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Recommendation for a

COUNCIL RECOMMENDATION

on the National Reform Programme 2011 of Malta

and delivering a Council opinion

on the updated Stability Programme of Malta 2011-2014

{SEC(2011) 726 final}

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Recommendation for a

COUNCIL RECOMMENDATION

on the National Reform Programme 2011 of Malta

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States[3], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ C , p. .
3 Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011.

(3) On 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy.

(4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their Stability or Convergence Programmes and National Reform Programmes.

(5) On 25 March 2011, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments on time for their inclusion in their Stability or Convergence Programmes and their National Reform Programmes.

(6) On 28 April 2011, Malta submitted its 2011 National Reform Programme and, on 29 April 2011, its 2011 Stability Programme update covering the period 2011-2014. In order to take account of the interlinkages, the two programmes have been assessed at the same time.

(7) As the economic crisis hit, exports and investment fell sharply and real GDP contracted by 3.4% in 2009. Employment contracted only mildly, also supported by government assistance. With exports and business investment picking up strongly in 2010, Malta experienced a marked rebound in economic activity in 2010 and unemployment inched down. Given the high government debt (61.5% of GDP in 2008), the government did not undertake a large fiscal stimulus and the general government deficit in 2009 (3.7% of GDP) remained below that for the euro area as a whole. In 2010, the government's fiscal deficit and debt ratios remained broadly stable.

(8) Based on the assessment of the updated Stability Programme pursuant to Regulation Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections is slightly favourable, especially in the later years of the programme period. From 3.6% of GDP in 2010, the Stability Programme plans to bring the general government deficit below the Treaty reference value by 2011. Thereafter, gradual progress towards the medium-term objective (MTO) of a balanced position in structural terms is to be backed up by a commitment to ensure a sustainable, largely expenditure-based consolidation. However, the Stability Programme does not envisage the achievement of the MTO within the programme horizon. The debt ratio is projected to decline from its 2010 peak of 68% of GDP to 63.7% in 2014, due to a positive and strengthening primary balance. The average annual structural adjustment effort in the period 2012-14, as calculated by the Commission, is broadly in line with the Stability and Growth Pact. However, budgetary outcomes could be worse than targeted because of possible expenditure overruns and the lack of information on the measures underpinning the consolidation effort after 2011.

(9) Pursuing fiscal consolidation to achieve the MTO is a key challenge for Malta. While the budget for 2011 put in place measures to correct the excessive deficit in 2011, additional action would be required in case of slippages. The credibility of the medium-term consolidation strategy, which is not yet underpinned by concrete measures, would be enhanced by a stronger multi-annual budgetary framework. A key weakness is the non-binding nature of the multi-annual targets, which implies a relatively short fiscal planning horizon. The Stability Programme states that the introduction of an expenditure rule is being considered.

(10) The long-term budgetary impact of ageing, including pensions, is significantly higher in Malta than the EU average. Moreover, the labour market participation of older workers is very low, due to a still relatively low retirement age, frequent recourse to early retirement schemes and the very low participation of older women. The 2006 pension reform increases the retirement age, albeit very gradually, and addresses the adequacy of future pensions, in particular through more generous indexation arrangements and the introduction of a guaranteed national minimum pension. The National Reform Programme reports on the ongoing consultation on the proposals for further pension reform put forward by the Pensions Working Group, including the establishment of an explicit link between retirement age and life expectancy and the introduction of a mandatory second pension pillar and a voluntary third pillar. However, the National Reform Programme does not put forward a comprehensive active ageing strategy to accompany the ongoing and envisaged legislative changes. The relatively high incidence of undeclared work poses a risk to the sustainability of public finances in the long run. The government presents some measures to address this problem in the National Reform Programme, but there are no proposals to revise the tax-benefit system with a view to making work pay. Fostering participation of women in the labour market is another major challenge for Malta, given that its female employment rate is the lowest in the EU. In the National Reform Programme the government has put forward a substantial number of initiatives targeting female workers. Their implementation and impact should be evaluated in 2012.

(11) In recent years, Malta has experienced intensive industrial restructuring with traditional, labour-intensive manufacturing being replaced by new high added-value activities. This has led to a mismatch between the demand and supply of skills on the labour market, pointing to the need to provide the skills required by the new sectors, particularly through higher education, in a bid to diversify Malta's economic base further.

(12) Malta has the highest rate of early school-leavers in the EU, standing at 36.8% in 2009 compared to an EU average of 14.4%. The country also records a low share of people aged 30-34 with a tertiary level of education or equivalent (21.1% compared to an EU average of 32.3% in 2009). Malta aims to reduce early school-leaving to 29% and to increase the share of tertiary or equivalent education for 30-34 year-olds to 33% by 2020. In 2011, it introduced measures to channel potential early school-leavers to interesting career paths through vocational educational training or second-chance learning opportunities.

