



Malta:

Update of Stability Programme

2012 - 2015

Ministry of Finance, the Economy and Investment
April 2012

The following symbols have been used throughout this document:

. . . to indicate that data are not available;

— to indicate that the figure is negligible;

0 to indicate that the figure is zero;

- to indicate that data are not applicable or cannot be determined;

n/c to indicate that there is no change in the data.

Figures may not add up due to rounding.

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Introduction

This Programme constitutes the fourth update of Malta's Stability Programme, which was submitted in 2007. The first Update was submitted in December 2008, the second in February 2010 whilst the third Update was submitted in April 2011. This Programme has been prepared in accordance with Council Regulation (EC) No. 1466/97 as amended by Council Regulation (EC) No. 1055/05 and Council Regulation (EC) No 1467/97 as amended by Council Regulation (EC) No. 1056/05.

This Programme is also in line with the new requirements of the Stability and Growth Pact, namely the amendments to Council Regulation (EC) No. 1466/97 by Council Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 and the amendments to Council Regulation (EC) No 1467/97 by Council Regulation (EU) No 1177/2011 of 8 November 2011. The programme also takes into account Council Directive 2011/85/EU of 8 November 2011 on the requirements for budgetary frameworks of the Member States.

The document is in line with 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 on 24th January 2012.

This Programme takes account of the Recommendation of the ECOFIN Council to Malta of 16th February 2010 under Article 126(7) of the Treaty on the Functioning of the European Union to bring to an end the situation of an excessive Government deficit. Moreover, the Programme also takes into account the horizontal guidance by the European Council. In particular Council conclusions on fiscal policies of 4 October 2011 called on all five Member States with a deadline for correction of their excessive deficits in 2011 and 2012 to fully implement their commitments under the Stability and Growth Pact through additional measures. Subsequently the additional measures announced by Malta were considered by the European Commission to be sufficient to bring the correction of the excessive deficit back on track, in line with the Council's recommendations.

This document was compiled by the Ministry of Finance, the Economy and Investment, with an important contribution from the National Statistics Office as well as from other Ministries and entities. The Programme includes seven sections: Chapter 1 presents Government's objectives for economic policy; Chapter 2 presents the main macroeconomic projections for the medium-term as well as the potential impact of a selection of structural reform measures; Chapter 3 outlines the overall fiscal policy strategy and updated budgetary plans for the current year, followed by a presentation of the medium-term fiscal projections and debt developments; the budgetary implications of major structural reforms featuring in the National Reform Programme are also outlined; Chapter 4 contains a sensitivity analysis of the budgetary projections as well as a comparison between the current forecasts and those presented in the February 2010 Update of the Stability Programme; Chapter 5 reviews the long-term sustainability of public finances; Chapter 6 analyses the quality of public finances, and finally Chapter 7 reviews the institutional features of public finances.

1. Overall Policy Framework and Objectives

1. Overall Policy Framework and Objectives

The further strengthening of Malta's fiscal consolidation process remains at the forefront of Government's efforts and primary objectives. This is also in line with the renewed emphasis which EU economies are putting on public finances and fiscal frameworks within the EU. The Government therefore remains committed to achieving lower deficit and debt ratios and to ensuring fiscal sustainability over the medium term. Equally important are the broader macroeconomic objectives of sustainable macroeconomic growth, higher employment, as well as maintaining low and stable inflation and unemployment, and moving towards further convergence with EU average income levels. The structure policies envisaged in the National Reform Programme are expected to contribute positively to attain the macroeconomic objectives and to sustain the fiscal consolidation efforts.

Given the prevailing global macroeconomic environment, downside risks have inevitably risen across the whole of the EU and euro area. Global growth prospects remain moderate over the medium-term and the stability in financial systems continues to depend on the developments in sovereign debt. Moreover, the intensification of fiscal consolidation within the euro area is also expected to continue weighing down on near-term demand conditions and growth. In mitigating the effects of the external environment while at the same time continuing on its fiscal consolidation path, Government has strived to enhance its fiscal stance in a way so as not to impact unduly on economic activity. Additionally, Government has also continued to implement measures and reforms which complement the growth potential of the local economy and which will continue to yield support for further growth over the longer run.

Despite the prevailing economic conditions, the local economy still managed to grow in 2011, registering a growth in real GDP of 2.1 per cent. The growth registered last year was mainly sustained by the external sector while domestic demand also contributed positively to growth. Growth in the domestic sector was mainly supported by private consumption and government expenditure. In 2012, the Maltese economy is expected to continue growing albeit GDP growth is expected to be more subdued in line with the global macroeconomic environment. Real GDP growth is expected to reach 1.5 per cent in 2012, supported by both the domestic and external sectors of the economy. In particular, exports are expected to grow more than imports, whilst positive developments are also expected in private consumption and government expenditure. Investment is expected to contribute positively to growth, albeit driven by public investment as a negative growth is expected in private investment. Growth in the Maltese economy is expected to improve in 2013, remaining more subdued in the outer years of the Programme period.

The deficit of general Government during 2011 was reduced to 2.7 per cent of GDP reflecting an increase in the revenue ratio coupled with a marginal decline in the expenditure ratio and thus successfully reducing the fiscal deficit to below the 3.0 per cent of GDP threshold and an adjustment of 1.0 percentage point over the deficit ratio recorded a year earlier. The reduction in the deficit to GDP ratio will continue in 2012, reaching 2.2 per cent of GDP; an adjustment of 0.5 percentage points over 2011. The improvement in the deficit to GDP ratio in 2012 is expected on behalf of an improvement in the revenue ratio which should more than outweigh the increase in the expenditure ratio. The deficit to GDP ratio is expected to continue improving over the remainder of the forecast horizon for the Programme period reaching a ratio of 0.3 per cent in 2015 and underpinned by lower expenditure to GDP ratios which over compensate for milder declines in the ratio of revenue to GDP over the same comparative period. The depth ratio is expected to follow a downward path from 72.0 per cent of GDP in 2011 to 65.3 per cent of GDP in 2015.

The Maltese Government is currently also considering the adoption of fiscal rules in order to comply with the recent strengthening of the fiscal frameworks in the EU. With this aim, the fiscal rules being envisaged would include a target for general Government deficit and debt, towards the achievement of a balanced budget medium-term objective in structural terms, towards a minimum annual structural effort, as well as towards attaining a greater control on expenditure via the introduction of an expenditure rule. Moreover, in line with the new rules which will govern budgetary frameworks in the EU as from 2013, Malta is also considering further measures to strengthen the institutional framework underlying the formulation of fiscal policy.

In remaining committed to the fiscal consolidation process, the Budget for 2012 presented Government's efforts to further its revenue in a way so as not to overly weigh on the local economy. The Budget for 2012 also continued to build on important past efforts aimed at encouraging female labour market participation and also in promoting a sounder work-family balance. Within the Budget, Government also presented measures aimed at sustaining the local social fabric, in particular at maintaining social cohesion, the sustainability of the education system, as well as the environment. Further in line with the recommendations identified in the 2012 Annual Growth Survey, the National Reform Programme (NRP) builds on the efforts of the previous year's NRP in continuing to steer the economy towards higher and more sustainable GDP per capita and a sustainable fiscal and environmental path. The structural measures outlined in the NRP also provide a basis for sustainable long term growth and improved competitiveness which is also an essential requisite for sustaining public finances and future ageing costs. In particular, the NRP addresses areas of employment, research and development, energy, education and poverty reduction and social cohesion with an overarching aim of addressing improvements in competitiveness and productivity gains.

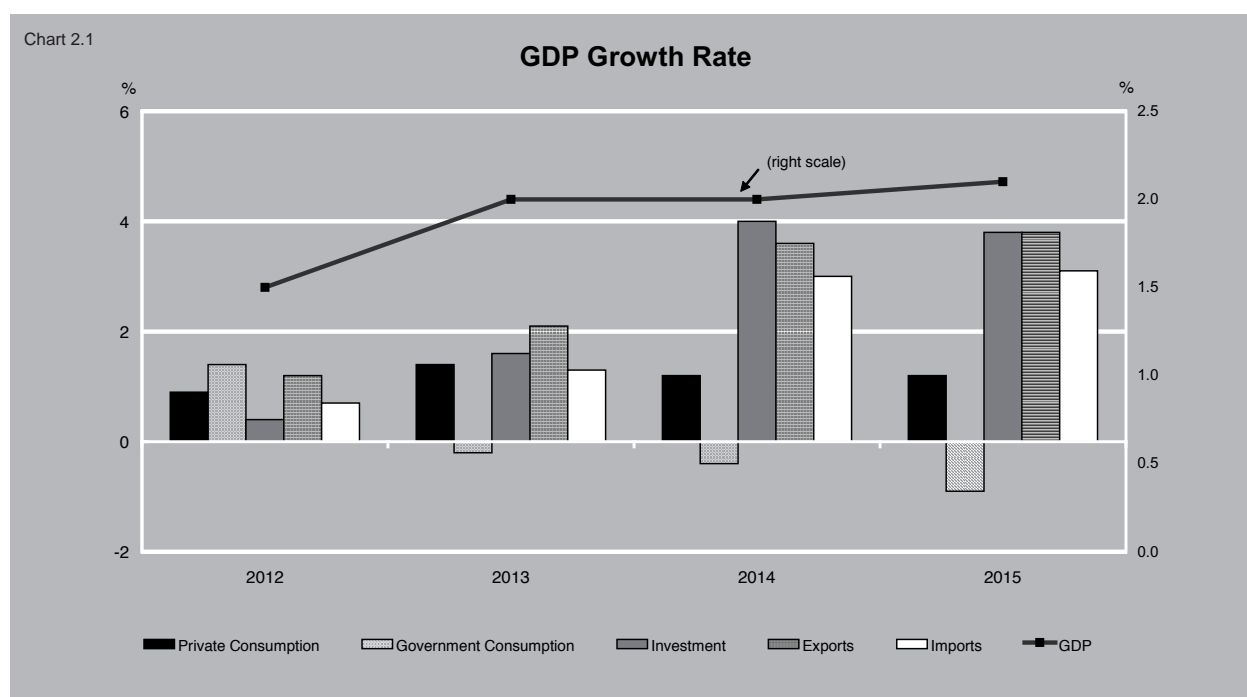
2. Economic Outlook

2.1 The Medium-Term Scenario

The problems that caused the international recession at the end of 2007 were due to deep structural faults in the form of fundamental imbalances that have built up for decades. Such deficiencies could not be resolved overnight and the adjustment is still ongoing. Nevertheless, in 2011 the Maltese economy continued to grow albeit at a slower rate where a slight contraction in GDP was registered in the last quarter of the year. This slower pace of growth can be partly attributed to the developments in the Euro Area where the loss of economic momentum towards the end of 2011 was stronger than anticipated. On a more positive note, the risk of an aggressive de-leveraging process in the euro-area as a whole has decreased. Nevertheless, the EU's economy is still expected to contract in the early part of 2012 and return to modest growth in the second half of the year on the back of a more sustained growth in both investment and consumption.

Despite the uncertainty in the international sphere, especially in peripheral economies of the Euro Area, the Maltese economy still managed to register robust growth during 2011. Latest data released by National Statistics Office (NSO) shows that the economy expanded by 2.1 per cent in real terms during 2011 mainly on the back of a strong performance in exports. The external sector contributed 2.2 percentage points towards overall growth while domestic demand contributed to 0.8 percentage points. Growth in the domestic sector was underpinned by growth in private consumption and government expenditure which expanded by 3.1 per cent and 3.9 per cent respectively. On the other hand, there was a contraction in gross fixed capital formation which registered a decline of 13.4 per cent in 2011.

In 2012, the Maltese economy is expected to continue growing with a growth rate of 1.5 per cent in real terms. This growth rate is expected to be underpinned by positive developments in both the domestic and the external sectors of the economy. Private consumption is expected to increase by 0.9 per cent while government expenditure is expected to increase by 1.4 per cent during 2012. Investment is also forecasted to increase marginally by 0.4 per cent mostly underpinned by strong increases in public investment. Private investment is still expected to continue acting as a drag with negative growth expected during the current year. Despite a more modest export performance compared to 2011, growth in net exports is expected to persist during 2012 with exports expected to increase by 1.2 per cent compared to an expected growth rate of 0.7 per cent in imports.



Main Macroeconomic Indicators

Table 2.1

	2010	2011	2012 ⁽¹⁾	2013	2014	2015
GDP growth at current market prices (%)	5.4	4.4	3.6	4.4	4.4	4.5
GDP growth at constant (2000) prices (%)	2.3	2.1	1.5	2.0	2.0	2.1
Expenditure Components of GDP						
at constant (2000) prices (% change)						
Private final consumption expenditure ⁽²⁾	-1.7	3.1	0.9	1.4	1.2	1.2
General government final consumption expenditure	0.6	3.9	1.4	-0.2	-0.4	-0.9
Gross fixed capital formation	9.8	-13.4	0.4	1.6	4.0	3.8
Exports of goods and services	17.7	1.0	1.2	2.1	3.6	3.8
Imports of goods and services	13.7	-1.0	0.7	1.3	3.0	3.1
Inflation rate (%)	2.0	2.4	2.3	2.4	2.2	2.2
Employment growth (%)	2.3	2.4	1.0	1.6	1.6	1.6
Unemployment rate (%)	7.0	6.5	6.4	6.3	6.3	6.3
Labour productivity (% change)	0.0	-0.3	0.5	0.4	0.4	0.5
External Goods and Services Balance (% of GDP)	2.7	4.7	5.2	5.9	6.5	7.4

⁽¹⁾ Forecasts from 2012 onwards

⁽²⁾ Includes NPISH final consumption expenditure

This relatively balanced composition of growth determinants from the expenditure side is expected to remain broadly unaltered for the 2013-2015 period, with a slightly higher contribution from the external sector and from investment. Private consumption is expected to increase further in 2013 and to return to a more modest growth in 2014.

Chart 2.1 illustrates the projected growth rate of GDP together with a detailed breakdown of the various expenditure aggregates. Table 2.1 presents the main macroeconomic indicators for the years 2010-2015. The figures for 2010 and 2011 have been published by the NSO¹, whilst figures from 2012 onwards are forecasts. The macroeconomic forecasts take into account the latest available data and are being provided in Tables 1a, 1b, 1c, and 1d of the Statistical Appendix.

2.1.1 Assumptions for Projections

The macroeconomic forecasts presented in this Stability report are based on the following assumptions:

- Economic activity in Malta's main trading partners is expected to increase in real terms by 0.4 per cent in 2012 followed by more positive growth rates of 1.4 per cent in 2013 per cent thereafter.
- Oil prices are assumed to increase further in 2012, from an average US\$111.5 per barrel (€80.2 per barrel) in 2011 to US\$119.5 per barrel (€99.9 per barrel) in 2012 and to decrease marginally thereafter.
- Both short-term and long-term interest rates are assumed to decline during the forecast period while

nominal effective exchange rate is assumed to decline to -2.6 in 2012 and to remain broadly constant for the remaining forecast period.

- It is being assumed that, in line with Government policy, Government employment follows a downward trajectory as Government restricts recruitment in non-essential categories.
- Changes in inventory are assumed not to contribute materially to GDP growth.

2.1.2 Risks to Outlook

The medium-term outlook for the global economy is one of steady growth. Nevertheless there are a number of factors that could restrain growth prospects.

The macroeconomic forecast is subject to developments in the global economy and to the euro-area in particular and these in turn are subject to a degree of uncertainty. Among the most immediate risks is the possibility of a renewed escalation of the sovereign-debt crisis in the EuroArea. This could happen if certain measures which were already announced are not adopted or if they are not implemented quickly enough. Furthermore, weaker than expected global economic growth could impact adversely on Malta's main trading partners and as a result exports prospects will be negatively hit. Another downside risk stems from the possibility of heightened geopolitical uncertainty that could trigger a sharp increase in the price of oil. On the other hand there are also a number of upside risks: growth might turn out stronger than projected, particularly in emerging economies which could help a more rapid recovery in Malta's main trading partners. Greater confidence stemming from successful policy measures and waning supply-side disruptions, if the risk premium in oil prices dissipates, could foster a more forceful rebound in investment. There is also the possibility that trade will be boosted by renewed economic activity in North Africa, mainly in Libya. A weaker euro exchange rate against the US Dollar and the UK Sterling would also make Maltese exports more competitive and boost external demand for Maltese output. Overall, the risks surrounding the forecasts remain significant and are broadly balanced.

2.1.3 Private Final Consumption Expenditure

Following the contraction in private final consumption expenditure during 2010, consumer expenditure increased by 3.1 per cent in 2011 and is expected to continue expanding in 2012 albeit at a significantly lower pace. Private consumption is forecasted to increase by 0.9 per cent in real terms in 2012 sustained by a positive performance in the labour market. Indeed, underlying these forecasts are sustained increases in employment supported by a moderate appreciation of wages over the forecast horizon. Over the forecast period, growth in private final consumption expenditure is expected to gradually improve, increasing to 1.4 per cent in 2013 and to return to a more moderate growth rate of 1.2 per cent in 2014 and 2015.

2.1.4 General Government Final Consumption Expenditure

Growth in Government final consumption expenditure is projected to increase by 1.4 per cent in 2012 but is expected to decline from 2013 onwards. Government final consumption is expected to decline by 0.2 per cent in real terms in 2013 and to decline even further for the outer years of the forecast period with forecasted rates of -0.4 per cent and -0.9 per cent in 2014 and 2015 respectively. This contraction in Government expenditure reflects the effort underway in terms of fiscal consolidation strategy with special emphasis placed on the restraint of expenditure of a recurrent nature.

2.1.5 Gross Fixed Capital Formation

Gross fixed capital formation is expected to increase only marginally during 2012 as growth in private investment is still expected to remain negative while public investment is expected to expand significantly during 2012. With regards 2013, investment is expected to improve marginally by 1.6 per cent in real terms

and to continue expanding in the outer years with the private investment gradually becoming the major contributor to overall investment as growth in profits gains momentum and external demand is expected to spur further investment.

2.1.6 External Balance of Goods and Services

During 2011, net exports continued to contribute positively to growth. This positive performance is expected to continue during the forecast period.

For 2012, exports are expected to increase by 1.2 per cent while imports are expected to grow by 0.7 per cent. The gap between exports and imports is expected to widen further in 2013 with exports expected to increase by 2.1 per cent while imports expected to increase by 1.3 per cent. Thereafter, net exports are expected to moderate despite higher exports growth prospects of 3.6 per cent and 3.8 per cent for 2014 and 2015 respectively.

Growth in net exports during the forecast period is expected to be underpinned mainly by growth in exports of goods which are forecasted to increase by 5.2 per cent in 2012 and 2013 mainly underpinned by positive expectations with regards exports of specialised manufacturing goods including pharmaceuticals. Growth in exports of services is forecasted to be more moderate at around 1.7 per cent and 3.4 per cent in 2012 and 2013 respectively.

2.1.7 Productivity and Employment Prospects

Following a registered growth rate of 2.3 per cent in 2010, total employment increased by a further 2.4 per cent in 2011. Growth in employment is expected to slow down in 2012 to around 1.0 per cent. Thereafter, in line with the expected improvement in the economic environment, employment is expected to grow on average by 1.6 per cent. These increases in employment are expected to be underpinned by an increase in both self-employed, with a forecasted average rate of 1.2 per cent, as well as employed which is expected to increase on average by 1.5 per cent. Furthermore, growth in employment is expected to stem mainly due to a higher female employment rate, partly reflecting increased efforts from Government to increase female participation, and an increase in employment flexibility in terms of labour hours.

The growth in employment is also sustained by the provision of wage moderation expected over the forecast period. Average wages are expected to grow moderately, with compensation per employee forecasted to grow by 0.9 per cent in 2012 and by around 0.6 per cent in the end of the forecast period. Given the increases in employment and developments in compensation of employees, labour productivity is expected to be positive over the forecasted period with an expected average growth of 0.5 per cent during 2012-2015 period.

Growth in output is expected to be supported by the emerging growth sectors with the possibility of gaining market shares in industries such as pharmaceuticals, aircraft maintenance, remote gaming, information technology, and the financial and related business services. These sectors will increasingly offset the decline of more traditional sectors of the Maltese economy and are likely to increase further the openness of the economy. Nevertheless the gradually recovering but still anaemic external demand will still continue to act as a drag on the performance even of these emerging industries.

In 2012, the unemployment rate (based on the Harmonised definition) is expected to decline marginally by 0.1 percentage points to 6.4 per cent and to remain broadly stable at 6.3 per cent during the forecast period.

2.1.8 Inflation

During 2011, recorded inflation (calculated as the twelve month moving average of the HICP) stood at 2.4 per cent with significant price increases registered in energy and food. These upwards pressures are expected to persist during 2012. As a result, inflation is expected to remain close to 2.3 per cent in 2012 while for

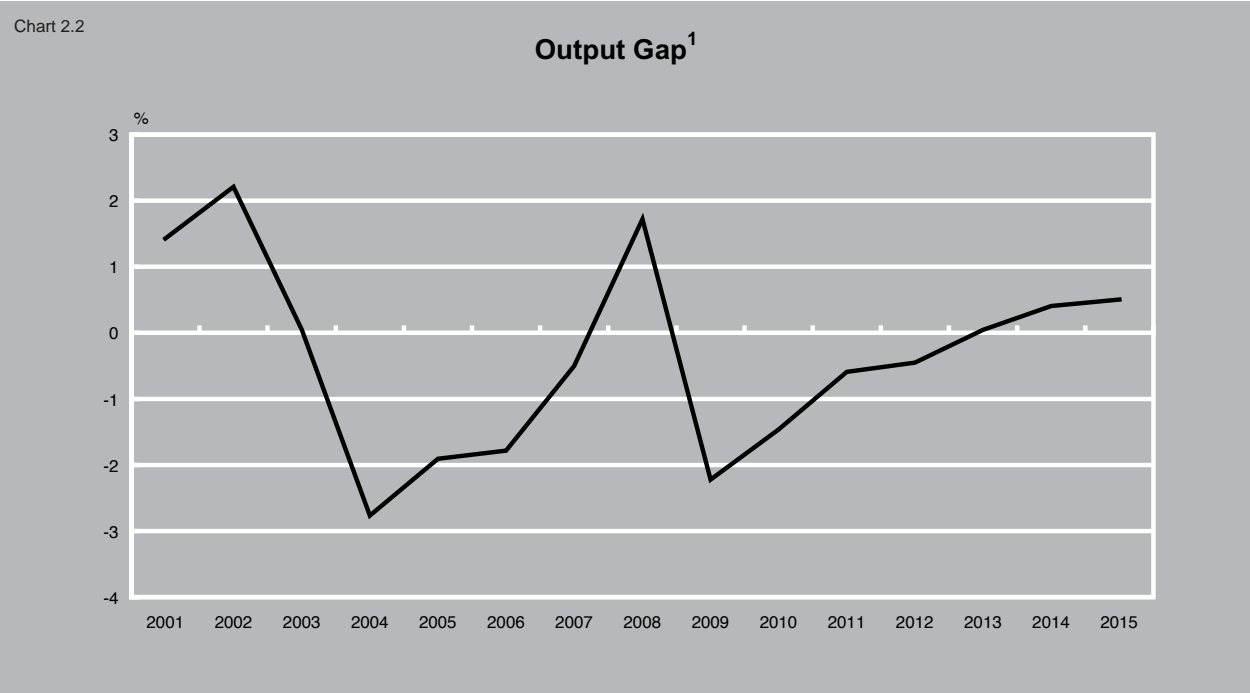
2013 inflation is expected at 2.4 per cent. For the outer years, inflation is expected to remain stable at an average rate of around 2.2 per cent.

2.2 Potential Output and the Output Gap

The estimation of potential output and the output gap within this Programme is based on the commonly-agreed Production Function method. In this regard the main differences between ECFIN and the Government’s estimation pertain to differences in the macroeconomic forecasts and the working age population figures. Developments in the output gap are presented in Chart 2.2.

