



**Malta:**

**Update of Stability Programme**

**2009 - 2012**

**Ministry of Finance, the Economy and Investment**  
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The following symbols have been used throughout this document:

... to indicate that data are not available;

— to indicate that the figure is negligible;

0 to indicate that the figure is zero;

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

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

Figures may not add up due to rounding.

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# Introduction

This Programme constitutes the second update of Malta's Stability Programme, which was submitted in 2007. The first update was submitted in December 2008. This Programme 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 stability and convergence programmes, endorsed by the ECOFIN Council on 10 November 2009. This Programme takes account of the Recommendation of the Ecofin Council to Malta of 16<sup>th</sup> February under Article 126(7) of the Treaty on the Functioning of the European Union to bring to an end the situation of an excessive government deficit.

This document was compiled by the Ministry of Finance, the Economy and Investment, with an important contribution from the National Statistics Office as well as from other Ministries and entities. The programme includes eight sections: Chapter 1 presents Government's economic policy objectives; Chapter 2 provides the projections for the main macroeconomic variables for the medium term; Chapter 3 outlines the medium-term fiscal projections and debt developments and Malta's medium term budgetary objective; Chapter 4 contains a sensitivity analysis of the budgetary projections as well as a comparison between the current macroeconomic forecasts and those presented in the December 2008 Update of the Stability Programme; Chapter 5 includes a review of the Budget for 2010 and outlines the integration with the National Reform Programme; Chapter 6 provides an analysis of the long term sustainability of public finances; Chapter 7 reviews the institutional features of public finances; and Chapter 8 reports on the implementation of the Council Recommendations to correct the excessive deficit situation.





## 1. Overall Policy Framework and Objectives

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# 1. Overall Policy Framework and Objectives

Government continues to maintain its macroeconomic policy objectives aimed at pursuing sustainable economic growth and further convergence towards EU average income levels. To achieve these overall goals, Government maintains its commitment towards fiscal sustainability over the medium term, whilst aiming to achieve low and stable inflation and pursuing a high employment level and a low unemployment rate.

At the current juncture, Government's immediate objective is to adopt a fiscal stance which supports the still uncertain economic recovery. On a longer term basis, Government remains committed to adopt a more restrictive fiscal stance so as to ensure a sustainable fiscal position. Furthermore, Government is undertaking various measures to expand the growth potential of the economy, by increasing productivity and improving competitiveness, which, coupled with a stable macroeconomic environment, will achieve stronger growth over the medium term.

The financial crisis impacted on the Maltese economy through a downturn in global demand for domestic goods and services. In particular, export-oriented manufacturing sectors and the tourism industry were particularly hard hit. The international crisis seems to be having a lagged impact on domestic economic performance, with latest available data showing that the decline in GDP was most accentuated as from the second quarter of 2009. It is being estimated that the Maltese economy might have contracted by 2 per cent in 2009. Similar macroeconomic developments affected negatively the budgetary performance, particularly those tax components of related to consumption and to transactions in the property sector. Moreover, in 2009, Government implemented various measures aimed at supporting economic activity and employment levels. For 2009 the general Government deficit is expected at 3.8 per cent of GDP.

It is expected that economic growth will turn positive in 2010, but this recovery is still subject to a high degree of uncertainty. Within this context, Government's short term priority is to assist the economic recovery and support employment. Government is thus aiming to broadly stabilise the deficit ratio at 3.9 per cent of GDP in 2010, so as not to jeopardise the attainment of a sounder public finance position over the medium term. The Budget for 2010 announced various support measures, mainly earmarked to encourage investment and employment, as well as a number of fiscal consolidation measures.

In line with the revised Recommendation by the Ecofin Council of 16<sup>th</sup> February, Government will adopt a more restrictive fiscal stance and reduce the deficit to below 3 per cent of GDP as soon as the economic recovery gains momentum in 2011. This consolidation will be implemented through the phasing out of support measures, expenditure restraint, including restricting government employment, as well as through the impact of the improvement in economic performance.

This fiscal trajectory, whereby the deficit falls to 2.8 per cent by 2012, ensures that the debt to GDP ratio returns on a downward trend in the outer years of the Programme. Government's medium term budgetary objective remains that of a balanced structural budget over the cycle. Government remains committed to achieving this target, as it would ensure a stable and sustainable debt ratio, would help better meet rising costs associated with an ageing population and would facilitate the adoption of counter-cyclical fiscal responses, particularly in times of slower growth rates. This objective will not however be reached within the Programme period.

To ensure a sustainable fiscal position, Government is examining the national budgetary framework with a view to strengthen the institutional and legislative aspects, particularly those relating to discipline in budgetary execution and integration of the medium term strategy in budgetary formulation. Government is also intensifying its efforts to curb abuse of social benefits and to fight tax evasion. In the context of the challenges posed by the ageing population, improving the long term sustainability of public finances constitutes a key priority. A report reviewing the state of pensions in Malta together with recommendations for achieving further adequacy,

sustainability and social solidarity will be finalised in 2010. As regards the health care system, efforts are largely being focused on improving efficiency of expenditure.

Government is also aiming to improve the economy's growth potential over the medium term. Indeed, the short-term stimulus measures being implemented include specific measures earmarked to improve the physical infrastructure and to encourage investment by the private sector, especially by small and medium sized enterprises and by a host of emerging higher value added sectors. Efforts are also directed towards supporting the labour market through the provision of training opportunities, the improvement of the skill level of human resources and through active labour market measures which encourage job creation. In addition, emphasis is being laid on the need to reverse the cyclical increase in unemployment over the short- to medium-term. These measures should favourably position the domestic economy to exploit the growth opportunities that will be generated once the international economic recovery is firmly established.

Concurrently, as highlighted in Malta's National Reform Programme 2008-2010, the Government is continuing with the implementation of its structural reform programme. This programme focuses on five strategic elements: the sustainability of public finances, competitiveness, employment, education and training and the environment. In view of an increasingly competitive international environment, cost competitiveness remains key to ensure sustainable economic growth. Government will continue to dismantle anti-competitive behaviour in specific sectors of the economy. The strengthening of the regulatory institutions which oversee market competition and consumer protection and the liberalization of hitherto regulated sectors are of paramount importance. Market imperfections would thus be addressed and price flexibility enhanced. Furthermore, efforts will be directed to diversify the economy in particular through the promotion of high value added growth sectors. This is in line with Government's Vision 2015 which aims to position Malta as a centre of excellence in the fields of information and communications technologies, financial services, tourism, high value added industry and services, as well as in international educational services and health services. Success in attracting these high value added industries depends on the availability of human resources with the necessary skills and competencies. Thus, investment in education and training is a key requirement.

Summing up, Government will retain its focus on the attainment of a stable macro-economic environment of the medium term, with a healthy fiscal position and a leaner economy which can more rapidly respond to an ever-changing economic environment. This requires a longer term commitment towards continued structural reform within the economy so as to improve competitiveness and increase productivity.





## 2. Economic Outlook

### 2.1 The Medium-Term Scenario

During the first half of 2009, GDP growth was negative in all the major economies, with GDP expected to have fallen by around 4.0 per cent in both the EU and Euro Area. However, the latest indicators reinforce the view that the significant contraction in global economic activity has come to or is nearing an end, both in emerging and developed economies. This positive development is widely credited to the wide-ranging public intervention by Governments and Monetary Authorities that supported demand, lowered uncertainty and averted a meltdown of the financial system. In fact, the latest forecasts of Consensus Forecasts and the European Commission have revised upwards growth prospects for 2010 in the euro area and the US. On a more cautionary note, one highlights that the sustainability of the improvement in global economic activity still has to be ascertained as the stimulus measures start to be withdrawn over the course of 2010. In addition, uncertainty surrounding future developments in the international environment remains high as financial systems remain impaired while households that suffered the negative consequences associated with asset price busts will continue to rebuild their savings.

Given the high degree of openness of the Maltese economy, these international developments weighed heavily on Malta's economic performance. In particular, the manufacturing sector and the tourism industry suffered a significant downturn with negative consequences on the labour market. On a broader level, in the first three quarters of 2009, the Maltese economy registered a negative growth of 2.4 per cent in real terms. This contraction was due to a lower domestic demand largely reflecting a marked fall of 20.4 per cent in investment. On the other hand, a marginal positive improvement was recorded in private consumption as well as an increase in Government expenditure. A positive contribution from the external sector was registered due to the fact that imports contracted more sharply than exports, with imports and exports declining by 11.3 per cent and 7.2 per cent, respectively.

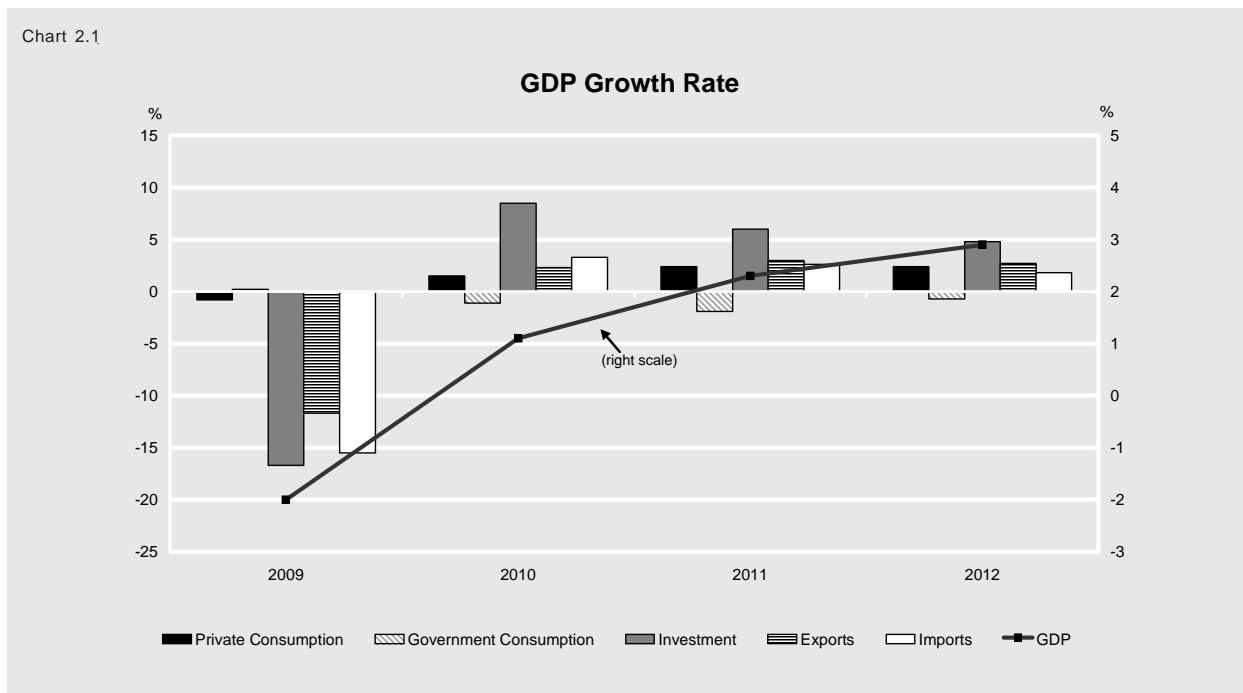
**Main Macroeconomic Indicators**

Table 2.1

	2007	2008	2009 <sup>(1)</sup>	2010	2011	2012
GDP growth at current market prices (%)	6.8	4.5	1.0	3.5	5.0	5.0
GDP growth at constant (2000) prices (%)	4.0	2.1	-2.0	1.1	2.3	2.9
<b>Expenditure Components of GDP at constant (2000) prices (% change)</b>						
Private final consumption expenditure <sup>(2)</sup>	2.1	4.9	-0.8	1.5	2.4	2.4
General government final consumption expenditure	0.0	12.6	0.2	-1.1	-1.9	-0.7
Gross fixed capital formation	1.2	-21.8	-16.7	8.5	6.0	4.8
Exports of goods and services	2.7	-5.4	-11.7	2.3	3.0	2.7
Imports of goods and services	1.2	-5.8	-15.5	3.3	2.6	1.8
Inflation rate (%)	0.7	4.7	1.8	1.7	2.0	2.0
Employment growth (%)	3.1	2.5	-0.4	0.2	0.7	0.9
Unemployment rate (%)	6.4	5.9	7.1	7.4	7.2	6.7
Labour productivity (% change)	0.6	-0.4	-1.6	0.9	1.7	2.0
External Goods and Services Balance (% of GDP)	-2.8	-3.2	1.6	1.0	1.7	2.2

<sup>(1)</sup> Forecasts from 2009 onwards, except for inflation for 2009

<sup>(2)</sup> Includes NPISH final consumption expenditure



Against this background, the Maltese economy is expected to have contracted by 2.0 per cent in real terms during 2009, in contrast to a growth of 2.1 per cent experienced during 2008. Looking towards next year and the forecast period, it is clear that the uncertainty attached to the outlook remains substantial, given the highly uncertain international economic environment. At the same time, it is expected that major government projects co-financed by the EU, coupled with government initiatives to support investment initiatives by business concerns will support aggregate economy activity in Malta. In 2010, GDP is expected to rise by around 1.0 per cent as growth rates in the main GDP components are expected to turn positive reflecting the pick up in manufacturing and tourism. Nevertheless, due to higher growth in imports the external sector is still expected to contribute negatively to GDP growth. Prospects for GDP growth are expected to improve in 2011 in light of the positive contribution from both the domestic and the external sectors of the economy. Table 2.1 presents the main macroeconomic indicators for the years 2007-2012. Chart 2.1 illustrates the projected growth rates of GDP together with a detailed breakdown of the various expenditure aggregates. The figures for 2007 and 2008 have been published by the National Statistics Office (NSO)<sup>1</sup>, whilst figures from 2009 onwards are forecasts. The macroeconomic forecasts take into account the latest available data and are being provided in Tables 1a, 1b, 1c, and 1d of the Statistical Appendix.

### 2.1.1 Assumptions for Projections

The forecasts presented in this section and the different sensitivity scenarios presented in this document were estimated using econometric techniques and analytical methods. The following are the main assumptions used in obtaining the base forecasts for 2009-2012. They are in line with those presented by the European Commission presented in the Autumn 2009 forecast.

- Economic activity in Malta's main trading partners is expected to deteriorate by 4.1 per cent in 2009 followed by positive growth rates of 1.0 per cent in 2010 and by 1.6 per cent thereafter. Inflation as measured by HICP is assumed at 1.8 per cent in 2009, 1.7 per cent in 2010 and by around 2.0 per cent thereafter.
- Oil prices are assumed to increase further in 2010, from an average US\$61.3 per barrel (€44.1 per barrel) in 2009 to US\$76.5 per barrel (€51.7 per barrel) in 2010 and to increase slightly thereafter
- Interest rates are assumed to increase during the forecast period while the Euro is expected to strengthen against the Dollar in 2010 and to remain stable thereafter.



- It is assumed that Government continues to implement its policy of restricting recruitment in non-essential categories.
- Changes in inventory are assumed not to contribute materially to GDP growth.

### **2.1.2 Risks to Outlook**

The medium-term outlook for the global economy is for a gradual recovery although a full recovery is still subject to a high degree of uncertainty and risk, with several factors restraining growth prospects. However, overall risks to the growth outlook are broadly balanced.

The recovery in Malta's main trading partners' economies could prove stronger than currently expected boosted by the temporary discretionary measures and by the turning of the inventory cycle. Furthermore, policy measures might boost the soundness of the financial sector and confidence. Such developments would have an expansionary effect on global demand and hence Malta's exports could also pick up more strongly. On the other hand, the performance of the external environment poses a number of downside risks to Malta's growth prospects. In particular, the effect of deteriorating labour market conditions on wage formation and saving behaviour could prove worse than expected, thus affecting demand for Malta's goods and services, particularly tourism. Moreover, if the international banking sector does not repair its balance sheet, the credit channel is likely to remain impaired posing a major downside risk to the sustainability of the recovery.

### **2.1.3 Private Final Consumption Expenditure**

Private final consumption expenditure is expected to have declined by 0.8 per cent in 2009, reflecting the slowdown in growth in compensation of employees, as well as lower consumer confidence in light of the worsening labour market conditions. Over the forecast period, growth in private final consumption expenditure is expected to gradually improve, increasing to 1.5 per cent in 2010 and reaching 2.4 per cent thereafter, making this component of GDP a driver of economic expansion in 2011 and 2012. These developments are in line with the improving economic conditions forecasted over the medium term.

### **2.1.4 General Government Final Consumption Expenditure**

Over the forecast period, growth in Government final consumption expenditure is projected to record growth rates that are significantly below the historical trend growth rates. In 2009, Government final consumption expenditure in real terms is expected to have increased marginally by 0.2 per cent, while it is expected to decrease by a 1.1 per cent in 2010. In both 2011 and 2012 Government final consumption expenditure is forecasted to decline further by 1.9 per cent and 0.7 per cent respectively. This reflects Government's fiscal consolidation strategy, whereby significant emphasis is being placed on the restraint of expenditure of a recurrent nature.

### **2.1.5 Gross Fixed Capital Formation**

The contribution of gross fixed capital formation is forecasted to be negative in 2009 with a decline of 16.7 per cent in real terms, as a result of decreases in private investment. However, investment activity is expected to be the main driving force for the following years, in light of upcoming public projects including those financed from EU Cohesion and Structural Funds as well as expected private investment projects.

In 2010 gross fixed capital formation is expected to increase by 8.5 per cent, while for 2011 and 2012 investment is forecasted to increase further by 6.0 per cent and 4.8 per cent, respectively.

## 2.1.6 External Balance of Goods and Services

Given the openness of the Maltese economy, Malta's economic performance tends to be highly sensitive to the international economic environment. The contraction in economic activity in Malta's main trading partners resulted in pronounced declines in both exports and imports, partly reflecting Malta's heavily export oriented manufacturing industry. The performance of the domestic tourism industry also suffered considerably with significant declines in the number of tourist departures.

During 2009, it is expected that exports have declined by 11.7 per cent while imports are projected to have decreased by around 15.5 per cent. As economic activity in Malta's main trading partners is expected to improve in the coming years, foreign demand for domestic exports is expected to recover. Thus, in 2010 exports are expected to increase by 2.3 per cent. This is slower than the expansion in imports that is expected at around 3.3 per cent, being driven by investment growth as well as a pick up in private consumption. The external sector is expected to continue picking up momentum and contribute positively to GDP growth in 2011 and 2012, where exports are expected to increase by 3.0 per cent and 2.7 per cent, respectively, while imports are expected to grow by 2.6 per cent and 1.8 per cent over the same period.

## 2.1.7 Productivity and Employment Prospects

Employment is expected to have decreased by 0.4 per cent in 2009. It is notable that the impact of the economic slowdown in Malta on the labour market was mitigated through a resort to reduced working hours instead of lay-offs. For 2010 employment growth is expected to turn again positive with a marginal increase of 0.2 per cent. Thereafter, in line with the expected improvement in the economic environment, employment is forecasted to grow by 0.7 per cent and 0.9 per cent in 2011 and 2012, respectively. Over this period, the increase in real GDP is expected to exceed the forecasted increase in employment. As a result, real labour productivity is expected to increase by around 1.0 per cent in 2010 and by around 2.0 per cent over the rest of the trajectory period.

In 2010, the unemployment rate (based on the Harmonised definition), is expected to increase to 7.4 per cent, from 7.1 per cent in 2009. Thereafter, the unemployment rate is projected to fall, reaching 6.7 per cent in 2012, thus remaining higher than the levels observed in recent years.

## 2.1.8 Inflation

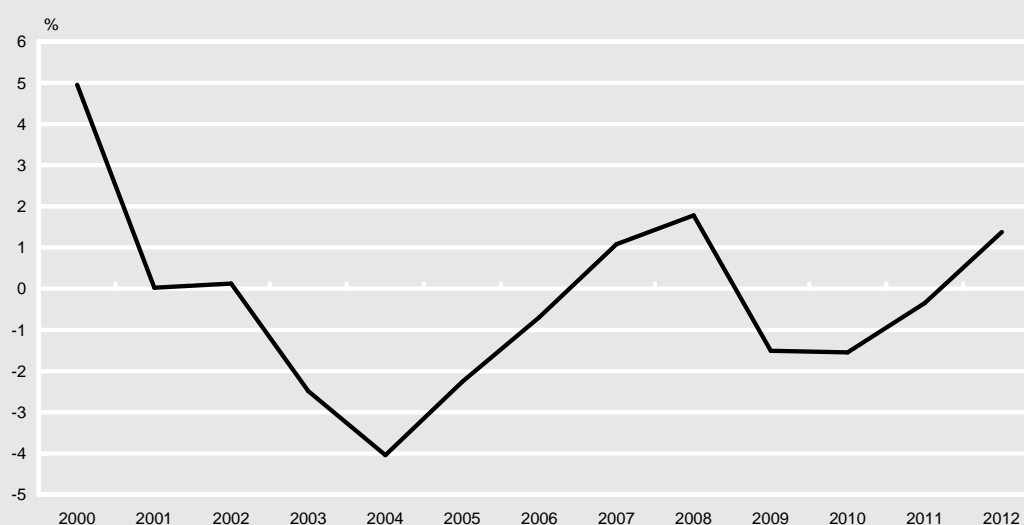
During 2009, inflation (calculated as the twelve month moving average of the HICP) was characterised by both significant base effects as well as unstable commodity prices. The inflation rate is expected to decrease slightly to 1.7 per cent in 2010 from 1.8 per cent registered in 2009. Price developments for the following years are forecasted to remain stable at an average rate of around 2.0 per cent.

## 2.2 Potential Output and the Output Gap

Potential output is the output produced should all factors of production be fully employed in an economy. The estimation of potential output and subsequently that of the output gap presented in this Programme 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.

It is to be noted that the estimation of potential output is subject to a degree of uncertainty given the present volatile macroeconomic conditions, the openness of the local economy, as well as the continuous structural changes taking place in various sectors of the economy. Thus, it is likely that estimates of the output gap are subject to a significant margin of errors, therefore caution is warranted in its use and interpretation.

Chart 2.2

**Output Gap<sup>1</sup>**

<sup>1</sup> Defined as actual output less potential output as a per cent of potential output.

Economic performance between 2001 and 2004 was rather sluggish as on average economic growth stood at around 0.3 per cent per annum. This reflected both the effects of international shocks on the Maltese economy as well as domestic factors, mainly the effects of the restructuring process that the Maltese economy was undergoing at the time. In contrast, the annual average economic growth rate stood at 3.4 per cent between 2005 and 2008, mainly reflecting the improved conditions of the external environment and the emergence of new growth sectors of economic activity in Malta. However, as argued above, GDP is expected to contract by 2.0 per cent in 2009 in light of the impact of the international recession on the Maltese economy. A slight improvement is forecasted for 2010 with the economy expected to grow by 1.1 per cent. In the outer years of the forecast period, more favourable developments are foreseen with an average economic growth rate of around 2.6 per cent in 2011-2012.

