



MALDIVES

TECHNICAL ASSISTANCE REPORT—REVISING THE FISCAL RESPONSIBILITY ACT

January 2022

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Maldives

Revising the Fiscal Responsibility Act

Ozlem Aydin, Laura Doherty, Nabil Hamliri, Ian Lienert, and José Miguel Ramos Carrasco



Technical Report

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ACRONYMS

ACA	Accountable government agencies
AGO	Auditor General's Office
COFOG	Classification of the functions of government
DSA	Debt sustainability analysis
EU	European Union
FAD	Fiscal Affairs Department of the IMF
FRA	Fiscal Responsibility Act
GFS	Government Finance Statistics
GFSM	Government Finance Statistics Manual
IFI	Independent fiscal institution
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
LIC-DSF	Debt Sustainability Framework for Low-Income Countries Framework
MMA	Maldives Monetary Authority
MOF	Ministry of Finance
MPAO	Maldives Pension Administration Office
MTFF	Medium-Term Fiscal Framework
MTFS	Medium-Term Fiscal Strategy
MTDMS	Medium-Term Debt Management Strategy
MVR	Maldivian Rufiyaa
PFM	Public financial management
PPPs	Public-private partnerships
PSIP	Public Sector Investment Program
SAP	Strategic action plan
SARTTAC	South Asia Regional Training and Technical Assistance Center
SDF	Sovereign development fund
SOE	State-owned enterprise
USAID	United States Agency for International Development

PREFACE

In response to a request from the Ministry of Finance (MOF) of Maldives, a capacity development mission from the Fiscal Affairs Department (FAD) was conducted remotely during the period of November 1–November 30, 2020, to assist authorities in revising the 2013 Fiscal Responsibility Act (FRA). The mission was led by Ms. Ozlem Aydin (FAD Economist) and comprised Ms. Laura Doherty (FAD Senior Economist), Mr. Nabil Hamliri (FAD Technical Assistance Advisor), and Mr. Ian Lienert and Mr. José Miguel Ramos Carrasco (both FAD experts). During the mission, the authorities requested the mission not to limit its scope to reviewing the 2013 FRA and proposals for amending the law but also to prepare a new FRA draft. The mission agreed to provide drafting suggestions for a new FRA, consistent with the recommendations of this report.

The mission held the wrap-up meeting on key findings and recommendations with Hon. Ibrahim Ameer, Minister of Finance; Mr. Ismail Ali Manik, State Minister of Finance; and the heads of key departments in the MOF. The mission started with an introductory meeting with the State Minister and a kick-off meeting with the Counterpart Group comprising senior officials of the MOF. The mission presented and discussed the preliminary findings and recommendations with the Counterpart Group.

At the MOF, the team met with Ms. Fathimath Razeena, Financial Controller; Mr. Ahmed Saruvash Adam, Head of Fiscal Affairs Department; Mr. Ashraf Rasheed, Senior Legal Counsel; Ms. Hawwa Safna, Head of Treasury and Public Accounts Department; Ms. Maryam Abdul Nasir, Head of Resource Mobilization & Debt Management Department; and Mr. Mohamed Zaeem, Internal Auditor. In addition to meetings with MOF departments, the mission also met with Hon. Mohammed Nasheed, speaker of the Majlis; Hon. Mohamed Nashiz, Chair of the Majlis Public Accounts Committee and their members; Ms. Nuha Mohamed Riza, Under Secretary; the President's Office; and the staff of the Auditor General's Office and of the Maldives Monetary Authority.

The mission would like to thank the Maldivian authorities for their cooperation during the course of the mission. The mission is especially grateful to State Minister Ismail Ali Manik for his overall guidance and to Ms. Maryam Shawadhin Abdulla and Mr. Ali Abdul Raheem for their excellent organization of meetings and support throughout the mission.

EXECUTIVE SUMMARY

The Fiscal Responsibility Act (FRA) came into effect in 2013 to reduce rising public debt and achieve fiscal stability. Maldives has experienced rapid public debt accumulation over the past decade. The FRA establishes objectives for maintaining debt at a sustainable level and reducing the overall fiscal balance. The Act also sets minimum standards for fiscal transparency and accountability and requires the Government to prepare and publish medium-term fiscal and debt strategy reports.

The government has not met the FRA's numerical targets for fiscal deficits and public debt.

The authorities intended to set debt on a downward and sustainable path, which is stipulated as 60 percent of GDP in the FRA. Maldives, however, continues to face large and growing public debt; total public and publicly guaranteed debt increased from 52 percent of GDP in 2009 to approximately 77 percent of GDP in 2019 (see IMF 2020a). The establishment of three numerical fiscal targets in the FRA (debt-to-GDP, budget balance, primary balance) with a three-year timeframe to achieve them proved to be overly ambitious. The debt limit has been breached since 2016, and the fiscal deficit limits were never respected (with the exception of the overall deficit limit in 2017). The Act's fiscal rules were breached without consequences.

Noncompliance was due to a poorly designed framework and insufficient government

commitment to attaining the FRA's targets. Design weaknesses include unrealistic and multiple fiscal targets, unclear coverage of fiscal aggregates, and inadequate accountability provisions. The effectiveness of the FRA was limited by the lack of enforcement mechanisms and inadequate reporting on compliance or noncompliance with the fiscal rules. The FRA includes an escape clause that can be activated when specific events occur, with the consent of Parliament and for a period determined by the Parliament. However, the FRA failed to provide clear definitions of the trigger events, and it did not require the Minister of Finance to report on the steps being taken to return to compliance with the fiscal rules when there were deviations from fiscal targets. Also, the FRA did not require a Final Budget Outcome Report, in which the Minister would explain annual fiscal outturns.

To ensure fiscal sustainability and enhance transparency, the Maldivian authorities are

committed to introducing a new FRA in 2021. The Government needs firm and credible targets for debt and fiscal deficits in its debt-reduction efforts; however, past experiences of noncompliance with the numerical fiscal rules has undermined "its" credibility. The impact of the COVID-19 pandemic has made the FRA's targets even more unrealistic and unachievable. The ongoing high uncertainty with the pandemic and with the near and medium-term economic and macro-fiscal outlook calls for flexibility in the medium-term trajectory of key fiscal aggregates.

A "Principles-Based" Framework

A principles-based approach, accompanied by strong accountability requirements, would provide the authorities with the flexibility to respond to adverse macroeconomic

developments. This report recommends that the new FRA does not include numerical fiscal rules.

Rather, it requires that the Government specifies fiscal principles in the Act and sets quantified key fiscal objectives (“targets”) relating to public debt, the fiscal balance, and fiscal risks in fiscal documents. The medium- to long-term fiscal targets should be consistent with the fiscal principles specified in the FRA and should be included in Government documents that outline its multiannual fiscal strategy. These documents could be updated by the Government without amending the FRA.

A new intermediate Government fiscal document, a Charter of Fiscal Responsibility, could be produced to quantify key fiscal targets. The Charter would be prepared by each incoming Government. It would lay out the Government’s key fiscal targets, consistent with the new FRA’s principles of responsible fiscal management (for example, the achievement and maintenance of public debt at a sustainable level). The Charter would only specify key medium-term fiscal targets for public debt, the budget balance, and Government guarantees, notably, those pertaining to the fifth year of an incoming Government’s five-year term. A rolling three-year, medium-term Fiscal Strategy Report would be updated annually and would provide details of fiscal developments and compliance with the Government’s five-year targets.

Although the principles-based approach to fiscal management would provide more flexibility than the 2013 FRA, it is very important to continue to quantify and monitor the medium- and long-term fiscal and debt objectives. The difference from the “rules-based” approach is that numerical fiscal rules are not included in a law but rather in government documents that are endorsed by Parliament.

It is outside the mandate of this report to suggest a path for reducing public debt and fiscal deficits. This report lays out a framework for a new legal framework to underpin future strategic fiscal policymaking. Specific fiscal targets—for example, “to reduce public debt to x percent of GDP and the fiscal deficit to y percent of GDP by 2026”—would be built on an analysis of medium- to longer-term macroeconomic fiscal and debt developments, and decisions by the Government on fiscal policies that achieve a feasible fiscal deficit reduction path.

The steps of a principles-based framework include the following:

- Identifying in the FRA the various fiscal responsibility principles and a limited number of unquantified fiscal objectives, such as achievement and maintenance of public debt at a sustainable level, with low risks; the maintenance of the overall fiscal balance at a prudent level over the medium term; and the prudent management of fiscal risks.
- Formulating a Charter, including quantified medium-term fiscal objectives over a five-year period. A credible Debt Sustainability Analysis, covering 10 or more years, would assist in deciding the values of the debt, fiscal deficit, and Government guarantee anchors in the Charter and any updates of it.
- Enhancing the annual Fiscal Strategy Report by operationalizing the medium-term fiscal objectives, quantified operational targets, and fiscal and debt projections for three years, consistent with the five-year fiscal anchors in the Charter.

- Ensuring that the annual budget is consistent with the Charter’s fiscal anchors and the Fiscal Strategy Report’s targets.
- Requiring the Minister of Finance to explain any departures from fiscal responsibility principles and quantified fiscal objectives (anchors/targets).

Accountability

The flexible principles-based approach requires strong accountability provisions in the new FRA. Under the “comply or explain” approach, the Minister would be accountable for ensuring that the contents and explanations provided in fiscal reports meet the Act’s requirements. The Minister would explain, to Parliament or its committees, all of the updates to the Charter and any deviations from the Government’s stated fiscal objectives and key fiscal targets. The Minister’s written report would explain the reasons for any changes in the key fiscal targets or any temporary suspension of them when escape clauses are invoked, in conjunction with the planned corrective actions and a timeline to return to the targets. The FRA would also require the Minister to appear before a parliamentary committee to explain the contents of a Final Budget Outcome document, particularly why annual budget outcomes differ from initial budget projections.

Fiscal Transparency

The new FRA could enhance transparency by requiring the Government to present to Parliament various ex-ante and ex-post reports and publish them on the MOF website:

- The FRA’s **Fiscal Strategy Report**, which now includes a medium-term debt strategy, could be improved by including multi-year fiscal and debt targets, consistent with the objectives in the Charter. The Fiscal Strategy Report would, in turn, be used to guide the annual budget preparation and to facilitate public scrutiny and accountability. The new FRA could set out the minimum contents for the Fiscal Strategy Report and require its submission to Parliament by the end of June, with an update in October with the annual budget documentation.
- A **Fiscal Risks Statement** and a **Statement of Tax Expenditures** would be prepared and submitted to Parliament in October with budget documentation.
- The new FRA could require publishing/updating annually a **Debt Sustainability Analysis (DSA)** as a part of the Fiscal Strategy Report, which would guide the three-year objectives under the Fiscal Strategy Report, consistent with the fifth-year targets for public debt and the fiscal deficit that are specified in the Charter. The DSA would be also updated every time the targets in the Charter are revised and/or the Fiscal Strategy Report is updated.
- A **Final Budget Outcome** (inclusive of annual financial statements) would be the main ex-post accountability document. It would explain any deviations through the budget year from the submitted budget and Fiscal Strategy Report

Fiscal Oversight

The new FRA would clearly define the specific roles of Parliament and the Auditor General in the fiscal responsibility framework. This report suggests enhancing fiscal oversight by strengthening the role of Parliament and the Auditor General. The new FRA would require the Auditor General to audit whether the Minister of Finance has complied with the FRA's specific accountability requirements. The Peoples' Majlis (particularly the Public Accounts Committee) would monitor compliance with the proposed Charter and Fiscal Strategy Report. The new FRA would also require the Minister of Finance to report annually to Parliament on the actions by the Government to implement the budget-related recommendations of parliamentary committees and the Auditor General. To provide effective external audit and legislative oversight, this report advocates enhancing the technical and staffing capacity of the MOF, the Auditor General's Office, and relevant parliamentary committees.

The credibility of the proposed new framework requires the political commitment to implement it and to meet the fiscal objectives established by the Charter and the Fiscal Strategy Report. Although the design elements provided by the proposed new FRA are important factors for the success of the new fiscal rules framework, their implementation is ultimately linked to the authorities' ambitions to improve fiscal outcomes, especially the political will to establish responsible fiscal management and to strengthen other aspects of the public financial management (PFM) system to support the implementation of the new FRA.

Coherency In PFM Legal Reform Agenda And Transitional Issues

A clear and consistent PFM legal framework is a prerequisite for a credible fiscal responsibility framework. This report suggests improvements in the FRA. At the request of the authorities, a first draft of a new FRA (Appendix 1) is provided to guide the authorities in adopting this report's policy recommendations in the legislative drafting process. However, the authorities should continue to work on the proposed draft provided by this mission, in particular, by carefully integrating the new FRA into existing PFM laws and the ongoing PFM legal reform agenda. The report also identifies several areas of PFM that should be addressed in other PFM laws for the successful implementation of the new FRA. Given the uncertain macro-fiscal circumstances and possible capacity constraints for preparing some of the new documents proposed in this report, the new FRA would also include transitional provisions to delay the implementation of some of its provisions.

KEY RECOMMENDATIONS

Recommendations for the design of the new FRA

Objectives, Definitions, and Coverage

- Ensure that all terms used in the new FRA are defined clearly in a single Article, especially by clarifying the institutional coverage of the various fiscal aggregates mentioned in the FRA.
- Clarify in the new FRA public debt to be the gross debt of the Central Government and all Central Government guarantees, that is, all guarantees to local councils, state-owned enterprises (SOEs), and private entities.
- Limit the coverage of the Government's fiscal strategy documents and ex-post budget reports to Central Government entities, that is, exclude local councils' own revenues, expenditures, fiscal balances, and nonguaranteed debt from fiscal aggregates.

Moving from a rules-based FRA to a principles-based law

- Adopt a principles-based FRA that articulates fiscal responsibility principles to guide the government's fiscal policy.
- Include the fiscal responsibility principles and unquantified key fiscal objectives in the FRA. Instead of including fiscal rules in the FRA, develop a principles-based fiscal responsibility Charter that includes quantified fiscal objectives, and enhance the Fiscal Strategy Report to incorporate numerical fiscal targets to operationalize objectives.
- Introduce in the new FRA a requirement for the Minister of Finance of an incoming Government to present to Parliament a Charter that specifies the numerical values for key fiscal objectives ("targets") consistent with the fiscal responsibility principles in the FRA, notably, the debt-to-GDP target for achieving fiscal sustainability, based on a comprehensive DSA. Parliament would approve the Charter by Resolution.
- Consider quantifying three key fiscal objectives—a total public debt objective as an "anchor," an overall fiscal deficit objective, and a debt guarantee limit—in the Charter for the fifth year of the government's term, which would be converted into year-by-year operational targets in the Fiscal Strategy Report (for three years).
- Include provisions in the new FRA that do the following: (1) require a compulsory review of the Charter after two years that may or may not lead to a modification of the fiscal targets; and (2) allow temporary departures from the principles of fiscal responsibility for specific events enumerated in the FRA's escape clauses.
- Require the Minister of Finance, when modifying the Charter, to explain to Parliament the reasons for deviating from previous fiscal targets, the approaches that the Government intends to take, and the time period to return to the FRA's principles of fiscal responsibility.
- Use a DSA to determine the feasible and realistic values of the key fiscal objectives for the five years beyond the present fiscal year.

Improving the Reporting of the Government's Fiscal Intentions

- Require the Minister of Finance to table a Fiscal Strategy Report before Parliament by end-June, with the Peoples' Majlis approving it by Resolution, thereby gaining buy-in.
- Update the Fiscal Strategy Report with recent economic and fiscal developments and any new policy changes and resubmit it to Parliament in October as part of the annual budget documentation.
- Specify the minimum contents for the Fiscal Strategy Report in a schedule to the FRA.
- Require the following in the FRA: (1) a fiscal risk statement, (2) an annual statement on tax expenditures, and (3) a DSA. The first two documents would be submitted to Parliament with the annual budget by end-October. The last two documents could be prepared once the capacity is available in the MOF.

Ex-post Reporting

- Include in the FRA a requirement for a Final Budget Outcome to accompany the submission of the annual financial statements to Parliament before end-June, consistent with the Public Finance Act.
- Include a requirement in the FRA that the Minister appear before a parliamentary committee to explain the following: (1) the contents of the Final Budget Outcome document, (2) the reasons for deviations from the revenues and expenditures approved in the annual budget, and (3) whether annual fiscal and debt outcomes will result in departures from the fiscal targets in the Charter and operational targets in the Fiscal Strategy Report.
- Include in the FRA a requirement to publish key fiscal reports (mentioned in this report) once they are approved by the Cabinet of Ministers at the time of the submission of the documents to Parliament.

Fiscal Oversight Institutions

- Require in the FRA the Peoples' Majlis to discuss the Government's Charter and Fiscal Strategy report and approve them by Resolution.
- Enhance the analytical, technical, and staffing capacity of the MOF, the Auditor General's Office (AGO), and Parliamentary Committees to enable them to assess the government's medium-term fiscal strategy and annual budget outcomes.
- Include in the FRA a requirement for the Auditor General's Office to audit whether the Minister of Finance has complied with the FRA's specific accountability requirements.
- Require in the FRA that the Minister of Finance report annually to Parliament on the actions taken by the Government to implement the budget-related recommendations of the parliamentary committees and the Auditor General.

Transitional Provisions

- Decide which provisions of the draft FRA need to be delayed, given the present uncertain macro-fiscal circumstances and the capacity constraints in the MOF, the AGO, and Parliament.

Other Recommendations

- Ensure consistency in the PFM legal reform agenda and consider the merits of adopting the FRA and the Public Debt Act in the same parliamentary session in 2021.
- Consider the areas where changes are needed in the Public Finance Act and Financial Regulations and make appropriate draft amendment proposals for Parliament’s consideration.
- Remove all cash flow planning provisions (chapter 8) from the 2013 FRA and transfer the relevant provisions to the Public Finance Act or the financial regulations.
- Consider transferring Article 32(a) of the 2013 FRA—restrictions on advances to the government from the Maldives Monetary Authority (MMA)—to the Public Finance Act.

I. INTRODUCTION AND CONTEXT

A. Introduction

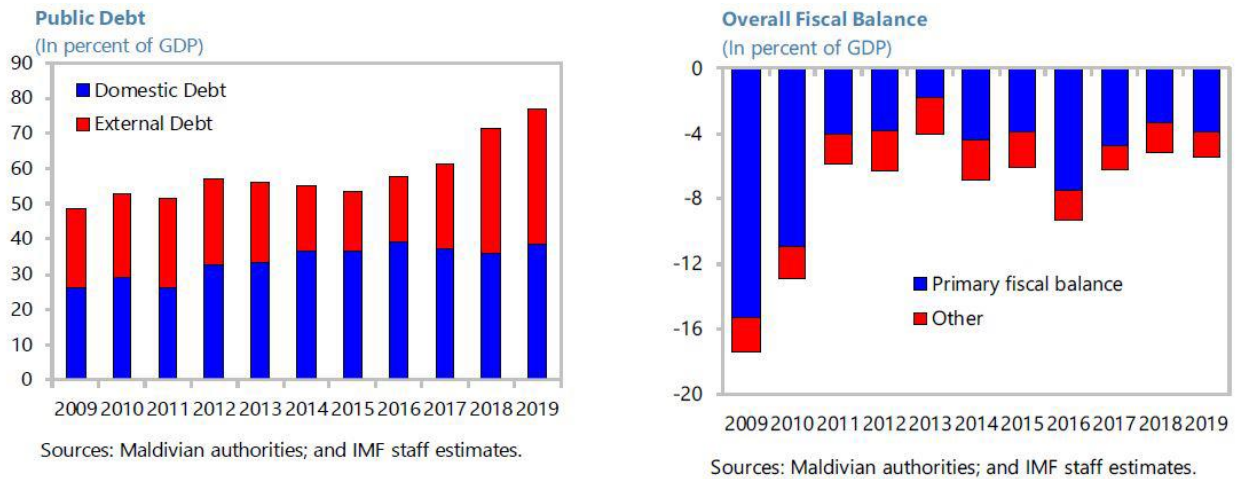
1. The 2013 Fiscal Responsibility Act was adopted to set up a comprehensive fiscal responsibility framework. The Act's aim was to ensure that fiscal policy actions were taken in an accountable and transparent manner, especially by imposing limits on various fiscal aggregates. To enhance the transparency of the Government's medium-term fiscal strategy, the Act required new fiscal and debt reporting requirements. The FRA also contained provisions pertaining to local councils' loans, guarantees, and debt.

2. The FRA included three main numerical fiscal rules, namely: (1) a debt-to-GDP fiscal rule, with the ratio not to exceed 60 percent; (2) a budget balance rule requiring that the overall deficit be reduced to a level of 3.5 percent of GDP and maintained at that level thereafter; and (3) a primary balance rule requiring a primary surplus from end-2016 onward. The Act also imposed limits on short-term borrowings by the government from the Maldives Monetary Authority (MMA); as from 6/5/2016 government borrowing was to be undertaken only to finance investment projects. The Act also included provisions for limiting guarantees and participation in state-owned enterprises (SOEs) and established a fiscal reserve.¹

3. The FRA was unsuccessful in achieving its numerical objectives, partly because of design issues. The FRA contains useful elements, including the principles of fiscal policy and reporting requirements, but it falls short of good practices in a number of respects (see paragraph 4). The targets and three-year timeframe for achieving the three fiscal targets by 2016 proved to be overly ambitious. After 2013, fiscal expansion was driven by significant public infrastructure investments; the government allocated an average of 9 percent of GDP to capital expenditures between 2013 and 2019. The external financing of infrastructure projects and SOEs' large infrastructure projects contributed to the increase in public debt (Figure 1). However, the results of attempts to enhance revenue generation and curtail current expenditures were mixed. The government was unable to generate the primary surpluses as envisaged in 2013. As a result, the overall deficit, including grants, averaged 6 percent of GDP during 2013–19; total public and publicly guaranteed debt was estimated to reach 77 percent of GDP as of end-2019.

