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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**

{C(2013) 8007 final}

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### COMMISSION OPINION

### on the Draft Budgetary Plan of MALTA

#### 1. INTRODUCTION

Malta has submitted its Draft Budgetary Plan (DBP) for 2014 on 15 October 2013 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. As recommended by the Council in June 2013, moreover, a report on effective action and an Economic Partnership Programme have been submitted on 01 October 2013.

Malta is currently subject to the corrective arm of the Pact. The Council opened a new Excessive Deficit Procedure 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.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2013 autumn 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 the Commission 2013 autumn forecast. Section 4 assesses the recent and planned fiscal developments in 2013 and 2014 (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 the fiscal structural reforms presented in the Economic Partnership Programme, as requested in the latest Council recommendations. Section 6 summarises the main conclusions of the present document.

#### 2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The Draft Budgetary Plan (DBP) 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. Growth in 2013 and 2014 is projected to come mainly from domestic demand thanks to improving private consumption expenditure and investment activity, while the positive contribution from net exports is forecast to decline. Job creation is projected to somewhat lose pace compared to 2012, but to remain strong at 1.8% in 2013-14.

Compared to the 2013 stability programme, the macroeconomic scenario in the Draft Budgetary Plan is slightly more optimistic mainly due to a more positive outlook for private consumption, reflecting also a more positive labour market outlook, and investment, resulting in a more tax-rich composition of growth.

The macroeconomic scenario underpinning the Draft Budgetary Plan was finalised in the early summer (on 24 June). As a result, contrary to the Commission 2013 autumn forecast, it takes into account neither the national accounts data for Q2-2013 nor the data revision of 21 October, which posts a much better-than-expected real GDP growth for this quarter (3.6% vs. 1.7% y-o-y). This explains the higher real GDP growth projected by Commission in 2013 and 2014, which is driven by stronger net exports, partly offset by a more pessimistic outlook on domestic demand.

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.

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

The macroeconomic forecast underpinning the Draft Budgetary Plans is produced by the Economic Policy Division of the Ministry of Finance. In 2013 for the first time the forecast and the methodology behind it were reviewed by an external institution – the National Audit Office (NAO). The 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 will be empowered to function as an independent fiscal council. In its endorsement of the macroeconomic forecast produced by the Ministry of Finance, the NAO concluded that the forecast was based on sound methodology and plausible assumptions. However, it also highlighted risks to the forecast related to not taking into account the latest macroeconomic developments and pointed to some optimism in the projections for domestic demand. The NAO's findings were made public by the Ministry of Finance. As the fiscal framework reform has not been presented to the parliament yet, the functions of the fiscal council are yet to be finalised and put in legislation.

**Table 1. Comparison of macroeconomic developments and forecasts**

	2012	2013			2014		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	0.8	1.4	1.2	1.8	1.6	1.7	1.9
Private consumption (% change)	-0.2	0.9	1.2	0.6	1.0	1.3	1.7
Gross fixed capital formation (% change)	-3.9	0.5	0.7	-2.0	3.2	3.5	0.5
Exports of goods and services (% change)	7.0	2.1	1.9	-1.6	1.6	1.9	4.5
Imports of goods and services (% change)	5.5	1.6	1.5	-2.7	1.2	1.8	4.2
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	0.3	0.8	0.8	0.4	1.1	1.5	1.3
- Change in inventories	-1.2	0.0	0.0	0.4	0.0	0.0	0.0
- Net exports	1.7	0.6	0.4	1.0	0.5	0.2	0.5
Output gap <sup>1</sup>	-0.9	-0.5	-0.8	-0.5	-0.3	-0.3	0.2
Employment (% change)	2.3	0.7	1.8	2.3	0.9	1.8	1.8
Unemployment rate (%)	6.4	6.6	6.3	6.4	6.4	6.3	6.3
Labour productivity (% change)	-1.5	0.2	-0.6	-0.5	0.8	-0.1	0.1
HICP inflation (%)	3.2	2.0	1.7	1.1	1.6	2.3	1.8
GDP deflator (% change)	2.3	1.9	2.5	2.2	2.2	2.1	2.3
Comp. of employees (per head, % change)	2.2	0.7	0.8	2.1	1.1	2.5	1.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.8	4.0	4.4	4.0	4.7	4.3	3.7
<b>Note:</b>							
<sup>1</sup> 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.							
<b>Source:</b>							
<i>Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.</i>							

