Malta:

Draft Budgetary Plan

2015

Ministry for Finance
October 2014

The following symbols have been used throughout this document:

. . .	to indicate that data are not available;
—	to indicate that the figure is negligible;
0	to indicate that the figure is zero;
-	to indicate that data are not applicable or cannot be determined;
n/c	to indicate that there is no change in the data.

Figures may not add up due to rounding.

This document is based on statistical information available up to the 7th of October, 2014

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1. Overall Policy Framework and Objectives

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Ten year after Malta's entry in the EU and seven years after adopting the euro, the Maltese economy has undergone significant structural changes. The economy has been significantly diversified, with emerging services sectors and high end manufacturing firmly entrenched and creating employment opportunities. These developments were supported by a strong and stable banking sector which provided ample credit particularly in recessionary periods thus contributing to the resilience of the Maltese economy. Nevertheless, other factors principally among them the low labour participation rate and the inefficient provision of energy, have constrained Malta's growth potential.

1.1 Macroeconomic Scenario

This Draft Budget Plan constitutes the first annual budget plan within the context of the National Medium-Term Fiscal Plan presented last April which is also being presented in the context of the recently enacted Fiscal Responsibility Act. The April macroeconomic and fiscal projections presented in the Update of the Stability Programme 2014-2017 have been revised, in order to take into account the more recent economic data and expectations. In particular this Draft Budget Plan is based on stronger economic growth projections underlined by a better than expected macroeconomic outcome for the first half of 2014.

Economic growth is expected to reach 3.0 per cent in 2014 and accelerate further to 3.5 per cent in 2015. Employment growth is also expected to maintain a strong momentum and rise by an average of 2.0 per cent in 2014 and 2015. Inflation is expected to be relatively low in 2014 and to moderate to 1.5 per cent in 2015. Revised fiscal projections for 2015 were thus carried out in the context of a stronger real growth but a weaker inflationary environment.

1.2 Fiscal Policy Objectives

A number of structural reforms, particularly in the transport and energy sector are expected to exert a positive impact on public finances. These reforms include the privatisation of the local public transport, the ongoing restructuring of Air Malta and the service level agreements with Enemalta. These reforms include non-repeatable expenditure, such as the final capital injection to Air Malta as part of its restructuring plan, as agreed with the European Commission.

A number of fiscal consolidation measures (beyond what was contemplated in the Stability Programme of April 2014) are being envisaged for the 2015 Budget. This complements Government's commitment to further shift direct taxation on labour towards indirect taxation without increasing VAT. This is expected to encourage further labour market participation.

By the end of 2015, Government is aiming to reach a deficit target of 1.6 per cent of GDP. The debt-to-GDP ratio is expected to decline to 69.0 per cent mainly as a result of the primary surplus of 1.2 percent of GDP, being targeted.

1.3 Fiscal Governance

The Fiscal Responsibility Act will strengthen the commitments contained in this Plan and provide the necessary tools for enabling the framework which will allow Government to meet its fiscal targets. It will do so by enshrining the fiscal rules contained in the SGP into national rules and setting up a functionally independent fiscal council to act as a fiscal watchdog. The Act will also strengthen the role of the Ministry for Finance in the budgetary process and the multi-annual fiscal planning.

1.4 Conclusion

The fiscal targets to be presented in the 2015 Budget shall also be supported by a range of structural economic policies as presented in this year's National Reform Programme. The Government's economic and fiscal strategy rests on a number of policy objectives, primarily meant to address the country's main economic challenges, in particular:

1. Continue to deliver Government's commitment of ensuring public finance sustainability in the short to medium-term, while also addressing the long-term dimension;

2. Raising potential output, in particular by continuing to increase the labour force participation, especially of women, raising skill and education levels, promoting lifelong learning, and increasing productive capital investment;

3. Enhancing the competitiveness and transparency of the products and services markets whilst strengthening consumer protection, including a holistic justice reform;

4. Effectively reducing bureaucracy especially the length of the public procurement process, and ensuring that the public service is efficient and cost effective;

5. Safeguarding the successes achieved by the Maltese financial sector by reducing macroeconomic imbalances related to the financial sector and ensuring it continues to follow rigorous practices; and

6. Prioritising the promotion of a diversified and balanced economy.

In order to continue fulfilling these policy objectives, the Government, as outlined in the Economic Partnership Programme, is implementing a number of supply-side policies which are aimed at raising the country's potential growth whilst also ensuring responsible environmental management and social cohesion.

Government believes that sound economic policies which address Malta's growth potential and competitiveness can also strengthen the sustainability of public finances.

The Draft Budget for 2015 is also complementing the strategy to make work pay by ensuring that the social security system positively incentivises work effort and discourages dependency. Government is also introducing measures to strengthen social cohesion and reduce poverty for families with children with low income. These measures reflect the principle that economic prosperity and wealth should be felt and enjoyed by all.

2. Economic Outlook

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2.1 The Short-Term Scenario

Following the robust growth registered in 2013, the Maltese economy continued to grow at an average rate of 3.2 per cent in real terms in the first half of 2014, outperforming growth in the European economy. Over the same period, labour market developments strengthened markedly as gains in employment were coupled with a falling unemployment rate.

During the first half of this year, the Maltese economy expanded by 4.6 per cent in nominal terms. Specifically, gross value added increased by 3.6 per cent during this period attributable to a positive performance in the majority of the sectors of the economy particularly in the service sectors including, the professional, scientific and technical activities, the administration and support services activities and the information and communication activities. During the same period of 2014, both compensation of employees and gross operating surplus exhibited positive performance, expanding by 5.6 per cent and 1.7 per cent, respectively. Meanwhile, taxes on production and imports increased by an average rate of 12.2 per cent while subsidies on production and imports increased by 19.9 per cent.

