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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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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Malta

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Malta

1. INTRODUCTION

Malta submitted its Draft Budgetary Plan (DBP) for 2019 on 15 October 2018 in compliance with Regulation (EU) No 473/2013. Malta is subject to the preventive arm of the Stability and Growth Pact and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective (MTO).

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2018 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 2018 autumn 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 2018-2019 (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 in the context of the European Semester adopted by the Council in July 2018. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the DBP forecasts real GDP growth in 2018 to remain robust but to slow down to 5.8%, from 6.7% in 2017. Less dynamic economic activity in 2018 reflects a negative contribution from net exports, due to a rebound in imports and a slowdown in exports. Domestic demand is expected to be the main contributor to growth, with stronger household consumption and a slow recovery in investment. Real GDP growth is forecast to moderate further to 5.3% in 2019 as a recovery in imports offsets the projected rebound in investment, while private consumption is expected to decelerate. As a result, domestic demand is projected to remain the main contributor to growth also in 2019. This scenario presents a downward revision of the projections underpinning the 2018 Stability Programme (SP), which projected a more dynamic economic expansion in 2018 due to a higher contribution from the external sector.

The labour market outlook differs somewhat to the SP projections. The unemployment rate is forecast to be marginally higher, at 4.0% in 2018 and inching up to 4.1% in 2019. At the same time, employment growth is also projected to be higher, reaching 5.0% in 2018 and slowing down to 3.7% in 2019. Wage growth is projected to accelerate with respect to 2017, but at a slower pace compared to the SP projections. HICP inflation is expected to rise gradually to 1.7% in 2018 and further to 1.9% in 2019. This inflation path has been revised slightly up compared to the projections in the latest SP, due to higher services inflation in the first half of 2018.

Table 1. Comparison of macroeconomic developments and forecasts

	2017	2018			2019		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	6.7	6.1	5.8	5.4	5.3	5.3	4.9
Private consumption (% change)	3.7	4.4	5.6	5.2	3.8	4.1	3.8
Gross fixed capital formation (% change)	-7.3	4.2	1.3	1.6	10.0	8.4	8.2
Exports of goods and services (% change)	3.8	3.1	1.3	1.5	3.4	2.2	1.9
Imports of goods and services (% change)	-1.9	2.9	2.0	1.9	2.8	2.2	2.3
Contributions to real GDP growth:							
- Final domestic demand	0.4	5.4	5.4	5.1	4.2	5.0	4.9
- Change in inventories	-1.5	0.0	1.4	0.4	0.0	0.0	0.0
- Net exports	7.8	0.8	-1.0	-0.1	1.1	0.3	-0.1
Output gap[1]	1.5	1.1	1.1	0.9	0.1	1.0	0.4
Employment (% change)	5.2	3.8	5.0	5.0	3.5	3.7	3.6
Unemployment rate (%)	4.6	3.8	4.0	3.9	3.9	4.1	4.0
Labour productivity (% change)	1.4	2.1	0.8	0.4	1.7	1.4	1.3
HICP inflation (%)	1.3	1.6	1.7	1.8	1.8	1.9	1.9
GDP deflator (% change)	2.6	2.2	1.8	2.2	2.2	2.2	2.2
Comp. of employees (per head, % change)	1.7	3.2	2.9	2.3	3.2	2.9	3.2
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	14.3	13.6	10.4	12.9	16.2	14.6	12.0

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 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

The macroeconomic scenario underlying the DBP is more favourable than the Commission 2018 autumn forecast. The real GDP growth projections are higher in both years. In 2018, the main differences between the two scenarios are driven by domestic demand, since the lower contribution from net exports is offset by a higher contribution from the change in inventories according to the authorities. In 2019, net exports are expected to have a stronger positive contribution to growth according to the DBP. As a result, volatility in Malta's main export markets could pose a risk to the DBP's underlying macroeconomic scenario. The (recalculated) output gap in both 2018 and 2019 closes only marginally, while in the Commission forecast it declines at a faster pace.