Average potential output growth, which is a measure of the growth potential of the economy, stood at 2.5 per cent during the period 2001-2004, declining to 2.1 per cent between 2005 and 2007. The decline in potential output growth during that period reflects mainly developments in potential labour input. Potential output growth fell further in 2008 to a rate of 1.4 per cent, while it is expected to increase by around 1.3 per cent for 2009. Over the forecasted period 2010-2012, average potential growth is expected to be around 1.1 per cent. Demographic factors are acting as a drag on potential output while positive contributions are forecasted from total factor productivity and, to a lesser extent, from the stock of capital employed in economic activity.

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. Following a peak of 5.0 per cent of GDP in 2000, the output gap started to narrow, turning negative in 2003 and reached a trough of -4.0 per cent of GDP in 2004. The output gap narrowed for the following two years and turned positive in 2007 and 2008. However, the output gap is expected to be negative for 2009 at -1.5 per cent, and is expected to remain negative for the following two years, indicating that the economy will be operating below its potential in the coming years. The output gap is expected to start to narrow in 2011 and is then expected to turn positive again in 2012.

*Footnote:*

<sup>1</sup> Data in line with NSO News Release (National Accounts, GDP, September Quarter 2009), No 220/2009

### **3. General Government Balance and Debt**

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### 3. General Government Balance and Debt

Faced with the challenge of restoring growth and employment levels, the Government's immediate priority is to design fiscal policy so as to encourage investment and job creation. In this manner, fiscal policy will assist the recovery of the domestic economy and contribute to improve the growth potential of the economy. Nevertheless, the return to a sustainable fiscal stance remains one of Government's main medium-term fiscal and economic policy objectives. Thus, as the economic environment improves, Government will adopt a more restrictive fiscal stance.

The general Government deficit-to-GDP ratio is projected at 3.8 per cent in 2009. The adverse international economic developments left their mark on public finances particularly on certain revenue components of the budget. Moreover, in 2009 a number of measures were earmarked to stimulate economic activity and support those sectors mostly hit by the downturn in foreign demand. Subsequently, in 2010, in view of a still relatively subdued economic environment, the deficit ratio is projected to remain broadly stable compared to the 2009 level, as the budget provides for further specific temporary support to the economy. As the economic recovery gains momentum, fiscal consolidation is resumed in 2011. Indeed, the deficit ratio is expected to decline by 1 percentage point of GDP to 2.9 per cent. In 2012, the fiscal balance is projected to improve slightly to 2.8 per cent.

Government will continue to aim for a balanced structural budget as its medium-term objective (MTO). However, in view of the revised fiscal trajectory, this target will not be reached within the Programme period.

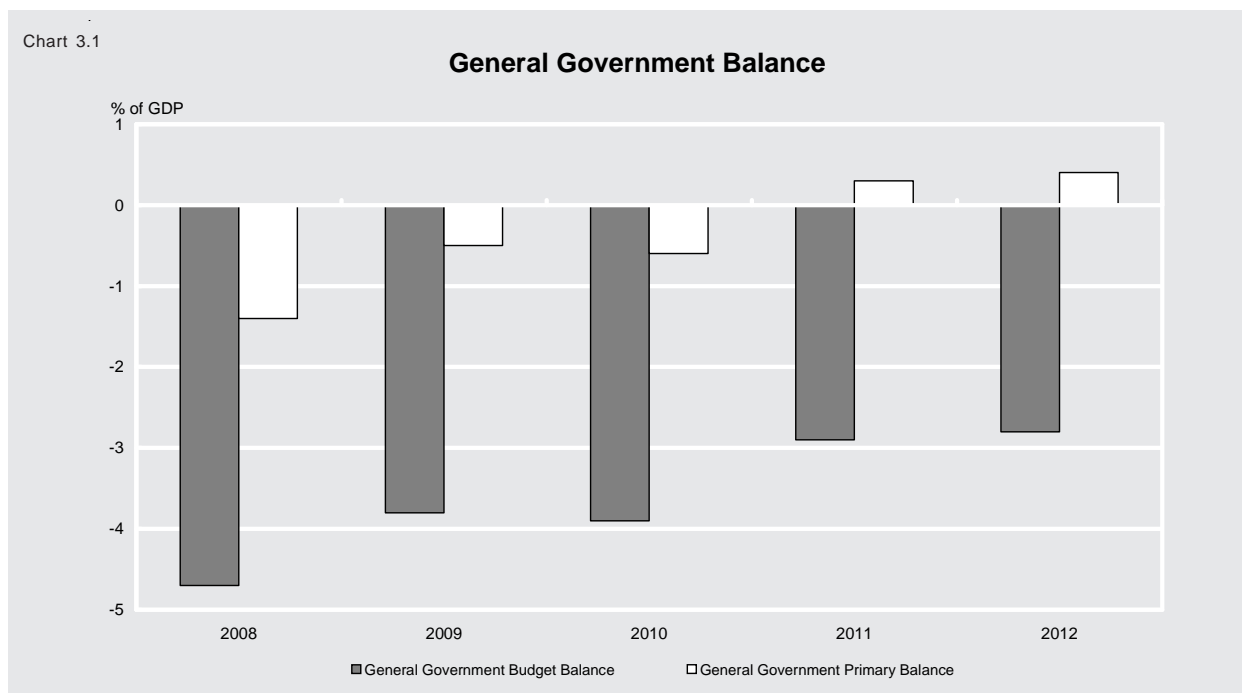
The public debt-to-GDP ratio is projected to increase in 2009 and 2010 reflecting developments in the fiscal balance. Subsequently, the debt-to-GDP ratio is projected to follow a declining trend in 2011 and 2012, reflecting declining negative contributions from the fiscal balance as well as a positive contribution from the improved economic conditions.

The budgetary targets presented in this Update represent a significant revision from the fiscal path presented in the December 2008 Update. This variance in the fiscal adjustment path needs to be viewed against the backdrop of a notably more negative economic environment which negatively impinged on public finances and a less restrictive fiscal stance adopted by Government to counter the worse macroeconomic scenario. These revisions in the deficit-to-GDP targets were also reflected in a revised adjustment of the debt ratio over the Programme period, compared to that presented in the 2008 Update.

#### 3.1 The Medium-Term Fiscal Framework

The general Government deficit is expected to decline from 4.7 per cent of GDP in 2008 to 3.8 per cent in 2009. It is pertinent to note that this decrease reflects the impact of exceptional expenditure outlays which impinged heavily on the 2008 fiscal position. In particular, these included outlays related to the voluntary redundancy schemes to workers of Malta Shipyards Ltd. as well as the reclassification of this company within the general Government sector, amounting to around 1.1 per cent of GDP. These factors affected the deficit ratio by a much lesser extent in 2009 (0.3 per cent of GDP). Furthermore, the deficit ratio for 2008 was also affected by the extension on a temporary basis of a subsidy to the utility sector equivalent to 0.8 per cent of GDP.

In 2010, the general Government deficit ratio is expected to remain broadly unchanged from the 2009 level. The 2010 Budget announced various support measures targeted at encouraging investment and supporting the labour market, as well as fiscal consolidation measures which were designed so as not to impact unduly on economic activity. Details of the 2010 Budget measures are provided in Chapter 5. Subsequently, the deficit ratio is expected to decline from 3.9 per cent in 2010 to 2.9 per cent and 2.8 per cent in 2011 and 2012 respectively. Chart 3.1 illustrates developments in the general Government balance between 2008 and 2012,



whilst Table 2 in the Statistical Appendix presents general Government revenue and expenditure projections for the period 2008-2012.

As highlighted below, during the Programme period, the reliance on one-off deficit reducing measures is expected to be marginal as revenue from one-off operations is projected to decline from 0.3 per cent in 2008 to around 0.1 per cent of GDP in subsequent years. Over the Programme period, one-off revenue reflects proceeds from the sale of Government property.

In view of stable debt servicing costs, the primary balance is a reflection of the deficit ratio over the Programme period. The primary balance is projected to remain in deficit in the three-year period to 2010, but to decline from 1.4 per cent in 2008 to around 0.5 per cent in 2009 and 2010. Subsequently, the primary balance is expected to regain positive territory in 2011, returning to a surplus of around 0.4 per cent in 2011 and 2012.

### 3.1.1 Fiscal Developments in 2009

As highlighted above, the decline in the general Government deficit ratio in 2009 reflects specific factors which impinged negatively on the fiscal position in 2008. Excluding these exceptional outlays, the deficit would increase from 2.7 per cent of GDP in 2008 to 3.5 per cent in 2009. As the Maltese economy was affected by the adverse international economic developments in 2009, the contraction in economic activity exerted negative repercussions on the public finance position.

It is pertinent to note that the fiscal position for 2009 was also influenced by a number of measures announced in the 2009 Budget which aimed at stimulating economic activity and counteracting the effects of the international economic downturn. Moreover, the measures in the Budget for 2009 were complemented with targeted, limited and focused assistance to help a number of sustainable enterprises in the manufacturing sector and tourism industry, which were particularly hard hit by the downturn in global demand. Indeed, the recovery measures implemented in 2009 are estimated to impact the fiscal position by 0.6 per cent of GDP. In addition, other initiatives supporting the economy, amounting to 0.2 per cent of GDP, were financed from EU funds. These initiatives and policies are in line with the European Economic Recovery Plan (EERP) that was endorsed by the European Council of 11 and 12 December 2008.



### **3.1.1.1 General Government Revenue**

In 2009, the general Government revenue to GDP ratio is expected to stand at 41.4 per cent, up from 40.2 per cent in 2008, reflecting an increasing tax revenue ratio and a higher ratio of the 'other' component of revenue. The tax revenue ratio is expected to increase from 27.8 per cent in 2008 to 28.8 per cent in 2009 underpinned by a higher ratio of current taxes on income and wealth which more than outweighs the decline in the ratio of taxes on production and imports.

The decline in the ratio of taxes on production and imports reflects subdued consumption patterns evident in the Maltese economy, as well as lower tax receipts on property transactions due to a weak level of activity in the property market. On the other hand, the ratio of current taxes on income and wealth is expected to increase in 2009. As the impact of the economic downturn on the domestic labour market has been relatively contained, revenues from taxation on employment, as well as social security contributions, have been relatively resilient. Furthermore, higher revenue from the annual circulation tax as well as a scheme - whereby income tax defaulters benefit from waiving off fines and penalties accruing in relation to their dues - contributed to the increase in the ratio of current taxes on income and wealth. Moreover, the ratio of the 'other' component of revenue increased mainly reflecting higher funds forthcoming under the EU Structural and Cohesion Funds 2007-2013 Programme. The ratio of revenue from property income to GDP is expected to remain broadly stable in 2009.

### **3.1.1.2 General Government Expenditure**

General Government expenditure is expected to increase from 44.8 per cent of GDP in 2008 to 45.2 per cent in 2009. This increase reflects higher outlays on social transfers and gross fixed capital formation which more than outweighed a lower ratio for compensation of employees, subsidies and 'other' expenditure category.

The ratio of compensation of employees to GDP is expected to decline by 0.2 percentage points to 14.4 per cent in 2009, on account of a lower wage bill for Malta Shipyards Ltd. (including payments related to the voluntary redundancy schemes). Indeed, if one were to exclude this factor, the ratio of compensation of employees is expected to increase in 2009. Better working conditions to specialised professionals in specific sectors contributed to this increase. Moreover, the ratio of subsidies to GDP is expected to decline from 2.1 per cent in 2008 to 1.3 per cent of GDP in 2009, largely reflecting the termination of financial support to the utility sector, following the revision of the utility tariffs in October 2008. The 'other' expenditure category is also expected to decline from 2.3 per cent in 2008 to 1.9 per cent in 2009, reflecting lower output by Malta Shipyards Ltd. as the process of liquidation of the company was initiated in 2008. This development also affected the ratio of intermediate consumption to GDP. The ratio of gross fixed capital formation to GDP is expected to increase by 1 percentage point to 3.5 per cent of GDP in 2009, due to higher outlays earmarked for the development of infrastructure and improving the environment. Meanwhile, in 2009, an increase of 0.7 percentage points is also expected in social benefits and social transfers in kind, mainly reflecting higher retirement pensions.

## **3.1.2 General Government Budgetary Projections for 2010-2012**

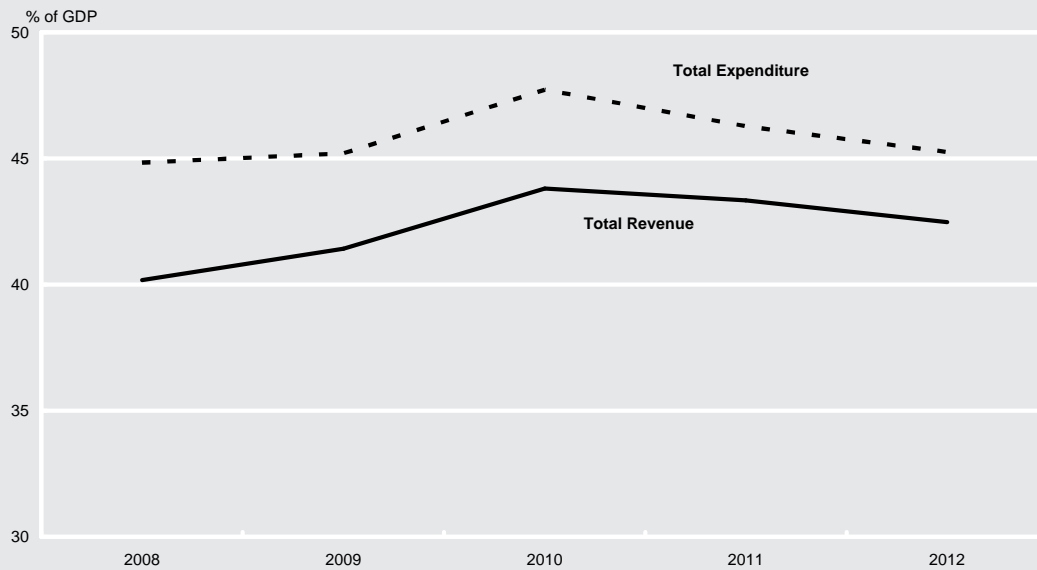
Set against the backdrop of a still uncertain economic recovery, the fiscal target for 2010 is 3.9 per cent, broadly unchanged from the expected deficit ratio for 2009. This development in 2010 reflects an increase in the revenue ratio which is expected to be offset by a similar increase in the expenditure ratio. Subsequently, the general Government deficit ratio is expected to decline to 2.9 per cent in 2011 as the decline in the expenditure ratio exceeds the decline in the revenue ratio. The deficit ratio for 2012 is projected to stand at 2.8 per cent.

### **3.1.2.1 General Government Revenue Projections**

The general Government revenue-to-GDP ratio is expected to increase by 2.4 percentage points to 43.8 per cent of GDP in 2010, mainly attributable to a higher tax ratio to GDP as well as an increase in the ratio of the 'other' component of revenue, namely due to higher EU funds. On the other hand, a marginal decline is

Chart 3.2

### General Government Revenue and Expenditure



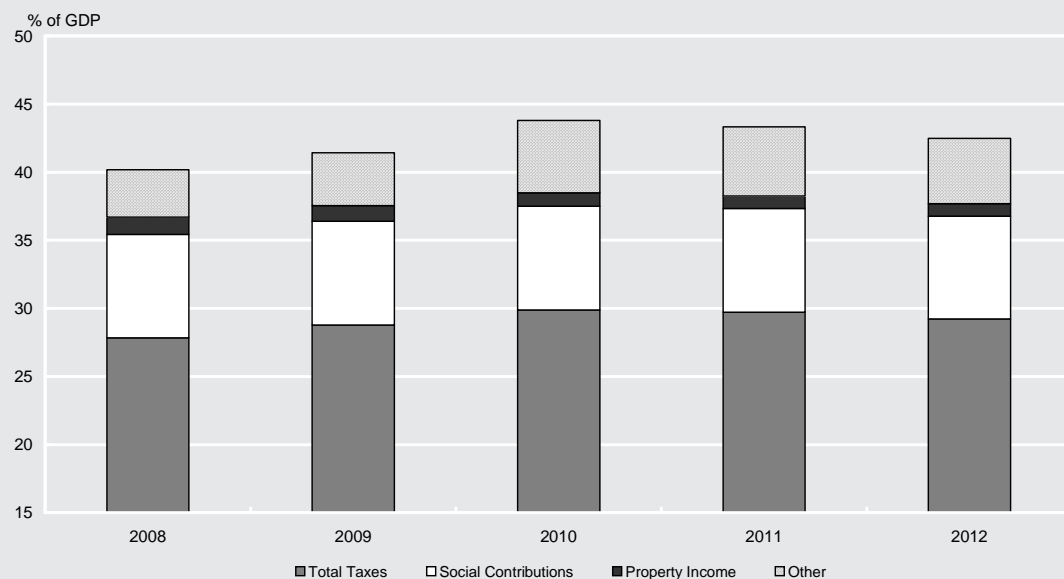
expected in the property income ratio. As illustrated in Chart 3.2, over the outer years of the Programme period, the revenue-to-GDP ratio is projected to decline to 42.5 per cent of GDP by 2012 on account of a lower tax ratio as well as a lower ratio of the ‘other’ component of revenue.

### Tax Revenue

The ratio of tax revenue-to-GDP is expected to increase by 1.1 percentage points to 29.9 per cent of GDP in 2010. Subsequently, as illustrated in Chart 3.3, the tax revenue ratio-to-GDP is projected to follow a gradually declining trend to 29.2 per cent of GDP by 2012. Government considers that fiscal consolidation should be largely expenditure based and the fiscal projections are thus not based on significant tax increasing measures. Rather, the developments in tax revenue mainly reflect macroeconomic developments as well as Government’s ongoing efforts to curb tax evasion.

Chart 3.3

### Composition of General Government Total Revenue



Developments in the tax ratio in 2010 mainly reflect a notably higher ratio of taxes on production and imports as well as a marginal increase in the ratio of current taxes on income and wealth. The ratio of taxes on production and imports is expected to increase from 13.7 per cent of GDP in 2009 to 14.6 per cent in 2010, mainly underpinned by the revision in the excise duties on cigarettes and other tobacco products, the strengthening of enforcement against the evasion of excise levy on petroleum announced in the 2010 Budget and the contribution per night spent in paid accommodation, which was announced in the Budget for 2009 and will enter into force in April 2010 as planned. Moreover, the expected initial signs of economic recovery are anticipated to positively influence taxes on production and imports particularly through higher receipts from consumption tax as well as increased revenue from taxation on property transactions. Meanwhile, the ratio of current taxes on income and wealth is also expected to be positively affected by the pick-up in the domestic economy in 2010. Meanwhile, this upward trend in the ratio of total taxes-to-GDP is expected to be partly reversed in the outer years of the Programme period.

### **Social Contributions**

The ratio of social security contributions is expected to remain stable at 7.6 per cent of GDP in 2010 and 2011. In the subsequent year, this component of revenue is expected to decline marginally to 7.5 per cent of GDP. Developments in projections for social security contributions broadly follow projected developments in the labour market.

### **Property and Other Income**

The ratio of revenue from property income-to-GDP is expected to decline marginally from 1.0 per cent in 2010 to 0.9 per cent in 2011 and 2012.

Meanwhile, the ‘other’ component of revenue, which mainly includes revenue of Extra-Budgetary Units (EBUs), local councils, and other non-tax revenue including grants, is expected to increase significantly in 2010 to 5.3 per cent of GDP from 3.9 per cent a year earlier. This marked increase is mainly underpinned by a substantially higher level of funds forthcoming from the EU under the 2007-2013 Financial Framework. Given that such inflows correspond to similar increases in outlays, they have a broadly neutral impact on the budget balance. In subsequent years, the ‘other’ component of revenue is expected to decline marginally reflecting a slower growth in the components of the ‘other’ revenue category compared to nominal GDP. Indeed, in absolute terms, the main categories of revenue included in this category (including EU grants) are not expected to register significant changes.

### **3.1.2.2 General Government Expenditure Projections**

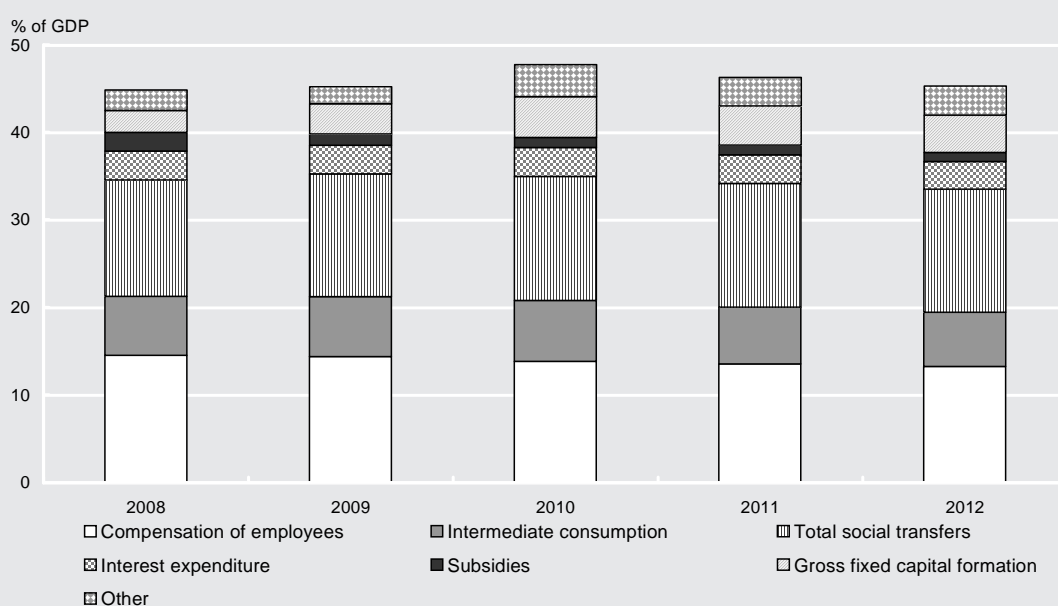
The ratio of total Government expenditure-to-GDP is expected to increase from 45.2 per cent in 2009 to 47.7 per cent in 2010, mainly reflecting significant increases in the ‘other’ expenditure category and in gross fixed capital formation, which more than outweigh the decline in the ratio of compensation of employees. Subsequently, as illustrated in Chart 3.4, the ratio of general Government expenditure to GDP is projected to follow a downward trend, declining to 45.3 per cent by 2012, reflecting lower expenditure ratios mainly for all components of expenditure, but in particular compensation of employees and intermediate consumption.

### **Compensation of Employees**

The ratio of compensation of employees-to-GDP is projected to decline by 0.5 percentage points of GDP to 13.9 per cent in 2010. This decline is entirely due to outlays in respect of Malta Shipyards’ employees (including part of the payments of the voluntary redundancy schemes) in 2009, which do not feature in 2010. Indeed, if this factor is excluded, the ratio of compensation of employees in 2010 would remain at the same level as that recorded for 2009. In the subsequent years, the ratio of compensation of employees-to-GDP is projected to decline gradually to 13.3 per cent by 2012, reflecting Government’s policy to restrict recruitment in non-essential categories in the public sector.

