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COMMISSION OPINION

of 15.11.2013

on the Draft Budgetary Plan of MALTA

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a draft budgetary plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING MALTA

3. On the basis of the Draft Budgetary Plan for 2014 submitted on 15 October by Malta, the Commission has adopted the following opinion in accordance with Article 7 of the Regulation (EU) No 473/2013.

4. Malta is currently subject to the corrective arm of the SGP. In addition to the Draft Budgetary Plan, Malta submitted a report on effective action and an Economic Partnership Programme as recommended by the Council in June 2013. The Council opened a new Excessive Deficit Procedure (EDP) on 21 June 2013. Malta was given a deadline of 1 October 2013 to take effective action 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. The Council called on Malta to reduce its deficit to 3.4% of GDP in 2013, 2.7% of GDP in 2014, consistent with 0.7% of GDP improvement in the strucutral balance in both years, respectively.

5. The Draft Budgetary Plan is based on a macroeconomic scenario where real GDP growth is expected to accelerate gradually, reaching 1.7% in 2014 from 0.8% in 2012. Compared to the 2013 stability programme, the macroeconomic scenario in the Draft Budgetary Plan, which was finalised in the early summer (on 24 June), is slightly more optimistic. The Commission services 2013 autumn forecast project higher real GDP growth. Assessed against currently available information, the Draft Budgetary Plan macroeconomic scenario appears cautious for 2013 and plausible for 2014. The scenario could turn out better than expected if the positive momentum from the first half of 2013 is carried forward. Downside risks, particularly for 2014, are related mainly to the pace of recovery in the main trading partners, given the very high openness to trade of the domestic economy.

6. The macroeconomic forecasts underlying the draft budgetary plan have been produced by Economic Policy Division of the Ministry of Finance and endorsed by the National Audit Office (NAO). NAO concluded that the forecast was based on sound methodology and plausible assumptions. However, it also highlighted some risks regarding the composition of growth and some related to not taking into account the latest macroeconomic developments. NAO, whose independence is

established with Article 108(12) of the Constitution of Malta, is the body that according to the indications in the Economic Partnership Programme (submitted by Malta to the Commission on 1 October 2013) will be empowered to function as an independent fiscal council.

7. The Draft Budgetary Plan confirms the deficit targets of 2.7% of GDP and 2.1% of GDP respectively for 2013 and 2014 set in the 2013 stability programme. Compared to the 2013 stability programme, both current revenue and expenditure have been revised up by 0.3 pp. of GDP, with a neutral impact on the deficit. On the revenue side, higher income taxes and current transfers receivable more than offset lower indirect taxes, despite the better outlook for private consumption. On the expenditure side, intermediate consumption is the only current expenditure item that has been revised downwards, following the spending review that was conducted in July. For 2014 the consolidation is largely revenue-based. Compared to the 2013 stability programme, the Draft Budgetary Plan projects higher current revenue due to revenue-increasing measures envisaged with the 2014 budget which offsets the upward revision in both current expenditure as well as in capital expenditure net of EU grants. However, the Draft Budgetary Plan provides an explanation only for the revision in the targets for the general government balance at unchanged policy.

8. The Commission services' 2013 autumn forecast projects the 2013 deficit to be at 3.4% of GDP. The difference with the target in the Draft Budgetary Plan is mainly explained by lower growth for current revenue, in particular indirect taxes. For 2014, the difference between the Draft Budgetary Plan target and the Commission services forecast widens to 1.3 pps of GDP and is explained by both the base effect from a different deficit projection for 2013, a lower estimation of revenue elasticities as well the absence of new corrective measures in the Commission forecast as the 2014 budget was presented to parliament after the cut-off date. There are risks that the deficit outcomes could be worse than targeted in the Draft Budgetary Plan. The projected dynamic increase in tax revenues in 2013-14, especially as regards indirect taxes, does not appear to be fully explained by the underlying macroeconomic scenario, nor is it underpinned by measures. There is a risk of slippages in the public sector wage bill and in intermediate consumption, given previous years' experience. In addition, the financial situation of the energy provider Enemalta, which could require additional subsidies. On the other hand, as has frequently occurred in the past, net capital expenditure could be lower than planned if it used to compensate for slippages in budgetary execution.

9. According to the Draft Budgetary Plan, the general government gross debt ratio is planned to continue increasing until 2014. From 71.3% of GDP in 2012, it would increase to 73.2% of GDP in 2014 under the impact of both interest expenditure and the stock-flow adjustment. The difference with the 2013 stability programme is explained by a downward revision in the 2012 outturn (by 0.8 pp. of GDP). According to the Commission services' 2013 autumn forecast, the debt ratio is projected to reach 73.3% of GDP by 2014. The difference with the Draft Budgetary Plan targets is due to the expected higher primary deficit, partly offset by a lower, debt-increasing stock-flow adjustment in both years. In addition, it should be reminded that the government-guaranteed debt is high (17.4 % of GDP in 2012).

