	**74.6**	**74.6**	**74.6**	**481.0**	-	**1,744.5**	**1,690.6**
MIRA Revenue	871.3	59.6	59.6	59.6	59.6	59.6	298.0	-	1,291.5	1,109.7
Customs Revenue	223.6	10.0	10.0	10.0	10.0	10.0	50.0	-	230.0	263.6
Other Revenue	189.2	73.0	45.0	5.0	5.0	5.0	133.0	-	223.0	317.2
Expenses	**1,313.1**	-	**614.4**	**150.0**	**192.4**	-	**956.8**	-	**2,326.2**	**2,269.9**
Salaries & wages & pension	65.1	-	450.0	150.0	132.4	-	732.4	-	732.4	797.5
Payments to SOEs	438.3	-	84.4	-	-	-	84.4	-	820.1	522.7
STO	154.0	-	-	-	-	-	-	-	172.7	154.0
Fenaka	2.9	-	5.0	-	-	-	5.0	-	25.0	7.9
MTCC	52.5	-	10.0	-	-	-	10.0	-	80.0	62.5
MITCO	10.0	-	-	-	-	-	-	-	-	10.0
STELCO	13.2	-	16.4	-	-	-	16.4	-	33.9	29.6
MWSC	39.1	-	-	-	-	-	-	-	35.0	39.1
Aasandha	-	-	12.0	-	-	-	12.0	-	12.0	12.0
DML	-	-	-	-	-	-	-	-	-	-
Island Aviation	18.1	-	2.5	-	-	-	2.5	-	20.0	20.6
MRDC	-	-	-	-	-	-	-	-	1.0	-
Dhiraagu	10.8	-	2.5	-	-	-	2.5	-	20.0	13.3
WAMCo	2.8	-	-	-	-	-	-	-	10.0	2.8
Fuel Supplies Maldives	25.8	-	26.4	-	-	-	26.4	-	26.4	52.2
Allied Insurance	-	-	-	-	-	-	-	-	-	-
SITCO/POLCO	9.6	-	2.0	-	-	-	2.0	-	16.0	11.6
POLWEC	-	-	-	-	-	-	-	-	-	-
SIWEC	-	-	-	-	-	-	-	-	-	-
Other SOEs	99.4	-	7.6	-	-	-	7.6	-	368.1	107.0
Payments to other vendors	723.8	-	65.0	-	60.0	-	125.0	-	533.0	848.8
Small Vendors	327.9	-	15.0	-	10.0	-	25.0	-	125.0	352.9
Foreign Vendors	327.2	-	20.0	-	-	-	20.0	-	100.0	347.2
Other Vendors PSIP	-	-	30.0	-	50.0	-	80.0	-	290.0	80.0
Ooredoo	5.4	-	-	-	-	-	-	-	-	5.4
Others 1	51.7	-	-	-	-	-	-	-	18.0	51.7
Others 2	11.6	-	-	-	-	-	-	-	-	11.6
Others 3	-	-	-	-	-	-	-	-	-	-
Other Payments	86.0	-	15.0	-	-	-	15.0	-	129.6	101.0
Aasandha Insurance	42.5	-	15.0	-	-	-	15.0	-	78.0	57.5
Transfers to Sovereign Development Fund	38.8	-	-	-	-	-	-	-	51.6	38.8
IGMH payments	4.7	-	-	-	-	-	-	-	-	4.7
PBA Overdraft Interest	-	-	-	-	-	-	-	-	-	-
Others 1	-	-	-	-	-	-	-	-	-	-
Others 2	-	-	-	-	-	-	-	-	-	-
Others 3	-	-	-	-	-	-	-	-	-	-
MMA Unprocessed Payments	-	-	-	-	-	-	-	-	111.0	-
Net Cash Flow from budgetary activities	**(28.9)**	**142.6**	**(499.8)**	**(75.4)**	**(117.8)**	**74.6**	**(475.8)**	-	**(581.7)**	**(579.3)**
Cash Flow from Financing Activities										
Inflow from t-bills and other debt	**436.4**	-	**260.0**	-	-	-	**260.0**	-	**682.7**	**696.4**
T-bills	89.9	-	260.0	-	-	-	260.0	-	340.0	349.9
Bonds	-	-	-	-	-	-	-	-	-	-
Domestic budget deficit financing	-	-	-	-	-	-	-	-	-	-
External budget deficit financing	-	-	-	-	-	-	-	-	-	-
Transfers from other funds	346.5	-	-	-	-	-	-	-	342.7	346.5
Settlement of Debt	**181.6**	-	**80.3**	-	-	-	**80.3**	-	**210.8**	**261.9**
T-bills	50.8	-	40.0	-	-	-	40.0	-	132.4	90.8
Bonds	73.6	-	18.4	-	-	-	18.4	-	18.4	92.0
Domestic budget deficit financing	-	-	-	-	-	-	-	-	0.8	-
External budget deficit financing	57.2	-	21.9	-	-	-	21.9	-	59.1	79.1
Budget support loans	-	-	-	-	-	-	-	-	-	-
Net Cash Flow from financing activities	**254.8**	-	**179.7**	-	-	-	**179.7**	-	**471.9**	**434.5**
Net Cash inflow/outflow	**225.9**	**142.6**	**(320.1)**	**(75.4)**	**(117.8)**	**74.6**	**(296.1)**	-	**(109.7)**	**(144.8)**
PBA Closing Balance	**392.0**	**534.6**	**214.5**	**139.1**	**21.3**	**95.9**	**95.9**	-	**56.4**	**21.3**

3. Creating a borrowing plan and publishing the borrowing plan's Treasury Bill timetable in order to inform banks and the general public of the days in which the Treasury Bill market is active

Formulating a medium-term Public Sector Investment Program

The sole focus when formulating PSIPs are on the following year. This causes ongoing and new projects that are set to commence in the medium-term are not being properly forecasted for the medium term. On this note, it is recommended by the IMF's Public Investment Management Assessment (PIMA) that having a "rolling PSIP plan" is important in order for the smooth execution of such projects and compiling a more credible budget.

Establishing a Tax Policy Unit

It is important to establish a tax policy unit to commence work on coordinating, analysing and implementing the Government revenue policy. Although there have been many accomplishments by establishing the Maldives Inland Revenue Authority (MIRA) in tax collection and carrying out the administrative work of the tax regime, there are limitations to research and analysis of new tax policies that could be beneficial to the economy. As a result, there are setbacks to making well informed decisions on the Government revenue and taxation. Therefore, a tax policy unit must be established within the Ministry of Finance and Treasury in order to design the tax framework, conduct public consultancy, revenue and economic impact analysis, updating the legal framework of the tax regime and contributing to the international tax treaties.

To establish a tax policy unit, the Ministry has sought consultancy from the IMF to work with the Ministry staff to holistically evaluate the existing revenue policies and identifying measures to optimize public revenues. An optimal policy should find the best balance from the competing demands of a government revenue policy in designing the most optimal configuration of the revenue system of the Maldives.

The following activities will be carried out through this exercise.

1. Survey of the revenue measures including meeting with stakeholders
2. Evaluation of the revenue needs to achieve fiscal target
3. Evaluation on the efficiency of revenue measures and the effective tax burden
4. Propose the revisions to revenue policy and prepare revenue agenda
5. Draft revenue policy paper to be presented to policy makers

TABLE 3 REVISED BUDGET 2018

Details	Approved Budget MVR Millions	Revised Estimates MVR millions
Revenue	22,401	22,302
Tax Revenue	16,301	16,185
Non-Tax Revenue	5,366	5,383
Grants	734	734
Budget	27,966	27,914
Expenditure	24,895	24,354
Recurrent Expenditure	16,066	15,983
Capital Expenditure (Excluding PSIP)	1,741	1,344
PSIP - Domestic Contribution	3,519	3,600
PSIP - Donor Funded	3,568	2,206
Transfers to Sovereign Development Fund	855	1,200
Loan Repayment	2,184	2,328
Subscription to Multilateral Agencies	33	32
Primary Balance	**(1,057)**	**(831)**
Overall Balance	**(2,494)**	**(2,052)**

SOURCE: MINISTRY OF FINANCE AND TREASURY

Revised Budget 2018

Government Annual Budget 2018 was formulated to overcome social issues, improving the standard of services offered by the Government and improving the productivity of the public sector employees. In addition, priority was given to complete the ongoing infrastructure projects, realizing their benefits to the general public and investing on projects that would further benefit the general public.

Although it is expected that overall expenditures will be carried out according to the 2018 approved budget, some recurrent expenditures are expected to exceed the approved budget while some capital expenditures are expected to realize below the approved budget, as it has happened in the past few years.

The only significant change to the 2018 approved revenue was made to the tax revenue forecasts. The main reasons for this is the failure to implement the changes proposed to the revenue in the 2017 Supplementary Budget. It also highly unlikely that these changes would be implemented during the ongoing fiscal year. However, tourism related revenues are likely to increase at a faster rate than previously forecasted, as tourism figures for the fiscal year 2017 and the first quarter of 2018 illustrate a more positive performance than that was forecasted. A total revenue of MVR 6.2 billion was recorded at the end of March 2018. This is 27.5 percent of the total forecasted revenue.

Therefore, assuming expenditures are carried out as budgeted and given that actual revenues are forecasted to be less than the budget figures, a budget deficit of MVR 2.1 billion is expected at the end of the fiscal year.

Public Debt

As in 2017 external public debt is expected to grow in 2018, as more of the funds are disbursed in the year on the major externally funded projects.

The medium term debt strategy is to expand and develop the domestic financial markets. The objective is to reduce borrowing to finance recurrent expenditures and to use debt as an instrument for financing capital expenditures. Furthermore, the objective is to reduce the budget deficit year by year and reach a primary surplus in the medium term. This will enable to reduce debt over the long term and reach the debt ratios specified under the Fiscal Responsibility Act.

Baseline budget estimates 2019

With due consideration for the operation expenses of Government offices and the ongoing programs, the recurrent expenditure for 2019 is estimated to be MVR 16.2 billion. The biggest increase in operation expenses in 2019 is expected to come from the completion of the Dharumavantha Hospital project and the commencement of operations at the hospital. Furthermore as more of the projects that are completed through the recent scale up in infrastructure goes into operation and usage, this would impose additional burden on funding recurrent expenditures.