Chart 3.4

### Composition of General Government Total Expenditure



#### Intermediate Consumption

At a ratio to GDP of 6.9 per cent, intermediate consumption is expected to remain broadly stable in 2010, before declining in the outer years of the Programme period. It is pertinent to note that outlays under this expenditure item in 2010 include temporary support measures, namely research and innovation initiatives and labour market measures, as well as additional expenditure earmarked towards improved quality of public healthcare services as announced in the 2010 Budget. Government remains committed to contain the growth of intermediate consumption. To this intent, the financial allocations to various Ministries and Departments for 2010 were either retained at the same level as in 2009, or were reduced, whilst various cost cutting measures are being implemented. This policy will be maintained also in the outer years of the Programme.

#### Social Payments

The ratio of social payments-to-GDP is expected to increase marginally to 14.2 per cent in 2010 and to remain broadly stable thereafter. Higher expenditure on retirement and widows' pensions is projected throughout the Programme period. In order to ensure that social benefits are being targeted to those who are most in need, a number of provisions specifically earmarked at curtailing social benefits fraud will be continued and new measures to this effect will also be introduced, as announced in the Budget for 2010.

#### Interest Expenditure

Interest expenditure as a ratio to GDP is expected to remain broadly unchanged at 3.3 per cent during 2010 and 2011 and to decline marginally to 3.2 per cent in 2012. The projected developments in interest payments primarily consist of the servicing of long-term local loans.

#### Subsidies

The subsidies-to-GDP ratio is expected to decline to 1.1 per cent of GDP in 2010 from 1.3 per cent a year earlier. This decrease primarily reflects the implementation of the public transport reform, as well as lower incentives to the film industry, following a significant high level of activity in 2009. Meanwhile, in subsequent years to 2012, expenditure on subsidies is expected to remain relatively stable at around 1 per cent of GDP.

## **Gross Fixed Capital Formation**

The ratio of gross fixed capital formation-to-GDP is expected to increase significantly in 2010 by 1.1 percentage points to 4.6 per cent of GDP. This development primarily reflects higher outlays in respect of the implementation of capital projects financed from EU funds under the 2007-2013 Financial Framework. Thereafter, in absolute terms, capital outlays are projected to remain relatively stable but, against the background of a higher level of GDP, the ratio of this component of expenditure is anticipated to follow a declining trend to reach 4.2 per cent of GDP by 2012.

## **'Other' Expenditure Components**

In 2010, significant increases are anticipated in the 'other' expenditure category, mainly on account of increases in current and capital transfers. Whereas the former reflects temporary support to households income in view of the revised utility tariffs as well as temporary support to the tourism industry announced in the 2010 Budget, the projected increase in capital transfers reflects the implementation of projects financed from EU funds under the 2007-2013 Financial Framework and thus corresponds with analogous increases in revenue, as highlighted above. Moreover, temporary support measures to small and medium enterprises earmarked to facilitate investment and encourage creativity, innovation and entrepreneurship also underpin the increase in capital transfers in 2010. These include measures financed from EU funds.

In 2011, the 'other' expenditure category is expected to decline marginally to reach 3.3 per cent of GDP, mainly due to the withdrawal of the 2010 temporary support measures. In 2012, this component of expenditure is projected to remain broadly stable, as the levels of current and capital transfers are expected to increase less rapidly than GDP.

### **3.1.3 Comparison with the December 2008 Update of the Stability Programme**

The fiscal targets presented in the December 2008 Update were revised significantly in this Update. This variance in the fiscal adjustment path needs to be viewed against the backdrop of a worse macroeconomic environment than expected in the December 2008 Update, which negatively impinged on public finances. Furthermore, in view of the still uncertain economic recovery, in 2010 Government is providing further support to the economy.

The fiscal outturn in 2008 varied from that reported in the December 2008 Update of the Stability Programme. This revision, from 3.3 per cent of GDP to 4.7 per cent, was affected by the reclassification of Malta Shipyards Ltd. within the general Government sector as well as delayed tax payments by enterprises in the last quarter of 2008 as the international crisis started to affect the domestic economy.

While the December 2008 Update of the Stability Programme targeted a deficit of 1.5 per cent in 2009, the deficit is now expected to stand at 3.8 per cent of GDP. This reflects a higher expenditure ratio coupled with a lower revenue ratio. The economic performance in 2009 was worse than expected in the December 2008 Update and this impacted negatively on public finances. In particular, indirect tax revenue particularly those components linked to consumption and the property market suffered a downturn. In addition, whilst Government continued with its efforts to restrain current expenditure, in the context of a more difficult economic environment, the fiscal stance was not as restrictive as envisaged in the December 2008 Update. In particular, compensation of employees and intermediate consumption were revised upwards.

The significant revision in the expected fiscal outturn for 2009 impacted on the fiscal trajectory presented in this Programme, when compared to that presented in the previous Update. At 3.9 per cent, the deficit-to-GDP ratio in 2010 is expected to remain broadly unchanged from the ratio projected for 2009, implying an upward revision of 3.6 percentage points when compared to the ratio projected in the 2008 Update. In 2011, the general Government deficit ratio is expected to fall to 2.9 per cent, compared to a surplus of 1.2 per cent of GDP projected in the 2008 Update.

### 3.2 Structural Adjustment

Although the fiscal consolidation path necessary to achieve the objective of a balanced structural position in the medium-term continues to be a major policy objective, during 2010, fiscal policy will mainly be targeted to provide short-term support to the economy and the consolidation process will be resumed in 2011. Underlying the fiscal path illustrated in Chart 3.5 is an improvement in the budget deficit from 3.9 per cent of GDP in 2010 to a deficit of 2.8 per cent of GDP in 2012.

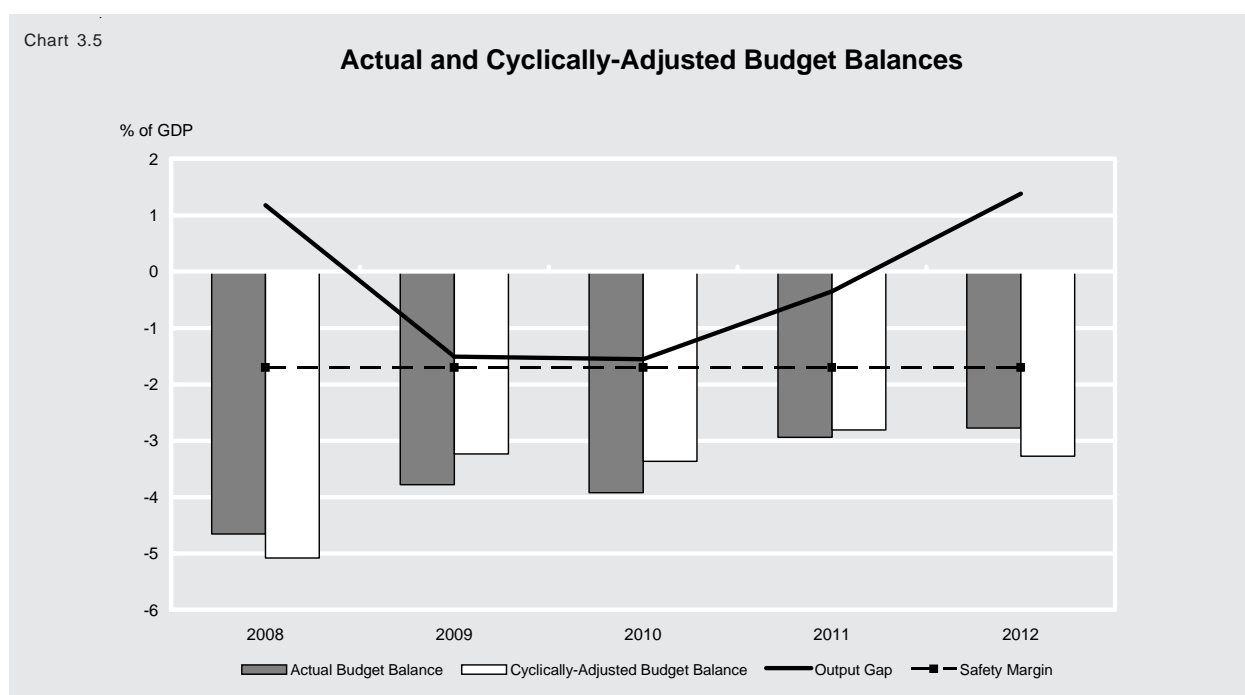
The reliance on one-off measures towards the fiscal consolidation path in the medium-term will continue to be marginal. One-off revenue measures shall not exceed 0.2 per cent of GDP in the forecast period. When one excludes one-off revenue measures, the general Government budget deficit is expected to reach 4.1 per cent of GDP in 2010 and then recover gradually, reaching a deficit of 2.8 per cent of GDP in 2012. Most of the adjustment is expected to take place in 2011 when the deficit (net of one-offs) is expected to decline by 1.0 percentage point of GDP.

The analysis of the structural budgetary position depends on estimations of the cyclical position of the economy. There is significant uncertainty surrounding the potential output and output gap estimations. In this context, a certain degree of caution is warranted in the analysis of the structural adjustment over the forecast period.

Overall, when one excludes one-off deficit-reducing measures and the estimated cyclical component, the structural budget deficit is expected to remain relatively stable at 3.3 per cent of GDP between 2009 and 2012 as shown in Table 3.1. It is to be noted that a fiscal effort of 0.7 percentage points of GDP is projected in 2011.

### 3.3 The Medium-Term Budgetary Objective (MTO)

Malta will continue to aim for a balanced structural budget as its medium-term objective (MTO). Achieving this MTO is necessary in order to ensure a stable and sustainable debt-to-GDP ratio in line with the requirements of the Stability and Growth Pact and make allowance for the future cost of ageing. However, this target will be reached beyond the Programme period. Every effort will however be made to ensure that public finances remain on a stable footing despite the recession, with the nominal budget deficit expected at 3.9 per cent of GDP in 2010 and to be below 3 per cent of GDP as from 2011.



## Fiscal Consolidation

as a percentage of GDP

Table 3.1

	2008	2009	2010	2011	2012
General Government Balance	-4.7	-3.8	-3.9	-2.9	-2.8
Excluding exceptional items*	-2.7	-3.5	-3.9	-2.9	-2.8
One-off Measures	0.3	0.1	0.2	0.1	0.1
General Government Balance net of One-offs	-5.0	-3.8	-4.1	-3.0	-2.8
Output Gap Estimates	1.2	-1.5	-1.6	-0.4	1.4
Cyclically-Adjusted Budget Balance	-5.1	-3.2	-3.4	-2.8	-3.3
Structural Balance	-5.4	-3.3	-3.6	-2.9	-3.3
Structural Adjustment		2.1	-0.3	0.7	-0.5
Excluding exceptional items*		0.5	-0.6	0.7	-0.5

\* exceptional items amount to 1.9% of GDP in 2008 and 0.3% of GDP in 2009

### 3.4 Debt Levels and Developments

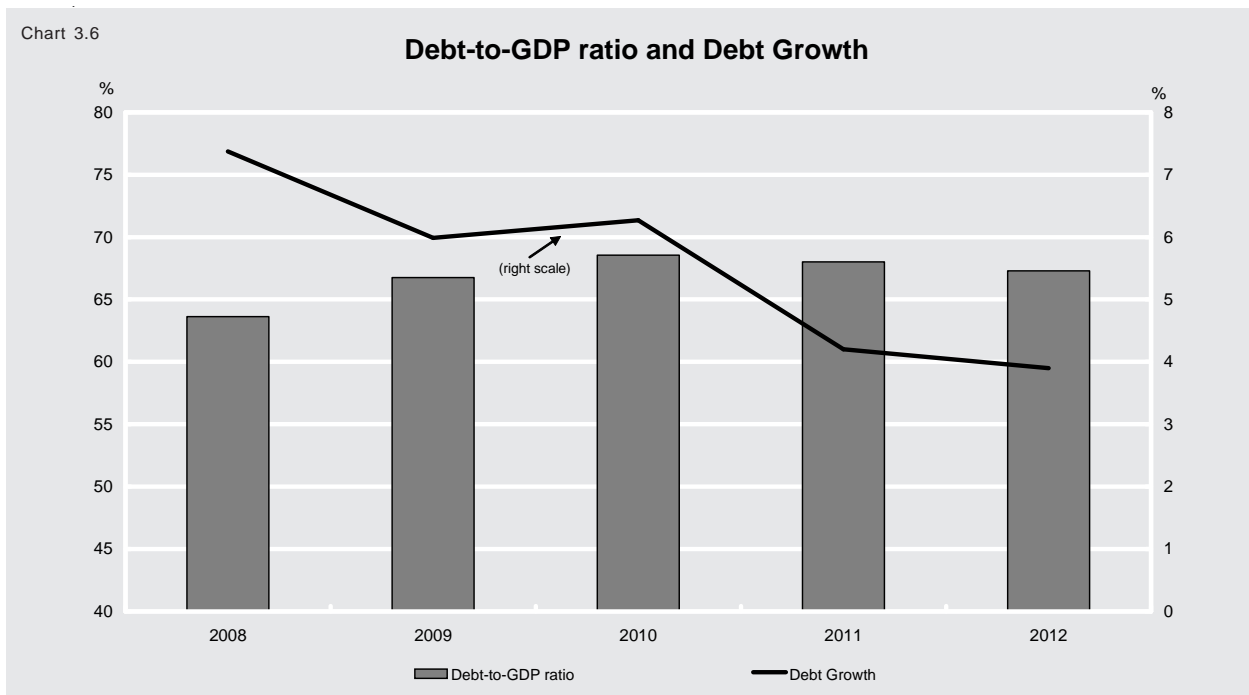
The developments in the fiscal balance over the short-term are reflected in increasing funding requirements and public debt. In this context and against the backdrop of a weak economic environment, the ratio of public debt-to-GDP is expected to trend upwards in 2009 and 2010. Nevertheless, Government's fiscal policy is set to ensure that the debt-to-GDP ratio declines over the medium-term horizon. Indeed, the debt-to-GDP ratio is projected to follow a declining trend in 2011 and 2012, reflecting lower fiscal deficit contributions as well as a positive contribution from the improved economic conditions.

As in recent years, Government's debt strategy is to ensure that the financing needs of the public sector are met at the lowest possible cost while at the same time minimising the level of interest rate risk in the medium and long term. Given that short-term debt is expected to account for only around 11 per cent of total Government debt in 2009 and to decrease significantly thereafter, and also since the projected amounts of maturing stock and new loans account for around 12 per cent of the total stock of debt outstanding, interest payments and consequently the fiscal balance are not highly sensitive to changes in interest rates. Moreover, total Government debt is characterised by negligible exchange rate risk since it is almost entirely denominated in Euros.

#### 3.4.1 Projected Debt Developments

Public debt sustainability primarily depends on the ability of Government to continue servicing it without requiring an unrealistically large future correction to the balance of income and non-interest expenditure. Other factors impacting on the debt-to-GDP ratio include the real rate of interest, the real growth rate of the economy and inflation. Other influences on Government debt which are not accounted for by these factors are captured by the Stock Flow Adjustment (SFA). These contributors to the trajectory path of the debt-to-GDP ratio are presented in Statistical Appendix Table 4.

The debt-to-GDP ratio is expected to increase by 3.2 percentage points from 63.6 per cent in 2008 to 66.8 per cent in 2009. This upward trend is projected to persist in 2010 as the debt ratio is expected to increase by



a further 1.8 percentage points to 68.6 per cent. However, this increase in the debt ratio is projected to be reversed in subsequent years, declining gradually to 67.3 per cent by 2012 as the deficit is reduced to below 3 per cent of GDP, coupled with the effects of the economic recovery. These developments in the debt-to-GDP ratio are presented in Chart 3.6. It is pertinent to note that the debt projections presented in this Programme do not take into account any privatization proceeds that may result from divestments of Government's assets over the Programme period.

In 2009 and 2010, the primary balance is expected to remain in deficit, providing an expansionary contribution to the debt ratio of around 0.5 percentage points. On the other hand, improvements in the primary balance are projected to exert a contractionary effect to the debt ratio of around 0.3 percentage points in 2011 and 2012.

The 'snowball effect', which captures the relative contributions to changes in the debt ratio of the real rate of interest and real economic growth, is expected to have a significant expansionary effect in 2009 and 2010. However, during the last two years of the forecast period, the 'snowball effect' is expected to be negligible as the debt increasing effect exerted by interest payments is offset by the decreasing effect exerted by real GDP growth and inflationary pressures.

As shown in Table 3.2, in 2009 and 2010, the 'snowball effect' is expected to exert a debt increasing effect of 2.6 percentage points and 1.1 percentage points respectively, becoming negligible in the outer years of the Programme period. As the domestic economy is adversely affected by the international economic crisis, the expected contraction in real GDP growth in 2009 exerts an expansionary contribution of 1.3 percentage points to the debt ratio. A turnaround is expected in 2010 as real GDP growth is projected to exert a contractionary contribution of 0.7 percentage points to the debt ratio. However, as economic growth is subdued, this contribution remains relatively small when compared to the average contribution recorded over previous years. Subsequently, as the economic recovery gains momentum, the contribution of real GDP growth to lower the debt ratio is expected to amount to 1.6 percentage points and 1.9 percentage points in 2011 and 2012, respectively. Meanwhile, the expansionary contribution of interest expenditure to the debt ratio is projected to remain relatively stable at around 3.3 percentage points throughout the Programme period. On the other hand, the contractionary contribution of inflationary pressures is expected to fluctuate between 1.9 and 1.3 percentage points throughout the period 2009-2012.



### The Dynamics of Government Debt<sup>(1)</sup>

Table 3.2

Percentages of GDP	2008	2009	2010	2011	2012
Gross debt	63.6	66.8	68.6	68.0	67.3
Change in gross debt	1.7	3.2	1.8	-0.5	-0.7
<b>Contribution to change in gross debt</b>					
Primary Balance	1.4	0.5	0.6	-0.3	-0.4
Snowball Effect	0.6	2.6	1.1	0.0	-0.1
Interest Expenditure	3.3	3.3	3.3	3.2	3.2
Real GDP growth	-1.3	1.3	-0.7	-1.6	-1.9
Inflation Effect	-1.4	-1.9	-1.5	-1.7	-1.3
Stock-flow adjustment	-0.3	0.0	0.1	-0.2	-0.2
p.m. implicit interest rate on debt	5.6	5.2	5.1	5.0	4.9

<sup>(1)</sup> Developments in the debt- to-GDP ratio depend on: 
$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{P D_t}{Y_t} + \left( \frac{D_{t-1}}{Y_{t-1}} \cdot \frac{i_t - y_t}{1 + y_t} \right) + \frac{SFA}{Y_t}$$

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.

The other factors which influence the debt-to-GDP ratio are captured by the estimated SFA. The contribution of the SFA is expected to be negligible in 2009 and 2010. Subsequently, the SFA is expected to exert a contractionary effect of around 0.2 percentage points in both 2011 and 2012.

### 3.4.2 Comparison with the December 2008 Update of the Stability Programme

The ratios of general Government debt-to-GDP presented in this Programme are expected to be higher when compared to those presented in the December 2008 Update of the Stability Programme. This reflects both the revised fiscal trajectory as well as the revisions in the macroeconomic outlook for 2008-2010. The revision in the debt ratio stands at 0.8 percentage points in 2008 but as the impact of the revised debt and nominal GDP levels accumulates, the magnitude of the revision increases significantly for the subsequent years.

The debt ratio was revised by 0.8 percentage points in 2008, as the downward revision in GDP increased the debt ratio by 0.4 percentage points while the remaining 0.4 percentage points resulted from higher debt levels. It is pertinent to note that the revision in the absolute level of debt, besides reflecting the revised fiscal balance, also reflects the inclusion of the debt of Malta Shipyards Ltd. to the general Government debt, following the reclassification of this entity within the general Government sector. The debt-to-GDP ratio for 2009 was revised upwards by 4.9 percentage points, of which 2.3 percentage points were attributed to revisions in GDP, augmented by an additional 2.5 percentage points attributed to a higher level of debt. These revisions reflect the fact that the international economic crisis hit the domestic economy and public finances more than anticipated in the previous Programme.

In 2010 and 2011, the debt-to-GDP ratio was revised upwards by 8.8 percentage points and 11.7 percentage points respectively, reflecting an upward revision of the debt level which increased the debt ratio by 5.4 percentage points and 8.8 percentage points respectively in 2010 and 2011. These revisions were coupled with a downward revision in the nominal GDP level which increased the debt-to-GDP by a further 3.0 percentage points in 2010 and 2.5 percentage points in 2011.

Following these developments, the annual downward adjustments in the debt ratio projected for the 2009-2011 period presented in the previous Stability Programme were revised accordingly. In the December 2008 Update, the debt-to-GDP ratio was expected to follow a downward trend from 61.9 per cent in 2009 to 56.3 per cent in 2011. This reflected a decline of 0.9 percentage points in 2009 and further declines amounting to 2.1 percentage points and 3.5 percentage points in 2010 and 2011 respectively. In contrast, the debt-to-GDP ratio presented in this Programme is expected to increase by 3.2 percentage points and 1.8 percentage points in 2009 and 2010 respectively before declining gradually by 0.5 percentage points to 68 per cent in 2011. This reflects a revision in the adjustment of the debt ratio of around 4 percentage points in 2009 and 2010 and a lower revision of 3 percentage points in the adjustment for 2011.

These revisions are largely a reflection of higher expected primary deficits and lower GDP growth rates in 2008-2010. In fact, the expansionary contribution of the primary balance is expected to vary from that of the previous Stability Programme by around 1 to 4 percentage points. At the same time, the contractionary contribution of real GDP growth has been revised downwards by 2.6 percentage points and 0.8 percentage points in 2009 and 2010 respectively, but is expected to remain unchanged for 2011. Meanwhile, the contractionary impact of inflation on the debt ratio is expected to be more significant than that presented in the 2008 Stability Programme by an average of 0.6 percentage points throughout the Programme period. In addition, the stock flow adjustment contribution has been revised downwards to almost zero percentage points in 2009 and 2010 and to a negative 0.2 percentage points in 2011 compared to a positive average of 0.2 percentage points throughout the Programme period projected in the previous Stability Programme.

