Malta:

Update of Stability Programme

2008 - 2011

Ministry of Finance, the Economy and Investment
December 2008

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.

This document is based on statistical information available up to 14th November 2008.

Contents

Charts

Introduction

This Programme constitutes an Update of Malta's first Stability Programme, submitted in 2007. It has been prepared in accordance with Council Regulation (EC) No. 1466/97 as amended by Council Regulation (EC) No. 1055/05. 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 the Stability and Convergence Programmes’, endorsed by the Ecofin Council on 11 October 2005.

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 comprises seven sections: Chapter 1 presents Government’s objectives for economic policy; Chapter 2 outlines the projections for the main macroeconomic variables for the medium-term; Chapter 3 presents the medium-term fiscal projections and debt developments together with the overall fiscal policy framework and Malta’s medium-term objective; Chapter 4 contains a sensitivity analysis of the budgetary projections as well as a comparison between the current forecasts and those presented in the Stability Programme 2007-2010; Chapter 5 analyses the quality of public finances and includes a review of the Budget for 2009; the integration with the National Reform Programme is also outlined; Chapter 6 reviews the long-term sustainability of public finances, and finally Chapter 7 reviews the institutional features of public finances.

1. Overall Policy Framework and Objectives

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On 1 January 2008, Malta adopted the euro as its currency. The changeover process is considered to have been a smooth and successful process. Joining the Euro Area was an important step towards furthering the country's integration process in the European Union.

As a member of the Euro Area, Government's main macroeconomic policy objectives continue to be the achievment of sustainable economic growth and ensuring real convergence with EU levels; the generation of a high level of employment and securing a low unemployment rate; the consolidation of public finances so as to secure a sustainable fiscal position; and ensuring a low and stable level of inflation.

The fiscal consolidation process implemented over the past years has resulted in a significant decrease in the deficit to GDP ratio from 4.7 per cent of GDP in 2004 to 1.8 per cent in 2007. The deficit increased to 3.3 per cent of GDP in 2008. However, this was largely due to two specific one-time expenditure outlays incurred during the year. On their own, these two factors amply explain the excess over the 3 per cent reference value. Indeed, these exceptional outlays amounted to 1.7 per cent of GDP, and if excluded, the deficit would have stood at 1.6 per cent. The deficit dynamics in 2008 also led to a halt in the downward trend of the debt to GDP ratio.

The Budget for 2009 was compiled within the context of a challenging international economic and financial environment. Whilst the available economic indicators suggest that in the first half of the year, the Maltese economy has maintained a relatively robust rate of economic growth and job creation, the macroeconomic outlook has been revised in view of the international developments. The economic growth for the Programme period is expected to be lower than envisaged in the 2007 Stability Programme. Though such forecasting was undertaken within unprecedented levels of economic uncertainty, indictors thus far suggest that the Maltese economy can be reasonably expected to register modest growth.

In its Budget for 2009, Government has sought to achieve an appropriate balance between ensuring fiscal sustainability over the medium-term - a pre-requisite for macroeconomic stability - and using fiscal policy to provide a counter-cyclical response to the downside risks posed by the international scenario. In this context, the pace of fiscal consolidation over the medium-term has been revised and the budgetary provisions for 2009 target a deficit of 1.5 per cent of GDP. Although this is higher than the target presented in the Stability Programme 2007-2010, it is significantly below the 3 per cent benchmark, and is low enough to restore the declining trend in the debt ratio. Over the medium- term, the fiscal position will continue to improve, so that the budget will be close to balance in 2010 and a surplus is expected to be registered in 2011. Thus, Malta is planning to reach its medium-term objective (MTO) of a balanced structural budget in 2011, one year later than envisaged last year.

Within the overarching goal of ensuring sustainability of public finances over the medium-term, Government's fiscal policy aims to enhance the growth potential of the economy. Through public investment – financed through own and EU funds - Government will continue to invest in areas that are crucial for the country's infrastructure, education, environment and social development whilst supporting industry, including tourism.

Government aims to steer towards an economic structure that benefits from more competition. In fact, Government will continue with its policy of reducing its direct involvement in economic activity. At the same time, Government will continue to strengthen its regulatory institutions in order to ensure fair market competition and consumer protection. This policy area is a key priority for Malta where, the small size of the economy tends to generate market imperfections. This should help to attain price stability.

Government attaches importance to improving the efficiency and effectiveness of public spending. In this context, Government has reviewed certain subsidies which were not appropriately targeted. Government considers that subsidies can be used temporarily to facilitate adjustment by economic agents. However, once in place, subsidies tend to become entrenched, and would thus result not only in a fiscal drag, but also in the distortion of economic behaviour, thus creating market inefficiencies. Therefore the curtailment of subsidies - whilst taking into account social considerations - should not only improve internal market functioning but also free resources that can be used to improve the growth potential of the economy.

Over the coming years, Government will continue to implement its structural reform agenda, so as to raise productivity and enhance competitiveness. Such reforms will also instil further flexibility in the economy, thus facilitating national adjustment capacity within EMU. Malta's National Reform Programme 2008-2010 presents a number of measures aimed at enhancing the competitive profile of the Maltese economy. These measures are focused on five strategic thrusts, namely sustainability of public finances, competitiveness, employment, education and training and the environment. A core part of this strategy is the promotion of high value added growth sectors in line with Government's Vision 2015, a strategy based on the attainment of excellence in the domains of employment, education and the environment. Government's goal is to position Malta as a centre of excellence in information, communication technologies, financial services, tourism, high value-added industry and services, international educational services and health services. This would strengthen and diversify the economic base and thus reduce the extent of the country's vulnerability to sector-specific external shocks thus reducing the volatility of the growth path.

Overall, Government's economic and fiscal policy is earmarked to achieve a growing economy capable of sustaining improvements in the living standards of the Maltese. Besides economic well-being, a wider concept of quality of life is taken into account, including the environmental and social aspects.

2. Economic Outlook

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2.1 The Medium-Term Scenario

During 2007, the Maltese economy grew by 3.7 per cent, whilst in the first six months of 2008 the economy exhibited an annualized growth rate of 3.3 per cent. However, over the forecast period, the Maltese economy is expected to exhibit a slowdown in economic performance. The rate of economic growth throughout the forecast horizon is expected to remain well below the levels registered in 2006 and 2007.

The domestic sector of the economy is expected to be the main driver of economic growth during the forecast period. On the other hand, the external balance is expected to contribute negatively to GDP growth in the near term, due to the expected impact of the prevailing financial crisis on the economic performance of trading partners. Over the medium term, the outlook for the external sector is expected to turn marginally positive in line with the expected improvement in the international economic environment, thus playing a supportive role to the domestic sector which is expected to remain the principal generator of output growth. Table 2.1 presents the main macroeconomic indicators for the years 2006-2011. The figures for 2006 and 2007 have been published by the National Statistics Office (NSO)[1]. Figures from 2008 to 2011 are forecasts. The macroeconomic forecasts by the Ministry of Finance, the Economy and Investment take into account the latest statistical data for Malta and are outlined in Tables 1a, 1b, 1c and 1d of the Statistical Appendix. It is notable to point out that the macroeconomic forecasts being presented in this Chapter were prepared in a context of intense global economic uncertainty following the developments that have prevailed in recent months.

In the first two quarters of 2008, the Maltese economy grew by 3.4 and 3.2 per cent respectively. In the second half of 2008 the pace of economic growth is expected to decelerate considerably such that during 2008 a real growth rate of 2.8 per cent is forecasted. This growth is expected to be underpinned by the domestic side of the economy, which is forecasted to offset the negative contribution stemming from the

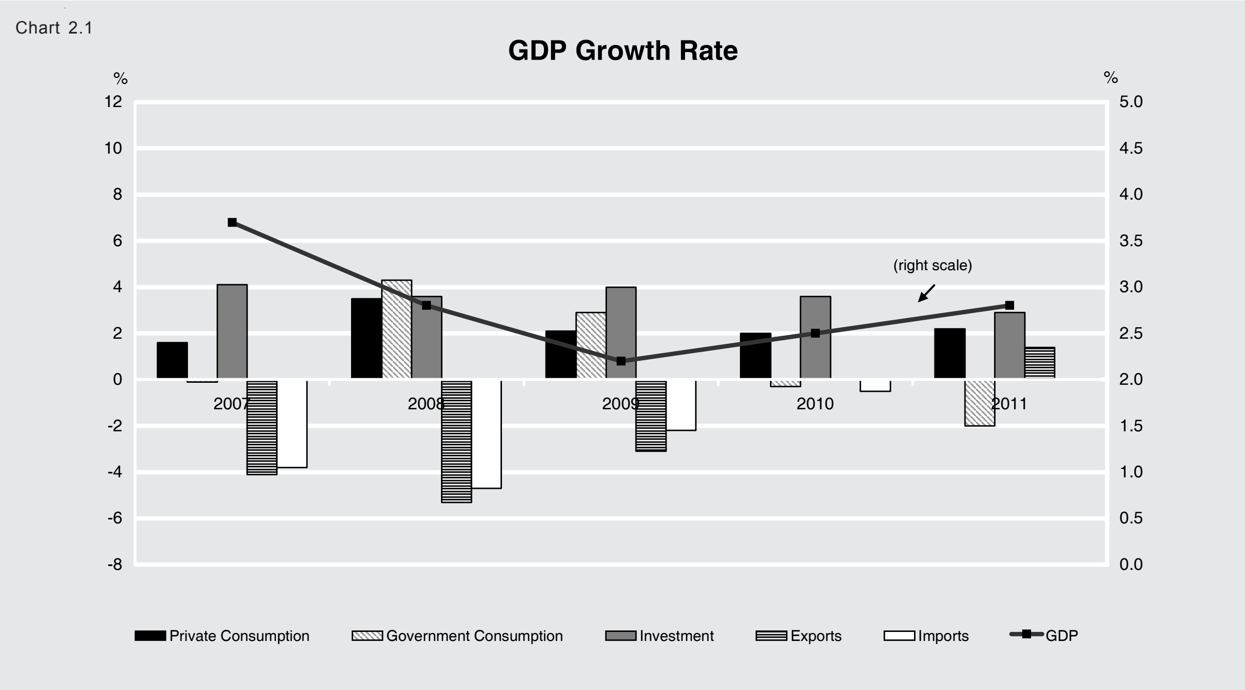
Main Macroeconomic Indicators

Table 2.1

	2006	2007	2008[(1)]	2009	2010	2011
GDP growth at current market prices (%)	6.2	6.3	6.0	4.4	4.6	4.4
GDP growth at constant (2000) prices (%)	3.1	3.7	2.8	2.2	2.5	2.8
Expenditure Components of GDP at constant (2000) prices (% change)						
Private final consumption expenditure[(2)]	0.7	1.6	3.5	2.1	2.0	2.2
General government final consumption expenditure	5.9	-0.1	4.3	2.9	-0.3	-2.0
Gross fixed capital formation	4.2	4.1	3.6	4.0	3.6	2.9
Exports of goods and services	17.1	-4.1	-5.3	-3.1	—	1.4
Imports of goods and services	14.7	-3.8	-4.7	-2.2	-0.5	0.0
Inflation rate (%)	2.6	0.7	4.5	2.7	2.3	2.0
Employment growth (%)	1.3	2.7	3.0	1.3	1.3	1.5
Unemployment rate (%)	7.1	6.4	5.8	6.0	6.1	5.9
Labour productivity (% change)	1.8	0.9	-0.2	0.8	1.1	1.3
External Goods and Services Balance (% of GDP)	-3.8	-2.8	-3.3	-4.3	-4.2	-3.5

(1) Forecasts from 2008 onwards

(2) Includes NPISH final consumption expenditure



external side. The negative contribution from the external sector is attributable to a decline in exports which is expected to more than offset the decrease in imports. Although the domestic economy has thus far emerged almost unscathed from the ongoing financial and credit crisis, the pace of economic growth is expected to slow down in 2009, to 2.2 per cent as the seizure witnessed in credit markets inevitably curtails purchasing power in Malta's main export markets. In 2010 and 2011 the pace of economic growth is expected to modestly pick-up to 2.5 and 2.8 per cent respectively. The projected growth rates of GDP together with a detailed breakdown of the various expenditure aggregates are illustrated in Chart 2.1.

2.1.1 Assumptions for Projections

The forecasts presented in this section and the different sensitivity scenarios presented in this document were estimated using econometric techniques and analytical methods. The main assumptions used in compiling the base forecasts for 2008-2011 are in line with the European Commission's forecast assumptions presented in the 'Economic Forecasts – Autumn 2008'.

- Economic activity in Malta's main trading partners is expected to expand by 1.1 per cent in 2008, and contract by 0.2 per cent in 2009, and then grow by 0.7 per cent thereafter. Meanwhile, HICP prices in Malta's major trading partners are assumed to increase by 3.5 per cent in 2008, by 2.0 per cent in 2009 and then decrease to 1.8 per cent thereafter.

- Oil prices are assumed to peak at US$104.0 per barrel in 2008 and decline to $86 per barrel in 2009. Oil prices are expected at $89 per barrel in subsequent years.

- Exchange rates are assumed to remain constant over the 2009-2011 period, whilst interest rates are expected to hover around 4.9 per cent.

- It is being assumed that, in line with Government policy, Government employment follows a downward trajectory as Government restricts recruitment in non-essential categories.

- The share of inventory changes in GDP are assumed at around 2.2 per cent of GDP during the forecast period.

2.1.2 Risks to Outlook

The current international macroeconomic environment suggests that the risks to the economic forecast are characterized by an abnormal level of uncertainty. A major downside risk is that the seizure in credit markets and the corresponding curtailment of economic growth in trading partners proves to be more intense or more protracted than currently expected. There is the risk that the severe financial stress witnessed during October 2008 in financial markets re-emerges with a greater intensity implying that the impact of the financial disruptions on the macro-economy would be more severe. Consequently, the drag on economic growth could be stronger than is currently being envisaged.

A second downside risk stems from the deterioration in asset prices in several countries. If the deterioration in asset prices accelerates faster than is currently expected, the impact on growth in trading partners would inevitably be more severe. On the other hand, there are some upside risks to growth associated with the rapid deceleration in commodity prices witnessed in recent months, especially if these prices remain at a level lower than currently being assumed. Such development would have a benign effect on headline inflation as well as a positive impact on purchasing power in Malta's main export markets.

Moreover it is pertinent to point out that there are downside and upside risks with respect to developments in currency markets. One upside risk relates to the recent depreciation of the euro against the dollar currency. If such depreciation below the level currently being assumed persists, manufacturing firms in Malta, notably those engaged in the semiconductor industry stand to benefit from reduced competitive pressures on their operations. This contrasts with the downside risk that the sterling currency maintains the steady erosion in its value against the euro which would impinge negatively on Malta's tourism exports.

2.1.3 Private Final Consumption Expenditure

Private final consumption expenditure is forecasted to grow by 3.5 per cent in 2008. Published data for the first half of 2008, shows that private final consumption expenditure has increased by 4.1 per cent over the same period in 2007. This growth was influenced by the improvement in purchasing power that followed the revision in income tax bands and the increases in transfer payments enacted in the 2008 Budget. This improvement has been further supported by the buoyant labor market environment that has prevailed thus far in 2008. Over the forecast horizon, consumption growth is expected to decelerate from the levels forecasted to prevail in 2008 and return towards the trend level of growth. Private consumption growth is expected to be 2.1 per cent in 2009 and hover in the region of 2.0 – 2.2 per cent in the outer years of the forecast.

2.1.4 General Government Final Consumption Expenditure

During the forecast period, real Government consumption expenditure is expected to decelerate. In 2008, Government consumption is expected to increase by 4.3 per cent. This is underlined by the finalization of collective agreements and employee recruitment in specialised areas of the public service. In 2009, Government consumption is expected to exhibit a deceleration in growth to 2.9 per cent. Moreover, in the outer years of the forecast period Government consumption is expected to decline by 0.3 and 2.0 per cent in real terms.

2.1.5 Gross Fixed Capital Formation

In 2008, gross fixed capital formation is expected to increase by 3.6 per cent. This growth is underpinned by an expansion in private sector investment which is expected to outweigh the negative contribution from public sector investment. The decline in the latter is partly underpinned by a considerable reduction in outlays related to the construction and finalization of the new hospital, which became operational in the last quarter of 2007. During 2009 and 2010, gross fixed capital formation is expected to grow by 4.0 and 3.6 per cent respectively. In both years the largest contribution to growth in gross fixed capital formation is expected to stem from the public sector which is expected to expand capital investment outlays as the economy's growth rate decelerates. A notable contribution underpinning the growth in public investment relates to projects under the 2007-2013 EU Cohesion and Structural funds framework. The private sector is expected to register only marginal positive growth rates in investment during 2009 and 2010. The postponement of investment decisions in the sectors of the economy that are exposed to the global downturn is likely to be marginally offset by the investment related to the Smart City project. In 2011, gross fixed capital formation is forecasted to grow by 2.9 per cent as public sector investment is expected to revert back to its trend level at around 4 per cent of GDP, and the major contribution to growth is expected to be underpinned by growth in private sector investment as the impact of the global downturn tails off.

2.1.6 External Balance of Goods and Services

Recently published data suggests that the turnaround in tourism that was registered in 2007 is gradually slowing down. Tourism earnings registered during the first half of 2008 were close to the high levels registered in 2007 and it is expected that the performance of this important sector will be subdued in the final part of 2008 and in 2009. Moreover, semiconductor exports have thus far exhibited a decline from the levels registered in 2007. On the other hand, data published for 2008 suggests that an expansion in exportation was registered in the emerging growth sectors namely pharmaceuticals, remote gaming and business services.

Over the short-term horizon, the performance of the external side of the economy is expected to be rather subdued. The contribution of the external sector of the economy is forecasted to be negative in 2008 and decline further in 2009, as the expected downturn in global economic performance takes hold. In 2008, exports are forecasted to decline by 5.3 per cent whilst imports are expected to exhibit a 4.7 per cent decline. In 2009, real exports are expected to register a further decline. Similarly, real imports are expected to continue to fall during 2009.

As the impact of the international economic downturn subsides in the outer years of the forecast horizon, the contribution of the external sector is expected to turn positive and reach 0.4 per cent in 2010 and 1.1 per cent in 2011, as Malta's export performance gradually recovers.

2.1.7 Productivity and Employment Prospects

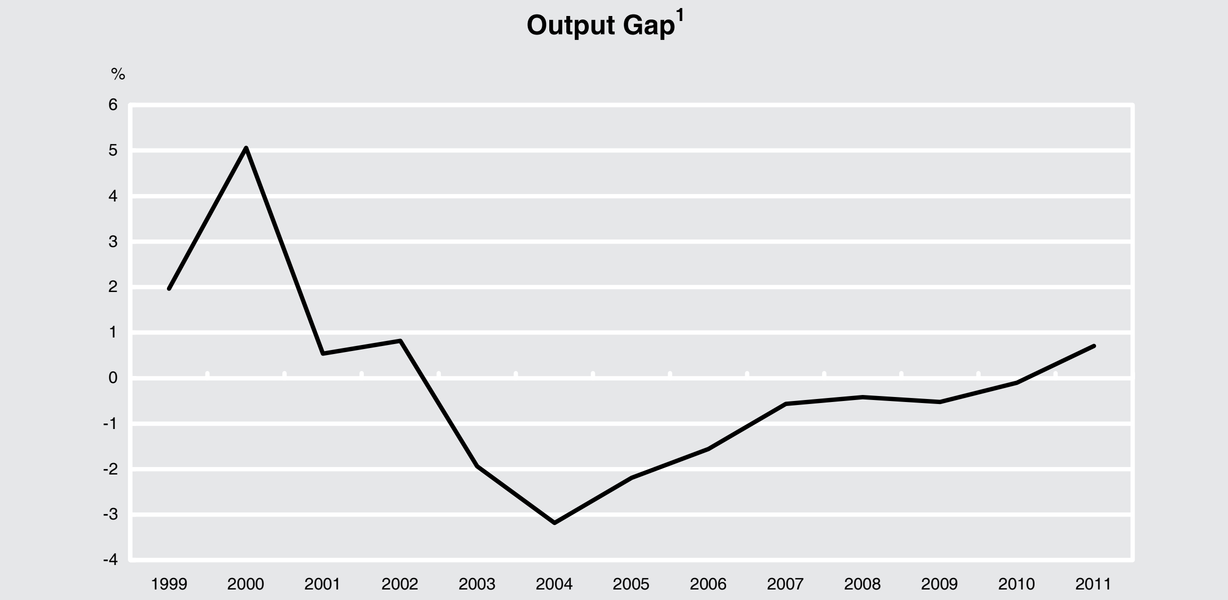
In the first two quarters of 2008, a rate of growth of 3.2 per cent was registered in employment, whereas, over the forecast period, employment growth is expected to average 1.8 per cent. During 2008 employment growth is expected to peak at 3.0 per cent, before the cyclical upturn in employment loses steam as from 2009 onwards. In the subsequent two years employment growth is expected to decelerate to 1.3 per cent as the forecasted moderation in economic performance gradually hits the labour market. In 2011, employment growth is forcasted to edge up to 1.5 per cent. Real labor productivity is expected to average 0.8 per cent over the forecast period.

