Malta:

Update of Convergence Programme

2006 - 2009

Ministry of Finance
December 2006

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 20th November 2006.

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Introduction

This document presents an Update of Malta's Convergence Programme. This Update was prepared in line with the 'Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of the Stability and Convergence Programmes', endorsed by the ECOFIN Council on the 11 October 2005. This Code of Conduct takes into consideration the report endorsed by the European Council on 22 March 2005 entitled 'Improving the implementation of the Stability and Growth Pact' and the Council Regulations amending Regulations No. 1466/97 and No. 1467/97.

This update was compiled by the Ministry of Finance, with important contributions from various Ministries, as well as the Central Bank of Malta and the National Statistics Office. This document encompasses the following seven sections. Chapter 1 presents Government's objectives for macroeconomic policy and monetary and exchange rate policy; Chapter 2 outlines the medium-term projections of the main macroeconomic variables; Chapter 3 reviews Malta's medium-term objectives, fiscal policy and the medium-term fiscal projections and debt developments; Chapter 4 contains a number of sensitivity analysis of the budgetary projections and an analysis of the divergences between the current forecasts and the forecasts presented in the December 2005 Update of the Convergence Programme; Chapter 5 analyses the quality of public finances and reviews the main measures inherent in the Budget for 2007 which demonstrate how fiscal targets will be achieved; in addition the integration between the Convergence Programme and the National Reform Programme is outlined; Chapter 6 deals with the sustainability of public finances, including long-term budgetary prospects and the implications of ageing populations; and in conclusion Chapter 7 presents the institutional features of public finances.

1. Overall Policy Framework and Objectives

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1.1 Main Macroeconomic Policy Objectives

Government's vision for Malta remains that of a dynamic, high value-added economy founded on competence, skills and excellence and capable of sustaining a high standard of living for its people. In this context, Government's main macroeconomic policy objectives continue to be the following:

- The achievement of sustainable economic growth and a high and stable level of employment;
- Continue to strengthen the public finance situation so as to secure a sustainable fiscal position;
- Ensuring stability in the external sector.

The attainment of a stable and sound macroeconomic environment is necessary for achieving sustainable economic growth and employment creation. Thus, a fiscal policy which aims to secure a sustainable fiscal position, in line with the Stability and Growth Pact, continues to constitute a key element in Government's economic policy agenda. The latest fiscal projections confirm that the deficit is expected to fall below 3 per cent of GDP in 2006, whilst the debt-to-GDP ratio is expected to continue on a downward trend. Government's medium-term fiscal targets aim to achieve further reductions in the fiscal deficit and this will be achieved mainly through expenditure restraint measures.

Government remains committed to reach a balanced structural budget. This will not be achieved in 2008 as projected in last year's Update of the Convergence Programme, due to higher capital expenditure in 2008 compared to the levels projected in the December 2005 Programme and a higher than expected structural deficit in 2006. Instead, a structural deficit of 0.4 per cent of GDP is now projected for 2009. Thereafter, Government remains committed to reduce further the structural deficit by at least 0.5 percentage points of GDP annually until Malta's MTO, as set out in the December 2005 Update of the Convergence Programme, is achieved. Such an achievement will take place outside the Programme period.

Government is committed to the fiscal targets presented in this Programme and stands ready to introduce additional corrective measures, should this be warranted by unforeseen circumstances which affect these targets.

The long-term sustainability of public finances is another key aspect of Government's fiscal policy. In the area of pensions, an important step was taken with the publication of the Pensions reform Bill which is currently in the final stages of the legislative process. This constitutes an important step to ensure the long-term sustainability of the public pension system in Malta.

Besides a sustainable fiscal position, another important requisite for macroeconomic stability is achieving a low and stable level of inflation. Recently, the inflation rate has been following an increasing trend, being significantly affected by the relatively high international oil prices. It is expected that the contribution of energy related components on the domestic inflation rate should subside by the end of 2006 and the inflation rate is projected to decline in 2007. Government is closely monitoring inflationary developments and is taking measures to ensure that imperfect competition in specific markets, reflecting the small size of the domestic market, is not resulting in price rigidities or in unjustified price increases. Government also recognises that in order to avoid undue inflationary pressures, it is important that wage increases correspond to increases in productivity.

A sound fiscal situation together with a relatively low inflation rate entail stability in the external sector. This remains a priority for the Maltese Government, especially in view of Malta's participation in ERMII and the Maltese authorities' intention for Malta to adopt the euro on 1 January 2008.

Within the context of the fiscal consolidation programme underway, Government is using the fiscal policy tool in order to spur long-term economic growth. In particular, as outlined in the Budget Speech for 2007, Government's fiscal policy aims to continue to ensure the necessary investment, particularly in infrastructure and education, also through the effective and efficient absorption of EU funds. Furthermore, specific measures have been announced which aim to improve the incentive to work, in order to encourage an increase in employment rates, in line with the Lisbon agenda. Thus fiscal policy is being used to improve the supply side of the economy, so as to address certain constraints which were hampering the attainment of further economic growth. These measures should result in higher potential growth of the domestic economy and thus facilitate real convergence with EU average levels.

The investment in the infrastructure as well as the efforts to improve the education and skills levels of Malta's human resources are in line with the policy to shift the economy to high value-added sectors. It is considered that this is imperative in the context of the increasingly globalised and competitive international environment in which the small and highly open domestic economy is operating. Such a shift towards higher value-added economic activities is particularly evident in the manufacturing industry as well as in the emergence and development of service activities, including financial services and those related to information technology. At the same time, Government remains committed to support the development of traditional sectors, particularly the tourism industry, whilst recognising that improving their competitive position is also essential. In this context, Government is committing significant outlays, including EU funds, in order to improve the domestic tourism product.

The high degree of openness in the domestic economy implies that a sustained increase in prosperity can only be acquired through export-led growth. Furthermore, the increasingly competitive international environment requires flexibility so that economies can adapt quickly to emerging changes. Within this context, structural reforms to instil greater efficiency and to improve competitiveness are of utmost importance. Government remains committed to increase the efficiency of the public sector, whilst focusing on its role as a regulator rather than as an operator in the economy. Furthermore, measures are being implemented to nurture competitive forces in domestic markets, to improve the business environment, to support small enterprises and to encourage research and innovation.

Government believes that social cohesion should remain an important goal in its economic and fiscal policy. There should be equal opportunities, so that there is a fair contribution and a fair benefit from economic gains. In this regard, Government considers that education is a key aspect to ensure employment and hence to achieve social cohesion and avoid poverty. Over the years an extensive welfare system has been developed, which ensures that there is an adequate social safety net. The welfare system must ensure equity, adequacy and sustainability of the benefits provided. Furthermore, abuse of social benefits should be curbed whilst the welfare system, and particularly its interaction with the taxation systems, should not act as a disincentive to work.

The improvement of the environment is another key priority of the Government. This will not only contribute to improve the quality of life in Malta but also support economic activities, in particular the tourism industry. To this effect, significant funds, particularly EU funds, are being earmarked for environment projects.

1.2 Monetary and Exchange Rate Policy

The Central Bank of Malta is responsible for the conduct of monetary policy in Malta with the primary objective of maintaining price stability. In turn, exchange rate policy is the shared responsibility of the Government and the Bank. Since the entry of the Maltese lira into ERM II, on 2 May 2005, the central parity rate has been unilaterally maintained constant at MLT/EUR 0.429300, the closing rate prevailing on the previous trading day. This decision was taken to safeguard the net gains of a fixed exchange rate regime which the country has benefited from in the past.

The Bank sets official interest rates at a level considered to provide the necessary support for the fixed euro exchange rate peg, broadly mirroring the policy stance in the Euro Area, together with a premium. Each month, the Bank assures the underlying trend in the official foreign reserves and their likely future developments to ensure that domestic financial conditions are conducive to the successful participation in ERM II of the Maltese lira.

In 2006 the Bank raised the central intervention rate by 25 basis points in May and by a further 25 basis points in October, bringing the benchmark official interest rate to a level of 3.75 per cent. These decisions were consequent to the narrowing of the interest rate differential in favour of the Maltese lira assets amid the tightening stance adopted by the European Central Bank. The Bank also noted an underlying downward trend in external reserves against a background of a further deterioration in the current account deficit and relatively high energy-induced inflation.

The monetary policy tightening process proved to be smooth, with financial markets reacting positively. Successful conduct of monetary policy, in conjunction with structural reforms and the fiscal consolidation under way, should enable the country to satisfy all the Maastricht criteria and adopt the euro on 1 January 2008, in line with the Maltese authorities' intention. The adoption of the single currency will allow Malta to benefit fully from its membership in the European Union.

2. Economic Outlook

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2.1 The Medium-Term Scenario

Economic growth over the forecast period is expected at a rate of around 3.0 per cent in real terms. The main driver of economic growth over the period is expected to be the domestic side of the economy, primarily through investment growth and private consumption expenditure. Whilst in the short term, the external balance of goods and services is expected to contribute negatively to GDP growth, it will turn positive over the medium term. Table 2.1 presents the main macroeconomic indicators for the years 2004-2009. The figures for 2004 and 2005 have been published by the National Statistics Office (NSO)[1], whilst figures from 2006 onwards are forecasts. The macroeconomic forecasts take into account the latest available data and are being provided in Tables 1a, 1b, 1c, and 1d of the Statistical Appendix.

The Maltese economy is estimated to grow by 2.9 per cent in real terms during 2006. It is expected that domestic demand remains a major contributor to economic growth. In fact, the domestic side of the economy will continue to exhibit a positive contribution to GDP growth during the forecast period. In 2006, a significant increase in import growth is expected particularly as a result of high investment growth as well as sustained growth in private consumption expenditure. This is expected to outweigh the modest increase forecasted for exports of goods and services, and thus the external sector is expected to contribute negatively to GDP growth. This negative influence from the external sector is expected to decline but continue in 2007, however, in 2008 and 2009 it is projected that the external sector will start to contribute positively to GDP growth. Real GDP is expected to grow by 3.0 per cent in 2007, and by 3.1 per cent in 2008 and 2009. The projected growth rates of GDP together with a detailed breakdown of the various expenditure aggregates are illustrated in Chart 2.1.

Main Macroeconomic Indicators

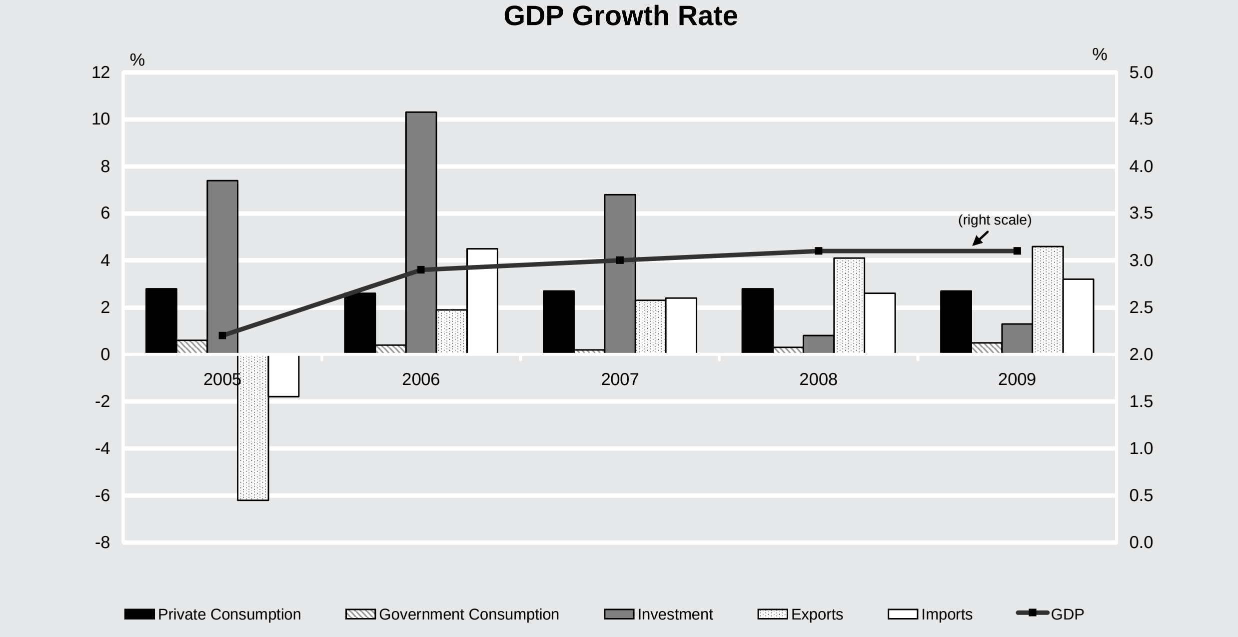
Table 2.1

	2004	**2005**	**2006(1)**	**2007**	**2008**	**2009**
GDP at constant (2000) prices (Lm million)	1,703.5	1,741.0	1,791.2	1,845.2	1,903.1	1,961.5
GDP at current market prices (Lm million)	1,861.3	1,941.1	2,070.3	2,195.5	2,328.5	2,471.7
GDP growth at constant (2000) prices (%)	–	2.2	2.9	3.0	3.1	3.1
Expenditure Components of GDP at constant (2000) prices (% change)						
Private final consumption expenditure(2)	1.1	2.8	2.6	2.7	2.8	2.7
General government final consumption expenditure	1.4	0.6	0.4	0.2	0.3	0.5
Gross fixed capital formation	0.8	7.4	10.3	6.8	0.8	1.3
Exports of goods and services	4.1	-6.2	1.9	2.3	4.1	4.6
Imports of goods and services	4.3	-1.8	4.5	2.4	2.6	3.2
Inflation rate (%)	2.7	2.5	3.1	2.2	2.1	2.0
Employment growth (%)	-0.8	1.5	0.9	1.1	0.9	0.9
Unemployment rate (%)	7.4	7.3	7.0	6.5	6.4	6.2
Labour productivity (% change)	0.8	0.7	2.0	1.9	2.2	2.2
External Goods and Services Balance (% of GDP)	-6.1	-10.1	-12.1	-11.3	-9.2	-7.1

(1) Forecasts from 2006 onwards

(2) Includes NPISH final consumption expenditure

Chart 2.1



2.1.1 Assumptions for Projections

The forecasts presented in this section and the different sensitivity scenarios presented in this document were estimated using econometric techniques and analytical methods. The following are the main assumptions used in obtaining the base forecasts for 2006-2009.

- Economic activity in Malta's main trading partners is expected to improve by 2.3 per cent and 1.9 per cent in 2006 and in 2007 respectively, and by 2.1 per cent in 2008 and 2009. World prices, based on producer price indices of the Euro Area, are assumed to rise by 1.6 per cent in 2006 and by around 2.0 per cent thereafter.

- Assumptions for world oil prices develop in line with the European Commission's forecast assumptions presented in the 'Economic Forecasts - Autumn 2006'. Oil prices are assumed to increase further in 2006, from an average US$53.4 per barrel in 2005 to US$66.5 per barrel in 2006 and increase slightly thereafter.

- Interest rates and exchange rates are assumed to remain constant throughout the forecast period.

- Average wage inflation is assumed to be relatively low compared to historical growth rates, reflecting the global competitiveness pressure on employment costs. Average wages are expected to grow by an average of around 2.0 per cent per annum during the forecast period. Meanwhile, it is assumed that Government employment continues to decline in line with past trends reflecting Government's policy of restricting recruitment in non-essential categories.

- Inventory changes are assumed at around 1.7 per cent of GDP during the forecast period.

2.1.2 Private Final Consumption Expenditure

During the forecast period, growth in private final consumption expenditure is expected to be somewhat in line with that recorded in 2005. A growth rate of 2.6 per cent is expected in 2006, and thereafter, this component of GDP is expected to register further increases and grow by around 2.7 per cent.

2.1.3 General Government Final Consumption Expenditure

During the forecast period, Government final consumption expenditure is projected to record growth rates that are significantly below the real GDP growth rates for the respective years. In 2006, Government final consumption expenditure is expected to increase by 0.4 per cent, and to increase by a further 0.2 per cent in 2007, while in 2008 and 2009 it is expected to record a growth rate of 0.3 per cent and 0.5 per cent respectively. This reflects Government's fiscal consolidation strategy, whereby significant emphasis is being placed on restraint of expenditure of a recurrent nature.

2.1.4 Gross Fixed Capital Formation

In the short term, investment activity is expected to remain the main driving force of economic growth, increasing by 10.3 per cent in 2006 and 6.8 per cent in 2007. This strong growth in gross fixed capital formation primarily reflects developments in public sector capital expenditure. In the forecast period, public investment includes expected outlays on projects financed by the EU Structural and Cohesion Funds. It is noteworthy that investment expenditure in 2007 includes projects financed both from the current operational programme as well as that under the 2007-2013 Cohesion Policy operational framework. Public investment outlays are also significantly affected by expected expenditure related to the new hospital. Given that the targeted completion of this project is by 2007, gross fixed capital formation by general Government is expected to contract in 2008 and 2009 and revert to historical levels as a share of GDP. Meanwhile, private sector investment activity is expected to contribute positively to total investment throughout the forecast period. Accordingly, total investment is projected to record a growth rate of 0.8 per cent and 1.3 per cent in 2008 and 2009, respectively.

2.1.5 External Balance of Goods and Services

Latest available trade data published by the NSO for 2006 indicates a notable improvement in nominal exports of semiconductors, as well as an increase in sales by the pharmaceutical sector. Economic activity in Malta's main trading partners improved, helping to stimulate foreign demand for domestic exports. Furthermore, there were more favourable developments in the international semiconductor market. On the other hand, the performance of the domestic tourism industry remained subdued. As a result of these developments, it is forecasted that in 2006, exports of goods and services increase by 1.9 per cent. However, this increase in exports is not expected to be enough to compensate for the increase of 4.5 per cent in imports. The increase in imports of capital goods includes exceptional items of a substantial magnitude whilst imports of consumer goods continued to advance in the light of additional consumer expenditure. Additionally, the rise in the fuel import bill continued as a result of the relatively high international oil prices. Accordingly, the external sector is expected to contribute negatively to GDP growth by 2.7 per cent in 2006.