The first half of the past decade was characterised by a low rate of economic growth compared to Malta’s average rate of economic growth. Indeed, during the period 2000-2005, economic growth averaged 1.8 per cent. The rather subdued rate of growth during this period was underpinned by a combination of international developments and domestic factors. Following EU accession, the Maltese economy exhibited a notable improvement in growth prospects and during the period between 2006 and 2008, annual economic growth increased notably to slightly below 4 per cent. This strong performance was however curtailed with the advent of the financial crisis in 2008 and the subsequent global recession. As a result, during 2009, the domestic economy shrank by 2.7 per cent. Notwithstanding, the Maltese economy exhibited a rather rapid recovery from the recession, and grew at a rate of 2.3 and 2.1 per cent during 2010 and 2011 respectively. The recovery was underpinned by a sustained strong performance in the external sector. GDP is expected to expand by 1.5 per cent in 2012 and by 2.0 per cent in 2013.

Average potential output growth, which is a measure of the growth potential of the economy, stood at 1.9 per cent during the period 2006 – 2011. This rate of growth is marginally lower than the average potential growth rate pertaining to the period 2000 – 2005. It is pertinent to point out that the rate of growth of potential output decelerated markedly from the year 2008 onwards. This deceleration is expected to reach a through in 2011, and to exhibit a marginal gradual increase over the forecast period. This slower growth rate in potential output was underpinned by lower contributions from both potential labour input, mainly in terms of average hours worked, and in the capital factor as a direct result of the international recession. Over the forecast period 2012 – 2015, average potential growth is expected to hover around the 1.6 per cent level, mainly underpinned by positive developments in the labour market, largely through a higher



¹ Defined as actual output less potential output as a per cent of potential output.

participation rate, and improvements in total factor productivity. Investment activity is however expected to remain subdued in the short term.

The output gap, is defined as the difference between actual and potential output, expressed as a ratio of potential output. The gap, is indicative of the cyclical developments prevailing in the Maltese economy. After reaching a peak at 5.3 per cent in 2002, the output gap started to decline and turned negative in 2004. Actual output remained below the potential level up to 2008, when the output gap turned positive. Following the international recession and the subsequent contraction of the domestic economy in 2009, the output gap turned negative. Indeed, in 2009 the output gap is estimated to have declined to -2.2 per cent. In the subsequent two years, although the gap between potential and actual output contracted, the output gap remained negative and is estimated to have stood at -0.6 per cent in 2011.

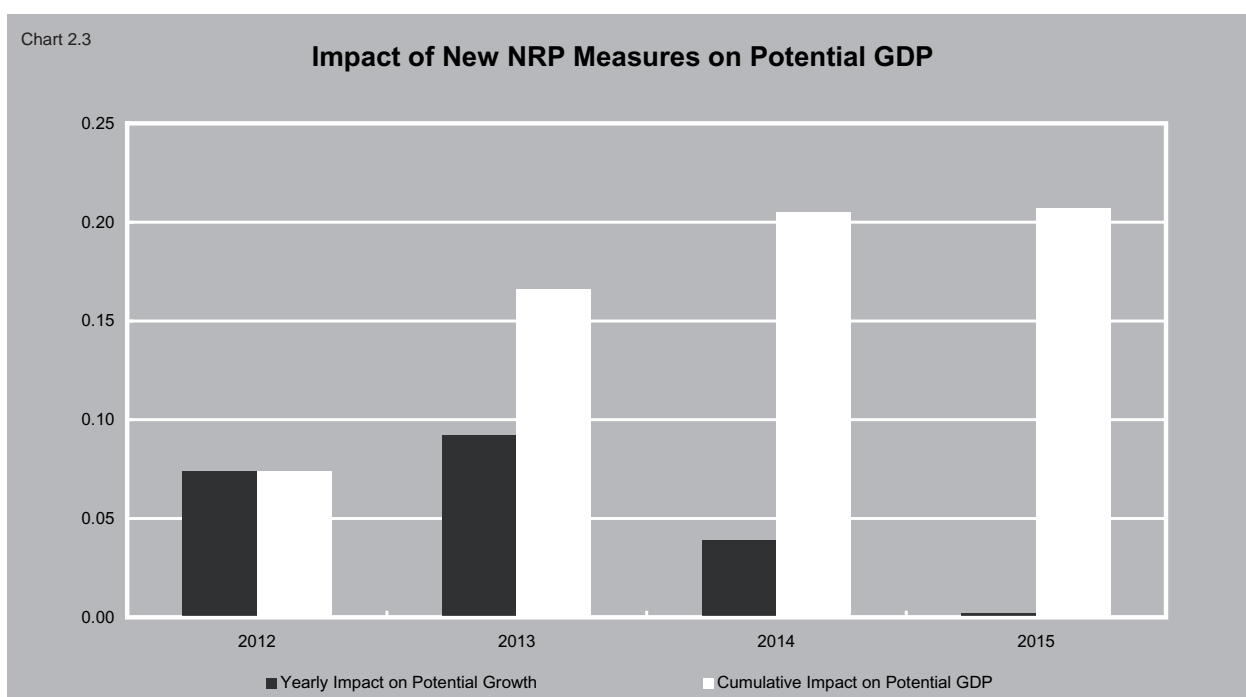
During the forecast period the output gap is estimated to continue closing down steadily until the year 2013. In the outer years of the forecast period the output gap is expected to remain positive with the Maltese economy registering a rate of economic growth that is slightly above potential.

2.3 Potential Growth and Structural Reforms

Following the international financial crisis, Government started to implement a number of reforms aimed at easing the negative impact of the recession on the Maltese economy whilst at the same time addressing the bottlenecks to economic growth which were evident even prior to the crisis. In continuation with a number of measures implemented in recent years, in 2012 the Maltese Government introduced, or is planning to introduce, a number of new measures aimed at improving the country's potential output.

Amid the difficulties faced by economies worldwide, in 2011 potential GDP growth for the Maltese economy declined. However, potential GDP is expected to follow an upward trend from 2012 onwards and to reach a 2.0 per cent growth rate by 2015. In addition, the measures introduced in the NRP 2012 should further sustain the country's economic growth.

Chart 2.3 shows estimates of the impact on potential GDP growth for a selection of measures presented in NRP 2012. These include the employment in the social economy project, employment support for persons with disability, the upgrading of industrial estates, the extension of the Malta College of Arts, Science and



Technology (MCAST), energy efficient measures for the hospitality sector, the distribution of national research and innovation funds and the setting up and development of the National Interactive Science Centre. Specifically, the chart shows the estimated yearly impacts of these measures on potential GDP growth and their cumulative impact.

It shows that the new measures will increase the growth rate of Maltese economy's potential output by a yearly average 0.07 per cent during 2012-2014. In subsequent years, the higher base effect resulting from the shift of potential GDP growth to earlier years leads to negligible potential GDP growth in 2015. The estimated cumulative impact on potential GDP growth is expected to reach 0.2 per cent by 2014 and to remain at that level in 2015. However, it should be noted that these estimates may underestimate the impact of the new measures on potential GDP growth because it is assumed that they have no impact on the economy's productivity.

Footnote:

¹Data in line with NSO News Release (National Accounts, GDP 2011), No. 049/2012

3. General Government Balance and Debt

3. General Government Balance and Debt

Achieving a balanced budget over the cycle remains a main objective of Government's economic policy as documented in successive Stability Programmes and in National Reform Programmes (NRP's). The crisis in a number of Euro area economies has brought to the fore the relevance of ensuring that growth sustains the fiscal consolidation efforts and that fiscal consolidation does not stifle growth to the extent that the fiscal targets set in the beginning of a programme period are jeopardised.

In this context, Government has sought to embark on a plan of fiscal consolidation which is, as far as possible, growth friendly. Moreover, a clear effort remains in order to ensure that public investment is sustained in spite of the fiscal consolidation efforts. Furthermore, the increasing absorption of EU funds is expected to ensure that the increase in public investment has a limited impact on public finances. Where possible revenue raising measures were designed with a view to minimise the negative economic impact of these measures. The efficiency of tax systems is constantly being monitored and measures aimed at recovering tax arrears have been implemented over a number of years and will continue to be implemented.

Expenditure consolidation efforts have tried to maximise value for money and reduce benefit fraud. Moreover, recruitment policy in the public sector is expected to remain consistent with fiscal consolidation efforts; restrictive but without resorting to lay-offs at this fragile moment in the economic cycle. A further tightening of recruitment and further restraints in overtime costs were also implemented in January 2012 and these policies are expected to remain in place over the Programme period. In addition, the pension reform initiative legislated in 2006 is expected to lead both to revenue increases in terms of national insurance contributions as well as lowering pension expenditure thus putting public finances on a more sustainable footing.

Furthermore, as documented in the National Reform Programme, structural reforms are expected to sustain economic growth prospects of the Maltese economy. Whilst uncertainty prevails in the international environment, structural reform efforts can contribute to competitiveness gains allowing Malta to retain and in certain instances increase market shares thus cushioning the effect of a possible slowdown in external demand on which the Maltese economy is heavily dependent.

Over the medium-term Malta remains committed to reach a balanced structural budgetary position. While a positive balanced structural budget will be reached beyond the forecast horizon set out in the Programme period, Government has been and remains committed to keep implementing plans which meet the commitments under the Stability and Growth Pact for annual structural fiscal efforts. A structural effort averaging 0.5 per cent of GDP per annum will allow the structural deficit to decline from 2.8 per cent of GDP in 2011 to 0.7 per cent in 2015.

The continued improvement in the primary surplus projected over the medium term together with positive growth prospects and sustained investor confidence should ensure further improvements in the debt dynamics. Indeed, after reaching 72.0 per cent of GDP in 2011, gross Government debt is expected to follow a downward path during the outlook period to reach an envisaged level of 65.3 per cent of GDP by 2015. In addition it is worth highlighting that over the Programme period the proportion of short-term debt is expected to decline from 6.7 per cent of total Government debt to 1.6 per cent by 2014, whilst the share of maturing stocks and new loans in total Government debt is expected to decline from 14.0 per cent in 2012 to 8.5 per cent in 2015.

3.1 Fiscal Developments in 2011

The impact of the economic downturn, together with some discretionary expenditure increases in 2008, led to a widening of the general Government deficit. Against this background, on 7 July 2009, the Council decided that an excessive deficit existed and addressed recommendations to Malta in accordance with Article 104(7) of the Treaty establishing the European Community with a view to bringing an end to the situation of an excessive government deficit by 2010. On 16 February 2010, on the basis of a Commission

recommendation, the Council concluded that effective action had been taken in compliance with the above recommendations but unexpected adverse economic events with major unfavourable consequences for public finances were also considered to have occurred. As a result, the Council recommended that the deadline for the Maltese authorities to put an end to the excessive deficit be extended by one year. Indeed, the Council recommended Malta to bring the deficit below 3 per cent of GDP in a credible and sustainable manner by 2011 and to ensure a fiscal effort of $\frac{3}{4}$ of a percentage point of GDP in 2011.

In line with the EDP recommendation, Malta took effective action to bring down the general Government deficit below the 3 per cent threshold by the end of 2011. In fact, the general Government deficit-to-GDP ratio for 2011 declined to 2.7 per cent of GDP, largely reflecting an increase in the revenue ratio as well as a marginal decline in the expenditure ratio. These developments echo the implementation of Government's fiscal plan for 2011, which pursued the implementation of a number of measures, mainly impacting on revenue supplemented by expenditure-containment measures, aimed at reducing the fiscal deficit.

3.1.1 General Government Revenue

In 2011, the general Government revenue-to-GDP ratio increased by 0.7 percentage points of GDP to 40.2 per cent on account of a higher tax revenue ratio. The latter increased from 27.1 per cent in 2010 to 27.7 per cent in 2011, mainly reflecting developments in the ratio of taxes on production and imports. The latter contributed to an increase of 0.5 percentage points in the revenue-to-GDP ratio, mainly underpinned by higher receipts from value added type taxes as private consumption rebounded in 2011. Higher proceeds from excise duty on petroleum also contributed to the increase in the ratio of taxes on production and imports, reflecting the revision in the excise duty rates on fuel and power products.

Meanwhile, marginal increases recorded in the ratio of current taxes on income and wealth, social contributions and 'other' revenue were in part offset by a lower ratio of property income, mainly reflecting lower payments for structural encroachment on Government property.

3.1.2 General Government Expenditure

The ratio of general Government expenditure decreased by 0.3 percentage points of GDP from 43.3 per cent in 2010, reflecting lower ratios recorded for capital transfers and 'other' expenditure, in part offset by higher ratios for intermediate consumption and gross fixed capital formation.

The ratio of capital transfers to GDP declined by 0.6 percentage points in 2011. This decline mainly reflects lower expenditure on projects in part financed from EU funds, in particular in respect of the JEREMIE programme, which provides for improved access to finance for micro business and SMEs in the regions of the EU. Meanwhile, a lower ratio of the 'other' expenditure category was mainly due to lower current transfers payable.

The ratio of intermediate consumption to GDP increased by 0.5 percentage points of GDP in 2011, mainly on account of higher expenditure by Extra Budgetary Units (EBUs) in respect of tourism-related activities, waste and mental health, and an increase in outlays for medicines and surgical materials. In order to control the cost of medicines the Ministry of Health, the Elderly and Community Care has initiated negotiated procedures for medicines to be supplied by an exclusive source and shall also be negotiating better prices in cases where consumption is increasing due to the relevant demand during the contract period. There is also the intention of introducing e-procurement on all medicines with reverse auctioning. The introduction of IT measures to increase efficiency and just-in-time stocks is also being planned.

The increase in the ratio of gross fixed capital formation from 2.2 per cent of GDP in 2010 to 2.5 per cent in 2011 is mainly underpinned by higher outlays for the upgrading of tourism zones, for the upgrading and embellishment of industrial estates, and for the restoration and rehabilitation of historic fortifications. These projects were in part financed from EU funds.

Meanwhile, the ratios of compensation of employees, social payments, interest expenditure and subsidies remained relatively stable in 2011.

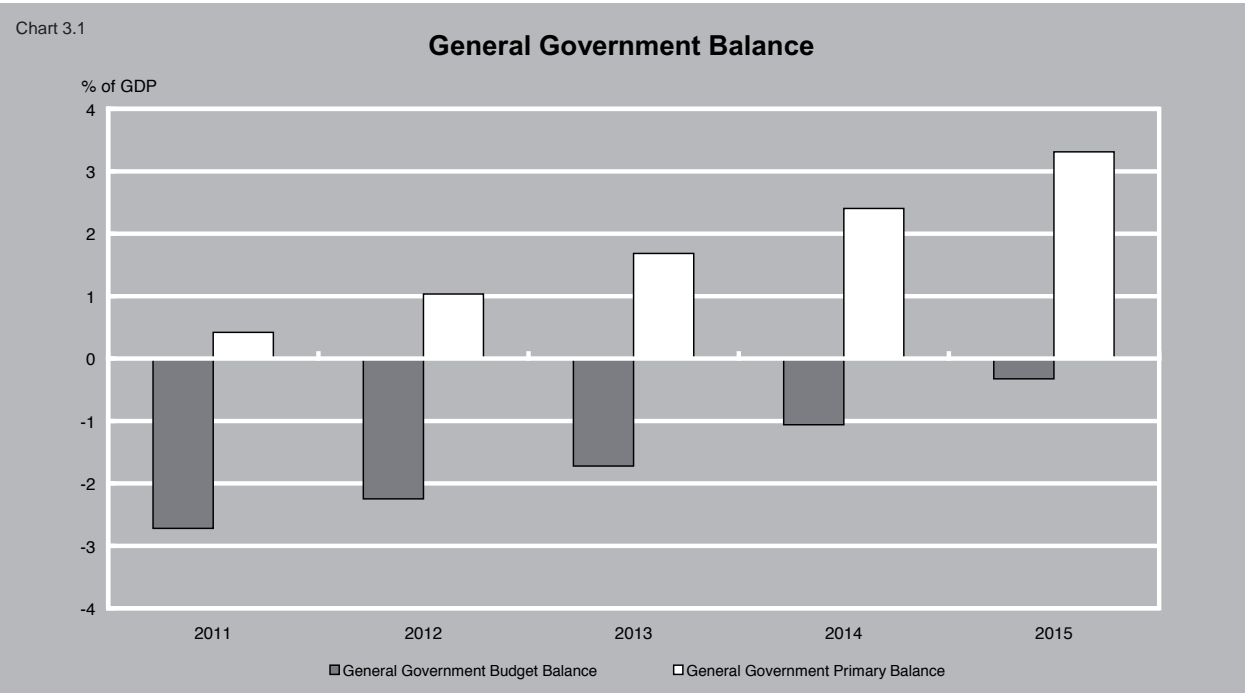
3.2 The Medium-Term Budgetary Outlook

As illustrated in Chart 3.1, the general Government deficit as a per cent of GDP declined below the 3.0 per cent of GDP reference value in 2011, and is expected to continue on a downward path thereafter. In fact, the general Government deficit ratio is expected to decrease further from 2.7 per cent of GDP in 2011 to 0.3 per cent in 2015. Table 2a in the Statistical Appendix presents general Government revenue and expenditure projections for the 2012-2015 period.

Without policy intervention, as illustrated in Table 2b in the Statistical Appendix, the revenue ratio is expected to increase by 2.1 percentage points to 41.5 per cent of GDP in 2012 and to remain relatively stable thereafter. These developments mainly reflect changes in revenue from EU investment grants. However, since such revenue flows correspond to similar increases in expenditure, in view of the overarching goal of ensuring the sustainability of public finances over the medium-term, the natural developments in revenue occurring as a result of developments in the macroeconomic environment will be supported with policies which have a positive impact on the deficit-to-GDP ratio. The fiscal impact of these discretionary revenue measures is expected to decline from 1.6 percentage points in 2012 to 0.2 percentage points by 2015.

The fiscal consolidation envisaged over the medium-term framework also relies on expenditure restraint measures. This is in line with Government’s priority to pursue fiscal consolidation without undermining the competitiveness of the Maltese economy by increasing the tax burden unnecessarily. Meanwhile, Government’s fiscal policy also aims to enhance the growth potential of the economy through expenditure, financed through own and EU funds, in areas that are crucial for the country’s economic development, including infrastructure, education, the environment and social development whilst supporting industry, including tourism.

A more detailed analysis of Government’s fiscal policy over the medium-term framework is presented in the next Section.



3.2.1 The Medium-Term Fiscal Strategy

The Maltese Government acknowledges the need to maintain sound and sustainable public finances and to prevent the general Government deficit from becoming excessive. In view of the required progress towards the medium-term objective, Government is pursuing the implementation of a number of measures announced in the 2012 Budget aimed at reducing further the fiscal deficit. Further to these measures, in January 2012 Government announced a review of spending allocations to support the deficit target set in the 2012 Budget. In addition, Government is strengthening and stepping up its efforts towards curbing fiscal and benefit abuse and to increase efficiency in revenue collection. Details of Government's fiscal strategy are illustrated in Table 3.1.

The medium term fiscal strategy is also being sustained by the impact of the pension reform initiatives legislated in 2006 which is expected to lead both to higher revenue due to the increase in contribution rates and lower number of retirees and reduced expenditure due to the changes in the retirement age. The Pension reform provides for a gradual rise in the pension age. This reform has immediate implications for expenditure over the short term. Prior to the reform pension age stood at 60 years for females and 61 for males, and this remained the case for persons born on or before the 31st December 1951. For persons born in calendar years 1952 to 1955, pension age shall be 62 years for both males and females. However one notes a proviso – that for persons with 1,820 (35 years) contributions, pension age remains that of 61 years, if such a person is no longer gainfully occupied.

This reform will have its first impact in 2012 as females who would have otherwise retired in 2012 at age 60 years will now be retiring at age 62 years in 2014. Meanwhile in 2013, males who would have retired at age 61, will now be retiring at age 62 in 2014. In addition females born in 1953 who would have otherwise retired in 2013 at age of 60 will now be retiring in 2015. Thus savings in expenditure relative to a 'no reform' baseline would include the savings on females (born in 1952) in 2012 and the savings on both males and females (males and females born in 1952, females born 1953) in 2013.

A conservative estimate of the impact of pension reform suggests that in 2012 Government would save €7.1 million in expenditure on pensions. The expenditure savings rise to €20.4 million in 2013. These estimates reflect the additional pension benefits that would have been paid had the pension age not been increased. It is estimated that in 2012 around 920 less would retire compared to a baseline scenario in the absence of reform. These are females who are expected to postpone their pension entitlements because they had accumulated less than 35 years equivalent of social security contributions. In 2013 the number of additional individuals who would have retired in the absence of reform rises to 2,626. This includes an estimated 819 males aged 61 and 916 females aged 60 in 2013 who have become ineligible in 2013 due to the increase in the pension age. Also included is the impact of an estimated 891 females born in 1952 who would have otherwise retired in 2012 but are now retiring in 2014 due to the reform.

One must add that these figures are rather cautious and there is potential for further savings, especially if persons who are eligible to retire early at 61 years, actually remain in employment up to pension age. The potential for this further savings can be further ascertained when administrative statistics for 2012 become available. In addition one notes that new entrants, on average tend to have a pension that is higher than the average for previous cohorts. By basing the estimate on the average for entire group, there is the potential for further savings in expenditure.

As a result of pension reform an increase in social security contributions for persons born after 1st January 1962 or later is also expected for 2012 and 2013. For 2012 the impact of pension reform is expected to amount to an estimated €1.3 million with a further increase expected in 2013. The impact of the further rise in the contribution ceiling in 2013 is expected to be quantitatively similar to 2012. In addition, one would expect any slowdown in revenue increases in 2013 due to the rise in the ceiling in the distribution of income will be countered by the increase in the wage bill.

Discretionary Factors Underpinning Fiscal Consolidation

Table 3.1

€ million

	2012	2013	2014	2015
Main Measures Impacting on Revenue				
Fiscal consolidation measures	11.4	16.2	0.2	0.2
Revision in excise duty on mobile telephony	0.5	0.1	0.1	0.1
Revision in excise duty on cement	1.2	0.1	0.1	0.1
Revision in excise duty on cigarettes and tobacco	3.7	–	–	–
The introduction of excise duty on fuel for bunkering of ships outside territorial waters	6.0	–	–	–
Structural measures	–	16.0	–	–
Growth enhancing measures	-10.0	–	–	–
Revision in the income tax rates for parents supporting children who are not gainfully employed up to 18 years of age	-10.0	–	–	–
Measures promoting a sustainable environment	7.8	-2.3	–	–
Revision in the registration tax of private vehicles	7.8	-2.3	–	–
Social cohesion measures	9.8	8.8
Removal of television licence fees	-1.5	-2.5	–	–
Pension reform initiatives (excluding State contribution)*	11.3	11.3
Other measures	85.3	15.9	3.1	1.2
The revision of commercial rents in Valletta	3.0	–	–	–
Net revenue from capitalisation and sale of property	2.2	–	-0.1	–
Efficiency in revenue collection	41.0	15.9	3.2	1.2
Lottery operator concession fee	39.1	–	–	–
Total	104.3	38.6	3.2	1.4
Main Measures Impacting on Expenditure				
Fiscal consolidation measures	-40.0	–	–	–
Additional post-budgetary expenditure containment effort	-40.0	–	–	–
<i>of which</i>				
Restraint in recruitment and overtime	-9.6	–	–	–
Expenditure restraint by Government entities	-11.5	–	–	–
Lower expenditure on Programmes & Initiatives	-14.1	–	–	–
Social cohesion measures	21.1	-9.2	0.1	0.1
Pension reform initiatives **	-7.1	-13.3	–	–
Energy subsidy	21.0	4.0	–	–
Fund for strengthening the sustainability of private schools	1.0	–	–	–
An increase in the minimum rate for children's allowance	2.8	–	–	–
A grant to the elderly over 80 years of age living independently	3.4	0.1	0.1	0.1
Growth enhancing measures	0.5	0.5	–	–
Extension of maternity leave by 2 weeks in 2012 and a further 2 weeks in 2013	0.5	0.5	–	–
Other measures	20.0	40.0	15.0	–
Equity acquisition in Airmalta plc	20.0	40.0	15.0	–
Total	1.6	31.3	15.1	0.1

*The estimate contained in the NRP is inclusive of the State contribution.

