MALDIVES BUDGET REVIEW

2023

INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF THE MALDIVES

بسم الله الرحمن الرحيم

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2023

INSTITUTE OF CHARTERED ACCOUNTANTS OF THE MALDIVES

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FOREWORD

I am pleased to present our report on the review of the Budget 2023. This report is the culmination of constructive discussions, extensive research and analysis by a team of diligent professionals that make up the Tax and Public Policy Committee (T&PPC) of the Institute of Chartered Accountants of the Maldives (CA Maldives). CA Maldives conducted the review of the 2023 budget as part of its commitment to protecting the public interest and encouraging sound public financial management, accountability, transparency and good public sector governance. The conclusion of this review demonstrates our willingness and commitment to contribute to efforts by governments and other stakeholders to make a difference in the lives of Maldivians.

As a professional accountancy organisation, we continue to engage with our stakeholders in the arenas of public policy, public administration, law-making and regulatory enforcement to respond to the emerging needs of our social, economic and ecological environment. We are also making commendable progress in our international collaborations to develop the accountancy profession in the Maldives to enable us to play a more significant role in championing sound public financial management, transparency, accountability and good governance.

I wish to congratulate the T&PPC and the Council for the achievement of such a significant milestone at such an important juncture as we look to increase our efforts towards obtaining membership of the International Federation of Accountants (IFAC).

President of CA Maldives

H. Niyazy

Mr. Hussain Niyazy

EXECUTIVE SUMMARY

The Institute of Chartered Accountants of the Maldives ("CA Maldives") was established on September 8, 2020, upon ratification of the Chartered Accountants Act of the Maldives. The formation of the entity represents an important milestone on the long road to creating a legally recognized professional accountancy organization in the country. CA Maldives functions through various committees to achieve its strategic goals and objectives. The Tax and Public Policy Committee (T&PPC) consists of five members, and its mandate is to discuss, review, and advise the CA Maldives Council on public policy-related matters, including reviewing and commenting on relevant legislations and policies of the government on tax, public finances, business, etc and Environmental, Social and Governance (ESG).

Under the above-mentioned mandate, the Committee decided to review the Maldives 2023 Budget passed by the Parliament to give an independent and professional view of the CA Maldives towards the Budget, in the form of opinions, suggestions and recommendations. This report is expected to raise awareness among the public and relevant stakeholders about the economic situation of the country in terms of growth and the risks posed by the increasing government debts and fiscal deficit year-on-year.

This report reviews the Maldives 2023 Budget passed by the Parliament, which discusses the situation of the country with regard to economic growth, revenue, expenditure, and budget deficit. Research by members of T&PPC was conducted from relevant secondary sources in presenting data for this report with comparisons of trends and analysis focused on the past five years where relevant, which also highlights pre and pre-pandemic and post-pandemic years. The report presents descriptions that are relevant to the situation of the Maldives rather than including technical data.

The Maldives has achieved a strong economic growth rate after a swift recovery from the Covid-19 pandemic in 2021 due to the strong performance of the tourism industry and related taxes contributing to government revenue. Tourism remains the main driver of economic growth in the country, which also makes it vulnerable to external and economic shocks due to heavy reliance on the tourism sector and lack of diversification in other industries. Despite a strong growth in the tourism sector, the government is facing challenges with a widening fiscal imbalance deficit due to expenses surpassing budget expectations on capital and public expenditure.

The Revenue section of the report identifies the new revenue measures including dividend income from SOEs, cash grants, tax revenues and debt financing presented with trends and analysis. It further emphasises that a significant portion of government revenue comes from tourism-related taxes.

Over the years, the government's spending on grants, contributions and subsidies has skyrocketed. The report analyses the government's spending on subsidies such as the Aasandha scheme, fuel subsidies, electricity subsidies, waste management, transport subsidies, and grants to local councils. It reiterates the need for the government to better align its subsidy expenditure with its social policy objectives.

The budget deficit has been increasing due to increased spending on subsidies, global inflation and a significant decline in government revenue during the pandemic. However, the government expects to reduce the budget deficit to a more sustainable level, with reforms to fiscal strategies and measures to increase government revenue over the coming years.

Under the section on new tax revenue measures, the report discusses the newly passed GST rates and the impacts of this hike such as inflation. It further highlights some inefficiencies in the current GST regime. These include the non-imposing of GST on imports and an overemphasis on where the supplier is in determining the place of supply rules; excessive zero-ratings and exemptions; the current GST regime's inability to keep pace with the digital economy; issues in the refund of excess input tax; and limitations of input tax in relation to capital expenditure. Further an insight about "Plastic Bag Levy" under the newly enacted Waste Management Act from a practical compliance perspective has also been addressed.

Maldivian government has a propensity of spending beyond the means due the massive spending on infrastructure, social welfare, and debt repayments. Measures proposed by government to reduce public expenditure through a series of reforms to ease the financial burden and ensure public funds are spent efficiently and effectively are further discussed in the report. Implementation of effective and sustainable measures such as income-based subsidy systems are important to better serve the people and improve the standard of living of the Maldivians.

Chapter 1

An Overview of the Maldivian Economy

Overview

The Maldives is a small, open economy with approximately 550,000 people living on 185 islands. This highly dispersed population creates challenges for the Maldivian economy, including high costs of delivering basic services and a limited domestic revenue base. This section gives an overview on the Maldivian economy.

Population and Poverty

Maldives is classified as an upper-middle-income country[1] with a strong economic growth rate. Despite a sharp decline in economic activity during the Covid-19 pandemic in 2020, the economy quickly recovered in 2021. Over the past decade, sustained growth has significantly reduced poverty and the Maldives performs well in terms of poverty compared to other regional, income, and small island nations. In 2019, 3.9%[2] of the population lived below the international poverty line of US$6.85 per day per person, with the majority of these individuals living in the atolls. However, due to the pandemic, the poverty rate is estimated to have increased to 19.8%[3] in 2020. It is expected that the poverty rate will decrease to 3.8%[4] by the end of 2022 as the economy recovers.

Real Gross Domestic Product

The Maldives Bureau of Statistics released revised estimates in October 2022 showing that the country's real GDP grew by 41.7% in 2021 after a significant decline of 33.5% in 2020 due to the impact of the Covid-19 pandemic on the tourism sector and other major industries. According to revised forecasts published in October 2021[5], real Gross Domestic Product (GDP) is expected to continue growing, with a projected 12.3% increase in 2022 and a 7.6% increase in 2023. The real GDP grew by 10.5% in Q3-2022 compared to the same quarter in 2021.[6] This follows a growth of 27% in Q2-2022.[7]

Additionally, annual real GDP for Q3-2022 was 8.7% higher than it was in Q3-2019, before the pandemic.[8]

During Q3-2022, the annual real GDP growth saw an increase due to the strong performance of the tourism industry, which had a positive impact on related sectors such as transportation and communication, wholesale and retail trade, and human health and social work activities.[9]

The Main Economic Driver – Tourism Sector

Tourism is the main contributor to the country's economic growth, but it also makes the Maldives vulnerable to macroeconomic and external shocks. Additionally, the public sector has a high debt level, the government plans to fund large infrastructure projects through external non-concessional borrowing, and there are numerous subsidies, which all contribute to fiscal risks for the Maldives.

The Maldives has experienced a rapid recovery in its main economic driver, tourism, following the Covid-19 crisis. Despite a decrease in tourists from Russia, a major market for the Maldives, due to the Russia-Ukraine war, the arrival of Russian tourists has been improving since May 2022 with the resumption of Aeroflot flights.[10] In addition, the return of tourists from traditional European markets and an increase in interest from Middle

1 World Bank: Maldives Public Expenditure Review, August 2022
2 World Bank staff estimates based on MBS HIES (2019). Note: National Poverty Line – MVR71.4 per person per day or MVR2,173 per person per month
3 Ibid
4 Ibid
5 Maldives Monetary Authority: Economic Update, December 2022 Volume 4 Issue 12
6 Quarterly National Accounts (QNA) for Q3-2022 released by the Maldives Bureau of Statistics (MBS)
7 Ibid
8 Ibid
9 Maldives Monetary Authority, Economic Update, December 2022 Volume 4 Issue 12
10 Aeroflot increased frequency of flights from three times a week to six times a week in June 2022.

Eastern countries have contributed to this growth. However, the Maldives' heavy reliance on tourism and lack of diversification in other industries leave the country vulnerable to external and economic shocks.

During Q1 2022, the economy experienced a 19.3%[11] growth in real terms, due to the sustained recovery in tourism. The sector has surpassed expectations, with arrivals in the first half of 2022 totaling 813,211[12], a 59% increase from the previous year. Based on this strong performance, it is anticipated that arrivals will reach a pre-pandemic high of 1.7 million[13] by the end of 2022, surpassing the previous forecast of 1.57 million.

Current Account Deficit

Maldives, as an economy that relies heavily on imports, is currently experiencing significant issues with its current account and inflation due to the rapid increase in global commodity prices. This is also causing issues with public finances. In order to try and mitigate the rising domestic prices, the government provides subsidies for food and fuel through state-owned enterprises. However, the large investments in infrastructure and social development made since 2016, which were meant to improve growth, productivity, and tourism capacity, have also contributed to an increase in Maldives' fiscal and debt vulnerabilities due to the external non-concessional sources and sovereign guarantees used to finance them. Although Maldives has managed to extend a large portion of its foreign debt that was due in 2022[14], it is expected that debt servicing risks will remain high in the medium-term.[15]

Trade Deficit

Despite the boost in tourism leading to stronger export earnings, the trade deficit for merchandise significantly increased in the first half of 2022. The deficit was caused by a 48%[16] year-over-year increase in imports, which was due to rising commodity prices and increased imports of capital goods and construction materials. At the same time, official reserves decreased by 7% to US$750.4 million[17] at the end of June 2022, resulting in reserve coverage dropping from 3.8 months of imports at the end of 2021 to 2.9 months of imports. The rise in commodity prices also affected the prices of services, transportation, food, and housing, leading to a 1.2% annual average increase in headline inflation in July 2022, compared to a 0.5% increase in 2021.[18]

Public Expenditure and Public Finances

In recent years, the Maldives has also made significant strides in the area of social protection by implementing comprehensive programs. In 2009, the government modernized its pension system and, in 2012, introduced the first universal healthcare program.[19] During the same period, the government also expanded the provision of electricity subsidies. These actions were taken in order to improve the well-being of citizens, reduce poverty and inequality, particularly among vulnerable groups.[20] The introduction of these programs was widely welcomed, including by international organizations. However, the rapid implementation of these programs and the lack of targeting in subsidy schemes put a strain on public finances and raised questions about the sustainability of these programs.

