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Fiscal Costs and Challenges of Social Protection and Subsidies: The Case of the Maldives

Aishath Zara Nizar and Shifneen Rasheed

FISCAL COSTS AND CHALLENGES OF SOCIAL PROTECTION AND SUBSIDIES: THE CASE OF THE MALDIVES

*by: Aishath Zara Nizar and Shifneen Rasheed**

Abstract

This paper examines the various social protection programs and subsidies in place in the Maldives focusing on four major components: electricity subsidies, health insurance, pensions and food subsidies. Simple analyses have been used to analyse the fiscal costs incurred by the government from these social protection and subsidy schemes with a particular emphasis on explaining the factors that have led to a significant rise in expenditure by the government in recent years. Building on these, the paper brings to light crucial issues within the existing framework of social protection and subsidy schemes that pose large risks to fiscal sustainability in the future.

1. Introduction

The Maldives has achieved several significant milestones in the field of social protection in the recent past, by establishing comprehensive social protection programs and overhauling existing systems mired by deficiencies. The government modernised the pension system in 2009 while it introduced the first universal healthcare scheme in 2012. The expansion of the provision of electricity subsidies, in terms of both eligibility and cost, was also undertaken by the government around the same period, during 2009–2010. The main aim of the introduction of these social protection programs and the changes brought to the existing subsidy programs was to increase the welfare of the citizens through managing the cost of living, alleviating poverty and reducing inequality, particularly among the most vulnerable groups in society. As no formal social protection schemes

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had existed at a large scale in the past, the introduction of these programs was welcomed by many, including both the local community and international organisations.

Nevertheless, these drastic changes which took place within a relatively short period of time posed many fiscal challenges. The lack of targeting in subsidy schemes and the sudden implementation of large-scale social protection programs at a time when there was not enough fiscal space increased the burden on public finances and constrained fiscal consolidation, raising concerns over the sustainability of these programs.

In this respect, this paper aims to explore the fiscal costs and challenges plaguing the major social protection and subsidy programs carried out by the government at present. For conciseness, this paper will only consider the four social protection programs and subsidies that have the largest impact on the government budget: electricity subsidies, health insurance, pension and food subsidies.

This paper is organised as follows. Following this introduction, Section 2 provides an overview of the current social protection programs and subsidies in the Maldives while Section 3 elaborates on the history and the structure of these programs. Section 4 discusses recent trends in social protection and subsidy spending by the government, attempting to identify the underlying causes behind the growth patterns of each of the major components. Finally, Section 5 briefly discusses some of the issues present in the framework of the social protection programs and subsidies, highlighting on some policy implications with reference to other similar economies. Section 6 provides some concluding remarks.

2. Overview of Social Protection Programs and Subsidies in the Maldives

Social protection covers a wide aspect of programs with the key objective of protecting those who temporarily or persistently fall below acceptable levels of livelihood. Various programs are carried out under the umbrella of social protection; Norton, Conway & Foster (2001) identifies three main categories into which these social protection programs can be generally grouped into: insurance-based programs, social assistance programs and other instruments.[1]

1 Other instruments generally include labour market policies, state intervention to support prices and other programs such as microfinance and employment support.

Considering the application of this concept to the Maldives, Ibrahim (2012) provides a comprehensive overview of the various social protection programs in the Maldives and categorises them into the mentioned three main categories (Table 1).

Table 1: Social Protection Programs in Maldives, 2009

Social protection category	**Type of protection**
Social assistance programs	• Cash assistance for the absolute poor* • Welfare assistance for medical services within Maldives and abroad • Assistance for the elderly (initiated as the Senior Citizens' Allowance in January 2009, revised after the enactment of the Maldives Pensions Act in 2009 as the old-age Basic Pension for citizens above 65 years of age) • Child protection (assistance for institutional care of children; educational assistance for low-income families through the educational support fund or the *Thauleemee* Fund) • Disaster relief assistance • Assistance for critical drugs for the mentally ill • Assistance for assistive devices for persons with disabilities • Single parent allowances • Foster children and foster parent/guardian allowances • Institutional care for vulnerable groups (e.g., mentally ill, elderly) • Islamic charity or the *Zakath* Fund • Disability benefits or allowance for the blind • Senior citizens' allowance (introduced in February 2014)**
Social insurance programs	• Maldives Retirement Pension Scheme • Civil Service Pensions scheme* • Government Provident Fund* • *Madhana* / *Aasandha* health insurance[1] within Maldives and abroad** • Redundancy and early retirement • Insurance programs of state institutions**
Labor market programs	• Employment skills development and training

Source: Athifa Ibrahim (2012). Republic of the Maldives: *Updating and Improving the Social Protection Index*. Technical Assistance Consultant's Report.

*These programs have been phased out and do not currently exist. In the case of the Civil Service Pension Scheme and the Government Provident Fund, they have been integrated into the new pension system.

**These programs have been added to the list as to update the list of social protection programs in the Maldives by including the major programs that have been introduced after 2009.

[1] *Madhana* was introduced in 2009, being replaced by *Aasandha* in 2012. For the purpose of updating information for this paper, "*Aasandha* Health Insurance within Maldives and abroad" has been written in place of the original points—(1) "Health Insurance (e.g., social health insurance for citizens in *Zakath* list which is the absolute poverty target group; civil servants; pensioners; elderly above 65 years old and persons with disabilities)"; and (2) "*Madhana* within Maldives and *Madhana* plus for medical treatment from abroad"— which was written in the source report.

Table 2: List of Subsidies Given Out in the Maldives, 2014

Type of subsidy
• Electricity subsidies • Food subsidies • Water subsidies • Subsidies given to fishermen • Subsidies given to farmers

Source: Based on information from the 2015 government budget documents, Ministry of Finance and Treasury

Note: For the sake of simplicity, this table lists these programs as subsidies as stated in the government budget documents although some programs (such as subsidies given to fishermen) are carried out as insurance schemes.

As seen in Table 1, there are a large variety of social protection programs carried out in the Maldives, with most of them falling into the category of social assistance programs.[2] In this context, it must be noted that subsidies have been omitted from the classification in Table 1 as subsidies only fall under the compass of social protection if they are targeted at particular vulnerable groups, as per the methodology followed by Ibrahim. Moreover, general subsidies (as in the case of the Maldives) are excluded in the social protection definition, even if their rationale is to assist the poor.

As the scope of this paper covers both social protection programs and subsidies, Table 2 provides a list of subsidies given out in the Maldives as at 2014, to complement the information provided in Table 1.

Given the aim of this paper to assess the fiscal costs of social protection programs and subsidies, the main focus of this paper has been limited to a few programs that have a significant effect on government expenditure: electricity subsidies, health insurance, old-age basic pensions and retirement pensions and food subsidies.

2 Social assistance programs covers non-contributory, tax financed benefits, in cash or kind, sometimes universal but generally targeted towards certain categories assumed to be vulnerable.

3. History and Structure of the Main Social Protection Programs and Subsidies in the Maldives

This section will describe the history and the structure of the following social protection programs and subsidies, and how each system is managed and financed in the context of Maldives.

- Electricity subsidies
- Health insurance
- Pensions
- Food subsidies

Moreover, a brief overview of several other programs that exist in the Maldives will also be provided.

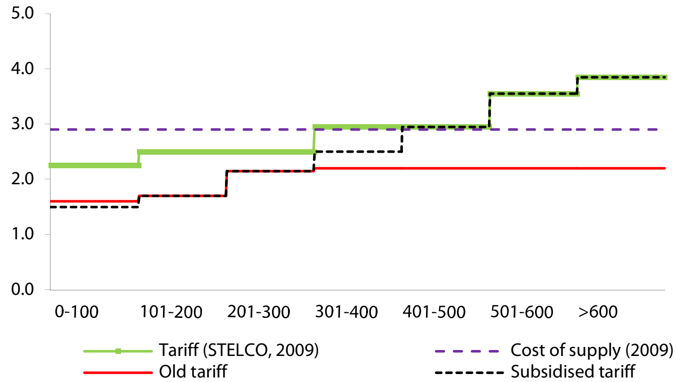
3.1 Electricity Subsidies

The two state-owned companies State Electric Company Limited (STELCO) and Fenaka Corporation Ltd are responsible for the generation and distribution of electricity in the country. These companies provide electricity to over 50% of the total population.[3] Due to the lack of natural land-based energy resources in the Maldives, the country has to rely heavily on imported diesel (Marine Gas Oil) to generate electricity. The fuel needs to be transported frequently to powerhouses on different islands, thus increasing the cost of production. In addition, due to storage capacity constraints, the oil has to be imported in small quantities in refined form, which also adds to the cost of electricity generation. Regardless of these difficulties, electricity access is universal in Maldives, as the government is mandated by law to provide electricity to every inhabited island.[4] To provide this service to the public at an affordable rate, the government was compensating STELCO for its revenue losses since 2005 and spending explicitly on electricity subsidies since 2009 (The World Bank, 2014). Government documents also indicate that it has given out subsidies for private electricity providers in 2005.

3 A number of islands, particularly those with a relatively small population rely on their own engine houses.

4 The resorts produce electricity using electricity generators on the resorts.

Figure 1: Tariff Rates, 2009
(rufiyaa per kwh)



Source: Ministry of Environment and Energy

Electricity tariff rates are set by the Maldives Energy Authority and these rates follow an increasing block tariff rate structure. Consumers pay different rates depending on their usage. As Figure 1 shows, each succeeding block of usage is charged at a higher rate than the preceding block (Ministry of Environment and Energy, Maldives, 2014).