(13) Malta is one of the few EU Member States with a generalised wage indexation mechanism. Wage increases are linked to a mandatory cost-of-living adjustment (COLA) mechanism, resulting in wage increases in line with past inflation developments though proportionately higher at the low end of the wage spectrum.

Adding to the minimum wage, this adjustment may further hamper the competitiveness of the labour-intensive sectors. The issue is particularly pertinent in view of the recent increases in energy prices, which could lead to wage-price spirals.

(14) Malta is almost entirely dependent on imported oil for energy, making the economy vulnerable to oil price changes. This, together with the inadequacy of Malta's energy system, may be posing problems to entrepreneurship and the competitiveness of SMEs. Exploiting the potential to produce energy from renewable sources could bring the double benefit of improving competitiveness and achieving energy and climate targets. The information provided in the National Reform Programme on energy measures is limited, however, making it difficult to assess their feasibility and cost-effectiveness.

(15) Malta has made a number of commitments under the Euro Plus Pact[4]. The commitments relate to two areas of the Pact: competitiveness and the sustainability of public finances. On the fiscal side, the commitments involve strengthening the accountability and transparency of the budgetary framework, together with consideration given to introducing mechanisms to increase discipline in budgetary execution. To address productivity, there are measures to improve the business environment and financing conditions for firms, as well as enhancing competition in services, especially in telecommunications. Although present in the National Reform Programme, the Euro Plus Pact commitments do not address employment and financial stability. While the authorities focus on raising productivity, they do not acknowledge that the current wage indexation mechanism affects Malta's competitiveness. The Euro Plus Pact commitments have been assessed and taken into account in the recommendations.

(16) The Commission has assessed the Stability Programme and National Reform Programme, and the Euro Plus Pact commitments for Malta[5]. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Malta but also their conformity with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. In this light, the Commission considers that, while the targeted progress towards the medium-term objective (MTO) is appropriate, there are important risks to the consolidation strategy, because it is not backed up with concrete measures and expenditure could overrun as has happened in the past. In addition, the non-binding nature of the medium-term budgetary framework may not foster fiscal discipline. The relatively high long-term cost of ageing, particularly pension expenditure, puts the long-term sustainability of Malta's public finances at risk. The National Reform Programme acknowledges the main structural challenges that Malta's economy is facing, though additional attention to certain issues, particularly better utilisation of the economy's labour potential, reforming the wage-setting mechanism to ensure better alignment of wage and productivity developments, and energy diversification, appear warranted.

(17) In the light of this assessment, also taking into account the Council Recommendation of 16 February 2010 under Article 126(7) of the Treaty on the Functioning of the

[4] More details on the commitments made under the Euro Plus Pact can be found in SEC(2011) 726.
[5] SEC(2011) 726.

European Union, the Council has examined the 2011 update of the Stability Programme of Malta and its opinion[6] is reflected in particular in its recommendation under (1) and (2) below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the National Reform Programme of Malta.

HEREBY RECOMMENDS that Malta should take action within the period 2011-2012 to:

(1) Ensure correction of the excessive deficit in 2011, standing ready to take additional measures so as to prevent possible slippages, and adopt concrete measures to back up the 2012 deficit target. With a view to strengthening the credibility of the medium-term consolidation strategy, define the required broad measures, embed the fiscal targets in a binding, rule-based multi-annual fiscal framework and improve the monitoring of budgetary execution.

(2) Take action to ensure the sustainability of the pension system by accelerating the progressive increase in the retirement age and by linking it to life expectancy. Accompany the higher statutory retirement age with a comprehensive active ageing strategy, discourage the use of early retirement schemes and encourage private pension savings.

(3) Focus education outcomes more on labour market needs, notably by taking measures to improve access to higher education and by strengthening the effectiveness of the vocational training system. Take measures to reduce early school-leaving by identifying, analysing and measuring its causes by 2012 and by setting up a regular monitoring and reporting mechanism on the success rate of the measures.

(4) Reform the automatic wage indexation mechanism, in consultation with the social partners in accordance with national practice, to ensure that wage growth better reflects developments in labour productivity and competitiveness.

(5) Strengthen efforts to reduce Malta’s dependence on imported oil, by bringing forward investments in renewable energies and making full use of available EU funds to upgrade infrastructure and promote energy efficiency.

Done at Brussels,

For the Council
The President

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[6] Foreseen in Article 5(3) of Council Regulation (EC) No 1466/97.