¹ More specifically, the FRA requires that (1) loans and guarantees to a public enterprise by the Government or with Government participation in the name of the state, or guarantees given to any party in the name of the state, shall not exceed the limit set out to take loans or give guarantees in the annual national budget; and (2) the National Fiscal Reserve is the reserve to which the amount from the primary balance surplus is deposited as determined by the President with the advice of the Parliament's Financial Committee.

Figure 1. Maldives: Fiscal Developments



B. Experience with the 2013 Fiscal Responsibility Act

4. The main strengths and weaknesses of the FRA are as follows:

Main Strengths

- The FRA's main aim is laudable: to reduce rising public debt and maintain medium-term fiscal sustainability.
- The law is relatively concise.
- The FRA requires medium-term fiscal and debt strategies, which change the sole focus of policymakers from the new fiscal year. The multi-year consequences of revenue and expenditure policies, as well as the future trajectory of public debt, are made transparent.
- The FRA requires loan, debt and guarantee limits on local councils, to be established each year by the Minister of Finance in the annual budget.
- The FRA includes an escape clause that allows exceptions to the adherence to the fiscal rules in cases of a natural disaster or economic downturns, with the consent of, and for a period determined by, the Parliament.

Main Weaknesses

- The numerical fiscal rules on debt and fiscal deficits proved to be too ambitious within the three-year period, and the multiple fiscal rules were too rigid.
- The lack of respect for the numerical fiscal rules and the failure to implement of some of the FRA's procedure rules also reflect the inadequate political buy-in to the FRA.

- The FRA does not include adequate accountability provisions requiring the Minister of Finance to put public finances back on a sound footing after a deviation from fiscal targets.
- The FRA does not include a requirement for a Final Budget Outcome Report, in which the Minister provides explanations of why the budget outturns differ from the annual budget aggregates.
- The FRA does not specify the timing of publication of the Fiscal and Debt Strategies.
- The FRA does not require a comprehensive annual Fiscal Risk Statement.
- The events triggering the activation of an escape clause are not clearly defined. The FRA also does not require the Minister of Finance to report on the implications of the activation of the escape clause and the adjustment path to revert to the rule; suggested improvements are included in the Box 1.
- Finally, some definitions are ambiguous, and some parts of the Act (for example, Chapter 8 on cash planning) do not belong in the FRA.

Performance Of Numerical Fiscal Rules Under The 2013 FRA

5. Few of the FRA’s numerical fiscal rules have been complied with. The fiscal deficit limits were not respected (except the overall deficit limit that was respected in 2017) , and the debt-to-GDP ratio rose above the 60 percent limit in 2016. However, until 2019, the “golden rule” was respected. Table 1 summarizes the extent of the noncompliance with the FRA’s quantitative limits.

Table 1. Performance of Legislated Fiscal Rules

Chapter 10 of the Fiscal Responsibility Act, 2013		
	Quantitative limits	Performance
Key fiscal aggregates		
Public debt	Not to exceed 60% of GDP within 3 years from 1/1/2014	The debt limit was respected until end-2016; it has been violated since then.
Overall fiscal balance	Not to exceed 3.5% of GDP within 3 years from 1/1/2014	This criterion was not respected, except in 2017 ¹ .
Primary balance	To be in surplus within 3 years from 1/1/2014	This criterion was never respected.
Various loan limits		
“Golden rule”	Loans only for national development projects (= current balance > 0), as from 1/1/2016.	Respected until 2019; there was a strong breach of this limit in 2020.
Loan guarantees	Not to exceed the limit set by the Minister in the annual budget	Such a limit was not included in the annual budget.

Advances from MMA <i>(to be repaid within 91 days)</i>	Not to exceed 1% of 3-year average of GDP	This was respected until 2019; there was a strong breach of this limit in 2020 ² .
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¹The overall deficit reached 3.0% of GDP in 2017. See http://statisticsmaldives.gov.mv/nsdp/upload/CGO_MDV.xlsx;

²The end-2020 Maldives Monetary Authority advances are estimated at 5.3 percent of GDP.

The FRA’s Fiscal Reporting Requirements

6. The 2013 FRA contains positive fiscal reporting features, namely, three forward-looking documents. The FRA requires the Minister of Finance to submit the following to the People’s Majlis:

1. A Medium-Term Fiscal Strategy document before end-July of each year.
2. A Budget Position Paper after the submission to the People’s Majlis and before preliminary discussions on the annual budget.
3. A National Debt Strategy before end-July of each year.

7. The publication date of the Fiscal and Debt Strategies is not specified. Under the FRA, the publication decision will be given by the Cabinet prior to the submission of the documents to Parliament (Article 30). Therefore, the FRA does not make the publication of Strategies mandatory or specify the timing of their publication. The Act only requires that the Budget Position Paper be published in the Government Gazette (Article 14c), but the publication date is not specified.

8. Since 2018, the Government has been publishing more documents on the MOF website. A single Fiscal and Debt Strategy Report was published in 2018. The document has become more analytical in recent years. It describes the macroeconomic outlook and the annual budget (including the composition of revenues and expenditures), provides medium-term fiscal projections, and quantifies the impact of new revenue and expenditure policy measures adopted in the budget. Also, the Government publishes a “Budget in Statistics” document (in English) following the approval of the annual budget by the People’s Majlis. Sections IV and V discuss fiscal reporting issues—including improvements—in some detail.

C. Context in Maldives for Amending the FRA

9. The current macro-fiscal outlook is very different than in 2013, the year the FRA was adopted. During 2013–19, strong growth in tourism and public infrastructure investment contributed in varying degrees to economic growth, but fiscal deficits and debt-to-GDP also grew.

10. The COVID-19 crisis has led to unprecedented fiscal imbalances. With sharp declines in tourist arrivals and economic growth in 2020, the overall fiscal deficit (including grants) is

estimated to exceed 27.5 percent of GDP in 2020.² The 2021 budget envisages cuts in some spending; however, with revenues not recovering to pre-crisis levels, as well as larger capital expenditure, another large fiscal deficit is envisaged. Total public and publicly guaranteed debt will continue to rise, possibly exceeding 130 percent of GDP by end-2021. This level is substantially higher than the one used in the last performed Debt Sustainability Analyses (DSA) conducted by IMF and World Bank staff, which already highlighted high risks with respect to debt sustainability.³ To respond to challenges posed by COVID-19, the People's Majlis approved the suspension of certain provisions of the FRA; these provisions include limitations on borrowing from the MMA and the requirement to borrow only for national development projects.⁴

11. There is much uncertainty over the medium-term outlook for economic growth, the fiscal deficit, and impacts on debt-to-GDP. While there is a need to reduce debt to a sustainable level by continuing fiscal consolidation efforts, there is also an ongoing need to support economic activity and limit the impact of the crisis on vulnerable social groups. There are fiscal policy trade-offs between (1) supporting infrastructure projects, while addressing environmental concerns, and (2) pursuing ambitious deficit-reduction plans to secure debt sustainability.

12. In addition to fiscal policy trade-offs, there is also a trade-off between the credibility and flexibility of fiscal management. On the one hand, to be credible in debt-reduction efforts, there is a need for firm targets for debt, fiscal deficits, and total expenditures. This approach could suggest firm numerical fiscal rules to bind the medium-term fiscal trajectory. On the other hand, the unusually high uncertainties concerning the medium-term fiscal outlook call for flexibility with respect to the trajectory. The Government is committed to continuing its debt-reduction efforts with firm and credible targets for debt and fiscal deficits; however, the country is also cognizant of the past experience of noncompliance with numerical fiscal rules and the current uncertainty over the macro-fiscal outlook arising from the COVID-19 crisis. The authorities aim to rebuild the credibility of the fiscal responsibility framework that establishes the key principles of fiscal responsibility without quantitative targets in the law itself. Instead, the law could define the process for how medium-term fiscal targets will be defined and monitored for compliance.

13. Against this backdrop, this report discusses options to revamp the 2013 FRA, taking into account the challenges posed by the current context. The report proposes to transition from a *rules-based* fiscal sustainability framework to a *principles-based* one.⁵ A draft new FRA is included in Appendix 1 to address the weaknesses of the 2013 FRA and to guide the authorities

² According to the authorities' 2021 budget document. See also IMF's COVID-19 [policy tracker](#) indicating that "to minimize the economic impact of the COVID-19 virus, the authorities announced on March 20, 2020 an Economic Recovery Plan of 2.5 Billion rufiyaa (3.4 percent of GDP)".

³ See the [April 2020 IMF RCF Staff report](#) for further details.

⁴ However, it is not clear whether the Minister of Finance activated FRA's escape clause for this suspension.

⁵ Van Eden and others (2013) discuss design issues for fiscal responsibility laws.

in formulating a new high-level legal framework for fiscal policymaking. Section II discusses the main objectives, as well as the definitional and coverage issues of the new FRA. Section III discusses several options, from embedding numerical medium-term fiscal targets in the law—such as the approach of the 2013 FRA—to the more flexible option of moving to a principles-based FRA. Sections IV and V discuss fiscal reporting and accountability provisions. Section VI looks at the role of external oversight institutions. Section VII discusses the importance of integrating the FRA into the ongoing public financial management (PFM) legal reform agenda. Appendices 2 to 6 supplement the main text of this report.

II. REVIEW OF THE OBJECTIVES, DEFINITIONS, AND COVERAGE OF THE NEW FRA

A. Main objectives of the FRA

14. The main purposes and objectives of an Act are typically set out at the beginning of the law. Several countries' FRAs have a paragraph specifying the objectives of the Act before the first article.⁶ In a few countries, the first article provides a summary statement of the purposes of the Act. Maldives is in the second category: Article 1(a) summarizes the aim of the FRA. This report prefers the first option because it visibly highlights the law's purpose.

15. It is important to clearly reformulate the main purpose of the FRA. The aim of the new FRA would no longer be "to state the limits (numerical targets) for fiscal actions" but to include principles of accountability, sustainability, prudence, and fiscal transparency. Clarity of purpose will make it easier for Members of Parliament and the public to understand the law. Although there is no unique formulation, Appendix 1 offers a possible wording.

B. Definitions

16. The terms used in the FRA should be defined clearly. In the 2013 FRA, some terms are not defined well, and others are ambiguous. For example, does the "overall balance" include or exclude grants? Do "national" budget policy and "national" debt (also translated as "total" debt in Article 40(k) of the FRA) cover only the Central Government, or do they include local councils and other public sector entities? Also, a variety of terminology is used interchangeably, such as "Total Debt," "National Debt," "Government Debt," and "Total National Debt," creating confusion for the coverage of fiscal rules. Subsection C provides guidance for the institutional coverage of fiscal aggregates in the new FRA.

17. All definitions of terms used in the FRA should be grouped in one Article. In the 2013 FRA, there are two separate lists of definitions: Chapter 2 (Articles 3 to 8) and Article 40 (a)

⁶ Examples include the FRAs of India (2006), Pakistan (2007), and Sri Lanka (2003).

to (n). Also, in the new FRA, terms that are not needed or difficult to measure—for example, “unemployment rate” and “balance of payments crisis”—could be eliminated. The mission’s draft new FRA in Appendix 1 proposes many definitions. To avoid ambiguity, these will need careful review, especially before the new draft law is finalized in Dhivehi.

C. Coverage

18. There are two separate coverage issues for the FRA: (1) the institutions and levels of government to which the law will apply (“legal coverage”); and (2) the public sector entities included in the fiscal aggregates referred in the FRA. This subsection elaborates on these two issues, especially the second.

Legal Coverage Of Institutions

19. The institutional coverage should apply to the whole of Maldives. This universal coverage includes each level of government and the wider public sector. The FRA’s focus, however, is the responsibility of the Central Government, and the Minister of Finance in particular, to the Peoples’ Majlis. Nevertheless, some provisions of the FRA apply to local councils and SOEs, as these entities must report to the Government (in practice, to the MOF) to fulfill the FRA’s fiscal objectives and reporting requirements.

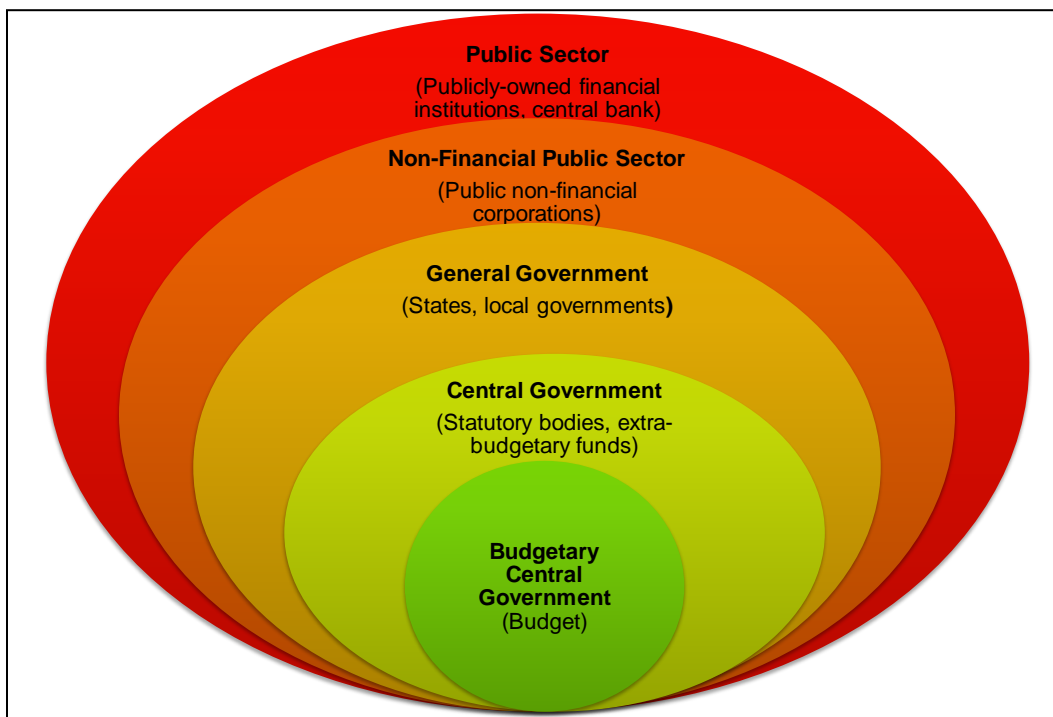
20. Article 2 of the 2013 FRA limits the applicability of the Act to “all institutions run on a government budget.” This coverage is too restrictive. The FRA should include, for example, a fiscal risks analysis of all major public sector entities and public-private partnership (PPP) projects, not only those institutions that are operated on a government budget. Article 2, even if modified, is unnecessary.

Coverage Of Fiscal Aggregates In The Fiscal Framework And FRA

21. The IMF’s *Government Finance Statistics Manual (GFSM)*⁷ provides a basis for categorizing components of the public sector. Figure 2 illustrates the five main components. In Maldives, the fiscal activities of budgetary Central Government and SOEs are dominant.

⁷ IMF 2014. Available at <https://www.imf.org/external/pubs/ft/gfs/manual/gfs.htm>

Figure 2. Possible “Universes” for the Coverage of the FRA



22. Internationally, there is no uniformity in the coverage of fiscal aggregates for monitoring purposes. Some countries’ FRAs or PFM Acts solely cover the Central Government, inclusive of extrabudgetary funds. This is the case, for example, when local governments’ own revenues are small relative to the grants that they receive from the Central Government’s budget. In contrast, European Union countries—whether small island countries like Malta or Cyprus or large federal countries like Germany—prepare medium-term fiscal frameworks (MTFFs) with a “General Government” coverage (third circle of Figure 2) to provide uniformity across countries.

23. Maldives has two levels of government and 32 SOEs. In addition to the Central Government, there are some 200 autonomous local councils, which were created in 2010 following the adoption of the Decentralization Act.⁸ The number of budgetary and extrabudgetary Central Government units—including trust funds, the pension fund, and the sovereign development fund (SDF)—has recently been reviewed, with Government Finance Statistics (GFS) technical assistance by the South Asia Regional Training and Technical Assistance Center (SARTTAC).⁹ There are 31 SOEs (of which five are publicly listed), some of which are profit-making. Several loss-making SOEs receive government subsidies to cover operating costs.

⁸ The Decentralization Administration Act of July 2010 has subsequently undergone extensive amendments, several of which became effective in December 2019.

⁹ Concerning extrabudgetary Central Government units, SARTTAC (2019) listed 26 trusts funds, the Sovereign Development Fund, three other funds, and 13 corporations (SOEs) that were not charging economically significant prices. This tentative list was reviewed and shortened; see SARTTAC (2020) for the modifications.

24. In Maldives, the coverage of the fiscal aggregates targeted in the FRA could vary.

This report proposes that the FRA’s “public debt” includes all Central Government debt, as well as all Central Government debt guarantees (those benefitting local councils, SOEs, and the private sector). In contrast, the main fiscal policy aggregates—total revenues, total expenditures, and the overall fiscal balance—could, for pragmatic reasons, be confined to those of the Central Government.

25. Public debt in the FRA could be based on debt instruments and debt-guarantees that are readily monitorable by the Central Government.

The institutional coverage of public debt in the FRA could be identical to that of the DSA conducted by IMF and World Bank staff (see IMF 2020c). The DSA includes the major sources of debt-related risks¹⁰. SOE guarantees have increased in recent years, associated with large infrastructure projects. These are included in the DSAs prepared by IMF staff. Thus, apart from the Government’s direct external and domestic debt, debt guarantees should be included in the public debt aggregate monitored under the FRA, because SOE guarantees may pose a threat to debt sustainability.¹¹

26. The coverage of the public debt aggregate of the new FRA would not be identical to GFS’s public sector shown in Figure 2.

This difference is mainly because: (1) direct debt contracted by SOEs and local councils is excluded; and (2) all Central Government guarantees are included (one-off debt guarantees are not debt instruments). SARTTAC (2020) identifies six categories of debt liabilities, to which this report proposes adding debt guarantees (off-balance sheet contingent liabilities).

27. Public debt would continue to be measured on a gross basis.

This report does not propose adopting a net public debt definition, for example, by including the assets of the SDF.¹²

28. The FRA’s coverage of fiscal aggregates should aim for “consolidated Central Government.”

The definition of fiscal aggregates should go beyond “budgetary Central

¹⁰ The IMF RCF Staff report (April 2020) indicates that the debt sustainability analysis includes public and publicly guaranteed (PPG) external and domestic debt. Public debt includes debt of the Central Government, including guarantees to SOEs. Public debt does not include the non-guaranteed debt of SOEs, because some can borrow without the guarantee of the government.

¹¹ SOEs are a major source of fiscal risk in the economy of Maldives because they rely excessively on government support. Both the Staff Report for the 2019 Article IV Consultation and the Fiscal Transparency Evaluation (April 2021) indicate that, in 2019, SOEs unconsolidated liabilities represented 84 percent of GDP, of which 21 percent of GDP is government guaranteed debt and 12 percent of GDP direct loans and on-lending by Treasury.

¹² Extrabudgetary Central Government comprised five institutions and a recently created SDF. The Maldives’ Fiscal Transparency Evaluation (April 2021) indicates that SDF could be considered partly off-budget because although transfers to the Fund (around 4 percent of total budget) are on budget, the IMF’s investment transactions are off budget. The SDF is a contingency fund formed in 2017 if the government faces difficulty in repaying the loans contracted for major development projects or sovereign bond issues. Given the SDF’s direct link with loan repayments, its assets could, in principle, be netted out from gross public debt. When accrual accounting is adopted (a longer-term aim), the SDF’s assets and liabilities would be included in the Central Government balance sheet.

Government” (the smallest circle of Figure 1) and include all off-budget activities and extrabudgetary funds controlled by the Government (the second circle of Figure 2). The FRA should require that the fiscal documents discussed in sections IV and V cover both budgetary and off-budget Central Government revenues, expenditures, and financing. Given that the categorization of extrabudgetary units is changing,¹³ it is recognized that this suggestion would be difficult to implement fully in the short-term.

29. In the FRA, the “pension fund” could be excluded from total revenues, total expenditures, and the overall fiscal balance, at least in the short-term. SARTTAC (2020) proposed a reclassification of the “pension fund”—the pension schemes administered the Maldives Pension Administration Office (MPAO).¹⁴ Instead of being a “social security fund,” the pension fund would be classified in GFS’s “public financial corporation” sector. However, given that MPAO administers government pension schemes, in the longer-term, the pension fund’s revenues, expenditures, balance, and net debt should be covered by the FRA’s fiscal and debt aggregates. The law’s “transitional issues” (see section VII.B) could envisage a longer-term phase-in.

30. For pragmatic reasons, local councils could be excluded from the fiscal aggregates monitored under the FRA. Ideally, for reasons of transparency and completeness, local councils’ fiscal activities should be included. However, their weight in general government finances currently is quite small. For revenues, local councils depend heavily on grants from the Central Government’s budget. Accordingly, most local councils’ revenues are included in the Central Government’s medium-term fiscal projections. The local councils’ self-financed fiscal activities are small at present. Borrowing by local councils is currently nonexistent because it is conditional on legislated limits for borrowing and Central Government approval of their loans and loan guarantees. Although local councils would be excluded from having to provide inputs to the Government’s medium-term fiscal aggregates, they would not be excluded from fiscal risk analysis. Similarly, local councils should not be discouraged from drawing up their own MTFs on a voluntary basis.

31. Local councils’ debt limits of the 2013 FRA could be maintained, pending a debt law. Chapter 7 of the 2013 FRA contains strong limitations on local councils’ debt, including: (1) for an individual local council, the debt (loans, PPP liabilities and guarantees issued) should not exceed one-third of the council’s revenues¹⁵ of the previous year; and (2) the total debt of all councils should not exceed the level announced by the Minister in the annual budget statement. Pending the adoption of a new Public Debt Act (see section VII) and a review of government

¹³ Many, but not all, trust funds identified in SARTTAC (2019) are on-budget or at least recorded in Central Government accounts. According to SARTTAC (2020), Central Government extrabudgetary units in 2020 consisted of the Bar Council, the Capital Market Development Authority, the Civil Aviation Authority, and certain nonmarket institutional units.

