Medium-Term Fiscal Strategy for Malta:

Update of Stability Programme

2017 - 2020

Ministry for Finance
April 2017

The following symbols have been used throughout this document:

. . .	to indicate that data are not available;
—	to indicate that the figure is negligible;
0	to indicate that the figure is zero;
-	to indicate that data are not applicable or cannot be determined;
n/c	to indicate that there is no change in the data.
f	to indicate that it is a forecast

Figures may not add up due to rounding.

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Introduction

This Programme constitutes the eight update of Malta's Stability Programme, which was submitted in 2007. The first Update was submitted in December 2008. This Programme has been prepared in accordance with Council Regulation (EC) No. 1466/97 as amended by Council Regulation (EC) No. 1055/05 and Council Regulation (EC) No 1467/97 as amended by Council Regulation (EC) No. 1056/05.

This document is also in line with the new requirements of the Stability and Growth Pact, namely the amendments to Council Regulation (EC) No. 1466/97 by Council Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16th November 2011 and the amendments to Council Regulation (EC) No 1467/97 by Council Regulation (EU) No 1177/2011 of 8th November 2011. The programme also takes into account Council Directive 2011/85/EU of 8th November 2011 on the requirements for budgetary frameworks of the Member States.

The Stability Programme now also meets the reporting requirements under Article 15 of the Fiscal Responsibility Act and will thus constitute Malta's Medium-Term Fiscal Plan. It is the intention of the Government to lay this Plan on the table of the House of Representatives together with the fiscal risk assessment to be provided by the Malta Fiscal Advisory Council in line with Article 15(1) of the Fiscal Responsibility Act.

The document is in line with the Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes, endorsed by the Economic and Financial Affairs Council (ECOFIN) on 24th January 2012. Nevertheless, it contains additional information as required by the Fiscal Responsibility Act.

The Ministry for Finance (MFIN) compiled this document, with an important contribution from the National Statistics Office (NSO) as well as from other Ministries and entities across Government. It was prepared on the basis of policies proposed in the 2017 Budget and updated with the latest macroeconomic projections and more recent fiscal data.

The Programme includes seven chapters: Chapter 1 presents Government's Medium-Term Fiscal Policy Strategy including the expenditure priorities and the public investment programme in order to fulfil the requirements of Article 15(7) of the Fiscal Responsibility Act; Chapter 2 presents the main macroeconomic projections for the medium-term as well as the potential impact of a selection of structural reform measures; Chapter 3 outlines the overall fiscal policy strategy and updated budgetary plans for the current year, followed by a presentation of the medium-term fiscal projections and debt developments as well as the budgetary implications of major structural reforms featuring in the National Reform Programme; Chapter 4 contains an analysis of forecast uncertainty and the balance of risk surrounding macroeconomic projections and an evaluation of the risks to the achievement of fiscal targets conditional on alternative plausible macroeconomic conditions; Chapter 5 reviews the long-term sustainability of public finances; Chapter 6 analyses the quality of public finances, and finally Chapter 7 reviews the institutional features of public finances particularly the implementation of the Fiscal Responsibility Act.

The macroeconomic forecasts underlying this Programme have been submitted to the Fiscal Advisory Council for its endorsement. The Council concluded that "On the basis of the information made available to the MFAC and on the assessment undertaken by the MFAC, the projected increase in the headline GDP figure for 2017 and the other years is within the MFAC's endorsable range". The fiscal projections underlying this Programme will be submitted to the Council for its evaluation and endorsement in line with the requirements of the Fiscal Responsibility Act. This exercise is expected to be concluded in the coming weeks.

1. Medium-Term Fiscal Policy Strategy

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The year 2016 saw a substantial over-achievement of fiscal targets resulting in a surplus of 1.0 per cent of Gross Domestic Product (GDP) and a structural balance of 0.2 per cent of GDP. This indicates that Malta has attained its Medium-Term Budgetary Objective (MTO) of a balanced budget in structural terms, two years ahead of target. The projections underlying this programme suggest that the surplus position can be maintained and that the results are sustainable. The macroeconomic risk assessment further points out that even in the most adverse scenario considered in this Programme, the fiscal position can remain close to the MTO of a balanced budget in structural terms.

In the context of the requirements of the Fiscal Responsibility Act, this Programme is being submitted to the Malta Fiscal Advisory Council for its endorsement thus elevating it to the status of Malta's Medium-Term Fiscal Plan. The Medium-Term Fiscal Policy Strategy includes the expenditure priorities and the public investment programme highlighted in this chapter in order to fulfil the requirements of Article 15(7) of the Act. In the process of its assessment, the Malta Fiscal Advisory Council will carry out a fiscal risk assessment. Once this is completed, the report of the Malta Fiscal Advisory Council will be considered by Government and will then be submitted to Parliament in conjunction with the Stability Programme.

1.1 Economic Situation and Risks to the Outlook

The strong economic performance being registered by the Maltese economy is justifying the Government's prudent approach towards fiscal consolidation combined with an ambitious structural reform agenda. The latest national accounts estimates indicate that growth in 2016 was around 1.0 percentage point higher than was projected in autumn, both in nominal and in real terms. This was underpinned by a revision in historical national accounts statistics which relate primarily to stronger activity in the services sector (particularly in remote gaming) and higher corporate profits driven by a more buoyant export activity. Furthermore, the import content of domestic production is also shown to be diminishing, consistent with a stronger element of domestic production and value added in gross turnover. Indeed, the main discrepancy between the actual and the forecast expenditure aggregates stemmed from higher than anticipated exports and a slower than anticipated growth in imports.

In this context, economic growth reached 5.0 per cent in 2016, following another strong increase of 7.4 per cent registered a year earlier. During these two years, exports increased by around 4.0 per cent per annum. On the other hand, household consumption moderated to 3.8 per cent in 2016, in line with expectations in successive rounds of forecasts. Overall, despite the stronger than anticipated economic activity, the tax-rich component of growth was still generally in line with expectations. This includes the employment and compensation of employees elements, which are particularly important for the performance of revenue from taxes on income and social contributions and consumption. In fact, the major variance between what was projected in autumn and the actual turnout was in the growth in corporate profits, including the revised historical national accounts data. This is consistent with a more dynamic and profitable corporate sector which is increasing exports and hence generating a stronger than anticipated growth in revenue from taxes on income.

The growth in economic activity is supported by the strengthening of potential growth and a strong investment activity. Potential growth continued to strengthen and the average growth between 2013 and 2016 was estimated at around 5.0 per cent. The improvements in the structural conditions were marked by a substantial rise in the investment-to-GDP ratio which climbed to 23.6 per cent of GDP in 2015 and 22.1 per cent of GDP in 2016. This included the substantial public investment financed by the European Union (EU) budget, the projects in the energy sector and significant investments in the aviation industry amongst others.

These investments will continue to support the strong pace of potential growth albeit a moderation is expected over the forecast period. It is also interesting to note that the substantial increase in the investment-to-GDP ratio was achieved at a time when the economy was registering successive surpluses in the current account of the balance of payments. This suggests that the overall savings ratio in the economy were increasingly financing the rise in investment activity. The improvement in the current account is also underlined by the gradual improvement in the fiscal position. In particular, it is worth noting that Government has been registering a primary surplus (budget balance excluding interest payments) and a current surplus (budget balance excluding investment) since 2013. This increase in public savings has also contributed to the correction of the twin deficits suggesting that the Maltese economy is not suffering any major imbalances.

Output gap estimates suggest notably positive cyclical conditions particularly in 2015 and 2016. Nevertheless, the low inflationary pressures, relatively moderate wage growth and the stabilisation of debt-to-income ratios suggest that this pace of economic activity can be sustained without major imbalances.

The macroeconomic forecasts underlying this Programme suggest a moderation in economic activity and a gradual correction in the positive output gap expected over the next three years. This is in part due to the prudent forecasts surrounding this three-year plan, in line with past practices. Indeed, growth is expected to moderate to 4.3 per cent in 2017 and 3.4 per cent by 2020. These macroeconomic projections have been endorsed by the Malta Fiscal Advisory Council as directed under the Fiscal Responsibility Act.

Like all forecasting exercises, this largely positive macroeconomic outlook is subject to a measure of uncertainty. The baseline scenario underpinning this Programme has been subjected to a series of exogenous shocks producing alternative growth scenarios. Based on these scenarios and an evaluation of past forecast accuracy, the risks surrounding macroeconomic forecasts have been quantified. Based on the established methodology, this risk assessment suggests exposure to both upside and downside risks though the risk profile is balanced on the upside over the entire forecast period. Again, this is in part a reflection of the prudent practices adopting in the preparation of macroeconomic forecasts. The alternative macroeconomic scenarios have also been used to gauge the fiscal response to the materialisation of such risks. It is encouraging to note that under the worst case macroeconomic scenarios, the budget balance, although turning negative, doesn't deviate significantly from a balance budget position and remains close to the MTO in structural terms. This is indicative that the budgetary results for 2016 and the outlook presented in this Programme are sustainable over the short to medium-term.

1.2 Fiscal Performance and Stance

Over the last four years, Government managed to turn a deficit of 3.6 per cent of GDP in 2012 to a surplus of 1.0 per cent of GDP in 2016. The gradual but consistent reduction in the deficit positively impacted the debt ratio which fell below the 60.0 per cent target to 58.3 per cent of GDP in 2016. The fiscal strategy presented in this Programme will reduce the debt burden even further to 47.6 per cent of GDP by 2020. Government considers fiscal developments over the last four years as an important achievement, particularly the recovery of the necessary fiscal space to allow fiscal policy to act in a countercyclical manner. The achievement of the MTO is also an important step in the safeguard of long-term sustainability of public finances. The budget surplus also allows more room for manoeuvre to address other structural challenges such as infrastructural bottlenecks and further investments in human capital and technology, thus further strengthening potential growth and supporting the process of convergence to higher living standards. At the same time, Government is conscious of persistent challenges in the external environment which support the need for continued prudence in the fiscal targets and the creation of additional buffers.

In this context, the medium-term fiscal strategy portrayed in this Programme is one which balances these requirements. The Government is essentially aiming to maintain a surplus of 0.5 per cent of GDP over the next three years and a structural balance which gradually increases from 0.2 per cent of GDP in 2016 to 0.6 per cent of GDP by 2020. Such targets are themselves based on prudent fiscal assumptions which create an extra buffer in these projections. As explained earlier, these targets permit Government to maintain a structural budget balance close to the MTO even in the worst macroeconomic scenario considered in this Programme. These targets also allow the necessary investment in infrastructure and human resource development. The targets presented in this Programme are consistent with the allocation of around 3.0 per cent of GDP towards public investment programmes. These investments do not include additional investment which can be devoted to the improvement of human capital to meet the challenges in the education sector, which are generally classified elsewhere in the European System of Accounts (ESA) categorisation.

1.2.1 Government's Expenditure Priorities

Whilst the term of this legislature is approaching its end, Government is committed to implement the remaining pledges of the Electoral Manifesto. It is also committed to make the best use of EU funds from the 2014-2020 Programming period. The medium-term expenditure priorities also include major commitments related to Malta's EU Presidency in 2017 and commitments related to Valletta 2018.

Health, Education and Social Protection continue to be a priority in line with Government's commitment to improve the standard of living of the Maltese population, including the most vulnerable individuals and families whilst at the same time ensure equality of opportunities for everyone willing to further their education or to contribute directly in the labour market. The 2017 Budget consolidated on earlier achievements and ensured that prosperity reaches all groups in society, especially those who are or could become at risk of poverty including pensioners, low income earners such as minimum wage earners and vulnerable people such as persons with disability.

Whilst expenditure on Health, Education and Social Protection remain priority areas, Government is constantly striving to ensure that expenditure leads to high quality outcomes. It is inevitable that given the positive budgetary developments, this year's Programme focuses more exclusively than previous years on the quality of public spending. Indeed, ensuring that expenditure growth does not exceed the economy's growth potential remains an intermediate target in this Programme. As outlined in this programme, gains in public sector productivity can play a role in enhancing the quality of public expenditure. Furthermore, the spending review process has shown that incremental benefits are possible not just in terms of expenditure savings but more importantly against better public sector outcomes and productivity.

Government remains committed to continue with the pension reform process. In particular, important steps were adopted in the Budget for 2016 through measures intended to strengthen the sustainability of pensions, particularly through the lengthening of the contribution period and the introduction of incentives to defer retirement. Measures were also adopted to strengthen adequacy of contributory pensions, particularly through increases to minimum pensions. Furthermore, following the market launch of voluntary third pillar pension products in 2015, Government has announced in the Budget for 2017 the introduction of fiscal incentives for employers that opt to introduce occupational pensions on a voluntary basis.

The conduct of comprehensive reforms in the public health system to ensure the delivery of a cost-effective and efficient service has been high on the political agenda over the past few years. This has been mainly driven by strategic investments to underpin the revision of existing processes, whilst shifting the focus of care away from hospital and towards the primary health care setting. The review of existing processes is also highlighting which areas are best suited for structural expansion in capacity with a view to maximising return on investment. Progress has also been registered with respect to strengthening health promotion and disease prevention. These developments reflect the adoption of a new National Health Systems Strategy covering 2014-2020 focusing on three pillars: Improving Governance; Health Promotion and Disease Prevention; and Strengthening of Primary Care. The Government has also increased the involvement of the private sector in the health sector. This should improve efficiency while easing pressures on public finances.

1.2.2 Public Investment Programme

Malta's Partnership Agreement presents the overarching strategy and identifies the priorities in the allocation of EU funds. In this regard, the Partnership Agreement has identified three funding priorities which are considered as the main overarching objectives for the 2014-2020 programming period, namely:

1. Fostering competitiveness through innovation and the creation of a business-friendly environment;
2. Sustaining an environmentally-friendly and resource efficient economy; and
3. Creating opportunities through investment in human capital and improving health and well-being.

The main overarching objectives will be addressed through two Operational Programmes and their respective priority axis. The Priority Axes of the first Operational Programme are the following:

1. Investing in research, technological development and innovation;
2. Consolidating investment within the ICT sector;
3. Enhancing Malta's competitiveness through investment in SMEs;
4. Shifting towards a low-carbon economy;
5. Protecting our environment - investing in natural and cultural assets;
6. Sustainable Urban Development;

7. Shifting towards a more low-carbon transport sector;
8. Investing towards a more socially-inclusive society;
9. Developing our future through education, training and lifelong learning;
10. Investing in a more environmentally-friendly society;
11. Investing in TEN-T Infrastructure; and
12. Technical Assistance.

The second Operational Programme targets employment, education, social inclusion and health and is aimed at achieving inclusive growth. The priority axes of the second Programme are:

1. Investing in the employability and adaptability of human capital;
2. Towards a more inclusive society;
3. Investing in people through Education, Training and Lifelong Learning;
4. Building the Institutional Administrative Capacity; and
5. Technical Assistance.

These objectives and priority axis in general, also apply to the national funds earmarked for capital investment. In addition to the co-financing part EU-funded projects, local funds are mostly targeted to road, education and health infrastructure, waste management and environmental management.

1.3 Structural Reforms

The strong economic performance registered in recent years is reflective of the policy reform programme implemented by the Government. Indeed, Government continues to monitor and address the challenges outlined in the Commission Staff Working Document with respect to taxation, quality of public finances and long-term fiscal sustainability, labour market, education and skills and social aspects, the business environment and competitiveness. The 2016 National Reform Programme and this Update of the Stability Programme outline Government's strategy and policy measures intended to address challenges in the structural and fiscal policy domains.

In addressing its policy objectives, Government is implementing a number of policies aimed at improving the supply-side of the economy while raising the country's potential output. In addition, the Government is attentive at ensuring responsible environmental management and safeguarding social cohesion. As part of its work programme, Government has through the budgetary process stimulated work effort through measures intended to make work pay whilst ensuring that the social security system positively incentivises work effort and discourages dependency. These measures have been complimented by initiatives intended to improve the distribution of income especially the incomes of households defined as being at the risk of poverty and indeed ensuring that economic prosperity reaches all groups in society.

Going forward, the Government is sustaining its investment in enhancing human capital and enhancing the business environment through improved access to finance, whilst maintaining momentum in infrastructural investment in the economy. At the same time, it remains committed towards prudent fiscal policy oriented towards the long-term sustainability of public finances and reducing further the public debt ratio. Moreover, the Government will seek to harness long-term sustainability risks by sustaining its improvement in the fiscal position as well as through careful reforms to age-sensitive components of public expenditure.

2. Economic Outlook

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2.1 Economic Conditions in 2016

In 2016, the Maltese economy once again surpassed that of most European Member States, with the latest National Statistics Office (NSO) release confirming an economic growth rate of 5.0 per cent. This robust performance was primarily driven by strong net exports with domestic demand also being a positive contributor. Domestic demand contributed one percentage point to economic growth, reflecting robust private consumption in spite of the declining gross fixed capital formation and government consumption figures.

Private consumption remained strong, growing by 3.8 per cent over the previous year, reflecting a moderate appreciation in wages, strong labour market conditions and subdued acceleration in prices. Employment continued to grow by 3.7 per cent, reflecting the buoyant economic environment and government's success in implementing effective active labour market policies. This positive employment growth was coupled with an unemployment rate of 4.7 per cent. Stable inflation helped sustain strong levels of private consumption, as prices increased by a mere 0.9 per cent, 0.3 percentage points less than the previous year. Throughout 2016, gross fixed capital formation fell by 1.3 per cent, yet this was primarily due to a base effect following the sizeable investment growth in 2015. General government consumption also fell by 3.1 per cent, negatively impacting real Gross Domestic Product (GDP) growth.

The Maltese economy rounded up 2016 with a positive external balance, with net exports being the prime driver of real GDP growth. In fact, net exports contributed 4.2 percentage points to economic growth, outperforming domestic demand. Exports increased by 4.0 per cent, reflecting the gradually improving external demand conditions in Malta's trading partners but more importantly the improved competitiveness of the Maltese economy. The growth in imports of 1.1 per cent was lower relative to previous years, primarily due to the declining import content associated with the relatively lower investment.

An analysis of the output side shows an increase in gross value added of 6.2 per cent in 2016, with the majority of the economic sectors recording positive growth. The most notable growth was recorded in the agriculture, forestry and fishing sector, which grew by 12.4 per cent. Double digit growth rates were also registered in the professional, scientific and technical activities sector and the information and communication sector, which grew by 11.9 per cent and 11.6 per cent respectively. The financial and insurance activities sector sustained positive growth in 2015 and 2016 thus recovering from the performance reported for 2013 and 2014. The arts, entertainment and cultural sector also maintained its strong performance, which is encouraging given the significant contribution of the sector to Malta's growth. The manufacturing sector recovered from last years' decline, registering a positive growth rate of 2.1 per cent. In contrast, the construction sector recorded a negative growth rate in 2016, however this drop is attributable to a base effect in 2015, where a number of construction-intensive projects were undertaken in association with the exhaustion of European Union (EU) funding from Programming Period 2007-2013.

From an income perspective, in 2016, compensation of employees sustained its upward trend, increasing in nominal terms by 6.3 per cent to €4,165.4 million. Gross operating surplus and mixed income also experienced a notable 7.0 per cent growth, reaching €4,588.1 million. Meanwhile, subsidies on production and imports experienced a mild

0.4 per cent increase, while taxation on production and imports rose by 6.4 per cent or €76.4 million.

When considering the global economy, the International Monetary Fund estimated global economic growth for 2016 to be 3.1 per cent. The global economy is expected to gain momentum in 2017 and 2018, as projections point towards 3.4 per cent and 3.6 per cent growth rates in each of these respective years. While advanced economies are expected to continue achieving modest growth, economic activity is anticipated to particularly pick up pace in emerging market and developing economies. Additionally, a strong policy stimulus rendered China's growth in 2016 to be stronger than expected, further enhancing global economic sentiment. Recent increases in the price of oil coupled with corresponding movements in commodity prices have instigated inflationary pressures and reduced consumers' purchasing power. However, core inflation rates remain broadly unchanged and the European Central Bank at present has no plans to draw back on its asset purchase programme. In this regard, the zero-interest rate environment and the Euro's relatively competitive exchange rate will continue to help boost investment and increase EU's exports, which should contribute to further recovery in the EU.

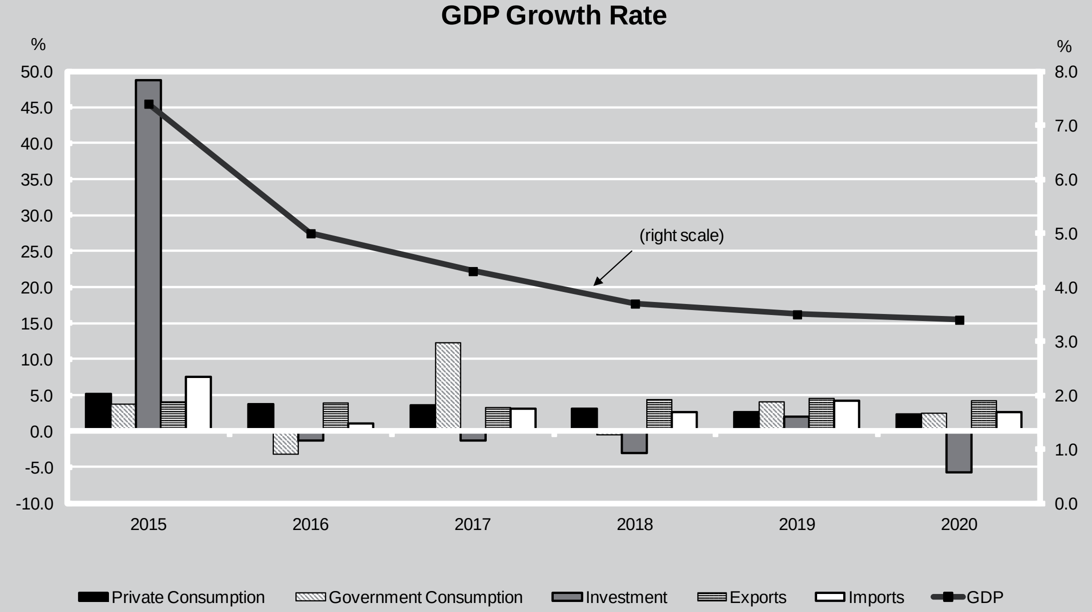
Despite the optimistic global economic outlook, the actual outcome in the short and medium-term remains surrounded by uncertainty, particularly concerning the size, composition and timing of the policy stimulus the United States (US) will adopt, as well as a number of upcoming elections in the EU. Thus, uncertainty may negatively impact consumer confidence and investment decisions, skewing global risks to the downside.

2.2 The Medium-Term Scenario

Throughout the forecast horizon, the Maltese economy is expected to continue growing at a moderate pace over the forecast horizon, though at a slower rate than that seen in 2016, with real GDP growth forecasted at 4.3 and 3.7 per cent for 2017 and 2018, respectively. The growth in 2017 will be on the tailwinds of domestic demand which is set to remain strong, mainly on the back of private and public consumption expenditure. Private consumption expenditure is expected to remain strong and to further increase by 3.6 per cent in 2017. As for the outer years, as inflation picks up and employment growth moderates, private consumption is expected to decelerate to 3.1 per cent in 2018, 2.7 per cent in 2019 and to 2.4 per cent in 2020. In line with the developments in domestic demand, in 2017, imports are projected to increase by 3.2 per cent, 0.2 percentage points less than exports, which will result in a positive contribution to growth of 0.6 percentage points from external demand. This positive contribution is expected to strengthen in 2018 and amount to 2.8 percentage points and to persist in 2019, although to a lesser extent, by 1.0 percentage point. The contribution from external demand is projected to remain positive for 2020 as domestic demand is forecasted to slow down relative to 2019, resulting in export growth to moderately outpace the growth in imports by a difference of 1.6 percentage points.