Prior to 2009, STELCO was the sole electricity provider to the public in the Maldives. The company fared well until 2005 when it began operating at a loss. This was due to the tariff rates not being revised in accordance with the increase in oil prices in the international market. Given that such revisions could increase the financial burden on households, the government decided to compensate for STELCO's revenue losses on an ad hoc basis between 2005 and 2009.

However, the year 2007–08 saw significant increases in oil prices, following the overheating of the global economy, which resulted in the revision of tariff rates during 2009 to reflect market rates (The World Bank, 2014). In order to minimise the impact of this tariff reform on low-income households, the government introduced two types of electricity subsidies in the period 2009–2010:

- Usage subsidy: The government introduced a subsidised tariff rate for consumption bands up to 400 units which is largely equivalent to the tariff rates set for these consumption bands prior to the price reform. The usage subsidy is also slab-based, which means that consumption up to 400 units are subsidised irrespective of the total number of units consumed.

• Fuel surcharge subsidy: During 2010, the utility providers were allowed to raise the tariff rates to reflect fuel price increases above a certain threshold. In the case of STELCO, if fuel prices were to increase more than MVR8.0/liter, the tariff will increase by MVR0.03 KWH for every MVR0.1/liter increase. As fuel surcharge accounts for 50–60% of the total electricity bill and the government subsidises 100% of the fuel surcharge, this poses a massive fiscal cost for the government. All consumers receiving the usage subsidy are eligible to receive the fuel surcharge subsidy as well.

3.2 Health Insurance

Due to its unique geography and high dependence on imports and expatriate labour, health services in the Maldives are relatively costly when compared with other countries in the region. The government has undertaken several measures in order to ensure lower healthcare costs for its citizens over the past years. Prior to mid-2008, the government provided a medical allowance to all the government employees once every three months and provided financial assistance to the poor under a medical welfare assistance scheme. By August 2008, the government broadened this welfare scheme and introduced a national health insurance system, *Madhana*, which was aimed at all civil servants, senior citizens and those living in extreme poverty (Nagpal, 2011). Given that no form of government-initiated health insurance scheme at the national or regional level had ever existed prior to this, the introduction of *Madhana* in 2008 marked a significant milestone for the Maldives. This scheme, which was managed by the National Social Protection Agency (NSPA), covered 61,739 people by the end of 2010, which was around 20% of the population.[5] The premium for the *Madhana* scheme was MVR2,000 (US$130) per head per annum and this cost was fully borne by the government for the aforementioned groups. The scheme also allowed voluntary enrolment for those who were willing to pay the premium, although a partial subsidy was granted to those citizens earning below MVR17,000 per month.[6] However, by March 2011, only 11,613 members had enrolled in the scheme voluntarily (Nagpal, 2011).

Members were enrolled under three variants of the scheme: Standard *Madhana*, *Madhana* Plus and *Madhana* Basic. Under the standard version, the enrolled members

5 NSPA was established with assistance from the World Bank, who also provided their technical assistance in preparing related legislature on social protection.

6 As per the Household Income and Expenditure Survey 2009/2010, the median monthly income per household for 2009/2010 was MVR10,679 (Department of National Planning, 2012).

were allowed to obtain outpatient and inpatient services (with certain conditions and exceptions) at any empanelled facility within an overall cap of MVR100,000 per annum per head. *Madhana* Plus offered overseas care at a higher premium while *Madhana* Basic was similar to the standard version with lower monetary caps on different categories of treatment (Nagpal, 2011).

Management of the claim system was outsourced to Allied Insurance Company Pvt Ltd. The claims were managed via an online system that was established in all the hospitals and health facilities. Allied Insurance pays the hospitals and health facilities using an advance payment made by NSPA, via a processing system that contains basic checks for coverage and eligibility. The insurance company is paid a percentage of the claims for its services (Nagpal, 2011).

On 1 January 2012, the government replaced *Madhana* with the universal health insurance scheme, *Aasandha*, aiming to promote affordability and access to health services with a broader coverage. The government formed a new company to manage this scheme which was a joint venture with Allied Insurance Pvt Ltd. Under this scheme, a premium of MVR2,750 per head per annum was paid by the government during 2012 (Nagpal & Redaelli, 2013). Similar to its predecessor *Madhana*, *Aasandha* covers inpatient and outpatient treatments (which are subject to certain conditions and exclusions) with an overall cap of MVR100,000 per head per year. The entire population of the Maldives,[7] which is over 330,000, is eligible to obtain health services under this scheme without making any premium payments (Nagpal & Redaelli, 2013). In addition, Maldivians living abroad in any country that has empanelled hospitals (namely, Sri Lanka and India) are eligible to obtain inpatient healthcare under *Aasandha*. However, it is noteworthy that even in such cases, *Aasandha* scheme only covers medical services that cannot be obtained from the Maldives.

Despite the expansion in coverage, it is noteworthy that due to the overall limits and sub limits given in the scheme, some patients were unable to continue their treatments under the scheme after reaching the specified limits. In such cases, NSPA provided financial assistance under their Emergency Welfare scheme upon request. In addition to this, NSPA also provided financial assistance for any health related cost which is not covered under *Aasandha*, after a case-by-case evaluation. Hence, to reduce the logistical costs associated with providing these services under two different schemes and to

7 This excludes the expatriate workers in Maldives.

limit the services given under the Emergency welfare scheme, the government further broadened *Aasandha* and re-branded it as *Husnuvaa Aasandha* (literally translating to "unlimited *Aasandha*") during February 2014. Under the new scheme, health care under the system was no longer subject to an overall cap of MVR100,000 per head per year. Furthermore, the scheme covered all transportation costs of emergency cases, annual medical checkups for people over the age of 30 and for children under the age of 18 years. In addition, the scheme also covered all medical costs associated with pregnancy, treatment costs for people with special needs and terminally ill patients (The Presidents Office, 2014).

3.3 Pension

Prior to 2009, the pension system in the Maldives covered only public sector employees and consisted of two components: the Civil Service Pension (CSP) scheme and the Government Provident Fund (GPF). While the CSP was an unfunded pension scheme whereby the government simply made monthly payouts to employees who completed at least 20 years of uninterrupted government service, the GPF was a fund in which both the government and the employee voluntarily contributed a certain amount of the employee's basic pay and from which withdrawals were allowed.

The features of these schemes meant that while the government incurred a significant cost in financing the national pension plans, these pension schemes had two main deficiencies:

Firstly, it did not truly provide a safety net for the elderly, as the coverage of the pension schemes was limited only to government employees. Those employed in the private sector and engaged in self-employment or informal activities were excluded from any benefits from this pension plan, and thus had no means to prepare for retirement.

Secondly, the pension plan could not guarantee a sufficient amount of payouts after retirement. As pension benefit were calculated as a percent of the basic salary (while overtime or allowances made up a major chunk of the earnings for most civil servants), the amount of payout was generally quite small. Moreover, as the pension payouts were fixed and not indexed to inflation, the real value of the payouts would decline steeply over the receivable period.

Against this background, and given that a growing proportion of the Maldivian population was in their youth, there was a significant need for reform in the pension system, both to design a scheme where the young population planned financially for their future and to provide financial security for all senior citizens. What followed was a milestone change in 2009, with the implementation of the Maldives Pension Act and the formation of the Maldives Pension Administration Office (MPAO).[8] Under this Act, two particular pensions were outlined: an (old-age) Basic Pension Scheme and the Maldives Retirement Pension Scheme (MRPS).

The new pension schemes varied drastically from the previous ones, most notably that the new schemes provided an old-age basic pension (a fixed monthly payout to all senior citizens) and mandated all Maldivian private and public sector employees, to contribute a certain amount of their basic pay each month into a retirement savings fund that would be managed by the MPAO.[9] This structure generally aimed to lower the fiscal burdens in the future by defining the pension liabilities of the government and was targeted to overcome the specific shortages of the previous schemes. The new pension scheme mirrored pension schemes of most developed countries which include a universal basic pension funded by the state budget and an earnings-linked pension funded through a private or public pension scheme.[10]

As at the end of 2014, the old-age basic pension stands at MVR2,300, and with the introduction of a senior citizens' allowance by the government in 2014, the old-age basic pension has been topped up to MVR5000. As for the retirement pension fund, the mandatory contribution of income that must be paid into the MRPS each month is at 14% of the basic salary (7% each for the employer and the employee).

Apart from the old-age basic pension scheme and the MRPS, some state institutions carry out institution-specific pension schemes which exist outside of the Maldives Pension Act.

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8 The implementation of the Maldives Pension Act and the formation of the MPAO were carried out with assistance by the World Bank.

9 Drawings on these funds are currently restricted until the employee retires or reaches 65 years of age, although discussions are underway for these restrictions to be relaxed, allowing withdrawals for specific purposes.

10 Among the OECD countries, these include Hungary, Japan, Netherlands, Sweden and the United Kingdom.

Box 1: Features of the Old and New Pension Schemes

Before the overhaul of the pension system in 2009, two pension schemes existed: the CSP scheme and the GPF. Both the schemes covered only public sector employees although they aimed to serve two different purposes.