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

The macroeconomic projections underlying the DBP have been endorsed by the Malta Fiscal Advisory Council (MFAC), an independent fiscal council established with the Fiscal Responsibility Act. The endorsement took the form of a letter addressed to the Minister of Finance and a report, published on the MFAC's website.[1] According to the MFAC, the DBP's macroeconomic scenario is plausible. In particular, the MFAC considers the full set of macroeconomic forecasts for 2018 and 2019 prepared by the Ministry for Finance as part of the DBP to lie within its endorsable range.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

In 2018, the DBP expects the headline surplus to decline sharply to 1.1% of GDP, after a surplus of 3.5% of GDP in 2017. This is in line with the target set in the SP, with some revisions in its composition and despite some changes in the fiscal and macroeconomic scenario. The government fiscal balance for 2017 has been revised downwards by 0.4% of GDP, from 3.9% to 3.5% of GDP, due to deferred income related to the International Investor Programme (IIP) and new data for the local government sector. This amount was re-allocated to revenue in the first two quarters of 2018. The macroeconomic projections were revised downwards, with lower but more job rich GDP growth in the DBP compared to the SP.

In the DBP, the proceeds related to the IIP have been revised upwards, following also the above-mentioned revision to the 2017 data, and are expected to reach 1.5% of GDP in 2018 (compared to 0.9% of GDP in the SP). The stronger-than-expected growth in private consumption is estimated to contribute to more buoyant indirect taxes. As a result, the DBP expects current revenue to be 0.3 percentage points of GDP higher compared to the SP. At the same time, compared to the SP, current expenditure is expected to be more dynamic, following also the renewal of wage agreements in some sectors (e.g. police, education and academic). While government investment net of EU funds is projected to be less dynamic, reflecting higher absorption of these funds in the second half of the year.

As a result, according to the DBP, the fiscal surplus in 2018 is expected to decline by 2.4 percentage points compared to the previous year. The decline is explained by several factors. Current taxes are expected to increase by 0.4 percentage points boosted by the favourable macroeconomic scenario, while the other current revenues are expected to decrease by 1.3 percentage points due mainly to lower proceeds from the IIP. Overall, current revenue are expected to decrease by 0.9 percentage points. At the same time, expenditure is expected to accelerate compared to the previous year, with current expenditure increasing by 0.4 percentage points and government investment net of EU funds by 1.1 percentage points, also on the back of the capital transfer to Air Malta (worth 0.5% of GDP).

The Commission 2018 autumn forecast projects the 2018 government surplus at 1.3% of GDP, which is 0.2 percentage points higher than the authorities' target. With regard to the main driving forces, the Commission projects lower nationally financed public investment, which is partly offset by a more dynamic growth of current expenditure.

[1] Publication available on https://mfac.org.mt/en/publications/Pages/Publications.aspx

For 2019, the DBP targets a slight increase of the surplus to 1.3% of GDP, which is 0.4 percentage points higher compared to the target set in the SP. In nominal terms, higher tax revenues and higher expected proceeds coming from the IIP (at 0.9% of GDP compared to the previous estimate of 0.7% of GDP) are accompanied by lower net capital expenditure. These revisions are partly offset by higher current expenditure. The revisions to revenue and expenditure components is also explained by both the more favourable scenario for private consumption and the labour market as well as the measures (with an expansionary impact of around 0.6% of GDP) included in the 2019 budget.

According to the DBP, in 2019 current revenues (in nominal terms) are projected to increase by 6.2% (less than nominal GDP growth) thus decreasing as a share of GDP (by 0.5 percentage points) as a result of the expected reduction in proceeds linked to the IIP compared to the previous year. Current expenditure[2] is projected to decelerate, increasing at a rate of 5.7%, and to decrease by 0.5 percentage points relative to GDP. Net capital expenditure is expected to decrease marginally, by 0.1 percentage points, thanks also to an expected increase in the absorption of EU funds and despite the end of the capital transfer into Air Malta.

The Commission 2018 autumn forecast projects the 2019 government surplus at 1.2% of GDP, 0.1 percentage point lower than the authorities' target. In addition, there are some differences in the composition. Higher current expenditure (mainly compensation of employees and social spending) is only partly compensated by lower spending for investment from national funds. Current revenues are only marginally lower in the Commission forecast compared to the DBP projection.