** The cumulative impact of the Pension Reform initiative in 2013 is estimated at €20.4 million.

3.2.1.1 The 2012 Budget

As in previous years, in the Budget for 2012, fiscal consolidation remained high on Government's agenda. Indeed, in the 2012 Budget, Government introduced a number of measures aimed at reducing the fiscal deficit, in particular the revisions to the excise duty on mobile telephony, cement, and cigarettes and tobacco, and the introduction of an excise duty on fuel for bunkering of ships outside territorial waters. These fiscal consolidation measures were designed so as not to impact unduly on economic activity. Collectively they are estimated to have a positive fiscal impact amounting to 0.2 per cent of GDP in 2012.

In a bid to encourage higher female labour market participation, the 2012 Budget builds on past efforts in aiding the creation of a proper work-family balance by providing for the revision in the income tax rates for parents supporting minors who are not gainfully employed. Furthermore, the maternity leave has been extended from 14 weeks to 16 weeks as from the beginning of this year and shall increase by a further two weeks in 2013. The extra weeks are payable from public finances at a fixed weekly rate of €160. These measures are expected to exert a negative impact on public finances amounting to 0.2 per cent of GDP.

The environment dimension remains an important consideration in Government's policy. In this context, the 2012 Budget announced further incentives for cleaner private vehicles, as a result of which the amount of tax payable upon registration of private vehicles will also be based on the Euro standard of the vehicle, in addition to carbon dioxide, particulate matter, length and value of the car according to the make. Additional revenue from this revision is estimated to amount to 0.1 per cent of GDP in 2012. A shift in consumer preference towards cleaner private vehicles, which incur a lower registration tax, is expected to result in lower revenue from this measure in 2013, although this will have a negligible impact on the fiscal imbalance.

The Budget for 2012 also continued to strengthen social cohesion through the provision of enhanced assistance to households and specific disadvantaged groups. In particular, the removal of television licence fees, the increase in the minimum rate for children's allowance and a grant payable to the elderly over 80 years of age living independently are expected to exert a negative impact on public finances amounting to 0.1 per cent of GDP in 2012. Meanwhile, in the 2012 Budget, Government set up a fund in order to strengthen the sustainability of private schools. This fund provides for services related to the individual needs of students, for investment in software and IT licences, for the improvement of science and sports facilities, and for the professional development of teachers in private schools.

Other measures announced in the 2012 Budget include the revision of commercial rents in Valletta and the launch of a scheme whereby the Lands Department will capitalise acquisition rent paid on residences in Valletta and Cottonera allowing these households to become homeowners. These schemes are expected to collectively exert a positive impact on public finances to the effect of 0.1 per cent of GDP in 2012.

3.2.1.2 Additional Expenditure Containment Measures

Owing to the increasing risks in the international economic situation, in January 2012 additional measures aimed at strengthening the fiscal consolidation efforts of Budget 2012 were announced. Ministries, departments and public entities are being encouraged to critically evaluate the current resource allocation, to ensure further synergy of processes, eliminate duplication, share logical support both intra- as well as inter- Ministry, and consolidate further back-office work in Gozo. Moreover, a more stringent recruitment policy limits recruitment when vacancies arise due to resignations or retirement unless in professional grades in the health, education, social and EU-related sectors. The more stringent recruitment policy is expected to remain operational over the entire Programme period. These measures, which have started to be implemented, are expected to result in additional savings across recurrent expenditure headings, in particular from improved work practices and from a more efficient use of resources, as reflected in the expected decline in the ratios of compensation of employees and intermediate consumption by 0.3 percentage points and 0.2 percentage points respectively.

3.2.1.3 Other Factors shaping Fiscal Consolidation over the Medium-Term

As in other developed countries, age-related spending is projected to increase in the coming decades. However, the changes introduced by the 2006 pension reform are expected to mitigate the projected increase in pension expenditure, in particular through the increase in the pension age, the increase in the contribution period for full pension eligibility and the changes to the benefit formula. Throughout the Programme period, the reform in the pension system is estimated to result in additional revenue from social contributions amounting to 0.2 per cent of GDP in 2012 and roughly the same amount in 2013, whilst on the expenditure side, the pension reform is estimated to cumulatively reduce expenditure by 0.1 per cent of GDP in 2012 and 0.3 per cent of GDP in 2013.

Meanwhile, increased efficiency in revenue collection, which primarily includes pecuniary incentives to reduce tax arrears, is expected to yield around 0.6 per cent of GDP in 2012. In the remaining years of the Programme period, revenue from these schemes mainly reflects multi-annual contractual agreements for the settlement of arrears due in monthly instalments. Further to the measures to improve tax collection efficiency, several other initiatives are being put in place to combat tax evasion and avoidance, including Double Taxation Agreements (DTAs) and Tax Information Exchange Agreements (TIEAs) with third countries, tax audits and the inclusion of various anti-abuse measures in the Income Tax Management Act (Cap 372). In addition, further to an internal risk control exercise, the VAT Department's risk analysis system is currently being overhauled in order to increase the effectiveness of tax audits, which are expected to become more targeted and focused.

Revenue accruing from the concession fee payable in respect of the exclusive license to operate National Lottery games in Malta for the coming decade is expected to result in a 0.6 percentage point increase in revenue in 2012.

Meanwhile, Government will cushion the impact that the recent increases in the price of crude oil in the international markets have on the operational costs of Enemalta in order to keep the cost of utility tariffs to households, small businesses and industry unchanged. This is expected to increase expenditure by 0.3 percentage points of GDP in 2012 and by a further 0.1 percentage points in 2013.

Moreover, Government acknowledges the important function of Malta's national airline in supporting the local tourism industry. In this context, the ongoing restructuring of Air Malta will be sustained by a Government equity injection, which over the medium-term budgetary outlook is expected to amount to €75 million.

3.2.2 General Government Budgetary Prospects over the Medium-Term

3.2.2.1 Determinants of the 2012 Fiscal Outcome

During the current fiscal year, the consolidation of fiscal balances will be sustained further, such that the general Government balance is expected to decline to 2.2 per cent of GDP, suggesting an improvement in the fiscal position of 0.47 percentage points of GDP. The projected decline in the fiscal imbalance in 2012 mainly reflects a significant improvement in the revenue-to-GDP ratio, in part offset by the expected increase in the expenditure ratio.

As indicated in Table 3.2 and Chart 3.2, the noteworthy increase in the revenue ratio, which is expected to rise by 2.86 percentage points of GDP to 43.1 per cent in 2012, is mainly on account of discretionary revenue measures and 'other' revenue. The category of 'other' revenue is expected to contribute to a 1.32 percentage point decline in the 2012 deficit-to-GDP ratio, mainly on account of EU investment grants reflecting the expected timing of implementation of projects financed from the Financial Framework for the period 2007-2013. However, as highlighted below, such inflows correspond to similar increases in outlays and thus have a predominantly neutral impact on the budget balance.

Analysis of the Change in the Deficit-to-GDP Ratio for 2012

(percentage points)

Table 3.2

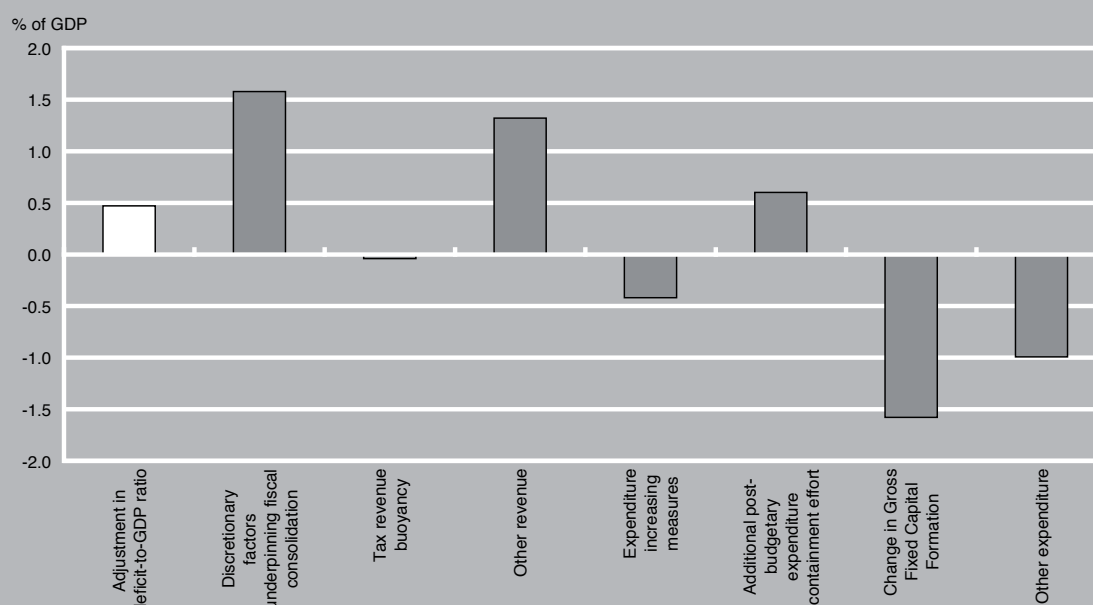
Discretionary factors underpinning fiscal consolidation	1.58
Tax revenue buoyancy	-0.04
Other revenue	1.32
Change in revenue ratio	2.86
Expenditure increasing measures	-0.42
Additional post-budgetary expenditure containment effort	0.60
Change in Gross Fixed Capital Formation	-1.58
Other expenditure	-0.99
Change in expenditure ratio	-2.39
Change in deficit ratio	0.47

Note: positive represents a decline in the deficit-to-GDP ratio

Discretionary revenue measures are expected to contribute positively to the fiscal outcome, and are expected to improve the budget balance by 1.58 percentage points of GDP. Revenue accruing from the concession fee payable by the local lottery operator and from enhanced efficiency in revenue collection are expected to contribute significantly to the improvement in the fiscal imbalance. The main revenue increasing measures announced in the 2012 Budget, in particular the revision in the motor vehicle registration tax, and the additional revenue from social contributions as a result of the 2006 pension reform, are also expected to contribute positively to the decline in the deficit-to-GDP ratio. Meanwhile, the negative impact of revenue reducing measures announced in the 2012 Budget is expected to in part offset the impact of revenue increasing discretionary measures, mainly reflecting the most recent revision in the income tax bands in favour of

Chart 3.2

Analysis of Change in Deficit-to-GDP ratio for 2012



parents of children below 18 years of age.

Meanwhile, economic activity is expected to be positive but relatively subdued. The relative strength of corporate profits and the resilience of employment is expected to sustain further increases in tax revenue net of the fiscal impact of discretionary budgetary measures. The resilience of economic growth is expected to remain an important component of the fiscal consolidation effort in 2012. A sensitivity analysis of the fiscal projections to alternative macroeconomic assumptions is provided in Chapter 4 of this Programme.

The ratio of general Government expenditure to GDP is expected to increase from 43.0 per cent in 2011 to 45.3 per cent in 2012, mainly on account of significant increases in gross fixed capital formation. The increase in this component of expenditure from 2.5 per cent of GDP to 4.1 per cent of GDP primarily reflects higher expenditure related to capital projects financed from EU funds under the 2007-2013 Financial Framework and thus corresponds to analogous increases in revenue, as highlighted above. Further increases are also expected in projects financed from national sources.

Expenditure increasing measures announced in the 2012 Budget, in particular the equity injection in Air Malta, are also expected to exert a negative effect on the fiscal deficit to the effect of 0.42 percentage points of GDP.

On the other hand, the reductions in expenditure emanating from the additional measures announced last January have a budgetary impact of 0.6 per cent of GDP and are expected to exert an analogous positive effect on the deficit ratio.

In particular a stringent recruitment policy limits recruitment when vacancies arise due to resignations or retirement unless in professional grades in the health, education, social and EU-related sectors. This policy is consistent with a more subdued growth in compensation of employees. Indeed compensation of employees is expected to grow by 1.2 per cent in 2012 over the level recorded in 2011. Together with the restraint in overtime this is expected to generate additional savings in the 2012 compensation of employees amounting to €0.1 million.

Furthermore, one needs to add the impact of the pension reform which in 2012 is estimated to generate additional savings of 0.1 per cent of GDP. Meanwhile, changes in the other components of expenditure, net of the impact of the discretionary expenditure measures and of gross fixed capital formation, are expected to adversely affect the deficit ratio by 0.99 percentage points of GDP, mainly on account of higher capital transfers and subsidies. The latter reflects the financial support to Enemalta to compensate for the stable utility tariffs notwithstanding the higher oil prices in the international markets. Other measures include the additional funding for private schools, the changes in the children's allowances regime, the grant to the elderly over 80 years of age living independently and the extension of maternity leave.

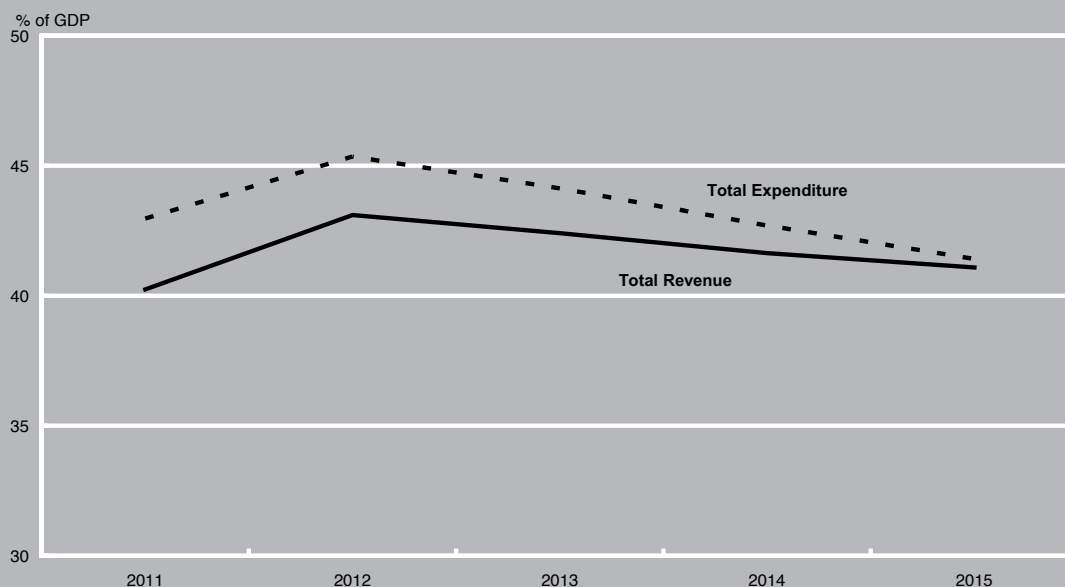
3.2.2.2 The Fiscal Strategy for 2013

During 2013, the general Government deficit is projected to decline by a further 0.5 percentage points of GDP from 2.2 per cent to 1.7 per cent. The more restrictive fiscal stance projected for the next fiscal year is mainly attributable to a decline in the expenditure-to-GDP ratio, which is in part offset by a lower anticipated revenue ratio to GDP. Indeed, the ratio of total revenue to GDP is expected to decline by 0.7 percentage points of GDP from 43.1 per cent in 2012 to 42.4 per cent in 2013, whereas the expenditure-to-GDP ratio is expected to decline by 1.2 percentage points of GDP to 44.1 per cent in 2013. Developments in general Government revenue and expenditure and in the components of general Government expenditure are illustrated in Chart 3.3 and Chart 3.4, respectively.

Increases in the main items of tax revenue are expected to keep pace with the projected macroeconomic developments. In particular, the ratios-to-GDP of current taxes on income and wealth, capital taxes and social contributions are expected to remain relatively stable. Nonetheless, the ratio of taxes on production

Chart 3.3

General Government Revenue and Expenditure

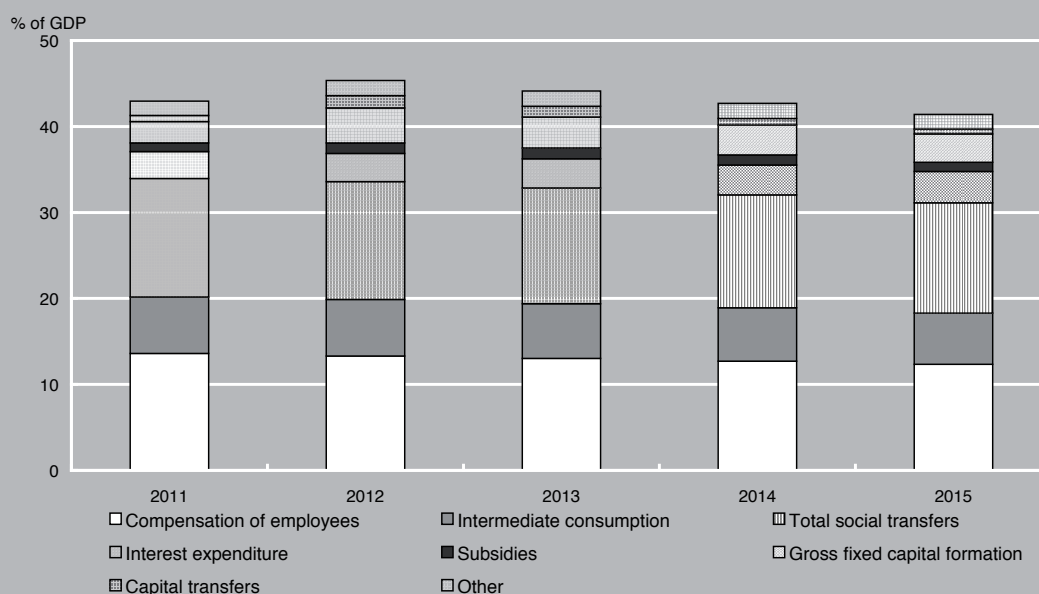


and imports is expected to decline by 0.9 percentage points of GDP, mainly reflecting lower revenue from discretionary measures in place in 2012.

Meanwhile, the higher ratio of ‘other’ revenue to GDP mainly reflects the expected impact of discretionary measures to be targeted in the budget for 2013 in order to bridge the gap between the deficit target referred to above and the projections at unchanged policies. Government is planning the implementation of a permanent revenue raising measure of €16 million. Given the persistent fragility of the international economic environment the policy will be designed so as not to impact unduly on economic activity and will likely be of an indirect nature. At this stage, it is premature to provide additional details on the budgetary measures to be taken to achieve the budgetary objectives in 2013, on account of the upcoming pre-budget consultation process. This consultation process, initiated by means of the publication of the Pre-Budget document allows policy-makers, the social partners and other stakeholders to critically evaluate the economic and social

Chart 3.4

Composition of General Government Total Expenditure



situation and to discuss the most appropriate policy options for the implementation of Government's vision for Malta's economic and social development against the backdrop of the aggregate budgetary targets.

Meanwhile, on the expenditure side, the more efficient and effective use of public funds is expected to result in a decline in the ratios of most components of recurrent expenditure, in particular of the ratios of compensation of employees, intermediate consumption and social payments to GDP.

The decline in the ratio of compensation of employees to GDP by 0.3 percentage points reflects the further intensification of Government's permanent tightening on recruitment in the public sector as part of the additional expenditure containment effort in 2012. A stringent recruitment policy limits recruitment when vacancies arise due to resignations or retirement unless in professional grades in the health, education, social and EU-related sectors. This policy is consistent with a more subdued growth in compensation of employees. Indeed compensation of employees is expected to grow by 2.2 per cent in 2013, well below GDP growth.

The 2006 pension reform as well as efforts to limit benefit fraud will further contribute to contain the increase in social payments relative to GDP. The 2006 pension reform initiatives are expected to lower expenditure on social benefits by 0.3 per cent of GDP in 2013 compared to a scenario in the absence of reform. The Benefit Fraud and Investigation Department continues to contribute, through its operations, to the identification of cases that are in breach of the Social Security Act (Cap 318). Over the period 2006-2011, benefit fraud investigations have resulted in savings estimated at over €1 million, of which €3.7 million in 2011.

The further decline in the ratio-to-GDP of intermediate consumption by 0.2 percentage points is mainly on account of less buoyant developments of this component of expenditure compared to economic growth, in part reflecting a marginal decline in capital expenditure classified under this item as well as efforts to increase value for money, particularly in public procurement.

Meanwhile, developments in capital expenditure will also contribute to the decline in the expenditure ratio. Indeed, the ratio of gross fixed capital formation to GDP is expected to decline from 4.1 per cent to 3.6 per cent, mainly reflecting the completion of projects related to the upgrading of the road network. Developments in the ratio of capital transfers to GDP reflect lower expenditure for the refurbishment of the Valletta and Marsaxlokk breakwaters and investment incentives, in part offset by expenditure related to the equity injection in Air Malta.

3.2.2.3 General Government Budgetary Projections for 2014-2015

Government's fiscal policy objective in the outer years of the Programme period remains that of ensuring a sustainable fiscal position by gradually but consistently reducing the fiscal imbalance. Indeed, the decline in the ratio of general Government deficit-to-GDP is expected to be sustained and the fiscal imbalance is expected to be reduced further from 1.7 per cent in 2013 to 1.1 per cent and 0.3 per cent in 2014 and 2015, respectively. The envisaged fiscal consolidation in the outer years of the Programme period primarily relies on the continuation of expenditure restraint measures (including the tightening of recruitment policy announced in January 2012) since lower expenditure ratios outweigh the declines in the revenue ratio. The latter is expected to decline from 42.4 per cent in 2013 to 41.6 per cent in 2014, and to decline further to 41.1 per cent of GDP in 2015.

Meanwhile, most components of expenditure are expected to grow at a slower rate than the growth in GDP. As a result the ratio of general Government expenditure-to-GDP is expected to decline by 1.4 percentage points of GDP in 2014 and by a further 1.3 percentage points in 2015 to 41.4 per cent by the end of the Programme period. These developments echo Government's strategy for stricter controls on expenditure outlays towards the achievement of improved efficiency in public spending, reducing waste and ensuring value for money, in particular as regards compensation of employees, intermediate consumption, and social payments. The ratio of capital transfers is expected to follow a declining trend, mainly reflecting lower expenditure related to the equity injection in Air Malta. Meanwhile, the ratio of gross fixed capital formation

is expected to decline to 3.3 per cent of GDP by the end of the Programme period.