Chart 2.1 illustrates the projected growth rate of GDP together with a detailed breakdown of the various expenditure aggregates. Table 2.1 presents the main macroeconomic indicators for the years 2015-2020. The figures for 2015 and 2016 have been published by the NSO, whilst figures for 2017 onwards are forecasts. The macroeconomic forecasts take into account the latest available data and are being provided in Table 1a, 1b, 1c and 1d of the Statistical Appendix.

Chart 2.1



Main Macroeconomic Indicators

Table 2.1

	2015	2016	2017f	2018f	2019f	2020f
GDP growth at current market prices (%)	10.0	6.7	6.3	5.9	5.9	6.0
GDP growth at Chain Linked Volumes by period (Reference year 2010) (%)(1)	7.4	5.0	4.3	3.7	3.5	3.4
Expenditure Components of GDP						
at Chain Linked Volumes by period (Reference year 2010) (%)						
Private final consumption expenditure(2)	5.2	3.8	3.6	3.1	2.7	2.4
General government final consumption expenditure(3)	3.8	-3.1	12.4	-0.5	4.1	2.6
Gross fixed capital formation	48.8	-1.3	-1.3	-3.1	2.1	-5.7
Exports of goods and services	4.1	4.0	3.4	4.4	4.6	4.3
Imports of goods and services	7.5	1.1	3.2	2.7	4.3	2.7
Inflation rate (%)	1.2	0.9	1.5	1.8	1.8	1.9
Employment growth (National Accounts Definition) (%)	3.8	3.7	3.2	2.9	2.7	2.5
Unemployment rate (Harmonised definition, Eurostat) (%)	5.4	4.7	4.6	4.7	4.8	4.8
Compensation per employee (% change)	3.8	2.3	3.6	3.6	3.5	3.4
Labour productivity (% change)	3.8	1.1	1.1	0.8	0.8	0.9
Nominal Unit Labour Cost (% change)	-0.1	1.2	2.5	2.8	2.7	2.5
Real Unit Labour Costs (% change)	-2.1	0.3	1.1	1.0	0.9	0.6
External Goods and Services Balance (% of GDP)	7.8	11.9	12.3	14.9	15.7	18.6

(1) Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

(2) Includes NPISH final consumption expenditure.

(3) According to ESA 2010 methodology market output, which includes the proceeds from IIP, is recorded as a negative entry in the computation of the general Government final consumption expenditure.

2.2.1 Assumptions for Projections

The macroeconomic forecasts presented in this Stability Programme are based on the following assumptions:

- Both short-term and long-term interest rates are assumed to remain stable during the forecast period with a uniform spread between the two.
- The growth of Malta's main trading partners is expected to increase by 1.7 per cent in 2017, slightly increasing to 1.8 per cent in 2018 and back to 1.7 per cent in 2019 and 2020.
- World prices are expected to start recovering in 2017. In fact, world prices are projected to increase by 2.2 per cent in 2017 and by an average growth rate of 1.9 per cent throughout the forecast horizon.
- Oil prices are assumed to increase to $53.6 per barrel in 2017, then increase marginally to $56.4 per barrel in 2018 and stabilize at this level until 2020.
- The Dollar/Euro exchange rate is expected to decline from a yearly average of 1.1047 Dollars per Euro in 2016 to 1.0528 Dollars per Euro in 2017 and 1.0530 Dollars per Euro in 2018, only to start slowly appreciating to an average of 1.0810 Dollars per Euro in 2019 and 2020.
- Throughout 2017, the Sterling/Euro exchange rate is expected to rise slightly to 0.8699 Pounds per Euro on average, relative to the previous average of 0.8338 Pounds per Euro in 2016. The Pound is anticipated to depreciate further against the Euro in 2018 with the exchange rate increasing to 0.8710 Pounds per Euro and subsequently stabilising around 0.8683 Pounds per Euro throughout the rest of the forecast horizon.

These assumptions are outlined in Table 8 of the Statistical Appendix.

2.2.2 Risks to Outlook

The medium-term outlook for the global economy is one of steady growth. Nevertheless, there are a number of factors that could boost or restrain growth prospects. These risk factors will be explored in more detail in Chapter 4. Nevertheless, it is worth mentioning at this stage that judging by the latest forecasts for Malta published by other independent institutions, the Ministry for Finance (MFIN's) forecasts are considered prudent and the upside risks are deemed to be stronger than the downside risks.

2.2.3 Private Final Consumption Expenditure

Private final consumption expenditure moderated in 2016 reaching a growth rate of 3.8 per cent while in the previous year it had grown by 5.2 per cent. Such positive momentum was the result of various factors, among which are the improvements in the labour market that Malta has seen during 2016, along with migratory inflows. Apart from having an employment growth of 3.7 per cent coupled with a low unemployment rate of 4.7 per cent, there were also government initiatives which helped to increase disposable income. The rise in compensation of employees of 6.3 per cent has also contributed to the growth of private final consumption expenditure. Moreover, prices increased at a subdued rate of 0.9 per cent over the same period. That said, in 2017, private consumption is expected to be marginally lower by 3.6 per cent and then by 3.1 per cent in 2018. Over the outer years, private consumption is expected to level out and grow by 2.7 per cent in 2019 and 2.4 per cent in 2020.

2.2.4 General Government Final Consumption Expenditure

In 2016, general Government final consumption decreased by 3.1 per cent when compared with the previous year's growth of 3.8 per cent. In 2017, government expenditure is expected to accelerate and to grow by 12.4 per cent, primarily attributed to the Individual Investor Programme (IIP) included under market output. If the IIP is excluded, government consumption would increase by 7.3 per cent in 2017, reflecting in part higher intermediate consumption, including the one-off costs related to the EU presidency and higher outlays due to the health concession agreements. Additionally, public consumption is projected to decrease by 0.5 per cent in 2018. Over the outer years, public consumption is expected to increase by 4.1 per cent and by 2.6 per cent in 2019 and 2020, respectively.

2.2.5 Gross Fixed Capital Formation

Following the considerable spike in gross fixed capital formation of 48.8 per cent in 2015, investment in 2016 has decreased by 1.3 per cent. For 2017, it is being forecasted that gross fixed capital formation will decline by 1.3 per cent. Gross fixed capital formation is forecasted to be rather volatile over the outer years in light of the timing of specific large scale projects. Following the high investment to GDP ratio attained in 2015 and 2016, the ratio is expected to remain above average in 2017 (at 20.3 per cent of GDP) and converge to the average in 2018 and 2019.

The sharp rise seen in 2015 was mainly the result of a number of large scale projects, including the construction of a new power plant as well as other private investments, in particular in the aviation sector following the exhaustion of EU funding from Programming Period 2007-2013. Furthermore, Government policy has facilitated further investment in construction both for tourism facilities as well as for residential dwellings. For the latter in particular, the temporary relief of stamp duty for first time buyers of residential property and the strong inflow of foreign workers and investors have also encouraged further investment into residential construction. This was further boosted by the buoyant demand for high-end residential property, particularly from participants of the Individual Investor Programme.

It should be noted, that for the baseline scenario of this forecast a number of large scale projects were not taken into consideration, either due to the fact that there is a material risk of non-realisation or due to lack of available details regarding the particular project. This was done to ensure a prudent medium-term scenario which is not overly optimistic. That said, other major investments that are considered to have a high probability of realisation, such as the major investments in the health, education and aviation sectors, further investments in the energy sector, the investments by Malta International Airport, the relocation of the Institute of Tourism Studies (ITS) and the redevelopment of the former ITS site have been taken into account.

2.2.6 External Balance of Goods and Services

2016 saw exports growing at a moderate rate of 4.0 per cent in line with the 4.1 per cent growth in 2015. This trend is expected to be maintained in the coming years reaching growth rates of 3.4 per cent and 4.4 per cent in 2017 and 2018, respectively. In the outer years of the forecast horizon, exports are expected to continue growing at 4.6 per cent and 4.3 per cent in 2019 and 2020, respectively. Given the weaker domestic demand especially in the second half of 2016 relative to the previous year, imports expanded by a subdued rate of 1.1 per cent thus resulting in positive net exports, which contributed positively towards growth. This is forecasted to remain in 2017, although to a lesser extent as exports are expected to rise by 3.4 per cent while imports are expected to grow by 3.2 per cent, resulting in a positive contribution to growth of 0.6 percentage points. This positive net trade is set to strengthen in 2018 as imports are expected to increase by a more moderate growth of 2.7 per cent while exports are expected to increase by 4.4 per cent in 2018. The positive contribution from the external sector is expected to decelerate in 2019 to 1.0 percentage points, as the growth in exports is expected to outpace the growth in imports. In 2020, as the growth in investment decelerates relative to 2019, import growth will moderate to 2.7 per cent relative to a growth rate of 4.3 per cent in exports. This means that 2020 will see net exports and a positive contribution of 2.8 percentage points towards growth.

2.2.7 Productivity and Employment Prospects

Employment fared well in 2016 registering 3.7 per cent growth according to the National Accounts definition. This reflected strong labour demand conditions and the strong pace of economic activity. This was further supported by several structural reforms that this Government has initiated including free child care services, the opening of schools earlier and providing after school child care services, the maternity leave reform, promotion of flexible working arrangements, in-work benefits and the tapering of benefits, lower taxes on labour and tax incentives. This has led to a significant increase in the female participation rate. In fact, between 2015 and 2016, according to the Labour Force Survey (LFS), female participation increased by an average of 1.7 percentage points.

Employment growth is expected to remain strong, while moderating somewhat in the outer years of the forecast horizon to edge closer to the long run average. In 2017, employment growth is expected to slow down a little, but nonetheless grow at 3.2 per cent, before decelerating to 2.9 per cent in 2018. In 2019, employment growth is forecasted to increase by 2.7 per cent, remaining above the long run average. In 2020, employment is expected to grow by 2.5 per cent. Such growth is mainly supported by the increasing female participation rate as well as the inflow of foreign workers.

Compensation of employees increased by 6.3 per cent in 2016 and it is anticipated that the growth momentum will be maintained in 2017, where compensation of employees is forecasted to increase by 7.0 per cent. The growth rate is expected fall slightly in 2018 to 6.6 per cent. This marginal fall in the growth rate is expected to be maintained into 2019 and 2020 where compensation for employees is expected to increase by 6.3 per cent and 6.0 per cent, respectively. Real labour productivity in 2016 increased by 1.1 per cent with this growth momentum expected to be maintained in 2017. Over the medium-term, real labour productivity is expected to retain a positive but more moderate trajectory in line with the moderation of economic activity.

Nominal unit labour costs increased by 1.2 per cent in 2016 after registering marginally negative growth in 2015. In 2017, nominal unit labour costs are expected to accelerate, increasing by 2.5 per cent. Over the outer years of the forecast horizon, the growth in nominal unit labour costs is expected to average 2.7 per cent. Real unit labour costs are also expected to increase relative to the subdued growth rate of 0.3 per cent in 2016.

In fact, real unit labour costs are projected to increase by 1.1 per cent in 2017, by 1.0 per cent in 2018, by 0.9 per cent in 2019 and to decelerate to 0.6 per cent in 2020.

Unemployment in 2016 hit a historical low of 4.7 per cent, well below the EU average of 8.5 per cent. It is expected that unemployment will average around 4.7 per cent for the rest of the forecasting period.

2.2.8 Inflation

In 2016, the inflation rate (which is measured as a twelve-month moving average of the Harmonised Index for Consumer Prices (HICP)) increased by 0.9 per cent. This was mainly driven by services' prices as well as increases in the price of foods (both processed and unprocessed) and industrial goods, although this was partly mitigated by a fall in energy prices. Inflation is expected to keep rising, reaching 1.5 per cent and 1.8 per cent in 2017 and 2018, respectively. This will mainly be driven by services prices as well as processed and unprocessed food prices. Inflation is projected to increase by 1.8 per cent and 1.9 per cent in 2019 and 2020 respectively, primarily driven by higher services prices.

2.2.9 Comparison with the Commission's Winter Forecast

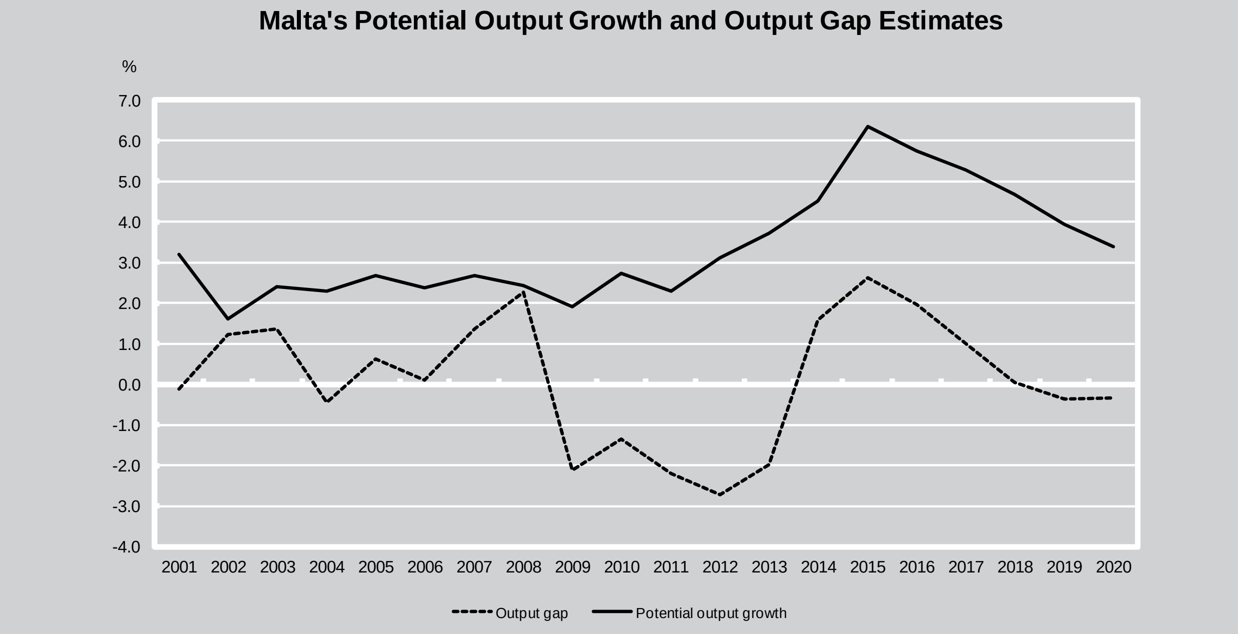
The European Commission (EC)'s winter forecast for Malta and the forecasts presented are broadly in line. For 2017, the EC forecasts a real GDP growth of 3.7 per cent, being 0.6 percentage points below this forecast's expectations. In 2018, the EC's winter forecast is expecting GDP to grow by 3.7 per cent which is in line to what MFIN is projecting. However, whereas the EC is expecting domestic demand to contribute by 3.3 percentage points and external demand to contribute by 0.5 percentage points to real GDP growth, MFIN expects growth to be driven primarily by external demand while domestic demand is also expected to contribute positively to growth although to a lesser extent. Here, the main difference lies in net exports, from which the EC expects a lower positive contribution to growth relative to that expected by MFIN. In 2018, the EC is expecting household consumption to increase by 2.7 per cent while in this forecast we expect it to rise by 3.1 per cent. That said, it must be kept in mind that the EC's winter forecast does not use the latest statistical data and the forecasts are currently in the process of being revised.

2.3 Potential Output and the Output Gap

The estimation of potential output and the output gap[1] within this Update of the Stability Programme is based on the commonly-agreed Production Function method. The main differences between the EC's and MFIN's estimation pertain to differences in the macroeconomic forecasts. Developments in the potential output and output gap are presented in Chart 2.2.

Between 2002 and 2009, potential output growth averaged 2.4 per cent, rising to 4.1 per cent in the following seven-year period. In 2016, the rate of growth of potential output climbed to 5.8 per cent and is expected to average around the 4.3 per cent level over the forecast period. The labour market contribution is expected to be the main contributor to potential GDP growth reflecting a higher participation rate. Concomitantly, growth is underpinned by capital accumulation as a result of higher investment and from Total Factor Productivity. Potential growth is expected to converge to 3.4 per cent in 2020.

Chart 2.2



The output gap is indicative of the cyclical developments prevailing in the Maltese economy. With the exception of the year 2004, the period 2002-2008 has been a period where the Maltese economy operated above its potential level. The output gap turned negative between 2009 and 2013 following the international recession and the subsequent contraction of the domestic economy in 2009. In 2015 and 2016, the output gap widened to an average of 2.4 per cent of potential output. For the forecast horizon, the output gap is expected to remain positive in 2017 but to close down in 2018.

Footnote:

[1] Defined as actual output less potential output as a per cent of potential output.

3. Fiscal Outlook and the Medium-Term Fiscal Strategy

3. Fiscal Outlook and the Medium-Term Fiscal Strategy

The Medium-Term Objective (MTO) of a balanced structural budget was achieved in 2016, well ahead of the 2019 target consistent with the calendar of convergence established by the European Commission for Malta. The recent fiscal developments were supported by strong and sustainable economic growth which sustained robust direct tax revenue, the proceeds from the International Investor Programme (IIP), and a more contained growth in current expenditure backed by the Comprehensive Spending Reviews. On account of these developments, the debt-to-Gross Domestic Product (GDP) ratio has declined to 58.3 per cent of GDP in 2016 from 60.6 per cent a year earlier, below the 60 per cent of GDP reference value.

Over the coming years, Government's primary focus shall remain the continued control over current expenditure, both to gear up public finances into attaining a vantage position which would be able to absorb any unexpected shocks, as well as to address long-term fiscal sustainability challenges posed by an ageing population. As explained in further detail in Chapter 6, the spending review will continue to ensure improved efficiency in public spending, reduction of waste and value for money. Nevertheless, the positive budget balance remains an opportunity to continue to invest and strengthen the economy's growth potential by enhancing the physical and human capital whilst strengthening institutions. Indeed, as documented in Malta's 2017 National Reform Programme, several ongoing and planned structural reforms will be contributing to raising potential economic growth, whilst ensuring fiscal sustainability.

Over the forecast period, economic growth projections have been revised upwards and the output gap is expected to be more positive in 2017 than expected but to close rapidly by 2018, before going into negative territory in 2019/2020. The negative output gap is a reflection of prudent growth estimates rather than an indication of negative economic conditions. In the context of buoyant economic growth and a starting position where the MTO was over-achieved already in 2016 (a target originally meant to be achieved in 2019), the fiscal situation transcends the normal fiscal rules of the Stability and Growth Pact (SGP) and the Fiscal Responsibility Act (FRA). Over the medium-term, a broadly neutral fiscal stance is thus envisaged. Further improvements in the underlying debt dynamics are expected to be attained through an improvement in the primary surplus, positive growth prospects, sustained investor confidence, and an efficient and effective debt management system. In this respect, the debt-to-GDP ratio is expected to remain below the 60 per cent threshold, and decline further, until the end of the forecast horizon.

In line with the practice of the previous two Updates of the Stability Programme, the Government's medium-term budget framework as outlined in this Programme constitutes Malta's national medium-term fiscal plan as required by Article 4(1) of the European Union (EU) Regulation No 473/2013 on common provision for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the Euro Area.

3.1 Fiscal Developments in 2016

In 2016, the general Government recorded a surplus of 1.0 per cent of GDP, surpassing the deficit target of 0.7 per cent of GDP contemplated in the 2016 Update of the Stability Programme and later confirmed in the 2017 Draft Budget estimates.

3.1.1 General Government Revenue in 2016

In 2016, the general Government revenue-to-GDP ratio declined by 0.8 percentage points to 39.1 per cent of GDP.

Higher tax revenues were recorded in 2016, such that the tax revenue ratio increased by 0.6 percentage points, from 26.3 per cent of GDP in 2015 to 26.8 per cent of GDP in 2016. Indeed, tax revenue buoyancy was positive in 2016 as economic growth composition was significantly influenced by tax-rich components, in particular corporate profits. Underpinning these developments, while the ratios to GDP of taxes on production and imports and capital taxes remained unchanged at the 2015 level, the ratio to GDP of current taxes on income and wealth increased by 0.6 percentage points reflecting increases in the ratios of income tax paid by both individuals as well as companies. Similarly, social security contributions registered a slight increase of 0.1 percentage point of GDP in 2016.

The better than expected performance is largely accounted for by an element of prudence in-built in the original projections, in reflection of heightened policy risks resulting from a volatile international political environment and aggravating geopolitical conflicts prevalent at the time. In addition, higher than expected and more tax rich macroeconomic growth conditions explain around a quarter of the variance between revenue projections and the actual turnout. Most of this is related to substantial upward revisions in historical national accounts data, which corrected for an underestimation of gross operating surplus. As a consequence, the Ministry’s fiscal forecasting model was also underestimating the potential growth of the corporate income tax base, which is modelled as a function of the average operating surplus of previous years to reflect potential lags in the collection of revenue and corresponding refunds.

Meanwhile, compared to 2015, declines were registered in the ratio of property income, which declined by 0.2 percentage points of GDP, and in ‘other revenue’, which recorded a more pronounced decline of 1.2 percentage points of GDP. The latter was mainly underpinned by significantly lower receipts from capital transfers and investment grants. This decline was anticipated in view of the slow uptake of EU funds typically experienced at the start of a new Financial Programme. It is nevertheless worth noting that lower revenue from EU funds in 2016 is translated in lower capital projects financed by EU funds, thus rendering such decline in revenue generally budget neutral except for the co-financing element. On the other hand, higher receipts from Government market output in part offset these declines, reflecting contributions from the IIP, as required by applicants for the naturalisation of foreign individuals and their families who contribute to the economic development of Malta to qualify for citizenship.

3.1.2 General Government Expenditure in 2016

In 2016, the ratio of general Government expenditure to GDP declined by 3.1 percentage points from 41.2 per cent in 2015. This development is mainly due to lower lower gross fixed capital formation, which declined from 4.3 per cent of GDP to 2.5 per cent of GDP and low capital transfers payable which declined by 0.6 percentage points, primarily reflecting lower expenditure related to capital projects financed from EU funds as well as a significantly decline in the equity injection in the national airline.

Against the background of the ensuing low interest rate environment and the Treasury’s debt management strategy, interest payments in 2016 were lower than those in 2015, such that interest expenditure as a percentage of GDP declined by 0.3 percentage points.

