Brussels, 16.11.2016
C(2016) 8013 final

COMMISSION OPINION

of 16.11.2016

on the Draft Budgetary Plan of Malta
COMMISSION OPINION
of 16.11.2016
on the Draft Budgetary Plan of Malta

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 DBP 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 (DBP) for 2017 submitted on 17 October 2016 by Malta, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Commission opinion is to be seen in light of the latest economic and budgetary data. In this context, as indicated in the Commission recommendation for a Council Recommendation on the economic policy of the euro area as well as in the Commission Communication 'Towards a positive fiscal stance for the euro area', it is important that the aggregate fiscal stance of the euro area is positive and supports the ongoing recovery, while ensuring the long-term sustainability of national public finances.

5. Malta is subject to the preventive arm of the SGP and should ensure sufficient progress towards its medium term budgetary objective (MTO) of a structural balance of 0% of GDP. In particular, the Council on 12 July 2016 recommended Malta to achieve an annual fiscal adjustment of 0.6% of GDP towards the MTO in both 2016 and 2017. As the debt ratio was 64% of GDP in 2015 Malta must also comply with the debt reduction benchmark.

6. The Draft Budgetary Plan’s macroeconomic scenario appears plausible for 2016 and 2017, albeit with some differences in terms of the main drivers of growth compared to the Commission 2016 autumn forecast. The macroeconomic scenario underlying the Draft Budgetary Plan projects a slowdown in real GDP growth from the peak of 6.2% in 2015 to 3.9% in 2016. GDP growth is expected to decelerate further to 3.5% in 2017. Compared to the 2016 Stability Programme, the projection for real GDP growth underlying the Draft Budgetary Plan has been revised downwards (from 4.2%) for 2016 due to weaker external demand and upwards for 2017 (from 3.1%) due to stronger domestic demand. The Commission 2016 autumn forecast projects real GDP growth of 4.1% in 2016 and 3.7% in 2017, broadly in line with the Draft Budgetary Plan. Inflation is expected to decline to 1.0% in 2016 and to rise to 1.5% in 2017 according to the Draft Budgetary Plan. That path, which is in line with the Commission 2016 autumn forecast, has been revised down compared to the projections in the latest Stability Programme. Upside risks to those projections could
come from stronger private consumption, in view of the favourable labour market outlook.

7. Malta complies with the requirement of Regulation (EU) No 473/2013 that the draft budget must be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the Malta Fiscal Advisory Council. In its endorsement of the forecasts the Malta Fiscal Advisory Council flagged that the macroeconomic scenario is generally cautious and plausible, highlighting that risks to the scenario appear broadly balanced and are linked with the ability of private consumption to maintain its momentum, the materialisation of planned investment projects and the economic developments in main trading partners. The independent status and tasks of the Fiscal Advisory Council are provided for in the Fiscal Responsibility Act.

8. The Draft Budgetary Plan confirms the 2016 deficit target of 0.7% of GDP set in the 2016 Stability Programme, while targeting a slightly lower headline deficit for 2017, at 0.5% of GDP, compared to 0.6% of GDP in the 2016 Stability Programme. However, in nominal terms, both revenue and expenditure have been revised upwards for 2017 following an upward revision in the expected proceeds related to the Individual Investor Programme and the additional measures included in the 2017 budget, which have an expansionary impact. Overall, both revenue and expenditure are expected to contribute to the deficit reduction in 2016 and 2017. In structural terms, the government plans imply an improvement in the recalculated balance amounting to more than 1 percentage point of GDP in 2016 and ¾ percentage points of GDP in 2017, above the improvement expected in SP, due also to a revision in the one-off measures. It should be noted that the national authorities have included the costs related to the presidency of the Council of the EU as one-off measures, amounting to 0.2% and 0.3% of GDP in 2016 and 2017 respectively, which is not in line with the classification principles used by the Commission in fiscal surveillance. Considering that expenditure as structural, the pace of adjustment to the MTO is slightly lower in both 2016 and 2017 (by 0.2 percentage points and 0.1 percentage points of GDP respectively) and more in line with what was estimated in the Commission 2016 autumn forecast. In the Draft Budgetary Plan, the general government gross debt ratio is expected to decrease to 63.3% in 2016 from 64% in 2015. It is then expected to decrease further by 1.4 percentage points of GDP in 2017, reaching 61.9% of GDP.

Based on the information included in the Draft Budgetary Plan, interest expenditure in Malta is expected to fall from 2.6% of GDP in 2015 to 2.3% in 2016 and is projected to decrease further next year, to 2.1% of GDP. Against the background of falling interest expenditure, the projected improvement in the structural balance in 2016-17 (1.1 percentage points and 0.8 percentage points, respectively) is accompanied by a less pronounced improvement in the structural primary balance (0.8 percentage points and 0.6 percentage points, respectively).

9. The government’s 2017 budget includes measures which are estimated to have a net deficit-increasing impact of 0.3% of GDP. The revenue measures, with a net decreasing impact on the deficit of 0.1% of GDP, include the increase of excise duties on goods which are harmful to health and the environment and the granting of a partial one-year concession on stamp duty for the transfer of business from parents.

---

1 European Commission (2015), ‘One-offs measure – Classification principles used in fiscal surveillance’, Report on Public Finances in EMU.
to their children, partly offset by the gradual introduction over the next two years of a tax exemption on pension income and the extension of the stamp duty exemption for first-time buyers. On the expenditure side, the measures are estimated to increase the deficit by nearly 0.5% of GDP. They include several social measures addressing in particular social inequality and pro-actively targeting those in/at risk of poverty, with a particular emphasis on low income brackets and pensioners, and the use of part of the National Development Social Fund for both public investments and other current expenditure, and a compensation payment.