3.3 Structural Adjustment and the Medium-Term Objective

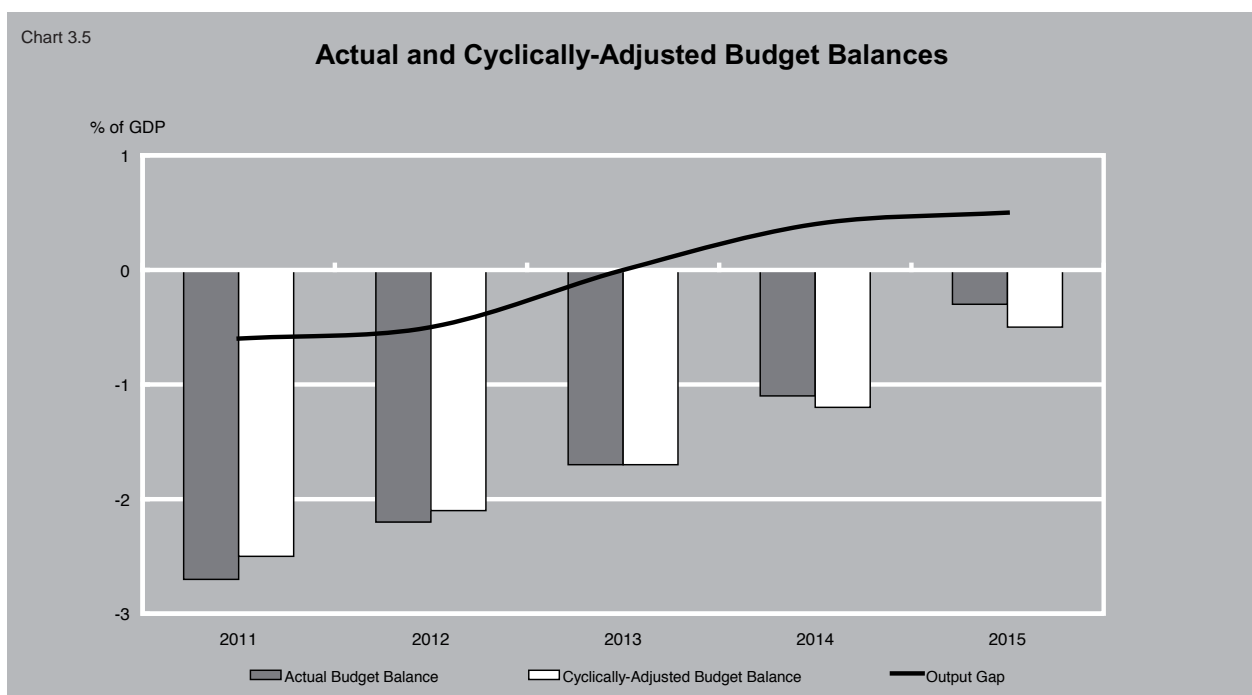
Malta's medium-term-objective will remain in line with the requirements set out in the revised Stability and Growth Pact. Over the medium-term, Malta will aim towards a balanced budgetary position net of one-off and temporary measures; a necessary requisite in ensuring a stable and sustainable debt-to-GDP ratio and in order to make the necessary adjustments required for the financing of the future cost of ageing. While a positive balance budget will be reached beyond the forecast horizon set out in the Programme period, Government has been and remains committed to keep implementing plans which meet the commitments for annual structural fiscal efforts.

As presented in Chart 3.5 and Table 5 in the Statistical Appendix, the budget deficit is expected to improve from 2.7 per cent of GDP in 2011 to 0.3 per cent of GDP in 2015. When cyclical effects are accounted for, the budget deficit improves from 2.5 per cent of GDP in 2011 to 0.5 per cent in the final year of the Programme period. The output gap is foreseen to close in 2013 and to move into positive territory in the remaining years of the Programme period. Nevertheless, one should keep in mind that potential output and output gap estimates involve an appreciable amount of uncertainty and as a result, a certain degree of caution is needed in the analysis of the structural adjustment over the Programme period.

The structural deficit (net of one-offs), which is displayed in Table 3.3, is expected to decline from 2.8 per cent of GDP in 2011 to 2.3 per cent in 2012. Moreover, the increase in general Government expenditure, net of interest expenditure, expenditure on EU programmes fully matched by EU funds revenue and non-discretionary changes in unemployment benefit expenditure, is expected to be below the expenditure benchmark of 2.3 in 2012.

The reliance on one-off deficit reducing measures remains contained throughout the Programme period as the extent of one-offs declines from 0.3 per cent of GDP in 2011 to 0.2 per cent in 2012 thereafter remaining unchanged over the forecast horizon.

Over the medium term forecast horizon, the structural deficit (net of one-offs) is projected to decline from



Fiscal Consolidation
as a percentage of GDP

Table 3.3

	2011	2012	2013	2014	2015
General Government Balance	-2.7	-2.2	-1.7	-1.1	-0.3
One-off Measures	0.3	0.2	0.2	0.2	0.2
General Government Balance net of One-offs	-3.0	-2.5	-2.0	-1.3	-0.5
Output Gap Estimates	-0.6	-0.5	0.0	0.4	0.5
Cyclically-Adjusted Budget Balance	-2.5	-2.1	-1.7	-1.2	-0.5
Structural Balance	-2.8	-2.3	-2.0	-1.4	-0.7
Structural Adjustment	1.5	0.5	0.4	0.5	0.7

2.3 per cent in 2012 to 0.7 per cent in 2015, such that a structural effort averaging 0.5 per cent of GDP per annum is expected. The structural effort is marginally back-loaded with a higher structural effort targeted for the later years of the Programme period than in 2013. This follows the slower than anticipated growth and recovery prospects for 2012 and 2013 with the output gap moving to in the positive territory only in the later years of this Programme period.

3.4 Comparison with the April 2011 Update of the Stability Programme

The fiscal consolidation path being presented in this year's Update of the Stability Programme points to a slightly better performance in 2011 when compared to the Update presented in April 2011. For the subsequent years, the improvement in the fiscal consolidation path being presented is marginally slower, nevertheless, gaining momentum in the last year of this year's Programme period.

The improvement in the fiscal target for 2011 is mainly underpinned by lower general Government expenditure which impinged positively on Government finances despite lower revenue. As a result, the fiscal outturn in 2011 improved marginally from 2.8 per cent of GDP to 2.7 per cent. The differences in fiscal targets for 2012, 2013 and 2014 are mainly the result of developments in the expenditure component.

In 2012, the fiscal consolidation path is expected to slow down marginally to a deficit-to-GDP ratio of 2.2 per cent when compared to a target of 2.1 per cent presented a year earlier. The dynamics underpinning the slowdown in 2012 when compared to 2011 are mainly attributable to higher expenditure that marginally offset better revenue prospects.

At the same time, despite the more moderate projected GDP over the Programme period presented in this year's Stability Programme when compared to the previous Update, discretionary revenue measures, as announced in the Budget for 2012, impacted positively on revenue estimates throughout the forecast horizon.

Similar developments shaped the marginal revision in the deficit-to-GDP ratio for 2013 which in this year's Update of the Stability Programme is expected to reach 1.7 per cent when compared to 1.6 per cent in the

previous year's Update.

In 2014, the fiscal consolidation path is expected to be marginally slower as the deficit-to-GDP ratio increases slightly by 0.1 percentage point. This development is mainly the result of expenditure developments which slightly outweigh the revenue component.

The effect of the revisions in the estimates for GDP had only a minimal negative effect on the revisions in the fiscal consolidation path throughout the comparable period.

3.5 Debt Levels and Developments

Restoring the trajectory of public finances to a sustainable path is Government's main medium-term fiscal objective. In this regard, a two pronged approach is being pursued in respect of attaining the target of sustainable public finances. The approach involves addressing the current imbalance in public finances on the one hand, and reducing the debt-to-GDP ratio at a satisfactory pace on the other.

Government's debt strategy remains that of ensuring that the financing needs of the public sector are met at the lowest possible cost while concurrently minimising medium and long-term interest rate risk. In 2011, short-term debt accounted for 6.7 per cent of total Government debt, and is projected to decline to 1.6 per cent by 2014. Meanwhile, the share of maturing stocks and new loans in total Government debt is expected to increase to a level of 14.0 per cent in 2012, from a level of 12.4 per cent in 2011. In 2013, this ratio will decrease marginally to 13.7 per cent, and thereafter continue along a declining path to reach 8.5 per cent in 2015. The lengthening of the maturity structure of Government debt is expected to reduce further the risk of interest rate hikes which may materialise in the future should economic conditions improve and the monetary stance become more restrictive than at present.

3.5.1 Projected Debt Developments

The major factors that influence projected debt developments and sustainability are the Government's planned budgetary trajectory as well as the interest and growth dynamics, in conjunction with stock-flow adjustment items. The Maltese economy is still characterised by resilient growth and in 2011 a primary surplus was registered. The continued improvement in the primary surplus projected over the medium term together with positive growth prospects and sustained investor confidence should ensure further improvements in the debt dynamics. Developments in the debt ratio for the Programme period and the contributors to the trajectory path of the debt-to-GDP ratio are presented in Table 3.4 and Statistical Appendix Table 4.

After reaching 72.0 per cent of GDP in 2011, gross Government debt is expected to follow a downward path during the outlook period to reach an envisaged level of 65.3 per cent of GDP by 2015. In 2012, the debt-to-GDP ratio is expected to fall by 1.6 percentage points of GDP. This reduction in the debt-to-GDP ratio is underpinned by improvements in the primary balance, in conjunction with envisaged debt reducing stock-flow transactions during 2012. During 2013, the debt-to-GDP ratio is envisaged to decline further to 68.7 per cent of GDP. In the outer years of the forecast period, the debt to GDP is expected to remain along a declining path to reach 65.3 per cent by 2015.

Over the forecast period, the projected reduction in the gross debt is mainly driven by a growing primary surplus and by nominal GDP growth, which are expected to more than compensate for the upward pressure that the interest burden triggers on the debt ratio. The programme does not take into account proceeds from privatisation that may result from divestments of Government assets contributing to the decline in gross debt. Developments in gross Government debt are illustrated in Chart 3.6.

During 2011, the primary balance provided a contractionary contribution to the debt ratio of around 0.4 percentage points. Over the forecast period, further improvements in the primary balance are projected to

The Dynamics of Government Debt⁽¹⁾

Table 3.4

Percentages of GDP	2011	2012	2013	2014	2015
Gross debt	72.0	70.3	68.7	67.4	65.3
Change in gross debt	2.5	-1.6	-1.6	-1.4	-2.1
Contribution to change in gross debt					
Primary Balance	-0.4	-1.0	-1.7	-2.4	-3.3
Snowball Effect	0.2	0.8	0.4	0.6	0.7
Interest Expenditure	3.1	3.3	3.4	3.5	3.6
Real GDP growth	-1.4	-1.1	-1.4	-1.4	-1.4
Inflation Effect	-1.5	-1.4	-1.6	-1.5	-1.6
Stock-flow adjustment	2.8	-1.4	-0.3	0.5	0.5
p.m. implicit interest rate on debt	4.7	4.7	5.1	5.3	5.6

⁽¹⁾ Developments in the debt- to-GDP ratio depend on:

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

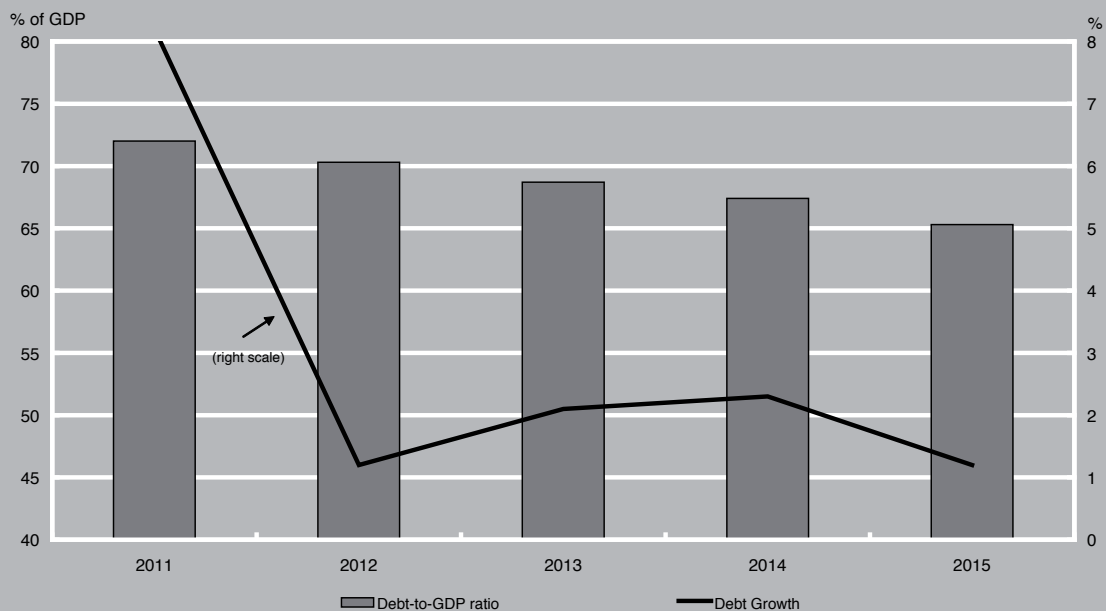
where t denotes a time subscript, D, PD, Y and SFA are the government debt, primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth.

exert an even more pronounced contractionary effect on the debt ratio. This contractionary effect is expected to increase to 1.0 percentage points in 2012 and to 3.3 percentage points in 2015.

The ‘snowball effect’ contributed to a marginal increase in the debt ratio in 2011 of around 0.2 percentage points. The ‘snowball effect’ is expected to remain an expansionary driver in the debt-to-GDP ratio during the forecast period, as the burden of the interest expenditure is expected to more than offset the downward

Chart 3.6

Debt-to-GDP ratio and Debt Growth



pressures that the moderate real GDP growth and inflation pressures will have on the debt ratio.

During the outlook period, real GDP growth is expected to contribute around 1.3 percentage points to the decline in the debt ratio. Meanwhile, the expansionary contribution of interest expenditure on the debt ratio is expected to average 3.5 percentage points over the forecast period. The impact of the interest expenditure on the debt ratio is expected to exhibit an upward path during the forecast period. Similarly, the contractionary contribution of inflationary pressures is also expected to exhibit an increase in magnitude over the forecast period and is expected to increase from a level of 1.4 percentage points in 2012 to 1.6 percentage points in 2015.

The other factors contributing to changes in the debt-to-GDP ratio are captured by the estimated Stock Flow Adjustment (SFA). In 2011, the SFA is estimated at 2.8 percentage points. This partly reflects an increase in the size of Government debt related to Malta's contribution in view of the agreement approved by the Euro Area Member States in pursuance of a decision of the Council of the European Union providing for the lending of money to the Hellenic Republic and the EFSF debt re-routing procedure. Moreover, an increase in the level of cash balances used for day-to-day operations by the Treasury, also acted as an expansionary factor underpinning the SFA. During 2012 the SFA is estimated to be negative, and is forecasted to amount to -1.4 percentage points. In the outer years of the forecast period the impact of the SFA on the debt-to-GDP ratio is estimated to be marginal.

3.5.2 Comparison with the April 2011 Update of the Stability Programme

The ratios of general Government debt-to-GDP presented in this Programme are expected to be higher than those presented in the previous Stability Programme Update. The expected worsening from the trajectory outlined in the previous Update is largely underpinned by more subdued revisions in the macroeconomic outlook for the period 2012 – 2014, in conjunction with a more subdued performance in economic growth in 2011 than expected in the previous update. The revisions in general Government net lending are marginal and do not exhibit any noteworthy influence on the change in the debt trajectory.

For 2011, the debt-to-GDP ratio was revised upwards by 4.2 percentage points. Such revisions reflect a more subdued growth scenario than envisaged in the previous Update and a major upward revision in the SFA for 2011 that led to an increase in the debt level. The debt-to-GDP ratio for 2012 and 2013 were also revised upwards, albeit by lower amounts. The upward revision in the debt-to-GDP ratio amounted to 3.4 percentage points and 3.3 percentage points respectively in 2012 and 2013.

In the 2011 Update, the debt-to-GDP ratio was expected to follow a downward path from a level of 67.8 per cent in 2011 to 63.7 per cent in 2014. This projected downward path reflected a decrease of 0.9 percentage points in 2012 and a decrease of 1.5 percentage points in 2013. During 2014 the previous Update envisaged a decline of 1.7 percentage points in the debt-to-GDP ratio.

In contrast, in this Update of the Stability Programme, the debt-to-GDP ratio is estimated to decline to 67.4 per cent by 2014. Notwithstanding, the average decrease in the debt-to-GDP ratio of 1.5 percentage points is marginally higher in the current update than that outlined previously. The average decrease in the debt-to-GDP ratio in the previous update amounted to 1.4 percentage points.

3.6 Budgetary Implications of 'Major Structural Reforms'

3.6.1 Major Structural Reforms presented in the NRP

The measures presented in Malta's NRP 2012 seek to continue addressing the bottlenecks to economic growth identified in the country's NRP 2011 and are in line with the recommendations identified in the Annual Growth Survey 2012. In fact, the new measures aim to reinforce the measures introduced in the

NRP for 2011. The aim of the Maltese Government is to continue steering the economy towards higher GDP per capita levels whilst ensuring that the economy is on a sustainable fiscal (and environmental) path. The structural measures also provide a stronger basis for sustainable long term growth which is essential in order to sustain public finances and meet the challenges related to ageing.

Quantification of NRP Thematic Measures

Table 3.5

Measure	Timeline	Net cumulative Fiscal impact (Eur million)				Of which EU Funds
		2012	2013	2014	2015	
Employment						
1 Employment in the Social Economy Project	2011/2014	0.5	0.5	0.0		0.9
2 Employment Support for persons with disabilities	2011/2014	0.2	0.3	0.1		0.6
3 Pensioners working part-time for the Government will pay 15% income tax	2012	0.6	0.6	0.6	0.6	
4 New Income tax computation	2012	10.0	10.0	10.0	10.0	
5 Increase in the maternity leave	2012	0.5	1.0	1.0	1.0	
Upgrading and embellishment of industrial estates						
Building of childcare facilities in Xewkija, Kordin and Mosta	2010/2013	0.9	0.9			1.5
Get qualified	2009/2013	1.3	1.3			
Education						
6 Increasing Accessibility, Flexibility and innovation to MCAST lifelong learning course offer	2011/2015	2.9	2.9	1.4	0.1	6.2
7 Making VET education more relevant and attractive	2011/2014	2.3	2.4	0.7	0.1	4.7
8 Inclusion for employment	2011/2014	2.2	2.7	2.3		6.1
9 Extension of the Malta College of Arts, Science and Technology	2010/2014	9.2	10.0	1.0		8.2
10 Foundation certificate hospitality trades course	2011	0.1	0.1	0.1	0.1	
Energy						
11 Motor Vehicles Registration Tax	2012	0.1				
12 Scrappage scheme	2012	6.0				
13 Energy efficiency measures for the hospitality sector (energy target)	2011/2013	1.1				
14 Promotion of uptake of RES and building envelope insulation	2012	0.1				
Research and Development						
Preparation of a Health Research and Innovation Strategy	2010/2012	0.0				
16 National R&I Fund 2012	2004/2012	1.6	3.8	3.9	4.0	
Setting-up and development of the National Interactive Science Centre	2010/2014	1.3	10.2	9.0		12.0
18 Awareness Campaign on Innovation	2012					
Poverty						
Providing an Independent Living Service to Persons with Disability at the Sonia Tanti Independent Living Centre, Hal Far	2011/2012	0.1	0.1	0.1	0.1	
€300 Grant per annum to pensioners over 80 who live independently in their own home	2012	3.5	3.5	3.5	3.5	
21 Private Property Rental Scheme	2012/2020	1.0	1.0	1.0	1.0	
TOTAL		45.6	51.2	34.6	20.4	40.2
% of GDP		0.7	0.7	0.5	0.3	

In line with these goals, the Government's reform efforts are focused on the areas of employment, education, energy, R&D and poverty. The new measures presented in the NRP 2012 for the period 2012-2014 are expected to cost around €31.4 million. Of these, €40.2 million are expected to be financed through EU funds such that the total net outlay by the Maltese Government during this three-year period amounts to an estimated €0 million. Outlays in relation to these measures in 2015 and 2016 are expected to amount to €20 million and €16 million respectively. Table 3.5 shows that these expenditures amount to 0.7 per cent of GDP in 2012 and 2013, and to 0.5 per cent and 0.3 per cent in the two subsequent years.

Employment

Government recognizes that the participation of females and older workers in the labour market needs to be encouraged further, especially because of the country's aging population. Measures to encourage participation and working conditions in the labour market are aimed not only at females, but also at old age workers and disadvantaged persons. The new measures seeking to further encouraging female participation in the labour market include new 'parent income tax' rates and an increase in the maternity leave (from 14 to 16 weeks in 2012 and to 18 weeks in 2013). In addition, working parents will also benefit from the development of three new child care centres. In order to encourage older persons to remain active in the labour market, pensioners working in the Public Sector will benefit from a favourable rate of 15 per cent income tax on part-time work. Meanwhile, measures aimed at increasing the participation rate of persons with disability include employment support in the form of learning support assistance and job coaching, amongst others.

Research and Development

As in recent years, the measures introduced in NRP 2012 seek to encourage research and innovation. Efforts include the preparation of a health research and innovation strategy and an awareness campaign on innovation. This is complemented by financial support from Malta's National R&I Fund 2012. Other measures, such as the setting-up and development of the National Interactive Science Centre, ensure that the necessary infrastructure is in place.

Energy

The sustainability of public finances is complemented by measures that aim for environmental sustainability. These include measures that aim to increase energy efficiency, including soft loans to the hospitality sector to implement energy saving solutions, a reformed motor vehicle registration tax to incentivise a younger, small and less polluting vehicle fleet as well as a scrappage scheme which aims to encourage first-time vehicle buyers or owners of aged cars to shift to new vehicles which better meet accepted criteria relating to the environment.

Education

Government also recognizes the need to further encourage participation in education in order to close the technical skills gap and to move towards employment in higher value added activities. NRP 2012 presents a number of new measures to reach these aims, including the introduction of new courses and the building of a new campus at the Malta College of Arts, Science and Technology (MCAST) and the introduction of a foundation certificate for hospitality trades course. In addition, NRP 2012 proposes measures aimed at increasing accessibility to lifelong learning, making vocational and educational training more relevant and attractive as well as the revision of curricula to facilitate the progression of vulnerable students to higher levels of vocational education and ultimately employment.

Poverty Reduction and Social Exclusion

An equitable distribution of gains from economic development necessitates measures that ensure that the well-being of all segments of society is improving. The NRP 2012 addresses this concern by presenting measures aimed at helping persons with disability, pensioners and vulnerable young individuals or families. Specifically, the measures include a €300 grant per annum to pensioners over 80 who live independently in their own home, the subsidisation of private property rent and the provision of advice, information and

training in aspects of independent living to persons with disability.

3.6.2 Major Structural Reforms presented in accordance with the Euro Plus Pact

Government is also committed to undertake necessary reforms to further strengthen the fiscal position and competitiveness of the country as per the Euro Plus Pact. Below is a list of these measures.

Strengthening the Fiscal Framework

The adoption of fiscal rules is currently being considered by the Maltese Government. As a minimum and in order to comply with the recent strengthening of the fiscal frameworks in the EU, this would include a deficit target of not more than 3 per cent, a balanced budget medium-term objective in structural terms, a minimum structural effort of 0.5 per cent of GDP per annum as well as an expenditure rule stipulating that Government expenditure growth (net of interest, EU funds and non-discretionary changes in unemployment benefits) should not exceed the medium-term potential growth rate unless matched by discretionary revenue measures. In addition, it will include a debt target of 60 per cent of GDP and a numerical debt rule which ensures that any debt in excess of the benchmark is put on a declining path at a pre-determined rate of 1/20th per annum.

Amongst others, Malta is also considering other measures to strengthen the institutional framework underlying the formulation of fiscal policy, in line with the new rules which will govern budgetary frameworks in the EU as from 2013.

Introduction of Electronic Procurement Procedures and Simplification of Public Procurement

As part of the Better Regulation project Government is seeking to shift public tendering from conventional to electronic procurement. This has the potential to improve the efficiency of individual purchases, the administration of public procurement in general and the functioning of markets for Government contracts.

Setting-up a Sector Skills Committee

Government is planning to set up a sector skills committee to ensure consistency and relevance of occupational standards within each sector, to reduce skills gaps and shortages, to improve skills and productivity of a sector's workforce and to ensure recognition and certification of skills and competencies within each sector. The committee will be made up of representatives of industry, education and training, Government Authority or Board and employees associated with the sector.

