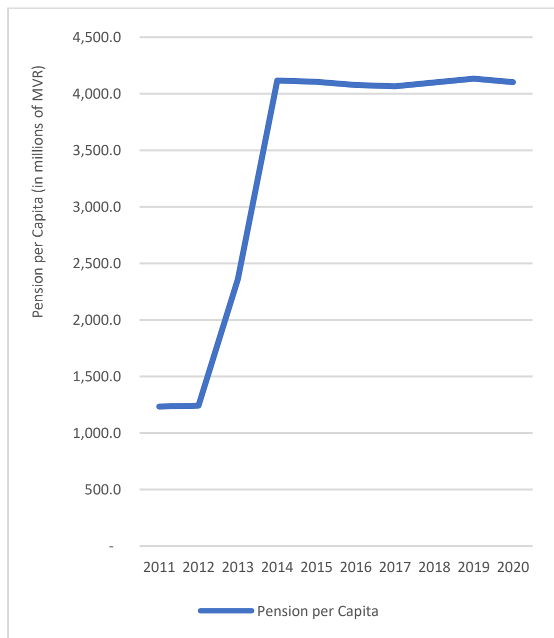
Maldives redistributive model in focus: the need for pension reforms and fiscal implications

In 2006 the Government of Maldives with the assistance of the World Bank rolled-out major pension reforms to overhaul its pension schemes which previously covered only state employees and were unfunded in nature. A pension assessment was completed in 2006 by the World Bank, which identified a set of pension reform options. As a result a pension law was drafted and passed in 2009 which established a two-tier pension structure: a universal basic pension scheme for all citizens reaching 65 years of age funded from tax proceeds guaranteeing a monthly pension of MVR2000 (2) and also establishing a self-funded, Defined Contribution (DC) pension scheme “Maldives Retirement Pension Scheme (MRPS)” which extends its coverage to both the private and public sectors. Participants of MRPS are mandated to pay 14 percent of their base wage, which would then be invested and accumulated until member retirement to allow self-financing of pensions in the future. The overarching purpose of the new pension system is to reduce the government’s contingent liability on pension and reduce the future cost of pension expenditure. This objective was meant to be achieved by reducing the universal basic pension for other pension income (such as MRPS) by an equivalent of 50% (so that taxes payed only for retirees who did not receive any other pension) . As a transition mechanism from DB to DC scheme, the Pension Act also stopped the Defined Benefit (DB) pensions (20/40/60 year-service based pension schemes) which existed prior to the new pension scheme and also awarded Recognition Bonds[1] to State employees to ensure the past service periods are recognised under the new retirement scheme

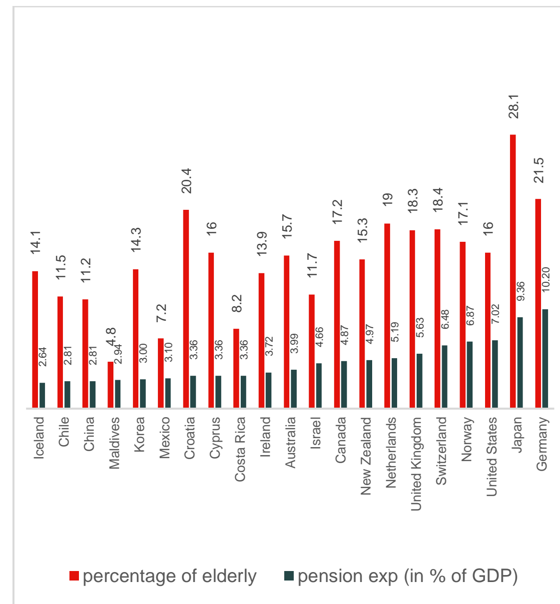
Chart 1: Pension per capita (in millions of MVR): 2011-2020



