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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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1. INTRODUCTION

Malta submitted its Draft Budgetary Plan for 2020 on 15 October 2019 in compliance with Regulation (EU) No 473/2013. Malta is subject to the preventive arm of the Pact and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2019 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 2019 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 2019-2020 (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 the 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 2019, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

According to the Draft Budgetary Plan, real GDP growth is expected to ease to 5% in 2019 from 6.8% a year earlier. Domestic demand is projected to pick up driven by strong investments while the growth of household consumption is set to slow down. On the external side, a stronger weakening of exports compared to imports is projected to lead to a negative contribution from net exports to overall growth. A non-negligible drag on growth is expected to come also from inventories.

In 2020, economic activity is set to decelerate to 4.3%, reflecting mainly a slowing down of household and public consumption, which will be only partly counterbalanced by increasing investment. Net exports are projected to remain a drag on growth with exports slightly slowing down and imports accelerating mirroring the somewhat stronger investment activity. The Draft Budgetary Plan macroeconomic scenario is less buoyant than the one presented in the 2019 Stability Programme mainly on account of slower domestic demand in 2019 and a weaker external sector in 2020.

Table 1. Comparison of macroeconomic developments and forecasts

	2018	2019			2020		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	6.8	6.2	5.0	5.0	5.7	4.3	4.2
Private consumption (% change)	7.3	5.8	4.6	4.2	3.9	4.0	3.8
Gross fixed capital formation (% change)	-1.8	13.7	9.0	10.0	5.4	11.9	9.5
Exports of goods and services (% change)	2.6	2.4	1.8	1.7	4.2	1.7	1.8
Imports of goods and services (% change)	2.6	3.4	2.0	2.6	3.1	2.1	2.1
Contributions to real GDP growth:							
- Final domestic demand	4.8	7.0	5.6	5.8	3.7	4.5	4.2
- Change in inventories	1.5	0.0	-0.5	-0.1	0.0	0.0	0.0
- Net exports	0.5	-0.8	-0.1	-0.7	2.1	-0.2	0.0
Output gap[1]	2.2	0.7	1.5	1.5	0.1	0.4	0.4
Employment (% change)	5.4	4.6	4.8	4.0	4.3	4.1	3.0
Unemployment rate (%)	3.7	3.8	3.5	3.6	3.9	3.5	3.5
Labour productivity (% change)	1.3	1.4	0.2	1.0	1.6	0.2	1.1
HICP inflation (%)	1.7	1.9	1.7	1.6	2.0	1.6	1.7
GDP deflator (% change)	2.1	2.9	2.4	2.1	2.4	2.1	2.0
Comp. of employees (per head, % change)	2.3	3.3	1.7	2.4	3.2	2.8	3.4
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	10.8	10.9	11.6	10.0	14.0	13.7	9.5

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 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

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

The macroeconomic projections underlying the Draft Budgetary Plan have been endorsed by the Malta Fiscal Advisory Council, an independent fiscal council established with the Fiscal Responsibility Act. The endorsement took the form of a letter addressed to the Minister of Finance, published on the Malta Fiscal Advisory Council's website.[1] The Malta Fiscal Advisory Council concludes that the macroeconomic forecast for 2019 and 2020 prepared by the Ministry for Finances 'lies within its endorsable range'.

The labour market is projected to remain strong with employment growing over 4% in 2019 and 2020. Despite sound employment prospects, compensations are projected to grow at relatively modest pace in 2019 before accelerating somewhat in 2020. The unemployment rate is, nevertheless, set to stabilise at 3.5% in both years. While the labour market outlook presented in the Draft Budgetary Plan is somewhat more positive in 2019 compared to the 2019 Stability Programme, it is less optimistic for 2020. HIPC inflation has been revised down compared to the 2019 Stability Programme, and is projected to remain at moderate levels below 2% in both years.

