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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plans of Malta

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of Malta

{C(2016) 8013 final}

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1. INTRODUCTION

Malta submitted its Draft Budgetary Plan (DBP) for 2017 on 17 October 2016 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Malta is subject to the preventive arm of the Stability and Growth Pact (SGP) and should ensure sufficient progress towards its medium term budgetary objective (MTO). As the debt ratio amounted to 64% of GDP in 2015 Malta is also required to comply with the debt reduction benchmark.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission Forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2016 autumn forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2016-2017 (also taking into account the risks to their achievement) against the obligations stemming from the SGP. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council in the spring of 2016, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the DBP sees a slowdown in real GDP growth from the historical high of 6.2% in 2015 to 3.9% in 2016 reflecting a more moderate expansion of domestic demand on a high base. Real GDP growth is projected to decelerate further to 3.5% in 2017. This scenario has been somewhat revised with respect to the projections underpinning the 2016 Stability Programme (SP), with the forecast for 2016 revised down on weaker external demand, while the one for 2017 has been revised upwards due to stronger domestic demand. HICP inflation is seen to decline somewhat in 2016 to 1% before rising to 1.5% in 2017, a path that has been revised down compared to the projections in the SP. The labour market projections are more positive than those underpinning the SP. Employment growth is forecast to remain roughly unchanged in 2016 at 3.3%, before decelerating to 2.7% in 2017, while the unemployment rate remains low.

The DBP's macroeconomic scenario is in line with the Commission 2016 autumn forecast, albeit with some differences in terms of the main drivers of growth. The DBP is based on a more moderate contribution of domestic demand to growth for 2016, partly compensated by higher contribution from the build-up of inventories. Stronger private consumption, in view of the favourable labour market outlook, could therefore pose an upside risk to the DBP projections. For 2017, on the contrary, domestic demand is projected to have a higher contribution to growth, offset by a less favourable outlook for net exports. Overall, assessed against currently available information, the DBP's macroeconomic scenario appears plausible for 2016 and 2017.

Box 1: The macro economic forecast underpinning the budget in Malta

The macroeconomic projections underlying the DBP have been endorsed by the Malta Fiscal Advisory Council (MFAC), an independent fiscal council established with the Fiscal Responsibility Act. The endorsement took the form of a letter addressed to the Minister of Finance and a report, published on the MFAC's website. According to the MFAC, the macroeconomic scenario is generally cautious and feasible. The endorsement highlights that risks to the scenario appear broadly balanced and are linked with the ability of private consumption to maintain its momentum, the materialisation of planned investment projects and the economic developments in main trading partners. The MFAC expressed satisfaction with its cooperation with the departments in charge of forecasting. Nevertheless, it recommended further streamlining of the forecast process and invited the Ministry to finalise its projections earlier to allow appropriate time for their assessment.

The independent status and tasks of the Fiscal Council are provided for in the Fiscal Responsibility Act. The mandate of the Council includes also endorsing the fiscal projections of the Draft Budgetary Plan, but this endorsement was not finalised in time to be included in this document.

Table 1. Comparison of macroeconomic developments and forecasts

	2015	2016			2017		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	6.2	4.2	3.9	4.1	3.1	3.5	3.7
Private consumption (% change)	5.5	3.5	3.5	4.0	2.4	3.2	2.8
Gross fixed capital formation (% change)	43.1	1.6	2.2	4.0	9.2	10.8	5.0
Exports of goods and services (% change)	2.1	3.4	1.9	2.0	3.0	2.8	3.7
Imports of goods and services (% change)	5.6	2.4	1.9	2.1	3.9	4.2	4.1
Contributions to real GDP growth:							
- Final domestic demand	11.7	2.6	3.0	3.8	4.0	5.4	4.1
- Change in inventories	-0.8	0.0	0.8	0.3	0.0	0.0	0.0
- Net exports	-4.7	1.6	0.1	0.0	-0.9	-2.0	-0.4
Output gap[1]	1.6	1.6	1.1	0.9	0.5	0.0	0.1
Employment (% change)	3.4	2.7	3.3	2.7	2.7	2.7	2.5
Unemployment rate (%)	5.4	5.3	4.9	5.0	5.3	5.0	5.2
Labour productivity (% change)	2.7	1.5	0.6	1.4	0.4	0.8	1.1
HICP inflation (%)	1.2	1.6	1.0	1.0	1.9	1.5	1.6
GDP deflator (% change)	2.3	2.6	1.8	1.8	2.5	2.3	2.2
Comp. of employees (per head, % change)	2.7	2.8	2.8	2.9	2.4	2.8	2.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.4	9.0	2.2	3.7	8.4	3.3	3.4