**4. Sensitivity Analysis and Comparison with the December 2008  
Update of the Stability Programme**

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# 4. Sensitivity Analysis and Comparison with the December 2008 Update of the Stability Programme

## 4.1 Sensitivity Analysis

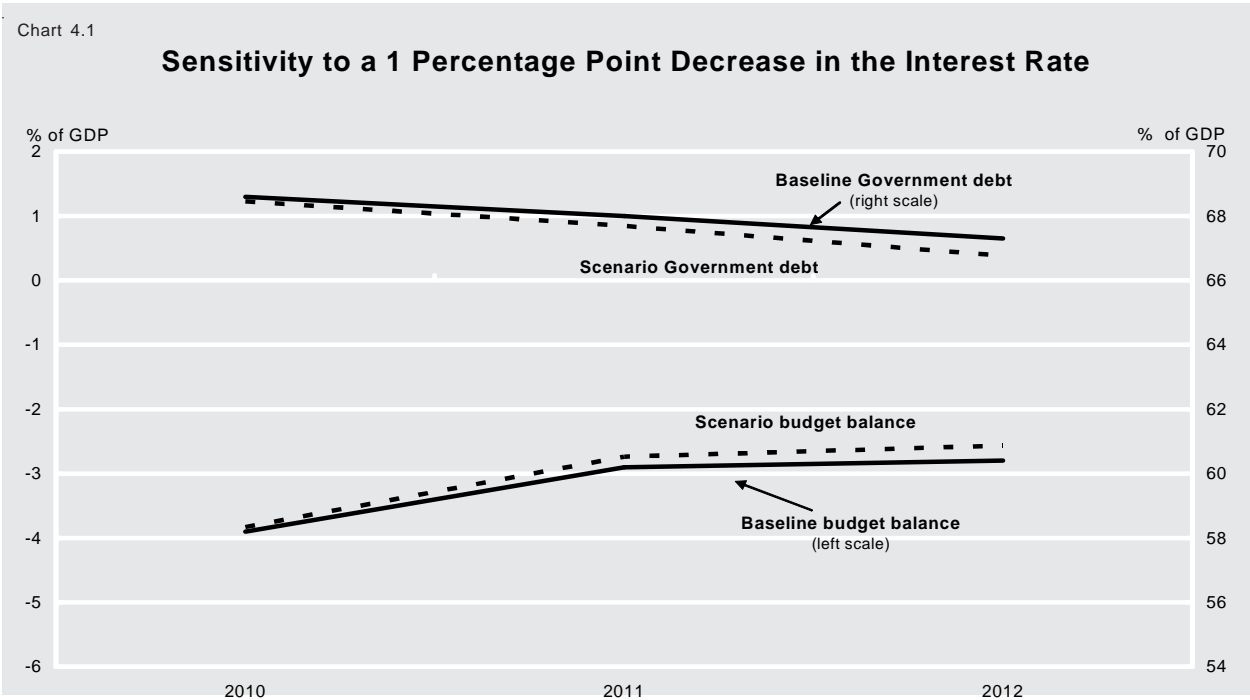
The remarkable level of uncertainty surrounding international economic prospects coupled with the uncertainty typically associated with any forecasting exercise highlights the importance of analysing the sensitivity of the macroeconomic and budgetary forecasts to changes in certain macroeconomic assumptions.

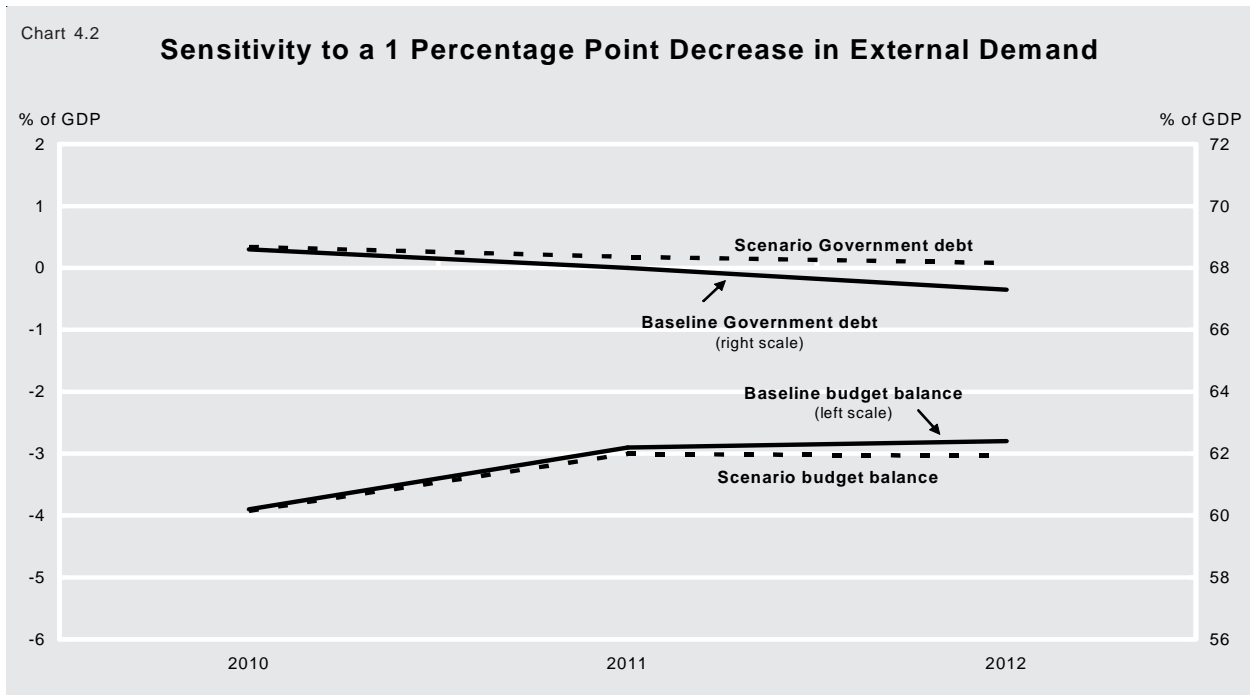
This Chapter presents three alternative sensitivity scenarios and in each case, 2010 is considered as the first year of the forecast. The first sensitivity scenario concerns a change in the interest rate, the second scenario deals with a decrease in economic activity in Malta’s main trading partners leading to a lower external demand for domestically produced goods and services, and the third sensitivity scenario features a lower rate of economic growth. The results of the three different scenarios are presented in terms of the effect of the deviation from the baseline on the Gross Domestic Product, general Government budget deficit, and general Government debt. These sensitivity analyses are illustrated in Charts 4.1, 4.2 and 4.3.

A number of points should be borne in mind when examining the results of the sensitivity analysis set out below. First, the estimates should be seen as indicative and are subject to considerable uncertainty regarding the response of economic agents to shocks. Secondly, it is assumed that there is no fiscal policy response to the changed budgetary position depicted in the scenario over the period.

### 4.1.1 Sensitivity to Interest Rate Fluctuations

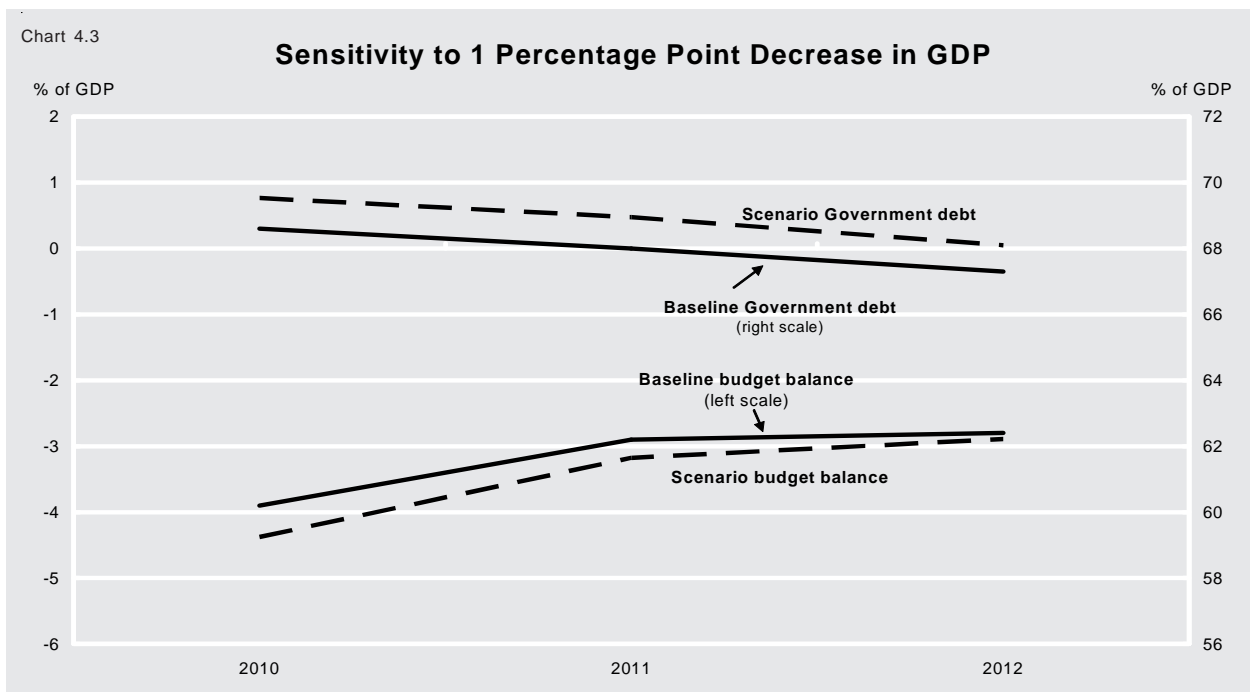
A domestic interest rate shock is expected to affect economic activity through the real and monetary sectors. The net effect of these changes depends on the degree of elasticity of the components of output to changes in the interest rate. Furthermore, Government finances are also directly affected by the change in the interest rate through the impact on components of revenue and expenditure that are sensitive to economic activity as well as the effect of changes in the interest rate on the debt servicing costs. However, as the share of short-term debt in total general Government debt in Malta is relatively small, changes in the interest rate are mainly expected to affect the debt servicing costs in relation to the rolling-over of past long-term debt and new





issues of stock. The impact of a change in the interest rate on the deficit and debt positions is thus relatively small.

This scenario is modelled as a decrease of 1 percentage point in the interest rate between 2010 and 2012. As a result of this change in the interest rate, economic growth is expected to increase marginally by 0.1 percentage points in 2010 and remain unchanged thereafter. Furthermore, this decrease in the interest rate will result in an improvement of the budget balance of 0.1 percentage points of GDP in 2010 and an improvement of around 0.2 percentage points in both 2011 and 2012. Subsequently, Government debt-to-GDP ratio is envisaged to decrease by around 0.1 percentage points and 0.3 percentage points in 2010 and 2011, respectively. At the end of the forecast period the ratio is expected to improve by a further 0.5 percentage points when compared to the baseline. The change in the budget balance reflects a decrease in total expenditure which amounts to around 0.3 per cent by the end of the forecast period, while the impact on total revenue is negligible.



### **4.1.2 Sensitivity to Change in External Demand**

Considering the level of volatility in the international economic environment and given the openness of the domestic economy it is of particular relevance to carry out a sensitivity analysis of GDP to changes in external demand. Thus, this section investigates a scenario where external demand declines by 1 percentage point in the first year and throughout the forecast horizon until 2012.

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

The stimulated fall in external demand is expected to lower the rate of economic expansion by around 0.5 percentage points by the end of forecast period when compared to the base scenario. This negative shock is also expected to result in a worsening in the budget deficit in 2012 by 0.2 percentage points of GDP when compared to the baseline. The subsequent worsening of the budget balance will impact the Government debt-to-GDP ratio, where the ratio is expected to increase by around 0.9 percentage points by the end of 2012. The developments in the budget balance mainly reflect a decrease in total revenue of 0.4 per cent in 2012 as the impact on total expenditure is negligible.

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

This scenario models the effects of a lower rate of economic growth on the budget balance and debt-to-GDP ratio. It considers a 1 percentage point decline in GDP in the first year and throughout the forecast horizon until 2012. 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. This decrease in demand in turn generates a decrease in domestic output but also a decrease in demand for imports of goods which is expected to partly offset the negative effects of the decline in private consumption.

Hence, a 1 percentage point decline in GDP is expected to worsen the budget balance by around 0.5 percentage points in 2010. However, the impact on the budget balance is expected to narrow and become negligible by 2012 period. The Government debt-to-GDP ratio is expected to increase by 0.9 percentage points upon impact and the impact is expected to remain broadly of the same magnitude at the end of the forecast period when compared to the baseline scenario. Total revenue falls by 0.9 per cent upon impact, though by the end of the forecast period total revenue is almost unchanged relative to the baseline. Additionally, the decrease in consumption has a negligible impact on total expenditure by the end of the forecast period.

## **4.2 Comparison with the Projections in the December 2008 Update of the Stability Programme**

### **Economic Growth**

The macro-economic forecasting exercise underpinning the 2008 Update of the Stability Programme, carried out in the last quarter of 2008, was subject to an abnormal level of uncertainty as the economic and financial crisis was still unfolding. Indeed, major international institutions revised their projections downwards as the impact of the crisis became clearer. This Programme thus presents significant revisions to the growth outlook projected in the December 2008 Programme. The main revisions in real economic growth largely affect 2009 and 2010, with the forecast for 2011 remaining more in line with that presented in the 2008 Programme.

The impact of the international downturn on the local economy was mostly felt in 2009. Indeed, whilst in 2008 real growth was 0.7 percentage points lower than forecasted in the 2008 Programme, real economic growth

forecast for 2009 has been significantly revised downwards by 4.2 percentage points. The GDP growth rate for 2010 and 2011 has also been revised downwards by 1.4 percentage points and 0.5 percentage points, respectively.

In terms of composition of growth, the contribution of the external sector in 2008 was more positive than anticipated following a more accentuated than expected decline in imports. Developments in exports for 2008 were broadly in line with those outlined in the 2008 Programme while imports were 1.1 percentage points lower than forecasted. Such trends, albeit with higher magnitude, are expected to persist in 2009 with the drop in imports outpacing that of exports, thus contributing positively to growth. Indeed, the contribution of the external sector has been revised upwards by a significant margin. Meanwhile, the domestic sector's contribution to economic growth for 2008 and 2009 has been revised downwards mainly in view of the decline in the investment category of expenditure, whilst in 2009 both private and Government expenditure have also been revised downwards.

Growth in private consumption expenditure has been revised downwards by 2.9 and 0.5 percentage points for 2009 and 2010 respectively. This reflects the slower rate of growth in real disposable income associated with the slowdown in economic activity, as well as a deterioration in labour market outlook. For 2011, the growth in private consumption was revised marginally upwards by 0.2 percentage points.

The forecast for growth in Government consumption expenditure for 2009 has been revised down significantly by 2.7 percentage points from 2.9 per cent in 2008 to a marginal growth rate of 0.2 per cent in 2009. This is largely due to a base effect, reflecting revisions in 2008 Government consumption figures. For 2010, a decline in Government expenditure is expected at -1.1 per cent compared with -0.3 per cent in the 2008 Programme, whilst the expected decline in 2012 is broadly unchanged. These developments reflect the unfolding of fiscal consolidation over the Programme period.

Gross fixed capital formation for 2009 has been revised significantly downwards to a negative growth rate of 16.7 per cent. This revision is in line with the latest published national accounts data. On the other hand, growth in gross fixed capital formation in 2010 and 2011 has been revised upwards by 4.9 and 3.1 percentage points respectively, partly in view of a favourable base effect as well as the expected outlook for projects by both private and public sectors.

For 2008 and 2009 there were considerable upward revisions in the external sector's contribution to growth despite lower exports due to the fact that imports fell more sharply than exports. This reflects trends in exports and imports as emerging from latest published data for 2008 and the first three quarter of 2009. On the other hand, the external sector contribution to growth was revised downwards for 2010 and 2011.

### **Inflation and Employment Prospects**

The downward trend in inflation forecasted in the 2008 Programme has been maintained, albeit a sharper decline is forecasted in this Programme. Indeed, the inflation rate in 2009 was 0.9 percentage points lower than expected, standing at 1.8 per cent in December 2009. The inflation rate has been revised downwards by 0.6 percentage points for 2010.

Labour market indicators have been revised markedly in view of the updated economic outlook. In line with recently published data, the labour market is projected to be affected by the downturn in economic activity with a lag. The unemployment rate was revised upwards by 1.1 percentage points in 2009, whilst the extent of the revision is higher in 2010 and 2011 at 1.3 percentage points. Similarly, a slightly more pessimistic outlook is being projected for employment where employment growth is forecasted to decrease by 1.1 percentage points and 0.8 percentage points in 2010 and 2011 respectively when compared with the 2008 Programme.



## 5. Quality of Public Finances

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## 5. Quality of Public Finances

Government's fiscal plan for 2010 is aiming at addressing the fiscal imbalance over the medium-term, while providing the necessary support to the economy in these turbulent times. In fact, the 2010 Budget has been set against the backdrop of a still uncertain and hesitant economic recovery. The Maltese government is not losing sight of the need to provide a stable macro environment but at the same time it is planning for a protracted fiscal consolidation over the short term, such that the deficit ratio for 2010 will remain broadly unchanged from the 2009 level. Government will return to a more aggressive fiscal consolidation stance in 2011.

### 5.1 The 2010 Budget

The Budget for 2010 announced a number of fiscal consolidation measures which were designed so as not to impact unduly on economic activity. Meanwhile, efforts will be intensified further against tax evasion and fraud related to abuses from social benefits. This will contribute towards a fairer fiscal system and towards a social assistance network that is effectively targeting those who are most in need.

Simultaneously, support measures are targeted at encouraging investment and supporting the labour market. In this regard, the budgetary provisions for 2010 represent Government's enhanced efforts in areas that will improve the economy's productive capacity. These fiscal measures focus on the creation of new jobs, the upgrading of the skills of the workforce, and the provision of support to small and medium enterprises by facilitating investment and encouraging creativity, innovation and entrepreneurship. Furthermore, a number of initiatives are also earmarked towards investment in education, health and a social welfare system that ensures an all-inclusive and caring society. A number of measures aim at a sustained improvement in the environment. Moreover, the 2010 Budget announced a number of initiatives to improve the control and effectiveness of the fiscal framework.

### 5.2 Structural Measures

This section reviews the main fiscal measures announced in the 2010 Budget and their budgetary impact, which is also presented in Table 5.1.

#### Deficit Reducing One-Off Operations

In 2010, the reliance on deficit-reducing one-off operations is expected to stand at 0.2 per cent of GDP, broadly unchanged from that recorded in the preceding two years. It is noteworthy that since 2008, one-off revenue reflects proceeds from the sale of Government property.

#### Growth Enhancing Measures

As outlined above, Government's fiscal plan for 2010 focuses on supporting businesses and encouraging employment creation through incentives for business investment, research and innovation. These measures are earmarked towards the manufacturing industry, the tourism sector, and other emerging sectors, including the creative economy. These initiatives are expected to exert a budgetary impact of €5.8 million or 0.1 per cent of GDP.

In particular, the 2010 Budget allocated €2.5 million in a Reserve Fund aimed at assisting enterprises which are willing to invest but which, in spite of their fundamentally sound commercial prospects, are facing temporary difficulties. Furthermore, a fund of €10 million, or 0.2 per cent of GDP will be set up to provide micro-credit to small and medium enterprises and the self-employed. The fund, which is in part financed from EU funds, could be supplemented with a further €10 million from the European Investment Bank should demand warrant it. Moreover, the Budget for 2010 introduced specific fiscal measures aimed at encouraging investment by

## Main Measures Budget 2010<sup>1</sup>

Table 5.1

	€ million	Percentage of GDP
<b>Main Measures Impacting on Revenue</b>		
Growth Enhancing Measures	-1.6	—
Incentives for small and medium enterprises (SMEs) and creative economic sectors	-1.6	—
Measures Promoting a Sustainable Environment	-1.0	—
Amendments in the administration of eco-contribution	-2.5	
Reform of the registration tax and licencing of commercial vehicles	1.5	—
Additional Measures	11.7	0.2
Strengthening of enforcement against evasion of excise levy on petroleum	10.0	0.2
Revision in excise duty on cigarettes and other tobacco products	3.7	0.1
Removal of levy on credit cards	-2.0	—
<b>Total</b>	<b>9.1</b>	<b>0.2</b>
<b>Main Measures Impacting on Expenditure</b>		
Growth Enhancing Measures	13.1	0.2
Incentives for research, innovation and creativity	2.0	—
Incentives for industry and enterprise	5.8	0.1
Measures towards the promotion of the tourism industry	3.5	0.1
Labour market support measures	1.8	—
Measures Promoting a Sustainable Environment	1.5	—
Social Cohesion Measures	17.7	0.3
Increase in 'Child in Care' benefit	0.7	—
Financial assistance to households	10.0	0.2
Measures towards improved health care	7.0	0.1
Additional Measures	-14.8	-0.2
Restrictions on Recruitment of Public Sector Employees	-10.0	-0.2
Revised subvention to public entity	-4.8	-0.1
<b>Total</b>	<b>17.5</b>	<b>0.3</b>

<sup>1</sup> EU funded measures, though amounting to a substantial 0.5 per cent of GDP, are not included since these have a minimal impact on the fiscal position. EU funded measures include the provision of micro-credit to small and medium enterprises, the extension of an incentive scheme for industry, initiatives related to youth employment, as well as schemes promoting renewable energy sources.

self-employed persons and small enterprises. In particular, these measures, which are expected to result in a budgetary impact of €1.5 million, include a 40 per cent tax credit to self-employed, micro enterprises and sole traders who engage in the implementation of investment projects over the coming two years. Meanwhile, a fund of €0.2 million will be set up to sustain the crafts and artisans sector. Moreover, efforts will also be directed to expand awareness on enterprise and to enhance the entrepreneurial culture.

The 2010 Budget also announced an increase of €0.7 million in the allocation to Malta Enterprise, the agency responsible for the promotion of foreign investment and industrial development in Malta, to strengthen enterprise development and the provision of integrated services, enhance the promotion of foreign and local investment

with an emphasis on emerging high value added sectors, and to grant assistance to enterprises with strategic plans to engage in international business. The budget at the disposal of Malta Enterprise to implement business incentives schemes was also increased by €2.4 million. This increase should enable it to launch initiatives to encourage foreign investments in Malta. Furthermore, these initiatives aim to encourage foreign companies already operating in Malta to engage in vertical integration expansions in Malta. Foreign companies active in areas such as call centres, software development, digital gaming, human resources, accounts and finance management, market research and internet publication are being targeted. Moreover, the categories of enterprises eligible to benefit from the Reinvestment Tax Credit (Income Tax) Rules are also expected to be widened. Furthermore, the '20 Million for Industry' scheme that is administered by Malta Enterprise and part-financed through EU funds will be extended, providing a further €7 million, or 0.1 per cent of GDP in allowances to industries focusing on international competitiveness, innovation, research and development, and e-business.

Since the tourism industry is a significant contributor to employment creation and foreign exchange earnings, particular importance is being given to the industry. Similar to export-oriented manufacturing sectors, the tourism sector was hard hit by the international economic crisis. As announced in the Budget for 2010, Government will continue to strengthen its efforts to support the tourism industry during the current unfavourable international economic environment. For this purpose, the Budget for 2010 allocated an additional €3 million to the Malta Tourism Authority to intensify its marketing campaign and to step up its efforts to improve air links and to identify and tap underserved routes in order to improve Malta's accessibility. Moreover, the 2010 Budget provided for an allocation of €0.5 million to extend the schemes aimed at attracting international events to Malta.