In 2007, the growth rate in exports is expected to pick up to 2.3 per cent being mainly underpinned by continued positive results in the semiconductor sector as well as emerging manufacturing sectors. Growth in imports is expected to slow down to 2.4 per cent, reflecting the relatively lower growth rate in investment. Nevertheless, in 2007, the external sector is expected to continue to contribute negatively to GDP though by a lesser extent than in the previous two years. On the other hand, in 2008 and 2009 the external sector is expected to pick up momentum and contribute positively to GDP growth. In 2008, exports are expected to increase by 4.1 per cent, while imports are expected to increase by 2.6 per cent, while in 2009, exports are expected to increase by 4.6 per cent, while imports are expected to advance by 3.2 per cent.

2.1.6 Productivity and Employment Prospects

During the forecast period, employment (based on National accounts definition) is expected to increase by an average of 0.9 per cent per annum between 2006 and 2009. Over this period, the increase in real GDP is expected to exceed the forecasted increase in employment. As a result, real labour productivity is expected to increase by around 2 per cent over the trajectory period.

In 2006, the unemployment rate (based on the Harmonised definition), is expected to decrease to 7.0 per cent, from 7.3 per cent in 2005. Thereafter, the unemployment rate is projected to fall, reaching 6.2 per cent in 2009. These developments are in line with the expected improvements in the Maltese economy, whereby the expected economic expansion will contribute to an increase in employment levels.

2.1.7 Inflation

The inflation rate (calculated as twelve month moving average HICP) is expected to increase to 3.1 per cent in 2006 from 2.5 per cent in 2005, being significantly affected by the contribution of energy prices. However, given that energy prices developments are expected to be relatively modest during the forecast period, consumer prices are projected to record a declining rate reaching 2.0 per cent in 2009.

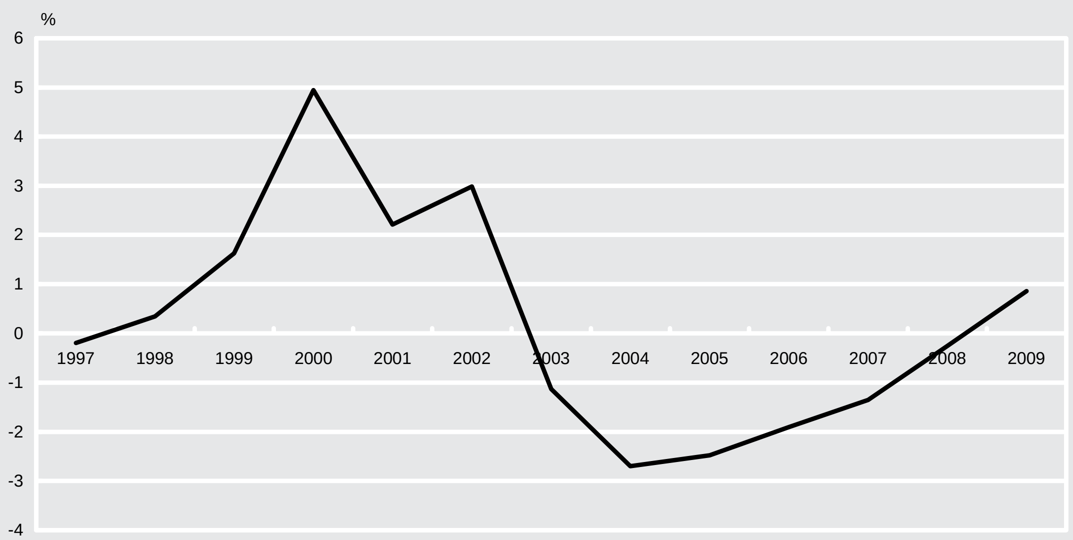
2.2 Potential Output and the Output Gap

During 2006, GDP growth is expected to rise to 2.9 per cent, up from 2.2 per cent recorded in 2005. As explained in Annex 1 of the December 2005 Update of the Convergence Programme, the method used in the estimation of the output gap is based on the European Commission's Production Function method, with the main differences related to the macroeconomic forecasts and the working age population figures. Developments in the output gap are depicted in Chart 2.2.

Economic performance between 2001 and 2004 was sluggish as well as volatile owing to heightened uncertainty in the international environment coupled with the effects of external shocks as well as domestic developments. On the domestic front, economic activity was impacted by the unfolding of the fiscal consolidation process and the competitiveness challenges faced by a number of sectors. Consequently, the average annual rate of economic growth registered between 2001 and 2004 stood at -0.2 per cent, considerably lower than the average annual growth rate of 4.7 per cent recorded between 1997 and 2000. Even after excluding the exceptional developments recorded in 2000, attributable to the performance of a major player in the domestic semiconductor manufacturing sector, the average growth for the 1997-2000 would still be significantly higher than that recorded for the period 2001-2004. In 2005, a rebound in economic activity was registered, which

Chart 2.2

Output Gap[1]



[1] Defined as actual output less potential output as a per cent of potential output.

is expected to be sustained in 2006. The average annual growth rate is expected to rise to around 3 per cent over the period 2006-2009.

Average potential output growth stood at 3.0 per cent during the period 1997-2000, declining to 1.7 per cent between 2001 and 2004. The decline in potential output growth reflects amongst other things, the relatively slower rate of capital accumulation recorded during the period, as well as demographic and labour market developments. Potential output growth stood at 2.0 per cent during 2005, whilst it is expected to rise further to 2.2 per cent over the period 2006 – 2009.

The output gap, defined as the difference between actual and potential output as a share of potential output is indicative of cyclical developments in the Maltese economy. As shown in Chart 2.2, the output gap was positive during 1998-2002, peaking at 4.9 per cent in 2000. Since 2003, the output gap turned negative, reaching a trough of -2.7 per cent in 2004. The output gap narrowed in 2005 and is expected to continue narrowing during the forecast period, turning positive in 2009.

Note:

[1]Data in line with NSO News Release (National Accounts, GDP, June Quarter 2006), No. 206/2006.

3. General Government Balance and Debt

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The fiscal consolidation effort implemented in recent years continues to be the main objective of this Programme. This is essential in order to recover fiscal policy as a policy tool necessary to address cyclical fluctuations. Fiscal consolidation is also necessary in order to ensure public finance sustainability, further reduce macroeconomic imbalances and increase investor confidence in the Maltese economy.

This Update continues to outline Government's fiscal plan so as to proceed with the fiscal consolidation of public finances over the medium term and to undertake the structural adjustment to ensure the sustainability of public finances in the long-term. This fiscal plan aims to adhere to the Council Recommendation under Article 104(7) to abrogate the excessive deficit procedure and the requirements of the Stability and Growth Pact. This Programme aims to achieve these objectives in the context of the public investment necessary to reach EU standards of economic development and to absorb the EU funds following the conclusion of the Financial Perspectives for 2007 – 2013.

It is Government's objective, as set out in the Budget Speech for 2007, to address constraints in the domestic economy which might be creating difficulties for the economy to grow at an acceptable pace. The fiscal consolidation programme is also consistent with Government's efforts within the Lisbon Framework. In this context, whilst fiscal sustainability is ensured, the goal of enhancing the growth potential of the economy is also achieved. In particular, the budgetary measures underpinning this Programme secure a sustainable fiscal adjustment whilst introducing measures to make work pay and thus encourage work effort particularly female participation, improve the labour market, encourage private sector initiative and further promote research and development.

The fiscal measures announced to this effect have been limited and compensated by consolidation measures primarily from the expenditure side, in order to ensure progress in the fiscal consolidation process. Government stands ready to introduce additional corrective measures, should this be warranted by unforeseen circumstances which impinge on the deficit targets presented in this Programme.

The general Government deficit is estimated at 2.6 per cent of GDP in 2006, down from 5.0 per cent of GDP in 2004. This represents an accumulated fiscal adjustment of 2.4 percentage points of GDP in two years. As a result, the general Government deficit for 2006 is estimated to be below the 3 per cent target, in line with the target set out in the December 2005 Convergence Programme.

The fiscal consolidation undertaken in the last few years has also led to a decline in the debt-to-GDP ratio in 2005. Indeed, at the end of 2006, this ratio is expected to fall further from 74.2 per cent in 2005 to 68.3 per cent in 2006 and is expected to continue on a downward trend over the Programme period reaching the 60 per cent of GDP reference value in 2009.

When one excludes one-off revenue measures, the adjustment in the general Government deficit undertaken in 2006 is estimated at 1.1 per cent of GDP, of which 0.8 percentage points represent a structural adjustment. The main elements of the fiscal consolidation strategy as set out in the 2006 Budget and subsequently carried out throughout the year included the following:

- Reduction in public-sector employment and a policy to restrict employment in non-essential categories;
- Reduction in subsidies;
- Control of contractual salary increases in the public sector;
- Control of other current expenditure;
- Control of benefit fraud through the operations of the Benefit Fraud and Investigations Directorate;

- Better enforcement of the tax regime and more efforts to combat tax evasion including the strengthening of the investigative powers of the Tax Compliance Unit;
- Simplification of the administration and reduction of the administrative costs of tax collection.

The fiscal consolidation effort in 2005 and 2006 occurred despite the exceptional level of public investment. Indeed, the recurrent balance was positive and stood at 2.2 per cent of GDP and 3.0 per cent of GDP respectively. These developments reflect Government's commitment to undertake the public investments necessary in order to reach EU levels of economic development. These include investments in infrastructure, information technology, education and health.

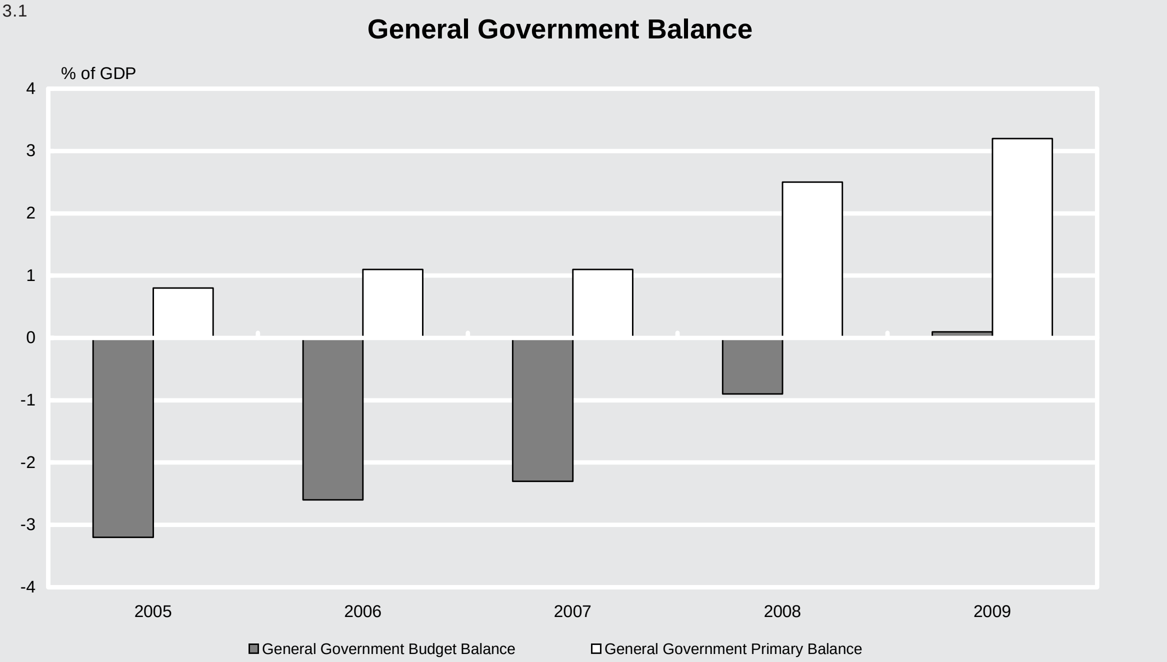
Government made use of a number of one-off revenue measures amounting to 0.8 per cent of GDP in 2004 and 1.6 per cent of GDP in 2005 mainly to cover the extra costs of public investment, particularly expenditure on the new hospital project. Nevertheless, the reliance on one-off revenue measures in 2006 was reduced by 0.5 percentage points of GDP compared to 2005, despite the persistence of above-average public investment. One-off revenue in 2006, consisting of sale of real estate, is estimated at 1.1 per cent of GDP.

3.1 The Medium-Term Fiscal Framework

The general Government deficit is expected to remain below 3 per cent of GDP, reaching 2.3 per cent of GDP in 2007. Details on the 2007 Budget are provided in Chapter 5 of this Programme. Thereafter, the deficit to GDP ratio is expected to continue on a downward trend, falling to a balanced budget in 2009. Table 2 in the Statistical Appendix presents general Government revenue and expenditure projections for the 2005 – 2009 period. Chart 3.1 highlights developments in the general Government balance over the Programme period. The deficit reducing measures for 2007 to 2009 include one-off revenue from the sale of real estate by Government. These measures amount to an annual 0.2 per cent of GDP being significantly below the levels in the previous years.

When one-off measures are excluded, the general Government budget deficit is expected to be below 3.0 per cent of GDP and is expected to reach 2.5 per cent of GDP in 2007. The correction is further sustained in 2008 and 2009. Indeed, the general Government deficit net of one-off and temporary measures will continue to decline to 1.1 per cent of GDP in 2008 and almost reach a balanced budget situation at 0.1 per cent of GDP in 2009.

Chart 3.1



It is noteworthy that the fiscal consolidation in 2007 will take place despite a significantly high public investment activity. The current surplus (defined as the general Government balance excluding gross fixed capital formation) for 2007 is expected to reach 3.8 per cent of GDP in 2007. Even if one were to exclude from the current balance the level of EU grants and the funds received under the Italian Financial Protocol (on the basis that most of these grants are conditional on the capital expenditure which they finance), a surplus would still be registered. Current balance is expected to remain positive in 2008 and 2009. In addition, a surplus would still be registered when one excludes foreign grants. This underlines Government's commitment to retain a current surplus even when investment activity subsides to its historical level of around 4 per cent of GDP.

In the context of the introduction of a fuel surcharge on water and electricity consumption to cover the increase in international oil prices and given the high degree of openness and the level of economic development of the Maltese economy, increases in the current tax burden through additional revenue-raising measures risk undermining Malta's competitiveness and the efforts undertaken within the Lisbon framework. In this context, the fiscal consolidation programme envisaged in the medium-term framework relies significantly on expenditure restraint measures.

3.1.1 Comparison with the December 2005 Update of Convergence Programme

Although the fiscal consolidation path has remained broadly unchanged, the targeted general Government deficit-to-GDP ratios presented in this Convergence Programme have been marginally revised when compared to the ratios projected in the December 2005 Update of the Convergence Programme. Whilst the December 2005 Update targeted a deficit of 2.7 per cent of GDP for 2006, the deficit is now estimated to reach 2.6 per cent of GDP. This reflects higher GDP estimates for 2006 compared to last year's Programme which were partly offset by a marginally higher deficit level.

In 2007, the deficit-to-GDP ratio is expected to go down further to 2.3 per cent, as projected in the 2005 Convergence Programme Update, with the upward revision in GDP mitigating the marginal increase in the absolute deficit level when compared to the December 2005 Update.

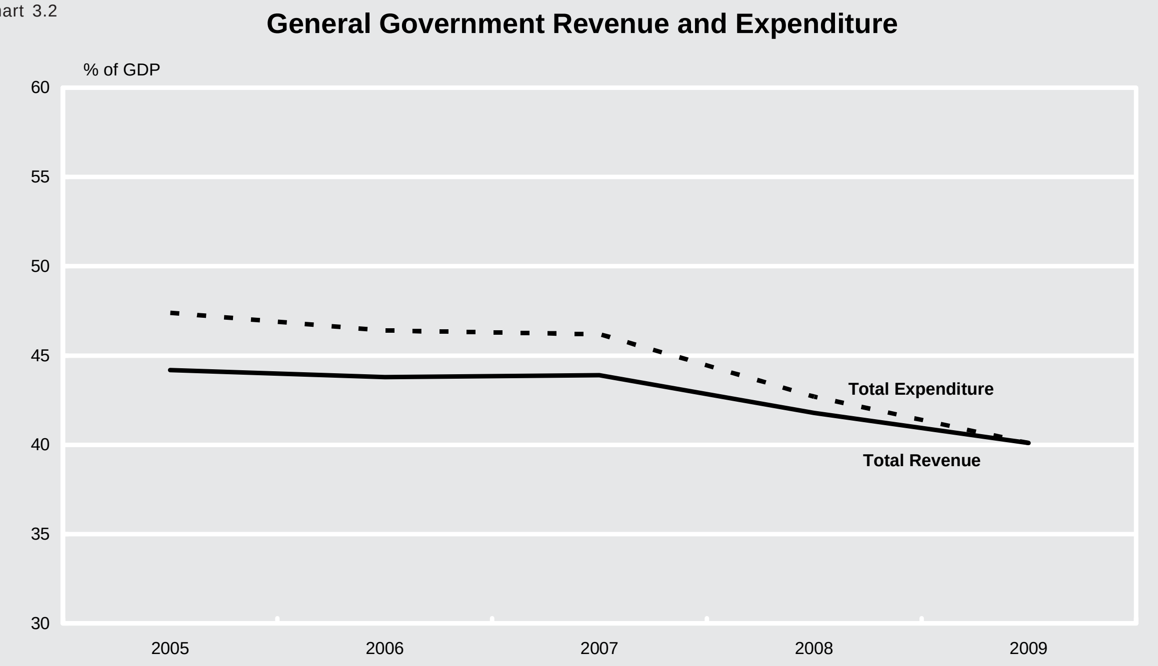
Further fiscal consolidation will be undertaken in 2008. The deficit-to-GDP ratio for 2008 was revised downwards by 0.3 percentage points of GDP from 1.2 per cent of GDP to 0.9 per cent of GDP when compared to the previous Programme. This reflects both a downward revision in the deficit level as well as higher GDP growth projections.