¹⁴ Under the Pension Act, the MPAO administers three schemes, including an Old-Age Basic Pension Scheme and the Maldives Retirement Pension Scheme. MPAO also disburses other pensions; see SARTTAC (2019, page 31).

¹⁵ For FRA purposes, block grants to local councils could be included in the definition of “revenues”. The Council’s revenue should be the audited and certified annual revenue in line with the Decentralization Act.

guidelines on local council borrowing, these strong restrictions could remain in the new FRA temporarily.

D. Recommendations

- Ensure that all terms used in the new FRA are defined clearly in a single article.
- Specify clearly the institutional coverage of various fiscal aggregates mentioned in the FRA.
- Eliminate Article 2 of the 2013 FRA from the new FRA, since public sector entities are covered in some aspects of the law.
- Define, in the new FRA, “public debt” to be the gross debt of the Central Government (budgetary and off-budget) and all government guarantees.
- Limit the government’s forward-looking fiscal strategy documents and various ex-post budget reports to “Central Government,” by excluding local councils’ and commercial SOEs’ own revenues and expenditures, from “Central Government” fiscal aggregates.

III. NUMERICAL FISCAL RULES: OPTIONS FOR THE NEW FRA

32. This section discusses options concerning fiscal objectives and rules. In view of the noncompliance with the FRA’s limits on debt and deficits and the current uncertain context, this section discusses options for replacing the 2013 FRA’s Chapter 10. It first discusses different approaches to including or excluding numerical fiscal rules in a law or a government document. After reviewing three options, the section recommends excluding numerical fiscal rules on public debt and the fiscal deficit from the FRA, but it recommends including quantitative fiscal targets in a separate government document—the Charter of Fiscal Responsibility.

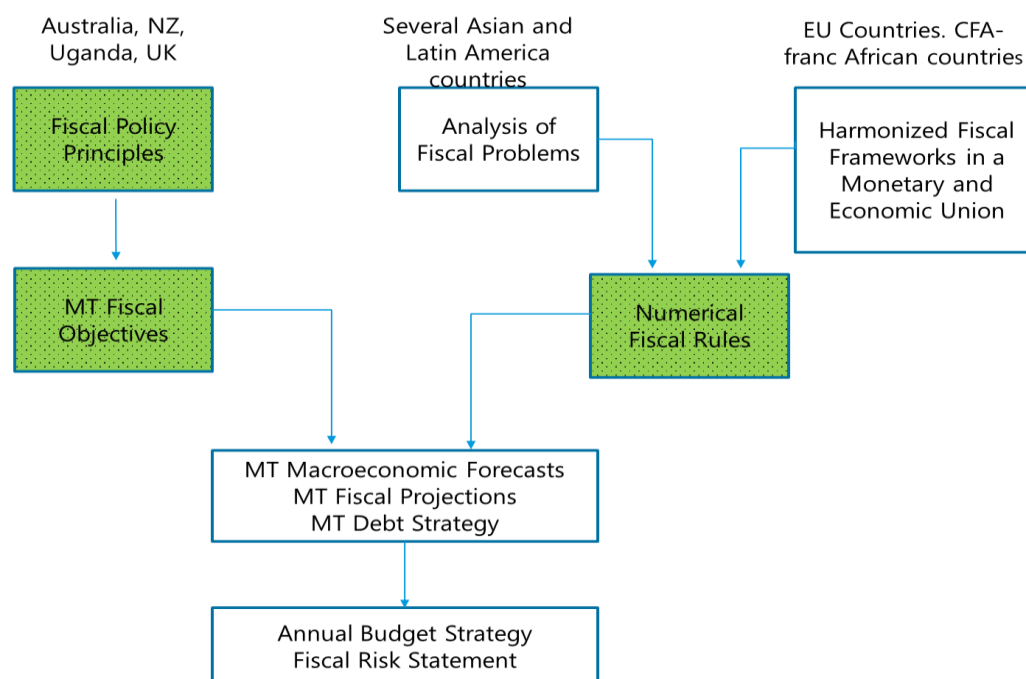
A. Principles-Based and Rules-Based Approaches to Medium-Term Fiscal Management

33. There are two broad approaches for attaining medium-term (MT) fiscal objectives by use of a law (Figure 3).

- A principles-based law. Under this approach, the FRA sets out fiscal responsibility principles and the fiscal objectives, which are used to measure progress in achieving fiscal objectives relative to the FRA’s fiscal principles. The fiscal objectives are quantified in a separate government document, which can be changed or updated by the government without changing the law; or

- A rules-based law. Under this approach, the FRA includes numerical fiscal rules¹⁶—on debt, deficit, or total expenditure—as a means of constraining the fiscal policy decision-making.

Figure 3. Principle-based and other approaches to MTFF and annual budgeting



Source: IMF Team.

34. Principles of sound fiscal management can be one starting point for MTFF formulation. A key advantage of this approach is flexibility. It allows the government to adjust fiscal policy to changing circumstances, such as increasing spending when there is an economic downturn. The credibility of the Government’s commitment to fiscal discipline is not undermined. The challenge under the principles-only approach is to accompany the quantified fiscal objectives with strong accountability and transparency mechanisms to ensure scrutiny of any changes in fiscal targets as and when they occur

35. An alternative approach is to begin with an analysis of key fiscal problems and address them by including one or more numerical fiscal rules in the FRA. To address fiscal sustainability and stability, many countries in Asia, the European Union, and Latin America have introduced fiscal rules in primary legislation (right hand side of Figure 3).

¹⁶ A fiscal rule is defined as a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates and which has a legislative basis. See Kopits and Symansky (1998) and Lledó and others (2017).

Option 1: Revise The FRA's Numerical Limits For Debt And Deficits

36. The inclusion of numerical fiscal targets in the 2013 FRA did not produce the intended results. With one exception (2017), the fiscal deficit targets were never met, and the debt target was breached from 2016 onward. The FRA's escape clause (see the discussion that follows) were not invoked at the time that the targets were breached. Rather, the noncompliance was mainly due to a poorly designed framework, unrealistic or overly ambitious fiscal targets, and weaknesses in transparency and accountability mechanisms, as well as insufficient government commitment to attaining these targets.

37. The mere introduction of fiscal rules in law does not guarantee success in reaching the desired fiscal outcomes. Introducing revised numerical targets for debt and deficits in an amended FRA would not help strengthen the fiscal framework. There is a long list of countries where numerical rules were included in the FRA or similar legislation, and where the debt and/or fiscal deficit rules were breached.¹⁷ The breaches usually occurred when fiscal policymakers slackened their commitment to sound fiscal policies. For example, in European Union countries prior to the 2009/10 financial crisis, fiscal authorities used the "good times" of the 2000s to boost public spending, which led to a breaching of the fiscal rules in several of the European Union countries (see IMF 2018b).

38. With the onset of the COVID-19 crisis, escape clauses in laws allowed many countries to suspend their fiscal rules. In several countries, fiscal rules can be suspended in times of "severe economic downturns" (see IMF 2020b). Maldives' 2013 FRA also allows for suspension when there is a natural disaster (where 15 percent of the population suffers damages due to natural causes) or an economic downturn (such as when GDP growth falls below 0 percent for two consecutive quarters or in cases of a financial or systemic banking crisis, and a balance of payments crisis). However, the FRA does not clearly identify these trigger events.¹⁸ Also, delays in the publication of quarterly National Accounts prevents the use of the economic downturn definition. Box 1 provides guidance for strengthening the escape clause specified in Article 36 of the FRA.

¹⁷ For Argentina, Colombia, Ecuador, Panama and Peru, see Corbacho and Schwartz (2007). For India, Japan, Pakistan, Sri Lanka and United States, see annexes of Lienert (2010). Legislated fiscal rules in ASEAN countries are documented in Lienert (2015). Studies of experience with fiscal rules in European Union countries include Kamps and Kamps and Leiner-Killinger (2019) and Schaechter and others (2012).

¹⁸ For instance, the definitions of "inflation rate" and "unemployment rate" are quite vague. The inflation rate is defined as "the change in prices of goods and services within a certain period of time," and the unemployment rate refers to "those among the working age group who are willing to work but unable to find work, within a certain period of time."

Box 1. Escape clauses in fiscal responsibility acts

Escape clauses allow the temporary suspension of fiscal rules when exceptional events occur, which would otherwise make rule compliance a constraint on appropriate responses and/or too costly for the economy. A well-defined escape clause should specify the following:

- A limited and clearly defined set of events triggering the operation of the clause
- The authority to request and activate it
- The timeline and procedures to revert to the rule
- An effective control mechanism
- A good communication strategy.

Such provisions need be included in a new FRA, but they should not be extensively elaborated so as to allow some discretion for implementing the spirit of the law. For the new FRA:

- Severe economic downturns, large natural disasters, public health pandemics, and states of emergency are legitimate trigger events—provided that they are clearly defined.
- The authority to request activation would reside in the Government.
- The Minister of Finance would communicate the change to Parliament and the public (for example, the FRA should require the publication of reports assessing the implications of the activation of the escape clauses, the expected size and duration of the deviation, and the adjustment path to revert to the rule.
- Depending on other FRA provisions—notably, those that require updates of the medium-term fiscal strategy—the timeline and procedures to return to compliance would be made known to Parliament, which would approve changes by means of a Resolution.

Source: IMF 2020b.

39. Near-term dates for achieving ambitious fiscal targets should not be included in the FRA. India, Pakistan, and Sri Lanka tried this approach and did not succeed. In the Maldives' 2013 FRA, the debt and deficit targets that should have been attained "within three years" were too ambitious and did not fully take into account, at the time of their formulation, the fiscal implications of the priority given to infrastructure spending in terms of deficit and debt-to-GDP. The fiscal framework loses credibility when a government has to continuously return to Parliament to modify overly ambitious dates included in the law.¹⁹

40. Multiple fiscal rules can become complex when noncompliance is recurring. In the European Union, for example, the Maastricht criteria—limits on headline deficits (3 percent of GDP) and gross debt (60 percent of GDP)—were later added to with a "balanced budget over the cycle" criterion, which later was complemented by total expenditure rules and strengthened compliance conditions. However, the additional fiscal rules and the tightening of procedural rules did not prevent ongoing noncompliance in some European Union countries. By 2019, it was

¹⁹ Unrealistic dates were also a major reason why the United Kingdom's FRA, adopted in 2010, was repealed one year later and was replaced by the Budget Responsibility and National Audit Act 2011.

recognized that the European Union’s fiscal rule system was too complex and needed simplification (EFB 2019). In contrast, Maldivian authorities have not attempted to address noncompliance by strengthening existing debt and deficit rules or by adding more rules and procedures.

41. In the current circumstances, there is too much uncertainty surrounding the establishment, in the new FRA, of revised debt and deficit targets. There is considerable uncertainty concerning the timing of the return to the previous level of GDP growth, tourist arrivals, tax revenues, remittances, etc. The level of public investment is also uncertain, as there is a trade-off between viable priority spending (for example, social spending and growth-enhancing infrastructure projects) that boosts long-term economic growth and short- to medium-term fiscal consolidation.

42. It would be unwise to introduce revised numerical targets for debt and deficits in the FRA. Until the COVID-19 health crisis is over, there is a highly volatile macro-fiscal situation and a high level of uncertainty over achievable longer-term targets for public debt and fiscal deficits. Spending to contain the impact of the current crisis mitigates the speed by which public debt could be reduced. In summary, Option 1 should be eschewed.

Option 2: Include Only A Long-Term Debt Objective In The FRA

43. There are merits in the view that the FRA should include one numerical rule only, namely a longer-term debt target or “anchor.” Arguments favoring this view include the following:

- Such an anchor would be a clear sign of the government’s commitment to fiscal sustainability and a public recognition that a longer-term debt target is the best way to focus attention on achieving sustainability.
- Fiscal policymakers would keep a watchful eye on fiscal deficit and debt developments in the longer term, while simultaneously providing short-term support to the economy.
- Embedding the debt anchor in the FRA would make it difficult for incoming governments to change the objective.
- Debt interacts closely with other critical fiscal aggregates, such as the overall balance and general macro parameters (such as the cost of debt, inflation, and the exchange rate). As such, having a debt anchor implicitly amounts to having a constraint on deficits.

44. However, there are also arguments favoring excluding a numerical value for the debt anchor from the FRA, notably:

- The long-term debt anchor, if not accompanied by a firm terminal date for its achievement, would become a far-off wish that could readily be ignored by fiscal policymakers.

- The credibility of the long-term debt anchor would be undermined if there was never progress, or extremely slow progress, in achieving it.
- Fiscal policymakers are myopic. A long-term debt anchor would not be binding on policymakers when making decisions for the annual budget or even the medium-term.
- If the debt anchor is legislated, the limit can be modified by Parliament relatively easily
- Determining a single, realistic value for Maldives' sustainable debt level is difficult in normal times, let alone in present circumstances. As such, anchoring public expectations on a single value could prove too rigid.
- Enforcing a single and highly visible debt anchor could encourage higher recourse to contingent liabilities or higher SOE indebtedness to fund public investment and quasi-fiscal activities.
- Finally, as discussed in the next subsections, there are alternative ways of achieving government commitment to a debt anchor other than embedding it in the FRA.

On balance, the mission considers that the disadvantages of including a long-term debt objective in the new FRA outweigh its advantages.

Option 3: Include Numerical Fiscal Targets In Government Documents, Not In The FRA

45. Under the principles-based approach to fiscal management, there is still a need for medium- and long-term fiscal and debt projections and quantified objectives. The difference between the two main approaches is that numerical fiscal rules are included in a law (right side of Figure 3), whereas medium- to long-term fiscal targets are included in a government document (left side of Figure 3).

46. Several countries have not included numerical fiscal rules in their FRAs or PFM acts. Such countries include Australia, Canada, Kenya, New Zealand, Sweden, Uganda, and the United Kingdom. In these countries, the emphasis is on legislating transparency and accountability requirements, while leaving successive governments with the flexibility to alter key fiscal objectives when needed. However, new governments must justify why they are changing the medium-term fiscal objectives. Also, there is strong oversight by Parliament and the media.

47. In some cases, FRAs have proven to be long-lasting laws. Over 20–30 years, the FRAs of Australia and New Zealand have served as a commitment device that instilled fiscal discipline into fiscal policymaking decision processes across all political parties.²⁰ This contrasts with FRAs

²⁰ For New Zealand's experience, see Gill (2018).

with numerical targets incorporated in the law itself. In nearly all cases, such FRAs were either abrogated or the quantitative limits sections of the law were repealed or amended.

48. Reliance on the flexible principles-based approach to fiscal policy management would seem appropriate for Maldives. In the short-term term (2021–22), because of the high degree of uncertainty of fiscal developments associated with COVID-19 and to preserve credibility, the Minister of Finance needs the flexibility to change key medium-term fiscal and debt targets.

49. Under the principles-based approach, the accountability requirements in the new FRA need to be strong. The law would list specific events that would allow the Government to deviate from its key fiscal objectives, provided the Minister of Finance justifies the deviations. The FRA would require the Minister to indicate why changes in the numerical values of key fiscal objectives (hereafter “targets”) are consistent with the FRA’s principles for responsible fiscal management. The Minister’s written report would explain how the government—through revenue and expenditure policy measures or other means—intends to return to attaining the fiscal targets, consistent with the fiscal principles of the FRA.

50. Some principles-only countries rely exclusively on a three- to four-year moving MTF. Australia and New Zealand adopted this approach partly because of three-year electoral cycles. Other countries—for example, Uganda and the United Kingdom with five-year parliamentary terms—have provisions in their FRA-type laws that require each new Government to specify key fiscal targets to be achieved in the fifth and final year of the government’s mandate. These documents are the Charters of Fiscal Responsibility and are approved by Parliament (lower House only in the United Kingdom).²¹

51. Maldives’ new FRA could require a Government document with key fiscal targets for the fifth year of each new Government mandate. Five-year planning was reintroduced in Maldives with the publication of the Strategic Action Plan (SAP) for 2019–23 that covers 33 subsectors of the economy. The SAP is an expression of the government’s sectoral development priorities. However, the SAP does not provide a view on medium-term fiscal policy.

Proposal Of A Charter Of Fiscal Responsibility

52. To strive toward achieving a sustainable, then a prudent, public debt level, a Charter of Fiscal Responsibility is proposed. The Charter would be a government document that lays out each incoming government’s principal fiscal objectives. The document would not provide a detailed five-year macroeconomic and fiscal framework for various categories of revenues, expenditures, budget deficit financing, and public debt. Rather, it would focus on the

²¹ For the latest Charters of Fiscal Responsibility for these two countries, see Uganda (2016) and UK (2017).

targets for key fiscal aggregates to be reached by the fifth and final year of the government's term.

53. The Charter would be an intermediate government document, wedged between the new FRA and a rolling three-year MTFF document. Since its essential components would be the key fiscal targets (for debt, the fiscal deficit, and government guarantees), the Charter could have the same timeframe as a medium-term planning document, such as the current government's five-year SAP. However, the Charter would be a separate document, since it could be prepared more quickly than a new SAP, following general elections. The Charter would not be detailed and would first be approved by the Cabinet of Ministers. The Minister would submit the Charter to the People's Majlis, which would review it and approve it by issuing a Resolution. Unlike the SAP, the Charter would not require considerable consultation with spending ministries and civil society. It would be operationalized by a yearly three-year MTFF document, which would translate the overarching targets into more granular ones, such as revenues, current expenditures, capital expenditures, overall balance. The MTFF document would be updated with every budget submission.

54. The fiscal targets included in the Charter would be based on a credible and viable DSA. The IMF and World Bank debt sustainability framework provides a comprehensive view of the risks associated with debt, as well as a robust indication of a sustainable debt level. The April 2020 DSA needs to be updated to reflect current developments and the 2021 budget that was approved by Parliament in November. The updated DSA would need to move public debt to a sustainable level and would include feasible yearly fiscal deficit adjustments. It would take into account fiscal risks and external shocks (including interest rate, currency, refinancing risks) through conservative assumptions. Such an approach would allow the Maldives authorities to adopt realistic debt limits and corresponding operational targets to guide fiscal policymaking in the coming years. In updating the DSA, the authorities could make use of publicly available tools. Appendix 5 provides further guidance on a DSA tool that could inform the fiscal targets of the proposed Charter.

55. The MOF already has capacity for fiscal and debt projections over a five-year period. The MOF could prepare different fiscal consolidation scenarios to achieve debt sustainability. The MOF would need to reinforce the existing capacities to use complete DSA tools. Developing in-house capacity is needed to provide the MOF with a solid analytical basis for proposing numerical values of the debt anchor to the government, consistent with the principles of responsible fiscal management in the new FRA.

56. The Charter could be reviewed as a matter of course after two years. Such a review could include new indicative fiscal objectives five years ahead, that is, beyond the electoral term of the Government. If the Charter is not updated during the five-year term of the government, the third-year values of the key fiscal targets in the MTFF projections would become the fiscal anchors for the remaining years of the government's five-year mandate. Importantly, any

contemplated update of the fiscal projections under the Charter and/or the MTFP would need to trigger a DSA update.

57. Temporary departures from the FRA’s principles of fiscal responsibility could be allowed for specific events. An unanticipated severe economic shock—including a health pandemic, a natural disaster, or another significant unforeseen event that cannot be funded from the unallocated contingency spending provision of the annual budget—would be the only acceptable escape clauses. A schedule to the FRA or the equivalent could elaborate on the details, including on the conditions and the authority for activating triggering events (Box 1), which would result in the need to revise the Charter.

58. Parliament could be requested to approve updates of the Charter. When the Charter’s key targets for debt or other fiscal aggregates need to be modified or temporarily suspended (as discussed in paragraphs 55 and 56), the Minister would first seek approval from the Cabinet of Ministers and then submit the modified Charter to Parliament for its review and approval by Resolution.

B. Accountability of the Minister of Finance

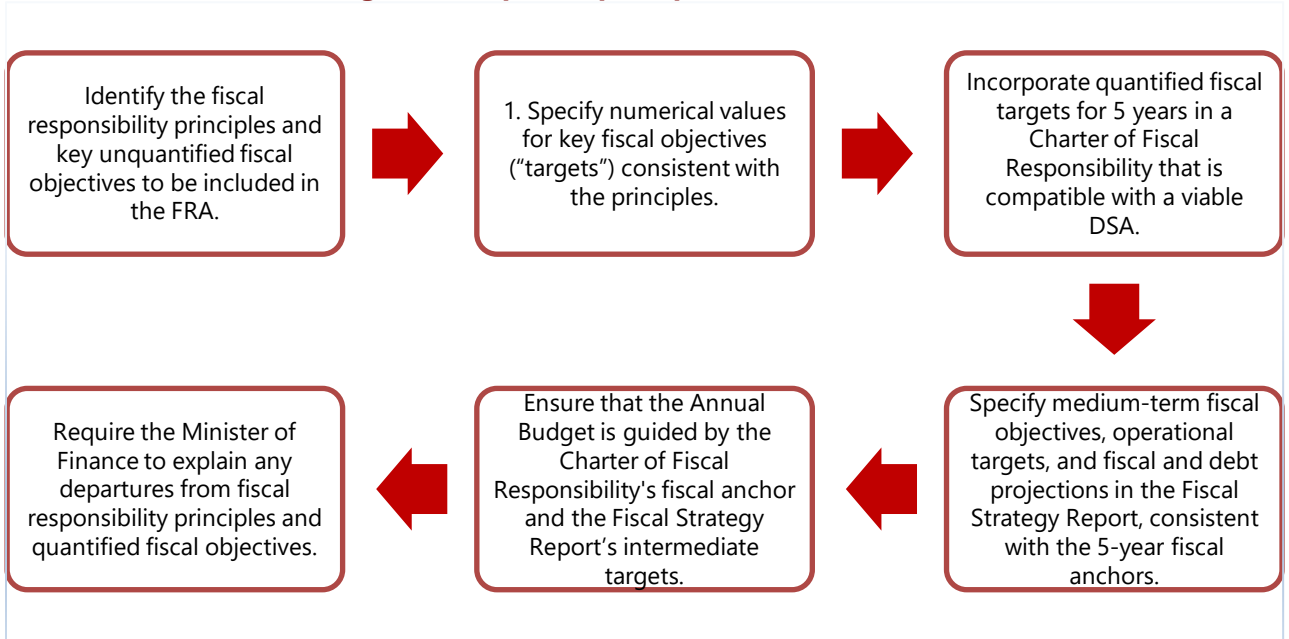
59. The FRA would require the Minister of Finance to be accountable to Parliament for any changes in the key fiscal targets. The FRA would require the Minister to explain any Government decisions to modify the key fiscal targets. In particular, the Minister would, when updating the Charter, explain the following to Parliament: (1) the reasons for deviating from previous fiscal targets; (2) how the new fiscal targets are consistent with the FRA’s principles of fiscal responsibility; and (3) any fiscal policy changes that the Government has taken, or intends to take, to ensure compliance with the new fiscal targets. The Minister would also be accountable for submitting key fiscal documents to Parliament, consistent with the Charter.