The government is facing financial strain due to its expenses surpassing its budget expectations for the first half of 2022. Subsidies and investments in development projects have been completely used up by the end

11 Quarterly National Accounts (QNA) estimates released by the Maldives Bureau of Statistics (MBS) on 30 June 2022
12 Ministry of Tourism
13 Ministry of Tourism, Maldives Development Update (MDU) released by the World Bank in October 2022
14 World Bank: Maldives Country Overview updated on 28 September 2022
15 World Bank: Maldives Country Overview updated on 28 September 2022, Ministry of Finance: Medium Term Debt
16 Maldives Monetary Authority
17 Ibid
18 Maldives Bureau of Statistics
19 Nizar, A.Z. and Rasheed, S. (December 2015) Fiscal Costs and Challenges of Social Protection and Subsidies: The Case of the Maldives. Maldives Monetary Authority: Research and Policy Notes, RPN 2-15,
20 Ibid

of June, and with the possibility of inflation continuing and plans to finish important infrastructure projects, it may be hard for the government to fund the current subsidy program and other expenses in second half of the year 2022. If these subsidies for necessities such as food, fuel, and healthcare are not better targeted, it could harm the disadvantaged population.

Inflation

Inflation is expected to be at 3.5% in 2022, but it is likely to decrease in 2023 as global energy prices become more stable.[21] The current account deficit is expected to remain high in the coming years as imports increase due to increased domestic consumption and ongoing public investments.[22]

The deficit in the current account has grown and the country's official reserves have fallen to their lowest point since 2018.[23] Inflation and certain budget cuts could hurt those who are already marginalized. However, if tourism is stronger than expected, it could help boost the economy.

Fiscal Deficit

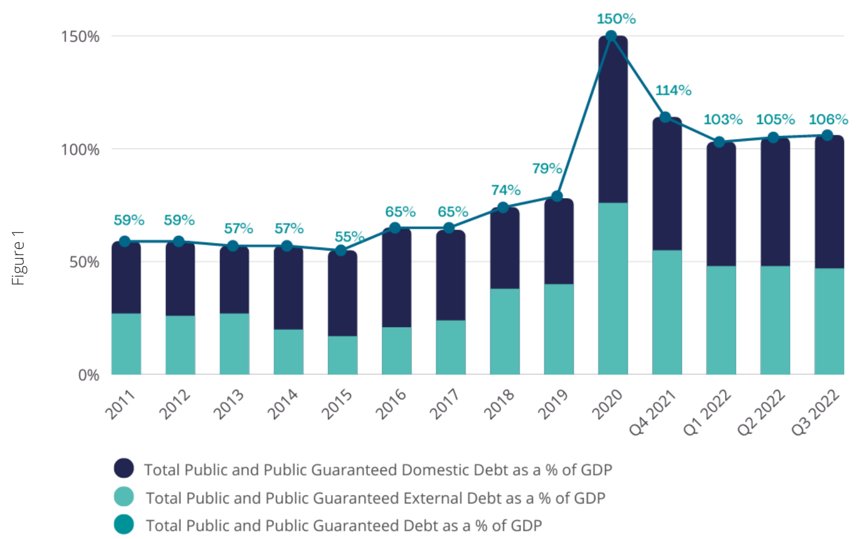
Due to an increase in capital expenses and subsidies, the fiscal deficit is expected to increase in 2022.[24] While the government has announced plans to cut back on spending, it is likely that recurrent expenses will rise in the coming years as the Public Sector Pay Harmonization Policy (PSPH) is put into place. However, it is expected that the fiscal deficit will decrease in 2023/24 because of an increase in revenues from strong tourism and the increase in general and tourism GST rates.

Public Debt

Due to continued government spending, especially on large Public Sector Investment Program (PSIP) initiatives, public debt remains high. By the end of 2021, total public and publicly guaranteed debt reached 114% of GDP,[25] as the government took on US$1 billion in new debt for general expenses, deficit support, debt refinancing, and funding for PSIP projects. However, public and publicly guaranteed debt decreased to 106% of GDP by the end of the third quarter of 2022, with external debt still making up a significant 47% of GDP.[26] These figures do not take into account the significant advances made by the central bank since the suspension of the Fiscal Responsibility Act (FRA) in April 2020.[27] Additionally, fiscal risks, including guaranteed and on-lent loans, trade payables, subsidies, and capital injections to State Owned Enterprises (SOEs), were estimated to be around US$2.5 billion or 45% of the GDP in 2019. While these risks have not materialized, the Maldives does not have the financial resources to address any potential negative impacts on its public finances if they were to occur.

21 World Bank estimates as of September 2022.
22 Maldives Development Update (MDU) released by the World Bank in October 2022.
23 Ibid
24 Ibid
25 Maldives Bureau of Statistics
26 Ibid
27 As at end-March 2022, advances to the government from the Maldives Monetary Authority (MMA) were at US$118.5 million. In April 2020, the Parliament had approved a one-year suspension of certain clauses of the FRA to enable the government to borrow more from the central bank. In November 2021, Parliament approved the government's request to extend the FRA suspension until December 2023.

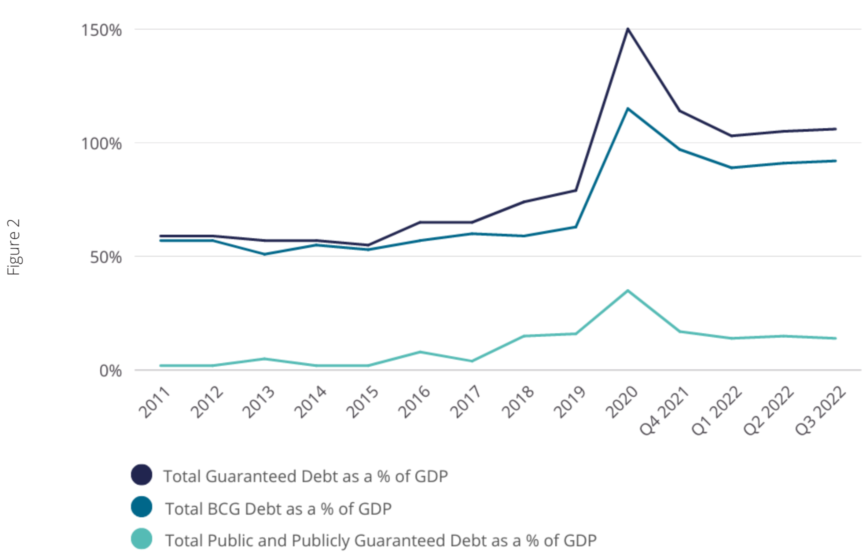
Public Debt and Guarantees



Source: Data obtained from Ministry of Finance: Disbursed outstanding debt as of Q3, 2022

In the period between 2020 and H1 2022, the PSIP spending as a percentage of GDP averaged over 7%,[28] compared to under 5% in 2019. Although the PSIP spending in H1 2022 was lower than the budgeted amount for 2022, it is expected to increase in the latter half of 2022 and into 2023 as the government works to complete major infrastructure projects, such as the expansion of Velana International Airport and the Greater Malé Connectivity Project, by the end of 2023. Additionally, there are plans for large-scale public housing developments in Hulhumalé, but some financing for these projects still needs to be secured.

Disbursed outstanding Debt as a % of GDP



Source: Data obtained from Ministry of Finance: Disbursed outstanding debt as of Q3, 2022

Post-Covid Recovery

In 2022, the strong recovery in tourism and related taxes has continued to contribute to revenue growth, as it did in 2021. This growth has mainly come from the Tourism Goods and Services Tax (TGST) and resort rents, which make up more than 40%[29] of revenues at around 11.5% of GDP. Additionally, the government implemented changes to the Airport Development Fee and a new Airport Departure Tax in 2022. Furthermore,

28 Maldives Development Update (MDU) released by the World Bank in October 2022.
29 Ministry of Finance, Maldives Development Update (MDU) released by the World Bank in October 2022.

income tax and the General Goods and Services Tax (GGST) at around 7.2%[30] of GDP have also contributed to the increase in revenue in H1 2022, due to the ongoing recovery in domestic consumption and business activity.

Overall, although the total expenditure in 2022 is largely in line with the budget, there have been significant increases in subsidy and interest spending during the first half of the year. This is largely due to rising global commodity prices and a more difficult financial environment worldwide. In particular, the government's spending on food and fuel subsidies has already surpassed the budgeted amount for the entire year due to the steep increase in commodity prices. In the past, the government spent an average of MVR1.3 billion (US$85 million)[31] per year, or about 2% of GDP, on interest payments. However, this increased to 2.8% and 2.6% of GDP in 2020 and 2021, respectively. In the first half of 2022, interest payments have jumped even higher and are now at MVR1.78 billion (US$115 million) or 3.8%[32] of GDP. This is partly due to higher domestic interest payments and the additional burden of external commercial debt, which is expected to continue in the coming years.