Source: Calculations by UNDP

However, following the constitutional changes of 2008 and the resulting establishment of new independent institutions, new state pension schemes began to emerge under the institution-specific laws and regulations outside of the pension act which were also funded by the state. Under a presidential pledge in 2014, a new “top-up” allowance was also further introduced for retirees who guaranteed all retirees a minimum MVR5000 pension funded from tax revenues, which had the effect of more than doubling the guaranteed universal Basic Pension set in 2009 under Pension Law. In 2018, the new government absorbed the “top-up” allowance directly into the Basic Pension, by raising the guaranteed Basic Pension under Pension Law from MVR2300 to MVR5000 through legislative changes. These changes to a large extent disrupted the adjustment mechanism under the pension act which was meant to reduce the state expenditure on pensions and created parralel pension schemes that led to certain pensions being duplicated. As seen in the Chart 1, because of these changes, pension per capita figures significantly increased to MVR4117 in 2014 from MVR2361 in 2013 and has reached MVR4108 by the end of 2020.

Chart 2: Percentage of Elderly in population (in percents) vs Expenditure on pension as a percent of GDP (in percents) in different economies



Source: OECD and Maldives budget figures

By the end of the year 2020, the Maldives is estimated to have spent 2.94 percent of its GDP as pension expenditure (5 percent of national budget 2021), despite having only 5 percent of population as elderly population (Chart 2). This spending level is comparable to expenditure levels reported in some OECD nations with greater levels of elderly populations. For example, countries like Iceland, Chile, China, and South Korea all have more than 11 percent elderly populations and still report pension expenditure levels comparable to Maldives (close to 3 percent of GDP), which may indicate that the Maldives may actually be reaching high social security expenditure ahead of an aging population. The percentage of elderly population

[1] Recognition Bond (RBs) is a government-issued bond recognizing the past accrued services of government employees at the inception of MRPS in 2009. Liquidation of the RB takes place when members retire at 65 years, at which point the government makes a cash payment to retire the debt to the pension fund.

in Maldives (age cohort above 65 years) is expected to reach 10% in 2040 and 14% in 2050. Without adequate reforms/harmonization of the pension and other benefit schemes, the cost of social protection will be an enormous and rising burden on the State. Without reforming the social security mechanism, as the population grows older the burden of pensions would become a binding constraint on the budget, leaving little fiscal space for other important development plans and future social security schemes targeting the most vulnerable populations.

In this article, UNDP projects a baseline scenario where pension expenditure is expected to continue under the current spending pattern and estimated the fiscal savings possible under a proposed reform scenario. For the reform scenario UNDP assumes a "path-to-convergence" where it is assumed that by 2030, the Maldives could target to converge to a pension expenditure per capita level that would have prevailed if pension expenditure were kept at pre-2014 levels on an inflation adjusted basis using a combination of pension reform options recommended below. As mentioned earlier, it was during 2014 when the pension expenditure experienced a significant hike due to a presidential pledge. Accordingly, the scenario developed assumes that pre-2014 levels of pension expenditure per capita would be the level to which pension expenditure was originally targeted in the medium-term. During 2013, pension per capita was at MVR2363 and when this figure is adjusted for inflation in the medium-term, by 2030 a convergent pension per capita should reach MVR2643.

To achieve the convergence path level of pension per capita, the Government has several multi-faced approaches which it can pursue independently or as a combination. Possible approaches to pension reform can include:

• Better targeting: adjustment of the basic pension to be made fully taking into consideration other personal incomes (such as rental income, personal investments etc). This will require a centralized database that collects this information to effectively target pensions against personal income.

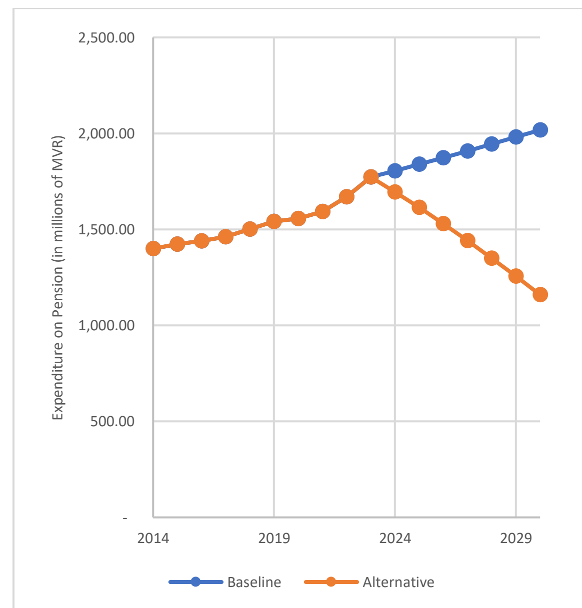
• Putting a stop on arbitrary increase to pension parameters (as it was done in 2014) by putting in place appropriate review processes which considers technical input and comprehensive forward looking fiscal impact analysis. In some advanced economies, state pension schemes are assessed by independent, or state actuaries and a professional opinion is passed on the financial sustainability of pension schemes and specific reviews maybe done on planned pension reforms to understand the socio-economic implications. The Maldives may benefit from such a review process where professional reviews are carried out in a transparent manner and the findings of such studies are published for public consumption.