The macroeconomic assumptions underpinning the Draft Budgetary Plan are plausible and broadly in line with the 2019 Commission autumn forecast. In 2019, both projections expect the same GDP growth although with a slightly different structure. The Commission assumes

[1] Publication available on https://mfac.org.mt/publications/reports/reports-2019/

more dynamic investment activity while household consumption is projected to be lower compared to the Draft Budgetary Plan. In addition, the Commission forecast expects a much smaller negative growth contribution from inventories. In 2020, the GDP growth projected by the Commission is only slightly lower due to a somewhat more subdued growth of domestic demand. Given only small differences in the macroeconomic assumptions, the Draft Budgetary Plan and Commission output gaps in both years are identical pointing to a gradual reduction of the output gap in 2019 and 2020.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

In 2019, the Draft Budgetary Plan estimates the general government headline surplus to decline to 1.4% of GDP from 1.9% of GDP a year earlier. This is higher than the planned headline surplus in the 2019 Stability Programme of 0.9% of GDP. The improvement comes mainly from the revenue side due to stronger-than-expected intake of tax revenues from income and consumption taxes. Receipts from the Individual Investor Programme are also expected to be higher, amounting to some 1.1% of GDP. Additional revenue is not projected to be fully spent. While most outlays are expected to increase compared to the 2019 Stability Programme (especially investment), social spending and interest costs are expected to be lower. The Commission 2019 autumn forecasts projects the 2019 headline surplus at 1.2% of GDP, which – similarly to the Draft Budgetary Plan – is to a large extent driven by revenues from the Individual Investor Programme. The small difference is due to a somewhat lower projection of social contributions, and marginally higher spending on compensations and social benefits. The divergence in GDP ratios is also driven by a lower nominal GDP projected in the Commission 2019 autumn forecast.

In 2020, the Draft Budgetary Plan targets to retain the headline surplus of 1.4% of GDP, which is well above the target of 1% presented in the 2019 Stability Programme. In spite of the more subdued macroeconomic developments, tax revenues are expected to be higher compared to the 2019 Stability Programme projection, primarily reflecting the higher-than-expected outturn foreseen for 2019. On the expenditure side, outlays on intermediate consumption and capital expenditure are expected to be higher in the Draft Budgetary Plan. The same is true for compensation of employees and social payments, although to a somewhat lesser extent. The increase in GDP ratios is also driven by a downward revision of the nominal GDP for 2020.

When comparing the 2020 projected fiscal adjustment compared to the expected outcomes in 2019, tax revenues are expected to increase slightly faster than nominal GDP in 2020. Revenues from the Individual Investor Programme are expected to increase, contributing positively to non-tax revenues and to an overall positive budgetary position. A lower drawdown on EU funds is expected to reduce revenues, but it will also translate into reduced projections for government investment. Other parts of government spending are expected to follow GDP developments.

The Commission 2019 autumn forecast projects the 2020 general government headline surplus at 1% of GDP, 0.4 percentage points lower than the Draft Budgetary Plan target. The Commission assumes somewhat lower revenues from social contributions reflecting an assumption of a less dynamic labour market. Nevertheless, this does not translate into a lower GDP ratio since the Commission projects a lower nominal GDP. On the expenditure side, the Commission 2019 autumn forecast projects higher current expenditure for compensation of employees and social payments. Also in the Commission's forecast the revenue from the Individual Investor Programme is an important contributor to the fiscal surplus.

Risks related to the fiscal targets appear balanced. Tax revenue may turn out better than expected since the Draft Budgetary Plan projections assumes more conservative elasticities than those observed in recent years. However, similar to past developments, higher revenues tend to be accompanied by faster growth of spending. In addition, any use of funds accumulated in the Contingency Reserve[2] will increase expenditure.

The government plans are expected to lead to a decline in the recalculated structural surplus[3] to 0.6% of GDP in 2019 from 0.8% of GDP in 2018. The unchanged target for the nominal surplus coupled with the reduction in the positive output gap imply an improvement in the recalculated structural balance in 2020 to 1.1% of GDP. The structural balance developments are broadly confirmed by the Commission 2019 autumn forecast. The small differences are fully explained by the differences of estimates of nominal balances.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Malta currently standing at 0.19[4]. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in Malta is expected to fall from 1.5% of GDP in 2018 to 1.3% in 2019 and is projected to decrease further next year to 1.2% of GDP, well below the 3% recorded in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from Malta's plans is broadly confirmed by the Commission forecast.

According to the Draft Budgetary Plan, the Plan targets comply with the national numerical fiscal rules related to the balance of public finances.

