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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plan of MALTA

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of MALTA

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1. INTRODUCTION

Malta has submitted its Draft Budgetary Plan for 2015 on 15 October in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Malta is currently subject to the corrective arm of the Pact. The Council opened the Excessive Deficit Procedure for Malta on 21 June 2013, recommending Malta to ensure a sustainable correction of the excessive deficit by 2014 while at the same time ensuring that the government gross debt ratio will approach the 60% of GDP reference value at a satisfactory pace. After the correction of the excessive deficit, Malta will be subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term objective (MTO). As the debt ratio in 2015 is projected at 69% of GDP, exceeding the 60% of GDP reference value, Malta continues to be subject to the debt rule.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission Forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on Commission Forecast. In particular, it also includes an assessment of the measures underpinning the draft budgetary plan. Section 4 assesses the recent and planned fiscal developments in 2014-2015 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council on 8 July 2014. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario, underlying the Draft Budgetary Plan, assumes an acceleration in real GDP growth from 2.5% in 2013 to 3% in 2014 and further to 3.5% in 2015 reflecting buoyant domestic demand. Employment growth is expected to remain strong, averaging 2% in 2014-15, while unemployment is foreseen to drop below 6%, a historic low, by 2015. The growth outlook is considerably more favourable than the one in the stability programme, which envisaged real GDP growth of 2.3% in 2014 and 2.1% in 2015, on account of a more accommodative fiscal stance in 2014-15 and an upward revision in exports in 2015. Compared with the Commission forecast, the real GDP growth projection underlying the Draft Budgetary Plan is in line with the Commission’s view for 2014 but it is more optimistic for 2015 mainly on account of a more positive outlook for net exports.

Assessed against currently available information, the Draft Budgetary Plan’s macroeconomic scenario appears plausible for 2014 and optimistic for 2015. The main downside risks for the scenario lie in the pace of recovery in Malta’s export markets in 2015, given the relatively optimistic outlook for net exports in the authorities' projections. Moreover, slippages in the major energy projects, which drive the investment projections, could shift the growth profile forward.

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

In July 2014, the Maltese parliament adopted the Fiscal Responsibility Act that envisages the establishment of a Fiscal Council that would endorse the macroeconomic and fiscal projections prepared by the Ministry of Finance. In the first year following the adoption of the Act, its functions are carried out by the National Audit Office (NAO) – a public institution, whose independence is established in Article 108(12) of the Constitution of Malta.

The Draft Budgetary Plan does not indicate if the underlying macroeconomic and fiscal projections have been assessed and endorsed by the NAO. Nevertheless, on 29 October the NAO published an assessment of the macroeconomic forecasts prepared by the Ministry of Finance. The real GDP growth forecasts for 2014 and 2015 are found "feasible, although subject to a number of risks". The particular risks identified include: (i) the implementation of the large investment projects, (ii) developments in expenditure deflators, and (iii) the interlinkages between the domestic economy and external macroeconomic environment, particularly for 2015. The NAO points out that the macroeconomic forecasts were prepared under very particular circumstances related to the statistical changes introduced by the National Statistical Office in the context of the transition to the European System of Accounts 2010 and other revisions. The fiscal projections prepared by the Ministry of Finance are also meant to be endorsed by the NAO, but the endorsement was not published by the cut-off date of this document.

Table 1. Comparison of macroeconomic developments and forecasts

	2013	2014			2015		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	2.5	2.3	3.0	3.0	2.1	3.5	2.9
Private consumption (% change)	1.7	2.3	2.1	2.0	2.2	2.1	2.4
Gross fixed capital formation (% change)	2.2	15.6	14.3	12.0	3.4	4.8	6.6
Exports of goods and services (% change)	-1.6	2.3	0.7	1.0	4.2	5.9	4.6
Imports of goods and services (% change)	-1.7	3.9	1.9	2.0	4.3	5.5	4.5
Contributions to real GDP growth:							
- Final domestic demand	1.4	3.8	5.0	4.3	2.0	2.7	2.6
- Change in inventories	1.1	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	0.0	-1.4	-2.0	-1.5	0.0	0.7	0.2
Output gap[1]	-0.2	0.1	0.2	0.1	0.3	1.1	0.3
Employment (% change)	3.8	2.1	2.1	2.3	1.8	1.9	1.8
Unemployment rate (%)	6.4	6.5	6.0	6.1	6.5	5.9	6.1
Labour productivity (% change)	-1.3	0.2	0.9	0.7	0.3	1.5	1.1
HICP inflation (%)	1.0	1.3	0.7	0.7	1.8	1.5	1.5
GDP deflator (% change)	2.1	2.4	2.0	1.3	2.6	1.2	1.6
Comp. of employees (per head, % change)	-0.4	1.1	4.6	3.4	2.0	2.3	2.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.9	2.6	n.a.	4.3	2.3	n.a.	4.3

