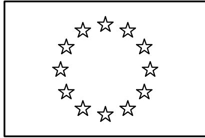

COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION

Malta

Report prepared in accordance with Article 104(3) of the Treaty

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1. The application of the Stability and Growth Pact in the current crisis situation

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which impact on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to prepare a report such as the present one whenever the deficit of a Member State exceeds the 3% of GDP reference value. This report, which represents the first step in the "excessive deficit procedure" (EDP), analyses the reasons for the breach of the reference value with due regard to the economic background and all other relevant factors. The amendments to the Stability and Growth Pact in 2005 aimed specifically at ensuring that in particular the economic and budgetary background was fully taken into account in all steps in the EDP. This means for instance that, if an "excessive deficit" is deemed to exist, adequate attention needs to be paid to the economic background and outlook when making recommendations on the pace of the correction. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation, thereby ensuring long-term sustainability of public finances.

2. LEGAL BACKGROUND

This report, which assesses recent and current budgetary developments in Malta and reviews the short- and medium-term prospects in the light of overall economic conditions and policy action taken by the government, is prepared according to Article 104(3) of the Treaty.

Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[1], which is part of the Stability and Growth Pact. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

Immediately after accession to the EU, an EDP for Malta was initiated in May 2004 with the Commission's adoption of a report under Article 104(3) based on a general government deficit of close to 10% of GDP and general government gross debt of 72% of GDP in 2003[2]. In July 2004, the Council decided that Malta was in excessive deficit according to Article 104(6) and addressed recommendations to Malta under Article 104(7) with a view to bringing the situation of an excessive government deficit to an end by 2006, at the latest. In May 2007, the Council abrogated its decision on the existence of an excessive deficit according to Article 104(12). This was based on a decline in the deficit from close to 10% of GDP in 2003 to 2.6% of GDP in 2006, i.e. below the 3% of GDP reference value, while the Commission services' spring 2007 forecast projected a further fall to 2.1% of GDP in 2007 and 1.6% in 2008. Government debt was seen to have declined from a peak of some 74% of GDP in 2004 to 66½% in 2006[3], while the

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[1] OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005, available at http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

[2] The EDP-related documents for Malta can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2

[3] In the meantime, these figures have been revised to 72.2% of GDP in 2004 and 63.7% in 2006.

Commission services' spring 2007 forecast projected a further fall to around 64¼% by the end of 2008, thus coming closer to the 60 % of GDP reference value.

On 18 February 2009, the Commission reopened the EDP for Malta with the adoption of a report under Article 104(3) based on a planned deficit of 3.3% of GDP in 2008 and gross debt of 63.8% of GDP according to data notified by the authorities in September 2008[4,5]. The report highlighted that, while the excess of the deficit over the reference value was small but not exceptional, it was likely to be temporary as the Commission services' January 2009 interim forecast projected the deficit to already return below 3% of GDP in 2009 and to further decline in 2010. The report also noted that, in view of the significant decline in the general government debt during the period 2004-2007, and despite the projected increase in the debt ratio over the forecast horizon in the Commission services' January 2009 forecast, the debt ratio, from a medium-term perspective, could be considered as "sufficiently diminishing and approaching the reference value at a satisfactory pace" in the sense of the Treaty and the Stability and Growth Pact. This analysis suggested that the deficit criterion was not fulfilled while the debt criterion was. Given that the deficit satisfied the double condition of closeness and temporariness, the report, in line with the Treaty, also examined other relevant factors, which on balance were relatively favourable. Taking into account also the opinion of the Economic and Financial Committee in accordance with Article 104(4), which was consistent with the assessment in the Commission report, it was concluded that no further steps under the excessive deficit procedure were necessary at that time.

According to data notified by the authorities in March 2009 and subsequently validated by Eurostat[6], the general government deficit in Malta was revised upward to 4.7% of GDP in 2008, thus largely exceeding the 3% of GDP reference value, while general government gross debt stood at 64.1% of GDP, above the 60% of GDP reference value but considerably lower than the 2004 peak of 72%.