In 2019, domestic PSIP is expected to cost MVR 2.2 billion, and loan and grant funded PSIP would cost MVR 3.5 billion. The total capital expenditure for the baseline budget is expected to be MVR 7.0 billion.

As such, baseline expenditure (excluding new projects and programs under the NPIs) is estimated to amount to MVR 24.6 billion. Including debt amortization the total budget is estimated to be MVR 28.4 billion. Table 4 below shows the baseline budget estimates for 2019. The baseline expenditure for specific items are estimated based on the past trends in expenditure on these items and their growth. Experience from previous years has shown that ambitious targets to rationalize expenditure has proved difficult to achieve, resulting in reallocation of funds for these

TABLE 4 BASELINE BUDGET 2019

Details	2019 Baseline MVR Millions
Revenue	23,301
Tax Revenue	17,186
Non-tax Revenue	5,664
Grants	451
Budget	28,387
Expenditure	24,597
Recurrent Expenditure	16,165
Capital Expenditure (Excluding PSIP)	1,331
PSIP – Domestic Budget	2,200
PSIP – Loans and Grants	3,495
Transfers to Sovereign Development Fund	1,571
Loan Repayment	2,198
Subscription to Multilateral Agencies	22
Primary Balance	**110**
Overall Balance	**(1,296)**

SOURCE: MINISTRY OF FINANCE AND TREASURY

activities during the budget year. Therefore to maintain budget credibility it is important to maintain baseline expenditures at practical levels to facilitate the implementation of the approved budget faithfully. If expenditure rationalization measures are to be included in the budget, this should be accompanied by concrete action plans produced three months before the commencement of the fiscal year and the implementation of these actions, if the budget credibility is to be maintained.

The 2019 baseline budget, without any NPIs, would still result in a deficit of MVR 1.3 billion. This is an overall deficit to GDP ratio of 1.7 percent. The inclusion of NPIs as illustrated in the scenarios above in Table 5, will increase the budget amount.

If NPIs of MVR 1.3 billion is added to the budget the total budget would increase to MVR 29.7 billion and total expenditure would increase to MVR 25.9 billion and overall deficit to MVR 2.6 billion. This is an overall deficit to GDP ratio of 3.1 percent. To finance this deficit MVR 3.6 billion in treasury bills will have to be issued in the year.

Similarly, additional NPIs of MVR 2 billion would increase total budget to MVR 30.4 billion, total expenditure to MVR 26.6 billion and overall deficit to MVR 3.3 billion. This is

TABLE 4 2019 NEW POLICY INITIATIVES SCENARIOS

Details	Scenario 1 MVR millions	Scenario 2 MVR millions	Scenario 3 MVR millions
Total Revenue	23,301	23,301	23,301
Total Expenditure	25,897	26,597	27,297
Total Budget	29,687	30,387	31,087
New Policy Initiatives	1,300	2,000	2,700
Primary Balance	**(1,190)**	**(1,890)**	**(2,590)**
Overall Balance	**(2,596)**	**(3,296)**	**(3,996)**
Primary Balance (share of GDP)	-1.4	-2.3	-3.1
Overall Balance (share of GDP)	-3.1	-4.0	-4.8
T-bill financing	3,601	4,301	5,001

SOURCE: MINISTRY OF FINANCE AND TREASURY

TABLE 6 BUDGET 2020-2021

Details	2020 MVR Millions	2021 MVR Millions
Revenue	24,548	25,978
Tax Revenue	18,113	19,208
Nontax Revenue	5,918	6,203
Grants	517	567
Expenditure	26,033	30,301
Recurrent Expenditure	16,705	17,645
Capital Expenditure (excluding PSIP)	1,330	1,343
PSIP – domestic budget	459	246
PSIP – loan and grants	3,559	7,000
New Policy Initiatives	2,000	2,000
Transfer to Sovereign Development Fund	1,035	1,073
Debt Amortization	2,198	2,611
Other cash outflows (not included in expenditure)	22	22
Primary Balance	**495**	**(2,256)**
Overall Balance	**(986)**	**(3,823)**

SOURCE: MINISTRY OF FINANCE AND TREASURY

an overall deficit to GDP ratio of 4.0 percent. Lastly, additional NPIs of MVR 2.7 billion would increase the budget to MVR 31.1 billion, total expenditure to MVR 27.3 billion and overall deficit to MVR 4.0 billion. This is an overall deficit of GDP ratio of 4.8 percent.

Medium term budget estimates

If the growth in expenditure can be contained in the medium term, even with the addition of MVR 2 billion in NPIs a surplus can be reached by 2030.

The main reason for this is that in the next 5 years the tax system would be able to generate an additional MVR 4.0 billion in revenue through the natural growth in tax revenue. This assumes that tourist arrivals and bed-nights, as well as the economic growth would be maintained in the medium term. It is assumed that no new revenue measures and changes to existing revenue measures would be brought in the medium term.

Table 6 looks at the budget scenarios for 2020-2021 with the inclusion of MVR 2 billion in new policy initiates.

Economic impact of 2019 budget

The Maldives economy is dependent on the tourism industry. Looking at the recent trends in the sector, a downturn in the sector in 2015 has followed two consecutive years of strong recovery. As such, a fall in bed-nights by 2.4 percent in 2015 was followed by growth of 6.1 percent and 10.6 percent in 2016 and 2017, respectively. This momentum could be maintained into 2018 and 2019, barring global or local events that could affect the industry. Although tourism is the main economic sector, the fastest growing sector in the past four years has been the construction sector. The strength of the industry in recent years has come from the pickup in resorts development, housing construction, and to a large extent from the major public infrastructure projects undertaken by the Government. As the 2019 budget will include spending on the ongoing infrastructure projects as well as the new projects that will commence in the year under the New Policy Initiatives, public investments will increase in the year. As in recent years this will stimulate the growth of the construction sector. Although the construction sector has become a significant driver of growth in recent years, growth fuelled from capital expansion cannot be sustainable over the medium to long term. It is important for the growth drivers to transition in the medium terms towards the economic activities that are facilitated and created as a result of the investments made in recent years. It is expected that a number of the major infrastructure projects initiated by the Government in recent years will reach a conclusion within 2018. As such, the China-Maldives Friendship Bridge, Velana International Airport new runway project and parts of the Dharumavantha Hospital is expected to be completed during the year and will go into operation. As these facilities are utilized for economic production, there would be a greater contribution to the economic growth and production flowing directly from these facilities. Therefore, this will boost growth in sector such as transport, health and tourism in 2019 and beyond.

As Maldives is heavily dependent on imported products from production and consumption, the changes in the general price level or the inflation rate is dependent on the movements in global commodity prices. The downward trend in global fuel and commodity prices between 2013 and 2016 are mirrored in the falling inflation rates in the Maldives economy during the same period. This trend was reversed in 2017, with an increase in the inflation rate as a result of domestic and external factors. On the domestic front one-off policy changes that affected the price of some consumer goods, namely the 2016 revision to the control prices on staple foods and the revision to the import duties of cigarettes and fizzy drinks in 2017 increased inflation. On the external front, after years of decline in global commodity prices, including fuel prices, in 2017 the prices of fuel and other commodities increased substantially. While this trend is expected to continue into 2018, the proposed changes to the food and energy subsidies may help subside some of the inflationary pressures arising from global price movements. For 2019 inflation would be determinant on two factors: movement in global prices and domestic policy measures such as subsidies and control prices. As such the current forecasts indicate the global commodity prices including fuel is expected to decline in 2019. The current strategy does not propose any new measures for 2019 that would affect domestic prices.

The recent growth in construction activities, backed by expansion in the Government infrastructure expenses has resulted in further increases in the current account deficit. As such with the infrastructure expansion set to continue into 2019, this would widen the current account deficit in the year. However, the expectation over the medium term is for the current account deficits to improve as more of the major infrastructure projects draws to a close and the infrastructure spending tapers off from its peaks.

Maldives needs to import all the machinery and equipment and most of the inputs required such as cement, wood and metal products, required for an infrastructure project. As such the increase in infrastructure spending translates to a greater demand for foreign exchange. To limit the pressure on foreign exchange reserves from the increase in demand for imported construction material, the Government made the decision to raise foreign exchange financing to fund the public infrastructure expansion. As such in addition to the project related loans, the Government for the first time issued a foreign exchange bond in the international markets in 2017, raising USD 250 million with a 5 year conventional bond. Additionally, USD 100 million was raised in 2018 with the sale of a USD 100 million 5 year conventional bond to the Abu Dhabi Fund for Development. While this exercise helps to reduce the short term burden on the foreign reserves to finance the infrastructure expansion, this would over the medium term increase the foreign exchange requirement to service the debts.

As the 2019 budget is also expected to be a deficit budget, this deficit would need to be financed through the issuance of treasury bills in the domestic market. Furthermore treasury bills are issued on a regular basis for cash flow management. Greater borrowing by the Government in the domestic financial markets leads to crowding out of the private sector. So reducing the extent of Government borrowing in the domestic financial markets is important to stimulate lending to the private sector. While Maldives Monetary Authority Statistics indicate that there is excess liquidity in the domestic financial market to finance the deficits, financing a deficit of MVR 2.6 billion could prove to be challenging.

Conclusion

This paper contains the baseline estimates for the 2019 budget and explore the various budget scenarios for the new policy initiatives that could be contained in the budget. This paper takes into account the medium term fiscal objectives to compute the revised expenditure estimates for 2018 and the baseline estimates for the medium term budget and deficits.

As such this paper proposes a deficit budget for 2019 with an overall deficit of 3.1 percent of GDP. The medium term fiscal plans are set towards reaching an overall surplus by the year 2023. The 2019 budget is estimated at MVR 29.7 billion, of which MVR 16.2 billion is estimated to be required for recurrent expenditures, and MVR 10.8 billion for capital expenditures (including project funded through domestic budget, loans and grants). Furthermore if a deficit of 3.1 percent of GDP is to be maintained a fiscal space of MVR 1.3 billion would be available for NPIs.