Culture and Creative Industries

The Maltese Government is committed towards the improvement of skills in the local film industry. In addition, Government stated its intention to improve the competitiveness of the Maltese cultural and creative sector by improving copyright related issues. This will be further supported by an exemption from the payment of registration fees for new companies in the sector as well as from their annual payments to the Malta Financial Services Authority (MFSA) for three years. Finally, Government is also promoting the development of digital games in Malta through the establishment of the Malta Games Fund, a tax credit scheme for companies wishing to commission educational or promotional digital games and by extending a flat 15 per cent income tax rate for international professionals specialising in this sector.

Next generation e-Government Framework

This measure is intended to broaden the range of available e-Government services, to revolutionise the exchange of information between Government departments and the general public, to allow access by citizens across other EU Member States and to enable access to all Government services from a single place.

CREATE Scheme

Through the CREATE scheme, Government intends to support creative businesses whose economic performance is directly linked to the creative talent of those involved in the business.

MicroInvest

MicroInvest is a fiscal incentive intended to encourage micro enterprises and self-employed persons to invest in their business. The idea is to foster innovation and expansion as well as to implement compliance directives and to further develop their operations. Micro enterprises and self-employed will be supported through a tax credit representing a percentage of the eligible expenditure and wages of newly recruited employees or apprentices.

Setting up of an Expert Group to draw up a report and recommend measures to reduce sick leave in the public sector

Government intends to address excessive and unjustified workplace absence and sick-leave in the public sector by setting up an expert group to propose a set of measures that will contribute to the reduction of sick leave within the sector.

Launch of the Greening our National Economy document

The document entitled Greening our National Economy is expected to be launched in the second quarter of 2012. It will provide practical policy recommendations on ways and means to green Malta's economy. The document will also form the basis for the Green Economy Action Plan identified in the National Environment Policy (NEP).

4. Sensitivity Analysis and Comparison with the 2011 Update of the Stability Programme

4. Sensitivity Analysis and Comparison with the 2011 Update of the Stability Programme

4.1 Sensitivity Analysis

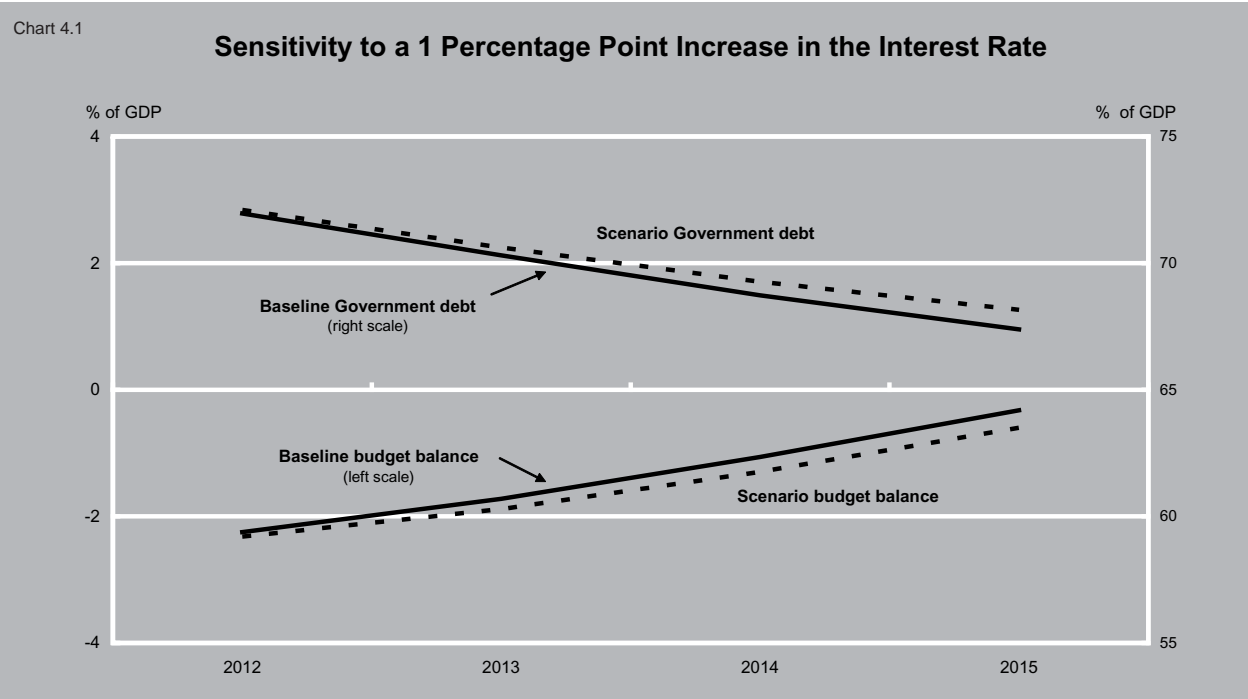
International developments during last few years served to further highlight the level of fluctuations and adjustments that continuously take place in the global economy. The Maltese economy, being such a small open economy, is particularly sensitive to these external developments especially given the prevailing uncertainty in relation to the downward risks with respect to the degree of the global recovery, remaining imbalances in the Euro Area, and higher prices of oil. Thus, it is important to present the potential implications of alternative developments on the Maltese economy covering the 2012-2015 forecast period.

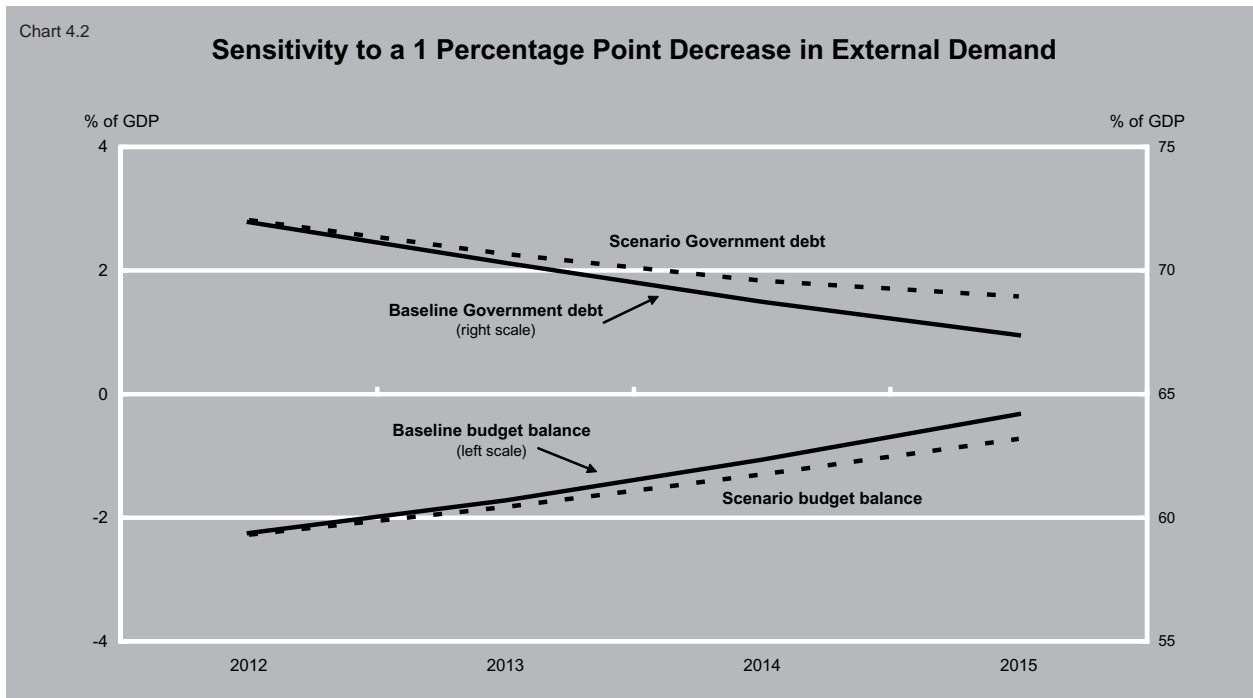
This Chapter presents three alternative sensitivity scenarios with 2012 considered as the first year of the forecast. The first sensitivity scenario simulates an increase in the interest rate, the second scenario explores the implications of a decrease in economic activity in Malta’s main trading partners while the third sensitivity scenario simulates a lower rate of economic growth. All three scenarios are considered decidedly relevant at this particular junction and the results of the different scenarios are presented in terms of the effect of the deviation from the baseline on the Gross Domestic Product, general Government budget deficit, and general Government debt. These sensitivity analyses are illustrated in Charts 4.1, 4.2 and 4.3.

It is also important to bear in mind that estimates are subject to considerable uncertainty chiefly among them the response of economic agents, whose responses could differ from those exhibited in the past under different circumstances, and thus should be considered only as indicative. Secondly, these estimates are based on the assumption that there is no fiscal policy response to the changed budgetary position over the forecasted period.

4.1.1 Sensitivity to Interest Rate Fluctuations

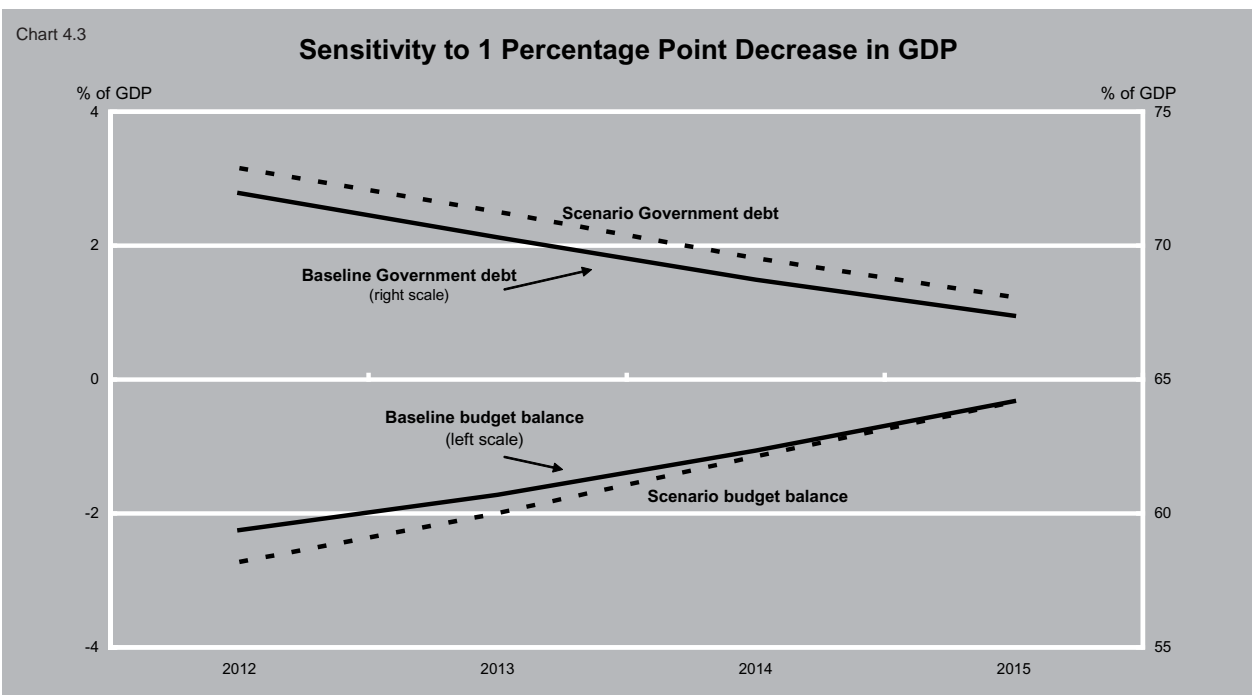
Interest rates fluctuate as a result of changing economic environment with expectations about profitability and investment playing a major part. Presently, both the short-term interest rates as well as the long-term interest rates are at very low levels, thus there is the risk that interest rates will increase over the short and





medium term. This scenario explores the implications of an increase in interest rates which will be expected to affect economic activity through the real and monetary sectors.

A-priori an increase in the interest rate implies an added cost of financing capital as well as a higher opportunity cost. The net effect of these changes depends on the degree of elasticity of the components of output to changes in the interest rate. Government finances are also directly affected by the change in the interest rate through its impact on components of revenue and expenditure that are sensitive to economic activity as well as the effect of changes in the interest rate on the debt servicing costs. However, taking into account the relatively low share of short-term debt in total General Government debt in Malta, changes in the interest rate are mainly expected to affect the debt servicing costs in relation to the rolling-over of past long term debt and new issues of stock. In view of this, the impact of a change in the interest rate on the deficit and debt positions is expected to be moderate.



This scenario is modelled as an increase of 1 percentage point in the interest rate between 2012 and 2015. As a result of this change in the interest rate, economic growth is expected to decrease marginally by 0.1 percentage points in 2012 and remain unchanged thereafter. Furthermore, this increase in the interest rate will result in a deterioration of the budget balance of 0.1 percentage points of GDP in 2012 and a further deterioration of around 0.2 percentage points in both 2013 and 2014. In 2014, the deficit is expected to increase further by 0.3 percentage points. These changes in the budget balance are attributable to an increase in total expenditure which amounts to around 0.4 per cent by the end of the forecast period while in impact on the total revenue is negligible. As a consequence, Government debt-to-GDP ratio is envisaged to increase by around 0.1 percentage points and 0.3 percentage points in 2012 and 2013 respectively. At the end of the forecast period the ratio is expected to deteriorate by a further 0.8 percentage points when compared to the baseline.

4.1.2 Sensitivity to Change in External Demand

The recovery of the global economy could be weaker in the short-term due to a combination of various factors including slower restoration of consumer and producer confidence in Malta's main trading partners. Given the openness of the domestic economy and the downward risks still present, it is of particular relevance to carry out a sensitivity analysis to changes in external demand. This section investigates a scenario where external demand declines by 1 percentage point in the first year and throughout the forecast horizon until 2014.

A negative shock in external demand for domestically-produced goods and services is expected to generate a decrease in aggregate demand and consequently in output. Additionally, the negative demand for exports will be amplified as it affects the rest of the domestic economy through the multiplier effect. On the other hand, in view of the high degree of import-content of domestically produced goods and services, the effect of a decline in demand for exports on output and on economic growth is expected to be partly offset by a subsequent decrease in imports.

The simulated fall in external demand is expected to lower the rate of economic expansion by around 0.5 percentage points by the end of forecast period when compared to the base scenario. This negative shock is expected to impact only marginally during the first two years under consideration but it is expected to result in a worsening in the budget deficit of 0.2 percentage points in 2014 and by a further 0.4 percentage points by 2015. The developments in the budget balance mainly reflect a decline in total revenue of around 0.7 per cent while the impact on total expenditure is largely negligible. The subsequent worsening of the budget balance will impact adversely on the Government debt-to-GDP ratio, where the ratio is expected to increase by around 1.6 percentage points by the end of the forecast period.

4.1.3 Sensitivity to Change in the Growth Rate of Real Gross Domestic Product

Consumer confidence is responsive to both local and international developments. If the anticipated recovery does not take place, consumer confidence can be negatively affected. This would entail higher savings by consumers and thus less private consumption. This subsection models a 1-percentage point decline in GDP. It is assumed that this decline in the growth rate of real GDP is stimulated through a contraction in private final consumption expenditure, resulting in lower demand for goods and services. This decline in demand consequently results in lower domestic output as well as lower demand for imports of goods. The latter is expected to partly offset the negative effects of the decline in private consumption.

This scenario will result in a decline of around 1 percentage point in GDP in 2012 and consequently the budget balance will be worse off by around 0.5 percentage points during the same year. However, the impact on the budget balance is expected to narrow and become negligible by 2014 period. Given this scenario, total revenue is expected to shrink by 0.9 per cent upon impact, though by the end of the forecast period total revenue is relatively unchanged to the baseline. On the other hand, the increase in consumption is expected to have a negligible impact on total expenditure by the end of forecast period. The Government debt-to-GDP

ratio is expected to increase by 0.9 per cent upon impact and the impact is expected to remain broadly of the same magnitude at the end of the forecast period when compared to the baseline scenario.

4.2 Comparison with the Projections in the 2011 Stability Programme

Economic Growth

Since the last Update of the Stability Programme, the global economy underwent several changes. The fragile recovery from the global crisis that had started in 2009 has been negatively affected by sharp commodity price increases and by increased uncertainties about the resolution of the sovereign debt crisis in the Euro Area. This and other developments had a significant impact on the local economy and as a result expectations about macro-economic developments had to be revised. This section presents revisions to the growth outlook projected compared to the Programme presented last year.

The economic outcome registered for the end of 2011 was slightly lower compared to the forecast presented in the last Update. Indeed, whilst in the last Programme a real growth rate of 2.4 per cent was forecasted, the actual growth for 2011 was 2.1 per cent, 0.3 percentage points lower. In nominal terms the actual growth rate for 2011 was 4.4 per cent compared to 4.7 per cent which was forecasted in the last Update.

There were, however, notable changes in the composition of growth during the 2011-2014 period. In 2011, the contribution of the external sector to economic growth turned out to be more positive than previously forecasted although both exports and imports were revised downwards. On the other hand, there was a downward revision in the contribution of the domestic sector from 2.1 percentage points to 0.8 percentage points mainly due to a sharp revision in the growth of gross fixed capital formation. For 2012, the contribution of the domestic sector was revised slightly upwards while the external sector was revised downwards by 1.1 percentage points as the result of more moderate growth expectations in exports for 2012. For both 2013 and 2014, the composition of growth was also revised downwards as a more cautious outlook underpins the new Update of the Stability Programme compared to the previous one.

Private consumption expenditure for 2011 was 2.1 percentage points higher than expected, as a more buoyant consumption was registered. However, a mean reversion effect is expected for 2012, thus the outlook in private consumption for this year was revised slightly downwards by 0.2 percentage points. For 2013 and 2014, the growth rates in this expenditure component were kept unchanged reflecting the long-term growth of private consumption expenditure.

Growth in Government consumption expenditure for 2011 was 2.5 percentage points lower than the rate projected in the last Programme. This was mainly due to higher outlay on compensation per employee and intermediate consumption. For 2012, Government consumption expenditure was also revised significantly upwards by 1.7 percentage points mainly due to higher intermediate consumption expenditure. There was a downward revision in 2013 of 1.0 percentage points whilst for 2014 government consumption expenditure was revised upwards from -1.7 per cent to -0.4 per cent.

The most notable changes in the expenditure components during 2011 were registered in the gross fixed capital formation. Indeed, during 2011 this component turned out to be 21.4 percentage points lower than expected in the last Update, mainly reflecting the spare capacity in the private sector that was accumulated during the previous years. For 2012, the outlook for GFCF was kept broadly unchanged while there were slight downwards revisions for 2013 and 2014.

Actual exports and imports were lower in 2011 than previously forecasted, although the net exports turned out more positive than expected. This downward revision in exports and imports was carried forward to the end of the forecast period, although the revision in exports was more accentuated than that in imports. Indeed, exports were revised by -1.5 and -0.3 for 2013 and 2014 respectively while growth in imports was revised by

-1.1 percentage points in 2013. For 2014, growth in imports was revised upwards by 0.6 percentage points.

Inflation and Employment Prospects

The inflation rate in 2011 was 2.4 per cent, 0.3 percentage points lower than expected in the last Update. This was mainly due to lower increases than expected in the price of energy. For 2012, the inflation rate is forecasted to be slightly higher than expected during the last Update, from 2.1 per cent to 2.3 per cent. There is also an upward revision of 0.4 percentage points and 0.2 percentage points for the outlook in inflation for 2013 and 2014 respectively.

Employment growth turned out better than anticipated in 2011. Indeed, growth in employment was 1.4 percentage points higher than forecasted. On the other hand, the outlook for employment growth for 2012 was revised downwards by 0.5 percentage points. A more buoyant performance than previously expected is forecasted in the labour market for 2013 and 2014. As a consequence of these developments, the unemployment rate for 2011 was 0.4 percentage points lower than expected. This lowering of the unemployment rate is expected to perpetuate during the 2012-2014 period as the unemployment rate is forecasted to be 0.3 percentage points lower than that outlined in the previous Update. In view of the more positive performance in the labour market but a more contained outlook in output, labour productivity in 2011 was 1.6 percentage points lower compared to the rate forecast in the last Programme. For 2012 and 2013, labour productivity has been revised downwards by 1.0 and 1.2 percentage points respectively.

5. Sustainability of Public Finances

5. Sustainability of Public Finances

Malta's population, similar to other developed and developing countries, will undergo significant changes due to a combination of a lower birth rate, longer life expectancy and the entry into retirement of the 'baby-boom' generation. These changes are expected to pose major economic, budgetary and social challenges, which will have a significant impact on growth. This will lead to significant pressures to increase public spending, thus representing a central endeavour for long-term fiscal sustainability.

This Chapter provides an assessment of Malta's long-term sustainability of public finances for the period 2010-2060 on the basis of the projections of the Ageing Working Group (AWG) within the Economic Policy Committee (EPC). It provides an overview of the pension system in Malta, and an analysis of the expenditure projections. Besides pensions, the projections cover other age-related expenditure items including health care, long-term care, education and unemployment benefits for the period 2010-2060. The long-term projections that result from this exercise provide an indication of the timing and scale of economic changes that would result from an ageing population in a 'no-policy change' scenario.

5.1 Long-term Budgetary Projection Results for Malta

This section provides an analysis of the long-term sustainability of public finances for Malta for the period 2010-2060 on the basis of commonly agreed assumptions for the EU Member States. In particular, the pension outlays projections incorporate the latest changes to the Social Security System, in particular the reform law enacted during December 2006. The model used in projecting pension expenditure was the World Bank's Pension Reform Options Simulation Toolkit (PROST) 12. Statistical Appendix Table 7 shows the expenditure components of the long-term budgetary projections as a percentage of GDP for the period 2010-2060 and the assumptions used.

5.1.1 Assumptions Applied

In modelling pensions, PROST was updated on the basis of the AWG-EPC assumptions. These assumptions included the real GDP growth rate, labour productivity (growth rate per hour), inflation rate, labour participation rate by age and gender, unemployment rate by age and gender, population (EUROPOP2010), fertility rate by age, mortality rate by age and gender, and net migration by age and gender. A number of variables included in the assumptions as provided by the AWG-EPC were not incorporated in the PROST workings for the pension projections, primarily due to the fact that such variables are not required as PROST inputs. Accordingly, the budgetary projections for Malta covering the period up to 2060 include the following two main sets of assumptions:

As regards the **demographic** evolution, the fertility rate for Malta is projected to increase from 1.4 children in 2010 to around 1.6 children in 2060. Life expectancy at birth for men is projected to increase from 77.6 years in 2010 to 84.9 years in 2060, whilst in the case of women it is expected to rise from 82.3 years in 2010 to 88.9 years in 2060. This implies that despite some convergence, female life expectancy in 2060 is projected to remain 4 years higher than that of males. Meanwhile, life expectancy at 65 years for both males and females is projected to increase by 5.2 years between 2010 and 2060. Net migration inflows as a share of total population are projected to remain relatively stable as from 2019 at around 0.1 per cent.

With respect to **macroeconomic** assumptions, potential GDP growth rate is assumed to increase from 1.4 per cent in 2010 to around 2 per cent by 2020, thereby declining to 1.4 per cent by 2040. It is assumed to decline further to 0.8 per cent by 2050 and increase slightly to 0.9 per cent by 2060. The unemployment rate (15-64 years) is assumed to record marginal declines along the projection period decreasing from 7.0 per cent in 2015 to 6.6 per cent in 2060. The female participation rate (15-64 years) is assumed to increase to 57.0 per cent by 2035, remaining relatively stable at around that level thereafter. The male participation rate (15-64 years) is assumed to increase to 83.4 per cent by 2030 and to decline gradually to 82.4 per cent by 2060.