Risks related to the fiscal targets appear balanced. Current expenditure could be higher if budgetary execution turns out better than expected. On the other hand, given that a precise estimate of the expected revenue from the IIP has so far proven difficult to obtain, upside risks to the revenue projections exist. In addition, tax revenue may turn out more buoyant if employment growth surprises, pushing up households' consumption.

Euro-area sovereign bond yields remain at historically low levels, with 10-year rates in Malta currently standing at 1.52[3]. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. The decrease in interest expenditure is also due to the decrease in the general government debt level. Based on the information included in the DBP, interest expenditure in Malta is expected to fall from 1.8% of GDP in 2017 to 1.6% in 2018 and to decrease further next year to 1.5% of GDP, well below the 3.0% recorded in 2012 at the peak of the euro-area sovereign debt crisis. The picture stemming from Malta's plans is confirmed by the Commission forecast.

In structural terms[4], the government plans imply a sizeable decrease in the surplus in 2018, to 0.6% of GDP (from 3.1% in 2017) and a slight increase to 0.8% of GDP in 2019. Based on the Commission forecast, the structural balance is expected to stabilize at 0.9% of GDP in both years.

[2] The current expenditure projections for 2019 includes a contingency reserve of 0.1% of GDP (in line with the Fiscal Responsibility Act) that should be activated in case of unforeseen expenditure or revenue slippages in order to ensure compliance with the fiscal rules (while, if unused, it will be translated into additional savings).

[3] 10-year bond yields average in September 2018. Source: Eurostat.

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

Against the background of falling interest expenditure, the projected deterioration in the structural balance in 2017-19 (2.3 percentage points of GDP) is accompanied by a more pronounced deterioration in the structural primary balance (2.6 percentage points of GDP).

Table 2. Composition of the budgetary adjustment

(% of GDP)	2017	2018			2019			Change: 2017-2019
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**39.7**	**38.7**	***39.4***	**39.0**	**38.0**	***39.1***	**38.6**	**-0.6**
of which:								
- Taxes on production and imports	12.6	12.3	*12.7*	12.5	11.9	*12.5*	12.3	-0.1
- Current taxes on income, wealth, etc.	14.1	14.5	*14.5*	14.4	14.6	*15.0*	14.8	0.9
- Capital taxes	0.2	0.2	*0.2*	0.2	0.2	*0.2*	0.2	0.0
- Social contributions	6.3	6.3	*6.3*	6.3	6.2	*6.2*	6.2	-0.1
- Other (residual)	6.6	5.4	*5.7*	5.6	5.1	*5.2*	5.1	-1.4
Expenditure	**36.2**	**37.6**	**38.4**	**37.7**	**37.1**	**37.8**	**37.5**	**1.6**
of which:								
- Primary expenditure	34.3	36.0	36.8	36.1	35.7	36.3	36.0	2.0
of which:								
Compensation of employees	11.4	11.4	11.5	11.6	11.1	11.4	11.6	0.0
Intermediate consumption	6.5	6.7	6.9	6.9	6.7	6.9	7.0	0.4
Social payments	10.2	10.0	10.1	10.1	9.7	10.0	10.1	-0.2
Subsidies	1.3	1.2	1.4	1.4	1.2	1.4	1.4	0.1
Gross fixed capital formation	2.3	3.0	3.3	2.5	3.3	3.6	2.8	1.3
Other (residual)	2.7	3.7	3.6	3.6	3.7	3.0	3.2	0.3
- Interest expenditure	1.8	1.6	1.6	1.6	1.4	1.5	1.5	-0.3
General government balance (GGB)	**3.5**	**1.1**	**1.1**	**1.3**	**0.9**	**1.3**	**1.2**	**-2.2**
Primary balance	**5.4**	**2.7**	**2.7**	**2.9**	**2.4**	**2.7**	**2.6**	**-2.7**
One-off and other temporary measures	-0.3	0.1	0.0	0.0	0.1	0.0	0.1	0.3
GGB excl. one-offs	**3.8**	**1.0**	**1.1**	**1.3**	**0.9**	**1.3**	**1.1**	**-2.5**
Output gap[1]	1.5	1.1	1.1	0.9	0.1	1.0	0.4	-0.4
Cyclically-adjusted balance[1]	2.8	0.6	0.6	0.9	0.9	0.8	1.0	-2.1
Structural balance (SB)[2]	**3.1**	**0.5**	**0.6**	**0.9**	**0.8**	**0.8**	**0.9**	**-2.3**
Structural primary balance[2]	4.9	2.1	2.2	2.5	2.3	2.3	2.4	-2.7