The Maltese economy is expected to retain the positive momentum in the second half of 2014. Overall growth in 2014 is expected to reach 3.0 per cent in real terms, supported primarily by positive developments in the domestic sector of the economy. Indeed, private consumption is expected to increase by 2.1 per cent in real terms, sustained by a robust growth in employment and growth in disposable income which is in turn being driven by an appreciation in wages. Government expenditure is projected to rise by 6.0 per cent in 2014, reflecting increases in compensation of employees and intermediate consumption. Gross fixed capital formation is expected to remain strong over the second half of the year and increase by 14.3 per cent in 2014, largely on the back of a large-scale project in the energy sector. Exports are expected to grow marginally by 0.7 per cent during 2014, reflecting the subdued external demand counter-balanced by a weaker exchange rate. The strong domestic demand (particularly investment) is expected to drive up imports by 1.9 per cent, resulting in a negative net trade contribution to growth.

During 2015, economic growth is set to accelerate, growing by 3.5 per cent in real terms, with domestic demand remaining the main driver. However, the negative trade gap forecasted for 2014 is expected to be reversed with net exports contributing positively to economic growth. Domestic demand is expected to be supported by a positive performance in both private and public consumption expenditure and gross fixed capital formation. Positive external developments are expected to be primarily underpinned by the significant depreciation of the euro against the currency of our main trading partners. In particular, the projected depreciation of the Euro against the US$ is expected to contribute to a significant growth in exports, particularly those attributed to the remote gaming sector. Other export-oriented sectors are expected to register only moderate increases in exports whilst a recovery of 8.0 per cent in the electronics sub-sector is anticipated in 2015.

A foreseen recovery in imports is largely reflecting strong domestic and external demand conditions. Robust growth is being envisaged for both imports of capital and intermediate goods, primarily reflecting the growth in investment and consumption. Imports of consumer goods and of services are also expected to register strong growth rates.

Table 2.1 presents the main macroeconomic indicators for the years 2011–2015. The figures for the 2011-2013 period and the January–June figures for 2014 are based on the latest data released by the National statistics Office (NSO) under the new European System of National and Regional Accounts (ESA 2010).

2.1.1 Assumptions for Projections

The macroeconomic forecasts presented in this Draft Budgetary Plan are based on the following assumptions:

Main Macroeconomic Indicators

Table 2.1

	2011	2012	2013	2014[1]	2015
GDP growth at current market prices (%)	4.5	4.1	4.6	5.1	4.8
GDP growth at chain linked volumes (2010) (%)	2.2	2.0	2.5	3.0	3.5
Expenditure Components of GDP at constant (2000) prices (% change)					
Private final consumption expenditure[2]	2.5	0.5	1.7	2.1	2.1
General government final consumption expenditure	2.9	6.2	0.5	6.0	2.5
Gross fixed capital formation	-17.1	-0.8	2.2	14.3	4.8
Exports of goods and services	1.8	6.3	-1.6	0.7	5.9
Imports of goods and services	-0.5	4.2	-1.7	1.9	5.5
Contribution to GDP growth:					
Domestic Demand	-1.7	1.4	1.5	5.0	2.7
Inventories	...	...	...	0.0	0.0
Net Exports	3.5	3.3	-0.0	-2.0	0.7
Inflation rate (%)	2.5	3.2	1.0	0.7	1.5
Employment growth (%)	1.3	3.5	2.4	2.1	1.9
Unemployment rate (%)	6.5	6.4	6.4	6.0	5.9

(1) Forecasts from 2014 onwards

(2) Includes NPISH final consumption expenditure

1. Economic activity in Malta’s main trading partners is expected to increase by 1.6 per cent and 1.8 per cent in 2014 and 2015 respectively.

2. Oil prices are assumed to average US$106.9 per barrel in 2014. In 2015, oil prices are expected to decrease to US$103.7 per barrel.

3. Short-term interest rate is expected to average 0.18 per cent in 2014 and to further decline to 0.05 per cent in 2015. The long-term interest rate is set to follow a similar pattern.

4. The nominal effective exchange rate is expected to average 1.0226 in 2014 and to gradually fall to 1.004 in 2015, reflecting the recent depreciation of the Euro exchange rate. Specifically, the USD/EUR exchange rate is expected to average 1.3444 in 2014 and to decline to 1.2789 in 2015, whilst the STG/EUR exchange rate is expected to average 0.8097 and 0.7822 in 2014 and 2015 respectively.

5. It is being assumed that, Government restricts recruitment in non-essential categories. The privatization of Malta's public transport system is also taken into account.

6. Changes in inventory are assumed not to contribute materially to GDP growth.

2.1.2 Risks to Outlook

The economic outlook in this Draft Budget Plan is more positive than the one projected in spring 2014. This is attributable to the higher than expected economic growth rate registered in the first half of 2014 coupled with a more favourable outlook in the exchange rate.

Risks on the downside include weaker than expected economic activity in Malta's main trading partners following renewed uncertainty in the euro area and an increased level of geopolitical risks. On the other hand upside risk relates mainly to a stronger than expected private investment. These forecasts do not include the impact of lower commercial energy prices on private investment which could further boost private investment.