Information Box 1: Difference between budget and expenditure

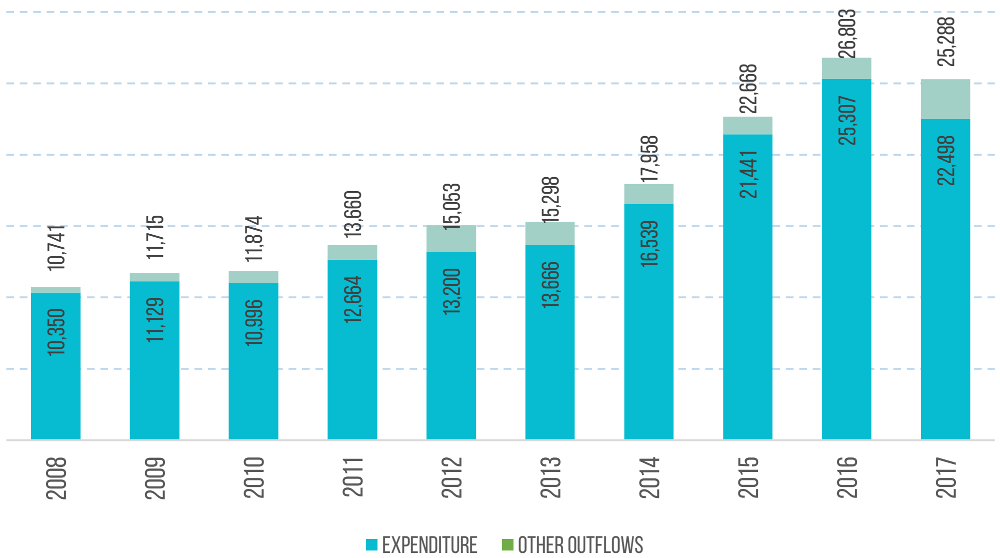
Shifna Ali, Fiscal Affairs Division

The budget is understood as the amount of money allocated for an activity for the following year. The total Government annual budget consists of the general office budgets, expenditures of trust funds, disbursements of foreign loans and grants, and Government expenditures on political parties.

The government annual budget includes all amounts allocated for all cash out flows by the Government during a given fiscal year. Therefore, the total Government budget includes its expenditure as well as loan repayments, subscriptions to multilateral institutions and loan repayments. Government expenditure consists only of the costs of provision of public goods and services, and the redistribution of wealth and income. The amounts budgeted for loan repayments, capital contributions to multinational organizations and the proceedings to the Sovereign Development Fund are not considered as part of expenditure as these costs and investments do not correspond to the spending for the budget period. Since the budget is compiled based on expenditures and the revenues during a given fiscal period, including this components in the government expenditures would lead to double counting of the figures.

Furthermore, the Government expenditure is also used, instead of the budget, to calculate the overall balance and the primary balance to determine the budget deficit or surplus. Government expenditure is defined in the same way that the International Monetary Fund (IMF) has defined expenditures in their Government Finance Statistics (GFS) manual of 1986 and 2014.

FIGURE 1.1 BUDGET AND EXPENDITURE (MVR MILLIONS)



SOURCE: MINISTRY OF FINANCE AND TREASURY

Information Box 2: State Owned Enterprises

Abdulla Imran, Public Enterprises Monitoring

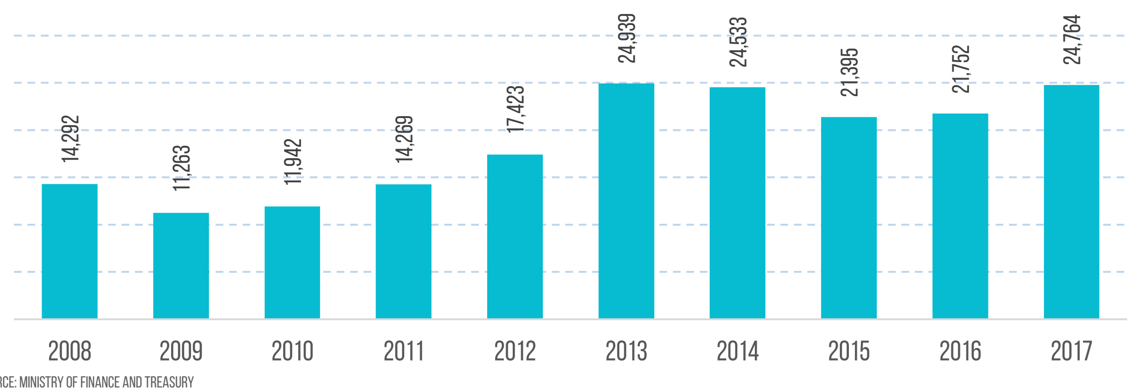
State owned enterprises (SOEs) play a vital role in improving social and economic standards and the development of infrastructure of a country. In recent years, the contribution of state owned enterprises towards the development of Maldives has been increasing. The involvement of state owned enterprises can be seen in almost every industry in Maldives. These companies assist the government in achieving their development goals.

The government of the Maldives has made efforts to provide essential services to the people at affordable rates by delegating the service provision to state owned enterprises. Hence, greater amounts are allocated in the state budget as compensation of revenue loss and capital injection for SOEs, which act as support for these companies to provide services at affordable rates.

In order to improve governance of SOEs, the majority of the board directors are now non-executive directors and are responsible for keeping the executives directors and the entire board accountable for business decisions. Thus, private fund providers and the Government have now become more content to provide financing for SOEs. Further, the Privatization and Corporatization Board has established a mechanism to sure that SOEs are made accountable for their business operations, thus encouraging to bring about efficiencies in doing-business.

Additionally, to assist in business growth, the Government has awarded several PSIP and infrastructure development project to SOEs. Through these projects, numerous SOEs have generated a decent revenue over the years. From 2008 to 2017 the total revenue generated from SOEs has increased by 73%. Further, formulation and implantation of business and strategic plans have helped SOEs improve on their financial performance.

FIGURE 2.1 SOE REVENUE (MVR BILLIONS)

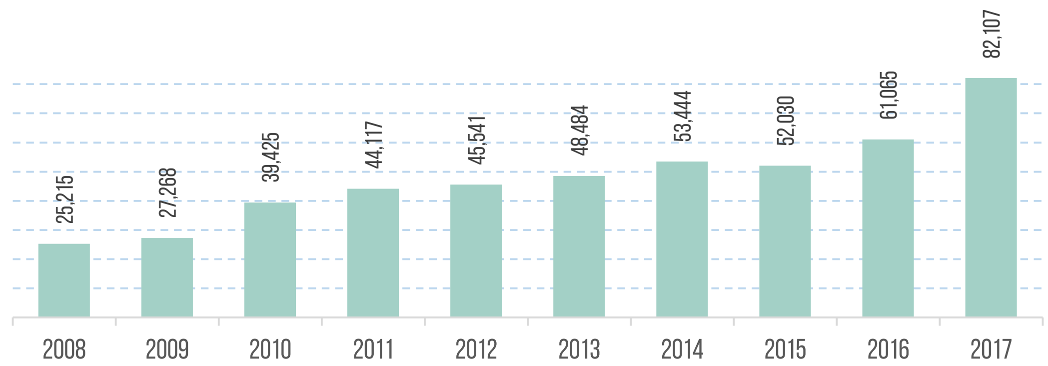


SOURCE: MINISTRY OF FINANCE AND TREASURY

The number of state owned enterprises has increased in Maldives. This, along with growth of existing SOEs, has resulted in a growth in combined total equity and reserve of state owned enterprises. It has also improved the aggregate value of reserve and shareholder funds, and further created value for shareholders and improve net assets per share. The total equity of the companies has increased by

226% from 2008 to 2017.

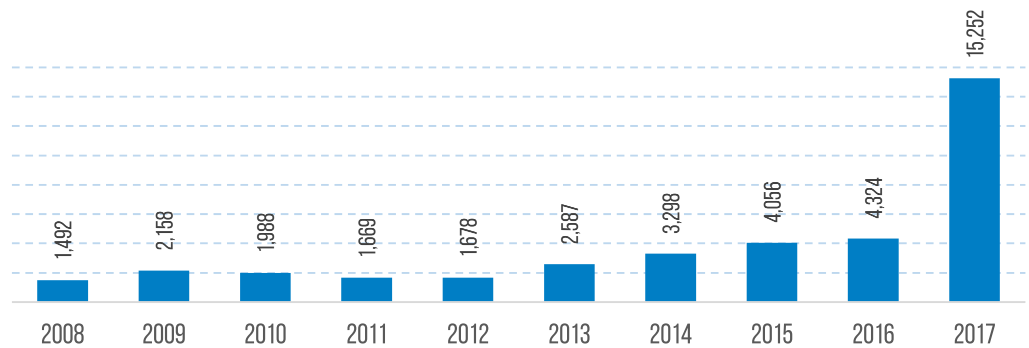
FIGURE 2.2 SOE EQUITY



SOURCE: MINISTRY OF FINANCE AND TREASURY

Figure 2.3 shows a 922% improvement in combined net profits of SOEs. Consequently, the annual dividend received by the Government has also increased by 18%. A huge jump in net profits is seen from 2016 to 2017 as Hulhumale Development Corporation generated high profits during the year from sale of land from Hulhumale' Phase II. Further, it is expected to earn higher dividend in the coming years. In addition, along with the initiatives to improve SOE performance, many companies have taken measures in managing cost and expenses, which in turn help to improve overall financial performance of these companies.

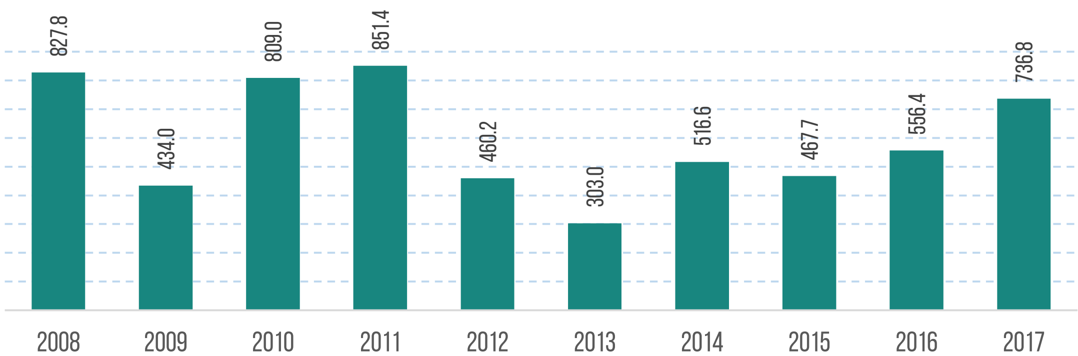
FIGURE 2.3 SOE PROFITS



SOURCE: MINISTRY OF FINANCE AND TREASURY

Due to the significant investments by SOEs on large infrastructure project, the financing requirement of SOEs has drastically increased in recent years. Thus, there has been a significant change in capital structure of these companies which in turn increases financial risk of the company. Once the capital projects are complete and the returns on investments begin to flow into the company, the overall financial situation of these companies are once again expected to improve. As these companies have invested in promising projects, it is expected to generate a reasonable return in the future which will benefit the company and the nation as a whole. With high returns on investment, business profit tax paid by the companies to the government is expected to improve in the future thus generating high tax revenue for the State.

