COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL RECOMMENDATION TO MALTA

with a view to bringing an end to the situation of an excessive government deficit

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission;

Whereas:

(1) According to Article 104 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(4) The Council has decided on [7 July 2009], in accordance with Article 104(6), that an excessive deficit exists in Malta.

(5) In accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[1] (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances, and request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of 0.5 % of GDP as a benchmark. In deciding whether special

[1] OJ L 209, 2.8.1997, p. 6.

circumstances exist, “relevant factors” as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account.

(6) In the case of Malta, the relevant factors, as clarified in Article 2(3) of Regulation (EC) No 1467/97 and examined in the Commission’s report under Article 104(3), present a mixed picture and do not suggest the existence of special circumstances warranting a departure from the standard deadline for correcting the deficit. The breach of the deficit reference value in 2008 is partly due to specific developments on the expenditure side rather than to the impact of the economic downturn, which was only starting in 2008. Despite decelerating, real GDP growth in 2008 remained positive, at 1.6%.[2]

(7) According to the Commission services’ spring 2009 forecast, the general government deficit is projected to decline, on a no-policy change basis, to 3.2% of GDP in 2010, just above the reference value. The projected decline in the headline deficit between 2008 and 2009 reflects the revenue-increasing measures announced in the 2009 budget (which help stem the impact on taxes of the slowing economy) as well as the disappearance of the bulk of the one-off deficit-increasing impact of the following measures: the granting of early retirement benefits to Malta Shipyards Ltd. employees; the liquidation of the shipyards expected to occur in the course of the year, and; the reduction in energy subsidies to households. Based on a very favourable macroeconomic scenario that has already become outdated, the budgetary strategy envisaged in the December 2008 update of the stability programme of Malta aimed at bringing the headline deficit well below the reference value in 2009, to 1.5% of GDP[3], and at further improving the general government balance over the programme horizon, to a surplus position of 1.2% of GDP in 2011.

(8) In order to bring the deficit below the reference value by 2010 in a credible and sustainable manner, it is necessary that Malta rigorously implement the budgetary measures planned for 2009 and avoid any further deterioration in public finances. For 2010, new consolidation measures will need to be spelled out and implemented.

(9) This path for the general government balance would be instrumental to ensure that the increasing trend in the debt ratio since 2008 is reversed, so as to allow the debt ratio to diminish sufficiently and approach the reference value at a satisfactory pace.

(10) While expenditure outturns have been below plans over the period 2004-2007, the budgetary framework shows signs of weaknesses at the execution stage. As noted by the Council in its Opinion of 10 March 2009 on the Maltese stability programme, public expenditure is still subject to discretionary decisions in the implementation phase, whilst the budget lacks a clear medium-term focus. Accordingly, the Council invited Malta to strengthen the medium-term budgetary framework.

(11) Almost 70% of general government expenditure is accounted for by compensation of employees, social benefits and interest expenditure, which are difficult to change in the short term, making fiscal adjustment in response to changing macroeconomic

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[2] According to the latest data, GDP growth for 2008 was revised upwards to 2.5%.

[3] For 2008, the December 2008 update of the stability programme estimated a general government deficit of 3.3% of GDP. The deficit target of 1.5% of GDP for 2009 was confirmed in the data notified by the authorities in March 2009.

circumstances difficult to attain. In the medium term, the renewal of the public sector wage agreement scheduled for 2011 may lead to increased pressure on the expenditure side, while demographic shifts, the need to recruit additional personnel and heightened running costs including more expensive pharmaceuticals would push up public healthcare spending. The Council invited Malta to enhance the efficiency and effectiveness of public spending, including by accelerating the design and implementation of a comprehensive healthcare reform.

(12) Enhanced surveillance under the EDP will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the updates of Malta's stability programme which will be prepared between 2009 and 2010 could usefully be devoted to this issue.

(13) In general, in the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy.

HEREBY RECOMMENDS:

(1) On the basis of the macroeconomic outlook of the Commission services' spring 2009 forecast, the Maltese authorities should put an end to the present excessive deficit situation at the latest by 2010.

(2) The Maltese authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner. Specifically, to this end, the Maltese authorities should:

(a) ensure that the budgetary measures planned for 2009 are rigorously implemented, while avoiding any further deterioration of public finances;

(b) spell out and implement additional consolidation measures in 2010 with a view to bringing the deficit below the reference value by 2010.

(3) The Maltese authorities should ensure that the increase in the government gross debt ratio since 2008 is reversed so as to allow the debt ratio to diminish sufficiently and approach the reference value at a satisfactory pace.

(4) The Council establishes the deadline of [7 January 2010] for the Maltese government to take effective action to rigorously implement the budgetary measures planned for 2009 and to specify 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' spring 2009 forecast.

(5) 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 between 2009 and 2010.

In addition, the Council highlights the importance of achieving the medium-term objective (MTO) for appropriate budgetary management of economic downturns. It therefore invites the Maltese authorities to ensure that budgetary consolidation towards the medium-term objective

- a balanced budgetary position in structural terms - is sustained after the excessive deficit will have been corrected. To this end, the Maltese authorities are invited to spell out the measures necessary to achieve a lasting consolidation, especially to contain budgetary pressures from the public sector wage bill and healthcare costs, and to strengthen the medium-term focus of the budgetary framework.

This recommendation is addressed to the Republic of Malta.

Done at Brussels,

For the Council
The President