2.1.3 Employment Prospects

The Labour Force Survey (LFS) recorded an employment rate of 61.6 per cent in the second quarter of 2014, a 1.0 percentage point increase when compared to the corresponding quarter in 2013. Growth in employment is expected to remain strong and increase by 2.1 per cent and by 1.9 per cent in 2014 and 2015, respectively. As a result, the unemployment rate (based on Harmonised definition) is expected to decrease by 0.4 percentage points to 6.0 per cent and to remain broadly stable in 2015. This is well below the expected EU average rate and reflects efforts in ongoing active labour market policies.

In 2014, all sectors are expected to register notable growth in employment in excess of 2.0 per cent, except for manufacturing and construction where employment growth is expected to be lower. In 2015, employment growth is expected to be more moderate in the majority of the sectors. This overall positive performance is expected to be largely supported by a higher female employment rate, reflecting increased efforts from Government to increase female participation, and increased employment flexibility.

2.1.4 Inflation

The HICP inflation rate (twelve month moving average) which during 2013 stood at 1.0 per cent continued in its downward trajectory during the first half of this year and stood at 0.8 per cent in the latest report. Inflationary pressures are expected to remain subdued at 0.7 per cent in 2014, on the back of lower inflationary pressures in the energy sector stemming from the reduction in utility tariffs for households. In 2015, inflation is expected to rise moderately to 1.5 per cent, underpinned by price pressures emanating from processed and unprocessed food as well as services.

2.2 Comparison to Commission's Spring Forecast

The Spring forecasts published by the European Commission projected a growth rate for Malta of 2.3 per cent in both 2014 and 2015, with domestic demand being the main driver of growth. Therefore, forecasts for real GDP growth presented in this draft budgetary plan are 0.7 and 1.2 percentage points higher than the rate forecasted by the Commission for 2014 and 2015, respectively. This is attributed mainly to a higher than expected contribution from domestic demand. At the same time, the Commission's forecast expected the net contribution from the external sector to be 1.4 percentage points higher in 2014 and 0.2 percentage points lower in 2015. Both sets of forecasts are consistent with a domestically-led growth scenario and are both envisaging a recovery to take place in the external component in 2015.

Nominal GDP growth presented in this draft budgetary plan is projected at 5.1 per cent and 4.8 per cent for 2014 and 2015, respectively. For 2014, this represents a higher growth of 0.8 percentage points over the baseline presented by the Commission in its Spring forecast for 2014 while it is unchanged for 2015.

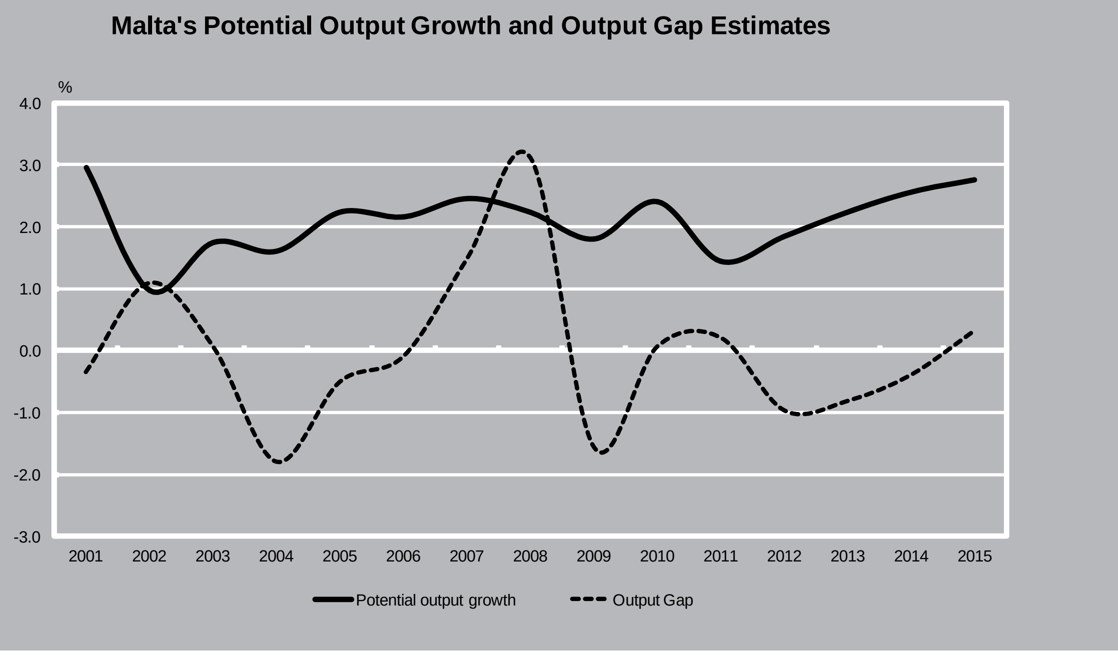
The European Commission will be updating its forecasts in the coming weeks by its autumn round of forecasts.

2.3 Potential Output and the Output Gap

The average potential output growth stood at 2.1 per cent during the period 2006 to 2013. Over the forecast period 2014 to 2017, potential output growth is expected to exhibit a gradual increase. In fact, average potential growth is expected to hover around the 2.9 per cent level, mainly underpinned by positive developments in the labour market through higher participation rates, improvements in investment and improvements in the total factor productivity.

The output gap is expected to remain negative in 2014. However, in 2015 the output gap is expected to turn positive and to remain so over the forecast horizon with the Maltese economy registering a rate of economic growth that is above potential.