The unemployment rate (based on the Harmonised definition) is expected to bottom out at 5.8 per cent in 2008. The slowdown in real GDP growth over the short-term, is expected to trigger a moderate pick-up in the unemployment rate to 6.0 per cent in 2009 and 6.1 per cent in 2010. Unemployment is expected to improve marginally to 5.9 per cent in 2011.

2.1.8 Inflation

In 2008, the inflation rate (calculated as the twelve month moving average of the HICP) is forecasted at 4.5 per cent, underpinned by the significant base effect associated with the low inflation rate of 0.7 per cent that was registered in 2007. In particular, food, restaurant and accommodation prices, transport and energy prices contributed considerably to the increase in the HICP rate. During 2009, inflation is forecasted to be 2.7 per cent. Hence, although the HICP rate is expected to moderate in 2009 it is still expected to remain above its trend rate of growth. A return to trend growth is however expected in the medium term, with the inflation rate expected at 2.3 and 2.0 per cent in 2010 and 2011 respectively.

Chart 2.2



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

2.2 Potential Output and the Output Gap

The estimation of potential output and the output gap is based on the commonly agreed Production Function method, with the main differences being the different macroeconomic forecasts and the working age population figures. Developments in the output gap are depicted in Chart 2.2.

Following relatively weak economic growth between 2001 and 2004, economic growth was more sustained between 2005 and 2007 with an average registered growth rate of 3.4 per cent. However, growth is expected to be negatively hit by the prevailing international developments, with an expected growth rate of 2.8 per cent and 2.2 per cent for 2008 and 2009 respectively. An improvement is forecasted for 2010 and 2011 with an average annual increase in economic growth expected to be around 2.7 per cent.

Average potential output growth, which measures the growth potential of the economy, stood at 2.4 per cent for the period 2003-2006. For 2007, the growth in potential output stood at 2.7 per cent while for 2008 the growth rate is expected to decline to 2.6 per cent. Over the forecasted period 2009-2011, average potential growth is expected to be around 2.1 per cent. This decline in potential output growth is mainly attributable to demographic factors.

The output gap, defined as the difference between actual and potential output as a ratio of potential output is indicative of the cyclical developments in the Maltese economy. The output gap was positive during the 1999-2002 periods, peaking at 5.1 per cent of GDP in 2000. In 2003, the output gap turned negative and reached a trough of -3.2 per cent of GDP in 2004. The output gap narrowed since then, reflecting both the sustained economic growth registered in recent years and a slower growth rate in potential output. However, it is still expected to be negative between 2008 and 2010, with the output gap expected to be between -0.5 per cent and -0.1 per cent of GDP during this particular period. The output gap is then expected to turn positive in 2011, partly as the economic growth is expected to exceed the rate of potential expansion.

Footnote:

[1] Data in line with NSO News Release (National Accounts, GDP, June Quarter 2008), No. 159/2008

3. General Government Balance and Debt

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Over the past few years, the Maltese Government attached high importance to the attainment of fiscal sustainability. The fiscal deficit has followed a remarkable downward trend during the 2004-2007 period. Subsequently, in 2008, two specific factors had a major negative impact on the fiscal position. Indeed, in 2008, the deficit-to-GDP ratio is expected to increase to 3.3 per cent on account of exceptional expenditure outlays towards the shipyards and utilities sectors.

During the recent past, the Maltese Government has undertaken various actions to restructure Malta Shipyards Ltd, with the aim of transforming it into a commercial viable entity. Despite registering improvements, the financial position of the company has remained precarious and Government decided to privatise this company. However, in order not to compromise the privatisation process, it was necessary to reduce the workforce through granting financial incentives to the shipyard workers. Consequently, Government launched voluntary redundancy schemes which are estimated to have an impact on the deficit of 1.0 per cent of GDP. It is noteworthy that the cost of these schemes has a short payback period of slightly more than one year.

In view of the rising international oil prices, Government decided to temporarily cushion the impact of energy price increases in a bid to help the economy move smoothly towards an environment of permanently higher utility prices. Thus, it extended, on a temporary basis, a subsidy to the energy corporation. This was followed by an increase in the utility tariffs. Outlays related to these energy support measures are estimated to amount to 0.7 per cent of GDP. Excluding the aforementioned two specific factors, the deficit would have continued to fall from 1.8 per cent in 2007 to reach 1.6 per cent of GDP in 2008, thus significantly below the 3 per cent reference value.

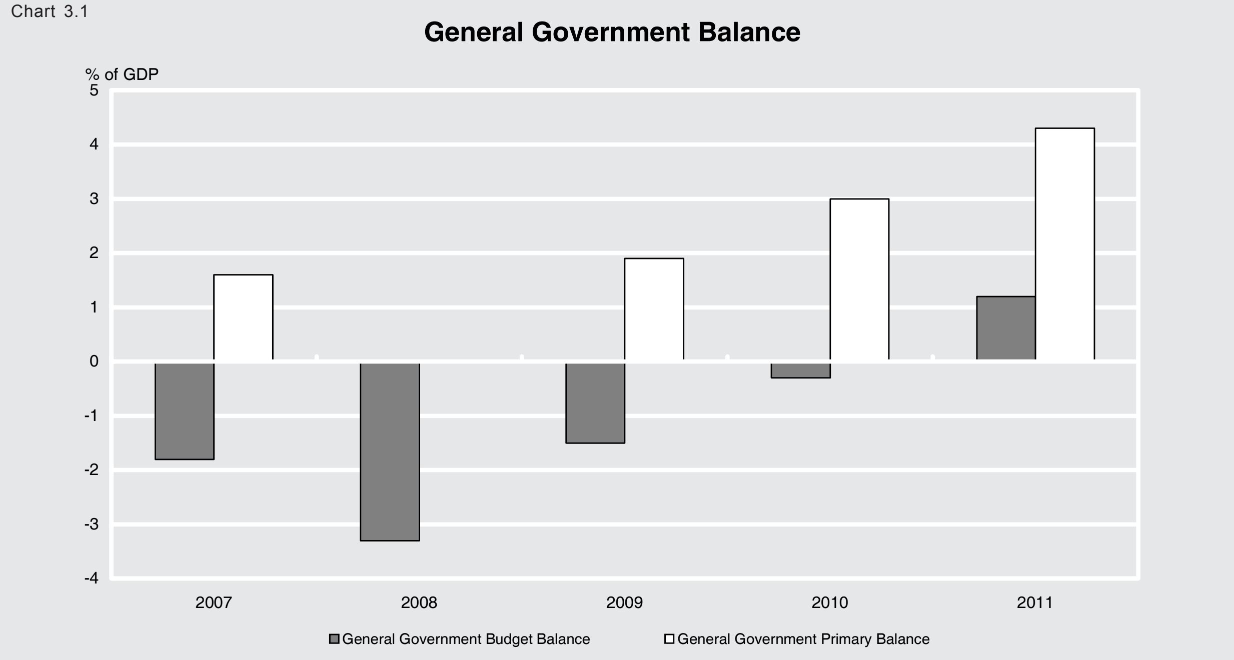
The fiscal targets set out in the December 2007 Stability Programme were revised in the context of an array of adverse international economic developments which are expected to leave their mark on the local economy. Indeed, it is pertinent to note that the fiscal plan presented in the 2007 Programme was designed against a markedly different economic environment. As outlined in Chapter 2 of this Programme, the macroeconomic outlook was revised downwards. The output gap projections contained in the December 2007 Stability Programme have also been revised such that the output gap is now expected to remain in negative territory up till 2010.

Against the present backdrop of challenging international economic conditions, Government has embarked on a slower pace of fiscal adjustment when compared to that outlined in the December 2007 Stability Programme. In the Budget for 2009, the Maltese Government considered it necessary to protract fiscal consolidation in order to facilitate the adoption of a number of measures to address the current disappointing international macroeconomic performance. Government also remains committed towards investing in priority areas such as education and health in order to improve the citizens' well being. The general Government deficit is now projected to fall to 1.5 per cent in 2009 and to continue to improve to 0.3 per cent in 2010, reaching a budget surplus of 1.2 per cent in 2011.

Government remains committed to reach the medium-term objective (MTO) of a balanced structural budget. The fiscal effort targeted in this Programme will allow Malta to attain a structural budget surplus in 2011. This implies that the achievement of the MTO set out in the 2007 Programme is being delayed by one year.

Developments in the debt-to-GDP ratio are a reflection of the trajectory in the budget balance. Indeed, following a downward trend between 2005 and 2007, the debt ratio is projected to increase to 62.8 per cent of GDP in 2008, reflecting the increase in the deficit as outlined above. Subsequently, the debt ratio is projected to decrease reaching the reference value in 2010 and declining further thereafter. These developments reflect a slower projected adjustment for the debt ratio for 2009 and beyond, than that included in the 2007 Programme.

Chart 3.1



3.1 The Medium-Term Fiscal Framework

The general Government deficit as a per cent of GDP is expected to increase from 1.8 per cent in 2007 to 3.3 per cent in 2008 mainly on account of the exceptional expenditure outlays referred to above. Thereafter, the general Government deficit ratio is expected to decrease to 1.5 per cent in 2009 on the back of measures and policies as outlined in the Budget for 2009 details of which are presented in Chapter 5. Subsequently, the deficit ratio is expected to decline further to close to a balanced budget in 2010 and to reach a surplus of 1.2 per cent of GDP in 2011. Chart 3.1 illustrates these developments in the general Government balance between 2007 and 2011. Table 2 in the Statistical Appendix presents general Government revenue and expenditure projections for the 2007-2011 period.

Over the forecast period, one-off deficit reducing measures are projected to provide a minor contribution to the overall fiscal balance. Indeed, revenue from one-off operations, which consist of the proceeds from the sale of property, is expected at 0.3 per cent in 2008 and 2009 and to decline to 0.1 per cent in 2010 and 2011. Consequently, the general Government budget deficit net of one-off and temporary measures is projected to increase from 2.4 per cent in 2007 to 3.6 per cent in 2008 but decline thereafter to 1.8 per cent and 0.4 per cent in 2009 and 2010 respectively, before turning into a surplus of 1.0 per cent in 2011.

Developments in the primary balance as a per cent of GDP indicate that while a surplus of 1.6 per cent of GDP was recorded in 2007, the primary balance is expected to be close to zero in 2008 reflecting the increase in the expenditure to GDP ratio for that year. Subsequently, the primary balance is expected to return to a surplus increasing from 1.9 per cent in 2009 to 4.3 per cent in 2011.

3.1.1 Comparison with the December 2007 Stability Programme

The fiscal deficit ratio recorded in 2007 varied marginally from that reported in the Programme submitted last year. This variance largely reflects the impact of a court ruling whereby VAT refunds of previously collected taxes were paid in favour of a telecommunications company. In 2008, the nominal deficit has been revised significantly upwards, reflecting the exceptional expenditure-increasing measures.

While the December 2007 Programme targeted a deficit of 1.2 per cent in 2008, the deficit is now expected to rise to 3.3 per cent of GDP largely underpinned by exceptional outlays. These relate to the voluntary redundancy schemes for employees of Malta Shipyards Ltd and an extension, on a temporary basis, of a subsidy to the energy corporation aimed to cushion the significant impact of higher energy price increases in 2008. In addition, this upward revision also resulted from the finalisation of collective agreements and from new recruitment in targeted sectors within the public sector which was necessary to ensure a sustained good quality service to the public.

Government is cognisant of the contribution which public finance play towards a stable macroeconomic framework. Specifically, the implementation of counter-cyclical fiscal policy remains an integral part of the tool kit at the disposal of Government in its bid to help the economy generate sustainable growth. In the context of the turmoil hitting the international economy, Government has revised the pace of fiscal adjustment included in the December 2007 Programme.

In 2009, the deficit-to-GDP ratio is expected to reach 1.5 per cent, or 1.4 percentage points higher than the ratio projected in the 2007 Programme. This variance in the fiscal path outlined in last year's Programme needs to be viewed against a backdrop of the current global economic situation which instigated the Maltese Government to adopt a number of measures to support the local economy in the face of an unfavourable external environment. In 2010, the general Government balance is expected to reach a deficit ratio of 0.3 per cent, when compared to a surplus of 0.9 per cent of GDP reported in the 2007 Programme.

3.1.2 General Government Revenue Projections

The ratio of general Government revenue to GDP is expected to increase from 40.6 per cent in 2007 to 41.9 per cent in 2011, reflecting an increasing tax revenue ratio and a generally higher ratio of the 'other' component of revenue which more than offsets a declining ratio of property income.

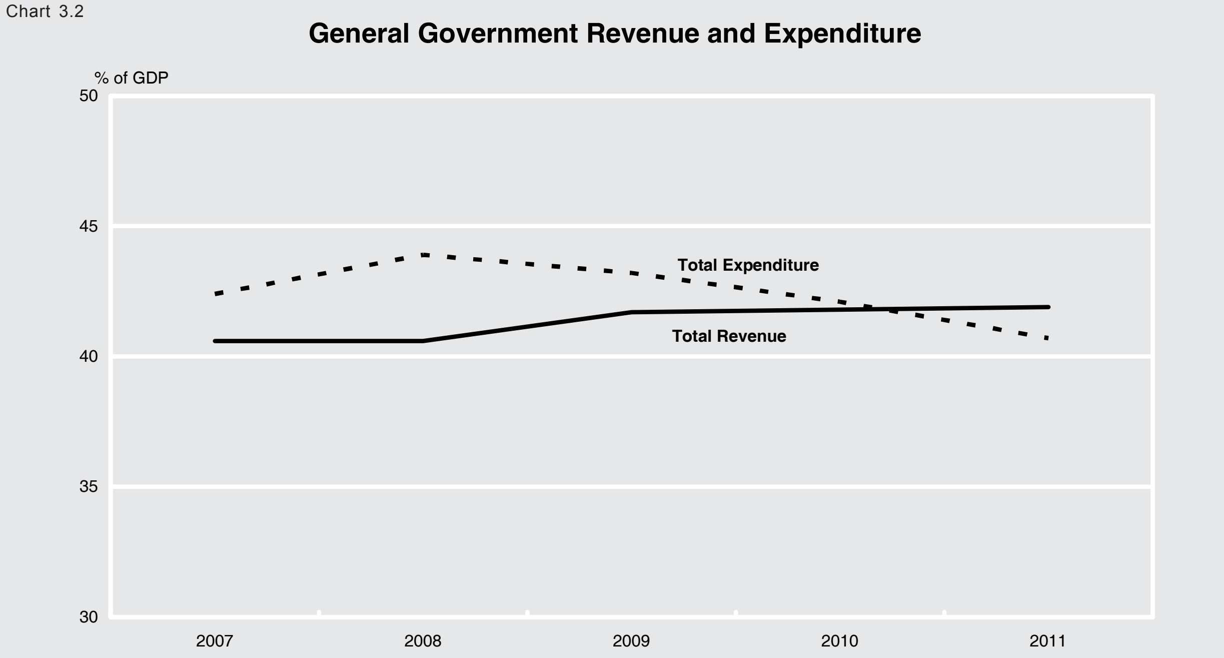
In 2008, the general Government revenue to GDP ratio is expected to stand at 40.6 per cent, unchanged from that recorded in 2007. This is attributable to marginal decreases in the ratios of proceeds from taxes and property income which were offset by a marginal increase in the ratio of the 'other' component of revenue. Meanwhile, as illustrated in Chart 3.2, general Government total revenue as a per cent of GDP is expected to rise to 41.7 per cent in 2009. This is mainly attributable to an increase in the ratio of the 'other' component of revenue (namely EU funds). In addition, a higher tax ratio to GDP is projected whilst a decline is expected in the property income ratio. Over the outer years of the Programme period, general Government total revenue as a ratio of GDP is projected to rise marginally to 41.9 per cent by 2011. This development mainly reflects higher ratios of proceeds from taxes which more than offset lower ratios of the 'other' component of revenue.

3.1.2.1 Tax Revenue

After remaining relatively unchanged at a ratio of 28.4 per cent in 2008, the ratio of tax revenue to GDP is expected to follow an upward trend over subsequent years. Indeed, as illustrated in Chart 3.3, the tax revenue ratio to GDP is projected to increase to 29.4 per cent of GDP by 2011. Over the coming years, Government will continue to focus on raising the efficiency of revenue collection while also implementing measures to combat tax evasion.

Developments in the tax ratio in 2008 mainly reflect a lower ratio of taxes on production and imports which more than outweighs a rise in the ratio of current taxes on income and wealth. The lower ratio of taxes on production and imports largely reflect lower receipts from excise tax coupled with lower tax receipts from duty on documents, the latter reflecting stagnant levels of activity in the local property market. These declines were partly offset by higher revenue from VAT receipts. Meanwhile, the higher ratio of current taxes on income and wealth is mainly attributable to higher revenue from provisional tax (which comprises tax on profits reported by companies and self-employed persons). In particular, higher tax revenue resulted from an increase in the number of international operators registered in Malta. Furthermore, higher tax receipts from

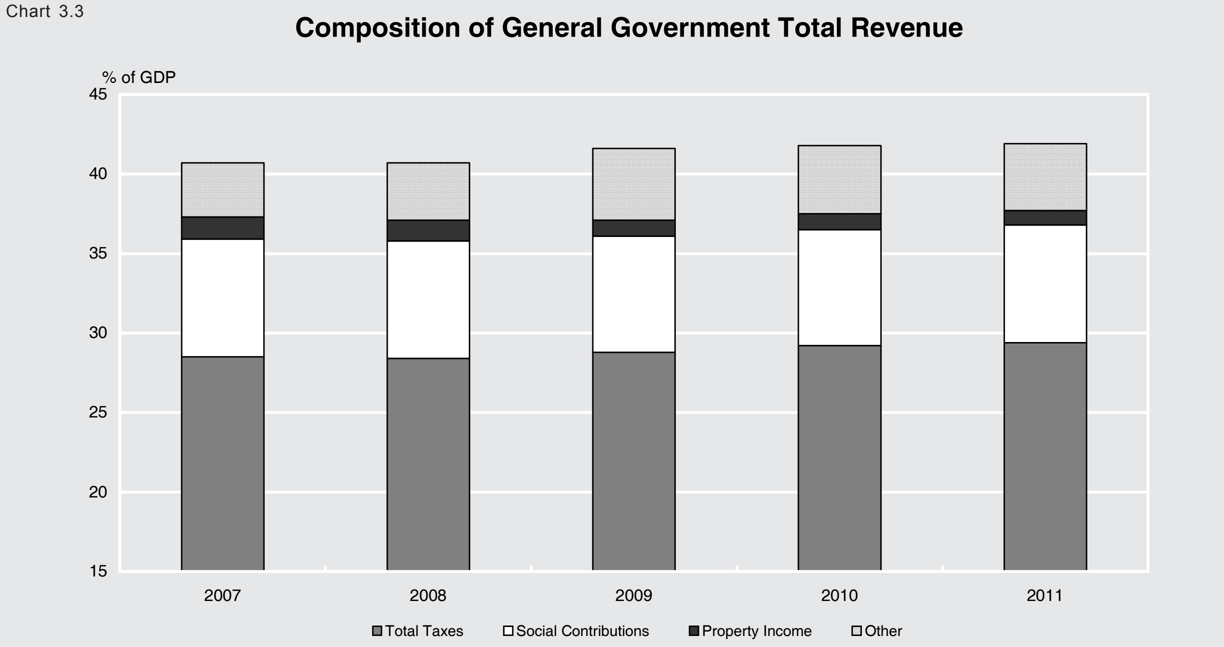
Chart 3.2



income from employment also contributed to the increase in the ratio of current taxes on income and wealth, reflecting the buoyant labour market of 2008. It is noteworthy that this development was achieved notwithstanding the revision in the income tax regime announced in the 2008 Budget.