At this juncture it is worthy to note that the ratio of gross fixed capital formation to GDP in 2008 was revised upwards by 1 percentage points of GDP when compared to the December 2005 Convergence Programme projections. This reflects a higher projected absorption of EU funds when compared to the December 2005 Programme. As a result, the element of co-financing from national funds is expected to increase accordingly for that same year.

3.1.2 General Government Revenue Projections

General Government total revenue stood at 44.2 per cent of GDP in 2005 and is expected to decline to 43.8 per cent of GDP by 2006. This decline is primarily due to lower social security contributions and property income. In 2007, the share of revenue in GDP is expected to remain broadly unchanged, mainly reflecting lower receipts from property income and a lower growth in other revenue compared to GDP growth on the one hand and higher taxes on the other. As presented in Chart 3.2, General Government total revenue as a per cent of GDP is expected to continue on a downward path in the remaining projected period, reaching 40.1 per cent of GDP in 2009. The decline in the revenue ratio during this period is primarily the result of lower growth in tax revenue when compared to GDP growth together with lower receipts from the other revenue component. Chart 3.3 depicts the trend in the components of General Government total receipts over the medium-term framework.

Chart 3.2

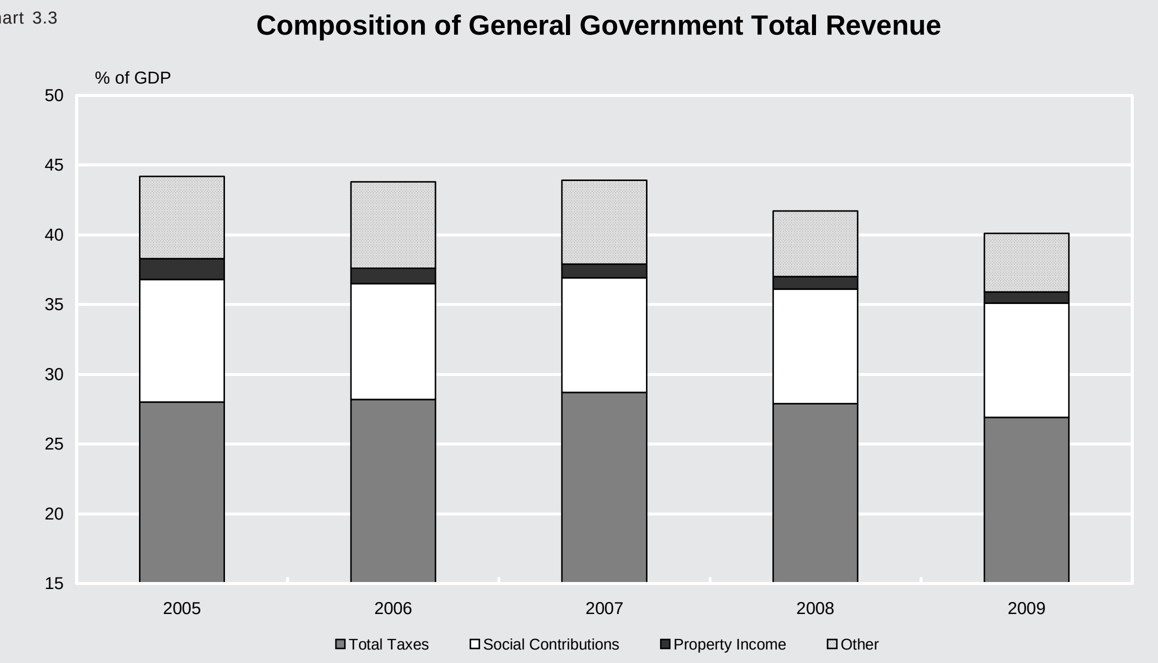


3.1.2.1 Tax Revenue

Around two-thirds of General Government revenue comprises tax receipts. Total tax receipts which were recorded at 28.0 per cent of GDP in 2005 are projected to increase marginally to 28.2 per cent of GDP in 2006 and to 28.7 per cent in 2007. The tax revenue ratio is however expected to embark on a downward trend, reaching 26.9 per cent of GDP in 2009.

The increase in tax revenue in excess of GDP growth expected in 2006 is due to an increase in revenue from current taxes on income and wealth. The increase in the tax ratio to GDP for 2007 is primarily due to higher taxes on production and imports. Growth in revenue from current taxes on income and wealth is expected to slow down in 2007 reflecting the tax measures announced in the 2007 Budget. These measures

Chart 3.3



are expected to affect domestic output, employment and private consumption expenditure positively. Further details on the tax measures are provided in Chapter 5 of this Programme Update.

For the 2008-2009 period, a decline in the ratio of total taxes to GDP is being projected. This decline is mainly the result of a slowdown in the rate of growth of taxes on production and imports and current taxes on income and wealth.

3.1.2.2 Social Contributions

Social security contributions make up around 20 per cent of General Government total receipts. Social security contributions are expected to decline from 8.8 per cent of GDP in 2005 to 8.2 per cent of GDP in 2007 and then remain stable at this ratio in the last two years of the Programme period. Proceeds from social security contributions are expected to decline marginally in 2006, but will increase during the following three years. Total revenue from this component is expected to rise broadly in line with economic growth in the 2007-2009 period.

3.1.2.3 Property and Other Income

Revenue from property income is expected to decline in 2006. This primarily reflects lower revenue from dividends, as a result of the privatisation process. The decrease in dividend income is however expected to stabilise in the rest of the Programme period.

The 'Other' component of revenue, which accounts for around 14 per cent of general Government total receipts in 2006, mainly consists of revenue of Extra-Budgetary Units (EBUs), local councils and other non-tax-revenue including grants. This revenue item is expected to stand at around 6 per cent of GDP in 2006 and 2007, and then decline by 1.3 percentage points in 2008 and by a further 0.5 percentage points in 2009, to reach 4.2 per cent of GDP at the end of the Programme period. Consequently, the share of 'Other' revenue in total Government revenue is expected to decline to around 11 per cent in 2008 and 2009.

These developments mainly reflect changes in the forthcoming funds from the EU and transfers received in terms of the Fifth Italian Financial Protocol. Receipts of EBUs and local councils over the medium-term framework are not expected to register significant changes.

3.1.3 General Government Expenditure Projections

In line with the fiscal consolidation strategy, total expenditure as a per cent of GDP is expected to follow a declining trend during the Programme period, from 46.4 per cent in 2006 to 40.1 per cent of GDP in 2009. Table 3.1 gives an overview of expenditure consolidation in the medium-term fiscal framework.

The expenditure consolidation envisaged in the medium-term framework is mainly underpinned by lower expenditure on subsidies and the containment of growth in collective consumption and interest expenditure below GDP growth rates. In addition, following the completion of the new hospital (which represented more than 1.3 per cent of GDP in 2006) and a number of other major capital projects financed from the 2004-2006 EU funds, Government gross fixed capital formation is expected to decline significantly in 2008 leading to a notable reduction in expenditure, both in absolute terms and as a ratio of GDP in the outer years of the Programme period.

The expenditure consolidation in 2006 and 2007 will occur primarily from current expenditure. In 2008 and 2009, lower public investment will partly contribute towards the fiscal consolidation process. However, the control of the growth in current expenditure (total expenditure excluding gross fixed capital formation) will in general remain the major source of consolidation.

Expenditure Consolidation Measures

changes in percentage points of GDP

Table 3.1

	2006	2007	2008	2009
Expenditure				
Collective Consumption	0.4	-0.5	-0.6	-0.4
Total Social Transfers	-0.3	-0.2	-0.2	-0.2
Interest Expenditure	-0.2	-0.3	-0.1	-0.2
Subsidies	-0.2	—	-0.2	-0.3
Gross Fixed Capital Formation	0.2	0.4	-2.1	-0.8
Other	-0.9	0.4	-0.4	-0.8
Total Expenditure	-1.0	-0.2	-3.5	-2.6
Compensation of Employees	-0.6	-0.7	-0.6	-0.4
Current Expenditure	-1.2	-0.7	-1.4	-1.8

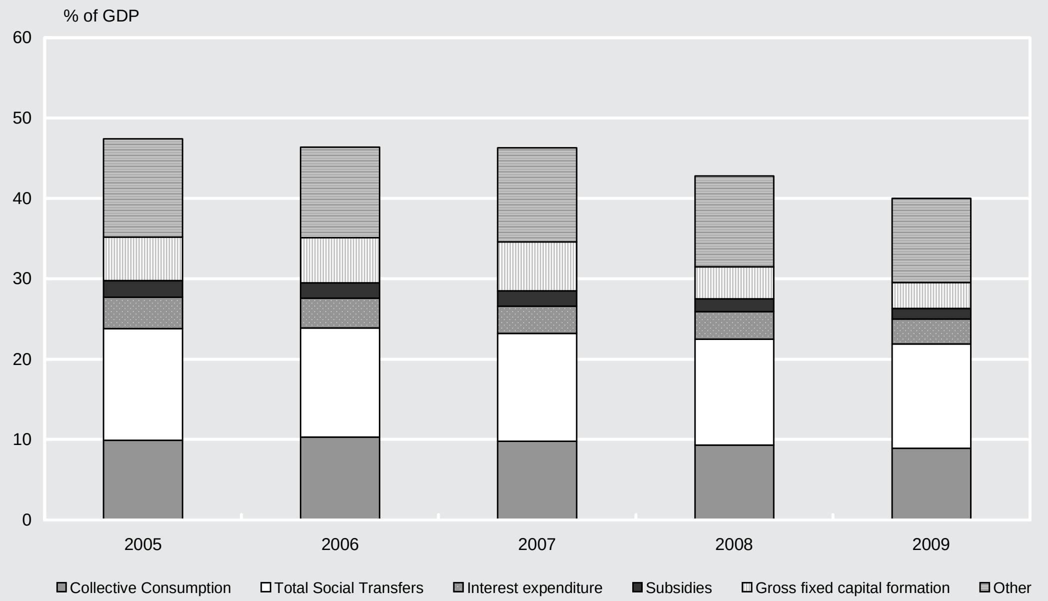
The commitment towards expenditure consolidation was further reinforced by means of a letter sent by the Prime Minister to all Cabinet Members dated 28th September 2006, wherein it was instructed that:

1. under no circumstances should aggregate financial allocations be exceeded;
2. save for unforeseen and unavoidable circumstances, and following a rigorous evaluation process by the Ministry of Finance, no expenditure overruns will be allowed;
3. in the case of unforeseen and unavoidable circumstances, and justified cases, any additional expenditure is to be neutralised either through reduced expenditure elsewhere or improvements in revenue collection.

This clearly attests to the commitment towards attaining the targets contained in the Convergence Programme. The letter clearly states that these targets should be achieved through better revenue collection, increased efficiency gains and stricter controls on expenditure outlays. The projected developments in the main

Chart 3.4

Composition of General Government Total Expenditure



components of general Government expenditure classified according to ESA95 methodology are presented in Chart 3.4.

3.1.3.1 Collective Consumption

Collective consumption is expected to decline by 0.5 percentage points of GDP in 2007. The downward trend will be maintained in the outer years of the Programme period, with a further decline of 0.6 percentage points of GDP in 2008 and 0.4 percentage points of GDP in 2009. Over the Programme period, collective consumption will decline by 1.0 percentage points of GDP from 9.9 per cent of GDP in 2005 to 8.9 per cent of GDP in 2009. Underlying this reduction is Government's commitment to control the growth of employee compensation and intermediate consumption below GDP growth.

3.1.3.2 Social Transfers

Expenditure on social transfers as a share of GDP is expected to follow a declining trend during the Programme period, falling from 13.9 per cent in 2005 to 13.0 per cent in 2009. Major components of total social transfers, mainly, retirement and widows' pensions, pension allowances and social assistance are expected to increase in absolute terms.

3.1.3.3 Interest Expenditure

The declining share of interest payments being projected mainly reflects the reduction in the debt-to-GDP ratio in line with Government's fiscal consolidation programme. Fiscal consolidation could also affect the risk premium thus helping to contain further the growth of interest payments below GDP growth.

Furthermore the trend decline in interest rates registered in recent years following measures undertaken in the past in order to liberalise interest rates, the capital account and fixing the exchange rate to the Euro contributed to reduce the cost of debt servicing and thus contain the growth in interest payments. Interest expenditure, which mainly consists of payments on long-term local loans, is projected to reach 3.7 per cent of GDP in 2006 and to decline to 3.1 per cent of GDP by the end of the Programme period.

3.1.3.4 Subsidies

Subsidies are expected to decline from 2.1 per cent of GDP in 2005 to 1.9 per cent of GDP in 2006 and to continue on a downward trend reaching 1.3 per cent of GDP in 2009. This represents a reduction of 0.8 percentage points of GDP between 2005 and 2009.

The share of subsidies to total Government expenditure is estimated at 4 per cent in 2006 and 2007, and is expected to decline thereafter to reach 3.3 per cent in 2009. This downward trend mainly reflects declines in the level of subsidies directed towards the shipyard sector. Furthermore, subsidies on products, which are around one third the size of subsidies on production, are expected to follow a downward trend throughout the Programme period primarily reflecting lower subsidies on the agriculture support scheme. These developments are in line with the provisions in the Accession Treaty.

3.1.3.5 Public Investment

The fiscal consolidation projected in this Programme, particularly in 2006 and 2007 is being achieved despite heavy commitments by Government towards the necessary public investment. In particular, the investment required to complete the new hospital project by 2007 has meant that public investment between 2005 and 2006 will be significantly above average public investment in previous years. Indeed, whereas on average Government gross fixed capital formation between 1999 and 2004 stood at around 4 per cent of GDP, this increased to 5.4 per cent of GDP in 2005 and is estimated to increase further to 5.6 per cent of GDP in 2006.

In 2007, a further increase is projected, with public investment reaching a record high 6.1 per cent of GDP. This increase includes the commencement of a number of new projects financed under the new Financial Perspectives for 2007-2013 period. The cumulative impact of additional public investment in 2006 and 2007 is estimated at 0.6 percentage points of GDP.

Following the completion of the new hospital project, a number of projects financed under the Fifth Italian Protocol, and other capital projects some of which were ongoing since 2006 and financed from the 2004-2006 EU funds, Government gross fixed capital formation is expected to decline to a lower level in 2008 at around 4 per cent of GDP, in line with historical trends. The impact of lower capital expenditure in 2008 is expected to be 2.1 percentage points of GDP. A further reduction of 0.8 percentage points of GDP in 2009 is also being projected.

3.1.3.6 Other Expenditure Components

The other expenditure category is primarily made up of individual consumption expenditure. Indeed, the fiscal adjustment evident in this item of expenditure primarily reflects lower individual consumption as a share of GDP throughout the medium-term fiscal framework. Underlying this reduction is Government's commitment to control the growth of employee compensation and intermediate consumption below GDP growth.

Between 2005 and 2009, other expenditure will decline by an accumulated adjustment of 1.7 percentage points of GDP. Only in 2007 is an increase expected in other expenditure as a share of GDP. This is mainly related to the decline in one-off revenue from the sale of land which is recorded as negative expenditure in the other expenditure category. This is indicative of the lower reliance on one-off revenue for fiscal consolidation in 2007.

3.1.3.7 Employee Compensation

Underlying the decline in collective consumption and in individual consumption classified under the other expenditure category is Government's policy to reduce employment in the public sector by restricting employment in non-essential categories. This policy, together with a restraint on growth in wages and salaries in line with the last public service collective agreement is already resulting in a significant drop in employee compensation of 0.6 percentage points of GDP in 2006. Government will continue to implement this policy. The impact of this policy will result in a decline in expenditure of 0.7 percentage points of GDP in 2007. In both 2008 and 2009, further consolidation is expected amounting to an average yearly adjustment of 0.5 percentage points of GDP. Over the Programme period, employee compensation will decline by 2.3 percentage points of GDP from 14.8 per cent of GDP in 2005 to 12.5 per cent of GDP in 2009.

3.2 Structural Adjustment

The structural deficit (the cyclically-adjusted deficit net of one-offs and other temporary measures) declined from 4.9 per cent of GDP in 2004 to 3.9 per cent of GDP in 2005 and is estimated to reach 3.0 per cent of GDP in 2006. This implies a structural effort (measured by the estimated change in the structural balance) of 1.8 per cent of GDP between 2004 and 2006.

Within the context of a closing negative output gap scenario, the budgetary stance will remain restrictive along the medium term framework. Underlying the decline in the general Government budget deficit for 2007 is a further structural adjustment of 1.1 per cent of GDP. This fiscal adjustment is also being projected despite the anticipated termination of temporary compensating grants associated with accession to the EU. As a result of these developments, the structural deficit is expected to reach 2.0 per cent of GDP in 2007. It is notable that the reliance on one-off measures in 2007 projected in the 2005 Update of the Convergence Programme has been reduced considerably from 0.7 per cent of GDP to 0.2 per cent of GDP.

In view of the notable structural adjustment in 2006 and 2007, the cyclically adjusted budget deficit for 2007 is almost within the safety margin established for Malta which stands at 1.7 per cent of GDP.[1]

Meanwhile, the structural deficit is projected to decline further from 3.0 per cent of GDP in 2006 to 0.4 per cent of GDP in 2009. This represents an accumulated structural adjustment of 2.6 percentage points of GDP. Between 2007 and 2009 an average adjustment of 0.9 percentage points of GDP per annum is expected.

