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COMMISSION OPINION

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GENERAL CONSIDERATIONS

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

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

CONSIDERATIONS CONCERNING MALTA

3. On the basis of the Draft Budgetary Plan for 2015 submitted on 15 October by Malta, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Malta is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure for Malta on 21 June 2013, recommending Malta to ensure a sustainable correction of the excessive deficit by 2014 while at the same time ensuring that the government gross debt ratio approaches the 60% of GDP reference value at a satisfactory pace. In particular, the Council recommended Malta to reduce its deficit to 3.4% of GDP in 2013 and 2.7% of GDP in 2014, consistent with 0.7% of GDP improvement in the strucutral balance in both years. After the correction of the excessive deficit, Malta will be subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. As the debt ratio in 2015 is projected at 69% of GDP, exceeding the 60% of GDP reference value, Malta continues to be subject to the debt rule.

5. The macroeconomic scenario, underlying the Draft Budgetary Plan, assumes an acceleration in real GDP growth from 2.5% in 2013 to 3% in 2014 and further to 3.5% in 2015 reflecting buoyant domestic demand. Assessed against currently available information, the macroeconomic scenario underpinning the Draft Budgetary Plan appears plausible for 2014 and optimistic for 2015. The main difference with the Commission 2014 autumn forecast lies in the pace of recovery in Malta’s export markets in 2015, in view of the more optimistic outlook for net exports in the authorities’ projections.

6. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by National Audit Office, which is carrying out the function of a Fiscal Council, until the latter is officially set up. In its endorsement of the forecasts, the National Audit Office nevertheless flagged that growth forecasts are subject to a number of risks, including (i) the implementation of the large investment projects, (ii) developments in expenditure

deflators, and (iii) the interlinkages between the domestic economy and external macroeconomic environment, particularly for 2015.

7. The Draft Budgetary Plan confirms the deficit targets of 2.1% of GDP and 1.6% of GDP for respectively 2014 and 2015, as set in the 2014 stability programme, despite higher nominal GDP growth and lower unemployment in the Draft Budgetary Plan macroeconomic scenario. However, in nominal terms, both revenue and expenditure have been revised upwards. The new target for income tax revenue is partly explained by the expected impact of the recently introduced Investment Registration Scheme. For 2015, the consolidation strategy is revenue-based, contrary to the expenditure-based consolidation announced in the Stability Programme. Indeed, upwards revisions to current expenditure and net capital expenditure would be offset by higher current revenues which include the expected proceeds from the Individual Investor Programme.

8. The Commission 2014 autumn forecast projects the 2014 deficit to be at 2.5% of GDP. The 0.4% of GDP difference with the authorities' target is explained by higher current expenditure projections. Without incorporating the measures of the 2015 budget, as the latter was not presented before the cut-off date, the Commission 2014 autumn forecast projects the deficit in 2015 to deteriorate slightly to 2.6% of GDP. As a result, the difference between the Draft Budgetary Plan target and the Commission 2014 autumn forecast widens to 1.0% of GDP. Part of the difference (0.4% of GDP) is explained by the worse starting position, while the rest is related to more dynamic current expenditure as well the absence of new corrective measures in the Commission 2014 autumn forecast. There are risks linked to the deficit targets in the Draft Budgetary Plan, as the projected dynamic increase in income from indirect taxes in 2014-15 does not appear to be fully explained by the underlying macroeconomic scenario, nor is it underpinned by measures. In addition, delays in the privatisation of the public transport service could require additional subsidies on top of what is already budgeted. On the other hand, in line with past practices, net capital expenditure could be lowered to compensate for potential slippages in budgetary execution.

9. According to the Draft Budgetary Plan, the general government gross debt ratio is expected to increase slightly in 2014 (by 0.3% of GDP), reaching 70.1% of GDP. In 2015, however, the debt ratio is projected to decrease by 1.1% of GDP on account of a reduction in the stock-flow adjustment. According to the Commission 2014 autumn forecast, the debt ratio is projected to reach 71% of GDP in 2014 and to stabilize to that level in 2015. The difference, compared to the Draft Budgetary Plan targets, is explained by the lower nominal GDP growth projections.