5.1.2 Demographic Developments

Population projections (EUROPOP2010) indicate that population in Malta by 2060 will be both smaller and older.¹ Total population is projected to rise from around 413,000 in 2010 to around 417,000 in 2030, and to decline thereafter to around 387,000 by 2060. As shown in Table 5.1, the age structure of the Maltese population is projected to change significantly. The share of the very young people (aged 0-14 years) in the total population is projected to decline. From an economic perspective, the most significant change concerns the working-age population (aged 15-64 years), which reflects the share of the population that will bear the financial ‘burden’ of the elderly. From a share of 69.4 per cent in 2010, this ratio will subsequently fall to 61.7 per cent by 2030 and reach 55.8 per cent in 2060. By contrast, the share of the elderly population (aged 65+ years) in total population will increase steeply from 15.1 per cent in 2010 to 31.2 per cent by 2060.

The dynamics of the ageing process could be better appreciated by analysing the developments in the relative share of the elderly to the working-age population. These dependency ratios relate the number of individuals that are likely to be “dependent” on the support of others for their daily living – youths and the elderly – to the number of those individuals who are capable of providing such support. The key indicator of age dependency in Table 5.1 relates the number of individuals aged less than 15 years and of those aged 65 and over to the population aged 15-64 years. Two other indicators are presented in Table 5.1: the youth-dependency ratio (for individuals aged less than 15 years) and the old-age-dependency ratio (for persons aged 65 years and more), both calculated relative to the number of individuals aged 15-64 years.

The youth dependency ratio (0-14 years bracket as a percentage of the 15-64 year bracket) is projected to record a marginal increase between 2010-2020 and to decline from 22.9 per cent in 2030 to 20.8 per cent in 2040 thereby increasing to 23.4 per cent by 2060. The old-age dependency ratio (65+ year bracket as a percentage of the 15-64 year bracket) is projected to increase persistently from 21.8 per cent in 2010 to 55.9 per cent in 2060, an increase of 34.1 percentage points. Thus, by 2060, the total dependency ratio, which is the combined burden of these two components of the economically active population, will amount to 79.3

Total Population, by Selected Age Groups

Table 5.1

Age	2010	2020	2030	2040	2050	2060
0-14 yrs	64,127	62,191	58,738	52,605	51,516	50,501
15-64 yrs	286,364	267,385	256,901	252,370	235,020	215,813
65+ yrs	62,379	86,088	100,992	102,082	110,113	120,621
Total	412,870	415,664	416,631	407,057	396,649	386,935
0-14 yrs	15.5	15.0	14.1	12.9	13.0	13.1
15-64 yrs	69.4	64.3	61.7	62.0	59.3	55.8
65+ yrs	15.1	20.7	24.2	25.1	27.8	31.2
Youth dependency ratio (0-14 yrs)	22.4	23.3	22.9	20.8	21.9	23.4
Old-age dependency ratio (65+ yrs)	21.8	32.2	39.3	40.4	46.9	55.9
Total dependency ratio	44.2	55.5	62.2	61.3	68.8	79.3
15-64 yrs/65+ yrs	4.6	3.1	2.5	2.5	2.1	1.8

Note: Figures may not add up due to the rounding

Source: EUROPOP2010, Eurostat

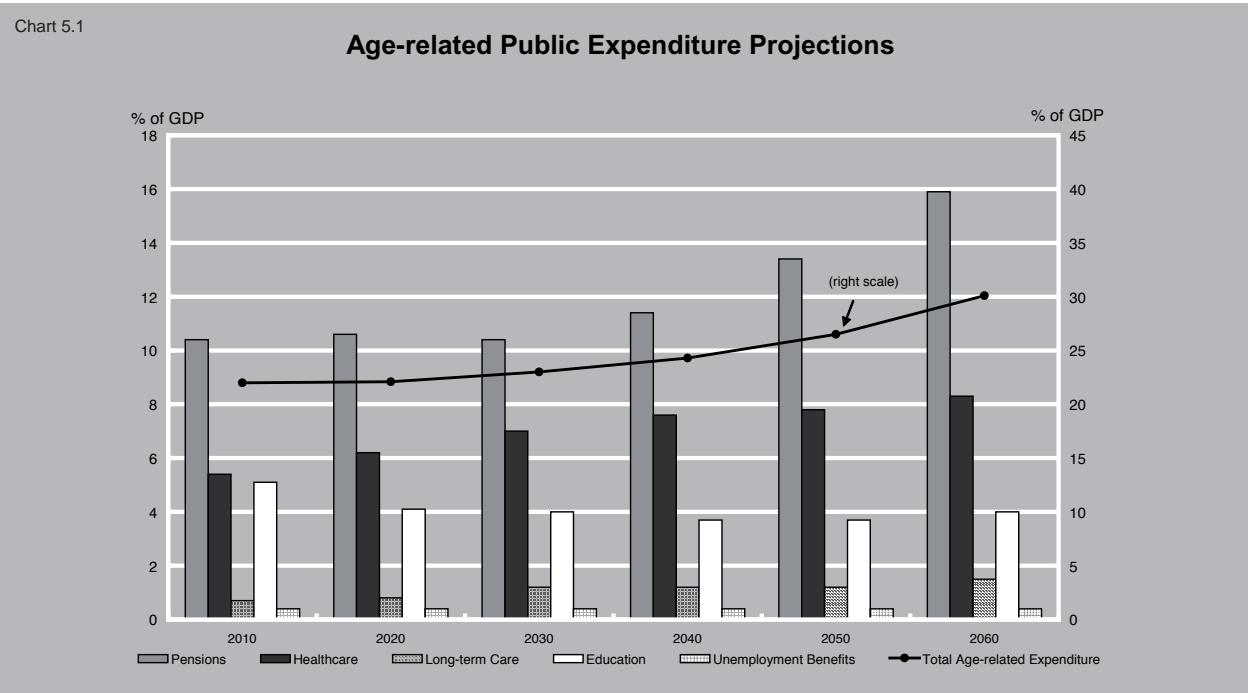
per cent, which means that every person in the working age population will have to support around 0.8 non-active persons compared to 0.4 non-active persons in 2010. As a result of these demographic developments, the support ratio (15-64 years bracket/65+ year bracket) declines from 4.6 in 2010 to 1.8 in 2060. This means that while in 2010 there were around 5 persons of working age for every person that reached pension age, by 2060 this ratio will decrease to around 2 persons of working age for every person that reached pension age.

5.1.3 Age-related Public Expenditure

Age-related spending including pensions, health care, long-term care, education and unemployment benefits in Malta is projected to increase by 8.1 percentage points of GDP over the period 2010-2060. Chart 5.1 shows the age-related public expenditure as a share of GDP for this projection period.

Public expenditure on pensions is the most important age-related government expenditure item, in terms of size both at present and in the future. Pension projections cover the contributory pension benefits (mainly includes pensions related to retirement pension, survivorship and invalidity), the non-contributory old-age pension paid under the Social Security Scheme and Treasury Pensions. At present, private pensions play a rather minor role as regards pension provision for the old-aged persons. The coverage of pension schemes is different from the previous round of budgetary projections, since in this round the pension projections include also the expenditure on non-contributory old-age pension, the payment of bonuses² to pensioners, as well as the Treasury Pensions³. Over the projection period 2010-2060, pension expenditure in Malta is projected to rise from 10.4 per cent of GDP in 2010 to 15.9 per cent of GDP by 2060. The increase in old-age pension expenditure is driven by the ageing process, in reflection of projected demographic developments. At the same time, one notes that the parametric changes introduced in the pension reform also contribute to raise expenditure, especially after 2030. The increase in the pension age, the increase in the contribution period for full pension eligibility and the changes to the benefit formula contribute to lower the projected increase in pension expenditure. However, at the same time the more dynamic indexation of the ceiling on pensionable income, the statutory changes to indexation for old-age pensions and the introduction of the guaranteed national minimum pension for persons retiring from 2026 onwards contribute to increase expenditure pressure.

Another important contributor to the increase in age-related spending is healthcare. Results indicate that Malta is projected to record an increase of 2.9 percentage points of GDP in health care and an increase of 0.8 percentage points of GDP in long-term care during the period 2010-2060. This increased spending on



health care and long-term care is primarily due to an ageing society and an increase in life-expectancy at birth over the projection period. On the other hand, public spending on unemployment benefits as a share of GDP is projected to remain relatively unchanged at 0.4 per cent between 2010 and 2060. Additionally, education spending is projected to decrease by 1.1 percentage points of GDP during the projection period in light of the projected changes in the population of persons in education.

5.2 Focus on Pension Reforms

As a result of the demographic developments, the outlays on pensions paid by Government will rise over the coming decades leading to a worsening in the balance of the current system. In light of these developments in December 2006, the House of Representatives adopted a series of parametric reforms (Act No. XIX of 2006) to the definition of pension age, retirement before pension age, the full rate of two-thirds pension calculation formula, the maximum pensionable income and the crediting of contributions as provided for under the preceding legislative framework, aiming at enhancing the sustainability of the pension system whilst improving the adequacy of the pension enjoyed by retirees in the future. Further detail on the pension system in Malta and the key pension reform parameters are provided in Appendix 5A.1.

As a continuation of the pension reform process, the first review of the impact of the reform was recently carried out and a technical report was presented to Parliament by the Pensions Working Group (PWG) in December 2010. The Maltese Government has not pronounced itself officially on the recommendations expressed in the Report.

Following the presentation of this Strategic Review it was decided that the findings should be placed in the public domain for further discussion and consultation with the aim of reaching a consensus on the way forward. During the period of the public consultation process which occurred during the 15 March 2011-31 July 2011, the PWG met with various stakeholders and obtained their views and discussed various issues and matters with these stakeholders. Official written feedback has been received by a number of stakeholders and the PWG has held various meetings with these and other stakeholders. The extensive consultation process was followed up by further pension system modelling in late autumn in conjunction with the World Bank on considerations presented to it during the consultation process. A Report, taking stock of the feedback in light of the recommendations, has been presented to the Minister responsible for the Department of Social Security. The Report, which is expected to be made public shortly, largely re-affirmed the recommendations of the Strategic Review. The Chairman of the PWG has presented the main findings to the Cabinet of Ministers during the month of March.

The Report submitted to Parliament by the PWG in December 2010 contained 45 recommendations as a continuation of the pension reform process initiated in 2007. In view of the projected gains in life expectancy and the impact of the latter on the sustainability of pension systems, one of the recommendations of the 2010 Report was the introduction of an explicit link between the pension age and life expectancy. Also, the PWG recommended that Government introduces the Third Pension framework to provide the appropriate vehicle for persons to save on a voluntary basis for their pension. In fact, the Retirement Pensions Act (Cap. 514) of 2011 has been approved by the House of Representatives, but has not yet come into force. This Act allows for the licensing of retirement schemes in Malta.

Furthermore, in order to enhance the sustainability of the pension system in Malta, the PWG proposed the recommendation to study further the possibility of introducing a notional defined contribution (NDC) first pension. An NDC Pension system has in-built features, which allow it to self-adjust in order to enhance its financial sustainability and to award higher replacement rates for persons that remain active in the labour market. In view of these desirable features, the PWG recommended that Government appoints a Working Group to assess further this policy option by 2013. The PWG also recommended that Government considers introducing a Mandatory Second Pension directed towards persons who are aged 45 years and younger at the time when it is introduced and that decisions on the size of contributions, the sources of financing for these contributions and the phasing in of the framework be based on a national consensus in a setting that

includes the participation of the Opposition in Parliament and relevant representatives of both employers and employees. In addition, the PWG recommended also that the Second Pension should be supported by a Default Fund framework based on a lifecycle investment strategy in which people who fail or are unwilling to make an investment choice are de facto enrolled in, whilst ensuring that the most optimal administrative cost structure for the Mandatory Second Pension is introduced.

Footnotes:

¹ Demographic assumptions based on EUROPOP2010 do not necessarily fully reflect the views of the AWG neither as a group nor of individual Member States or national statistical offices. The Maltese authorities have expressed reservations on EUROPOP2010.

² The bonuses covered in the projections include the full Cost Of Living Adjustment (COLA) granted to all employees and pensions – a flat-rate compensation for inflation computed on the basis of a base wage that in 2010 stood at around 63 per cent of the average wage. Other bonuses covered in the projections include flat-rate amounts granted to employees and pensioners at the end of each quarter.

³ Treasury Pensions cover principally pensions and allowances to Public officers who joined the Public Service of Malta prior to 15th January 1979, thereby making it a closed pension scheme.

Appendix 5A.1

The Pension System in Malta

The current pension scheme in Malta is based on the Social Security Act, Chapter 318 of the Laws of Malta. The Act provides for two basic schemes, the Contributory Scheme, and the Non Contributory Scheme. In the Contributory Scheme, the basic requirement for entitlement is that specific contribution conditions are satisfied. In the Non Contributory Scheme, the basic requirement is that the conditions of the means test are satisfied.

The Non Contributory Scheme has made possible the allocation of more than one benefit at the same time, thus providing simultaneous coverage in those cases where more than one contingency is present. Through the process of targeting, this scheme has succeeded in the provision of additional assistance to certain specific categories such as, in the case of persons with a disability, in the case of single parents, as well as in the case of the family as a single unit.

The Contributory Scheme is universal since it practically covers all strata of the Maltese society. Within this scheme, employees, self-occupied and self-employed persons acquire social insurance rights through the payment of a weekly contribution as laid down by the Social Security Act.

Contributions are payable by all gainfully occupied persons between the age of sixteen and their pension age.¹ The scheme allows for different types of contributions in order to extend coverage to all types of persons in employment, including employed persons and self-occupied persons². For each person, a tripartite contribution is payable: the employed person, the employer and the State each pay 10 per cent of the basic salary of the employee; with the contribution capped to the Maximum Pensionable Income that stood at €7,116 in 2010, that is, around 18 per cent higher than the average wage. The rate of contributions by self-occupied persons is shared by the State and self-occupied persons, whereby the self-occupied pays 15 per cent and the State pays 7.5 per cent of their annual income that is subject to the same ceiling that applies for employees.

5A.1.2 Key Pension Reform Parameters

This section focuses on the key pension parameters of the old-age pension (also known as the Two-Thirds Pension Scheme) that were addressed in the pension reform in December 2006. Table 5A.1 provides an outline of selected parameters of the pension reform.

The Definition of Pension Age

One of the main parametric changes announced in the reform concerns changes to the statutory pension age. Prior to the reform, pension age stood at sixty years for females and sixty-one years for males. Following the implementation of the reform, pension age was raised to sixty-five years, however, a number of provisos apply:

As outlined in Table 5A.1, in the case of a person born on or before the 31 December 1951, pension age is sixty-one years for the males while for females pension age is sixty years; in the case of a person born during the calendar years 1952-1955, pension age shall be sixty-two years; for persons born during the period 1956-1958, pension age shall be sixty-three years; for persons born in the period 1959-1961, pension age shall be sixty-four years.

Retirement before the Pension Age

Prior to the enactment of the reform, the full weight of a pension was payable to a person who has paid or has been credited with a yearly average of fifty contributions over a thirty year contributions period upon reaching pension age. Fewer years of contribution resulted in linearly reduced pensions, with the minimum years of contributions paid required to collect a pension currently set at ten years. Following the reform, a

Pension Reform: Summary of Selected Measures

Table 5A.1

		Pension Age			
		Before		After	
		Males	Females	Males	Females
2010		61	60	61	60
2013		61	60	62	62
2018		61	60	63	63
2022		61	60	64	64
2026		61	60	65	65
No. of Contributions Years for Full-Pension Entitlement					
Before		30 years			
After	Born on or before 31 December 1951	30 years			
	Born between the years 1952 to 1961	35 years			
	Born on or after 1 January 1962	40 years			
Calculation of Pensionable Income					
Before	Best 3 out of last 10 years for employed persons Last 10 years for self-occupied persons				
After	No change for persons born before 1962 For persons born on or after 1962 pension determined as the yearly average of the basic wage/salary/net income/net earnings of the best 10 years within the last 40 years				
Minimum Pension					
Before	4/5ths of the National Minimum Wage for a couple 2/3 of the National Minimum Wage for any other person				
After	Establishment of the Guaranteed National Minimum Pension payable at a rate that is not less than 60 per cent of the National Median Income				

person who has attained the age of sixty-one years but has not yet attained pension age, can after attaining sixty-one years of age claim a pension in respect of retirement if such person is no longer gainfully occupied. It is necessary that since reaching his eighteenth birthday, the claimant has had a total of:

- 2,080 (or 40 years) paid or credited contributions in the case of a person born on or after the 1st January 1962, or
- 1,820 (or 35 years) paid or credited contributions in the case of a person born during calendar years 1952 to 1961.

Pensionable Income

Prior to the enactment of the pension reform law, the pension was determined on the basis of the yearly average of the basic wage³ during the best three years of the last ten years in the case of employees while the best ten years were taken into consideration for self-occupied persons. Under the reform law, in the case of a person born on or after the 1 January 1962, the pension is determined by taking the yearly average of

the basic wage/salary/net income/net earnings as the case may be, during the best ten calendar years within the last forty years immediately preceding his retirement or invalidity. In determining pensionable income, past wages and incomes are updated with the COLA granted with respect to those years.⁴

Pension Formula

Prior to the reform, the pension formula for the two thirds pension was as follows:

$$\text{Contribution_Average} * \left(\frac{2}{3}\right) * \text{Pensionable_Income} - \text{Service_Pension}^5$$

where the Contribution Average was determined as the average of two averages with the first average being the average weekly contribution over the last ten years prior to retirement (Avg_Cont10) and second being the average weekly contribution paid during a maximum of twenty years falling prior to the last ten years before the retirement of an insured person (Avg_Cont20):

$$\text{Contribution_Average} = \frac{(\text{Avg_Cont}_{10} + \text{Avg_Cont}_{20}) / 2}{50}$$

Therefore, prior to the enactment of the reform, the full rate of the Two-Thirds Pension was equal to two-thirds of pensionable income for a claimant who has paid or been credited with a yearly average of fifty contributions over a period of thirty years. Under the reform law, the period of contribution was changed as follows:

1. thirty years in the case of a person born on or before the 31 December 1951;
2. thirty-five years for a person born during calendar years 1952 to 1961; and
3. forty years in the case of a person born on or after the 1 January 1962.

For a person born on or after the 1 January 1962, the yearly average of contributions required for the purposes of awarding a Two-Thirds Pension is assessed on any period of forty years between the first day of his contribution year in which he reaches the age of eighteen and the last day of his last complete contribution year before the beginning of his benefit year.

The Maximum Pensionable Income

Prior to the reform, the maximum pensionable income was fixed by law and was revised in recent years in line with the COLA. Following the reform, in the case of a person born on or before the 31 December 1961, whose retirement occurs on or after the 1 January 2007, the basic wage/salary/net income/net earnings and the resultant pensionable income, will not exceed €16,207.78 increased by such sum as the Government may award as a cost of living increase.

The following provisions stand: (i) for a person born on or before the 31 December 1951, the resultant pensionable income including any such cost of living increase shall not exceed the sum of €7,470.30; (ii) in the case of a person born during calendar years 1952-1961, the resultant pensionable income including any such cost of living increase shall not exceed the sum of €20,964.36.

In the case of a person born on or after the 1 January 1962 whose retirement occurs on or after the 1 January 2007, the resultant pensionable income shall not exceed: (i) €16,207.78 increased by such sum that the Government awards for the cost of living, in respect of the years 2007-2010; (ii) €16,207.78 increased on the 1 January of each year between 2011-2013 by one third of the difference between the sum referred to above and €20,964.36; (iii) €20,964.36 increased annually by 70 per cent of the percentage increase in the national average wage for the previous calendar year, plus 30 per cent of the inflation rate for that same year. This applies as from the 1 January 2014.

The Guaranteed National Minimum Pension

Changes were enacted to the National Minimum Pension, which stood at 4/5ths of the National Minimum Wage for a couple and 2/3rds of the National Minimum Wage for any other person. Following the enactment of the reform law, a person born on or after the 1 January 1962 who is not entitled to a Service Pension shall be entitled to a Guaranteed National Minimum Pension (GNMP) which shall be payable at a rate that is not less than 60 per cent of the National Median Income. This represents a higher rate than that awarded to pensioners at present. The exact rate shall be determined by the Minister in charge of the Department of Social Security with the concurrence of the Minister responsible for Finance. In any case, the rate of GNMP cannot be less than that declared for the preceding year.

Crediting of Contributions

The categories of persons to whom credit of contributions is allowed has been extended to include persons born on or after the 1 January 1962, who have the legal care and custody of a child who is less than six years old, or ten years old in the case of a child suffering from a serious disability. Crediting of contributions may be claimed for a maximum period of two years in the case of a parent who has stopped working to take care of his/her child, extended to four years in the case of a child suffering from a serious disability. An adoptive parent is also able to claim such credits. Credits may be claimed for every child, with no distinction between employed and self-employed persons. The claimant is bound to have worked a minimum number of years equal to the duration of the crediting period. In the case of a parent's death, the latter proviso ceases to apply.

Pension Indexation

Persons born before the 1 of January 1962 (including present retirees) have their pension updated on the basis of the COLA as well as any increases in wages presently awarded through collective bargaining to the occupation or salary scale previously occupied by the person in retirement. Following the pension reform, persons born after the 1 of January 1962 have their pension updated annually by such a sum that corresponds to 70 per cent of the increase in the national average wage and 30 per cent of the inflation rate as published by the National Statistics Office.

Ministerial Powers and Responsibilities

The Minister in charge of the Department of Social Security will, within intervals not exceeding five years, prepare a report reviewing the workings regarding the Retirement Pensions together with recommendations for achieving further adequacy, sustainability and social solidarity. This first report was submitted in 2010. The Minister, in concurrence with the Minister of Finance has the power to make and vary any regulations requiring persons who have not reached pension age and their employers as the case may be, to make contributions into Mandatory Second Pension Funds. Such regulations may provide for the rate of contribution payable, method and frequency of payment. Second Pension funds shall be governed by the Special Funds (Regulation) Act (Cap. 450). The Minister may in conjunction with the Minister for Finance provide exemptions from income tax in respect of contributions made by any person to Third Pension funds. These funds will be governed by the Special Funds (Regulation) Act (Cap. 403) as applicable.

Other Reforms

Moreover, the Maltese Government also introduced changes to the regime regulating the award of the invalidity pensions and the review procedure. The new regime was implemented over the course of 2007 after the necessary legislative and organisational changes were instituted. These measures introduced a new medical review process for this benefit and amongst the measures involved one finds:

1. A change in the application format that includes more medical data and further responsibility on the part of the claimant to prove his case. No invalidity pension is issued for life and each case is subject to regular reviews. All cases are reviewed every three to four years – where updated medical evidence is requested from the beneficiary.
2. A change in the current medical panel system, where under the new system the Department of Social

Security has recruited medical practitioners through an Expression of Interest to act as a Medical Review Team. The Team's main function is to advise the Director (Social Security) on the medical aspects of Invalidity claims.

3. The establishment of specific medical criteria for the award of benefits which has been achieved by establishing "Impairment Tables" that provide the basic guidelines under which that Medical Review Team would decide on work-related impairment for Invalidity pension.
4. The establishment of an independent systems audit, which established a medical audit for benefit claims awarded and rejected on medical grounds, in order to establish whether such benefits have been awarded correctly.

Changes were also made to minimum period of sickness prior to payment of invalidity pension benefit which is now set at three months. However, this waiting period does not apply in the case of sudden severe or terminally-ill persons.

Footnote:

¹Contributions are also payable by pensioners in gainful employment that retired after 5 of January 2008. Pensioners who retired earlier than this date are allowed to work without prejudicing their pension rights in the ages of 61 years to 65 years without paying social security contributions, subject to a ceiling on earnings equivalent to the national minimum wage. For this group, ceiling on earnings is removed at the age of 65 years and no further contributions are due.