### 3. RECENT AND PLANNED FISCAL DEVELOPMENTS

#### 3.1. Deficit developments

The Draft Budgetary Plan confirms the 2013 deficit target of 2.7% of GDP set in the 2013 stability programme, despite the slightly more tax-rich composition of GDP growth and higher employment growth in the Draft Budgetary Plan macroeconomic scenario.

The projections for 2013 incorporate the 2013 budget that was endorsed by parliament in April 2013, which includes expansionary measures on both the revenue and the expenditure side, with a net deficit-increasing impact of 0.3% of GDP.

As laid down in the 2013 stability programme, the planned narrowing of the deficit in 2013, from 3.3% of GDP in 2012, is to a large extent revenue-based, relying also on some revenue buoyancy. Compared to the 2012 outturn, the increase in total current revenue (by 1.2 pps. of GDP), in both income and indirect taxes, is projected to more than offset the increase in both current expenditure (0.3 pps. of GDP) and capital expenditure (0.4 pps. of GDP). In particular, the increase in indirect revenue is driven by the expected recovery in private consumption, as well as on some administrative measures aimed at enhancing the collection of tax arrears.

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.

The Commission 2013 Autumn Forecast projects the 2013 deficit to be at 3.4% of GDP. The 0.7 pp. of GDP difference with the authorities' target is explained by lower growth for current revenue, in particular indirect taxes, in line with the more subdued recovery in domestic demand in the Commission forecast. The Commission 2013 autumn forecast also projects higher intermediate consumption but lower net capital expenditure.

For 2014, the Draft Budgetary Plan targets a further reduction of the deficit to 2.1% of GDP, with the primary surplus reaching 1.0% of GDP. Compared to the 2013 stability programme, the target is unchanged, but with the consolidation being more revenue-based. The Draft Budgetary Plan projects higher current revenue due to revenue-increasing measures envisaged with the 2014 budget which offset the upward revision in both current expenditure as well as in capital expenditure net of EU grants. In addition, tax buoyancy is projected to add 0.45% of GDP.

Without including the measures in the 2014 budget, as the latter was presented in parliament after the cut-off date, the Commission 2013 Autumn Forecast projects the deficit in 2014 to remain unchanged at 3.4% of GDP. As a result, the difference between the Draft Budgetary Plan target and the Commission forecast widens to 1.3 pps of GDP and is explained by 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.

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, notwithstanding the continued commitment to the restrictive policy on recruitment in the public sector, and in intermediate consumption, given previous years' experience, particularly in pharmaceutical expenditure. In addition, the financial situation of the energy provider Enemalta 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 continues to be used to compensate for slippages in budgetary execution.

In structural terms, the deficit targets for the period 2013-2014 correspond to an effort of 1.3 pps. of GDP in 2013 and 0.5 pp. of GDP in 2014, as recalculated by the Commission services based on the information in the Draft Budgetary Plan following the commonly agreed methodology. By contrast, according to the Commission 2013 Autumn Forecast, the change in the structural balance would be around 0.3 pp. of GDP in 2013 while in 2014 the structural deficit is projected to deteriorate marginally (-0.1 pp. of GDP).