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP confirms the 2016 deficit target of 0.7% of GDP set in the SP, which revised the target of 1.1% of GDP outlined in the 2016 DBP following the introduction of additional consolidation measures on the expenditure side and a revision of the impact of revenue measures introduced with previous budgets. Compared to the SP, the composition of expenditure put forward in the DBP has changed as higher expenditure (mainly in intermediate consumption, also related to the Maltese presidency of the Council of the EU in the first semester of 2017 for around 0.2 pps. of GDP in 2016, identified as one-offs in the DBP) is expected to be offset by higher revenue from the Individual Investor Programme (IIP), which is now estimated at 1.4 pps. of GDP compared to 0.9 pps. of GDP in the SP). As a result, the improvement in the headline balance compared to 2015 is mostly driven by higher non-tax revenues related to the IIP, while lower current expenditure (mainly interest expenditure and social transfers) is offset by higher spending for investment from national funds.

The Commission 2016 autumn forecast projects the 2016 deficit at 0.7% of GDP. While the headline deficit is in line with the authorities' target, the composition is somewhat different. The Commission projects lower nationally financed public investment which is offset by lower current revenue matched by a more dynamic growth of current expenditure and higher capital subsidies.

For 2017, the DBP targets a further reduction of the deficit to 0.5% of GDP, with the primary surplus reaching 1.6% of GDP. Compared to the SP, the deficit target improves slightly (by 0.1 pps. of GDP) and the consolidation is anchored in both current expenditure and revenue revisions in terms of GDP. In nominal terms, upward revisions to current expenditure (mainly compensation of employees and intermediate consumption, also related to the costs associated to the Maltese presidency of the Council of the EU in 2017) and net capital expenditure have been offset by higher current revenues, including the upward revision in the expected proceeds coming from the IIP (at 1 pp. of GDP compared to the previous estimate of 0.4 pps. of GDP). The revision is also explained by the measures included in the 2017 budget, also presented on 17 October, which have an expansionary impact (0.3% of GDP).

Current revenues (in nominal terms) are projected to increase by 4.4% (less than nominal GDP growth) thus decreasing as a share of GDP (by 0.5 pps. of GDP), mainly due to the decrease, compared to 2016, in the proceeds linked to the IIP. Current expenditure is projected to increase at 4% and to decrease by 0.6 pps. relative to GDP, thanks to a decreasing interest expenditure and a deceleration in spending linked to social transfers. It should also be noted that intermediate consumption is expected to increase on the back of additional spending related to the Maltese presidency of the Council of the EU for around 0.3 pps. of GDP, which are identified as one-offs in the DBP. Net capital expenditure is expected to decrease marginally, as a result of a reduction in capital subsidies due to the phasing out of the capital injection into Air Malta (which in 2016 amounted to 0.1% of GDP). The absorption of EU funds would increase only marginally. It should also be noted that the current expenditure projection for 2017 includes a contingency reserve of 0.1% of GDP (in line with the Fiscal Responsibility Act) that should be activated in case of unforeseen expenditure or revenue slippages in order to ensure compliance with fiscal rules (while, if unused, it will be translated into additional savings).