[2] The Contingency Reserve account was established by the Article 31 of the Fiscal Responsibility Act, which requires earmarking funds in the range of 0.1% and 0.5% of GDP in any particular year, whenever the budget is in surplus (first transfer was done in 2017). The reserve is to be built up over five years. Any drawdown must be replenished gradually over a period of three years until the contingency reserve is within the range set out in the Act. The account is projected to reach 0.3% of GDP in 2020.

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

[4] 10-year bond yields as of September 2019. Source: Eurostat.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2018	2019			2020			Change: 2018-2020
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**38.7**	**38.1**	***39.3***	**39.4**	**36.7**	***39.1***	**39.1**	**0.4**
of which:								
- Taxes on production and imports	12.8	12.4	*12.7*	12.7	12.1	*12.8*	12.9	0.0
- Current taxes on income, wealth,	13.4	13.3	*14.1*	14.1	13.3	*14.2*	14.2	0.8
- Capital taxes	0.2	0.2	*0.2*	0.2	0.2	*0.2*	0.2	0.0
- Social contributions	6.2	6.1	*6.2*	6.1	6.0	*6.2*	6.1	0.0
- Other (residual)	6.1	6.1	*6.1*	6.3	5.1	*5.7*	5.7	-0.4
Expenditure	**36.7**	**37.2**	**37.9**	**38.1**	**35.7**	**37.8**	**38.1**	**1.1**
of which:								
- Primary expenditure	35.2	35.8	36.6	36.8	34.5	36.6	36.9	1.4
of which:								
Compensation of employees	11.1	11.1	11.2	11.3	10.8	11.1	11.3	0.0
Intermediate consumption	6.6	7.0	7.2	7.2	6.8	7.5	7.5	0.9
Social payments	9.6	9.5	9.3	9.4	9.1	9.3	9.4	-0.3
Subsidies	1.4	1.2	1.4	1.4	1.2	1.4	1.4	0.0
Gross fixed capital formation	3.1	3.9	4.4	4.4	3.3	4.1	4.1	1.0
Other (residual)	3.5	3.1	3.1	3.1	3.3	3.2	3.2	-0.3
- Interest expenditure	1.5	1.4	1.3	1.3	1.2	1.2	1.3	-0.3
General government balance (GGB)	**1.9**	**0.9**	**1.4**	**1.2**	**1.0**	**1.4**	**1.0**	**-0.5**
Primary balance	**3.5**	**2.3**	**2.7**	**2.5**	**2.2**	**2.6**	**2.3**	**-0.9**
One-off and other temporary measures	0.0	0.0	0.1	0.0	0.0	0.1	0.0	0.1
GGB excl. one-offs	**1.9**	**0.9**	**1.3**	**1.2**	**1.0**	**1.3**	**1.0**	**-0.6**
Output gap[1]	2.2	0.7	1.5	1.5	0.1	0.4	0.4	-1.8
Cyclically-adjusted balance[1]	0.8	0.6	0.7	0.5	0.9	1.2	0.8	0.3
Structural balance (SB)[2]	**0.8**	**0.6**	**0.6**	**0.5**	**1.0**	**1.1**	**0.8**	**0.2**
Structural primary balance[2]	2.4	1.9	1.9	1.8	2.2	2.3	2.1	-0.1

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 corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

3.2. Debt developments

Based on the Draft Budgetary Plan, the general government debt-to-GDP ratio is projected to remain on a downward path, reaching 43% of GDP in 2019 and 40.3% of GDP in 2020, driven by budgetary surpluses and high growth of nominal GDP. Stock flow adjustment is projected to slow down the reduction in the debt-to-GDP ratio. Compared to the 2019 Stability Programme, the Draft Budgetary Plan assumes a somewhat higher debt ratio due to a downward revision of the macroeconomic outlook. The Commission 2019 autumn forecast projects a higher debt-to-GDP ratio both in 2019 and 2020, which is to a large extent due to differences in the general government primary balance and to a small extent due to lower projections of nominal GDP.