60. Escape clause provisions under the principles-based approach would be maintained. There may be exceptional circumstances that require a temporary suspension of moving toward the fiscal anchors. In this regard, the provisions of Article 36 on “Exceptions” are still needed in the FRA. Whereas this clause is broadly satisfactory, since it includes natural disasters and economic downturns as reasons for suspension, it should nevertheless be modified to align more completely with the good practices outlined in Box 1.

C. Specifying the Charter of Fiscal Responsibility

61. Various choices and steps are needed when moving to a principles-based FRA with strong accountability requirements. The key steps are summarized in the next section and in Figure 4:

Figure 4. Steps of a principles-based FRA



Source: IMF Team.

62. Choices are needed as to which principles should be included in the FRA. Table 2 proposes three key fiscal principles and objectives (“key fiscal targets”) and five other principles and objectives. All are examples and should be tailored to the context in Maldives. As discussed, the numerical fiscal objectives would be specified in a Charter of Fiscal Responsibility.

Table 2. Fiscal Principles And Fiscal Objectives: Examples Of Different Documents

To be included in:			
Fiscal Responsibility Act		Charter of Fiscal Responsibility	MTFF document (Fiscal Strategy Report)
Principles	Fiscal Objectives (qualitative)	Quantified Fiscal Objectives (“targets”) (the Charter and Fiscal Strategy Report would specify the chosen values of X)	
1. Prudent debt level	Reduce total public debt as a % of GDP to a sustainable level, with low risk.	Reduce the level of total public debt to x% of GDP by [the 5 th year beyond the current year]. This would be the “debt anchor.”	Intermediate targets for public debt-to-GDP, with a few details on composition of debt: e.g., external/domestic
2. A sustainable budget balance	Achieve and maintain a sustainable budget balance as a % of GDP	Ensure that the overall budget balance (including grants) does not exceed x% of GDP by [the 5 th year beyond the current year].	Year 3 objective for the Primary and Overall Fiscal Balances, total revenues, total primary expenditures, as a % of GDP ¹
3. Manage fiscal risks prudently	Limit fiscal risks arising from government guarantees as a % of GDP	Limit new government guarantees to a maximum of x% of GDP (alternatively: reduce the stock of guarantees to x% of GDP)	

Other principles (examples):			Other indicators
Macroeconomic stability	These could be included in the FRA if it is considered important that they should be.		Volatility of such factors as GDP, tourist arrivals, and inflation
Intergenerational equity			Examples: investment in infrastructure, depletion of resources, and living standards of age-specific cohorts
Low Inequality			Trend in Gini coefficient
Environmental sustainability			Various indicators, such as sea water levels and air/water quality
Value for money in the use public use of resources			Various indicators, for example, from program-based budgets

Source: IMF Team.

¹ The authorities can also consider setting yearly targets in the MTF to provide incentives to formulate a steady path of deficit reduction and avoid concentrating any needed fiscal adjustment on the final year.

63. Once the principles and key fiscal objectives are decided, there is a need to quantify the key fiscal objectives for inclusion in the Charter. The public debt anchor and operational targets would be decided simultaneously and derived from the DSA. Medium-term fiscal anchors would be complemented with short-term operational targets. Medium-term fiscal targets are not fully sufficient to guide fiscal policy choices in the short term, because they are not always under the direct control of policymakers. Short-term operational targets provide direct links with the medium-term targets. Debt-to-GDP, a key fiscal target, can be linked, directly or indirectly, with fiscal aggregates such as the overall balance, the primary balance, total expenditures and total revenues.

64. Operational targets need to be simple to monitor and enforce, yet effective in contributing to meeting the public debt anchor. They must take into account country-specific factors and priorities. Appendix 6 provides guidance on the choice of operational targets.

65. The Fiscal Strategy Report—the MTF document—would include quantified values for the key objectives and could include operational targets. The Fiscal Strategy Report, which covers a three-year period, would be updated once a year under the proposals discussed in section IV. The Charter would specify the operational targets for close monitoring in the Fiscal Strategy Report. All pertinent fiscal aggregates, accompanied by narrative on their expected developments, would be included in the Report presented to Parliament.

66. Countries with principles-based FRAs have different approaches to including these details in the law. Australia and New Zealand include principles and, to varying degrees, the fiscal objectives and other important details in their FRAs (Table 3). In contrast, the United Kingdom’s primary statute requires the government to prepare a Charter of Budget

Responsibility. The Charter, rather than the law, lays out the key fiscal objectives and other narrative for the duration of the Charter. Uganda adopted the United Kingdom’s approach; however, its 2015 Public Finance Act has several fiscal principles and other important details that are elaborated further in a Schedule to the Act (which the Minister can modify).

Table 3. Are Medium-Term Fiscal Principles, Objectives, And Frameworks Included In Law?

	Australia and New Zealand	United Kingdom	Uganda
Are the following included in their FRA-equivalent laws?			
Fiscal principles	Yes	No	Yes
Medium-term fiscal objectives	Yes	No	No
Quantified fiscal objectives	No	No	No
Medium-term fiscal framework			
<ul style="list-style-type: none"> • Content of medium-term fiscal policy strategy 	Yes	No	Yes
<ul style="list-style-type: none"> • Fiscal risk statement 	Yes	No	Yes
<ul style="list-style-type: none"> • Tax expenditures 	Yes	No	Yes
Medium-term debt strategy	Yes	No	Yes
<p><i>Notes:</i></p> <p>1. The content of Australia’s and New Zealand’s laws differ significantly in some areas.</p> <p>2. In Australia and New Zealand, net worth is one fiscal objective, consistent with their accrual-based budgeting systems.</p> <p>Sources: Relevant laws of each country; Charters of Budget Responsibility for Uganda and the United Kingdom.</p>			

67. Targets for public debt and debt guarantees would be established in the proposed Charter of Fiscal Responsibility. Consistent with the discussion in Section II on the coverage of fiscal aggregates, the public debt aggregate should include all Government guarantees. Placing quantitative limits on government guarantees in the Charter would be an important, although incomplete, way of “managing fiscal risks prudently”—the third principle shown in Table 2 (Fiscal risks are discussed in Section IV and Appendix 3).

68. Fiscal principles and key fiscal objectives could be included in the main text of the Act. A schedule²² of the new FRA (or a government regulation) could specify the format of the proposed Charter.

²² In some countries, annexing schedules to an Act is a common legal practice. The Act would authorize the Minister to change the schedule. This may be done by an order subject to the affirmative resolution of Parliament. If the legislative drafting style does not allow a schedule to the Act, the minimum context of the fiscal reports could be included in the government regulation.

D. Recommendations

- Adopt a principles-only FRA to replace the rules-based approach. Quantified key fiscal targets, notably, the debt-to-GDP target for achieving fiscal sustainability, would be specified in government documents, rather than in the FRA.
- Identify the fiscal responsibility principles and key fiscal objectives (see Table 2) and associated operational targets (Appendix 6) to be included in the new FRA.
- Specify three key fiscal objectives in the FRA: a total public debt objective, an overall fiscal deficit objective, and a debt guarantee limit—all of which would be quantified in the proposed Charter of Fiscal Responsibility (for example, for the 5th year) and in the Fiscal Strategy Report (year-by-year for three years) (see Section IV) but not in the FRA itself.
- Consider introducing a requirement in the FRA for the Minister of Finance of an incoming Government to present to Parliament (after approval by the Cabinet of Ministers) a Charter of Fiscal Responsibility that includes numerical values for key fiscal objectives (“targets”).
- Include a compulsory mid-term review of the Charter after two years, in which new key fiscal targets could be adopted for the 5th year beyond the update year.
- Allow, in the FRA, temporary departures from the principles of fiscal responsibility for specific events enumerated in the FRA’s escape clauses.
- Require the Minister of Finance, when updating the Charter, to explain the following to Parliament: (1) the reasons for deviating from previous fiscal targets; (2) how the new fiscal targets are consistent with the FRA’s principles of fiscal responsibility; and (3) any fiscal policy changes designed to attain the new fiscal targets.
- Determine, using a debt sustainability analysis as proposed in Appendix 5, feasible and realistic values of the key fiscal objectives for year five beyond the present fiscal year.
- Strengthen the capacity in the MOF to conduct full-fledged DSAs, using the IMF’s publicly available DSA framework, for inclusion in the yearly Fiscal Strategy Report.

IV. IMPROVING THE REPORTING OF FISCAL POLICY INTENTIONS

69. It is good practice to specify reporting requirements in the FRA, with key reports to be published according to a defined schedule. The schedule should be consistent with the annual budget preparation calendar. Reliable and timely budget execution data are needed to

prevent sizeable revisions. This section discusses forward-looking fiscal strategy documents and ex-post budget reports that would improve fiscal reporting in Maldives.

A. Clarifying the FRA's Requirements for Fiscal and Debt Strategy Reports

70. The 2013 FRA requires the MOF to prepare and submit to the Parliament a statement of fiscal strategy and a report on the national debt strategy. The Act also specifies the strategy's main contents: (1) a description of fiscal policy and the steps being taken by the Government to achieve the fiscal policy; (2) the proposals by the Government on how to reduce the national debt to a sustainable level during the period referred to in the statement; (3) and in cases of deviation, the reasons for the noncompliance and the steps that the Government would take to achieve compliance.

71. In practice, the MOF only started to publish Medium-Term Fiscal Strategy (MTFS) and the Medium-Term Debt Management Strategy (MTDMS) in 2018.²³ The MTFS includes a mid-year update of the economic situation for the current budget year, a review of budget outturns and execution in the first six months of the current budget year, the medium-term projections for economic indicators, and the revenues and expenditures for the next budget year plus two outer years. The MTDMS presents the details of the aggregate outstanding total debt (in nominal terms and as a percentage of GDP) for a three-year period and includes a debt strategy.

72. There have been recent improvements in 2019 and 2020 Fiscal Strategy Reports.

- Estimates of all proposed changes in revenues and expenditures are now incorporated into the fiscal strategy.
- The 2020 Fiscal Strategy includes a section on achieving the targets of the FRA and provides annexes on measures proposed to increase revenue and reduce expenditure in the medium term.
- There is a section with qualitative discussion of potential fiscal risks; however, this information should be further improved by a greater focus on identifying a broader range of risks (rather than only macroeconomic risks) and also on quantifying potential risks.
- The Ministry of Finance also decided in 2020 to annually study the progress made against the fiscal strategy published during the previous year, and it included a chapter on the

²³ The MOF published in 2018 a single report called "Fiscal and Debt Strategy Report" containing both the MTFS and the MTDMS and covering a three-year period. In 2019 and 2020, the MOF published the MTFS and MTDMS separately.

comparison of 2019 Fiscal Strategy and approved 2020 budget for the first time in the 2020 Fiscal Strategy Report.

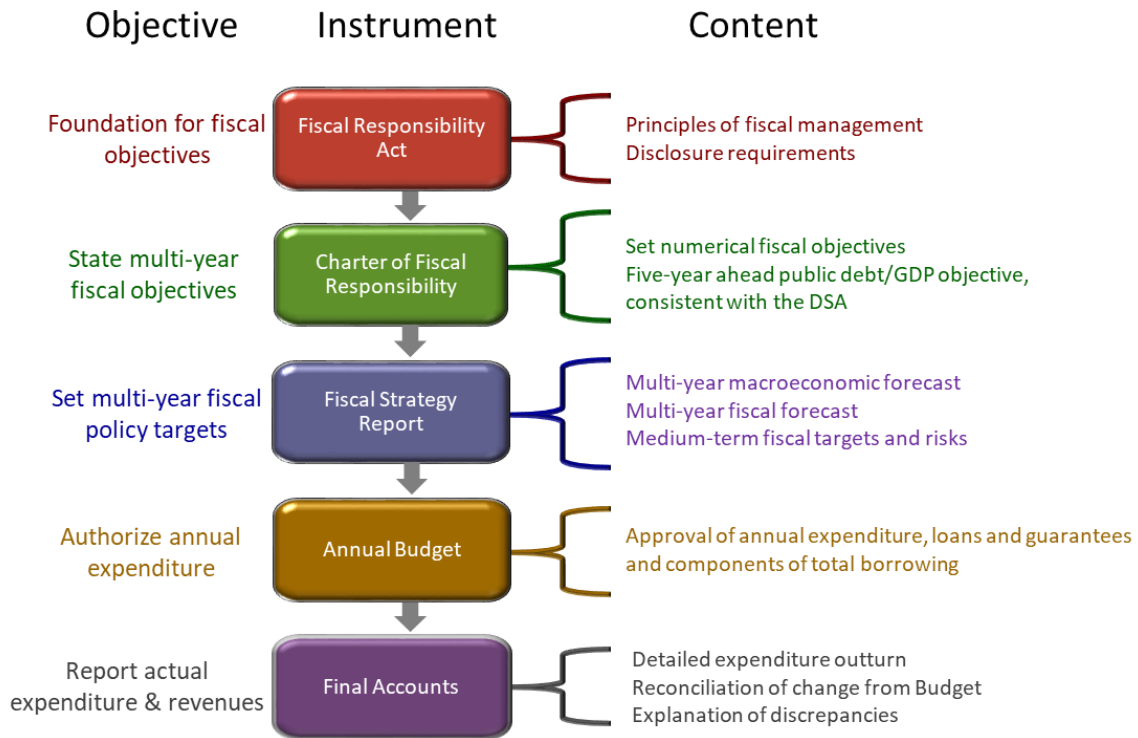
73. The mission endorses the preparation of the fiscal strategy and debt strategy in a single report. Henceforth, this report (and the draft new FRA in Appendix 1) refers to this document as the “Fiscal Strategy Report,” even though it includes the debt strategy provisions.

74. The Fiscal Strategy Report should translate the fiscal objectives into fiscal policy targets for the budget plus two years. The Charter of Fiscal Responsibility (as proposed in Section III) would set numerical values for key fiscal objectives for the five coming years (medium-term debt anchor and operational targets) for close monitoring. As shown in Figure 5, the role of the Fiscal Strategy Report is to translate the objectives from the Charter into three-year fiscal policy targets, which, in turn, are used to guide the annual budget preparation.

75. The revised Fiscal Strategy Report would include a medium-term debt strategy (MTDS). Section 6 of Appendix 2 proposes a “chapter” on a debt management strategy. This subsection would include links among deficit financing (external and domestic), debt projections (details to be decided), and ceilings on debt guarantees (as discussed in section III). The projections outlined in the MTDS would be fully consistent with the DSA, and both documents would be developed hand-in-hand: the MTDS would serve as an input to the DSA and would, in turn, be adjusted to take into account the constraints of a sustainable DSA. If a new Public Debt Act is adopted, this high-level summary of the medium-term debt management strategy could be elaborated further in a separate MTDS document.

76. The Fiscal Strategy Report should be developed in a way that provides multi-year fiscal planning to guide annual budget formulation and to facilitate public scrutiny and accountability. A strategy setting phase should entail the preparation of the Fiscal Strategy Report that sets the aggregate expenditure envelope for the upcoming budget and subsequent years (that is, the two-year expenditure ceilings for both current and capital spending on top of the ceilings in the annual budget). The Report should explain any changes to expenditure estimates between the second year of the last medium-term budget projections and the first year of the current medium-term budget projections at the aggregate level.

Figure 5. Role Of The Fiscal Strategy Report



Source: IMF Team.

77. Compliance with the FRA should not be interpreted as simply publishing the required reports if sufficient context and documentation are not provided. For the Fiscal Strategy Report to play an effective role in the promoting fiscal responsibility, it should be formalized with the following key features:

- Medium-term macroeconomic framework that includes main macroeconomic forecasts and assumptions underlying the projections
- Explanation of the government’s medium-term and annual fiscal and debt strategy and how they are consistent with the fiscal policy objectives contained in the Charter of Fiscal Responsibility and the underlying DSA
- Short- and medium-term fiscal targets and progress in achieving them
- Aggregate expenditure envelopes for the upcoming budget and subsequent year for both current and capital spending that will then inform the expenditure ceilings for the Budget Call Circular
- Yearly updated DSA that is consistent with the targets shown in the Fiscal Strategy Report

- Statement on compliance with the FRA and Charter of Fiscal Responsibility, including fiscal objectives and reporting and accountability requirements
- Performance against the previous year’s fiscal targets and how the targets and projections have changed, if relevant, between updates
- Examination of the fiscal risks to achieving the fiscal and debt targets.

Appendix 2 suggests a detailed outline for a revised Fiscal Strategy Report. A Schedule of the new FRA could specify the minimum format of the Fiscal Strategy Report.²⁴

B. Extending the FRA’s Documentation Requirements

78. Other forward-looking reports could be considered for inclusion as requirements by the FRA (ex-post reports are discussed in Section V).

Fiscal Risk Statement

79. To meet medium-term fiscal objectives, governments must manage fiscal risks and other factors that can cause fiscal outcomes to differ from expectations. Management starts with identifying, monitoring, and disclosing risks, but it also involves mitigating those risks that the government should avoid and developing the ability to absorb them. Some risks are unavoidable, and some are borne by the government’s budget; other risks are shared or borne by other private or public sector entities.

80. The 2021–23 Fiscal Strategy Report already identifies some sources of fiscal risk, but there is further work to be done. There is a section in the latest Fiscal Strategy Report titled “Sensitivity analysis.” It includes a qualitative discussion of the impact of key macroeconomic challenges on fiscal forecasts and a sensitivity analysis of the impacts on debt and required amounts of debt financing, from increases/decreases to revenue and expenditure. However, a key source of fiscal risk in Maldives is from SOEs; they place high demands on the budget but the fiscal oversight of SOEs is weak.²⁵ Other sources of risks include government guarantees, concessions, and other PPPs; other natural disasters; and manmade environmental risks.

81. The government is committed to producing and publishing a Fiscal Risk Statement in 2021. As part of the Public Finance Management Reform Project with the World Bank, with support from the United States Agency for International Development (USAID), the MOF is

²⁴ The legal framework should allow the Minister of Finance to extent the minimum context of the Fiscal Strategy Report. As stated in footnote 26, this could be done through a schedule to the FRA that can be amended by the Minister (and that may be subject to a review by Parliament) or a government regulation.

²⁵ The fiscal risks of SOEs were the topic of a FAD Technical Assistance Mission in January 2020.

developing its technical capacity to identify and quantify key fiscal risks. A Fiscal Risk Statement has been published in May 2021²⁶.

82. The FRA should require that a Fiscal Risk Statement is part of (or an attachment to) the Fiscal Strategy Report. It should be submitted to Parliament as part of the budget documentation in October. Full disclosure of fiscal risks is a key component of international practice for fiscal responsibility legislation.

83. The Fiscal Risk Statement would include assessments of the main macroeconomic risks around the forecasts. One form of macroeconomic risk assessment is to conduct a sensitivity analysis and to publish the rule of thumb estimates of the fiscal impact caused by varying certain key assumptions (such as tourist arrivals and the exchange rate). A more complex approach would be to prepare one or two alternative economic scenarios to illustrate how varying a wider set of macroeconomic factors flows through to the budget (for example, a low GDP growth scenario that requires varying other related assumptions about inflation and the external balance of payments).

84. The identification, monitoring, and mitigation of specific fiscal risks also needs to be developed. Specific risks include all those risks that translate into an explicit or implicit contingent payment for the Government—for example, risks stemming from guarantees, SOEs, PPPs, and natural disasters. In the first instance, this could involve providing broader qualitative explanations of the nature and potential impact of the main fiscal risks to the medium-term fiscal projections.

85. In due course, more explicit disclosures of risk can be made, and provisions for specific fiscal risks can be built into the medium-term estimates. For example, a risk statement might reflect various expenditure pressures, such as the expected cost of SOE restructuring, public sector wage negotiations, provision for the expected annual costs of natural disasters, and possible increases in debt servicing from rising interest rates or the impact of changes in exchange rates on foreign debt, as well as the budget contingency reserve. As the capability is developed, the framework would become more comprehensive. Appendix 3 provides an outline of a Fiscal Risk Statement to illustrate the desired depth of analysis.

86. The FRA should require that the Fiscal Risk Statement also include those risks from local councils and PPPs. As discussed in Section III, the fiscal planning by local councils would not feed into the fiscal aggregates of the Central Government (other than through the transfers provided and already identified). However, with the potential for local councils to access debt markets, there could be an implicit assumption of Central Government guarantees; similarly, the Central Government may be expected to increase transfers to local councils that experience fiscal distress. Accordingly, the MOF should identify, monitor, and manage these risks and should

²⁶ <https://www.finance.gov.mv/public/attachments/Xhw6R8NGDrTiwqBKrqRIBsbp2Mm9aLPPaIZ0I6Fj.pdf>

ensure that they are receiving appropriate financial information from local councils to monitor their fiscal positions.²⁷ Similarly, although PPPs are not numerous in Maldives, they could grow in the future as the government seeks to reduce direct budget financing of infrastructure or other projects and foster private sector participation in infrastructure provision. It would be useful to include risks from local councils and PPPs in the FRA's requirement for fiscal risk statements.