Table 1: General government deficit and debt [a]

	2003	2004	2005	2006	2007	2008	2009	2010
General government balance	-9.8	-4.7	-2.9	-2.6	-2.2	-4.7	-3.6	-3.2
General government gross debt	69.3	72.2	69.8	63.7	62.1	64.1	67.0	68.9

Note:

[a] In percent of GDP.

Source: Eurostat and Commission services' spring 2009 forecasts.

[4] According to Council Regulation (EC) No 3605/93, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Malta can be found at: http://epp.eurostat.ec.europa.eu/portal/page?_pageid=2373,58110711&_dad=portal&_schema=portal.

[5] Subsequently, in the budget for 2009 presented on 3 November 2008, and confirmed in the December 2008 update of the stability programme, the planned deficit for 2008 was confirmed at 3.3% of GDP, while debt was planned at 62.8% of GDP.

[6] Eurostat news release No 56/2009 of 22 April 2009.

The figures for the deficit and debt in 2008 provide *prima facie* evidence on the existence of an excessive deficit in Malta in the sense of the Treaty and the Stability and Growth Pact. The Commission has therefore decided to initiate the excessive deficit procedure for Malta with the adoption of this report. Section 2 of the report examines the deficit criterion and Section 3 the debt criterion. Section 4 deals with public investment and other relevant factors. The report takes into account the Commission services' spring 2009 forecasts, released on 4 May.

3. DEFICIT CRITERION

In 2008, the general government deficit reached 4.7% of GDP.

Well in excess of 3% of GDP, the deficit is <u>not close</u> to the Treaty reference value.

The excess over the 3% of GDP reference value <u>cannot</u> be regarded as <u>exceptional</u>. In particular:

- it does not result from an unusual event in the sense of the Treaty and the Stability and Growth Pact. This definition is to be applied narrowly to cover events such as wars or natural disasters;

- it does not result from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. Real GDP growth between 2005 and 2007 was above 3% annually, significantly higher than potential growth. Economic growth slowed down in 2008, but remained positive at 1.6%. Looking forward, according the Commission services' spring 2009 forecast GDP growth in 2009 is projected to contract by 0.9% but is expected to recover slightly to 0.2% in 2010. The positive output gap since 2007 is estimated to turn slightly negative in 2009 and widen further in 2010. Therefore, the excess over the 3% of GDP limit is not the result of a severe economic downturn, which in the sense of the Treaty would have to precede the breach of the reference value.

Table 2: Macroeconomic and budgetary developments [a]

	2003	2004	2005	2006	2007	2008	2009	2010
Real GDP (% change)	-0.3	1.3	3.7	3.2	3.6	1.6	-0.9	0.2
Potential GDP (% change)	2.2	1.9	1.8	1.8	2.0	1.1	1.1	1.1
Output gap (% of potential GDP)	-2.7	-3.4	-1.5	-0.2	1.4	1.8	-0.2	-1.1
General government balance	-9.8	-4.7	-2.9	-2.6	-2.2	-4.7	-3.6	-3.2
Primary balance	-6.4	-1.1	0.8	1.0	1.1	-1.4	-0.2	0.4
One-off and other temporary measures	-3.1	2.3	1.6	0.7	0.6	-0.5	0.1	0.0
Government gross fixed capital formation	4.7	3.9	4.9	4.1	4.0	2.7	3.4	3.4
Cyclically-adjusted balance	-8.9	-3.5	-2.3	-2.5	-2.7	-5.4	-3.6	-2.8
Cyclically-adjusted primary balance	-5.5	0.1	-2.3	1.0	0.7	-2.0	-0.1	0.7
Structural balance [b]	-5.8	-5.9	-3.9	-3.1	-3.3	-4.9	-3.6	-2.8
Structural primary balance	-2.4	-2.2	-0.2	0.4	0.0	-1.6	-0.2	0.7

Notes:

[a] In percent of GDP unless specified otherwise.