In 2009, the tax ratio to GDP is expected to increase by 0.4 percentage points, being largely underpinned by developments in current taxes on income and wealth. The upward trend in the ratio of total taxes to GDP is expected to be sustained in 2010 and 2011, generally reflecting a higher ratio of proceeds from current taxes on income and wealth to GDP. The expected developments in the ratio of current taxes on income and wealth reflect Malta's success in attracting international business by providing a safe investment location.

Chart 3.3



3.1.2.2 Social Contributions

The ratio of social security contributions is expected to remain broadly stable over the Programme period, varying from 7.4 per cent of GDP in 2007 and 2008, marginally down to 7.3 per cent of GDP in the following two years and returning to 7.4 per cent in 2011. Projections for social security contributions reflect macroeconomic assumptions including the projected growth in employment income.

3.1.2.3 Property and Other Income

The ratio of revenue from property income to GDP is expected to decline over the forecast period from 1.4 per cent of GDP in 2007 to 0.9 per cent by 2011.

The ratio of the 'other' component of revenue to GDP, which mainly consists of revenue of Extra-Budgetary Units (EBUs), local councils, and other non-tax revenue including grants, is expected to rise to 3.6 per cent of GDP in 2008, compared to 3.4 per cent recorded in 2007. This increase primarily reflects a higher level of funds under the EU Structural Funds 2007-2013 programme. Subsequently, in 2009, the 'other' component of revenue is expected to rise significantly, reaching 4.5 per cent of GDP. This increase is mainly underpinned by a substantially higher level of funds under the EU Structural and Cohesion Funds 2007-2013 programme. A high absorption of EU funds is deemed necessary as part of Government's strategy of stimulating economic growth. Thereafter, total revenue from this component is expected to decline marginally to 4.3 per cent and 4.2 per cent of GDP in 2010 and 2011 respectively. The flow of funds forthcoming under the EU Structural and Cohesion Funds 2007-2013 Programme is expected to remain relatively stable at the levels forthcoming in 2009. At the same time, EU Structural Funds 2004-2006 Programme will taper off. Thus, developments in this category of revenue largely reflect the expected time line for the implementation of EU funded projects. Meanwhile, receipts of EBUs and local councils are not expected to register significant changes over the forecast period.

3.1.3 General Government Expenditure Projections

General Government expenditure as a ratio to GDP is expected to increase in 2008, before declining thereafter. Indeed, as highlighted in Table 3.1, general Government expenditure is expected to increase by 1.5 percentage points of GDP in 2008 largely reflecting exceptional items of expenditure. Meanwhile, total expenditure is anticipated to decline by 3.3 percentage points over the remaining medium-term fiscal framework.

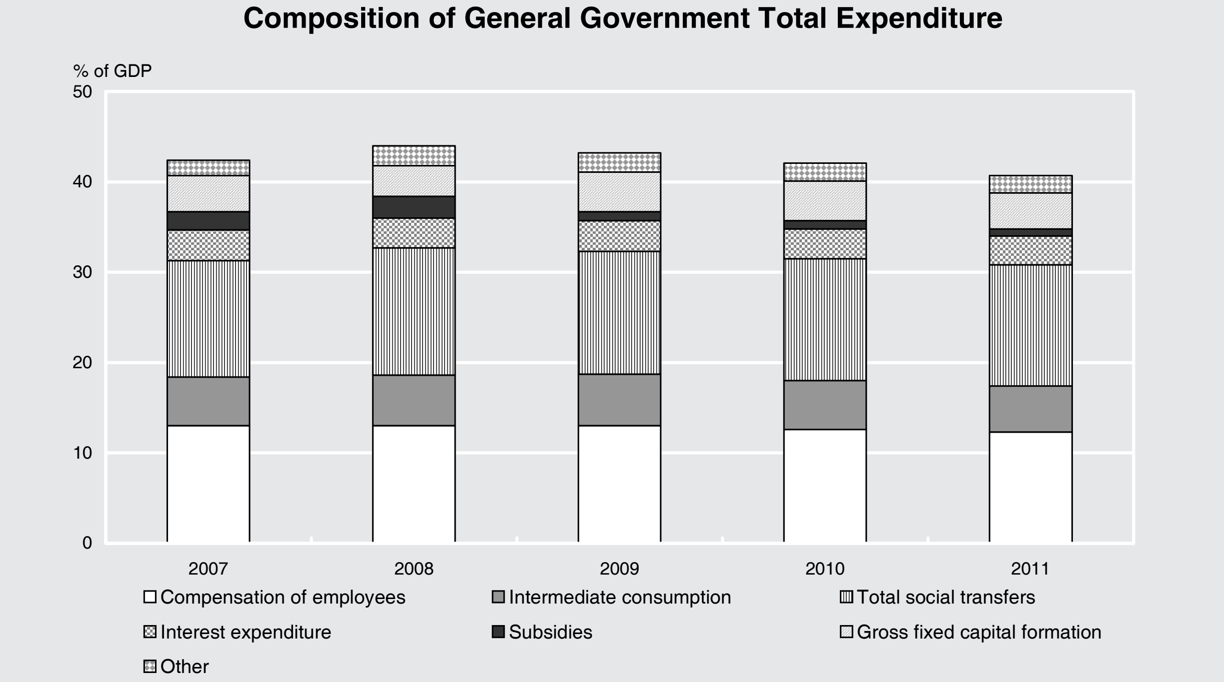
General Government Expenditure

changes in percentage points of GDP

Table 3.1

	2008	2009	2010	2011
Expenditure				
Compensation of employees	0.0	0.0	-0.4	-0.3
Intermediate consumption	0.2	0.1	-0.3	-0.3
Social Payments	1.2	-0.5	-0.1	-0.1
Interest Expenditure	0.0	0.0	-0.1	-0.1
Subsidies	0.4	-1.4	-0.1	0.0
Gross Fixed Capital Formation	-0.6	1.0	0.1	-0.4
Other	0.4	0.0	-0.1	-0.1
Total Expenditure	1.5	-0.8	-1.1	-1.4

Chart 3.4



The ratio of general Government expenditure to GDP is projected to increase from 42.4 per cent in 2007 to 43.9 per cent in 2008, mainly on account of exceptional outlays referred to earlier. In 2009, the expenditure ratio is projected to fall to 43.2 per cent of GDP, as lower outlays on subsidies and social transfers are partly offset by higher gross fixed capital formation. Subsequently, the ratio of total Government expenditure to GDP is expected to decline further to 40.7 per cent by 2011, reflecting lower expenditure ratios mainly for all components of expenditure, but in particular compensation of employees and intermediate consumption. Developments in the main components of general Government expenditure between 2007 and 2011 are illustrated in Chart 3.4.

3.1.3.1 Compensation of Employees

The ratio of compensation of employees to GDP is forecasted to remain relatively stable at 13.0 per cent during the first two years of the Programme period, before declining in the outer years of this Programme to 12.3 per cent of GDP in 2011. Notwithstanding increases in the absolute level of wages, particularly reflecting better conditions for public sector employees, developments in the ratio to GDP will reflect Government's policy to restrict employment in non-essential categories in the public sector. Indeed, recruitment is done on a strictly need basis, following screening by an ad hoc high level committee.

3.1.3.2 Intermediate Consumption

During 2008 and 2009, the ratio of intermediate consumption to GDP is expected to follow an increasing trend, primarily on account of higher expenditure related to projects in part financed from certain EU Funds classified under such category, as well as marginally higher operational and maintenance expenditure and expenditure with respect to Third Country Nationals. In the subsequent two years to 2011, the completion of several projects in part financed from EU Transition Facility funds is expected to result in a lower ratio of intermediate consumption to GDP. Indeed, fluctuations in the intermediate consumption expenditure ratio during the Programme period mainly reflect developments in the implementation of projects financed from EU funds, reaffirming Government's policy to control the growth of other components of intermediate consumption below GDP growth.

3.1.3.3 Social Payments

The ratio of social payments to GDP is forecasted to increase from 12.9 per cent in 2007 to 14.1 per cent in 2008, and to follow a declining trend thereafter to 13.4 per cent of GDP in 2011. Indeed, whilst the ratio of social transfers in kind to GDP is expected to remain stable over the Programme period at 0.6 per cent, the ratio of social transfers other than in kind is anticipated to register a significant increase in 2008 but decline thereafter.

The ratio of social transfers other than in kind is projected to increase from 12.3 per cent in 2007 to 13.5 per cent in 2008 on account of significant exceptional outlays related to the voluntary redundancy schemes for employees of Malta Shipyards Ltd. If one were to exclude the one-time fiscal cost of these schemes amounting to around 1 per cent of GDP, the ratio of social transfers other than in kind will increase to 12.5 per cent on account of higher expenditure on retirement pensions and an increase in children's allowance outlays reflecting the measures announced in the 2008 Budget.

The ratio of social payments other than in kind to GDP is expected to decline to 12.9 per cent in 2009 when compared to the ratio of 13.5 per cent in 2008. In this context, it is pertinent to note that this decline is attributed to the exceptional expenditure on the shipyards' voluntary redundancy schemes in 2008 which will not reoccur in 2009. In 2009, higher outlays are projected on retirement pensions.

3.1.3.4 Interest Expenditure

Interest expenditure as a ratio to GDP is expected to decline in 2008 to 3.3 per cent before edging up again in 2009 and declining thereafter to 3.2 per cent in 2011. Developments in interest payments, which primarily consist of expenditure relating to long-term local loans, mainly reflect developments in the debt-to-GDP ratio for the period 2008-2011. Indeed, projected improvements in the debt ratio in the outer years of the Programme period are expected to result in a lower ratio of interest expenditure to GDP.

3.1.3.5 Subsidies

The ratio of subsidies to GDP is forecasted to increase from 2.0 per cent in 2007 to 2.4 per cent in 2008, and to decline significantly thereafter to 0.8 per cent of GDP in 2011. In 2008, the subsidies-to-GDP ratio is expected to increase mainly on account of higher outlays to the utility sector. In the subsequent year, the termination of financial support to the utility sector following a revision in the utility tariffs is expected to contribute to the decline in the subsidies-to-GDP ratio, to 1.0 per cent of GDP. Moreover, the decline in this ratio in 2009 is also attributable to the termination of financial assistance to the shipyards sector. The decline in the subsidies-to-GDP ratio is expected to decline marginally during the outer years of the Programme period.

3.1.3.6 Gross Fixed Capital Formation

The ratio of gross fixed capital formation to GDP is anticipated to decline from 4.0 per cent in 2007 to 3.4 per cent in 2008, mainly reflecting lower expenditure on capital projects particularly due to the completion of the new hospital. Subsequently, the ratio of gross fixed capital formation to GDP is forecasted to increase by 1 percentage point of GDP to 4.4 per cent in 2009. The increase in investment constitutes an important element of Government's response to the negative international environment. Thereafter, gross fixed capital formation as a per cent of GDP is expected to remain relatively stable in 2010, prior to declining to 4.0 per cent of GDP in 2011. Developments in capital outlays particularly during the three years to 2011 mainly reflect the implementation of projects financed from EU funds under the 2007-2013 Financial Framework as well as projects financed from national sources.

3.1.3.7 Other Expenditure Components

The 'other' expenditure category is forecasted to increase from 1.7 per cent in 2007 to 2.2 per cent in 2008. Lower one-off revenues from sale of property, which is recorded as negative expenditure in the 'other' expenditure category, are expected to be partly offset by lower current transfers. In 2009, additional outlays are allocated in respect of energy efficiency measures. However, these additional outlays will be partly counteracted by marginally lower outlays on acquisition of property. Increases in the 'other' expenditure category are expected to be offset by increases in GDP, thus the ratio of this expenditure category to GDP is expected to decline to 2.1 per cent of GDP in 2009.

Thereafter, the ratio of this component of expenditure is anticipated to follow a declining trend to reach 1.9 per cent of GDP in 2011, as relatively stable current and capital transfers as well as lower dependence on one-off revenues from sale of land, which has an expansionary effect on the ‘other’ expenditure category, are expected to be offset by increases in GDP.

3.2 Structural Adjustment

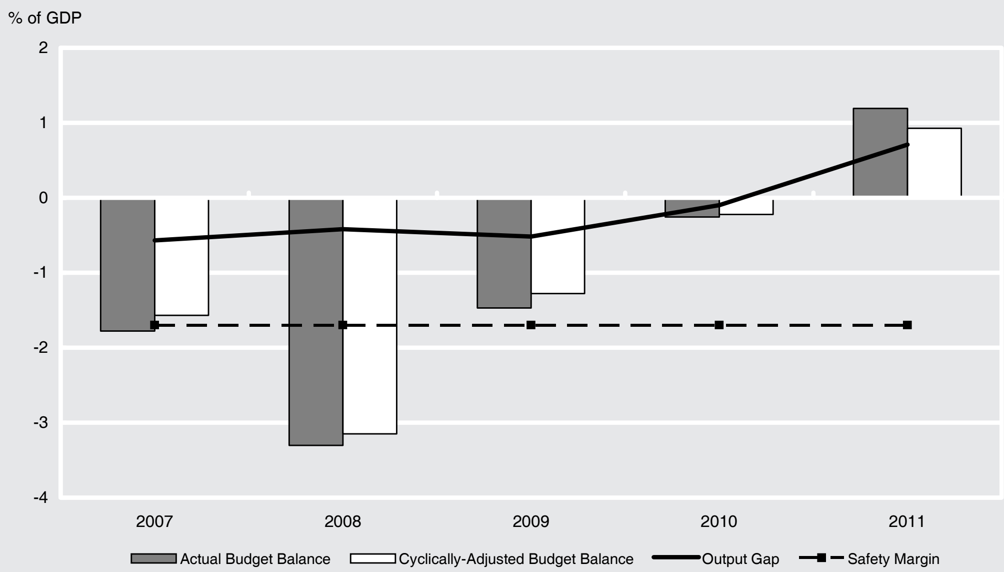
The fiscal consolidation path necessary to achieve the objective of a balanced structural position in the medium-term continues to be an important policy objective. Underlying the fiscal path illustrated in Chart 3.5 is an improvement in the budget balance from 1.8 per cent of GDP in 2007 to a surplus of 1.2 per cent of GDP in 2011. When one corrects for the cyclical effects, the budget balance improves from a deficit of 1.6 per cent of GDP in 2007 to a surplus of 0.9 per cent of GDP in 2011.

It is noteworthy that, with the exception of 2008, the cyclically adjusted budget balance remains within the safety margin for Malta, estimated at 1.7 per cent of GDP. This means that on the basis of the cyclically adjusted budget balance projections in the medium term, automatic stabilisers can be allowed to act freely without undermining the 3 per cent deficit target. As already explained, the increase in the cyclically adjusted budget deficit registered in 2008 is primarily due to extraordinary expenditure items which will not repeat themselves in subsequent years. If one were to remove such expenditure items equivalent to 1.7 per cent of GDP, the cyclically adjusted budget deficit in 2008 would be 1.4 per cent of GDP, thus still within the safety margin.

The reliance on one-off measures towards the fiscal consolidation path in the medium-term will be marginal. One-off revenue measures between 2009 and 2011 shall not exceed 0.3 per cent of GDP.

Chart 3.5

Actual and Cyclically-Adjusted Budget Balances



Fiscal Consolidation
as a percentage of GDP

Table 3.2

	2006	2007	2008	2009	2010	2011	Annual Average Adjustment 2009/2011
General Government Balance	-2.3	-1.8	-3.3	-1.5	-0.3	1.2	1.5
Excluding extraordinary expenditure*	-2.3	-1.8	-1.6	-1.5	-0.3	1.2	0.9
One-off Measures	0.7	0.6	0.3	0.3	0.1	0.1	
General Government Balance net of One-offs	-2.9	-2.4	-3.6	-1.8	-0.4	1.0	
Output Gap Estimates	-1.6	-0.6	-0.4	-0.5	-0.1	0.7	
Cyclically-Adjusted Budget Balance	-1.7	-1.6	-3.1	-1.3	-0.2	0.9	1.4
Structural Balance	-2.4	-2.2	-3.5	-1.6	-0.4	0.8	
Structural Adjustment		0.2	-1.3	1.9	1.2	1.2	1.4
Excluding extraordinary expenditure*		0.2	0.4	0.2	1.2	1.2	0.9

* extraordinary expenditure is estimated at 1.7% of GDP in 2008

When one excludes one-off revenue measures, the general Government budget deficit is expected to reach 1.8 per cent of GDP in 2009 and continue to improve thereafter, reaching a surplus of 1.0 per cent of GDP in 2011. Moreover, if exceptional expenditure items in the 2008 figures are excluded, a fiscal consolidation of 2.9 per cent of GDP from 2008 to 2011 is expected. Overall, when one excludes one-off deficit-reducing measures and the cyclical component, the structural budget balance is expected to improve from 1.6 per cent of GDP in 2009 to a surplus of 0.8 per cent of GDP in 2011 as shown in Table 3.2. The structural adjustment expected in the 3-year interval between 2008 and 2011 is expected to reach 4.3 percentage points of GDP, or 2.6 percentage points of GDP if one excludes exceptional expenditure items in 2008.

One notes that the structural adjustment in 2009 includes the effect of the extraordinary expenditure items occurring in 2008 which will not be repeated in 2009. If one were to remove these extraordinary items, the structural adjustment in 2009 would be equivalent to 0.2 per cent of GDP. This marginal adjustment should be viewed in the context of Government's policy response to the significant pressures from the international economic environment. Real GDP growth projections for 2009 have already been revised downwards from 3.2 per cent as projected in last year’s Programme to 2.2 per cent in this year’s projection. Indeed, the positive output gap for 2009 of 0.7 per cent of potential output which was expected last year has been revised and is now expected to be a negative gap of 0.5 per cent of potential output.

3.3 The Medium-Term Budgetary Objective (MTO)

As a result of this fiscal effort, Malta is expected to reach a structural deficit of 0.4 per cent of GDP in 2010, which is close to the medium-term objective of a balanced budget in structural terms. This outcome will be achieved in the context of a closing but still negative output gap. In 2011, Malta aims to reach a positive structural budget balance of 0.8 per cent of GDP. This will allow Malta to meet its MTO one year later than planned in the December 2007 Stability Programme.

3.4 Debt Levels and Developments

In addition to addressing the current fiscal imbalance, the attainment of the sustainability of public finances also hinges on a declining debt-to-GDP ratio over the medium-term horizon. While budgetary consolidation contributes towards reducing the debt ratio, in turn, a declining debt ratio also improves the fiscal position through lowering of the debt servicing costs.

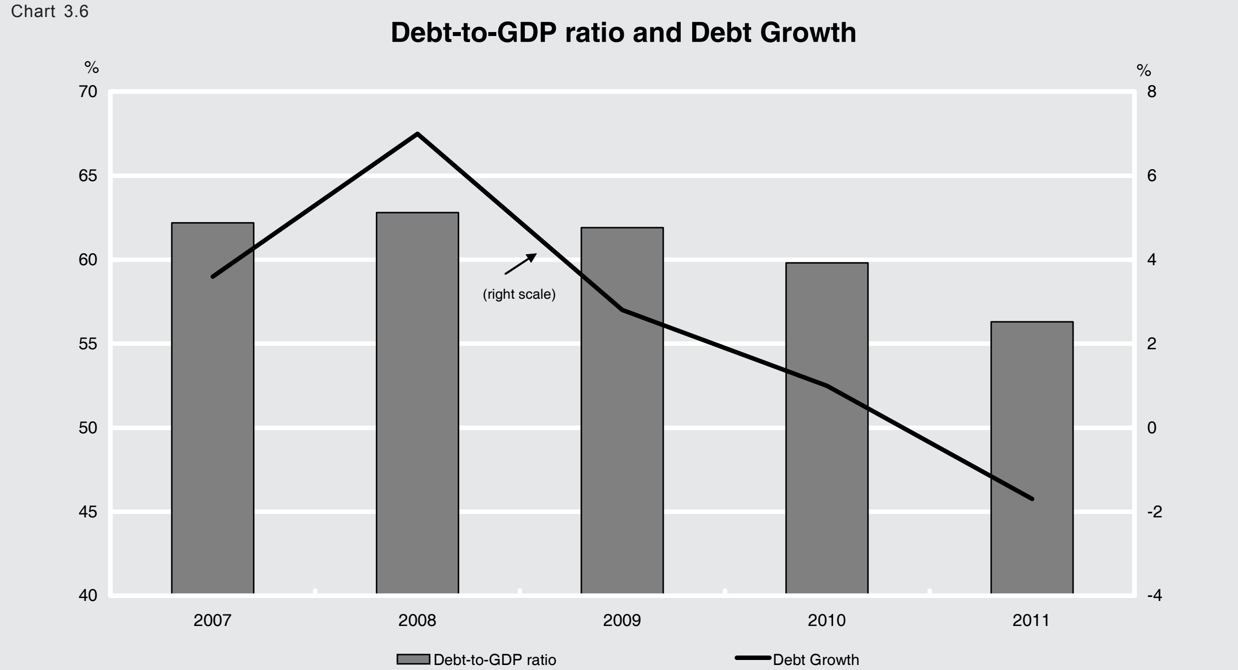
It is part of Government's debt strategy to ensure that the financing needs of the public sector are met at the lowest possible cost whilst minimising the level of interest rate risk in the medium and long term. Following Euro adoption and the subsequent conversion of the debt from Maltese lira into Euro, total Government debt is almost entirely denominated in Euros, rendering exchange rate risk insignificant. At the same time, short term debt in 2008 accounted for only 10.3 per cent of total Government debt, and is projected to decline to 1.5 per cent by 2011. Additionally, the share of maturing stocks and new loans in total government debt is expected to stand at 8.2 per cent in 2008, increasing to 13.5 per cent in 2009 and declining thereafter to 4.1 per cent in 2011. As a result, a 1.0 per cent increase in interest rate payments will exert a relatively minimal effect on total interest expenditure, thereby implying that the fiscal balance is not highly sensitive to changes in interest rates.