Notes:

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

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

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

3.2. Debt developments

The general government debt-to-GDP ratio declined to 50.9% of GDP in 2017 thanks to favourable fiscal and macroeconomic developments and despite the debt-increasing stock-flow adjustment (amounting to 2.9% of GDP). The latter was related, among others, to the IIP revenues and cash buffer. In the DBP, the general government gross debt ratio is expected to decrease to 46.9% in 2018 and to decrease further by 3.1 percentage points of GDP in 2019, reaching 43.8% of GDP.

The stock-flow adjustment is projected to be lower in 2018 (0.8% of GDP) and to double in 2019 (1.6% of GDP). The lower stock-flow adjustment in 2018 is due to a negative balance in the sinking fund used to manage the debt.

Table 3. Debt developments

(% of GDP)	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**50.9**	**45.8**	**46.9**	**47.9**	**42.5**	**43.8**	**44.8**
Change in the ratio	-5.4	-5.1	-4.0	-3.0	-3.3	-3.1	-3.1
Contributions[2] :							
1. Primary balance	**-5.4**	**-2.7**	**-2.7**	**-2.9**	**-2.4**	**-2.7**	**-2.6**
2. "Snow-ball" effect	**-2.9**	**-2.3**	**-2.0**	**-2.0**	**-1.7**	**-1.9**	**-1.7**
Of which:							
Interest expenditure	1.8	1.6	1.6	1.6	1.4	1.5	1.5
Growth effect	-3.4	-2.9	-2.7	-2.6	-2.2	-2.3	-2.2
Inflation effect	-1.3	-1.0	-0.8	-1.0	-0.9	-1.0	-1.0
3. Stock-flow adjustment	**2.9**	**-0.1**	**0.7**	**1.9**	**0.8**	**1.6**	**1.3**

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 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

Compared to the SP, the DBP projects a lower reduction in the debt ratio, especially in 2018. In 2018, the DBP projects a lower contribution of nominal growth to the reduction of the debt. In 2019, compared to the SP, the lower debt reduction is mainly explained by the higher debt increasing stock flow adjustment, which is only partly compensated by the higher contribution to the debt reduction of both the primary surplus and the snow-ball effect.

According to the Commission forecast, the debt ratio is projected to decrease to 47.9% in 2018 and to decrease further to 44.8% of GDP in 2019. The difference compared to the DBP target in 2018, is explained by the higher stock-flow adjustment in the Commission forecast, which is in line with past values, a slightly lower primary surplus and a lower impact of inflation on the debt-to-GDP ratio. In 2019, the Commission forecasts a marginally lower primary surplus and a lower stock-flow adjustment.

The risks highlighted for the deficit targets also apply to the debt projections of the DBP. Moreover, compared to other Member States, the government guarantees provided by the central government on the debt of non-government units remains high in Malta. After having reached 16.6% of GDP in 2012, they have decreased to 15.8% of GDP in 2014 and further to 14.1% of GDP in 2016.

3.3. Measures underpinning the draft budgetary plan

The Maltese authorities presented the 2019 budget to the Parliament on 22 October 2018.

On the revenue side, according to the DBP the measures are expected to decrease the headline surplus by 0.2% of GDP. These include, among other measures, the negative impact on VAT revenue related to the directive on electronic commerce; the extension of the reduction of duty on documents for first time and second time buyers, for the acquisition of a property in Gozo as well as for people with disabilities; the introduction of fiscal incentives for contributions to private pensions as well as the revision in the income tax bands for lower income earners.