Economic Outlook

The economy is predicted to thrive due to a rise in tourist arrivals, capital spending, and personal consumption. It is anticipated that the real GDP will grow 12.4% in 2022 and 8.1%[33] on average in the 2023/24 period. This outlook is better than the period prior to the pandemic, during which growth averaged 6.3% from 2015-2019.[34] The forecast for growth in 2022 is 4.8% higher than expected earlier in the year due to a higher number of tourists, but it is expected to be 2% lower in 2023 due to the base effect and delays in the Velana Airport expansion project.[35] The return of Chinese tourists in early 2023 and increasing number of visitors from India, Western Europe, and the Middle East may also contribute to growth. Private consumption is likely to improve due to the positive impact of growth in the tourism sector and the gradual implementation of the PSPH policy, which should increase household incomes and purchasing power. Increased spending on infrastructure, housing, and renewable energy projects under the PSIP will also likely contribute to economic growth in the long-term.

The increase of the TGST rate in 2023 from 12% to 16% and the GGST rate from 6% to 8% is expected to bring in additional revenues of 3%[36] of GDP annually and help improve the country's fiscal balance in the long term. This is expected to result in a decline of the fiscal deficit from 16.1% of GDP in 2022 to 9.6% and 8.7%[37] in 2023 and 2024, respectively. While these measures represent a significant step towards fiscal adjustment, more efforts are needed, particularly on the expenditure side, including reducing the financial burden of state-owned enterprises and improving the management of subsidized goods and services.

Key Challenges

As global commodity prices remain high, the government's program of providing subsidies on necessities and fuel is expected to continue, leading to increased recurrent spending in the next two years. The PSPH policy, set to be implemented in late 2023, is expected to further increase spending. While austerity measures may mitigate some of the spending growth in the next two years, election-related expenses may cause an increase in administrative and operational expenses for the government. The current blanket subsidy program may strain government finances and it is suggested that a more targeted subsidy program be implemented to reduce the fiscal burden. Capital spending is expected to remain high in the coming years, with the completion of the Velana airport terminal project in 2024 and ongoing housing, harbor, road and land reclamation projects.

30 Ibid
31 Ibid
32 Ministry of Finance, Maldives Development Update (MDU) released by the World Bank in October 2022.
33 Maldives Development Update (MDU) released by the World Bank in October 2022
34 Ibid
35 Ibid
36 Ibid
37 Ibid

It is anticipated that the import of capital goods and increased spending on consumption will maintain a high current account deficit in the medium term. Rising global commodity prices, along with increased imports of construction materials and household consumption goods, are likely to cause the current account deficit to widen to 29.1%[38] of GDP in 2022. However, it is expected that the deficit will decrease to 19.1% and 17.6% in 2023 and 2024, respectively, as commodity prices return to normal levels over the medium term. In addition to the large import bill, the need for external debt repayment is expected to put further pressure on official reserves, which have significantly decreased in 2022.

The Maldives has a high public debt, which is larger than the size of the entire country's economy. While the fiscal and current account deficits are expected to decrease over time, the public debt to GDP ratio is expected to remain high. This high level of public debt, along with the associated risks of refinancing, make the Maldives' economy very vulnerable to internal and external shocks. Therefore, managing debt carefully is essential for improving fiscal stability, reducing the cost of investments that promote growth, and making the economy more resilient in the future, despite improving economic growth and fiscal prospects.

38 Maldives Development Update (MDU) released by the World Bank in October 2022.

Chapter 2

Revenue

New Revenue Measures

A major percentage of government tax revenue comes from tourism-related taxes. Tax revenues make up the bulk of total revenues. About half of the Maldives' total revenues (including grants) are directly attributable to tourism-related revenues. Indirectly, this percentage is likely to be even higher, given that tourism is the primary driver of economic growth. The majority of tourism-related revenues (80%) consist of taxes, including TGST, an airport service fee, a per-night green tax, and a portion of import duties. Through airport development fees and resort rents, non-tax tourism revenues are collected. Considering only tax revenues, the tourism Goods and Services Tax accounts for more than one-third of the total. In addition to this, approximately 19% of the Maldives' total tax revenues come from trade taxes.[39]

The budget for Fiscal Year (FY) 2022 included new revenue measures of MVR727 million. However, the revenue measures were not realized during the year. The parliament recently passed the plastic bag tax bill, and it is expected that the revenue will be realized during FY 2023. Other revenue measures, such as land sales and real estate tourism, were included in the 2022 budget but were not implemented during the fiscal year. The reasoning was that the required laws and regulations were not implemented during the year.

In the 2023 budget, new revenues were not included. However, the Ministry of Finance (MoF) has proposed to increase the GST and TGST rates, respectively. The new rates were recently approved by the parliament, and from January 1, 2023, onward, the new rates will be implemented. The Ministry of Finance estimated that this would increase the FY 2023 revenue.

Dividend Income

State-owned enterprises paid MVR324 million as dividend in 2021 for their profits in 2020 and in 2022 SOEs paid MVR663.6 million.[40] Revised dividend estimates for 2021 is MVR582.2 million and the estimates are lower compared to the initial forecast as the profits declared for 2020 is less than forecasted as some profits were retained for carrying out capital projects by some state-owned enterprises.

As of December 2021, MoF has reported MVR2,438.5 million[41] as dividend receivables. As per the data published by the MoF the dividend receivables are being increased throughout the year as the dividends are not paid by the SOEs regularly.

Table 1: Dividend Receivables Figures from 2017-2021

Fiscal Year	Amount
2021	2,438,514,757
2020	1,445,177,715
2019	1,184,019,520
2018	925,922,112
2017	848,244,343

Dividend Receivable (2017-2021)

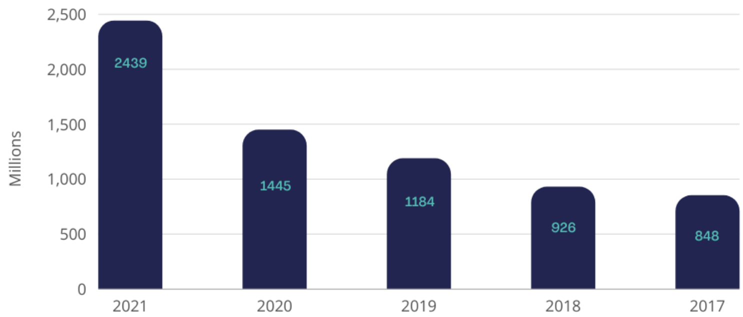


Figure 3

Source: Figures chosen from the GoM Audited Financial Statement (2018-2021)

39 Maldives Public Expenditure Review - Restoring fiscal health
40 MoF revenue data as of August 2022; https://budget.gov.mv/en/monthly/office-revenue-details/88
41 Figure from the GoM 2021 Audited Financial Statement

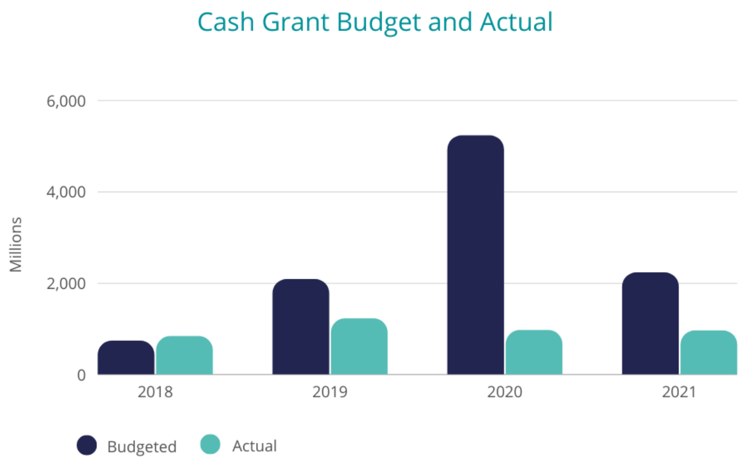
Cash Grants: Variance Analysis Between Budgeted and Actuals

Grants for the year 2023 is estimated to be MVR2.5 billion, which includes US$100 million as cash grants from bilateral donors.[42] The revised FY 2022 budget include MVR602.8 million as cash grants. However as of August 31, 2022, a total of MVR 551.4[43] million is realized as cash grant.

Table 2: Budgeted and Actual of Cash Grants from 2018-2021

Fiscal Year	Budgeted	Actual	Variance
2018	733,696,717	833,546,980	(99,850,263)
2019	2,081,109,468	1,222,907,163	858,202,305
2020	5,228,582,886	972,465,326	4,256,117,560
2021	2,226,539,752	959,340,021	1,267,199,731

Figure 4



Source: Figures chosen from the GoM Audited Financial Statement (2018-2021)

Except for 2018, the data shows that the cash grant realized for FY 2019, 2020 and 2021 is lower compared to the budgeted figure. The main reason for the decrease is cash grant in FY 2020 and 2021 might be due to the Covid-19 pandemic. Even though there are decreases in the grant, grants for the year 2023 is estimated to be MVR2.5 billion which higher than the FY 2021 budgeted figure. As per the budget book, it is estimated that US$100 million to be received as cash grants from bilateral donors during FY 2023. However, it is not very clear where the grants will receive and whether there is any commitment received from any donors.