The 2010 Budget also introduced specific measures aimed to stimulate employment creation. Indeed, an increase of €1.3 million is allocated to the Employment and Training Corporation to launch new initiatives which support those looking for employment. A number of support and training schemes will also be launched in order to ensure that unemployed youths are given the opportunity to retrain and be prepared to join the labour market. For this purpose, €6.2 million are to be allocated from the European Social Fund. Moreover the 2010 Budget provides financial resources for the implementation of measures related to the National Youth Policy, for which purpose, €0.2 million were allocated. Furthermore, in a bid to encourage higher female labour market participation, additional funds amounting to €0.3 million are earmarked to increase the provision of specialised childcare services. Furthermore, fiscal incentives will also be given to both parents whose children attend child care centres during the summer school holidays, as well as to employers that provide child care services for their employees' children.

Government recognises that research and innovation, as well as the development of new high value added activities, including niche targets related to artistic and technological creativity and innovation, are critical to ensure sustainable economic growth. In this context, the 2010 Budget allocated €1.7 million for various research and innovation initiatives. Furthermore, €0.3 million are earmarked for the promotion of economic activities which flourish on the back of artistic and cultural creativity, while a number of fiscal incentives in support of ICT, films, arts and design are expected to have a budgetary impact of €0.1 million.

### **Sustainable Environment**

As in previous years, the Budget for 2010 retains an emphasis on the promotion of a sustainable environment. Government also recognises the potential which the sector has to contribute towards economic and social development, and the creation of jobs. Indeed, in the 2010 Budget, Government introduced a number of measures earmarked towards a sustained improvement in the environment with a negative net budgetary impact estimated at €2.5 million.

In the 2010 Budget, Government introduced further amendments to the eco-contribution system aimed to recognise, through exemptions and refunds, the contribution to the environment given by producers who fulfil their environmental obligations with respect to the management of packaging waste. This measure is expected to have a budgetary impact of €2.5 million.

The reform of the motor vehicle tax system launched last year was continued with the reform in the registration tax and licensing of the commercial vehicles sector. The reformed commercial vehicle system is also based on the polluter pays principle, as both the registration tax and the annual circulation tax are emissions-based. The reform is expected to yield €1.5 million in Government revenue.

The 2010 Budget builds further on efforts implemented in past years and provides for the establishment of schemes, totalling a provision of €8 million or 1.1 per cent of GDP, to promote the use of renewable energy by households. These schemes are financed from EU funds. Moreover, the 2010 Budget also allocated a further €1.5 million to enhance the quality of the physical environment as well as to recognise efforts by enterprises and households to reduce their carbon footprint.

### **Social Cohesion Measures**

The Budget for 2010 also continued to strengthen social cohesion through the provision of enhanced assistance to families, as well as efforts towards improved healthcare. These measures are expected to exert a budgetary impact of €17.7 million.

In order to continue to invest in the protection of children, the 2010 Budget enhanced the 'Child in Care' benefit aimed to assist families providing foster care. This measure is expected to have a budgetary impact of €0.7 million.

As from January 2010, the utilities' tariff structure was revised to reflect the higher international price of oil. In this context, and taking into account the current difficult economic environment, the 2010 Budget provided for support to households' income which is anticipated to cost €10 million or 0.2 per cent of GDP. This support, which is linked to household size, also aims to promote energy efficiency and saving by assisting only those households whose consumption levels do not exceed a specific ceiling.

In view of Government's priority to the healthcare sector, the Budget announced measures aimed at improving the quality of public healthcare services. These include an allocation of €4 million or 0.1 per cent of GDP to reduce waiting lists for hospital procedures, and €3 million or 0.1 per cent of GDP to finance the expansion of the list of medicines provided by the national health service to eligible patients.

### **Additional Measures**

In the 2010 Budget, Government reiterated its commitment to intensify its efforts to reduce tax evasion and fiscal abuse. In particular, Government will continue to strengthen the enforcement against the evasion of excise levy on petroleum through enhanced physical checks and stricter penalties for users and traffickers of illegally imported fuel. This measure is expected to yield €10 million or 0.2 per cent of GDP in Government revenue. Government also announced the intensification of efforts against illegal importation activities which undermine an important source of government revenue, including that of cigarettes and alcohol, by increasing the penalties for this abuse. Moreover, coordination between the Income Tax and VAT Departments will be increased, particularly as regards the settlement of tax refunds.

The Budget for 2010 also announced revisions in the excise duties on cigarettes and other tobacco products. This measure is expected to generate €3.7 million or 0.1 per cent of GDP in Government revenue. Moreover, the 2010 Budget also announced the removal of the levy on credit cards. This measure is expected to reduce Government revenue by around €2 million.

Government will continue to implement its policy to restrict recruitment in non-essential categories in the public sector. As a result, the number of workers recruited in the public sector in 2010 is expected to be substantially less than the number of workers leaving the public service either due to resignations or because

they have reached retirement age. This is expected to result in a decrease in expenditure of around €10 million or 0.2 per cent of GDP.

Government is adopting a policy whereby entities having the potential to generate revenue from the sector in which they operate are encouraged to become independent of Government subventions. This policy releases resources that can be utilised in a more efficient manner. In this context, a new tariff structure for permits issued by the Malta Environment and Planning Authority<sup>1</sup> will come in force. This measure is expected to result in a decrease in expenditure of €4.8 million or 0.1 per cent of GDP

### 5.3 Determinants of the 2010 Fiscal Outcome

This section provides an analysis of the main determinants of the expected fiscal outcome for 2010, which are also presented in Table 5.2 and Chart 5.1. At a ratio to GDP of 3.9 per cent, in 2010, the general Government deficit is projected to remain broadly unchanged when compared to the deficit ratio for 2009 on account of an increase in the revenue-to-GDP ratio which is expected to almost offset a higher expenditure ratio to GDP.

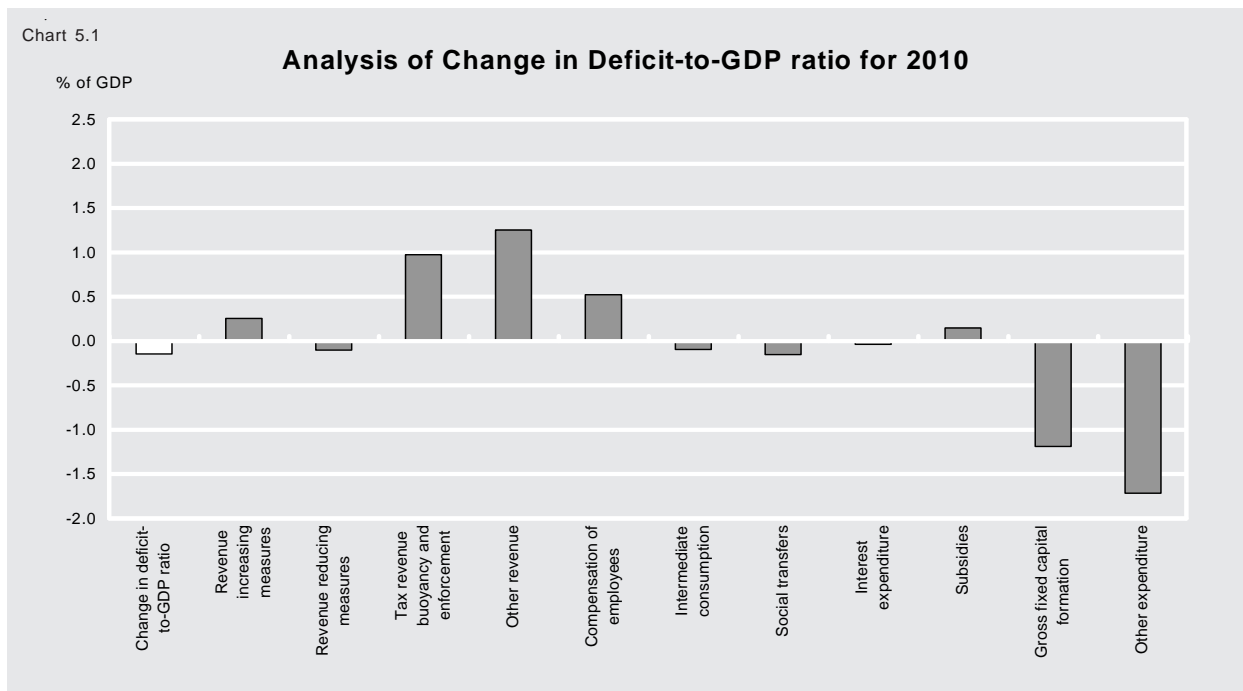
The revenue-to-GDP ratio is expected to increase by 2.4 percentage points of GDP, from 41.4 per cent in 2009 to 43.8 per cent in 2010, mainly on account of revenue buoyancy and higher ‘other’ revenue. Indeed, the category of ‘other’ revenue is expected to contribute to a 1.25 percentage point decline in the 2010 deficit-to-GDP ratio, mainly on account of higher funds forthcoming from the EU under the 2007-2013 Financial Framework. However, as highlighted below, such inflows correspond to similar increases in outlays and thus have a neutral impact on the budget balance. Meanwhile, tax buoyancy, which represents changes in tax revenue excluding the fiscal impact of the 2010 Budget measures as compared to GDP growth, is expected to have a positive effect on the deficit ratio of 0.97 percentage points of GDP. This impact partly includes the effect of ongoing efforts to curb tax evasion.

#### Analysis of the Change in the Deficit-to-GDP Ratio for 2010 (percentage points)

Table 5.2

Revenue increasing measures	0.25	
Revenue reducing measures	-0.10	
Tax revenue buoyancy and enforcement	0.97	
Other	1.25	
<b>Change in revenue ratio</b>		<b>2.38</b>
Compensation of employees	0.52	
Intermediate consumption	-0.10	
Total social transfers	-0.15	
Interest expenditure	-0.04	
Subsidies	0.15	
Gross fixed capital formation	-1.19	
Other	-1.72	
<b>Change in expenditure ratio</b>		<b>-2.52</b>
<b>Change in deficit ratio</b>		<b>-0.14</b>

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



The 2010 Budget announced both revenue reducing and revenue increasing measures, but overall the measures impacting on revenue are expected to contribute positively to the fiscal outcome. The revenue reducing measures announced in the 2010 Budget comprise the removal of the levy on credit cards, amendments to the eco-contribution system, as well as the introduction of incentives for small and medium enterprises (SMEs) and creative economic sectors, which are expected to encourage investment. These are expected to exert a 0.1 percentage point negative contribution in the deficit-to-GDP ratio. The revenue increasing measures, which include the revision in the excise duties on cigarettes and other tobacco products, the reform of the registration tax and licensing of commercial vehicles and the strengthening of enforcement against the evasion of excise levy on petroleum, are expected to improve the deficit by 0.25 percentage point of GDP in 2010. As a result, the main revenue measures of the 2010 Budget are expected to have a positive net effect on the deficit ratio of 0.15 percentage points of GDP.

The ratio of general Government expenditure to GDP is expected to increase from 45.2 per cent 2009 to 47.7 per cent in 2010, resulting in a worsening in the deficit-to-GDP ratio of 2.5 percentage points. The increase in the expenditure-to-GDP ratio mainly reflects significant increases in the 'other' expenditure category, in particular, increases in current and capital transfers. Indeed, current transfers are expected to increase primarily on account of support to household's income announced in the 2010 Budget in view of the revised utility tariff structure. Meanwhile, the projected increase in capital transfers reflects the implementation of projects financed from EU funds under the 2007-2013 Financial Framework and thus corresponds with analogous increases in revenue, as highlighted above. Moreover, capital transfers are also expected to increase on account of a number of temporary measures taken by Government in 2010 primarily in a bid to support small and medium enterprises by facilitating investment and encouraging creativity, innovation and entrepreneurship. These include measures financed from EU funds.

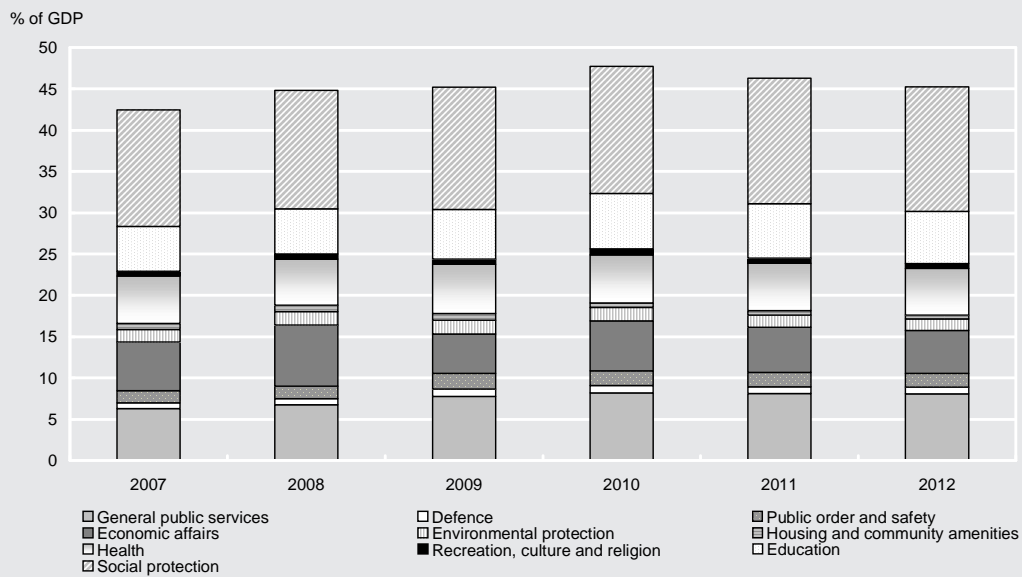
Meanwhile, an increase in the ratio of gross fixed capital formation is also expected to exert a negative impact of around 1.2 percentage points on the deficit-to-GDP ratio, primarily on account of higher expenditure related to capital projects financed from EU funds and of projects financed from national sources.

The anticipated increases in the ratios of the 'other' expenditure category and gross fixed capital formation as a per cent of GDP are expected to be in part offset by declines registered in the ratios of compensation of employees and subsidies. Compensation of employees is expected to contribute positively to the 2010 fiscal outcome by 0.52 percentage points of GDP. It is pertinent to note that the ratio of compensation of employees



Chart 5.2

### Functional Classification of General Government Expenditure



for 2009 was affected by outlays on the voluntary redundancy schemes to Malta Shipyards' employees<sup>2</sup>. Indeed, if this exceptional expenditure in 2009 is excluded, the ratio of compensation of employees in 2010 would remain at the same level as that recorded for 2009 on account of an increase in compensation of employees coupled with a similar increase in GDP. Furthermore, the subsidies-to-GDP ratio is expected to sustain the downward trend registered over the recent past years and exert a positive impact of 0.15 percentage points on the deficit-to-GDP ratio. The decline in subsidies primarily reflects the implementation of the public transport reform, as well as lower incentives to the film industry, following a significant high level of activity in 2009.

Meanwhile, the ratio of social payments to GDP is expected to increase in 2010 contributing negatively by 0.15 percentage points to the deficit-to-GDP ratio. This development reflects an increase in social payments mainly on account of higher expenditure on retirement and widows' pensions.

Other components of expenditure, namely intermediate consumption and interest expenditure are expected to adversely affect the deficit-to-GDP ratio only marginally. The ratio of intermediate consumption to GDP is expected to increase by 0.10 percentage points during 2010, whereas interest expenditure is expected to slightly affect the deficit-to-GDP ratio by 0.04 percentage points.

## 5.4 Functional Classification of Expenditure

This section analyses the following components of general Government expenditure by functional classification: Social Protection, General Public Services, Health, Economic Affairs and Education as well as Environmental Protection. Developments in these components of general Government expenditure as a share of GDP for the period 2007-2012 are presented in Chart 5.2 and Table 3 in the Statistical Appendix.

Expenditure on General Public Services as a ratio of GDP is expected to follow an upward trend, rising from 6.3 per cent in 2007 to 8.2 per cent of GDP in 2010, and then to decline marginally to 8.1 per cent in 2011 and 2012. The increase in the ratio of this item of expenditure in 2010 mainly reflects higher capital outlays including higher expected implementation of projects co-financed by the 2007-2013 Structural Fund Programme. Similarly, capital outlays are also expected to increase in the subsequent two years. However,

since the increases in the expenditure on General Public Services in absolute terms are coupled with similar increases in GDP, the expenditure ratio in 2011 and 2012 is expected to remain relatively stable.

The ratio of expenditure on Economic Affairs as a share of GDP rose by 1.5 percentage points to 7.4 per cent in 2008. This increase reflects the extension, on a temporary basis, of the subsidy to the energy corporation aimed to cushion the significant impact of higher international energy price increases as well as the voluntary redundancy schemes for employees of Malta Shipyards Ltd and the reclassification of the company in the general Government sector. As a result of these exceptional factors in 2008 and despite that part of the payments related to the voluntary retirement schemes for Shipyards employees were incurred in 2009, the ratio of expenditure on Economic Affairs fell sharply to 4.8 per cent in 2009. In 2010, expenditure on Economic Affairs as a per cent of GDP is expected to increase significantly, primarily reflecting the expected implementation of capital projects co-financed by EU Cohesion and Structural Funds under the 2007-2013 Programme. Moreover, higher outlays earmarked towards temporary support to the tourism sector and industry are also expected to contribute to a higher expenditure ratio in 2010. In view of these specific temporary allocations in 2010, the expenditure on Economic Affairs is expected to decrease in absolute terms in 2011 and remain relatively stable in 2012 thus leading to a decline in the ratio to GDP, to 5.5 per cent and 5.2 per cent in 2011 and 2012 respectively.

Government's policy seeks to achieve a balance between socio-economic development and environmental sustainability. The ratio of expenditure on Environmental Protection rose from 1.5 per cent of GDP in 2007 to 1.7 per cent of GDP in 2009, before following a declining trend to 1.4 per cent of GDP by the end of the Programme period. In 2010, lower capital outlays are forecasted as projects co-financed by EU Funds are completed. Meanwhile, higher outlays are earmarked for waste management. A similar marginal decline in expenditure on Environmental Protection is also projected in absolute terms in the subsequent two years.

The ratio of expenditure on Health to GDP rose to 6.0 per cent in 2009, mainly reflecting higher compensation of employees, as well as increased outlays in respect of operational and maintenance expenses as the new hospital became fully operational. During the 2010-2012 period, the ratio of expenditure on Health to GDP is expected to fall marginally to 5.7 per cent. Higher expenditure on compensation of employees is expected to be sustained throughout the Programme period, whilst increased outlays are also earmarked towards new health facilities.

Investment in education and training secures the development of a skilled and flexible workforce which is essential in an increasingly competitive environment. Expenditure on Education as a per cent of GDP is projected to follow an upward trend, rising from 5.4 per cent in 2007 to 6.7 per cent of GDP in 2010, thereafter decreasing by 0.4 percentage points to 6.3 per cent of GDP in 2012. The upward trajectory expected to be followed until 2010 is partly underpinned by higher compensation of employees which are expected to be sustained in subsequent years. More notably, in 2010, the increase in expenditure on Education also reflects significantly higher outlays towards the vocational training institute – the Malta College for Arts, Science and Technology (MCAST). Moreover, throughout the 2010-2012 period, higher outlays are also expected to be earmarked towards the University of Malta and significant outlays are also expected to be financed from the 2007-2013 Structural Funds Programme throughout the outer years of the Programme period. Since in absolute terms, expenditure on Education is expected to increase less rapidly than GDP, the ratio of expenditure is projected to decline in the outer years of the Programme period.

Expenditure on Social Protection accounts for around one third of total expenditure and mainly consists of outlays on pensions. The ratio of expenditure on Social Protection to GDP is expected to follow an upward trend from 14.1 per cent in 2007 to 15.4 per cent in 2010. It is pertinent to note that the increase in the expenditure ratio in 2010 partly reflects the temporary support to households in view of the revised tariff structures for utilities as well as higher capital outlays co-financed under the 2007-2013 EU Structural Funds Programme. Thereafter, expenditure on Social Protection is expected to decline to around 15.1 per cent in 2011 and 2012.

## **5.5 Integration between the Stability Programme and the National Reform Programme**

In 2008, the National Reform Programme (NRP), with its objective of consolidating and strengthening Government's reform plan, entered its second three-year cycle. The 2009 Progress Report represents the first follow up on the NRP for the 2008-2010 period. It provides an extensive overview of the initiatives and reforms undertaken over the year ending September 2009, in order to reach the objectives set out in the NRP. Indeed, this Progress Report attaches particular attention to addressing the challenges outlined in the country specific recommendations endorsed by the March 2009 European Council, as well as the national priorities which aim at enhancing Malta's competitiveness.

The current cycle of the NRP focuses on the creation of the right environment for growth and jobs, improvement in the sustainability of the healthcare system, the unlocking of business potential, investment in knowledge and innovation, energy and climate change, and investment in people and the modernization of the labour markets. Based on these priority areas, the strategy presented in the NRP addresses the key challenges of sustainability of public finances, competitiveness, the environment, education and training, and employment.

Akin to the first cycle, the 2008-2010 NRP was formulated within the context of the medium-term budgetary framework. Indeed, the priorities identified in the NRP were reaffirmed in the Budget for 2009 which announced concrete measures to make work more attractive, reduce bureaucracy and improve the skills of the workforce. Specifically, as highlighted in the NRP Progress Report, over the year ending September 2009 significant progress has been registered in different areas. One notes the emphasis on employment creation through the implementation of measures aimed at increasing female participation and employment among older persons, enhancing adaptability of the workforce through training, adopting measures to promote life-long learning, and attaining a healthier environment through the provision of the right fiscal incentives in the area of private transportation and adopting incentives to boost R&D in industry.

Central to Government's objectives remains the need to continue strengthening Malta's competitiveness. To this end, the Budget for 2010 announced a number of support measures aimed towards small and medium enterprises. These measures facilitate investment and innovation initiatives, encourage the creation of jobs and the upgrading of skills of the workforce and promote investment in education, health and a socially-just welfare system. A number of measures announced in the Budget 2010 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 period 2009-2012 encompasses the budgetary implications of the reform measures outlined in the NRP.

This section presents an Implementation Grid which illustrates the NRP measures aimed at addressing the national key challenges mentioned as well as indicates their status of implementation so far. The Implementation Grid has been compiled in collaboration with the Policy Development Directorate within the Ministry of Finance, the Economy and Investment. A review of the main measures, which were incorporated in the second cycle of the NRP 2008-2010, and re-affirmed in the Budget for 2009 and 2010, follows:

### **Sustainable Public Finances**

The sustainability of public finances remains a key medium-term objective in Government's agenda. As announced in the Budget for 2010, the Government plans to sustain efforts to improve the control and effectiveness of the fiscal framework. Specifically, Government reiterated a more determined commitment to reduce tax evasion and fiscal abuse in particular as regards social benefits. Moreover, Government will continue to implement its policy to restrict recruitment in non-essential categories in the public sector, thereby generating significant expenditure reductions.