**Table 2. Composition of the budgetary adjustment**

(% of GDP)	2012	2013			2014			Change: 2012-2014
	COM	SP	DBP	COM	SP	DBP	COM	DBP
<b>Revenue</b>	<b>40.1</b>	<b>42.1</b>	<b>41.9</b>	<b>41.0</b>	<b>42.8</b>	<b>43.1</b>	<b>41.0</b>	<b>3.0</b>
<i>of which:</i>								
- Taxes on production and imports	13.4	14.4	14.0	13.3	14.3	14.5	13.2	1.1
- Current taxes on income, wealth, etc.	13.7	13.9	14.2	14.1	14.3	14.2	14.1	0.5
- Capital taxes	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.0
- Social contributions	7.4	7.4	7.4	7.4	7.4	7.5	7.5	0.1
- Other (residual)	5.3	6.2	6.1	6.0	6.6	6.7	5.9	1.4
<b>Expenditure</b>	<b>43.4</b>	<b>44.9</b>	<b>44.6</b>	<b>44.5</b>	<b>44.9</b>	<b>45.3</b>	<b>44.3</b>	<b>1.9</b>
<i>of which:</i>								
- Primary expenditure	40.3	41.7	41.5	41.3	41.7	42.2	41.2	1.9
<i>of which:</i>								
Compensation of employees	13.4	13.5	13.5	13.4	13.3	13.3	13.3	-0.1
Intermediate consumption	6.7	6.7	6.4	6.6	6.7	6.6	6.7	-0.1
Social payments	13.6	13.7	13.6	13.6	13.7	13.7	13.6	0.1
Subsidies	1.1	1.2	1.3	1.3	1.3	1.3	1.3	0.2
Gross fixed capital formation	3.1	3.5	3.3	3.0	3.7	3.8	3.1	0.7
Other (residual)	2.3	3.1	3.4	3.3	3.0	3.5	3.3	1.2
- Interest expenditure	3.1	3.2	3.1	3.1	3.2	3.1	3.1	0.0
<b>General government balance (GGB)</b>	<b>-3.3</b>	<b>-2.7</b>	<b>-2.7</b>	<b>-3.4</b>	<b>-2.1</b>	<b>-2.1</b>	<b>-3.4</b>	<b>1.2</b>
<b>Primary balance</b>	<b>-0.2</b>	<b>0.5</b>	<b>0.4</b>	<b>-0.3</b>	<b>1.1</b>	<b>0.9</b>	<b>-0.3</b>	<b>1.1</b>
One-off and other temporary measures	0.9	0.2	0.3	0.3	0.1	0.2	0.1	-0.7
<b>GGB excl. one-offs</b>	<b>-4.2</b>	<b>-2.9</b>	<b>-3.0</b>	<b>-3.7</b>	<b>-2.2</b>	<b>-2.3</b>	<b>-3.5</b>	<b>1.9</b>
Output gap <sup>1</sup>	-0.9	-0.5	-0.8	-0.5	-0.3	-0.3	0.2	0.5
Cyclically-adjusted balance <sup>1</sup>	-2.9	-2.5	-2.4	-3.2	-2.0	-2.0	-3.5	1.0
<b>Structural balance (SB)<sup>2</sup></b>	<b>-3.9</b>	<b>-2.7</b>	<b>-2.7</b>	<b>-3.5</b>	<b>-2.1</b>	<b>-2.2</b>	<b>-3.6</b>	<b>1.7</b>
<i>Change in SB</i>	<i>-0.4</i>	<i>0.5</i>	<i>1.3</i>	<i>0.3</i>	<i>0.6</i>	<i>0.5</i>	<i>-0.1</i>	<i>-</i>
<i>Two year average change in SB</i>	<i>0.4</i>	<i>0.4</i>	<i>0.4</i>	<i>0.0</i>	<i>0.5</i>	<i>0.9</i>	<i>0.1</i>	<i>-</i>
Structural primary balance <sup>2</sup>	-0.7	0.5	0.4	-0.4	1.1	0.9	-0.5	1.7
<i>Change in structural primary balance</i>		<i>0.5</i>	<i>1.3</i>	<i>0.4</i>	<i>0.6</i>	<i>0.5</i>	<i>-0.1</i>	<i>-</i>
<b>Expenditure benchmark</b>								
Applicable reference rate <sup>3</sup>	n.r.	-						
Deviation <sup>4</sup> (% GDP)	n.r.	-						
Two-year average deviation (% GDP)	n.r.	-						

Notes:

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

<sup>2</sup>Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

<sup>3</sup>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.

