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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Assessment of the action taken

by Malta

in response to the Council Recommendation of 16 February 2010 with a view to bringing an end to the situation of excessive government deficit

SEC(2010) 1630 final

1. EXCESSIVE DEFICIT PROCEDURE AND MOST RECENT RECOMMENDATIONS

The impact of the economic downturn and some discretionary expenditure increases in 2008 led to a widening of the general government deficit in Malta to 4.8% of GDP in 2008 and 3.8% on 2009 compared to 2.3% in 2007. Against this background, on 7 July 2009, the Council decided that an excessive deficit existed and addressed recommendations to Malta in accordance with Article 104(7) of the Treaty establishing the EC with a view to bringing an end to this situation by 2010.[1] In its recommendations, the Council established a deadline of 7 January 2010 for effective action to be taken.

On 16 February 2010, the Council concluded that effective action had been taken in compliance with the above recommendations but unexpected adverse economic events with major unfavourable consequences for the government finances were also considered to have occurred in Malta. As a result, the Council recommended that the deadline for the Maltese authorities to put an end to the excessive deficit be extended by one year, to 2011, in accordance with Article 3(5) of Regulation (EC) No 1467/97.

In particular, the Maltese authorities were recommended by the Council to (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; and (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. In addition, the Maltese authorities were requested to 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. To limit risks to the adjustment, they were recommended to strengthen the binding nature of its medium-term budgetary framework and improve the monitoring of budget execution throughout the year.

The Council established 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.

Finally, the Council also invited the Maltese authorities to introduce reforms to enhance the quality of public finances, namely through enhanced efficiency of government expenditure, especially in the areas of health and education.

The Commission makes its assessment of action taken after the adoption by the government of the 2011 budget, on 25 October, and based on the Commission services' autumn 2010 forecast, which incorporates the budgetary measures therein.

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

2. ASSESSMENT OF ACTION TAKEN

After reaching 3.8% of GDP in 2009, the deficit ratio is projected by the authorities to increase slightly to 3.9% of GDP in 2010, in line with the target set in the 2010 budget underpinning the Council recommendation. This projection is made against the background of a higher real GDP growth than in the Commission services' autumn 2009 forecast, which underpinned the Council recommendations of 16 February 2010. Furthermore, it includes one-off deficit-reducing items resulting from a tax amnesty (0.2% of GDP) and the sale of equipment pertaining to the shipyards by 0.3% of GDP, while it incorporates overruns in current primary expenditure and a shortfall in current taxes when compared to the plans set out in the 2010 budget. The Commission services' autumn 2010 forecast projects a higher deficit ratio in 2010, at 4.2% of GDP, mainly due to larger expected shortfalls in tax collection than those already accounted for by the authorities. The autumn 2010 forecast points to a worsening of the structural balance by around 1% of GDP in 2010.

The Commission therefore points to some deviation from the Council recommendation to achieve the 2010 deficit target of 3.9% of GDP that was set in the 2010 budget. Furthermore, although economic conditions are turning out better than expected at the time the Council issued its recommendations, there was no acceleration in the reduction of the deficit.

For 2011, the authorities target a deficit-to-GDP ratio of 2.8%, which they aim to achieve through an acceleration in tax collection related to the ongoing economic recovery as well as revenue-increasing measures, the planned phasing out of most stimulus measures introduced in 2010 and improved spending efficiency. However, the budgeted expenditure savings are expected to be partially offset by a number of expenditure-increasing measures. The Commission services' autumn 2010 forecast projects a slightly higher deficit, at 3% of GDP for 2011, mainly explained by the higher deficit anticipated for 2010. The 1.2 pps of GDP annual deficit reduction forecast in 2011 is based on the assumption of a strict implementation of the 2011 budget, including the planned efficiency gains that are expected to curb growth in current primary expenditure. The Commission services' forecast points to an improvement in the structural balance of 1¼% of GDP in 2011.