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

Source:
Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The Draft Budgetary Plan confirms the 2014 deficit target of 2.1% of GDP set in the 2014 stability programme, despite a higher nominal GDP growth and lower unemployment in the Draft Budgetary Plan macroeconomic scenario.

The nominal GDP has been revised up substantially in the Draft Budgetary Plan due to statistical revisions also due to the transition to the European System of Accounts 2010. Therefore, as a share of GDP, the deficit remains unchanged. In particular, in nominal terms, both total revenue and expenditure have been revised up significantly, with the increase spread all over the items. On current expenditure, the increase is particularly substantial for compensation of employees, intermediate consumption and subsidies. The increase in public wages, in spite of the restrictions on recruitment envisaged by the 2014 budget and confirmed by the 2014 stability programme, follows the growth in employment in the public sector due to higher recruitments mainly in the health and the education sectors as well as to the nationalisation of the public transport sector at the beginning of the year (which, however, is projected to shift again outside the public sector next year). Other increases in current expenditure are due, mainly, to higher subsidies to the public transport sector and to Enemalta, the outsourcing of hospitalization for the elderly and the repayment of some arrears in medicines. On the revenue side, income from both direct and indirect taxes have been revised upwards. The new target for income tax revenue is partly explained by the expected impact of the recently introduced Investment Registration Scheme. This scheme, which gives the opportunity to Maltese residents who hold eligible assets (including bank accounts and other foreign investments) abroad to legally register them against a penalty, was announced in the 2014 budget but it came into force only in July with the publication of the Legal Notice which includes all the details of the measure. It is estimated to have a temporary impact of 0.13% of GDP in 2014 and a permanent increase of the tax base for the following years.

The Commission 2014 autumn forecast projects the 2014 deficit to be at 2.5% of GDP. The 0.4 pp. of GDP difference with the authorities' target is explained by higher current expenditure, especially compensation of employees and social payments, although partly compensated by lower net capital expenditure. While total current revenue are in line, the composition is different, with the Commission projecting higher income taxes and lower indirect taxes, in line with the somewhat more subdued recovery in domestic demand in the Commission forecast.

For 2015, the Draft Budgetary Plan targets a further reduction of the deficit to 1.6% of GDP, with the primary surplus reaching 1.2% of GDP. Compared to the 2014 Stability Programme, the target is unchanged, but the consolidation is becoming revenue-based contrary to the previously announced expenditure-based consolidation. Indeed, upward revisions to current expenditure (mainly compensation of employees, intermediate consumption and subsidies) and net capital expenditure have been offset by higher current revenues, which include the upward revision in the expected proceeds coming from the Individual Investor Programme (at 0.6 pp. of GDP). As a result, due also to revenue-increasing measures envisaged with the 2015 budget, current revenues (in nominal terms) are projected to increase more than the nominal GDP growth (by 6.8% vs. 4.8%) thus improving as a share of GDP (by 0.7 pp. of GDP). Lower current expenditure (-0.2 pp. of GDP) is anticipated to partly offset the increase in capital transfers owing to the expected higher capital injection into Air Malta (0.3 pp. of GDP).