Table 3. Debt developments

(% of GDP)	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**45.8**	**42.7**	**43.0**	**43.3**	**39.4**	**40.3**	**41.0**
Change in the ratio	-4.5	-3.0	-2.8	-2.5	-3.4	-2.7	-2.2
Contributions[2]:							
1. Primary balance	**-3.5**	**-2.3**	**-2.7**	**-2.5**	**-2.2**	**-2.6**	**-2.3**
2. "Snow-ball" effect	**-2.6**	**-2.4**	**-1.8**	**-1.7**	**-2.0**	**-1.4**	**-1.3**
Of which:							
Interest expenditure	1.5	1.4	1.3	1.3	1.2	1.2	1.3
Real growth effect	-3.1	-2.6	-2.1	-2.1	-2.2	-1.7	-1.7
Inflation effect	-1.0	-1.2	-1.0	-0.9	-1.0	-0.9	-0.8
3. Stock-flow adjustment	**1.6**	**1.8**	**1.8**	**1.8**	**0.9**	**1.3**	**1.3**
Of which:							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds							
Valuation effect & residual							

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 effects.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

The government presented the 2020 budget to the Parliament on 14 October 2019. Based on information in the Draft Budgetary Plan, the budget does not envisage any tax increases, but plans a series of tax-reducing measures in 2020. Their negative impact on revenues is projected to be broadly offset by an additional positive impact of measures adopted in previous years. On the other hand, discretionary expenditure measures are expected to have a negative impact on the headline surplus, amounting to 0.4% of GDP.

The measures that are expected to impact negatively on government revenues include (i) a lower personal income tax rate of 15% on the first 100 hours of overtime for those not earning more than EUR 20 000 per year; (ii) an increase in the tax exemption thresholds for minimum wage earners and pensioners, and (iii) an increase in the tax exemption/tax credit for personal pension plans and voluntary occupational pension plans. In the area of property taxation, a stamp duty exemption available for first-time home buyers on the first EUR 175 000 (previously EUR 150 000) was extended also to 2020. Second-time buyers are eligible to stamp duty reduction when selling their residential property and acquiring a new one. Finally, a reduced stamp duty of 2% on purchases of residential property in Gozo has also been retained.

Table 4. Main discretionary measures reported in the Draft Budgetary Plan

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Taxes on production and imports	-0.1	0.0
Current taxes on income, wealth, etc.	0.0	0.0
Capital taxes		
Social contributions	0.0	0.0
Property Income		
Other	-0.4	0.2
Total	**-0.5**	**0.1**

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source:

Draft Budgetary Plan for 2020

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Compensation of employees	0.0	0.0
Intermediate consumption	0.0	0.0
Social payments	0.2	0.3
Interest Expenditure	0.0	0.0
Subsidies	0.0	0.0
Gross fixed capital formation	0.1	0.1
Capital transfers	0.0	0.0
Other	0.0	0.1
Total	**0.3**	**0.4**

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source:

Draft Budgetary Plan for 2020

On the expenditure side, the 2020 budget envisages a number of initiatives targeting pensioners including (i) an increase of pensions above the Cost of Living Adjustment index, (ii) an additional allowance for persons aged 65 years and over in risk of poverty, (iii) an extension of the EUR 300 grant scheme to all persons of 75 years and over in addition to a further EUR 50 grant to persons over 80 years of age living in their house, with the scheme being extended to persons living in private residential homes, (iv) a new allocation to a Regularisation fund to cater for inequalities suffered by persons in the past due to changes in the pension system, and (v) free transport for persons aged 75 years or older. Furthermore, a new EUR 300 bonus is planned to be introduced for every new-born or adopted child. A payment for persons with severe disabilities is also expected to be increased and the state plans to pay social contribution for a period of eight years for parents to cease work to take care for their children suffering from rare ailments. The National Development and Social Fund, main revenue of which comes from Individual Investor Programme receipts, projects an allocation of EUR 35 million to finance projects in specific areas as defined by respective legislation.

The estimated impact of measures is plausible and in line with the Commission 2019 autumn forecast.

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

4.1. Compliance with the medium-term budgetary objective

Malta is subject to the preventive arm of the Pact and should ensure compliance with its medium-term budgetary objective. The general government headline balance posted a surplus of 1.9% of GDP in 2018. The Draft Budgetary Plan targets a headline surplus of 1.4% of GDP for 2019 and 2020. This is broadly confirmed by the Commission 2019 forecast with slightly lower headline projections of 1.2% of GDP in 2019 and 1% of GDP in 2020.