10. The targets for revenue and expenditure presented in the Draft Budgetary Plan are not underpinned by sufficiently detailed information on the discretionary measures. A similar situation occurred in the 2014 Draft Budgetary Plan, thus persisting in not complying with the information requirements specified in Regulation (EU) No 473/2013. Specifically, the Draft Budgetary Plan announces new measures for 2015, namely increases in indirect taxation which will be levied on consumer goods and services (0.3% of GDP), a revision in fees on market output (0.06% of GDP) and measures to control the public sector wage bill (0.12% of GDP). Overall, these measures are estimated to have a net deficit-reducing impact amounting to 0.47% of GDP. However, the necessary details for the concrete implementation were only to be specified in the forthcoming 2015 budget.

11. On the basis of the Commission 2014 autumn forecast, the projected headline deficit for 2014 fulfils the EDP requirement. The structural balance, after having decreased by more than 1% of GDP in 2013, is projected to remain stable in 2014. The change in the adjusted structural balance (-0.5% of GDP) is below the recommended annual structural effort (0.7% of GDP). According to the bottom-up assessment, the size of the consolidation measures for 2014 (-0.7% of GDP) are inferior to the target spelled out in the EDP recommendation (0.8% of GDP). In cumulative terms, the change in the structural balance in 2013-14 (1.1% of GDP) as well as the adjusted change in the structural balance (-0.8% of GDP) remain below the 1.4% of GDP recommended adjustment. The bottom-up assessment confirms that the size of consolidation measures for 2013-14 (-0.7% of GDP) is does not reach the structural targets (1.2% of GDP).

Regarding compliance with the debt rule, the assessment is made on the basis of the Commission 2014 autumn forecast in the absence of projections for 2016 and 2017 in the Draft Budgetary Plan. Compliance with the forward looking debt rule is not ensured in 2013 and falls slightly short of the benchmark in 2014, while it appears to be met in 2015. These estimates will have to be reassessed against notified data in the spring 2015 deficit and debt notification.

12. Once a sustainable correction of the excessive deficit is achieved, Malta would have to comply with the requirements of the preventive arm of the SGP. According to an overall assessment of the Draft Budgetary Plan, there is a risk of some deviation from the required adjustment path towards the MTO in 2015. However, the Commission 2014 autumn forecast, which is based on the no-policy-change assumption and does not incorporate the consolidation measures in the 2015 budget, the annual change in the structural balance (-0.2% of GDP) falls short of the required adjustment of 0.6% of GDP and expenditure growth would exceed the benchmark by 0.8% of GDP in 2015, thereby breaching the threshold for significant deviation. Therefore, based on both the structural balance and the expenditure benchmark, there is a risk of a significant deviation from the adjustment path towards the MTO in 2015.

13. Regarding progress with the implementation of fiscal-structural reforms, Malta has adopted the reform of the fiscal framework, has rolled out a number of already reported measures to improve tax compliance and fight tax evasion, and finally is in the process of approving a bill providing for the set-up of third pillar pension scheme with a view to improving pension adequacy.

14. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Malta is at risk of non-compliance with the provisions of the Stability and Growth Pact. Malta is currently under the corrective arm, but could become subject to the preventive arm from 2015 in case a timely and sustainable correction is achieved. According to the Commission 2014 autumn forecast, the structural effort in 2014 is far from what was recommended by the Council in the EDP recommendation, highlighting the risk that the correction of the excessive deficit may not be achieved, owing to the apparent lack of a sufficient effort to support it. Also, based on the Commission 2014 autumn forecast, compliance with the debt rule falls slightly short in 2014. Finally, a significant deviation from the adjustment path towards the MTO is to be expected in 2015 based on the Commission 2014 autumn forecast, according to both the structural balance and the expenditure benchmark, unlike in the Draft Budgetary Plan. The Commission therefore invites the authorities to take the necessary

measures within the national budgetary process to ensure that the 2015 budget will be compliant with the Stability and Growth Pact.

The Commission acknowledges that Malta has made some progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the 2014 European Semester. However, it invites the authorities to accelerate progress on the planned efforts to improve the financial sustainability of the healthcare system, to ensure that further pension reform measures are put in place and to ensure that the efforts to improve tax compliance and fight tax evasion yield the expected results.

Done at Brussels, 28.11.2014

For the Commission
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