As highlighted in the NRP, improving the sustainability of the health care system is an issue which needs to be tackled against the backdrop of Government's commitment to preserve the solidarity-based model of universal access to health care. Thus considerable attention is being devoted to enhancing entitlement policy to ensure that the provision of health services better addresses the real needs of patients. Government's efforts to address the sustainability of the health care system are in particular focused on health promotion and disease prevention and improvement of financial management and control systems. Various efforts are being undertaken to improve management of resources and achieve better value for money, including through reviews of procedures regulating the procurement, distribution and utilisation of medicines, through improved productivity and accountability levels and through a strengthening of mechanisms to verify entitlement. The shortage of specialised human resources is also being tackled, mainly through the set up of structured training.

## **Competitiveness**

A number of measures were announced in the Budget for 2010 aimed at the creation of the right environment for growth and jobs. More specifically, these measures included support to businesses and the provision of incentives for investment and research and innovation to the manufacturing industry, the tourism sector, and other emerging sectors in the cultural and creative/performing arts sectors of the economy.

## **Environment**

The sustainability of the environment has constituted a key priority in the 2009 and 2010 Budgets. The 2010 Budget announced a continuation of the reform of the motor vehicle tax system launched last year with the reform in the registration tax and licensing of the commercial vehicles sector based also on the polluter pays principle. Moreover, following the measures introduced in previous years, the 2010 Budget announced the continuation of the promotion of the generation of energy from alternative sources.

## **Education and Training**

Acknowledging that the workforce is central for Malta's current and future economic and social development, the 2010 Budget continued to attach particular importance to education and training in line with the strategy presented in the NRP. In particular, the 2010 Budget announced increased investment in education and training fields.

## **Employment**

The creation of more and better jobs remains a priority area for the Maltese Government. Indeed, the second cycle of the NRP aimed to continue to build on the positive performance of the labour market over the first cycle of the NRP. Also, in the 2010 Budget, Government announced specific measures aimed at stimulating employment creation. These measures included a number of initiatives aimed at supporting those looking for employment, measures to further encourage female participation and extending support to unemployed youths to facilitate their participation in the labour market.

### *Footnotes:*

<sup>1</sup> The Malta Environment and Planning Authority (MEPA) is the national agency responsible for land use planning and environmental regulation in Malta.

<sup>2</sup> The voluntary redundancy scheme to workers of Malta Shipyards Ltd. was launched in the second half of 2008. Outlays to finance the lump sum element of the scheme incurred in 2008 amounted to €41 million. A further €17 million were paid out in 2009 to the remaining workers who subscribed to the scheme in 2008 but who were retained in employment by the company in order to finish the ongoing workload.

NRP Implementation Grid										
Key challenges	Integrated Guidelines	Measure	Implementation		Direct budgetary costs (as a percentage of GDP)					
			Status	Timeline		2008	2009	2010	2011	2012
				Start	End					
Sustainability of Public Finances	3	Invest in sustainable Healthcare: • A new Healthcare Act	On hold	Q4 2005		-				
		• Strengthening of primary and community care	On-going	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				
		• Creation of a framework pricing policy for medicines that are introduced into the health service		Q4 2008		-				
Competitiveness	7	Strengthening research infrastructure at the University of Malta	On-going	Q4 2008	Q4 2011	0.03	0.11	0.10	0.10	-
		Increase Investment in R&I through the implementation of Malta's R&I programme	Not yet initiated	Q1 2009	Q4 2010	-	0.01	0.01	-	
		Introduce schemes which focus on the promotion of R&D, Innovation and Growth	On-going	Q4 2008	Q4 2010	0.05	0.21	0.20	-	
		Manufacturing research projects	Not yet initiated	Q1 2010	Q3 2012	-		---		
	14	Strengthen the Better Regulation Unit	On hold	Q4 2008		-				
		Complete the current Action Plan for Simplification	Fully implemented	Q1 2006	Q2 2009	-				
		Carry out an intensive, sectoral based consultation to target the key pain points felt by businesses	Fully implemented	Q1 2009	Q2 2009	-				
		Put in place consultation guidelines and better practice for use within the public administration	On-going	Q3 2009	Q3 2010	-				
		Review the customer care system within the public administration	On-going	Q1 2006	Q1 2009	---		-		
		Carry out a review of the enforcement regime(s)	On hold			-				

**NRP Implementation Grid**

continued

Key challenges	Integrated Guidelines	Measure	Implementation		Direct budgetary costs (as a percentage of GDP)					
			Status	Timeline		2008	2009	2010	2011	2012
				Start	End					
Competitiveness	10	Set up a one-stop-shop for the licensing/registration of commercial activities	On-going	Q3 2009	Q1 2010	-	...	-	-	-
	14	Carry out pre-diagnostic visits to local firms to increase IP awareness and assist SMEs to use IP that may benefit their business	On-going	Q2 2009	Q4 2010	-	---	-	-	-
		Carry out awareness activities such as an Intellectual Property information campaign as well as workshops and training events on IP	On-going	Q1 2008	Q4 2009	---	-	-	-	-
		Embark on a project for the digitization of all national patent records thus offering a complete database of all national patents	On-going	Q3 2009	Q4 2010	-	---	-	-	-
		On-line filing for patents as part of eGov services to local citizens	On-going	Q2 2009	Q4 2009	-	---	-	-	-
		Customize and implement other patent software tools	On-going	Q4 2009	Q4 2010	-	---	-	-	-
		On-line filing for trademarks as part of eGov services to the local citizens	On-going	Q2 2009	Q4 2009	-	---	-	-	-
		Implement a new trademark system which will facilitate processing of trademark applications and searching on national trademarks by interested parties	Not yet initiated	Q1 2010	Q4 2010	-	-	-	-	-
		Accession of Malta to the Madrid Protocol for the International Registration of Trademarks	Not yet initiated	Q2 2010	Q4 2010	-	-	-	-	-
		4	Reduction in income tax through the further widening of the tax bands	Fully implemented	Q4 2008	Q1 2009	-	0.21	-	-
	Reduction of maximum rate of income tax from 35% to 25%		Not yet initiated		Q4 2012	-	-	-	-	-
	10	Removal of airport departure tax	Fully implemented	Q4 2008	Q4 2008	-	0.12	-	-	-
	9	Develop a robust ICT environment and Next Generation Infrastructure	Not yet initiated	Q2 2008	Q4 2011	0.07	0.09	0.09	0.08	-
		Invest in a connected society	Not yet initiated	Q2 2008	Q4 2010	0.10	0.13	0.12	-	-
		Develop a smart workforce with the necessary ICT skills	On-going	Q2 2008	Q4 2010	0.13	0.17	0.17	-	-
		Enhance the quality of life of citizens through ICT	On-going	Q4 2010	Q4 2011	-	-	0.02	0.09	-
		Re-inventing government transformation and open government	On-going	Q2 2008	Q4 2012	0.08	0.10	0.10	0.09	0.09

**NRP Implementation Grid**

continued

Key challenges	Integrated Guidelines	Measure	Implementation		Direct budgetary costs (as a percentage of GDP)					
			Status	Timeline		2008	2009	2010	2011	2012
				Start	End					
Competitiveness	9	Taking care of e-business	On-going	Q2 2008	Q2 2010	—			-	
		Developing Malta as a world leader in ICT	On-going	Q2 2008	Q4 2010	-				
	10	Invest in the tourism sector: • Upgrade tourism zones in St. Paul's Bay, Qawra, Pembroke	On-going	Q4 2007	Q4 2010	0.07	0.07	0.06	-	
		• Developing Leaders for Change and Innovation in Tourism		Q4 2007	Q4 2012	0.01	0.01	0.01	0.01	0.01
		• Improvements to the coastal areas in Qawra and Sliema		Q4 2007	Q4 2012	0.01	0.01	0.01	0.01	0.01
		• A Master Plan for Cittadella		Q4 2008	Q2 2010	—			-	
Reform Public Land Transport	On-going	Q4 2007	Q4 2010	-						
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 sector		Q1 2010	Q4 2013	-		0.04	0.04	0.03
		• Promotion of Renewable Energy Sources in the commercial sector	On-going	Q4 2008	Q4 2010	0.02	0.08	0.07	-	
		• The introduction of tax incentives with a view to promote newer and cleaner commercial vehicles		Q4 2009	Q1 2010	-	...		-	
		• Reform in Vehicle Registration Tax Regime	Fully implemented	Q4 2008	Q1 2009	-	0.09	-		
Employment	17	Preventive and active labour market policies for increasing the overall employment rate	On-going	Q1 2008	Q4 2010	—		...	-	
		Employability Programme	On-going	Q2 2008	Q4 2011	0.02	0.02	0.02	0.02	-
	18	Training Aid Programme	On-going	Q2 2008	Q3 2013	0.02	0.03	0.03	0.03	0.03
	19	Employment Aid Programme	On-going	Q1 2009	Q4 2013	-	0.03	0.03	0.03	0.03
		Youth Employment Programme	On-going	Q4 2008	Q4 2011	—			-	
		Implementation of the Gender Equality Programme	On-going	Q1 2009	Q4 2010	-	—		-	
Social Inclusion Partnership Programme	Not yet initiated	Q3 2009	Q3 2012	-	—					

**NRP Implementation Grid**

continued

Key challenges	Integrated Guidelines	Measure	Implementation		Direct budgetary costs (as a percentage of GDP)					
			Status	Timeline		2008	2009	2010	2011	2012
				Start	End					
Employment	21	Increase educational programmes to instil a culture of health and safety at work for both employers and employees	On-going	Q1 2009	Q4 2010	-	...			-
		Improve the enforcement capabilities of the Occupational Health and Safety Authority	Put on hold/Abolished	Q1 2009	Q4 2010					-
Education and training	7	Bursaries for PhD students	On-going	Q1 2009	Q4 2013	-	0.03	0.03	0.03	0.03
	24	Investing in specialist education and training to develop the human capital of educators and trainers: • Building a state-of-the-art facility for ICT	On-going	Q4 2008	Q4 2013	0.01	0.06	0.06	0.05	0.05
		• Malta Government Scholarship Scheme (MGSS) Postgraduate Scheme		Q2 2009		-				
	23	• Promoting staff development in education sector and postgraduate studies in science and technology	On-going	Q1 2009	Q4 2013	-	0.04	0.04	0.04	0.03
	• MCAST scholarship for staff continuous development programmes	Q2 2009		Q4 2012	-	0.02	0.03	0.03	0.02	
	24	Address education and training needs of different sectors: • Valuing all skills for the labour market	On-going	Q1 2009	Q4 2011	-				-
		• Addressing skills mismatches in the aviation industry		Q2 2006	Q4 2015	0.01	0.01	0.01	0.01	
		• Parents and teachers fusion ICT training programme		Q2 2009	Q4 2010	-		0.01		-
		Open, distance and e-learning strategies, tools and programmes by MCAST, ITS and the University of Malta: • Launch e-Learning strategy and schools implementation	On-going	Q1 2009	Q4 2013	-	0.02	0.02	0.02	0.02
		• University of Malta IT Services Centre		Q4 2009	Q4 2013	-	0.01	0.03	0.03	0.03
	24	More adult education, training and retraining programmes: • Launch 2 new evening programmes for adults addressing skills gaps in emerging growth sectors at MCAST	On-going	Q4 2009	Q4 2012	-				
		• Launch 2 new evening programmes for adults addressing skills gaps in emerging growth sectors at the University of Malta		Q4 2009	Q4 2013					-



**NRP Implementation Grid**

continued

Key challenges	Integrated Guidelines	Measure	Implementation		Direct budgetary costs (as a percentage of GDP)					
			Status	Timeline		2008	2009	2010	2011	2012
				Start	End					
Education and Training	24	Licensing and quality assurance framework for Further and Higher Education: • Reform Education Act Cap 327 and publish regulations for the development of new licensing and quality assurance framework	Not yet initiated	Q4 2009	Q1 2010	-				
		• Launch Quality Assurance Agency		Q4 2009	Q1 2010	-	0.01	0.01	-	
		Increase financial support to the University of Malta to build its capability to conduct high quality teaching and research	On-going	Q4 2009		-	0.01	0.01	0.01	0.01

*Notes:*  
 Not applicable -  
 No data ...  
 Negligible \_\_\_\_



## 6. Sustainability of Public Finances

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## 6. Sustainability of Public Finances

Malta's population, similar to other developed and developing countries, will undergo dramatic changes due to low fertility and continuous gains in life expectancy. This demographic ageing is expected to be partly mitigated by inward migration. Population ageing is expected to have wide-ranging and long-lasting economic effects. In particular it will lead to significant pressures to increase public spending, representing a central issue in the endeavour of long-term fiscal sustainability.

This Chapter provides an assessment of Malta's long-term sustainability of public finances on the basis of long-term budgetary projections built on a set of common assumptions as prepared by the Economic Policy Committee (EPC). It provides an overview of the pension system in Malta, and an analysis of the projection results. The projections cover pensions, health care, long-term care, education and unemployment benefits for the period 2007-2060. The long-term projections that result from this exercise provide an indication of the timing and scale of economic changes that would result from an ageing population in a 'no-policy change' scenario.

### 6.1 The Pension System in Malta

As a result of the demographic shifts, the outlays on pensions paid by Government will rise over the coming decades leading to a worsening in the balance of the current system. In light of these developments in December 2006, the House of Representatives adopted a series of parametric reforms (Act No. XIX of 2006) to the definition of pension age, retirement before pension age, the full rate of two-thirds pension, calculation formula, the maximum pensionable income and the crediting of contributions as provided for under the preceding legislative framework. By virtue of Legal Notice 336 of 2006 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, 2006 will enter into force. Some of these measures entered into force as from 2007 while others shall come into force as from 1 January 2011. The reform law adopted by the Maltese Parliament is aimed at enhancing the sustainability of the pension system whilst improving the adequacy of the pension enjoyed by retirees in the future. Further detail on the pension system in Malta and the key pension reform parameters are provided in Appendix 6A.1.

### 6.2 Long-term Budgetary Projection Results for Malta

This section provides an analysis of the long-term sustainability of public finances for Malta for the period 2007-2060 on the basis of commonly agreed assumptions. The pension outlays projections incorporate the latest changes to the Social Security System, in particular the reform law enacted during December 2006. The model used in projecting pension expenditure was the World Bank's Pension Reform Options Simulation Toolkit (PROST) 12. Statistical Appendix Table 7 shows the expenditure components of the long-term budgetary projections as a percentage of GDP for the period 2007-2060 and the assumptions used.

#### 6.2.1 Assumptions Applied

The PROST input files were updated in order to incorporate the EPC assumptions. The assumptions included are the real GDP growth rate, labour productivity (growth rate per hour), inflation rate of 2 per cent, participation rate by age and gender, unemployment rate by age and gender, population (EUROPOP2008), fertility rate by age, mortality rate by age and gender, and net migration by age and gender. A number of variables included in the assumptions as provided by the EPC were not incorporated in the PROST workings for the pension projections, primarily due to the fact that such variables are not required as PROST inputs. Accordingly, the budgetary projections for Malta covering the period up to 2060 include the following two main sets of assumptions:

As regards the demographic evolution, the fertility rate for Malta is projected to increase from 1.4 children in 2008 to around 1.6 children in 2060, implying it still remains below the natural replacement rate of 2.1 children per woman. Life expectancy at birth for men is projected to rise by 8.1 years over the 2008 level to reach 83.9 years in 2060, whilst in the case of women it is expected to reach 88.2 years, an increase of 7.5 years over the respective 2008 level. This implies that despite some convergence, female life expectancy in 2060 is projected to remain 4.3 years higher than that of males. Meanwhile, life expectancy at 65 years for males is projected to increase by 5.5 years between 2008 and 2060, while for women it is projected to increase by 5.7 years during this period. Net migration inflows as a share of total population are projected to remain relatively stable at around 0.2 per cent.

As far as macroeconomic assumptions are concerned, we highlight that the inflation rate is assumed to remain constant at 2 per cent during the period of 2007-2060. Real GDP growth rate is assumed to hover around the 3 per cent per annum during the period of 2007-2020, declining gradually to around 1 per cent per annum by 2060. The unemployment rate is assumed to remain relatively stable at around the rate of 6.2 per cent. The female participation rate (15-64 years) is assumed to increase to 45.5 per cent by 2030 and to decline marginally to 45.1 per cent by 2060. The male participation rate (15-64 years) is assumed to decline to 77.6 per cent by 2010, increasing gradually to 84.0 per cent by 2030, declining to 83.0 per cent by 2040 and maintaining that rate throughout the projection period.

## 6.2.2 Demographic Developments

Population projections (EUROPOP2008) indicate that population in Malta by 2060 will be both smaller and older. Total population is projected to rise from around 410,000 in 2007 to around 432,000 in 2030, and to decline thereafter to around 405,000 by 2060. As shown in Table 6.1, the age structure of the Maltese population is projected to change significantly. The share of the very young people (aged 0-14 years) in the total population is projected to decline. From an economic perspective, the most significant change concerns the working-age population (aged 15-64 years), which reflects the share of the population that will bear the financial 'burden' of the elderly. After increasing from a share of 69.1 per cent in 2007 to 69.6 per cent in 2010 it will subsequently start to fall to 61.8 per cent by 2030, reaching 54.9 per cent in 2060. By contrast, the share of the elderly population (aged 65+ years) in total population will increase steeply from 14.3 per cent in 2007 to 32.4 per cent by 2060.

**Total Population, by Selected Age Groups**

Table 6.1

Age	2007	2010	2020	2030	2040	2050	2060
Total population							
0-14 yrs	68,135	64,507	62,272	60,253	53,971	52,107	51,265
15-64 yrs	283,437	288,011	277,929	266,895	261,352	242,162	222,205
65+ yrs	58,728	61,024	86,844	104,453	109,011	120,512	131,267
Total	410,300	413,542	427,045	431,601	424,334	414,781	404,737
Percentage distribution							
0-14 yrs	16.6	15.6	14.6	14.0	12.7	12.6	12.7
15-64 yrs	69.1	69.6	65.1	61.8	61.6	58.4	54.9
65+ yrs	14.3	14.8	20.3	24.2	25.7	29.1	32.4
Demographic dependency ratio							
Youth dependency ratio (0-14 yrs)	24.0	22.4	22.4	22.6	20.7	21.5	23.1
Old-age dependency ratio (65+ yrs)	20.7	21.2	31.2	39.1	41.7	49.8	59.1
Total dependency ratio	44.8	43.6	53.7	61.7	62.4	71.3	82.1
Support ratio							
15-64 yrs*/65+ yrs	4.8	4.7	3.2	2.6	2.4	2.0	1.7

Note: Figures may not add up due to the rounding

Source: EUROPOP2008, Eurostat

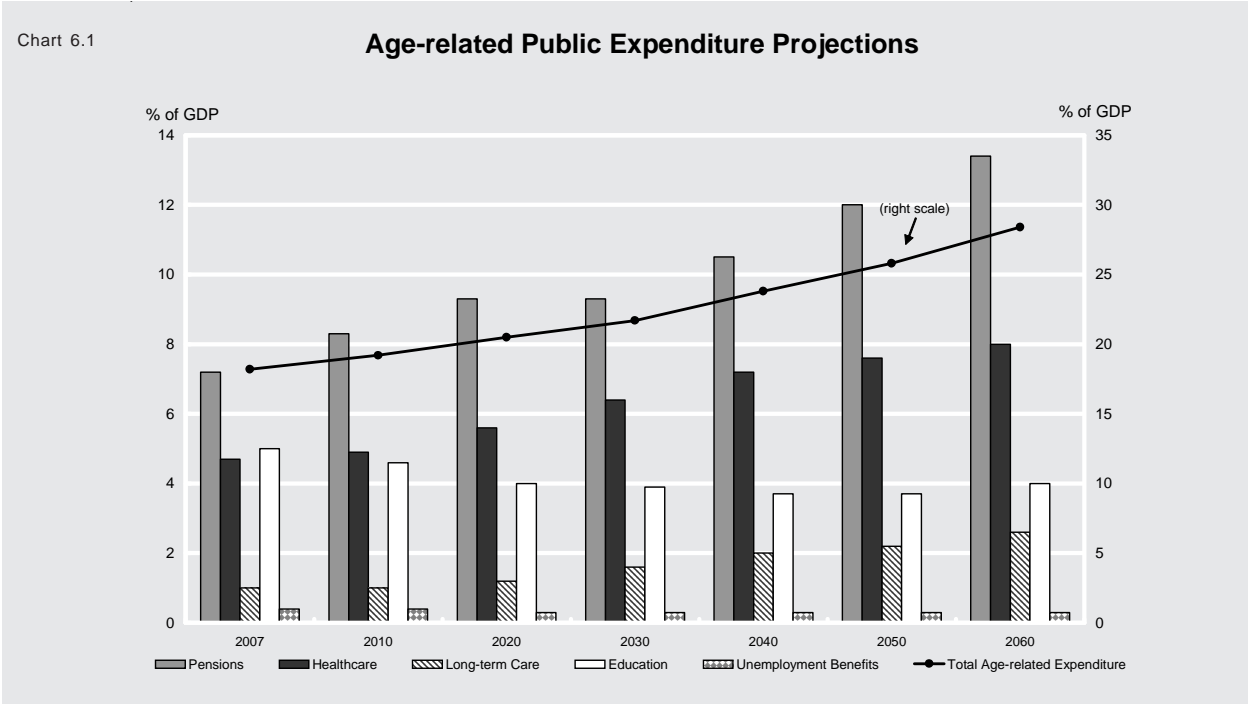
The dynamics of the ageing process could be better appreciated by analysing the developments in the relative share of the elderly to the working-age population. These dependency ratios relate the number of individuals that are likely to be “dependent” on the support of others for their daily living – youths and the elderly – to the number of those individuals who are capable of providing such support. The key indicator of age dependency in Table 6.1 relates the number of individuals aged less than 15 years and of those aged 65 and over to the population aged 15-64 years. Two other indicators are presented in Table 6.1: the youth-dependency ratio (for individuals aged less than 15 years) and the old-age-dependency ratio (for persons aged 65 years and above), both calculated relative to the number of individuals aged 15-64 years.

The youth dependency ratio (0-14 years bracket as a percentage of the 15-64 year bracket) is expected to decrease from 24.0 per cent in 2007 to 23.1 per cent by 2060, a decrease of around 0.9 percentage points. The old-age dependency ratio (65+ year bracket as a percentage of the 15-64 year bracket) is expected to increase persistently from 20.7 per cent in 2007 to 59.1 per cent in 2060, an increase of 38.4 percentage points. Thus, by 2060, the total dependency ratio, which is the combined burden of these two components of the economically active population, will amount to 82.1 per cent, which means that every person in the working age population will have to support around 0.8 non-active persons compared to 0.4 non-active persons in 2007. As a result of these demographic developments, the support ratio, which is the ratio of the number of persons of working-age (15-64 years) to the number of persons aged 65 years and over, declines steadily over the projection period, reaching 1.7 by 2060. This means that while in 2007 there were around 5 persons of working age for every person that reached pension age, by 2060 this ratio will decrease to around 2 persons of working age for every person that reached pension age.