FIGURE 2.4 DIVIDENDS FROM SOES



SOURCE: MINISTRY OF FINANCE AND TREASURY

SOEs are an important part of the economy but, some of these companies have performed poorly in terms financial profitability, and other non-financial social measures. Despite increased spending by the government on these companies by means of capital injunctions, their performance seems to get worse, thereby reducing the net returns the government receives.

Due to conflicting financial and social objectives, state owned enterprises are often pressured to provide services to the public at low and affordable prices, and therefore are unable to increase margins – in some instances, SOEs are forced to absorb costs incurred resulting in consecutive losses. SOEs that operate in competitive markets are burdened by pressures to achieve non-economic goals, thus reducing the ability of these companies to compete. Furthermore, SOEs are constrained in increasing their profitability as these companies are not able to increase prices, implement cost cutting measures (such as staff lay-offs) or acquire funding, without prior approval from the Government.

Another issue found in state owned enterprises is the employment of excessive and unnecessary staff, thereby increasing the company's expenditure. In most companies, staff expenses is the biggest expenditure.

Although SOEs are for-profit business entities, some companies do not have the flexibility to operate under the profit motive. Thus, these SOEs do not give much importance to manage or control its costs. Therefore, their expenditure keeps increasing year by year, but they are not incentivize to generate

Information Box 3: Efficiency in government spending on health

Mariyam Rashfa, Fiscal Affairs Division

Reflecting major policy reforms, such as the introduction of the universal public health insurance scheme Aasandha program in 2012, launching of the Husnuvaa Aasandha in 2014 and Dharumavantha Hospital project, overall health spending in Maldives witnessed a rapid increase during 2012-2017 and remains relatively high in relation to comparator countries in the region. According to National Health Accounts 2014 overall health spending in Maldives was MVR 4,287 million of which government spending (which includes Ministry of Health budget, Aasandha and IGMH) accounted for two thirds of overall health spending. The high and rising levels of government health spending has led to a decline in household out of pocket expenditure on health as a share of total household expenditure, which has fallen from 9 percent in 2011 to 6 percent in 2016 (Household Income and Expenditure Survey, 2016), increasing the financial protection of households.

FIGURE 3.1 LIFE EXPECTANCY AT BIRTH VS INCOME, 2016

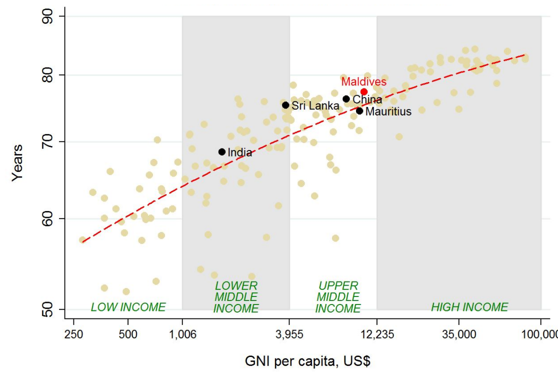


FIGURE 3.2 UNDER 5 MORTALITY RATE, 2015

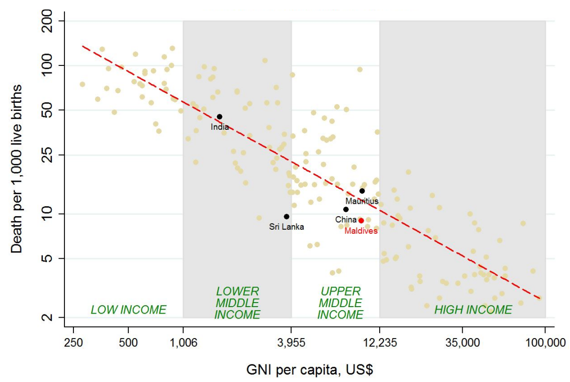


FIGURE 3.3 PUBLIC HEALTH EXPENDITURE AS A % OF TOTAL GOVERNMENT EXPENDITURE

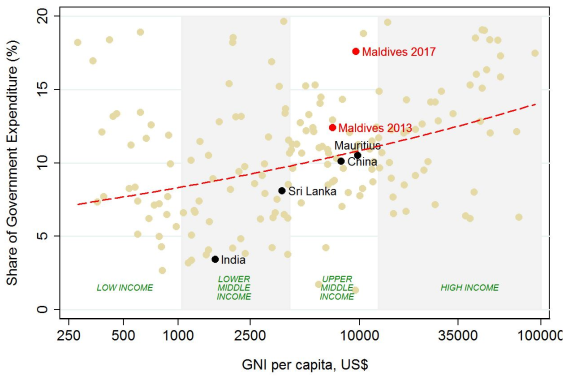
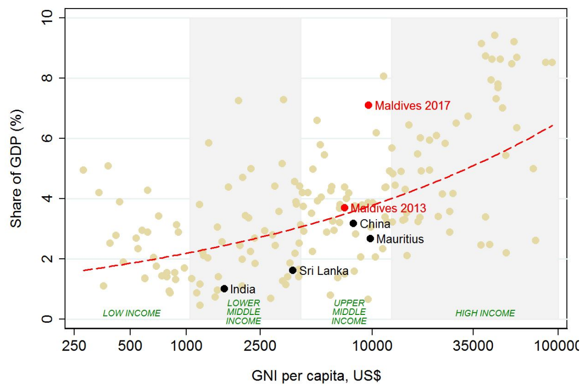


FIGURE 3.4 PUBLIC HEALTH EXPENDITURE AS A % OF GDP

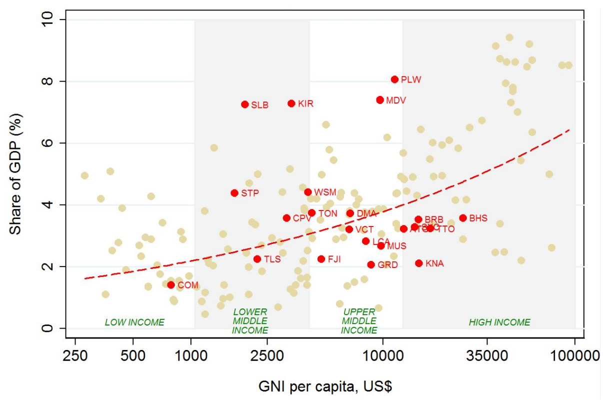


While health outcomes have been remarkably good in Maldives, there are areas of spending inefficiencies. Life expectancy is 79 years in Maldives, higher than the global average for its income level and is also the highest among small island states and South Asia comparators. Similarly, Maldives performance is also better in other health indicators such as infant mortality (under 1), mortality under five and maternal mortality rates. Maldives attained all targets for MDG4 and 5 well before 2015 (Figure 3.1 and Figure 3.2). However, government spending in health has become an outlier when compared with countries with similar income levels, both as a percent of total government spending (Figure 3.3) as well as a percent of GDP (Figure 3.4).

There have also been notable changes in patterns of government health spending over the last five years. Recurrent expenditure, namely a high wage bill and spending on medical consumables such as drugs and laboratory consumables, has been the main source of health spending prior to 2014, although since then there has been a shift towards capital spending owing to the Dharumavantha Hospital project. It is also important to note that health insurance expenditure by Aasandha, which accounted for 15.3% of total health spending in 2017, increased fourfold during 2012-2016, from MVR 357.7 million in 2012 to MVR 1,471.1 million in 2016, out of this the majority was spent on drugs and consumables. During 2012-2017, total government spending on medical consumables by both the IGMH and the Ministry of Health budget also increased significantly from MVR 12.7 million in 2012 to MVR 431.3 million in 2017.

Like other small island states, healthcare service delivery costs in Maldives are high reflecting challenges such as geographic isolation; small populations; reliance on expatriate health workers and inadequate and skilled health personnel in rural areas. Nonetheless, government health spending as a ratio to GDP is seen as a relative outlier among comparator small island states (Figure 3.5). While this could be due to country specific factors, there appears to be areas of inefficiencies where cost savings can be made in the short to medium term, which would be crucial in the context of broader fiscal consolidation efforts.

FIGURE 3.5 HEALTH EXPENDITURE AS A SHARE OF GDP - SMALL ISLAND STATES



Areas of inefficiencies[1]:

- Underuse of generics and higher than necessary prices for medicines. In Maldives drug prices are 15 to 75 per cent higher than international comparators;
- Service delivery, both inpatient admissions and outpatient visits in percent of level of care (categorized as primary care, specialists and hospitals) are concentrated at Male' hospitals at 40 per cent, which are more costly than in regional and atoll hospitals. For example average unit costs for inpatients and outpatient in IGMH are roughly 30-40 percent higher than in regional/ atoll hospitals;
- While inpatient and outpatient utilization rates—143 admissions per 1,000 population and 5.6 visits per person, respectively—are reaching OECD norms, it is somewhat higher for a country with a relatively young population. This could be the result of a rather generous health care package instigating the overuse of investigations and procedures, the absence of a standard treatment guideline or an integrated information system linking patient care that will reduce duplication of services;
- Preventive health care spending is low at 1.1 per cent of total government spending on health compared to an average of 5-10 per cent in advanced health care systems.

Potential areas of reform could focus on the following:

- Reduce costs of drugs and other consumables by bulk purchasing and engaging international wholesalers, promoting generics and appropriate use of co-payments;
- Implement standard treatment guidelines to rationalize costs and care;
- Invest in management information systems to improve the current mechanism of procurement, inventory management and monitoring; and provide training on forecasting techniques to procurement/ inventory personnel in health care systems;
- Strengthen service delivery reforms in the atolls for primary health care that would generate cost savings such as rotating Male' specialists to atolls on short term basis;
- Medium- to long-term measures such as the rationalization of Aasandha package by introducing co-payments and exemption for certain services as well as introduction of premium contribution.

Data used in figures 3.1,3.2,3.3,3.4 and 3.5 are taken from the World Development Indicators online database.