Civil Service Pension Scheme

The CSP scheme, which had been in place as early as the 1970s, is a non-contributory arrangement funded entirely by the government budget where all government employees receive monthly pension payments only after they complete 20 years of uninterrupted government service. The payout is calculated as a percentage of their basic pay,[1] and is increased after every twenty years of service by the employee. Each stage is referred to as first pension, second pension and third pension respectively. The CSP is globally unique in the sense that pensions are paid out following every twenty years of continuous government service and there is no requirement to retire (The World Bank, 2006). It can be observed that the CSP, which had been in existence for much longer than the GPF, primarily served to recognise and reward continued service to the government. Pensioners who had achieved second or, in a few cases, even third pension were held in great esteem within the community, receiving congratulations from the president himself, and commonly being recognised in the national media.

Government Provident Fund

In contrast to the CSP scheme, the GPF, introduced in 1988, is defined contribution arrangement in the public sector where both the employee and employer contribute 5% of the employee's basic salary each month to a common fund. Participation is voluntary and withdrawals are allowed for education of their children, house construction and repair, health care and obligatory hajj. Coverage of public sector employees under this scheme was approximately 60%. Although this fund was initiated to create a pool of savings to prepare for retirement, the flexibility of being able to withdraw funds for these purposes led to most participants withdrawing large sums for investment purposes. This meant that in essence, there was a huge hindrance for the government to manage the fund and obtain investment returns.

1 Accrual rate of 2.5% per year applied to the last wage in the 20-year period.

The main differences between these two schemes are highlighted in Table 1.

As at 2006, these pension schemes covered over 26,000 employees.

Table 1: Features of the Civil Service Pension Scheme and the Government Provident Fund

	Civil Service Pension	**Government Provident Fund**
Contribution	Non-contributory	Employer and employee each contributes 5% of basic salary
Type of scheme*	Defined benefit	Defined contribution
Financing	Financed entirely by the government	Financed by contributions from employer (government) and employee
Participation	All government employees are automatically included in the scheme	Voluntary
Participants	Public sector employees	Public sector employees (about 60% coverage)
Pension payouts	After every 20 years of service	Withdrawals allowed for specific purposes

Source: Maldives Pension Administration Office

*Retirement or pension plans are usually categorised as defined benefit (DB) or defined contribution (DC) plans. A defined benefit plan identifies the specific benefit or payout that will be payable at the end of the plan whereas a defined contribution plan specifies how much money will go into the retirement plan, which, together with the performance of the investment vehicles, determines the payout at retirement.

The main purpose of any pension plan is to provide financial stability to the plan member after they retire. The new pension schemes introduced in 2009—Basic Pension Scheme and the Maldives Retirement Pension Scheme (MRPS)—aimed specifically to overcome the shortcomings of the previous schemes and to achieve the two following social objectives:

- To reduce poverty among the elderly, and
- To smoothen consumption between the working years and the retirement years, such that an individual does not suffer a huge drop in living standards when old age or disability reduces his earning ability (Maniku, 2012).

The features of the two schemes are discussed below.

Basic Pension Scheme

Introduced in 2009, the Basic Pension Scheme is a flat-rate scheme where all citizens above the age of 65, residing in Maldives receive a lifetime basic pension of MVR2,000 every month. However, in the case where senior citizens receive any other pension scheme, the amount they receive on the old-age basic pension is adjusted (lessened) to reflect a fair value.[2] Moreover, the Basic Pension Scheme Act allows for this old-age basic pension amount to be revised according to changes in the standard of living. Thus, in January 2012, the old-age basic pension amount was raised to MVR2,300. Currently, with the introduction of the senior citizens' allowance, the elderly are guaranteed a minimum of amount of MVR5,000.[3]

Maldives Retirement Pension Scheme

The MRPS is a defined contribution (DC) scheme where both the employee and employer each contribute a defined amount of the employee's pensionable wage on a monthly basis.[4] These contributions are then pooled in a fund managed by the MPAO, which is used to make payouts to the retirees. Unlike the Basic Pension Scheme, the payouts from MRPS depend on the amount the participants have contributed over their working lives, plus investment returns.

Participating in the MRPS is mandatory for all employees who work under a contractual agreement with an employer, while it is voluntary for foreigners and those who are self-employed.[5] This, coupled with the clause that prevents withdrawals from the fund before the participant reaches 55 years of age, means that the money pooled from MRPS is significantly larger than the fund established under GPF. Contributions to the MRPS fund amounted to MVR3.0 billion at the end at 2014 compared with MVR2.2 billion at end 2013.

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2 If a person receives pension from any other pension scheme (such as Retirement Pension Scheme), their Basic Pension amount will be adjusted accordingly (MPAO website, FAQs).

3 A senior citizens' allowance was introduced by the government in February 2014 to ensure the receipt of MVR5000 per month by the elderly. This change did not occur within the pension regulations, but under a presidential decree.

4 The mandatory contribution amount is 14%, although members have the option of contributing more.

5 To improve the coverage further, MPAO launched efforts in 2014 to encourage participation by foreign workers in Maldives.

3.4 Food Subsidies

As trade with other countries began to flourish in the 1960s, the government of Maldives set up a state-owned enterprise—State Trading Organisation (STO)[11]—for the key purpose of strengthening national food security. The company was responsible for importing essential food items in bulk and distributing them to local consumers via retail outlets at a low mark-up. The objective of this function was to ensure the affordability of basic food items for all citizens of the country.

To facilitate the goal of food security further, the government introduced administered prices for staple food items of rice, sugar and flour which reflect global commodity prices. This prevented STO from setting up their own prices for these products. In the midst of rising international food prices in the world market, the decision by the government to introduce administered prices also meant that STO would incur losses as they were forced to sell below their cost price. Hence, along with the policy of maximum prices for staple food items, the government agreed to begin subsidising essential food items of rice,[12] sugar[13] and wheat flour. This arrangement has been in place as early as 1981.

Under this arrangement, the government provides direct subsidies to STO, compensating for the loss arising from the difference between the import price and the administered prices for these staples.[14] The non-existence of subsidies for private parties importing the same items coupled with the sustained increase in global commodity prices ultimately discouraged private importers from importing staple foods. This has led to STO supplying an overwhelming majority of rice, flour and wheat to the domestic market, despite efforts by the government to encourage other private importers.[15]

Food subsidies for the price administered staples have since been in place, continuing without any significant change for over three decades. While administered prices are set by the Ministry of Economic Development, at present there is no periodical review of these administered prices.

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11 At the time of its establishment in 1964, the company was named Athireemaafannu Trading Agency. The company was renamed STO in 1979. Apart from the import of food items, STO also undertook all trading and commercial activity on behalf of the government to accelerate economic development and raise the standard of living.

12 This refers to semi-milled or wholly milled rice and does not extend to other types of rice such as Basmati.

13 This refers to raw beet sugar (in solid form) and does not extend to other types of high-quality sugar.

14 Government food subsidies to STO also include compensation for implicit overhead costs (which take into account warehousing, transport and selling costs) that are incurred. This overhead cost was fixed at MVR0.4/kg in 2007 under an agreement with the government.

15 STO was the sole importer of staple foods until January 1989 when the government revised its policy to provide quota to the private sector for imports of these items. This quota has ranged around about 20% in the following decade.

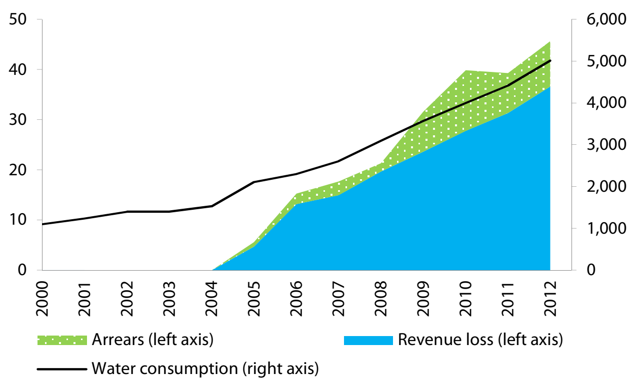
3.5 Other Programs

Water Subsidies

Similar to food subsidies, water subsides are given by the government as a blanket subsidy via the producer. However, water production was subsidised by the government only from 2005 onwards. Due to the natural freshwater lens that exists beneath each island of the country, water shortage was not a significant problem in the Maldives up until a few decades ago. With increased migration to Male' city, particularly after the mid-1970s, the country inevitably observed an increase in the demand for its resources within the Male' region. This created the need for the production and provision of water by the government, which occurred during the 1990s.

Like most developing countries, water provision in the Maldives is carried out by state-owned enterprises due to the essential nature of the service. In this respect, Maldives Water and Sewerage Company (MWSC) provides water service to the Male' region, while Fenaka Corporation Ltd is mandated to provide utility services, including water, to regions other than Male'. Households in the Maldives traditionally used to rely on freshwater collected from wells (which may be located within the house itself, or at communal locations such as mosques) and rain water, also collected in tanks or wells. Currently, islands with relatively large populations have desalination plants although most islands still use freshwater collected in wells and tanks for their daily needs.