### 6.2.3 Age-related Public Expenditure

Age-related spending including pensions, health care, long-term care, education and unemployment benefits in Malta is projected to increase by 10.2 percentage points of GDP over the period 2007-2060. Chart 6.1 shows the age-related public expenditure as a share of GDP for this projection period.

Public expenditure on pensions is the most important age-related government expenditure item, in terms of size both at present and in the future. Pension schemes in Malta mainly include the two-thirds retirement pension, survivors’ pension and the invalidity pensions. At present, private pensions play a rather minor role as regards pension provision for the old-aged persons. Over the projection period 2007-2060, pension expenditure in Malta is projected to rise from 7.2 per cent of GDP in 2007 to 13.4 per cent of GDP by 2060.<sup>1</sup>



This increase in pension expenditure is primarily attributable to old-age pension expenditure where such an increase is driven by the ageing process. However, it is pertinent to point out that the parametric changes introduced in the pension reform (outlined in 6A.1) also contribute to raise expenditure. Conversely, the increase in the pension age, the increase in the contribution period for full pension eligibility and the changes to the benefit formula contribute to lower the projected increase in pension expenditure. However, at the same time, the more dynamic indexation of the ceiling on pensionable income, the statutory changes to indexation for old-age pensions and the introduction of the guaranteed national minimum pension for persons retiring from 2026 onwards contribute to increase the expenditure pressure.

Another important contributor to the increase in age-related spending is healthcare. Projections indicate that Malta is projected to record an increase of 3.3 percentage points of GDP in health care and an increase of 1.6 percentage points of GDP in long-term care during the period 2007-2060. This increased spending on health care and long-term care is primarily due to an ageing society and an increase in life-expectancy at birth over the projection period. Moreover, since part of the gain in life expectancy may be spent in moderate health this may impact spending on health and long-term care. On the other hand, public spending on unemployment benefits as a proportion of GDP is projected to remain relatively unchanged between 2007 and 2060. Additionally, education spending is projected to decrease by 1.0 percentage points of GDP during the projection period in light of the projected changes in the population of persons in education.

### 6.3 Further Developments

The pension reform law of 2006 has enshrined the principle of ongoing review of the pension system in Malta. Long-term financial projections pose a modelling challenge and are sensitive to slight changes in the underlying assumptions. Government is committed to continuously review developments in the pension system in Malta, including through the updating of long-term projections and to ascertain that policies are fine-tuned to emerging realities. It is expected that during 2010, the first report reviewing the state of pensions in Malta together with recommendations for achieving further adequacy, sustainability and social solidarity will be submitted to the House of Representatives.

On a more pragmatic level, one highlights that during the course of 2008, the Pensions Working Group has been re-constituted with the aim of making recommendations regarding the introduction of funded second and third pensions in Malta. Work has been undertaken in an effort to ascertain the contribution which the introduction of the 2<sup>nd</sup> and 3<sup>rd</sup> Pillar pensions could make towards enhancing the system's adequacy aspects, while strengthening its financial sustainability. The work undertaken thus far included specifically looking into the impact which the financial crisis is having on pension systems which rely heavily on defined contribution schemes. It is being hoped that experiences are drawn from current developments in financial markets and the respective impacts on private pension schemes with a view to strike a healthy balance between the respective roles of governments and of financial markets in pension systems which are more tuned to emerging realities.

*Footnote:*

<sup>1</sup> Pension payments projections cover the contributory pension (outlined in 6A.1) paid under the Social Security Scheme and do not cover non-contributory old-age pensions.



# Appendix 6A

## 6A.1 The Pension System in Malta

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

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

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

Contributions are payable by all gainfully occupied persons between the age of 16 and their pension age.<sup>1</sup> The scheme allows for different types of contributions in order to extend coverage to all types of persons in employment, including employed persons and self-occupied persons<sup>2</sup>. For each person, a tripartite contribution is payable: the employed person, the employer and the State each pay 10 per cent of the basic salary of the employee; with the contribution capped to the Maximum Pensionable Income that stood at €16,419 in 2007, which is 25 per cent higher than the average wage. The rate of contributions by self-occupied persons is shared by the State and self-occupied persons, whereby the self-occupied pays 15 per cent and the State pays 7.5 per cent of their annual income that is subject to the same ceiling that applies for employees.

### 6A.1.2 Key Pension Reform Parameters

This section focuses on the key pension parameters of the old-age pension (also known as the Two-Thirds Pension Scheme) that were addressed in the pension reform in December 2006. Table 6A.1 provides an outline of selected parameters of the pension reform.

#### The Definition of Pension Age

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

As outlined in Table 6A.1, in the case of a person born on or before the 31 December 1951, pension age shall be sixty-one years while for females pension age shall be sixty years; in the case of a person born during the calendar years 1952-1955, pension age shall be sixty-two years; for persons born during the period 1956-1958, pension age shall be sixty-three years; for persons born in the period 1959-1961, pension age shall be sixty-four years.

#### Retirement before the Pension Age

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

contributions paid required to collect a pension currently set at ten years. Following the reform, a person who has attained the age of sixty-one years but has not yet attained pension age, may after attaining sixty-one years of age claim a pension in respect of retirement if such person is no longer gainfully occupied. It is necessary that since reaching his eighteenth birthday, the claimant has had a total of:

- 2,080 (or 40 years) paid or credited contributions in the case of a person born on or after 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.

## Pensionable Income

Prior to the enactment of the pension reform law, the pension was determined on the basis of the yearly average of the basic wage<sup>3</sup> during the best three years of the last ten years in the case of employees while the best ten years were taken into consideration for self-occupied persons. Under the reform law, in the case

### Pension Reform: Summary of Selected Measures

Table 6A.1

		Pension Age			
		Before		After	
		Males	Females	Males	Females
	<b>2004</b>	61	60	61	60
	<b>2010</b>	61	60	61	60
	<b>2013</b>	61	60	62	62
	<b>2018</b>	61	60	63	63
	<b>2022</b>	61	60	64	64
	<b>2026</b>	61	60	65	65
No. of Contributions Years for Full-Pension Entitlement					
Before		30 years			
After	Born on or before 31 December 1951	30 years			
	Born between the years 1952 to 1961	35 years			
	Born on or after 1 January 1962	40 years			
Calculation of Pensionable Income					
Before	Best 3 out of last 10 years for employed persons Last 10 years for self-occupied persons				
After	No change for persons born before 1962 For persons born on or after 1962 pension shall be determined as the yearly average of the basic wage/ salary/net income/net earnings of the best 10 years within the last 40 years				
Minimum Pension					
Before	4/5ths of the National Minimum Wage for a couple 2/3 of the National Minimum Wage for any other person				
After	Establishment of the Guaranteed National Minimum Pension payable at a rate that is not less than 60 per cent of the National Median Income				

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. In determining pensionable income, past wages and incomes are updated with the cost of living adjustment (COLA) granted with respect to those years.<sup>4</sup>

### **Pension Formula**

Prior to the reform, the pension formula for the Two-Thirds pension was as follows:

$$\text{Contribution}_{\text{Average}} * \left(\frac{2}{3}\right) * \text{Pensionable}_{\text{Income}} - \text{Service}_{\text{Pension}}^5$$

where the Contribution Average was determined as the average of two averages with the first average being the average weekly contribution over the last ten years prior to retirement (Avg\_Cont10) and second being the average weekly contribution paid during a maximum of twenty years falling prior the last ten years before the retirement of an insured person (Avg\_Cont20):

$$\text{Contribution}_{\text{Average}} = \frac{(\text{Avg}_{\text{Cont}}_{10} + \text{Avg}_{\text{Cont}}_{20}) / 2}{50}$$

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

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

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

### **The Maximum Pensionable Income**

Prior to the reform, the maximum pensionable income was fixed by law and was revised in recent years in line with the COLA. Following the reform, in the case of a person born on or before the 31 December 1961, whose retirement occurs on or after the 1 January 2007, the basic wage/salary/net income/net earnings and the resultant pensionable income, 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 1952-1961, the resultant pensionable income including any such cost of living increase shall not exceed the sum of €20,964.36.

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

### **The Guaranteed National Minimum Pension**

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

### **Crediting of Contributions**

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

### **Pension Indexation**

Persons born before the 1 of January 1962 (including present retirees) have their pension updated on the basis of the COLA as well as any increases in wages presently awarded through collective bargaining to the occupation or salary scale previously occupied by the person in retirement. Following the pension reform, persons born after the 1 of January 1962 will have their pension updated annually by such a sum that corresponds to 70 per cent of the increase in the national average wage and 30 per cent of the inflation rate as published by 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 is due in 2010. The Minister, in concurrence with the Minister of Finance has the power to make and vary any regulations requiring persons who have not reached pension age and their employers as the case may be, to make contributions into Mandatory Second Pension Funds. Such regulations may provide for the rate of contribution payable, method and frequency of payment. Second Pension funds shall be governed by the Special Funds (Regulation) Act (Cap. 450). The Minister may in conjunction with the Minister for Finance provide exemptions from income tax in respect of contributions made by any person to Third Pension funds. These funds will be governed by the Special Funds (Regulation) Act (Cap. 403) as applicable.

### **Other Reforms**

Moreover, the Maltese Government also introduced changes to regime regulating the award of the invalidity pensions and the review procedure. The new regime was implemented over the course of 2007 after the

necessary legislative and organisational changes were instituted. In view of these measures, the number of invalidity pensioners<sup>6</sup> declined from 8,990 persons in 2007 to 8,287 persons in 2008. These measures introduced a new medical review process for this benefit and amongst the measures involved one finds:

(i) Change the application format – to include more medical data and further responsibility on the part of the claimant to prove his case. No invalidity pension is issued for life and each case is subject to regular reviews. All cases are reviewed every three to four years – where updated medical evidence is requested from the beneficiary.

(ii) Change the current medical panel system – under the new system, the Department of Social Security has recruited medical practitioners through an Expression of Interest to act as a Medical Review Team. The Team's main function is to advise the Director (Social Security) on the medical aspects of Invalidity claims.

(iii) Establish specific medical criteria for the award of benefits – this has been achieved by establishing “Impairment Tables” that provide the basic guidelines under which that Medical Review Team would decide on work-related impairment for Invalidity pension.

(iv) Establish an independent systems audit – Establish a medical audit for benefit claims awarded and rejected on medical grounds, in order to establish whether such benefits have been awarded correctly.

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

*Footnotes:*

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

<sup>2</sup> A self-occupied person is defined by the Social Security Act as “person who is engaged in any activity through which earnings exceeding €910 per annum are being derived”.

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

<sup>4</sup> 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 Retail Price Index 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 1 January 2007.

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

<sup>6</sup> Invalidity Pensions include Invalidity Pension, Increased Invalidity Pension and National Minimum Invalidity Pension.



## **7. Institutional Features of Public Finances**

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## 7. Institutional Features of Public Finances

The Maltese Government acknowledges that a strong national fiscal framework, encompassing the rules, regulations and procedures that influence how budgetary policy is planned, approved, carried out and monitored, is an important factor contributing towards attaining sound budgetary positions.

Government remains committed to steer a course towards the gradual but consistent improvement of the fiscal framework in Malta. Similar strengthening will allow for a more effective contribution of public spending towards the attainment of government's social and economic objectives. On a more general level, the Maltese Government recognises the importance of an efficient functioning of public administration towards the attainment of a healthy macro-economic environment which supports economic growth and the delivery of social assistance programs targeting the needy sections of the population.

The key elements of Government's current programme of improving quality of public finances include improving the national budgetary, institutional and legislative framework, increasing accountability, improving efficiency, and curbing abuse in social benefits and tax evasion.

### 7.1 The Budgetary Process – Design, Implementation and Monitoring

Since the past recent years, the Pre-Budget Document has been an integral part of the annual Budget process, providing an overview of the state of the economy and outlining policy options for the implementation of Government's vision for Malta's economic and social development. The Pre-Budget Document 2010 included an in-depth review of recent and current economic performance as well as a detailed analysis of national competitiveness, the labour market, the fiscal position and regional development. The Pre-Budget Document launches a national debate and consultation process on various policy challenges and proposes initiatives in advance of the Budget, prompting discussion amongst 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 against the backdrop of Government's overall economic and social targets as expressed within the framework of the fiscal programme. These fiscal targets 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.

In Malta, 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 the conduct of 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, and of public sector organisations. 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 encouraged by the Financial Management Monitoring Unit, also within the Ministry of Finance, the Economy and Investment, which supervises the financial operations of public entities.

Public funds are also managed and supervised by the Accountant General 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 scrutinised 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 plans and implements borrowing strategies. The Treasury also prepares debt sustainability analysis to assess the long-term sustainability of projected public sector borrowing levels.

## **7.2 Strengthening the Fiscal Framework**

Government acknowledges that strong national fiscal governance is of essence for the achievement of sound and sustainable public finances. This is particularly relevant at this juncture when space for fiscal manoeuvre is limited. In particular, Government is actively looking at improvements in the fiscal institutional framework, as well as at ways which lead towards a stronger budget execution discipline and better integration of the medium-term strategy in budgetary formulation.

It is recognised that reforms affecting the fiscal framework are complex and present particular challenges as they involve changing practices which have become established within the administration of public finances. In this context, in recent months, Government has sought the expert technical advice of international institutions having practical experience in the design, implementation and reform of national fiscal frameworks such that, with the active involvement of the national authorities the optimal budgetary framework within the context of the wider macro-economic scenario is developed.

Moreover, the Financial Administration and Audit Act (Cap. 174) will be updated, with the aim of strengthening the fiscal and budgetary policy and framework, thus achieving an enhanced level of transparency and accountability.

## **7.3 Control and Effectiveness of the Fiscal Framework**

Over the past decade, Government has implemented various measures aimed at increasing accountability and control of the fiscal framework. Implemented measures mainly comprised largely administrative procedures which, over the years, resulted in significant improvements being registered in the provision of public services, in the quality of public finances, as well as in promoting a network of support services to the genuinely disadvantaged sections of the population. In particular, reforms involved the management methods in public administration, a range of expenditure savings measures, as well as increasing oversight of the budgetary framework.

Administrative reforms targeting the provision of public services are tangible proof of Government's commitment to modernise the public administration, improve governance and human resource management quality, increase the effectiveness and efficiency of the provision of the public service, and to increase the wellbeing of society. In this context, specific objectives related to fiscal discipline and service delivery have been included in the performance contracts of the management class of the public service.

Achieving modern, high quality and customer-focused public services remains a key Government priority. However, 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. In this context, past efforts included targeted cost-cutting initiatives and the reduction of subsidies traditionally allocated to public entities. More recently, it is being explicitly recognised that the attainment of objectives which include the realisation of efficiency gains, the control of costs within the parameters set out by the budget and the achievement of an improved service to the public constitute important parameters for the evaluation of the performance of all public service employees. Moreover, the 2010 Budget announced several measures intended to increase the control and effectiveness of public expenditure. In a bid to reduce public expenditure, the

financial allocations to the various Ministries and Departments for 2010 were either retained at the same level as in 2009, or were reduced. Further savings are envisaged to result from Government's policy to restrict recruitment in non-essential categories in the public sector. These measures contribute to secure maximum value for money in public services and to release resources for frontline service delivery.

In addition, in relation to Government's priority of increasing control of the budgetary framework, the financial management and control system in the public service is expected to be improved by the introduction of a new accounting system for Government. Meanwhile, notwithstanding the significant progress achieved in the curtailment of social benefits fraud in the past years, leading to savings of around €13 million over the last four years or an average of 0.06 per cent of GDP per year, efforts will be intensified further against fraud related to abuses from social benefits with the integration of various sections of inspectorate under the Ministry of Social Policy. Moreover, the single means testing mechanism, relating to the process for persons to qualify for services and social benefits, will be reformed so that the mechanism is easier and more transparent, while ensuring it is not abused.

In the budget for 2010 the Government announced the introduction of a number of provisions specifically targeted at decreasing uncertainties in the application and interpretation of fiscal laws with the aim of avoiding tax leakages. Furthermore, at an institutional level, tax collecting entities will be integrated, thus placing them in a better position to enforce fiscal laws while at the same time enabling them to provide an improved service to clients. Co-ordination between tax collecting entities is being enhanced and as from 1 June 2010, VAT and income tax refunds will not be paid if the taxpayer has not fulfilled the tax reporting obligations under both systems. This measure will also encourage taxpayers to fulfill their tax returns filing obligations in time. Efforts to further curtail illegal importation of goods will also be stepped up. Measures include the introduction of stricter penalties and increased physical checks. The Government is also fostering reciprocal trust between departments and taxpayers by developing a Taxpayer's Charter which will outline taxpayer's rights, the service and level of service that should be expected from the various departments, as well as tax obligations.

## **7.4 Improving the Legal and Administrative Framework for Fiscal Management - The Public Administration Act**

The Public Administration Act (Cap. 497), which came into effect in 2009 and provides a comprehensive legal framework for public administration, aims to affirm the values of public administration as an instrument for the common good, to provide for the application of those values throughout the public sector, and to provide for the organisation and management of the public sector. Indeed, this Act aims to strengthen the public services' leadership, improve efficiency, strengthen the ethical framework of public administration and provide for the establishment of agencies.

The Act also enhances the efficient use of public resources. In particular, this Act calls for departments, agencies and government entities, and public employees to efficiently and effectively implement Government's policies. Indeed, heads of departments are responsible to manage their department economically, efficiently and effectively, ensure that services are delivered well, establish departmental performance indicators and co-ordinate activities with other organisations.

Moreover, public employees are called to provide their services to the public in the most economical, efficient and effective manner possible. Indeed, this Act places particular emphasis on customer focus, public service delivery and increased public service efficiency.

The Public Administration Act incorporates a Code of Ethics for all Government employees and an obligation on all public employees to comply with the Code. The Public Administration Act is to be seen in the light of the various rules and guidelines prepared in anticipation of the entering into force of this Act, namely a revised Code of Ethics for Board Directors in the Public Sector and a second document entitled 'Corporate Governance Framework for Public Sector Entities'.



## **8. Implementation of the Excessive Deficit Procedure Recommendation to Malta**

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## 8. Implementation of the Excessive Deficit Procedure Recommendation to Malta

### 8.1 Background

On 7 July 2009, the Ecofin Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community, that an excessive deficit exists in Malta, and issued recommendations, under Article 104(7), to correct the excessive deficit by 2010, at the latest. The Council established a deadline of 7 January 2010 to rigorously implement the budgetary measures planned for 2009 and to specify the necessary measures to progress towards the correction of the excessive deficit. The Council Recommendation specified that the assessment of whether effective action has been taken will take into account economic developments compared to the economic outlook in the Commission services' Spring 2009 forecasts, which underpinned the Recommendation.

In January 2010, against the backdrop of a significant downward revision in the economic outlook for 2009, the EU Commission reported on budgetary developments. It concluded that the unexpected adverse economic events had major unfavourable consequences for government finances and that Malta had taken effective action as required by the Council Recommendation of 7 July 2009. In accordance with the Stability and Growth Pact, on 16th February, the Ecofin Council adopted a revised recommendation for Malta under Article 126(7) of the Treaty on the Functioning of the European Union. The revised recommendation provides for an extension of one year, to 2011, to the deadline for the correction of the excessive deficit situation. The following are the revised Council Recommendations to Malta.

### 8.2 Council Recommendations to Malta

- (1) The Maltese authorities should put an end to the present excessive deficit situation by 2011.
- (2) The Maltese authorities should bring the general Government deficit below 3 per cent of GDP in a credible and sustainable manner. Specifically, to this end, the Maltese authorities should:
  - (a) achieve the 2010 deficit target set in the budget, if necessary by adopting additional consolidation measures, and ensure in 2011 a fiscal effort of  $\frac{3}{4}$  p.p. of GDP. This should also contribute to bringing the general government gross debt ratio back on a declining path that approaches the 60 per cent of GDP reference value at a satisfactory pace by restoring an adequate level of the primary surplus;
  - (b) specify the measures that are necessary to achieve the correction of the excessive deficit by 2011, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.
- (3) In addition, the Maltese authorities should seize any opportunity beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the 60 per cent of GDP reference value.
- (4) To limit risks to the adjustment, the Maltese authorities should strengthen the binding nature of its medium-term budgetary framework and improve the monitoring of budget execution throughout the year.
- (5) The Council establishes the deadline of 16 August 2010 for the Maltese Government to take effective action to achieve the 2010 deficit target and to outline the measures that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast. The Maltese authorities should report on progress made in the implementation of these recommendations in a separate Chapter in the updates of the stability programmes which will be prepared in 2010 and 2011.

In addition, the Council invites the Maltese authorities to implement reforms with a view to raising potential GDP growth. This includes reforms conducive to enhancing the quality of public finances. In particular, reforms should be geared towards enhancing the efficiency of government expenditure, especially in the high resource-absorbing areas of health and education. In addition, to reduce the risks to the long-term sustainability of public finances, the Maltese authorities are invited to pursue further reforms of the social security system and reduce the budgetary costs of ageing populations.

## **8.3 Implementation of the Recommendations**

Malta is committed to implement the recommendations of the Council adopted on 16th February 2010. The Budget for 2010 sets a fiscal target of 3.9 per cent of GDP, broadly unchanged from the deficit ratio expected for 2009. A number of fiscal consolidation measures for 2010 were announced and Government's objective is to reduce the deficit below 3 per cent of GDP in 2011, as outlined in the fiscal trajectory presented in this Programme.

### **8.3.1 Short-term Fiscal Strategy**

The Budget for 2010 aims to keep the deficit-to-GDP ratio broadly stable. Against the backdrop of a still hesitant international economic recovery and the somewhat lagged effect that the international crisis is having on the domestic economy, further support will be provided to economic activity in 2010. In this context, the Budget announced a number of stimulus measures, mainly earmarked to encourage investment and employment. These have a fiscal impact of around 1.1 per cent of GDP. Measures amounting to 0.6 per cent of GDP will be financed from domestic resources. The remaining measures, amounting to 0.5 per cent of GDP, will be largely financed from EU funds and will thus have a minimal impact upon the fiscal position. At the same time, the 2010 Budget announced fiscal consolidation measures amounting to around 0.5 per cent of GDP. As a result, the deficit is projected at 3.9 per cent of GDP in 2010, compared to the expected 3.8 per cent in 2009. Further detail on the specific measures announced in the Budget for 2010, and their estimated fiscal impact, is provided in Chapter 5 of this Update of the Stability Programme. An overview of the status of the implementation of the main Budget measures follows.