[1] This is based on the health expenditure review undertaken by the World Bank in 2017 upon request of the Ministry of Finance and Treasury.

Annex 1: Government Finance in MVR millions

	2014 Actual	2015 Actual	2016 Actual	2017 Actual	2018 Rev	2019 Proj	2020 Proj	2021 Proj	2022 Proj
Central Government Finances									
Total Revenue and Grants	**15,164**	**17,306**	**18,578**	**20,259**	**22,302**	**23,301**	**24,548**	**25,978**	**27,256**
Total Revenue	**14,999**	**16,669**	**18,325**	**19,893**	**21,568**	**22,850**	**24,031**	**25,411**	**26,744**
Import Duties	1,975	2,346	2,487	2,799	2,930	3,105	3,265	3,468	3,589
Business and Property Tax	3,789	3,220	3,264	3,423	4,281	4,562	4,838	5,192	5,567
Tourism Tax	805	1	0	0	0	0	0	0	0
Business Profit Tax & Witholding Tax	2,471	2,674	2,748	2,107	2,888	3,081	3,282	3,496	3,699
Bank Profit Tax	482	513	492	650	726	814	890	1,029	1,200
Goods and Services Tax	4,515	6,054	6,249	6,882	7,415	7,858	8,290	8,751	9,233
Tourism Goods and Services Tax	3,002	4,150	3,921	4,199	4,531	4,787	5,027	5,283	5,556
Goods and Services Tax	1,513	1,904	2,328	2,683	2,883	3,071	3,263	3,468	3,677
Other Taxes and Duties	470	571	1,218	1,561	1,559	1,662	1,719	1,797	1,868
o/w Airport Service Charge	432	497	538	706	657	699	738	776	817
o/w Green tax	0	37	623	696	793	829	861	893	927
Fees and Charges	812	1,533	1,038	1,053	968	1,018	1,058	1,098	1,139
Registration and Licence Fees	249	274	338	392	402	407	411	415	418
Property Income	1,708	1,472	2,365	2,201	2,334	2,473	2,614	2,764	2,916
Interest, Profit and Dividends	815	523	664	906	979	1,042	1,108	1,177	1,248
New Revenue Measures				0	0	0	0	0	0
Other Revenue	794	834	859	802	848	868	867	894	909
Grants	165	637	253	365	400	451	517	567	511
Total expenditure	**16,539**	**21,441**	**25,307**	**22,498**	**24,354**	**25,897**	**26,006**	**30,269**	**28,999**
Total budget	**17,958**	**22,668**	**26,803**	**25,288**	**27,914**	**29,687**	**29,674**	**34,566**	**34,100**
Primary expenditure	**15,561**	**20,093**	**24,124**	**21,401**	**23,133**	**25,891**	**24,053**	**28,234**	**26,964**
Current primary expenditure	**12,982**	**15,386**	**14,959**	**13,854**	**15,983**	**16,165**	**16,705**	**17,645**	**18,361**
Personal Emoluments	5,829	6,821	6,899	6,972	7,629	7,855	8,102	8,533	8,967
Pensions, Retirement Benefits & Gratuities	1,399	1,423	1,440	1,462	1,502	1,811	1,963	2,284	2,534
Goods and Services	2,847	4,259	3,774	3,341	3,635	4,007	4,130	4,284	4,354
Travel Expenses	134	189	187	177	159	249	246	248	251
Supplies and Requisites	492	591	612	561	532	580	620	648	670
Operational Services	1,366	2,050	1,634	1,593	1,709	2,268	2,306	2,334	2,365
Supplies and Requisites for Service Provision	334	627	569	550	564	439	462	477	484
Training	306	415	456	248	396	259	276	346	351
Repairs and Maintenance	216	386	316	212	276	212	219	231	234
Grants, Contributions and Subsidies	2,532	2,831	2,769	2,036	3,096	2,441	2,431	2,460	2,492
Other current primary expenditures	375	53	78	44	120	52	79	84	14
Capital Expenditure	**2,579**	**4,707**	**9,166**	**7,547**	**7,150**	**7,025**	**5,348**	**8,589**	**6,603**
Development Projects	39	73	149	53	35	40	40	40	41

	2014 Actual	2015 Actual	2016 Actual	2017 Actual	2018 Rev	2019 Proj	2020 Proj	2021 Proj	2022 Proj
Budget Contingency						400	400	400	400
Public Sector Investment Program	1,944	3,118	7,079	5,828	5,806	5,695	4,018	7,246	5,249
O/W Domestic	1,703	2,403	4,148	3,037	3,600	2,200	459	246	249
O/W Foreign	242	715	2,931	2,791	2,206	3,495	3,559	7,000	5,000
Capital Equipment, Investment & Loan Outlays	596	1,516	1,938	1,665	1,310	891	890	903	913
New Policy Initiatives (NPIs)					0	1,300	2,000	2,000	2,000
Interest Payments	978	1,348	1,182	1,097	1,222	1,406	1,480	1,567	2,017
Transfer to Sovereign Development Fund				337	1,200	1,571	1,035	1,073	1,114
Debt Amortization (exc. T-bills)	1,413	1,172	1,382	2,404	2,328	2,198	2,611	3,202	3,965
Capital Contributions to Multilateral Organisations	6	55	114	49	32	22	22	22	22
Primary fiscal balance	**-397**	**-2,787**	**-5,546**	**-1,142**	**-831**	**-1,190**	**495**	**-2,256**	**292**
Overall fiscal balance	**-1,375**	**-4,135**	**-6,728**	**-2,239**	**-2,052**	**-2,596**	**-986**	**-3,823**	**-1,726**
Financing									
Financing needs	2,788	5,307	8,101	3,862	6,799	7,261	5,853	9,069	7,525
Overall fiscal deficit	1,375	4,135	6,728	2,239	2,052	2,596	986	3,823	1,726
Amortizations (debt repayments, including maturing Tbills)	1,413	1,172	1,382	1,623	2,328	2,198	2,611	3,202	3,965
Financing sources	2,788	5,307	8,101	3,862	6,799	7,261	5,853	9,069	7,525
Gross borrowings	2,655	5,092	7,831	3,686	6,620	7,096	5,692	8,904	7,361
Foreign sources	242	715	2,864	1,534	2,206	3,495	3,559	7,000	5,000
Sovereign Bond/Sukook				2,455	4,484	0	0	0	0
Domestic sources	2,414	4,378	4,966	-303	-70	3,601	2,132	1,904	2,361
Privatization receipts	0	0	0	0	0	0	0	0	0
Other identified sources of financing (net)	133	214	271	176	180	165	161	165	164
Fiscal Indicators									
Primary Balance (% of GDP)	-0.7	-4.5	-8.5	-1.6	-1.1	-1.4	0.6	-2.4	0.3
Fiscal Balance (% of GDP)	-2.4	-6.7	-10.4	-3.1	-2.7	-3.1	-1.1	-4.1	-1.7
Debt (% of GDP)	0.0	54.1	58.8	60.7	60.1	62.4	63.0	64.9	64.9
Debt service (% of Revenue)	15.8	14.6	13.8	17.3	15.9	15.5	16.7	18.4	21.9
Debt (% of Revenue)	0.0	192.3	205.6	214.7	208.6	220.7	224.8	232.8	235.3
Memorandum items									
Nominal GDP (million MVR)	56,867	61,566	64,919	71,677	77,439	82,475	87,638	93,138	98,775
Growth of nominal GDP (%)	12.3	8.3	5.4	10.4	8.0	6.5	6.3	6.3	6.1
Growth of real GDP (%)	7.3	2.2	6.2	6.9	6.0	5.9	5.7	5.7	5.5
Total Debt (million MVR)	0	33,283	38,202	43,494	46,530	51,425	55,172	60,490	64,136
Inflation	2.1	1.0	0.5	2.8	1.1	1.1	1.1	1.2	1.3
Exchange rate MVR per USD	15.4	15.4	15.4	15.4	15.4	15.4	15.4	15.4	15.4

SOURCE: MINISTRY OF FINANCE AND TREASURY

Annex 2: Government Finances as a percent of GDP

	2014 Actual	2015 Actual	2016 Actual	2017 Actual	2018 Rev	2019 Proj	2020 Proj	2021 Proj	2022 Proj
Central Government Finances									
Total Revenue and Grants	**26.7**	**28.1**	**28.6**	**28.3**	**28.4**	**28.3**	**28.0**	**27.9**	**27.6**
Total Revenue	**26.4**	**27.1**	**28.2**	**27.8**	**27.9**	**27.7**	**27.4**	**27.3**	**27.1**
Import Duties	3.5	3.8	3.8	3.9	3.8	3.8	3.7	3.7	3.6
Business and Property Tax	6.7	5.2	5.0	4.8	5.5	5.5	5.5	5.6	5.6
Tourism Tax	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Business Profit Tax & Witholding Tax	4.3	4.3	4.2	2.9	3.7	3.7	3.7	3.8	3.7
Bank Profit Tax	0.8	0.8	0.8	0.9	0.9	1.0	1.0	1.1	1.2
Goods and Services Tax	7.9	9.8	9.6	9.6	9.6	9.5	9.5	9.4	9.3
Tourism Goods and Services Tax	5.3	6.7	6.0	5.9	5.9	5.8	5.7	5.7	5.6
Goods and Services Tax	2.7	3.1	3.6	3.7	3.7	3.7	3.7	3.7	3.7
Other Taxes and Duties	0.8	0.9	1.9	2.2	2.0	2.0	2.0	1.9	1.9
o/w Airport Service Charge	0.8	0.8	0.8	1.0	0.8	0.8	0.8	0.8	0.8
o/w Green tax	0.0	0.1	1.0	1.0	1.0	1.0	1.0	1.0	0.9
Fees and Charges	1.4	2.5	1.6	1.5	1.2	1.2	1.2	1.2	1.2
Registration and Licence Fees	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.4	0.4
Property Income	3.0	2.4	3.6	3.1	3.0	3.0	3.0	3.0	3.0
Interest, Profit and Dividends	1.4	0.8	1.0	1.3	1.3	1.3	1.3	1.3	1.3
New Revenue Measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue	1.4	1.4	1.3	1.1	1.1	1.1	1.0	1.0	0.9
Grants	0.3	1.0	0.4	0.5	0.9	0.5	0.6	0.6	0.5
Total expenditure	**29.1**	**34.8**	**39.0**	**31.4**	**31.4**	**31.4**	**29.7**	**32.5**	**29.4**
Total budget	**31.6**	**36.8**	**41.3**	**35.3**	**36.0**	**36.0**	**33.9**	**37.1**	**34.5**
Primary expenditure	27.4	32.6	37.2	29.9	29.9	29.7	28.0	30.8	27.3
Current primary expenditure	22.8	25.0	23.0	19.3	20.6	19.6	19.0	18.9	18.6
Personal Emoluments	10.2	11.1	10.6	9.7	9.9	9.5	9.2	9.2	9.1
Pensions, Retirement Benefits & Gratuities	2.5	2.3	2.2	2.0	1.9	2.2	2.2	2.5	2.6
Goods and Services	5.0	6.9	5.8	4.7	4.7	4.9	4.7	4.6	4.4
Travel Expenses	0.2	0.3	0.3	0.2	0.2	0.3	0.3	0.3	0.3
Supplies and Requisites	0.9	1.0	0.9	0.8	0.7	0.7	0.7	0.7	0.7
Operational Services	2.4	3.3	2.5	2.2	2.2	2.7	2.6	2.5	2.4
Supplies and Requisites for Service Provision	0.6	1.0	0.9	0.8	0.7	0.5	0.5	0.5	0.5
Training	0.5	0.7	0.7	0.3	0.5	0.3	0.3	0.4	0.4
Repairs and Maintenance	0.4	0.6	0.5	0.3	0.4	0.3	0.2	0.2	0.2
Grants, Contributions and Subsidies	4.5	4.6	4.3	2.8	4.0	3.0	2.8	2.6	2.5
Other current primary expenditures	0.7	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.0
Capital expenditure	4.5	7.6	14.1	10.5	9.2	8.5	6.1	9.2	6.7
Development Projects	0.1	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0