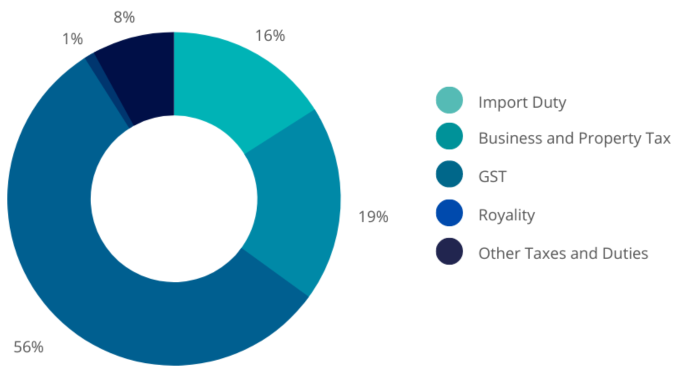
Break Up of Tax Revenue Analysis

The tax revenue is estimated for FY 2023 is MVR23.5 billion out of which, 56% of revenue is to be collected from GST and 19% is from the business and property tax. Additionally, 16% of revenue is to be collected from Import duty. Other tax revenue includes royalty and other taxes and duties.

42 Data from the FY2023 budget
43 Figures from MOF budget execution report; https://budget.gov.mv/en/monthly/summary

Budgeted Tax Revenue Composition - FY 2023

Figure 5



Source: Financial Year 2023 Budget Book

As per the FY 2023 budget book, there are over MVR5 billion in tax receivables from business to the government. The taxes paid by the business declined due to adverse shocks from Covid-19 and it is important necessary measures are taken to collect the revenue in FY 2023 in order to reduce the budget deficit.

Chapter 3

Debt and Debt Financing

Overview

Direct public debt consists of Treasury bills, bonds, and other securities issued to cover government expenditures, as well as loans, including loans for infrastructure development projects, and bonds and sukuks issued to the international financial market. In addition to direct debt, the government's total debt also includes guaranteed debt.

A rapid growth in public debt has been observed due to major infrastructure development projects undertaken by the Government. Despite the drastic decline in government revenue caused by the pandemic-induced economic crisis, Government of Maldives (GoM) invested in the health sector to maintain the economy.[44] Consequently, costs were financed through borrowing, resulting in a significant increase in the national debt in 2020, which includes the overdraft facility issued by the central bank.

Table 3: GoM Debit Figures (2018-2022)

Borrowings	2018	2019	2020	2021
Long Term Borrowings - Domestic	18,715,762	146,807,297	520,126,992	866,898,000
Long Term Borrowings – Foreign	341,959,161,020	22,021,063,373	24,936,635,203	31,165,155,057
Long-term Bond	6,160,957,255	6,086,681,383	9,863,511,092	3,852,500,000
Accried Pension Rights Bond	3,422,788,949	3,530,440,935	3,631,167,431	3,732,824,755
Fixed Coupon Bond	3,048,000,000	3,498,000,000	3,526,000,000	9,609,096,664
Short-term Borrowings – Domestic/Foreign	26,072,085,234	18,964,748,000	24,087,532,000	30,415,928,000

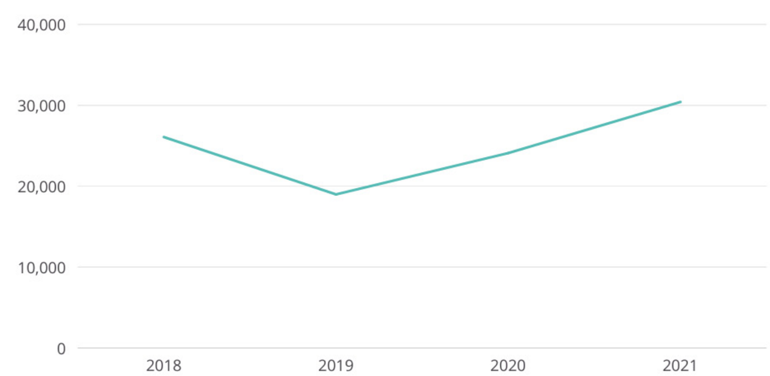
Source: Figures from Audited Financial Statements

The majority of the GoM's short-term borrowing consists of Treasury bills issued by the government. Treasury bills are primarily issued to fund the GoM's recurring expenses, rather than capital expenditures. Notable is the fact that borrowings are increasing year over year and deficit reduction measures are not fully implemented by the Ministry of Finance. The pandemic was one of the primary causes of the debt increase between 2020 and 2022.

Moreover, it is not advised to issue Treasury bills or any other instrument to finance recurring expenditures, such as the payment of the GoM's salaries and wages, due to the instruments' high interest rates. In order to reduce the budget deficit, the GoM should spend based on the revenue it receives and reduce both recurring and capital expenditures. Despite the fact that the ministry takes steps to reduce costs, it should be noted that costs do not decrease as the reduction measures are not being implemented. Instead, most agencies receive special permission and hence the expenditure remain the same. It is also noted that the foreign borrowing increased by 25% in FY 2021 compared to FY 2020.

Short-Term Borrowings - Domestic/Foreign

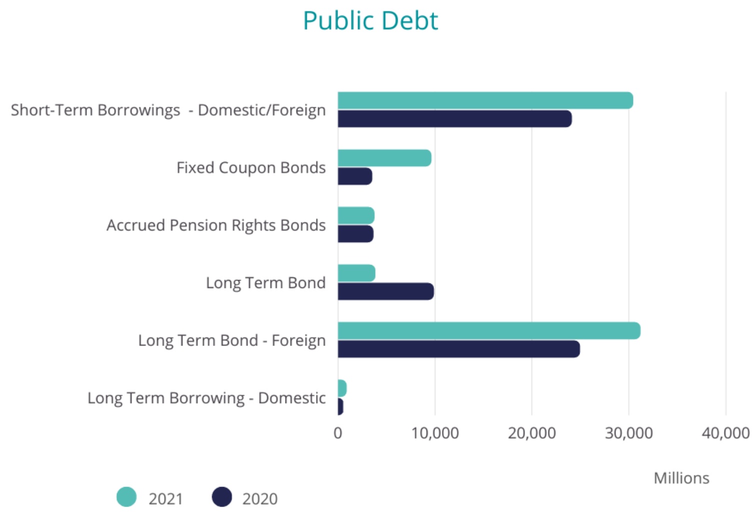
Figure 6



Source: Figures from GoM Audited Financial Statements

44 Budget in Statistics 2021 https://www.finance.gov.mv/public/attachments/Em0mwtqxQ9hYFJUq6lhfuqvFjs4Bpp5wIAE4FxUF.pdf

Figure 7



Source: Figures from GoM Audited Financial Statements

Chapter 4

Subsidies

Overview

In the most general terms, a subsidy can be defined as any government assistance, in cash or in kind, to private sector producers or consumers for which “the government receives no equivalent compensation in return, but conditions the assistance on a particular performance by the recipient” (U.S. Congress, Joint Economic Committee (1972). From an economic perspective, the main purpose of subsidies is to reallocate resources, that is, to alter economic activity to achieve an outcome that is "more desirable" from what would occur otherwise.[45]

The budget 2023 includes expenditures on direct and as well as indirect subsidies. Direct subsidies are those that involve an actual payment of funds toward a particular individual, group, or industry whereas indirect subsidies are subsidies that do not have a target person or business and of which the benefit is enjoyed by everyone who use or buy the subsidized product or service. The indirect subsidies currently included in the budget includes the following:

i. Aasandha
ii. Fuel subsidy: subsidy to reduce cost of fuel used by electricity producing companies
iii. Electricity subsidy: revenue loss recovery subsidy, to compensate electricity producers for the loss in revenue from selling a unit of electricity below a cost recoverable unit price
iv. Food Subsidy: subsidy to reduce consumer price of staple foods
   - Fisheries subsidy
   - Sewerage management subsidy: subsidy to produce the service free of charge to the public by Fenaka corporation limited
   - Waste Management Subsidy: subsidy to reduce the price of waste disposal service provided by Waste Management Corporation (WAMCO)
   - Transport Subsidy: subsidy to operate the public ferry services
   - Water subsidies

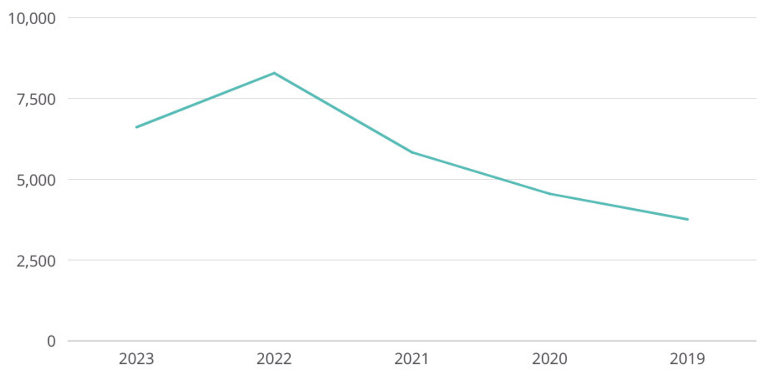
Expenditure on Subsidies Over the Past 5 Years

Over the years the government spending on grants, contributions and subsidies has rapidly increased from MVR3,760.3 million in 2019 to MVR8,281.4 million in revised budget 2022.

In the year 2022, the budgeted figure for Grants, Contributions and Subsidies are MVR4,661.7 million however the expenditure is expected to be at MVR8,281.4 million at the end of this year.