Without incorporating the measures of the 2015 budget, as the latter was not presented in parliament before the cut-off date, the Commission Forecast projects the deficit in 2015 to deteriorate slightly to 2.6% of GDP. As a result, the difference between the Draft Budgetary Plan target and the Commission forecast widens to 1.0 pps of GDP. Part of the difference (0.4 pp.) is explained by the worse starting position, while the rest is related to more dynamic current expenditure as well the absence of the 2015 measures in the Commission forecast. While the projection for current revenue is overall in line in the two forecasts, the composition concerning income from direct and indirect taxation is different.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2013	2014			2015			Change: 2013-2015
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**39.8**	**42.2**	***40.9***	**41.0**	**42.4**	***41.8***	**41.6**	**2.0**
of which:								
- Taxes on production and imports	13.0	14.1	*13.7*	13.3	14.1	*14.0*	13.3	1.0
- Current taxes on income, wealth, etc.	13.9	14.2	*13.8*	14.3	14.4	*14.0*	14.4	0.1
- Capital taxes	0.2	0.2	*0.2*	0.2	0.2	*0.1*	0.2	-0.1
- Social contributions	7.0	7.4	*7.1*	7.1	7.5	*7.0*	7.1	0.0
- Other (residual)	5.8	6.3	*6.1*	6.1	6.2	*6.7*	6.7	0.9
Expenditure	**42.5**	**44.2**	**43.0**	**43.5**	**44.0**	**43.4**	**44.2**	**0.9**
of which:								
- Primary expenditure	39.6	41.2	40.2	40.7	41.1	40.6	41.4	1.0
of which:								
Compensation of employees	13.0	13.2	12.8	13.2	13.0	12.7	13.2	-0.3
Intermediate consumption	6.2	6.5	6.4	6.5	6.5	6.6	6.7	0.4
Social payments	12.9	13.5	12.8	13.0	13.6	12.5	12.8	-0.4
Subsidies	1.1	1.5	1.4	1.5	1.2	1.6	1.6	0.5
Gross fixed capital formation	2.8	3.2	3.3	3.1	3.1	3.5	3.3	0.7
Other (residual)	3.7	3.3	3.5	3.5	3.7	3.7	3.8	0.0
- Interest expenditure	2.9	3.0	2.8	2.8	2.9	2.8	2.8	-0.1
General government balance (GGB)	**-2.7**	**-2.1**	**-2.1**	**-2.5**	**-1.6**	**-1.6**	**-2.6**	**1.1**
Primary balance	**0.2**	**0.9**	**0.7**	**0.4**	**1.3**	**1.2**	**0.2**	**1.0**
One-off and other temporary	0.1	0.2	0.2	0.2	0.1	0.2	0.2	0.1
GGB excl. one-offs	**-2.8**	**-2.3**	**-2.3**	**-2.7**	**-1.7**	**-1.8**	**-2.8**	**1.1**
Output gap[1]	-0.2	0.1	0.2	0.1	0.3	1.1	0.3	1.2
Cyclically-adjusted balance[1]	-2.6	-2.1	-2.2	-2.5	-1.7	-2.1	-2.7	0.5
Structural balance (SB)[2]	**-2.7**	**-2.3**	**-2.4**	**-2.7**	**-1.8**	**-2.3**	**-2.9**	**0.4**
Structural primary balance[2]	0.2	0.7	0.4	0.1	1.1	0.5	-0.1	0.3

Notes:

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

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

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

There are risks related to the deficit targets in the Draft Budgetary Plan as the projected dynamic increase in income from indirect taxes in 2014-15 does not appear to be fully explained by the underlying macroeconomic scenario, nor is it underpinned by measures. There is also a risk of slippages in the public sector wage bill, based also on the actual trend in cash data, and in intermediate consumption, given previous years' experience. In addition, any delay in the privatisation of the public transport service could require additional subsidies on top of what is already budgeted. On the other hand, in line with past experience, net capital expenditure could be lower than planned if it continues to be used to compensate for slippages in budgetary execution.

In structural terms[1], the government plans imply an improvement in the balance in both years, amounting to ½ pp. and ¼ pp. of GDP in 2014 and 2015, respectively. On the contrary, in the Commission Forecast (based on the no-policy change assumption) the deficit is expected to be deteriorate slightly in 2014 and to remain stable in 2015.

3.2. Debt developments

In the Draft Budgetary Plan, the general government gross debt ratio is expected to increase by 0.3 pp. of GDP in 2014, reaching 70.1% of GDP. In particular, the projected primary surplus and the positive impact of growth and inflation are not sufficient to offset the significant stock-flow adjustment which is due to a high cash buffer. In 2015 the debt ratio is then projected to deacrease by 1.1 pp. of GDP on account of a reduction, compared to the previous year, in the stock-flaw adjustment.