	2014 Actual	2015 Actual	2016 Actual	2017 Actual	2018 Rev	2019 Proj	2020 Proj	2021 Proj	2022 Proj
Public Sector Investment Program	3.4	5.1	10.9	8.1	7.5	6.9	4.6	7.8	5.3
O/W Domestic	3.0	3.9	6.4	4.2	4.6	2.7	0.5	0.3	0.3
O/W Foreign	0.4	1.2	4.5	3.9	2.8	4.2	4.1	7.5	5.1
Transfer to Sovereign Development Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital Equipment, Investment & Loan Outlays	1.0	2.5	3.0	2.3	1.7	1.1	1.0	1.0	0.9
New Policy Initiatives (NPIs)	0.0	0.0	0.0	0.0	0.0	1.6	2.3	2.1	2.0
Interest Payments	1.7	2.2	1.8	1.5	1.6	1.7	1.7	1.7	2.0
Debt Amortization (exc. T-bills)	2.5	1.9	2.1	3.4	3.0	2.7	3.0	3.4	4.0
Capital Contributions to Multilateral Organisations	0.0	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Primary fiscal balance	**-0.7**	**-4.5**	**-8.5**	**-1.6**	**-1.1**	**-1.4**	**0.6**	**-2.4**	**0.3**
Overall fiscal balance	**-2.4**	**-6.7**	**-10.4**	**-3.1**	**-2.7**	**-3.1**	**-1.1**	**-4.1**	**-1.7**
Financing									
Financing needs	4.9	8.6	12.5	5.4	8.8	8.8	6.7	9.7	7.6
Overall fiscal deficit	2.4	6.7	10.4	3.1	2.7	3.1	1.1	4.1	1.7
Amortizations (debt repayments, including maturing Tbills)	2.5	1.9	2.1	2.3	3.0	2.7	3.0	3.4	4.0
Financing sources	4.9	8.6	12.5	5.4	8.8	8.8	6.7	9.7	7.6
Gross borrowings	4.7	8.3	12.1	5.1	8.5	8.6	6.5	9.6	7.5
Foreign sources	0.4	1.2	4.4	2.1	2.8	4.2	4.1	7.5	5.1
Sovereign Bond/Sukook				3.4	5.8	0.0	0.0	0.0	0.0
Domestic sources	4.2	7.1	7.6	-0.4	-0.1	4.4	2.4	2.0	2.4
Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other identified sources of financing (net)	0.2	0.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2

SOURCE: MINISTRY OF FINANCE AND TREASURY

Medium Term Debt Strategy

Medium Term Debt Management Strategy 2019-2021

Introduction

This Strategy outlines the position of the country's current debt portfolio, and the efforts to be made towards strengthening debt management. The Strategy details the position of the debt portfolio at the end of 2017, the estimated debt position at the end of 2018, and the strategy for debt management for the period 2019-2021.

This Strategy is prepared in accordance with Section 20 of the Fiscal Responsibility Act (Law Number 7/2013). Section 22 of the Act details the information required to be included in the strategy, as follows:

1. Public debt targets;
2. Target ratio of public debt to the Gross Domestic Product (GDP);
3. Target ratio of external to domestic debt;
4. Actions planned or being implemented to mitigate risks related to the public debt; and
5. Details of utilization of borrowed funds.
6. Public Debt at the end of 2017 and the expected debt position at the end of 2018

At the end of 2017, total public debt[2] stood at MVR 43,785 million, equivalent to 61 percent of GDP, and 211 percent of total revenue. Table 1 shows details of public debt at the end of 2016 and 2017, and the estimates for 2018.

A major share of the outstanding external debt at the end of 2017 represents loans contracted for housing projects, airport development, and budget support, and the sovereign bond issuance to finance the construction of Dharumavantha Hospital. Domestic debt represents mainly borrowings made for budget support, pension recognition, and for closing the financing gaps for small projects.

[2] Public debt in this Strategy refers to the disbursed and outstanding debt of Government's direct borrowings. It does not include committed undisbursed balances or sovereign guaranteed debt.

TABLE 5 DEBT PROFILE, 2016-2018

	2016	2017	2018
(in MVR millions)			
Total Debt	38,202	43,785	49,136
External Debt	11,726	16,669	21,744
Domestic Debt	26,476	27,116	27,391
(% of GDP)			
Total Debt	59	61	63
External Debt	18	23	28
Domestic Debt	41	38	35
(% of Revenue)			
Total Debt	201	211	220
External Debt	62	80	97
Domestic Debt	139	131	123
Memorandum Items (in MVR millions)			
Nominal GDP	64,919	71,677	77,439
Revenue	19,032	20,778	22,311

SOURCE: MINISTRY OF FINANCE AND TREASURY

Medium-term Debt Strategy 2019 – 2021

Given the total debt composition, and the debt service costs and risks at the end of 2017, and the expected changes to these indicators in 2018, it is understood that further development of the domestic debt market is important in order to reduce the costs and risks inherent in the debt portfolio. As such, below is the medium-term strategy for debt management.

External debt: The external debt strategy is to fully utilize the loans that have been committed but not yet fully disbursed, and to negotiate concessional loans bilaterally.

Domestic Debt: The domestic debt strategy is to expand the domestic debt market by introducing intermediate-term Treasury instruments and by eliminating barriers to investing in the domestic debt market.

The main objectives of this Strategy are to keep the public debt at sustainable levels, to raise finance for the Government at the lowest possible cost and risk, and to develop the domestic debt market.

The implementation of this Strategy is expected reduce the costs and risks present in the public debt portfolio. As such, by the end of the Strategy period (end of 2021), total debt is expected to be 20 percent higher (at approximately MVR 52.5 billion) compared to 2017, while the ratio of debt to GDP is expected to be 4.6 percentage points lower. That is, while debt to GDP at the end of 2017 stood at 61 percent, it is expected that the debt to GDP at the end of 2021 will be at 56.4 percent.

Contingent upon the implementation of this Strategy, the share of domestic debt is expected to increase from 62 percent (at the end of 2017) to 64 percent. It is expected that this would lead to an increase in the refinancing risk in the domestic debt portfolio. However, due to the expected reduction in the refinancing risk in the external debt portfolio, it is estimated that the total risk for refinancing will be reduced. In addition, it is expected that the interest rate risks and exchange rate risks in the total debt portfolio will be lower by the end of 2021, compared to 2017.

Implementation of the strategy

The following steps were taken in order to raise finance for the Government at the lowest cost and risk in 2017.

1. A borrowing plan was formulated for the purpose of keeping the banks and the public informed about upcoming Treasury bill issuances.
2. The Maldives Monetary Authority (MMA) obtained technical assistance from the International Security Consultancy (ISC) for developing the secondary market of Treasury instruments.
3. An Investor Forum was organized to understand investor concerns and to further develop the domestic debt market.
4. The debut sovereign bond was issued, with an issuance volume of US$ 250 million.
5. The Sovereign Development Fund (SDF) was established, worth US$ 47 million as of date of publication, with the objective of acting as debt-sinking fund.
6. A new policy was introduced for issuing Government guarantees, which has been published on the Government Gazette.
7. Maldives' credit rating was obtained.

Below are the steps that has been planned to be taken for the implementation of the medium-term debt management strategy 2019-2021.

1. Publish the borrowing plan that has already been formulated for the purpose of keeping the banks and the public informed about upcoming Treasury bill issuances.

2. Redenomination of Treasury instruments to encourage a greater number of investors in the domestic market.

3. Introduce 2-year Treasury notes to widen the variety of instruments available in the domestic market.

4. Work with the MMA and the Maldives Pension Administration Office (MPAO) in developing the secondary market for Treasury instruments.

5. Introduce new Islamic instruments to expand the domestic Islamic securities market.

6. Refinance the long-term Treasury bonds held by the MMA and the MPAO.

7. Build-up funds in the SDF to support the bullet repayments on sovereign bonds.

8. Negotiate concessional loans bilaterally.

9. Further strengthen the reporting of public debt statistics.

10. In addition to this, plans have been made for further strengthening of the management of risks associated with the contingent liabilities of the Government.

Conclusion

This is the Government's Strategy for public debt management prepared and submitted to the People's Majlis in compliance with the Fiscal Responsibility Act. This Strategy has been formulated in consideration of various alternatives within a cost-risk framework. The employment of this methodology in preparing the Strategy is part of the public financial management reforms led by the Government. In light of the reformative steps being taken in other areas of public finance, it is expected that the medium-term debt management objectives can be achieved.