Figure 2: Water Consumption in Male', Vilingili and Huluhumale' and Revenue Loss (and Arrears) of MWSC, 2000–2012
(millions of rufiyaa; thousand metric tonnes)



Source: Various Statistical Yearbooks (National Bureau of Statistics), MWSC

Subsidies for water were first given out in the Maldives in August 2005, following a downward revision in the water tariff rates. Tariff rates continue to be regulated by the government, ensuring the affordability of water by all Maldivian citizens. This tariff revision was implemented by MWSC, conditioning the government to compensate for the loss in income due to the lower price. Since then, the government has been providing the company with revenue loss—primarily acting like a subsidy—for the provision of piped water to Male' city at the "subsidised" rate.

The amount spent by the government on revenue loss to MWSC has been increasing steadily, in line with water consumption in the greater Male' region (Figure 2).

Allowances and Medical Welfare

As seen in Table 1, the government provides a large number of social assistance programs, which involve the transfer of cash or kind to numerous parties. While some programs (such as cash assistance for the absolute poor and allowance for the blind) had been in place for several decades, other such social welfare programs have been introduced only recently. These programs mainly aim to improve the general welfare and living standards of marginalised groups in society who are more vulnerable to fall into poverty.

Following is a brief description of the some programs initiated by the government with this purpose:

Disability Allowance

The government started providing financial support to persons with disabilities during March 2011. The ratification of the Convention on rights of Persons with Disabilities during April 2010 necessitated the existence of a database that included information regarding people with disabilities in Maldives. Hence, in order to develop such a database, people with disabilities were allowed to submit application forms and were assessed to determine their eligibility to receive the disability allowance of MVR2,000.

Prior to the distribution of the disability allowance, an allowance of MVR22.5 was distributed every month to blind persons during 1950s. However, it had been increased periodically since 1979 and amounted to MVR500 by the end of 2008. In response to a petition submitted to the Human Rights Council of Maldives which argued that the allowance for blind persons was not sufficient to meet their basic needs, the allowance was further raised to MVR1,500 per month from 1 January 2009.

Single Parent Allowance

The government introduced a single parent allowance in 2010, in order to provide financial support to children under the age of 18 who are being looked after by single parents. This allowance is given to the children of single parents at the rate of MVR1,000 per child per month. However, one family cannot receive an amount exceeding MVR3,000 per month under this scheme.

Emergency Welfare

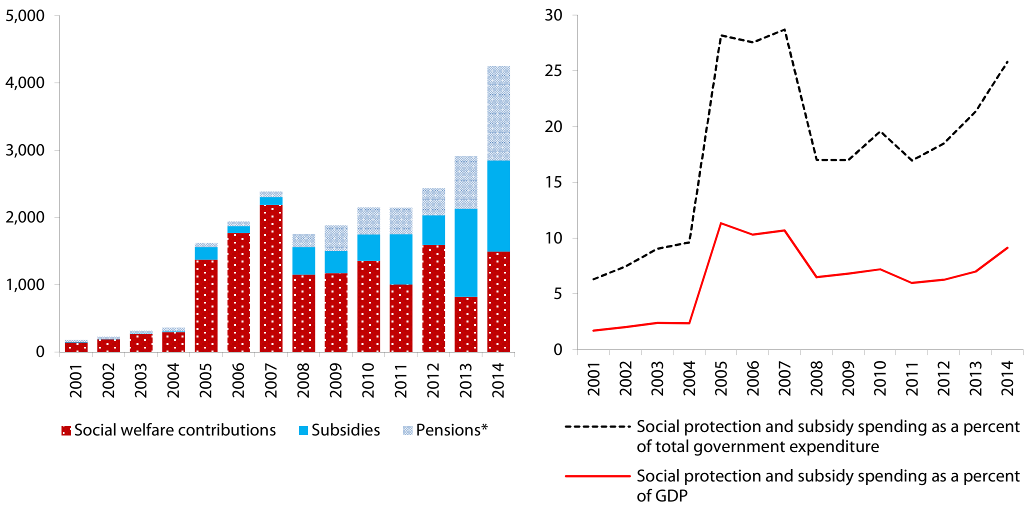
Although the government provides a health insurance subsidy to its citizens, the scheme has limitations and does not cover certain health-related costs. However, the government has provided the opportunity for the citizens living in abject poverty to request for financial assistance for those services not covered under Aasandha. The citizens submit their requests to NSPA, who then provides them with the financial assistance, after a thorough case-by-case analysis. This service has been given by the NSPA since 2010.

Foster Parent Allowance

Similar to the single parent allowance, a foster parent allowance was introduced by the government in May 2010. The main aim of this is to provide financial assistance to foster parents who are legally responsible for looking after orphan children or children with a guardian who is unable to look after their children for various reasons. A monthly payment of MVR1000 is given to every child under foster care and MVR500 is given to the foster parent.

Although the introduction of newer social assistance programs by the government have been generally met by positive acceptance by the general public, the lack of regulatory framework coupled with the inability to monitor the activities and conditions of each target group have created significant shortcomings in achieving the primary purpose of these programs. For instance, senior officials at NSPA highlight that some people exploit the current guidelines under each program (such as failing to register remarriages or exaggerating mild disabilities) to obtain cash transfers when they do not necessarily require it. This creates concern on the subject of fiscal sustainability, particularly in the long-run; collectively, the four programs mentioned above accounted for 1% of total government expenditure in 2014.

Figures 3 and 4: Government Spending on Social Protection and Subsidies, 2001–2014
(millions of rufiyaa, percent)



Source: Ministry of Finance and Treasury, GFS format
* Pensions include expenditure on two budget codes: pensions and "other benefits and gratuities".

4. Developments in Government Spending on Social Protection Programs and Subsidies

Between 2001 and 2004, total government spending on social protection programs and subsidies[16] was relatively low, averaging 2% of GDP. Such spending was almost entirely centered on social welfare contributions, which were mostly cash transfers given to the absolute poor. Fiscal costs for social protection skyrocketed in 2005, owing to the tsunami in December 2004, necessitating a large amount of cash and in-kind transfers to the large portion of the population affected by the disaster. The large scale of government spending under this program continued for the next three years, resulting in elevated levels of social protection spending. During this period, such spending increased substantially to more than 10% of GDP and remained at that level until 2008 (Figure 3 and 4), when spending decreased considerably to lower levels, although higher than those experienced in the early 2000s. In the latter half of the decade, social protection

16 This data is based on the Government Finance Statistics from the Ministry of Finance and Treasury. Social protection and subsidies spending as per this article comprises of government spending on pensions, subsidies and social welfare contributions. Social welfare contributions include all social assistance programs carried out by the government. Subsidies here are also not limited to the electricity and food subsidies provided by the government. Pensions include expenditure on two budget codes: pensions and "other benefits and gratuities".

spending increased slowly but gradually owing to the introduction of various new schemes and other external factors. In 2014, government spending on social protection reached MVR4.3 billion, accounting for 9% of GDP and more than a quarter of total government expenditure for the year.

Looking at the separate components of social protection and subsidies, the growth in spending on the social welfare component in 2012 largely stemmed from the implementation of the universal healthcare scheme, Aasandha. As for the succeeding years, the growth in government expenditure can be seen to be driven by considerable subsidy costs, reflecting large payments of arrears by the government. In 2014, social protection and subsidy spending by the government accelerated substantially, due to the introduction of the senior citizens' allowance which fuelled the increase in spending on pensions.

This rest of this section of the paper will evaluate government spending[17] under each of the major components in-depth.

4.1 Electricity Subsidies

In the Maldives, the largest portion of government subsidies is allocated to electricity. In 2014, MVR987.5 million or 75% of government expenditure on subsidies was spent on electricity. As shown in Figure 5, the government expenditure on electricity subsidies has increased significantly over the period 2009–2014. With regard to total electricity subsidy spending as a percent of GDP, it also followed an increasing trend during the period 2011–2014. Electricity subsidy amounted to 2% of GDP at the end of 2014, compared with the 1% recorded in 2011.

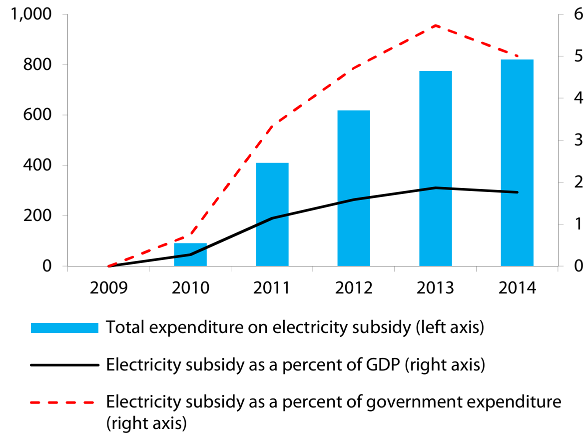
There were three main reasons behind the six-fold increase in government expenditure on electricity subsidies between 2010 and 2012.

- Relaxation of the eligibility criteria (see Box 2 for developments in electricity subsidies between 2009 and 2011).

17 Although the introductory paragraphs in Section 4 use broad-level data as per the Government Finance Statistics, detailed data for each component of social protection and subsidies as per this format was not available at the time of publication. Hence, government expenditure data as per the Economic Classification or local format has been used. Moreover, this has been supplemented by data obtained from the respective administrative authorities such as the National Social Protection Agency.

