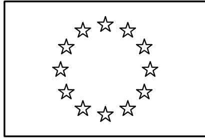
EN



EUROPEAN COMMISSION

Brussels, 27.1.2010
SEC(2010) 56 final

Recommendation for a

COUNCIL RECOMMENDATION TO MALTA

of 27.1.2010

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

EXPLANATORY MEMORANDUM

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty on the Functioning of the European Union. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December 2008. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 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, and thereby ensuring long-term sustainability of public finances.

2. PREVIOUS STEPS IN THE EXCESSIVE DEFICIT PROCEDURE

Article 126 of the Treaty on the Functioning of the European Union (TFEU) lays down an excessive deficit procedure (EDP). This procedure is further specified in 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.

According to Article 126(2) TFEU, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b)

[1] OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes" (Code of Conduct), endorsed by the ECOFIN Council of 10 November 2009, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm.

whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 126(3) TFEU (ex 104(3) of the Treaty establishing the European Community (TEC)) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

On the basis of the data notified by the Maltese authorities in March 2009[2] and subsequently validated by Eurostat[3] and taking into account the Commission services' spring 2009 forecast, the Commission adopted a report under Article 104(3) TEC for Malta on 13 May 2009[4].

Subsequently, and in accordance with Article 104(4) TEC, the Economic and Financial Committee formulated an opinion on the Commission report on 28 May 2009.

On 24 June 2009 the Commission, having taken into account its report under Article 104(3) TEC and the opinion of the Economic and Financial Committee under Article 104(4) TEC, addressed to the Council, in accordance with Article 104(5) TEC, its opinion that an excessive deficit existed in Malta.

Subsequently, acting upon a recommendation by the Commission, the Council decided on 7 July 2009 that an excessive deficit existed in Malta in accordance with Article 104(6) TEC, and, also on a recommendation by the Commission, it addressed recommendations to Malta in accordance with Article 104(7) TEC with a view to bringing an end to the situation of an excessive government deficit by 2010. In its recommendations, the Council established a deadline of 7 January 2010 for effective action to be taken.

Regulation (EC) No 1467/97, Article 3(5), states that if effective action has been taken in compliance with a recommendation under Article 126(7) TFEU and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) TFEU. To this end, the Commission has assessed recent macro-economic and budgetary developments as well as effective action taken by Malta.

3. RECENT MACRO-ECONOMIC AND BUDGETARY DEVELOPMENTS

According to Article 3(5) of Council Regulation (EC) No 1467/97, the occurrence of unexpected adverse economic events with major unfavourable consequences for government finances shall be assessed against the economic forecast underlying the initial Council

2 According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Malta can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables

3 Eurostat news release No 56/2009 of 22 April 2009.

4 All EDP-related documents for Malta can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm.

recommendation, adopted on 7 July 2009, i.e. in this case the Commission services' spring 2009 forecast.

With real GDP growth at 2.1%, the general government deficit rose to 4.7% of GDP in 2008 (from 2.2% in 2007), also due to (i) deficit-increasing one-offs of 0.4% of GDP (from net deficit-decreasing one-offs of 0.6% of GDP in 2007)[5], (ii) the reclassification of Malta Shipyards Ltd into the general government sector and (iii) weak tax receipts, particularly between November 2008 and February 2009 when businesses facing short-term liquidity problems delayed the payment of taxes[6]. The Commission services' spring 2009 forecast underlying the initial Council recommendation projected that Malta's real GDP would contract by 0.9% in 2009 to then return to positive territory in 2010, albeit at the subdued rate of 0.2%. Based on this macroeconomic scenario, the spring 2009 forecast projected the deficit to decline to 3.6% of GDP in 2009 and, on a no-policy change assumption, to 3.2% of GDP in 2010. The significant projected improvement in the deficit ratio between 2008 and 2009 occurred in spite of stimulus measures adopted in 2009 (amounting to some 0.6% of GDP) and was driven by (i) the revenue-increasing measures announced in the 2009 budget, (ii) the liquidation of the shipyards expected to occur in the course of the year, (iii) the reduction in energy subsidies to households, (iv) a gradual and partial recuperation of the 2008 delayed tax payments and (v) the disappearance of the deficit-increasing one-offs recorded in 2008 (one-offs had a broadly neutral impact in 2009).