²A self-occupied person is defined by the Social Security Act as "person who is engaged in any activity through which earnings exceeding €10 per annum are being derived".

³The basic wage refers to the gross wage or salary that is payable to an employed person by or on behalf of his employer excluding any remuneration for overtime, any form of bonus, any extra allowances, any remuneration in kind and commissions.

⁴COLA is a flat rate increase in wages and pensions (the latter granted in full as from Budget for 2008) that reflects the uprating of the basic wage (€177.61 per week in 2011) to the average Retail Price Index inflation measured as the 12 months moving average recorded in September of that year. In 2011, the basic wage was around 16% higher than the National Minimum Wage that came into effect on 1 January 2011.

⁵The Social Security Act defines the 'service pension' as a pension or any allowance awarded to a person at any time before and after 1 April 1978 that is payable by or on behalf of his employer with respect to past services in Malta or abroad. A change made over the years is that if the person's service pension is less than two-thirds of pensionable income then the person is awarded an Increased Retirement Pension that is equivalent to the difference between two-thirds of pensionable income and the service pension.

6. Quality of Public Finances

6.1 Policy Strategy

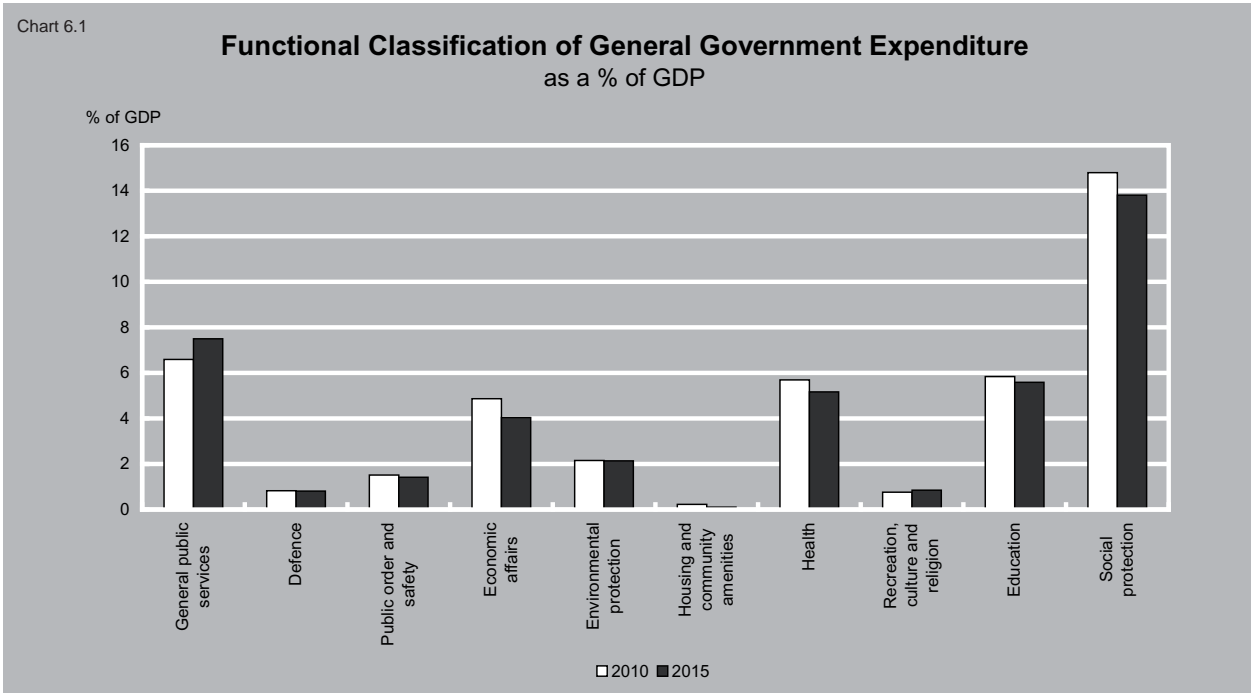
Government’s fiscal consolidation strategy through expenditure control is an essential element in the management of Government finances. At the same time, Government also aims for the improvement of the efficiency and effectiveness with which public spending is transformed into desired economic and social outcomes. Raising the efficiency and effectiveness of public spending provides Government with two opportunities; that of maintaining the level of spending using fewer resources, or alternatively, to improve outcomes keeping inputs constant. Furthermore, Government’s fiscal policy strategy towards increasing the efficiency and effectiveness from the revenue side is achieved through the promotion of macro-economic incentives. Reprioritisation of spending areas, as well as a reconsideration of appropriate policy instruments, may therefore be essential for the improvement in the efficiency and effectiveness of public finances.

6.2 Composition, Efficiency and Effectiveness of Expenditure

6.2.1 Composition of Expenditure Systems

An upward trend in total Government expenditure for 2015 of 18.0 per cent when compared to 2010 is expected to be outweighed by increases in economic growth, such that the ratio of total expenditure to GDP is expected to follow a generally downward trend from 43.3 per cent of GDP in 2010 to 41.4 per cent in 2015. Government expenditure classified by functions of Government as a percentage of GDP is displayed in Chart 6.1, while the analogous data is presented in Statistical Appendix Table 3.

For the period 2010-2015, a decline of 1.0 percentage point in the ratio of Government expenditure to GDP is expected from spending on Social Protection which is forecasted to reach 13.8 per cent of GDP. This is followed by a decline in Government spending on Economic Affairs which is expected to decline by 0.9 percentage points reaching 4.0 per cent of GDP in 2015 when compared to a ratio of 4.9 per cent registered in 2010. The ratio of spending on Health is expected to decline by 0.5 percentage points over the same comparative period, reaching 5.2 per cent in 2015. Additionally, marginal declines are expected in the ratios of expenditure to GDP for Education and Public Order and Safety, and Housing Community Amenities which are projected to decline by 0.2 and 0.1 percentage points respectively from 2010, each reaching a ratio of 5.6



per cent and 0.1 per cent of GDP in 2015. The ratio of spending on Defence and Environmental Protection is forecasted to remain stable at 0.8 per cent and about 2.2 per cent of GDP respectively. On the other hand, the ratio of expenditure to GDP on General Public Services is expected to increase by 0.9 percentage points to reach 7.5 per cent of GDP in 2015 when compared to 2010. Comparatively, expenditure on Recreation, Culture and Religion is expected to increase marginally by 0.1 percentage points.

The highest contribution to the increase in total general Government expenditure between 2010 and 2015 is expected to be recorded from the General Public Service which is projected to register an increase of 40.1 per cent over the period, mainly on account of interest expenditure related to Malta Government Stocks. Taking into account their respective shares in total general Government expenditure, other noteworthy contributions to the increase in expenditure over the period 2010-2015 are also expected in the Education, Social Protection, Environmental Protection, and Health categories which on an absolute level are projected to register increases of 18.0, 15.0, 22.3, and 11.8 per cent respectively.

The increase related to the Education category is mainly on account of higher projected expenditure with respect to the University of Malta, as well as higher personal emoluments relating to pre-primary, primary, and secondary education, and programmes and initiatives relating to contributions towards the financing of church schools and students' maintenance grants. The increase projected in the Social Protection category is mainly underpinned by expenditure relating to social security, pensions, and bonuses. Expenditure relating to Environmental Protection is projected to increase mainly as a result of higher expenditure relating to power utility and waste management and recycling. The projected increase in Health related expenditure over the Programme period is expected to be accounted for by expenditure relating to the Pharmacy of Your Choice Scheme, which is a national scheme facilitating a more efficient and equitable access to Government's pharmaceutical service, while higher outlays on medicines and surgical materials are also expected to be recorded.

Other increases in general Government expenditure over the forecast horizon are also expected in the Recreation, Culture and Religion, Defence, Public Order and Safety, and Economic Affairs categories. Nevertheless, due to their lower shares in total general Government expenditure, they are only expected to contribute 1.9 percentage points to the total increase in expenditure. On the other hand expenditure related to the Housing and Community Amenities category is expected to decline over the Programme period, albeit due to its small share in total expenditure, its negative contribution was almost negligible.

In 2010, the composition of Government spending shows that the categories with the largest shares in total general Government Expenditure were the Social Protection (34.2 per cent), General Public Services (15.2 per cent), Education (13.5 per cent), Health (13.2 per cent), and Economic Affairs (11.2 per cent). In total, these made up 87.3 per cent of total general Government expenditure, and their share is expected to decrease only marginally to around 87.2 per cent in 2015. The uppermost increase in the share of total Government expenditure in 2015 is expected with respect to the General Public Services category, which is expected to make up 18.1 per cent of total General expenditure in 2015, a 2.9 percentage points increase when compared to its share in 2010. Conversely, the biggest decline in the share of total Government expenditure in 2015 is expected to be attributed to the Economic Affairs category, which is forecast to decline to 9.8 per cent from 11.2 per cent registered in 2010.

6.2.2 Efficiency and Effectiveness of Expenditure Systems

There is considerable debate in the economic literature on the relationship between the size of government and economic growth. Whilst this debate is ongoing, it is clear that from a growth perspective one needs to distinguish between productive and non-productive expenditure. Indeed, the composition of government expenditure can be an important element in determining whether government expenditure can be growth enhancing or otherwise in the long term.

Through the effects on the factors of production, productive Government spending can have a positive impact

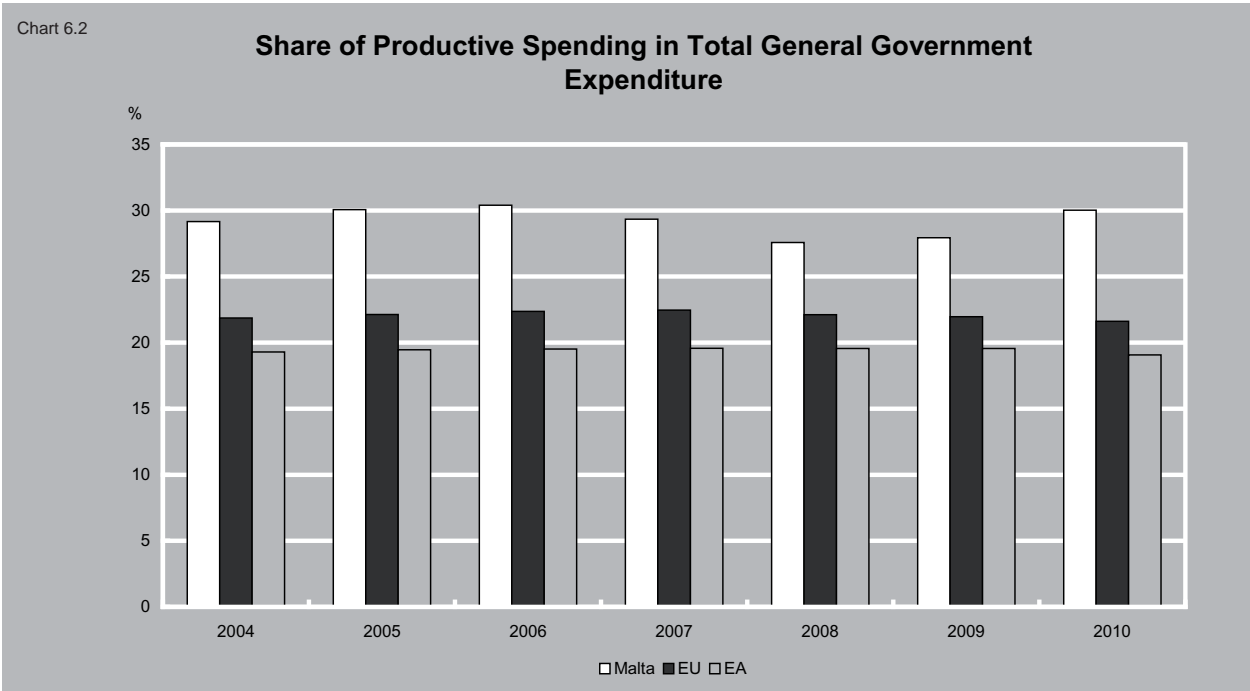
on the potential growth of the economy. The quality of Government expenditure can therefore be measured in terms of the proportion of Government spending which goes towards productive activities.

The World Bank¹ identifies general public services, defence, education, health, housing, transportation, and communication as productive expenditure components, which definition can be adapted in order to account for additional country specific characteristics as well as other factors that may affect growth potential. Estimating the quality of Government finances through these productive spending categories could possibly include components of these same categories which are not productive themselves, such as benefits and transfers, which do not create output per se. Building on these concepts, outlined both by the World Bank and by the Austrian Institute of Economic Research², while also keeping in line with the Government’s strategy for economic growth and development, and taking account of data availability constraints, the above definition of productive Government expenditure for Malta is adapted to be defined as Government expenditure net of social benefits and social transfers in kind for the aforementioned productive spending categories of total Government expenditure.

When comparing the share of the aforementioned components of productive expenditure in total general Government expenditure across Member States for the period 2004-2010, Malta stands above the average for EU and Euro Area countries in all of the expenditure categories except for Housing and Community Amenities. In fact, the average share of productive spending with respect to total Government spending in Malta averaged 29.2 per cent. In comparison, using the same definition of productive spending, the share of the latter in total Government expenditure averaged 22.1 per cent and 19.4 per cent respectively for the EU and Euro Area during the same period. Chart 6.2 portrays the share of productive government spending as a share of total spending in Malta vis-à-vis the EU and Euro Area over the period 2004-2010.

The Budget for 2012 continues to highlight Government’s efforts towards productive spending, particularly in the areas of health, education, housing and environment protection. In this respect, Government has announced incentives for households in specific locations to become home owners. Government has also continued its support for the embellishment and maintenance projects of existing schools, while announcing the setting up of a secondary school specialising in sports. Additionally, the Budget for 2012 also announced that further work will be carried out on an oncology centre, and on other health programmes.

The fight against abuse in Government spending and the improvement in the allocation of Government



expenditure feature high on Government priorities. To this end, Government will continue with its support towards the Benefit Fraud and Investigation department, while further work is to be carried out on the integration of tax departments to strengthen efforts against abuse.

6.3 Structure and Efficiency of Revenue Systems

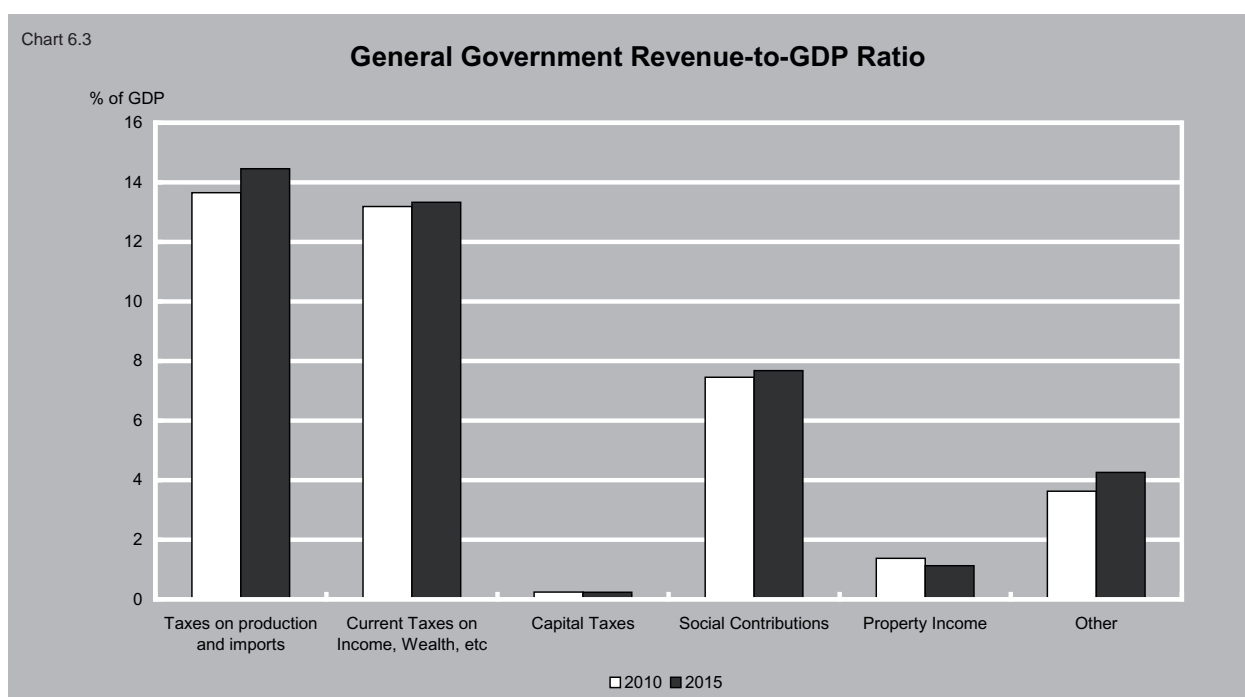
6.3.1 Structure of Revenue Systems

The use of taxation as a fiscal policy tool is one way in which Government aims to encourage economic growth and productivity. Additionally, Government is also undertaking a series of measures so as to enhance revenue collection.

Based on the 2010-2015 period, an increase of 28.0 per cent in total Government revenue is expected for 2015 when compared to 2010. Chart 6.3 and Statistical Appendix Table 2a portray the revenue-to-GDP ratios of the various revenue components.

Tax revenue accounts for 68.5 per cent of general Government revenue. The major components of tax revenue consist of taxes on production and imports, and current taxes on income and wealth, each of which comprise roughly half of total income from taxes. This is followed by a lesser but still significant share of revenue from social contributions, which represented 18.9 per cent of total Government revenue.

The general Government revenue-to-GDP ratio is expected to increase marginally from 39.5 per cent in 2010 to 41.1 per cent in 2015, mainly reflecting an increase of 0.9 percentage points from 27.1 per cent in 2010 to 28.0 per cent in 2015 for the tax revenue-to-GDP ratio. The increase in the tax revenue-to-GDP ratio mainly reflects an increase of 0.8 percentage points in the ratio of taxes on production and imports. The ratio of general Government revenue from social contributions is expected to remain stable, increasing only marginally to 7.7 per cent in 2015 when compared to a share of 7.5 per cent registered in 2010. Comparatively, property income as a ratio to GDP is projected to decrease marginally by 0.3 percentage points in 2015 when compared to 2010 thus reaching 1.1 per cent. Conversely, the ratio of the 'other' revenue component is expected to increase by 0.6 percentage points in 2012, reaching 4.3 per cent mainly attributable to increases in capital transfers as a ratio to GDP.



When compared to 2010, the share of tax revenue from total general Government revenue for 2015 is expected to decline marginally from 68.5 per cent to 68.2 per cent. This is attributable to a projected decline in the share of current taxes on income and wealth of 0.9 percentage points when compared to 2010, albeit taxes on production and imports are forecasted to increase by 0.7 percentage points during the same period. Revenue from capital taxes contributes marginally to the total tax revenue accounting for 0.6 per cent. The share of capital taxes is expected to remain relatively stable for the forecast horizon. Declines are expected in the shares of revenue from social contributions and property income to total general Government revenue by 0.2 and 0.7 percentage points respectively. Conversely, the share of revenue from the remaining ‘other’ revenue category is expected to increase by 1.2 percentage points from 9.2 per cent in 2010 to 10.4 per cent in 2015, comprising mainly of changes in capital transfers receivable pertaining to EU funds. These developments attest to the increasing importance of indirect revenue compared to direct revenue and the growing contribution of EU funds.

6.3.2 Efficiency and Effectiveness of Revenue Systems

Government’s aims for fiscal consolidation are primarily focused on further controls on expenditure, rather than on taxation increases. However, as iterated earlier, it is still part of Government’s fiscal policy to use taxation as a policy tool to stimulate economic growth and productivity. The growing importance of indirect revenue measures vis-à-vis direct revenue is deemed to be more supportive of growth.

To improve revenue collection, Government is strengthening schemes which allow for the collection of tax arrears, while also allowing more time for the settlement of tax payments. This is expected to allow Government to meet expenditure and deficit targets without the need to resort to significant increases in tax rates, particularly of a direct nature.

It has been recognised that incentives in research and development, entrepreneurship, and foreign direct investment could increase efficiency in production. In particular, in the Budget for 2012, Government announced further schemes giving tax credits to small companies on costs incurred relating to their new investment and to new jobs they create.

Moreover, in the Budget for 2012, Government has again made available fiscal incentives to encourage as well as to facilitate women entering the work force, in addition to schemes which provide more family friendly measures. These tax policies promote the formation of human capital, which in turn improves the labour supply.

Footnotes:

¹ Nihal Bayraktar and Blanca Moreno-Dodson (2010), ‘How can public spending help you grow? – An empirical analysis for developing countries’, Policy Research Working Paper 5367. (The World Bank, Poverty Reduction and Economic Management Network, Office of the Vice President)

² Pitlik Hans and Schratzenstaller Margit (2011), ‘Growth Implications of Structure and Size of Public Sectors’, WIFO Working Papers Number 404.

7. Institutional Features of Public Finances

7. Institutional Features of Public Finances

The further strengthening of economic governance for the EU and the Euro area, in particular the entry into force of the directive of the Council and the European Parliament on the requirements for budgetary frameworks of Member States, have important implications for the institutional features of public finances. Government acknowledges the important role that national fiscal frameworks may play in sustaining budgetary retrenchment. This is reflected in Malta's commitment to the Euro Plus Pact, the EU economic governance legislative package, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and the significantly stronger coordination of economic policies in areas of common interest, including the common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of an excessive deficit. Towards this end, the accountability and transparency of the budgetary framework are being strengthened. Moreover, Government is actively considering the implementation of systems which lead towards increased budget execution discipline.

In view of the Government's commitment to the strengthening of fiscal frameworks earlier in 2012, the Prime Minister moved the first reading of a Bill to amend the Constitution in line with the Fiscal Compact. In view of the sensitivity of this development, the Prime Minister has stated this amendment shall reflect the result of talks between Government and the Opposition, with a view to ensure that the necessary changes to the Constitution are adopted.

7.1 The Current Institutional Framework

The draft annual and medium term expenditure and revenue projections for Ministries, Departments and public entities are compiled by the Budget Affairs Department within the Ministry of Finance, the Economy and Investment, keeping in perspective the aggregate budgetary targets of Government throughout the public finance management cycle and expected macroeconomic developments. The Department is also entrusted with the monitoring of the financial performance of Ministries and Departments, and of public sector organisations, recommending upon timely corrective measures where issues of budget containment or revenue shortfalls are envisaged as the financial year unfolds. Financial control, discipline and cost effectiveness are also encouraged by the Financial Management Monitoring Unit, also within the Ministry of Finance, the Economy and Investment, which supervises the financial operations of public entities.

Public funds are also managed and supervised by the Accountant General, assisted by the Treasury's Government Accounts Department as the executive arm of the Accountant General. The Government Accounts Directorate ensures that Ministries and Departments adopt and maintain uniformity in the accounting system and exercises a monitoring role on the disbursements of public funds.

The accounts of all Ministries and Departments are audited and reported upon annually by the Auditor General, an institution that is accountable to the House of Representatives. The Constitution and the National Audit Office Act of 1997 empower the Auditor General to audit the accounts of all Departments and Offices of the Government of Malta, and of such public authorities or other bodies administering, holding, or using funds belonging directly or indirectly to the Government of Malta. Furthermore, the National Audit Office Act extends the mandate further to include also the Performance audit of Central Government Departments and Offices and other public sector entities, as well as the audit of the operations of companies or other entities in which the Government of Malta owns not less than 51 per cent of the shares.

Further scrutiny on the financial conduct of Government Departments is exercised by the Parliamentary Standing Committee on Public Accounts, which is chaired by a member of the Opposition. The Committee enquires into matters relating to public accounts and expenditure, and examines the accounts of statutory authorities whose accounts are presented to Parliament, amongst other tasks.