Chart 2.1



Macroeconomic forecasts
(Basic assumptions)

Appendix Table 0.i

	2013	2014	2015
Short-term interest rate[1] (annual average)	0.50, 0.25 *	0.18	0.05
Long-term interest rate (annual average)	3.80	3.48	3.35
USD/€ exchange rate (annual average)	1.328	1.344	1.279
STG/€ exchange rate (annual average)	0.849	0.810	0.782
Nominal effective exchange rate	1.038	1.025	1.004
Real GDP Growth of main trading partners	1.20	1.56	1.82
Nominal GDP Growth of main trading partners	2.81	2.49	3.10
World import volumes, excluding EU	...	...	...
Oil prices (Brent, USD/barrel)	108.64	106.94	103.70

** 0.50 with effect from 8/May/2013*

** 0.25 with effect from 13/Nov/2013*

Macroeconomic forecasts
(Macroeconomic prospects)

Appendix Table 1.a		€000s *CLV 2010 Prices*	rate of change		
	ESA Code	**2013**	**2013**	**2014**	**2015**
1. Real GDP	B1*g	7,052.5	2.5	3.0	3.5
Of which					
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth [1]			...		
2. Potential GDP			2.3	2.6	2.8
contributions:					
- labour					
- capital					
- total factor productivity					
3. Nominal GDP	B1*g	7,510.1	4.6	5.1	4.8
Components of real GDP					
4. Private final consumption expenditure	P.3	3,992.6	1.7	2.1	2.1
5. Government final consumption expenditure	P.3	1,413.4	0.5	6.0	2.5
6. Gross fixed capital formation	P.51	1,187.3	2.2	14.3	4.8
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	...	...	1.2	1.1
8. Exports of goods and services	P.6	10,776.4	-1.6	0.7	5.9
9. Imports of goods and services	P.7	10,379.4	-1.7	1.9	5.5
Contributions to real GDP growth					
10. Final domestic demand		6,593.4	1.5	5.2	2.7
11. Changes in inventories and net acquisition of valuables	P.52 + P.53	...	...	0.0	0.0
12. External balance of goods and services (% of Nominal GDP)	B.11	430.0	5.7	5.0	5.3

[1] Please report here the estimated impact on real GDP growth of the aggregated budgetary measures contained in the DBP.

Macroeconomic forecasts
(Price developments)

Appendix Table 1.b	Index	rate of change		
	2013	**2013**	**2014**	**2015**
1. GDP deflator	106.5	2.1	2.0	1.2
2. Private consumption deflator	106.1	1.2	0.5	2.1
3. HICP	120.1	1.0	0.7	1.5
4. Public consumption deflator	105.2	2.5	1.6	3.2
5. Investment deflator	105.8	2.1	0.1	-1.2
6. Export price deflator (goods and services)	107.8	0.3	-0.5	-1.1
7. Import price deflator (goods and services)	107.8	-0.1	-1.5	-0.8

Macroeconomic forecasts
(Labour market developments)

Appendix Table 1.c			rate of change		
	ESA Code	**2013**	**2013**	**2014**	**2015**
1. Employment, persons (€000s) [1]		176.7	2.4	2.1	1.9
2. Employment, hours worked **(**€000s) [2]		393,226.3	2.4	2.1	1.9
3. Unemployment rate (%)[3]		6.4	6.4	6.0	5.9
4. Labour productivity, persons[4]		39,907.2	0.1	0.9	1.5
5. Labour productivity, hours worked [5]		17.9	0.1	0.9	1.5
6. Compensation of employees (€000s)	D.1	3,340.3	4.0	6.8	4.2
7. Compensation per employee		18,901.6	1.6	4.6	2.3

[1] *Total employment, resident population concept, labour force survey definition.*

[2] *National accounts definition.*

[3] *Harmonised definition, Eurostat; levels.*

[4] *Real GDP per person employed.*

[5] *Real GDP per hour worked.*

Macroeconomic forecasts
(Sectoral balances)

Appendix Table 1.d				% GDP
	ESA Code	**2013**	**2014**	**2015**
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	...	...	...
of which:				
- Balance on goods and services		5.7	5.0	5.3
- Balance of primary incomes and transfers		...	...	...
- Capital account		...	...	...
2. Net lending/net borrowing of the private sector	B.9	...	...	...
3. Net lending/net borrowing of general government	B.9	...	...	...
4. Statistical discrepancy		...	...	...

3. General Government Budgetary Developments

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Following the reduction in the deficit from 3.7 per cent of GDP in 2012 to 2.7 per cent of GDP in 2013, Government is continuing with its fiscal consolidation strategy to ensure that the deficit is kept permanently and in a sustainable manner well below the 3.0 per cent threshold and respects the agreed deficit and debt trajectory.

3.1 Budgetary Targets

Government is targeting a deficit of 2.1 per cent of GDP for 2014. The indications and data available up to September 2014 are broadly consistent with this target. Whilst expenditure is expected to be higher than what was projected in the Update of the Stability Programme submitted in April of this year, revenue is also expected to be stronger than anticipated. If these developments persist over the last quarter of this current

Budgetary Targets
(General government budgetary targets broken down by subsector)

Table 2.a — % GDP

	ESA Code	2014	2015
Net lending (+) / net borrowing (-) by sub-sector [1]	B.9		
1. General government	S.13	-2.1	-1.6
2. Central government	S.1311	-1.9	-1.4
3. State government	S.1312	-	-
4. Local government	S.1313	-0.1	-0.1
5. Social security funds	S.1314	-	-
6. Interest expenditure	D.41	2.8	2.8
7. Primary balance [2]		0.7	1.2
8. One-off and other temporary measures [3]		0.2	0.2
9. Real GDP growth (%) (=1 in Table 1.a)		3.0	3.5
10. Potential GDP growth (%) (=2 in Table 1.a)		2.6	2.8
11. Output gap (% of potential GDP)		-0.37	0.31
12. Cyclical budgetary component (% of potential GDP)		-0.17	0.14
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-1.89	-1.71
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		0.91	1.06
15. Structural balance (13 - 8) (% of potential GDP)		-2.1	-1.9

[1] TR-TE= B.9.