The Commission services' autumn 2009 forecast projects a sharper contraction in real GDP for 2009 (by 2.2%) than assumed in spring. Private consumption is projected to be weaker on the back of looser labour market conditions. A more significant drop in investment is expected, reflecting also weaker construction activity. Exports are also foreseen to contract by a larger amount as the global crisis affects Malta primarily through the trade channel, badly hitting the key export sectors of electronics and tourism. However, as a result of falling domestic demand and the high import-intensity of exports, imports are forecast to drop more significantly, leading to a positive contribution of net exports to GDP growth. For 2010, the autumn forecast anticipates a slightly stronger recovery than in the spring forecast, with real GDP growing by 0.7%, due to a less negative contribution of net exports from the improved outlook for Malta's main trading partners. Domestic demand is in fact foreseen to be less dynamic than predicted in the spring forecast due to weaker private consumption and investment. In 2011, real GDP is forecast to increase by 1.6%.

The sharper-than-expected recession has had a significant impact on the general government deficit, which in the Commission services' autumn 2009 forecast is estimated to decrease to 4.5% of GDP in 2009 and, on a no-policy change basis, to 4.4% in 2010 and 4.3% in 2011. The higher deficit projection for 2009 relative to the spring forecast, by almost 1 p.p. of GDP, is primarily linked to the fact that the economic downturn had a larger budgetary impact than the around ½% of GDP implied by the standard budgetary sensitivity. Direct taxes show some resilience, also due to an amnesty, introduced in autumn 2009, on late payment penalties for past income tax dues (expected to provide a one-off support to tax revenue of around 0.2% of GDP in 2009). However, the worse domestic and external demand relative to the spring forecast has had an adverse impact on other revenue categories. In particular, the drop in

[5] A major deficit-increasing one-off affecting 2008 and, to a lesser extent, 2009 is the lump-sum payments to Malta Shipyard Ltd workers made redundant. Traditional deficit-reducing one-offs in Malta consist of the sale of land, which are decreasing as a percent of GDP over the period 2007-2009.

[6] Malta follows the time-adjustment method of recording taxes and social contributions whereby the 12-month period for recording revenue is March-February.

private consumption and imports is reflected in a much lower intake from indirect taxes, which are expected to contract by 0.7% (vs. +3.7% in the spring forecast). As a result of a cooling real estate market, tax receipts on property transactions are set to decline and one-offs from the sale of land will be lower than budgeted. Social contributions are also projected to decline, by 0.4% (vs. +1.4% in spring), as a consequence of lower employment.

On 1 December 2009, Malta adopted the budget for 2010. It estimates the 2009 deficit outturn at 3.8% of GDP. The main differences with the autumn forecast reflect (i) 0.3 p.p. of GDP higher revenue, mainly due to higher income taxes from international companies registered in Malta, and (ii) 0.4 p.p. of GDP lower expenditure related to less dynamic government consumption (both compensation of employees and intermediate consumption).

		2008	**2009**	**2010**	**2011**
Real GDP (% change)	COM spring 2009 forecast	1.6	-0.9	0.2	n.a.
	COM autumn 2009 forecast	2.1	-2.2	0.7	1.6
Nominal GDP (% change)	COM spring 2009 forecast	4.0	1.4	2.0	n.a.
	COM autumn 2009 forecast	4.4	-0.3	3.0	4.0
General government balance (% of GDP)	COM spring 2009 forecast	-4.7	-3.6	-3.2	n.a.
	COM autumn 2009 forecast	-4.7	-4.5	-4.4	-4.3

Overall, it can be concluded that, assessed against the economic forecast underlying the initial Council recommendation, adopted on 7 July, unexpected adverse economic events with major unfavourable consequences for government finances have occurred in Malta.