[b] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Eurostat and Commission services' spring 2009 forecasts.

The increase in the headline deficit in 2008 compared to the 2007 outturn was expenditure-led and mainly reflected the following factors. First, a reclassification of Malta Shipyards Ltd. into general government resulted in an increase in government consumption expenditure of 1.3% of GDP.[7] Another factor consisted of a deficit-increasing one-off cost of 0.8% of GDP related to early retirement schemes given to Malta Shipyards Ltd. employees. Tax revenue and social contributions, particularly between November 2008 and February 2009, have been weak, as businesses facing short-term liquidity problems delayed the payment of taxes[8]. While overall revenues increased marginally as a percent of GDP compared to 2007, current taxes as a ratio to GDP fell by 0.2 percentage points in 2008. The decision to keep utility rates unchanged during the first half of the year was another development burdening the budget in 2008.

The excess over the 3% of GDP reference value is not temporary in the sense of the Treaty and the Stability and Growth Pact. According to the Commission services' spring 2009 forecast, the deficit ratio is projected to decline but remain above the threshold at 3.6% of GDP[9] in 2009. This projection takes into account the disappearance of the bulk

7 Netting out the sales of Malta Shipyards Ltd., which are booked under revenue, the impact of the re-classification on general government deficit amounts to 0.4% of GDP.

8 Malta follows the time-adjustment method of recording taxes and social contributions whereby the 12-month period for recording revenue is March-February.

9 The Commission services' spring 2009 forecast is based on a prudent assumption that 20% of the delayed tax and social contributions in 2008 will be recovered in 2009, while another 30% in 2010.

of the one-off transaction mentioned above[10], the liquidation of the Malta Shipyards Ltd. expected to occur in the course of the year, the reduction in subsidies as a result of the government's decision to eliminate energy subsidies to households and the revenue-increasing measures announced in the 2009 budget. The March 2009 fiscal notification sets a budgetary target of 1.5% of GDP for 2009, which is unchanged from that in the December 2008 update of the stability programme and thus based on an outdated macroeconomic scenario. Under the customary no-policy-change assumption, the Commission services project the general government deficit to decline further to 3.2% of GDP in 2010.

In sum, the deficit is not close to the 3% of GDP reference value and the excess over the reference value is neither exceptional nor temporary in the sense of the Treaty and the Stability and Growth Pact. This analysis suggests that the deficit criterion in the Treaty is not fulfilled.

4. DEBT CRITERION

In 2008, general government gross debt was 64.1% of GDP, above the 60% of GDP Treaty reference value. This represents a reversal in the downward trend registered between 2004 and 2007. During this period, the debt-to-GDP ratio declined by some 10 percentage points from a peak of 72.2% of GDP in 2004 to 62.1% in 2007. Around half of this decline was accounted for by stock-flow adjustments and mainly reflected privatisation receipts in view of the government's policy to divest non-core public entities. A relatively strong economic performance and a growing primary surplus also contributed to the falling debt ratio. The debt ratio jumped to slightly above 64% of GDP in 2008 primarily reflecting the deterioration in the primary balance and weaker economic growth. The reclassification of Malta Shipyards Ltd. with the general government sector added ¼% of GDP in gross debt. According to the Commission services' spring 2009 forecast, the expected weakening of nominal GDP growth in 2009 and 2010 and the continued primary deficit in 2009 are projected to result in a rising general government debt, to 67% of GDP in 2009 and to almost 69% of GDP in 2010.

From a medium-term perspective and in spite of the significant decline during the period 2004-2007, the debt ratio cannot be considered as "sufficiently diminishing and approaching the reference value at a satisfactory pace" in the sense of the Treaty and the Stability and Growth Pact.

This analysis suggests that the debt criterion in the Treaty is not fulfilled.