The Commission 2016 autumn forecast projects the 2017 deficit at 0.6% of GDP. The 0.1 pps. of GDP difference with the authorities' target is due to more dynamic current expenditure and lower revenue related to other current revenues which is only partly compensated by more bouyant income taxes and lower net capital expenditure. In particular, the Commission envisages a higher absorption of EU funds and higher spending for capital subsidies.

Risks to the deficit targets are mainly linked to slippages in intermediate consumption for expenditure related to the Maltese presidency of the Council of the EU and the public sector wage bill due to the wage agreement which will expire at end-2016. State-owned enterprises, namely Enemalta and Air Malta, could also require additional subsidies. On the other hand, capital expenditure could be lower than planned if it is used to compensate for slippages in budgetary execution. Finally, current revenue could turn out more buoyant than expected due to a more favourable economic environment and higher proceeds coming from the IIP.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Malta currently standing at 0.5[1]. As a consequence, total interest expenditure by the general government has continued to decrease as a share of GDP. Based on the information included in the DBP, interest expenditure in Malta is expected to fall from 2.6% of GDP in 2015 to 2.3% in 2016 and is projected to decrease further next year, to 2.1% of GDP, well below the 3.0% recorded back in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from Malta's plans is broadly confirmed by the Commission forecast.

In structural terms[2], the government plans imply an improvement in the balance in both years, amounting to more than 1 pp. of GDP in 2016 and ¾ pps. of GDP in 2017. Based on the Commission forecast, the improvement in the structural balance is estimated at around 1 pp. of GDP in 2016 and around ½ pps. of GDP in 2017. This difference is mainly due to a different quantification and identification of one-off measures on the expenditure side. In particular, the DBP identifies the expenditure (non-employee) related to the Maltese presidency of the Council of the EU in 2016 and 2017 as one-offs, amounting respectively to 0.2% and 0.3% of GDP. However, based on the criteria used by the Commission to identify one-off measures[3], these costs cannot be considered a one-off, but rather a structural component of the EU membership. Hence, using the Commission's identification of one-offs, the pace of adjustment to the medium-term objective is slightly lower in both 2016 and 2017 (by 0.2 pps. and 0.1 pps. of GDP respectively) and more in line with Commission's projections. The improvement in the structural effort expected over the period 2015-2017 is higher compared to what was expected in the SP due mainly to a revision in the one-off measures and a lower headline deficit in 2017.

Against the background of falling interest expenditure, the projected improvement in the structural balance in 2016-17 (1.1 pps. and 0.8 pps., respectively) is accompanied by a less pronounced improvement in the structural primary balance (0.8 pps. and 0.6 pps., respectively).

[1] 10-year bond yields as of 21 October 2016. Source: Eurostat.

[2] Cyclically adjusted balance net of one-off and temporary measures, as recalculated by the Commission using the commonly agreed methodology.