Other Reports

87. The FRA could include a requirement for tax expenditures to be fully disclosed in annual budget documents. The growth of tax expenditures—that is, deviations from established tax norms or benchmarks, intended to provide a benefit for a specific activity or class of taxpayer—can be a source of leakage, as governments or legislatures seek to circumvent institutional constraints on spending. Comprehensive monitoring and control of tax expenditures can protect Government consolidation plans from a major source of fiscal risk. Tax expenditures need to be identified and, as much as possible, quantified and controlled as part of the annual budget process. Since the tax base in Maldives is currently quite narrow, it should be relatively easy to include a listing and quantification of existing tax expenditures in the annual budget.

88. It would be helpful to include a requirement in the FRA to publish the debt sustainability analysis as part of the yearly Fiscal Strategy Report. Doing this would be consistent with the inclusion in the FRA of a total debt anchor in the Charter of Fiscal Responsibility and a requirement for preparing an MTDS as part of the Fiscal Strategy Report. The DSA discussed in Section III would include debt projections over a 10-year period or longer. An updated DSA would also be published every time the targets in the Charter are revised. The DSA could come from IMF surveillance reports for the first years, as the MOF progressively reinforces its capacity to undertake the DSA in-house.

C. Timing and Publication of the Fiscal Strategy Report

89. Under the current 2013 FRA, the Fiscal Strategy Report should be presented annually to the Parliament before the end of July. The Reports of the past three years were submitted to Parliament in June, in compliance with the FRA's end-July deadline.²⁸ However, the July timing in the FRA is late in the budget calendar; the Cabinet of Ministers discusses budget strategy for the following year in May, when baseline budget ceilings are determined (Table 4). The Fiscal Strategy Report needs to be prepared and submitted to the Cabinet before its May discussions to enable the Fiscal Strategy Report to guide the budget process through binding ceilings; it could be submitted to Parliament for discussion by end-June. After a parliamentary

²⁷ This could be done through specifying reporting requirements as part of the financial regulations related to the PF Act.

²⁸ The Medium-Term Fiscal Strategy 2020–22 was submitted to the People's Majlis on July 31, 2019.

committee discusses it to ensure that the medium-term fiscal framework is sound, Parliament could issue a Resolution approving the government’s MTFs.

90. The 2013 FRA requires the publication of the Fiscal Strategy Report by end-July through the Government Gazette. As required in the 2013 FRA, the Report is submitted to the Cabinet, which decides on the publication of the Report before it is sent to the Financial Committee of the Parliament. The Fiscal and Debt Strategy Reports are submitted to the Parliament before end-July, but in practice they are published on the MOF’s website at a much later date.²⁹ In 2020, it was not published until November in conjunction with the budget.

Table 4. Current Budget Calendar

Activity	Planned Date	Responsible Agency
Prepare economic and fiscal outlook	February 1–April 31	Ministry of Finance
Baseline budget: Technical meetings	April 15–May 15	Ministry of Finance
Forecast revenue, establish baseline expenditure, propose a summary budget (Fiscal Strategy)	April 1–30	Ministry of Finance
Recommendation of the Cabinet for the Fiscal Strategy	May 1–31	President’s Office/Cabinet
Determine baseline budget ceilings	May 15–31	Ministry of Finance
Budget Circular 1 (new program proposals)	April 10–June 30	Ministry of Finance
Budget Circular 2 (baseline budget)	June 1–July 15	Ministry of Finance
Evaluate new program proposals and send to Cabinet	July 1–31	Ministry of Finance, Ministry of National Planning and Infrastructure
Cabinet decisions on new program proposals	August 1–15	President’s Office/Cabinet
Compile and evaluate submitted budgets	16 th July–August 31	Ministry of Finance
Recommendation to the Cabinet on the budget	September 1–30	President’s Office/Cabinet/ Ministry of Finance
Submit budget to Parliament	October 15–31	Ministry of Finance
Parliament’s approval of the Budget	November 1–30	Parliament

Source: MOF.

91. The new FRA should specify the publication date of the Fiscal Strategy Report. Since the Fiscal Strategy Report should be approved by the Cabinet before the first budget circular is issued (that is, by end-April), it should be published shortly after and tabled in Parliament by

²⁹ The 2018, 2019, and 2020 Fiscal and Debt Strategy Reports are available on the MOF’s site. The Reports were published in November in 2018 and October in 2019.

end-June. The Fiscal Strategy—and more detailed fiscal projections— should be updated in August-September to reflect the most recent economic and fiscal developments and further new policy decisions by the Cabinet. It then should be resubmitted to Parliament with the budget documentation and published on the MOF website.

D. Recommendations

- Include the following reporting requirements in the FRA:
 - A Fiscal Strategy Report, to be tabled in Parliament by end-June, updated with recent economic and fiscal developments, and resubmitted to Parliament in October with the annual budget documentation
 - The minimum contents for the Fiscal Strategy Report should be stated in a schedule to the FRA (or in a government regulation); it should include the underlying macroeconomic assumptions and DSA,³⁰ a discussion of the fiscal policy actions to be implemented, and the explanations of how the expected medium-term fiscal trajectory would be aligned with the fiscal targets in the Charter of Fiscal Responsibility.
 - Parliament to approve the Fiscal Strategy Report by resolution.
 - A fiscal risk statement, to be submitted to Parliament with the Fiscal Strategy Report and annual budget by end-October.
 - An annual report on tax expenditures, also part of annual budget documentation
 - A debt sustainability analysis in the Fiscal Strategy Report and in updates of the Charter of Fiscal Responsibility.

V. IMPROVING ACCOUNTABILITY AND EX-POST FISCAL REPORTING

A. Importance Of Ex-Post Compliance Reports

92. Although a fiscal strategy report is developed annually, no report is prepared by the government on the progress made against its fiscal strategy. The Auditor General’s annual audit of the government’s financial statements includes an assessment of compliance

³⁰ The DSA that would be required as part of the fiscal strategy report could be a yearly summary update of the DSA’s underlying the targets set in the Charter of Fiscal Responsibility.

under the FRA. However, the interpretation of compliance has been limited to confirming that the documents identified in the FRA have been submitted to the Parliament. There is no assessment of the outcomes against the stated objectives, in part because there is no requirement for the Government to report on performance with respect to the Fiscal Strategy (see Section VI for further discussion of the role of the Auditor General).

93. In order for the government to be accountable for its fiscal policy targets, there should be an ex-post report focused on fiscal policy aggregates, a Final Budget Outcome.

This report should identify and explain any deviations through the budget year from the submitted budget and Fiscal Strategy Report, particularly those that impact the fiscal aggregates and progress in achieving the government's fiscal objectives, as identified in the proposed Charter of Fiscal Responsibility.

94. The FRA could require the Minister to appear before a parliamentary committee to explain the contents of the Final Budget Outcome document,

The final budget outcome report could accompany the unaudited annual financial statements that, under the Public Finance Act 3/2006, should be presented to the Cabinet of Ministers by the Minister within three months after the end of the financial year. After the audit of the financial statements, the Final Budget Outcome report could be published and tabled in Parliament by end-June.

95. The Final Budget Outcome report would provide further information about and context to the annual financial statements.

Appendix 4 outlines the key elements of the Final Budget Outcome report, citing OECD best practices that could be simplified in some cases for Maldives. The Minister would explain any departures from fiscal responsibility principles, any modifications in the Charter (notably, the targets for total public debt and the fiscal deficit) and/or in the Fiscal Strategy Report, and the reason why budget outcomes differ from the approved annual budget forecasts of revenues and expenditures.

96. It is essential that the Final Budget Outcome report is presented on the same basis as the budget.

The budget outcome report and the financial statements are both needed to hold the government accountable for the execution of the approved budget. This task is simpler when budgeting and reporting are presented in the same format. As Maldives prepares to move to program-based budgeting (and eventually to accrual accounting), the Government should ensure that classifications and presentations of budget estimates and actual outcomes remain aligned, that is, the fiscal strategy, budget, and Final Budget Outcome documents should present economic and fiscal information on a consistent basis.

B. Sanctions

97. Sanctions can promote the effectiveness of the FRA by ensuring that the cost of breaking the law is higher than the benefit of adhering to the FRA's requirements.

Sanctions can promote compliance when all levels involved in budget policymaking and budget

execution follow strict procedures. However, sanctions require an effective third-party enforcer. Formal sanctions are generally difficult to implement for FRA-type legislation.

98. Sanctions can be personal, institutional, or reputational.

- *Personal sanctions* can include criminal proceedings for specified alleged breaches, disciplinary procedures that lead to pay reductions or dismissal, and personal liability for financial consequences of specified breaches proved through due process proceedings.³¹ *Institutional sanctions* are typically directed at subnational governments that do not comply with their rules. They can include (1) the suspension of budget payments to other spending authorities until the breach situation is rectified, (2) the denial of rights to borrow or issue guarantees, or (3) the requirement to follow an adjustment program that is automatically triggered by specified breaches of fiscal rules.³²
- *Reputational sanctions* involve the obligation to publicly explain deviations for fiscal rules and to publish the violation in an official journal or on an official website. In Australia, Colombia, and the United Kingdom, for example, the reasons for deviations are published and commented on. Poor performance, not adequately explained, adversely affects the credibility of the Government.

99. The main sanction for countries using fiscal principles in law without fiscal rules are reputational sanctions. These FRAs require that the disclosure of deviations from fiscal responsibility principles and the government’s planned response to be included in reports that are tabled in Parliament and published. The examination of fiscal performance by parliamentary select committees and/or by a fiscal council also adds to the reputational pressure on the government (see section VI).

100. Relying on reputational sanctions would be an appropriate approach in Maldives, provided there is strong oversight. Under the “comply or explain” approach of the new FRA, the Minister would be held accountable for explaining to Parliament and its committees all updates to the fiscal strategy, providing a full explanation of any deviations and any changes in key fiscal targets. This approach depends on fully implementing and publishing the various ex-ante and ex-post budget documents discussed in this report; it also depends on active oversight by parliamentary committees and the Auditor General’s Office on the Minister’s reporting responsibilities. It also requires the Government to address the recommendations from these bodies.

³¹ Brazil is one of the few cases where penalties and sanctions may apply to public officials deemed responsible for noncompliance. Brazil’s sanctions are not embedded in its FRA but in a separate “Fiscal Crimes Law” that includes fines, dismissal, or jail time. In 2016, the President of Brazil was convicted under the Constitution and this law and was removed from office.

³² For example, in Ecuador, the failure of an institution to provide information can result in the denial of access to credit and the suspension of budget grants.

C. Introducing New Reporting Requirements

101. The FRA should also include requirements for other ex-post reporting. It appears that good practices exist for in-year fiscal reporting and for the preparation of annual financial statements. However, challenges remain regarding the classification and additional transactions after statements are sent to the Auditor General. There is also capacity constraint in the AGO regarding timeliness of audits.

- **In-year reporting:** The Research and Publication unit in FAD produces and publishes weekly, monthly, and quarterly fiscal developments reports. These reports provide details on the aggregate revenue and expenditure figures, year-to-date and for the respective time period; they also include corresponding figures of the preceding years for comparison. These reports are prepared as a practice. However, they could be made explicit requirements of the Public Finance Act and cross-referenced in the FRA.
- **Audited annual financial statements.** Articles 38–40 of the Public Finance Act 3/2006 require the MOF to prepare the annual consolidated financial statements and submit them to the AGO within three months (and 14 days) of the end of the year. Some challenges were reported regarding the consistent classification of transactions; the chart of accounts needs updating, and the capacity of line ministries to classify transactions needs improvement.

102. The FRA should mention these reports and cross-reference the corresponding legislation, rather than be their basis. These issues should not be addressed through the FRA. The relevant legal framework exists for in-year reporting of the annual financial statements in the Public Finance Act and the Audit Act, respectively. Therefore, recommendations are not provided to address the challenges identified; however, they should be addressed to improve the quality of fiscal reporting.

103. All ex-ante and ex-post fiscal reports should be published when submitted to Parliament. Sections III, IV, and V of this report have discussed a Charter of Fiscal Responsibility, a Fiscal Strategy Report (twice a year), annual budget documents, and a Final Budget Outcome Report. To enhance fiscal transparency, all fiscal reports prepared by the Government should be published on the MOF website immediately following their approval by the Cabinet of Ministers and President's Office, at the time of submission of the documents to Parliament; a calendar of annual publications could also be included in the FRA (Table 5).

Table 5. Calendar of publication for annual FRA documents

Publication	Suggested annual timing
Preliminary Fiscal Strategy Report	By end-June
Updated Fiscal Strategy Report	By end-October
Annual Budget	By end-October
Fiscal Risk Statement	By end-October
Tax Expenditures Report	By end-October
Final Budget Outcome	By end-June of the subsequent year

Source: IMF team.

D. Recommendations

- Include in the FRA a requirement for a Final Budget Outcome report, to be tabled in Parliament before end-June, which identifies and explains the reasons for any deviations from the revenues and expenditures of the approved budget and Fiscal Strategy Report.
- Include in the FRA cross-references to ex-post reporting requirements for in-year reports and annual financial statements that are outlined in other PFM legislation.
- Include in the FRA a requirement that all fiscal reports described in sections IV and V of this report be published on the MOF website once they are approved by the Cabinet of Ministers, at the time of submission of the documents to Parliament.
- Include in the FRA, a requirement for the Minister to appear before a parliamentary committee to explain the contents of the Final Budget Outcome document, any departures from fiscal responsibility principles, any modifications in the Charter of Fiscal Responsibility (notably, the targets for total public debt and the fiscal deficit) or in the Fiscal Strategy Report, as well as deviations in annual budget outcomes.

VI. ENHANCING FISCAL OVERSIGHT INSTITUTIONS

A. The People’s Majlis And Its Committees

104. The People’s Majlis is de facto the primary fiscal oversight body in the country. The Constitution grants the Parliament unlimited powers to question ministers and members of the

Government. The FRA requires the MOF to prepare and submit a statement of fiscal strategy and a report on debt strategy to the Public Accounts Committee (PAC).³³

105. However, the fiscal oversight role of the Majlis remains hindered by weaknesses in the PFM systems. The lack of a formal Appropriation Act for expenditures, with the Majlis only approving the overall expenditures envelope, has led to substantial intra-year reallocations among spending categories that adversely affect budget credibility. The PAC was not provided with a report on actual spending compared with initial budget spending by ministries and other accountable government agencies (AGAs). However, in 2019, the MOF Gazette included a new Virements and Appropriations Procedure, which was applied beginning with the 2020 budget.

106. It is important that fiscal reporting facilitates accountability. The ex-ante and ex-post reports recommended in this Report should be timely and of good quality to improve the effectiveness of the oversight by Parliament and the public.³⁴ In practice, the Majlis has unlimited power to amend the draft budget, without being guided by any MTF or fiscal responsibility document. The Fiscal and Debt Strategy Report is not submitted early enough to guide the budget process.

107. The Majlis would have a key role to play in promoting compliance with the proposed Charter and Fiscal Strategy Report. The Majlis' role in calling the Minister to account and monitoring deviations from the government's declared medium-term fiscal objectives will be crucial. By asking questions—written or oral—the PAC can request the Minister to elaborate on the reasons for deviations from fiscal targets, as well as on the government's plan to revert to achieving targets within an acceptable timing. Parliament could also use its powers to question other government ministers to justify budget outcomes. The Majlis' role will become particularly important when a performance-based budget system is introduced—as is planned. Questioning and auditing raises the costs associated with noncompliance and promotes higher fiscal transparency.

108. The Peoples' Majlis could discuss the government's Charter and Fiscal Strategy Report in a committee and then approve it by Resolution. This oversight role would require building further capacity within the various committees to discuss the Charter and Fiscal Strategy report and ensure that the subsequent budget discussions do not compromise the attainment of the medium-term fiscal targets.

³³ Although not published before 2018, it was submitted to the Parliament in 2016 and 2017.

³⁴ See "basic," "good," and "advanced" practices for reporting and forecasting under the IMF's Fiscal Transparency Code, <https://www.imf.org/external/np/fad/trans/>.

B. Auditor General's Office

109. The Auditor General has the legal power to conduct compliance and performance audits for all government institutions, as well as the government's compliance with the FRA. The AGO is currently finalizing its Public Debt Audit Report of 2018. The credibility of an external audit requires that the Auditor General and its staff be independent of the government units being audited and to have unrestricted access to required information.

110. The Public Finance Act 3/2006 specifies the procedures for auditing annual financial statements. The main challenge has been to audit the consolidated accounts. There are no audit reports on the annual financial statements for 2016 and 2017. The audit report on the financial statements of 2018 was submitted to Parliament in January 2020. Further, there is no effective system for AGO to monitor and/or follow-up on the implementation of the audit recommendations. The Minister of Finance should be required to respond to the AGO's recommendations in a timely manner.

111. The effectiveness of the AGO is limited by capacity constraints. The office does not have sufficient capacity to conduct audits of all institutions under its broad mandate, which include the government, SOEs, and local councils.

112. The 2013 FRA is unclear with respect to the AGO's role in auditing the reports specified in the FRA. Article 30(d) of the FRA requires *"The Auditor General should prepare a report once he has audited the reports prepared and presented by the Minister under this law."* The FRA does not include any endorsed framework on the tasks to be performed during the audits. Moreover, the FRA does not require the Auditor General to submit its audit reports on FRA compliance to the Public Accounts Committee or to publish them.

113. Going forward, the Auditor General could be assigned specific roles for auditing the government's performance under the new FRA. The proposed Charter will contain a set of fiscal targets. In the new FRA, the Minister of Finance must state the reasons for changes in the key fiscal targets or for the temporary suspension of them when escape clauses are invoked (see Box 1). In the final Budget Outcomes Report, the Minister must explain the reasons why annual budget outcomes differ from initial budget projections. The FRA could require the AGO to audit – report on whether the Minister has complied with the FRA's specific accountability requirements. These audits would be published and submitted to Parliament in a systematic way.

C. An Independent Fiscal Institution?

114. To improve compliance with the fiscal responsibility framework, an increasing number of countries has established an Independent Fiscal Institution (IFI). Since this report proposes greater flexibility for the Government in its fiscal management, it is important to also enhance the role of fiscal oversight agencies to monitor and audit whether the Minister of Finance has complied with the FRA's specific requirements. There are three main types of IFIs

that are becoming increasingly popular around the world. These are an independent standalone fiscal council, a parliamentary budget office (PBO), or an autonomous fiscal agency under the executive (Box 2).

Box 2. Institutional Models of IFIs

The mandates, functions, and sizes of IFIs vary widely across countries, as do their leadership structures and institutional arrangements. In all models, independence—the freedom to make assessments and publish the analytical reports without political interference—is essential and embedded in legislation.

- a) **Standalone fiscal councils.** The council can be a small decision-making body, staffed especially by academics; alternatively, it can be a larger council with members nominated by differing interest groups. Country examples include France, Ireland, Portugal, and Sweden.
- b) **PBOs.** These independent “offices” are an integral part of Parliament, serving the budget-related committees in particular. In several countries, their mandate includes costing specific fiscal policies. Country examples include Australia, Canada, Korea, Philippines (although not exclusively budget oriented), Uganda, and the United States.
- c) **Autonomous fiscal agencies under the executive.** These have a well-defined mandate, including preparing the government baseline MTFE projections, and they have strict guarantees of their independence. Country examples include Belgium, the Netherlands, and the United Kingdom.

Sources: Beetsma and others 2018; Debrun, Gerard, and Harris 2016; IMF 2013; Stapenhurst and others 2008; von Trapp and others 2015.

115. In Maldives, there are currently two fiscal oversight bodies: Parliament and the AGO. An IFI could complement, rather than substitute for, these two oversight bodies. An IFI’s mandate could be limited to reviewing and assessing the government’s macroeconomic and fiscal forecasts under the Charter and the three-year rolling Fiscal Strategy document, and to assessing compliance with the government’s medium-term fiscal targets.

116. There are three main options relating to independent oversight of the budget:

- Establish immediately a small fiscal council or PBO. Its remit could be limited to a few key assessment functions. Its narrow mandate and its independence could be annexed to the new FRA; Ireland and Portugal provide two examples of countries that follow this approach.
- Enhance fiscal oversight bodies by strengthening Parliament and the AGO. For example, more staff could be provided to the AGO or Parliament, and an independent research office could be established under Parliament with functions wider than budget policy analysis.
- Both of the above.

117. Given Maldives’ small size, limited capacity, and challenges of finding independent staff, the establishment of an IFI in the near future may not be the highest priority. The mission considers that, at this stage of economic development—and also for budgetary reasons—it would be preferable to strengthen current institutions. Parliament and the AGO could focus on assessing the ex-ante and ex-post reports. New follow-up mechanisms and improved technical capacity are needed. The FRA could require the MOF to report annually on how the government has implemented the budget-related recommendations of parliamentary committees and the AGO.

D. Recommendations

- Require in the FRA the Peoples’ Majlis to discuss the government’s Charter and Fiscal Strategy report and approve it by Resolution.
- Gradually enhance the analytical, technical, and staffing capacity of parliamentary committees and the Auditor General’s Office to enable them to assess the government’s medium-term fiscal strategy and annual budget outcomes, and to hold the government to account.
- Include in the FRA a requirement for the AGO to audit whether the Minister of Finance has complied with the FRA’s specific accountability requirements.
- Require in the FRA the Minister of Finance to report annually to Parliament on the actions taken by the government to implement the budget-related recommendations of parliamentary committees and of the Auditor General.
- Consider whether the establishment of an independent fiscal institution would be unrealistic at the present, given the more urgent need to enhance the analytical capacity in the MOF, the AGO, and Parliament.

VII. FRA FOR MALDIVES: OTHER ISSUES

A. Integrating the New FRA Into the Ongoing PFM Legal Reform Agenda

118. Given that the FRA is a limited-scope law, other laws should include provisions outside the scope of the FRA. The FRA is focused on fiscal transparency and the accountability of the Minister and the government to Parliament for the submission of the fiscal strategy and outcome reports, as well as for fiscal performance, especially with respect to attaining the objectives for public debt and fiscal balances. The FRA is part of the wider PFM legal framework, for which the Public Finance Act 2006 and its accompanying financial regulations provide

coverage, including for annual budget preparation, execution, and reporting. Many countries have not adopted an FRA; instead, their PFM Acts cover fiscal responsibility issues.³⁵

119. Several initiatives are underway to introduce new Acts or amend existing ones. The mission is aware of the following proposals, which are at varying stages of development:

- Amendments to the 2006 Public Finance Act, which would subsequently require modifying the government's financial regulations
- A draft public debt law
- A national planning act

120. Coherency in the PFM legal reform agenda is needed. A credible fiscal responsibility framework requires a clear and robust legal framework that ensures consistency within the entire framework, including the Constitution and other PFM-related laws. Harmonization of PFM laws (especially the Public Finance Law, the Decentralization Law, the FRA, and the Debt Law) is needed to reduce the risk of inconsistencies within Maldives' fragmented PFM legal framework.