[10] The remaining 0.2% of GDP in respect of early retirement schemes to Malta Shipyards Ltd. employees will be affected in 2009.

Table 3: Debt dynamics [a]

	2003	2004	2005	2006	2007	2008	2009	2010
Government gross debt ratio	69.3	72.2	69.8	63.7	62.1	64.1	67.0	68.9
Change in debt ratio [b] (1 = 2+3+4)	9.2	2.9	-2.3	-6.1	-1.6	2.0	3.0	1.8
Contributions:								
• Primary balance (2)	6.4	1.1	-0.8	-1.0	-1.1	1.4	0.2	-0.4
• "Snowball" effect (3)	1.9	1.9	-0.8	-0.6	-0.6	0.9	2.6	2.2
of which:								
Interest expenditure	*3.4*	*3.6*	*3.7*	*3.5*	*3.3*	*3.3*	*3.5*	*3.5*
Real GDP growth	*0.2*	*-0.9*	*-2.6*	*-2.1*	*-2.2*	*-1.0*	*0.6*	*-0.1*
Inflation (GDP deflator)	*-1.7*	*-0.9*	*-1.9*	*-2.0*	*-1.7*	*-1.5*	*-1.5*	*-1.2*
• Stock-flow adjustment (4)	0.9	-0.1	-0.7	-4.5	0.1	-0.3	0.2	0.0

Notes:

[a] In percent of GDP

[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; *D, PD, Y* and *SF* are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and *i* and *y* represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.

Source: Eurostat and Commission services' spring 2009 forecasts.

5. RELEVANT FACTORS

Article 104(3) of the Treaty provides that the Commission report "shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors including the medium-term economic and budgetary position of the Member State". These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Commission and to the Council" need to be given due consideration.

In view of the above provisions, the following four subsections consider in turn (1) the medium-term economic position; (2) the medium-term budgetary position (including public investment); (3) other factors put forward by the Member State; and (4) other factors considered relevant by the Commission.

5.1. Medium-term economic position

Cyclical conditions and potential growth. During the period 2005-2008, real GDP grew at a faster pace than potential GDP, leading the negative output gap to close and turn positive in 2007. Over the forecast period, following a contraction in 2009 of 0.9%, economic growth is anticipated to remain weak as the global economic slowdown is expected to adversely affect both domestic and external demand. The latter will give rise to a deterioration of Malta's external deficit. According to the Commission services' spring 2009 forecast, the external deficit, after narrowing to 5.2% of GDP in 2007, is anticipated to widen to close to 6% by 2010. Though much lower than in preceding years, potential growth remains above expected GDP growth rates over the period 2008-2010 and the output gap is set to turn slightly negative by 2009 and to worsen in 2010.

Recent structural reforms. Although increasing in recent years, Malta's employment rate (54.6% in 2007) is well below the EU average and far from the Lisbon target, especially for women and older workers. Structural reforms in this area have primarily focused on targeted fiscal measures to attract more people, especially women, into the labour market. These measures, together with efforts at tackling undeclared work, which is considered significant especially among women, have begun to show some positive results. Still, it appears that there is significant scope for improving labour market performance which would have a positive long-term impact on growth and the budgetary position as set out in the Council's country-specific recommendations on the implementation of the Lisbon strategy.[11] The Public Land Transport reform, which aims to liberalise the sector of taxis, mini buses and coaches operating within the unscheduled market, should lead to efficiency gains through increased competition and, in turn, improve employment opportunities. Despite the adverse budgetary impact for 2008, related to the reclassification of Malta Shipyards Ltd. into the general government sector and the early retirement schemes for their employees, the process leading to the liquidation of Malta Shipyards Ltd. is expected to have favourable long-term effects on growth and public finances, as resources are shifted to more productive uses and Malta's high level of state aid is lowered.