• Resolving pension duplication issues through legislative changes. In 2015 the Auditor General of Maldives conducted a special audit [2] on the pension duplication problem and estimated that duplicated pensions are likely to cost the state MVR 3 billion (USD 294 million) for the period 2021-2030 if the problem is left unaddressed and could save the State as much as MVR1.5 billion (USD 97million) if a legal remedy is crafted to specifically tackle the problem. The Audit findings envision that a potential legal remedy could include harmonising the pension schemes to stop people actively becoming eligible for similar pension schemes in the future, stopping lifetime demogrants and instead offering one-time lumpsum payments at the time of retirement.

• Increasing coverage of people covered in the self-funded contributory pension scheme "MRPS", so that when contributors retire, their pension can be self-funded to a larger extent, reducing the need for state to provide pensions through tax revenues. The current figures suggest a pension coverage of 42 percent (measured using active contributors[3]) leaving significant room to enroll informal sector and greater participation of private sector.

• Improving the investment returns of the current contributory pension scheme, so that contributors retire with greater savings balances. To achieve this, the current investment regime of MRPS may need to be reviewed allowing investments to be made in assets generating greater investment returns. Current data suggests the pension fund made an inflation adjusted return of approximately 1.89 percent since inception.

Chart 3: Projections on Expenditure on pension (in millions of MVR): Baseline vs Alternative



Source: Calculations by UNDP

By building in these assumptions to the model, total fiscal expenditure on pension per annum is estimated to reach MVR 2.02 billion in 2030 under the baseline scenario (Chart 3) with no reforms – representing a 27 percent increase from the spending levels estimated for 2021. However, pension expenditure is estimated to reach MVR1.2 billion in 2030 under the alternative scenario, representing a reduction of 27 percent compared to current

[2] Pension Special Audit on Institution specific pensions provided outside of Maldives Pension Act (2015) by Auditor General

[3] Based on figures provided by Pension Office, by the end of 2019 the estimated number of active contributors to pension scheme was more than 102,000, which represents 42% of resident Maldivian population between 16-65 years of age.

spending levels in 2021, if reforms are implemented to reduce the target pension per capita to MVR 2643 by 2030. The modelling predicts that if reforms are not implemented, between 2021-2030, the government will need MVR18.4 billion to fund the pension expenditure (under the current trajectory) compared to MVR15.1 billion if reforms are implemented—a total fiscal savings of MVR3.3 billion if reforms are implemented.

Creating such fiscal space is important for Maldives since data suggests the vulnerable and at-risk population of Maldives are significantly underserved by the existing social protection systems. The ILO World Social Protection Data Dashboard presents figures on 'effective social protection coverage' in Maldives measured against the indicators of SDG 1.3.1. The dashboard shows low rates of effective coverage as compared to rates globally and in upper middle-income countries: by share in total population (21.2 percent), by children in receipt of cash benefits (8.2 percent), by vulnerability (ratio of those in receipt of cash benefits relative to all children plus adults not receiving a cash benefit, (8.1 percent), disability (persons receiving disability grant relative to number with severe disability, 42.7 percent). The government made a pledge to harmonize its pension schemes to create fiscal space in 2021 and proposed legislative changes for parliament in April 2021. These, however, were rejected by the parliament, which shows the difficulty of resolving this issue given the socio-political nature of the problem.