It is important to highlight the higher public investment financed from EU funds projected in 2008 when compared to the levels projected in the December 2005 Programme. This implies an additional element of co-financing from national funds, estimated at 0.24 per cent of GDP in 2008. If one were to exclude this element, the structural adjustment in 2008 would be close to that projected in the December 2005 Update.

It is also important to highlight the notable structural adjustment in the beginning of the fiscal consolidation process. This front-loaded adjustment was significantly in excess of the minimum requirements of the SGP and was achieved despite a prolonged cyclical downturn. In 2007 and 2008, a significant structural adjustment of around 1.0 per cent of GDP is also being projected. Again, this is in excess of the minimum requirements of the SGP. In 2009 a further structural adjustment of 0.5 per cent of GDP is projected. The structural adjustment evident throughout the Programme period aims to sustain budgetary consolidation towards the medium term budgetary objective after the excessive deficit has been corrected.

The fiscal projections indicate that the cyclically adjusted budget deficit estimated for 2008 and 2009 will be well within the minimum benchmark of 1.7 per cent of GDP established for Malta, thus allowing automatic stabilisers to work freely without risking breaching the 3 per cent of GDP reference value. Chart 3.5 and Table 5 in the Statistical Appendix present estimates of Malta's output gap and cyclically-adjusted budget balance. Table 3.2 highlights Malta's structural adjustment during the Programme period.

The projected structural adjustment is also compatible with the development needs of the Maltese economy and allows for the implementation of reforms within the Lisbon framework, which should enhance the economy's growth potential.

Chart 3.5

Actual and Cyclically-Adjusted Budget Balances

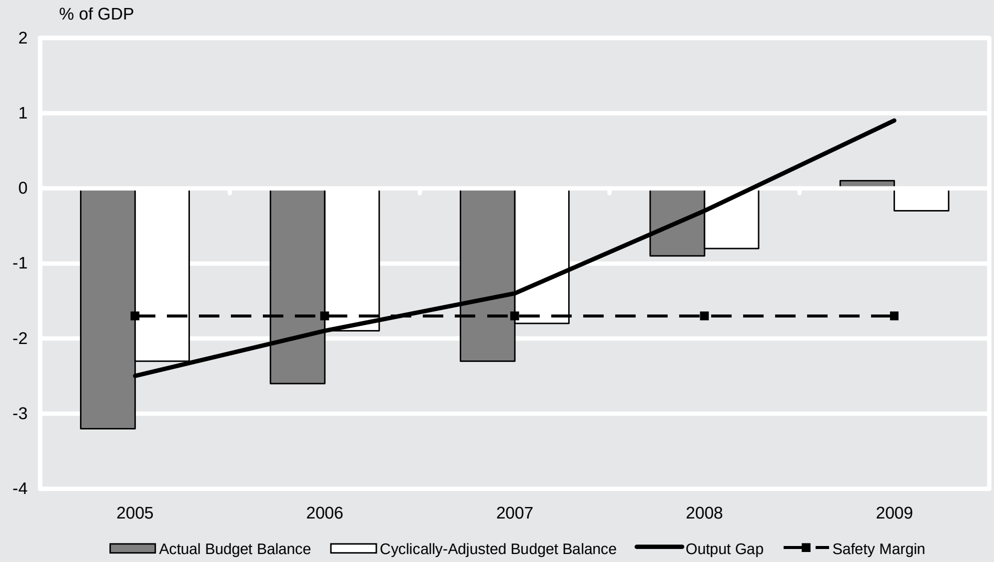


Table 3.2

Fiscal Consolidation
as a percentage of GDP

	2004	2005	2006	2007	2008	2009	Annual Average Adjustment 2007/2009
General Government Balance	-5.0	-3.2	-2.6	-2.3	-0.9	0.1	-0.9
One-off Measures	0.8	1.6	1.1	0.2	0.2	0.2	
General Government Balance net of One-offs	-5.9	-4.8	-3.7	-2.5	-1.1	-0.1	-1.2
Output Gap Estimates	-2.7	-2.5	-1.9	-1.4	-0.3	0.9	
Cyclically-Adjusted Budget Balance	-4.0	-2.3	-1.9	-1.8	-0.8	-0.3	-0.6
Structural Balance	-4.9	-3.9	-3.0	-2.0	-1.0	-0.4	
Structural Adjustment		-1.0	-0.8	-1.1	-1.0	-0.5	-0.9

3.3 The Medium-Term Budgetary Objective

The December 2005 Update of the Convergence Programme set out the medium term budgetary objective for Malta as achieving a balanced structural budget position over the cycle which was projected to be achieved by 2008 on the basis of the then prevailing projections for macroeconomic conditions. However, projections for the structural budget balance have been revised and in 2009 the structural balance is expected to be at -0.4 per cent of GDP. The revised projections of the structural deficit to GDP ratio reflect a higher structural deficit in 2006 compared to that projected in the December 2005 Convergence Programme. This delayed the attainment of the MTO as projected last year.

This was affected by a better than expected outturn in economic growth in 2005. In view of this, growth forecasts for 2006 till 2009 were significantly revised upwards. In view of the revised forecasts for output and potential output growth, negative output gap estimates based on the Commission agreed methodology have been revised considerably, in terms of both magnitude and direction, from last year's Convergence programme. Compared to a widening negative output gap between 2005 and 2007 as projected in the December 2005 Update, the negative output gap is now expected to narrow significantly with a positive output gap being projected for 2009. One notes an element of variability in output gap estimates.

As a consequence, the cyclical component of the budget balance has been reduced considerably. For instance, whereas the cyclical component of the budget deficit between 2005 and 2008 ranged from 1.3 per cent of GDP to 2.0 per cent of GDP in the December 2005 Convergence Programme Update, the cyclical component now ranges from 0.9 per cent of GDP to 0.1 per cent of GDP for the same period in this Programme.

In addition, the revised projections have to be considered in the context of:

1. the significant front-loaded structural adjustment that has already taken place;
2. the structural adjustment projected in 2007 and 2008 is significantly in excess of the minimum adjustment of 0.5 per cent of GDP;
3. the expenditure reduction programme envisaged in this Update;
4. Government's view, conditional on Malta's level of economic development and significant openness, not to undermine Malta's competitiveness by further increases in tax rates;

5. the commitment to ensure the level of public investment required by the Maltese economy to reach EU average levels of development, also through the absorption of the EU funds following the conclusion of the 2007-2013 Financial Perspectives;

6. Government's efforts within the Lisbon framework.

In view of these considerations, whilst the Government remains committed to reach a balanced budget, this will not be achieved in 2008 as projected in last year's Update of the Convergence Programme. Instead, a structural balance of -0.4 per cent of GDP is now projected for 2009. It is notable that in view of the long term growth potential of the economy and the debt-to-GDP ratio which is expected to reach the reference value of 60 per cent of GDP in 2009, this budgetary position represents a significant improvement in the long term sustainability of public finances.

Government remains committed to reduce further the structural deficit by at least 0.5 percentage points of GDP annually until Malta's MTO, as set out in the December 2005 Update of the Convergence Programme, is achieved. Such an achievement will take place outside the Programme period.

3.4 Debt Levels and Developments

The attainment of sustainability of public finances hinges not only on addressing the current imbalance in public finances but also on reducing the debt-to-GDP ratio at a satisfactory pace. The planned budgetary consolidation over the Programme period would contribute to reducing the debt ratio to the reference value by 2009 with positive consequences for risks to the sustainability of public finances.

Given that the proportion of local currency denominated debt to total financing is around 96 per cent the risk to exchange rate fluctuations is minimal. Moreover, given that around 30 per cent of total financing will mature in the next five years, interest rate risk is relatively low. Debt of Extra Budgetary Units (EBUs) accounts for around 3 per cent of General Government debt.

3.4.1 Projected Debt Developments

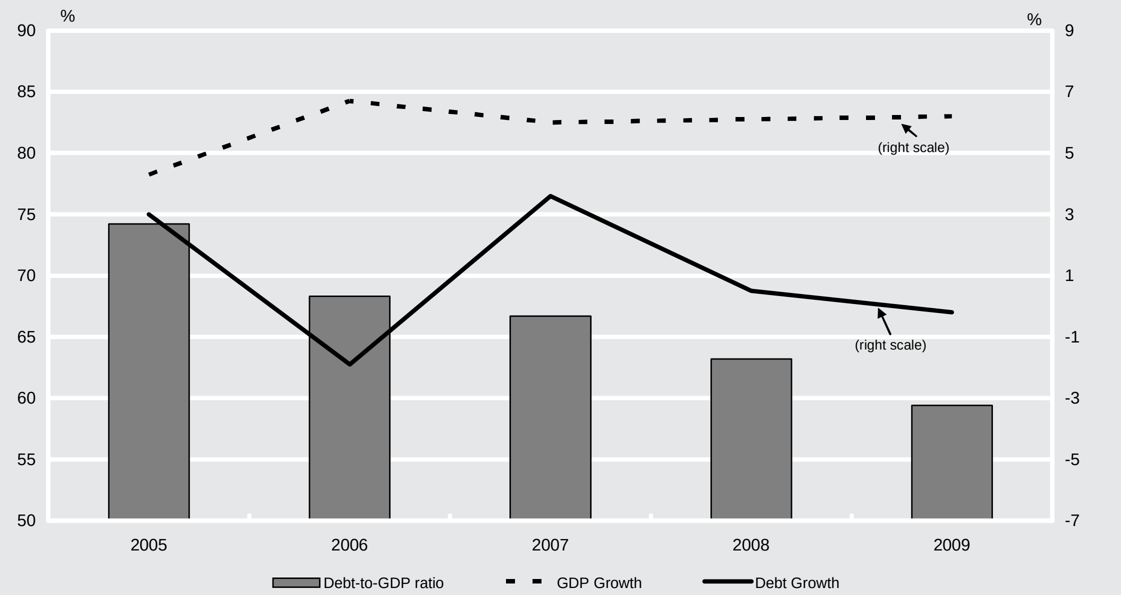
Projected debt developments are influenced by the planned budgetary trajectory as well as by other factors which influence the debt ratio, namely interest and growth contribution as well as the stock-flow adjustment. Over the Programme period, the planned fiscal consolidation coupled with the developments in the other factors which influence the debt ratio are expected to ensure a steady reduction of the debt-to-GDP ratio. Indeed, the debt-to-GDP ratio is expected to decline by around 15 percentage points of GDP between 2005 and 2009. At the end of 2006, the debt-to-GDP ratio is expected to decrease significantly to 68.3 per cent from 74.2 per cent in 2005. Thereafter, as illustrated in Chart 3.6, the debt-to-GDP ratio is expected to maintain a downward trend to reach the reference value of 60 per cent by 2009.

Over the 2006-2009 period, the downward trend in the debt-to-GDP ratio is attributable to an expected primary surplus, stock-flow operations as well as the combined contribution from interest expenditure and growth. As shown in Table 3.3, the debt-to-GDP ratio is expected to decrease by 1.6 percentage points in 2007 followed by 3.5 percentage points and 3.8 percentage points in 2008 and 2009 respectively.

Over the Programme period with the exception of 2006, the primary surplus is the main contributor to the decline in the debt-to-GDP ratio. As shown in Statistical Appendix Table 4, the primary surplus is expected to exert a contractionary effect on the debt ratio of 1.1 percentage points per year in 2006 and 2007. Thereafter, the primary surplus is expected to follow an upward trend thus exerting an increasing contractionary effect on the debt-to-GDP ratio of 2.5 percentage points and 3.2 percentage points in 2008 and 2009 respectively.

Chart 3.6

Debt-to-GDP ratio, GDP and Debt Growth



The implicit interest rate on debt is expected to vary marginally between 5.1 per cent and 5.5 per cent over the Programme period. As shown in Statistical Appendix Table 4, the ‘snowball effect’, which captures the impact on the debt ratio exerted from interest payments and nominal GDP growth, is expected to have a contractionary effect on the debt ratio during the 2006-2009 period. Indeed, the snowball effect is expected to have a debt decreasing effect on the debt-to-GDP ratio of around 0.9 percentage points in 2006 followed by around 0.5 percentage points each year up to 2009. This is attributable to the debt decreasing effect exerted by the nominal GDP growth which more than offsets an increasing effect on the debt ratio by interest payments. In fact, interest payments are expected to increase the debt-to-GDP ratio by around 4 percentage points in 2006, 3.6 percentage points each year in 2007 and 2008 and by 3.3 percentage points in 2009. Meanwhile, the nominal GDP growth is expected to decrease the debt-to-GDP ratio by 4.6 percentage points in 2006 and around 3.8 percentage points per annum up to 2009.

The estimated stock-flow component exerts a contractionary effect on the debt ratio over the Programme period. In 2007 this component is negligible. In 2006, the stock-flow adjustment is the main contributor to the reduction in the debt-to-GDP ratio and is estimated to exert a contractionary effect of 3.9 percentage points.

The Dynamics of Government Debt

Table 3.3

Percentages of GDP	**2005**	**2006**	**2007**	**2008**	**2009**
Gross debt	74.2	68.3	66.7	63.2	59.4
Change in gross debt	-0.7	-5.9	-1.6	-3.5	-3.8
Contribution to change in gross debt					
Primary Balance	-0.8	-1.2	-1.2	-2.6	-3.4
Interest Expenditure	4.1	4.0	3.6	3.6	3.3
Nominal GDP growth	-3.1	-4.6	-3.9	-3.8	-3.7
Stock-flow adjustment*	-1.0	-4.1	-0.1	-0.7	-0.1
of which privatisation proceeds	-1.2	-3.8	0.0	0.0	0.0

*Derived as a residual

This significant stock-flow component mainly reflects privatization operations. During 2008 and 2009, the stock-flow adjustment is expected to exert a contractionary effect of 0.6 percentage points and 0.1 percentage point respectively.

Privatisation receipts which materialized in the beginning of 2006 contributed to a significant stock-flow adjustment in that year. In fact, privatization operations have a contractionary effect on the debt-to-GDP ratio of 3.8 percentage points in 2006. Thus, if privatisation proceeds are excluded, the stock-flow component is estimated to decrease the debt ratio by 0.3 percentage points. There are no privatization proceeds expected in the following years during the Programme period. It is noteworthy that the stock-flow adjustment not accounted for by privatization proceeds is minimal and negative over the Programme period.

3.4.2 Comparison with the December 2005 Update of Convergence Programme

In the December 2005 Update of Convergence Programme, the debt-to-GDP ratio was expected to decrease from 76.7 per cent in 2005 to 67.3 per cent in 2008. The debt-to-GDP ratio was expected to decline by around 6.0 percentage points in 2006 and 1.8 percentage points and 1.6 percentage points in 2007 and 2008 respectively. As a result of divergences in the expected path of economic growth as well as in the fiscal consolidation adjustment, the projections of the debt ratio are revised in this Programme. According to the projections presented in this Programme, the debt ratio is expected to decline by a similar magnitude of around 6.0 percentage points and 1.6 percentage points in 2006 and 2007 respectively when compared to the downward path projected in the December 2005 Update of the Convergence Programme. In 2008, however, the debt-to-GDP ratio is expected to decline by a significantly higher magnitude of 3.5 percentage points as compared to 1.6 percentage points projected in the previous Update.

The revisions in the debt-to-GDP ratio mainly reflect revisions in GDP growth. The debt ratio for 2005 was revised from 76.7 per cent as presented in the previous Update to 74.2 per cent. This revision was mainly attributable to an upward revision in nominal GDP growth. Meanwhile, a downward revision in the absolute debt level also contributed to the lowering of the debt-to-GDP ratio projected in this Programme. In fact, revisions in nominal GDP growth exerted a downward revision on the debt ratio of 1.6 percentage points. This revision was coupled with a revision of 0.9 percentage points decline in the debt ratio as a result of lower debt levels.

During the period 2006 to 2008, the effect of revisions in the nominal GDP growth more than offset the impact of revisions in the absolute debt levels. In fact, in 2006, the debt ratio is revised downwards by 3.4 percentage points reflecting the revisions in the nominal GDP growth. This is partly offset by a revision of 0.8 percentage points as a result of higher absolute debt levels. Similarly, in the following two years, the revisions in the nominal GDP growth are expected to revise the debt ratio downwards by 4.7 percentage points and 5.8 percentage points in 2007 and 2008 respectively. At the same time, these revisions are partially offset by higher debt levels which exert an upward pressure on the debt ratio of 2.5 percentage points and 1.7 percentage points in 2007 and 2008 respectively.

Note:

[1]The minimum benchmark for Malta was established on the basis of an overall budgetary sensitivity estimated at 0.37 and a representative output gap of 3.6 per cent of potential output.

4. Sensitivity Analysis and Comparison with the December 2005 Update of Convergence Programme

4. Sensitivity Analysis and Comparison with the December 2005 Update of the Convergence Programme

4.1 Sensitivity Analysis

Given the level of uncertainty associated with any forecasting exercise, it was deemed important to analyse the sensitivity of the macroeconomic and budgetary forecasts to changes in certain macroeconomic assumptions.

This Chapter presents three alternative sensitivity scenarios and in each case, 2006 is considered as the first year of the forecast. The first sensitivity scenario concerns a change in the interest rate, the second scenario deals with an increase in economic activity in Malta's main trading partners leading to a higher external demand for domestically produced goods and services, and the third sensitivity scenario features a higher rate of economic growth. The results of the three different scenarios are presented in terms of the effect of the deviation from the baseline on the Gross Domestic Product, General Government Budget Deficit, and General Government debt. These sensitivity analyses, illustrated in Charts 4.1, 4.2 and 4.3, are similar to those presented in the Update of the Convergence Programme 2005-2008. In the absence of major structural changes in the Maltese economy during the same period, there are no major changes in the sensitivity analyses that need to be reported in this Update.