5.2. Medium-term budgetary position

Structural deficit and fiscal consolidation in good times. Malta's fiscal consolidation during 2004-2007 was notable even in periods of weak economic growth (2004) or a negative output gap (2004-06). The deficit-to-GDP ratio followed a downward path declining from 4.7% of GDP in 2004 to 2.2% of GDP in 2007. The adjustment during this period was accounted for by a lower expenditure-to-GDP ratio underpinned by a lower share of compensation of employees, social benefits and interest expenditure in GDP. The budgetary consolidation was also supported by recourse to one-off operations (mostly sale of land, which is conventionally recorded as negative expenditure) averaging around 1.3% of GDP per year. In structural terms, i.e. adjusted for the cycle and one-off

[11] As laid down in the draft report No 6638/09 from the ECOFIN Council to the European Council.

and other temporary measures, the deficit is estimated to have improved from a high of around 6% of GDP in 2004 to around 3¼% in 2007. According to the Commission services' spring 2009 forecast, the structural deficit is estimated to have increased significantly to almost 5% of GDP in 2008, temporarily reversing the declining path towards the medium-term objective (MTO) of a balanced position in structural terms, which the December 2008 update of the stability programme aims to achieve by 2011. Looking forward, the structural deficit is estimated to fall to around 3½% of GDP in 2009 and, on a no-policy change basis, to fall further to some 2¾% of GDP by 2010, against a background of a worsening output gap.

Public investment. General government gross fixed capital formation reached a peak of almost 5% of GDP in 2005 but fell thereafter to 4% of GDP in 2007 and 2.7% in 2008, reflecting declining capital outlays as the large healthcare facility reached the completion stage. During the period 2005-2007, the public investment ratio has consistently exceeded the general government deficit ratio but the reverse held true in 2008. According to the Commission services' forecasts, the headline deficit ratio is anticipated to fall by 1.5 percentage points of GDP between 2008 and 2010, while the public investment ratio is forecast to increase by almost 0.7 of a percentage point. Broadly similar results obtain when comparing the public investment ratio and the structural deficit ratio over the period 2005-2010.

Quality of public finances. The declining trend in total expenditure between 2004 and 2007 was reversed in 2008, primarily due to the impact of the shipyards' reclassification and the early retirement schemes to its employees. Total expenditure reached 45.3% of GDP in 2008 underpinned primarily by higher compensation of employees and social benefits. The latter together with subsidies and interest expenditure account for almost 73% of total spending. Being difficult to change, especially in the short term, the dominance of these expenditure categories suggests that Malta's budget structure may be rigid, making fiscal adjustment in response to changing macroeconomic circumstances difficult to attain. Such rigidity has also limited the progress in re-directing spending towards growth-enhancing categories. In addition, there is scope for enhancing the efficiency of public expenditure, especially in the high resource-absorbing areas of health and education.

Long-term sustainability of public finances. In its opinion of 10 March 2009 on the most recent stability programme, the Council assessed the long-term sustainability of Malta's public finances as follows. "The long-term budgetary impact of ageing in Malta is significantly lower than the EU average, with pension expenditure decreasing as a share of GDP over the long-term according to the projections made in 2005. Yet, the 2006 pension reform, which aims at improving the level of pension while also increasing the retirement age, is likely to imply higher spending over the long run. In addition, the current level of gross debt is above the Treaty reference value. The budgetary position in 2008 as estimated in the programme, which is worse than the starting position of the previous programme, compounds the budgetary impact of population ageing on the sustainability gap. Improving the budgetary position would contribute to reducing the

medium risks to the sustainability of public finances." The risk assessment of long-term sustainability has not changed since the adoption of the Council opinion.