Main Fiscal Projections
(percent of GDP)

Table 3.1

	2015	2016	2017	2018	2019	2020
Revenue	**39.9**	**39.1**	**38.5**	**38.3**	**37.5**	**36.8**
Components of revenue						
Taxes on production and imports	12.8	12.8	12.6	12.3	12.0	11.8
Current taxes on income and wealth	13.3	13.9	14.2	14.1	14.1	13.9
Capital taxes	0.2	0.2	0.2	0.2	0.1	0.1
Social contributions	6.4	6.5	6.5	6.4	6.3	6.2
Property income	1.1	0.9	1.0	0.9	0.9	0.8
Other revenue	6.1	4.9	4.1	4.4	4.1	3.9
Expenditure	**41.2**	**38.1**	**38.0**	**37.7**	**37.0**	**36.3**
Components of expenditure						
Compensation of employees	12.0	12.0	12.0	11.7	11.4	11.2
Intermediate consumption	6.5	6.4	6.8	6.4	6.4	6.3
Social payments in cash and in kind	11.1	10.9	10.6	10.3	10.1	10.0
Interest expenditure	2.5	2.2	2.0	1.8	1.7	1.6
Subsidies	1.2	1.3	1.1	1.1	1.1	1.0
Gross fixed capital formation	4.3	2.5	2.8	3.1	2.9	2.8
Capital Transfers Payable	1.4	0.8	0.9	1.1	1.0	1.0
Other expenditure	2.2	2.0	1.9	2.3	2.4	2.4
Deficit	**-1.3**	**1.0**	**0.5**	**0.5**	**0.5**	**0.5**
Primary Balance	**1.2**	**3.2**	**2.5**	**2.4**	**2.2**	**2.1**

Supported by the in-depth Comprehensive Spending Review, low inflation and the further strengthening of labour market conditions, growth in social benefits expenditure was weaker than GDP growth, such that the ratio to GDP of social benefits declined by 0.2 percentage points.

Meanwhile, notwithstanding one-off expenditure in respect of Malta's responsibility for the Presidency of the Council of the EU, marginally weaker growth relative to GDP growth was recorded in intermediate consumption, as a result of which the ratio to GDP declined by 0.1 percentage point. Furthermore, as documented in the 2017 National Reform Programme and in Chapter 6 of this Update, reviews of Government spending are contributing to the achievement of improved efficiency in public spending, reduction of waste and value for money.

Discretionary Factors Underpinning Budgetary Developments

(Euro millions)

Note: The impact of the measrues is reported on accruals basis. The impact is recorded in cumulative terms. A positive represents a decline in the deficit.

Table 3.2

	2015	2016	2017	2018	2019	2020
Main Measures Impacting on Revenue						
Fiscal consolidation measures	**24.58**	**13.47**	**11.17**	**-0.50**	**0.02**	**0.00**
Revision in excise duty on fuel	4.31	8.26	0.42	0.00	0.00	0.00
Revision in excise duty on cement	2.60	1.74	0.00	0.00	0.00	0.00
Revision in excise duty on cigarettes and tobacco	5.47	6.94	5.14	0.00	0.00	0.00
Revision in excise duty on mobile telephony	1.38	0.00	0.00	0.00	0.00	0.00
Revision in excise duty on beer, spirits and wine	1.90	0.00	0.00	0.00	0.00	0.00
A revision in fees of office	2.93	0.00	0.00	0.00	0.00	0.00
Cost recovery of current free banderoles on alcohol	0.90	0.00	0.00	0.00	0.00	0.00
Excise duty on tyres	1.41	0.00	0.00	0.00	0.00	0.00
Licence fee on explosive material	0.47	0.00	0.00	0.00	0.00	0.00
Excise duty on ammunition	0.18	0.00	0.00	0.00	0.00	0.00
Revision in the duty on documents on insurance products	1.20	0.00	0.00	0.00	0.00	0.00
Revision in the swimming pool tax	0.73	0.00	0.00	0.00	0.00	0.00
Fee on caging of blue fin tuna	1.10	-0.10	0.00	0.00	0.02	0.00
Estimated loss of revenue from the phasing out of Eco-Contribution	0.00	-6.90	-0.63	-0.50	0.00	0.00
Excise duty on plastic	0.00	3.03	0.82	0.00	0.00	0.00
Excise duty on chewing gum	0.00	0.50	0.10	0.00	0.00	0.00
Estimated increase in VAT from 2017 Budget measures	0.00	0.00	1.69	0.00	0.00	0.00
Excise duty on non-alcoholic beverages	0.00	0.00	0.20	0.00	0.00	0.00
Excise duty on toiletries and washing preparations	0.00	0.00	1.20	0.00	0.00	0.00
Excise duty on precast concrete, steel structures, and mesh, bars and rods for construction	0.00	0.00	1.87	0.00	0.00	0.00
Excise duty on glass and ceramic tiles	0.00	0.00	0.35	0.00	0.00	0.00
Growth enhancing measures	**-33.65**	**-13.00**	**1.43**	**-4.50**	**0.00**	**0.00**
Adjustment in Income Tax Rates	-19.22	-11.30	-3.50	0.00	0.00	0.00
Financial Support to First Time Buyers	0.25	-0.50	0.25	0.50	0.00	0.00
Investment Registration Scheme	-31.80	0.00	0.00	0.00	0.00	0.00
Widening of tax base due to International Registration Scheme	6.00	0.00	0.00	0.00	0.00	0.00
Efficiency in revenue collection	-1.95	-1.20	0.00	0.00	0.00	0.00
Tax compliance initiatives	13.07	0.00	0.00	0.00	0.00	0.00
Concessions on Stamp Duty for business inheritance	0.00	0.00	5.00	-5.00	0.00	0.00
VAT reduction on domestic crafts	0.00	0.00	-0.17	0.00	0.00	0.00
Capped Tax Incentive for Businesses sponsoring local council projects	0.00	0.00	-0.15	0.00	0.00	0.00
Measures promoting a sustainable environment	**1.68**	**0.25**	**3.25**	**0.00**	**0.00**	**0.00**
Annual Circulation Licence fee and coverage	2.18	0.00	0.00	0.00	0.00	0.00
Income Tax Credits - School Transport Incentives	-0.50	0.00	0.00	0.00	0.00	0.00
Environmental Contribution	0.00	0.25	3.25	0.00	0.00	0.00
Social cohesion measures	**11.50**	**3.20**	**0.00**	**0.00**	**0.00**	**0.00**
Pension reform initiatives	11.50	3.20	0.00	0.00	0.00	0.00
Tax incentive to take up private pension (third pillar)	0.00	0.00	0.00	0.00	0.00	0.00
Tax Credit Extension for Child Care	0.00	0.00	0.00	0.00	0.00	0.00
Social Security Exemption for Carers	0.00	0.00	0.00	0.00	0.00	0.00
	0.00	0.00	0.00	0.00	0.00	0.00
Other measures	**37.69**	**121.35**	**-71.54**	**0.00**	**-10.00**	**0.00**
International Investor Programme	37.69	121.35	-71.54	0.00	-10.00	0.00

3.2 Fiscal Outlook in 2017

During the current fiscal year, the general Government balance is expected to remain in surplus, although this is expected to decline to 0.5 per cent of GDP. Nevertheless, this constitutes a percentage point improvement in the targeted balance, as compared to a deficit of 0.5 per cent of GDP targeted in the 2017 Budget. Meanwhile, the structural balance is expected to remain stable at 0.2 percentage points of potential GDP.

For 2017, in line with the Fiscal Responsibility Act (2014), the Ministry for Finance (MFIN) is currently considering the modalities of establishing a Contingency Fund following the achievement of a balanced budget in 2016, which will help provide a further buffer to ensure that unforeseen expenditure or revenue slippages do not endanger

Table 3.2 (continue)

Main Measures Impacting on Expenditure						
Social cohesion measures	**-22.74**	**9.68**	**-7.71**	**4.14**	**3.59**	**0.00**
Revision in the minimum rate of children's allowance	0.00	0.00	0.00	0.00	0.00	0.00
Extension of maternity leave	0.00	0.00	0.00	0.00	0.00	0.00
Assistance to the Elderly	-0.96	0.12	-0.12	0.00	0.00	0.00
Free Child Care Centres	-5.83	0.15	-0.80	0.00	0.00	0.00
Pension reform initiatives	0.82	0.92	0.98	-0.00	0.00	0.00
Tapering of Social Benefits	1.56	3.36	3.63	4.31	3.75	0.00
Youth Gaurantee	2.65	1.15	0.03	0.04	0.03	0.00
Extended in-work benefit scheme	-1.06	-0.94	-1.00	0.00	0.00	0.00
Conditional Children's Allowance	-7.84	7.84	0.00	0.00	0.00	0.00
Pensions	-4.90	-7.60	-2.40	-0.20	-0.20	0.00
One-Time Additional Bonus	-7.18	7.18	0.00	0.00	0.00	0.00
Single Means Test	0.00	-1.50	-0.10	0.00	0.00	0.00
Live-in Carers Fund	0.00	-1.00	-0.40	0.00	0.00	0.00
Social fund for students in difficulty	0.00	0.00	-1.00	0.00	0.00	0.00
Disability allowance	0.00	0.00	-1.00	0.00	0.00	0.00
Supplementary allowance	0.00	0.00	-3.23	0.00	0.00	0.00
Rent subsidy	0.00	0.00	-2.30	0.00	0.00	0.00
Measures promoting a sustainable environment	**-0.44**	**0.08**	**-4.50**	**-0.50**	**0.00**	**0.00**
Scrappage Scheme	-0.44	0.48	0.00	0.00	0.00	0.00
Hotel Energy Efficiency Scheme	0.00	-0.40	-0.10	-0.50	0.00	0.00
Tourism Environmental Trust	0.00	0.00	-3.50	0.00	0.00	0.00
Tal-linja card to 18 year olds	0.00	0.00	-0.90	0.00	0.00	0.00
Other measures	**-31.66**	**29.32**	**-27.94**	**14.15**	**-3.00**	**0.00**
Equity acquisition in Airmalta plc	-28.00	31.00	12.00	0.00	0.00	0.00
Ex-Gratia Payment on Car Registration Tax	0.84	-1.87	-0.45	-0.15	0.00	0.00
Compensation payments	0.00	-4.01	-3.99	0.00	0.00	0.00
Expropriation Compensation	0.00	-4.50	0.00	0.00	0.00	0.00
IIP expenditure	0.00	0.00	-20.00	-12.00	-3.00	0.00
2016 SP Expenditure Consolidation Measures	0.00	15.00	0.00	0.00	0.00	0.00
EU Presidency	-4.50	-6.30	-15.50	26.30	0.00	0.00
Other measures	**0.00**	**0.00**	**0.00**	**-22.00**	**-8.00**	**25.00**
Total	**-13.04**	**164.34**	**-95.84**	**-9.21**	**-17.39**	**25.00**

(1) Consolidation measures in 2017, 2018 and 2019 are still to be specified in the respective budget, including the decision whether to resort to revenue and or expenditure or a mix of both.

(2) The recorded budgetary impact for historical years for all measures is the ex-ante impact, except for the budgetary impact marked in (2), which is the ex-post impact.

the sustainability of public finances. This fund is not expected to impact the general Government balance since this is recorded as a financial transaction.

Table 3.1 presents the main projections of Government, while Table 3.2 presents the measures supporting the fiscal developments envisaged over the medium-term.

3.2.1 General Government Revenue in 2017

Consistent with the upward revision in macroeconomic projections and the better than expected outturn in 2016, revenue projections have been updated accordingly. An element of prudence in terms of conservative elasticity assumptions and prudent growth forecasts has been maintained as vulnerabilities cannot be excluded, particularly those emanating from external economic conditions.

As indicated in Table 3.1, the general Government revenue-to-GDP ratio is expected to decrease by 0.6 percentage points to 38.5 per cent of GDP in 2017, mainly attributable to a decrease in the ratio of the 'other' component of revenue to the magnitude of 0.8

percentage points. Developments in 'other' revenue mainly reflect contributions from the IIP, since the contribution from this revenue component is expected to be less buoyant in comparison to the rate of GDP growth.

Meanwhile, tax revenue is expected to broadly follow economic developments, as the fiscal impact of discretionary revenue measures (other than contributions from the IIP) is expected to be relatively marginal. Indeed, the 2017 Budget legislated increases in the excise duty on goods which are harmful to health and the environment, as well as a temporary concession on stamp duty for business inheritance and an extension of the stamp duty exemption for first-time buyers until the end of 2017. These measures, in addition to the impact of measures implemented in previous budgets but which will still have an impact in 2017, are expected to result in an improvement in the budget balance of 0.1 percentage point of GDP.

When compared to historical performance, tax revenue forecasts for 2017 remain prudent and are expected to progress in line with underlying macroeconomic developments.

3.2.2 General Government Expenditure in 2017

In 2017, the ratio of general Government expenditure to GDP is expected to decline marginally by 0.1 percentage point from 38.1 per cent of GDP in 2016. This development is mainly due to a lower ratio of current expenditure, which is set to decline by 0.5 percentage points of GDP, primarily reflecting a lower ratio for social payments as the growth in social benefits expenditure is expected to be weaker than GDP growth. The lower ratio for social payments is expected in spite of a number of 2017 Budget measures addressing the working poor, youths, pensioners, and other vulnerable groups, which collectively are expected to increase expenditure by €13.0 million or 0.1 per cent of GDP. Indeed, their impact is in part offset by the expenditure-reducing effect of measures legislated in previous Budgets, in particular the tapering of social benefits.

Lower ratios to GDP are also expected for interest payments and subsidies which, during the current year, are each expected to decline by 0.2 percentage points of GDP. Such declines are offset by a higher ratio for intermediate consumption, reflecting added outlays due to Health Concession Agreements, as well as the Presidency of the Council of the EU. Expenditure of a recurrent nature (also net of expenditure on compensation of employees) in respect of Malta's responsibility for the EU Presidency is expected to reach €26.3 million in 2017. These outlays are of a temporary nature. Consequently, current outlays in respect of the Presidency of the Council of the EU (excluding expenditure on compensation of employees) are being considered as one-off expenditure in the estimation of the structural budget balance, since such expenditure has a significant, albeit transitory, budgetary effect.

Expenditure on compensation of employees as a share of GDP is expected to remain stable at 12.0 per cent of GDP, notwithstanding the new collective agreement for the public service with effect from 1st January 2017. Autumn projections already factored in an estimate for the cost of the collective agreement. Whilst this was lower than the actual cost of the agreement, until such time as the planned recruitment for 2017 becomes effective, savings are known to have materialised in the first quarter of 2017. These savings should cover the additional cost which was not factored in the autumn projections.

Meanwhile, such declines are expected to be in part offset by higher capital expenditure, reflecting a higher ratio of gross fixed capital formation. As established by the National Development and Social Fund (Establishment as an Agency) Order of 2015, the funds received by the IIP shall be used for the advancement of education, research, innovation, social purposes, justice and the rule of law, employment initiatives, the environment and public health. Towards this end, Government has included an allowance of €20 million in expenditure in 2017 for projects financed from the National Development and Social Fund, of which the absolute majority are expected to finance projects of a capital nature.

3.3 Medium-Term Fiscal Strategy

Malta's medium-term fiscal strategy envisaged for the 2018-2020 period reflects the macroeconomic projections contained in this Programme. Over the medium-term, the Maltese economy is expected to continue growing at a moderate pace, though at a slower rate than that recorded in recent years. The rate of growth of potential output is also expected to moderate over the medium-term, and the output gap is expected to remain positive though closing gradually by 2018 and to turn slightly negative in 2019/2020.

Inflation is expected to revert to its long-term average. Employment growth is expected to remain strong, while moderating somewhat in the outer years of the forecast horizon to edge closer to the long run average, with unemployment forecasted to remain below the historical average. No major external imbalances are foreseen and the contribution from external demand is projected to remain positive until 2020.

3.3.1 Structural Budget Balance and the Medium-Term Budgetary Objective

After correcting the excessive deficit in 2013, and reaching its MTO of a balanced budget in structural terms in 2016, the Maltese Government is targeting a stable general Government surplus over the medium-term at 0.5 per cent of GDP. Based on the outlined macroeconomic projections and estimates of the business cycle generated using the commonly agreed methodology, and expected developments in one-off and

Analysis of the Developments in the General Government Balance

(percentage points of GDP)

Table 3.3

	2015	2016	2017	2018	2019	2020
Change in Revenue Ratio	**0.40**	**-0.81**	**-0.62**	**-0.24**	**-0.75**	**-0.72**
Discretionary factors underpinning fiscal consolidation	0.36	1.18	-0.68	-0.10	-0.06	0.10
Tax revenue buoyancy	-0.71	0.58	-0.01	-0.42	-0.49	-0.61
Other revenue	0.75	-2.57	0.07	0.28	-0.21	-0.21
Change in Expenditure Ratio	**0.27**	**3.12**	**0.14**	**0.24**	**0.71**	**0.67**
Discretionary factors underpinning fiscal consolidation	-0.57	0.44	-0.36	-0.04	-0.15	0.05
Change in Gross Fixed Capital Formation	-0.73	1.75	-0.10	-0.22	0.23	0.08
Other expenditure	1.57	0.92	0.60	0.51	0.63	0.54
Change in the General Government Balance	**0.67**	**2.31**	**-0.48**	**-0.00**	**-0.04**	**-0.05**

Note: Positive represents an improvement in the general Government balance

Table 3.4

Cyclical Developments

(percentage points of GDP)

	2015	2016	2017	2018	2019	2020
General Government Balance	-1.3	1.0	0.5	0.5	0.5	0.5
One-off and other temporary measures(1)	0.1	-0.1	-0.2	0.1	0.1	0.1
General Government Balance net of One-offs	-1.4	1.1	0.7	0.5	0.4	0.4
Output Gap Estimates	2.7	2.0	1.0	0.0	-0.4	-0.4
Cyclically-Adjusted Budget Balance	-2.5	0.1	0.1	0.5	0.7	0.6
Structural Balance	-2.6	0.2	0.2	0.5	0.6	0.6
Structural Adjustment	0.4	2.8	0.0	0.2	0.2	-0.1

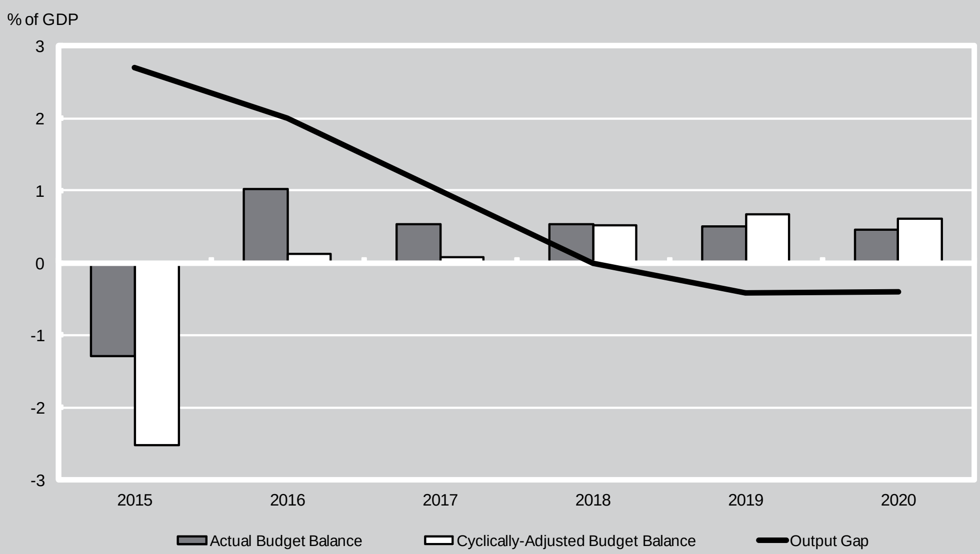
(1) A plus sign means deficit-reducing one-off measures

other temporary measures during the period under review, the outlined trajectory is translated into a gradually growing structural surplus. An analysis of the developments in the general Government balance is presented in Table 3.3, while further details on the cyclical developments over the medium-term are illustrated in Table 3.4 and Chart 3.1.

The primary surplus is expected to decline gradually to 2.1 per cent of GDP by 2020 as the ratio to GDP of interest payments is expected to follow a similar downward trajectory over the medium-term forecast horizon. Given a projected average annual growth rate

Chart 3.1

Actual and Cyclically-Adjusted Budget Balances



of nominal GDP of 6.0 per cent, the primary surplus targets are consistent with a further gradual reduction in the debt-to-GDP ratio over the medium-term, which is expected to remain below the 60 per cent of GDP reference value.

3.3.2 Revenue Forecasts

MFIN prepares revenue forecasts for general Government based on the most plausible and prudent medium-term macroeconomic forecasts and assumptions. Due to prudent elasticity assumptions and a slower growth in the tax base than nominal GDP, as well as more moderate contributions to the National Development and Social Fund, total revenue ratio is expected to decline to 36.8 per cent of GDP by 2020, from 39.1 per cent of GDP in 2016.

The tax burden is expected to decline by 1.2 percentage points of GDP to 32.3 per cent of GDP by the end of the Programme period. Such developments are partly driven by conservative elasticity assumptions, despite relatively strong growth in the underlying tax bases, as indicated by a negative revenue buoyancy. Underpinning these developments, revenue from taxes on production and imports is expected to follow a declining trend to 11.8 per cent of GDP in 2020, mainly reflecting a slower growth in the tax base relative to nominal GDP. Current taxes on income and wealth are expected to remain relatively stable over the Programme period, averaging 14.1 per cent of GDP between 2017 and 2020, as wages are expected to move roughly in line with nominal GDP. Meanwhile, social security contributions are expected to decline marginally to 6.2 per cent of GDP by the end of the forecast period as, notwithstanding buoyant wage growth and strong employment growth, as per the Social Security Act (Cap 318), the weekly rate of contributions payable by employed persons is capped at a maximum rate that is not fully indexed to wage growth.

Non-tax revenue, including property income and other revenue, is set to decline from 5.8 per cent of GDP in 2016 to 4.7 per cent of GDP in 2020 as contributions from the IIP moderate.

3.3.3 Expenditure Targets

A higher general Government expenditure is projected relative to the Budget 2017 forecast. Based on revenue projections conditional on macroeconomic conditions and budgetary measures, and grounded on a stable general Government surplus of 0.5 per cent of GDP, the targeted general Government expenditure ratio is set to decline gradually to 36.3 per cent of GDP by 2020. While the ratio of current expenditure to GDP is expected to decline over the medium-term to 32.6 per cent, capital expenditure is forecasted to average 3.8 per cent of GDP between 2017 and 2020. Indeed, by means of the planned capital programme, the Maltese Government will give precedence to the national infrastructure needs over the forecast horizon up to 2020, aligned with national economic and social priorities, and consistent with Government's objectives for sustainable economic growth.

Social benefits and social transfers in kind are set to continue on the declining trend relative to GDP recorded in recent years and are expected to decline by 0.9 of a percentage point of GDP over the forecast horizon. Such development reflects savings in social benefits stemming from implemented measures which are aimed to encourage and reward work effort as well as discourage dependency on the social security system.

Expenditure on compensation of employees is expected to decline by 0.8 of a percentage point of GDP to 11.2 per cent in 2020, as the growth in the average public sector compensation is expected to lag nominal GDP growth over the medium-term.

Expenditure on interest payments both in level terms but particularly as a share of GDP is expected to follow a declining trend over the medium-term to 1.6 per cent of GDP in 2020.

The ratio of intermediate consumption to GDP is set to stabilise at around 6.4 per cent of GDP during the period under review, in line with the historical average. Indeed, following an increase in expenditure in respect of the 2017 Council Presidency as well as added outlays due to Health Concession Agreements in 2017, expenditure on intermediate consumption is expected to grow in line with economic developments. Meanwhile, the ratio to GDP of subsidies is also expected to stabilise at around the historical average of 1.1 per cent of GDP.

The outlined developments are expected to be offset by a marginally higher ratio of ‘other’ expenditure, which is mainly explained by other current transfers payable. It is worth noting that developments in this component of expenditure are also influenced by expected outlays from the National Development and Social Fund.