[3] European Commission (2015), 'One-offs measure – Classification principles used in fiscal surveillance', *Report on Public Finances in EMU*.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2015	2016			2017			Change: 2015-2017
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**42.0**	**39.4**	***40.3***	**40.0**	**39.3**	***39.8***	**39.6**	**-2.3**
of which:								
- Taxes on production and imports	13.5	13.6	*13.6*	13.6	13.5	*13.5*	13.5	-0.1
- Current taxes on income, wealth, etc.	14.1	13.9	*14.0*	14.3	13.8	*14.0*	14.4	-0.1
- Capital taxes	0.2	0.2	*0.2*	0.2	0.2	*0.2*	0.2	0.0
- Social contributions	6.8	6.7	*6.8*	6.7	6.5	*6.7*	6.7	-0.1
- Other (residual)	7.5	5.1	*5.7*	5.3	5.3	*5.4*	4.9	-2.1
Expenditure	**43.4**	**40.1**	**41.0**	**40.7**	**39.9**	**40.3**	**40.2**	**-3.1**
of which:								
- Primary expenditure	40.8	37.8	38.7	38.5	37.6	38.2	38.1	-2.7
of which:								
Compensation of employees	12.7	12.5	12.7	12.7	12.3	12.6	12.7	-0.1
Intermediate consumption	6.8	6.5	7.0	7.0	6.5	7.0	7.0	0.1
Social payments	11.7	11.3	11.4	11.5	11.1	11.1	11.2	-0.6
Subsidies	1.3	1.2	1.2	1.2	1.2	1.1	1.2	-0.1
Gross fixed capital formation	4.5	3.5	3.5	2.9	3.6	3.6	2.9	-0.9
Other (residual)	3.8	2.8	2.9	3.2	3.0	2.8	3.2	-1.1
- Interest expenditure	2.6	2.3	2.3	2.3	2.2	2.1	2.1	-0.5
General government balance (GGB)	**-1.4**	**-0.7**	**-0.7**	**-0.7**	**-0.6**	**-0.5**	**-0.6**	**0.9**
Primary balance	**1.2**	**1.6**	**1.6**	**1.6**	**1.7**	**1.6**	**1.5**	**0.4**
One-off and other temporary measures	0.1	0.1	-0.1	0.0	0.1	-0.2	0.0	-0.3
GGB excl. one-offs	**-1.5**	**-0.8**	**-0.6**	**-0.7**	**-0.6**	**-0.3**	**-0.7**	**1.2**
Output gap[1]	1.6	1.6	1.1	0.9	0.5	0.0	0.1	-1.7
Cyclically-adjusted balance[1]	-2.1	-1.4	-1.2	-1.1	-0.8	-0.5	-0.7	1.7
Structural balance (SB)[2]	**-2.2**	**-1.5**	**-1.1**	**-1.1**	**-0.9**	**-0.3**	**-0.7**	**2.0**
Structural primary balance[2]	0.4	0.8	1.2	1.1	1.3	1.8	1.4	1.5

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.2. Debt developments

The general government debt-to-GDP ratio declined from 67% of GDP in 2014 to 64% of GDP in 2015 thanks to favourable macroeconomic developments and despite the debt-increasing stock-flow adjustment. The latter included the repayment of some tax arrears from

Enemalta (the public energy utility corporation). In the DBP, the general government gross debt ratio is expected to decrease to 63.3% in 2016. It is then expected to decrease further by 1.4 pps. of GDP in 2017, reaching 61.9% of GDP.

The stock-flow adjustment is projected to be sizeable over the two years 2016-2017. Nearly half of it is related to the positive balance in the National Development and Social Fund[4] related to the IIP which does not feature in the general government deficit. Other factors contributing to the high stock-flow adjustment in 2016-2017 are: (i) the contribution towards a special Malta Government Stocks sinking fund, (ii) a sizeable increase in government cash holdings and deposits in 2016, and (iii) an equity acquisition into Air Malta in 2017.

Nevertheless, the projected increase in primary surplus, the acceleration of inflation and the positive (even if moderating) impact of real growth as well as the planned decrease in interest expenditure are sufficient to keep the debt ratio on a declining path.

According to the Commission forecast, the debt ratio is projected to decrease to 62.1% in 2016 and to fall below the 60%-of-GDP threshold already in 2017 (to 59.9% of GDP). The difference compared to the DBP targets, is mainly explained by the lower stock-flow adjustment in the Commission forecast. The Commission also forecasts a slightly lower primary surplus and a lower impact of inflation on the debt-to-GDP ratio.

The same risks highlighted for the deficit targets apply to the debt projections of the DBP. Moreover, compared to other Member States, the government guarantees provided by central government on debt of non-government units continues to remain high in Malta. After a substantial increase in 2012 to 16.5% of GDP (by 3.8 pps.), it has remained broadly stable to reach 16% of GDP in 2015.