Table 3. Debt developments

(% of GDP)	2013	2014			2015		
		SP	**DBP**	**COM**	**SP**	**DBP**	**COM**
Gross debt ratio[1]	**69.8**	**69.4**	**70.1**	**71.0**	**68.5**	**69.0**	**71.0**
Change in the ratio	1.9	-3.6	0.3	1.2	-0.9	-1.1	0.1
Contributions[2]:							
1. Primary balance	**-0.2**	**-0.9**	**-0.7**	**-0.4**	**-1.3**	**-1.2**	**-0.2**
2. “Snow-ball” effect	**0.0**	**-0.2**	**-0.6**	**-0.1**	**-0.1**	**-0.4**	**-0.3**
Of which:							
Interest expenditure	2.9	3.0	2.8	2.8	2.9	2.8	2.8
Growth effect	-1.6	-1.6	-2.0	-2.0	-1.4	-2.3	-2.0
Inflation effect	-1.3	-1.6	-1.4	-0.9	-1.6	-0.8	-1.1
3. Stock-flow adjustment	**2.2**	**-2.4**	**1.6**	**1.6**	**0.6**	**0.5**	**0.6**
Of which:							
Cash/accruals difference		n.a.	n.a.		n.a.	n.a.	
Net accumulation of financial		n.a.	n.a.		n.a.	n.a.	
of which privatisation proceeds		n.a.	n.a.		n.a	n.a.	
Valuation effect & residual		n.a.	n.a.		n.a.	n.a.	

Notes:

[1] End of period.

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

Source:

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

According to the Commission Forecast, the debt ratio is projected to reach 71% of GDP in 2014 and to stabilize to that level in 2015. The difference, compared to the Draft Budgetary Plan targets, is due to the lower expected primary surplus and the lower nominal GDP growth projections. The stock-flow adjustment is in line with the Government's projection, which includes the repayment of tax arrears from Enemalta already in 2014.

The same risks highlighted for the deficit targets apply to the debt projections of the Draft Budgetary Plan. Moreover, despite a decrease in 2013 (to 16.6% of GDP from 17.2 % of GDP

[1] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

in 2012), the government-guaranteed debt in Malta remains high compared to other Member States.

3.3. Measures underpinning the draft budgetary plan

The Draft Budgetary Plan presented on 15 October provides details on the measures implemented for 2014, as well as the 2015 targets for revenue and expenditure by item. However, sufficient detailed information on discretionary measures underpinning the 2015 budgetary targets are lacking. A similar situation occurred in the 2014 Draft Budgetary Plan. Article 6(3) of Regulation (EU) No 473/2013 of 21 May 2013 and the Code of Conduct[2] on the Two Pack require the DBP to contain this information.

Specifically, the Draft Budgetary Plan announces new measures for 2015, namely increases in indirect taxation which will be levied on consumer goods and services (0.3% of GDP), a revision in fees on market output (0.06% of GDP) and measures to control the public sector wage bill (0.12% of GDP). Overall, these measures are estimated to have a net deficit-reducing impact amounting to 0.47% of GDP. However, the necessary details for the concrete implementation were only to be specified in the forthcoming 2015 budget[3]. In addition, given that the details are not specified, it is not possible to assess if and how these measures could contribute to meeting the recommendations addressed to Malta in the context of the European Semester in the area of public finances. It should be noted that this is the second year that the Draft Budgetary Plan does not provide sufficient information on the discretionary measures underpinning the targets.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2014	**2015**	**2016**
Taxes on production and	0.27	0.31	0
Current taxes on income, wealth,	-0.11	-0.36	0
Capital taxes	n.a.	n.a.	n.a.
Social contributions	0.06	0.07	0
Property Income	n.a.	n.a.	n.a.
Other	0.06	0.63	0
Total	0.28	0.65	0

Note:

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

Source: Draft Budgetary Plan 2015

[2] Code of Conduct "Specifications on the implementation of the Two Pack and guidelines on the format and content of Draft Budgetary Plans, Economic Partnership Programmes and Debt Issuance Reports".

[3] The 2015 budget was presented to Parliament on 17 November.