3.4.1 Projected Debt Developments

Developments in the debt-to-GDP ratio are primarily a reflection of the trajectory in the primary balance. Moreover, other contributors to changes in the debt ratio include developments in the real rate of interest, the real growth rate of the Maltese economy as well as inflation, referred to as the 'snowball effect'. Other factors which influence the debt-to-GDP ratio are captured by the Stock Flow Adjustment (SFA).

The debt-to-GDP ratio is expected to decline by 6.5 percentage points from 62.8 per cent in 2008 to 56.3 per cent in 2011. Following a downward trend between 2005 and 2007, the debt ratio is projected to increase by 0.6 percentage points to 62.8 per cent of GDP in 2008 reflecting the increase in the deficit as a result of exceptional outlays. Subsequently, the debt ratio is projected to follow a downward trend. Indeed, the increase in debt ratio forecasted for 2008 is expected to be reversed in the following year as the debt-to-GDP ratio is projected to fall to 61.9 per cent in 2009. Thereafter, the debt ratio is expected to decline by 2.1 percentage points and 3.5 percentage points in 2010 and 2011 respectively. As a result of these developments, the reference value is expected to be reached in 2010 as shown in Chart 3.6. It is pertinent to note that the debt

Chart 3.6



projections presented in this Programme do not take into account any privatization proceeds that may result from divestments of Government assets. Moreover, it is also worthy to note that the possible impact of the debt assumption of Malta Shipyards Ltd following its privatization is excluded from the debt projections presented in this Programme. 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 Statistical Appendix Table 4.

Due to exceptional expenditure items in 2008, the primary balance is projected to be negligible. Consequently, contrary to both previous and subsequent years, the primary balance will fall short of reducing the debt ratio in 2008. Thereafter, the primary surplus is expected to follow an upward trend thus exerting an increasing contractionary effect on the debt ratio of 1.9 percentage points and 3.0 percentage points in 2009 and 2010, respectively. Further improvements in the primary surplus are expected to exert an even higher contractionary effect of 4.3 percentage points on the debt-to-GDP ratio in 2011.

As shown in Table 3.3 the 'snowball effect' is expected to have a contractionary effect on the debt ratio in 2008 but an expansionary effect in the three subsequent years. The latter developments whereby the 'snowball' effect is expected to contribute negatively to the reduction of the debt ratio are attributed to a debt increasing effect exerted by interest payments which is only partly offset by the decreasing effect exerted by real GDP growth and inflationary pressures.

The 'snowball effect' is expected to exert a debt decreasing effect on the debt-to-GDP ratio of around 0.2 percentage points in 2008. Subsequently, the 'snowball effect' is projected to have an expansionary impact on the debt-to-GDP ratio of about 0.6 percentage points each year throughout the remaining years of the Programme period. A disaggregation of the components of the 'snowball effect' shows that the expansionary contribution of interest payments to the debt ratio is expected to remain relatively stable at around 3.3 percentage points throughout the 2008-2011 period. At the same time, the contractionary contribution of GDP growth is expected to vary between 1.3 and 1.7 percentage points during the Programme period. Inflationary pressures are projected to exert a contractionary effect, decreasing from 1.8 percentage points in 2008 to 0.9 percentage points in 2011.

The Dynamics of Government Debt[(1)]

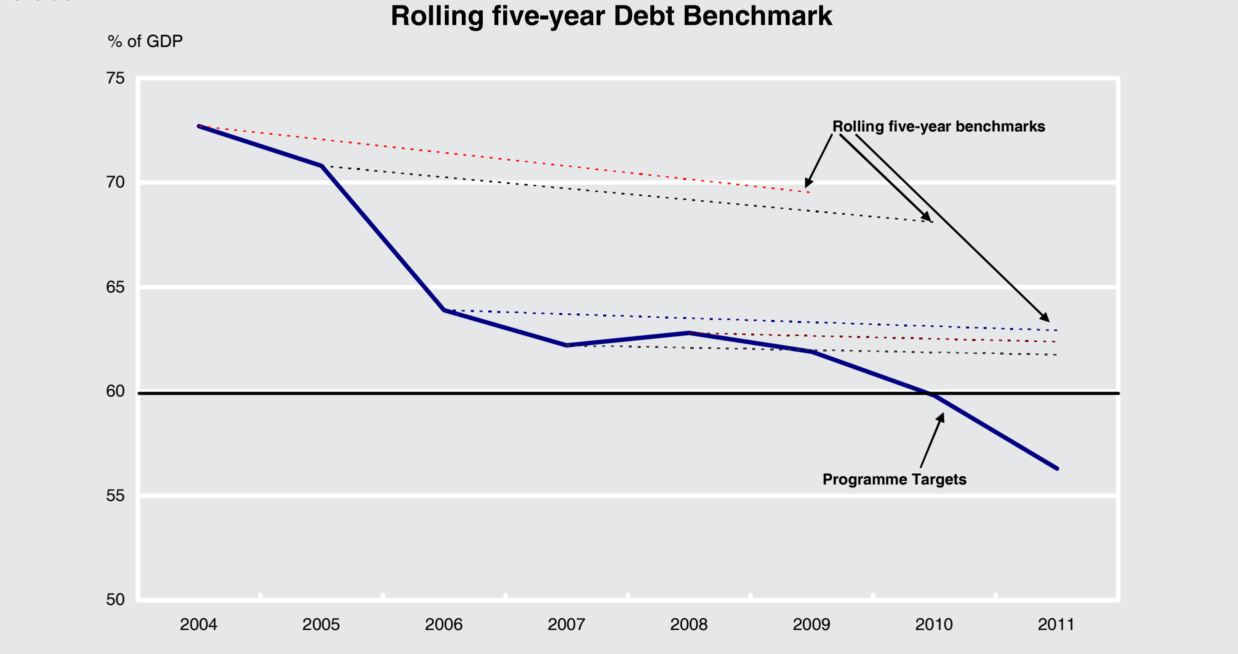
Table 3.3

Percentages of GDP	**2007**	**2008**	**2009**	**2010**	**2011**
Gross debt	62.2	62.8	61.9	59.8	56.3
Change in gross debt	-1.6	0.6	-0.9	-2.1	-3.5
Contribution to change in gross debt					
Primary Balance	-1.6	0.0	-1.9	-3.0	-4.3
Snowball Effect	-0.4	-0.2	0.7	0.6	0.6
Interest Expenditure	3.4	3.3	3.4	3.3	3.2
Real GDP growth	-2.3	-1.7	-1.3	-1.5	-1.6
Inflation Effect	-1.5	-1.8	-1.3	-1.2	-0.9
Stock-flow adjustment	0.4	0.8	0.2	0.3	0.2
p.m. implicit interest rate on debt	5.6	5.7	5.6	5.5	5.5

(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.

Chart 3.7



The other factors contributing to changes in the debt-to-GDP ratio are captured by the estimated SFA, whose contribution is expected to be slightly positive over the 2009-2011 period. In 2007, the SFA is estimated at 0.4 percentage points. Meanwhile, in 2008, the SFA is expected to increase the debt ratio by 0.8 percentage points. This partly reflects an increase in the size of Government debt following the adoption of the Euro and the consequent Maltese Euro coin issuance recorded as a currency liability pertaining to central government. During the remaining three years of the Programme period, the SFA contribution to the change in the debt-to-GDP ratio is expected to be around 0.2 percentage points of GDP.

A good indicator to assess the pace of debt reduction over a medium term horizon is the rolling five-year debt benchmark reflecting the idea that a minimum debt reduction should be ensured not year after year but over a medium-term horizon (assumed to be five years). Chart 3.7 shows that, albeit an increase in the debt-to-GDP ratio was recorded in 2008, the planned reduction of the ratio in the Stability Programme is more than that implied by the five-year rolling debt reduction benchmark.

3.4.2 Comparison with the December 2007 Stability Programme

General Government debt-to-GDP ratios presented in this Programme are expected to be higher than those reported in the December 2007 Stability Programme. These upward revisions, which range from 2.8 percentage points in 2008 to 6.5 percentage points in 2010, mainly reflect revisions in the projected fiscal position over the Programme period. As a result of these revisions the debt-to-GDP ratio is expected to reach the 60.0 per cent reference value in 2010 rather than in 2008 as projected in the December 2007 Stability Programme.

The debt-to-GDP ratio for 2007 presented in this Programme is 62.2 per cent, 0.7 percentage points lower than that presented in the 2007 Stability Programme. This was mainly attributed to an upward revision of GDP which lowered the debt ratio by 0.8 percentage points. This effect was partly mitigated by an upward revision of total debt which had an increasing effect on the debt ratio of 0.2 percentage points.

The debt ratios for the period 2008-2010 presented in this Programme are higher than those presented in the previous Stability Programme, mainly as a result of revisions in total debt. In fact, the debt-to-GDP ratio was revised upwards by 2.8 percentage points in 2008, reflecting an upward revision of the debt level which increased the debt ratio by 3.5 percentage points coupled with an upward revision in the nominal GDP level which contributed negatively by 0.7 percentage points. In 2009, the change in the debt ratio amounted to 4.7 percentage points. This is accounted for by an upward revision of the debt level. For 2010, the debt ratio was revised upwards by 6.5 percentage points, mainly reflecting an upward revision of the debt level which increased the debt-to-GDP ratio by 6.0 percentage points. This upward pressure was augmented by a lower level of GDP, which contributed an additional 0.5 percentage points to the increase in the debt ratio for 2010.

Following revisions in the fiscal adjustment path, the annual downward adjustments in the debt ratio projected for the 2008-2010 period were revised in this Programme. In the 2007 Stability Programme, the debt-to-GDP ratio was expected to decline from 62.9 per cent in 2007 to 53.3 per cent in 2010, reflecting declines of around 2.8 percentage points each year in 2008 and 2009 and a further decrease of 3.9 percentage points in 2010. In contrast, the debt-to-GDP ratio presented in this Programme increased by 0.6 percentage points in 2008 implying a revision in the adjustment of the debt ratio of 3.4 percentage points. Subsequently, a lower downward adjustment in the debt ratio is projected for 2009 and 2010.

These developments reflect a lower primary surplus throughout the Programme period following Government's revised fiscal adjustment path. The slower debt reductions are further explained by revisions in the projections of interest expenditure, real GDP and the SFA. The contribution of interest expenditure was revised by 0.4 percentage points yearly to around 3.3 percentage points in 2009 and 2010. The slower GDP growth rates projected for the Programme period also contribute to the slower debt reductions. Indeed, the contribution of real GDP growth in 2009 and 2010 declined by 0.6 percentage points and 0.4 percentage points, respectively. Furthermore, the SFA adjustment contribution for 2008 has been revised upwards by 1.2 percentage points when compared to the figures presented in the 2007 Stability Programme. However, as explained in the previous section, this development is partly a reflection of currency liability following Malta's adoption of the Euro. Meanwhile, the stock flow adjustment contributions for 2009 and 2010 remain relatively insignificant.

Footnote:

[1]The rolling five-year debt benchmark is calculated as follows: $\left(\frac{D_{t+1}}{Y_{t+1}}\right) = \left(\frac{D_t}{Y_t}\right) - 5\%\left[\left(\frac{D_t}{Y_t}\right) - 60\right]$ where t is the time period, D is the stock of government debt and Y is the nominal GDP

4. Sensitivity Analysis and Comparison with the December 2007 Stability Programme

4. Sensitivity Analysis and Comparison with the December 2007 Stability Programme

4.1 Sensitivity Analysis

Due to the uncertain factors associated with any forecasting exercise, it is important to analyse the sensitivity of the macroeconomic and budgetary forecasts to changes in the underlying macroeconomic assumptions. This becomes especially relevant in view of the current high level of uncertainty in the international environment.

This Chapter presents three alternative sensitivity scenarios with year 2008 taken as the first year of the forecast. The first scenario considers a decline in the interest rate, the second scenario deals with a decrease in economic activity in Malta's main trading partners leading to a lower external demand for domestically produced goods and services, while the third sensitivity scenario features a lower rate of economic growth. The choice of downside risks as sensitivity tests reflects the current growth prospects prevailing in the present international economic situation. Moreover, the three 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 noteworthy that given the uncertainty involving the responses in the economic environment to shocks, the results of the sensitivity analysis presented should be taken as indicative.

4.1.1 Sensitivity to Interest Rate Fluctuations

A shock in the domestic interest rate affects both the real and the monetary sectors which in turn impinge on recorded economic activity. The net effect of this shock depends on the degree of elasticity of the components of output to changes in the interest rate. Government finances are affected directly through changes in the debt servicing costs. Furthermore, Government finances are also indirectly affected by the change in the interest rate through the impact on components of revenue and expenditure that are sensitive to economic activity. The share of short-term debt in total general Government debt is relatively low. Thus, taking into account also the new borrowing requirements projected over the forecast period, as well as the rolling over

Chart 4.1

Sensitivity to a 1 Percentage Point Decrease in the Interest Rate

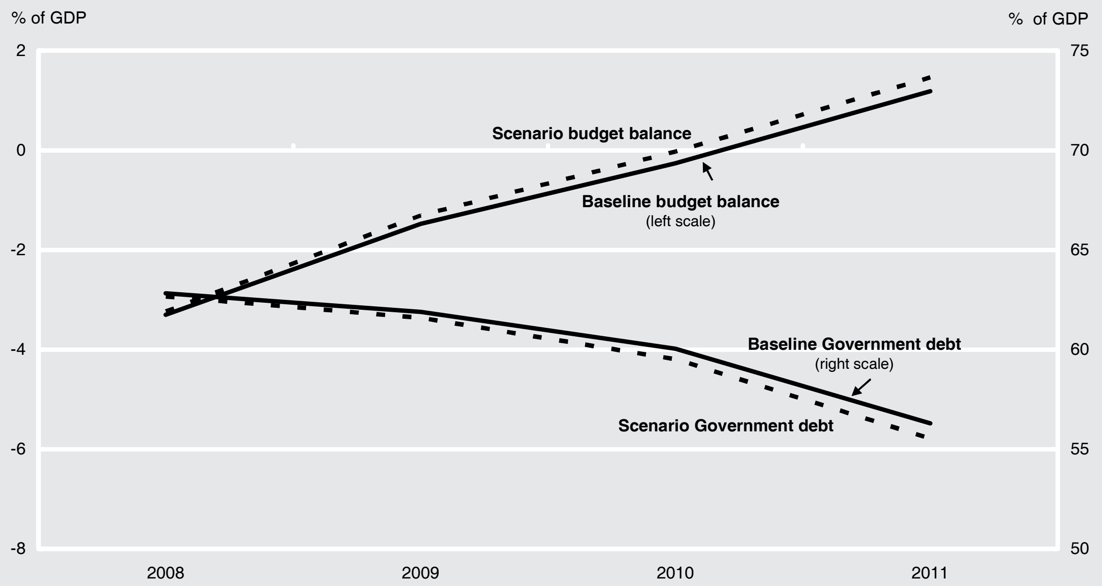
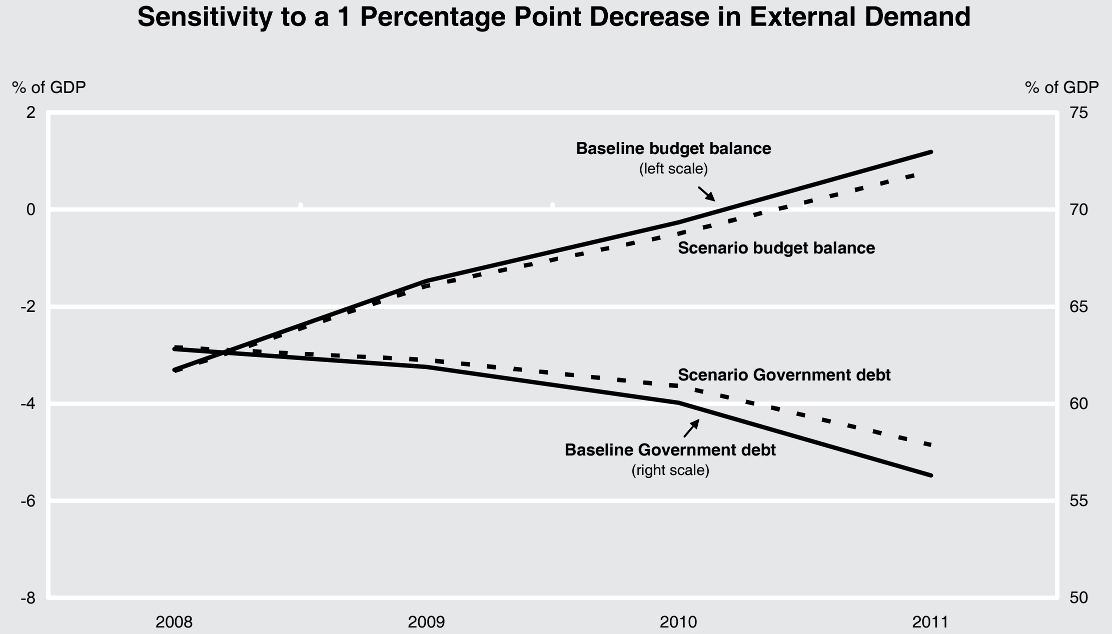


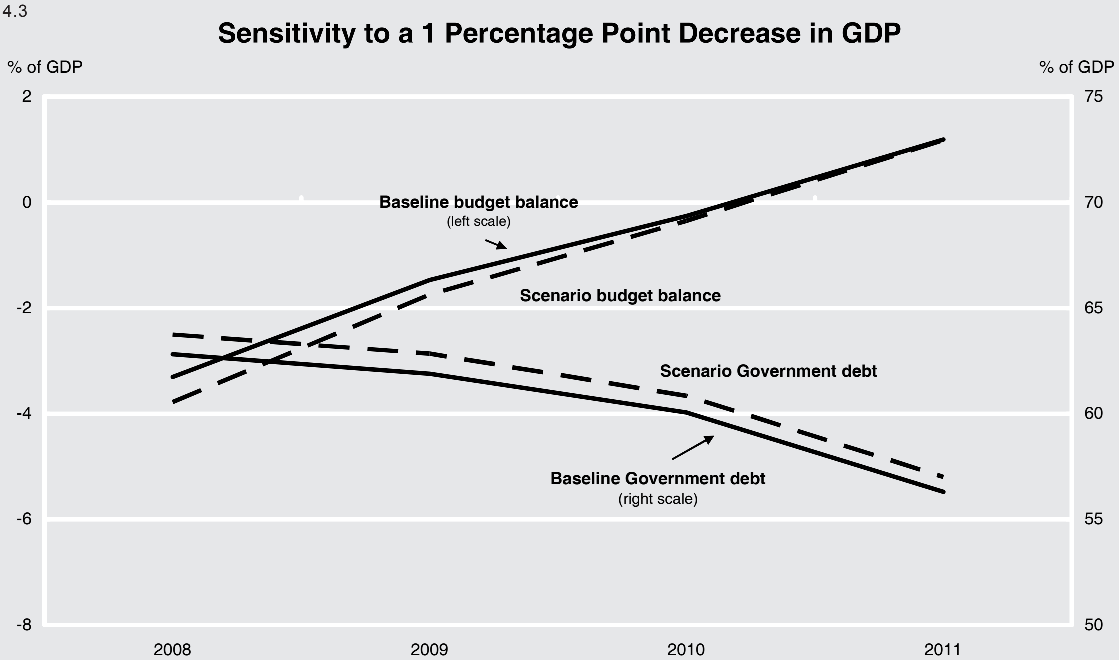
Chart 4.2



of maturing debt, a change in the interest rate is expected to have a relatively minimal effect on total interest expenditure.