3.4 Debt levels and developments

Government debt has declined below the 60 per cent Treaty requirements and has reached a debt-to-GDP ratio of 58.3 per cent in 2016. This is expected to decrease further to 47.6 per cent to GDP in 2020. The projected decrease in the debt-to-GDP ratio is expected to result from primary surpluses and the snowball effect which will mitigate the debt increasing Stock Flow Adjustments (SFA).

Meanwhile, the Government’s debt strategy remains that of ensuring that the financing needs of the public sector are met at the lowest possible costs, while simultaneously minimising medium and long-term interest rate risk. The Government’s reliance on short-term funding remains marginal, in line with the trends exhibited in recent years. During 2016, short-term debt accounted for 4.4 per cent of total Government debt. The latter is expected to temporarily decrease to 4.3 per cent in 2017 and reach 4.8 per cent by 2020.

Moreover, the share of maturing stocks in total Government debt is expected to decline marginally from a level of 7.2 per cent in 2016 to 6.3 per cent in 2017. Meanwhile, the proportion of maturing stocks in total Government debt is projected to embark on an upward trajectory, with the ratio reaching 7.8 per cent in 2020.

3.4.1 Projected Debt developments

Developments in the debt ratio for the Programme period and the contributors to developments in the debt-to-GDP ratio are presented in Table 3.5 and Statistical Appendix Table 4. In this regard, the positive primary surpluses targeted in the coming years are expected to decrease the debt-to-GDP ratio throughout the forecast horizon. Furthermore, the contractionary impacts of the primary balance and the ‘snowball effect’ will more than offset the expansionary impact of the SFA on the debt-to-GDP ratio foreseen through the forecast horizon.

The Dynamics of Government Debt[1]

Table 3.5

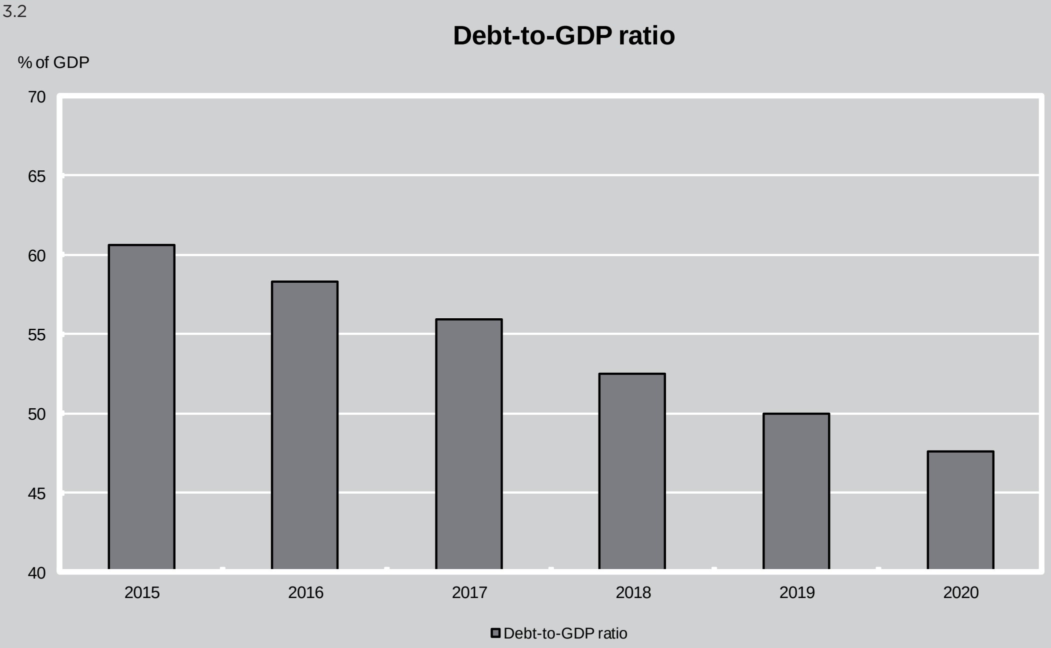
Percentages of GDP	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Gross debt	60.6	58.3	55.9	52.5	50.0	47.6
Change in gross debt ratio	-6.4	-2.3	-2.4	-3.4	-2.5	-2.4
Contributions to changes in gross debt						
Primary balance	-1.2	-3.2	-2.5	-2.4	-2.2	-2.1
Snowball Effect	-6.1	-1.6	-1.5	-1.2	-1.2	-1.2
Interest expenditure	2.5	2.2	2.0	1.8	1.7	1.6
Real GDP growth	-7.0	-2.9	-2.4	-2.0	-1.8	-1.6
Inflation Effect	-1.5	-0.9	-1.0	-1.1	-1.2	-1.2
Stock-flow adjustment	0.9	2.5	1.6	0.2	0.9	0.9
p.m. implicit interest rate on debt	4.2	3.9	3.6	3.4	3.5	3.4

[1] Developments in the debt- to-GDP ratio depend on: $\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} \cdot \frac{i_t - y_t}{1+y_t}\right) + \frac{SFA_t}{Y_t}$

where t denotes a time subscript, D, PD, Y and SFA are the government debt, primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth.

Developments in the gross Government debt are illustrated in Chart 3.2. After declining from 60.6 per cent in 2015 to 58.3 per cent of GDP in 2016, thus declining to a rate below the 60 per cent debt-to-GDP target, the ratio is expected to decline further by 2.4 percentage points in 2017. The debt ratio is expected to continue to fall by 3.4 percentage points in 2018 and 2.5 percentage points in 2019, and then continue a declining path to reach 47.6 per cent of GDP in 2020. Over the medium-term horizon, the projected reduction in the gross debt ratio is mainly driven by the primary surplus and the relatively high nominal growth scenario. Both components are expected to mitigate the upward

Chart 3.2



pressure that the interest expenditure and the stock flow transactions are expected to have on the debt-to-GDP ratio. The expansionary contribution of interest expenditure on the debt ratio is expected to moderate throughout the forecast horizon, from 2.2 per cent of GDP in 2016 to 1.6 per cent of GDP in 2020.

It is estimated that in 2016, the SFA contributed to a 2.5 percentage point increase in the debt-to-GDP ratio. This was mainly underpinned by the European System of National and Regional Accounts (ESA) adjustments made to the Consolidated Fund deficit which mainly relate to IIP Revenue and positive movements in the bank account and the cash balance. Beyond 2017, the projected IIP revenue will continue to underpin the positive stock-flow adjustments throughout the forecast period. Further details on the SFA can be found in Annex Table 10.

3.4.2 Comparison with the April 2015 Update of the Stability Programme

As illustrated in the Statistical Appendix Table 6, the ratios of general Government debt-to-GDP presented in this Programme are expected to be lower than those presented in the previous Stability Update. The expected improvement is largely attributable to a more favourable macroeconomic outlook and a more positive primary surplus for the period from 2016 to 2019 than that envisaged in the preceding Update, and a more beneficial 'snowball effect', especially in 2015 and between 2017 and 2019. Lower interest expenditure than that projected in the previous Update has also contributed towards this improvement in the debt ratio.

For 2016, the debt-to-GDP ratio was revised downwards by 4.3 percentage points to 58.3 per cent of GDP. This revision reflects a more buoyant macroeconomic environment than that expected in the earlier update. Consequently, the debt-to-GDP ratios for 2017 and 2018 were revised downwards by 4.5 and 5.0 percentage points, respectively.

In the 2016 Update, the debt-to-GDP ratio was expected to follow a downward path from a level of 62.6 per cent in 2016 to a level of 55.5 per cent in 2019. On the other hand, in this Update of the Stability Programme, the debt-to-GDP ratio is estimated to decline to a level of 50.0 per cent by 2019.

4. Sensitivity Analysis

4. Sensitivity Analysis

Ensuring the accuracy of macroeconomic forecasts in an economy is highly important especially for Malta as a small and very open economy. Since macroeconomic forecasts are the foundation of Government economic policy making, formulation and analysis and decision-making process, the assessment of past forecasting performance is important to improve the accuracy of forecasts and add credibility to the forecasting exercise. While the economy has proved to be very resilient to the international economic crisis, Gross Domestic Product (GDP) forecasting errors are relatively higher for Malta than those observed for larger and less open economies in the European Union (EU).[1] However, on a more positive note, a study undertaken by the Economic Policy Department (EPD) within the Ministry for Finance (MFIN) shows no systematic or significant biases in real GDP growth projections. Furthermore, if one excludes the recession of 2009 (which bears a disproportionate weight in the small sample of observations) and the subsequent recovery in 2010, Malta's forecasting performance is comparable to much larger and less open economies and becomes the best performer among small and open economies in the EU.

In recognition of the risks surrounding macroeconomic forecasts, this chapter provides an assessment of forecast uncertainty and the balance of risk surrounding the macroeconomic forecasts in this Programme. The analysis is in line with the requirements of Council Directive 2011/85/EU of the EU on the requirements for budgetary frameworks of the Member States.

4.1 The Accuracy of Past Forecasting Performance

The analysis does not find any systematic bias in the GDP growth projections carried out by EPD within MFIN. Furthermore, the EPD forecasting accuracy is comparable with that of other institutions that carry out regular forecasts of the Malta economy, including the European Commission and the Central Bank of Malta. While the one-year ahead forecasts display a root-mean squared error (RMSE) of 2.3, it is notable that the sample size employed is rather small and the earliest forecast available is that of 2004. As a result of the sample size, the recession of 2009, and the subsequent recovery play an undue influence on this evaluation and limits comparability with the forecast accuracy displayed by other economies. Indeed, when these two years are excluded, the RMSE declines to 1.9 and is much more comparable to that observed in other EU economies.[2]

The evaluation of the risk and uncertainty of the current macroeconomic projections underlying this Programme is based on an *ex ante* analysis of past forecast errors which determine the level of uncertainty. *Ex post*, a number of alternative but plausible economic scenarios generated with the forecasting model used by EPD are also simulated to determine the balance of risks surrounding the baseline projections.

4.2 The Balance of Risks

To determine the balance of risks surrounding macroeconomic forecasts, seventeen different alternative model-based growth projections were analysed. These represented scenarios that were considered to be plausible alternatives to the baseline projections. While a measure of economic judgement was deemed necessary in the choice of these scenarios, this was underlined by the constant monitoring of economic conditions prevailing at the time and confirmed at a number of meetings with economic stakeholders.

4.2.1 Private Consumption Expenditure

4.2.1.1 More optimistic Private Consumption Growth reflecting on-going structural factor improvements

Recent data releases indicate that consumption has been the most resilient domestic driver of GDP growth in the period following the financial crisis. In the Ministry's prudent baseline forecast, it was assumed that consumption growth would remain modestly strong in 2017 and 2018 at 3.6 per cent and 3.1 per cent, before levelling-out in the outer period in 2019 and 2020 at 2.7 and 2.4 per cent respectively. By assuming a more optimistic consumption scenario (could be consistent with a decline in savings), GDP growth increases by 0.4 percentage points in 2017 and 2018, and by 0.2 percentage points in 2019 and 2020, reflecting higher domestic demand contributions. The budget balance also marginally improves on a year by year basis.

4.2.2 Tourism Sector

4.2.2.1 Higher Tourist inflows in 2017

When considering the flourishing performance in the tourism sector over recent years, the baseline projections encompass a relatively prudent increase in tourist numbers in 2017. Based on meetings conducted with major operators in the sector, a record performance for 2017 is anticipated once again, with the number of tourists well-surpassing the record 2 million mark attained in 2016. This increase is supported by a less seasonal inflow of tourists. The shoulder months have witnessed significant growth rates over and above the record performance during peak months allowing more sustainable growth in tourism. Therefore, this scenario assumes higher tourist numbers in 2017, assuming a 200,000 increase over the record tourist inflow figure for 2016. Based on this scenario, GDP growth in 2017 increases significantly by 1.4 percentage points over the baseline projection. Growth in 2018 and 2019 is expected to be more modest at 3.5 per cent and 3.4 per cent, respectively while growth in 2020 remains unchanged. In terms of the budget balance, a 0.2 percentage point improvement is apparent in 2017. Thereafter, in the outer years, a 0.1 percentage point improvement is registered throughout.

4.2.2.2 Weaker than expected Tourism Growth in Outer Years

Despite the thriving performance of the sector, it is undeniable that tourism could experience an unexpected negative shock, say due to rise in geo-political tensions in the region. This scenario assumes a slowdown in the tourism export growth in 2018, 2019 and 2020. GDP growth in 2017 remains unchanged. In the outer years, GDP declines by 0.4 percentage points in 2018, 0.3 percentage points in 2019 and 0.2 percentage points in 2020. Concomitantly, the budget balance decreases by 0.1 percentage point in 2019 and 2020, respectively.

4.2.3 Global Economic Growth

In view of the prevailing uncertainties in the global economy, two scenarios yielding plausible outcomes are modelled. In the first scenario, it is assumed that global growth continues its recovery path while in the alternative scenario, global growth is assumed to be weaker than expected.

4.2.3.1 Improved global economic growth

This scenario assumes that growth in Malta's key trading partners is stronger than expected. The relatively higher than expected economic growth for Germany, United Kingdom (UK), Italy, France and the United States (US) is based on the Consensus

Forecasts March 2017 issue, assuming the most optimistic plausible growth figure for each trading partner for 2017 and 2018. The high-end range forecasts for consumer prices and producer prices are also based on this source. The outcome of this scenario yields a 0.1 percentage point increase in Malta's GDP in 2017, followed by significant upward revisions in real GDP of 1.1, 1.2 and 1.0 percentage points in 2018, 2019 and 2020, respectively. The budget balance would improve marginally by 0.1 percentage point in 2017 before continuing to improve in the outer years by 0.3 percentage points in 2018, 0.4 percentage points in 2019 and 0.6 percentage points in 2020, respectively.

4.2.3.2 Weaker global economic growth

This scenario is modelled on weaker than anticipated growth for Malta's key trading partners. Using a similar procedure as outlined in the previous section, this scenario is based on worst-case real GDP growth projections for Malta's main trading partners based on the March 2017 Consensus Forecasts publication. Consequently, lower forecasts for consumer prices and producer prices are assumed. Results indicate a growth rate of 3.9 per cent in 2017, 0.4 percentage points less than the baseline scenario. Moreover, Malta's real GDP growth for the outer years is expected to be lower relative to baseline, reflecting a weaker export growth which is more pronounced than the decline in imports. This subdued performance negatively affects the budget balance, with most of the impact reflected in the outer years. In fact, a marginal decline of 0.1 percentage point is registered in 2017, while a decline of 0.2, 0.5 and 0.6 percentage points is estimated for 2018, 2019 and 2020, respectively.

4.2.4 Subdued Wage Growth

Under the baseline scenario, it is assumed that compensation per employee continues to grow at a rate stronger than the average seen in recent years, reflecting strong labour market developments on the back of active labour market policies and a higher share of medium- to high-skilled migration flows.

This scenario models a situation where compensation per employee grows in line with the average of 2.3 per cent growth of the last 15 years. Under this scenario, growth in private consumption would be weaker than that expected under the baseline scenario with real GDP growth decreasing by 0.4 percentage points in 2017, followed by further declines of 0.3 percentage points in the subsequent years. The budget balance would worsen over the entire forecast period in line with lower economic activity.

4.2.5 Stronger Remote Gaming Growth Scenario

Based on meetings conducted with stakeholders in the remote gaming sector, the sector has further growth potential to be reaped. Therefore, this scenario assumes continued positive momentum by maintaining the same strong growth in 2015 over the forecast horizon. Based on this assumption, GDP growth strengthens throughout the entire forecast horizon. Consequently, the budget balance would strengthen over the forecast horizon in tandem with the movements in GDP growth.

4.2.6 Lower Manufacturing Growth Scenario

In 2016, the manufacturing sector started to show subdued signs of recovery relative to the declines experienced in the years preceding 2016. Although the baseline scenario assumes relatively subdued growth in this sector, given the prevailing uncertainty in the short-term, it is undeniable that downside risks especially in certain sub-sectors of the manufacturing sector still exist. That said, a scenario where negative growth of

3.0 per cent in the manufacturing sector is assumed throughout the entire forecast horizon is simulated. Given the declining contribution of the manufacturing sector to the economy's growth relative to other emerging sectors, the effects on real GDP growth are not significant. When compared to the baseline scenario, real GDP growth in 2017 declines by 0.1 percentage point. In 2018 and 2019, GDP growth remains unchanged, before declining once again by 0.1 percentage point in 2020. The budget balance remains unchanged in 2017 and 2018 before experiencing a drop of 0.1 percentage point in the outer years respectively when compared to the baseline case.

4.2.7 Alternative Growth, Exchange Rates and World Prices Scenario

As outlined above, GDP growth assumptions for Malta's main trading partners and the exchange rates are based on the March 2017 Consensus Forecasts issue. World prices are also an exogenous variable in the macroeconomic projections, proxied by the producer prices index weighted by the share of international trade of Malta's main trading partners. The baseline assumptions of how world prices are expected to develop over the forecast horizon are also based on the Consensus Forecast March 2017 issue.

4.2.7.1 Consensus Forecasts April 2017

To obtain an alternative view, a scenario incorporating assumptions for real GDP growth, exchange rates and world prices based on the latest Consensus Forecast April 2017 issue (available only after the cut-off date of the baseline forecasts) is simulated. In this case, GDP growth decreases by 0.3 percentage points to 4.0 per cent in 2017, followed by a 0.2 percentage point decline in 2018 GDP growth. Further declines in GDP growth relative to the baseline case are projected for 2019 and 2020. The budget balance only changes in the outer years, declining by 0.1 percentage point in 2019 and 2020, respectively.

4.2.8 Economic Spillovers emanating from US Policy

Two scenarios are modelled on the presumption that the US administration will be introducing a fiscal stimulus based on tax reductions. The first scenario assumes the lowering of taxes totalling 1.3 per cent of GDP (0.3 per cent in 2017 and 1.0 per cent in 2018), equally divided between corporate income tax (CIT) and personal income tax (PIT). The second scenario analyses the effects of a tax cut amounting to 2 per cent of GDP (entirely in 2018), divided between CIT and PIT in a 2/3:1/3 share ratio respectively. Over and above the projected fiscal stimulus, given the modest recovery in growth and inflation in the US economy, the Federal Reserve has also announced that it shall adopt a tighter monetary policy over the short-term, increasing interest rates by 25 basis points, equivalent to 0.25 per cent. Therefore, both of the above scenarios take into account this projected monetary policy stimulus, which would positively affect Eurozone exports.

4.2.8.1 Scenario 1: Tax Cuts amounting to 1.3 per cent of GDP [0.3 per cent in 2017, 1 per cent in 2018], equally divided between CIT and PIT

This scenario projects GDP growth to reach 4.6 per cent in 2017, up by 0.3 percentage points from the baseline scenario. In subsequent years, GDP growth declines by 0.3, 0.4 and 0.2 percentage points in 2018, 2019 and 2020 respectively, due to a continued base effect from 2017. The budget balance only changes in the outer years, declining by 0.1 percentage point in both 2019 and 2020, respectively.

4.2.8.2 Scenario 2: Tax Cuts amounting to 2 per cent of GDP [entirely in 2018], divided between CIT and PIT in a 2/3:1/3 share ratio

Results from this scenario indicate a 0.4 percentage point increase in growth for 2017, followed by a 0.1 percentage point decline in 2018. A decrease of 0.2 percentage points in growth relative to the baseline is once again projected for 2019, once again due to a continued base effect from 2017. No change is anticipated in 2020. The budget balance increases by 0.1 percentage point in 2017, 2019 and 2020, and remains unchanged in 2018.

4.2.9 Stronger Medium-Term Private Investment Scenario

Following the base effect in gross fixed capital formation in 2015 due to a number of large scale projects, a short-term decline in investment is anticipated in our baseline forecasts. It should be noted that only investment projects for which there is either a clear political commitment or contractual obligations between private operators are included in the baseline. There are nevertheless a number of other projects which have a positive probability of being implemented over the coming years, which are included as a positive risk scenario. Several scenarios were simulated, taking into account these upward risks.

4.2.9.1 Stronger Underlying Investment over the forecast horizon

This scenario assumes a stronger underlying investment relative to the baseline forecasts, underpinned by various factors including the establishment of the Development Bank. Under this scenario, GDP growth increases by 0.2 percentage points in 2017 reflecting a positive investment growth figure of 0.7 per cent. In 2018, GDP growth is 0.1 percentage point lower than the baseline. The budget balance improves by 0.1 percentage point in 2019 and 2020, yet remains unchanged in 2017 and 2018.

4.2.9.2 Gas Pipeline

This scenario assumes that the gas pipeline investment linking Malta to Sicily materialises over the 2019-2021 period. In 2019, GDP growth will increase by 0.1 percentage point in 2019 and by 0.2 percentage points in 2020. The budget balance in the outer years is expected to improve by 0.1 percentage point, respectively.

4.2.9.3 High Rise Buildings

Due to limited space for further development, a number of high rise buildings are being proposed by number of private developers for construction. Assuming that some of these projects are launched in 2018, GDP growth increases by 0.1 percentage point. The budget balance is expected to marginally improve in the outer years.

4.2.9.4 Lower Import Content of Investment

Another scenario simulated in this area relates to the import content associated with one-off investment projects. For one-off investment projects, the baseline scenario assumes an import share of 95 per cent for the machinery component part and 75 per cent for the construction part as import content of any major investment project. As a result, the effect on GDP from any one-off investment project tends to be muted as an element of prudence is inbuilt in the baseline. However, a 75 per cent share import content for the construction part of the investment project could be on the high side, so a 50 per cent share for Malta could be considered to be more realistic by other experts in the field. Under this assumption, GDP growth will increase by 1.1 percentage points in 2017. However, growth in the outer years is projected to decline by an average of 0.3 percentage points.

The budget balance will only increase by 0.1 percentage point over the entire forecast horizon as tax revenue is not particularly sensitive to such investment.

4.2.10 Short-term Interest rates to increase by 25 basis points in 2018 and remain the same throughout

The short-term interest rate, which is based on the fixed interest rate of the main refinancing operations by the European Central Bank (ECB) is an exogenous variable in our macroeconomic forecasting methodology and is assumed to remain constant at the previous year's average level over the forecast horizon. Given that inflation is expected to pick-up in the European economy over the coming years, this scenario simulates an increase of 25 basis points in the short-term interest rate in 2018 and remains unaltered for the outer years. The effects of this scenario are expected to decrease real GDP growth by 0.3 percentage points in 2018. Moreover, the effect on real GDP growth for the outer years is relatively more contained as real GDP growth is expected to decrease by 0.1 percentage point in both years. Consequently, the budget balance marginally deteriorates in 2018 by 0.1 percentage point and remains unaltered for the outer years.