4. ASSESSMENT OF EFFECTIVE ACTION TAKEN

According to Regulation (EC) No 1467/97 and the Code of Conduct a Member State should be considered to have taken effective action if it has acted in compliance with the Article 126(7) TFEU recommendation. The Code of Conduct states that the assessment of effective action should in particular take into account whether the Member State concerned has achieved the annual improvement of its cyclically adjusted balance, net of one-off and other temporary measures, initially recommended by the Council. In case the observed adjustment proves to be lower than recommended, a careful analysis of the reasons for the shortfall should be made.

On 7 July 2009, the Council recommended to Malta under Article 104(7) TEC that the budgetary measures planned for 2009 be rigorously implemented, while any further deterioration of public finances had to be avoided. Additional consolidation measures with a view to bringing the deficit below the reference value by 2010 had to be spelt out and implemented. The Maltese authorities were also recommended to ensure that the increase in the government gross debt ratio since 2008 be reversed so as to allow the debt ratio to diminish sufficiently and approach the reference value at a satisfactory pace. The deadline of 7 January 2010 was established for the Maltese government to take effective action to rigorously implement the budgetary measures planned for 2009 and to specify the measures necessary to progress towards the correction of the excessive deficit. The assessment of effective action would take into account economic developments compared to the economic outlook in the Commission services' spring 2009 forecast.

As mentioned above, the more negative economic developments expected in 2009 in the Commission services’ autumn forecast than in the spring forecast underlying the original Council recommendation imply that the 2009 deficit is projected to be significantly higher

than forecast in spring. The estimated annual improvement in the structural balance remains significant (¾ p.p. of GDP), but is lower than anticipated in the spring 2009 forecast (1¼ pps. of GDP). Indirect taxes and social contributions are much weaker than previously projected. The budgetary measures set out in the budget for 2009 were executed as planned and no important additional discretionary measures were taken (the only exception is the above-mentioned tax amnesty, which has a one-off positive impact on direct taxes). However, some expenditure overruns were recorded. Previously negotiated collective agreements covering public healthcare and tertiary education employees are turning out to be costlier than anticipated while intermediate consumption is higher-than-budgeted from healthcare pressures. Also, fewer savings were realised in the area of subsidies than foreseen in the budget for 2009.

The budget for 2010 was adopted after the publication of the Commission services' autumn 2009 forecast. On the basis of a more favourable real GDP outlook than assumed in the Commission services' forecast, the deficit ratio is targeted to broadly stabilise in 2010 (3.9% of GDP compared to 3.8% in 2009) and to remain just above 3% of GDP in 2011 in spite of real GDP growth at 2.3%.

The targeted near-stabilisation of the deficit ratio in 2010 results from, on the one hand, additional measures to continue supporting the still uncertain economic recovery in line with the EERP, estimated by the authorities at around 0.6% of GDP, of which around half to help businesses and the rest to sustain households, in particular the most disadvantaged. On the other hand, compensatory measures are expected to yield 0.5% of GDP. These include: (i) increased efforts to improve tax administration and reduce tax avoidance and benefit fraud; (ii) an increase of the duty on cigarettes; (iii) the withdrawal of funds to a public entity which is expected to self-finance its operations through a revised tariff structure; and (iv) a reduction in the number of public sector employees. According to the authorities, all compensatory measures have a permanent effect on the government balance, whereas only 40% of the additional recovery measures will affect the government balance in the years beyond 2010.

A general government deficit well above 3% of GDP in 2009 and 2010 does not allow the rise in the government gross debt ratio since 2008 to be halted. According to the projections presented together with the 2010 budget, the debt-to-GDP ratio would start falling again as from 2011, while the Commission services' autumn 2009 forecast projects a continued rise in the debt ratio on a no-policy change basis over the forecast horizon.

Starting from the estimated 4.5% of GDP deficit outcome in 2009 in the Commission services' autumn 2009 forecast, as from 2010 a fiscal consolidation effort of around 1½ pps. of GDP in structural terms would now be necessary to bring the deficit below the 3% of GDP reference value by 2010.