On the expenditure side, altogether, the budget measures are estimated to decrease the surplus by nearly 0.1% of GDP. The budget includes measures targeted at increasing pensions, including service pensions, while also extending the possibility to continue working beyond retirement age also to public sector employees; several social measures including an increase in the rate of children's allowance (so that beneficiaries earning the new increased minimum wage and low income families remain eligible to the maximum rate) and an increase in allowances for disability and children, the introduction of unemployment benefis for self employed individuals, an increase in the rate of medical assistance. In addition, an employment scheme targeted for Gozo and financial assistance to Gozitan employees, students and patients travelling or staying in Malta for work, study or medical visits.

Overall, the new measures included in the 2019 budget are estimated to reduce the fiscal surplus by around 0.3% of GDP.

In addition to these new measures described above, the DBP foresee the expansion of some measures introduced in the previous years, in particular the rent subsidy to address the high cost of rent, and the extension of the school transport network, with an expansionary impact of 0.2% of GDP.

Finally, the DBP projects expenditure financed by the National Development Social Fund to 0.1% of GDP which is split between public investments (¾) and other current expenditure (¼).

As a result, in total the measures described above are estimated to have a net surplus-decreasing impact of around 0.6% of GDP, which is plausible.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2018	**2019**	**2020**
Taxes on production and	-0.1	-0.1	0.0
Current taxes on income,	-0.1	0.0	0.0
Capital taxes			
Social contributions	0.0	0.0	0.0
Property Income			
Other	-0.7	-0.6	-0.2
Total	-0.8	-0.7	-0.1

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.

The table includes also the impact of measures that were introduced in past years.

Source: Draft Budgetary Plan for 2019

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2018	**2019**	**2020**
Compensation of employees	0	0.0	0
Intermediate consumption	0.24	0.0	0
Social payments	-0.08	-0.2	0.03
Interest Expenditure			
Subsidies	0	0.0	0
Gross fixed capital formation	-0.05	-0.1	-0.02
Capital transfers	0	0.0	0.04
Other	-0.13	0.1	-0.1
Total	-0.02	-0.24	-0.05

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.

The table includes also the impact of measures that were introduced in past years.

Source: Draft Budgetary Plan for 2019

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

4.1. Compliance with the MTO

Malta is subject to the preventive arm of the Stability and Growth Pact. The general government balance posted a surplus of 3.5% of GDP in 2017 and it is expected to remain in surplus throughout the DBP period. This is confirmed by the Commission forecast for the years 2018 and 2019.

Malta's structural balance reached a surplus of 3.1% of GDP in 2017, well above its medium-term objective of a balanced budgetary position in structural terms. The improvement in the fiscal position has largely benefitted from the revenue related to a particular budget measure, namely the IIP which increased revenue by 4.5% of GDP over the period 2014-17. Nevertheless, when removing the IIP revenue, the structural balance would still remain in surplus in 2017.

In 2018, according to the information provided in the DBP, the (recalculated) structural balance is expected to stand at 0.6% of GDP, that is above the MTO of a balanced budgetary position in structural terms. This is broadly in line with the Commission forecast. Therefore, this points to compliance with the provisions of the SGP in 2018, which is also confirmed by the Commission forecast.

In 2019, according to the DBP, at face value, the (recalculated) structural balance is set to increase by 0.2 percentage points and to reach a surplus of 0.8% of GDP, thus remaining above the MTO. This points to compliance with the provisions of the SGP in 2019, which is also confirmed by the Commission forecast.

Table 5 flags some large deviations in red since these figures are based on a much lower structural surplus in 2017 than currently estimated: 0.6% of GDP projected in the Commission autumn 2017 forecast as against 3.1% of GDP projected in the Commission autumn 2018 forecast. Thanks to this higher starting position in structural terms in 2017, Malta is currently expected to remain above its MTO in 2018 and 2019 despite the large structural deterioration projected in 2018.

At the same time, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible risks to the resilience of revenues going forward.