121. Since amendments to the 2006 Public Finance Act are being discussed, this report has not addressed several important PFM issues. The success of the FRA is partly dependent on having a well-functioning budget and PFM system that are clearly defined in law and regulations. The mission has identified several areas of PFM that would be better addressed in the Public Finance Act; in some cases, details would be elaborated in the financial regulations or MOF Circulars. These include the following:

- Parliament's budget amendment rights. Some countries' PFM laws restrain Parliament from making amendments to annual budget revenues (for example, preventing Parliament from increasing revenue estimates to finance more expenditures) or to total expenditures (for example, allowing Parliament to change the composition of spending but not to change the total expenditure).³⁶ In this context, the Public Finance Act could specify Parliament's role in approving multiannual, top-down expenditure ceilings.
- Structure of annual budget appropriations of expenditures. Most PFM laws specify the structure of annual spending within each ministry and accountable government agencies (in the "administrative classification"). For each ministry or agency, Parliament may approve the annual budget expenditure by economic classification, for example, current (salary and non-salary) expending and capital spending on projects. Currently, there is a legal void in this

³⁵ New Zealand's 1994 FRA, which has provided a model for other countries' FRAs, no longer exists as a stand-alone law. In 2004, it was integrated into New Zealand's PFM Act.

³⁶ For some country examples, see the Box 1 in Lienert and others (2010).

area; the MOF's Virement and Appropriation framework needs to be incorporated in the Public Finance Act.

- Performance Budgeting. The SAP states that "it is the Government's aim to shift towards full-fledged results-based budgeting or program budgeting during this term" (2019–23). If this aim is to be realized successfully, the appropriation structure of expenditure will need to change by "program," rather than by economic classification. The Public Finance Act would also need to elaborate on performance reporting to Parliament and the responsibilities of budget program managers.
- Virement rules. If the government proposes an annual program-based budget to Parliament, the Virements and Appropriations Procedure Gazette published by the MOF in May 2019 would need to be revised. Also, the Public Finance Act is the appropriate legal instrument for specifying the restrictions on the government's powers to swap between types of expenditure within programs and, possibly, between programs, without parliamentary approval.
- Duration of appropriations and carryover provisions. Articles of the Public Finance Act allow invoices to be paid up to 30 days after the end of the financial year. To accelerate the closing of annual accounts and meeting the Act's timetable for presenting audited financial statements to Parliament, this carryover requirement should be shortened. However, the Public Finance Act does not appear to allow for multi-annual budget appropriations for capital expenditures.
- Reversionary budgets. PFM laws typically specify how the government would execute the annual budget of a new fiscal year in the event that Parliament does not approve it by December 31.
- Cash management. Parliament's focus in the FRA should be on the medium-term and annual budget strategy. The in-year disbursement plans of the annual budget and the in-year revisions to the cash plans are matters for the Public Finance Act and, especially, the financial regulations. In this context, the FRA is not the appropriate law for elaborating any provisions on cash flow planning. Chapter 8 of the FRA on cash flow plans being presented to the Minister of Finance could be transferred elsewhere.
- Advances from the central bank. Article 32(a) of the 2013 FRA has proven useful as a way of restricting government borrowing from the Maldives Monetary Authority. However, this restriction is not a macro-fiscal indicator to be retained in the FRA. It could be transferred to the Public Finance Act.
- Accrual accounting. PFM laws do not extensively specify the details of government accounting arrangements, which are embodied in the Generally Accepting Accounting Principles (GAAP) of a country, with the chart of accounts aligned to the accounting system.

In Maldives, the Public Finance Regulation refers to the International Public Sector Accounting Standards (IPSAS) basis.³⁷ However, the Public Finance Act may lay out a few provisions relating to GAAP and also institutional arrangements for establishing government accounting standards (some countries have independent boards outside of the MOF). In view of the planned transition to accrual accounting in Maldives, the legislative basis of the accounting system needs to be established.

122. A draft public debt law is under review. A public debt law provides the legal basis for all aspects of debt management. A debt law can lay out: (1) a requirement for a medium-term debt strategy, possibly with numerical limits on different categories of debt, and a DSA; and (2) specific debt management issues, such as for developing external and domestic debt markets, or for laying out the functions of a debt management office. Several external partners are providing technical assistance in these areas, and a well-advanced draft Public Debt Law is under review.

123. The strategic issues of the draft public debt law overlap significantly with the FRA. In particular, the FRA requires the Minister to prepare a medium-term fiscal and debt strategy. Also, besides numerical limits on national debt, Chapter 7 of the 2013 FRA contains provisions pertaining to local council debt.

124. The medium-term fiscal strategy, the medium-term debt strategy, and fiscal and debt targets are intimately linked. Realistic, non-arbitrary debt targets cannot be established in isolation of a feasible medium-term fiscal strategy, since deficit financing—new net borrowing—feeds directly into the stock of outstanding public debt. For this reason, the FRA should continue to be the primary law for the establishment of debt limits and medium-term debt developments of key debt aggregates (total debt, Central Government debt, guaranteed debt, and local council debt). A Public Debt Law could elaborate the details specific to operational debt management and institutional arrangements, and it could outline the requirements for a detailed medium-term debt strategy to complement those included in the Fiscal Strategy Report (see especially chapter 6 of Appendix 2).

125. Ideally, the Public Finance Act amendments, the new FRA, and the Public Debt law would be adopted by Parliament simultaneously. Doing this would facilitate full consistency among all three laws. However, since the FRA is a standalone piece of legislation, it could be adopted in 2021 in advance of the other bills. Alternatively, the FRA and Public Debt bills could be presented to Parliament and adopted in the same parliamentary session.

126. This report assumes that the FRA will be adopted in the first parliamentary session of 2021. The medium-term debt strategy provisions of the draft FRA presented in Appendix 1 are considered adequate to ensure consistency with the nondebt provisions of the medium-term

³⁷ Public Finance Regulation Chapter 15.3 states that “Public Financial Statements shall be prepared in accordance with ‘International Public Sector Accounting Standards: Financial Reporting under the Cash Basis of Accounting’ published by the International Federation of Accountants.”

fiscal strategy. This implies that the other laws, especially the new Public Debt law, would either have to fit in to the FRA's provisions or that certain provisions of the FRA would need to be amended or repealed when the Public Debt law is adopted.

127. The adoption of the FRA may have implications for other existing laws. New reporting requirements for the Auditor General's Office in the FRA will need to be consistent with the Audit Act of 2007. Any new provisions for local councils fiscal and debt management need to be consistent with the Decentralization Act and the proposed Public Debt Act.

128. Finally, if five-year planning is institutionalized, a new National Planning law may be needed. Although the eventual enactment of a National Planning Act is mentioned in the government's SAP, this would need to be preceded by substantive discussion on the integration of five-year Strategic Action Plans, which mainly lists possible projects in 33 subsectors, with the Medium-Term Fiscal and Debt Strategies discussed in this report.

B. Transitional Issues

129. Given the uncertainty of the macroeconomic and fiscal outlook in 2021, it may be judicious to delay implementing some provisions of the FRA. The default option should be to implement all of the provisions of the new FRA soon after its adoption by Parliament and publication in the Gazette. However, should the authorities judge it to be necessary, the proposals relating to the Charter of Fiscal Responsibility could wait until the next incoming government. This would allow time to discuss how the timing of the introduction of the proposed Charter would best fit with the timing of presidential elections and the formation of a new government. In the interim, the fifth year of the DSA, updated annually as part of the IMF's Article IV surveillance, could provide the "debt anchor" and overall fiscal balance targets until 2023.

130. Implementation of some specific proposals of this report could be delayed. Examples include: (1) the inclusion, in fiscal aggregates, of specific Central Government institutional units that are currently off-budget; (2) the inclusion of the Pension Fund in fiscal and debt aggregates; (3) the fiscal risks report; and (4) a report on tax expenditures. All of these will take some time to prepare, given the capacity constraints in the MOF. The MOF is best placed to make a judgment on these and other issues. For (3) and (4), however, this report advocates the immediate preparation of the reports, even if incomplete, rather than waiting for full reporting capacity.

C. Recommendations

- Ensure consistency in the PFM legal reform agenda and consider the merits of adopting the FRA and the Public Debt Act in the same parliamentary session in 2021.

- Note that this report assumes the early adoption of the FRA in 2021, in a advance of the adoption of a new Public Debt Act.
- Consider the areas where changes are needed in the Public Finance Act and financial regulations, in line with the preceding discussion (on budget amendment rights, budget appropriations, program performance reporting, virement, budget carryover, cash management, and accrual accounting), and make appropriate draft amendment proposals for Parliament’s consideration (Public Finance Act) or the Cabinet of Ministers (financial regulations).
- Remove all cash flow planning provisions (chapter 8) from the FRA, and transfer relevant provisions to the Public Finance Act or to the financial regulations.
- Consider transferring Article 32(a) of the 2013 FRA—restrictions on advances to the Government from the MMA—to the Public Finance Act.
- Consider which provisions of the draft FRA need to be delayed in the present uncertain macro-fiscal circumstance, and draft appropriate transitional issues in the FRA.

Annex I. A Draft New FRA Proposal

Draft

Law No.

xx/2021

Fiscal Responsibility Act

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[FOR INFORMATION ONLY]

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**Law No.
xx/2021
Fiscal Responsibility Act**

This Act aims to achieve and maintain fiscal discipline, transparency, and accountability by:

- (1) specifying the principles, objectives, and procedures of responsible fiscal management;
- (2) establishing the requirements for formulating, adopting, and reporting the Government's medium-term fiscal strategy, including for public debt; and
- (3) facilitating parliamentary scrutiny by requiring the Minister of Finance to report and justify fiscal and public debt outcomes.

Chapter 1: Title, Scope, and Definitions

Title

1. This law will be named "Fiscal Responsibility Act."

Scope

2. The provisions of this Act apply to all ministries, agencies, and other entities of the Central Government. For the purposes of this Act, the Central Government includes:
 - (a) The Executive and all its ministries/agencies/entities, including autonomous agencies and funds established by law and under government control, with the exception of the Maldives Monetary Authority;
 - (b) The Legislature, the Peoples' Majlis, and its agencies/entities;
 - (c) The Judiciary and its agencies/entities;
 - (d) Independent agencies/entities/funds/commissions established under the Constitution of Maldives and relevant laws, and which are under the control of Central Government.

In addition, the entities referred to in (e), (f) and (g) below are governed by the provisions of this Act when stipulated in specific provisions of the Act.

- (e) Local councils and agencies/entities under the jurisdiction of local councils now or to be established in the future;

- (f) State-owned enterprises;
- (g) Any other legal person or entity that receives or uses public funds.

Definitions

3. The definitions below aim to achieve the objectives of the law to the greatest extent. The following words and phrases will be given the following meanings.

- (a) "Cabinet of Ministers" refers to the collective body of Ministers appointed by the President of Maldives, in accordance with the Constitution.
- (b) "Minister" refers to the Minister appointed by the President to develop and implement the Government's Fiscal Policy.
- (c) "The Government," when referring to a decision-making body, refers to the Executive branch, of which the President of Maldives is the Head, in accordance with the Constitution.
- (d) "Local Council" means the City Councils, Island Councils, and Atoll Councils established under Law 7/2010 (Decentralization Act).
- (e) "State-owned enterprise" (SOE) refers to a commercial nonfinancial or financial enterprise established by law, in which the Government has controlling shares, which produces goods or services for the market, and which finances its operations largely on the basis of its own revenues. "Controlling shares" means the ability to exercise powers to govern the financial and operating policies of the entity in order to obtain maximum benefits from its activities.
- (f) "Fiscal policy" refers to the policies pertaining to revenues, expenditures, public debt, and other elements of the Government's medium-term fiscal strategy and annual budget.
- (g) "Fiscal strategy" refers to the fiscal objectives and activities to be undertaken to implement a fiscal policy in the medium term, as well as the approach to be taken to implement fiscal activities.
- (h) "Medium term" refers to a period of three, four, or five consecutive years.

- (i) "Financial year" refers to the period from January 1 to December 31, including the start date and end date.
- (j) "Public debt" refers to the gross debt of the Central Government, as defined in Clause 2 of this Act, and shall include bills, bonds, loans, advances, and overdrafts, denominated in domestic or foreign currency and owed to residents or nonresidents, as well as Central Government guarantees, including all guaranteed debt of local councils, SOEs, and private entities.
- (k) "Overall fiscal balance" refers to the balance after deducting total budget and nonbudget Central Government expenditures from total budget and nonbudget Central Government revenues, including grants.
- (l) "Grants" refers to transfers made in cash, goods, or services for which no repayment is required.
- (m) "Intergenerational equity" refers to the use of national resources in a sustainable manner, keeping in mind the interests of future generations.
- (n) "Fiscal risks" refer to the possibility of deviations of fiscal outcomes from what was expected at the time that the budget and other fiscal forecasts were approved.
- (o) "Tax expenditure" refers to a reduction in a tax liability compared with an established tax norm or benchmark. The revenue forgone from tax expenditures has the same impact on the overall fiscal balance as an increase in expenditure of the same amount.
- (p) "Contingency spending provision" refers to a small reserve of unallocated expenditure in the annual budget that the Government may be authorized to spend on unforeseen contingencies that arise during budget execution.

Chapter 2

Principles of Fiscal Policy and a Charter of Fiscal Responsibility

Principles of Fiscal Policy

2.1. When setting fiscal policy objectives within the medium-term macroeconomic and fiscal framework, the Cabinet of Ministers shall seek to adhere to the following key principles:

- (a) achievement and maintenance of public debt at a sustainable level, with low risks;
- (b) maintenance of the overall fiscal balance at a prudent level over the medium term;
- (c) management of fiscal risks in a prudent manner.

In addition to the above three principles, when formulating fiscal policies, the Cabinet of Ministers may also consider the following three principles:

- (d) adequate revenue mobilization to contribute to the financing of Government expenditure programs and investment projects;
- (e) value for money in government expenditure;
- (f) intergenerational equity
- (g) environmental sustainability.

Measurable Fiscal Policy Objectives

2.2. The Minister shall set measurable fiscal policy objectives for the principles listed in subsection (1) (a) to (c) in a [Charter for Fiscal Responsibility].¹

Approval of the Charter of Fiscal Responsibility

2.3. Following a general election of the People's Majlis, the Minister shall prepare a draft Charter of Responsibility.

(a) The Charter of Responsibility is a government document for which the Government is accountable to the Peoples' Majlis for reporting on its implementation.

(b) The Cabinet of Ministers shall approve the Charter of Fiscal Responsibility.

(c) The Minister shall, no later than [three] months after the beginning of the first session of the People's Majlis after the presidential elections, submit a Charter of Fiscal Responsibility to the People's Majlis for parliamentary review and approval by issuing a Resolution.

¹ The authorities may consider using a different name for "Charter of Fiscal Responsibility", which would better fit with historical background, as well as legal institutional framework.

Contents of the Charter of Fiscal Responsibility

2.4 The Charter shall provide:

- (a) a statement indicating the measurable objectives for fiscal policy that are consistent with the principles set out in clause 2.1;
- (b) the measurable fiscal objectives, known as “targets,” during a period not less than the new five-year term of the Government;
- (c) an explanation of the methodology and data to be used to measure the performance of the Government against the fiscal policy targets required in subsection (b);
- (d) a demonstration—using macroeconomic and fiscal data, assumptions, and projections—of how the fiscal targets set out under subsection (b) are consistent with the principles set out in clause 2.1.
- (e) The Charter of Fiscal Responsibility shall include the minimum context provided in [Schedule 1].

Cabinet to Adhere to the Principles of Fiscal Policy

2.5. The Cabinet of Ministers shall, in making any policy decisions with implications on public finances, adhere to Principles of Fiscal Policy referred in Clause 2.1, the Charter of Fiscal Responsibility, and other requirements of this Act.

Publication of the Charter of Fiscal Responsibility

2.6. The Minister shall publish the Charter of Fiscal Responsibility at the time the Charter is submitted to the People’s Majlis.

Updates of the Charter of Fiscal Responsibility

2.7. (a) The Minister shall, using the principles of fiscal responsibility, review the Charter of Fiscal Responsibility two years after the Government adopts the initial Charter of its five-year term. This review may lead to a modification of the fiscal targets referred to in clause 2.2.

(b) At other times, the Minister may temporarily depart from the principles of fiscal responsibility and modify the fiscal targets in the Charter of Fiscal Responsibility, but only when Maldives experiences:

- (i) a natural disaster,
- (ii) an unanticipated severe economic shock, or
- (iii) another significant unforeseen event that cannot be funded from the unallocated contingency spending provision of the annual budget or by fiscal policy adjustments.

(c) In either of the two cases specified in subsections (a) and (b), the revised Charter shall indicate:

- (i) The reasons for the revisions to the fiscal targets set out in clause 2.2 of this Act;
- (ii) The approach the Government intends to take to ensure that its policy intentions regarding its new fiscal targets are consistent with the principles specified in clause 2.1; and
- (iii) The period of time that is expected to elapse before the Government's intentions regarding the fiscal targets specified in clause 2.2 become consistent with the principles and objectives specified in clauses 2.1 and 2.2.

(d) The Minister shall, no later than one week after the Cabinet of Ministers approves a revised Charter of Fiscal Responsibility, submit the Charter of Fiscal Responsibility to the People's Majlis for parliamentary review and adoption by Resolution.

(e) Should the Cabinet of Ministers modify the Charter of Fiscal Responsibility following the review by the Peoples' Majlis, the Minister shall publish the updated Charter of Fiscal Responsibility within one week following the issuance of the Resolution of the Peoples' Majlis.

(f) Each time the Charter is updated, the Minister shall provide, in writing, a statement of compliance with the requirements of subsection (c).

Chapter 3

Fiscal Strategy Report

Fiscal Strategy Report

3.1. (a) A Fiscal Strategy Report shall be approved by the Cabinet of Ministers prior to the preparation of the Government's draft detailed annual budget of revenues and expenditures.

(b) The Fiscal Strategy Report shall be submitted to the People's Majlis within one week of approval by the Cabinet of Ministers and no later than June 30 of each year.

(c) The Fiscal Strategy Report shall be published when it is submitted to the People's Majlis before end-June.

(d) The Peoples' Majlis shall approve the Fiscal Strategy Report by issuing a Resolution.

Purpose of the Fiscal Strategy Report

3.2. The purpose of the Fiscal Strategy Report is to:

(a) elaborate on how, over the forthcoming three-year period, the Government intends to achieve the key fiscal targets laid out in its Charter of Fiscal Responsibility mentioned in Clauses 2.2 and 2.4 of this Act.

(b) act as a prebudget document, by providing to the Peoples' Majlis and the public a statement of the Government's fiscal policy orientations several months prior to the submission of the detailed annual budget of revenues and expenditures to the Peoples' Majlis.

Format of the Fiscal Strategy Report

3.3. The Government's medium-term Fiscal Strategy shall include the minimum context provided in [Schedule 2].

Information to be included in the Fiscal Strategy Report

3.4 The following information to be included in the Fiscal Strategy Report mentioned in Clause 3.1 of this law.

- (a) The key fiscal policy targets of the Charter of Fiscal Responsibility and the Government's view on fiscal policy orientations to achieve its key fiscal targets over the upcoming three-year period.
- (b) Policy orientations would include those relating to:
 - (i) new revenue policies or changes in existing revenue policies;
 - (ii) priorities for current spending and investment project spending
 - (iii) priorities for managing public debt, including debt guarantees.
- (c) Medium-term macroeconomic, fiscal, and debt projections, and operational targets, as laid out in Schedule 2, sections (2) to (4).
- (d) Compliance with the Charter for Fiscal Responsibility, as laid out in Schedule 2, section (9). The Minister shall demonstrate how the fiscal and debt projections of the Fiscal Strategy Report are consistent with the objectives and targets set out in the Charter of Fiscal Responsibility.

Update of the Fiscal Strategy Report

3.5. (a) The Minister shall update, once a year, the Fiscal Strategy Report mentioned in Clause 3.1 of this law.

(b) The updated Fiscal Strategy Report referred to in subsection (a) shall, after approval by the Cabinet of Ministers, be submitted to the People's Majlis to complement the annual budget that the Minister submits to the Peoples' Majlis, in conformity with the provisions of Clause 32 of the Public Finance Act 3/2006, as amended.

Information to be Included in the Updated Fiscal Strategy Report

3.6 In addition to the information to be included in the Fiscal Strategy Report as mentioned in Clause 3.4 of this law, the following information shall be included in the updated Fiscal Strategy Report submitted to the Peoples' Majlis before end-

October of each year:

- (a) The timing and impact of new revenue and expenditure policies taken by the Government to achieve the key fiscal policy objectives, as laid out in the Charter of Fiscal Responsibility and in Schedule 2, section (5).
- (b) Information relating to:
 - (i) Fiscal risks as laid out in section (6) of the Schedule 2, and Schedule 3.
 - (ii) Tax expenditures as laid out in section (7) of the Schedule 2.
- (c) Explanations of the impact on the fiscal projections due to any changes in historical data, including coverage and accounting policies.

Chapter 4

Annual Budget and Fiscal Strategy Report

Consistency of Annual Budget and Fiscal strategy

4.1 The Minister shall, unless otherwise permitted by this Act, ensure that the annual budget presented to Parliament:

- (a) is consistent with fiscal targets of the Fiscal Strategy Report formulated according to Chapter 3 of this Act, notably, the overall fiscal balance target, as well as the operational fiscal targets referred to in Schedule 2 of this Act;
- (b) contains a total expenditure ceiling, a gross borrowing limit for Government, and a guarantee limit for the next financial year, consistent with the fiscal targets of the Charter of Fiscal Responsibility and the operational targets of the Fiscal Strategy Report, as laid out in Schedule 2 of the Act.