This scenario is modeled as a decrease in the interest rate of 1 percentage point between 2008 and 2011. As a consequence of this change, economic growth is expected to increase relatively by around 0.1 percentage point in 2008 and remain unchanged thereafter. Moreover, this decrease in the interest rate will result in improving the budget balance by 0.2 percentage points of GDP in 2009 and 2010. The budget surplus of 1.2 per cent of GDP forecasted for 2011 is expected to further improve by 0.3 percentage points. Subsequently, a decrease in Government debt-to-GDP ratio of around 0.8 percentage points at the end of the forecast period is expected when compared to the baseline. Since the impact of this shock on the total revenue in the budget balance is negligible, the change indicates a decrease in total expenditure which amounts to around 0.4 per cent by the end of the forecast period.

Chart 4.3



4.1.2 Sensitivity to Change in External Demand

This scenario models a decline in external demand of 1 percentage point in the first year and throughout the forecast horizon until 2009.

A negative shock in the external demand for domestically produced goods and services results in a decline in aggregate demand and consequently output. This will have negative spill-over effects on the domestic economy considering the openness of the Maltese economy. At the same time, given the relatively high import-content for exports of goods and services, the impact of a decrease in exports is expected to be partly countered by a decrease in imports.

The decrease in external demand results in a decrease in GDP growth of around 0.5 percentage points by the end of forecast period when compared to the base scenario. The shock is also expected to result in a worsening in the budget deficit in 2010 by 0.2 percentage points of GDP when compared to the baseline, whilst it will decrease the budget surplus in 2011 by 0.4 percentage points in 2011. The developments in the budget balance mainly reflect a decrease in total revenue of 0.7 per cent by 2011 as the impact on total expenditure is negligible. The Government debt-to-GDP ratio is expected to increase by around 1.6 percentage points at the end of the forecasted period.

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

This subsection models a 1 percentage point decrease in GDP. This decrease in the growth rate of real GDP is assumed to take place through a decrease in private final consumption expenditure, leading to lower demand for goods and services.

Following a worsening of around 0.5 percentage points upon impact, the impact on the budget balance is expected to narrow and become negligible by the end of forecast period. Total revenue decreases by 0.9 per cent upon impact, though by the end of the forecast period total revenue is unchanged relative to the baseline. Additionally, the increase in consumption has a negligible impact on total expenditure by the end of the forecast period. On the other hand, Government debt as a percentage of GDP is expected to increase by 0.7 percentage points by 2011, when compared to the baseline scenario.

4.2 Comparison with the Projections in the December 2007 Stability Programme

Economic Growth[1]

The main revisions to real economic growth were largely affected in 2009 and 2010. Conversely, real GDP growth for 2008 has been revised downwards by 0.3 percentage points to 2.8 per cent, in line with the deteriorating outlook for the main trading partners' economies. During 2007 the economy grew by 3.7 per cent, compared to the 3.5 per cent rate of growth forecasted in the December 2007 Stability Programme. Moreover in the first half of 2008, provisional data suggests that the Maltese economy registered a growth rate of 3.3 per cent. In the 2008 Stability Programme the GDP growth rates for 2009 and 2010 have been revised downwards by around 1.0 percentage point to 2.2 per cent and 2.5 per cent respectively.

In 2007, the contribution of the external sector to economic growth was marginally negative in contrast to a positive contribution expected in the 2007 Stability Programme. However the higher than expected contribution to economic growth registered by the domestic sector and inventory accumulation more than compensated for the outturn of the external sector. These patterns were also noted in the first two quarters of 2008. Such trends are expected to persist over the short term, in that the contribution of the external sector in 2008 is expected to be negative at 0.3 percentage points as opposed to the 0.2 percentage point contribution to economic growth expected last year. Meanwhile, the domestic sector's contribution to economic growth has been revised upwards by 1.2 percentage points from the previous forecast to 3.8 per cent, underpinned by the buoyant growth in private consumption registered in the first two quarters of 2008.

Private consumption expenditure for 2008 has been revised upwards by 1.3 percentage points to 3.5 per cent. On the other hand, private consumption growth has been revised downwards by 0.5 percentage points in 2009 and 2010. The upward revision in 2008 was triggered by a buoyant growth rate of 4.1 per cent that was registered in the first two quarters of 2008, which is considerably above the 2.2 per cent forecasted last year. The downward revisions in 2009 and 2010 reflect the slower rate of growth in real disposable income associated with the slowdown in economic activity.

The forecasts for Government consumption expenditure have been revised upwards following the recent trends in fiscal data. Thus, in line with recent fiscal developments, Government consumption expenditure has been revised upwards by 3.8 percentage points in 2008 and by 4.8 percentage points in 2009. In 2010, the growth rate in Government consumption has been revised upwards by 1.4 percentage points.

Gross fixed capital formation has been revised downwards throughout the forecasting horizon. Such revisions reflect the decline exhibited in the latest published national accounts which are in line with the expected deceleration in the underlying performance of the economy. Growth in gross fixed capital formation has been revised downwards by 1.7 and 0.8 percentage points in 2008 and 2009, respectively, and by a marginal 0.1 percentage points in 2010.

A considerable downward revision has been made in the external sector. Such revisions reflect both the lower growth rates in exports and imports during 2008 when compared to last year's forecasts and the intensification of the deterioration in the international economic environment. Such downward revisions were carried out over the entire forecast horizon in respect of both exports and imports. Export growth was revised downwards by 7.6 percentage points and is expected to decline by 5.3 per cent in 2008. Moreover, in 2009 and 2010 export growth has been revised downwards by 6.4 and 3.2 percentage points respectively. On the other hand, import growth has been revised downwards by 6.7 percentage points in 2008 and by 4.3 and 2.3 percentage points, respectively in 2009 and 2010.

In the current forecasting exercise, the contribution of the external sector has been adjusted downwards considerably throughout the forecast horizon. Thus during 2008 the external sector's contribution is expected to be 0.5 percentage points lower than orginally expected, at a negative 0.3 per cent. In the subsequent two years, the contribution of the external sector has been revised downwards by 1.6 percentage points and 0.9 percentage points respectively. Thus, the external sector contribution is expected to be a negative 0.6 per cent in 2009 and marginally positive at 0.4 per cent in 2010.

Inflation and Employment prospects

As expected in the inflation forecasts outlined in the December 2007 Stability Programme inflation during 2008 exhibited a pick up. However, such a pick up was more pronounced than expected, largely as a result of the fact that agricultural commodity prices grew by a higher extent than assumed last year. Consequently the inflation forecast for 2008 is being revised upwards by 2.0 percentage points to 4.5 per cent. Moreover, the inflation rate for 2009 and 2010 has been revised upwards by 0.4 and 0.2 percentage points respectively, as the inflation rate is expected to take longer than anticipated in last year's Stability Programme to return to its trend.

The forecast for the unemployment rate in 2008 has been revised downwards by 1.0 percentage point in line with the buoyant developments that have been exhibited in the labour market over the recent months. In contrast to the forecast outlined in the December 2007 Stability Programme, the unemployment rate is expected to exhibit a moderate increase to 6.0 per cent during 2009, whereas employment growth is expected to decelerate considerably to 1.3 per cent. During 2010, unemployment is expected to edge marginally higher to 6.1 per cent whilst employment growth is expected to maintain the 1.3 per cent growth level forecasted for the previous year.

Footnote:

[1] Projections contained in this Programme reflect the latest National Accounts published by the National Statistics Office (NSO) including provisional estimates for the first half of 2008.

5. Quality of Public Finances

5. Quality of Public Finances

Although fiscal consolidation is projected to continue at a slower pace than expected last year, the achievement of a sustainable fiscal stance remains high on Government's agenda. The deficit target for 2009 has been revised to 1.5 per cent of GDP. Over the medium-term, the general Government deficit is expected to follow a downward trend to reach a surplus in 2011. These developments in the fiscal balance are reflected in a declining general Government debt ratio, which is expected to fall below the 60 per cent reference value in 2010, to reach 56.3 per cent in 2011.

5.1 The 2009 Budget

The budgetary provisions for 2009 represent a determined effort by Government to strike an appropriate balance between the need for sustainability of public finances and the urgent demands placed upon policy makers to come up with effective responses to the current challenges placed by the international economy.

In this regard, the 2009 Budget announced a number of measures which aim to stimulate economic activity whilst at the same time addressing the challenges facing the Maltese economy. These include improving the incentive to work, sustaining local industry and also supporting the country's development through more investment in priority areas namely health, education and the environment. Moreover, initiatives are also earmarked towards sustaining the safety net for low income and specific disadvantaged groups in line with Government's policy of strengthening social cohesion. At the same time, in the 2009 Budget a number of fiscal consolidation measures on the revenue side were announced. Furthermore, the Budget for 2009 sustains Government's commitment to improve the effectiveness of public expenditure, mainly by cutting back subsidies, particularly those which are not sufficiently targeted towards the most vulnerable strata of society. Moreover, the 2009 Budget reduces State subventions in a number of public entities so that these rely less on Government support.

5.2 Structural Measures

This section reviews the main fiscal measures announced in the 2009 Budget and their budgetary impact, which are also presented in Table 5.1. Subsequently, Section 5.3 analyses the composition of fiscal effort for 2009.

Deficit-Reducing One-Off Operations

During 2009, the reliance on deficit-reducing one-off operations is expected to remain at the level recorded a year earlier, reaching 0.3 per cent of GDP, being significantly lower than the level recorded in 2007, at 0.6 per cent of GDP. It is noteworthy that one-off revenue in 2008 and 2009 reflects proceeds from the sale of Government property.

Growth Enhancing Measures

As outlined above, the 2009 Budget was designed such that Government's fiscal plan will be conducive to support economic performance which might be hindered by the current unfavourable external economic environment. To this end, the 2009 Budget aims to stimulate further economic activity particularly through a change in the income tax regime encouraging more work effort as well as through assistance to the local industry.

The revision of the income tax bands announced in the 2009 Budget builds further upon the income tax reform initiated in 2007 and continued in 2008 and seeks to further encourage labour market participation. This measure further extends the tax-free range of household income and broadens the income tax brackets. This initiative will boost disposable income, thus supporting consumption and ultimately, economic activity.

Main Measures Budget 2009

Table 5.1

	€ million	Percentage of GDP
Main Measures impacting on Revenue		
Change in income tax bands & measures encouraging female labour participation	-12.0	-0.2
Measures promoting a sustainable environment		
Emissions-based registration and licensing system for motor vehicles (net effect)	-4.9	-0.1
Revision in eco-contribution and other charges	5.1	0.1
Revision in excise duty on petroleum products	8.9	0.1
Revision in excise duties and licences	7.3	0.1
Total	4.4	0.1
Main Measure impacting on Expenditure		
Measures promoting a sustainable environment	6.7	0.1
Elimination of subsidies on utilities	-24.0	-0.4
Review of other subsidies/subventions to public entities	-12.0	-0.2
Measures towards social cohesion	3.7	0.1
Measures towards the promotion of the tourism industry	3.5	0.1
Incentives for industry	0.8	—
Measures towards sustainable localities	5.8	0.1
Cost controllers for health expenditure	0.5	—
Total	-15.1	-0.3

Moreover, the 2009 Budget also introduced specific fiscal measures aimed to encourage higher female participation. A one-year exemption from income tax will be granted to every mother who returns to the labour market after a five-year absence. Furthermore, a one-year income tax exemption is also granted to mothers whose children were born from 2007 onwards and who are already in employment or who have not been absent for five years and who choose to return to work. These measures are expected to have a total budgetary impact of around €12 million.

It is recognised that the tourism industry is one of the main contributors to economic growth. The 2009 Budget aims at addressing the expected slowdown in tourist arrivals during 2009, in response to the international economic and financial crisis, by increasing the budgetary allocation for the Malta Tourism Authority by €3.5 million when compared to last year's allocation. The increased outlays are earmarked to expand the marketing effort of Malta's tourism product.

Government constantly seeks to support local industry which largely consists of small and medium sized enterprises (SMEs), particularly through initiatives and schemes administered by Malta Enterprise. In order to complement such initiatives, the 2009 Budget allocated an additional €0.3 million towards assistance to SMEs. Meanwhile, Malta Enterprise was allocated €0.5 million to increase investment in trade missions which enable Maltese entrepreneurs to identify new market opportunities.

Sustainable Environment

The Budget presented for 2009 is synonymous with initiatives introduced to promote a better environment. The main measures which aim towards the promotion of a more sustainable environment are expected to exert a net budgetary impact of €6.5 million.

The 2009 Budget reformed the previous motor vehicle tax system into the emissions-based registration and licensing system which is based on the polluter pays principle. The new regime seeks to alleviate traffic congestion and emission related problems, while also providing the necessary funds to ensure that at the end of the life of vehicles, scrap material is adequately recycled and treated in order to safeguard the environment. Meanwhile, the annual licences of vehicles registered under the original regime have been increased. In aggregate, these measures are estimated to have a net budgetary impact of €4.9 million.

Moreover, in the 2009 Budget Government introduced various amendments to the eco-contribution system. In particular, such changes involved an increase in the eco-contribution charge on all plastic bags, a charge on printed material distributed to households as well as the introduction of a charge on inefficient energy-consuming light bulbs. These measures, estimated to yield €5.1 million, encourage households to minimise the consumption of such environmentally damaging products.

Moreover, €6.7 million were allocated towards initiatives to enterprises and households to make more efficient use of energy as well as to invest in alternative energy sources. Such initiatives include funds allocated towards non-domestic energy audits as well as schemes benefiting households investing in the installation of alternative energy generating equipment, roof insulation and solar water heaters. Furthermore, funds are also allocated towards the distribution of energy saving lamps to households.

Sustainable Localities

Government is committed to address environmental sustainability in a holistic manner. To this end, €5.8 million have been directed towards initiatives promoting sustainable development at a local level. In particular, financial support to local councils will be increased to €4.0 million while an award will be given to local councils who take up initiatives towards embellishing the local environment. Furthermore, a one-time special scheme is introduced for the restoration of facades of old residential buildings, with preference given to scheduled buildings in town and village cores. Moreover, Government shall finance two pilot projects on the drawing up of sustainable development strategies at a local level. Meanwhile, Government is encouraging economic activity at a local level. To this end, tax-credit schemes are introduced to encourage investment by SMEs in the various towns and villages.

Social Cohesion Measures

As in previous years, in the 2009 Budget, social policy remained high on Government's agenda. Indeed, Government continued with its efforts to strengthen the social safety net ensuring that assistance is directed to entitled citizens while curtailing benefit fraud. In particular, these initiatives support pensioners, families with children having special needs as well as first-time property buyers amongst others. The net budgetary impact of the main measures introduced in the 2009 Budget earmarked towards social cohesion is estimated at €3.7 million.

Following the measures introduced in 2008, the 2009 Budget announced an additional measure aimed to increase the disposable income of a specific group of pensioners. This initiative is expected to have a budgetary impact of €1.1 million. In support of inclusive education, Government will be allocating €0.2 million to finance the employment of facilitators assisting children with special needs attending private schools.

In 2009, Government will continue to facilitate access to the housing market by introducing further financial assistance schemes which will facilitate the purchase of property by first-time buyers whenever specific conditions are met. These measures are estimated to have a budgetary impact of €1.7 million. Furthermore, in order to continue providing high standard health and medical services, Government allocated €1.4 million for the free distribution of medicine treating specific life-threatening illnesses.

While Government remains committed to ensure that all households, particularly low income households, have access to an adequate provision of utilities, as from 2009, assistance related to the consumption of utilities by the entitled households is being capped in order to ensure that assistance towards unnecessary consumption is avoided.

Additional Measures

The 2009 Budget announced a revision in the excise duty on fuel products which is expected to yield €8.9 million. Through this measure, an Alternative Energy Fund is established earmarked towards the financing of investment and incentives promoting renewable energy.

In the 2009 Budget, Government also announced revisions in the excise duties on cigarettes, cigars and tobacco as well as alcohol. These measures, which are expected to yield €6.0 million in Government revenue, also seek to discourage citizens, particularly youths, from the consumption of such products. Another revenue generating measure includes the revision in the annual licences for yachts and swimming pools. This measure is expected to yield €1.3 million in Government revenue.

Government is committed to ensure that resources are employed in the most efficient manner. As health constitutes a main component of Government expenditure, Government is allocating €0.5 million towards the recruitment of a number of cost controllers trusted with the task of ensuring the provision of a cost-effective and efficient public health service. This measure will result in the reallocation of resources towards more efficient uses enabling Government to provide better health services for all citizens.

In 2009, Government will significantly curtail subsidies to public entities. The restructuring in the energy and water tariffs will enable a more timely adjustment of consumer utility prices to the cost of generating and distributing utilities. This will result in a decrease of €24.0 million in Government outlays towards utilities. Moreover, curtailment of subventions to other public entities is expected to result in an additional €7.3 million while the termination of subsidies to Malta Shipyards Ltd is expected to result in a decrease in expenditure by a further €4.7 million.

5.3 Determinants of the 2009 Fiscal Outcome

The general Government deficit is projected to increase to 3.3 per cent of GDP in 2008 on account of exceptional outlays towards the shipyards and energy sector. It is pertinent to note that if the exceptional outlays recorded in 2008 are excluded, the deficit ratio for 2008 would stand at 1.6 per cent. In the subsequent year, the deficit ratio is expected to be 1.5 per cent of GDP. The decline in the fiscal imbalance is mainly brought about by a higher revenue ratio to GDP, whilst a lower expenditure ratio is also expected to contribute significantly to the decline in the deficit-to-GDP ratio. The main contributors to the decline in the deficit-to-GDP ratio are illustrated in Table 5.2 and Chart 5.1.

The decline in the deficit-to-GDP ratio mainly reflects a significant improvement in the revenue-to-GDP ratio, which is expected to increase from 40.6 per cent in 2008 to 41.7 per cent in 2009, mainly due to revenue buoyancy and 'other' revenue, which includes EU investment grants. Indeed, tax revenue buoyancy and a stricter enforcement of tax collection will have a positive effect on the deficit ratio of 0.42 percentage points of GDP, whilst 'other' revenue is expected to result in a decline in the deficit-to-GDP ratio of 0.69 percentage points of GDP in 2009.