4.2.11 Alternative Models Scenario

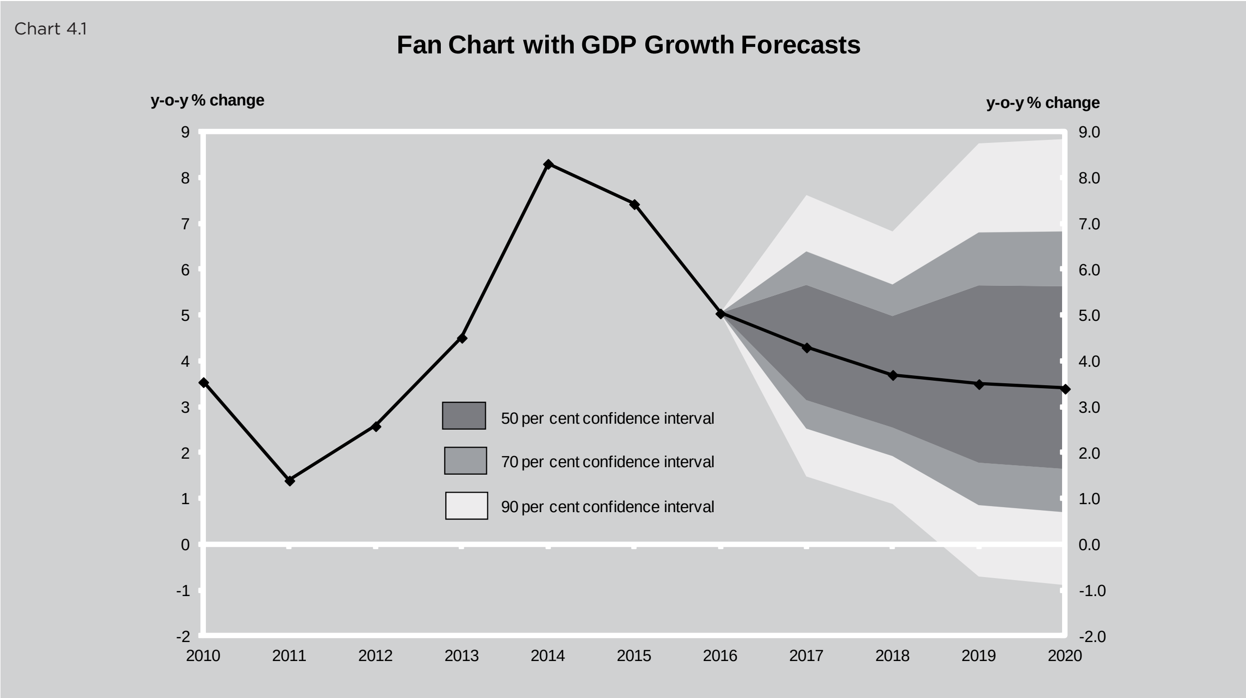
The EPD is responsible for the preparation of macroeconomic forecasts for the Government of Malta through the use of its Short-term Quarterly Econometric Forecasting Model for Malta (STEMM). Such macroeconomic forecasts serve as vital inputs to various Government policy decisions, including budgetary projections.

The sole reliance on one structural time-series econometric model could pose problems of statistical confidence and is often discouraged for more than one reason. In light of this, EPD has developed seven alternative forecasting models ranging from model-free statistical forecast (Random Walk and Holt-Winters Seasonal Smoothing Method), model-based univariate forecasts (2 ARIMA models) and model-based multivariate forecasts (2 VAR models and one VECM model). These models help EPD to benchmark the results inferred from STEMM and can be used to generate alternative growth forecasts.

On average, these models suggest higher GDP growth for 2017 and 2018 but lower growth in the outer years. Concomitantly, the budget balance is expected to improve over the short-term and marginally worsen over the outer years relative to the baseline scenario.

4.3 Uncertainty and the Balance of Risk Underlying the Macroeconomic Projections

The uncertainty surrounding the macroeconomic projections is based on the past forecast error variance of GDP. This is equal to 1.9 for the current year forecast, 1.8 for the one-year ahead forecast, 2.9 and 3.0 for the two-year ahead and the three year-ahead forecast, respectively. The balance of risk is based on the Pearson skewness indicator of the model generated alternative forecasts for GDP documented above. On balance, the indicator shows stronger upside risks for the forecast horizon covered in this Programme. Chart 4.1 depicts a representation of the uncertainty and the balance of risk surrounding the macroeconomic forecasts presented in this Programme.



4.4 Risks to Fiscal targets

The alternative macroeconomic scenarios documented above, can influence the attainment of the deficit targets in this Programme. Chart 4.2 illustrates the range of possible budget balance outcomes conditional upon the realisation of these alternative scenarios. The balance of risk is on the upside for the period being covered by the Programme. However, under the worst possible cyclical scenario contemplated, the budget balance would turn into a deficit of 0.3 per cent of GDP but still remain close to the Medium-Term Objectives (MTO) of a balanced budget in structural terms.

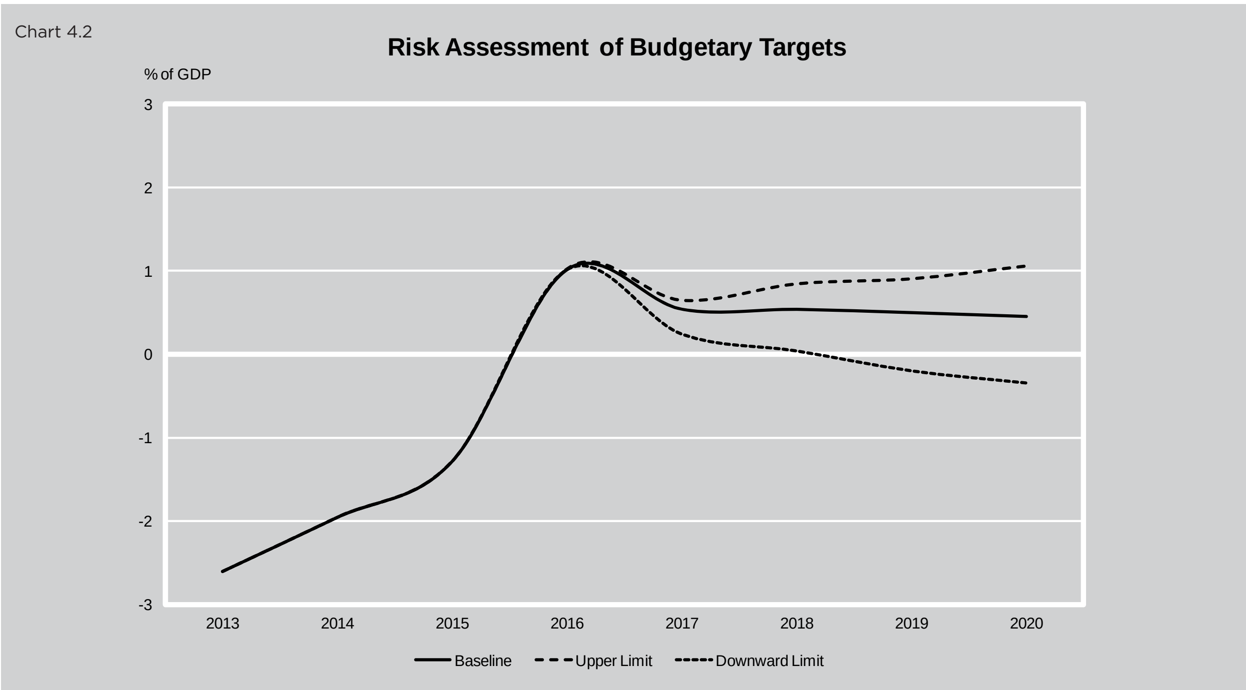
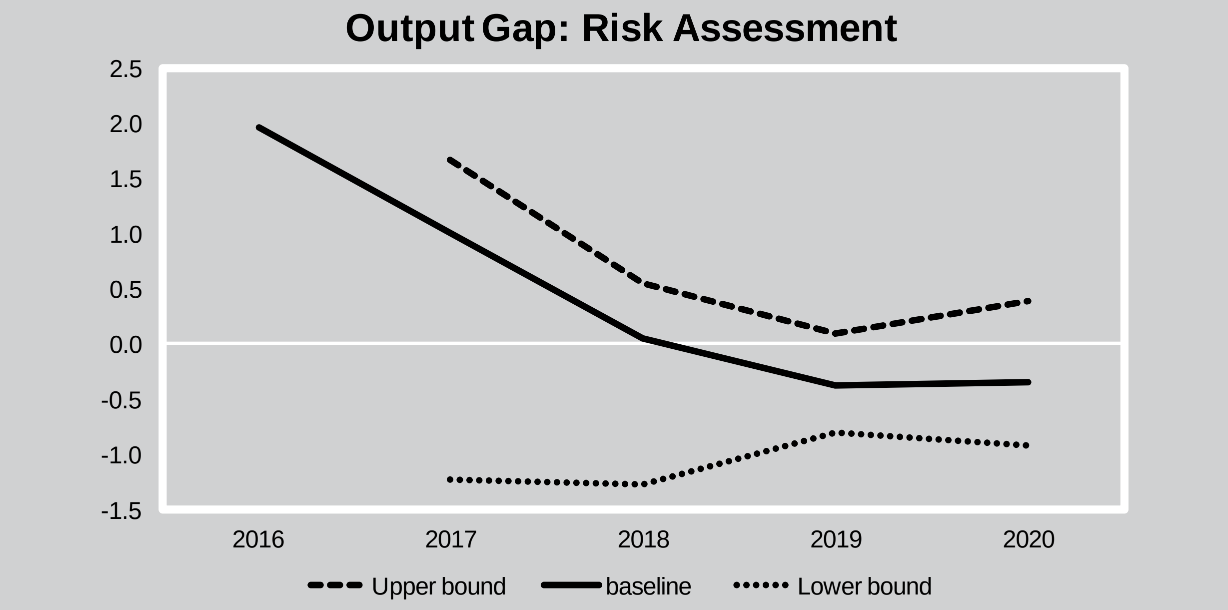


Chart 4.3



4.5 Alternative Output Gap projections and risks to Structural Fiscal Targets

This assessment has been extended to cover risks to the output gap projections and hence the structural commitments presented in this programme. Alternative output gap projections consistent with all the above economic scenarios have thus been carried out.

Compared to the baseline scenario, alternative output gap projections range from -1.2 in 2017 up to -0.9 in 2020 under the lower-bound and from 1.7 in 2017 down to 0.4 in 2020 under the upper-bound scenario.

Consistent with the range of output gap projections, the structural budget balance (inclusive of the impact on the budget balance) could range from a deficit of 0.2 per cent of GDP in 2017 increasing to 0.4 per cent of GDP in 2020 under the lower-bound, and from a surplus of 0.7 per cent of GDP in 2017 up to 1.0 per cent of GDP in 2020 under the upper-bound scenario.

This implies that even in the worse-case macroeconomic scenario considered, the structural surplus remains close to the MTO and that the baseline scenario contemplates a sufficient buffer in order to maintain the MTO.

Footnotes:

[1] Camilleri, G. and Vella, K. (2015). “Interpolating Forecast Errors for Assessing Uncertainty in Macroeconomic Forecasts: An Analysis for Malta.” EPD Working Paper Series, No. 1/2015, March 2015.

http://mfin.gov.mt/en/epd/Documents/Working_Papers/Working_Paper_Full.pdf

[2] Kindly note that the analysis on past forecast errors has been updated and is different than to what is outlined in Camilleri and Vella, (2015). The updated analysis features the latest Updates of the Stability Programme as part of the sample data. However, the methodology remains unchanged.

5. Sustainability of Public Finances

5. Sustainability of Public Finances

This Chapter seeks to assess Malta's long-term sustainability of public finances for the period 2013-2060. This assessment is founded based on the expenditure projections from the Ageing Report 2015 which in turn reflects the population projections EUROPOP2013 carried out by EUROSTAT. The concerns of this Chapter include pensions, health, long-term care, unemployment and education expenditure projections. These long-term projections provide an indication of the timing and scale of economic changes that would result from an ageing population in a 'no-policy change' scenario. The projections show where, when, and to what extent, ageing pressures will accelerate as the baby-boom generation retires and the average life span continues to increase. Hence, the projections are helpful in highlighting the immediate and future policy challenges posed for governments by demographic change

The Ageing Working Group (AWG) is currently working on the new round of long-term projections in the context of the next Ageing Report, which the ECOFIN mandated the Economic Policy Committee (EPC) to be endorsed and published by not later than autumn of 2018. The demographic projections (ESSPOP2015) have already been published by EUROSTAT and the time horizon covered is from 2015 to 2081 for the projected population.

5.1 Long-Term Budgetary Projection Results for Malta

This section provides an analysis of the long-term sustainability of public finances for Malta for the period 2013-2060 on the basis of commonly agreed assumptions for the European Union (EU) Member States under the EPC AWG. The modelling work for pension outlays projections reflects as strictly as possible the pension rules, both current as well as those applying in future years following the reform law enacted in December 2006. It is to be noted that the modelling work covers only reforms introduced up to 2014. Later pension reforms not incorporated in the projections include the launching of the Third Pillar pension scheme as well as the pension reforms introduced in the Budget for 2016 and for 2017. These pension reforms will be addressed in more detail in Section 5.2 of this Chapter.

It is to be noted that the necessary work showing the effect of the 2016 pension reform on the projections for pensions expenditure is now complete. Further to ongoing correspondence with the European Commission, it was agreed that Malta is to present these projections and undergo a peer review at a technical level in the EPC AWG meeting in May 2017.

The model used in projecting pension expenditure is the World Bank's Pension Reform Options Simulation Toolkit (PROST) 15. Statistical Appendix Table 7 shows the expenditure components of the long-term budgetary projections as a percentage of Gross Domestic Product (GDP) for the period 2013-2060 and the assumptions used.

5.1.1 Demographic Projections

Population projections, EUROPOP2013 as published by EUROSTAT were used as a primary input in the long-term age-related expenditure projections used by the European Commission in the assessment of the sustainability of public finances. For Malta, this set of population projections led to significant differences in terms of the trajectory as well as the dynamics of population changes in comparison to the previous set of projections. As

EUROPOP2010 and EUROPOP2013 Population Projections

Table 5.1

	2013	2020	2030	2040	2050	2060
EUROPOP2010						
Total population	412,637	415,664	416,631	407,057	396,649	386,935
Old-age dependency ratio (65+ yrs/15-64 yrs)	25.3	32.2	39.3	40.4	46.9	55.9
EUROPOP2013						
Total population	422,556	439,341	456,792	462,995	468,528	476,383
Old-age dependency ratio (65+ yrs/15-64 yrs)	25.8	33.2	40.5	40.8	45.0	50.9

Note: Figures may not add up due to the rounding

Source: Eurostat

shown in Table 5.1, according to EUROPOP2013 total population is projected to increase to around 476,000 by 2060, compared to the absolute decline to around 387,000 in the previous round of projections. Furthermore, the old-age dependency ratio is expected to reach 50.9 per cent in 2060, around 5 percentage points lower than that projected in EUROPOP2010. EUROPOP2013 population projections have resulted in a relatively smaller increase of 2.0 percentage points of the GDP over the entire projection period in the age-related expenditure relative to the 2012 Ageing Report. These revisions were in line with similar revisions to the demographic projections of other EU Member States.

5.1.2 Assumptions Applied

In projecting pensions, the demographic assumptions reflect EUROPOP2013 projections by Eurostat, while the macroeconomic assumptions reflect the commonly agreed methodology in the EPC. The assumptions used include the real GDP growth rate, labour productivity (growth rate per hour), inflation rate, labour participation rate by age and gender, unemployment rate by age and gender, population (EUROPOP2013), fertility rate by age, mortality rate by age and gender, and net migration by age and gender. A number of variables included in the assumptions as provided by the AWG-EPC, were not incorporated in the PROST workings for the pension projections, primarily due to the fact that such variables are not required as PROST inputs.

As regards the demographic evolution, life expectancy at birth for men is assumed to rise by 6.4 years over 2013 to reach 85.1 years in 2060, while for women it is expected to reach 89.1 years, an increase of 6.3 years over 2013. This implies that despite some convergence, female life expectancy in 2060 is projected to remain 4 years higher than that of males. Meanwhile, life expectancy at 65 years for males is projected to increase by 4.3 years between 2013 and 2060, while for women it is projected to increase by 4.4 years. The fertility rate is projected to increase from 1.4 in 2013 to around 1.8 in 2060. Another important variable in the evolution of the demography is net migration, which is projected to remain consistent even if declining in importance, from an annual average of 1,600 in 2013 to 1,146 in 2060. As a share of total population, net migration inflows to Malta is projected to decline from 0.4 per cent in 2013 to 0.2 per cent in 2060. Net migration shall represent an important factor in determining developments in total population during the projection period as indicated by the ratio of net migration over population change, which is projected to increase from 0.5 per cent in 2013 to 3.6 per cent in 2040 and to decline to 1.7 per cent in 2060.

With respect to macroeconomic assumptions, potential GDP growth rate is assumed to increase from 1.7 per cent in 2013 to around 2 per cent by 2020 and then falling to 1.8 per cent by 2040. It is assumed to decline further to 1.4 per cent by 2060. The unemployment rate (15-64 years) is assumed to increase marginally from 6.5 per cent in 2013 to 6.7 per cent in 2060. The female participation rate (15-64 years) is assumed to increase from 50.2 per cent in 2013 to 66.9 per cent by 2050 and to remain relatively stable at around that level by 2060. The male participation rate (15-64 years) is assumed to increase from 79.7 per cent in 2013 to 84.5 per cent by 2030 and to decline to 83.4 per cent by 2060.

5.1.3 Demographic Developments

Population projections (EUROPOP2013) indicate that the total population in Malta is projected to rise from around 423,000 in 2013 to around 457,000 in 2030, and to reach around 476,000 by 2060. As shown in Table 5.2, the age structure of the population is projected to change significantly. While the share of the very young people (aged 0-14 years) in the total population is projected to hover around the 15 per cent share, the share of the people aged 65+ is projected to increase from 17.5 per cent to 28.5 per cent. The most significant change in demography concerns the working-age population (aged 15-64 years), which reflects the share of the population that will bear the financial 'burden' of the elderly. From a share of 68.0 per cent in 2013, this ratio is projected to subsequently fall to 60.2 per cent by 2030 and to reach 56.1 per cent in 2060.

Total Population, by Selected Age Groups

Table 5.2

Age	2013	2020	2030	2040	2050	2060
0-14 yrs	61,182	65,365	70,157	67,451	69,839	73,397
15-64 yrs	287,317	280,771	275,096	280,827	274,938	267,095
65+ yrs	74,057	93,205	111,540	114,717	123,751	135,892
Total	422,556	439,341	456,792	462,995	468,528	476,383
Share (%)						
0-14 yrs	14.5	14.9	15.4	14.6	14.9	15.4
15-64 yrs	68.0	63.9	60.2	60.7	58.7	56.1
65+ yrs	17.5	21.2	24.4	24.8	26.4	28.5
Ratio						
Youth dependency ratio (0-14 yrs/15-64 yrs)	21.3	23.3	25.5	24.0	25.4	27.5
Old-age dependency ratio (65+ yrs/15-64 yrs)	25.8	33.2	40.5	40.8	45.0	50.9
Total dependency ratio	47.1	56.5	66.0	64.9	70.4	78.4
Ageing of the Aged Ratio (80+ yrs/65+ yrs)	21.7	23.1	31.8	38.9	35.6	36.7
Support ratio (15-64 yrs/65+ yrs)	3.9	3.0	2.5	2.4	2.2	2.0

Note: Figures may not add up due to the rounding

Source: EUROPOP2013, Eurostat

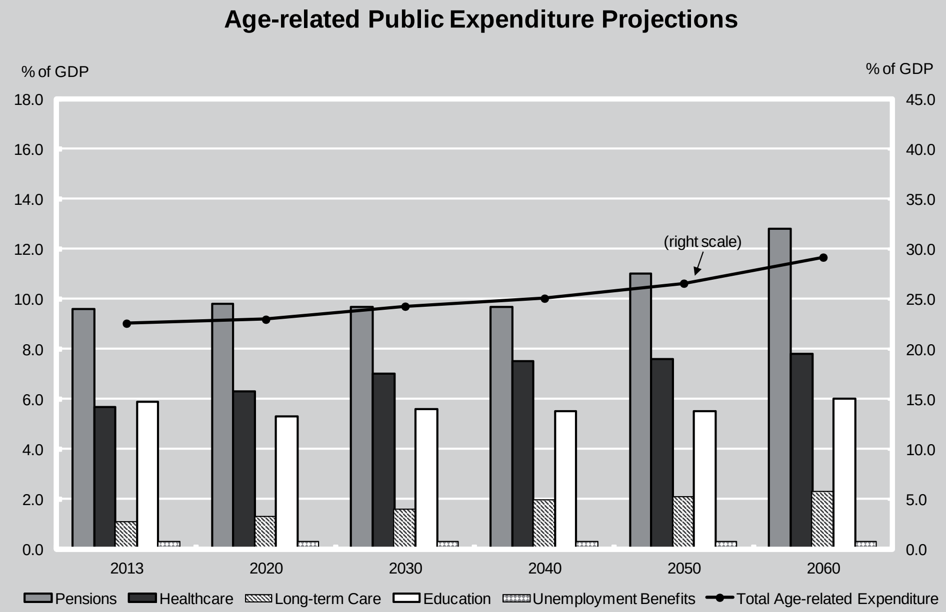
The dynamics of the ageing process could be better appreciated by analysing the developments in the relative share of the elderly to the working-age population. These dependency ratios relate the number of individuals that are likely to be "dependent" on the support of others for their daily living – the youth and the elderly – to the number of those individuals who are capable of providing such support. Key indicators of age dependency presented in Table 5.2 are the: the youth-dependency ratio (0-14 year bracket as a percentage of the 15-64 year bracket), old-age-dependency ratio (65+ year bracket as a percentage of the 15-64 year bracket) and the ageing of the aged ratio (80+ age bracket as a percentage of the 65+ age bracket). The youth dependency ratio is expected to increase from 21.3 per cent in 2013 to 25.5 per cent in 2030 and to hover around that level until 2050, and increase to 27.5 per cent by 2060. The old-age dependency ratio is projected to increase consistently from 25.8 per cent in 2013 to 50.9 per cent in 2060, an increase of 25.1 percentage points. Thus, by 2060, the total dependency ratio, which is the combined burden of these two components of the economically active population, will amount to 78.4 per cent. Meanwhile, the ageing of the aged ratio is projected to increase from 21.7 per cent in 2013 to 38.9 per cent in 2040, decline to 35.6 per cent by 2050 and increase to 36.7 per cent by 2060. As a result of these demographic developments, the support ratio (persons in the 15-64 years bracket as a proportion of persons aged 65+) is expected to decline from 3.9 per cent in 2013 to 2.0 per cent in 2060. This means that while in 2013 there were around 4 persons of working-age for every person that reached pension age, by 2060 this ratio is projected to decrease to around 2 persons of working-age for every person of pensionable age.

5.1.4 Age-Related Public Expenditure

Age-related spending including pensions, health care, long-term care, education and unemployment benefits is projected to increase by 6.6 per cent of GDP over the period 2013-2060, as opposed to an increase of 8.6 per cent outlined in the 2012 Ageing Report. Chart 5.1 shows the age-related public expenditure as a share of GDP for this projection period.