The fiscal consolidation measures included both revenue and expenditure measures. As regards revenue increasing measures, the excise duty measures entered into force with the presentation of the Budget for 2010 in November 2009. Legislation which will revise taxation of commercial vehicles is currently being discussed in Parliament. On the expenditure side, the measure affecting the tariffs imposed by the public entity responsible for issuing development permits is at an advanced planning stage, whilst the ongoing measures involving restricting public sector employment and curbing fiscal abuse are being stepped up. Furthermore, the contribution per night spent in paid accommodation, which was announced in the Budget for 2009, will enter into force in April 2010 as planned.

The Budget for 2010 announced various incentive schemes earmarked at encouraging investment and supporting the labour market. The schemes earmarked for the manufacturing industry and emerging high value added sectors are part of the investment promotion programme for 2010. The scheme with incentives for small and medium enterprises was launched in January 2010. Measures supporting the tourism industry are an extension of ongoing initiatives. The labour market support measures announced in the Budget Speech will be implemented as part of the programme for active labour market measures for 2010.

As regards the social cohesion measures, the modalities for the implementation of the temporary financial assistance scheme to households to compensate for the revised utility tariffs are being finalised, whilst the budgetary allocations in respect of measures towards improved health care and child care assistance have been affected.

Regarding the revenue support measures, the removal of the levy on credit cards entered into force as from 1 January 2010. The amendments to the eco-contribution system have followed a consultation process and



the relevant legislative provisions are being finalised.

Whilst the Budget for 2010 aimed to provide short-term support to the economy, Government's medium-term fiscal strategy remains that of achieving a sustainable budgetary position. In this context, Government is committed to achieve the 2010 deficit target of 3.9 per cent of GDP. Close monitoring of emerging developments in revenue and expenditure components will be made and additional measures will be adopted as necessary.

### **8.3.2 Correction of the Excessive Deficit by 2011**

The macroeconomic environment trajectory underpinning the Programme envisages a marked improvement in 2011. If this pick-up materialises, Government will more comfortably resort to the aggressive fiscal consolidation stance presented in the Programme, as from next year. Against this macroeconomic backdrop, the deficit will decline by 1 percentage point of GDP to 2.9 per cent in 2011. The correction of the excessive deficit will largely reflect the phasing out of stimulus measures, the impact of the economic recovery and consolidation on the expenditure side. Further detail on fiscal developments in 2011 is provided in Chapter 3 of this document.

The ratio of total revenue to GDP will decline by 0.5 percentage points of GDP in 2011. This reflects a stable level for EU grants which is materialising against the backdrop of an increase in GDP, thus resulting in a lower ratio of the other category of revenue to GDP. Meanwhile, tax revenue is projected to increase in absolute terms but at a slower rate than GDP.

The ratio of expenditure to GDP is projected to decline by 1.4 percentage points of GDP in 2011. This mainly reflects lower ratios to GDP of compensation of employees, intermediate consumption, gross fixed capital formation and the other category of expenditure.

Around 60 per cent of the support measures impacting on the 2010 deficit were of a temporary nature. The withdrawal of these stimulus measures accounts for 0.4 percentage points of the fiscal consolidation in 2011. These measures are mainly included in the other category of expenditure and in intermediate consumption.

During the Programme period, restraint of the general Government wage bill will constitute an important element in the fiscal consolidation strategy. This will largely be generated by restricting public employment levels in non-essential categories. Better conditions for public sector employees are envisaged, also following the expiry of the current collective agreement in 2010, as the public sector faces shortages of skilled human resources in specialised sectors. Government is determined to replace only part of the vacancies which will materialise following the retirement and/or resignation of current incumbents of these posts. Government's recruitment policy is being drawn up in the context of the capacity building requirements of the different Ministries, which are discussed in meetings between the Finance Ministry and the respective Ministry. In fact, recruitment is being undertaken on a strictly need basis, following screening by both the Management and Personnel Office and the Finance Ministry. This screening includes ascertaining whether the vacancies concerned can be filled through the transfer of public sector employees within the service rather than through external recruitment. Furthermore, efforts are being undertaken to improve the consistency in working conditions for employees in public entities which do not form part of the public service.

In addition, Government will also implement a policy of expenditure restraint as regards intermediate consumption. Any proposed alterations to departments' expenditure plans as provided for in the Budget will be carefully analysed within the constraints delineated by the overall financial allocations at the disposal of the respective departments. This encourages Ministries to undertake cost-cutting measures. Furthermore, public service wide initiatives to contain recurrent costs are ongoing. Furthermore, the Budget Affairs Division undertakes close monitoring of monthly expenditure to ensure that any desirable corrective behaviour is undertaken in a timely fashion.

To support the long-term development needs of the Maltese economy, specifically improved infrastructure, education and the environment, Government will sustain a relatively high level of investment during the Programme period. It is projected that the ratio of gross fixed capital formation to GDP will remain relatively high exceeding 4 per cent of GDP during 2010-2012. The decline in the ratio in the outer years of the Programme reflects a broadly stable level of outlays in absolute terms, which is being offset by a higher GDP level.

### **8.3.3 Medium-Term Fiscal Sustainability**

In 2012, the fiscal deficit is projected to decline by 0.1 percentage point of GDP. This reflects a decline in the expenditure ratio of 1 percentage point of GDP, which will be partly offset by a decrease in the revenue ratio of 0.9 percentage point.

The policy of expenditure restraint will be maintained in 2012. Consolidation will continue to largely reflect a strict Government recruitment policy and measures to contain recurrent expenditure.

The fiscal trajectory presented in this Update of the Stability Programme ensures that the debt-to-GDP ratio returns on a downward path as from 2011. This will be achieved through an improved budget balance, whereby a primary balance of 0.3 per cent and 0.4 per cent of GDP is foreseen in 2011 and 2012, respectively. Consequently, and also reflecting the improved economic outlook, the debt-to-GDP ratio will decline to 67.3 per cent in 2012.

Government is committed to accelerate the reduction of the deficit if economic or budgetary conditions turn out to be better than expected. To this end, one-off or surplus revenues that may arise in future years would be used to reduce the deficit and thus contribute to reduce further the debt-to-GDP ratio.

Government acknowledges the contribution of a strong budgetary framework to ensure a sustainable fiscal position. Government is seeking to gradually but consistently strengthen the national budgetary institutional and legislative framework. In particular, Government is focusing on ways to achieve stronger budget execution discipline and better integration of the medium-term strategy in budgetary formulation. Measures are also being undertaken to increase accountability and improve efficiency in public spending. Moreover, Government is also intensifying its efforts to curb abuses from social benefits and to curtail tax evasion. Further detail on the specific measures in these areas is provided in Chapter 7 of this Update of the Stability Programme.

Government recognises the challenge that the ageing population will pose to long-term fiscal sustainability, in particular as regards the pressures on public spending on pensions, as well as on the health care system.

As highlighted in Chapter 6 of this document, work is being undertaken to ascertain the contribution which the private sector could make to enhance the adequacy of the pension system, whilst strengthening its financial sustainability, taking into account the impact of the financial crisis. As provided for in the 2006 pension reform law, it is expected that the first report reviewing the state of pensions in Malta together with recommendations for achieving further adequacy, sustainability and social solidarity will be finalised during 2010.

Government is addressing the sustainability of the health care system in the context of the commitment to preserve the principle of solidarity underpinning the model which provides universal access to health care. Thus, efforts are being focused on improving financial management and control systems and enhancing entitlement policy to ensure that the real needs of patients are being met. Efforts to improve health promotion and disease prevention should also enhance the effectiveness of financial resources devoted to this sector. Further details on the measures being taken in this area is provided in Chapter 5 of this document.





## Macroeconomic Prospects

Table 1a

Percentages unless otherwise indicated	ESA Code	2008 <sup>(1)</sup>	2008	2009 <sup>(2)</sup>	2010	2011	2012
1. Real GDP	B.1g	4,601.2	2.1	-2.0	1.1	2.3	2.9
2. Nominal GDP	B.1g	5,702.7	4.5	1.0	3.5	5.0	5.0
<b>Components of real GDP</b>							
3. Private consumption expenditure <sup>(3)</sup>	P.3	3,043.7	4.9	-0.8	1.5	2.4	2.4
4. Government consumption expenditure	P.3	940.6	12.6	0.2	-1.1	-1.9	-0.7
5. Gross fixed capital formation	P.51	701.1	-21.8	-16.7	8.5	6.0	4.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53	155.1	3.4	-0.8	-0.8	-0.8	-0.8
7. Exports of goods and services	P.6	4,046.4	-5.4	-11.7	2.3	3.0	2.7
8. Imports of goods and services	P.7	4,285.7	-5.8	-15.5	3.3	2.6	1.8
<b>Contribution to real GDP growth</b>							
9. Final domestic demand		4,685.4	1.2	-2.3	1.9	2.0	2.2
10. Change in inventories and net acquisition of valuables	P.52+P.53	155.1	0.2	-4.2	0.0	0.0	0.0
11. External balance of goods and services	B.11	-239.3	0.7	4.4	-0.8	0.3	0.7

<sup>(1)</sup> € million

<sup>(2)</sup> Forecasts from 2009 onwards

<sup>(3)</sup> Includes NPISH final consumption expenditure

## Price Developments

Table 1b

Percentages unless otherwise indicated	ESA Code	2008 <sup>(1)</sup>	2008	2009 <sup>(2)</sup>	2010	2011	2012
1. GDP deflator		123.9	2.4	3.0	2.4	2.7	2.1
2. Private consumption deflator		118.1	3.0	1.7	1.7	1.9	2.0
3. Harmonised Index of Consumer Prices		108.1 <sup>(3)</sup>	4.7	1.8	1.7	2.0	2.0
4. Public consumption deflator		129.3	4.5	3.6	3.4	2.8	2.6
5. Investment deflator		127.8	5.0	1.9	3.5	3.4	2.8
6. Export price deflator (goods and services)		114.9	0.5	-2.1	0.4	1.3	1.6
7. Import price deflator (goods and services)		112.8	1.6	-3.4	0.4	0.7	1.6

<sup>(1)</sup> Index (base 2000 unless otherwise indicated)

<sup>(2)</sup> Forecasts from 2009 onwards, except for HICP for 2009

<sup>(3)</sup> Average 2005=100

## Labour Market Developments

Table 1c

Percentages unless otherwise indicated	ESA Code	2008	2008	2009 <sup>(1)</sup>	2010	2011	2012
1. Employment, persons <sup>(2)</sup>		163.4 <sup>(3)</sup>	2.5	-0.4	0.2	0.7	0.9
2. Employment, hours worked <sup>(4)</sup>		331,336 <sup>(3)</sup>	2.5	-0.4	0.2	0.7	0.9
3. Unemployment rate <sup>(5)</sup>		10.1 <sup>(3)</sup>	5.9	7.1	7.4	7.2	6.7
4. Labour Productivity, persons <sup>(6)</sup> (€)		28,113	-0.4	-1.6	0.9	1.7	2.0
5. Labour Productivity, hours worked <sup>(7)</sup> (€)		13.9	-0.4	-1.6	0.9	1.7	2.0
6. Compensation of employees (€ million)	D1	2,481.4	5.8	2.1	1.0	3.2	3.8
7. Compensation per employee (€)		17,251	3.4	2.7	2.3	2.6	2.9

<sup>(1)</sup> Forecasts from 2009 onwards

<sup>(2)</sup> Occupied population, domestic concept national accounts definition

<sup>(3)</sup> Thousands

<sup>(4)</sup> Annual actual hours (LFS Data)

<sup>(5)</sup> Harmonised definition, Eurostat; levels

<sup>(6)</sup> Real GDP per person employed

<sup>(7)</sup> Real GDP per hour worked

## Sectoral Balances

Table 1d

Percentages of GDP	ESA Code	2008	2009	2010	2011	2012
1. Net lending/ borrowing						
vis-à-vis the rest of the world	B.9	-4.9	-1.1	-3.6	-2.2	-1.4
of which:						
Balance on goods and services		-3.1	1.6	1.0	1.6	2.2
Balance of primary incomes and transfers		-2.4	-3.2	-5.4	-4.8	-4.7
Capital account		0.5	0.5	0.8	1.0	1.1
2. Net lending/ borrowing of the private sector	B.9	-0.2	4.7	-0.4	1.3	2.1
3. Net lending/ borrowing of General Government	EDP B.9	-4.7	-3.8	-3.9	-2.9	-2.8
4. Statistical discrepancy		0.0	-2.0	0.8	-0.6	-0.7



## General Government Budgetary Developments

Table 2

Percentages of GDP		ESA code	2008 <sup>(1)</sup>	2008	2009	2010	2011	2012
<b>Net Lending (EDP B9) by sub-sector</b>								
1.	General Government	S13	-265.4	-4.7	-3.8	-3.9	-2.9	-2.8
2.	Central Government	S1311	-265.0	-4.6	-3.8	-3.9	-2.9	-2.8
3.	State Government	S1312	-	-	-	-	-	-
4.	Local Government	S1313	-0.3	—	—	—	—	—
5.	Social security funds	S1314	-	-	-	-	-	-
<b>General Government</b>								
6.	Total revenue	TR	2,291.5	40.2	41.4	43.8	43.3	42.5
7.	Total expenditure	TE	2,556.9	44.8	45.2	47.7	46.3	45.3
8.	Net lending / borrowing	EDP B9	-265.4	-4.7	-3.8	-3.9	-2.9	-2.8
9.	Interest expenditure	EDP D41	187.7	3.3	3.3	3.3	3.3	3.2
10.	Primary balance		-77.6	-1.4	-0.5	-0.6	0.3	0.4
11.	One-off and other temporary measures <sup>(2)</sup>		15.6	0.3	0.1	0.2	0.1	0.1
<b>Selected Components of Revenue</b>								
12.	Total Taxes (12=12a+12b+12c)		1,588.1	27.8	28.8	29.9	29.7	29.2
12a.	Taxes on production and imports	D2	830.2	14.6	13.7	14.6	14.3	13.9
12b.	Current Taxes on Income, Wealth, etc.	D5	742.8	13.0	14.8	15.0	15.2	15.2
12c.	Capital Taxes	D91	15.1	0.3	0.2	0.2	0.2	0.2
13.	Social Contributions	D61	432.0	7.6	7.6	7.6	7.6	7.5
14.	Property Income	D4	72.6	1.3	1.2	1.0	0.9	0.9
15.	Other <sup>(3)</sup>		198.9	3.5	3.9	5.3	5.1	4.8
16=6.	Total Revenue	TR	2,291.5	40.2	41.4	43.8	43.3	42.5
p.m.:	Tax Burden (D2+D5+D61+D91-D995) <sup>(4)</sup>		2,047.5	35.9	37.0	38.0	37.8	37.3
<b>Selected Components of Expenditure</b>								
17.	Compensation of employees + intermediate consumption	D1+P2	1,214.6	21.3	21.3	20.8	20.1	19.5
17a.	Compensation of employees	D1	831.9	14.6	14.4	13.9	13.6	13.3
17b.	Intermediate consumption	P2	382.6	6.7	6.8	6.9	6.5	6.2
18.	Social payments (18=18a+18b)		758.0	13.3	14.0	14.2	14.1	14.1
18a.	Social transfers in kind supplied via market producers	D6311, D63121, D63131	31.7	0.6	0.7	0.6	0.6	0.6
18b.	Social transfers other than in kind	D62	726.3	12.7	13.3	13.6	13.5	13.5
19=9.	Interest expenditure	EDP D41	187.7	3.3	3.3	3.3	3.3	3.2
20.	Subsidies	D3	121.7	2.1	1.3	1.1	1.1	1.0
21.	Gross fixed capital formation	P51	141.9	2.5	3.5	4.6	4.4	4.2
22.	Other <sup>(5)</sup>		133.1	2.3	1.9	3.6	3.3	3.3
23=7.	Total Expenditure	TE	2,556.9	44.8	45.2	47.7	46.3	45.3
p.m.:	Government consumption (nominal)	P3	1,217.6	21.4	22.0	21.7	20.8	20.2

<sup>(1)</sup> € million

<sup>(2)</sup> A plus sign means deficit-reducing one-off measures

<sup>(3)</sup> P11+P12+P131+D39+D7+D9 (other than D91)

<sup>(4)</sup> Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate

<sup>(5)</sup> D29+D4 (other than D41)+D5+D7+D9+P52+P53+K2+D8

### General Government Expenditure by Function

Table 3

Percentages of GDP	COFOG Code	2007	2008	2009	2010	2011	2012
1. General public services	1	6.3	6.8	7.8	8.2	8.1	8.1
2. Defence	2	0.7	0.8	0.9	0.9	0.8	0.8
3. Public order and safety	3	1.5	1.5	1.9	1.8	1.7	1.7
4. Economic affairs	4	5.9	7.4	4.8	6.1	5.5	5.2
5. Environmental protection	5	1.5	1.6	1.7	1.6	1.5	1.4
6. Housing and community amenities	6	0.7	0.8	0.8	0.5	0.5	0.5
7. Health	7	5.8	5.6	6.0	5.8	5.7	5.7
8. Recreation, culture and religion	8	0.6	0.6	0.6	0.7	0.6	0.6
9. Education	9	5.4	5.5	6.0	6.7	6.6	6.3
10. Social protection	10	14.1	14.3	14.8	15.4	15.2	15.1
11. Total Expenditure	TE	42.5	44.8	45.2	47.7	46.3	45.3

## General Government Debt Developments

Table 4

Percentages of GDP	ESA Code	2008	2009	2010	2011	2012
1. Gross debt		63.6	66.8	68.6	68.0	67.3
2. Change in gross debt ratio		1.7	3.2	1.8	-0.5	-0.7
<b>Contributions to changes in gross debt</b>						
3. Primary balance		1.4	0.5	0.6	-0.3	-0.4
4. Interest expenditure	EDP D.41	3.3	3.3	3.3	3.2	3.2
5. Stock-flow adjustment		-0.3	0.0	0.1	-0.2	-0.2
p.m. implicit interest rate on debt <sup>(1)</sup>		5.6	5.2	5.1	5.0	4.9

<sup>(1)</sup> Proxied by interest expenditure divided by the debt level of the previous year.

## Cyclical Developments

Table 5

Percentages of GDP	ESA Code	2008	2009	2010	2011	2012
1. Real GDP growth (%)		2.1	-2.0	1.1	2.3	2.9
2. Net lending of General Government	EDP B.9	-4.7	-3.8	-3.9	-2.9	-2.8
3. Interest expenditure	EDP D.41	3.3	3.3	3.3	3.3	3.2
4. One-off and other temporary measures <sup>(1)</sup>		0.3	0.1	0.2	0.1	0.1
5. Potential GDP growth (%)		1.4	1.3	1.1	1.1	1.2
contributions:						
- labour (hours)		0.6	0.8	0.4	0.3	0.2
- capital		0.4	0.1	0.2	0.3	0.4
- total factor productivity		0.4	0.4	0.5	0.6	0.6
6. Output Gap		1.2	-1.5	-1.6	-0.4	1.4
7. Cyclical Budgetary Component		0.4	-0.5	-0.6	-0.1	0.5
8. Cyclically-Adjusted Balance (2-7)		-5.1	-3.2	-3.4	-2.8	-3.3
9. Cyclically-Adjusted Primary Balance (8+3)		-1.8	0.1	-0.1	0.5	-0.1
10. Structural Balance (8-4)		-5.4	-3.3	-3.6	-2.9	-3.3

<sup>(1)</sup> A plus sign means deficit-reducing one-off measures

## Divergence from the December 2008 Stability Programme

Table 6

Percentages of GDP	ESA Code	2008	2009	2010	2011	2012
<b>Real GDP growth</b>						
Previous update		2.8	2.2	2.5	2.8	...
Current update		2.1	-2.0	1.1	2.3	2.9
Difference		-0.7	-4.2	-1.4	-0.5	-
<b>General Government net lending</b>						
	EDP B.9					
Previous update		-3.3	-1.5	-0.3	1.2	...
Current update		-4.7	-3.8	-3.9	-2.9	-2.8
Difference		-1.4	-2.3	-3.6	-4.1	-
<b>General Government gross debt</b>						
Previous update		62.8	61.9	59.8	56.3	...
Current update		63.6	66.8	68.6	68.0	67.3
Difference		0.8	4.9	8.8	11.7	-

## Long-term Sustainability of Public Finances

Table 7

Percentages of GDP in 2007 Prices	2007	2010	2020	2030	2040	2050	2060
Total Expenditure	-	-	-	-	-	-	-
of which: age-related expenditures	18.2	19.2	20.5	21.7	23.8	25.8	28.4
Pension expenditure	7.2	8.3	9.3	9.3	10.5	12.0	13.4
Social security pensions*	-	-	-	-	-	-	-
Old-age and early pensions	4.2	5.3	6.4	6.7	8.0	9.6	11.1
Other pensions (disability, survivors)	3.0	3.0	2.8	2.6	2.5	2.3	2.3
Occupational pensions	-	-	-	-	-	-	-
Health care	4.7	4.9	5.6	6.4	7.2	7.6	8.0
Long-term care	1.0	1.0	1.2	1.6	2.0	2.2	2.6
Educational expenditure	5.0	4.6	4.0	3.9	3.7	3.7	4.0
Other age-related expenditures: (Unemployment benefits)	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Interest expenditure	-	-	-	-	-	-	-
Total revenue	-	-	-	-	-	-	-
of which: property income	1.4	1.3	1.3	1.3	1.2	1.2	1.2
of which: from pensions contributions	5.9	5.8	6.0	6.0	6.0	5.9	5.8
Pension reserve fund assets	-	-	-	-	-	-	-
of which: consolidated public pension fund assets	-	-	-	-	-	-	-
				Assumptions			
Labour productivity growth	1.5	2.2	2.7	1.8	1.7	1.7	1.7
Real GDP growth	2.9	2.6	2.7	1.7	1.2	0.8	1.0
Participation rate males (aged 20-64)	82.2	82.3	84.6	87.7	87.9	87.9	87.9
Participation rate females (aged 20-64)	40.7	41.9	45.6	47.9	48.1	48.1	48.1
Total participation rates (aged 20-64)	61.8	62.4	65.5	68.2	68.4	68.3	68.3
Unemployment rate (aged 15-64)	6.2	6.3	6.2	6.2	6.2	6.2	6.2
Population aged 65+ over total population	14.3	14.8	20.3	24.2	25.7	29.1	32.4

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

Note: Figures may not add up due to rounding

## Basic Assumptions

Table 8

	2008	2009	2010	2011	2012
Short-term interest rate (annual average)	4.6	1.3	1.5	2.5	2.5
Long-term interest rate (annual average)	4.3	3.2	3.5	3.8	3.8
USD/€ exchange rate (annual average)	1.47	1.39	1.48	1.48	1.48
Nominal effective exchange rate	4.4	2.7	1.6	0.0	0.0
World excluding EU, GDP growth	3.8	-0.4	3.8	4.1	4.1
EU GDP growth	0.8	-4.1	0.7	1.6	1.6
Growth of relevant foreign markets	0.3	-4.1	1.0	1.6	1.6
World import volumes, excluding EU	4.6	-12.6	4.6	5.0	5.0
Oil prices, (Brent, USD/barrel)	40.0	61.3	76.5	80.5	80.5