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2014	**2015**	**2016**
Compensation of employees	0	0.12	0
Intermediate consumption	n.a.	n.a.	n.a.
Social payments	n.a.	n.a.	n.a.
Interest Expenditure	n.a.	n.a.	n.a.
Subsidies	n.a.	n.a.	n.a.
Gross fixed capital formation	n.a.	n.a.	n.a.
Capital transfers	0.32	-0.35	0
Other	n.a.	n.a.	n.a.
Total	0.32	-0.23	0

Note:

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

Source: Draft Budgetary Plan 2015

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

Box 2. Council recommendations addressed to Malta

On 21 June 2013, the Council recommended Malta under Article 126(7) of the Treaty to correct its excessive deficit by 2014. To this end, Malta should:

(a) reach a headline general government target of 3.4% of GDP for 2013 and 2.7% of GDP in 2014, which is consistent with an annual improvement of the structural balance of 0.7% of GDP in 2013, and 0.7% of GDP in 2014. This adjustment path would allow bringing the headline government deficit below the 3% of GDP reference value by 2014 while at the same time ensuring that the government gross debt ratio will approach the 60%-of-GDP reference value at a satisfactory pace;

(b) specify and rigorously implement the measures that are necessary to achieve the correction of the excessive deficit by 2014, and use all windfall gains for deficit reduction.

On 8 July 2014, the Council also addressed recommendations to Malta in the context of the European Semester. In particular, in the area of public finances the Council recommended to Malta to correct the excessive deficit in a sustainable manner by 2014. In 2015, significantly strengthen the budgetary strategy to ensure the required structural adjustment of 0.6% of GDP towards the medium-term objective. Thereafter, pursue a structural adjustment of at least 0.5% of GDP each year, and more in good economic conditions or if needed to ensure that the debt rule is met in order to keep the general government debt ratio on a sustained downward path. Finalise the adoption of the Fiscal Responsibility Act with a view to putting in place a binding, rule-based multiannual fiscal framework and establishing an independent institution charged with monitoring of fiscal rules and endorsing macroeconomic forecasts underpinning fiscal planning. Continue improving tax compliance and fighting tax evasion by ensuring the continued roll-out and evaluation of measures taken so far, while taking additional action, notably by promoting the use of electronic means of payment.

Under the 2014 European Semester, the Council also recommended Malta to step up the ongoing pension reform, notably by significantly accelerating the planned increase in the statutory retirement age and by consecutively linking it to changes in life expectancy. Ensure that a comprehensive reform of the public health system delivers a cost-effective and sustainable use of available resources, such as strengthening primary care.

4.1. Compliance with EDP recommendations

The Draft Budgetary Plan plans to further reduce the headline deficit to 2.1% of GDP in 2014, from 2.7% of GDP in 2013, well below the EDP target (2.7% of GDP). The annual change in the (recalculated) structural balance in 2014 is slightly below the one recommended by the Council (0.4 pp. of GDP vs 0.7 pp. of GDP). In cumulative terms, the change in the (recalculated) structural balance in 2013-14 is 1.5 pp. of GDP, slightly above the 1.4 pp. of GDP recommendation, with the effort being frontloaded in 2013.

However, according to the Commission forecast, after having decreased by more than 1 pp. of GDP in 2013, the structural deficit is projected to stabilize in 2014. The change in the adjusted structural balance[4] (-0.5 pp. of GDP) is far from the recommended annual structural effort (0.7 pp. of GDP). This conclusion is confirmed by a bottom-up assessment, which estimates the size of the fiscal effort for 2014 on the basis of the additional discretionary revenue measures and the expenditure developments under the control of the government[5]. In particular, the size of consolidation measures for 2014 (-0.7 pp. of GDP) is not in line with the one deemed necessary to reach the structural targets spelled out in the EDP recommendation (0.8 pp. of GDP).

[4] Adjusted for the downward revision in potential output growth since the time when the EDP recommendation was issued and the impact of the composition of economic growth on revenue.
[5] Excluding notably unemployment benefit payments related to the evolution of the number of unemployed and changes in interest expenditure related to interest and exchange rate changes.