Public expenditure on pensions is presently the most important age-related government expenditure item, and is projected to remain for the foreseeable future. The pension

Chart 5.1



projection exercise covers contributory and non-contributory old-age pension paid under the social security scheme. The coverage of pension schemes includes also the expenditure on non-contributory old-age pension together with the share paid on the contributory and non-contributory bonus payment. At present, voluntary private pensions play a rather minor role as regards pension provision for old-aged persons, even if their importance is expected to rise in future. Over the projection period, pension expenditure is projected to increase from 9.6 per cent of GDP in 2013 to 12.8 per cent of GDP by 2060, an increase of 3.2 percentage points (as opposed to an increase of 5.7 percentage points in the 2012 Ageing Report). The increase in pension expenditure primarily reflects the expenditure on old-age pensions which will increase from 5.3 per cent of GDP in 2013 to 10.3 per cent in 2060. The increase in old-age pension expenditure is driven by the ageing process, in reflection of projected demographic developments. Furthermore, while the increase in the pension age and the contribution period for full pension eligibility and the changes to the benefit formula contribute to lower projected increase in pension expenditure, the more dynamic indexation of the ceiling on pensionable income, the statutory changes to indexation for old-age pensions and the introduction of the guaranteed national minimum pension for persons retiring from 2027 onwards contribute to increase expenditure pressure.

The decreasing contributions of Disability Pensions, Survivors' Pensions and Other Pensions (includes top-ups and treasury pensions) reflect a combination of factors. The expenditure on Disability Pensions is projected to decline marginally to 0.3 per cent of GDP and expenditure on survivors' pensions is projected to decrease from 1.6 per cent of GDP to 1.3 per cent of GDP. Similarly, expenditure on Other Pensions is projected to decrease from 2 per cent of GDP to 0.5 per cent of GDP. The decreasing contributions of such pensions reflect a combination of factors. The invalidity pension contributes negatively to the rise in expenditure in reflection of the demographic developments as well as the indexation to the Cost Of Living Adjustment (COLA). The survivors' pension contribution reflects the ageing process as well as its indexation that is similar to old-age pensions. The 'top-up' pension, which falls under the Other Pensions category, covers benefits currently payable to persons in receipt of service pensions which includes former servicemen in receipt of overseas pensions. This expenditure category is projected to decrease in importance over time in line with the life expectancy of the recipients of this pension. Similarly the Treasury Pension, also included in the Other Pension category, is projected to decrease in importance over time given that it has been closed to new Government employees since 1979.

Another important contributor to the increase in age-related spending is healthcare. Projections indicate that Malta is now expected to record a lower increase of 2.1 percentage points of GDP in health care when compared to the increase of 2.6 percentage points in the 2012 Ageing Report and an increase of 1.2 percentage points of GDP in long-term care as opposed to an increase of 0.8 percentage points in the 2012 Ageing Report, during the period 2013-2060. These results reflect an ageing society and an increase in life-expectancy at birth over the projection period. The Government is aware of the challenges posed by these demographic developments on healthcare and hence is implementing a holistic strategy that will ensure the long-term sustainability of the health sector.

Public spending on unemployment benefits as a share of GDP is projected to remain unchanged at 0.3 per cent between 2013 and 2060. Additionally, the 2015 projection exercise aimed at assessing the impact of demographic changes on the general government education expenditure showed that education spending is projected to increase by 0.1 percentage points of GDP during the projection period (compared to a decrease of 0.6 percentage points of GDP in the 2012 Ageing Report).

5.2 Focus on Pension Reforms

While the new projections present a relatively better outlook with regards to pension expenditure as well as pension sustainability and adequacy, when compared to the previous projections presented in the 2012 Ageing Report, the projected demographic developments will still cause the outlays on pensions paid by Government to rise over the coming decades. At present, Malta does not face fiscal risks over the short to medium-term however; medium sustainability risks appear for Malta over the long-run, where these risks seem to be entirely related to the strong projected impact of age-related public spending (notably pensions, healthcare and long-term care).

As already stated, these projections reflect the reforms enacted up to 2014. In December 2006, the House of Representatives adopted a series of parametric reforms (Act No. XIX of 2006) including: raising the pension age from 61 to 65; lengthening the contributory period from thirty to forty years; adopting changes to the two-thirds pension, calculation formula, the maximum pensionable income and the crediting of contributions as provided for under the preceding legislative framework. The reforms were aimed at enhancing the sustainability of the pension system whilst improving the adequacy of the pension enjoyed by retirees in the future.

Pension reform in Malta is an ongoing process. In fact, following the set-up of the new Pensions Strategy Group to continue the work of the previous Working Group, a report presenting pension reform recommendations was finalised in June 2015. Subsequently, the Group prepared a post-consultation report that took into consideration the feedback received (till the end of August 2015) from social partners, political partners and the public. The post-consultation report, including the final recommendations, was submitted by the Group for the attention of Government during September 2015.

Of these recommendations, the following were adopted by Government as from the Budget for 2016:

- As from 2016, the Minimum Pension for a person with a full contributory record is not less than €140 per week, aiming at contributing to address the problem of poverty amongst the elderly.
- Better credits for child rearing and family growth.
- Introduction of credits for human capital development and lifelong learning. Crediting (including child rearing) is subject to capping equivalent to 12 years for persons born on or after 1/1/1962 and at 6 years for persons born between 1/1/1952 and 31/12/1961.
- Service pensioners will continue to be given a €200 annual additional abatement.
- If they are entitled to a contributory pension in their own right, survivors are now entitled to the highest full pension, whether it is their own pension or the pension of their deceased spouse.
- In order to ensure a fair balance between the contributory period and the period spent in retirement across generations, the contribution period for a full pension will be based on a stable ratio between years contributing and years drawing pension. Consequently, the contributory period was raised from forty to forty-one years for persons born after 1968. The contributory period shall be reviewed every 5 years to ensure that stable proportion is kept between the contributory period and the period of time during which it is expected that the individual shall be in receipt of a pension.

Furthermore, the Government is obliged to lay on the Table of the House of Representatives, within intervals not exceeding the period of five years, a report giving recommendations with a view of keeping a stable proportion between the contribution periods and life expectancy at retirement. The report shall be discussed in the Social Affairs Committee or any other committee substituting the same. The Committee deals with all matters of social policy which may be referred to it by the House or by the Standing Committee on House Business. The report tabled by the Minister would serve to operationalise the link outlined in Article 64B and would be a clear statement of Government's policy. The report is necessary to measure the gains in life expectancy, as measured in the latest demographic projections, and thus, outline any necessary adjustments to the contributory period (as outlined in article 53), with a view to keep a stable proportion between the contribution periods and life expectancy at retirement.

The Pensions Strategy Group argued against a mandatory approach to increases in the statutory retirement age based on the linking of the retirement age to a longevity index. Such an approach does not take into account differences in life expectancy between different types of workers as well as differences between life expectancy and healthy life expectancy. The Group proposed that the Government should strive to increase active employment beyond the statutory retirement age by (i) incentivising late exits from the labour market; (ii) incentivising the deferral of a retirement decision; and (iii) initiating discussion within civil society and amongst constituted bodies for the eventual separation of the mandatory retirement age from the statutory retirement age.

The Government in the 2016 Budget accepted the principle behind recommendations (i) and (ii) above which have been adopted by the House of Representatives (Act No. XV of 2016) in March 2016. The incentive mechanism was publicly announced on the 22nd March and a legal notice LN289/16 was published in August. The scheme is open to workers in the private sector, who would have paid 35 years of social security contributions and are eligible to retire at 61 years of age. Those who continue working until 62 years will receive an increase of 5 per cent in their pension. The scale increases every year, whereby, a person who works until 63 years would receive an increase of 5.5 per cent for the second year, over and above the 5 per cent of the first year. The increase for the fourth year is 6 per cent and the fifth year, 6.5 per cent. In addition, another amendment was affected to Article 64A whereby persons born on or after 1/1/1969, such as to access the early exit option, require 35 years of paid contributions with a maximum of 6 years of credits. This is intended to lengthen careers and deter early retirement.

Furthermore, the application of the principle of achieving a fair balance between the contributory period and the period spent in retirement across generations ensures that the contribution period for a full pension is now based on a stable ratio between years contributing and years drawing a pension.

The incentive to encourage later retirement and the linking of the contributory period to the period spent in retirement are expected to contribute to the strengthening of the long-term sustainability of public finances. At the same time, the adequacy element was also safeguarded through the increase in the minimum pension, better crediting for child rearing (which is designed to mitigate gaps in the contributory periods of particularly women arising due to family responsibilities and as policy instrument contributing positively toward fertility increases) and the introduction of credits for human capital development and lifelong learning, alongside other measures.

In the Budget for 2017, the Government continued to address adequacy by introducing measures aimed at supporting the income of specific groups of pensioners. In fact, through the Budget for 2017, pensioners will be tax exempt on income arising from any type of pension amounting up to a maximum of €13,000. Pensioners, whose income is taxed at the married rates will retain a differential of a further €1,000 (arising from any source) on top of the €13,000. This measure shall be implemented over a period of 2 years. With respect to entitled beneficiaries of a minimum pension for married couples and to a non-contributory age pension, these will experience an increase in their pension of €4 per week. The Budget for 2017 is also raising the amount of service pension that is not taken into consideration for Social Security pension assessment purposes by another €200. In addition, the Budget for 2017 will be addressing the gender inequality in the pension benefit rate, with females benefiting from an increase in the pension rate of up to €20 per week.

As for the third pillar pensions in Malta, it is to be noted that the first pension products were launched on the market during November 2015. Furthermore, as announced in the Budget for 2016, a Working Group (WG) was set up with the scope of bringing to the consideration of Government, proposals relative to the introduction of fiscal incentives for employers that opt to introduce occupational pensions on a voluntary basis.

The WG presented a report to the Government and in fact, a measure intended to incentivise the take-up of voluntary occupational pensions was announced in the Budget for 2017. The measure stipulated that in the case of the voluntary occupational pension plans, employees shall continue to benefit from the incentives announced for the third pillar pensions. At the same time, the employer shall consider expenditure related to investment to the occupational scheme as part of the recurrent expenditure for company tax computation purposes. In addition, the company will also be receiving a credit of €150 for every €1,000 invested on behalf of its employees.

In addition, the post consultation strategy on the National Strategy for Retirement Income and Financial Literacy is now completed. The strategy is now repositioned as Retirement and Financial Capability. This is a result of adding more focus on financial capability as an instrument of poverty prevention during lifecycles and retirement of vulnerable groups. The strategy was launched on 25th January 2017. A coordinating body for the implementation constituted of government and private sector representatives is set up. This is a Retirement and Financial Capability Working Group chaired by the Ministry for the Family and Social Solidarity operating under the Pension Strategy Group.

6. Quality of Public Finances

6. Quality of Public Finances

The quality of public finances has become an even greater priority now that Malta has reached its medium-term budgetary objective. This chapter takes a look at the productivity associated with various functions of Government whilst extensively reviewing Government's efforts towards ensuring a more efficient spending through the Comprehensive Spending Review and improvements in the efficiency and effectiveness of the tax system.

6.1 Measuring Public Sector Productivity in Malta

This section aims to provide some tentative estimates of the growth in public sector productivity in Malta. At present, the measurements of these services in national accounts are based on the inputs used to produce these services (such as the number of doctors and nurses and their respective salaries) rather than on the actual outputs produced (such as the number of specific medical interventions performed).

While it is beyond the scope of this exercise to produce statistical estimates supplementing input-based estimates in the national accounts, measures of outputs can be a useful indicator of productivity measures and can thus act as an important input in collective bargaining or simply as a measure of key performance indicators in the public sector.

It is extremely difficult to measure productivity in the delivery of public services, especially since we are generally interested in public sector outcomes (i.e. effectiveness; for instance, better survival rates, life expectancy and standard of living), beyond the outputs themselves (for instance number of operations performed).

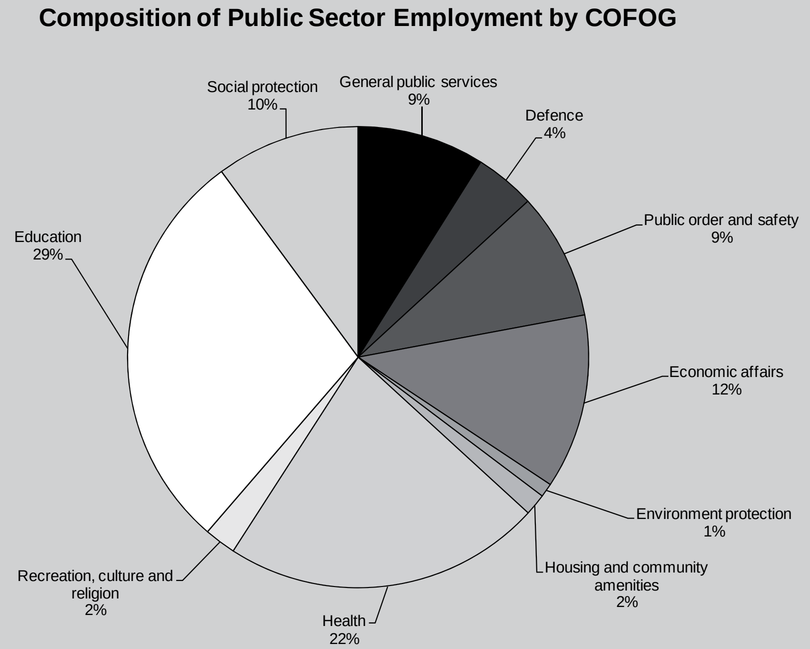
In terms of this study, the measure of public sector productivity gains or losses in Malta will be based on a methodology similar to that adopted by the Office for National Statistics of the United Kingdom (ONS, 2016). ONS methodology analyses the outputs and inputs associated with the provision of healthcare, education, social care, public order and safety, the policy, defence and other public services by weighting indices of volumes of outputs across the public services, and weighting indices of volume inputs in an attempt to compute an overall figure for productivity growth within the public sector.

6.1.1 Public Sector Inputs

The production inputs considered will be limited to labour inputs. As a result, no complete evaluation of the contributors to public sector productivity can be made. The labour inputs are disaggregated by the Classification of the Functions of the Government (COFOG) based on unpublished estimates provided by the National Statistics Office (NSO). Health, education and social protection generally represent around 60 per cent of both total expenditure and employment. This is followed by economic affairs which accounts for around 12 per cent of both employment and expenditure of general Government. Another 10 per cent of employment (but 17 per cent of total expenditure) is covered by general public services. Defence, public order and safety together represent a share of employment of around 13 per cent, although their share of expenditure stands at around 5 per cent. Employment shares are illustrated in Chart 6.1.

Whilst a comparative analysis of employment by COFOG within the Euro Area is not possible, a related comparison of expenditure as a share of Gross Domestic Product

Chart 6.1

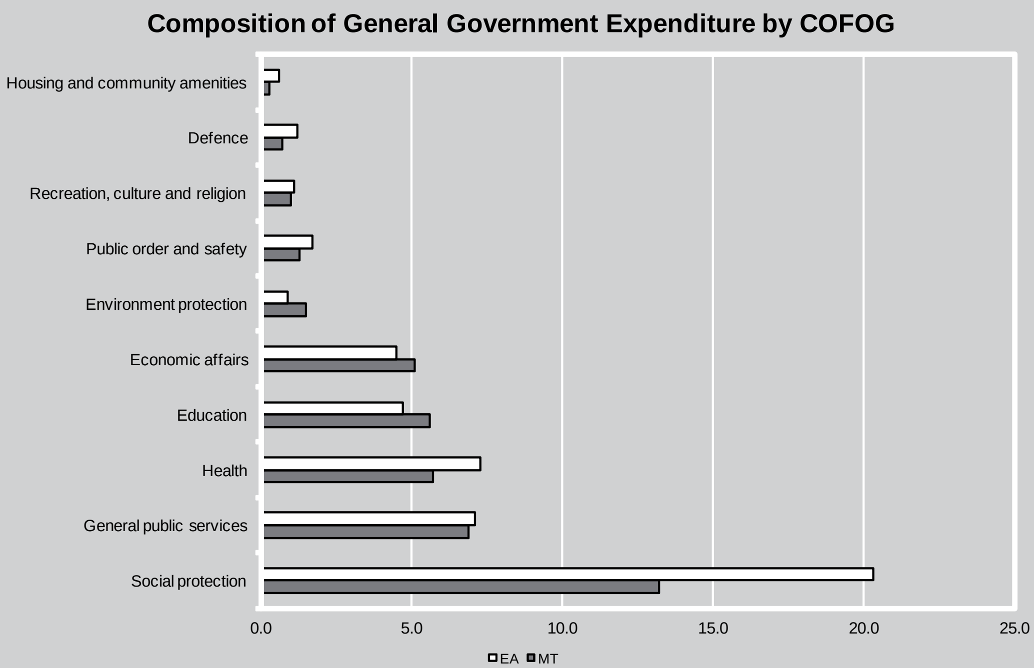


Data Source: NSO/EPD unpublished estimates

(GDP) suggests that public expenditure in Malta is generally comparable to that observed in the Euro Area except in the cases of social protection and health which is generally lower. On the other hand, Malta tends to spend more on education and economic affairs relative to its output as measured by GDP. These comparisons are illustrated in Chart 6.2.

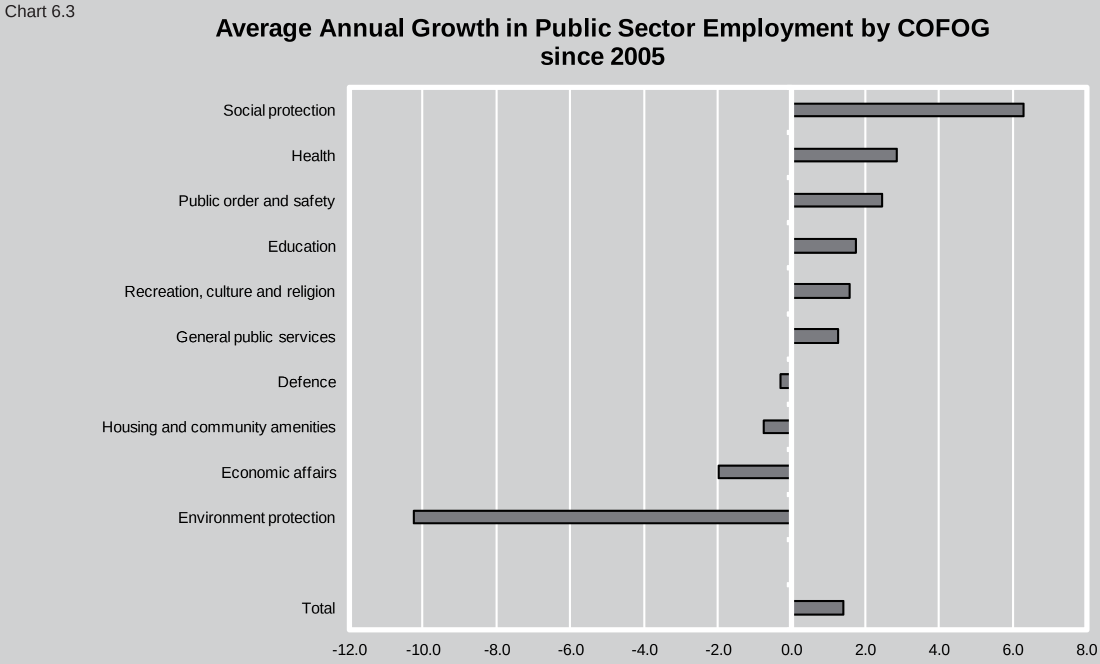
Employment growth between 2005 and 2015 (see Chart 6.3) has averaged 1.4 per cent per annum with a stronger element of growth in social protection, health and to some extent in education which was compensated for by declines in other parts of the public service.

Chart 6.2



Data Source: Eurostat

Chart 6.3



Data Source: NSO/EPD unpublished estimates

6.1.2 Public Sector Outputs

On the basis of a number of simplifying assumptions and easily available indicators, a measure of output has been constructed for each COFOG category. The indicators generally cover a mix of volumes and quality indicators. For each function the number of indicators could be more than one. Furthermore, an index for each COFOG category is constructed, and in the case where there are multiple indicators per category, a geometric mean is computed. Finally, an aggregate index of general Government output is obtained as a weighted average of the output indicators for each separate function, with the weights determined by the share of employment for each corresponding COFOG category. Most of the indicators identified for health and social protection were only available from 2005 so the index captures productivity gains in the last decade. It is also worth noting that although a separate functional indicator is constructed, the output may actually reflect the performance of more than one category.

In Education, the volume indicator is represented by the total number of students enrolled in the education system. This indicator is supplemented by three quality indicators involving the inverse of the early school leaving rate, the tertiary education attainment and expenditure on Research and Development (R&D). The quality indicators are all indicators of progress used in the European Union (EU) 2020 strategy which are linked to a significant extent to the education function of Government. The output indicator thus constructed has increased by an annual average of 3.1 per cent per annum between 2010 and 2015.

For Social Protection, the population aged 62 and over is chosen as a proxy indicator to capture the effect of ageing on the demands for social protection. This is justified by the rising importance of pension expenditure in national budgets. This volume indicator is complemented by the population at risk of poverty before social transfers and excluding pensions. Furthermore, the volume indicator is supplemented by quality indicators including the inverse of the s80/s20 indicator of inequality and the inverse of the "at risk of poverty" rate after social transfers. The overall indicator for social protection indicates that output has increased by an annual average of 1.0 per cent per annum since 2010.

For Health, the volume indicator is a composite indicator of both the in-patient and curative bed discharges multiplied by the length of stay. This is complemented by an indicator of longevity using the healthy life years and life expectancy at birth and another indicator of health portrayed by the population above 18 years who report to be in very good health. The overall indicator for health indicates output has increased by an annual average of 3.5 per cent per annum since 2010.

In the case of Economic Affairs, potential output has been selected as the volume indicator on the assumption that economic activity creates more demand for economic management. Cyclical conditions are by definition excluded from this measure to emphasise stable and sustainable conditions. Labour productivity and innovation, as proxied by R&D expenditure, were selected as quality indicators for economic affairs. The overall indicator for economic affairs indicates output has increased by an annual average of 3.5 per cent per annum since 2010.

For Defence and Public Order and Safety, a common indicator for the two separate functions was constructed. This is predominantly a volume indicator based on the assumption that these two functions provide protection to the population at large, including tourists residing on the Island and asylum seekers, protection of possessions such as residential and commercial property and traffic management. Unfortunately, time series data related to crime was not available over a sufficiently long period to allow the compilation of an index since 2005. The variables selected were the following: population, tourist numbers, property contracts, number of car registrations and asylum applications. Output in these two functions increased by an annual average of 2.8 per cent per annum since 2010 based on these indicators.