Meanwhile, the negative contribution of a number of measures announced prior to, or in the 2009 Budget, in particular the revision of the income tax bands, the removal of the departure tax as from November 2008 as

Analysis of Improvement in Deficit-to-GDP Ratio for 2009

(percentage points)

Table 5.2

Revenue increasing measures	0.35	
Revenue reducing measures	-0.32	
Reform of motor vehicle taxation	-0.08	
Tax revenue buoyancy and enforcement	0.42	
Other	0.69	
Change in revenue ratio		1.06
Compensation of employees	-0.02	
Intermediate consumption	-0.12	
Total social transfers	0.54	
Interest expenditure	-0.02	
Subsidies	1.39	
Gross fixed capital formation	-1.00	
Other	0.01	
Change in expenditure ratio		0.78
Improvement in deficit ratio		1.84

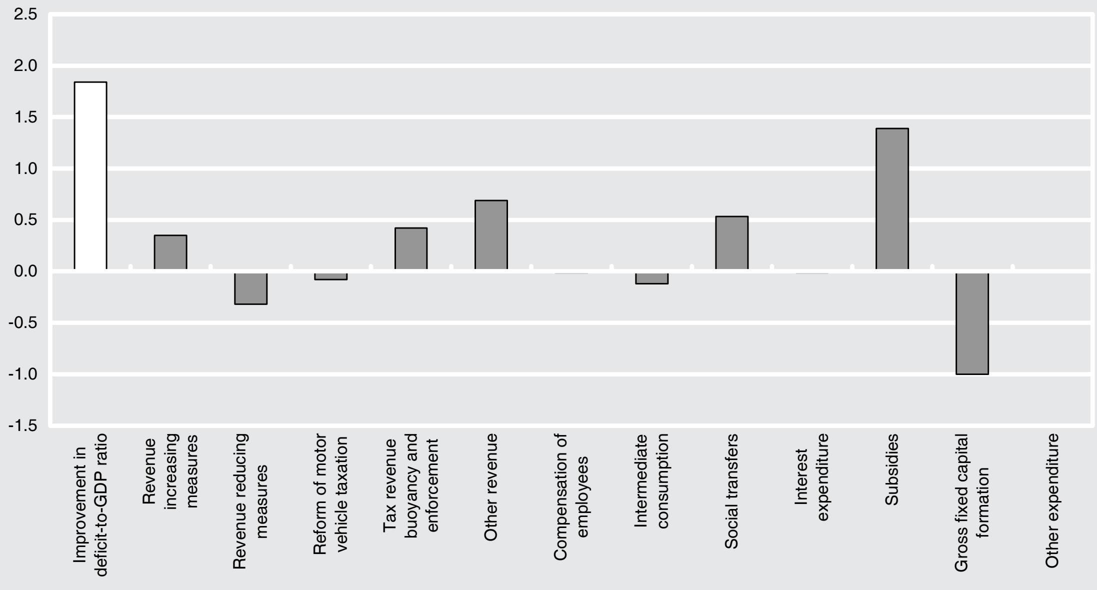
Note: positive represents a decline in the deficit-to-GDP ratio

well as the reform of the motor vehicle taxation system, are expected to be partly offset by the impact of revenue increasing measures also announced during the Budget for 2009. Indeed, whilst revenue reducing measures, including the reform of the motor vehicle taxation system, are expected to worsen the deficit by a total of 0.4 percentage point of GDP in 2009, revenue increasing measures are forecasted to partly offset the increase in the deficit-to-GDP ratio to a net of 0.05 percentage points of GDP.

The ratio of general Government expenditure to GDP, which is expected to decline from 43.9 per cent in 2008 to 43.2 per cent in 2009, is forecasted to result in an improvement in the deficit-to-GDP ratio of 0.78 percentage points. This is underpinned by declines in social transfers and subsidies, reflecting the exceptional

Chart 5.1

Analysis of Improvement in Deficit-to-GDP ratio for 2009



outlays incurred in 2008. Such improvement shall be partly offset by a higher ratio of gross fixed capital formation as a per cent of GDP. Developments in capital outlays during 2009 mainly reflect the implementation of projects co-financed from EU funds under the 2007-2013 Financial Framework and thus correspond with analogous increases in revenue, as highlighted above.

As already highlighted in previous sections of this Programme, the ratio of social payments to GDP is anticipated to register a significant increase in 2008 on account of outlays related to the shipyards' voluntary redundancy schemes. This expenditure will not recur in 2009, thereby contributing to contain expenditure increases. On the other hand, higher expenditure on retirement pensions and pharmaceutical products will contribute to push up the expenditure ratio during 2009. As a result of these contrasting developments, the ratio of social payments to GDP is expected to decline by 0.54 percentage points to 13.6 per cent.

The revised utilities' tariff structure and the termination of subsidies for the shipyards will result in a significant decline in the subsidies-to-GDP ratio. This decline in the subsidies ratio is expected to contribute to an improvement in the deficit-to-GDP ratio of 1.39 percentage points. Meanwhile, other components of expenditure, in particular intermediate consumption, as well as compensation of employees and interest expenditure are expected to adversely affect the deficit-to-GDP ratio. The ratio of intermediate consumption to GDP is expected to increase by 0.12 percentage points during 2009, primarily on account of higher expenditure related to projects in part financed from EU funds as well as projects financed from national sources classified under such category. Compensation of employees and interest expenditure are expected to affect the deficit-to-GDP ratio only marginally.

5.4 Functional Classification of Expenditure

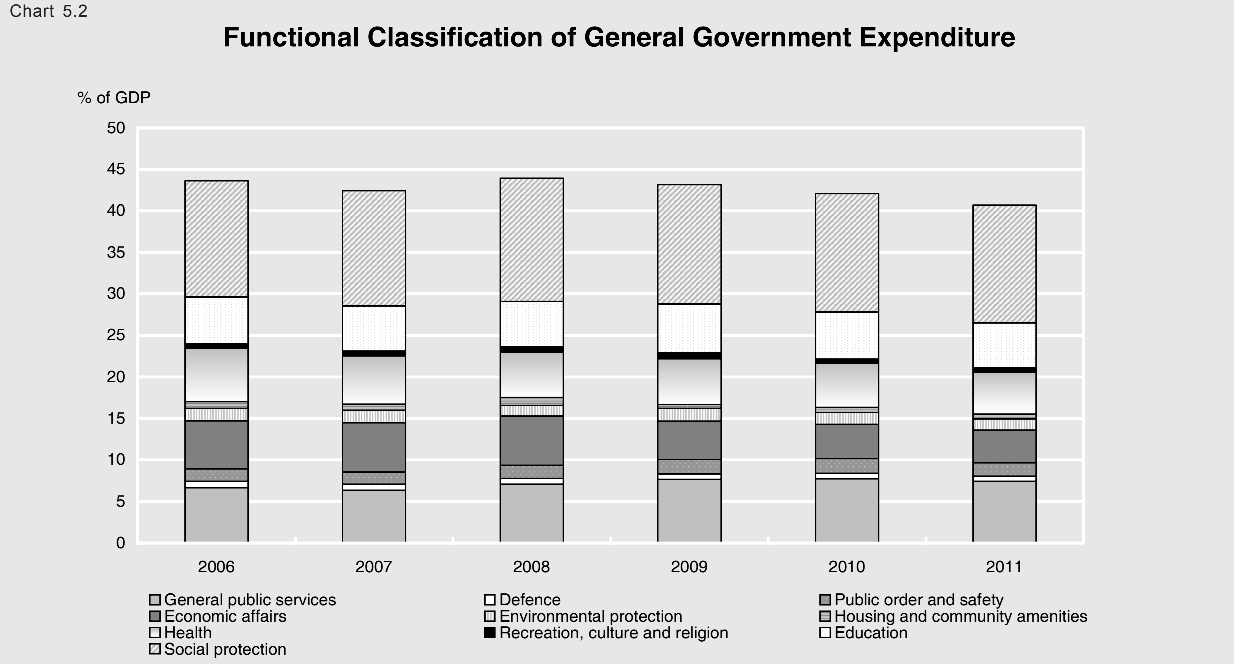
This section provides an analysis of the main components of general Government expenditure by functional classification, namely Social Protection, General Public Services, Health, Economic Affairs and Education as well as Environmental Protection. Chart 5.2 and Table 3 in the Statistical Appendix present developments in these components of general Government expenditure as a share of GDP for the period 2006-2011.

Expenditure on General Public Services as a per cent of GDP declined by 0.3 percentage points and stood at 6.4 per cent in 2007, when compared to the ratio recorded a year earlier. Thereafter, the ratio of this item of expenditure is expected to follow an upward trend, reaching 7.8 per cent of GDP in 2010, before declining to 7.4 per cent of GDP in 2011. The upward trajectory which is expected to be followed between 2008 and 2010, particularly reflects higher compensation of employees. The higher expenditure on compensation of employees is expected to be sustained in 2011. However, since this is coupled with a higher increase in GDP growth, the expenditure ratio is expected to decline in 2011.

The ratio of expenditure on Economic Affairs as a proportion of GDP is expected to remain at around 6 per cent of GDP between 2006 and 2008. It is pertinent to note that the expenditure ratio in 2008 includes the temporary subsidy to the energy corporation aimed to cushion the significant impact of higher energy price increases. Over the subsequent three years, the ratio of this expenditure component is expected to follow a downward trend, declining by 2.0 percentage points to 3.9 per cent of GDP in 2011. This reflects Government's policy to reduce subsidies and the dependence of Government entities on public resources.

Over recent years, Government's policy has increasingly taken a holistic approach towards sustainable development, providing a balance between economic development and environmental sustainability. After standing at 1.5 per cent of GDP in 2006 and 2007, the ratio of expenditure on Environmental Protection is expected to increase from 1.3 per cent of GDP in 2008 to 1.6 per cent in 2009, thereafter declining to 1.4 per cent in 2010 and 2011. Around half of the expenditure on Environmental Protection is of a capital nature. It is pertinent to note that the decline in the expenditure ratio in 2008 reflects the completion of projects which were co-financed by EU funds that were mainly related to the development of waste management facilities.

Chart 5.2



On the other hand, the increase in the expenditure ratio in 2009 principally reflects the expected implementation of projects co-financed by the 2007-2013 Cohesion Fund programme.

The ratio of expenditure on Health to GDP is expected to follow a generally downward trend, declining from 6.4 per cent recorded in 2006 to 5.0 per cent in 2011. The trajectory in the early part of the Programme period reflects the completion of the new hospital. In 2009, health expenditure is also earmarked to finance upgrading works and equipment in a number of centres providing health services.

Investment in human resources through education and training contributes towards a skilled and flexible labour force which is essential in an increasingly competitive environment. Expenditure on Education as a per cent of GDP is projected to remain generally stable at 5.5 per cent between 2006 and 2008. In 2009, the expenditure ratio as a per cent of GDP is expected to rise to 5.9 per cent before declining gradually to 5.4 per cent by 2011. Expenditure on education of a capital nature is expected to increase significantly over the Programme period, mainly co-financed from EU Structural and Cohesion Funds under the 2007-2013 Programme. Such expenditure is principally earmarked to co-finance projects related to the University of Malta and to the vocational training institute – the Malta College for Arts, Science and Technology (MCAST). Given that expenditure on education in absolute terms is expected to increase less rapidly than GDP, the ratio of expenditure on education is projected to decline in the outer years of the Programme period.

Expenditure on Social Protection consists of the largest component of total expenditure and namely reflects outlays on pensions. The ratio of expenditure on Social Protection to GDP fell marginally to 13.8 per cent in 2007, from 14.0 per cent recorded in 2006. In 2008, expenditure on social protection is expected to rise to 14.8 per cent of GDP, primarily reflecting exceptional outlays relating to the voluntary redundancy schemes for employees of Malta Shipyards Ltd. Thereafter, expenditure on Social Protection is expected to follow a declining trend, falling to 14.2 per cent of GDP in 2011, in particular reflecting a projected absolute increase in expenditure on pensions and other social benefits that is expected to be outweighed by higher rates of GDP growth.

5.5 Integration between the Stability Programme and the National Reform Programme

The second cycle of the National Reform Programme (NRP) set out in 2008 seeks to consolidate and strengthen Government's reform plan that was initiated in 2005. The NRP for the 2008 – 2010 period addresses those challenges and priorities outlined by the European Commission in its country specific recommendations in conjunction with those peculiar factors that underpin Malta's competitiveness position. Indeed, the current three-year cycle of the NRP seeks to allocate resources towards four major overriding priority areas, namely: the unlocking of business potential, investing in knowledge and innovation, energy and climate change and investing in people and modernizing labour markets. The comprehensive strategy presented in the NRP, which is based on these four priority areas, aims to address the following key challenges: sustainability of public finances, competitiveness, the environment, employment, as well as education and training.

The planned reforms will lead to improved competitiveness and better living standards if there is general consent by all stakeholders on the usefulness of pursuing such changes. For this reason, the current NRP was formulated following the execution of a wide public consultation exercise in order to ensure that it embraces the aspirations and views of all stakeholders.

As in the first cycle of the NRP, the NRP 2008-2010 was formulated within the context of the medium-term budgetary framework. Various NRP measures will be co-financed by EU funds under the 2007-2013 Structural and Cohesion Funds Programme. The fiscal framework presented in this Update of the Stability Programme for the 2008-2011 period encompasses the budgetary implications of the reform measures outlined in the NRP.

The Implementation Grid presented in this section portrays the planned NRP measures, which aim to address the key challenges mentioned above. This has been compiled in consultation with the Management Efficiency Unit (MEU) within the Office of the Prime Minister (OPM). A review of the main measures, which are incorporated in the second cycle of the NRP 2008-2010, and re-affirmed in the 2009 Budget, follows.

Sustainable Public Finances

The effective use of public funds particularly through the provision of quality service to the clients is a prerequisite to address the challenge of attaining sustainable public finances. In particular, as announced in the 2009 Budget, Government plans to invest in a number of different projects and initiatives in the health sector which aim to improve the quality of service that is delivered to end clients. Such improvements relate to the construction of new facilities which will complement the available infrastructure and measures that will bring about improvements in service delivery and effective financial accountability. This ensures that the investment that the Government makes in healthcare services is sustainable over the long-term.

Competitiveness

Faced with the challenge of improving Malta's competitiveness, the creation of the right environment for growth and jobs is an important theme in the strategy presented in the NRP and reiterated in the 2009 Budget. In fact, the 2009 Budget announced a further widening of the income tax brackets, following the income tax reform initiated in 2007.

Moreover, in a bid to safeguard competitiveness, priority is also attached to unlocking business potential. An important contributor to Malta's business potential is undoubtedly the tourism sector. As announced in the 2009 Budget, further investment in the sector will be made to address the negative impact that the ongoing international economic downturn will have on this sector. To this effect, a number of infrastructural works will commence in various touristic zones and beaches in Malta and Gozo, in the coming months. Government also increased the allocation of subvention towards the Malta Tourism Authority for 2009.

Investing in knowledge and innovation is a priority area in the strategy presented in the NRP. In line with this strategy, as announced in the 2009 Budget, during next year, Government will strengthen the research infrastructure at the University of Malta and launch new programmes that will enable more individuals to pursue postgraduate and doctorate studies. Furthermore, research and development, innovation and growth will be promoted through a number of schemes administered by Malta Enterprise whose overriding objective is that of improving firm's international competitiveness, enhance entrepreneurial spirit and stimulate research and innovation.

Environment

The sustainability of the environment is another challenge which Government is actively addressing. In fact, the environment is one of the priorities identified in the NRP while Government dedicated considerable attention to this area in the 2009 Budget. Indeed, the 2009 Budget announced various measures aimed to improve the efficiency of energy use and to promote the use of renewable sources of energy. A number of initiatives have been announced which will enable a wider number of firms and households to invest in technology - such as solar water heaters and photovoltaic power generating systems - that is more environmental friendly. Through such measures the Government's policy of increasing the use of energy that is derived from renewable sources is being enacted in a concrete manner. Moreover, an overhaul in the motor vehicle registration tax and annual circulation tax has been implemented. The changes undertaken have put into practice the polluter pays concept and aim to achieve a shift towards the utilization of small and efficient cars, thereby reducing the level of pollution generated by transportation.

Employment

During the first cycle of the NRP, Malta has achieved positive results in the labour market. Generating a high level of employment and securing a low unemployment rate remain priority areas in the second cycle of the NRP. In the 2009 Budget, Government also reiterated its intention of investing in people and hence outlined a number of employment policies. Such policies aim to increase the employment potential of the less skilled segment of the workforce. Moreover, Government also introduced income tax holidays for working mothers to consolidate the series of initiatives that have been undertaken in the recent past to trigger a rise in the female participation rate.

Education and Training

As competitiveness is inherently linked to the skills and abilities of individuals which in turn characterize the employability of individuals, particular attention is attached to education and training in the three year strategy of the NRP as well as in the 2009 Budget. Government has introduced measures that will enable firms to benefit from subsidies when offering training to their employees. Moreover, in the 2009 Budget Government consolidated further investment towards the education sector to provide higher quality educational service which would in turn result in a better skilled labour force.

NRP - Implementation Grid										
Key challenges	**Integrated Guidelines**	**Measure**	**Implementation**			**Direct budgetary costs (as a percentage of GDP)**				
			Status	**Timeline**						
				Start	**End**	**2007**	**2008**	**2009**	**2010**	**2011**
Sustainability of Public Finances	3	Invest in sustainable Healthcare: • A new healthcare Act	Ongoing	Q4 2005	Q4 2009	-				
		• Strengthening of primary and community care	Not yet initiated	Q4 2008	Q4 2015	-	Financed through Ministry's funds			
		• Improving cancer care		Q1 2009	Q4 2012	-		Financed through Ministry's funds		
		• Measures to introduce an effective financial strategy and the implementation of appropriate operational and IT systems				-	Financed through Ministry's funds; measures to introduce IT systems are still being devised			
Competitiveness	4, 10	Creating the right environment for growth and jobs: • Reduction in income tax through widening of income tax bands	Ongoing	Q1 2007	Q4 2013	Budget 2009 announced review of income tax bands with budgetary cost of 0.2% of GDP. Further revision of income tax system is being examined and will be devised in light of the evolving international economic situation.				
		• Reduction of maximum rate of income tax	Not yet initiated							
		• Removal of airport departure tax	Ongoing	Q4 2008	-	-		0.12	-	
	7	Invest in research and innovation: • Strengthening of the research infrastructure at the University of Malta	Not yet initiated	Q4 2008	Q4 2011	-	0.02	0.09	0.09	0.09
		• Bursaries for PhD students		Q4 2009	Q4 2011	-		___	0.01	___
		• Implementation of Malta's R&I programme		Q1 2009	Q4 2010	-		0.02	0.02	-
		• Introduction of schemes focusing on the promotion of R&D, Innovation and Growth		Q4 2008	Q4 2010	-	0.01	0.04	0.04	-
		• Manufacturing research projects		Q3 2008	Q2 2012	-	___			
		• Building of an ICT facility		Q4 2009	Q4 2013	-		0.02	0.06	0.06
		• MGSS Postgraduate Scheme		Q4 2009	Q4 2010	-		___	0.01	-
		• Launch of the University of Malta Trust Fund		Q4 2009	Q4 2011	-		___	0.02	0.02
	14	Better regulation: • Strengthen the Better Regulation Unit	On-going	Q1 2006	Q4 2008	___				-

NRP - Implementation Grid											
continued											
Key challenges	Integrated Guidelines	Measure	Implementation			Direct budgetary costs (as a percentage of GDP)					
			Status	Timeline		2007	2008	2009	2010	2011
				Start	End					
Competitiveness	14	• Complete the current Action Plan for Simplification	On-going	Q1 2006	Q4 2009	—				-
		• Carry out an intensive, sectoral based consultation to target the key pain points felt by businesses	Not yet initiated	Q3 2008	Q4 2008					
		• Put in place consultation guidelines and better practice for use within the public administration		Q2 2009	Q1 2010					
		• Review the customer care systems within the public administration	On-going	Q1 2006	Q4 2008					
		• Carry out a review of the enforcement regime(s)	Not yet initiated	Q1 2009	Q2 2009					
		Intellectual property: • Carry out pre-diagnostic visits to local firms	On-going	Q1 2008	Q4 2010	-	—			-
		• Carry out training events and workshops and an information campaign in relation to Intellectual Property								
		• Embark on a project for the digitization of all national patent records thus offering a complete database of all national patents	Not yet initiated	Q4 2008	Q4 2009					
		• On-line filling for patents as part of eGov services to the local citizens		Q2 2008	Q4 2008					
		• Customize and implement other patent software tools such as the on-line filling (eOLF) module and the e-Phoenix module through continued technical assistance with EPO		Q4 2009						
		• On-line filing for trademarks as part of eGov		Q2 2008	Q4 2008					
		• Implement a new trademark system which will facilitate processing of trademark applications and searching on national trademarks by interested parties		Q1 2009	Q4 2009					
		• Accession of Malta to the Madrid Protocol for the International Registration of Trademarks which will facilitate application and registration of local trademarks in other countries even those outside of the EU								
	12	Implementation of the Services Directive by 2009	On-going	Q1 2008	Q4 2009	-	—		-	