[2] The primary balance is calculated as (B.9) plus (D.41, item 6).

[3] A plus sign means deficit-reducing one-off measures.

Budgetary Targets
(General government debt developments)

Table 2.b			% GDP
	ESA Code	**2014**	**2015**
1. Gross debt [1]		70.1	69.0
2. Change in gross debt ratio		0.3	-1.1
Contributions to changes in gross debt			
3. Primary balance (= item 7 in Table 2.a)		0.7	1.2
4. Interest expenditure (= item 6 in Table 2.a)	D.41	2.8	2.8
5. Stock-flow adjustment		1.6	0.6
p.m.: Implicit interest rate on debt [2]		4.2	4.1

[1] *As defined in Regulation 479/2009.*

[2] *Proxied by interest expenditure divided by the debt level of the previous year.*

year, Government is confident that the deficit ratio would be kept well below the 3.0 per cent target for the second consecutive year.

This target is expected to be achieved on the back of a strong performance in economic activity as well as significant fiscal effort. It is to be noted that over the last two years Malta has undertaken an average structural effort of 0.6 percentage points of GDP with the effort being frontloaded in 2013. This is in line with Council recommendations to correct the excessive deficit procedure. Government budgetary targets are presented in Table 2a.

Due to the timing of the settlement of Enemalta's repayment of arrears related to excise on fuel, the expected decline of the debt ratio will also take place in 2014. By the end of 2015, Malta is expected to reach a debt of 69.0 per cent of GDP. For 2015, the projected reduction in the gross debt is mainly driven by a growing primary surplus and by nominal GDP growth, which are expected to more than compensate for the upward pressure that the interest burden is expected to have on the debt ratio. Meanwhile, stock flow adjustments are expected to have a rather muted impact on the underlying ratio in 2015. Developments in gross Government debt are presented in Table 2b.

3.1.1 Discretionary Measures

The reduction in the debt ratio is also supported by further fiscal consolidation in 2015 with an ambitious deficit target of 1.6 per cent of GDP. This is underlined by a number of permanent discretionary revenue measures which in particular include:

1. The International Investor Programme which is expected to render 0.57 per cent of GDP in 2015.

2. Further revenue in indirect taxation equivalent to 0.30 per cent of GDP will be levied on consumer goods and services and 0.06 per cent of GDP consisting of a revision in fees on market output, to compensate

for the revenue foregone due to the lowering of income tax bands. This in line with Government policy to shift tax burden away from labour income while still keeping the same VAT rates.

3. The asset registration scheme launched this year is expected to increase the income tax base through the newly declared assets and is expected to contribute additional income tax revenue per annum.

4. The increase in pensionable age announced as part of the 2006 pension reform is expected to contribute an additional 0.14 per cent of GDP in national insurance contributions.

These measures total 1.11 per cent of GDP and will be partly offset by the further reduction of 4.0 percentage points in the middle income tax bracket estimated at 0.24 per cent of GDP, the lost revenue stemming from the one-off investment registration scheme fee received in 2014 ammounting to 0.13 per cent of GDP and lower temporary revenue amounting to 0.02 per cent of GDP. Thus the net impact of discretionary revenue measures (including those implemented in previous budgets but which still have an impact in 2015) is estimated at 0.7 per cent of GDP.

Discretionary expenditure measures are expected to be relatively neutral on the deficit. Measures which will exert an upward pressure to the budgetary balance of 2015 include:

1. Higher expenditure over 2014 equivalent to 0.08 per cent of GDP towards an annual supplementary children's allowance which is conditional on attendance to school, health check-ups and psycho-social attention. The increase over 2014 is due to the measure being only affected as of September 2014.

2. A higher equity injection to Air Malta in 2015 equivalent to 0.34 per cent of GDP. This will show as a reduction in structural effort although by its very nature the impact of this injection is temporary in nature and cannot be repeated in 2016.

In order to control for Government expenditure increases, these upward pressures will be mainly offset through better control of the public sector wage bill. These are expected to yield 0.12 percentage points of GDP in lower expenditure, by attaining to the target of lowering the replacement rate in non-priority areas and better control on the non-wage component of the personal emoluments.

In aggregate, expenditure measures are expected to exert a negative effect of 0.3 percentage points of GDP on the fiscal deficit.

Furthermore, in line with the Fiscal Responsibility Act (July, 2014), a contingency reserve of 0.1 per cent of GDP has been established by the Ministry for Finance to ensure that unforeseen expenditure or revenue slippages do not jeopardise the compliance with fiscal rules enshrined in the same Act. If unused this will contribute towards further improvement in the budget balance and the structural balance, beyond what is being targeted in this Plan.

A description of discretionary measures is illustrated in Table 5a. It is to be noted, that none of the measures to be introduced in the Budget for 2015 exceed 0.05 per cent of GDP and in line with Article 6(3) of Regulation EU No 473/2013 the description provided is less detailed than that of measures exceeding 0.1 per cent of GDP. Furthermore, this is also in line with the "Guidelines on the format and content of draft budgetary plans, economic partnership programmes and debt issuance reports" (July 2013).

