Early Warning System

ADB-55263-001

Enhancing Debt Sustainability

Quick Facts

Countries	Maldives
Specific Location	Nation-wide
Financial Institutions	Asian Development Bank (ADB)
Status	Approved
Bank Risk Rating	U
Voting Date	2021-11-22
Sectors	Technical Cooperation
Investment Type(s)	Advisory Services
Investment Amount (USD)	$ 1.20 million

Project Description

According to ADB documents, the knowledge and support technical assistance (TA) will support public debt sustainability in Maldives by focusing on institutional strengthening for sound fiscal policy framework, particularly domestic resource mobilization and public investment management. The TA is included in the country operations business plan, 2021- 2023 for Maldives.

PROJECT RATIONALE AND LINKAGE TO COUNTRY/REGIONAL STRATEGY

Coronavirus disease (COVID-19) has severely affected the economy. Gross domestic product (GDP) is estimated to have contracted by 33.6% in 2020 as travel and tourism, and construction activities got severely disrupted by restrictions imposed to contain the pandemic. Tourist arrivals hit an all-time low in 2020, collapsing by 67%. Poverty is estimated to have increased to 7.2% in 2020 from 2.1% before the pandemic. With travel and tourism activities and related services such as communication, real estate, and entertainment contributing over 40% of GDP, 80% of exports and about 50% of total revenues, Maldives' economy is vulnerable to natural as well as global economic and health shocks.

The unprecedented pressure on public expenditure, especially to boost healthcare spending and social protection, amidst low revenue mobilization has heightened fiscal stress. Revenue mobilization contracted by 38.7% in 2020 while expenditure increased by 5.7%, resulting in fiscal deficit of 27.5% of GDP in 2020, up from just 6.6% of GDP in 2019. In 2020, public expenditure net lending, and total revenue including grants were 52.8% and 25.4%, respectively, of GDP. The government intends to scale up public sector investment programs (PSIPs) in 2021 and expects substantial increase in non-tax revenue, lowering fiscal deficit to 18.5% of GDP. Almost half of the investment required for PSIPs is financed by borrowing, often non-concessional external borrowing that potentially adds to external debt distress. Proper sequencing and prioritization of such projects are essential to ensure that well vetted investment project pipeline is consistent with fiscal and debt carrying capacities. In recent years, fiscal deficit and public debt have consistently overshot 3.5% of GDP and 60% of GDP thresholds, respectively, specified in Fiscal Responsibility Act.

Challenging macroeconomic fundamentals narrow economic and taxpayer base, weak public financial management (PFM), high fiscal and current account deficits, and vulnerability to external and climatic shocks complicate debt distress vulnerabilities. The country was at a high risk of debt distress even before the pandemic. In its April 2020 Debt Sustainability Assessment, the International Monetary Fund (IMF) assessed Maldives' public debt as sustainable contingent on implementation of substantial fiscal consolidation strategies as promised in the recent budget and macroeconomic policy frameworks. However, the country remains at high risk of external debt distress and a high overall risk of debt distress. The country's debt carrying capacity is assessed to be weak by IMF. Maldives participated in the G-20 Debt Service Suspension Initiative. Public and publicly guaranteed (PPG) debt was estimated at 149.3% of GDP as of yearend 2020, a sharp increase from 78.3% of GDP at yearend 2019. The government estimated a total outstanding PPG debt to reach 124.1% of GDP in 2021.

A faster growth of public expenditure relative to revenue growth together with high cost of borrowing pose a binding constraint to a stable macrofiscal framework and debt sustainability. High public expenditure is partly due to the inclusion of mega infrastructure projects as well as other ad hoc projects sans cost benefit analysis and proper due diligence, implying weak public investment management process. Sequencing, screening, and prioritization of PSIPs are important to ensure that capital spending surge is consistent with available fiscal space and high debt distress situation. Meanwhile, higher revenue mobilization is constrained by weak taxpayer compliance and audit capacities of the authorities. Non-compliance in the case of goods and services tax was as high as 32% in 2019. Tax revenue stagnated at around 19% of GDP before the pandemic but is projected to decline to 16.5% of GDP in 2021. The 2020 Public Expenditure and Financial Accountability (PEFA) assessment shows that the country has scored low (C+ and below) in public investment management, fiscal risk reporting, fiscal strategy, medium-term perspective in expenditure budgeting, revenue administration and accounting, and internal and external audit.

Investment Description

- Asian Development Bank (ADB)

The TA is estimated to cost $1,320,000, of which $1,200,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-7).17 The Government of Maldives will provide counterpart support in the form of counterpart staff, office accommodation, and other in- kind contributions. The key expenditure items are listed in Appendix 2.

Contact Information

Responsible ADB Officer	Sapkota, Chandan
Responsible ADB Department	South Asia Department
Responsible ADB Division	Public Management, Financial Sector and Trade Division, SARD
Executing Agencies	Ministry of Finance (formerly Ministry of Finance and Treasury) Ameenee Magu, Block 379, Male', Republic of Maldives

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Bank Documents

- Project Disclosure PDF [Original Source]
- Technical Assistance Report [Original Source]