Chapter 5

Final Budget Outcomes Report

Approval of a Final Budget Outcomes report

5.1. (a) The Minister shall present a Final Budget Outcomes report to the Cabinet of

Ministers within three months after the end of the financial year.

- (b) The Cabinet of Ministers shall approve the report within 14 days.
- (c) The Minister shall submit the Final Budget Outcomes to the Auditor General within three months and 14 days after the end of the financial year, consistent with the timing of the submission of annual financial statements to the Auditor General, as laid out in Clause 38 (c) of the Public Finance Act 3/2006.

Content of the Final Budget Outcomes Report

5.2. The report referred to section 5.1 shall:

- (a) identify and explain the main differences between the actual outcomes for revenues and expenditures, as compared with those contained in the annual budget adopted by the Peoples' Majlis for the same financial year;
- (b) show separately any in-year adjustments to the original budget;
- (c) provide comparative information on the revenues and expenditures of the preceding year;
- (d) use the same presentation format as that of the annual budget.

In addition, the report referred to section 5.1 shall:

- (e) contain a comprehensive discussion of public debt and its components;
- (f) identify and explain the main differences between the actual outcomes for Government borrowing, total public debt, guaranteed debt, and other contingent liabilities, using the same level of detail as contained in the updated Fiscal Strategy Report that accompanied the annual budget approved by the Peoples' Majlis in the previous financial year.
- (g) explain how any data revisions or changes in accounting practices or standards have impacted the reported fiscal outcomes.
- (h) explain the main differences between the projected financial assets and the actual outcomes, once accrual-based accounting replaces cash-based accounting.

(i) include comparative information for any nonfinancial performance data, once a performance-oriented budget is formally adopted.

Submission of the Final Budget Outcomes report to Parliament and Publication

5.3. The Minister shall:

- (a) table the Final Budget Outcomes report in the Peoples' Majlis at its session that begins after the Minister has submitted the report to the Auditor General, according to Clause 5.1(c) of this Act.
- (b) publish the Final Budget Outcomes report before the end of June of each year.

Chapter 6

Responsibilities of the Auditor General and Minister

Auditor General to Report on Compliance

6.1 In addition to the Auditor General's responsibilities to audit the Government's annual financial statements, in accordance with Clause 39 of the Public Finance Act 3/2006, the Auditor General shall prepare an annual report on the Government's compliance with this Act.

Auditor General's Compliance Responsibilities

6.2 The Auditor General's compliance report referred to in clause 6.2 shall relate to the Minister's responsibilities concerning:

- (a) the Charter of Fiscal Responsibility, notably, the procedures outlined in chapter 2 of this Act relating to its content, submission to the Peoples' Majlis, publication, updates, and use of escape clauses;
- (b) the Fiscal Strategy Report, notably, the procedures outlined in chapter 3 of this Act relating to its content, compliance with key fiscal targets, submission to the Peoples' Majlis, and publication;
- (c) Local councils, notably, the procedures outlined in chapter 8 of this Act relating to

establishing local councils' debt limits;

(d) the Final Budget Outcomes report, notably, the procedures outlined in chapter 5 of this Act relating to its content, explanations of deviations of outcomes from annual budget estimates, publication, and submission to the Peoples' Majlis.

Minister's Follow-up of Auditor General's Report to Parliament

6.3. (a) The Minister shall submit a report to the Peoples' Majlis following its consideration of the report of the Auditor General submitted to the Peoples' Majlis in accordance with Clause 40 of the Public Finance Act 3/2006.

(b) The Minister's report shall indicate measures taken by the Government to implement the recommendations of the Public Accounts Committee of Parliament with respect to the report of the Auditor General of the preceding financial year.

(c) The report referred to in subsections (a) and (b) shall, at the latest, be submitted to the Peoples' Majlis at the same time as the final Budget Outcomes report of the following year is tabled before the People's' Majlis, as laid out in clause 5.3 of this Act.

Chapter 7

Responsibilities of the Peoples' Majlis

7. 1. The People's Majlis, in fulfilling the roles and responsibilities set out in the Constitution, shall hold the Government accountable for fiscal policy and performance in accordance with the requirements of this Act, including by;

(a) reviewing the reports referred to in this Act through the Committee of Public Accounts and other relevant committees; and

(b) considering the recommendations of the Committee of Public Accounts and other relevant committees, and of the Auditor General, in discussing the reports referred to in this Act.

Chapter 8

Local Councils' Fiscal Strategies and Debt Limits

Exclusion of Local Councils from Fiscal Strategy Report Requirements

- 8.1.(a) Local councils established under law number 7/2010 (Decentralization Act) are not required to prepare medium-term Fiscal Strategy Reports similar to those applicable to the Government, as described in chapter 3 [clauses 3.1 to 3.6] of this Act.
- (b) Local councils may, however, prepare their own medium-term Fiscal Strategy Reports should these be useful for their own planning and budget purposes.

Taking a Loan as per the Law

- 8.2. By power of the law that local councils have, loans taken by local councils shall be according to the policies set out in this law.

Total Debt of Local Councils

- 8.3. (a) The total debt of the local councils and debt guarantees issued by the Government to local councils, shall be maintained at levels set by the Minister, consistent with the total public debt and debt guarantee objectives of the Charter of Fiscal Responsibility and the total public debt projections of the Fiscal Strategy Report, as required by this Act.
- (b) The level of debt and debt guarantees mentioned in subsection (a) of this Clause shall be included in total public debt targets of the Charter of Fiscal Responsibilities, as well as the same three years of the Fiscal Strategy Report.
- (c) Local councils' debt and debt guarantee limits shall be communicated to the Councils by the Minister as soon as possible following the Cabinet of Ministers' approval of the aforementioned limits.
- (d) The procedures to be followed in order to maintain the total debt of the councils at the level determined by the Minister under subsections (a), (b) and (c) of this Clause, shall be set by the Minister in the Financial Regulations under the Public Finance Act 3/2006.

Chapter 9

Miscellaneous

Entry into Force

9.1. (a) This Law shall come into force, at the latest, within one year from the date this Act is adopted by the Peoples' Majlis, ratified, and published in the Government Gazette.

(b) The Government, in implementing the provisions of this Act relating to the Charter of Fiscal Responsibility, may choose to establish the key fiscal targets mention in Clause 2.4 of the Act for a period 5 years beyond the year in which this Act enters into force.

Transitional Provisions

9.2. The Minister shall have the power to defer giving full effect to the sections of this law pertaining to:

(a) the provisions in the Fiscal Strategy relating to tax expenditures and [others?], which shall enter into force within [two] years following the adoption of this Act by the Peoples' Majlis;

(b) Accrual accounting and performance-oriented budget, the reporting requirements of which, as outlined in clauses 5.2 (h) and (i) shall enter into force within one year following their respective implementation for a given financial year.

Regulations

9.3. (a) The Minister may make regulations generally as may appear to the Minister to be necessary and expedient for the proper implementation of the intent and objectives of this Act.

(b) Any regulations made pursuant to subsection (a) shall be laid in the Peoples' Majlis.

Amendment of Schedules²

9.4. (a) The Minister may, by order [with the approval of Cabinet], amend the Schedules to this Act.

(b) Any amendments to the Schedules shall come into force after it is laid before the Peoples' Majlis.

Conflicts

9.5. In the event of any conflict or inconsistency between the provisions of this Act and the provisions of any other written law, the provisions of this Act shall prevail.

SCHEDULE 1

Format of a Charter of Fiscal Responsibility

1. Statement of fiscal policy objectives

(a) The statement shall indicate the measurable objectives of Government fiscal policy in the medium term, which are consistent with the principles laid out in section 2.1 of this Act.

(b) The Charter shall specify quantified targets, by the use of ranges, ratios, or other means, of the Government's intentions regarding each of the principles specified in Article 2.1(1) (a) to (c) of this Act. These three indicators may be referred to as the Government's key fiscal targets.

(c) The Charter may specify quantified targets, by the use of ranges, ratios, or other means, of the Government's intentions regarding each of the principles specified in Article 2.1(1) (d) to (f) of this Act, or of any other fiscal indicators judged necessary for attaining the fiscal objectives of this Act.

2. Methodology and data for assessing fiscal performance

(a) This shall indicate the methodology to be used to measure the performance of the Government against the objectives required under paragraph 1 of this Schedule.

² The Minister may use a statutory instrument (such as an order) to amend the schedules. This could be approved by Cabinet and submitted to the Majlis. If this is not a common legal practice in Maldives, the format of the fiscal reports mentioned in the new FRA can be set out in a Government Regulation.

(b) The sources of data shall include a debt sustainability analysis (DSA), the consolidated audited financial accounts of the Government, audited debt statements, and other relevant data.

3. *Consistency of Charter for Fiscal Responsibility with the principles of this Act*

The Charter shall demonstrate how the Government’s fiscal objectives required under paragraph 1 of this Schedule are consistent with the principles in section 2.1 of the Act. The consistency shall be determined using macroeconomic and fiscal data, assumptions, and projections of the economy, as well as any financial and fiscal policy updates.

SCHEDULE 2

Format for a Fiscal Strategy Report ³

1. Medium-Term Macroeconomic Forecast

The medium-term macroeconomic forecast shall indicate the actual, estimated, and projections covering the previous two financial years, the current financial year, and the next three financial years and shall indicate in respect of each financial year the following economic variables—

- (a) the gross domestic product;
- (b) the rate of inflation (average and year-end);
- (c) the average and year-end exchange rate;
- (d) a least one key indicative interest rate;
- (e) tourism arrivals; and
- (f) other relevant macroeconomic indicators.

2. Medium-Term Fiscal and Debt Framework

(a) Fiscal Strategy: This is a statement of the Government’s targets for the variables that are key fiscal objectives under Clause 2.1 of this Act. It shall explain the reasons if these targets

³ See Appendix 2 for a more detailed Fiscal Strategy Report Outline.

have changed from the previous budget and/or Charter and how the government intends to restore compliance with objectives.

(b) Debt Strategy⁴: This shall include information about financing sources, summary of the Debt Sustainability Analysis, public debt projections, guarantees, and summary of the medium-term debt management strategy.

3. Medium-Term Fiscal and Debt Forecasts

The medium-term fiscal forecast shall cover the previous two financial years, the current financial year, and the next three financial years and shall indicate in respect of each financial year, the following economic variables—

(a) the revenue of Government with respect to:

- (i) tax revenue;
- (ii) non-tax revenue;
- (iii) external grants for the annual budget and for projects; and
- (iv) privatization receipts.

(b) the expenditure and net lending of Government for:

- (i) current expenditure;
- (ii) capital expenditure; and
- (iii) net lending;

(c) the overall balance of Government;

(d) financing of the overall balance including:

- (i) net external financing;
- (ii) net domestic financing, including changes in the balance of the Sovereign Development Fund;

(e) total public debt, including:

- (i) total debt of the Central Government
- (ii) total debt of local councils, guaranteed and unguaranteed

⁴ See Section IV. The MTDS would serve as an input to the DSA and would, in turn, be adjusted to take into account the constraints of a sustainable DSA. If a new Public Debt Act is adopted, this high-level summary of the medium-term debt management strategy could be elaborated further in a separate MTDS document.

- (iii) total debt of state-owned enterprises, guaranteed and unguaranteed
 - (iv) other debt guaranteed by the Central Government.
- (e) total public debt, including:
- (i) external debt
 - (ii) domestic debt.

4. Operational targets and other fiscal indicators

Besides the overall balance required in subsection 3(c) above, the three-year projections shall indicate:

- (a) the primary balance, which is defined as the overall fiscal balance after deducting interest payments.
- (b) the current balance, which, in the case of a deficit, indicates the extent to which the Government is borrowing to finance current expenditure in addition to investment spending, and, in the case of the surplus, the extent to which resources are available for debt reduction or other uses.
- (c) total government expenditure, including subtotals for current expenditure and capital expenditure,
- (d) any other fiscal indicators judged by the Minister to be useful for transparency and analytical purposes.

5. Statement of new policy measures

This is a statement of the impact of major new revenue and expenditure policies the Government is to introduce to ensure that the targets in paragraph 2 and the limits in paragraph 5 of this Schedule are respected.

6. Fiscal Risks Statement

This is a statement of the main sources of risk to the attainment of the fiscal objectives of Government and a quantified estimation of the fiscal impact of these risks, including:

- (a) an alternate fiscal framework based on alternative realistic assumptions of the key macroeconomic variables; and
- (b) a statement relating to the specific fiscal risks outlined in Schedule 3 and an estimate of the likely fiscal impact of risks should they materialize.

7. Tax Expenditures report

(a) This is a statement of the revenue foregone from tax expenditures, tax by tax, and in total.

(b) The tax expenditure report covers significant tax revenue losses arise from all of the following:

- i. **Exemptions:** exclusions from the tax base
- ii. **Allowances:** amounts deducted from the tax base before applying the tax rate(s)
- iii. **Tax credits:** amounts deducted from a tax liability
- iv. **Tax rate relief:** a reduced tax rate
- v. **Tax deferral:** a delay in paying the tax liability

8. Compliance with the Charter for Fiscal Responsibility

(a) This is a demonstration of how the fiscal targets and other fiscal indicators in the Medium-Term Fiscal Strategy are consistent with the objectives and targets set out in the Charter for Fiscal Responsibility.

(b) In cases where there are inconsistencies, the reasons for non-compliance shall be specified by the Minister, along with a statement of the new revenue and expenditure measure that shall be taken by the Government to reach compliance, and the duration until compliance is expected to be reached.

9. If the Fiscal Strategy Report does not include any of the information required by this Schedule, the Minister shall state in the Fiscal Strategy Report the reasons for any missing information and shall ensure that such information is available as soon as practicable for future Fiscal Strategy Reports.

SCHEDULE 3
Fiscal Risk Statement

(See Appendix 3)

Annex II. Fiscal Strategy Report Outline

This Appendix provides a possible outline for the first Fiscal Strategy Report. There are no international standards for such a document; the Fiscal Strategy Report's content and structure vary according to different institutional and political contexts. What follows is an illustrative example of what the Fiscal Strategy Report for budget 2022 could look like. The report would be updated on an annual basis and would cover a three-year timeframe.

The main purpose of such a document is to set and communicate the Government's key objectives and priorities cast within a macroeconomic and fiscal framework. As discussed in the main text of this report, the Fiscal Strategy Report should be issued early in the budget formulation and preparation calendar, and it should be updated prior to the submission of the draft budget to Parliament by end-October.

Chapter 1. Overview

- The Fiscal Strategy Report is a strategic document that sets out the main objectives of budget policy for the three coming years. It outlines the medium-term fiscal prospects and priorities for the budget and the Central Government over the period from 2022–24, provides the assumptions and forecasts of the main economic parameters that form the basis of the budget projections for the next fiscal year and projection period, and sets out the main parameters of the state budget.
- Main fiscal policy objectives over the medium-term (examples below):
 - Maintaining sustainable fiscal policy consistent with the Government's fiscal targets, maintaining certain social protections, and providing for COVID-19-related additional health spending;
 - Delivering high quality public services through further improvements to the quality of educational institutions, health care services, etc.;
 - Promoting economic development by diversifying away from tourism through quality investments in public infrastructure, education, and health care, and through promoting innovation in selected industries;
 - Creating a more efficient tax system that increases competitiveness and creates incentives to promote economic activity;
 - Other issues could include ensuring the security of the State, fighting corruption, looking after the most vulnerable citizens, promoting long-term economic resilience (especially to climate change); these should be linked to the key initiatives underway and should be developed for the budget.

- For 2022, the consolidated budget deficit is estimated to be x percent of GDP. Public debt is forecast to be x Rufiyaa (x percent of GDP), rising/falling to x percent of GDP by 2024.

Appendix Table 2.1. Summary of Consolidated Fiscal Aggregates

	2021	2022	2023	2024
	Projected	Preliminary Budget	Objectives	Objectives
Budget Revenue				
Budget Expenditure				
Budget Balance				
Central Government Revenue				
Central Government Expenditure				
Other General Government Entities				
Revenues				
Expenditures				
Consolidated General Government Balance				
Percent of GDP				
General Government Debt				
Percent of GDP				

Chapter 2. Projections of Macroeconomic Indicators for the State Budget

2.1 Current situation: Economic conditions in 2020 and expected outcomes for 2021

- Describe recent developments in the global economy and domestic economy, including outcomes for GDP and prices.
- Detail expected outcomes for 2021 and how the situation and forecasts may have changed from the 2020 budget, with particular reference to the impacts of the COVID-19 pandemic and necessary health responses to the domestic economy

2.2 Macroeconomic projections for 2022–24

- Global economic outlook (discussion of global GDP projections and developments in major trading partners; it can be useful to include a table with world GDP projections and those of

major trading partners, either based on IMF, World Bank, Asian Development Bank, or your own).

- GDP growth forecasts for the budget year, with particular reference to recovery assumptions from the COVID-19 pandemic, as well as trend forecasts over the medium term
- Discussion of the main components of GDP growth to explain what is driving the forecasts (often this is by household consumption, business investment, public sector, and exports, but this could be done by sector including tourism).
- Discussion of employment expectations.
- Discussion of inflation and wages forecasts.

Appendix Table 2.2. Key Macroeconomic Indicators and Projections

	2019 Actual	2020 Actual	2021 Projected	2022 Projected	2023 Projected	2024 Projected
Nominal GDP Growth (percent on previous year)						
Gross Domestic Prices (nominal value)						
Real GDP Growth (percent on previous year)						
Components of GDP Growth						
Tourism Arrivals						
Consumer Price Index (change from previous year)						
Unemployment Rate						
Employment Growth						
Private Sector Wage Growth						

Assumptions: These can either be a note to the table that is included in the table, or can be discussed in the text (for example, what is assumed for the exchange rate and interest rates?).

Chapter 3. Fiscal Strategy

- Statement of medium-term fiscal policy targets (limits on debt and the deficit).
- If they have changed from the previous budget and/or Charter, explain why.

- Note whether expected outcomes for 2020 and medium term are consistent with these targets. If not, it should explain why not, and provide the explanation of how the Government intends to restore compliance with the objectives.

Chapter 4. Fiscal Results for 2020 and Expected Outcomes for 2021

4.1 Outcomes for the consolidated budget

- The consolidated budget deficit was x Rufiyaa (x percent of GDP) in 2019, which is higher/lower than in the approved budget. This reflects (higher/lower) revenues and expenditures.
- For 2020, the consolidated budget deficit is expected to be x Rufiyaa (x percent of GDP) in 2020, which is higher/lower than the approved budget due to...

4.2 Fiscal outcomes for 2020 compared with the approved budget

- Outcomes for revenue
- Outcomes for expenditure

4.3 Expected outcomes for 2021, compared with the approved budget

- Revenue performance and comparison to forecast in the 2021 budget
 - Main policies introduced after the budget that impact revenue
 - Economic developments that impact revenue

4.4 Expenditure outcomes

- Expenditure performance and comparison to approved levels in the 2021 budget
- Main policies introduced after the budget that impact expenditures

Chapter 5: Medium-Term Fiscal Projections and Spending Priorities for 2022–24

5.1 Spending priorities

- Spending priorities by key spending areas (subheadings for each sector)

5.2 Medium-term expenditure plans

- Indicative aggregate expenditure ceilings

Appendix Table 2.3. Expenditure Ceilings

	2019 Actual	2020 Actual	2021 Outlook	2022 Objective	2023 Objective	2024 Objective
Budget Expenditure						
• By ministry						
• By economic classification						
General Government						
By entity						
Consolidated General Government Expenditure						

- Expenditure ceilings for the budget year by administrative units (for discussion)
- Table on expenditure by function (Classification of the functions of government- COFOG) 5.3
Tax policy and revenue projections
- Summary of revenue projections
 - Policy measures that have been announced and are being introduced
 - Factors driving forecasts (stronger than expected growth, etc.)
- Revenue shares, state and local

Appendix Table 2.4. Revised Revenue Table (short version)

	2019 Actual	2020 Actual	2021 Outlook	2022 Objective	2023 Objective	2024 Objective
Budget Revenue						
• Tax revenue						
• Nontax revenue						
<i>Of which: repayment of policy lending</i>						
Central Government Revenue						
Consolidated General Government Budget Revenue						

Appendix Table 2.5. State Budget Revenue, by Detailed Component (economic classification)

	2019 Actual	2020 Actual	2021 Outlook	2022 Objective	2023 Objective	2024 Objective
Total Revenues						
Tax Revenues						
<ul style="list-style-type: none"> • Taxes on income and profits 						
<ul style="list-style-type: none"> • Personal income tax 						
<ul style="list-style-type: none"> • Company income tax 						
Taxes on goods and services and trade						
<ul style="list-style-type: none"> • Excise tax 						
<ul style="list-style-type: none"> • Customs duties 						
<ul style="list-style-type: none"> • Other 						
Taxes on property and resources						
Other taxes						
Nontax Revenues						
<ul style="list-style-type: none"> • Grants 						
<ul style="list-style-type: none"> • Interest 						
<ul style="list-style-type: none"> • Dividends 						
<ul style="list-style-type: none"> • Sale of goods and services 						
<ul style="list-style-type: none"> • Other 						

Chapter 6. Deficit Financing and Medium-Term Debt Strategy

- Financing sources 2022–24 (for example, drawing on bilateral loans or market)
- Summary of DSA
- Public debt projections: Central Government debt, including on-lent loans to SOEs
- Guarantees (maximum ceiling, with a breakdown by main beneficiaries, SOEs, local councils, etc.)
- Summary of the medium-term debt management strategy (high level objectives for managing the external and domestic debt portfolios), when developed as a separate document

Chapter 7. Fiscal Risks [summary; refer to the separate Fiscal Risk Statement

- Discussion of how alternative macroeconomic parameters would impact the fiscal projections (with a possible table showing sensitivity analysis)
- Information on Government guarantees, outstanding and by entity
- Discussion of the fiscal risks related to the SOE and PPPs sector, with brief reference to any reform plans to strengthen oversight

Chapter 8. Tax Expenditure

- This statement shall be included in the updated Fiscal Strategy Report submitted to the Peoples' Majlis before end-October of each year. This is a statement of the revenue forgone from tax expenditures, tax by tax, and in total. The tax expenditure report covers significant tax revenue losses arising from all of the following:
 - Exemptions: exclusions from the tax base
 - Allowances: amounts deducted from the tax base before applying the tax rate(s)
 - Tax credits: amounts deducted from a tax liability
 - Tax rate relief: reduced tax rate
 - Tax deferral: delay in paying the tax liability

Chapter 9. Public Financial Management Reforms

- Reference to medium term PFM reform strategy and brief summary of some of the major elements

Annex III. Outline of a Fiscal Risk Statement Outline

Introduction

- Medium-term macroeconomic and fiscal projections presented in the budget are formulated, taking into account the expected developments in the domestic and global economy, based on information available at the time of their preparation.
- There are multiple factors and various risks that, if they were to materialize, could cause budget outcomes differing from those presented. The most significant of these would result from unanticipated macroeconomic developments that adversely impact revenues and the budget position. The IMF classification outlines three types of risks:
 - **Macroeconomic risks:** risks related to deteriorated macroeconomic parameters, such as terms of trade, inflation, exchange rate, global/regional growth, and domestic growth
 - **Specific risks:** explicit or implicit public liabilities whose realization is contingent on a specific event (such as risks related to SOEs, PPPs, and natural disasters)
 - **Institutional risks:** risks that include policy implementation and governance risks

Macroeconomic Risks

- Fiscal risk statements would usually include some sensitivity analysis to illustrate how variations in key economic assumptions could affect the budget aggregates.