NRP - Implementation Grid										
continued										
Key challenges	Integrated Guidelines	Measure	Implementation			Direct budgetary costs (as a percentage of GDP)				
			Status	Timeline						
				Start	End	2007	2008	2009	2010	2011
Competitiveness	10, 17	Entrepreneurship: • Setting up of a one-stop-shop for the licensing/registration of commercial activities	Not yet initiated	Q4 2008	Q4 2010	-	Financed through Ministry's funds			-
		• Implementation of the Employability Programme which will consist of a number of training initiatives as well as a training subsidy scheme and a skills assessment system		Q4 2008	Q4 2010	-	0.01	0.04	0.04	-
	9	Developing Malta as a world leader in ICT: • Development of a robust ICT environment and Next Generation Infrastructure	Not yet initiated	Q2 2008	Q4 2010	-	0.09	0.12	0.11	-
		• Investment in a connected society					0.10	0.12	0.12	
		• Developing a smart workforce with the necessary ICT skills	On-going				0.13	0.17	0.16	
		• Enhancing citizens' quality of life through ICT	Not yet initiated				0.03	0.04	0.04	
		• Re-inventing government transformation and open government					0.13	0.17	0.16	
		• Taking care of e-business				-	___			-
		• Setting up of a University of Malta IT Services Centre		Q4 2009	Q4 2013	-		0.01	0.03	0.03
	10	Invest in our Tourism Sector: • Upgrade of Tourism Zones in St. Paul's Bay, Qawra, and Pembroke	On-going	Q4 2007	Q4 2010	0.02	0.07	0.06	0.06	-
		• Developing Leaders for Change and Innovation in Tourism – Business Development and CPD for Tourism Senior Management		Q4 2007	Q4 2012	___	0.01	0.01	0.01	0.01
		• Improvements to the costal areas in Qawra and Sliema				___	0.01	0.01	0.01	0.01
		Reforming Public Land Transport	On-going	Q4 2007	Q4 2013	-				
		Addressing growth and jobs in Gozo: • Employment Aid Programme	Not yet initiated	Q4 2008	Q4 2013	-	0.01	0.06	0.05	0.05
		• Upgrading of Operating Theatre and setting up of Radiology Unit								
		• Solar systems and support services installations at Gozo General Hospital								
		• Higher education courses to address skill mismatches in Gozo								

NRP - Implementation Grid

continued

Key challenges	Integrated Guidelines	Measure	Implementation			Direct budgetary costs (as a percentage of GDP)				
			Status	Timeline						
				Start	End	2007	2008	2009	2010	2011
Competitiveness	10	(continued…) • Training courses to enhance the employability and adaptability of the workforce	Not yet initiated	Q4 2008	Q4 2013	-				
		• The provision of hospitality courses								
		• Training Aid Framework								
		• Employability Programme								
		• Upgrading of tourism zones								
The Environment	11	Pursue the fight against climate change: • Enhancing Malta's capacity to mitigate and adapt to climate change	Not yet initiated	Q3 2008	Q2 2011	-	___	0.01	0.01	___
		• Promotion of Renewable Energy Sources in the domestic and commercial sector		Q4 2008	Q4 2010		0.02	0.07	0.06	-
		• The introduction of tax incentives with a view to promote newer and cleaner commercial vehicles		Q4 2008	-		Scheme still being devised			
		• Reform in Vehicle Registration Tax Regime	Ongoing	Q1 2008	-	-		0.08	-	
Employment	17	Preventive and active labour market policies for increasing the overall employment rate	On-going	Q1 2008	Q4 2010	-	0.03	0.03	0.03	-
	19	Addressing groups at risk: • Employment Aid Programme	Not yet initiated	Q1 2009	Q4 2010	-		0.05	0.05	-
		• Youth Employment Programme		Q4 2008	Q4 2010	-	___	0.01	0.01	-
		• Social Inclusion Partnership Programme		Q4 2008	Q4 2010	-	___	0.01	0.01	-
		Implementation of the Gender Equality Programme	Not yet initiated	Q4 2008	Q4 2010	-	___	0.01	0.01	-
	21	Promote a culture of health and safety: • Increase educational programmes to instill a culture of health and safety at work	On-going	Q1 2009	Q4 2010	-		0.01	0.01	-
		• Improve enforcement capabilities of the Occupational Health and Safety Authority	Not yet initiated							
		Implementation of Malta's Flexicurity Roadmap	Not yet initiated	Q4 2008	Q4 2010	-	Funded through Ministry's funds			-
	18, 24	Life long learning: • Training Aid Programme	Not yet initiated	Q1 2009	Q4 2010	-		0.05	0.05	-
		• MCAST scholarships		Q4 2009	Q4 2013			0.01	0.02	0.02
Education and training	23	Investing in educational system through the promotion of staff development	Not yet initiated	Q4 2009	Q4 2013	-		0.01	0.04	0.04

<table>
<tr><th colspan="11">NRP - Implementation Grid</th></tr>
<tr><td colspan="11">continued</td></tr>
<tr><th rowspan="3">Key challenges</th><th rowspan="3">Integrated Guidelines</th><th rowspan="3">Measure</th><th colspan="3">Implementation</th><th colspan="5">Direct budgetary costs (as a percentage of GDP)</th></tr>
<tr><th rowspan="2">Status</th><th colspan="2">Timeline</th><th rowspan="2">2007</th><th rowspan="2">2008</th><th rowspan="2">2009</th><th rowspan="2">2010</th><th rowspan="2">2011</th></tr>
<tr><th>Start</th><th>End</th></tr>
<tr><td rowspan="11">Education and training</td><td rowspan="11">24</td><td>Increase educational attainment and reduce early school leavers:
• Valuing all skills of the labour market</td><td rowspan="8">Not yet initiated</td><td rowspan="5">Q4 2009</td><td rowspan="5">Q4 2013</td><td rowspan="11">-</td><td rowspan="11">0.04</td><td rowspan="11">0.17</td><td rowspan="11">0.16</td><td rowspan="11">0.15</td></tr>
<tr><td>• Addressing skills mismatches in the aviation industry</td></tr>
<tr><td>• Parents and children fusion ICT training programme</td></tr>
<tr><td>• Launch of two new evening programmes for adults addressing skills gaps in emerging growth sectors at MCAST</td></tr>
<tr><td>• Launch of two new evening programmes for adults addressing skills gaps in emerging growth sectors at the University of Malta</td></tr>
<tr><td>• Open, distance and e-learning strategies, tools and programmes by MCAST, ITS, and the University of Malta</td><td>Q4 2008</td><td>Q4 2013</td></tr>
<tr><td>• Reform Education Act Cap327</td><td>Q4 2008</td><td>Q4 2009</td></tr>
<tr><td>• Launch of Quality Assurance Agency</td><td>Q4 2009</td><td></td></tr>
<tr><td>• Sustaining Students Maintenance Grants</td><td>On-going</td><td></td><td></td></tr>
<tr><td>• Malta Government Scholarship Schemes (MGSS) Undergraduate Scheme</td><td>Not yet initiated</td><td>Q4 2009</td><td>Q4 2010</td></tr>
</table>

6. Sustainability of Public Finances

6. Sustainability of Public Finances

There is a growing recognition that ageing populations will pose major economic, budgetary and social challenges in the coming decades. In particular, ageing could lead to significant pressures to increase public spending, making it difficult for countries to maintain sound and sustainable public finances in the long term. Demographic shifts and their implications on the future operation of welfare systems and Government revenue streams represent a central issue in the effort of achieving long-term fiscal sustainability. This indicates that in order to secure sustainable public finances, a long-term view of the evolution of public finances is required.

As a result of the demographic shifts, the outlays on pensions paid by Government will rise over the next twenty years leading to a worsening in the balance of the current system. In light of these developments, in December 2006, the House of Representatives formally adopted a bill reforming the public pension system. Some of these measures entered into force as from 2007, while others shall come into force as from the 1 January 2011.

This Chapter provides an assessment of Malta's long-term sustainability of public finances. The set of projections being presented is based on the common budgetary projections for the EU25 Member States on the basis of common assumptions as prepared by the Economic Policy Committee (EPC) in 2006. It is important to point out that Malta has reservations with regards to the population projection figures presented by the EPC. These population projections include the assumption that the workforce will increase annually by an average of around 2,500 during the forecast period, thus leading to a higher influx of immigrants than under the local population projections. This influx is leading to a significantly higher growth in Malta's population by the year 2050 under the EPC projections. It is important to remark, that the pension projections presented in this Chapter do not incorporate the impact of reform measures adopted in 2006. These reforms are described and assessed in the latter part of this Chapter.

At this juncture, it is important to note that the EPC Ageing Working Group and Commission Services are currently preparing a new set of long-term age-related expenditure projections on the basis of an updated set of demographic and macroeconomic assumptions. This work is expected to be completed in 2009.

6.1 Projections based on the work of the Economic Policy Committee

This section provides an analysis of the long-term sustainability of public finances on the basis of the 2005 EPC projections of age-related expenditure. Budgetary projections over the long-term are based on a common set of demographic and macroeconomic assumptions that ensure comparability of results and equal treatment among member states.

The pension projections are based on simulations carried out using the Pension Reform Option Simulation Toolkit (PROST) model. The PROST input files were updated on the basis of the assumptions of the Ageing Working Group. The variables included in the assumptions as provided by the EPC are the real GDP growth rates, inflation rates, population projections, participation rates and unemployment rates. A number of variables included in the assumptions as provided by the EPC were not incorporated in the PROST workings, primarily due to the fact that such variables are not required as PROST inputs. The demographic and macroeconomic assumptions used are listed in Malta's Update of the Convergence Programme 2005-2008.

6.1.1 Demographic Developments

Population projections based on the EPC underlying assumptions are presented in Table 6.1, which shows a breakdown of the population into three main age brackets. Total population is projected to grow to around 487,000 by 2030 and increase further to around 513,000 by 2050. It is pertinent to note that under this scenario it is assumed that net migration will amount to an annual average of around 2,500 during the projection

Population Trends
(based on Economic Policy Committee Assumptions)

Table 6.1

	2003	2010	2020	2030	2050
	Total population				
0-15 yrs	80,742	75,154	77,048	79,654	79,854
16-61 yrs*	254,618	269,391	273,070	280,802	281,521
61+ yrs	63,169	80,509	109,553	126,975	151,659
Total	398,529	425,054	459,671	487,431	513,034
	Percentage of total population				
0-15 yrs	20.3	17.7	16.8	16.3	15.6
16-61 yrs*	63.9	63.4	59.4	57.6	54.9
61+ yrs	15.9	18.9	23.8	26.0	29.6
	Demographic dependency ratio				
0-15 yrs	31.7	27.9	28.2	28.4	28.4
61+ yrs*	24.8	29.9	40.1	45.2	53.9
Total	56.5	57.8	68.3	73.6	82.2
	Support ratio				
16-61 yrs*/61+ yrs	4.0	3.3	2.5	2.2	1.9

* Figures based on pension system prior to the reform, where pension age was 60 years for females and 61 years for males

Note: Figures may not add up due to rounding

Source: PROST

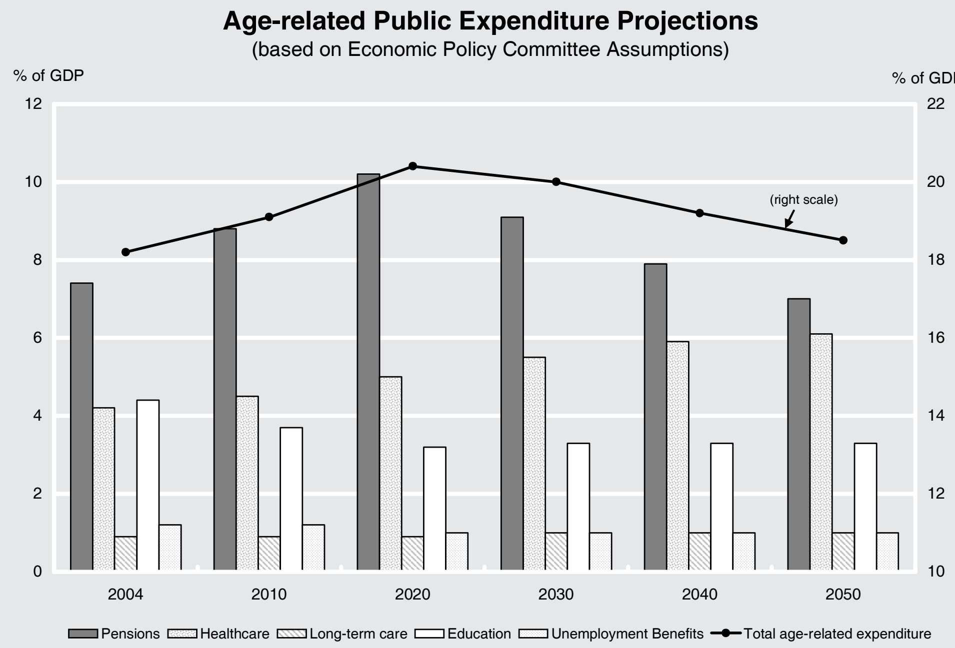
period up to 2050. The share of the sixty-one plus is projected to grow from 15.9 per cent in 2003 to 18.9 per cent in 2010 and then rise persistently to reach 29.6 per cent in 2050. The youth ratio (0-15 year olds as a proportion of those within the 16-61 years bracket) is expected to decrease by 3.3 percentage points by 2050 compared to 2003. The old-age dependency ratio is expected to increase as from 2010, with a more pronounced effect in 2020 where it will reach around 40.1 per cent and then it will continue to rise to 53.9 per cent by 2050. By 2050, the total dependency ratio will amount to 82.2 per cent, which means that every person in the working age population will have to support around 0.8 non-active persons compared to 0.6 non-active persons in 2003. The support ratio declines steadily over the projection period, reaching 1.9 by 2050. This means that while in 2003 there were around 4 persons of working age for every person that reached pension age, by 2050 this ratio will decrease to around 2 persons of working age for every person that reaches pension age.

6.1.2 Age-related Public Expenditure

Age-related spending comprises public expenditure on pensions, healthcare, long-term care, unemployment benefits and education expenditure and is projected to increase by 0.3 percentage points of GDP between 2004 and 2050. Chart 6.1 shows the age-related public expenditure as a share of GDP for the projection period. Appendix Table 7 shows the projections for age-related public expenditure and the assumptions used.

Public expenditure on pensions is the single most important age-related government expenditure item, both in terms of its current and projected size. The pension payments covered in the exercise take into account the contributory benefits that include the two-thirds retirement pension, survivors' pension and the invalidity pensions. Private pension schemes in Malta are of relatively minor importance. Expenditure on pensions is projected to fall by 0.4 percentage points between 2004 and 2050. As regards the starting position in 2004, public pension spending accounted for 7.4 per cent of GDP, being expected to reach the peak in 2020 with a level of 10.2 per cent of GDP, and then decline to 7.0 per cent of GDP by 2050.

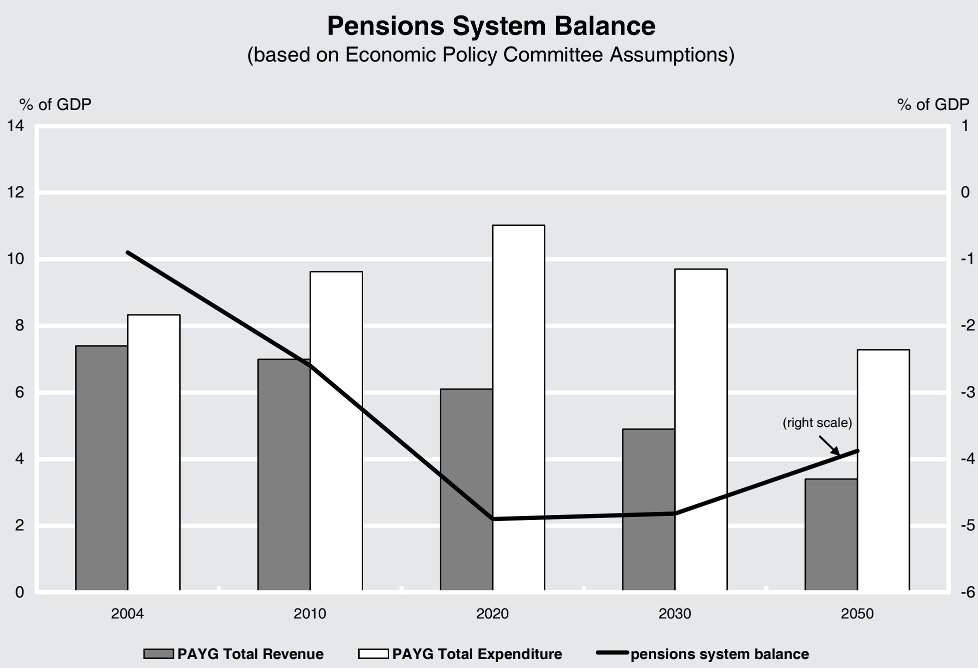
Chart 6.1



Public expenditure on healthcare is projected to increase from a level of 4.2 per cent in 2004 to 6.1 per cent of GDP by 2050, an increase of 1.8 percentage points over the projection period. Meanwhile, expenditure on long-term care is expected to increase by 0.2 percentage points of GDP, from a level of 0.9 per cent of GDP in 2004 to 1.1 per cent in 2050. Expenditure on unemployment benefits is projected to decline by 0.2 percentage points over the projection period, from a level of 1.2 per cent of GDP in 2004 to 1.0 per cent of GDP in 2050, while expenditure on education is projected to decline from 4.4 per cent of GDP in the starting year, to 3.3 per cent of GDP in 2050.

Chart 6.2 presents the main developments in PAYG Total Revenue, PAYG Total Expenditure and Pensions System Balance on the basis of the EPC common assumptions. The PAYG Total Revenue follows a declining trend from 7.4 per cent of GDP in 2004 to 3.4 per cent of GDP by 2050. Meanwhile, PAYG Total Expenditure

Chart 6.2



is on a rising trend up to around 2020, declining to around 7.3 per cent of GDP by 2050. As a result, the pension system balance worsens from a deficit of 0.9 per cent of GDP in 2004 to 4.9 per cent of GDP in 2020. In subsequent years, the pension system deficit is projected to narrow, reaching 3.9 per cent of GDP by 2050.

6.2 The Pension Reform Act

Act No. XIX of 2006 entitled the Social Security (Amendment) (No. 2) Act was published in the Supplement of the Government Gazette on the 7 December 2006, after it was formally adopted by the House of Representatives. By virtue of Legal Notice 336 published in the Malta Government Gazette of the 29 December 2006, Government announced the dates when provisions of the Social Security (Amendment) (No. 2) Act, will enter into force. Some of these measures entered into force as from 2007 while others shall come into force as from the 1 of January 2011. The main reform measures are outlined in Table 6.2. This Act mainly provides changes in the following:

Definition of 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, subject to a number of conditions. As outlined in Table 6.2, in the case of a person born on or before the 31 December 1951, pension age shall remain unchanged; in the case of a person born during the calendar years 1952 to 1955, pension age shall be sixty-two years; for persons born during the period 1956 to 1958, pension age shall be sixty-three years; for persons born in the period 1959 to 1961, pension age shall be sixty-four years.

Retirement before 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 50 contributions over a 30 year contributions period upon reaching pension age. Fewer years of contributions 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 person who has attained the age of sixty-one years but has not yet attained pension age, may after reaching 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 1 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.

Full rate of Two-Thirds Pension

Prior to the enactment of the reform, the full rate of the Two-Thirds Pension was equal to two-thirds of the pensionable income of the claimant subject to a ceiling, who has paid or has been credited with a yearly average of 50 contributions over a period of 30 years. Under the reform law, the period of contribution was changed as follows:

i 30 years in the case of a person born on or before the 31 December 1951;

ii 35 years for a person born during calendar years 1952 to 1961; and

iii 40 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 shall be assessed on any period of 40 years between the first

Pension Reform: Summary of Selected Measures
Table 6.2

	Pension Age			
	Before		After	
	Males	Females	Males	Females
2004	61	60	61	60
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 Janaury 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 shall be determined as the yearly average of the basic wage/ salary/net income/net earnings of the best ten years within the last forty 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

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.

Calculations of Pensionable Income

Prior to the pension reform, the pension was determined on the basis of the yearly average of the basic wage during the best three years of the last ten years in the case of gainfully-occupied persons 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 shall be 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.

The Maximum Pensionable Income

Maximum pensionable income, prior to the reform, was fixed by law at €15,723.27 and was revised in recent years in line with the cost of living adjustment (COLA)[1]. The maximum pensionable income has now changed as follows: 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, shall 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 €17,470.30; (ii) in the case of a person born during calendar years 1952 to 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 to 2010; (ii) €16,207.78 increased on the 1 January of each year between 2011 and 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 can also 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 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 subject to the ceilings previously mentioned.

Following the pension reform, persons born after the 1 January 1962 will have their pension updated annually by such a sum that corresponds to seventy per cent of the increase in the national average wage and thirty per cent of the inflation rate as published by 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. The first report shall be submitted by not later than the end of 2010, and shall then be discussed by the Social Affairs Committee of the House of Representatives.