<sup>4</sup>Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.

Source:  
Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

### 3.2. Debt developments

According to the Draft Budgetary Plan, the general government gross debt ratio is expected to continue increasing until 2014. From 71.3% of GDP in 2012, it is projected to increase to 73.2% of GDP in 2014 due to the impact of interest expenditure and the stock-flow adjustment (in particular in 2013, on account of the planned equity injection into Air Malta).

The debt forecast is lower compared to the Stability Programme due to a downward revision of debt outturn in 2012 (by 0.8 pp. of GDP).

**Table 3. Debt developments**

(% of GDP)	2012	2013			2014		
		SP	DBP	COM	SP	DBP	COM
<b>Gross debt ratio<sup>1</sup></b>	<b>71.3</b>	<b>74.2</b>	<b>73.2</b>	<b>72.6</b>	<b>74.2</b>	<b>73.2</b>	<b>73.3</b>
Change in the ratio	1.8	2.9	1.9	1.3	0.0	0.0	0.8
<i>Contributions<sup>2</sup> :</i>							
<b>1. Primary balance</b>	<b>0.2</b>	<b>-0.5</b>	<b>-0.4</b>	<b>0.3</b>	<b>-1.1</b>	<b>-0.9</b>	<b>0.3</b>
<b>2. “Snow-ball” effect</b>	<b>1.1</b>	<b>0.9</b>	<b>0.6</b>	<b>0.4</b>	<b>0.5</b>	<b>0.3</b>	<b>0.2</b>
<i>Of which:</i>							
Interest expenditure	3.1	3.2	3.1	3.1	3.2	3.0	3.1
Growth effect	-0.5	-1.0	-0.8	-1.2	-1.1	-1.2	-1.3
Inflation effect	-1.5	-1.3	-1.7	-1.5	-1.5	-1.5	-1.6
<b>3. Stock-flow adjustment</b>	<b>0.6</b>	<b>2.5</b>	<b>1.7</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>	<b>0.3</b>
<i>Of which:</i>							
Cash/accruals difference		n.a.	n.a.		n.a.	n.a.	
Net accumulation of financial <i>of which privatisation             proceeds</i>		n.a.	n.a.		n.a.	n.a.	
Valuation effect & residual		n.a.	n.a.		n.a.	n.a.	

**Notes:**

<sup>1</sup> End of period.

<sup>2</sup> 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 effects.

**Source :**  
Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

According to the Commission 2013 Autumn Forecast, the debt ratio is projected to reach 73.3% of GDP by 2014. The difference compared to the DBP targets is due to the higher expected primary deficit, partly offset by a lower debt-increasing stock-flow adjustment in both years (reflecting also different assumptions regarding the impact of guarantees to EFSF disbursements, bilateral loans to Greece and capital contributions to the ESM). The same risks highlighted for the deficit targets apply to the debt projections of the Draft Budgetary Plan. Moreover, the government-guaranteed debt in Malta is high (17.4 % of GDP in 2012) compared to other Member States, 60% of which is accounted for by the public energy utility corporation (Enemalta).

### 3.3. Measures underpinning the Draft Budgetary Plan

The Draft Budgetary Plan presented on 15 October provides details on the measures implemented for 2012 and 2013, as well as the 2014 targets for revenue and expenditure by item, but does not provide sufficient details on the discretionary measures underpinning the 2014 budgetary targets.

In particular, the Draft Budgetary Plan announces expansionary measures on the expenditure side compensated by increases in indirect taxation and restrictions to recruitment, but for all the details it just refers to the forthcoming budget ("to be announced in the 2014 budget"). On

the revenue side, the measures (0.5% of GDP) are targeted at increasing indirect taxation as well as fees of office (reportedly coming from a new high net worth individual programme which will provide for the granting of citizenship to foreign individuals and families who contribute to the economic development of Malta; eligible persons will be required to pay a fee). 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. However, 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 as well as in related areas.