In accordance with the Section 32 (b) of the Fiscal Responsibility Act (Law Number 7/2013), the Government is working towards reducing the public debt as a percentage of GDP. The most important steps to be taken to this end are; strengthening the management of the Government and state-owned enterprises, reducing the budget deficit, and maintaining macroeconomic stability. Moreover, works is being done in collaboration with the Attorney General's Office to draft an amendment to Fiscal Responsibility Act such that the targets relating to public debt are revised.

Information Box 4: Currency Composition of the External Debt Portfolio

Mohamed Firzul Hussain Firaz, Resource Mobilisation and Debt Management Division

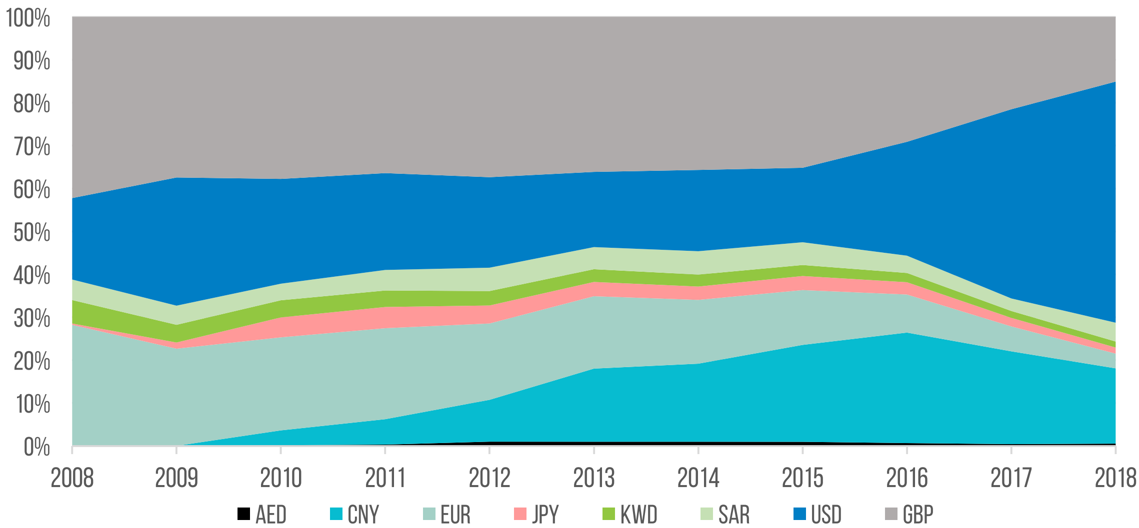
Managing foreign exchange risk is a key role of public debt management. As at the end of June 2018, external debt accounts for 42% of the public debt portfolio. It is expected that by the end of the year 2018, 56% of external debt will be denominated in United States dollars (USD), 18% in Chinese yuan (CNY), and 15% in Special Drawing Rights (SDR). The remaining 11% is expected to be denominated in Saudi riyal (SAR), Euro (EUR), Kuwaiti dinar (KWD), Japanese yen (JPY), and United Arab Emirates dirham (AED).

SDR is a form of currency maintained by the International Monetary Fund, and defined as a weighted average of various convertible currencies. While they are subject to occasional revisions, the weights are currently distributed among the currencies USD, EUR, CNY, JPY, and Pound sterling (GBP) as 41.73%, 30.93%, 10.92%, 8.33%, and 8.09%, respectively. When SDR is decomposed into its constituent currencies, the share of USD denominated external debt is expected to go up to 62% by end of the year 2018, while the shares of external debt denominated in CNY, EUR, and JPY is expected to increase by 1.3, 4.7, and 1.2 percentage points, respectively. Although the current external debt portfolio of the Government does not include GBP denominated debt, decomposition of the SDR, will introduce GBP into the currency mix, accounting for 1.7% of the external debt.

The share of CNY denominated debt in the external debt portfolio was on a rising trend from 2009 until the issuance of the Maldives' debut Eurobond in 2017, which was denominated in USD. With consideration to the external debt in the current pipeline and the government's medium-term debt management strategy, it is expected that the CNY denominated debt will continue to lose share against the USD in the years 2018 and 2019.

Figure 4.1 shows how the currency composition of the external debt portfolio has evolved over the past ten years, and how it is expected to evolve during the year 2018.

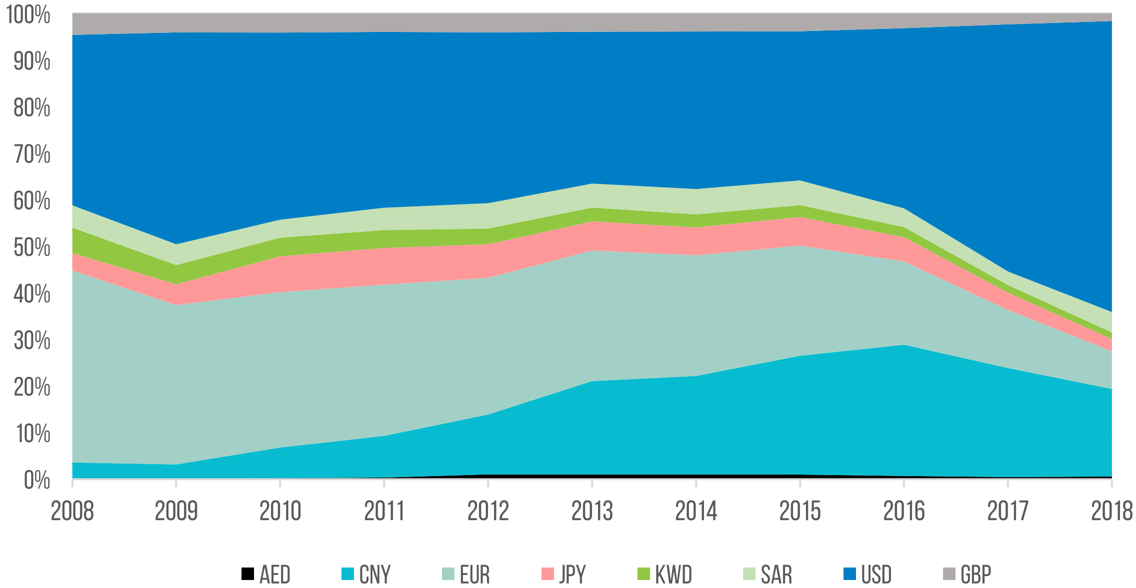
FIGURE 4.1 CURRENCY COMPOSITION OF EXTERNAL DEBT, 2008 - 2018



SOURCE: MINISTRY OF FINANCE AND TREASURY

Figure 4.2 shows the currency composition during the same period, but with the SDR decomposed.

FIGURE 4.2 CURRENCY COMPOSITION OF EXTERNAL DEBT (SDR DECOMPOSED), 2008 – 2018



SOURCE: MINISTRY OF FINANCE AND TREASURY

Foreign exchange risk remains largely mitigated due to the fact that the majority of the external debt has been denominated in USD, against which the Maldivian rufiyaa is pegged. For this reason, the government, to some extent, gives preference to USD denominated loans and securities when new debt is being contracted. Furthermore, the currency composition of external debt that needs to be serviced in the medium term is one of the factors considered by the Maldives Monetary Authority in managing its foreign reserves.

Information Box 5: The Evolution of External Financing in Maldives

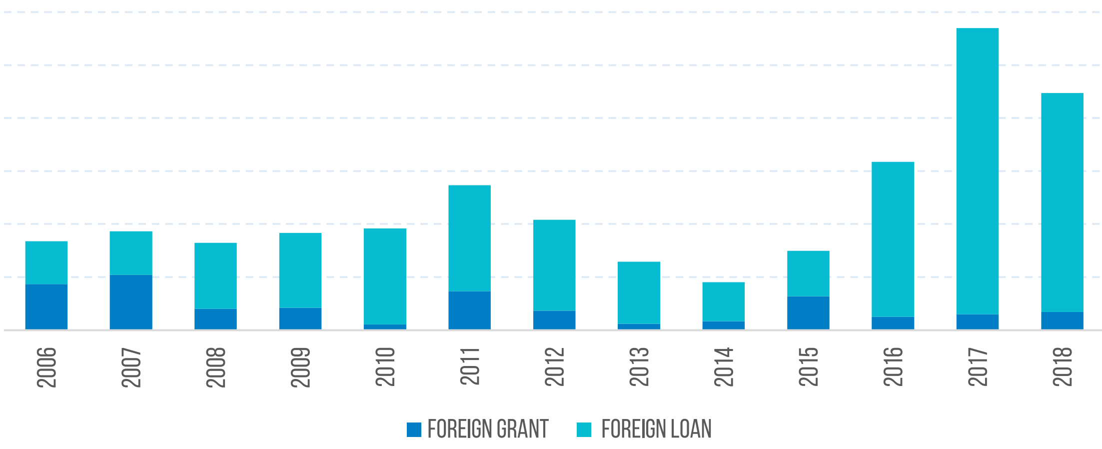
Aishath Zara Nizar, Resource Mobilisation and Debt Management Division

External financing is one of the key financing methods that the government utilizes in order to pursue various developmental projects. The sources and types of such financing has evolved significantly over the past decade.

External sources of funds comprise of loans and grants, contracted mainly through multilateral and bilateral agencies, and financial institutions providing buyer's credit facility. Multilateral funding agencies are international financial institutions created by a group of countries for the purpose of providing funds to countries for economic and social development. Some of the biggest multilateral funding agencies which Maldives receives assistance from are the OPEC Fund for International Development and the World Bank.[1] Bilateral organizations, on the other hand, are agencies of a single country that provides development funding for other countries. Notable bilateral creditors are the Saudi Fund for Development and Abu Dhabi Fund for Development, whereas the Export-Import Bank of China (China Exim Bank) is the main institution that provides financing to Maldives in the form of buyer's credit.

While the total amount of external financing disbursed by foreign donors in 2006 amounted to MVR 1.7 billion, the government utilized over MVR 5.2 billion in external financing in 2018.