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.

6.2.1 Illustration of the Impact of the Reform

As described in the previous section, the pension reform adopted by the Maltese Parliament is composed of a number of measures that may have differing implications for employment, the number of pensioners and total expenditure on pensions.

Changes in the Pension Age

Prior to the reform, the pension age stood at sixty years for females and sixty-one years for males. The gradual introduction of a higher pension age and the consequent lengthening of the working life are expected to result in a gradual reduction in the number of pensioners at each point in time - a development having a positive effect on the pensions system balance.

Changes to the Contribution Period and the Calculation of Pensionable Income

The changes in the contribution period and the calculation of pensionable income are expected to have no impact on the number of pensioners and the employment levels. Moreover, by themselves these parametric changes are expected to result in a reduction of the generosity of the pension system.

Changes to the Maximum Pensionable Income, Pension Indexation and the Guaranteed National Minimum Pension

The changes to the maximum pensionable income, pension indexation and the guaranteed national minimum pension are expected to have no impact on the number of pensioners and employment levels. However, in view of dynamics of the Maltese pension system, especially the presence of a cap on pensionable income, these measures by themselves are likely to increase expenditure on pensions relative to the pre-reform scenario, thereby improving the adequacy of pensions.

Thus, in balance, one may conclude that the pension reform in Malta is likely to result in an increase in the number of employees coupled with decreases in the number of pensioners. Additionally, the combination of measures enlisted here are likely to result in an increase in total pension expenditures whilst enhancing the adequacy of the pension system in the future.

Footnote:

[1] COLA is a flat rate increase in wages and pensions (the latter granted in full as from Budget for 2008) that reflects the indexation of the basic wage to the average inflation of the last 12 months to September of that year. In 2007, the basic wage was around 17 per cent higher than the National Minimum Wage that came into effect on 1st January 2007.

7. Institutional Features of Public Finances

7. Institutional Features of Public Finances

The Maltese Government recognises the importance of fiscal governance in order to ensure that appropriate budgetary policies are pursued. Furthermore, the effective and efficient functioning of public administration can play an important role in achieving a growth supportive environment.

Over the recent years, significant improvements have been achieved in the provision of public services. Achieving modern, high quality and customer-focused public services remains a key Government priority. Moreover, such objective must be achieved whilst ensuring that the available financial resources are spent, and the human resources are deployed, in the most efficient and effective manner. The smoothing capacity of automatic stabilisers may be limited for small open economies such as Malta. Thus, the adjustment capacity of the Maltese economy within the Euro Area may be facilitated through enhancing the flexibility and efficiency of public spending.

7.1 Budgetary Procedure

In recent years, Government has published a pre-Budget document outlining the state of the economy and Government's vision for Malta's economic and social development as well as Government's policies in various spheres. This consultation document, intended as a precursor to the Budget, also presents Government's views and options regarding the priorities and measures under consideration for the forthcoming Budget. This document is the basis for consultation amongst the widest possible range of stakeholders and is extended to engage all strata of society, social partners, civil society and the general public in addition to the Malta Council for Economic and Social Development (MCESD).

Meanwhile, planning of public expenditure and revenue takes place through three-year Business and Financial Plans prepared by Ministries and Government Departments in perspective of Government's overall economic and social targets within the framework of the fiscal programme. These Financial Business Plans are in turn reflected in the Budget presented and discussed on an annual basis in Parliament, with discussions leading to the approval of the Financial Estimates of the various Ministries. Once the Financial Estimates of the various Ministries are approved by Parliament, it is the responsibility of Permanent Secretaries and Heads of Departments to ensure that the Budget is implemented as planned and that the global financial allocation is not exceeded.

7.1.1 Control and Effectiveness of Public Expenditure

Government is committed to ensure that resources are employed in the most efficient manner. As health constitutes a main component of Government expenditure, increasing focus is being made on ensuring that expenditure on health services is spent effectively, efficiently and without any waste or abuse. In the Budget for 2009, half a million Euros are earmarked for the engagement of a number of Cost Controllers entrusted with the task of ensuring that the health services offered to the public are cost-effective and efficient. This will result in the reallocation of resources towards more efficient uses enabling the provision of better health services.

7.2 Fiscal Targets and Institutions Supporting the Budgetary Framework

Fiscal policy and budgetary surveillance are formulated on the basis of national objectives within the context of the Stability and Growth Pact. Annual fiscal targets on deficit and debt ratios are set by Government and act as guiding principles for conducting fiscal policy.

The Budget Affairs Division within the Ministry of Finance, the Economy and Investment is entrusted with the monitoring of the financial performance of Ministries and Departments, as well as public sector organisations, in particular those that either depend on a Government subvention for their operations or contribute towards the Government Budget through part of their profits. Consequently, the Division ensures that the annual contributions voted in the Financial Estimates in favour of public organisations are utilised efficiently. Financial control, discipline and cost effectiveness are also fostered 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 who is also responsible for the day-to-day cash-flow position of the operations of Government. Moreover, the system and procedure used in Government accounting within Ministries and Government Departments is scrutinized by the Internal Audit and Investigations Directorate. Furthermore, the accounts of all departments and offices of Government are audited and reported upon annually by the Auditor General to the House of Representatives. 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 to ensure a more transparent scrutiny of how public finances have been utilised.

With regards to Public Debt, the Treasury 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.

7.2.1 Institutions Supporting the Absorption of European Funds

The Planning and Priorities Co-ordination Division (PPCD) forms an integral part of the administrative infrastructure required to manage the funds allocated to Malta by the EU. The PPCD, acting as a Managing Authority, aims to ensure the efficient absorption and management of European assistance, both EU and bilateral, through effective coordination across Government Departments, Authorities, Agencies and other stakeholders. Apart from providing the above-mentioned services, PPCD also ensures maximum transparency and information in relation to the funds which fall under its responsibility. This function is carried out through the organisation of training sessions, information activities and communication with the media, potential applicants for funding and the general public.

The European Union (Paying Authority) Directorate within the Ministry of Finance, the Economy and Investment is entrusted with the certification of the declarations of expenditure and applications for payment. As the Certifying Authority, the EU Paying Authority certifies expenditure and subsequent drawdown of EU funds, manages accounts in connection with receipts and payments of EU-related funds, and disburses funds relating to Own Resources as part of Malta's contribution to the EU Budget.

Meanwhile, the Internal Audit and Investigations Directorate (IAID) within the Office of the Prime Minister, is entrusted with the performance of financial investigations into suspected cases of mismanagement and fraud. Indeed, the IAID is assigned responsibility for the conduct of the Government Internal Audit and Financial Investigations function.

Statistical Appendix

Macroeconomic Prospects

Table 1a

Percentages unless otherwise indicated	ESA Code	2007[1]	2007	2008[2]	2009	2010	2011
1. Real GDP	B.1g	4,477.0	3.7	2.8	2.2	2.5	2.8
2. Nominal GDP	B.1g	5,415.0	6.3	6.0	4.4	4.6	4.4
Components of real GDP							
3. Private consumption expenditure[3]	P.3	2,878.9	1.6	3.5	2.1	2.0	2.2
4. Government consumption expenditure	P.3	839.3	-0.1	4.3	2.9	-0.3	-2.0
5. Gross fixed capital formation	P.51	912.2	4.1	3.6	4.0	3.6	2.9
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53	132.9	3.0	2.2	2.2	2.2	2.2
7. Exports of goods and services	P.6	4,266.1	-4.1	-5.3	-3.1	—	1.4
8. Imports of goods and services	P.7	4,552.4	-3.8	-4.7	-2.2	-0.5	—
Contribution to real GDP growth							
9. Final domestic demand		4,630.4	1.9	3.8	2.8	2.0	1.7
10. Change in inventories and net acquisition of valuables	P.52+P.53	132.9	1.9	-0.7	—	0.1	—
11. External balance of goods and services	B.11	-286.3	-0.1	-0.3	-0.6	0.4	1.1

(1) € million

(2) Forecasts from 2008 onwards

(3) Includes NPISH final consumption expenditure

Price Developments

Table 1b

Percentages unless otherwise indicated	ESA Code	2007(1)	2007	2008(2)	2009	2010	2011
1. GDP deflator		121.0	2.5	3.1	2.2	2.0	1.6
2. Private consumption deflator		114.9	1.6	4.2	2.9	2.6	2.4
3. Harmonised Index of Consumer Prices		103.3(3)	0.7	4.5	2.7	2.3	2.0
4. Public consumption deflator		124.3	2.5	2.7	2.9	2.8	2.3
5. Investment deflator		116.5	1.4	1.8	2.4	1.9	1.7
6. Export price deflator (goods and services)		113.8	6.0	7.9	3.9	3.1	2.5
7. Import price deflator (goods and services)		109.9	4.7	7.9	4.4	3.4	3.2

(1) Index (base 2000 unless otherwise indicated)
(2) Forecasts from 2008 onwards
(3) Average 2005=100

Labour Market Developments

Table 1c

Percentages unless otherwise indicated	ESA Code	2007	2007	2008[1]	2009	2010	2011
1. Employment, persons[2]		158.7[3]	2.7	3.0	1.3	1.3	1.5
2. Employment, hours worked[4]		307,795[3]	3.9	3.0	1.3	1.3	1.5
3. Unemployment rate[5]		10.7[3]	6.4	5.8	6.0	6.1	5.9
4. Labour Productivity, persons[6] (€)		28,218	0.9	-0.2	0.8	1.1	1.3
5. Labour Productivity, hours worked[7] (€)		14.5	-0.2	-0.2	0.8	1.1	1.3
6. Compensation of employees (€ million)	D1	2,323.5	4.4	5.9	4.2	4.1	3.9
7. Compensation per employee (€)		16,618	1.7	3.3	2.8	2.9	2.5

(1) Forecasts from 2008 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	2007	2008	2009	2010	2011
1. Net lending/ borrowing						
vis-à-vis the rest of the world	B.9	-5.5	-5.1	-3.1	-2.7	0.7
of which:						
Balance on goods and services		-2.9	-3.3	-4.3	-4.2	-3.5
Balance of primary incomes and transfers		-3.5	-2.8	-0.6	-0.4	2.4
Capital account		0.9	0.9	1.9	1.9	1.8
2. Net lending/ borrowing of the private sector	B.9	-6.6	-1.9	-1.4	-2.4	-0.3
3. Net lending/ borrowing of General Government	EDP B.9	-1.8	-3.3	-1.5	-0.3	1.2
4. Statistical discrepancy		2.9	0.0	-0.2	0.0	-0.2

General Government Budgetary Developments

Table 2

Percentages of GDP		ESA code	2007[1]	2007	2008	2009	2010	2011
Net Lending (EDP B9) by sub-sector								
1.	General Government	S13	-96.4	-1.8	-3.3	-1.5	-0.3	1.2
2.	Central Government	S1311	-95.8	-1.8	-3.3	-1.5	-0.3	1.2
3.	State Government	S1312	-	-	-	-	-	-
4.	Local Government	S1313	-0.6	—	—	—	—	—
5.	Social security funds	S1314	-	-	-	-	-	-
General Government								
6.	Total revenue	TR	2,200.3	40.6	40.6	41.7	41.8	41.9
7.	Total expenditure	TE	2,296.7	42.4	43.9	43.2	42.1	40.7
8.	Net lending / borrowing	EDP B9	-96.4	-1.8	-3.3	-1.5	-0.3	1.2
9.	Interest expenditure	EDP D41	182.1	3.4	3.3	3.4	3.3	3.2
10.	Primary balance		85.7	1.6	0.0	1.9	3.0	4.3
11.	One-off and other temporary measures[2]		34.7	0.6	0.3	0.3	0.1	0.1
Selected Components of Revenue								
12.	Total Taxes (12=12a+12b+12c)		1,541.8	28.5	28.4	28.8	29.2	29.4
12a.	Taxes on production and imports	D2	800.2	14.8	14.5	14.6	14.7	14.7
12b.	Current Taxes on Income, Wealth, etc.	D5	726.0	13.4	13.6	14.0	14.3	14.5
12c.	Capital Taxes	D91	15.7	0.3	0.2	0.2	0.2	0.2
13.	Social Contributions	D61	398.3	7.4	7.4	7.3	7.3	7.4
14.	Property Income	D4	73.6	1.4	1.3	1.0	1.0	0.9
15.	Other[3]		186.6	3.4	3.6	4.5	4.3	4.2
16=6.	Total Revenue	TR	2,200.3	40.6	40.6	41.7	41.8	41.9
p.m.:	Tax Burden (D2+D5+D61+D91-D995)[4]		1,965.3	36.3	36.2	36.6	36.9	37.1
Selected Components of Expenditure								
17.	Compensation of employees + intermediate consumption	D1+P2	995.7	18.4	18.6	18.7	18.0	17.4
17a.	Compensation of employees	D1	705.0	13.0	13.0	13.0	12.6	12.3
17b.	Intermediate consumption	P2	290.6	5.4	5.6	5.7	5.4	5.1
18.	Social payments (18=18a+18b)		699.0	12.9	14.1	13.6	13.5	13.4
18a.	Social transfers in kind supplied via market producers	D6311, D63121, D63131	32.3	0.6	0.6	0.6	0.6	0.6
18b.	Social transfers other than in kind	D62	666.8	12.3	13.5	12.9	12.9	12.8
19=9.	Interest expenditure	EDP D41	182.1	3.4	3.3	3.4	3.3	3.2
20.	Subsidies	D3	109.1	2.0	2.4	1.0	0.9	0.8
21.	Gross fixed capital formation	P51	217.0	4.0	3.4	4.4	4.4	4.0
22.	Other[5]		93.9	1.7	2.2	2.1	2.0	1.9
23=7.	Total Expenditure	TE	2,296.7	42.4	43.9	43.2	42.1	40.7
p.m.:	Government consumption (nominal)	P3	1,036.2	19.1	19.3	19.4	18.6	17.9

(1) € million
(2) A plus sign means deficit-reducing one-off measures
(3) P11+P12+P131+D39+D7+D9 (other than D91)
(4) Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate
(5) D29+D4 (other than D41)+D5+D7+D9+P52+P53+K2+D8

General Government Expenditure by Function

Table 3

	Percentages of GDP	COFOG Code	2006	2007	2008	2009	2010	2011
1.	General public services	1	6.7	6.4	7.1	7.7	7.8	7.4
2.	Defence	2	0.8	0.7	0.7	0.7	0.6	0.6
3.	Public order and safety	3	1.5	1.5	1.6	1.7	1.8	1.6
4.	Economic affairs	4	5.8	5.9	5.9	4.6	4.1	3.9
5.	Environmental protection	5	1.5	1.5	1.3	1.6	1.4	1.4
6.	Housing and community amenities	6	0.8	0.7	0.9	0.4	0.6	0.6
7.	Health	7	6.4	5.8	5.5	5.5	5.3	5.0
8.	Recreation, culture and religion	8	0.6	0.6	0.6	0.7	0.5	0.5
9.	Education	9	5.6	5.5	5.5	5.9	5.7	5.4
10.	Social protection	10	14.0	13.8	14.8	14.4	14.3	14.2
11.	Total Expenditure	TE	43.6	42.4	43.9	43.2	42.1	40.7

General Government Debt Developments

Table 4

Percentages of GDP	ESA Code	2007	2008	2009	2010	2011
1. Gross debt		62.2	62.8	61.9	59.8	56.3
2. Change in gross debt ratio		-1.6	0.6	-0.9	-2.1	-3.5
Contributions to changes in gross debt						
3. Primary balance		-1.6	0.0	-1.9	-3.0	-4.3
4. Interest expenditure	EDP D.41	3.4	3.3	3.4	3.3	3.2
5. Stock-flow adjustment		0.4	0.8	0.2	0.3	0.2
p.m. implicit interest rate on debt[1]		5.6	5.7	5.6	5.5	5.5

[1] Proxied by interest expenditure divided by the debt level of the previous year.

Cyclical Developments

Table 5

Percentages of GDP	ESA Code	2007	2008	2009	2010	2011
1. Real GDP growth (%)		3.7	2.8	2.2	2.5	2.8
2. Net lending of General Government	EDP B.9	-1.8	-3.3	-1.5	-0.3	1.2
3. Interest expenditure	EDP D.41	3.4	3.3	3.4	3.3	3.2
4. One-off and other temporary measures(1)		0.6	0.3	0.3	0.1	0.1
5. Potential GDP growth (%)		2.7	2.6	2.3	2.0	2.0
contributions:						
- labour (hours)		1.4	1.2	0.8	0.5	0.4
- capital		1.2	1.2	1.2	1.2	1.2
- total factor productivity		0.1	0.2	0.3	0.3	0.4
6. Output Gap		-0.6	-0.4	-0.5	-0.1	0.7
7. Cyclical Budgetary Component		-0.2	-0.2	-0.2	0.0	0.3
8. Cyclically-Adjusted Balance (2-7)		-1.6	-3.1	-1.3	-0.2	0.9
9. Cyclically-Adjusted Primary Balance (8+3)		1.8	0.2	2.1	3.1	4.1
10. Structural Balance (8-4)		-2.2	-3.5	-1.6	-0.4	0.8

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

Divergence from the December 2007 Stability Programme

Table 6

Percentages of GDP	ESA Code	2007	2008	2009	2010	2011
Real GDP growth						
Previous update		3.5	3.1	3.2	3.4	…
Current update		3.7	2.8	2.2	2.5	2.8
Difference		0.2	-0.3	-1.0	-0.9	-
General Government net lending	EDP B.9					
Previous update		-1.6	-1.2	-0.1	0.9	…
Current update		-1.8	-3.3	-1.5	-0.3	1.2
Difference		-0.2	-2.1	-1.4	-1.2	-
General Government gross debt						
Previous update		62.9	60.0	57.2	53.3	…
Current update		62.2	62.8	61.9	59.8	56.3
Difference		-0.7	2.8	4.7	6.5	-

Long-term Sustainability of Public Finances

Table 7

Percentages of GDP	**2004**	**2010**	**2020**	**2030**	**2050**
Total Expenditure	-	-	-	-	-
of which: age-related expenditures	18.2	19.1	20.4	20.0	18.5
Pension expenditure	7.4	8.8	10.2	9.1	7.0
Social security pensions*	-	-	-	-	-
Old-age and early pensions	3.8	5.2	7.0	6.9	6.5
Other pensions (disability, survivors)	3.6	3.6	3.2	2.2	0.5
Occupational pensions	-	-	-	-	-
Health care	4.2	4.5	5.0	5.5	6.1
Long-term care	0.9	0.9	0.9	1.0	1.1
Educational expenditure	4.4	3.7	3.2	3.3	3.3
Other age-related expenditures					
Interest expenditure	-	-	-	-	-
Total revenue	-	-	-	-	-
of which: property income	2.2	1.2	1.1	0.7	0.3
of which: from pensions contributions	7.1	6.8	5.9	4.7	3.3
Pension reserve fund assets	-	-	-	-	-
of which: consolidated public pension fund assets	-	-	-	-	-
			Assumptions		
Labour productivity growth	1.4	0.9	2.4	2.7	1.7
Real GDP growth	1.9	2.5	2.7	3.1	1.7
Participation rate males (aged 16-61)	84.2	85.8	86.3	86.4	86.4
Participation rate females (aged 16-60)	40.9	48.1	55.3	57.8	58.3
Total participation rates (aged 16-61)	62.6	66.7	70.4	71.6	71.7
Unemployment rate (aged 16-61)	9.0	9.4	9.0	8.8	8.6
Population aged 61+ over total population	15.9	18.9	23.8	26.0	29.6

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

Note: Figures may not add up due to rounding

Basic Assumptions

Table 8

	2007	2008	2009	2010	2011
Short-term interest rate (annual average)	4.3	4.6	3.5	4.1	4.1
Long-term interest rate (annual average)	4.7	4.9	4.8	4.9	4.9
USD/€ exchange rate (annual average)	1.37	1.48	1.36	1.36	1.36
Nominal effective exchange rate	3.1	2.5	-2.9	-2.9	-2.9
World excluding EU, GDP growth	5.6	4.3	2.9	3.8	3.8
EU GDP growth	2.9	1.4	0.2	1.1	1.1
Growth of relevant foreign markets	2.4	1.1	-0.2	0.7	0.7
World import volumes, excluding EU	7.2	6.0	3.1	4.7	4.7
Oil prices, (Brent, USD/barrel)	73.0	104.0	86.0	89.0	89.0