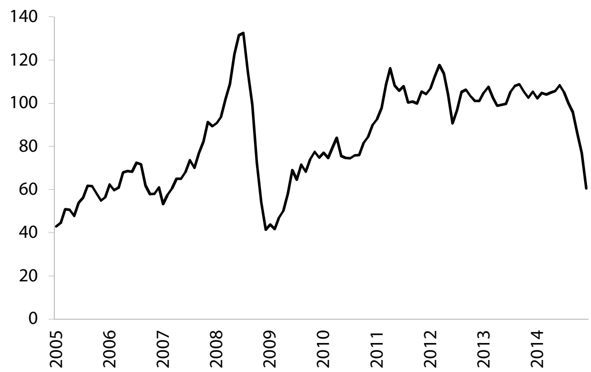
- Introduction of the fuel surcharge subsidy: the fuel surcharge subsidy was introduced by the government during 2010 in response to rising oil prices in the international market. As shown in Figure 6, crude oil prices in the international market continued to follow an upward trend even after 2010, directly affecting the fuel surcharge cost which is fully borne by the government. As a result of its high dependence on oil

Figure 5: Expenditure on Electricity Subsidies, 2009–2014
(millions of rufiyaa, percent)



Source: Ministry of Finance and Treasury, GFS format

Figure 6: Price of Crude Oil (Average of Brent, West Texas Intermediate and Dubai Fateh), 2005–2014
(US dollars per barrel)



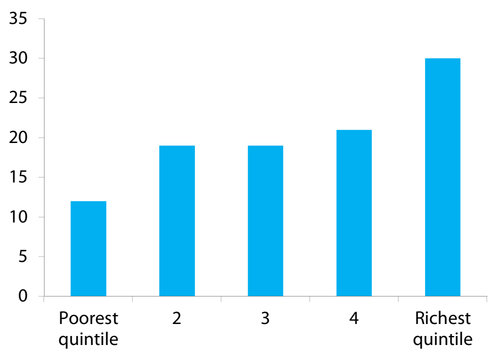
Source: International Monetary Fund

imports for energy purposes, Maldives is extremely vulnerable to oil price changes in the international market. According to a study done among 158 countries, Maldives ranked highest in the oil price vulnerability index in the South Asian region with a vulnerability of 16% during 2008, as opposed to less than 8% recorded for other countries in the region (Kojima, 2011). Hence, any oil price shock translates to an increase in the cost of producing electricity in the Maldives and given the nature of electricity subsidies, adds to the government expenditure.

- Devaluation of the Maldivian rufiyaa: Effective from April 2011, the exchange rate of the Maldivian rufiyaa was devalued by 20% which caused the exchange rate of the rufiyaa per US dollar to move to MVR15.42 per US dollar. As a result, oil imports became more expensive in terms of rufiyaa, which also contributed to the increase in expenditure on fuel subsidies during the period 2009–2010.

Although a significant portion of total government spending on subsidies are being spent on providing electricity subsidy to the citizens, a study done by the World Bank in 2012 indicated that only 12% of the total electricity subsidy is spent on the poorest quintile of the Maldivian population (Figure 7). In contrast, 30% or the largest portion of the electricity subsidy is received by the richest quintile (The World Bank, 2012).

Figure 7: Proportion of Subsidy Benefits Received by Quintile of Population, 2012
(percent)



Source: World Bank

Box 2: Developments of the Electricity Subsidy Scheme in the Maldives

The administered electricity tariff rates underwent an upward revision during November 2009 to reflect the increasing global energy prices. Simultaneously, the government introduced a usage subsidy to reduce the impact of this price increase on the poorer households. Consumers with a per capita income of less than MVR45 per day were eligible to receive the usage subsidy. Under this arrangement, this subsidy was given to approximately 300 households during this period.

The eligibility criteria were revised for a second time during January 2010. Consumers were no longer required to submit an application form to receive the subsidy. The new eligibility criteria were meter-based rather than household-based. Under the new criteria, households with an average spending on electricity of less than MVR400 over the past five-month period received 100% of the subsidy while households consuming over MVR400 on average were given 60% of the discount.

By March 2010 the suppliers were allowed to raise tariff rates to account for the changes in the global fuel prices. Subsequently, the government also introduced a fuel surcharge subsidy whereby 100% of the fuel surcharge cost will be borne by the government.

In May 2010 the government broadened its subsidy coverage and usage subsidy was made available to all households with a monthly consumption of less than 400 units. Nevertheless, in September 2010, after re-opening the application process, the government removed the eligibility criterion and provided electricity subsidy to all applicants.

The electricity subsidy was extended to the atolls using utility power during January 2011. By September 2012, 70%–80% of the meters received the subsidy, while 100% of the households in atolls were receiving the subsidy benefits.[1]

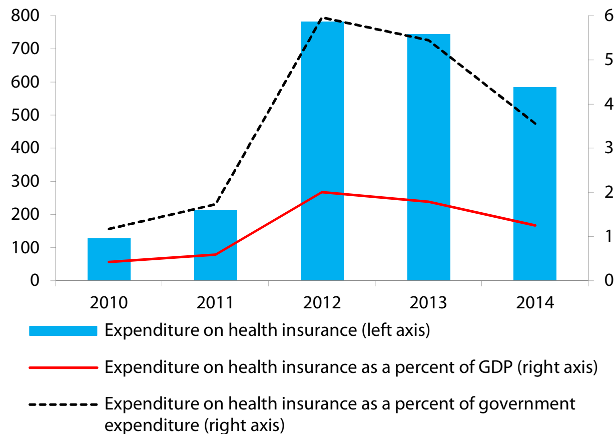
1 In atolls, households received subsidy benefits automatically and an application was not required.

4.2 Health Insurance

As mentioned earlier, the first health insurance scheme introduced in the Maldives was *Madhana* (introduced in 2008), which was followed by the universal health insurance scheme, *Aasandha* about three years later. As seen in Figure 8, the government expenditure on the *Aasandha* scheme in 2012 rose by more than two fold compared to its predecessor *Madhana*, largely owing to the universal coverage of *Aasandha*. Meanwhile, a decline in health insurance expenditure can be observed during the two consecutive years after 2012. This can be attributed to the accumulation of arrears arising from the payment irregularities by the government. In addition, studies also suggest that the scheme was overutilised during the first year of its inception. For example, approximately 84% of the total population had already used the scheme at least once by the end of the first year. The average claims amounted to approximately MVR20 million per week in the *Aasandha* scheme, which is a significant increase when compared with the average premium of MVR16 million per week for *Madhana* scheme. (Nagpal & Redaelli, 2013).

With respect to the expenditure on health insurance as a percentage of GDP, it rose from 0.4% in 2010 to 1.3% in 2014, owing to the introduction of the universal subsidy scheme in 2012. Similarly, expenditure on health insurance as a percentage of total government expenditure has also risen from 1% to 4% in the aforementioned period; although it is noteworthy that a slight decline can be observed in 2013 and 2014 in both cases, owing to the accumulation of arrears as mentioned before.

Figure 8: Usage and Expenditure on Government Health Insurance Schemes, 2010–2014
(millions of rufiyaa, percent)



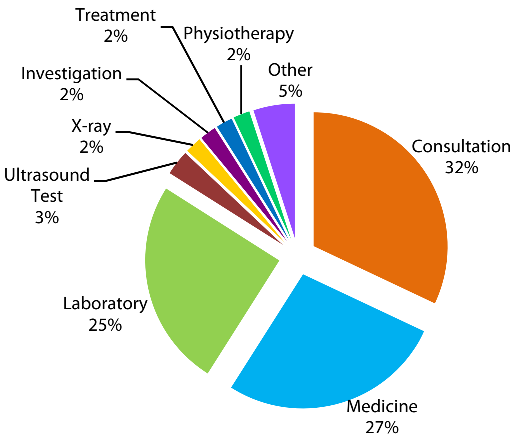
Source: National Social Protection Agency

Note: Data for 2010 and 2011 shows the development in expenditure for Madhana scheme, while expenditure data for Aasandha is shown for the remaining years.

Delving into the cost breakdown for *Aasandha* in 2012, the majority of the expenditure was towards consultation fees and purchase of medicine. *Aasandha* coverage of medicines accounted for 27% of total cost of the scheme (Figure 9). This was mainly due to the coverage of branded drugs under the scheme as opposed to generic medicines (Nagpal & Redaelli, 2013).

Interestingly, in an analysis done by Nagpal and Redaelli (2013), they found out that poorer segments of the population used the scheme most. They matched the data in the Monitoring and Information System at NSPA with data from MPAO. Their findings from the data triangularisation exercise showed that with regard to the total amount billed and number of average transactions, the poorest quintile used the scheme most, while the two richest groups had the lowest utilization (Table 3). Hence, it is evident from this study that the poorer population of the country has benefited most from the scheme.