Description of discretionary measures included in the draft budget[1]
(Discretionary measures taken by General Government)

Table 5.a

List of measures	Detailed description	Target (Expenditure / Revenue component) ESA Code	Accounting principle	Adoption Status	Introduced in Budget for…	Incremental Budgetary impact[2]	
						2014 % of GDP	2015 % of GDP
Taxation	Indirect taxes	D2 - R	Accruals	Adopted	2012	-0.03	-
Taxation	Indirect taxes	D2 - R	Accruals	Adopted	2013	0.03	-
Taxation	Indirect taxes	D2 - R	Accruals	Adopted	2014	0.27	0.01
Taxation	Indirect taxes	D2 - R	Accruals	Approved	2015	-	0.30
Widening of income tax rates & Efficiency in revenue collection	The impact on 2014 and 2015 of the widening of the income tax rates introduced in 2013 together with revenue stemming from efficiency in revenue collection and Tax Arrears Collection Schemes.	D5 - R	Accruals	Adopted	2012 & 2013	-0.19	-0.26
Various measures effecting the tax base of current taxes on income	Strengthening of the income tax base following the Investment Registration Scheme, a revision in Income Tax Bands for Family Computation, COLA Tax Exemption on Minimum Wage & Pensions, Third Pillar Pension Incentive and a Tax Credit extension for Child Care	D5 - R	Accruals	Adopted	2014	-0.05	0.03
Investment Registration Scheme	A scheme which encourages declaration of funds for tax purposes aimed at Individuals residing in Malta who hold eligible assets without the necessary exchange control permits and/or, without declaring the relevant income (including capital gains) for the purposes of the Income Tax Act.	D5 - R	Accruals	Adopted	2014	0.13	-0.13
Pension reform initiatives & Social Security Exemption for Carers & Efficiency in revenue collection	The incremental impact on national insurance contributions stemming from the 2006 pension reform intiative, the exemption of social security contributions for carers announced in the 2014 budget & revenue stemming from efficiency in revenue collection and Tax Arrears Collection Schemes.	D6 - R	Accruals	Adopted	2006 & 2012 & 2014	0.13	0.14
International Investor Programme	International Investor Programme.	P10 - R	Accruals	Adopted	2014	0.06	0.57
A number of measures impacting Market Output	Revision in fees on Market Output.	P10 - R	Accruals	Approved	2015	0.00	0.06
Pension reform initiatives & Assistance to the Elderly & Supplementary Children's Allowance	The incremental impact from lower pension expenditure stemming from the 2006 pension reform, together with expenditure towards assistance to help the elderly live independently and a supplementary children's allowance as from September 2014.	D6 - E	Accruals	Adopted	2006	-0.07	-0.07
Equity acquisition in Airmalta plc	The investment was carried out in Air Malta to support the national airline's restructuring programme.	D9 - E	Accruals	Adopted		0.32	-0.35
Public Sector Wage Bill	Measures to control public sector wage bill	D1 - E	Accruals	Approved	2015	-	0.12
					TOTAL	**0.61**	**0.41**

[1] The impact is recorded in incremental terms - as opposed to levels - compared to the previous year's baseline projection. The total figure is the Total impact on the budget balance, as a revenue increasing measure is listed as positive, while an expenditure decreasing measure is also positive. The contrary applies for negative figures, such that a revenue decreasing measure is negative and an expenditure increasing measure is also positive. Simple permanent measures are recorded as having an effect of +/- X in the year(s) they are introduced and zero otherwise (the overall impact on the level of revenues or expenditures does not cancel out). If the impact of a measure varies over time, only the incremental impact is recorded in the table. By their nature, one-off measures are recorded as having an effect of +/- X in the year of the first budgetary impact and -/+ X in the following year, i.e. the overall impact on the level of revenues or expenditures in two consecutive years is zero.

[2] None of these different measures exceed 0.05 per cent of GDP and in line with Article 6(3) of Regulation EU No 473/2013 the description provided can be less detailed than that of measures exceeding 0.1 per cent of GDP. Furthermore, in line with the "Guidelines on the format and content of draft budgetary plans, economic partnership programmes and debt issuance reports" (July 2013), measures below the 0.05 per cent of GDP threshold are identified, quantified and meaningfully grouped together

3.2 Expenditure and Revenue Projections under the No-Policy Change Scenario

Projected revenue increases for 2015 under the no policy change scenario are primarily driven by increased economic activity, the composition of economic growth and any improvements in the efficiency of revenue collection. It is therefore essential to underline the growth projections which sustain revenue growth under the no policy change scenario.

Economic activity in 2015 is expected to be characterised by a relatively strong real GDP growth but a somewhat more subdued inflationary environment particularly with respect to import and export prices, but less so in the case of domestic consumption. Such a strong recovery is consistent in the macroeconomic projections underlying the Draft Budget with a stronger growth in profits compared to wages and salaries.

As a result of the expected distribution of income gains, revenue from taxes on income is anticipated to be stronger than nominal GDP growth in 2015. Moreover, this distribution of income where wages are growing at a slower rate than the rate of economic growth is consistent with a slower growth in social security contributions than the pace of nominal economic growth.

Growth from the expenditure components of GDP are driven by strong consumer demand and a further increase in tourism activity such that the growth in taxes on production and imports is expected to marginally exceed the growth in nominal GDP. Imports of goods (excluding fuel and industrial supplies) is also expected to rise faster than nominal GDP in 2015, further contributing to a stronger increase in taxes on production and imports. The gaming and lotteries sector and car registrations are also expected to influence positively indirect tax revenue.