**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)	
	2013	2014
Taxes on production and imports	0.00	0.32
Current taxes on income, wealth, etc.	0.00	0.00
Capital taxes	0.00	0.00
Social contributions	0.00	0.00
Property Income	0.00	0.00
Other	0.00	0.20
<b>Total</b>	<b>0.00</b>	<b>0.53</b>
<u>Note:</u>		
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.		
<u>Source:</u> Draft Budgetary Plan		

**B. Discretionary measures taken by general Government- expenditure side**

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2013	2014
Compensation of employees	0.00	-0.07
Intermediate consumption	-0.30	0.00
Social payments	0.00	0.00
Interest Expenditure	0.00	0.00
Subsidies	0.00	0.00
Gross fixed capital formation	0.00	0.00
Capital transfers	0.00	0.00
Other	0.00	0.38
<b>Total</b>	<b>-0.30</b>	<b>0.31</b>
<u>Note:</u>		
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.		
<u>Source:</u> Draft Budgetary Plan		

#### 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 Art. 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 9 July, 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 specify and implement the measures needed to achieve the annual structural adjustment effort set out in the Council recommendations under the EDP in order to correct the excessive deficit by 2014 in a sustainable and growth-friendly manner, limiting recourse to one-off/temporary measures. After correcting the excessive deficit, pursue the structural adjustment effort at an appropriate pace so as to reach the MTO by 2019. Put in place a binding, rule-based multiannual fiscal framework in 2013. Ensure concrete delivery of measures taken to increase tax compliance and fight tax evasion, and take action to reduce the debt bias in corporate taxation.

Under the 2013 European Semester, the Council also recommended Malta to ensure the long-term sustainability of public finances. Overall, the authorities have presented plans that aim to address most of these recommendations, but not all of them have been put in place yet. Moreover, the information provided is often insufficient for a proper assessment of the potential impact of the planned measures.

##### **4.1. Compliance with EDP recommendations**

The government targets for the headline balance planned in the Draft Budgetary Plan in years 2013 and 2014 are well below the EDP targets (3.4% of GDP and 2.7% of GDP in 2013 and 2014 respectively). In addition, the recourse to one-off measures is projected to be limited, as requested by the fiscal country-specific recommendation published under the 2013 European Semester. However, according to the Commission 2013 Autumn Forecast, the fiscal effort stands at 0.3% of GDP. When 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, the adjusted change in the structural balance (0.5% of GDP) comes slightly short of the recommended annual structural effort (0.7% of GDP), thus highlighting the risk that the correction of the deficit may not be achieved, owing to the apparent lack of a sufficient effort to support it. These estimates will have to be reassessed against the data that will be notified in the spring 2014 notification.

By contrast, pending a full assessment of the 2014 budget, the headline deficit for 2014, according to the Commission deficit forecast, remains above the EDP target of 2.7% of GDP. Moreover, according to the Commission 2013 Autumn Forecast, the structural balance is projected to deteriorate by 0.1% of GDP in 2014. When 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, the change in the adjusted structural balance (0.4% of GDP) is still lower than the recommended annual fiscal effort (0.7% of GDP) in 2014. This conclusion is supported 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<sup>1</sup>, as the size of consolidation measures for 2014 is not in line with the one deemed necessary to reach the structural targets spelled out in the EDP recommendation. However, the projected deficit of 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. Taken at face value, the Draft Budgetary Plan would reduce the deficit by 0.2% of GDP. This would still be insufficient to achieve the EDP recommendation.

#### **4.2. Other considerations**

Under the 2013 European Semester, the Council also recommended (i) putting in place a binding, rule-based multiannual fiscal framework, (ii) ensuring concrete delivery of measures taken to increase tax compliance and fight tax evasion, (iii) taking action to reduce the debt bias in corporate taxation and (iv) ensuring the long-term sustainability of public finances. Overall, the authorities have presented plans that aim to address most of these recommendations, but not all of them have been put in place yet. Moreover, the information provided is often insufficient for a proper assessment of the potential impact of the planned measures.