When presenting the budget for 2010, the Maltese authorities announced some new initiatives aimed at strengthening the budgetary framework and enhancing the financial monitoring and evaluation system of the public sector. This could improve the conditions for achieving the set budgetary targets and enhance accountability in the conduct of fiscal policy.

Overall, taking into account economic developments compared to the outlook in the Commission services' spring 2009 forecast, it can be concluded that Malta has taken effective action as required by the Council recommendation of 7 July 2009.

5. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 126(7) TFEU has to establish a deadline of six months at most for effective action to be taken by the Member State concerned. Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation".

Since the authorities are considered to have taken effective action in compliance with the Council recommendation of July 2009 and unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred in Malta, an extension of the deadline for the correction of the excessive deficit by one year, from 2010 to 2011, is warranted.

Bringing the deficit below the reference value by 2011 in a credible and sustainable manner would require the Maltese authorities to achieve the 2010 deficit target of 3.9% of GDP set in the budget, if necessary by adopting additional consolidation measures, and ensure in 2011 a fiscal effort of ¾% of GDP. The Maltese authorities should 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. The required additional consolidation measures should focus on containing current primary government expenditure while increasing its efficiency. Moreover, in view of the recent experience whereby companies facing liquidity problems could delay payment of tax dues, tax compliance and enforcement should be enhanced.

Implementing these consolidation efforts would contribute to bringing the general government gross debt-to-GDP ratio, which increased from 62% in 2007 to 68.5% in 2009 according to the Commission services' autumn 2009 forecast, back on a declining path that approaches the 60% reference value at a satisfactory pace by restoring an adequate level of the primary surplus.

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 December 2008 update of 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 in the sense that the multi-annual projections presented in the annual budget are not underpinned by an articulated medium-term strategy, nor by an indication of the broad measures to achieve them. Accordingly, the Council invited Malta to strengthen the medium-term budgetary framework. Some new initiatives in this area were recently announced by the authorities that could represent steps in the right direction.

The long-term budgetary impact of ageing in Malta is well above the EU average, mainly as a result of a relatively high increase in pension and health-care expenditure as a share of GDP over the coming decades. The budgetary position in 2009 compounds the budgetary impact of population ageing on the sustainability gap. High primary surpluses over the medium term and further reforms of the social security system aimed at curbing the substantial increase in

health and age-related expenditures would contribute to reducing risks to the long-term sustainability of public finances as defined by the Commission Communication[7] on 'Long-term sustainability of public finances for a recovering economy' and discussed by the ECOFIN Council[8] on 10 November 2009.

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. In particular, reforms should be geared towards enhancing the efficiency of public expenditure, especially in the high resource-absorbing areas of health and education.

Enhanced surveillance under the EDP, which seems necessary in view also of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit. In this context, a separate chapter in the updates of the Maltese stability programme which will be prepared in 2010 and 2011 could usefully be devoted to this issue.

Comparison of key macroeconomic and budgetary projections[1]

		2007	2008	2009	2010	2011
Real GDP (% change)	COM autumn 2009 forecast	3.7	2.1	-2.2	0.7	1.6
	2010 budget	3.7	2.1	-2.0	1.1	2.3
Output gap (% of potential GDP)	COM autumn 2009 forecast[2]	1.3	2.0	-1.0	-0.9	0.1
	2010 budget	n.a.	n.a.	n.a.	n.a.	n.a.
General government balance (% of GDP)	COM autumn 2009 forecast	-2.2	-4.7	-4.5	-4.4	-4.3
	2010 budget	-2.2	-4.7	-3.8	-3.9	-3.2
Primary balance (% of GDP)	COM autumn 2009 forecast	1.2	-1.4	-1.2	-1.2	-0.9
	2010 budget	1.2	-1.4	-0.5	-0.6	0.1
Cyclically-adjusted balance (% of GDP)	COM autumn 2009 forecast[3]	-2.6	-5.4	-4.2	-4.1	-4.4
	2010 budget	n.a.	n.a.	n.a.	n.a.	n.a.
Structural balance (% of GDP)	COM autumn 2009 forecast	-3.3	-5.0	-4.3	-4.1	-4.4
	2010 budget	n.a.	n.a.	n.a.	n.a.	n.a.
Government gross debt (% of GDP)	COM autumn 2009 forecast	62.0	63.8	68.5	70.9	72.5
	2010 budget	62.0	63.8	67.0	68.7	68.2