Figure 9: Aasandha Usage Categorised by Activity, 2012



Source: Nagpal & Redaelli (2013)

Table 3: Aasandha Utilisation by Different Income Levels of MPAO Beneficiaries

Quintiles' total monthly earnings	Total amount billed (in millions of MVR)	Share of total amount billed	Per capita amount billed	Average number of transactions
Poorest (1)	26,000	23	2293	10.2
2	22,400	20	2296	9.7
3	25,900	23	2234	9.4
4	18,700	17	2192	8.7
Richest (5)	19,600	17	2164	7.6
Total	112600	100	2239	9.2

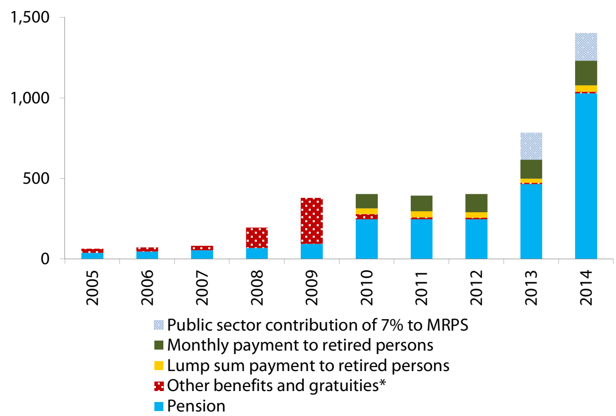
Source: Nagpal & Redaelli (2013)

4.3 Pension

Government spending on pensions remained relatively muted prior to 2008. However, several significant upward jumps have occurred for this portion of government social protection spending. A marked increase in pension expenditure was observed in 2008 and 2009 following the implementation of the Maldives Employment Act and the Law on Civil Service, which mandated the redundancy of employees above 65 years and allowed for the voluntary retirement of those who had reached 55 years of age. In line with this, substantial retirement packages were introduced and this encouraged a significant number of early retirees as well. Thus, as seen in Figure 10, the government expenditure on pensions rose markedly during this period, reflecting this change.

In 2014, the government spent MVR1.4 billion on pensions, equivalent to 8% of total government expenditure. Of this, over MVR1.0 billion was spent on old-age basic pension and the senior citizens' allowance, equivalent to 3% of total expenditure and accounting for over 70% of total government expenditure on pensions. The substantial increase in pension expenditure can be said to have stemmed almost entirely due to the introduction of the senior citizens' allowance.

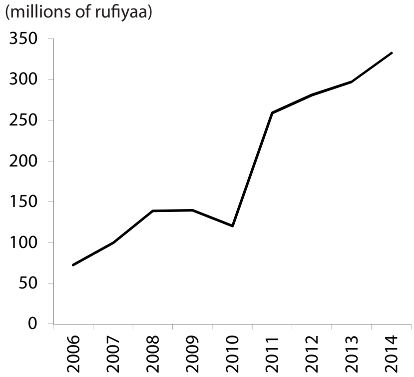
Figure 10: Government Expenditure on Pensions, 2005–2014
(millions of rufiyaa)



Note: In 2014, government expenditure on senior citizens' allowance has been included under "Pensions" – which refers to the old-age basic pension. Hence, the expenditure for the old-age basic pension and the senior citizens' allowance separately is not available for 2014. A new budget code for the senior citizens' allowance has been introduced for 2015.

Source: Ministry of Finance and Treasury

Figure 11: Food Subsidy Received by STO, 2006–2014



Source: STO Annual Reports

4.4 Food Subsidies

The food subsidy bill of the government is the second largest subsidy expenditure, following electricity subsidies. In 2014, MVR294.9 million or 22% of government expenditure on subsidies was spent on food subsidies. Over the past decade, the amount spent on food subsidies has followed a gradual upward trend (Figure 11). In 2006, food subsidies received by STO amounted to MVR72.5 million and accounted for 1% of the total government expenditure. By 2014, this amount had more than quadrupled, totalling MVR332.8 million and accounting for 2% of the budget. Due to the blanket nature of the subsidy on food staples, the subsidies are provided universally, without any type of targeting or discrimination between the poor or rich households or expatriates working in the Maldives. Furthermore, luxury resorts and hotels are also eligible to receive these subsidies to the same extent as the poorest citizen of Maldives.

As seen in Figure 10, expenditure on food subsidies[18] have been generally rising between 2006 and 2014, except for a slight decline in 2010. More significantly, the amount spent on food subsidies more than doubled from 2010 to 2011, exceeding MVR200 million for the first time.

As for the administered prices of staples, data obtained indicate that they have not changed significantly from 2000 onwards. Moreover, the fixed prices for rice, sugar and flour have remained relatively low at MVR4 per kg or below. In contrast, import prices[19] for food staples have been on an increasing trend over the past decade, with slight fluctuations, particularly in the late 2000s (Figure 12).

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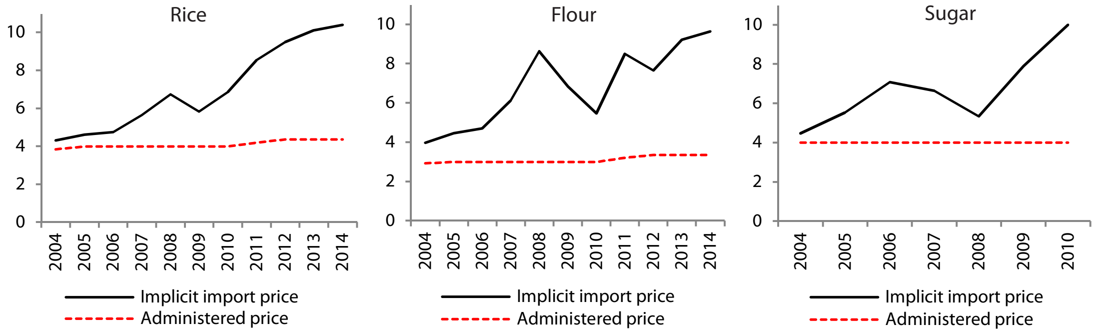
18 These amounts do not include arrears and only reflect the amount received by STO as food subsidy during the year.

19 Import prices here refer to implicit import prices on food staples for STO. This has been calculated using data from Maldives Customs Service, on the quantity and value of staple food imports by STO.

Figure 12: Price Differentials Between Administered Prices and Implicit Import Prices, 2004–2014
(rufiyaa per kg)



Source: Authors' calculations based on data from Maldives Customs Service. An overhead cost of MVR0.4/kg has been assumed and added to the implicit import price to obtain a clearer picture of the total price differential.

Given the mechanism of providing direct subsidies to STO and the lack of change in administered prices, it can be seen that government expenditure on food subsidies will be determined by two main factors: the cost of imports and the volume of demand for basic staples.

Cost of Imports of Basic Staples

As per information provided by the STO, the increasing cost for the import of rice, flour and sugar and consequently the food subsidy bill of the government, can be attributed to three particular reasons, explained below:

- Changes in global commodity prices play a significant role in determining the final import price of staples. The general upward trend in the import price of staples is reflective of hikes in global food prices (especially of the global food crisis in 2007–08), particularly in India, where about 80% of such imports by STO are made from. The cost of purchasing these staples is further increased by the role of middlemen, as STO does not import directly from primary producers but via third parties. However, as agreements are made for a one-year period, the import price does not fluctuate during this contract period.

- In late 2008, a combination of domestic and external factors led to increasing pressure in the foreign exchange market, leading to the creation of a parallel market for foreign exchange, where an exchange rate that was considerably higher than the official exchange rate of MVR12.85 prevailed. This meant that for businesses such as STO with a large requirement for foreign exchange were unable to fulfill their foreign exchange needs through official channels and had to resort to the parallel market, bearing an additional cost for imports of goods. The high premium in the parallel market was sustained for the next several years, continuing even after the exchange rate depreciated by roughly 20% in April 2011.

- Due to cash flow restrictions in STO (contributed by delays in compensation of food subsidies by the government, which frequently faced cash flow problems itself), the company decided to settle for a longer credit term of 180 days for its creditors. The more favourable credit terms implied that STO had to settle on a higher import price.

Sources of Demand for Staples

The main sources of demand for basic food staples can be said to come from three sources in the Maldives: expatriate labour force, the tourism sector, and domestic demand excluding the first two sources.

The most significant factor accounting for the increase in domestic demand for staples is the growth in expatriate workers. While the expatriate workforce stood at less than 30,000 in 2000, this has grown significantly to an estimated 88,175 by 2013.[20] This large increase in the workforce of Maldives will contribute considerably to an increase in demand for staple food items. Moreover, as a significant majority of expatriate workers in Maldives are unskilled workers[21] earning relatively low wages, they are less likely to substitute staples with more expensive foods. Thus, the blanket subsidy on food implies that the government's food subsidy bill is affected by changes in the expatriate labour force.

The growth of the tourism sector in the Maldives also poses an interesting facet to explain the increase in demand for basic food staples. The growth of tourism in Maldives has been considerable over the past ten years and accounts significantly for local demand. With the amount of tourist arrivals more than doubling over the past decade, the

20 Official expatriate numbers are not available from 2011 onwards. The estimate used in this paper was made by Ahmed Zayan Mohamed in "The Expatriate Workforce: Boon or Bane?" published in 2014. Although official expatriate worker numbers are below 100,000 unofficial estimates are made around 130,000.

21 In 2011, 48% of registered expatriate workers were unskilled workers. This proportion is likely to be higher once unregistered workers are taken into account.

demand for food can also be presumed to have increased proportionately. Although the demand for subsidised rice is likely to be quite small in the tourism sector, it is generally believed that tourist establishments may account for a significant portion of demand for sugar and flour. This is because the tourism sector in Maldives generally caters for high-income visitors and high-quality rice (such as Basmati) is more likely to be used by tourist establishments instead of price administered rice, which is of a lower quality. However, based on observational evidence, high-quality substitutes for sugar and flour are less frequently used in Maldives, and this is believed to be true for the tourism industry as well. Nonetheless, given the absence of data or first-hand reports to specifically prove this, the volume of demand for staple foods (or lack thereof) from the tourism sector cannot be accurately gauged.