Overall, despite the relatively strong and tax rich composition of economic growth forecast for 2015, tax

Expenditure and Revenue Projections under the no-policy change scenario [1]
(General government expenditure and revenue projections at unchanged policies broken down by main components)

Table 3 — % GDP

	ESA Code	2014	2015
General government (S13)		-2.1	-2.0
1. Total revenue at unchanged policies	TR	40.9	41.1
Of which			
1.1. Taxes on production and imports	D.2	13.7	13.7
1.2. Current taxes on income, wealth, etc	D.5	13.8	14.3
1.3. Capital taxes	D.91	0.2	0.1
1.4. Social contributions	D.61	7.1	6.9
1.5. Property income	D.4	1.2	1.2
1.6. Other [2]		5.0	4.9
p.m.: Tax burden		34.8	35.2
(D.2+D.5+D.61+D.91-D.995)[3]			
2. Total expenditure at unchanged policies	TE[3]	43.0	43.1
Of which			
2.1. Compensation of employees	D.1	12.8	12.8
2.2. Intermediate consumption	P.2	6.4	6.6
2.3. Social payments	D.62 D.632	12.8	12.4
of which Unemployment benefits [4]		0.4	0.4
2.4. Interest expenditure	D.41	2.8	2.8
2.5. Subsidies	D.3	1.4	1.6
2.6. Gross fixed capital formation	P.51	3.3	3.5
2.7. Capital transfers	D.9	1.0	1.1
2.8. Other [5]		2.4	2.3

[1] Please note that the no-policy change scenario involves the extrapolation of revenue and expenditure trends before adding the impact of the measures included in the forthcoming year's budget.

[2] P.11 + P.12 + P.131 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[3] Tax revenue including those collected by the EU (Own Resources) and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.

[4] Includes cash benefits (D.621 and D.624) and in kind benefits (D.632) related to unemployment benefits.

[5] D.29pay + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

revenue is expected to grow only marginally faster than nominal GDP growth. Indeed the implied elasticity of tax revenue to GDP under the no policy change scenario is estimated at 1.2. This is underlined by prudent elasticity estimates for the revenue components with their respective tax base.

As a result, the tax burden is expected to rise from 34.8 per cent of GDP to 35.2 per cent of GDP under a no policy change scenario as depicted in Table 3. This increase is primarily due to taxes on income which are expected to rise by 0.56 percentage points of GDP. Taxes on production and imports and capital taxes are expected to maintain an unchanged ratio to GDP. On the other hand, social security contributions as a share of GDP, under the no policy change scenario, are expected to decline by 0.15 percentage points. Similarly, a drop of the same magnitude is expected in the share of other revenue.

Total expenditure under the no policy change scenario is expected to increase marginally from 43.0 per cent of GDP in 2014 to 43.1 per cent in 2015. The categories with the highest expenditure increase are intermediate consumption and capital transfers (a 0.2 percentage points increase for each category). On the other hand, social payments as a share of GDP, at unchanged policies, are expected to decrease by 0.3 percentage points to 12.4 per cent of GDP, primarily reflecting lower Cost of Living Adjustment resulting from a low inflationary environment.

Higher expenditure for subsidies in 2014 was due to the temporary takeover of the Public Transport Services by the Government. In the 2014 Update of the Stability Programme, subsidies were expected to return to their ratio prior to the temporary take over in 2015. Government remains committed to divest itself off the transport operation.

3.3 Expenditure and Revenue Targets

General Government expenditure and revenue targets are presented in Table 4a. Revenue targets are supported by the favourable macroeconomic conditions highlighted in Section 3.2 and also the revenue measures highlighted in Section 3.1. In particular, total revenue is expected to rise by 0.9 percentage points of GDP, from 40.9 per cent of GDP to 41.8 per cent of GDP. The tax burden is expected to rise by 0.5 percentage points of GDP to reach 35.3 per cent of GDP in 2015. The increase in tax revenue is underlined by tax buoyancy whilst the net impact of discretionary measures is estimated at 0.1 per cent of GDP. The International Investor Programme is expected to contribute a further 0.6 percentage points of GDP to the increase in total revenue.

The ratio of general Government expenditure to GDP is expected to increase from 43.0 per cent in 2014 to 43.4 per cent in 2015. Discretionary expenditure measures are expected to exert a negative effect of 0.3 percentage points of GDP on the fiscal deficit, particularly stemming from the increase in capital transfers of 0.3 percentage points relate to the higher equity injection in Air Malta when compared to 2014.

Meanwhile, changes in the other components of expenditure, net of the impact of the discretionary expenditure measures and of gross fixed capital formation, are expected to have a neutral effect on the deficit ratio (refer to Table 4a).

Expenditure and Revenue Targets
(General government expenditure and revenue targets, broken down by main components)

Table 4.a			% GDP
	ESA Code	**2014**	**2015**
General government (S13)		-2.1	-1.6
1. Total revenue target	TR	40.9	41.8
Of which			
1.1. Taxes on production and imports	D.2	13.7	14.0
1.2. Current taxes on income, wealth, etc	D.5	13.8	14.0
1.3. Capital taxes	D.91	0.2	0.1
1.4. Social contributions	D.61	7.1	7.0
1.5. Property income	D.4	1.2	1.2
1.6. Other [1]		5.0	5.5
p.m.: Tax burden		34.8	35.3
(D.2+D.5+D.61+D.91-D.995)[2]			
2. Total expenditure target	TE[3]	43.0	43.4
Of which			
2.1. Compensation of employees	D.1	12.8	12.7
2.2. Intermediate consumption	P.2	6.4	6.6
2.3. Social payments	D.6M	12.8	12.5
of which Unemployment benefits [3]		0.4	0.4
2.4. Interest expenditure (= item 6 in Table 2.a)	D.41	2.8	2.8
2.5. Subsidies	D.3	1.4	1.6
2.6. Gross fixed capital formation	P.51G	3.3	3.5
2.7. Capital transfers	D.9	1.0	1.5
2.8. Other [4]		2.4	2.3

[1] P.11 + P.12 + P.131 + D.39rec + D.7rec + D.9rec (other than D.91rec).