Notes:
[1] The Commission services' autumn 2009 forecast was finalised before the adoption of the budget for 2010.
[2] Based on estimated potential growth of 2.1%, 1.3%, 0.8%, 0.6 and 0.6% respectively in the period 2007-2011.
[3] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.6% of GDP in 2007 (deficit-reducing), 0.4% in 2008 (deficit-increasing), 0.1% in 2009 (deficit-reducing) and 0.0% in 2010 and 2011 according to the Commission services' autumn 2009 forecast.

Source: Budget for 2010; Commission services' autumn 2009 forecasts (COM); Commission services' calculations.

[7] Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf.
[8] Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf.

Recommendation for a

COUNCIL RECOMMENDATION TO MALTA

of 27.1.2010

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

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof;

Having regard to the recommendation from the Commission;

Whereas:

(1) According to Article 126(1) of the Treaty on the Functioning of the European Union (TFEU) 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) On 7 July 2009 the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community (TEC), that an excessive deficit exists in Malta and issued recommendations to correct the excessive deficit by 2010 at the latest, in accordance with Article 104(7) TEC and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[9]. The Council also established a deadline of 7 January 2010 for effective action to be taken.

(5) The Council agreed on 20 October 2009 that, provided that the Commission forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, fiscal consolidation in all EU Member State should start in 2011 at the latest, that specificities of country situations should be taken into account, and that a number of countries need to consolidate before then.

---

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

(6) Regulation (EC) No 1467/97 (which is part of the Stability and Growth Pact) establishes provisions for the implementation of Article 126 TFEU. According to Article 3(5) of Council Regulation (EC) No 1467/97, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation, the Council may decide, on a recommendation from the Commission and before taking into account the relevant factors mentioned in Article 2(3) of Regulation (EC) No 1467/97, to adopt a revised recommendation under Article 126(7) TFEU.

(7) Maltese real GDP was expected to decline by 0.9% in 2009 according to the Commission services' spring 2009 forecast underlying the initial Council recommendation, but a sharper fall, by 2.2%, is now projected in the Commission services' autumn 2009 forecast, driven by a stronger decline in domestic demand. This economic deterioration has been reflected in an upward revision of the general government deficit in 2009 by almost 1 percentage point vis-à-vis the spring forecast, to 4.5% of GDP. This is primarily linked to the fact that the economic downturn had a larger budgetary impact than the around ½% of GDP implied by the standard budgetary sensitivity. Direct taxes show some resilience, also due to an amnesty, introduced in autumn 2009, on late payment penalties for past income tax dues. However, the worse domestic and external demand relative to the spring forecast has led to a much lower intake from indirect taxes, while, as a result of a cooling real estate market, tax receipts on property transactions are set to decline and one-offs from the sale of land will be lower than budgeted. Finally, lower employment implies a fall in social contributions instead of continued positive growth as assumed in the spring forecast. In view of the above, unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred after adoption of the recommendation under Article 104(7) TEC.