The Government recurrent spending on grants, contributions and subsidies 2019-2023

Figure 8



Source: Data obtained from MoF Budget Booklet 2023

45 IMF Working Paper on subsidies

The spending on subsidies over the years has increased due to the increase in commodity prices in the international markets. Some of the specific reasons include the increase in population leading to increase in the consumption of electricity and rise in price of fuels leading to increase in fuel subsidies to provide the fuels to the public at a reasonable price. Additionally, a rise also results from a policy decision to reduce electricity prices in atolls.[46] Another reason included the subsidies provided to the State-owned enterprise as a compensation to the losses they face due to the services provided by them to the public below the market prices. (Budget booklet 2023, (MoF).[47]

Proposed Expenditure on Subsidies for the Year 2023

Majority of the funds for Grants, Contributions and Subsidies are directed towards the national health insurance scheme (Aasandha), fuel, electricity, fisheries, and transport along with food subsidies. The total proposed expenditure for this component is MVR3,510.8 million. This expenditure is expected to be at MVR5,449.2 million by the end of this year.[48]

Aasandha Health Scheme

The highest proportion of the above-mentioned component is estimated to be for health insurance premiums. MVR1,045 million is estimated to be spent by the end of 2023 on the scheme. This is 36.1% lower than the expenditure in the year 2022. The main reason this for this decrease is due to the government's plan in strengthening the Aasandha scheme to minimize the wastage through the scheme. To lower the prices of the medicines, the government is working on introducing the bulk procurement system when it comes to medical consumables. If those plans are implemented, the government expects to reduce the expenditure on Aasandha scheme from MVR1,637.6 million in 2022 to MVR1,045 million in 2023.

Expenditure on Aasandha from (2018-2025)

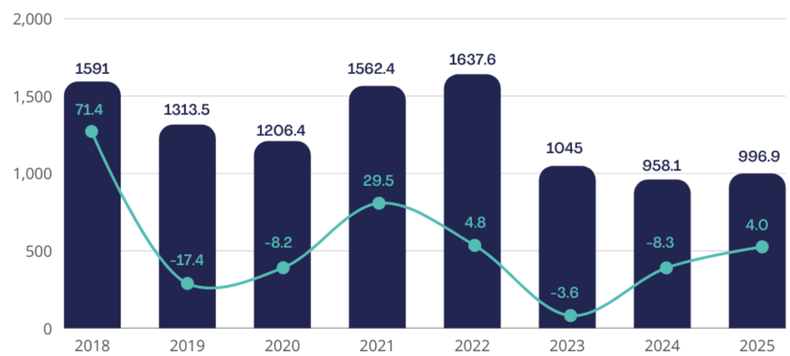


Figure 9

Source: Data obtained from MoF Budget Booklet 2023

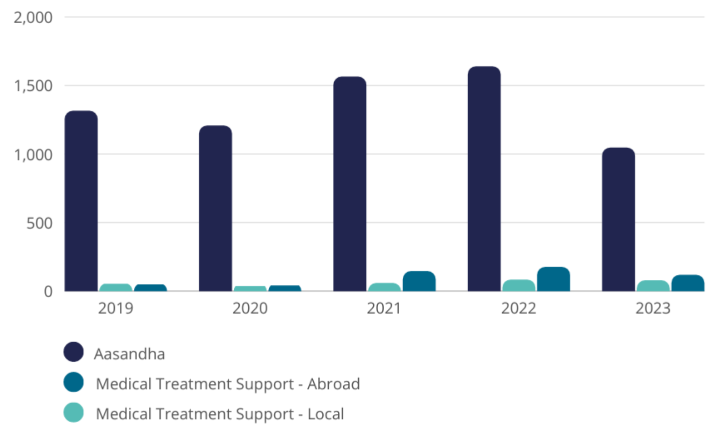
The Aasandha scheme, include coverage of specified inpatient and outpatient treatments and medication from all public hospitals and health centres as well as health facilities empanelled by Aasandha. The scheme, fully financed by the government, has enabled access to health care for across the nation. The company introduced its "Meranaa" health scheme in 2019, to provide financial assistance in healthcare to Maldivians residing in the countries - Sri Lanka, India, and Malaysia, where there is a large Maldivian diaspora. Furthermore, they provide cover for overseas treatment if the required medical treatment is not available in Maldives. Referrals for treatment abroad is made by specialist doctors treating patients at Aasandha empanelled facilities.[49]

46 Budget Booklet 2019
47 Budget Booklet 2023
48 Budget Booklet 2023
49 Asandha Company Ltd

Even though that Aasandha scheme includes the medical expenses for local and as well as for oversea treatments, apart from providing subsidies to the Aasandha company, the budget includes direct subsidies for medical treatment support- abroad, and medical treatment support – local. These expenditures could be managed if the Aasandha scheme is strengthened to avoid the mismanagement.

Direct and Indirect Subsidies - Medical

Figure 10



Source: Data obtained from MoF Budget Booklet 2023

Fuel Subsidies

To prevent a hike in cost of producing electricity due to a hike in fuel prices, the price of diesel supplied to electricity producers by State Trading Organization (STO) is sold at a fixed price. Hence, if the market price of diesel is higher than the fixed price, the difference between the market price and the fixed price is reimbursed to STO as a subsidy.

It is estimated that MVR588.2 million will be expended on fuel subsidies by the end of 2023 and this is 74.7% lower than the expenditure in the year 2022. The main reason of this decrease is due to the government's plan on making the fuel subsidy a direct subsidy.[50]

Food Subsidies

It is estimated that MVR331.1 million will be expended on food subsidies in the year 2023. Expenditure on food subsidies in the past five years was on average MVR300 million. However, the exact amounts varied over the years due to the changes in the subsidy regime. In October 2016, when the control price (price ceiling) on staple food were raised, the loss recovery paid to STO reduced by 41% in 2017. However, the lowering of the control price again in 2018, increased the expenditure on food subsidies in that year.

Table 4: Food Subsidies from (2019-2021)

Fiscal Year	Budgeted
2019	321,000,000
2020	423,000,000
2021	329,000,000

Source: Data obtained from MoF Budget Booklet 2023

Although MVR284 million was budgeted for food subsidies in the year 2022, the expenditure is expected to be at MVR314 million at the end of this year.[51]

50 Budget Booklet 2023
51 Budget Booklet 2023

Electricity Subsidies

Indirect subsidy is given in two ways, to reduce the price of electricity:

i. Electricity subsidy: reimbursement for revenue loss to the electricity producing company, as the current tariff rates are set below the cost of producing a unit of electricity
ii. Fuel subsidy: reimbursement of losses to STO for selling fuel to electricity producers- State Electric Company Limited (STELCO), Fenaka Corporation Limited and Male' Water and Sewerage Company (MWSC) at a fixed price below the market rate

The year 2019 incurred MVR668.5 million for electricity subsidies, as per MoF this increased expenditure on electricity subsidy during the year 2019 is due to the harmonization of household tariff rates across the country and business tariff rates in the atolls in 2019 further increased the expenditure on electricity subsidy in that year. While MVR661.4 million were exhausted during the year 2020 and MVR735.6 million in the year 2021. There seems 29.3% increase in electricity subsidies in the year 2022 and this jump is due to the increase in oil prices in the international markets due to Russia-Ukraine war and it is estimated that there will be a decrease of 19.8% in the proposed expenditure for 2023. As per MoF, this decrease is due to the government's plan on making the fuel subsidy a direct subsidy.

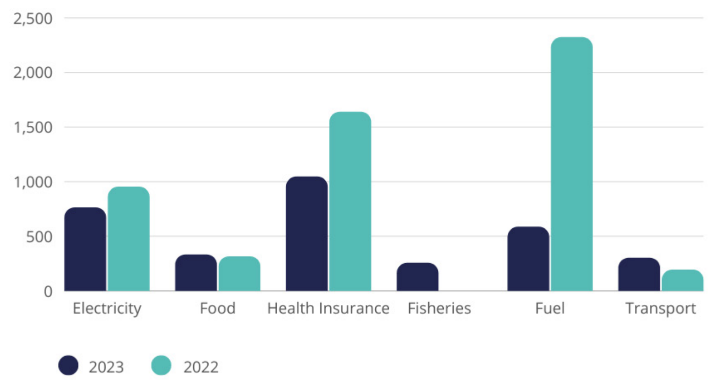
Waste Management and Transport Subsidies

MVR300.6 million are propose for transport subsidies while MVR33 million are expected to be spent on waste management subsidies. An increase of 55.2% can be seen in transport subsidies due to the Raajje Transport Link (RTL) to be expanded to the atolls.

Apart from spending on seven indirect subsidies in budget 2022, the proposed budget for 2023 includes two more indirect subsidies which are to be introduced in the name of fisheries subsidies and subsidies for the management of sewerage system. The subsidies for better management of sewerage system will be given to Fenaka Corporation limited since the services are provided to the public free of charge. The fisheries subsidies are given to Maldives Industrial Fisheries Company (MIFCO) as to compensate for the purchase of fish from the fisherman at a lower rate than market value.[52]

Expenditure on 2022 Vs 2023

Figure 11

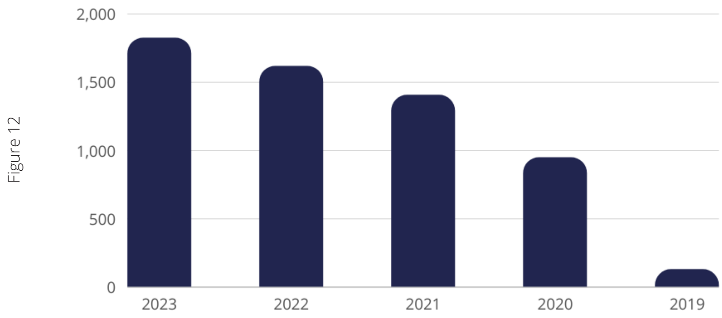


Source: Data obtained from MoF Budget Booklet 2023

52 Budget Booklet 2023

Electricity Subsidies

Grants to Coucil



Source: Data obtained from MoF Budget Booklet 2023

As stipulated by the 8th amendment to the Decentralization Act (7/2010), which was ratified in 2019, all elect atoll, island and city councils in Maldives began to receive grants from the central government according to a pre-determined formula in 2020. The total block grant allocation is supposed to be equivalent to the sum of (i) 5% of total state revenue and (ii) 40% of rental and lease rent received from land, reefs and lagoons that are not under the jurisdiction of councils.