[4] The Individual Investment Programme was established by LN 47/2014. This scheme grants naturalization to foreign individuals and their dependants following substantial investment and a due diligence process. By virtue of LN 2/2015, which amends the Public Administration Act, a legal framework was provided for the funds received through the IIP applications, and managed by the National Development and Social Fund Agency as a separate legal entity. The National Development and Social Fund was established in 2015 and it is expected to receive 70% of the contributions paid by the applicants. According to the establishing act, the funds received by the National Development and Social Fund shall be used in the public interest inter alia for the advancement of education, research, innovation, social purposes, justice and the rule of law, employment initiatives, the environment and public health.

Table 3. Debt developments

(% of GDP)	2015	2016			2017		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**64.0**	**62.6**	**63.3**	**62.1**	**60.4**	**61.9**	**59.9**
Change in the ratio	-3.0	-1.4	-0.7	-1.9	-2.1	-1.4	-2.2
Contributions[2] :							
1. Primary balance	**-1.2**	**-1.6**	**-1.6**	**-1.6**	**-1.7**	**-1.6**	**-1.5**
2. "Snow-ball" effect	**-2.6**	**-1.7**	**-1.1**	**-1.3**	**-1.0**	**-1.3**	**-1.3**
Of which:							
Interest expenditure	2.6	2.3	2.3	2.3	2.2	2.1	2.1
Growth effect	-3.8	-2.5	-2.4	-2.5	-1.8	-2.1	-2.1
Inflation effect	-1.4	-1.5	-1.1	-1.1	-1.4	-1.4	-1.3
3. Stock-flow adjustment	**0.9**	**2.0**	**2.1**	**1.0**	**0.7**	**1.6**	**0.7**
Of which:							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds							
Valuation effect & residual							

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

The Maltese authorities presented the 2017 budget to the Parliament on 17 October 2016. The 2017 budget contains some measures on the revenue side with a net impact on revenues of about 0.1% of GDP, which were reported in the DBP. The revenue-increasing measures include the increase of excise duties on goods which are harmful to health and the environment (namely on construction-related material, cigarettes and tobacco, non-alcoholic beverages, toiletries and washing preparations, glass and ceramic tiles, and non-biodegradable plastic bags used for waste collection) and the granting of a partial one-year concession on stamp duty for the transfer of business from parents to their children. These measures are partially offset by the gradual introduction over the next two years of a tax exemption on pension income of up to EUR13,000 per annum and the extension of the stamp duty exemption for first-time buyers until the end of 2017.

On the expenditure side, the budget includes several social measures targeted at social justice, in particular addressing social inequality and pro-actively targeting those in/at risk of poverty, with a particular emphasis on low income brackets and pensioners (e.g. the introduction and the extension of a number of measures such as the extension of the in-work benefit, increase in the supplementary allowance, increase in the minimum pension, reform of the disability pension, increase in the rental subsidy, extension of the Carer at Home Project, and other initiatives for student in difficulty and free public transport to youth). In addition, the budget foresees to spend part of the funds in the National Development Social Fund in both public investments and other current expenditure. Finally, there is a compensation payment. Altogether, the expenditure measures are estimated to increase the deficit by nearly 0.5% of GDP.

Overall, the measures included in the 2017 budget are estimated to have a net deficit-increasing impact of around 0.3% of GDP, which is plausible.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2016	**2017**	**2018**
Taxes on production and	0	-0.2	-0.2
Current taxes on income,	0	0.1	0
Capital taxes			
Social contributions	0	0.0	0
Property Income			
Other	0	-0.9	0.3
Total	0	-0.9	0.2

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2017

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2016	**2017**	**2018**
Compensation of employees	0	0.0	0
Intermediate consumption	0	-0.2	-0.1
Social payments	0	0.1	-0.1
Interest Expenditure			
Subsidies	0	0.0	0
Gross fixed capital formation			
Capital transfers	0	0.4	0.1
Other	0	-0.1	-0.3
Total	0	0.3	-0.5

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2017

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Malta is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. Box 2 reports the latest country specific recommendations in the area of public finances.

