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COMMISSION STAFF WORKING DOCUMENT

Analysis by the Commission services of the budgetary situation in Malta in view of a possible abrogation of Council Decision 2009/587/EC on the existence of an excessive deficit in Malta

Accompanying the document

Recommendation for a Council Decision

abrogating Decision 2009/587/EC on the existence of an excessive deficit in Malta

{COM(2012) 676 final}

1. INTRODUCTION

As the general government deficit in Malta increased to 4.7% of GDP in 2008, from 2.2% in 2007, the Council decided, on 7 July 2009, that an excessive deficit existed in Malta and addressed recommendations to the national authorities in accordance with Article 104(7) of the Treaty establishing the European Community (TEC)[1] with a view to bringing an end to that situation by 2010[2]. In its recommendations, the Council established a deadline of 7 January 2010 for effective action to be taken.

On 16 February 2010, on the basis of a Commission recommendation, the Council concluded that Malta had taken effective action 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. As a result, the Council extended by one year, to 2011, the deadline for correcting the excessive deficit, in accordance with Article 126(7) of the Treaty. Specifically, Malta was recommended to achieve the 2010 deficit target set in the budget, if necessary by adopting additional measures, and to ensure in 2011 a fiscal effort of ¾% of GDP, so as to contribute to bringing the government debt ratio back on a declining path. To limit risks to the adjustment, the Council also recommended to strengthen the binding nature of Malta's medium-term budgetary framework and better monitor budget execution throughout the year.

On 6 January 2011, the Commission adopted a Communication to the Council concluding that, based on information available at the time, Malta appeared to have taken action representing adequate progress towards the correction of the excessive deficit by 2011 and that no further steps under the excessive deficit procedure were needed at that stage. At the same time, the Maltese authorities were requested to closely monitor budgetary developments and be ready to take corrective measures should risks materialise. On 18 January 2011, the Council concluded that it shared these views.

On 11 January 2012, the Commission adopted a second Communication to the Council concluding that, based on the available information, Malta appeared again to have taken effective action towards a timely and sustainable correction of the excessive deficit. In particular, the Commission services' 2011 Autumn Forecast projected the general government deficit for 2011 at 3% of GDP, while the 2012 budget, adopted by the Maltese authorities after the cut-off date of that forecast, included measures that appeared to ensure a deficit below the threshold also in 2012. In view of the above assessment, the Commission considered that no further steps in the excessive deficit procedure of Malta were needed at that time.

This paper examines budgetary developments in Malta since the Commission Communication to the Council of 11 January 2012, with a view to assessing progress towards a timely and sustainable correction of the excessive deficit. The basis for the assessment is the Commission services' 2012 Autumn Forecast.

[1] The corresponding article in the Treaty on the Functioning of the European Union, which entered into force on 1 December 2009, is Article 126(7).

[2] 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. RECENT ECONOMIC AND BUDGETARY DEVELOPMENTS

The Maltese economy has weathered the global economic and financial crisis relatively well. In 2009, real GDP contracted mildly compared to the euro area, on the back of a resilient performance by net exports and a contained decline in employment, partly thanks to government assistance. Economic activity rebounded in 2010, to 3.4% for the year as a whole, due to improving external trade and a pick up in business investment. The positive momentum continued in 2011 but economic activity started losing pace towards the end of the year and slipped back into technical recession in the final quarter of 2011 and the first quarter of 2012. Still, in 2011 as a whole, real GDP growth expanded by 1.9%, outperforming the average for the euro area (1.4%).

Table 1: Comparison of macroeconomic developments and forecasts

	2011	2012		2013		2014	
	Outturn	COM	SP	COM	SP	COM	SP
Real GDP (% change)	1.9	1.0	1.5	1.6	2.0	2.1	2.0
Contributions to real GDP growth							
Final domestic demand	0.9	-0.1	0.9	1.3	1.1	1.8	1.2
Changes in inventories	-1.6	-1.5	0.0	0.0	0.0	0.0	0.0
Net exports	2.6	0.6	0.6	0.3	0.9	0.3	0.8
GDP deflator (% change)	2.3	2.8	2.1	2.5	2.4	2.4	2.5
Nominal GDP (% change)	4.2	3.9	3.6	4.2	4.4	4.5	4.4
Employment (% change)	2.5	0.9	1.0	1.3	1.6	1.6	1.6
Total compensation per employee (% change)	0.8	1.1	0.9	2.1	0.5	2.0	0.6

Note: COM – Commission services' 2012 Autumn Forecast; SP – Stability programme 2012
Sources: National Statistics Office, Commission services, national authorities

The Commission services' 2012 Autumn Forecast projects real GDP growth to moderate further to 1.0% in 2012 on the back of weaker household consumption. Economic growth is projected to strengthen in 2013 and 2014, reflecting an improving outlook for domestic demand.