5.3. Other factors put forward by the Member State

In a letter of 30 April 2009, the authorities of Malta listed some relevant factors in accordance with Article 2(3) of Council Regulation (EC) No 1467/97. The analysis presented above already covers most of the items put forward by the authorities, in particular the impact on the 2008 outturn of the delayed taxes and social contributions, the reclassification of Malta Shipyards Ltd, the redundancy scheme for their employees and the energy subsidies to households. The authorities underscore that the delayed tax revenue and social contributions will be recovered over the coming months. Moreover, the authorities confirm their commitment to improving the sustainability of the fiscal position.[12]

5.4. Other factors considered relevant by the Commission

Recent public finance developments in Malta were also influenced by the following factors in the area of budgetary institutions and procedures. . While over the period 2004-2007 expenditure outturns have been below budgeted amounts, and Malta's track record during this period of achieving its deficit targets has been good, the budgetary framework shows signs of weaknesses at the execution stage. Public spending is to a large extent still subject to discretionary decisions in the budget implementation phase. As a consequence, consolidation plans may be derailed as evidenced in 2008. Besides the unbudgeted early retirement schemes to Malta Shipyards Ltd. employees, spending overruns in 2008 were due to discretionary measures (energy subsidies) and a higher wage bill in health care (both average wages and staff levels).

Public finances in 2008 were affected to a large extent by the reclassification of Malta Shipyards Ltd. within the general government sector and the payment of the bulk of early retirement schemes to its employees before its operations ceased in end of the year. The eventual liquidation of Malta Shipyards Ltd., which should happen in 2009, could have a further impact on public finances but no further information is available.

In October 2008, the government announced an increase in the guarantee on deposits held with banks in Malta from €20 000 to €100 000. No other measures to help stabilise the financial system have proved necessary so far.

In its opinion on the most recent update of the stability programme, the Council considered that the budgetary outcomes are subject to downside risks throughout the programme period. The risks mostly relate to the favourable macro-economic scenario,

[12] In addition, the Maltese authorities explain that as a result of revised GDP figures following the submission of the fiscal notification, the general government deficit for 2008 now stands at 4.6% of GDP rather than 4.7% as notified earlier. This revision does not change the conclusions of this report.

the reliance on volatile revenue items (an uncertain increase in direct taxes from international companies) and the possibility of expenditure slippages compared to the envisaged back-loaded decline in public consumption. For 2010 and 2011, an additional risk factor is the lack of information on measures underpinning the consolidation process, in particular as regards the envisaged continued restraint in the public wage bill. The Council therefore invited Malta to "resume fiscal consolidation as envisaged in the programme so as to return to a deficit-to-GDP ratio below 3% in 2009 as planned and ensure that the general government debt ratio is reduced accordingly, by spelling out the measures underlying the planned consolidation in the outer years towards the MTO" and to "strengthen the medium-term budgetary framework and enhance the efficiency and effectiveness of public spending, including by accelerating the design and implementation of a comprehensive healthcare reform".

6. CONCLUSIONS

The general government deficit in Malta reached 4.7% of GDP in 2008. Although Malta is experiencing the impact of the economic downturn and has responded to the call in the European Economic Recovery Plan with some measures to support the economy, the medium-term budgetary strategy is geared towards making further progress with consolidation. The breach of the reference value in 2008 is partly due to specific developments on the expenditure side rather than to the impact of the economic downturn which was only starting in 2008.

The deficit was above and not close to the 3% of GDP reference value. The excess over the reference value cannot be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. Furthermore, it cannot be considered temporary. This suggests that the deficit criterion in the Treaty is not fulfilled.

General government gross debt has been above the 60% of GDP reference value since 2001 and stood at 64.1% of GDP in 2008. The debt ratio cannot be considered as diminishing sufficiently and approaching the reference value at a satisfactory pace within the meaning of the Treaty and the Stability and Growth Pact. This suggests that the debt criterion in the Treaty is not fulfilled.

In line with the Treaty, this report has also examined “relevant factors”, which, according to the Stability and Growth Pact, can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the double condition - that the deficit remains close to the reference value and that its excess over the reference value is temporary - is fully met. Considered on their own merit, the relevant factors in the current case on balance present a mixed picture.

The existence of a severe economic downturn, with potential public finance implications, increases the need to undertake enhanced surveillance under the EDP.