Table 5. Compliance with the EDP recommendation

(% of GDP)	2013	2014		2015	
	COM	DBP	COM	DBP	COM
Headline balance					
Headline budget balance	-2.7	-2.1	-2.5	-1.6	-2.6
EDP requirement on the budget balance	-3.4	-2.7			
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	1.1	0.4	0.0	0.1	-0.2
Cumulative change[2]	1.1	1.5	1.1	n.a.	
Required change from the EDP recommendation	0.7	0.7			
Cumulative required change from the EDP recommendation	0.7	1.4			
Fiscal effort - adjusted change in the structural balance					
Adjusted change in the structural balance[3]	-0.3	-	-0.5	-	n.a.
of which: *correction due to change in potential GDP estimation (α)*	-0.4	-	-0.5	-	
correction due to revenue windfalls/shortfalls (β)	1.0	-	1.0	-	
Cumulative adjusted change [2]	-0.3	-	-0.8	-	
Required change from the EDP recommendation	0.7	0.7		n.a.	
Cumulative required change from the EDP recommendation	0.7	1.4			
Fiscal effort - calculated on the basis of measures (bottom-up approach)					
Fiscal effort (bottom-up)[4]	-0.1	-	-0.7	-	n.a.
Cumulative fiscal effort (bottom-up)[2]	-0.1	-	-0.7	-	
Requirement from the EDP recommendation	0.4	0.8		n.a.	
Cumulative requirement from the EDP recommendation	0.4	1.2			

Notes

[1]Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural balance based on DBP are recalculated by Commission on the basis of the Draft Budgetary Plan scenario using the commonly agreed methodology. Change compared to t-1.

[2] Cumulated since the latest EDP recommendation.

3 Change in the structural balance corrected for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendations.

[4]The estimated budgetary impact of the additional fiscal effort delivered on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the current forecast.

Source :

Draft Budgetary Plan 2015 (DBP), Commission 2014 autumn forecast (COM), Commission calculations

In cumulative terms, the change in the structural balance in 2013-14 is 1.1 pp. of GDP, below the 1.4 pp. of GDP recommended. When adjusted[6], the gap with the recommended adjustment opens up further (to -2.2 pp. of GDP), thus highlighting the risk that the correction of the excessive deficit may not be achieved, owing to the apparent lack of a sufficient effort to support it. This conclusion is confirmed by a bottom-up assessment, as the size of

[6] Adjusted for the downward revision in potential output growth since the time when the EDP recommendation was issued and the impact of the composition of economic growth on revenue.

consolidation measures for 2013-14 (-0.7 pp. of GDP) is below the one deemed necessary to reach the structural targets spelled out in the EDP recommendation (1.2 pp. of GDP).

The Draft Budgetary Plan does not mention any information with regard to compliance with the debt rule nor sufficient details (namely the debt forecast for 2016-17) to assess it. Therefore, the assessment is based on the Commission 2014 autumn forecast, showing that Malta does not yet respect the forward looking debt rule in 2013 and falls slightly short of it in 2014, while it appears to be met in 2015. These estimates will have to be reassessed against notified data in the spring 2015 notification.

Overall, the timely correction of the excessive deficit within the deadline is at risk, pending confirmation that the debt rule (to be reassessed against notified data in spring 2015) will be met.

4.2. Adjustment towards the MTO

In case a timely and sustainable correction is achieved and the EDP would be abrogated, Malta will have to comply with the preventive arm requirements. The preventive arm of the SGP requires Member States neither in good or in bad times and with a general government debt ratio above 60% of GDP that are not yet at their MTO to deliver a structural adjustment of at least 0.5 pp. of GDP so as to make sufficient progress towards it.

For 2015, the annual change in the (recalculated) structural balance of 0.1% of GDP falls short of the required adjustment of 0.6% of GDP, therefore highlighting a slight risk of deviation (-0.48% of GDP, which is below the 0.5 threshold) from the required 0.6% of GDP adjustment towards the MTO (and putting under risk the compliance with the requirements of the preventive arm of the Pact).

In addition, the growth rate of expenditure would exceed the benchmark by a significant margin in 2015, thus contributing to a 0.8 pp. of GDP deterioration in the structural balance and breaching the threshold of a significant deviation. However, the excess over the benchmark is to some extent to be attributed to lower potential growth (10-year average) in the expenditure benchmark than the annual potential GDP growth currently estimated. Therefore, following an overall assessment of Malta's Draft Budgetary Plan, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, there is a risk of some deviation from the required adjustment path towards the MTO.