Data released by Eurostat in its second notification on deficit and debt for 2011, following the 2012 October reporting by Malta, show that the general government deficit declined to 2.7% of GDP, from 3.6% of GDP in 2010, against the background of a weakened GDP growth. This compares with a targeted deficit of 2.8% of GDP set in the 2011 stability programme. The nominal adjustment between 2010 and 2011 was driven by buoyant current revenues, coupled with lower net capital expenditure. Measures in the 2011 budget to increase excise duties and VAT boosted indirect revenues, while direct taxes benefitted from one-off proceeds of the extension to 2011 of a tax scheme lauched in 2010 to collect arrears of direct taxes and social contributions. Capital expenditure decreased thanks to the one-off sale of shipyards assets and of buildings of the City gate project, as well as lower subsidies to investments, partly offsetting more dynamic current primary expenditure driven by intermediate consumption.

Table 2: Budgetary developments, 2008-2014

(% of GDP)	2008	2009	2010	2011	2012		2013		2014	
					COM	SP[2]	COM[1]	SP	COM[1]	SP
Revenue	**39.2**	**39.4**	**38.9**	**39.6**	**40.0**	**42.5**	**40.2**	**42.4**	**40.2**	**41.6**
of which:										
- Taxes on production and imports	14.2	13.8	13.5	13.9	14.3	15.0	13.9	14.7	13.7	14.5
- Current taxes on income, wealth, etc.	12.7	13.6	13.0	13.1	12.9	13.2	13.3	13.3	13.6	13.4
- Social contributions	7.4	7.4	7.3	7.5	7.5	7.7	7.5	7.7	7.4	7.7
- Other (residual)	5.0	4.6	5.1	5.1	5.4	6.6	5.6	6.7	5.5	6.0
Expenditure	**43.8**	**43.3**	**42.5**	**42.3**	**42.6**	**44.7**	**43.2**	**44.1**	**42.8**	**42.7**
of which:										
- Primary expenditure	40.6	40.1	39.5	39.2	39.4	42.0	39.9	40.7	39.6	39.2
of which:										
Compensation of employees	14.2	14.2	13.5	13.4	13.2	13.3	13.1	13.0	12.9	12.7
Intermediate consumption	6.4	6.1	6.0	6.3	6.4	6.6	6.5	64.0	6.5	6.2
Social payments	12.9	13.8	13.6	13.5	13.9	13.7	13.6	13.5	13.3	13.1
Subsidies	2.1	1.1	1.1	1.0	1.2	1.2	1.2	1.2	1.2	1.2
Gross fixed capital formation	2.4	2.3	2.1	2.5	2.6	3.5	2.6	3.6	2.7	3.5
Other (residual)	2.6	2.7	3.2	2.4	2.1	3.2	2.9	3.1	2.9	2.5
- Interest expenditure	3.2	3.1	3.0	3.1	3.2	3.3	3.3	3.4	3.2	3.5
General government balance (GGB)	**-4.6**	**-3.9**	**-3.6**	**-2.7**	**-2.6**	**-2.2**	**-2.9**	**-1.7**	**-2.6**	**-1.1**
Primary balance	**-1.4**	**-0.7**	**-0.6**	**0.4**	**0.6**	**1.0**	**0.3**	**1.7**	**0.6**	**2.4**
One-off and other temporary measures	0.0	0.6	1.1	0.7	1.0	0.2	0.3	0.2	0.2	0.2
GGB excl. one-offs	**-4.6**	**-4.5**	**-4.7**	**-3.4**	**-3.6**	**-2.4**	**-3.3**	**-1.9**	**-2.8**	**-1.3**
Output gap[3]	1.3	-2.3	-0.3	0.3	-0.1	-0.5	-0.1	-0.3	0.1	0.0
Cyclically adjusted balance[3]	-5.1	-2.9	-3.5	-2.8	-2.5	-2.0	-2.9	-1.6	-2.6	-1.1
Structural balance[4]	**-5.1**	**-3.6**	**-4.6**	**-3.5**	**-3.6**	**-2.2**	**-3.2**	**-1.8**	**-2.8**	**-1.3**
Change in structural balance[5]		*1.5*	*-1.0*	*1.0*	*0.0*	*0.7*	*0.4*	*0.5*	*0.4*	*0.5*
Structural primary balance[4]	**-1.9**	**-0.5**	**-1.6**	**-0.5**	**-0.4**	**1.1**	**0.1**	**1.6**	**0.4**	**2.2**
Change in structural primary balance[5]		*1.5*	*-1.1*	*1.1*	*0.1*	*0.9*	*0.4*	*0.6*	*0.3*	*0.6*

Notes:

[1]On a no-policy-change basis.