On the reform of the fiscal framework, the government announced in its Draft Budgetary Plan the intention to introduce a rolling three-year framework that would specify expenditure commitments and include specific provisions to prevent overruns. Budget monitoring and evaluation are to be reinforced with a view to ensuring increased compliance with the budgetary targets as well as to avoid revenue shortfalls and slippages in expenditure targets. The reform is to be complemented with empowering the National Audit Office to act as an independent fiscal council. These proposals, based on the information available to the Commission at this stage, however, have not been presented/approved in the parliament yet. In addition, a structural balanced budget rule, as provided for in the Treaty on Stability, Coordination and Governance, has not yet been introduced in legislation.

In taxation, the authorities are carrying out a number of measures to reinforce the tax administration, including the merging of the revenue departments and the streamlining of procedures. These efforts should help increase tax compliance and fight tax evasion, but their impact is difficult to assess due to lack of information. In addition, no measures are currently planned to reduce the debt bias in corporate taxation.

As regards the long-term sustainability of public finances, decisive policy action is still missing. The authorities are putting in place measures to improve expenditure efficiency in the healthcare sector, but it is not yet clear what savings they can bring. As for the pension system, no concrete steps to improve its sustainability in the long term have been proposed.

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<sup>1</sup> 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.

## **5. ANALYSIS OF THE ECONOMIC PARTNERSHIP PROGRAMME (EPP)**

The Economic Partnership Programme lays out the main priorities for structural reforms to ensure the sustainability of public finances as well as tackle other key policy areas, going also beyond the CSRs. The presented measures are a mix of already existing measures and new ones that the government plans to put in place. The programme could be expected to contribute to a durable correction of the excessive deficit as well as to the creation of growth and jobs, while maintaining financial stability. In particular, the planned reform of the fiscal framework can be expected to strengthen fiscal governance, while a number of measures are being put in place to reinforce the public administration in ensuring tax compliance and fighting tax evasion. The non-fiscal structural reforms, which include comprehensive reforms of the judicial system and the diversification of energy sources, also appear to go in the right direction. 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.

## **6. SUMMARY**

The deficit targets set out in the Draft Budgetary Plan for 2013 and 2014 are below the deficit targets recommended in June under the EDP. Still, while so far the intermediate nominal target of the EDP recommendation for 2013 is within reach, the Commission forecast highlights the risk that the correction of the deficit may not be achieved, given a lower-than-recommended change in the adjusted structural effort. In addition, the Commission Forecast points to a headline deficit as well as a structural adjustment that are not in line with the final targets of the EDP recommendation for 2014. It must, however, be noted that the DBP presented by Malta does not specify in detail the measures that underpin the revenue and expenditure targets for 2014. In addition, some parts of the fiscal recommendations issued in the context of the 2013 European Semester to Malta have not yet been addressed while the reform of the fiscal framework still has to be introduced in legislation.