Against this background, the Commission concludes that Malta has ensured a fiscal effort of ¾ pp. of GDP and taken effective action to put an end to the present situation of excessive deficit by 2011.

The Maltese authorities project the general government debt to increase to 69% of GDP in 2010, from 68.6% in 2009, mainly due to a debt-increasing stock-flow adjustment, partly related to the financial support to Greece. For 2011, the authorities project a slight decline in the debt ratio, to 68.7%, thanks to the achievement of a small primary surplus and dynamic nominal GDP growth that outweighs the expected debt-increasing stock-flow adjustment mainly related to the financial support to Greece. In the autumn 2010 forecast, the Commission services estimate Malta's gross debt-to-GDP ratio to increase to 70.8% by 2011, also due to the incorporation of the financial needs related to the rescue loan to Air Malta adopted after the presentation of the 2011 budget.

In light of the Commission services' projections, Malta is not expected to bring the general government gross debt ratio back on a declining path within the forecast horizon.

Finally, no progress has been reported in the area of fiscal governance, while some initiatives have been taken to improve spending efficiency and plans for further reforms to the pension system are under discussion.

3. CONCLUSIONS

On current information it appears that Malta has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, Malta has taken measures to correct the excessive deficit by 2011, while ensuring an adequate fiscal effort in 2011, in line with the Council's recommendations.

However, the 2010 deficit target of 3.9% of GDP set in the 2010 budget is unlikely to be achieved, in spite of a more favourable economic outlook for Malta than that foreseen in the Council recommendations. Risks to the achievement of the 2011 deficit target mainly pertain to the repayment of the rescue loan to Air Malta and the forthcoming restructuring plan. The public sector wage bill may also be affected by a new collective agreement to come into force in January 2011, details of which are not yet available. In light of these risks, the Maltese authorities must closely monitor budgetary developments and be ready to take corrective measures should any of these risks materialise.

Furthermore, the Commission is of the opinion that Malta needs to be more effective in strengthening the binding nature of its medium-term budgetary framework and introducing measures aimed at addressing the long-term sustainability of Malta's public finances, in line with Council recommendations and invitations.

In view of the above assessment, the Commission considers that no further steps in the excessive deficit procedure of Malta are needed at present. The Commission will continue to closely monitor budgetary developments in Malta in accordance with the Treaty and the SGP.

Table: Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	COM	2.6	-2.1	3.1	2.0	2.2
	MT	2.6	-2.1	3.4	3.0	2.9
	SP	2.1	-2.0	1.1	2.3	2.9
Output gap (% of potential GDP)	COM	0.6	-2.6	-0.8	-0.2	0.5
	MT	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	1.2	-1.5	-1.6	-0.4	1.4
General government balance (% of GDP)	COM	-4.8	-3.8	-4.2	-3.0	-3.3
	MT	-4.8	-3.8	-3.9	-2.8	-2.1
	SP	-4.7	-3.8	-3.9	-2.9	-2.8
Primary balance (% of GDP)	COM	-1.5	-0.6	-1.1	0.2	-0.2
	MT	-1.5	-0.6	-0.8	0.3	0.9
	SP	-1.4	-0.5	-0.6	0.3	0.4
Cyclically-adjusted balance (% of GDP)	COM	-5.0	-2.9	-3.9	-2.9	-3.5
	MT	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	-5.1	-3.2	-3.4	-2.8	-3.3
Structural balance (% of GDP)	COM	-5.3	-3.5	-4.5	-3.3	-3.5
	MT	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	-5.4	-3.3	-3.6	-2.9	-3.3
Government gross debt (% of GDP)	COM	63.1	68.6	70.4	70.8	70.9
	MT	63.1	68.8	69.1	68.8	67.8
	SP	63.6	66.8	68.6	68.0	67.3

Source: COM - Commission services' 2010 autumn forecast; MT - Malta's Budget for 2011; SP - Stability Programme February 2010.