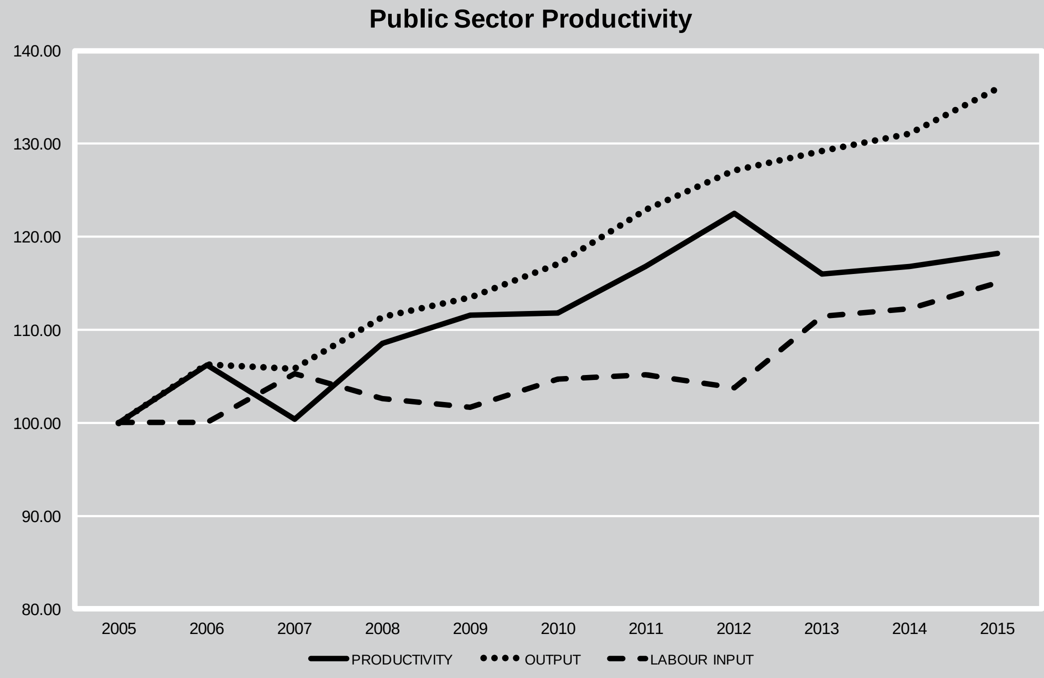
The Environment Protection function is determined by the population and the amount of economic activity generated by each individual as captured by GDP. Quality indicators used to measure this function were the inverse of the amount of green-house gas emissions (GHGE) generated and the indicator for resource productivity. Based on these indicators, output related to environment protection has declined by an average of 0.7 per cent per annum since 2010. The decline is mainly due to the continued increase in GHGE which offset the improvements in resource productivity and demand for environment protection as measured by GDP.

For Housing and Community Care, the amount of marriages has been chosen as a proxy indicator for the volume demand for housing services. As a quality indicator, the proportion of the population at risk of poverty which benefits from no or reduced rental accommodation has been selected. Based on these indicators, output for housing and community care has increased by an annual average of 3.7 per cent per annum since 2010.

For the Recreation and Cultural function, consumption expenditure for recreation and culture, printed matter, package holidays, restaurants and hotels and personal care were chosen as a volume indicator. No quality indicator could be identified for this function. Output related to this function has increased by an annual average of 4.2 per cent per annum since 2010.

In the case of General Public Services, it is difficult to identify a particular indicator as this generally facilitates the provision of the other main functions. It is assumed that the

Chart 6.4



provision of public service is directly linked to the economic activity generated in the country as measured by GDP. This means that output is estimated to have increased by an average of 3.2 per cent per annum since 2010.

Based on these estimates, the weighted average indicator for public sector output is estimated to have increased by 3.0 per cent per annum since 2010.

6.1.3 Public Sector Productivity

The Ministry for Finance (MFIN) estimates indicate that real public sector labour productivity has increased by an annual average of 1.1 per cent per annum since 2010.

The value of public sector labour productivity can be estimated by the real public sector labour productivity together with a measure of the increase in prices related to public service provision. In the absence of a specific deflator from the output side, the GDP deflator is used as a measure of prices. This indicator is useful when comparing wage increases in the public sector. The value of productivity in the public sector is thus estimated to have increased by an annual average of 3.2 per cent [1] per annum since 2010.

6.1.4 Limitations of the study

Although these estimates provide an easy to compute index of public sector labour productivity, there are a number of limitations which need to be kept in mind. First, externalities involved in public service provision are not being measured. In some cases, no measure of quality could be identified. The unpublished estimates of the COFOG employment levels are still being fine-tuned by NSO and can add some instability in the corresponding functional components. The use of a weighted average tends to detract from the more complex inter-dependencies and inter-relations between each function. Inter-temporal effects are also excluded from this analysis. Finally, the absence of an output deflator for public service provision constitutes another limitation of this analysis.

6.1.5 Conclusion

Whilst output is estimated to have increased by an annual average of around 3 per cent during 2010-2015, labour inputs have increased by an annual average of 1.9 per cent during the same period. This means that real productivity in the public sector has increased by at least 1.1 per cent per annum during these past five years until 2015. This estimate is comparable and broadly consistent with the annual average real productivity growth of 1.2 per cent recorded for the total economy.

6.2 The Comprehensive Spending Reviews: Enhancing the Efficiency and Efficacy of Expenditure

High quality public services contribute to a just society. The efficacy of public expenditure ensures that the Government is able to meet changing social needs. The Comprehensive Spending Review (CSR) is one of the many instruments that the Government is utilising to ensure the efficient and effective use of public finances, reform the policy process and improve decision making.

6.2.1 The Annual Ministerial Reviews

The annual review process in Malta was founded on a dual approach - that of having an annual ministerial review of line items, as well as in-depth reviews of Government departments. The review process was launched during 2014 with a series of outreach presentations held between the spending Ministries and teams from the Budget Affairs Division within MFIN. These presentations sought to connect Government's macroeconomic and fiscal strategy with departmental spending plans and to ensure that these plans coalesced with targets for Government spending. The CSR provided a methodology for zero budgets, line by line analysis and aimed to provide an input-output model for public spending. The aim of a CSR was to shift the focus from expenditure inputs towards the idea of outputs.

The four components of Government's recurrent expenditure include Personal Emoluments, Operational and Maintenance Expenses, Contributions to Government Entities, and Programmes and Initiatives, with the latter component amounting to about 55 per cent of total recurrent expenditure in 2016. The better control of Programmes and Initiatives provides pathways for making decisions that ensure spending decisions reflect Government priorities. In this regard, a line by line analysis is carried out for each line item of Programmes and Initiatives for all the ministries. This enables MFIN to review spending decisions prior to the bilateral meetings with the various spending ministries. There is now an input output model for programmes and initiatives for all ministries.

6.2.2 The In-Depth Reviews of Government Departments

The in-depth reviews take the shape of a series of hearings between stakeholders and a panel of experts from both inside and from outside MFIN. The stakeholders are asked to produce policy statements that relate to their budget responsibility. These policy documents are assessed by the panellists and subsequently the panel members ask the stakeholder to expand and explore policy issues. On average there are about twenty hearings with stakeholders, with the Department Minister and the Department Permanent Secretary also attending some of the hearings. After the hearings, a report is drafted by the person chairing the hearings and includes individual chapters written by the panellists. The final report is then presented to the Ministers involved. This methodology is deemed to have encouraged ownership of the in-depth review by the stakeholders themselves whilst allowing the necessary flexibility in the identification and measurement of policy options and targets.

6.2.2.1 Social Security Benefits

In February 2014, a Comprehensive Review in the Department for Social Security was launched. This in-depth study of Social Security Benefits resulted in the introduction of a number of budget measures as outlined in the Budget of November 2014. The main reforms included the Youth Guarantee Programme, the introduction of the tapering of benefits and the introduction of the in-work benefit offered to single parents or to two parent households when one of the adults joined the labour market.

The tapering of benefits (UAT) scheme was introduced in Budget 2014 with the aim of encouraging persons in receipt of Unemployment Assistance (UA), Social Assistance (SA) and Social Assistance for Single Unmarried Parents (SUP) for more than two years to engage in employment. This reform allowed individuals on these benefits to retain their entitlement upon entry into the labour market, which benefits would be tapered down gradually over a period of three years.

Beneficiaries are entitled to retain 65 per cent of their benefit in the first year, 40 per cent in the second year, and 25 per cent in the third year. In the 2015 Budget, the UAT scheme was extended to persons benefitting from social assistance for single unmarried parents who got married or formed a civil union with a person in employment. The 2016 Budget extended this scheme to single parents with children under the age of 23 years who become engaged in employment as long as they worked for at least 10 hours per week earning the hourly rate equivalent to the national minimum wage.

By the end of 2016, there were 2,482 persons who moved from living off the social benefit system to employment, of which 1,602 persons had been claimants of social assistance whereas 869 persons were in receipt of unemployment assistance for more than 2 years.

In order to strengthen the concept of ‘making work pay’, the in-work benefit (IWB) scheme was also introduced in the 2015 Budget. The benefit targeted low-to-medium income families with dependent children who have not reached the age of 23 years. In Budget 2016, the scheme was extended to single-earner households while in 2017, the benefit was strengthened further as the ceiling of the scheme was raised and the benefit increased. During January to December 2016, there were around 2,200 households who took advantage of the in-work benefit scheme.

Given that employment remains the main path out of the risk of poverty, the reforms outlined above seek to make work pay while encouraging the reduction of dependency on the benefit system. In this regard, as a result of the making-work pay initiatives and also due to the increased employment opportunities recorded during 2015-2017, savings from social security were conservatively estimated at around €25 million. This includes expenditure savings of €0.6 million in 2014, €3.9 million in 2015 and €10.3 million in 2017 from the tapering of benefits alone whilst higher national insurance contributions cumulatively generated €10 million in revenue over the three-year period. The savings in social security enabled the implementation of new initiatives including free child care services, a reform in disability allowances and an increase in the carer’s allowance which gave the opportunity to more dependent individuals to remain living at home in their communities rather than in institutional care.

6.2.2.2 Health

In 2015, the CSR focused on Mater Dei Hospital. This CSR commenced in February 2015 and was completed in August of that same year. The two major components of health spending are compensation of employees, outpatients and hospital services, which make up about 50 per cent of total spending, and intermediate consumption towards outpatient and hospital services, making up about a further 25 per cent. Intermediate consumption and social transfers in kind in medical products, appliances and equipment make up a further 7 per cent. Health expenditure is mainly concentrated in Mater Dei Hospital. As patients' expectations increase, services have been expanding at 7 per cent a year with the introduction of new clinical services and new technologies.

The panel at Mater Dei was established during February 2015 and listened to some 25 different hearings from stakeholders involved in the Hospital including clinicians, nurses, nurse managers, the voluntary sector, senior managers and finance officers. The study was completed in September 2015 and recommended:

- a better scrutiny of the payroll system, working overtime, sick leave and allowances;
- the introduction of new technology at the hospital to allow for single dosage dispensing to patients in a bid to reduce the expiry of drugs;
- the set-up of mechanisms to ensure contracts are adhered to whilst ensuring that Government achieves value for money for these contracts;
- the review of the process of medical equipment repairs.

The contractual obligations at the Hospital total around €30 million. These include hospital cleaning, hiring of care workers, hiring of administrative clerks and the provision of food for patients and hospital staff. The CSR recommended that Mater Dei should ensure value for money for these contracts. The contracts have now been placed under the direct supervision of the CEO of the Hospital and savings are already being recorded.

A budget decentralisation process is being implemented in the Departments for surgery, medicines, cardiology, anaesthesia, A and E pathology and imaging in order to increase transparency in decision making. These seven departments make up over 70 per cent of the budget at Mater Dei. The process reconciles personnel against cost centres as well as consumables including medicines and medical supplies. A process of notional billing between departments has now also been established to identify the cost of blood tests and imaging. The concept of notional billing has now been introduced between the Hospital and external entities including the Oncology Centre. In the meantime, clinical chairs in the seven departments are to gradually assume a role as resource managers. Each month, senior management meetings at the medicine surgery, pathology and imaging departments are held to review the process of decentralisation.

The CSR at Mater Dei is estimated to contribute to actual and potential savings totalling €11 million over a period of two years. These savings comprise:

- €1.0 million in savings from the reforms in overtime and payroll over two years;
- Savings of €3.5 million from the introduction of notional billings for pathology, reduction in unnecessary blood tests as well as the notional invoicing systems for the Oncology Centre, Primary Care and other external entities including Homeland Security and Justice;

- €0.5 million savings related to the reforms of contractual obligations, stronger supervision, the slowdown in new employment of clerks and care workers, as well as value for money in hospital cleaning and food services;
- the shift of blood tests for International Normalized Ratio (INR) scores reduced patients at Mater Dei from 260 to 140 per day, saving €2.6 million in two years;
- the reform of repeat prescription drugs between the Pharmacy of Choice (POYC) and the Hospital has the potential to generate savings of €2.8 million;
- the shift of the functions from Mater Dei to Primary Care also has the potential of creating major savings. At present, the Diabetes Clinic is estimated of making a saving of €0.6 million.

The conduct of reforms in the public health system aimed at ensuring the delivery of a cost-effective and efficient service has been high on the political agenda over the past few years. As from February 2017, the CSR programme has focused on other services within the Ministry for Health (MFH). This includes MFH itself, Primary Care Services, POYC and the Contracts Procurement Services Unit (CPSU).

6.2.2.3 Education

In December 2013, Malta confirmed its commitment to reduce the rate of early school leavers (ESL) to 10 per cent by 2020. Provisional figures for 2016 indicate that the rate for ESL in Malta stood at 19.6 per cent as opposed to 20.5 per cent in 2013. In addition, the share of the 30-34-year-old population having completed tertiary education is to be increased to 33 per cent by 2020. Malta's provisional rate recorded for 2016 stood at 29.8 per cent, an increase of 3.8 percentage points over the rate recorded in 2013 but still well below the EU2020 benchmark of 40.0 per cent.

The in-depth review in Education was carried out in February 2016, focusing on primary and secondary education sectors. There are five panel members from within the Education Department complementing consultants. To date, the panel has met with officials responsible for developing policy frameworks in education as well as college principals. Regular meetings are also being held with the Minister and the Permanent Secretary for Education. At present, the study can already highlight some very encouraging and important initiatives that may improve primary and secondary education.

The panel has also met with the Quality Assurance Team and several new initiatives have been suggested to ensure better connections between the quality assurance teams and internal quality assurance within schools. In the next phase of the in-depth review, the panel will be meeting with approximately 40 heads of schools to involve all stakeholders.

There is now a senior management team under the headship of the Permanent Secretary that meets each month to implement the recommendations of the CSR. The goal is for the Ministry of Education to utilise existing resources and yet improve on student performance. The aim is to reform teaching and learning which will be more student focused. The aim is that by 2024, the pass rate in the Matriculation and Secondary Education Certificate (MATSEC) in state schools will improve from the present 40 per cent to 80 per cent, thus putting state schools at the same level as the independent sector and church schools.

6.2.3 Conclusions

The Government spending reviews will continue to ensure improved effectiveness and efficiency through an input-output approach in spending decisions that reflects changing social needs. In turn, this will ensure greater financial discipline and fiscal accountability in the public sector. The in-depth CSR has provided the Government with a series of policy recommendations and pathways that seek to improve the policy process. In both social security and health, the results are tangible savings that could be utilised elsewhere.

6.3 Improving the Structure and Efficiency of Revenue Streams

The Government, in line with its pledge to further the efficiency and efficacy of the Maltese taxation system, has been working on a number of initiatives with the aim of providing an optimal taxation system that is fair, simple and does not hinder economic growth. Reforms have tended to focus on four areas, all of which aim at increasing taxation efficiency. These include:

- Shifting the tax burden away from labour;
- Widening the tax bases;
- Simplification of the taxation system; and
- Combating tax evasion and avoidance.

Supervision with respect to Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT), is expected to increase with more resources being dedicated to this area and also as a result of closer supervisory cooperation and coordination between the Malta Financial Services Authority (MFSA) and the Financial Intelligence Analysis Unit (FIAU). This increase in resource availability and the risk-based joint supervisory regime jointly adopted by the MFSA and FIAU, is expected to increase the frequency and intensity of onsite visits to financial services operators. The FIAU will continue to oversee other pertinent non-financial entities.

6.3.1 Shifting the Tax Burden away from Labour

It is acknowledged that high levels of taxation on labour have dampening effects on growth and employment in general. In this respect, over recent years, the focus has been to shift the burden of taxation away from labour and onto consumption. Indeed in the previous four years, Government has reduced taxation on labour and increased mainly the excise duty on certain goods harming health or the environment. These included an increase in excise duty on tobacco as well as the introduction of custom duties on certain materials such as concrete beams and steel structures, steel rods and reinforced wire mesh and glass sheeting used in the construction industry.

6.3.2 Widening Tax Bases

In line with the objective of widening the tax base, the Government undertook various initiatives to make work pay, as already highlighted in earlier sections of this chapter. These initiatives strengthen the tax base. Meanwhile, measures to encourage female participation in the labour market continued to feature strongly in Government's policies including the establishment of the Maternity Fund and tax credits for women. Other measures that aimed to widen the tax base include changes in property taxation towards a 15 per cent withholding tax.

6.3.3 Simplification of Taxation System

A taxation system which is complex and hard to understand will discourage compliance, at times leading to unintentional evasion. Furthermore, a simple tax system is usually much easier to maintain, control and administer, thus making the revenue stream more stable and more efficient. In this respect, the Government has moved away from capital gains taxation towards the simpler and more straightforward Final Withholding Tax system, both with respect to sales or purchases of land property as well as for income derived from rent. The provision of pre-filled tax returns and a variety of e-services further reflect Government's commitment to simplify the tax system. Additionally, in order to simplify the process of tax collection on inherited property sold by court auction, all properties resulting from inheritance and transferred by court auction will henceforth be taxed at a final rate of 7 per cent.

6.3.4 Combating Tax Evasion and Avoidance

Government is committed to curtail the injustices that arise from tax evasion and avoidance while seeking to ensure that everyone pays their fair share of tax. This is supported by the risk-based approach adopted by the Risk Analysis Unit that has recently been set up and the enhanced exchange of information between the Social Security, Value Added Tax (VAT), and Inland Revenue departments. In this regard, MFIN launched the Joint Enforcement Unit last November in order to strengthen compliance and fight unfair competition in Malta. Furthermore, the amalgamation of the Investigative/Inspectorate Units has been concluded and are now under the responsibility of the Compliance and Investigations General Directorate.

In the second quarter of 2017, the first phase of the strengthening of the IT system will be launched with the enhancement of the current data warehouse which will facilitate the monitoring of tax-compliance. Furthermore, during the second half of the year, training initiatives will be launched to increase technical knowledge and readiness to improve the inspections related to cash registers and related IT systems by economic operators.

Following the International Monetary Fund (IMF) report on the merger of different revenue departments, the Malta Information Technology Agency (MITA) Project Team in consultation with the office of the Commissioner for Revenue (CFR) and the Permanent Secretary at MFIN planned the main tasks so that the critical services may be implemented. The first phase of this project was aligned to central Government initiatives where processes, such as the procedures to Start up a Business, were reviewed. Business process reviews were carried out at the VAT and Inland Revenue Department (IRD) such that the registration processes could be automated. Consequently, VAT numbers, Income Tax Numbers (where required) and Employer Numbers (PE) Numbers are now issued online when information is received from a central form. This process will be enhanced throughout 2017 to include activities related to operating a business.

Subsequently, the VAT and Inland Revenue departments have also consolidated their call centre services with those of *servizz.gov*[2] enabling a one stop shop for citizens and businesses. This process will be consolidated and enhanced further during 2017. In this regard, a consolidated approach encouraging taxpayers and their representatives to use online services was implemented in November 2016, while further work is ongoing to have all cash office functions consolidated into a single application. Furthermore, during 2017 the IRD will be engaging with Maltapost to provide payment service in a number of branches nationwide. The VAT processes will be integrated during the year within this process. The business process related to IRD/VAT refunds was reengineered to identify any missing returns. Setoffs are also being effected upon request between IRD and VAT.

In 2017, a requirements analysis process will also be launched to consolidate the debt collection processes across the tax departments so as to facilitate the implementation of a new modern solution in the years to come.

In order to encourage the declaration of income, the choice of a reduced income tax rate of 15 per cent from the leasing of residential (as from January 2014) and commercial premises (as from January 2016), was introduced. As from this year, a system of control will be introduced, whereby lease agreements for three months or more, including renewal agreements, will need to be registered with the IRD.

Footnotes:

[1] Alternatively, one could use the deflator for public consumption expenditure which averaged 1.6 per cent per annum bringing the value of public sector productivity growth to 2.7 per cent per annum. The GDP deflator is preferred as a measure of output prices as the public consumption expenditure deflator is heavily influenced by increases in public sector wages which would thus make it unsuitable as an indicator with which to compare public sector wage growth.

[2] Servizz.gov is the name for several new Government hubs, providing services to the public at a community level. These hubs request information on Government services, raise applications or request a service, schedule appointments with Departments and Government Entities and report problems or complaints and provide feedback, suggestions or compliments on Government services. Each query is forwarded to the Ministry or Department concerned.

7. Institutional Features of Public Finances

7. Institutional Features of Public Finances

The reforms of the Stability and Growth Pact put stronger emphasis on medium-term planning, better synchronised and more transparent budgeting processes, procedures to foster the use of unbiased macroeconomic forecasts for budget planning, as well as independent monitoring of compliance with fiscal rules at national level. These reforms led to the enactment of the Fiscal Responsibility Act (FRA) on 8th August 2014. No major revision to the process have been carried out in 2016, although some minor changes are envisaged in 2017 to ensure full legislative compliance with the Directive on Budgetary Frameworks. In addition, it is worth noting that the European Commission has evaluated Malta's transposition of the Fiscal Compact and concluded that the FRA transposes in full the requirements of the Fiscal Compact in national legislation, including through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes.

7.1 Ministries' Business and Financial Plans, including HR Plans

In terms of the Fiscal Responsibility Act, Ministries, Departments and Government Entities are required to prepare their three-year business and financial plans which are based on the (most recently announced) medium-term fiscal strategy. In this regard, in 2016, the Ministry for Finance (MFIN) issued circular MF1/16 (entitled 2017-2019 Business and Financial Plans).

MFIN assessed the plans received by each Ministry/Department/Entity in order to compile the three-year fiscal projections. Along the budgetary process, two rounds of bilateral meetings were held with each line Ministry, one at Permanent Secretarial level and the second at Ministerial level. The business and financial plans were discussed in detail, clarifications were sought and the fiscal forecasts were consolidated. This was done with a view towards eventually reflecting the estimates of revenue and expenditure in the 2017 Financial Estimates presented to Parliament in October 2016 and subsequently approved in December of the same year.

Following the issue of Directive 10, which aims at enabling the streamlining of procedures and processes for the formulation of business plans and the human resource (HR) function, Ministries and Departments were required to provide a revised version of the HR Plans for 2017, based on the budget allocations provided for in the 2017 Financial Estimates. This was done to ensure that recruitment occurring during 2017 was within the parameters of the approved budgetary estimates.

7.2 The Malta Fiscal Advisory Council

The Malta Fiscal Advisory Council (MFAC) is an Independent Fiscal Institution (IFI) established on 1st January 2015 as defined by FRA, 2014. In its second year of operations, the MFAC has achieved a number of important milestones. In particular, it strengthened its organisational structure; established a regular publications timetable; and gradually expanded the visibility of the organisation's role.

The MFAC is composed of a chairman and two executive members, and at present, is supported by three economists and an administrator. During 2016, the MFAC held eleven formal meetings to discuss administrative and operational issues. From time to time, ad-hoc meetings were also held to discuss macroeconomic and fiscal issues.

In 2016, the MFAC issued its first Annual Report and Statement of Accounts for 2015. The MFAC then issued three reports on the assessment of the Medium-Term Fiscal Strategy of the Maltese Government for 2016-2019. These reports were related to the endorsement of the macroeconomic forecasts, the endorsement of the fiscal forecasts, and an overall assessment in terms of compliance with fiscal rules. The same modus operandi was used for the assessment of the Draft Budgetary Plan for 2017. Two further reports were issued during the year, which assessed MFIN's Annual Report for 2015 and the Half-Yearly Report for 2016. Throughout the year, the MFAC continued to make recommendations in the area of public finances and monitor their progress. The full set of recommendations made to date, and the extent of progress, were reported in the MFAC's 2016 Annual Report, which was published in April 2017.