It is noteworthy that given the uncertainty involving the responses in the economic environment to shocks, the results of the sensitivity analysis presented should be taken as indicative.

4.1.1 Sensitivity to Interest Fluctuations

A domestic interest rate shock is expected to affect economic activity through the real and monetary sectors. The magnitude of these changes depends on the degree of elasticity of the components of output to changes in the interest rate. Moreover, Government finances are also directly affected by the change in the interest rate through the impact on components of revenue and expenditure that are sensitive to economic activity as well as the effect of changes in the interest rate on the debt servicing costs. However, it is important to note at the outset that in view of the long-term nature of Government debt in Malta, changes in the interest rate

Chart 4.1

Sensitivity to a 1 Percentage Point Increase in the Interest Rate

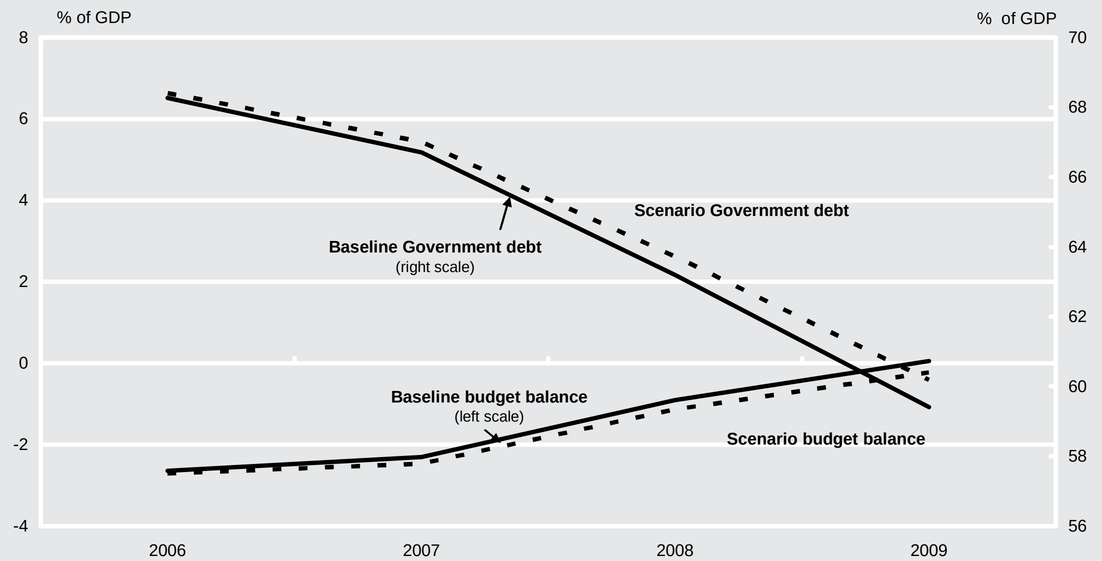
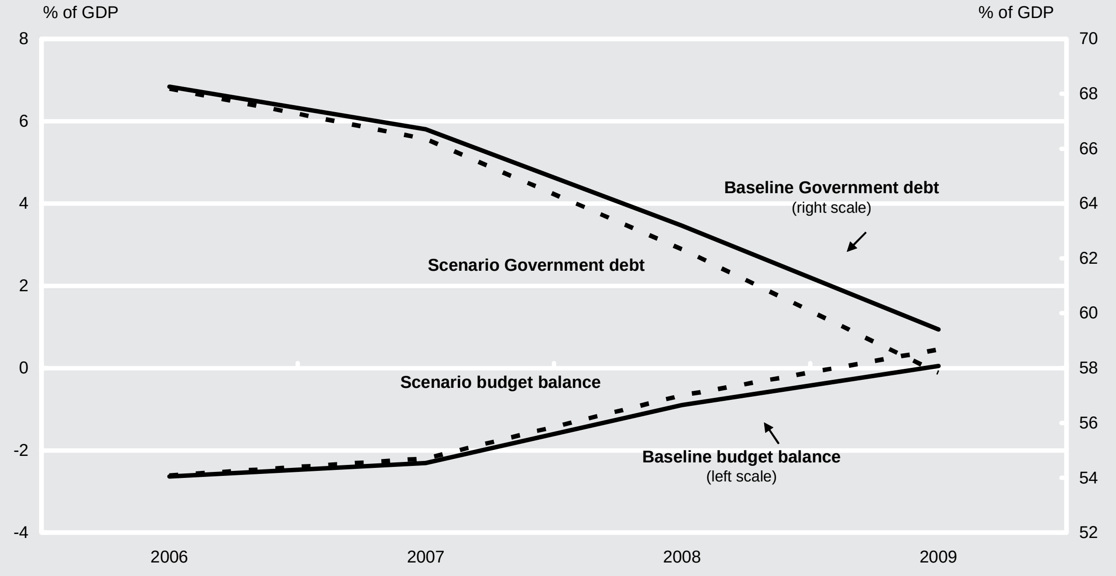


Chart 4.2

Sensitivity to a 1 Percentage Point Increase in External Demand

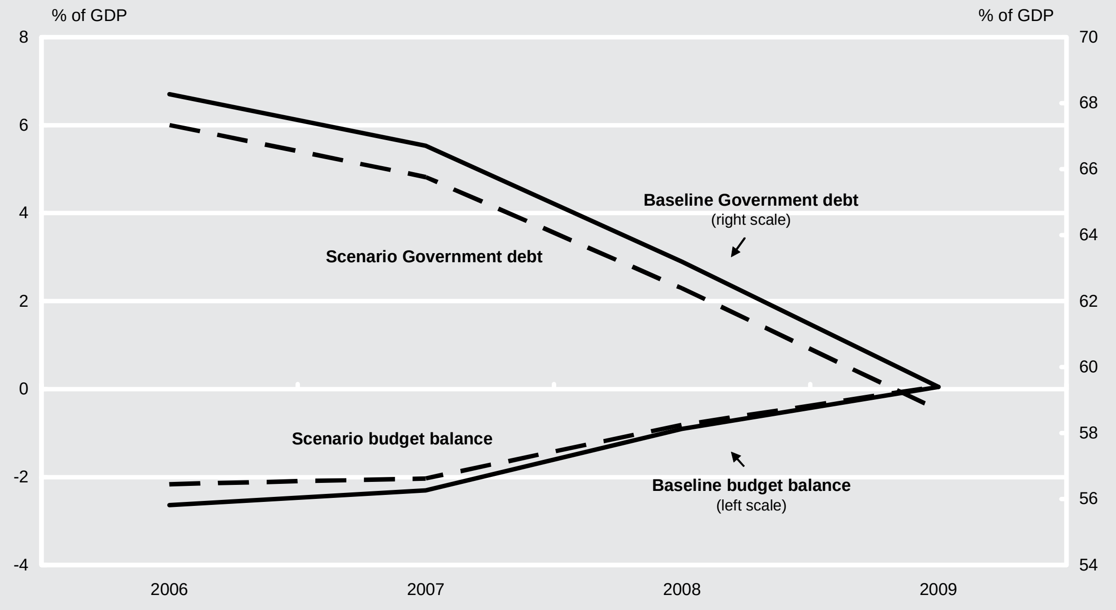


are mainly expected to affect the debt servicing costs in relation to the rolling-over of past long term debt and new issues of stock. Hence, the impact of a change in the interest rate on the deficit and debt positions is not expected to be significant.

The shock is modeled as an increase in the interest rate of 1 percentage point between 2006 and 2009. As a result of this change, economic growth is expected to decrease relatively by around 0.1 percentage point in 2006 and remain unchanged thereafter. Moreover, this increase in the interest rate will also result in a worsening of the budget balance of 0.3 percentage points of GDP and a subsequent increase in Government debt-to-GDP ratio of around 0.8 percentage points at the end of the forecast period when compared to the baseline. The change in the budget balance reflects an increase in total expenditure by around 0.4 per cent by the end of the forecast period, as the impact on the total revenue is negligible.

Chart 4.3

Sensitivity to a 1 Percentage Point Increase in GDP



4.1.2 Sensitivity to Change in External Demand

This scenario models an increase in external demand of 1 percentage point in the first year and throughout the forecast horizon until 2009.

A positive shock in external demand for domestically-produced goods and services is expected to generate an increase in aggregate demand and consequently in output. The increase in output, through the multiplier effect, is expected to have positive spill-over effects on the domestic economy. However, in view of the high degree of import-content of domestically produced goods and services, the effect of an increase in demand for exports on output and on economic growth is expected to be partly offset by a subsequent increase in imports.

The increase in external demand results in an increase of around 0.5 percentage points in GDP at the end of forecast period when compared to the base scenario. The shock is also expected to result in an improvement in the budget balance by 0.4 percentage points of GDP when compared to the baseline whilst the Government debt-to-GDP ratio is expected to decline by around 1.6 percentage points. The developments in the budget balance mainly reflect an increase in total revenue by 0.7 per cent by 2009 as the impact on total expenditure is negligible.

4.1.3 Sensitivity to Change in the Growth Rate of Real Gross Domestic Product

This subsection models a 1 percentage point increase in GDP. This increase in the growth rate of real GDP is assumed to be stimulated through an increase in private final consumption expenditure, leading to higher demand for goods and services. This increase in demand in turn generates an increase in domestic output but also an increase in demand for imports of goods which is expected to partly offset the positive effects of the increase in private consumption.

Following an improvement of around 0.5 percentage points upon impact, the budget balance as a percentage of GDP is expected to remain unchanged from the baseline scenario by the end of forecast period. On the other hand, Government debt as a percentage of GDP is expected to decline by 0.7 percentage points by 2009, when compared to the baseline scenario. Total revenue increases by 0.9 percentage points upon impact, though by the end of forecast period total revenue is unchanged relative to the baseline. Additionally, the increase in private consumption has a negligible impact on total expenditure by the end of the forecast period.

4.2 Comparison with the Projections in the December 2005 Update of Convergence Programme

Economic Growth[1]

The economic growth forecasts presented in this Update have been revised upwards when compared to those in the December 2005 Update of Convergence Program. Indeed, real GDP growth in 2006 is now forecasted at 2.9 per cent, an upward revision of 1.8 percentage points. This expected development is based on the latest published national accounts data which shows that for 2005 real GDP growth stood at 2.2 per cent, significantly above the 0.9 per cent forecasted in the December 2005 Update of the Convergence Programme. Furthermore, real GDP growth during the January-June 2006 period stood at 2.6 per cent.

In 2005 a more positive increase in the contribution of domestic demand to GDP growth was registered and this served to offset the more than expected fall registered in the contribution of the external sector to GDP. This trend persisted during the first half of 2006. Consequently, in 2006, the contribution of domestic demand to GDP growth is expected to be of 4.0 percentage points, compared to an expected contribution of 0.5 percentage points in the previous forecast. On the other hand, whereas the net foreign demand sector in 2006 was expected to contribute positively to GDP growth in the December 2005 Update, the latest forecasts show that a negative contribution of 2.7 percentage points is being expected.

Medium term growth prospects have also been revised upwards. For 2007, GDP growth has been revised upwards by 1.8 percentage points, resulting from upward revisions in the domestic demand component which more than offset the downward revisions in the external component contribution to GDP. Furthermore, economic growth for 2008 is projected to reach 3.1 percent, compared to 2.0 per cent projected in the December 2005 Update of Convergence Programme. This revision relates mainly to higher projected domestic demand.

The upward revision in private consumption expenditure mainly reflects a better than expected outcome in this category of expenditure as emerging in recent National Accounts data. In comparison to the forecasted decline of 0.9 per cent in real consumption in the December 2005 Update of Convergence Programme, latest data shows that private consumption expenditure for 2005 in real terms registered an increase of 2.8 per cent. This growth was sustained in the first two quarters of 2006 with private consumption advancing by 2.3 per cent. Consequently, an upward revision of 2.8 percentage points for 2006, 2.1 and 1.8 percentage points for 2007 and 2008, respectively was carried out.

A marginal increase of 0.4 per cent is being forecasted for Government consumption expenditure in 2006, an upward revision from that projected in the December 2005 Update of the Convergence Programme in line with the latest trends in available data. For 2007 and 2008, this component of expenditure is expected to grow by a marginal rate, practically in line with that forecasted in the December 2005 Update.

Growth projections for gross fixed capital formation for 2006 and 2007 have been significantly revised upwards to reflect capital expenditure projections by the public sector, mainly reflecting outlays financed from the Structural and Cohesion Funds. This includes the effect of outlays which were expected in 2005. As a result, investment expenditure is expected to increase by 10.3 per cent in 2006 compared to a growth rate of 3.3 per cent projected in the December 2005 Update. It is projected that gross fixed capital formation will grow by 6.8 per cent in 2007. In 2008, gross fixed capital formation is expected to rise by 0.8 per cent in reflection of higher than expected growth in private investment expenditure.

Imports growth forecasted for 2006 and 2007 reflect the expected developments in private consumption expenditure and in gross fixed capital formation. Imports of goods and services are expected to grow by 4.5 per cent in 2006, an upward revision of 3.3 percentage points when compared to the December 2005 Update of the Convergence Programme. For 2007, imports of goods and services are expected to grow by 2.4 per cent, an upward revision of 0.8 percentage points. Exports of goods and services are expected to grow by 1.9 per cent in 2006, practically in line with the 2.1 per cent increase forecasted in the December 2005 Update. For 2007, exports are expected to increase by 2.3 per cent, a lower growth rate compared to that reported in the December 2005 Update. As a result of these developments, whereas the external balance of goods and services was expected to contribute 0.6 percentage points in real GDP, current forecasts indicate that the external balance of goods and services will contribute negatively by 2.7 per cent in 2006. For 2007, a negative contribution of 0.4 percentage points is being forecasted compared to a positive contribution of 1.5 percentage points reported in the December 2005 Update. In 2008, the external sector is expected to contribute 0.9 percentage points to real GDP, 0.4 percentage points lower than the rate projected in the December 2005 Update.

Inflation and Employment Prospects

It is pertinent to note that the figures published in this Convergence Programme for inflation are not directly comparable to those published in the December 2005 Update of the Convergence Programme. In fact, the inflation rate forecast in this Programme is based on the HICP, whereas in the previous Update the Retail Price Index was used as a basis for the forecast of inflation. Moreover, the employment and unemployment forecast figures are now in accordance with the National Accounts Definition and the Harmonised

Unemployment measure, respectively and thus not directly comparable to figures used in the previous forecast which were based on the administrative measure compiled by the Employment and Training Corporation.

The expected trend in the inflation rate projected in the December 2005 Update of Convergence Programme has been maintained. The forecasted inflation in 2006 is expected to reach 3.1 per cent, compared to 2.5 per cent recorded for 2005. Subsequently the HICP inflation rate is expected to reach 2.1 per cent in 2008.

The downward trend expected in the unemployment rate in the December 2005 Update is also expected in this forecast. The unemployment rate is expected to decrease to 7.0 per cent in 2006 and to continue to decline gradually thereafter. In line with the latest available data and the expected growth in the economy, employment growth is expected at around 1.0 per cent for the forecast horizon.

Notes:

[1]Projections contained in this Programme reflect the latest National Accounts published by the National Statistics Office (NSO) including provisional estimates for the first half of the year 2006.

Moreover as from March 2006, the National Accounts publication reflects the statistical allocation of the FISIM component to user sectors/industries. This treatment leads to different GDP levels and thus the latest data available is not directly comparable to data included in the December 2005 Update of the Convergence Programme.

5. Quality of Public Finances

5. Quality of Public Finances

The Maltese Government remains firmly committed to achieve a sustainable fiscal position namely through the fiscal objectives of keeping the deficit to GDP ratio below 3 per cent, achieving further declines in the deficit ratio in line with the requirements of the SGP whilst also ensuring that the debt-to-GDP ratio continues to decline at a satisfactory pace towards the reference value. The measures announced in the Budget for 2007 are consistent with these fiscal objectives as well as the goal of increasing the economy's growth potential particularly through job creation and investment so as to achieve convergence in per capita income to EU levels. By focusing on the supply side of the economy these measures, which are in line with the Lisbon Agenda, aim to address those areas which were hindering the achievement of higher GDP growth.

5.1 The 2007 Budget

As a result of the fiscal consolidation efforts undertaken in recent years, Malta’s general Government deficit has been following a downward trajectory path. During the current fiscal year the target of achieving a deficit below the 3 per cent of GDP benchmark will be achieved. Moreover, in 2007 the general Government deficit is expected to decline further to 2.3 per cent.

The improvement in the public finance situation and achievement of fiscal targets improves investor confidence in the economy. A shrinking general Government deficit contributes to a stable macroeconomic framework, thus creating a favourable environment for economic growth.

The 2007 Budget combines the goal of fiscal consolidation with the goal of channelling the economy to a path of higher economic growth, which in recent years has been rather low. The thrust of fiscal consolidation is on restraints in current expenditure since further increases in tax rates are likely to hinder the country’s competitiveness position given the current level of economic development and openness. Within the context of the fiscal consolidation programme, the Budget for 2007 also aims to increase the incentive to work, thus increasing employment and to continue investing in infrastructure, education and health, in line with the Lisbon Agenda. These measures should contribute to increase potential output in the medium-term. The Budget also includes incentives intended to further support private initiative.

5.2 Structural Measures

The Budget for 2007 includes a number of measures aimed to achieve further fiscal consolidation. Table 5.1 provides a list of the main fiscal measures. Whilst revenue raising measures are reviewed below, the expenditure restraint measures are described in Section 5.4.

Revenue Raising Measures

In order to improve the regulation of existing amusement and gaming machines a licensing regime for such machines will be introduced. This will be coupled with the imposition of a number of conditions, regulations and control measures. This licensing regime is expected to generate around Lm4 million. This measure is consistent with the impetus of recent years of shifting the tax burden from direct to indirect taxation.