Moreover, the growth of the tourism sector has been accompanied by a huge rise in employment in the industry. Among this, a significant portion of employees are foreign workers. Statistics indicate that 17% of expatriate workers in the Maldives work in the tourism sector (Department of National Planning, 2012). Given this context, a large portion of subsidised food items (particularly rice) will also be spent on the foreign workers in the tourism sector.

As for the demand stemming from the local population in the Maldives, data from the Household Income and Expenditure Survey 2009/2010 indicates that the poorest deciles of the population consume more rice than the richest deciles. However, this trend is not observed for either sugar or flour, where the expenditure by population deciles follows no specific pattern. This gives somewhat of an indication that, while price-administered rice may be an inferior good, it is not the case for sugar and flour, where the rich do not necessarily consume a lower quantity of these goods compared to the poor.

5. Challenges to Sustainable Social Protection and Spending

Looking at the social protection and subsidy schemes discussed in this paper, the most significant challenges to fiscal sustainability with regard to social protection and subsidy spending can be identified to be: lack of targeting; frequent and unanalysed policy changes by the government; and a lack of monitoring and evaluation to determine the effectiveness of these schemes.

A report by the Unites Nations Children's Fund on reviewing social protection in South Asia notes that the fiscal sustainability of individual social protection programs is at risk, owing to their unsystematic nature, and that this is especially the case in smaller, more aid-dependent countries. It also goes on to highlight that across South Asia, government agencies appear to have devoted limited resources and built insufficient capacity for social protection policy analysis, delivery monitoring, or impact evaluation. This makes it difficult to assess the effectiveness of these programs regarding actual coverage and impact on excluded groups (Köhler, Cali, & Stirbu, 2009).

Among the most significant challenges identified above, the lack of targeting in the provision of subsidies and social assistance programs is emphasised as the most concerning problem that exists in the current social protection system in Maldives by local politicians, senior government officials and international organisations. The 2014 annual Article IV mission by IMF recommended that the better targeting of subsidies was necessary to rein in public expenditure, which has been contributing to large fiscal deficits and high level of debt over the years.

Thus, this section of the paper will briefly discuss targeting issues before moving on to other shortcomings present in the social protection schemes evaluated.

5.1 Targeting of Subsidies

As mentioned in the paper, the provision of electricity and food subsidies in Maldives are carried out under a universal or blanket subsidy scheme. The main aim of providing the electricity subsidy is to make electricity accessible and affordable to everyone—especially those falling under the lower income brackets. However, a central consequence that has resulted from the provision of blanket subsidies is the lack of equity among different strata of society. For instance, as discussed earlier, a study by the World Bank in 2012 revealed that the poorest quintile of the population receive only 12% of the electricity subsidy in Maldives. The underlying reason behind this is that the rich tend to consume more electricity and fuel compared to the low-income households, implying that the existing electricity subsidy scheme reinforces inequality rather than helping to eliminate it.

While the desirability of a blanket subsidy stems from its low administrative costs, these universal schemes lead to inefficiency and social inequality as they are not targeted to those who truly need it. The large administrative costs associated with targeting, particularly in the initial stages, are likely to put additional pressure on the government budget, however, this may be offset in the long run by the lower expenditure on the subsidies itself. The associated costs can be minimised by having a central authority to undertake the administration of the various social protection programs and subsidy schemes.

It must be noted that the government has had plans to target subsidies as early as 2009, soon after the provision of electricity subsidies. Plans to undertake subsidy targeting was included in the proposed government budget for 2010 as well as in the 2009 Strategic Action Plan, which specifically referred to targeting plans for electricity, water and staple food items. Although efforts to undertake subsidy targeting have consistently been on the government agenda, no tangible results have materialised.

5.2 Other Issues

Electricity Subsidies

Fuel or electricity subsidies are pervasive and exist as one of the most common types of subsidies around the globe. It is estimated that in 2011, 0.7% of the world GDP was spent on subsidies for petroleum products, electricity, natural gas and coal.

Apart from the lack of targeting, there are a number of other issues in the electricity subsidy scheme which exacerbates the growing government budget deficit. The following are some of the additional issues identified in this respect:

1. Due to the provision of electricity subsidies by the government, the true cost of electricity production is not borne by the supplier. This reduces the incentive for the supplier to increase its productive efficiency and to improve the quality of its customer service. As a result, the inefficient and outdated technology which may be used in the process of electricity generation adds to the cost of production, thus raising the subsidy expense for the government (International Monetary Fund, 2013).

2. As a consequence of underpricing electricity, the consumers underestimate the true production cost and are unaware of the increasing cost of generating electricity. This results in excessive electricity consumption, causing the government to spend more on energy subsidies (International Monetary Fund, 2013). For instance, in Singapore, electricity is not subsidised. This is to ensure that consumers take in to consideration the true cost of the electricity production and avoid wasteful consumption of a scarce

resource. However, the government has identified the low-income households and extends rebates every year to help offset part of their utility bills (Energy Market Authority of Singapore).

However, despite the above reasons, energy subsidy reform is often met with resistance. Once in place, such subsidies are difficult to remove or alter (Box 3).

Health Insurance

The existing *Aasandha* health insurance scheme has many issues that need to be addressed in order to make the scheme efficient and cost effective. The following are the main problems identified in the scheme.

1. *Aasandha* does not work as an insurance scheme as the name suggests. Instead, government makes the premium payment on an irregular basis and some of it is accumulated as arrears. The government lacks the capacity to make annual premium payments and only pays for claims.[22] It is also notable that a number of claims are rejected as a result of incomplete documentation, which increases the transaction costs incurred by the service providers, who are also mostly state-owned (Nagpal & Redaelli, 2013).

2. *Aasandha's* coverage of drugs makes up almost one-third of the total health insurance subsidy.[23] This is because *Aasandha* covers proprietary drugs as generic drugs are seldom used in the country. Hence this substantially increases the health insurance subsidy (Nagpal & Redaelli, 2013).

3. The scheme is designed in such a way that a very small portion of the cost is transferred to the consumer. Hence there is potential for moral hazard and gives little incentive for the beneficiaries to reduce costs (Nagpal & Redaelli, 2013).

In this respect, there are several reform measures that can be taken in order to improve the efficiency and the cost effectiveness of the *Aasandha* scheme without compromising its coverage. For instance, the government can develop a co-insurance scheme whereby citizens contribute to the insurance fund rather than it being fully funded by the government budget. Meanwhile, households from low-income brackets can be excluded from making financial contributions to this scheme and their healthcare can be funded

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22 The government changed Aasandha into an administrative scheme on 1 March 2015, which means that annual premium payments need not be paid by the government; instead the government will only pay for claims.

23 As at March 2013, 30% of the total Aasandha expenditure was spent for medicine.

Box 3: Energy Subsidy Reforms: Global Experiences

In general, implementing policy reform in large-scale subsidy programs, particularly, those that have not undergone any change for a long period, is a difficult task. One of the reasons why such programs continue to be in place is due to the political and social repercussions which may ensue if these subsidies are removed. It is usually feared that such a change would lack public support, especially from those who benefit most from the subsidy. Moreover, misunderstandings or misperceptions among both policymakers and the public about the benefits and costs of policy reforms commonly lead to the default situation of the continuance of price subsidies (The World Bank, 2010). However, in order to minimise the burden on the government budget, reform is necessary, especially in universal subsidy schemes which are almost always regressive, in which most of the benefit goes to the well-off citizens.

With regard to country experiences in energy subsidy reform, history shows that public protests following subsidy reforms have led to the partial or complete reversal of some reforms. In Bolivia, fuel subsidies were removed in 2010 to stop the smuggling of oil products to neighbouring countries due to the low administered prices. This resulted in a general price increase of more than 80%. Following the significant price hike, thousands took to the street to demonstrate against the reform, which ultimately led to the reinstatement of the subsidy by the government (World Economic Forum, 2013).

On the other hand, Ghana brought about its energy subsidy reform after a thorough assessment of the possibilities and outcomes. The government funded an independent study to assess the winners and the losers of a subsidy reform, which revealed that the greatest benefit of the subsidy was received by the rich. They used this information in a communication campaign to create awareness about the negative impacts of energy subsidies (World Economic Forum, 2013).

The above examples demonstrate the importance of educating decision makers and the public before implementing the de-subsidisation. Nevertheless, it is not necessary to remove the subsidy entirely, as this would have an adverse impact on the low-income households. According to a study by the IMF, based on data from 20 countries (Africa, Asia, Middle East and Latin America) undertaken between the period 2005–2009, regarding welfare impacts of fuel price increases, an increase of 25 cents per liter in fuel prices leads to a decline of real household incomes by approximately 5.9% (International

Monetary Fund, 2010). Hence it is important to take measures to safeguard the real incomes of the poorest households while carefully assessing the political, economic and global conditions before implementing a reform.

by the government. This can be developed as a way of providing targeted health insurance, and encouraging individuals to reduce costs and increases their savings to obtain healthcare services.

A similar scheme is carried out in Singapore where it is compulsory for every individual in the working population to contribute part of their monthly wages to a medical savings account. In addition, their employers are also required to contribute an equivalent amount to the aforementioned account. Hence, these savings could be used for medical treatments whenever the need arises. However, the government provides subsidies if the savings are inadequate to cover the essential healthcare service charges (Ministry of Health Singapore).