[2] Tax revenue including those collected by the EU (Own Resources) and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.

[3] Includes cash benefits (D.621 and D.624) and in kind benefits (D.632) related to unemployment benefits.

[4] D.29pay + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

Expenditure and Revenue Targets
(Amounts to be excluded from the expenditure benchmark)

Table 4.b % GDP

	ESA Code	2013 Level	2013	2014	2015
1. Expenditure on EU programmes fully matched by EU funds revenue		104.7	1.4	2.5	2.2
2. Cyclical unemployment benefit expenditure [1]		0.5	0.0	0.0	0.0
3. Effect of discretionary revenue measures [2]		-20.0	-0.3	0.4	0.7
4. Revenue increases mandated by law		-	-	-	-

[1] The cyclical unemployment benefit expenditure is calculated by multiplying the gap between the Non-Accelerating Wage Rate of Unemployment (NAWRU) and the unemployment rate (expressed in terms of the unemployment rate) by the total unemployment benefit expenditure. Data for the NAWRU is obtained from the AMECO Database, updated May 2013, data for the unemployment rate is per Table 1.c of this report, and data for the total unemployment benefit expenditure is per Table 4.a in this report as defined in COFOG under the code 10.5.

[2] Revenue increases mandated by law is not included in the effect of discretionary revenue measures: data reported in rows 3 and 4 are mutually exclusive.

Divergence from latest SP

Table 7 % GDP

	ESA Code	2013	2014	2015
Target general government net lending/ net borrowing	B.9			
Stability Programme		-2.8	-2.1	-1.6
Draft Budgetary Plan		-2.7	-2.1	-1.6
Difference		-0.1	-0.0	-0.0
General government net lending projection at un-changed policies	B.9			
Stability Programme		-2.4	-2.7	-1.5
Draft Budgetary Plan		-	-2.1	-2.0
Difference [1]		-	-0.6	0.5

[1] This difference refer to both deviations stemming from changes in the macroeconomic scenario and those stemming from the effect of policy measures taken between the submission of the SP and the submission of the DBP. Differences are also due to the fact that the no-policy change scenario is defined differently for the purpose of this Code of Conduct with respect to the Stability Programme.

3.4 Divergence from the April 2014 Stability Programme

The targets for the general Government budget balance have remained unchanged since the latest Update of the Stability Programme. Meanwhile, as can be noted in Table 7, the estimates for the general Government balance at unchanged policy have been revised by -0.6 and +0.5 per cent of GDP in 2014 and 2015, respectively. These revisions are mainly attributable to both deviations stemming from changes in the projected macroeconomic scenario, as well as the fact that the no policy change scenario is defined differently for the purpose of the Draft Budgetary Plan as compared to the Stability Programme.

Expenditure and Revenue Targets
(General government expenditure by function)

Appendix Table 4.c.ii — % GDP

Classification of the functions of the Government

Functions of the Government	COFOG Code	2014	2015
1. General public services	1	8.0	7.3
2. Defense	2	0.7	0.7
3. Public order and safety	3	1.3	1.3
4. Economic affairs	4	4.6	5.5
4. Environmental protection	5	1.5	1.6
6. Housing and community amenities	6	0.5	0.5
7. Health	7	5.5	5.6
8. Recreation, culture and religion	8	1.1	1.2
9. Education	9	6.0	6.1
10. Social protection	10	13.8	13.6
11. Total Expenditure (= item 2 in Table 4.a)	TE	43.0	43.4

4. Distributional Implications of Budget Measures

4. Distributional Implications of Budget Measures

Building on the robust economic performance and the fiscal consolidation results attained over the past year, the Draft Budget for 2015 is complementing the strategy to make work pay by ensuring that the social security system positively incentivises work effort and discourages dependency. This also reflects the principle that economic prosperity and wealth should be felt and enjoyed by all.

Government shall legislate the final tranche of the widening of the income tax brackets originally announced in the Budget for 2013. This widening in the income tax bands will not affect post-tax household income for households living in the lower quintiles of the income distribution, with the majority of the gains being accrued to households in the top quintiles of the income distribution. As noted in the Draft Budgetary Plan 2014, Government is conscious of this fact, nevertheless, it is to be noted that the scope of such measure is intended to encourage the supply of effort especially amongst the most productive elements of the labour force.

The fiscal consolidation effort will continue to reflect Government's commitment to shift away from direct taxation on labour towards indirect taxation with the aim of making work pay and hence further increasing employment growth, competitiveness and ultimately economic growth. In this light, the fiscal consolidation effort is based on the contribution of a number of indirect tax measures. An analysis of the consumption patterns of different households indicates that the share of consumption of the product and services categories affected by the tax measure is highest amongst higher income brackets, with the highest proportion being for households in the 4th income quintile. The lowest proportion is noted among households in the bottom income quintile. Consequently, in the case of this particular selection of indirect tax measures, the incidence of taxation is rather progressive.

Government is also introducing a measure to strengthen social cohesion through the introduction of an income support measure for families with children with low income. The measure is means-tested so as to ensure better targeting of benefits and is conditional upon positive outcomes such as regular school attendance and regular health checks. This increase in child benefits is expected to benefit 22,000 children living in 9,000 households. This measure is expected to address positively the poverty challenges faced by low-income working families and children more generally.