Box 2: Council recommendations addressed to Malta

On 12 July, the Council addressed recommendations to Malta in the context of the European Semester. In particular, in the area of public finances the Council recommended to Malta to achieve an annual fiscal adjustment of 0.6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017, by taking the necessary structural measures.

4.1. Compliance with the debt criterion

As the debt ratio was 64% of GDP in 2015 Malta is required to comply with the debt reduction benchmark.

The DBP does not include sufficient information to assess ex-ante compliance with the debt rule. Based on the Commission 2016 autumn forecast, the debt benchmark is expected to be met in 2016, with an average margin of 4.8 pps.. In 2017, the debt is projected to decrease below the 60%-of-GDP threshold according to the Commission forecast.

Table 5. Compliance with the debt criterion*

	2015	2016			2017		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	64.0	62.6	63.3	62.1	60.4	61.9	59.9
Gap to the debt benchmark [1,2]	-5.4	-4.5	n.r.	-4.8	n.r.	n.r.	n.r

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

(*) Since in 2018 the debt-to-GDP ratio is below the 60% threshold, it is not possible to compute the debt rule on a forward-looking basis.

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

4.2. Adjustment towards the MTO

According to the DBP, in 2016, the annual change in the (recalculated) structural balance is above (positive margin of 0.6% of GDP) the required adjustment towards the MTO (0.6% of GDP) and the growth rate of government expenditure net of discretionary revenue measures is projected to remain below (positive margin of 0.8% of GDP) the applicable expenditure benchmark rate (1.3%). However, over the two years 2015-2016, while the structural balance is in line with the required adjustment towards the MTO and therefore points to compliance, the expenditure benchmark points to some deviation (gap of 0.2 % of GDP) from the required adjustment towards the MTO. Therefore, an overall assessment needs to be carried out. On the one hand, the structural balance excludes costs related to the Maltese presidency of the Council of the EU amounting to 0.2% of GDP in 2016. When applying the Commission criteria for identifying one-off measures, the improvement in the structural balance over the two years 2015-2016 would be reduced. On the other hand, the structural balance seems negatively impacted by sizeable revenue shortfalls, especially in 2016, as the GDP growth does not appear to be tax-rich, possibly reflecting the high volatility of the very small domestic economy. In addition, a swift closure of the output gap implies a somewhat rapid improvement in structural terms. Finally, developments in public investment are decreasing the effort as computed by the structural balance. Overall, correcting for these elements, compliance on the basis of the structural balance pillar is confirmed. At the same time, the expenditure benchmark indicator seems to be a more appropriate indicator in the case of Malta at the current juncture, as it makes use of a more stable estimate of medium term potential growth. On average over 2015 and 2016, the fiscal effort measured by the expenditure benchmark is negatively impacted by one-off measures (both on the revenue and the expenditure side), which account for around 0.3 pps. of the average deviation. Thus, the deviation based on the expenditure benchmark would be reduced, pointing to compliance over the two years 2015-2016 taken together as the 2015 slippage is expected to be compensated for in 2016. As a result, the overall assessment also points to compliance with the adjustment path towards the MTO in 2015 and 2016 taken together.

Based on the Commission 2016 autumn forecast, in 2016 both the structural balance and the expenditure benchmark point to compliance with the required adjustment towards the MTO. However, over the two years 2015-2016 taken together, the structural balance would point to some deviation from the required 0.6% of GDP adjustment towards the MTO (gap of 0.1% of GDP). In addition, the growth rate of government expenditure net of discretionary revenue measures is expected to exceed the benchmark by 0.3% of GDP, thereby breaching the threshold for significance. When taking into account all the factors mentioned above, both indicators would point to compliance over the two-years. As a result, based on the Commission forecast, the overall assessment points to compliance with the adjustment path towards the MTO in 2015 and 2016 taken together.