[2]The 2012 stability programme classified the concession fee as a revenue among the category "Taxes on production and imports". To make it possible to compare the Commission services' forecast and the 2012 stability programme, the concession fee has been reclassified as a negative capital asset sales in the 2012 stability programme..

[3]Output gap (in % of potential GDP) and cyclically adjusted balance according to the programme as recalculated by the Commission on the basis of the information in the programme.

[4]Structural (primary) balance = cyclically adjusted (primary) balance excluding one-off and other temporary measures.

[5]The figure for SP uses one-offs for 2011 as estimated in the programme (0.3% of GDP), not as estimated by the Commission.

Source:

Stability programme (SP); Commission services' 2012 Autumn Forecasts (COM); Commission services' calculations.

Malta's consolidation strategy continues to rely on measures that, according to the Commission services' methodology and in line with past practice, qualify as one-off. In 2011, deficit-reducing one-off measures amounted to 0.7% of GDP, mainly due to the the extension to 2011 of the 2010 scheme for the collection of income tax and social security contributions' arrears; in the absence of these measures, the 2011 deficit would have been at 3.4% of GDP, above the 3% of GDP reference value.

Still, the structural balance, i.e. the cyclically adjusted budgetary balance excluding one-off measures, is estimated to have improved by 1 pp. of GDP in 2011. This exceeds the fiscal effort of at least ¾% of GDP recommended by the Council.

3. DEFICIT PROJECTIONS FOR 2012 AND BEYOND

According to the Commission services' 2012 Autumn Forecast, the general government deficit in 2012 is projected to narrow slightly further, to 2.6% of GDP. The forecast incorporates the impact of the measures adopted with the 2012 budget and the January review of spending allocations. Capital expenditure is set to decline as a result of one-off proceeds from the concession fee on the local lottery operator, which are recorded as negative capital asset sales[3]. Primary current expenditure is set to rise by 0.6 pp. of GDP compared to 2011 on the back of higher social transfers (as the expected savings from the gradual impact of the 2006 pension reform will materialize only gradually) and subsidies to the national energy company (Enemalta). Continued hiring restrictions in the public sector will help contain growth in the wage bill despite the new public sector agreement and increased spending related to some components of the wage bill (i.e. allowances and overtime) especially in the education and health sector. As economic growth in 2012 is driven by net exports, while domestic demand appears to be rather weak, the current revenue ratio is projected to increase only slightly compared to 2011 despite, among others, measures to increase VAT revenue collection.

According to the Commission services Autumn 2012 forecast, net of one-off measures - i.e. proceeds from the sale of real assets, a concession fee from the local lottery operator as well as the proceeds expected from the tax arrears' collection scheme - the deficit in 2012 would still be above the reference value, at 3.6% of GDP.

In the April 2012 update of the stability programme of Malta, the deficit target for 2012 was 2.2% of GDP, with real GDP growing by 1.5%, driven by stronger domestic demand. Despite the better-than-estimated 2011 deficit outturn, the deficit projection for 2012 was revised slightly upwards, to 2.3% of GDP, in the October 2012 notification. The difference between the projected deficit in the Commission services forecast and the national projections is due to more dynamic revenue growth in the latter.

For 2013, the Commission services' 2012 Autumn Forecast projects the general government deficit to rise to 2.9% of GDP. The forecast is based on unchanged policies, hence the 2013 Budget presented at the end of November/beginning of December, is not included. The current revenue ratio is projected to decline slightly, as the one-off revenue projected for 2012 disappears. Primary current expenditure is forecast to drop by 0.3 pp. of GDP, reflecting a continuation of the tight recruitment policy in the public sector as well as less pronounced growth of social transfers as the 2006 pension reform gradually kicks in. Net capital expenditure, including the planned additional equity injection into Air Malta of 0.6% of GDP, is expected to grow by 0.5 pp. of GDP.

In 2014, the deficit is projected to narrow, also due to a lower equity injection into Air Malta as well as higher tax revenue following the expected domestic demand-driven recovery in economic activity.

The main downside risks to the Commission services' forecasts relate to the vulnerable financial situation of the energy provider (Enemalta), which could entail further subsidies (in

[3] The 2012 stability programme classified the concession fee as a revenue among the category "Taxes on production and imports". To make it possible to compare the Commission services' forecast and the 2012 stability programme, the concession fee has been reclassified as a negative capital asset sales in the 2012 stability programme.

addition to the planned injection of 21 millions already incorporated in the Commission services' forecast) as well as to possible overruns in current primary expenditure, as has happened in the past. Risks also arise from the economic growth outlook.