According to the information provided in the Draft Budgetary Plan, the recalculated structural balance is expected at 0.6% of GDP in 2019 and 1.1% of GDP in 2020, remaining above the medium-term budgetary objective of a balanced budgetary position in structural terms. This is confirmed by the Commission 2019 autumn forecast, which estimates the structural balance to at 0.5% of GDP and 0.8% of GDP in 2019 and 2020, respectively.

Malta is therefore expected to be compliant with the requirements of the preventive arm of the Stability and Growth Pact both in 2019 and 2020. At the same time, fiscal surpluses are substantially driven by revenue from the Individual Investor Programme, whose development is difficult to predict. In addition, although the expenditure benchmark pillar does not point to a risk of compliance for 2019 and 2020, based on the Commission 2019 autumn forecast, the net public expenditure annual growth corrected for one-offs is expected to be one of the highest in the euro area. Hence expenditure developments should be monitored carefully, especially in light of possible future risks to the robustness of revenues, to safeguard compliance in line with the Stability and Growth Pact.

Table 7: Compliance with the requirements of the preventive arm

(% of GDP)	2018	2019		2020	
Initial position[1]					
Medium-term budgetary objective (MTO)	0.0	0.0		0.0	
Structural balance[2] (COM)	0.8	0.5		0.8	
Structural balance based on freezing (COM)	0.9	0.6		-	
Position vis-a -vis the MTO[3]	the MTO	At or above the MTO		At or above the MTO	
	2018	**2019**		**2020**	
(% of GDP)	**COM**	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	**Compliant**				
Required adjustment corrected[5]					
Change in structural balance[6]					
One-year deviation from the required adjustment [7]					
adjustment [7]					
Expenditure benchmark pillar					
Applicable reference rate[8]					
One-year deviation adjusted for one-offs [9]					
Two-year average deviation adjusted for one-offs [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 is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance corresponds to 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 ed. 2018, 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 2018) was carried out on the basis of Commission 2019 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 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

In 2020, the fiscal stance is expected to be contractionary, based on the structural balance estimates, according to both the Draft Budgetary Plan and the Commission 2019 autumn forecast. The headline surplus is expected to remain unchanged in 2020 at 1.4% of GDP, according to the information provided in the Draft Budgetary Plan. This stability is reflected also in the GDP ratio of revenue and expenditure – both projected to decline by some 0.1 percentage point. Nevertheless, there are some minor changes in the composition. Dynamic domestic demand and favourable labour market developments will push the growth of consumption and income taxes above GDP growth, leading to a small increase in GDP ratios. A more visible change will be for other revenue, which is projected to decline relative to GDP. While revenue from the Individual Investor Programme is projected to increase by 0.1 percentage point to 1.2% of GDP, capital transfers are set to decline, reflecting lower implementation of EU funds in 2020. On the expenditure side, an increase in the intermediate consumption relative to GDP is more than compensated by lower planned investment – also related to a planned dropdown of investment financed by the EU. Nevertheless, the investment is targeted to reach 4.1% of GDP in 2020, which is well above a historical average of around 3% of GDP.

In the context of comprehensive spending reviews, between February and June 2019 the authorities focused on Malta Police Force. Despite relatively low crime rates, Malta is one of the most policed countries in the EU. The review concluded that the ongoing move towards hubs with inter-disciplinary teams should enable more police officers to be better redeployed in new priority areas (i.e. the changing nature of crime). In addition, a split of the police force into operations and logistics would lead to better information and intelligence sharing. In terms of processes, some 50 officials from various ministries completed the training programme assisted by the EU Structural Reform Support Programme during 2019.

The tax revenues of Malta remain relatively low compared to other EU Member States and their composition is friendlier to growth, with a higher share of consumption taxes and lower share of labour taxation. Unlike its peers, Malta relies relatively heavily on tax receipts from corporates. The Draft Budgetary Plan does not present any major measures to change the current tax structure.