Table 5: Fiscal Year to Budgeted Grant

Fiscal Year	Budgeted
2019	947,220,000
2020	1,404,990,000
2021	1,617,370,000

Source: Data obtained from MoF Budget Booklet 2023

At present, there is little accountability and transparency, as local councils are not required to report their finances publicly. They are, however, required to submit financial statements to the Auditor General.

The MoF, together with the Local Government Authority, aims to bring local council finances online through a new system, but much work remains to be done to set up local financial and budgeting systems. To ensure that decentralization delivers better services to Maldivians, the government could explore increasing the weight of the "local council performance" in the grant allocation formula and ensure that this is objectively and transparently measured. Currently, council performance only makes up 5% of the formula determining the size of the block grant by island, which is mainly determined by resident population size (75%) and other fixed factors. The incentive is therefore insufficient to encourage better performance of councils in service delivery.

When analyzing the above-mentioned data, we can see that there still exists room for improving the mechanism of government spending on subsidies. Rather than having a blanket approach to the subsidies, the government could provide direct subsidies depending on the consumers' income. Or if the indirect methods are to be applied, the government can tie those subsidies to the social policy objectives.

The case for using government subsidies to offset various market imperfections is straightforward, as it is geared toward increasing efficiency. The argument applies to a case where markets do not allocate resources to their most efficient use, usually because the owners of these resources cannot reap their full return. In theory, a second-best policy tool, such as subsidies, may offset market imperfections.

Chapter 5

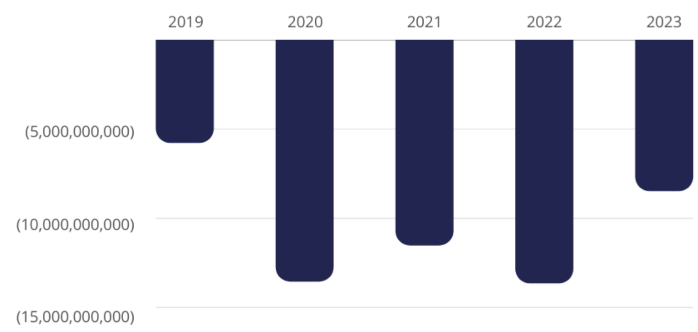
Budget Deficit Financing

Budget Deficit

Maldives has approved a budget of MVR42.8 billion and a sanction of MVR5.8 billion as a supplementary budget for the remaining of 2022. Over the last five years, the budget deficit has been increasing due to increased spending on subsidies resulting from a significant drop in government revenue during the pandemic and an increase in the global inflation rate. It should also be noted that some of the budgeted figures for public sector investment programs and subsidies do not accurately reflect the actual expenditure, as there is a substantial variance.

Budget Deficit/Surplus

Figure 13

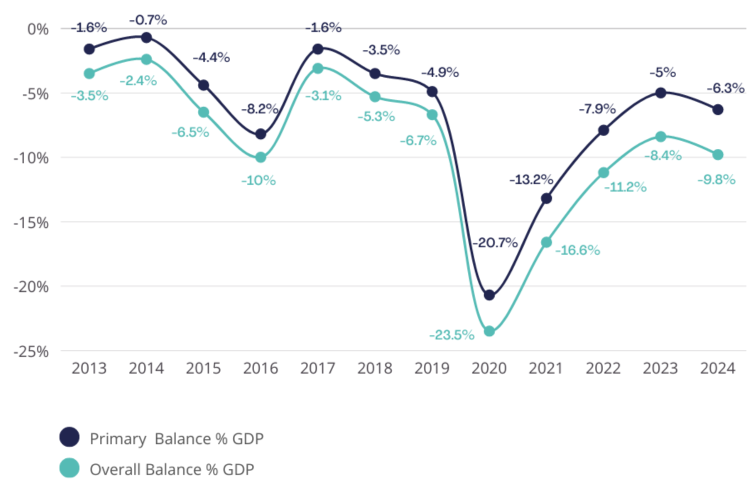


Source: Data obtained from MoF Budget Booklet 2023

Due to the pandemic, along with the significant decrease in the government revenue and significant increase in global inflation, the subsidies provided by the government were increased leading to significant increase in the budget deficit in the year 2020 and 2022. During the year 2011 to 2019 the budget deficit was an average of 5.7% to GDP while during 2020-2022 it is expected to rise an average of 16.6%. However, due to the strategic changes brought to the fiscal strategies, from 2023 onwards the government expects to reduce the budget deficit percentage to a manageable level, and it is projected that the budget deficit to be on an average of 7% during the year 2023-2025.

Overall Budget Deficit as a share of Nominal GDP %
(2013-2024)

Figure 14



Source: Data obtained from MoF Budget Booklet 2023

The projected overall budget deficit for 2023 is MVR8,459.4 million, which is 8.1% of GDP. The primary deficits are to be projected to be MVR5,022.6 million, which is 4.8% of GDP. This is a 37.9% saving compared to the budget deficit expected compared to the end of 2022, which is MVR13,631.1 million. In 2023, it is expected to have a primary budget deficit of MVR5,022.6 million, which is 4.8% of GDP. This is 51.7% decrease compared to the 2022 primary deficit of MVR10,396.7 million. The government has planned to reduce the primary deficit by 5% by including strategic fiscal measures in the fiscal strategies for 2023. The Ministry of Finance estimates that the deficit for fiscal year 2025 will be less than that of fiscal years 2023 and 2024 due to an increase in government revenue and the completion of several ongoing infrastructure development projects.

Deficit Financing

Financing is the cash flow required to plug the budget deficit and other cash needs such as loan repayments. In addition to these the transfer of revenue from Airport Development Fee to Sovereign Development Fund for the future repayment of loans and other securities are also included in financing.

According to the Ministry of Finance Budget Booklet 2023, to meet the financing needs of the year 2023, the government needs to raise MVR11,453.4 million as to finance the budget. This includes MVR8,459.4 million to manage the budget deficit, MVR2,101.1 million to repay the loans along with MVR271.4 million to transfer to the sovereign development fund and MVR21.4 million to contributor for the capital in foreign finance institutions. It is projected that 56.3% of the budget financing is expected to receive from foreign parties by MVR771 million through green/ blue bond. As per Ministry of Finance the preparation of sovereign sustainable financing framework to issue the green bond are at the latest stage. It is also estimated that MVR4,132.1 million will be elevated through project loan disbursement. The budget financing through domestic market is mainly through selling the Treasury Bills (T-bills) and bond. It is projected to raise MVR4,733.7 million through T-bills and bond to the domestic market.

Table 6: Forum of Financing

	2021 Millions	2022 Millions	2023 Millions	2024 Millions	2025 Millions
To be Financed	(15,877.04)	(17,192.58)	(11,453.43)	(13,162.99)	(11,192.38)
Budgeted Deficit	(11,505.96)	(13,631.11)	(8,459.45)	(9,593.43)	(5,270.63)
Loan Repayment	(3,647.78)	(2,754.75)	(2,101.12)	(2,614.96)	(4,836.61)
Transfer to Sovereign Development	(485.39)	(781.43)	(871.43)	(944.82)	(1,082.28)
Others	(237.91)	(25.29)	(21.43)	(9.78)	(2.86)
Forms of Financing	16,277.04	17,276.80	11,453.39	13,933.98	11,192.38
Loans	1,317.74,	3,403.04	4,132.12	4,716.34	2,458.43
Sukuk/Bond	7,712.20	-	-	-	-
Green/Blue Bond	-	-	771.00	771.00	771.00
Multilateral/Bilateral Budget	-	1,542.00	1,542.00	771.00	-
Domestic Securities and Loan	7,235.64	12,022.11	4,733.66	6,569.03	6,861.29
Sovereign Development Fund	-	-	-	-	-
Subsidiary Loan Repayment	11.46	300.65	274.62	335.60	330.66
Privatization Receipt	-	-	-	771.00	771.00

Source: Data obtained from MoF Budget Booklet 2023

The '2023 State Budget' of MVR42.8 billion is greater than the approved '2022 State Budget' of MVR37 billion. The budget deficit reported for 2022 is MVR9.8 billion which is 11.2% of the GDP. The deficit is expected to reduce to in 2023 owing to the grants from India. Nevertheless, in the absence of such grants in 2024, the Ministry of Finance has predicted an increase in the budget deficit amounting to 9.8% of its GDP. Such forecasts indicate that the deficit trend will continue for some time till the structural issues are addressed.

The Maldivian economy manages to maintain its budget deficit consistency over the years with exceeding public expenditure and limited revenue. The SOEs with large operating costs are also part of the problem. Additionally, huge reliance on tourism for its revenue further exposes the country to external shocks and financial risks. On the other hand, the objective to increase revenue through the TGST hike has the potential to damage the economy. It is only by reducing its unnecessary expenditure, reforming underperforming SOEs, and diversifying its economy can the Maldives mitigate its economic problems.

Chapter 6

New Tax Revenue Measures

Overview

Increasing the General Sector GST rate from 6% to 8% and Tourism Sector GST rate from 12% to 16% is the primary measure outlined in the budget for raising additional government revenue for the year 2023 to meet the increasing expenditure bill of the government.[53] The necessary amendment to the GST Act has already been enacted and become law with the new GST rates becoming effective on January 1, 2023.