(8) The Council established a deadline of 7 January 2010 for the Maltese government to rigorously implement the budgetary measures planned for 2009 and to specify the measures necessary to progress towards the correction of the excessive deficit. The budgetary measures set out in the budget for 2009 were executed as planned and no important additional discretionary measures were taken. However, some expenditure overruns were recorded. The budget for 2010, adopted on 1 December, targets a near-stabilisation of the deficit ratio in 2010 (3.9% of GDP compared to 3.8% in 2009 as estimated by the authorities) and a narrowing to just above 3% of GDP in 2011 based on a more favourable real GDP outlook than assumed in the Commission services' autumn 2009 forecast. The targeted near-stabilisation of the deficit ratio in 2010 results from, on the one hand, additional measures to continue supporting the still uncertain economic recovery in line with the EERP, estimated by the authorities at around 0.6% of GDP, and, on the other, compensatory measures expected to yield 0.5% of GDP. The latter include: (i) increased efforts to improve tax administration and reduce tax avoidance and benefit fraud; (ii) an increase of the duty on cigarettes; (iii) the withdrawal of funds to a public entity which is expected to self-finance its operations through a revised tariff structure; and (iv) a reduction in the number of public sector employees. According to the authorities, all compensatory measures have a permanent effect on the government balance, whereas only 40% of the additional recovery measures will affect the government balance in the years beyond 2010. Overall, taking into account economic developments compared to the outlook in the

Commission services' spring 2009 forecast, it can be concluded that Malta has taken effective action as required by the Council recommendation of 7 July 2009.

(9) Since the Maltese authorities are considered to have taken effective action in compliance with the Council recommendations of 7 July 2009 under Article 104(7) TEC and unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred in Malta, revised recommendations under Article 126(7) TFEU extending the deadline by one year are justified. Starting from the estimated 4.5% of GDP deficit outcome in 2009 in the Commission services' autumn 2009 forecast, a fiscal effort of around 1½% of GDP in 2010 would now be necessary to bring the deficit below the 3% of GDP reference value by 2010. In view of the above, a new deadline for the correction of the excessive deficit in Malta by 2011 is appropriate.

(10) Bringing the deficit below the reference value by 2011 in a credible and sustainable manner would require the Maltese authorities to achieve the 2010 deficit target of 3.9% of GDP set in the budget, if necessary by adopting additional consolidation measures, and ensure in 2011 a fiscal effort of ¾% of GDP. The Maltese authorities should 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.

(11) Implementing these consolidation efforts would contribute to bringing the general government gross debt-to-GDP ratio, which increased from 62% in 2007 to 68.5% in 2009 according to the Commission services' autumn 2009 forecast, back on a declining path that approaches the 60% reference value at a satisfactory pace by restoring an adequate level of the primary surplus.

(12) 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 December 2008 update of 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 in the sense that the multi-annual projections presented in the annual budget are not underpinned by an articulated medium-term strategy, nor by an indication of the broad measures to achieve them. Accordingly, the Council invited Malta to strengthen the medium-term budgetary framework. Some new initiatives in this area were recently announced by the authorities that could represent steps in the right direction.

(13) The long-term budgetary impact of ageing in Malta is well above the EU average, mainly as a result of a relatively high increase in pension and health-care expenditure as a share of GDP over the coming decades. The budgetary position in 2009 compounds the budgetary impact of population ageing on the sustainability gap. High primary surpluses over the medium term and further reforms of the social security system aimed at curbing the substantial increase in health and age-related expenditures would contribute to reducing risks to the long-term sustainability of public finances as defined by the Commission Communication[10] on 'Long-term sustainability of public

---

[10] Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf

finances for a recovering economy' and discussed by the ECOFIN Council[11] on 10 November 2009.

(14) Enhanced surveillance under the EDP, which seems necessary in view also of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit. In this context, a separate chapter in the updates of the Maltese stability programme which will be prepared in 2010 and 2011 could usefully be devoted to this issue.

(15) In general, 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. In particular reforms should be geared towards enhancing the efficiency of government expenditure, especially in the high resource-absorbing areas of health and education.

(16) In addition, in view of the importance of achieving its medium-term objective (MTO) to provide an adequate safety margin against cyclical downturns and to ensure convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, Malta should also ensure that budgetary consolidation towards the MTO is sustained after the excessive deficit will have been corrected.

HEREBY RECOMMENDS:

(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% 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 ¾ 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% 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% of GDP reference value.

---

[11] Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf

(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.

This recommendation is addressed to the Republic of Malta.

Done at Brussels, 27.1.2010

For the Council
The President