With regards to Public Debt, the Treasury's Debt Management Directorate implements the borrowing plan

based on the strategy approved by Government and prepares debt sustainability analysis to assess the long-term sustainability of projected public sector borrowing levels.

Another important role in the monitoring of public finances in Malta is played by the Central Bank of Malta. As an independent monetary institution and a member of the European System of Central Banks, the Central Bank conducts regular analysis of fiscal developments in Malta. This analysis is reported in the publications of the Central Bank and features from time to time in the public messages delivered by the Governor of the Central Bank.

7.1.1 Public Finance Statistical Governance

Public finance statistics, whether on an annual, quarterly or monthly basis, are compiled by the National Statistics Office. The National Statistics Office, as the executive arm of the Malta Statistics Authority, is responsible for the collection, compilation, analysis and publication of a wide range of statistical information and related matters. The Office has a strong legal basis in the Malta Statistics Authority Act (Cap. 422). It produces, on an impartial basis, data that is subject to the principles of reliability, objectivity, relevance, statistical confidentiality, transparency, specificity, and proportionality.

7.1.2 New Initiatives in this Area

In recent years, several initiatives aimed at enhancing budgetary policy both at the design and the implementation stages have sought to strike a balance between greater autonomy of budgetary institutions and between the need for lean institutional structures. Consequently, whilst recognising the value of greater autonomy, accountability and transparency of the budgetary framework and institutions, the Maltese Government sought to attain these standards through the avoidance of unnecessary duplication in institutions' oversight and competence.

Notwithstanding the absence of independent budgetary institutions, several of the important institutions referred to above are set up under the provision of the Maltese Constitution. Moreover, in exercising some of their functions, they may perform tasks normally associated with independent budgetary institutions, in particular through the publication of independent forecasts, analytical papers and other publications.

Nonetheless, in view of Malta's commitments under the EU economic governance legislative package and the new EU fiscal compact, the Maltese Government is considering the setting up of a body endowed with functional autonomy from the fiscal authorities, entrusted with the monitoring of compliance to national fiscal rules. Whilst the exact modalities of this proposal are still being evaluated the need to avoid duplication of structures and the need for a leaner institutional framework in a small state suggest the adaptation of existing structures as a first preference of the Government.

7.2 The Budgetary Process in Malta

The establishment of the main fiscal targets underpinning the annual Budget and the remaining years of the medium-term budgetary framework is undertaken within the context of Government's commitment to a sustainable fiscal position over the medium-term, and in reflection of foreseen macroeconomic developments. As a result, macroeconomic forecasts constitute an important element underpinning the budgetary process. Macroeconomic forecasts are based on the most recently available information, followed by detailed discussions on the methodology and the assumptions with the Central Bank of Malta and the European Commission alongside with annual discussions with the International Monetary Fund during the regular Article IV missions. In addition, consultations with main economic actors and constituted bodies are also undertaken. The consultation exercise has been strengthened further this year with the process now involving a wider breath of organisations and making use of structured interviews. Further investment in the econometric modelling capability was also undertaken.

In view of the new EU policy-making timetable, the European Semester, the commencement of the preparatory phase leading to the annual budget discussions and related financial estimates has in recent years been initiated in the spring by means of a Circular issued by the Ministry of Finance, the Economy and Investment. The Circular requires Ministries and Departments to draw up financial plans within the parameters permitted by the main fiscal targets sustaining the medium-term budgetary framework. Although the overriding principle guiding the drafting of financial plans remains that adjustments to the fiscal targets set out in the Budget Speech are to be kept at an absolute minimum, annual adjustments to the medium-term budgetary targets are possible to take into account specific unforeseen circumstances, so as to allow for a more effective contribution of the fiscal framework towards the attainment of Government's social and economic objectives.

The submission of draft financial plans to the Ministry of Finance, the Economy and Investment is followed up with a round of bilateral meetings held between the Ministry of Finance, the Economy and Investment and the respective Ministries at the Permanent Secretary level. A separate round of talks takes place at the Ministerial level and it is intended to provide a strategic vision of and focus on national priorities such that unresolved issues pertaining to the allocation of scarce financial resources may be settled.

Meanwhile, the pre-budget consultation process, initiated by means of the publication of the Pre-Budget Document, allows policy-makers, the social partners and other stakeholders to critically evaluate the economic and social situation and to discuss the policy options for the implementation of Government's vision for Malta's economic and social development.

In the second half of the year, the draft budget is finalised and submitted to the national Parliament for debate and the approval of the Financial Estimates of the various Ministries and Departments.

7.2.1 New Initiatives in this Area

In line with the requirements of the Council and the European Parliament directive on the requirements for budgetary frameworks of Member States, Malta is considering amendments to the annual budgetary procedure to take into account the common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit, which include:

- a. The publication of the draft central Government budget by 15 October, accompanied by the publication of the main parameters of the budgets of all the other sub-sectors of the general Government, which shall contain for the forthcoming year:
 - i. the targeted budget balance for the general Government as a ratio of GDP, broken down by sub-sector of general Government;
 - ii. the projections at unchanged policies for expenditure and revenue as a ratio of GDP for the general Government and their main components;
 - iii. the targeted expenditure and revenue as a ratio of GDP for the general Government and their main components, taking into account the conditions and criteria to establish the growth path of Government expenditure net of discretionary revenue measures;
 - iv. a detailed description and a well-documented quantification of the measures to be included in the budget for the forthcoming year in order to bridge the gap between the targets referred to above and the projections at unchanged policies;
 - v. the main assumptions about the expected economic developments and important economic variables which are relevant to the achievement of the budgetary targets;
 - vi. if applicable, additional indications on how recommendations in accordance with Article 121 of the Treaty will be met; and
 - vii. the annual debt issuance plan reflecting the financial needs arising from the targeted ratio for the general Government balance to GDP, renewal of outstanding debt and other relevant operations with impact on the debt of the general Government.
- b. Annual adoption or enforcement and publication of the budget for central Government by 31 December.

Moreover, in line with the requirements of Council Directive 2011/85/EU on budgetary frameworks, the forecasts underpinning the fiscal projections will be evaluated against independent/Commission forecasts.

7.3 Implementation of National Budgetary Rules

Malta is currently considering a fiscal rule to be embedded in the Constitution which is consistent with the obligations under the Stability and Growth Pact including the Council and the European Parliament directive on budgetary frameworks in the EU and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. This means that as a minimum, the new fiscal rule will contain the following elements:

- a. a deficit target of not more than 3%
- b. a balanced budget medium term objective in structural terms (i.e. cyclically adjusted net of one-offs and temporary measures)
- c. a minimum structural effort of 0.5% of GDP per annum with a higher effort in good times
- d. an expenditure rule stipulating that annual government expenditure growth net of interest, EU funded programmes and non-discretionary unemployment benefits should not exceed a medium term potential growth rate unless offset by discretionary tax revenue measures
- e. a debt target of 60% of GDP and a debt rule which ensures that
 - i. when the debt to GDP ratio exceeds the target the difference between the debt ratio and the target shall be sufficiently diminishing by at least 1/20th per annum over the last three years; OR
 - ii. the differential is expected to be reduced over the 3-year forecast period inclusive of the current year by the rate of 1/20th per annum

Apart from clear targets in line with the above, the implementation of fiscal rules will involve monitoring of compliance by an independent body or body endowed with functional autonomy from the budgetary authorities, a correction mechanism in case of deviations from the medium-term objective or the adjustment path towards it, specified consequences in case of non-compliance, as well as escape clauses and clearly delineated exceptional circumstances which may lead to temporary deviation from the medium-term objective or the adjustment path towards it.

Macroeconomic Prospects

Table 1a

Percentages unless otherwise indicated	ESA Code	2011 ⁽¹⁾	2011	2012 ⁽²⁾	2013	2014	2015
1. Real GDP	B.1g	4,792.7	2.1	1.5	2.0	2.0	2.1
2. Nominal GDP	B.1g	6,393.2	4.4	3.6	4.4	4.4	4.5
Components of real GDP							
3. Private consumption expenditure ⁽³⁾	P.3	3,117.8	3.1	0.9	1.4	1.2	1.2
4. Government consumption expenditure	P.3	973.2	3.9	1.4	-0.2	-0.4	-0.9
5. Gross fixed capital formation	P.51	601.1	-13.4	0.4	1.6	4.0	3.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53	-125.2	-2.6	-2.6	-2.5	-2.5	-2.4
7. Exports of goods and services	P.6	5,230.3	1.0	1.2	2.1	3.6	3.8
8. Imports of goods and services	P.7	5,004.5	-1.0	0.7	1.3	3.0	3.1
Contribution to real GDP growth							
9. Final domestic demand		4,692.1	0.8	0.9	1.1	1.2	1.1
10. Change in inventories and net acquisition of valuables	P.52+P.53	-125.2	-0.9	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	225.8	2.2	0.6	0.9	0.8	1.0

⁽¹⁾ € million

⁽²⁾ Forecasts from 2012 onwards

⁽³⁾ Includes NPISH final consumption expenditure

Price Developments

Table 1b

Percentages unless otherwise indicated	ESA Code	2011 ⁽¹⁾	2011	2012 ⁽²⁾	2013	2014	2015
1. GDP deflator		116.9	2.3	2.1	2.4	2.4	2.5
2. Private consumption deflator		113.8	1.0	2.2	2.2	2.2	2.2
3. Harmonised Index of Consumer Prices		115.1 ⁽³⁾	2.4	2.3	2.4	2.2	2.2
4. Public consumption deflator		113.2	0.7	1.9	1.9	2.1	2.1
5. Investment deflator		147.0	1.8	3.2	3.2	2.9	2.9
6. Export price deflator (goods and services)		120.9	6.4	2.2	2.2	1.4	1.8
7. Import price deflator (goods and services)		121.5	4.4	2.4	2.0	1.3	1.6

⁽¹⁾ Index (base 2005 unless otherwise indicated)

⁽²⁾ Forecasts from 2011 onwards

⁽³⁾ Average 2005=100

Labour Market Developments

Table 1c

Percentages unless otherwise indicated	ESA Code	2011	2011	2012 ⁽¹⁾	2013	2014	2015
1. Employment, persons ⁽²⁾		170.9 ⁽³⁾	2.4	1.0	1.6	1.6	1.6
2. Employment, hours worked ⁽⁴⁾		346,595 ⁽³⁾	2.4	1.0	1.6	1.6	1.6
3. Unemployment rate ⁽⁵⁾		11.5 ⁽³⁾	6.5	6.4	6.3	6.3	6.3
4. Labour Productivity, persons ⁽⁶⁾ (€)		28,043	-0.3	0.5	0.4	0.4	0.4
5. Labour Productivity, hours worked ⁽⁷⁾ (€)		13.8	-0.3	0.5	0.4	0.4	0.4
6. Compensation of employees (€ million)	D1	2,847.2	3.1	1.8	2.2	2.3	2.3
7. Compensation per employee (€)		18,947	0.4	0.9	0.5	0.6	0.6

⁽¹⁾ Forecasts from 2012 onwards

⁽²⁾ Occupied population, domestic concept national accounts definition

⁽³⁾ Thousands

⁽⁴⁾ Annual actual hours (LFS Data)

⁽⁵⁾ Harmonised definition, Eurostat; levels

⁽⁶⁾ Real GDP per person employed

⁽⁷⁾ Real GDP per hour worked

Sectoral Balances

Table 1d

Percentages of GDP	ESA Code	2010	2011	2012	2013	2014	2015
1. Net lending/ borrowing vis-à-vis the rest of the world	B.9	-4.7	-2.3	-2.6	-1.8	-1.0	0.2
of which:							
Balance on goods and services		1.4	4.9	5.2	6.1	6.7	7.6
Balance of primary incomes and transfers		-7.8	-8.2	-10.2	-10.3	-9.6	-9.2
Capital account		1.7	0.9	2.4	2.4	1.9	1.8
2. Net lending/ borrowing of the private sector	B.9	-7.9	-2.3	0.9	-2.5	-4.5	1.5
3. Net lending/ borrowing of general Government	EDP B.9	-3.7	-2.7	-2.2	-1.7	-1.1	-0.3
4. Statistical discrepancy		6.9	2.7	-1.2	2.5	4.5	-1.0

General Government Budgetary Prospects

Table 2a

Percentages of GDP		ESA code	2011 ⁽¹⁾	2011	2012	2013	2014	2015
Net Lending (EDP B9) by sub-sector								
1.	General Government	S13	-173.9	-2.7	-2.2	-1.7	-1.1	-0.3
2.	Central Government	S1311	-174.2	-2.7	-2.3	-1.7	-1.1	-0.3
3.	State Government	S1312	-	-	-	-	-	-
4.	Local Government	S1313	0.3	0.0	0.0	0.0	0.0	0.0
5.	Social security funds	S1314	-	-	-	-	-	-
General Government								
6.	Total revenue	TR	2,572.6	40.2	43.1	42.4	41.6	41.1
7.	Total expenditure	TE ⁽²⁾	2,746.5	43.0	45.3	44.1	42.7	41.4
8.	Net lending / borrowing	EDP B9	-173.9	-2.7	-2.2	-1.7	-1.1	-0.3
9.	Interest expenditure	EDP D41	200.8	3.1	3.3	3.4	3.5	3.6
10.	Primary balance ⁽³⁾		26.9	0.4	1.0	1.7	2.4	3.3
11.	One-off and other temporary measures ⁽⁴⁾		18.0	0.3	0.2	0.2	0.2	0.2
Selected Components of Revenue								
12.	Total Taxes (12=12a+12b+12c)		1,769.4	27.7	29.0	28.3	28.1	28.0
12a.	Taxes on production and imports	D2	905.2	14.2	15.6	14.7	14.5	14.5
12b.	Current Taxes on Income, Wealth, etc.	D5	849.4	13.3	13.2	13.3	13.4	13.3
12c.	Capital Taxes	D91	14.8	0.2	0.3	0.3	0.2	0.2
13.	Social Contributions	D61	486.6	7.6	7.7	7.7	7.7	7.7
14.	Property Income	D4	79.2	1.2	1.3	1.2	1.2	1.1
15.	Other ⁽⁵⁾		237.4	3.7	5.0	5.2	4.7	4.3
16=6.	Total Revenue	TR	2,572.6	40.2	43.1	42.4	41.6	41.1
p.m.:	Tax Burden (D2+D5+D61+D91-D995) ⁽⁶⁾		2,277.4	35.6	37.1	36.4	36.1	36.0
Selected Components of Expenditure								
17.	Compensation of employees + intermediate consumption	D1+P2	1,289.3	20.2	19.9	19.4	18.9	18.3
17a.	Compensation of employees	D1	870.1	13.6	13.3	13.0	12.7	12.3
17b.	Intermediate consumption	P2	419.2	6.6	6.6	6.4	6.2	6.0
18.	Social payments (18=18a+18b) of which Unemployment benefits ⁽⁷⁾		881.3	13.8	13.7	13.5	13.1	12.8
			25.1	0.4	0.4	0.4	0.4	0.3
18a.	Social transfers in kind supplied via market producers	D6311, D63121, D63131	45.4	0.7	0.8	0.8	0.7	0.7
18b.	Social transfers other than in kind	D62	835.9	13.1	12.9	12.7	12.4	12.1
19=9.	Interest expenditure	EDP D41	200.8	3.1	3.3	3.4	3.5	3.6
20.	Subsidies	D3	63.9	1.0	1.2	1.2	1.2	1.1
21.	Gross fixed capital formation	P51	159.4	2.5	4.1	3.6	3.5	3.3
22.	Capital transfers		44.6	0.7	1.5	1.3	0.8	0.6
23.	Other ⁽⁸⁾		107.2	1.7	1.7	1.8	1.7	1.7
24=7.	Total Expenditure	TE ⁽²⁾	2,746.5	43.0	45.3	44.1	42.7	41.4
p.m.:	Government consumption (nominal)	P3	1,353.8	21.2	21.1	20.5	20.0	19.4

⁽¹⁾ € million

⁽²⁾ Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B9

⁽³⁾ The primary balance is calculated as (EDP B9, item 8) plus (EDP D41, item 9)

⁽⁴⁾ A plus sign means deficit-reducing one-off measures

⁽⁵⁾ P11+P12+P131+D39+D7+D9 (other than D91)

⁽⁶⁾ Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate

⁽⁷⁾ Includes cash benefits (D621 and D624) and in kind benefits (D631) related to unemployment benefits

⁽⁸⁾ D29+D4 (other than D41)+ D5+D7+P52+P53+K2+D8

Breakdown of Revenue

Table 2b

Percentages of GDP	2011⁽¹⁾	2011	2012	2013	2014	2015
1. Total revenue at unchanged policies	2,518.4	39.4	41.5	41.8	41.4	40.9
2. Discretionary revenue measures	54.2	0.8	1.6	0.6	0.2	0.2

⁽¹⁾ € million

Expenditure to be excluded from the Expenditure Benchmark

Table 2c

Percentages of GDP		2011 ⁽¹⁾	2011	2012	2013	2014	2015
1.	Expenditure on EU programmes fully matched by EU funds revenue	103.7	1.6	3.0	3.0	2.6	2.3
2.	Expenditure fully matched by mandated revenue increases	0.0	0.0	0.0	0.0	0.0	0.0
3.	Non-discretionary changes in unemployment benefit expenditure	0.4	—	—	—	—	—

⁽¹⁾ € million

General Government Expenditure by Function

Table 3

Percentages of GDP	COFOG Code	2010	2015
1. General public services	1	6.6	7.5
2. Defence	2	0.8	0.8
3. Public order and safety	3	1.5	1.4
4. Economic affairs	4	4.9	4.0
5. Environmental protection	5	2.2	2.1
6. Housing and community amenities	6	0.2	0.1
7. Health	7	5.7	5.2
8. Recreation, culture and religion	8	0.8	0.9
9. Education	9	5.8	5.6
10. Social protection	10	14.8	13.8
11. Total Expenditure	TE	43.3	41.4

General Government Debt Developments

Table 4

Percentages of GDP	ESA Code	2011	2012	2013	2014	2015
1. Gross debt		72.0	70.3	68.7	67.4	65.3
2. Change in gross debt ratio		2.5	-1.6	-1.6	-1.4	-2.1
Contributions to changes in gross debt						
3. Primary balance		-0.4	-1.0	-1.7	-2.4	-3.3
4. Interest expenditure	EDP D.41	3.1	3.3	3.4	3.5	3.6
5. Stock-flow adjustment		2.8	-1.4	-0.3	0.5	0.5
p.m. implicit interest rate on debt ⁽¹⁾		4.7	4.7	5.1	5.3	5.6

⁽¹⁾ Proxied by interest expenditure divided by the debt level of the previous year.

Cyclical Developments

Table 5

Percentages of GDP	ESA Code	2011	2012	2013	2014	2015
1. Real GDP growth (%)		2.1	1.5	2.0	2.0	2.1
2. Net lending of General Government	EDP B.9	-2.7	-2.2	-1.7	-1.1	-0.3
3. Interest expenditure	EDP D.41	3.1	3.3	3.4	3.5	3.6
4. One-off and other temporary measures ⁽¹⁾		0.3	0.2	0.2	0.2	0.2
5. Potential GDP growth (%)		1.2	1.4	1.5	1.6	2.0
contributions:						
- labour (hours)		0.3	0.4	0.4	0.4	0.7
- capital		0.0	0.0	0.0	0.1	0.2
- total factor productivity		0.9	0.9	1.0	1.1	1.1
6. Output Gap		-0.6	-0.5	0.0	0.4	0.5
7. Cyclical Budgetary Component		-0.2	-0.2	0.0	0.1	0.2
8. Cyclically-Adjusted Balance (2-7)		-2.5	-2.1	-1.7	-1.2	-0.5
9. Cyclically-Adjusted Primary Balance (8+3)		0.6	1.2	1.7	2.3	3.1
10. Structural Balance (8-4)		-2.8	-2.3	-2.0	-1.4	-0.7

⁽¹⁾ A plus sign means deficit-reducing one-off measures

Divergence from the April 2011 Stability Programme

Table 6

Percentages of GDP	ESA Code	2011	2012	2013	2014	2015
Real GDP growth						
Previous update		2.4	2.3	2.6	2.8	...
Current update		2.1	1.5	2.0	2.0	2.1
Difference		-0.3	-0.8	-0.6	-0.8	-
General Government net lending						
	EDP B.9					
Previous update		-2.8	-2.1	-1.6	-1.0	...
Current update		-2.7	-2.2	-1.7	-1.1	-0.3
Difference		0.1	-0.1	-0.1	-0.1	-
General Government gross debt						
Previous update		67.8	66.9	65.4	63.7	...
Current update		72.0	70.3	68.7	67.4	65.3
Difference		4.2	3.4	3.3	3.7	-

Long-term Sustainability of Public Finances

Table 7

Percentages of GDP	2010	2020	2030	2040	2050	2060
Total Expenditure	-	-	-	-	-	-
of which: age-related expenditures	22.0	22.2	23.1	24.3	26.5	30.1
Pension expenditure*	10.4	10.7	10.5	11.4	13.4	15.9
Social security pensions**	-	-	-	-	-	-
Old-age and early pensions	5.8	6.7	7.2	8.5	10.8	13.3
Other pensions (disability, survivors)	4.6	4	3.3	2.9	2.6	2.7
Occupational pensions	-	-	-	-	-	-
Health care	5.4	6.2	7.0	7.6	7.8	8.3
Long-term care	0.7	0.8	1.2	1.2	1.2	1.5
Educational expenditure	5.1	4.1	4.0	3.7	3.7	4.0
Other age-related expenditures: (Unemployment benefits)	0.4	0.4	0.4	0.4	0.4	0.4
Interest expenditure	-	-	-	-	-	-
Total revenue	-	-	-	-	-	-
of which: property income	2.2	2.2	2.2	2.1	2.1	2.1
of which: from pensions contributions	8.8	8.9	8.9	8.6	8.5	8.3
Pension reserve fund assets	-	-	-	-	-	-
of which: consolidated public pension fund assets	-	-	-	-	-	-
Labour productivity growth	1.0	1.7	1.8	1.8	1.7	1.5
Real GDP growth	1.4	1.9	1.9	1.4	0.8	0.9
Participation rate males (aged 20-64)	83.0	85.4	88.5	87.5	87.0	87.3
Participation rate females (aged 20-64)	44.9	53.3	59.3	59.9	59.7	60.2
Total participation rates (aged 20-64)	64.3	69.7	74.3	74.1	73.9	74.3
Unemployment rate (aged 15-64)	6.9	6.8	6.7	6.6	6.6	6.6
Population aged 65+ over total population	15.1	20.7	24.2	25.1	27.8	31.2

* The coverage of pensions in Malta has been widened in this round compared to the 2009 Ageing Report. Alongside the pensions covered in the Ageing Report 2009, this round covered also Treasury pensions, the non-contributory old-age pension and the bonus associated with respective contributory and non-contributory benefits.

** Malta's two-thirds pension included under the pension expenditure category

Note: Figures may not add up due to rounding

Contingent liabilities

Table 7a	% of GDP	
	2010	2011
Public guarantees	16.3	16.8

Basic Assumptions

Table 8

	2011	2012	2013	2014	2015
Short-term interest rate (annual average)	1.4	0.8	0.8	0.8	0.8
Long-term interest rate (annual average)	2.6	1.9	2.2	2.2	2.2
USD/€ exchange rate (annual average)	1.4	1.3	1.3	1.3	1.3
Nominal effective exchange rate	-1.4	-5.4	0.0	0.0	0.0
World excluding EU, GDP growth	4.2	4.1	4.3	4.3	4.3
EU GDP growth	1.5	0.0	2.0	2.0	2.0
Growth of relevant foreign markets	10.0	5.0	5.0	5.0	5.0
World import volumes, excluding EU	7.4	6.2	6.8	6.8	6.8
Oil prices, (Brent, USD/barrel)	111.5	119.5	112.0	112.0	112.0