According to the DBP, as well as the Commission forecast, the debt-to-GDP ratio, which in 2017 was below the 60%-of-GDP threshold, is expected to remain below that threshold and to decrease further over the programme horizon.

Following an assessment based on the DBP, the compliance with the MTO seems in line with the requirements of the preventive arm of the Pact in both 2018 and 2019. The Commission 2018 autumn forecast confirms this assessment in both years.

Table 5: Compliance with the requirements of the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	0.0	0.0		0.0	
Structural balance[2] (COM)	3.1	0.9		0.9	
Structural balance based on freezing (COM)	0.6	0.9		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.0		0.0	
Required adjustment corrected[5]	-0.8	-0.6		-0.9	
Change in structural balance[6]	3.0	-2.6	-2.2	0.2	0.1
One-year deviation from the required adjustment [7]	3.8	-2.0	-1.6	1.1	0.9
Two-year average deviation from the required adjustment [7]	3.1	0.9	1.1	-0.4	-0.4
Expenditure benchmark pillar					
Applicable reference rate[8]	5.5	8.3		10.1	
One-year deviation adjusted for one-offs [9]	1.0	-2.4	-2.4	0.5	0.5
Two-year average deviation adjusted for one-offs [9]	1.1	-0.7	-0.7	-0.9	-0.9

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 38.).

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

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2017) was carried out on the basis of Commission 2018 spring forecast.

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

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

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

Source :

Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations.

5. Composition of public finances and Implementation of fiscal structural reforms

The budget balance is planned to decrease from a surplus of 3.5% of GDP in 2017 to a surplus of 1.3% of GDP in 2019. The exceptional high surplus in 2017 was the result of a high growth rate of current revenue as well as higher-than-expected proceeds from the IIP. Tax revenue growth is expected to slowdown somewhat, following the moderation in the macroeconomic scenario, but to remain quite dynamic. Also revenue related to the IIP are expected to decrease in comparison to the peak reached in 2017 (2.2% of GDP) to 1.5% of GDP in 2018 and to stabilize at around 0.9% of GDP in 2019. In addition, in the period considered, several measures have been introduced to increase indirect taxation (in particular excise duties on products that are dangerous for health and the environment), to support small and medium enterprises (by introducing a VAT exemption threshold) and to exempt/reduce duties on documents for first time and second time buyers, and to decrease direct taxation (in particular tax rebate for pensioners and low income earners, tax credit for education, and fiscal incentives for private pensions). As a result, current revenues are expected to decrease by 1.4 percentage points of GDP in the period 2017-19.

On the expenditure side, current expenditure is expected to decrease only marginally in the period 2017-19. The decrease in interest expenditure and social spending is mainly offset by higher intermediate consumption. Public investment and other capital expenditures, starting from a very low level in 2017, are expected to increase by 1.7 percentage points of GDP until 2019, due to both a pick up in the absorption of EU funds as a result of the start of a new programming period, and an increase in investment financed by national resources. It should also be noted that other capital expenditures include a non-recurrent capital transfer in 2018 to Air Malta.

The Council Recommendation addressed to Malta under the European Semester on 13 July 2018[5] recommended Malta to ensure the sustainability of the healthcare and the pension system, including by increasing the statutory retirement age and by restricting early retirement. The DBP also reports the relevant measures in the areas of healthcare and pensions.

In the area of healthcare, two relevant initiatives are ongoing to strenghten primary care. The first is the establishment of the Southern Regional Hub by 2023, which will serve as a one-stop facility for community care and will offer specialised care for several prevalent diseases. The second initiative is the introduction of the electronic patient record system, by 2020, by the Primary Care Services. The new system will replace the current paper-based methodology and it is expected to enhance continuity of care and coordination between primary and secondary care. While both initiatives seem to go in the right direction by reducing pressure on hospital care, their concrete impact on public health expenditure will have to be assessed.

In the area of sustainability of the pension system, during 2018 a Pension Strategy Group[6] was established, tasked with the preparations for the 2020 Strategic Review. A report is expected by December 2020, outlining recommendations for achieving adequacy and sustainability of the pension system. In addition, efforts are continuing to diversifying

[5] Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of Malta and delivering a Council opinion on the 2018 Stability Programme of Malta (OJ C 320, 10.9.2018, p. 76–79).