Tax enforcement remains a crucial priority for Government. In Bill No.81 entitled Budget Measures Implementation, currently on the agenda of the House of Representatives, a legislative framework is being proposed to update and improve tax enforcement by local authorities. This Bill seeks to lay down the legal underpinnings to allow a greater level of information sharing between different departments. The amendments give the Commissioner of Value Added Tax (VAT) the extended legal power to retrieve records and electronic data. Moreover, fines and imprisonment terms applicable in respect of credit and financial institutions that fail to furnish details about payments made by clients, requested by the Department of VAT, have been increased.

Main Measures Budget 2007

Table 5.1	Lm thousand
Main Measures impacting on Revenue	
Change in income tax bands	-12,000
Reduction in airport tax	-500
Licensing regime for gaming machines	4,000
Revision in National Insurance (NI)	-1,000
Amendments in respect of duty on documents	-120
Total	-9,620
Main Measure impacting on Expenditure	
Increase in supplementary allowance	250
Total	250

One-off Revenue Measure

In 2007, Government will rely to a significantly lesser extent on one-off measures to reduce the fiscal imbalance, when compared with the previous year. The revenue stream resulting from one-off measures will be of Lm4 million compared to Lm20.4 million in 2006 and will consist of sale of real estate by Government.

Growth-Enhancing Measures

Following a period of subdued economic growth, the local economy has registered a modest improvement in economic growth in 2005. Latest data indicate that this recovery has been sustained in the first half of 2006. A number of measures announced by Government in the 2007 Budget aim to sustain and ameliorate such gains mainly by focusing on improving the incentive to work.

In the 2007 Budget the income tax bands have been revised such that the income tax paid by employees is reduced. This measure is bound to increase the incentive to work and is expected to have an impact of around Lm12 million.

On the basis of existing regulations persons on a part-time employment must pay a lump sum minimum National Insurance (NI) contribution which was perceived to constitute a disincentive to work expecially at low levels of income. Hence Government announced the replacement of this minimum NI contribution by part-time employees with a proportional 10 per cent of gross income. Statutory requirements provide for a 10 per cent rate with the contribution capped at a maximum wage ceiling. This pro-rata contribution will entitle the payee to pro-rata contributory benefits. Estimates suggest that this measure will lower Government revenue by Lm1 million.

In a bid to raise female participation in the labour market and increase the incentive to work, the Budget for 2007 announced measures aimed to alleviate the costs of childcare services both to employees as well as employers.

Following the measures related to low cost airlines introduced earlier this year, a number of Budget measures provide further support to the tourism industry. In order to encourage entrepreneurship, another measure of the 2007 Budget will allow persons working in a family business to register as employees for fiscal purposes, thus having the opportunity to enjoy all social benefits.

Environment

The environment dimension constitutes an important consideration in Government's policy. In this context and particularly in view of developments in international oil prices, the 2007 Budget has introduced an energy conservation measure. This measure involves the partial refund of the price of an electric appliance that is certified to be an energy saving device.

In past years Malta has witnessed significant upward movements in house prices, despite a considerable stock of vacant buildings. In an attempt to get owners of empty dwellings to rent their property Government has announced the reduction of the tax payable in respect of rental income earned from rented properties.

Social Cohesion

Social cohesion constitutes another important aspect of Government's policy. A number of measures address the safety net established for low income and specific disadvantaged groups. Government has extended the exemption to low income groups from payment of the fuel surcharge on water and electricity consumption. The supplementary allowance received by eligible low income households has been increased. Estimates suggest that this measure will increase Government expenditure by Lm0.25 million.

Additional Measures

Government has increased the amount of private education tuition fees that can be deducted from taxable incomes. Moreover, the departure tax on international travel will be reduced from the current rate of Lm20 to Lm10 as from 1 June 2007. This will trigger a reduction of Lm0.5 million in 2007, whilst the full impact of a Lm2 million loss in revenue will be felt as from 2008. During 2006, excise duties on fuel products were increased.

5.3 Privatisation

During 2006 the privatisation of a major telecommunication operator was finalised. The sale of state owned shares, which amounted to 60 per cent of the company's share capital resulted in Lm74.2 million as a source of financing in the Consolidated Fund.

In respect of the 25 per cent shareholding which Government holds in a major domestic commercial bank, a decision was taken by Government to retain the bank's share and refrain from pursuing the privatisation effort further for the time being. This decision was made as the interest expressed did not satisfy all the requirements established by the Government of Malta in order to secure an increase in added value in the institution being privatised and ensure that the buyer's long-term objectives are in line with national development objectives. Government is not expected to raise any revenue from privatisation of assets during 2007 – 2009.

5.4 Determinants of the 2007 Fiscal Outcome

Government's efforts to achieve sustainable public finances entail a reduction in the general Government Budget deficit. Indeed, the budget deficit ratio is expected to decline below the 3 per cent reference value in 2006, to 2.6 per cent of GDP and further to 2.3 per cent of GDP in 2007. This signals an improvement in the fiscal position of 0.33 percentage points of GDP during 2007. This improvement is being projected despite significantly lower revenue from one-off items in 2007 compared to 2006.

The improvement in public finances mainly emanates from expenditure measures. Indeed lower expenditure as a proportion of GDP explains two-thirds of the improvement in the deficit-to-GDP ratio. It is noteworthy that expenditure restraint will stem entirely from outlays of a current nature. On the other hand, higher capital outlays will be registered in 2007, reflecting Government's commitment to provide the necessary infrastructure in the economy.

As shown in Table 5.2 and Chart 5.1, the 0.12 percentage point improvement in the deficit-to-GDP ratio deriving from the revenue side captures a number of contrasting movements in revenue. Revenue increasing measures explain 0.55 percentage points of the movement in the deficit-to-GDP ratio. This captures the impact of the licensing regime for gaming machines and an increase in excise duties on fuel in 2006. On the other hand, the Budget for 2007 includes a number of revenue reduction measures whose aggregate effect translates in an increase in the deficit-to-GDP ratio of 0.64 percentage points. The main revenue reduction measures are the revision in the income tax bands and amendments to National Insurance which are expected to trigger a 0.55 percentage point change and a 0.05 percentage point change in the deficit-to-GDP ratio respectively.

Revenue buoyancy and stricter enforcement of tax collection will bring about a 0.55 percentage point decrease in the deficit-to-GDP ratio. Revenue buoyancy is expected to occur in almost all sub-categories of Government revenue.

Changes in grants will yield an upward movement of 0.34 percentage points in the deficit-to-GDP ratio. It is pertinent to point out that grants will impact public finances negatively in 2007, reflecting a marginal decrease in absolute terms. Furthermore, the commencement of the financial framework for the period 2007 – 2013 will bring about the termination of termporary compensating grants associated with accession to the EU.

General Government expenditure as a per cent of GDP is expected to decline from 46.4 per cent in 2006 to 46.2 per cent in 2007. As a result, the improvement in the ratio of general Government expenditure to GDP represents 0.21 percentage point of the 0.33 percentage point improvement in the deficit-to-GDP ratio. This will be mainly achieved through stricter controls on expenditure outlays. Government is committed to attaining the fiscal targets and for this purpose, the Prime Minister and Minister of Finance has instructed Cabinet Ministers by means of a letter in September 2006 to ensure that requests for additional funds are only allowed in respect of unforeseen and unavoidable circumstances and even in such cases these must be justified and neutralised either through a trade off with reduced expenditure or through improvements in revenue collection.

Analysis of Improvement in Deficit-to-GDP Ratio for 2007

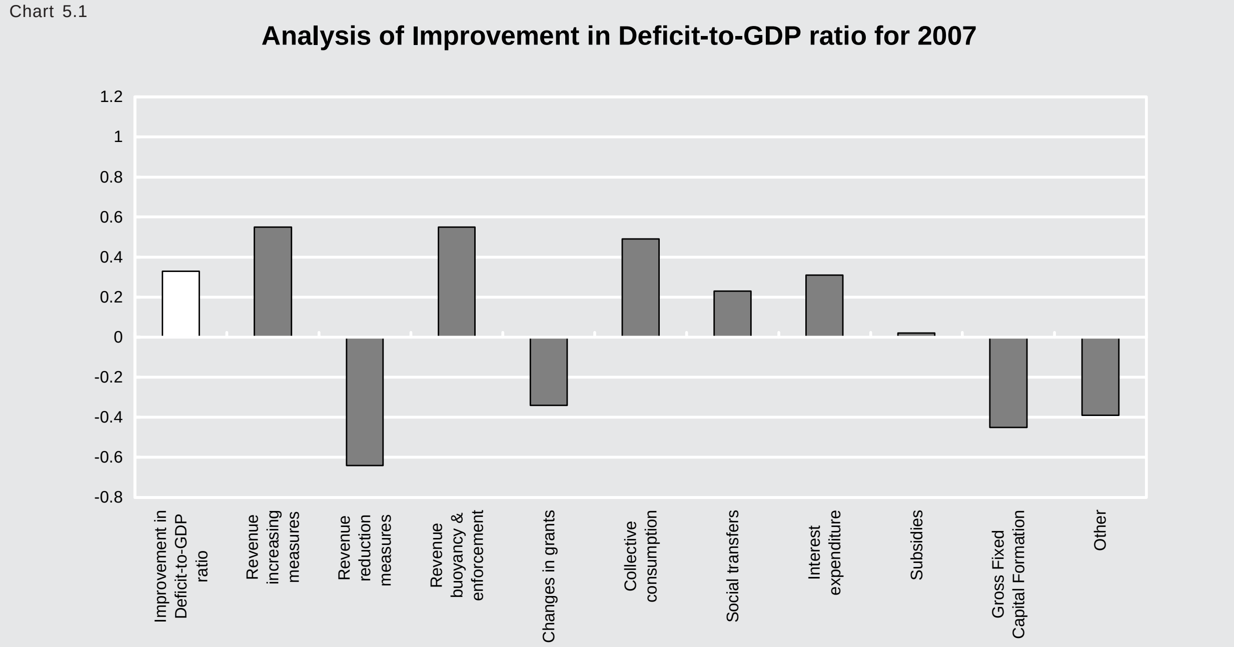
(percentage points)

Table 5.2

Revenue increasing measures	0.55	
Revenue reduction measures	-0.64	
Revenue buoyancy and enforcement	0.55	
Changes in grants	-0.34	
Change in revenue ratio		0.12
Collective consumption	0.49	
Total social transfers	0.23	
Interest expenditure	0.31	
Subsidies	0.02	
Gross fixed capital formation	-0.45	
Other	-0.39	
Change in expenditure ratio		0.21
Improvement in deficit ratio		0.33

Note: positive represents a decline in the deficit-to-GDP ratio

Chart 5.1



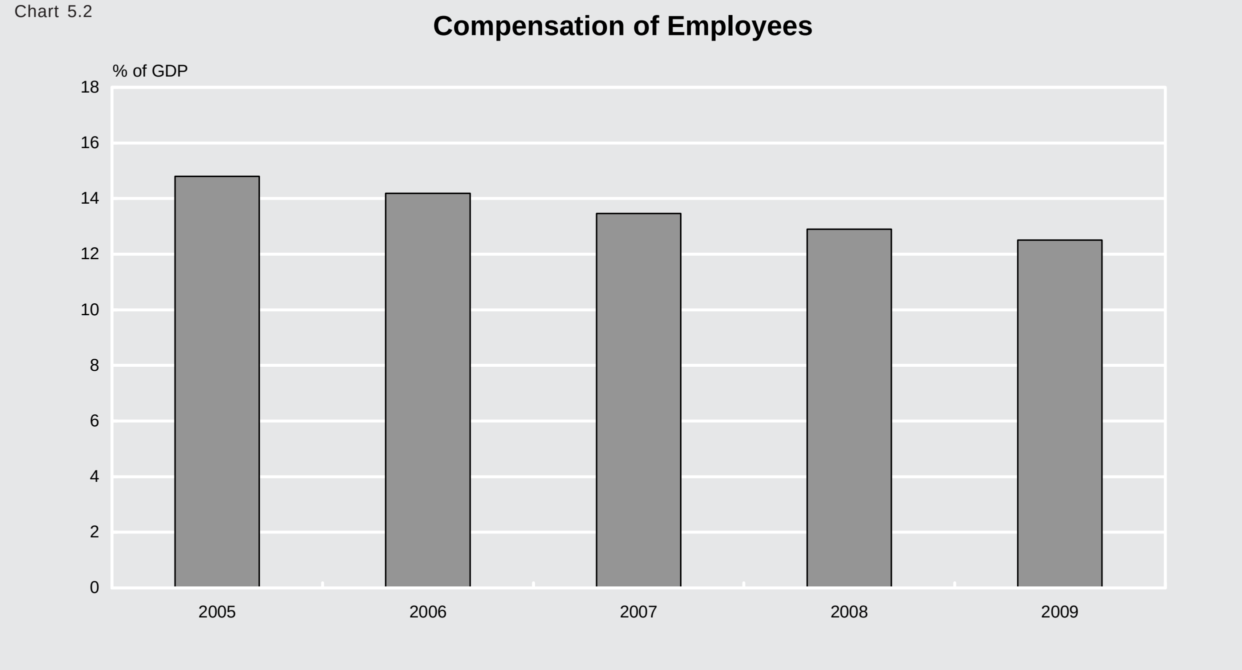
In addition, procedures ensuring more effective monitoring and review of budgetary performance by Ministries and Departments are being put in place.

The projected decline in the total expenditure-to-GDP ratio is mainly due to a decline in collective consumption, representing a 0.49 percentage point improvement in the deficit-to-GDP ratio. The fall in collective consumption is largely the result of the containment of growth in expenditure with respect to compensation of employees and intermediate consumption below GDP growth.

Expenditure on compensation of employees accounts for around 0.73 percentage point improvement in the deficit-to-GDP ratio. As a per cent of GDP, this component of expenditure has been following a downward trend in recent years. In fact, the ratio of compensation of employees to GDP has fallen from 15.2 per cent in 2004 to 14.8 per cent in 2005. Available figures indicate that this declining trend has been maintained in 2006. This ratio is expected to fall further from 14.2 per cent in 2006 to 12.5 per cent in 2009. These developments reflect measures implemented by Government to contain outlays on compensation of employees. In particular, Government's policy is to restrict recruitment in non-essential categories in the public sector. Indeed, the collective agreement for public service employees (reached between Government and employees' representatives in 2005) envisages a reduction in Government employees through natural attrition (partial non-replacement of retirees). Hiring in the public sector is subject to the approval by the Redeployment Advisory Group (which was set up in 2005 and includes the Ministry of Finance) and is being done on a strictly need basis. The development of online service by the public sector is also contributing to contain recruitment requirements in front-office operations. As a result of these developments, employment in Government Departments has fallen by around 3 per cent between December 2003 and December 2005 and a further decline of 1 per cent was registered between December 2005 and June 2006. Furthermore, the limited increases in salaries embedded in the Collective Agreement for public service employees are also contributing to contain outlays on compensation for employees. Chart 5.2 presents compensation of employees as a ratio to GDP for the period 2005 – 2009.

Expenditure on social transfers as a per cent of GDP is also projected to decline, contributing to a 0.23 percentage point improvement in the deficit-to-GDP ratio. Meanwhile, absolute expenditure on pensions is expected to increase reflecting demographic changes. Government is taking measures to curtail fraud of social assistance. In fact, developments in expenditure on social transfers reflect the intensification of investigations by the Benefit Fraud and Investigations Directorate, which was set up in 2005 to carry out investigations in cases of fraud of social benefits as well as in other areas of social policy.

Chart 5.2



Interest expenditure as a per cent of GDP is projected to decline and contribute to a 0.31 percentage point improvement in the deficit-to-GDP ratio. The anticipated decline in interest expenditure is brought about by lower interest rates for new bond issues relative to the rate of maturing bonds, as well as by a declining debt-to-GDP ratio. Meanwhile, the anticipated decline in the subsidies-to-GDP ratio is expected to have a minimal contractionary effect of 0.02 percentage points on the deficit-to-GDP ratio.

Gross Fixed Capital Formation and the 'Other' component of expenditure are projected to contribute to a 0.45 percentage point and a 0.39 percentage point increase in the deficit-to-GDP ratio respectively. The expansionary effect of Gross Fixed Capital Formation on the deficit is mainly attributable to higher expenditure on roads infrastructure, waste treatment, and tourism. Expenditure on the new hospital is marginally lower than in 2006 but still above pre-2005 levels, as it nears its completion in 2007. A number of projects were deemed necessary to complement Government's strategy of stimulating economic growth. In particular, the upgrading of the infrastructure was given priority as well as the improvement of the tourism product especially given the important contribution of the tourism industry to the economy. A number of these projects are to be financed from EU funds.