## Annex. EDP related tables

### Table A1. Baseline scenario underlying the EDP recommendation

<i>% of GDP</i>	2011	2012	2013	2014	2015	2016
Revenues	39.3	40.5	41.0	41.2	41.3	41.3
Current revenues	37.6	38.3	38.2	38.4	38.5	38.5
Discretionary measures with impact on current revenue (EUR bn)	0.6	0.8	-0.6	-0.3	-0.2	0.0
Expenditure	42.1	43.9	44.6	44.9	44.7	44.8
Real GDP growth (%)	1.7	0.8	1.4	1.8	1.8	2.2
Nominal GDP growth (%)	3.8	3.0	3.4	3.9	4.0	4.3
Potential GDP growth (%)	1.3	1.4	1.4	1.5	1.7	2.1
Structural balance	-3.6	-4.1	-3.8	-3.7	-3.5	-3.5
General government balance	-2.8	-3.3	-3.7	-3.6	-3.4	-3.4
<i>p.m CAB methodology revenue elasticity</i>	0.9	0.9	0.9	0.9	0.9	0.9
<i>p.m Apparent revenue elasticity</i>	1.7	1.7	0.9	1.1	1.0	1.0
<i>p.m Output gap (% of pot. Output)</i>	0.2	-0.3	-0.4	-0.1	-0.1	0.0
(1) Measures clearly specified and committed to by governments according to the 2013 Stability programme.						
(2) The standard revenue elasticity has been revised in line with the recently endorsed by EPC methodology for computing cyclically-adjusted balances.						
<i>Source: Commission Staff Working Document accompanying Recommendation for a COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit in Malta.</i>						

### Table A2. EDP scenario underlying the EDP recommendation

<i>% of GDP</i>	2012	2013	2014
Real GDP growth (%)	0.8	1.2	1.6
Potential GDP growth (%)	1.4	1.4	1.5
Structural balance	-4.2	-3.5	-2.7
General government balance	-3.3	-3.4	-2.7
<i>p.m Output gap (% of pot. output)</i>	-0.2	-0.4	-0.3
<i>Source: Commission Staff Working Document accompanying Recommendation for a COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit in Malta.</i>			

**Table A3. Current estimates of the macroeconomic and fiscal developments**

<i>% of GDP</i>	2012	2013	2014	2015
Revenues	40.1	41.0	41.0	41.0
Current revenues	37.9	38.2	38.2	38.2
Discretionary measures with impact on current revenue (EUR bn)	0.00	-0.05	0.02	0.00
Expenditure	43.4	44.5	44.3	44.5
Real GDP growth (%)	0.8	1.8	1.9	2.0
Nominal GDP growth (%)	3.1	4.1	4.2	4.4
Potential GDP growth (%)	1.5	1.4	1.2	1.1
Structural balance	-3.9	-3.5	-3.6	-4.1
General government balance	-3.3	-3.4	-3.4	-3.5
<i>p.m CAB methodology revenue elasticity</i>	<i>0.9</i>	<i>0.9</i>	<i>0.9</i>	<i>0.9</i>
<i>p.m Apparent revenue elasticity</i>	<i>1.6</i>	<i>1.2</i>	<i>1.0</i>	<i>1.0</i>
<i>p.m Output gap (% of pot. Output)</i>	<i>-0.9</i>	<i>-0.5</i>	<i>0.2</i>	<i>1.1</i>

*Source: Commission 2013 Autumn Forecast*

**Table A4. Adjustment of apparent structural effort for the revision in potential growth – details of calculation**

	Potential GDP growth underlying the Council Recommendation (%)	Potential GDP growth at the time of assessment (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient $\alpha$ (% of nominal potential GDP)
	(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
2013	1.4	1.4	0.1	43.3	0.0
2014	1.5	1.2	0.3	44.2	0.1

**Table A5. Adjustment of apparent structural effort for the unexpected revenue windfalls / shortfalls – details of calculation**

	Change in current revenues (yoy) (billions of national currency)		Discretionary current revenue measures (billions of national currency)		Nominal GDP growth assumptions (%)		Current revenues in year t-1 (billions of national currency)		Revenue gap (billion of national currency)*	Correction coefficient $\beta$ (% of nominal potential GDP)
	2013EDP	2013AF	2013EDP	2013AF	2013EDP	2013AF	2013EDP	2013AF		
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')	(5)=[(1')-(2')- $\epsilon$ *(3')*(4')]-[(1)-(2)- $\epsilon$ *(3)*(4)]	
2013	0.1	0.1	0.0	0.0	3.4	4.1	2.7	2.6	0.0	-0.1
2014	0.1	0.1	0.0	0.0	3.9	4.2	2.9	2.7	0.0	-0.4

\* Revenue elasticity  $\epsilon=0.86331252107741$