10. The Commission 2016 autumn forecast projects the 2016 deficit at 0.7% of GDP. While the headline deficit is in line with the authorities’ target, the composition is somewhat different. The Commission projects lower public investment which is offset by lower current revenue matched by a more dynamic growth of current expenditure and higher capital subsidies. The Commission 2016 autumn forecast projects the 2017 deficit at 0.6% of GDP. The 0.1 percentage points of GDP difference with the authorities’ target is due to more dynamic current expenditure and lower revenue related to other current transfers receivables and market output which is only partly compensated by more buoyant income taxes and lower net capital expenditure. In particular, the Commission envisages a higher absorption of EU funds and higher spending for capital subsidies. Risks to the deficit targets are mainly linked to slippages in intermediate consumption as well as expenditures for State owned-enterprises, namely Enemalta and Air Malta, which could require additional subsidies. On the other hand, current revenue could turn out more buoyant than expected due to a more favourable economic environment and higher proceeds coming from the citizenship programme. According to the Commission forecast, the debt ratio is projected to decrease to 62.1% in 2016 and to fall somewhat below the 60%-of-GDP threshold already in 2017. The difference compared to the Draft Budgetary Plan targets, is mainly explained by the lower stock-flow adjustment in the Commission forecast. The Commission also forecasts a slightly lower primary surplus and a lower impact of inflation on the debt-to-GDP ratio.

11. The Draft Budgetary Plan does not include sufficient information to assess compliance with the debt reduction benchmark. Based on the Commission 2016 autumn forecast, the projected structural improvement would allow the debt reduction benchmark to be met in 2016. The debt is projected to decrease below the 60%-of-GDP threshold in 2017.

12. According to the Draft Budgetary Plan, in 2016 both the structural balance and the expenditure benchmark point to compliance with the required adjustment towards the MTO. However, over the two years 2015-2016, while the structural balance points to compliance, the expenditure benchmark points to some deviation from the required adjustment towards the MTO. That situation warrants an overall assessment. On the one hand, the structural balance excludes the costs related to the Maltese presidency of the Council of the EU amounting to 0.2% of GDP in 2016. On the other hand, the structural balance seems negatively impacted by sizeable revenue shortfalls. Moreover, the development of public investment is decreasing the effort indicated by the structural balance. Taking those elements into account, the structural balance pillar would point to compliance with the required adjustment towards the MTO. However, the expenditure benchmark indicator seems to be a more appropriate indicator in the case of Malta at the current juncture, as it makes use of a more stable estimate of medium-term potential growth. On average, over the years 2015 and 2016, the fiscal effort measured by the expenditure benchmark is negatively
impacted by one-off measures (both on the revenue and the expenditure side), which account for around 0.3 percentage points of the deviation on average over those years. Correcting for it, the expenditure benchmark would point to compliance over 2015 and 2016 taken together, as the slippage in 2015 is expected to be compensated for in 2016. As a result, the overall assessment points to compliance with the adjustment path towards the MTO over 2015 and 2016 taken together. The overall assessment based on the Commission 2016 autumn forecast confirms that the adjustment appears compliant with the required adjustment towards the MTO over 2015 and 2016 taken together.

In 2017, according to the Draft Budgetary Plan, the projected 0.8% of GDP improvement in the recalculated structural balance points to compliance, while the growth rate of government expenditure net of discretionary revenue measures is projected to exceed the applicable expenditure benchmark rate, pointing to a risk of some deviation from the required adjustment towards the MTO. When including the costs related to the Maltese presidency of the Council of the EU (amounting to 0.3% of GDP) and taking into account the revenue shortfalls, the structural balance would still point to compliance in 2017. Nevertheless, the expenditure benchmark appears to be a more suitable indicator in view of a more stable estimate of medium-term potential growth rate. As a result, the overall assessment based on the Draft Budgetary Plan would point to a risk of some deviation in 2017. The overall assessment based on the Commission 2016 autumn forecast confirms that there is a risk of some deviation from the required 0.6% of GDP adjustment towards the MTO in 2017.

13. The Draft Budgetary Plan reports on the initiatives to address the fiscal structural country specific recommendations, although no new elements are reported compared to the situation in spring. In particular, in the area of pension reform, some measures were introduced already with the 2016 budget, targeted at addressing sustainability and adequacy. A full assessment of those measures, which entered into force in March 2016, is still pending. However, an initial assessment indicates that the measures to achieve sustainability may be fully offset by those aimed at ensuring adequacy. In addition, the 2017 budget introduced a number of measures targeted at increasing pension income. Policy action to improve the financial sustainability of the healthcare system is ongoing. However, it is uncertain whether these measures are sufficient to cope with the challenge of long-term sustainability. An estimate of their potential impact to be incorporated into the long-term budgetary projections is still missing. Malta’s Draft Budgetary Plan does not include any measure affecting the tax wedge on labour.

14. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Malta, which is currently under the preventive arm and subject to the debt rule is broadly compliant with the provisions of the SGP. In line with the Commission Communication 'Towards a positive fiscal stance for the euro area', the Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2017 budget will be compliant with the SGP.

The Commission is also of the opinion that Malta has made no progress with regard to the structural part of the fiscal country-specific recommendations issued by the Council in the context of the 2016 European Semester and thus invites the authorities to accelerate progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2017
Country Reports and in the context of the country-specific recommendations to be adopted by the Council in 2017.

Done at Brussels, 16.11.2016

For the Commission
Pierre MOSCOVICI
Member of the Commission