FIGURE 5.1 FOREIGN LOAN AND GRANT DISBURSEMENTS, 2006-2018



SOURCE: MINISTRY OF FINANCE AND TREASURY

As seen in Figure 5.1, the amount of external financing has experienced significant changes, particularly in recent years. In 2006 and 2007, the government received a relatively large proportion of external financing as grants. This was owing to the high amount of foreign grants received as assistance for tsunami recovery; such grants accounted for more than 80% of total foreign grants in both these

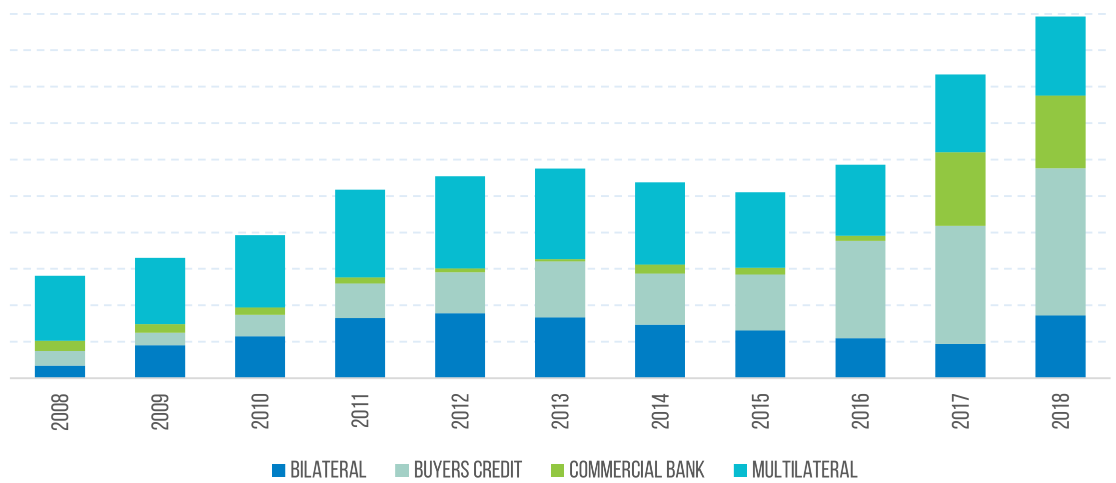
[1] In this paragraph, the main creditors highlighted are based on the largest disbursements made (both loan and grant) in the last five years, from 2014 to 2018.

years. Another trend that can be observed is the considerable decline in foreign grants immediately after 2011. This is largely due to Maldives graduating to middle income status in 2011, and thereby losing access to several funds that provide grant financing.

External financing has increased substantially in the past few years. The average annual growth in external financing during the period 2014 to 2018 is 41%, compared to a decline of 1% in the four-year period prior. This difference is primarily due to the large amount of foreign loans that the government contracted for pursuing infrastructure projects across Maldives since 2015. Such projects include the expansion of Velana International Airport and the construction of a second runway, construction of the Sina-Male' Bridge, the large-scale development of housing projects, and the construction of Dharumavantha Hospital.

The sources of external loans that the government has contracted over the years has also changed considerably (Figure 5.2).

FIGURE 5.2 DISBURSED OUTSTANDING AND EXTERNAL DEBT, 2008-2018



SOURCE: MINISTRY OF FINANCE AND TREASURY

Whereas multilateral loans comprised a large proportion of disbursed outstanding external debt in 2008, a gradual trend towards loan financing from buyer's credit can be seen over the ten-year period. The increase in external loans contracted through buyer's credit reflects increasing transactions made with the China Exim Bank to finance large-scale developmental projects in Maldives. Meanwhile, the spike in commercial loans in 2017 represent the first international sovereign bond issued by the government during the year. This marks a notable milestone for the country; that the government was able to tap into global commercial funds for the first time—by obtaining its first sovereign credit rating, and the subsequent bond issuance.

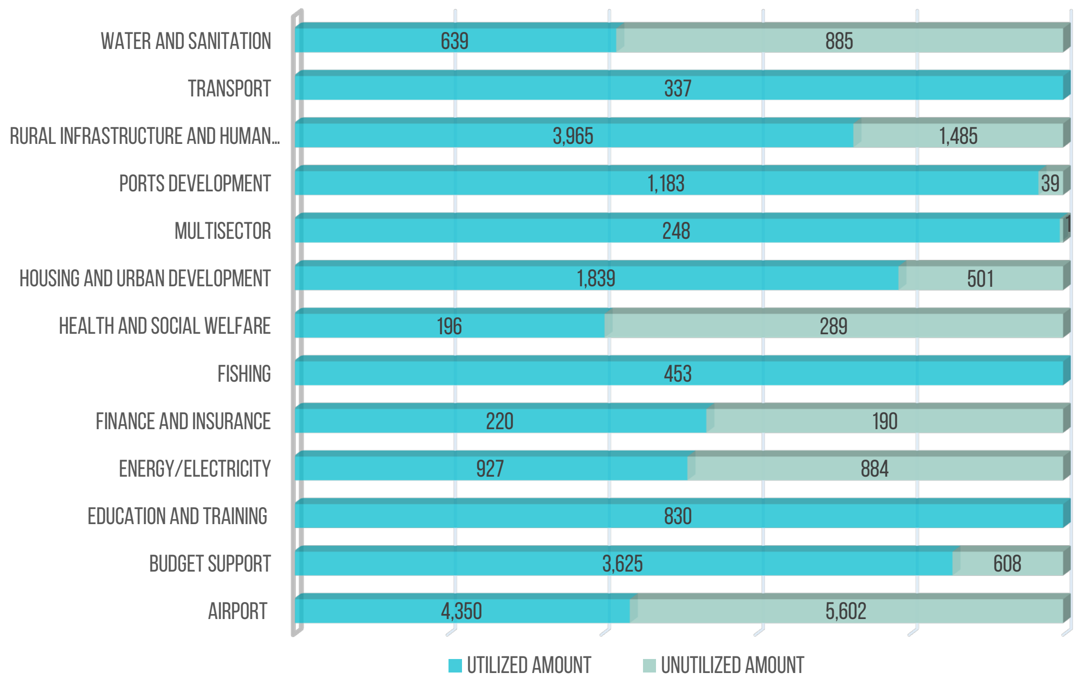
Information Box 6: Project Implementation and Cost of Borrowing

Aminath Imaha, Resource Mobilisation and Debt Management Division

Development projects are the building blocks of countries. It is a pre-requisite to ensure the development of priority sectors and to eliminate adverse macroeconomic repercussions. The success of any development project is determined by its effective implementation. Effective implementation implies that the predetermined outcomes of the project are met without significant time and/or cost overrun.

In Maldives, the average project implementation period for public sector projects is between 3 and 5 years. However, ineffective implementation of several projects demand extension of the pre-determined implementation period. This leads to increases in the cost of these projects. Cost increases arise from several sources. For instance, due to delays in implementation, the project may be faced with increased material and staff costs. Also many foreign loans, regardless of concessionality, require the recipient government to pay interest and commitment fees from the date of first disbursement of the loan until its maturity. As commitment fee is paid on the undisbursed portion of the loan, slower project implementation (and as a result slower disbursement) implies the Government's responsibility to pay a higher commitment fee than initially forecasted. At times, the Government may need to finance variations in the contract price and additional financing using its own budgetary resources.

FIGURE 6.1 SECTOR WISE UTILIZATION OF PROJECT FINANCE[1] (IN MVR MILLIONS)



Includes only projects aided via external loans and does not include grant-aid projects.

SOURCE: MINISTRY OF FINANCE AND TREASURY

As depicted in Figure 6.1, the performance of different sectors vary in utilization of project finance. A significant volume of the unutilized amount (36%) represent recent mega projects signed under various sectors, which are expected to be utilised as per schedule. Slow implementation of projects is the main reason for the unutilised funds under Water and Sanitation and Health and Social Welfare sector. While Fishing and Transport sector shows 100% fund utilization, Multi-sector and Ports Development sector show negligible amount of unutilized funds for the projects under the sector.

There are several factors that lead to slow and inefficient project implementation, such as poor project appraisals and monitoring, inadequate management, overambitious implementation timelines, failure to consider total funding during project design phase, delays in response from some foreign donors, and reformulation of project scope during the implementation stage. In addition, several projects have been delayed due to procurement related issues. Lack of coordination between concerned implementing agencies and delays in decision making due to government policy changes further lengthens the implementation process.

Effective implementation is crucial to avoid unnecessary costs associated with the slow implementation. Poor implementation may have a detrimental impact on the country's rating and portfolio which is an important consideration for future foreign assistance. Hence, it is vital to make the best use of funding from foreign donors to ensure continuous assistance for development projects in the country.

Information Box 7: Bond and Sukuk

Ali Abdul Raheem, Fiscal Affairs Division

A bond is a form of fixed income security which is issued by a company or a sovereign to raise debt in return for a fixed periodic interest payments, known as coupons paid to the lender. The issuer also agrees to repay the principal at the agreed maturity date. The main distinction between a conventional loan and a bond is the securitization of the debt which allows the borrower to raise debt by selling the security in the international financial market, with the investors able to trade the instrument in the secondary market.

In recent years a class of fixed income securities that has gained popularity are Islamic bonds or sukuk. The main feature of sukuk is its structure which allows investors to generate returns without infringing on the Islamic Sharia prohibitions on interest. To this effect a sukuk represents undivided shares in the ownership of tangible assets relating to particular projects or special investment activity thereby entitling to a share in the revenues generated by the sukuk assets.

Maldives as a developing country face a substantial investment gap that limits the growth and the productive capacity of the economy. With the graduation of Maldives from the list of Least Developed Countries in 2011 access to traditional sources of concessional financing and development grants are limited. As such the country has embarked on greater self-dependency in financing development needs through major reforms to the tax system since 2011. An important step in this process of attaining greater maturity and independence in managing public finances is the issuance of market based debt instruments. As such since 2006 the Government has issued short term treasury bills in the domestic financial markets to meet the borrowing needs of the government. This process of modernizing public finances culminated with the issuance of the first Government of Maldives foreign exchange bond sold to the international financial markets in 2017.

As of now the government of Maldives has two outstanding bond securities in the international financial markets. The first of these bonds, issued in June of 2017 is a USD 250 million 7% fixed coupon 5 year maturity conventional bond listed in the Singapore Stock Exchange. The second bond, issued April 2017 is a USD 100 million 5.5% fixed coupon 5 year maturity conventional bond listed in the Abu Dhabi Stock Exchange, privately placed with the Abu Dhabi Fund for Development. The proceeds of these bonds goes primarily toward the financing of the major investment projects being undertaken by the government. In line with the approved budget for 2018 the government is seeking to issue an additional USD 100-150 million through a sukuk issued in the international market.

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