[6] The Strategy Group builds on Recommendation 62B of the Social Security Act, which asks for a strategic review every five years on the adequacy, sustainability and solidarity of the pension system, which should be complemented by a bi-partisan technical pension commission.

retirement income and reducing dependency on state pensions. Personal private pensions schemes were launched in 2015 together with tax incentives. The 2019 budget strenghtens the fiscal incentives for private pension savings and volountary occupational retirement pensions. Other measures concern the strenghtening of financial literacy: a Strategy on Retirement and Financial Capability launched in January 2017 with a number of initiatives underway; several conferences organised by the Malta Stock Exchange (MSE) in 2015 and 2017; and the promotion of financial education throught the MSE Institute. A first assessment of these initiatives points to very little or no impact on the sustainability of the pension system, while possibly contributing to increase non-pension income.

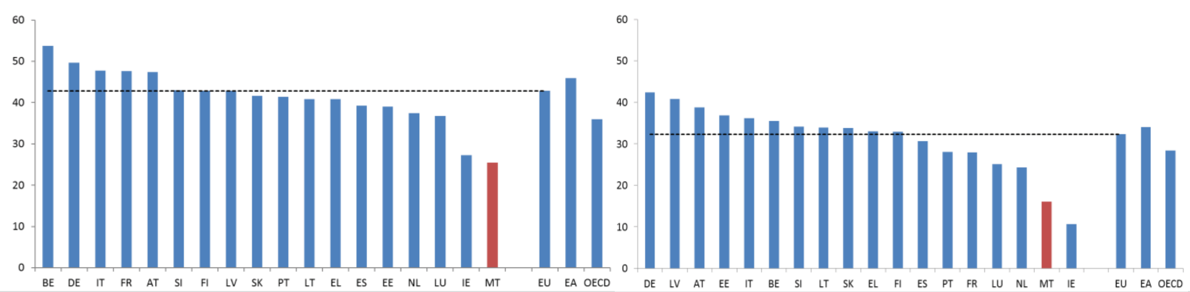
Overall, according to a preliminary assessment, the above-mentioned measures seem to have no impact on the sustainability of the healthcare and the pension system. A comprehensive assessment of progress made in the implementation of the country-specific recommendations will be made in the 2019 Country Report and in the context of the country-specific recommendations to be proposed by the Commission in May 2019.

Box 2 – Addressing the tax burden on labour in the euro area

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

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

The tax burden on labour in Malta at the average wage and a low wage (2017)



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

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

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

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

The 2019 budget includes several social measures. These measures continue to build on distributional policies enacted in recent years with the aim of strenghtening social cohesion and social justice, whilst supporting the appropriate conditions for the economy to continue growing and creating jobes. In particular these measures are targeted at increasing the disposable income of low and middle-income earners, families with children, sustaining affordable housing and reducing the risk of poverty amongst elderly by ehancing their income and supporting the provision of long-term care. Their budgetary impact is estimated at around 0.1% of GDP, fully financed with a reduction of the fiscal surplus.

The DBP also reports on the latest developments regarding the ongoing comprehensive spending reviews[7], which started in 2014 and have so far covered the areas of social security, health, education and the Management and Efficiency Unit. The process of institutionalising the comprehensive spending reviews has started through assistance from the Structural Reform Support Programme. In 2018, a Directorate was set up within the Budgetary Affairs Division that was tasked with the planning and coordination of reviews in collaboration with the respective ministry, department, entity or cost centre. Draft operational guidelines have been formulated and a training programme has been set up, with around 50 officials from various ministries to be trained.

6. OVERALL CONCLUSION

Following an overall assessment of the DBP for 2019, the planned structural adjustment is in line with the compliance with the MTO in both 2018 and 2019. The Commission 2018 autumn forecast confirms the assessment of compliance in both years.

[7] The Council Recommendation addressed to Malta under the European Semester on 11 July 2017 recommended Malta to expand the scope of the ongoing spending reviews to the broader public sector and to introduce performance-based public spending.