For 2017, based on the DBP, the (recalculated) structural balance shows an improvement by 0.8% of GDP, which points to compliance (positive margin of 0.2% of GDP). On the contrary, the growth rate of government expenditure net of discretionary revenue measures is projected to exceed the applicable expenditure benchmark rate (1.8%), thus pointing to a risk of some deviation (negative margin of 0.4% of GDP). There is thus a need for an overall assessment. The structural balance excludes costs related to the Maltese presidency of the Council of the EU amounting to 0.3% of GDP in 2017. Though, the structural balance is negatively impacted by revenue shortfalls (-0.4% of GDP) and therefore provides a too negative assessment. Corrected for these factors, the structural balance would point to compliance in 2017, with a positive margin of 0.5% of GDP. However, the expenditure benchmark appears to be a more suitable indicator in view of a more stable estimate of medium term potential growth rate. The expenditure benchmark is negatively impacted by one-offs measures (accounting for around 0.1 pps.). Correcting for this factor, the deviation would be slightly reduced. Based on the recalculated DBP Malta is assessed to be at risk of some deviation from the required adjustment towards the MTO in 2017.

The Commission forecast for 2017 points to a risk of some deviation from the required 0.6% of GDP adjustment towards the MTO since the structural balance is projected to improve by 0.4% of GDP. Also the growth rate of government expenditure net of discretionary revenue measures is expected to point to some deviation as it is expected to exceed the benchmark by 0.4% of GDP. Therefore, an overall assessment needs to be carried out. The arguments used to explain the higher reliability of the expenditure benchmark pillar when carrying out the overall assessment related to the recalculated DBP for 2017 remain valid for the Commission forecast. The overall assessment thus points to a risk of some deviation from the adjustment path towards the MTO based the Commission forecast in 2017.

Following an overall assessment of the Member State's DBP, the adjustment path towards the MTO seems to be appropriate and compliant with the requirements of the preventive arm of the Pact in 2016 while some deviation from the required adjustment path towards the MTO is to be expected in 2017. Such an assessment is confirmed based on Commission 2016 autumn forecast in 2017.

Table 6: Compliance with the requirements of the preventive arm

(% of GDP)	2015	2016		2017	
Initial position[1]					
Medium-term objective (MTO)	0.0	0.0		0.0	
Structural balance[2] (COM)	-2.2	-1.1		-0.7	
Structural balance based on freezing (COM)	-2.1	-1.1		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2015**	**2016**		**2017**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.6	0.6		0.6	
Required adjustment corrected[5]	0.6	0.6		0.6	
Change in structural balance[6]	-0.1	1.2	1.1	0.8	0.4
One-year deviation from the required adjustment [7]	-0.7	0.6	0.5	0.2	-0.2
Two-year average deviation from the required adjustment [7]	n.a. in EDP in 2014	0.0	-0.1	0.4	0.1
Expenditure benchmark pillar					
Applicable reference rate[8]	0.3	1.3		1.8	
One-year deviation [9]	-1.1	0.8	0.6	-0.4	-0.4
Two-year average deviation [9]	n.a. in EDP in 2014	-0.2	-0.3	0.2	0.1
Conclusion					
Conclusion over one year	Significant deviation	Compliance	Compliance	Overall assessment	Overall assessment
Conclusion over two years	n.a. in EDP in 2014	Overall assessment	Overall assessment	Compliance	Compliance

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 27.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations.

5. IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

The Council recommendations addressed to Malta under the European Semester on 12 July 2016 recommended the country to step up measures to ensure the long-term sustainability of public finances. The DBP reports on all initiatives to address the country specific recommendation related to long term sustainability of public finances, namely in the areas of pensions and healthcare. However, no new elements are reported compared to the situation in spring.