10. While providing all the details concerning the measures implemented for 2012 and 2013, as well as the 2014 targets for revenue and expenditure by item, the Draft Budgetary Plan does not provide sufficient details on the discretionary measures underpinning the 2014 budgetary targets and refers to the forthcoming budget for all

the details. On the revenue side, the measures (0.5% of GDP) are targeted at increasing indirect taxation as well as fees of office. On the expenditure side, the Draft Budgetary Plan includes some savings in wages in the public sector, through further restrictions in recruitment, and some expansionary measures aimed at spurring growth and employment. Overall, these measures are estimated to have a net deficit-reducing impact amounting to 0.2% of GDP.

11. For 2013, on the basis of the Commission 2013 autumn forecast, the projected deficit fulfils the EDP requirement. At the same time, according to the Commission 2013 Autumn Forecast, the change in the adjusted structural balance[1] (0.5% of GDP) comes slightly short of the recommended annual structural effort (0.7% of GDP). Therefore, while Malta can be considered to have complied so far with the Council recommendation of 21 June 2013, there is a risk that the correction of the deficit may not be achieved, owing to the apparent lack of a sufficient effort to support it. The situation will have to be reassessed against the spring 2014 notified data. By contrast, pending the assessment of the 2014 budget, the EDP requirements for 2014 are not fulfilled both in nominal and structural terms as the Commission deficit forecast remains above the EDP target of 2.7% of GDP and the adjusted structural balance (0.4% of GDP) is lower than the recommended annual fiscal effort (0.7% of GDP) in 2014. However, the projected deficit for 2014 (3.4% of GDP vs the recommended 2.7% of GDP) does not incorporate the consolidation measures in the 2014 budget, the details of which were not available by the cut-off date. It should be noted that, taken at face value, the measures included in the DBP would reduce the deficit forecast by 0.2% of GDP. This would still be insufficient to comply with the EDP recommendation.

12. The Draft Budgetary Plan contains fiscal-structural measures that aim at complying with the Council recommendations issued in the context of the European Semester in the fiscal area, adopted by the Council in June 2013. The planned reform of the fiscal framework, as well as the plans to improve the efficiency of the public administration, appear to go in the right direction, although measures are still work in progress and therefore subject to adoption and implementation risks. As regards the long-term sustainability of public finances, the provided information on policy plans in healthcare is not sufficient to assess whether they could contribute to lower public expenditure, while decisive policy action in the pension system is still missing.

13. The Draft Budgetary Plan contains other structural measures that aim at complying also with the non-fiscal Council recommendations issued in the context of the European Semester. The policy plans include comprehensive reforms of the judicial system and the diversification of energy sources alongside other new and ongoing measures. The measures appear to be in the right direction and can be expected to contribute to the creation of growth and jobs in Malta, while also safeguarding financial stability. Nevertheless, in general they are still work in progress, while the information provided is often limited. Therefore, further analysis of the impact of the policy plans and their contribution to addressing the challenges identified in the 2013 Country-Specific Recommendations will be needed once the policy plans become more concrete and their implementation advances.

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[1] The structural effort 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.

14. In accordance with the Council recommendation of 21 June, Malta has also submitted an Economic Parternship Programme. The Commission has examined the programme and concluded the programme could be expected to contribute to a durable correction of the excessive deficit. However, all reforms are work in progress and their adoption and implementation remain subject to risks. It is important to note that concrete and adequate policy plans to improve the sustainability of the pension system are still missing. On this basis, the Commission has made a proposal for a Council Opinion on the Economic Partnership Programme.

15. Overall, based on the 2013 Autumn Forecast, the Commission is of the opinion that there is a risk that the Draft Budgetary Plan for 2014 sent on 15 October will not fulfil the requirements in the EDP recommendation, since the headline deficit target is expected to be met in 2013, while this is not the case for the headline deficit in 2014 nor the structural effort in both 2013 and 2014. In addition, the Draft Budgetary Plan presented by Malta does not specify in detail the measures that underpin the revenue and expenditure targets for 2014, thus not complying with the obligations laid down in Art. 6(3e) of Regulation 473/2013. The Commission is also of the opinion that Malta has made limited progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the European Semester. Therefore, the Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2014 budget will be fully compliant with the SGP, notably to address the risks identified by the Commission in its assessment of the Draft Budgetary Plan. Moreover, it invites the authorities to accelerate progress towards implementation of the fiscal recommendations under the European Semester.

Done at Brussels, 15.11.2013

For the Commission
Olli REHN
Vice-President