Appendix Table 3.1. Sensitivity of Fiscal Position to Changes in Various Economic Parameters

Economic Assumption	Estimated Variation in Overall Balance	
	Rufiyaa	Percent of GDP
Real GDP growth is 1 percent lower than forecast		
Inflation is 1 percent higher than forecast		
Prices for key commodities fall by 10 percent		
Rufiyaa-US\$ exchange rate depreciates by 10 percent		
Tourist arrivals decline by 10 percent		
Corporate profits decline by 10 percent		

- An alternative and more technically demanding approach is to construct alternative macroeconomic scenarios, which involves (1) allowing economic parameters to vary at once (in a consistent way) and (2) presenting the fiscal position associated with each scenario.

Government Debt

- Fiscal risk statements would usually include summary indicators on public debt, even if these are published as part of a separate debt statement. These indicators would generally include domestic versus foreign, elaborating upon the specific foreign currency exposures, short versus long term debt, fixed versus variable interest rates, and the value of debt maturing within a year. These elements would need to be consistent with the MTDS and DSA.
- Some discussion of the possible impact of movements in the currency and market interest rates is warranted to illustrate the sensitivity of the debt estimates to such changes.

Government Guarantees

- One of the main specific risks faced by Governments relates to their guarantees of other public sector entities' debt.
- It is standard practice in fiscal risk statements to publish a table listing the total value of outstanding guarantees, by beneficiary. This might also be done through a debt statement.
- For SOEs, a summary analysis of the key financial risks may be included to give a sense of the probability that a guarantee may be called in the future.
- More sophisticated analysis would involve an assessment of the expected exposure from the portfolio of guarantees, which would combine the probability of individual guarantees being called and the loss given default.

Major Project Risks and PPPs

- Large public infrastructure projects usually present significant risks in terms of the ability to deliver them on time and on budget.
- It could be useful to include an assessment of such risks for major projects in the Public Sector Investment Program (PSIP), and to consider the performance of the PSIP as a whole.
- A specialized approach to risk assessment and monitoring of PPPs is warranted because the exposures of government are not always obvious, and may crystallize beyond the budget year. As a first step, it would be useful to disclose the main contractual arrangements that could translate into fiscal risks for the government down the road.

Other Contingent Liabilities

- Governments often are exposed through other forms of indemnities, such as those granted to statutory office holders and those that can manifest as future legal claims against the state.
- Contributions to international financial institutions are often in the form of callable capital, and such exposures should be reported.
- There may also be large future claims against the government, whose timing and magnitude are uncertain (for example, backpay arrangements for public sector salaries and unfunded pension liabilities). These should be discussed and quantified, where possible.

Financial Sector Exposures

- Governments can face (1) explicit fiscal risks through their ownership of financial institutions or (2) implicit risks through the fact that they are responsible for regulating the financial system.
- Fiscal risk statements often include a summary of the Financial Soundness Indicators prepared by the regulatory authorities, and some discussion of residual exposures (for example, a discussion of deposit insurance arrangements and the extent to which such schemes are fully funded).

Exposure to Other Public Sector Entities

- Fiscal risk statements are a good place to publish summary information on the overall performance and health of entities outside of the general Government sector.
- Beyond individual debt guarantees, the Government may face other exposures to public sector entities, including volatility in their dividend and tax payments; and from the occasional need to assist with refinancing nonguaranteed debt and facilitate major industry restructuring or to temporarily increase subsidies.
- Where such challenges are known, a fiscal risk statement would outline the situation and estimated exposures. Where such exposures are frequent, it may also be appropriate to make some provision for the average annual cost in the medium-term estimates.

Natural Disasters

- Natural disasters can have profound impacts on public finances through affecting economic output and revenue, and in requiring a substantial increase in public expenditure to provide income support and to repair major infrastructure.
- Although the timing and cost of such events can never be known in advance, fiscal risk statements can help to illustrate the average costs of such events and help governments to make an appropriate financial provision for them as part of the medium-term estimates.

Annex IV. Key Elements of a Final Budget Outcome

OECD Best Practices Budget Transparency for Year-End Report

- The year-end report is the government's key accountability document. It should be audited by the Supreme Audit Institution and should be released within six months of the end of the fiscal year.
- The year-end report shows compliance with the level of revenue and expenditures authorized by Parliament in the budget. Any in-year adjustments to the original budget should be shown separately. The presentation format of the year-end report should mirror the presentation format of the budget.
- The year-end report, or related documents, should provide nonfinancial performance information, including a comparison of performance targets and actual results achieved, where practicable.
- Comparative information on the level of revenue and expenditure during the preceding year should be provided. Similar comparative information should be shown for any nonfinancial performance data.
- Expenditure should be presented in gross terms. Earmarked revenue and user charges should be clearly accounted for separately.
- Expenditure should be classified by administrative unit (for example, ministry or agency). Supplementary information classifying expenditure by economic and functional categories could also be presented.
- The year-end report should contain a comprehensive discussion of the government's financial assets and financial liabilities, nonfinancial assets, employee pension obligations, and contingent liabilities.

Appendix Box 4.1. Australia and New Zealand End-of-Year Reporting

Australia: One of Australia's main ex-post accountability documents is the Final Budget Outcome, which is published within three months of the end of the financial year. This document is prepared on the same basis as the budget and the midyear update; it provides a direct comparison of the outcome to the budgeted amounts, both for the flows (revenues, expenditures, and balances) and for the stocks (net debt and net financial worth), with all major deviations explained. It also provides a direct comparison with the financial statements of the general Government sector, as well as the nonfinancial and financial public corporation sectors. All fiscal information is based on common reporting standards, largely in line with GFSM 2001.

New Zealand: New Zealand produces its audited annual report three months after the end of the financial year. This report provides a detailed comparison of budgeted amounts and outturns, as well as brief analysis of the major variations and a description of the progress the government has made in implementing its fiscal strategy, as laid out in the (prebudget) fiscal strategy report. Budgets and forecasts are prepared on the same accounting basis (mainly IPSAS) as accounts. Forecasts also comply with New Zealand's accounting standard that, among other things, requires the forecasts be prepared using assumptions that are "reasonable and supportable," internally consistent, and published.

Source: IMF Fiscal Transparency Handbook.

Annex V. Using a Debt Sustainability Analysis to Inform Medium-Term Fiscal Objectives

Many countries chose to anchor their fiscal policy on the ratio of public debt to GDP. Debt-to-GDP is a highly visible ratio that is easy to communicate and monitor. The evolution of the debt stock can be directly linked to a country's long-term fiscal objectives, including ensuring long-term fiscal sustainability, intergenerational equity, and economic resilience. The evolution of debt to GDP encompasses a broad range of risk factors affecting the country (for example, deficits, exchange rate movements, and materialization of fiscal risks). The coverage of debt differs across countries (Central Government, general government, and public sector), as do the targeted thresholds. Some developing countries (for example, the East African Monetary Union countries) set a medium-term anchor for debt based on the present value of debt to GDP to account for the concessionality of a large share of debt, consistent with the World Bank-IMF Debt Sustainability Framework for Low-Income Countries (LIC-DSF) framework.

Given the importance of country-specific factors, it is not possible to provide a one-size-fits-all debt-to-GDP ratio. A country's debt can be subject to a broad range of risks beyond its stock. Some risks are specific to a country's external debt, most notably, foreign exchange risks and market access risks. Beyond solvency concerns stemming from the stock of debt, short-term liquidity concerns can also arise when the debt service burden accounts for a substantial part of a country's budget or foreign exchange revenues.

The IMF's public debt limits policy is based on a framework that provides a comprehensive view of the risks associated with debt, and a robust indication of a sustainable debt level for countries. The LIC-DSF assesses the risk of a country experiencing debt distress based on its debt-carrying capacity and its projected debt burden under a baseline scenario and several adverse shock scenarios. The framework analyzes both total public debt and public external debt. It is based on the broadest possible coverage of public sector debt (beyond the Central Government, including the general government and SOEs). It takes into account the concessionality of a large share of debt in low-income countries by calculating debt ratios in present value terms (discounted at a standard discount rate of 5 percent). As such, the framework provides a superior analytical tool to assess debt sustainability in lower-income countries with limited access to market financing.

Applicability of the LIC-DSF Framework to Maldives

The debt sustainability framework analyzes both liquidity and solvency issues. Liquidity risks refer to the ability of the country to service its debt in the short run, while solvency risks refer to the ability of the country to repay its debt altogether in the long term. The framework is based on five ratios:

- For public debt: (1) public and publicly guaranteed debt as a percentage of GDP
- For public external debt:
 - o **Solvency (stock) metrics:** (2) External debt as a percentage of GDP, and (3) external debt as a percentage of exports
 - o **Liquidity (debt service) metrics:** (4) External debt service as a percentage of exports, and (5) external debt service as a percentage of revenues.

The framework also recognizes that the debt-carrying capacity of a country cannot be dissociated from country-specific institutional and macroeconomic factors. The risk thresholds for the five ratios for a country have to comply with an aggregate risk rating *composite indicator, CI*, which is a weighted average of the country's CPIA score, real GDP growth, import cover, global growth, and remittances. The CI yields for each country a rating of weak/medium/strong and measures a country's debt-carrying capacity. Public and external debt benchmarks are lower for a country with weak debt-carrying capacity than for a country with strong debt-carrying capacity.

Debt carrying capacity (CI classification)	PV of PPG external debt in percent of		PPG external debt service in percent of	
	GDP	Exports	Exports	Revenue
Weak	30	140	10	14
Medium	40	180	15	18
Strong	55	240	21	23

Debt carrying capacity (CI classification)	PV of total public debt
	GDP
Weak	35
Medium	55
Strong	70

The debt sustainability analysis is based on a long-term yearly projection of the evolution of the five ratios under realistic assumptions, as well as under comprehensive shock scenarios. Baseline projections are based on assumptions on the projected fiscal stance (captured by the primary balance) and on parameters affecting debt (including cost of debt, FX projections, and market access risks). When formulating the projections, the realism of the baseline scenario is critical. Baseline assumptions are examined in the light of four *realism tools*: (1) drivers of debt dynamics; (2) realism of planned fiscal adjustments; (3) fiscal adjustment-growth relationship; and (4) public investment-growth relationship. Shock scenarios take the form of six standardized stress-tests (for example, shock on real growth, primary balance, exports, depreciation, contingent liabilities, other shocks such as natural disasters, endogenous shocks such as fiscal slippages, and combined shocks).

The thresholds are indicative bounds above which the risk of debt distress is considered high. Compliance is assessed under the baseline scenario and under the most extreme shock scenario. The risk level is determined as follows:

- **Low risk** of external debt distress if none of the indicators breach the thresholds under the baseline and the most extreme shock scenarios.
- **Moderate risk** of debt distress if none of the indicators breach the thresholds under the baseline but at least one indicator breached the threshold under the most extreme shock.
- **High risk** of debt distress if any of the indicator breaches its thresholds under the baseline.

The framework provides a final rating of the risk of debt distress for both total and external public debt. It also concludes whether debt is sustainable or not, based on the existence of space to absorb further shocks without having its rating under the methodology downgraded. In assessing the risk level, IMF can also carry out adjustments, based on reasonable judgment, to assess the gravity of threshold breaches (notably, in terms of timeframe of the breaches) and country-specific factors before producing a final risk rating.

The latest Maldives DSA (April 2020) rates the country as being in a high risk of debt distress, even though its debt is assessed as sustainable. In the baseline scenario, debt is currently well in excess of the 30 percent threshold in PV for external debt and above the 35 percent threshold in PV for total debt. The only threshold that is not breached is the one on debt to exports. According to the DSA, key shocks that may cause further upward debt deviations include natural disasters, contingent liabilities (most notably, nonguaranteed SOE debt), and the availability of market financing. Nevertheless, debt ratios display a medium-term downward trend that needs to be accelerated. On this basis, IMF assessed debt as sustainable provided that the authorities comply with their stated ambitious fiscal adjustment strategy in the context of 2020 Rapid Credit Facility outright loan.

Maldives	
Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress:	High
Overall risk of debt distress:	High
Granularity in the risk rating:	Sustainable
Application of judgement:	No

Source: IMF DSA April 2020.

Moving from the Debt Sustainability Analysis to a Five-Year Total Debt Objective

In practice, the debt anchor and operational targets that would be included in the Charter of Fiscal Responsibility and the three-year Fiscal Strategy/MTFF would be directly taken from the updated DSA. The debt-to-GDP target would be taken from the fifth year (or more if a transitional arrangement is in place, for example, the eighth year) of the baseline scenario DSA and converted from a present value level to a nominal value level for the sake of simplicity. The number could also be rounded up by a reasonable amount (for example, by 5 percent of GDP) to take into account the possible materialization of future fiscal risks and provide a safety buffer. The overall balance target would also be taken from the DSA by summing up the fifth-year primary balance target and the expected debt interest servicing. Other operational targets (for example, expenditures targets) would have to be compatible with the primary balance path under the updated DSA.

In being included in the Charter and the MTFF, the debt and operational targets would be submitted to Parliament as the government's targets, although Parliament would not have to formally approve them. The Charter of Fiscal Responsibility commits the Government to a defined medium-term fiscal stance and includes the five-year objectives taken from the DSA. The three-year Fiscal Strategy/MTFF would be formulated on a yearly rolling basis, along with the annual budget and will need to be consistent with the targets set in the Charter.

Any deviations from the defined fiscal stance would have to be properly justified and would lead automatically to an update of the DSA projections. In case of intra-year fiscal deviations, any supplementary budget would need to include an updated MTFF. Any long-lasting substantial deviation would lead to an update of the Charter. In any case, an updated DSA will need to be attached to any update of the MTFF or the Charter; deviations will have to be justified, especially if they lead to a situation where debt could become unsustainable. The existence of an escape clause would constrain the cases where deviations are possible and acceptable.

Annex VI. Choosing Operational Targets in Maldives

Operational targets must strike a balance between several important, and sometimes competing, criteria. Operational targets should contribute to *ensuring fiscal sustainability*, sometimes broadly defined as debt sustainability, while also *stabilizing the economy*, that is, reducing economic volatility and promoting a countercyclical fiscal stance. They should also remain *simple*, that is, easily understood by policymakers and the general public, and *resilient* to political and economic cycles. Finally, they should be easy to translate into *clear operational guidance* in the annual budget process, and they should be *easy to monitor and enforce*.

The choice of the relevant operational targets must take into account the specific situation of the country. Although some parameters are common to most developing countries, others are specific to Maldives. Key elements to consider when choosing operational targets include the following:

- **Strong macroeconomic volatility.** As a small open economy, Maldives remains particularly sensitive to adverse international macroeconomic developments, such as lower global growth. The current global health crisis triggered a considerable reduction in tourist arrivals and related tourism revenues.
- **Large development needs.** The country is faced with substantial investment needs to build economic resilience by investing in infrastructure and diversifying the economy. These needs have translated into an ambitious capital investment program in the past five years. The country's five-year Strategic Action Plan identifies several medium-term investment priorities. Beyond capital spending needs, continued spending in health and education is also important for achieving the country's development objectives.
- **Susceptibility to long-term natural risk factors.** The rising threats associated with climate change, and their proven detrimental consequences on the Maldives islands, increase the urgency of climate-related adaptation spending. Rising and increasingly unpredictable climate events come with significant short-term reconstruction costs.
- **Limited additional revenue generation.** Fiscal revenues have been stable as a share of GDP in recent years. Further diversification of revenues would be useful.
- **Difficulty controlling spending pressures.** Although a large share of spending pressures stems from substantial investment needs, current expenditures have also proven difficult to compress in past times.
- **Current debt structure and high debt distress.** Maldives has been able to raise a substantial amount of its public debt at concessional terms, mostly linked to investment projects. Limited market access acts as a binding constraint to the country's fiscal possibilities and amplifies the possible negative consequences of a situation of high debt distress.
- **Exchange rate policy.** Maldives maintains a de facto peg to the US dollar, which has provided a useful anchor for macroeconomic stability and shielded the economy

from external shocks. Maintaining the peg requires maintaining prudent levels of central bank reserves.

Some of these characteristics may limit the set of adequate operational targets. The following sections provide a synthetic review of the advantages and drawbacks of the most common operational against the Maldivian constraints.

- **Budget balance targets** are based on a quantifiable fiscal variable under the direct control of policymakers, and therefore they offer simplicity and ease of implementation. They can effectively promote fiscal discipline by directly linking expenditures to revenues. They are generally expressed as a percentage of GDP. The coverage of such a target may be adapted to include one-off items and interest payments (primary balance rule), although the latter may weaken the link between the rule and a medium-term debt anchor. However, they may lead to a procyclical fiscal stance, as the country may have to undertake spending cuts in times of economic crisis. Even though they would leave the country some policy leeway to define the composition of any needed fiscal consolidation, they may also reduce the quality of spending by encouraging cuts in much-needed investment spending for development and climate resilience.
- **Current balance targets**, also known as “golden rules,” impose a limit on the balance of revenues and current expenditures. Their objective is to preserve investment spending from short-term spending cuts, and they de facto allow the country to raise debt only to finance capital expenditures. However, the scope of such targets excludes spending in crucial growth-friendly current expenditures such as health and education. It can also lower the quality of investment spending by reducing the incentives for cost-benefit analyses. Such targets must be associated with a sound public investment management framework prioritizing growth-enhancing projects; otherwise, the link with debt sustainability may be broken. Finally, golden rules can promote unorthodox reallocations between current and capital expenditures, that is, creative accounting.
- **Revenue targets** set either floors or ceilings on government revenues. Revenue floors aim to boost revenue collection. However, in encouraging higher tax receipts in crisis times, they may be procyclical. More importantly, they do not ensure fiscal sustainability on their own, and they have to be associated with rules on expenditures and/or fiscal balances.
- **Expenditures targets** are formulated as limits on the aggregate level of spending or on specific categories of spending (for example, current, primary, and capital spending). They can be set in level, either nominal or as a percentage of GDP, or in growth terms. Such targets are generally easy to understand, monitor, and enforce, as they target an aggregate that is under the most direct control of the government. However, expenditures targets linked to real GDP growth or set as a percentage of GDP tend to be procyclical, requiring spending cuts in difficult times, unless countercyclical automatic

stabilizers (such as social and unemployment benefits) are excluded from the scope of the rule.⁵ Expenditures targets do not give any guidance on the composition of fiscal consolidation efforts and may reduce the incentive to maintain capital spending. They can be limited in scope to some categories of spending, such as current expenditures; or they may include two separate ceilings on current and capital expenditures.

In choosing the operational target or set of operational targets to guide the efforts towards a medium-term debt anchor, the authorities are faced with a triple constraint:

(1) choosing rules that are directly linked to debt sustainability; (2) promoting short-term fiscal discipline; and (3) maintaining a target level and composition of spending to achieve development objectives and increase economic resilience. The choice of the operational targets associated with the debt anchor need to take into account the three objectives, while preserving the simplicity and enforceability of the framework.

A set of two to three operational targets could allow the authorities to reach their objectives. An overall balance target provides useful operational guidance for achieving both debt sustainability and fiscal discipline. A primary balance target also provides useful guidance on the soundness of fiscal policy, yet its link with debt sustainability is weaker. If adequately calibrated, revenue targets can allow the authorities to track progress on revenue mobilization. Maintaining an adequate spending mix would require separate targets or ceilings on current and capital expenditures. Ceilings could be envisaged on some categories of current expenditures, for example, they could exclude priority spending in health and education. Expenditure ceilings are typically expressed as a percentage of GDP, but they can also be expressed as a percentage of revenues (or of recurrent revenues) to avoid measurement issues associated with GDP forecasts.

Fiscal risks can also be addressed adequately through operational targets. A specific target that can be adopted could be a limit on government guarantees.

In the current context of high debt and high fiscal deficits, fiscal discipline could be enhanced through a transitional arrangement. To ensure immediate compliance, operational rules must remain realistic. The rules can be complemented with a path to compliance that clearly lays out an adjustment path of the levels of expenditures and deficits leading up to full compliance after a transition period of three years, for example.

⁵ Expenditures rules can actually have a stabilizing role if the level of expenditures growth is set in real terms at the level of potential output growth. This approach requires that the country has already reached a steady fiscal state (and is not undergoing substantial structural transformations) and poses important measurement challenges.

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