In particular, in the area of pension reform, some measures were introduced already with the 2016 Budget, targeted at addressing sustainability and adequacy. These measures entered into force in March 2016. A full assessment of these measures will follow the peer review in the Economic and Policy Committee, which has not yet taken place. But an initial assessment indicates that the measures to achieve sustainability may be fully offset by those aimed at ensuring adequacy. In addition, the 2017 budget introduced a number of measures targeted at increasing pension income. With regard to the third pillar pensions, a working group was set up, tasked with recommending a scheme which provides fiscal benefits for employers who set up a voluntary pension scheme at the place of work. The scheme was proposed in the Budget for 2016. Once completed, the working group's proposals will be discussed with the social partners other interested parties. In addition, a National Strategy for Retirement Income and Financial Literacy (now repositioned as Retirement and Finance Capability) is to be launched in November 2016. This repositioning intends to focus on financial capability as an instrument of poverty prevention during the lifecycles and retirement of vulnerable groups.

Policy action to improve the financial sustainability of the healthcare system is ongoing. It includes efforts to ensure the delivery of a cost-effective use of available resources, namely investments to underpin the revision of existing processes whilst shifting the focus of the care away from hospital and towards the primary health care setting; the adoption and implementation of the new National Health Strategy (2014-2020); a Health System Performance Report which would help in monitoring the implementation of the Strategy; the enactment of the Healthy Lifestyle Act which established an inter-ministerial body authorised to propose legislative instruments with the aim to reducing the burden of non-communicable disease on the country. Finally, several measures were implemented over the course of 2016 and carrying on in 2017 aimed at controlling expenditure from an operative perspective. However, it is uncertain whether these measures are sufficient to cope with the challenge of long-term sustainability. An estimate of their potential impact to be incorporated into the long-term budgetary projections is still missing.

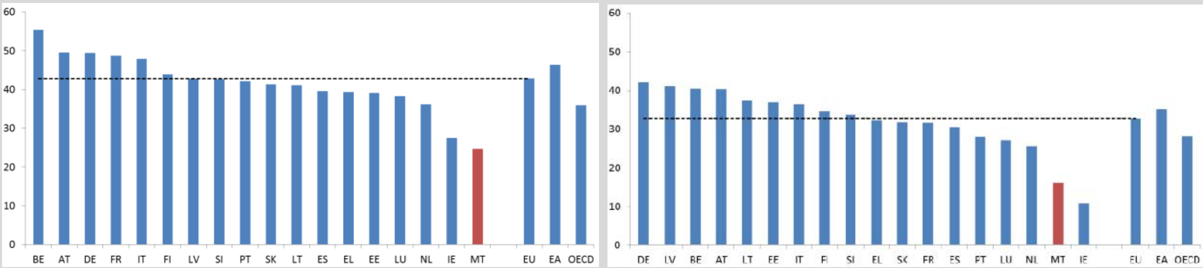
In addition, the DBP reports on the latest developments in the area of the ongoing spending review. The review started in 2014 and so far covered the Department for Social Security, the Mater Dei Hospital (in 2015), and the Ministry for Education and Employment (in 2016). Each review ended with the publication of a report which included recommendations, some of them have been already implemented (especially for the first two reviews) and others are being implemented.

Box 3: Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Malta for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Malta at the average wage and a low wage (2015)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Malta's Draft Budgetary Plan does not include any measures affecting the tax wedge on labour.

6. OVERALL CONCLUSION

According to the Commission 2016 autumn forecast, and notably based on the projected structural improvement in 2016, Malta is expected to comply with the debt reduction benchmark in 2016. In addition, according to the Commission forecast, the government debt is forecast to decline below the 60%-of-GDP value already in 2017. The DBP, however, does not include sufficient information to assess compliance with the debt rule.

Following an overall assessment of the DBP, the planned structural adjustment is in line with the required adjustment path towards the MTO in 2016. However, the planned structural adjustment points to some deviation from the required adjustment path towards the MTO in 2017. The risk of some deviation from the adjustment path towards the MTO in 2017 is confirmed following an overall assessment based on Commission 2016 autumn forecast.