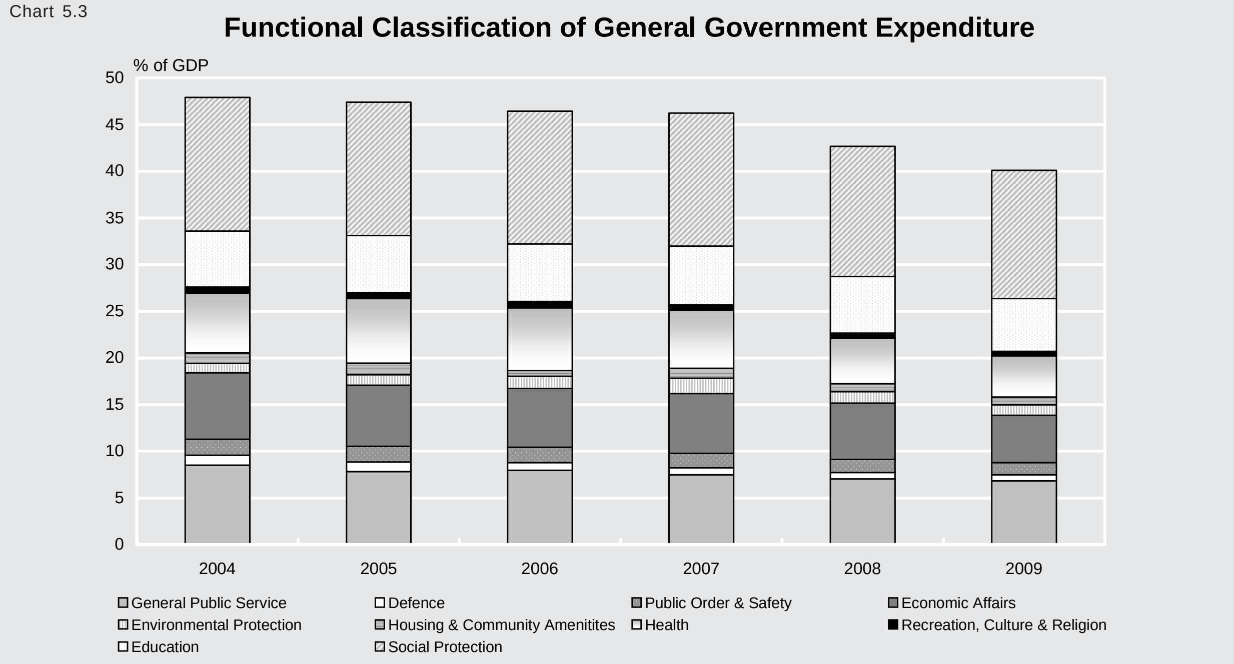
The expansionary effect of the 'Other' component of expenditure on deficit is mainly due to less reliance on one-offs in 2007, which element is deducted from the 'Other' component of expenditure. This is somewhat compensated for by a significant fall in individual consumption reflecting Government's policy to contain growth in current expenditure. This is expected to contribute to a 0.53 percentage point improvement in the deficit-to-GDP ratio.

5.5 Functional Classification of Expenditure

The main components of general Government expenditure by functional classification are Social Protection, General Public Service, Health, Economic Affairs and Education. Chart 5.3 presents the developments in the main components of general Government expenditure by functional classification for the period 2004-2009.

The ratio of outlays relating to General Public Service to GDP is expected to generally follow a downward path, declining from 8.5 per cent in 2004 to 6.8 per cent in 2009. This mainly reflects Government's efforts to

Chart 5.3



restrain expenditure outlays of a recurrent nature including compensation of employees. Interest expenditure is also anticipated to follow a downward trend.

The ratio of expenditure on Economic Affairs to GDP which stood at 7.1 per cent in 2004 is expected to decrease by 2.1 percentage points during the period 2004 – 2009, mainly on account of lower expenditure ratios reflecting Government's policy to contain expenditure. Nonetheless, in 2007, a higher ratio of Economic Affairs to GDP is expected partly as a result of higher capital expenditure linked to tourism, industry and roads infrastructure financed also through EU funds.

Expenditure on Environmental Protection as a proportion of GDP is expected to remain broadly unchanged. Nonetheless, the ratio of expenditure on Environmental Protection to GDP is set to increase between 2004 and 2007 and follow a declining trend thereafter, on account of higher capital expenditure related to waste management financed from EU funds.

The share of expenditure on Health to GDP is projected to decline, in particular after 2007 when the project of the new hospital is expected to be completed.

Human capital remains the major resource of the Maltese economy. In this context, higher productivity levels can be attained if the labour force is equipped with the skills and capabilities required in an ever dynamic and competitive environment. Considerable importance has been attached by Government to invest in the provision of education. Accordingly, expenditure on Education as a proportion of GDP is expected to increase during the period 2004 – 2007 and decline marginally thereafter. The increase in expenditure on education is mainly underpinned by higher capital expenditure earmarked for the University of Malta and the Malta College for Arts, Science and Technology (MCAST) co-financed by EU funds.

Social Protection is the main component of total expenditure reflecting significant outlays particularly on pensions. Its ratio to GDP is expected to decline from 14.3 per cent in 2004 to 13.7 per cent in 2009.

5.6 Integration between the Convergence Programme and the National Reform Programme

In October 2005, the Maltese Government presented the National Reform Programme (NRP) with a governance structure based on a three-year cycle. This Programme aimed to set out a comprehensive strategy to deliver growth and jobs in line with the refocus of the Lisbon Agenda agreed to in the 2005 Spring European Council. Subsequently, in October 2006, the Maltese Government presented the first annual progress report on Malta's implementation of the policies presented in the NRP. This report reflects Government initiatives undertaken during the course of this year aimed at making Malta more competitive and thereby enhancing our growth potential.

In the NRP, the Maltese Government identified the main economic challenges and outlined a coherent strategy to address them. The growth and employment goals of the Lisbon process presented in the NRP are conditioned by the fiscal context in which the national strategies are implemented. In view of this, it was considered important to link the Update of the Convergence Programme and the NRP. Whilst the Update of the Convergence Programme focuses on the fiscal policy measures that are foreseen in order to achieve and maintain the medium-term budgetary objective, the NRP focuses on the growth and employment enhancing potential of the foreseen measures in the macro, micro and employment domain. Indeed, the challenges and policy measures presented in the NRP are identified in the context of Government's fiscal framework. In turn, the Update of the Convergence Programme presents Government's fiscal strategy taking into account the budgetary implications of the planned implementation of the measures identified in the NRP. These measures are presented in the following Implementation Grid. In particular, the Updated Convergence Programme confirms the intention to pursue reforms to enhance the efficiency of the public sector, improve tax compliance, provide support for the training of the labour force, improve the business environment and enhance the environment amongst others.

Convergence Programme Implementation Grid

Key challenges	Integrated Guidelines	Measure	Implementation Status	Timeline	Direct budgetary costs (as a percentage of GDP[1]) 2005	2006	2007	2008	2009
Macroeconomic Policies									
Sustainability of Public Finances	1-6	Review of the existing taxation framework	Completed	August 2006	The cost of the project was financed from the operational costs of the Ministry of Finance				
		Enhance price flexibility through the liberalisation of monopolies and actively considering liberalisation entry into certain service sectors particularly the divestment of the gas sector	Ongoing	Completion by end 2008	This is a revenue-raising measure				
		Increase efficiency in the operations of the Public service and better management of human resources; a gradual decline of the public sector	Ongoing	Completion by end 2008	The cost of the project is financed from the operational costs of the Ministry of Finance and the Office of the Prime Minister				
		Maximisation of resources to achieve a better quality service	Ongoing	Completion by end 2007	The cost of the project is financed from the operational costs of the Office of the Prime Minister				
		Develop a more aggressive plan against benefit fraud	Ongoing	Completion by end 2008	—				
		Assess the role of means-testing instruments that determines eligibility for means-tested benefits	Ongoing	Completion by end 2006	—				
		Commencement of incremental measures in pensions reform	Ongoing	Completion by end 2008	The cost of the project was financed from the operational costs of the Ministry of Finance.				
		Ensure the sustainability of the provision of healthcare and better quality patient care	Late	Project was meant to be finalised by June 2006	The cost of the project is financed from the operational costs of the Ministry of Health and Elderly Care				
		Ensure a flexible and dynamic labour market; ensure that the workforce is adequately equipped with the necessary skills to find employment; increase the female participation rate	Ongoing	Completion by end 2008	Budgetary costs included under the employment pillar				
		Promote public service change to improve the delivery of the public service product and encourage a better work/life balance	Ongoing	Completion by end 2008	The cost of the project is financed from the operational costs of the Office of the Prime Minister				
Competitiveness	15	Set up a Working Group to identify Malta's competitive advantages	Ongoing	Completion by end 2006	—				
		Revise the Business Promotion Act in order to expand industry base and reduce burden to industry	Ongoing	Completion by end 2006	—				
		Develop SME loan guarantee scheme to provide easier access to finance[2]	Ongoing	Commenced in 2005	—				
		Formulate an action plan for Malta's industrial space	Late	Anticipated completion by end 2006	—				

Convergence Programme Implementation Grid

continued

Key challenges	Integrated Guidelines	Measure	Implementation		Direct budgetary costs (as a percentage of GDP[1])				
			Status	Timeline	2005	2006	2007	2008	2009
Competitiveness	10	Re-engineer FDI procedures to business set-up in Malta	Planned	Completion by end 2008			—		
	15	Provide tax credits for back-office services, reinvestment of profits by SMEs	Ongoing	Commenced in 2005	0.27[3]	0.29[3]	0.31[3]		
	14	Set up a Better Regulation Unit in order to achieve a higher service standard and reduction in burdens to enterprise through streamlining of government practices	Ongoing	End 2007			—		
		Introduction of Quality Assurance Mechanisms across Government	Planned	To commence in 2008			—		
	7	Enhance existing tax incentives for R&D	Ongoing	End 2008	0.06	0.05	0.05	0.05	
	8	Development of a regional Innovation Strategy[2]	Ongoing	Completion by mid 2008			—		
	15	Introduction of a loan guarantee scheme for innovative startups[2]	Ongoing	To commence in 2005			—		
	9	eWork Framework with guidelines on incentives and raising awareness[2]	Ongoing	Completion by end 2008	0.03	0.03	0.03	0.03	
		Drawing strategies for attracting multinational ICT companies	Ongoing	Completion by end 2007	Budgetary costs not yet available				
		Address ICT skills requirements[2]	Ongoing	Completion by end 2007			—		
		Financial and other assistance to foster ICT competencies[2]	Ongoing	Completion by end 2007	0.04	0.04	0.04		
		Feasibility assessment for an ICT park development	Ongoing	Completion by end 2007					
	16	Review Malta's broadband connectivity[2]	Ongoing	Completion by end 2008	0.11	0.10	0.10	0.09	
	10	Maintain the contribution of the tourism sector to the Maltese economy through the implementation of niche mainstream/tourism strategy	Ongoing	Completion by end 2006			—		
		Improve accessibility, conservation and promotion of key heritage sites[2]	Ongoing	Completion by end 2008	0.06	0.05	0.05	0.05	
		Introduce tourism zone management tools to raise quality standards[2]	Ongoing	Completion by end 2008	0.03	0.02	0.03	—	
	11, 10	Implement a branding exercise for tourism	Ongoing	Completion by end 2008		0.02	0.02	0.02	

Convergence Programme Implementation Grid									
									continued
Key challenges	**Integrated Guidelines**	**Measure**	**Implementation**		**Direct budgetary costs (as a percentage of GDP[1])**				
			Status	**Timeline**	**2005**	**2006**	**2007**	**2008**	**2009**
	16	Operate the Vessel Traffic Management System	Ongoing	Completion by end 2007	0.03	0.02	0.02		
	16	Complete economic, financial feasibility and impact study for enhancing the Grand Harbour and Freeport infrastructures	Ongoing	Completion by end 2006	0.02	0.03	0.01		
	16	Privatisation of all yacht marinas and identification of new yacht marina sites for development by private sector	Planned	To commence by end 2008	This is a revenue-generating measure				
	13	Initiate divestiture of the entire gas function and supply chain from importation of fuel to distribution of fuel in petrol stations	Ongoing	To commence by end 2006	ibid				
Environment	11	Developing a National Biodiversity Strategy Action Plan	Ongoing	Completion by end 2008	—				
		Conduct marine scientific surveys	Ongoing	Completion by end 2006	—				
		Develop a Regional Project for Marine and Coastal Protected Areas	Ongoing	Completion by end 2008	—				
		Strengthening the institutional capacity for implementing the Nature Protection Acquis[2]	Ongoing	Completion by Q1 – 2007	—				
		Construction of three sewage treatment plants	Planned	Completion by end 2008	0.52	0.48	0.46	0.43	
		Draft a national Environmental Technologies Action Plan	Ongoing	Completion by end 2006	—				
		Improve the environment through better management of public resources and reduction of waste	Planned	Completion by end 2009	—				
		Introduction of the Polluter Pays Principle through economic instruments	Ongoing	End 2006	—				
		Capture methane from waste disposal and treatment	Ongoing	Completion by end 2008	0.05	0.05	0.05	0.04	
		Replace uncontrolled landfills and improve treatment of Municipal Solid Waste	Ongoing	Completion by end 2008	0.27	0.25	0.24	0.22	
		Promote use of Bio-fuels and implementation of pilot scheme for collection of used cooking oil	Ongoing	Completion by end 2008	0.03	0.03	0.03	0.03	
		Encouraging greater use of non-conventional sources of water	Planned	To commence by 2008					

Convergence Programme Implementation Grid									
									continued
Key challenges	Integrated Guidelines	Measure	Implementation		Direct budgetary costs (as a percentage of GDP[1])				
			Status	Timeline	2005	2006	2007	2008	2009
Employment									
Employment	18	Make youth more employable, with the aim of reducing unemployment	Ongoing	By end 2008	—				
		Train and engage mothers absent from the labour market	Ongoing	2008	—				
		Review tax and benefit systems to encourage female participation in workforce	Completed	2005	The cost of this project was included in the operational costs of various Ministries				
		Promote family-friendly measures	Ongoing	Ongoing	—				
	19	Better train unemployed to increase their employability; reduce the number of illiterate persons	Ongoing	2008		0.01	0.01		
		Review policy regarding employment of third country nationals	Ongoing	2008	—				
		Enhance cooperation in matters related to visa and work authorisations	Ongoing	2007	—				
	21	Launch the Foster Entrepreneurial Skills scheme	Ongoing	2006	—				
Education and Training									
Education and Training	23	Increase literacy rates for school leavers; decrease rate of early school leavers; ensure an appropriate regulatory framework for primary and secondary education	Ongoing	Completion by end 2008	—				
		Set up a higher education directorate	Ongoing	2006	—				
		Establish a forum between educational and training providers and other stakeholders	Ongoing	2008	—				
	21	Increase the number of computer literate persons	Ongoing	2008	—				
	17	Nurture a culture of lifelong learning	Ongoing	2008	—				
	23	Ensure that formal, informal and non-formal qualifications and skills are certified[2]	Ongoing	Ongoing	—				
	23.5	Better train workforce to respond to new skill requirements	Ongoing	2008	—				

[1] Figures below 0.01 per cent of GDP are indicated as negligible
[2] Measure is subject to securing of EU funding
[3] Maximum Revenue foregone by Government if all Schemes are approved by State Aid Monitoring Board

6. Sustainability of Public Finances

6. Sustainability of Public Finances

It is widely recognised that demographic changes associated with lower fertility rates, longer life expectancy and the entry into retirement of the post-war 'baby-boom' generations is likely to pose major economic, budgetary and social challenges. These changes are expected to have a significant impact on growth and lead to significant pressures to increase public spending, thus making it difficult to maintain sound and sustainable public finances in the long-term.

Similar to other countries, the pressure on age-related expenditure is expected to represent a significant challenge in Malta in the coming years. As a result of the demographic shifts, the outlays on pensions paid by Government will rise over the next twenty years leading to a worsening in the balance of the current system. In light of these developments, in June 2004, Government tasked the Cabinet Committee's Support Unit to head a Pensions Working Group (PWG) to review all previous work carried out on pensions and to submit recommendations to Government on the way forward. Following an extensive and embracing national consultation and discussion process the PWG presented a final report in June 2005. The report provides a comprehensive and detailed analysis of developments in the Maltese Pension System under a baseline 'no reform' scenario and puts forward a set of recommendations in conjunction with the expected impact of the proposed reforms on long-term fiscal sustainability. Government published this report together with the feedback gathered from society and constituted bodies in November 2005. In March 2006, the Prime Minister announced a series of changes to the current Pension System. The Bill entitled 'An Act to further amend the Social Security Act' is currently being debated in the House of Representatives, where it has reached a relatively advanced stage in the legislative process. It is expected that the Bill will be adopted by the end of 2006 with some of the provisions of the Act coming into effect as from 1st January 2007.

This Chapter provides an assessment of Malta's long-term sustainability of public finances by reviewing two sets of projections. The first set of projections being presented is based on the work of the Economic Policy Committee (EPC). The aim of this work is to produce budgetary projections for the EU25 Member States on the basis of common assumptions as prepared by the EPC so as to ensure comparability between countries. However, some of these assumptions diverge from those adopted by the PWG. Hence, a second set of projections is being presented on the basis of the work prepared by the PWG entrusted by Government to analyse the current pension system and to chart the way forward with regards to the pension reform. The Chapter also provides an overview of the salient elements of the Pensions reform bill currently being discussed in the House of Representatives. It is the intention of the Maltese Government to submit an addendum to this Programme, which will update the long-term expenditure and revenue projections for pensions. Such update will reflect the amended Social Security Act (SSA) and will be presented after the completion of the legislative process.

6.1 Projections based on the work of the Economic Policy Committee

This section provides an analysis of the long-term sustainability of public finances on the basis of the 2006 EPC projections of age-related expenditure. Budgetary projections over the long-term are based on a common set of demographic and macroeconomic assumptions that ensure comparability of results and ensure comparability of results among Member States.

The pension projections are based on simulations carried out using the Pension Reform Option Simulation Toolkit (PROST) model. Following the receipt of a full set of underlying assumptions from the EPC, the PROST input files were calibrated, where possible, to incorporate such assumptions. The variables included in the assumptions as provided by the EPC are the real GDP growth rates, inflation rates, population projections, participation rates and unemployment rates. A number of variables included in the assumptions as provided by the EPC were not incorporated in the PROST workings, primarily due to the fact that such variables are not required as PROST inputs. The demographic and macroeconomic assumptions used are listed in Malta's Update of the Convergence Programme for the period 2005 – 2008.