The Council and staff continued to hold regular meetings with various stakeholders during the year. These included public officials and representatives from local and foreign organisations. The MFAC was also, for the first time, convened to a meeting of the Public Accounts Committee in 2016 for a discussion on the Council's 'First Annual Report and Statement of Accounts 2015', in terms of Article 57 of the Fiscal Responsibility Act. A second meeting was held in early 2017 to discuss the MFAC's assessment of the Draft Budgetary Plan for 2017.

In order to ensure high quality standards in its deliverables, the MFAC continued to develop connections with other international fiscal institutions and their counterparts. These included participation in the regular meetings of the Network of the European Union (EU) IFIs coordinated by the European Commission, the Informal Network of EU IFIs, as well as the OECD Network of Parliamentary Budget Officials and IFIs (as observer). It also participated in workshops and conferences organised by the European Commission and a number of European IFIs.

7.2.1 Recommendations

In the first Annual Report for 2015, the MFAC made a series of interrelated recommendations, dealing with the conduct of fiscal policy, the introduction of new legislation, improving the budgetary process and fiscal transparency. A review of the progress achieved with respect to these recommendations was made in the 2016 Annual Report of the MFAC.

The Fiscal Council is of the view that progress has been noted and that many of their recommendations had been addressed in particular, those dealing with ensuring full consistency between the macro and fiscal forecasts; the extension of the average maturity of public debt; the use of revenue windfalls primarily to build fiscal buffers; the cautious utilisation of the Individual Investor Programme funds; and the consideration of a buffer over the required minimum structural effort.

The MFAC made new recommendations in 2016 focusing again on the conduct of fiscal policy, improving the budgetary process and enhancing fiscal transparency.

Statistical Appendix

Macroeconomic Prospects

Table 1a

Percentages unless otherwise indicated	ESA Code	Level 2015[1]	2015	2016	2017[2]	2018	2019	2020
			Percentage change over previous period					
1. Real GDP	B.1g	8,347.0	7.4	5.0	4.3	3.7	3.5	3.4
2. Nominal GDP	B.1g	9,275.8	10.0	6.7	6.3	5.9	5.9	6.0
Components of real GDP								
3. Private consumption expenditure[3]	P.3	4,338.3	5.2	3.8	3.6	3.1	2.7	2.4
4. Government consumption expenditure	P.3	1,551.3	3.8	-3.1	12.4	-0.5	4.1	2.6
5. Gross fixed capital formation	P.51	1,908.5	48.8	-1.3	-1.3	-3.1	2.1	-5.7
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53		-0.7	-0.8	-0.8	-0.8	-0.7	-0.7
7. Exports of goods and services	P.6	12,294.9	4.1	4.0	3.4	4.4	4.6	4.3
8. Imports of goods and services	P.7	11,731.1	7.5	1.1	3.2	2.7	4.3	2.7
Contribution to real GDP growth[4]								
9. Final domestic demand		7,798.1	11.8	1.0	3.7	0.9	2.5	0.6
10. Change in inventories and net acquisition of valuables	P.52+P.53		-0.3	-0.2	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	563.8	-4.1	4.2	0.6	2.8	1.0	2.8

(1) € million

(2) Forecasts from 2017 onwards

(3) Includes NPISH final consumption expenditure

(4) Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

Price Developments

Table 1b

Percentages unless otherwise indicated	ESA Code	Level 2015[1]	2015	2016	2017[2]	2018	2019	2020
			Percentage change over previous period					
1. GDP deflator[3]		111.1	2.4	1.6	1.9	2.1	2.3	2.5
2. Private consumption deflator		107.2	1.2	0.4	1.5	1.5	1.8	1.8
3. HICP (Average 2010=100)		108.9	1.2	0.9	1.5	1.8	1.8	1.9
4. Public consumption deflator		109.0	1.5	1.7	1.5	2.4	2.0	2.0
5. Investment deflator		120.0	6.0	2.3	2.3	2.5	2.2	1.9
6. Export price deflator (goods and services)		108.6	1.5	0.8	0.9	2.0	2.1	2.5
7. Import price deflator (goods and services)		107.7	1.5	0.3	0.6	1.6	1.8	1.8

(1) Index (base 2010 unless otherwise indicated)

(2) Forecasts from 2017 onwards

(3) Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. Indeed, summing up the deflators of the components of GDP would not add up to the actual GDP deflator observed for the year. For this reason, the GDP deflator quoted in this table for 2014 and 2015 reflects the actual difference between nominal and real GDP growth rates for the year.

Labour Market Developments

Table 1c

Percentages unless otherwise indicated	ESA Code	Level 2015	2015	2016	2017(1)	2018	2019	2020
			Percentage change over previous period					
1. Employment, persons (National Accounts Definition, Domestic Concept)		195,670	3.8	3.7	3.2	2.9	2.7	2.5
2. Employment, hours worked (National Accounts Definition, Domestic Concept) ('000s)		384,932	3.1	3.9	3.2	2.9	2.7	2.5
3. Unemployment rate (Harmonised definition)		11,000	5.4	4.7	4.6	4.7	4.8	4.8
4. Labour Productivity, persons (Real GDP per person employed)		41,429	0.5	1.1	1.1	0.8	0.8	0.9
5. Labour Productivity, hours worked (Real GDP per hour worked)		21.7	4.2	1.1	1.1	0.8	0.8	0.9
6. Compensation of employees (€ million)	D1	3,918.35	7.3	6.3	7.0	6.6	6.3	6.0
7. Compensation per employee (€)		19,448	0.4	2.3	3.6	3.6	3.5	3.4

(1) Forecasts from 2017 onwards

Sectoral Balances

Table 1d

Percentages of GDP	ESA Code	2015	2016	2017	2018	2019	2020
1. Net lending/ borrowing		7.1	8.7	7.3	9.8	10.4	12.7
vis-à-vis the rest of the world	B.9						
of which:							
Balance on goods and services		7.8	11.9	12.3	14.9	15.7	18.6
Balance of primary incomes and transfers		-2.5	-4.1	-6.3	-6.4	-6.5	-7.1
Capital account		1.8	0.8	1.3	1.2	1.2	1.1
2. Net lending/ borrowing of the private sector	B.9	7.1	8.7	7.3	9.8	10.4	12.7
3. Net lending/ borrowing of general Government	EDP B.9	-1.3	1.0	0.5	0.5	0.5	0.5
4. Statistical discrepancy		-3.8	11.3	3.8	4.1	4.8	4.0

General Government Budgetary Prospects

Table 2a

Percentages of GDP		ESA code	2015(*)	2016(*)	2015	2016	2017	2018	2019	2020
Net Lending (EDP B9) by sub-sector										
1.	General Government	S13	-119.3	101.0	-1.3	1.0	0.5	0.5	0.5	0.5
2.	Central Government	S1311	-125.0	102.3	-1.3	1.0	0.6	0.6	0.5	0.5
3.	State Government	S1312	-	-	-	-	-	-	-	-
4.	Local Government	S1313	5.6	-1.2	0.1	-0.0	-0.0	-0.0	-0.0	-0.0
5.	Social security funds	S1314	-	-	-	-	-	-	-	-
General Government										
6.	Total revenue	TR	3,703.0	3,871.3	39.9	39.1	38.5	38.3	37.5	36.8
7.	Total expenditure	TE	3,822.3	3,770.2	41.2	38.1	38.0	37.7	37.0	36.3
8.	Net lending / borrowing	B9	-119.3	101.0	-1.3	1.0	0.5	0.5	0.5	0.5
9.	Interest expenditure	D41	228.0	217.8	2.5	2.2	2.0	1.8	1.7	1.6
10.	Primary balance(1)		108.7	318.9	1.2	3.2	2.5	2.4	2.2	2.1
11.	One-off and other temporary measures(2)		8.6	-7.3	0.1	-0.1	-0.2	0.1	0.1	0.1
Selected Components of Revenue										
12.	Total Taxes (12=12a+12b+12c)		2,439.0	2,656.5	26.3	26.8	26.9	26.6	26.3	25.8
12a.	Taxes on production and imports	D2	1,186.5	1,264.6	12.8	12.8	12.6	12.3	12.0	11.8
12b.	Current Taxes on Income, Wealth, etc.	D5	1,237.5	1,375.9	13.3	13.9	14.2	14.1	14.1	13.9
12c.	Capital Taxes	D91	15.0	15.9	0.2	0.2	0.2	0.2	0.1	0.1
13.	Social Contributions	D61	596.3	639.3	6.4	6.5	6.5	6.4	6.3	6.2
14.	Property Income	D4	99.9	92.0	1.1	0.9	1.0	0.9	0.9	0.8
15.	Other(3)		567.8	483.5	6.1	4.9	4.1	4.4	4.1	3.9
16=6.	Total Revenue	TR	3,703.0	3,871.3	39.9	39.1	38.5	38.3	37.5	36.8
p.m.:	Tax Burden (D2+D5+D6111+D6131+D91-D995)(4)		3,051.1	3,311.6	32.9	33.5	33.6	33.1	32.7	32.3
Selected Components of Expenditure										
17.	Compensation of employees + intermediate consumption	D1+P2	1,715.1	1,821.6	18.5	18.4	18.8	18.1	17.9	17.5
17a.	Compensation of employees	D1	1,115.6	1,185.7	12.0	12.0	12.0	11.7	11.4	11.2
17b.	Intermediate consumption	P2	599.5	635.9	6.5	6.4	6.8	6.4	6.4	6.3
18.	Social payments (18=18a+18b)		1,031.2	1,078.9	11.1	10.9	10.6	10.3	10.1	10.0
	of which Unemployment benefits (5)		35.4	31.8	0.4	0.3	0.3	0.3	0.3	0.3
18a.	Social transfers in kind supplied via market producers	D632	44.8	57.7	0.5	0.6	0.5	0.5	0.4	0.4
18b.	Social transfers other than in kind	D62	986.4	1,021.2	10.6	10.3	10.1	9.8	9.6	9.5
19=9.	Interest expenditure	D41	228.0	217.8	2.5	2.2	2.0	1.8	1.7	1.6
20.	Subsidies	D3	110.6	129.2	1.2	1.3	1.1	1.1	1.1	1.0
21.	Gross fixed capital formation	P51G	398.1	251.9	4.3	2.5	2.8	3.1	2.9	2.8
22.	Capital transfers	D9	134.5	77.3	1.4	0.8	0.9	1.1	1.0	1.0
23.	Other(6)		204.9	193.5	2.2	2.0	1.9	2.3	2.4	2.4
24=7.	Total Expenditure	TE	3,822.3	3,770.2	41.2	38.1	38.0	37.7	37.0	36.3
p.m.:	Government consumption (nominal)	P3	1,691.0	1,671.7	18.2	16.9	18.2	17.5	17.5	17.4

(*) € million

(1) The primary balance is calculated as (B9, item 8) plus (D41, item 9)

(2) A plus sign means deficit-reducing one-off measures

(3) P10 + D39rec + D7rec + D9N (ie D9 other than D91rec)

(4) Including those collected by the EU and including an adjustment for uncollected taxes and social contributions D995), if appropriate

(5) Includes social benefits other than social transfers in kind (D62) and social transfers in kind via market producers (D632) related to unemployment benefits

(6) D29pay + D4Npay (ie D4 other than D41pay) + D5pay + D7pay + P5M + NP + D8

No policy change projections

Table 2b

Percentages of GDP	2016(1)	2016	2017	2018	2019	2020
1. Total revenue at unchanged policies	3,746.0	37.9	39.2	38.4	37.6	36.7
2. Total expenditure at unchanged policies	3,731.2	37.6	38.3	37.8	37.1	36.3

(1) € million

Amounts to be excluded from the expenditure benchmark

Table 2c

	Percentages of GDP	2015(1)	2016(1)	2015	2016	2017	2018	2019	2020
1.	Expenditure on EU programmes fully matched by EU funds revenue	253.1	39.4	2.7	0.4	0.9	1.4	1.3	1.2
1a.	*of which* Investment fully matched by EU funds revenue(2)	151.9	18.5	1.6	0.2	0.5	0.8	0.7	0.7
2.	Cyclical unemployment benefit expenditure(3)	-0.3	-3.3	-0.0	-0.0	-0.0	-0.0	0.0	0.0
3.	Effect of discretionary revenue measures	41.8	125.3	0.5	1.3	-0.5	0.0	0.0	0.2
4.	Revenue increases mandated by law	-	-	-	-	-	-	-	-

(1) € million

(2) Based on an estimate of Gross Fixed Capital Formation financed from EU funds

(3) The cyclical unemployment benefit expenditure is estimated based on the difference between the unemployment rate and NAWRU. Data for the total unemployment benefit expenditure is defined in COFOG under the code 10.5

General Government Expenditure by Function

Table 3

	Percentages of GDP	COFOG Code	2015	2020
1.	General public services	1	6.7	5.7
2.	Defence	2	0.8	0.7
3.	Public order and safety	3	1.2	1.2
4.	Economic affairs	4	5.1	4.6
5.	Environmental protection	5	2.0	1.4
6.	Housing and community amenities	6	0.4	0.3
7.	Health	7	5.8	5.1
8.	Recreation, culture and religion	8	1.2	0.9
9.	Education	9	5.5	5.2
10.	Social protection	10	12.4	11.2
11.	Total Expenditure	TE	41.2	36.3

General Government Debt Developments

Table 4

Percentages of GDP	ESA Code	2015	2016	2017	2018	2019	2020
1. Gross debt		60.6	58.3	55.9	52.5	50.0	47.6
2. Change in gross debt ratio		-6.4	-2.3	-2.4	-3.4	-2.5	-2.4
Contributions to changes in gross debt							
3. Primary balance		-1.2	-3.2	-2.5	-2.4	-2.2	-2.1
4. Interest expenditure	EDP D.41	2.5	2.2	2.0	1.8	1.7	1.6
5. Stock-flow adjustment		0.9	2.5	1.6	0.2	0.9	0.9
p.m. implicit interest rate on debt(1)		4.2	3.9	3.6	3.4	3.5	3.4

(1) Proxied by interest expenditure divided by the debt level of the previous year.

Cyclical Developments

Table 5

Percentages of GDP	ESA Code	2015	2016	2017	2018	2019	2020
1. Real GDP growth (%)		7.4	5.0	4.3	3.7	3.5	3.4
2. General Government balance	EDP B.9	-1.3	1.0	0.5	0.5	0.5	0.5
3. Interest expenditure	EDP D.41	2.5	2.2	2.0	1.8	1.7	1.6
4. One-off and other temporary measures[1]		0.1	-0.1	-0.2	0.1	0.1	0.1
of which							
One-offs on the revenue side: general Government		0.1	0.1	0.1	0.1	0.1	0.1
One-offs on the expenditure side: general Government		-0.1	-0.1	-0.3	0.0	0.0	0.0
5. Potential GDP growth (%)		6.3	5.8	5.3	4.7	3.9	3.4
contributions:							
- labour (hours)		2.1	2.2	2.1	2.1	1.4	1.1
- capital		2.3	2.0	1.7	1.2	1.3	1.0
- total factor productivity		1.8	1.6	1.4	1.3	1.2	1.2
6. Output Gap		2.7	2.0	1.0	0.0	-0.4	-0.4
7. Cyclical Budgetary Component		1.2	0.9	0.5	0.0	-0.2	-0.2
8. Cyclically-Adjusted Balance (2-7)		-2.5	0.1	0.1	0.5	0.7	0.6
9. Cyclically-Adjusted Primary Balance (8+3)		-0.1	2.3	2.0	2.3	2.4	2.2
10. Structural Balance (8-4)		-2.6	0.2	0.2	0.5	0.6	0.6

[1] A plus sign means deficit-reducing one-off measures

Divergence from the April 2015 Stability Programme

Table 6

Percentages of GDP	ESA Code	2015	2016	2017	2018	2019	2020
Real GDP growth							
Previous update		6.3	4.2	3.1	2.9	2.4	…
Current update		7.4	5.0	4.3	3.7	3.5	3.4
Difference		1.1	0.8	1.2	0.8	1.1	-
General Government net lending	EDP B.9						
Previous update		-1.5	-0.7	-0.6	-0.2	0.1	…
Current update		-1.3	1.0	0.5	0.5	0.5	0.5
Difference		0.2	1.7	1.1	0.7	0.4	-
General Government gross debt							
Previous update		63.9	62.6	60.4	57.5	55.5	…
Current update		60.6	58.3	55.9	52.5	50.0	47.6
Difference		-3.3	-4.3	-4.5	-5.0	-5.5	-

Long-term Sustainability of Public Finances

Table 7

Percentages of GDP	2013	2020	2030	2040	2050	2060
Total Expenditure	-	-	-	-	-	-
of which: age-related expenditures	22.6	23.0	24.3	25.1	26.6	29.2
Pension expenditure	9.6	9.8	9.7	9.7	11.0	12.8
Social security pensions*	-	-	-	-	-	-
Old-age and early pensions	5.3	5.8	6.1	6.7	8.3	10.3
Other pensions (disability, survivors)	4.0	3.7	3.2	2.7	2.3	2.0
Occupational pensions	-	-	-	-	-	-
Health care	5.7	6.3	7.0	7.5	7.6	7.8
Long-term care	1.1	1.3	1.6	2.0	2.1	2.3
Educational expenditure	5.9	5.3	5.6	5.5	5.5	6.0
Other age-related expenditures: (Unemployment benefits)	0.3	0.3	0.3	0.3	0.3	0.3
Interest expenditure	-	-	-	-	-	-
Total revenue	-	-	-	-	-	-
of which: property income	1.9	1.9	1.9	1.8	1.8	1.7
of which: from pensions contributions	8.6	7.6	7.8	7.7	7.6	7.4
Pension reserve fund assets	-	-	-	-	-	-
of which: consolidated public pension fund assets	-	-	-	-	-	-
Labour productivity growth	-0.7	1.3	1.5	1.7	1.7	1.5
Real GDP growth	1.7	1.9	1.9	1.8	1.4	1.4
Participation rate males (aged 20-64)	84.7	86.1	89.7	88.9	88.6	89.0
Participation rate females (aged 20-64)	52.8	60.9	69.1	70.8	71.0	71.4
Total participation rates (aged 20-64)	69.0	73.8	79.6	80.1	80.0	80.4
Unemployment rate (aged 15-64)	6.5	6.6	6.7	6.7	6.7	6.7
Population aged 65+ over total population	17.5	21.2	24.4	24.8	26.4	28.5

** Malta's two-thirds pension included under the pension expenditure category*

Note: Figures may not add up due to rounding

Basic Assumptions

Table 8

	2016	2017(f)	2018(f)	2019(f)	2020(f)
Short-term interest rate (annual average)	0.00	0.00	0.00	0.00	0.00
Long-term interest rate (annual average)	0.90	0.80	0.80	0.80	0.80
USD/EUR exchange rate (value at end of period)	1.105	1.053	1.053	1.081	1.081
GBP/EUR exchange rate (value at end of period)	0.834	0.870	0.871	0.868	0.868
Malta's main trading partners growth	1.5	1.7	1.8	1.7	1.7
Oil prices, (Brent, USD/barrel)	43.6	53.6	56.4	56.4	56.4
World prices weighted by main trading partners (y-o-y % change)	-0.9	2.2	1.9	1.9	2.0

Basic Fiscal Assumptions

Table 8b

	ESA Code	2015	2016	2017(f)	2018(f)	2019(f)	2020(f)
Implied Elasticity with respect to respective Tax Base							
Taxes on Production and Imports	D2	0.8	-1.3	0.3	0.3	0.3	0.6
of which Value Added Taxes	D212	1.0	1.6	1.3	1.0	1.0	1.0
Current Taxes on Income, Wealth, etc. [Personal]	D5	0.9	2.0	1.3	0.8	0.9	0.8
Current Taxes on Income, Wealth, etc. [Corporate]	D5	2.8	0.9	0.7	0.5	0.6	0.8
Net social contributions	D61	0.9	1.1	0.9	0.7	0.7	0.9
General Government Adjustments (€ millions)		**113.5**	**92.2**	**89.3**	**70.4**	**60.9**	**61.4**
Other accounts payable and receivable		106.6	-33.5	28.9	21.9	21.9	21.9
Treasury Clearance Fund & Good Causes Fund		20.4	-24.4	20.4	20.0	20.0	20.0
Air Malta Adjustment		-43.0	-12.0	0.0	0.0	0.0	0.0
Social and Investment Fund - IIP - Revenue		35.1	120.1	70.0	70.0	63.0	63.0
Social and Investment Fund - IIP - Expenditure		0.0	0.0	-20.0	-32.0	-35.0	-35.0
Others		-5.6	42.0	-10.0	-9.5	-9.0	-8.5
Social Security Benefits							
COLA (€)		0.58	1.75	1.75	2.91	3.49	3.49
Contributory Benefits (€ millions)		668.2	712.2	744.1	773.6	821.0	870.8
Number of CB Beneficiaries (persons)		110,844	114,016	116,119	116,795	118,896	211,744
Non-Contributory Benefits (€ millions)		200.2	188.5	191.5	195.3	200.4	205.5
Number of NCB Beneficiaries (persons)		112,323	110,258	110,369	110,728	111,266	111,844

Contingent liabilities

Table 9 % of GDP

	2015	2016	2017	2018	2019	2020
Public guarantees	15.1	14.1	9.7	9.1	8.4	7.8

Note: The data for Contingent liabilities for 2015 to 2016 is actual, while data for 2017 to 2020 is an estimate

Stock Flow Adjustment Statement

Table 10

Millions of Euros	2016	2017	2018	2019	2020
General Governemnt deficit (-) / surplus (+) (ESA10)	**-101.0**	**-57.0**	**-60.0**	**-59.0**	**-57.0**
ESA Adjustments	92.9	89.3	70.4	60.9	61.4
Contribution to Sinking Fund (Local)	3.3	3.3	-88.4	0.0	0.0
Contribution to Sinking Fund (Foreign)	6.5	1.7	0.1	0.1	0.1
Contribution to Special MGS Sinking Fund	50.0	50.0	50.0	50.0	50.0
Equity Acquisition(incl. Air Malta)	14.6	32.6	2.6	2.6	2.6
EFSF/ESM Credit Line Facility		4.5	4.5	4.5	4.5
Courts and other deposits	38.2				
Stock Premium paid to Church	0.3	1.1	0.7	1.4	0.0
Advances made by Government					
Repayment of Loans to Government	-12.0	-0.0	-0.0	-0.0	-0.0
Sale of Assets	-1.1	-0.9	-0.9	-0.9	-0.9
Sale of Non-Financial Assets	-	-	-		
EBUs	3.6	0.0	0.0	0.0	0.0
Currency	6.3	6.6	7.2	7.8	8.5
Movement in Bank Account	48.8	-	-		
Other Statistical Discrepancies	-	-	-		
Increase/(Decrease)in cash balance	18.3	-10.5	-7.9	-0.2	-0.1
Increase/(Decrease) in Non-Consolidated Debt	**155.9**	**120.7**	**-21.7**	**67.2**	**69.1**
MGS Consolidation	-9.4	-7.9	-21.2	-17.1	-12.1
Increase/(Decreaese) in Consolidated Debt	**146.5**	**112.8**	**-42.9**	**50.1**	**57.0**
SFA	**247.5**	**169.8**	**17.1**	**109.1**	**114.0**