On 9 July 2019[5] under the European Semester the Council addressed to Malta Country Specific Recommendations including to ensure the fiscal sustainability of the healthcare and pension systems, including by restricting early retirement and adjusting the statutory retirement age in view of expected gains in life expectancy. While noting that the original position on pensions and health-care expenditure in Malta is significantly lower than the EU average, the Draft Budgetary Plan reports several measures in the concerned areas.

As for pensions, a strategic review will be submitted to the House of Representatives by end of 2020. The report is expected to assess the state of public pensions and put forward proposals and recommendations for achieving further adequacy, sustainability and social solidarity while retaining the ratio between contribution period and time spent in retirement. The Draft Budgetary Plan recalls previous reforms (e.g. gradual increase in pension age, lengthening of contributory period, stricter rules on the access to early retirement, introduction of financial incentives to lengthen working careers) which led to an increase in the duration of working life in Malta by more than 6 years over the period 2009-2018. In addition, the employment rate of older workers (55-64 years) has improved. The government also strives to diversify retirement income so as to reduce dependency on state pensions. The Third Pillar Pension Scheme and Voluntary Occupational Pension Scheme were strengthened. However, the latter has seen a relatively low participation rate. The Malta Stock Exchange has taken measures to improve financial literacy (e.g. publication of educational material, organising annual investor education conferences). Finally, the government launched the Home Equity Release scheme, which allows home-owner pensioners to raise their standard of living by allowing pensioners to convert a part of their residential value into a stream of income. A series of activies are planned in this respect in the next 18 months. While it appears too early to assess the full impact of these measures at the current stage, they do not appear to contribute significantly to the long-term sustainability of the public pension system.

In the area of healthcare, primary care remains a major priority of the government's healthcare strategy. The development of the Souther Primary Care hub and the electronic patient record within primary care are both well advanced. The latter is part of a broader strategy for

[5] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Malta and delivering a Council opinion on the 2019 Stability Programme of Malta (OJ C 301, 5.9.2019, p. 107–111).

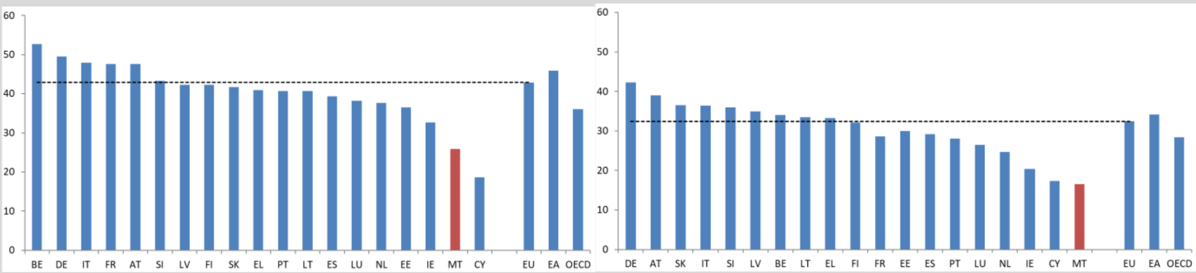
eHealth, which is expected to link the sectoral system together so as to exchange health data. New ICT solutions should contribute to a reduction in health services costs. In addition, the continuity of care between primary and secondary care should improve. At this stage it appears too early to assess the full impact of these measures.

Box 4 – 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 (2014)



Notes: 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 contains the following measures that affect the tax wedge. A lower tax rate of 15% was introduced on overtime work of up to 100 hours for low-paid employees (salary of less than EUR 20 000/calendar year). In addition, the tax refund paid in previous two years will be granted again to employees earning less than EUR 60 000. The refund will vary between EUR 48 to EUR 60 depending on the level of income and tax status of the employee.

6. OVERALL CONCLUSION

According to both the information provided in the Draft Budgetary Plan and the Commission 2019 autumn forecast, Malta is projected to respect its medium-term budgetary objective in 2019 and 2020. Therefore, Malta is projected to meet the requirements under the preventive arm of the Stability and Growth Pact both in 2019 and 2020. At the same time, expenditure developments should be monitored carefully, especially in light of possible future risks to the robustness of revenues, to safeguard compliance in line with the Stability and Growth Pact.