According to the Commission services' 2012 Autumn Forecast, the projected adjustment path towards the MTO over 2012-2013 is not in line with the at least 0.5% of GDP annual structural adjustment that is stipulated in the Stability and Growth Pact for Member States that have not yet reached their MTO and are faced with a debt ratio exceeding 60% of GDP. In fact, the structural deficit is projected to remain unchanged in 2012, and, on a no-policy-change basis, to improve by just ¼ pp. of GDP in 2013, before improving by ½ pp. of GDP in 2014.

The real growth rate of government expenditure, net of discretionary revenue measures, according to the Commission services' 2012 Autumn Forecast, is projected to be negative and below the benchmark reference medium-term rate of potential GDP growth in 2012. However, on a no-policy-change basis, the real growth rate of expenditure is projected to increase significantly in 2013 and 2014, thus breaching the benchmark reference rate.

4. DEBT DEVELOPMENTS AND PROJECTIONS AND COMPLIANCE WITH THE DEBT REDUCTION BENCHMARK

Data released by Eurostat on 22 October 2012 in its second notification on deficit and debt for 2011 show a general government debt at 70.9% of GDP in 2011, more than 2 pps higher than in 2010 and about 9 pps. of GDP above the level recorded at the time of accession to the euro area in 2008.

The debt increase in 2011 compared to 2010 was driven by a high stock-flow adjustment (including for the rescue loan of 0.8% of GDP that the Maltese government agreed to provide to Air Malta[4] to meet its cash-flow requirements as well as for the EFSF issuances and bilateral loans to Greece), which was only partly offset by the increasing primary balance, which in 2011 turned into a surplus for the first time since 2007.

According to the Commission services' 2012 Autumn Forecast, the debt ratio is expected to increase further in 2012, driven by the stock-flow adjustment essentially because of the impact of the guarantees to the EFSF, bilateral loans to Greece and the participation in the capital of the ESM and despite the repayment to the government of the rescue loan to Air Malta.

According to the Commission services' 2012 Autumn Forecast, on a no-policy-change basis, the debt ratio is projected to increase further and peak in 2013, driven by a debt-increasing stock-flow adjustment. An increasing primary surplus would result in a slight decline in the debt ratio in 2014. Risks associated with budgetary developments also apply to the debt-to-GDP ratio.

It should be noted that with the entry into force of the Six-Pack end-2011, Member States have to comply with a debt reduction benchmark, as defined in Article 2(1a) of Regulation

[4] In November 2010, the Maltese government agreed to provide Air Malta with a rescue loan to meet its cash-flow requirements until May 2011, after which a restructuring plan has been presented to the Commission. The loan was granted at market conditions and no debt financing was allegedly required, with government deposits used to make the necessary payments. Therefore the rescue loan is not incorporated in the Commission services’ 2011 Autumn Forecast deficit and debt projections.

(EC) No 1467/97. The legislation foresees a three-year transitional period for the Member States that were in EDP at the time of the entry into force of these new legal provisions - which is the case of Malta. According to Article 2(1a), the requirement under the debt criterion shall be considered fulfilled if, from the correction of the excessive deficit, Malta makes sufficient progress towards compliance.

Table 3: Debt developments, 2008-2014

(% of GDP)	2008	2009	2010	2011		2012		2013		2014	
				COM	SP	COM	SP	COM[1]	SP	COM[1]	SP
Gross debt ratio	**62.0**	**67.6**	**68.3**	**70.9**	**72.0**	**72.4**	**70.3**	**73.1**	**68.7**	**72.8**	**67.4**
Changes in the ratio (a) = (b) + (c) + (d)	*0.1*	*5.7*	*0.6*	*2.6*	*3.7*	*1.5*	*-1.7*	*0.7*	*-1.6*	*-0.4*	*-1.3*
Contributions:											
Primary balance (b)	1.4	0.7	0.6	-0.4	-0.4	-0.6	-1.0	-0.3	-1.7	-0.6	-2.4
Snowball effect (c)	-0.9	3.1	-1.0	0.3	0.3	0.6	0.7	0.4	0.5	0.1	0.6
of which:											
Interest expenditure	*3.2*	*3.1*	*3.0*	*3.1*	3.1	*3.2*	3.2	*3.3*	3.4	*3.2*	3.5
Growth effect	*-2.3*	*1.5*	*-2.2*	*-1.3*	-1.4	*-0.7*	-1.0	*-1.1*	-1.3	*-1.5*	-1.3
Inflation effect	*-1.8*	*-1.5*	*-1.9*	*-1.5*	-1.5	*-1.9*	-1.4	*-1.8*	-1.6	*-1.6*	-1.5
Stock flow adjustment (d)	-0.3	1.8	1.1	2.7	3.9	1.6	-1.4	0.7	-0.3	0.2	0.5

Notes:

[1]On a no-policy-change basis.

Source :

Stability programme (SP); Commission services' autumn 2012 forecasts (COM); Commission services' calculations.