COUNCIL OF
THE EUROPEAN UNION

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit

COUNCIL RECOMMENDATION TO MALTA

of

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), in conjunction with Article 136 thereof,

Having regard to the recommendation from the Commission, Whereas:

(1) In accordance with Article 126(1) of the Treaty on the Functioning of the European Union (TFEU), Member States are to 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 existed 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[1]. The Council also established a deadline of 7 January 2010 for effective action to be taken.

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

(5) On 20 October 2009, the Council agreed that, provided that the Commission forecasts continued to indicate that the recovery was 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 needed to consolidate before that date.

(6) Regulation (EC) No 1467/97 (which is part of the Stability and Growth Pact) establishes provisions for the implementation of Article 104 TEC (now Article 126 TFEU). Under Article 3(5) of Regulation (EC) No 1467/97, if effective action has been taken in compliance with a recommendation under Article 104(7) TEC (now 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 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 104(7) TEC (now 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 Council Recommendation under Article 104(7) TEC of 7 July 2009 (hereinafter "the Council's Recommendation of 7 July 2009"). However, a sharper fall, by 2,2 %, driven by a stronger decline in domestic demand, is now projected in the Commission services' autumn 2009 forecast. This economic deterioration has been reflected in an upward revision of the general government deficit in 2009 by almost 1 p.p. compared to 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 approximate 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 Council Recommendation of 7 July 2009.

(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 European Economic Recovery Plan (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 Recommendation of 7 July 2009 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, which could represent steps in the right direction, were recently announced by the authorities.

(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[1] on 'Long-term sustainability of public finances for a recovering economy' and discussed by the ECOFIN Council[2] on 10 November 2009.

(14) Enhanced surveillance under the excessive deficit procedure (EDP), which seems necessary also in view 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.

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1 Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf

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

(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 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.

(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,

For the Council
The President