Another way to significantly reduce costs is through the bulk-procurement of generic drugs, as *Aasandha* spends a sizable share of its costs on drugs, which is largely due to the market dominance of branded drugs. A list of essential and generic drugs that will be covered by the *Aasandha* scheme can be prepared and the coverage of proprietary or branded drugs can be discontinued. In order to prepare the list of generic drugs, detailed information regarding prescriptions in the claims portal can be used to understand the utilisation frequency and trends of different drugs in the country (Nagpal & Redaelli, 2013).

It is also noteworthy that *Aasandha* costs are driven up due to the mismanagement of chronic diseases at the primary care level. For instance, if ailments such as diabetes or hypertension are not managed at the early stages, severe complications can arise later on. It is less costly to manage the cases in the initial stage, rather than providing treatment costs when the case is more severe. With better attention to early detection and immediate preventive measures, the progress of such diseases and the occurrence of complications can be delayed. In addition, standard treatment guidelines as well as referral guidelines will greatly improve the care, financial security and outcomes for these patients (Nagpal & Redaelli, 2013).

Pension

In 2009, the various deficiencies that existed in the previous pension system were largely corrected by establishing a more efficient, means-tested system adhering to global standards. As a result, pensions now serve the purpose of a safety net much better, and covers the whole population of the country, whether employed or not.

Nonetheless, the World Bank and the MPAO have highlighted several issues that still exist in the Maldives pension system which are contrary to the social security purpose of pensions and put a considerable strain on fiscal costs of the government. Following are the two main problems highlighted in this respect:[24]

Introduction of pension schemes outside of the existing pension framework

Although there is an appropriate legal framework for the current pension system such as the Maldives Pension Act, changes in government policy on introducing pension schemes outside of the existing framework can cause the fiscal costs of the pension scheme to escalate significantly in the near to medium term. For instance, the introduction of the senior citizens' allowance in February 2014 following the presidential elections considerably increased the pressure on government finances. It must be noted that legal regulations sufficiently allow for the adjustment of the amount of old-age basic pension subject to living standards and macroeconomic conditions.

While the government initially budgeted MVR728.1 million on basic pension for 2014, this expenditure amount ballooned to over MVR1.4 billion.[25] This put extra pressure on government financing and the need to borrow greater amounts through T-bills.

The loose regulation that allows the introduction of new basic pension schemes means that government expenditure on pensions could increase on an unsustainable trajectory. Given that presidential elections occur every five years, and that social protection is an area of priority, it is important to align any changes to the schemes with the existing one

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24 Problems in the pension system which are not closely related to the fiscal costs of the government are not elaborated here, as it is beyond the scope of the paper. For further reading, please refer to Shahudh, M. (2015, February). Dhivehiraajjeyge Pension Nizaam Ehen Qaumuthakuge Pension Nizaamthakaa Alhaabalaalun. Maldives Pension Administration Office E-Bulletin, pp. 4–13 MPAO.

25 Government budget documents only made a distinction between the old-age basic pension scheme and the senior citizens' allowance from 2015 onwards. In 2014, payments made for both these schemes were recorded under the old-age basic pension.

and also to not introduce new schemes outside of the current pension system, as in the past, to reduce the fiscal burden on the government.

Double coverage in the pension system

Despite moving from a defined benefit system to a defined contribution system (as is employed by advanced economies around the world), in the Maldives, some state institutions still carry out defined benefit pension systems for employees of the respective institutions. This means that although many of the employees were awarded accrued rights with the implementation of the Maldives Pension Act, these employees continue to become eligible for institution-specific pension schemes funded by the government, thus receiving "double pensions".

Under institution-specific defined benefit schemes employees are commonly given a lump-sum amount on retirement and an additional monthly pension benefit for the rest of their lives thereafter.[26] The expected government expenditure on institution-specific pensions and benefits (outside of the Maldives Pension Act) is estimated to amount to MVR165.0 million in 2015 and increase significantly to MVR463.0 million by 2030 (Auditor General's Office, 2015).

In 2014, the government announced that it would bring a stop to the issue of double coverage in the pension system beginning 2015.[27] It was noted that there were substantial legal obstacles to solve this issue such as making amendments to several acts. Given this context, the government budget documents for 2015 nevertheless specify significant amounts to pay as "double pensions" for employees of the respective institutions from 2015 to 2017.

Moreover, as a number of state institutions are permitted to run their own pension schemes under the purview of their laws, it is possible that these institutions may commence their own institution-specific pension schemes in the future similar to the ones already in place. This would not only exacerbate the problem of double pensions mentioned above, but increase the fiscal burden of the government and additionally create inequality among the citizens of the country. Further pressure will be put on

26 Currently there are several institutions that in Maldives that grant pension benefits to their employees from a defined benefit system. These include Ministry of Finance and Treasury, Judicial Services Commission, Department of Judicial Administration, Maldives National University, President's Office, Maldives Customs Service, Maldives Police Services and Maldives National Defense Force.

27 Retrieved on 11 March 2015. http://www.haveeru.com.mv/news/57485

public finances in the future if these pensions are left to continue in an unfunded manner, as more employees will continue to become eligible to these schemes following their retirement. Hence, there is an urgent need to strengthen the legal framework of the pension system in Maldives to harmonise the various pension schemes and to promote equality.

Based on the methodology for the Melbourne Mercer Global Pension Index, Shahudh (2015) assesses the pension system of Maldives on three sub-indices as defined in this index—adequacy, sustainability and integrity—and gives a C rating to the pension system in Maldives. This indicates that "the system has some good features, but also has major risks and/or shortcomings that should be addressed. Without these improvements, its efficacy and/or long-term sustainability can be questioned."

Food Subsidies

The system for food subsidies in the Maldives can be categorised as a self-targeting program. A self-targeting program is one where only the target population elects to participate; food subsidies are considered self-targeted when the subsidised item is an inferior food. This is when the poor may consume more of the subsidised good than the rich. However, in the Maldives, although the subsidised food items are basic items and of generally low quality, almost all households consume the subsidised food items as they continue to be basic staples in everyday diet.

As discussed in Section 4, sudden changes in global commodity prices can cause significant problems for the government subsidy bill, giving rise to the need for reform. With regard to subsidy reforms, (Ahmad, 1998) examines the possibilities for reducing public expenditure on food subsidies in Jordan while protecting the poor.[28] For rice and sugar, which are assumed to be normal goods for Jordan, Ahmad suggests rationing as a short-term solution as it is more cost-effective than a blanket subsidy. He deduces that this would reduce the subsidy bill by half while additional targeting through coupons is likely to reduce the subsidy further. He states that the government of Jordan agreed to embark on a medium-term solution of adjusting administered prices upwards towards international levels for imported items, thus reducing the fiscal cost while maintaining stable prices.

28 Along the same lines as Maldives, Jordan's food subsidy bill mainly (76%) accounted for wheat, rice and sugar in 1990.

In the Maldives as well, it is important to periodically review the administered prices and gradually revise them based on the real income levels of locals and international prices. As highlighted earlier in this paper, current administered prices for rice, flour and sugar have remained on average, at MVR4/kg, since 2000.

6. Conclusion

As highlighted in this paper, there have been significant changes that have taken place in the Maldives with regard to social protection programs and subsidies in the past few years. With the aim of increasing welfare of the citizens, the government devoted a significant portion of its budget to such social protection programs and subsidy provision, implementing radical changes within a short period of time. Nonetheless, the large scale of these social protection schemes and the lack of targeting in subsidy schemes have created substantial fiscal costs for the government that are likely to become unsustainable in the medium term. Moreover, studies have shown that the benefits of some subsidy schemes do not accrue to the poorest households in the Maldives; rather it is received by the richest citizens. Thus, it is evident that reforms are necessary in all the major social protection and subsidy programs identified in this paper.

Following are the main recommendations for the social protection and subsidy programs that were discussed:

- Targeting both electricity and food subsidies by identifying low-income households
- Gradually adjusting administered prices of staple foods upwards in the short term, with respect to the increase in purchasing power of Maldivians
- Removing administered prices of staple foods altogether in the medium term, and replacing it with a targeted scheme
- Developing a co-insurance program whereby both the government and private individuals contribute towards health insurance costs, as to lessen moral hazard
- Providing targeted health insurance services to poorer households
- Procuring generic drugs in bulk while discontinuing the coverage of proprietary and branded drugs
- Facilitating individuals to obtain treatment for chronic diseases early at a preventative stage

- Removing double pensions and integrating it into the national pension scheme such that pension benefits will not be duplicated
- Aligning all policies relating to pensions with existing pension schemes
- Ensuring that new pension schemes be introduced only within the current legal framework to control government expenditure on pensions
- Centralising the administration of all social welfare and subsidy programs under one government office, to create efficiency and reduce costs
- Creating public awareness about the costs and benefits of changes brought to the social protection and subsidy programs

It must be noted that reforms require thorough evaluation regarding the outcomes before they can be implemented, particularly as they pose large political risks. However, many countries have experienced successful reform programs by bringing about gradual changes with ample public awareness. Implementing the necessary reforms to address the weaknesses in the current social protection and subsidy programs in the Maldives is crucial for promoting equality among its citizens and achieving fiscal sustainability in the long run.

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