On the other hand, based on the no-policy-change Commission forecast (i.e. which does not incorporate the consolidation measures in the 2015 budget), the annual change in the structural balance (which is projected to deteriorate by 0.2 pp. of GDP) falls short of the required adjustment of 0.6% of GDP and the expenditure growth would exceed the benchmark by 0.8 pp. in 2015, thereby contributing to a 1.3 pps.-of-GDP deterioration in the structural balance and breaching the threshold for significant deviation. Therefore, based on both the structural balance and the expenditure benchmark, a significant deviation is to be expected.

Table 6. Compliance with the requirements of the preventive arm of the Stability and Growth Pact

(% of GDP)	2013	2014		2015	
Initial position[1]					
Medium-term objective (MTO)	0.0	0.0		0.0	
Structural balance[2] (COM)	-2.7	-2.7		-2.9	
Structural balance based on freezing (COM)	-2.7	-1.7		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2013**	**2014**		**2015**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	n.a. in EDP in 2014			0.6	
Change in structural balance[5]				0.1	-0.2
One-year deviation from the required adjustment after considering the relevant factors[6]				-0.5	-0.8
Expenditure benchmark pillar					
Applicable reference rate[7]	n.a. in EDP in 2014			0.3	
One-year deviation[8]				-0.8	-1.3
Conclusion					
Conclusion (over one year)	n.a. in EDP in 2014			Overall assessment	Significant deviation

Notes

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

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

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

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 28.).

[5] Change in the structural balance compared to year t-1. Ex post assessment (for 2013) is carried out on the basis of Commission 2014 spring forecast.

[6] The difference of the change in the structural balance and the required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[7] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t. The reference rates applicable to 2014 onwards have been updated in 2013.

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

Source :

Draft Budgetary Plan 2015 (DBP), Commission 2014 autumn forecast (COM), Commission calculations

5. IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

A number of measures have been put in place or are in the pipeline with a view to respond to the Council recommendations of 8 July. The Maltese parliament adopted the Fiscal Responsibility Act in July 2014, thus transposing the provisions in the Treaty on Stability, Coordination and Governance in Economic and Monetary Union (TSCG). Not all provisions of the Act, however, are immediately operational. In particular, the Fiscal Council has not yet been set up.

With regard to improving tax compliance and fighting tax evasion, a number of already reported measures to streamline tax collection and strengthen audit and inspection are still being rolled out. First steps have been made to explore the promotion of electronic payment systems, but as yet this is restricted to the payment of taxes. A Pensions Strategy Group, established by the Ministry for the Family and Social Solidarity and the Ministry of Finance, is studying further pension reform avenues and is expected to present policy recommendations.

Moreover, a bill providing for the set-up of third pillar pension scheme with a view to improving pension adequacy going forward, has passed second reading in parliament.

Policy action to improve the financial sustainability of the healthcare system include moving towards the launching of a national health strategy, the introduction of a performance assessment framework in cooperation with the World Health Organisation, steps towards improving primary healthcare provision, and prevention measures.

6. OVERALL CONCLUSION

For the second year, the DBP presented by Malta does not specify in detail the measures that underpin the revenue and expenditure targets for 2015.

The deficit target set out in the Draft Budgetary Plan for 2014 is below the deficit target recommended in June 2013 under the EDP. Nevertheless, the Commission forecast highlights the risk that the correction of the excessive deficit may not be achieved, owing to the apparent lack of a sufficient effort to support it. In addition, the Commission 2014 autumn forecast points to a structural adjustment that is not in line with the targets of the EDP recommendation for 2014.

Furthermore, compliance with the debt rule needs to be ensured in 2014. Based on the Commission 2014 autumn forecast, the forward looking debt rule is expected to be slightly missed in 2014, while it appears to be met in 2015.

Once the EDP would be abrogated, Malta would have to comply with the preventive arm requirements in 2015. Following an overall assessment of Malta's Draft Budgetary Plan, the adjustment path towards the MTO seems to be appropriate in 2015. However, based on the no-policy-change Commission 2014 autumn forecast (i.e. which does not incorporate the consolidation measures in the 2015 budget), a significant deviation is to be expected, based on both the structural balance and the expenditure benchmark.

On the positive side, some parts of the fiscal-structural recommendations issued in the context of the 2014 European Semester to Malta have been addressed, notably the reform of the fiscal framework which has been adopted by Parliament at the end of July.