In addition, although it is not as significant as the increase in the GST rate, a plastic bag levy ("Plastic Tax") has been introduced by the newly enacted Waste Management Act.[54] Beginning on the April 18, 2023, all businesses that are operating in the Maldives are required to charge Plastic Tax from customers.[55]

Increase in Goods and Service Tax Rates

The Goods and Services Tax Act 10/2011 ("the GST Act") was amended by the Sixth Amendment to GST Act 20/2022, which raised the prevailing GST rates. Tourism sector GST rate was raised from 12% to 16%, and the general sector GST rate increased from 6% to 8% with the new increased GST rates are applicable from January 1, 2023. This Amendment Bill to the GST Act was enacted by the Parliament on November 16, 2022, ratified by the President and became law on November 22, 2022. The government estimates that the increase in GST rates would generate additional revenue of MVR3.6 billion for the year 2023.[56]

Several concerns were raised by stakeholders, including the limited time available for the proper implementation of the GST rate hike and the timing of the tax increase considering the rising inflation in the country and sensitive economic outlook in general.[57] It is worth noting that according to projections, the inflation rate would rise by an additional 2.5%[58] (projection for 2023 is 5.4%)[59] as a direct result of the GST hike.

Importantly, according to International Monetary Fund (IMF) analysis,[60] GST rate hike is not the only available revenue measure to increase government revenue. The rest of this section discusses GST policy design weaknesses and administrative issues in the current GST regime that must be addressed to enhance the efficiency of the system and in turn increase GST collection. This subsection delves into this newly enacted tax revenue strategy from a practical compliance perspective.

GST on Imports and Destination Principle

In simple terms, GST is designed to levy a broad-based tax on all final consumption by households.[61] As the fundamental feature of the design of GST is that it applies to practically all goods and services consumed, it is distinguishable from custom duties that are levied only on specific types of consumption, such as those on pork or alcohol.

In relation to international trade of goods and services, under the "Destination Principle", exports are generally zero-rated, and input taxes refunded, whereas GST is levied on domestic final consumption of imported goods and services in the same way as domestic supplies.[62]

The Maldives' GST regime does not levy GST at Customs when the goods are imported. Tax is charged when the goods are subsequently sold by registered persons.[63] However, no GST is levied when goods are imported

53 MoFT, Budget Book 2023
54 Waste Management Act (Law no: 24/2022)
55 Waste Management Act (Law no: 24/2022)
56 MoFT, Budget Book 2023
57 https://dhauru.com/LH7CG
58 MoFT, Budget Book 2023
59 https://dhauru.com/LH7CG
60 MoFT, Budget Book 2023
61 OECD, International VAT/GST Guidelines, (OECD Publishing, Paris 2017)
62 Ibid
63 Goods and Services Tax Regulation, s 104

for personal consumption or imported informally and then sold to customers.[64] The GST Act does not have place of supply rules. These are defined, rather unusually, in the GSTR. With respect to the place of supply rules for imported services, in contrast to the destination principle, the emphasis in on the location where the services are physically performed, rather than the location of the final consumption.[65] Imported services supplied by a person outside the Maldives without a physical presence in Maldives is not treated as a supply in Maldives, even if utilized or consumed in Maldives.[66] For example, in accordance with the GST Regulations, a foreign management service company providing management services to a Maldives resort, does not need to charge GST if the management services are not "[...] performed by or through a person who is in the Maldives at the time the services are performed".[67]

Consequently, foreign suppliers that supply goods and services to Maldives have a competitive edge over domestic suppliers since GST on goods and services must be charged by the latter.[68] If this design weakness in the current GST regime is not remedied, demand for the informal sector supplied goods will grow which would be detrimental to the economy. The IMF has suggested that the Maldives expands the GST base and begin collecting GST at the border by the Maldives Customs Service to fully implement the destination principle.[69] By doing so, the revenue loss will be remedied and the prejudice against local suppliers would be diminished.[70]

Excessive Zero-ratings and Exemptions

Zero-rated goods and services include goods and services exported from Maldives, supply of a business as a going concern, and a list of essential goods, which include twenty-two items.[71] In addition to zero-rated goods and services, the GST Act specifies sixteen different types of goods and services that are exempt from GST.[72]

The primary purpose for the GST Act to includes zero-ratings and exemptions is to reduce the tax burden on the consumption of essential goods and services on the general public.[73] Consequently, the current GST regime generates less revenue,[74] than the benchmark system.[75] This difference, known as "the Tax Expenditure," as estimated by the MoF is shown in the table 7.[76]

Table 7: The "Tax Expenditure" of providing exemption and zero-rating of goods & services from GST

Category	2020		2021	
	% of GST Revenue	MVR (Millions)	% of GST Revenue	MVR (Millions)
Exemption	9.7	438.6	27.6	2152.6
Zero-rating	12.5	563.5	9.6	747.1

Source: Data obtained from MoF Budget Booklet 2023

Consequently, it is uncertain if the policy intent of an ever-expanding list of exemptions and zero-ratings in benefiting the poor is being met. Evidence suggests that while the GGST is regressive, it has no substantial impact on the poverty levels of households.[77] Unsurprisingly, these GST concessions mostly favor the wealthy and constitute an unwarranted revenue leakage.[78]

Instead of providing social welfare via GST exemptions and zero-ratings, a better strategy would be to abolish the exemptions and zero-ratings or reduce them.[79] The increased revenue collected can then be utilize in providing social welfare through targeted subsidies to poorer families.[80]

64 Maria Coelho, Lee Burns, and Peter Mullins, Maldives - Modernizing the Goods and Services Tax (International Monetary Fund, Washington, March 2022).
65 Goods and Services Tax Regulation, s 104
66 Ibid.
67 Ibid.
68 Maria Coelho, Lee Burns, and Peter Mullins, Maldives - Modernizing the Goods and Services Tax (International Monetary Fund, Washington, March 2022).
69 ibid
70 ibid
71 Goods and Services Tax Act, s 22.
72 Goods and Services Tax Act, s 20
73 Budget Book 2023
74 Budget Book 2023
75 The benchmark for GST is that all goods and services consumed in the country are taxed at 12%, excluding any additional exemptions or different rates, except for the exemption for public services and zero rate of tax on exported goods and services.
76 Budget Book 2023
77 Maria Coelho, Lee Burns, and Peter Mullins, Maldives - Modernizing the Goods and Services Tax (International Monetary Fund, Washington, March 2022).
78 Ibid.
79 Ibid.
80 Ibid.

GST and Digital Economy

Cross-border e-commerce in commodities, services, and intangibles (including digital downloads) raises issues for GST systems.[81] The rapid growth of the digital economy compounds these difficulties since technology has substantially expanded customers' capacity to purchase online and businesses' ability to sell to globally without having a presence in the customer's jurisdiction of residence.[82]

As discussed in "GST on Imports and the Destination Principle", the Maldives' place of supply rules a foreign supplier of services is not required to register for Maldives GST if the supply is made without a physical presence in Maldives.[83] Due to this design weakness in the existing GST regime's architecture, cross-border digital products and services (such as e-books, software downloaded over the internet, cloud storage, online video and movie streaming services, music streaming services, online marketing etc.) are not taxed even when they are utilized in Maldives or their ultimate consumption takes place in Maldives. Applying GST to imported digital goods and services used in the Maldives will help local providers compete on a more equitable playing field, promote tax compliance across the board, and generate more revenue.[84]

Furthermore, import of low-value goods or parcels from foreign electronic marketplaces or distributor platforms go untaxed on the basis that Maldives does not levy GST at Customs. This enables customers and business in the informal sector to buy goods over the internet and sell locally in the informal sector. This issue can be overcome by registering the marketplace or platform if the total value of taxable supply made via the marketplace or platform exceeds a registration threshold.

There are several models that the Maldives could adopt to implement these reforms in respect of GST and the digital economy including reverse-charge mechanisms for Business to Business (B2B) supplies, registration of electronic marketplaces or online distribution platforms for Business to Consumer (B2C) supplies, and registration of digital service providers for other digital products and services.[85]

GST Neutrality for Business

The fact that firms that are registered for GST are normally exempt from bearing the cost of GST is one of the most important aspects of a GST system. Instead, they charge consumers the GST when they make a sale (referred to as the "output tax") and then seek a credit for the amount of GST that they paid on their purchases (referred to as the "input tax") against the output tax. When the tax administration returns any excess input tax above output tax received, the cost of the GST is neutralized for businesses that are registered for the GST.

Refund of Excessive Input Tax

Though GST Act allows refund of "tax paid excess",[86] the Tax Administration Regulation states that excess of input tax over the output tax is not considered as "tax paid in excess", and it only allows such excess to be set off against the output tax.[87] This rule applies irrespective of the type of business or how the excess input tax arises. For example, businesses that are in the business of exports are likely to continuously have an excess input tax over output tax position since exports are zero-rated. However, even for these businesses refund of excess input tax is not entertained leaving the businesses no choice but to keep on accumulating it.[88]

An effective input tax recovery system is essential for GST to achieve its goal of being a neutral tax on

81 OECD, Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, (OECD Publishing, Paris 2015).
82 Ibid.
83 GSTR s 104
84 Maria Coelho, Lee Burns, and Peter Mullins, Maldives - Modernizing the Goods and Services Tax (International Monetary Fund, Washington, March 2022).
85 OECD, Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, (OECD Publishing, Paris 2015).
86 Goods and Services Tax Act, s 32
87 Tax Administration Regulation, s 69(g).
88 Maria Coelho, Lee Burns, and Peter Mullins, Maldives - Modernizing the Goods and Services Tax (International Monetary Fund, Washington, March 2022).

businesses. According to IMF, best practice for a country like the Maldives would be to provide prompt refunds of excess input tax to those registered persons who principally make zero-rated supply, and a short carry forward term in all other circumstances.[89]

Limitation of Incomes Tax in Relation to Capital Expenditure

Another limitation that hampers GST neutrality on businesses is the rules on claiming capital expenditure input tax. A GST registered business can start to credit input tax incurred on capital expenditure against output tax only when that respective taxable activity starts to generate output tax for the first time.[90] Additionally, input tax in relation to capital expenditure is required to be equally credited against output tax over a period of 36 months.[91]

The GST's input tax credit system is crucial because it guarantees that the tax is eventually levied on final consumption.[92] Businesses that must spend heavily in capital assets are at a disadvantage under the current system because of the way GST is structured, which puts such business at a comparatively disadvantaged position compared to businesses in other industries.[93] For these reasons, businesses should be able to claim input tax in the period in which they are incurred irrespective of whether they are incurred on capital expenditure.[94]

Plastic Bag Levy

On November 28, 2022, the Parliament passed the Waste Management Act, which went into effect on December 18, 2022.[95] Starting on April 18, 2023,[96] all businesses in the Maldives are required by law to collect MVR2 from consumers for each plastic bag ("the Plastic Tax") that is sold or given away. The Plastic Tax was initially scheduled to be imposed by the Government in 2022; and it was anticipated to create a tax income of MVR47.7 million [97] for the year. The government has not yet released a revenue forecast for 2023, despite the fact that the tax is finally implemented in the current year.

The Act specifies that GST registered business must remit the tax collected to Maldives Inland Revenue Authority (MIRA), in accordance with regulations determined by MIRA, on or before the deadlines prescribed under the GST Act.[98] Consecutively, the MIRA has issued a draft regulation for public consultations which outlines the process for the collection of Plastic Tax by GST registered businesses.[99]

Conversely, the Act is silent on the disposition of Plastic Tax collected by businesses not registered for GST. As the law now stands, businesses that are not registered for GST must charge the tax to their consumers, but they are not mandated to pay the tax to MIRA or any other state institution. This seems to be an inadvertent drafting error that would prevent the projected income from being realized.

89 Ibid.
90 Goods and Services Tax Regulation, s 46(a)(4).
91 Ibid.
92 Maria Coelho, Lee Burns, and Peter Mullins, Maldives - Modernizing the Goods and Services Tax (International Monetary Fund, Washington, March 2022).
93 Ibid.
94 Ibid.
95 Waste Management Act (Law no: 24/2022)
96 Waste Management Act (Law no: 24/2022), s 33
97 MoF, Budget Book 2023, 76
98 Waste Management Act (Law no: 24/2022), s 35
99 Maldives Inland Revenue Authority, Regulation on Collecting Plastic Bag Fee by GST Registered Persons, <https://mira.gov.mv/tax_bills/plastic-bag-fee-regulation-public-consultation_1-.docx> accessed 5 January 2023.

Chapter 7

Public Expenditure Review

Overview

The Government of the Maldives proposed a budget of MVR42.7 billion for the year 2023 to the Parliament on October 31, 2022. The budget was passed by the Parliament on November 28, 2022 with an addition of MVR 160 million, resulting in a total approved budget of MVR 42.8 million for the year 2023.[100]

It is evident that the Maldivian economy recovered from the effects of the COVID-19 pandemic, which was majorly leveraged by the tourism concept of "one island, one resort" model and by diversifying the tourism industry. The World Bank ("WB") in their public expenditure review report issued on June 2022 stated that, the growth prospects are still positive for the little island nation despite the ongoing global conflict between Russia and Ukraine.

However, the external and fiscal imbalances remain significant as the Maldivian government has a habit of spent beyond its means even before the pandemic. Even though the country was able to collect revenue like other countries, its revenue-to-GDP ratio has stagnated.

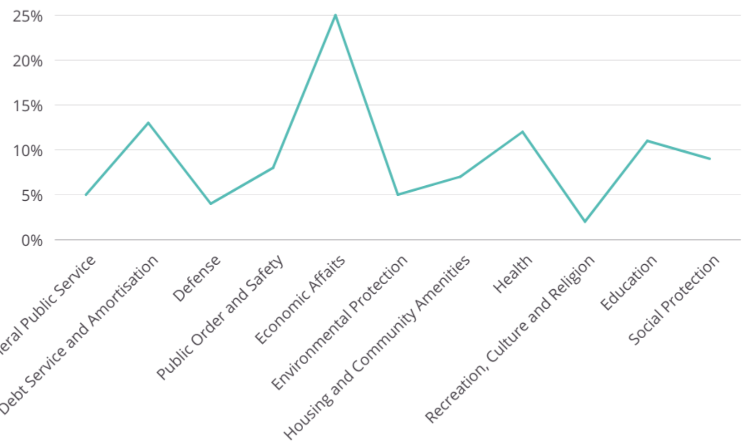
As highlighted by the WB in their report, the annual growth rate of public spending from 2014 to 2021 has almost doubled the average real GDP growth rate. As a result, we have a much larger budget deficit than other small island nations. For the year 2022, the budget deficit was expected to be MVR9.8 billion which is 11.2% of GDP. The approved budget for the year 2023 is expected to incur a further budget deficit of MVR8.5 billion while the approved budget will further increase the budget deficit to MVR8.6 billion.

Allocation of Public Spending by Economic Classifications

Public infrastructure, such as housing and health care, was the biggest driver of spending followed by debt repayment, which accounts to 13% of the approved budget. However, increased spending has not yielded an equivalent result in terms of meeting the development goals. Despite massive government subsidies and guarantees for large housing projects, housing remains unaffordable for most Maldivians, resulting in multiple families living together and overcrowding along with other social and economic conflicts.

Budget Expenditure Allocation

Figure 15



Source: Ministry of Finance

The introduction of a minimum wage and a new salary framework for civil servants could further push up wage costs and assist in bridging the gaps between low income and high-income families.

100 https://majlis.gov.mv/en/19-parliament/parliament-work/1150

Is the Budget for 2023 Sustainable and Efficient?

To sustainably fund the higher spending needs of the Maldivian Government, the Maldives needs to increase its domestically sourced income such as taxes levied. While there are several additional funding sources proposed in the budget such as increasing the GST rate applicable for both general and tourism sector, the Government has taken keen steps to reduce public expenditure with special focus on the following areas as discussed in detail in the proposed budget book by the MoF.

i. Addressing the inefficiencies in the indirect subsidies given by the government such as fuel and electricity subsidies
ii. Focusing on reducing the wastage from the Aasandha scheme by implementing a maximum retail price on the pharmaceutical prices and by improving the Aasandha scheme operations
iii. Implementation of minimum wage policy and harmonization of public sector workers salary

The World Banks' lead author of the PER, Pui Shen Yoong said, "Maldives is not at immediate risk of a crisis, but it needs to raise revenues and implement several expenditure and debt reforms to avoid one in the future. The government's proposed measures to increase revenues, including by raising General and Tourism GST rates, are timely in this regard. To be effective, greater transparency and accountability over why additional resources are needed and what they will be used for are needed."

The need to enact a series of reforms to ease the financial burden of public sector spending on health care, housing, wages, and pensions is needed in urgency. Such reforms could include strengthening public debt management and guarantees to reduce tax risks, especially for SOEs, and improving legal and institutional frameworks to encourage more private sector investment. By improving data collection, particularly on housing and real estate policies and improving the monitoring and evaluation of how efficiently and effectively public fundings are utilized is of utmost importance.

Proposed Improvements to the Government Budget 2023

The Government needs to ensure that public funds are used in the most beneficial way for the Maldivian people. This could be achieved by focusing on strengthening the public administration and adopting an income based subsidiary system rather than the one which are being implemented now.

The following series of reforms were recommended by the World Bank to restore our public finances back to a sustainable path and to ensure the public funds are spent efficiently and effectively in their report

i. raise more revenues from both international and domestic sources;
ii. curtail the high growth of public expenditures by making spending more targeted and efficient; and
iii. improve the management of public debt and guarantees.

Like other developing countries, the Maldives is a big spender, which as seen above is majorly spent on expansion of public sector growth and infrastructure. When looked at the government budget of the pasts, it can be seen that the high spending was initially driven by reconstruction work of 2004 Indian Ocean tsunami disaster soon followed by the higher political competition between the elected Presidents of the past. As the experience of many countries shows, rapid accumulation of debt is often associated with increased risk of economically and socially costly financial crises, sovereign defaults, and banking crises.

To avoid this situation, we must find ways to spend wisely and diversifies the tax base by mobilizing more domestic sources of revenue. As per the statistics illustrated in the World Bank Report Public Expenditure Report, between 2010 – 2014, the spending-to-GDP ratio remained relatively stable at around 30% but increased to an average of 34% from 2015 to 2019, and to 50% in 2020 due to a severe economic contraction. In 2021 the public spending reached a peak despite recovery from the pandemic and remained at at 43% of GDP.

Conclusion

The main purpose of the Government budget should always be to better serve the Maldivians. To make sure that the standard of living of each and every Maldivian is accounted for, to ensure that the concern of every citizen is addressed for and lastly to ensure that the budgets are future looking and is sustainable in a longer term, rather than simply restricting budgetary proposals to the Presidential term. To achieve this, the Government needs to focus on strengthening public administration and introducing an income-based subsidy system instead of the current system. The following series of reforms are recommended by the World Bank to put our finances back on a sustainable path and ensure that public funds are used efficiently and effectively.

i. Generate more revenue from international and domestic sources;
ii. Curbing massive growth in public spending by making spending more targeted and efficient; When
iii. Improve the management of public debt and guarantees;

To improve the overall efficiency and effectiveness of public spending, we must:

i. Strengthen the monitoring and evaluation functions in ministries and agencies and perform periodic evaluation of projects and its results to facilitate timely and informed decisions on these projects. and which are not will inform decisions about how to improve the targeting, With the De-Centralization the local councils are awarded funding to facilitate these projects in their local communities, hence the above mechanism must be applied and practiced at the local council levels and the ministerial levels
ii. Improve strategic resource allocation through medium-term spending or budget frameworks. This will ensure that available resources are more closely aligned with government priorities
iii. Improve transparency in public spending to ensure the funds are utilized as intended

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Maldives Budget Review 2023

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