Population Trends
(based on Economic Policy Committee Assumptions)

Table 6.1

	2003	2010	2020	2030	2050
	Total population				
0-15 yrs	80,742	75,154	77,048	79,654	79,854
16-61 yrs*	254,618	269,391	273,070	280,802	281,521
61+ yrs	63,169	80,509	109,553	126,975	151,659
Total	398,529	425,054	459,671	487,431	513,034
	Percentage of total population				
0-15 yrs	20.3	17.7	16.8	16.3	15.6
16-61 yrs*	63.9	63.4	59.4	57.6	54.9
61+ yrs	15.9	18.9	23.8	26.0	29.6
	Demographic dependency ratio				
0-15 yrs	31.7	27.9	28.2	28.4	28.4
61+ yrs*	24.8	29.9	40.1	45.2	53.9
Total	56.5	57.8	68.3	73.6	82.2
	Support ratio				
16-61 yrs*/61+ yrs	4.0	3.3	2.5	2.2	1.9

* Retirement age in Malta is 60 years for females and 61 years for males

Note: Figures may not add up due to rounding

Source: PROST

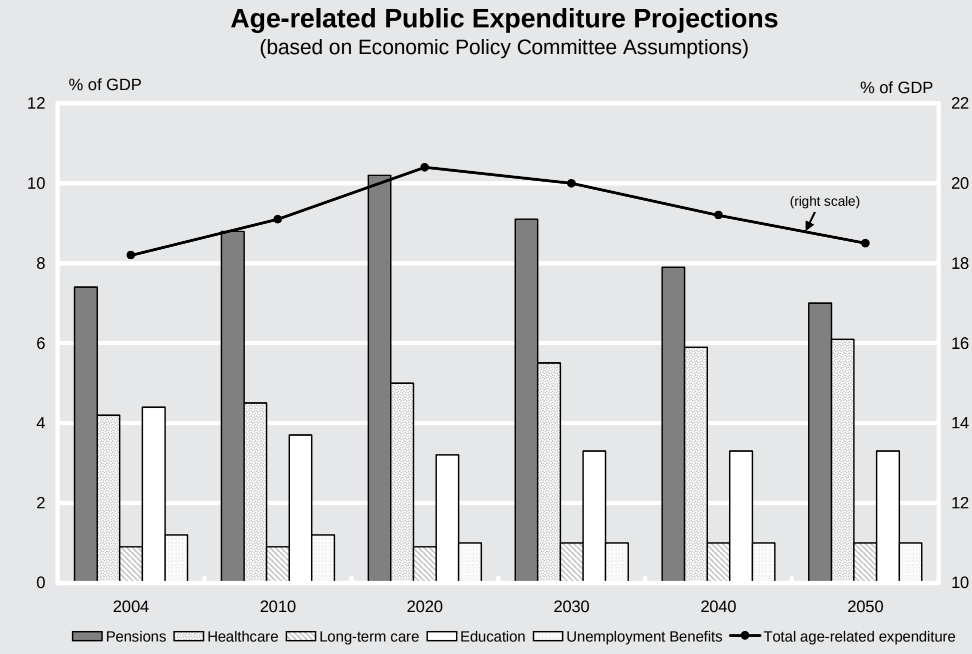
6.1.1 Demographic Developments

Population projections based on the EPC underlying assumptions are presented in Table 6.1, which shows a breakdown of the population into three main age brackets. Total population is projected to grow to around 487,000 by 2030 and increase further to around 513,000 by 2050. It is pertinent to note that under this scenario it is assumed that net migration will amount to an annual average of around 2,500 during the projection period up to 2050. The share of the sixty-one plus is projected to grow from 15.9 per cent in 2003 to 18.9 per cent in 2010 and then rise persistently to reach 29.6 per cent in 2050. The youth ratio (0-15 year olds as a proportion of those within the 16-61 years bracket) is expected to decrease by 3.3 percentage points by 2050 compared to 2003. Over the projection period, the old-age dependency ratio is generally on an upward trend, with a more pronounced effect in 2020 where it will reach around 40.1 per cent and then it will continue to rise to 53.9 per cent by 2050. By 2050, the total dependency ratio will amount to 82.2 per cent, which means that every person in the working age population will have to support around 0.8 non-active persons compared to 0.6 non-active persons in 2003. The support ratio is expected to record a decline, reaching 1.9 by 2050. This means that while in 2003 there were around 4 persons in employment for every retired person, by 2050 there will only be around 2 employed persons compensating for every retired person.

6.1.2 Age-related Public Expenditure

Age-related spending in Malta is projected to increase by 0.3 percentage points of GDP between 2004 and 2050. This level is composed of changes in the public expenditure on pensions, healthcare, long-term care, unemployment benefits and education expenditure. Chart 6.1 shows the age-related public expenditure as a share of GDP for the projection period. Appendix Table 7 shows the projections for age-related public expenditure and the assumptions used.

Chart 6.1



Public expenditure on pensions is the most important age-related Government expenditure item, in terms of size at present and in the future. Pension payments in Malta mainly include the two-thirds retirement pension, survivors' pension and the invalids' pension. Occupational pension schemes in Malta are of minor importance. Expenditure on pensions is projected to fall by 0.4 percentage points between 2004 and 2050. As regards the starting position in 2004, public pension spending accounts for 7.4 per cent of GDP, and is expected to reach the peak in 2020 at a level of 10.2 per cent of GDP, and then decline to 7.0 per cent of GDP by 2050[1].

Public expenditure on healthcare is projected to increase from a level of 4.2 per cent in 2004 to 6.1 per cent of GDP by 2050, an increase of 1.8 percentage points over the projection period. Meanwhile, expenditure on long-term care is expected to increase by 0.2 percentage points of GDP, from a level of 0.9 per cent of GDP in 2004 to 1.1 per cent in 2050. Expenditure on unemployment benefits is projected to decline by 0.2 percentage points over the projection period, from a level of 1.2 per cent of GDP in 2004 to 1.0 per cent of GDP in 2050, while expenditure on education is projected to decline from 4.4 per cent of GDP in the starting year, to 3.3 per cent of GDP in 2050.

6.2 Projections based on the work of the Pensions Working Group

This Section presents projections for pension expenditure based on work carried out by the PWG using the World Bank's PROST model, with the starting year being 2002. The macroeconomic and demographic assumptions used to derive such projections are presented in the Update of the Convergence Programme 2005 – 2008. It is pertinent to highlight that in terms of net migration, the PWG assumes that the population will be augmented annually by the inflow of 500 immigrants and by 150 returned migrants. This contrasts with the EPC assumption that net migration will increase by an annual average of around 2,500 persons over the projection period, thus leading to different trends in population projections relative to the PWG.

6.2.1 Demographic Developments

The shift in demographic projections up to 2050 may be observed from Table 6.2, which shows the population divided into three separate age classifications. Population projections indicate that total population is projected to grow to around 410,000 by 2030 and then decline to around 387,000 twenty years later. The challenge for the Maltese economy arises in particular when taking into account the shifts envisaged to the dependency

Population Trends
(based on Pensions Working Group Assumptions)

Table 6.2

	2002	2010	2020	2030	2050
	Total population				
0-15 yrs	80,002	65,410	59,877	61,068	58,576
16-61 yrs*	254,027	257,805	246,391	233,912	197,780
61+ yrs	63,267	80,862	102,050	114,541	130,716
Total	397,296	404,077	408,318	409,521	387,072
	Percentage of total population				
0-15 yrs	20.1	16.2	14.7	14.9	15.1
16-61 yrs*	63.9	63.8	60.3	57.1	51.1
61+ yrs	15.9	20.0	25.0	28.0	33.8
	Demographic dependency ratio				
0-15 yrs	31.5	25.4	24.3	26.1	29.6
61+ yrs*	24.9	31.4	41.4	49.0	66.1
Total	56.4	56.7	65.7	75.1	95.7
	Support ratio				
16-61 yrs*/61+ yrs	4.0	3.2	2.4	2.0	1.5

*Retirement age in Malta is 60 years for females and 61 years for males

Note: Figures may not add up due to rounding

Source: PROST

ratios, particularly to age 61 and over. The share of the sixty-one plus is projected to grow from 15.9 per cent in 2002 to 20.0 per cent in 2010 and then rise sharply to a high of 33.8 per cent in 2050.

The youth ratio (0-15 year olds as a proportion of those within the 16-61) is expected to fall by 1.9 percentage points during the next 50 years, while the old-age dependency ratio (61 years and over as a share of the 16-61 years bracket) is projected to increase. The generation of the 'baby-boomers' will move into the 61+ age bracket, where such an effect will intensify primarily in 2020 and continue to increase by 2050, when the old-age ratio will rise sharply by around 17 percentage points compared to 2030. Accordingly, after 2010, the increase in the old-age ratio leads to a continuous increase in the total dependency ratio. By 2050, the total dependency ratio will amount to 95.7 per cent, which means that every person in the working age population will have to support around 1 non-active person compared to 0.6 non-active persons in 2002. As from 2010, the support ratio records a decline throughout the projection period, reaching 1.5 by 2050, which implies that while in 2002 there were around 4 persons in employment for each retired person, by 2050 there will only be around 1.5 employed persons compensating for a retired person. In contrast, under the EPC population projections, by 2050 there will be around 2 employed persons compensating for a retired person. These differences in projections are primarily attributable to different population development assumptions.

6.2.2 The Cost of Ageing

As in the scenario based on the common EPC assumptions, pension expenditure under the PWG assumptions includes two-thirds retirement pensions, invalidity pensions and survivors' pensions based on contributions of employer and employees only. Table 6.3 highlights the PWG projections of the pensions system balance and presents the main assumptions used for these projections. More detail can be found in the December 2005 Update of the Convergence Programme.

While the pension system in 2002 was running a small surplus of 0.3 per cent of GDP, it is projected that as from 2005 onwards the balance will turn into deficit throughout the projection period. The deficit is projected to increase to 2.7 per cent of GDP by 2010 and 4.4 per cent of GDP by 2020, then declining to 3.3 per cent of GDP by 2050. This outcome mainly reflects developments in both Pay-As-You-Go (PAYG) total revenue

Pensions Working Group Projections

Table 6.3

Percentages of GDP	2002	2010	2020	2030	2050
PAYG Total Revenue	8.0	6.6	5.3	3.5	1.5
PAYG Total Expenditure	7.6	9.3	9.7	7.8	4.8
Pensions System Balance	0.3	-2.7	-4.4	-4.3	-3.3
			Assumptions		
Real GDP growth rate (%)	-1.8	2.8	3.8	3.8	3.2
Inflation (%)	2.2	2.1	2.2	2.2	2.2
Male Participation rate (aged 16-61)	85.2	84.3	83.3	82.3	80.2
Female Participation rate (aged 16-60)	37.8	40.4	43.7	47.0	53.5
Population (000's)	397.3	404.1	408.3	409.5	387.1

Note: Figures may not add up due to rounding

Source: PROST

and expenditure over the projection horizon. Total PAYG revenue as a percentage of GDP is expected to reach 1.5 per cent of GDP in 2050, whilst PAYG expenditure will reach a peak of around 10 per cent of GDP in 2020, then fall to 4.8 per cent of GDP by 2050. Developments in these two important variables are the result of changes in the structure of population, output developments over time and also the result of the mechanics of the current Maltese pension system.

It is important to highlight that the projections for PAYG total revenue and expenditure based on the assumption of the PWG differ from those based on the assumption of the EPC on the premise that there are differences in both demographic and macroeconomic assumptions. In particular, the projections by the PWG are underpinned by a higher nominal GDP over the projection period relative to those based on common EPC assumptions. Secondly, as explained above, population projections differ markedly. Accordingly, the current pensions deficit balance as a percentage of GDP is higher under the projections by the PWG as from 2020 onwards.

6.3 The Pensions Reform Bill

The Pensions reform bill entitled ‘An Act to further amend the Social Security Act’ is currently being debated in the House of Representatives where it has reached a relatively advanced stage in the legislative process. It is expected that the bill will be adopted by the end of 2006 with some of the provisions of the Act coming into effect as from 1st January 2007. The Bill proposes significant changes to the current pensions regime, to be introduced in a gradual manner which enables a smooth transition without causing social and economic disruptions. The following are the salient elements of the reform bill.

Definition of Pension Age

Currently, the pension age is sixty years for females and sixty one years for males. The Bill under discussion shall provide that the pension age mean sixty five years of age, provided that:

- In the case of a person born on or before the 31st December 1951, pension age shall be sixty one years.
- In the case of a person born during the calendar years 1952 to 1955, pension age shall be sixty two years.

- If the person is born during the period 1956 to 1958, pension age shall be sixty three years.
- If the person is born in the period 1959 to 1961, pension age shall be sixty four years.
- In the case of a woman born on or before the 31st December 1951, pension age shall be sixty years.

Disqualification from a Pension in respect of Retirement

Persons born on or before 31st December 1961 will continue to face the current legislation. They may be able to continue working if they are under sixty five years of age and have attained the pension age while also receiving a retirement pension, as long as they do not earn a weekly equivalent that is higher than the National Minimum Wage. On the other hand, persons born on or after 1st January 1962 will be disqualified from receiving a pension in respect of retirement in this circumstance whenever they are working.

Retirement before Pension Age

A person who has attained the age of sixty one years but has not yet attained pension age, may after attaining sixty one years of age claim a pension in respect of retirement if such person is no longer gainfully occupied. It is necessary that since reaching his eighteenth birthday, the claimant has had a total of:

- 2,080 paid or credited contributions in the case of a person born on or after the 1st January 1962, or
- 1,820 paid or credited contributions in the case of a person born during calendar years 1952 to 1961.

Full rate of Two-Thirds Pension

The full rate of the Two-Thirds Pension is equal to 2/3 of the pensionable income of the claimant who has paid or has been credited with a yearly average of 50 contributions over a period of:

- Thirty years in the case of a person born on or before the 31st December 1951,
- Thirty five years for a person born during calendar years 1952 to 1961,
- Forty years in the case of a person born on or after the 1st January 1962.

For a person born on or after the 1st January 1962, the yearly average of contributions required for the purposes of awarding a Two Thirds Pension shall be assessed on any period of 40 years between the first day of his contribution year in which he reaches the age of eighteen and the last day of his last complete contribution year before the beginning of his benefit year which includes the day on which the conditions are required to be satisfied.

Calculations of Pensionable Income

Meanwhile, the calculations of pensionable income will be revised. Under the current regime, pensions are determined by a formula based on the average of the best three consecutive calender years out of the last ten years basic wages in the case of employees; and the average of the last ten years' net income in the case of self-employed persons. According to the Bill, for a person born on or after the 1st January 1962, the pension shall be determined by taking the yearly average of the basic wage/salary/net income/net earnings as the case may be, during the best ten calendar years within the last forty years immediately preceding his retirement or invalidity.

The Maximum Pensionable Income

In the case of a person born on or before the 31st December 1961, whose retirement occurs on or after the 1st January 2007, the basic wage/salary/net income/net earnings and the resultant pensionable income, shall not exceed Lm6,958 increased by such sum as the Government may award as a cost of living increase. The following provisions stand:

- For a person born on or before the 31st December 1951, the resultant pensionable income including any such cost of living increase shall not exceed the sum of Lm7,500.

- In the case of a person born during calendar years 1952 to 1961, the resultant pensionable income including any such cost of living increase shall not exceed the sum of Lm9,000.

In the case of a person born on or after the 1st January 1962 whose retirement occurs on or after the 1st January 2007, the resultant pensionable income shall not exceed:

- Lm6,958 increased by such sum that the Government awards for the cost of living, in respect of the years 2007 to 2010.
- Lm6,958 increased on the 1st January of each year between 2011 and 2013 by one third of the difference between the sum and Lm9,000, thereby reaching Lm9,000.
- Lm9,000 increased annually by 70 per cent, of the percentage increase in the national average wage for the previous calendar year, plus 30 per cent, of the inflation rate for that same year. This applies as from the 1st of January 2014.

The Guaranteed National Minimum Pension

Changes are envisaged to the National Minimum Pension, which currently stands at 4/5ths of the National Minimum Wage for a couple and 2/3rds of the National Minimum Wage for any other person. A person born on or after the 1st January 1962 who is not entitled to a Service Pension shall be entitled to a Guaranteed National Minimum Pension (GNMP) which shall be payable at a rate which is not less than 60 per cent of the National Median Income. The exact rate shall be determined by the Minister in charge of the Department of Social Security with the concurrence of the Minister responsible for Finance. In any case, the rate of the GNMP cannot be less than that declared for the preceding year.

Crediting of Contributions

Changes are also envisaged to the categories of persons to whom crediting of contributions is allowed. The categories have been extended to include persons born on or after the 1st January 1962, who have the legal care and custody of a child who is less than 6 years old, or 10 years old in the case of a child suffering from a serious disability. Crediting of contributions may be claimed hereunder for a maximum period of two years in the case of a parent who has stopped working to take care of his/her child. This period is extended to four years in the case of a child suffering from a serious disability. An adoptive parent is also able to claim credits under this section. Credits may be claimed for every child, while there is no distinction between employed and self-employed persons. The claimant is bound to have worked a minimum number of years equal to the duration of the crediting period. In the case of a parent’s death, this latter legal binding ceases to apply.

Ministerial Powers and Responsibilities

The Minister in charge of the Department of Social Security will within intervals not exceeding five years, prepare a report reviewing the workings regarding the Retirement Pensions together with recommendations for achieving further adequacy, sustainability and social solidarity. The first report will be submitted by not later than the end of the year 2010, and shall then be discussed by the Social Affairs Committee of the House of Representatives.

The Minister, in concurrence with the Minister for Finance will have the power to make and vary any regulations requiring persons who have not reached pension age and their employers as the case may be, to make contributions into Mandatory Second Pension funds. Such regulations may provide for the rate of contribution payable, method and frequency of payment. Second Pension funds shall be governed by the Special Funds (Regulation) Act (Cap. 450) with the Malta Financial Services Authority (MFSA) being responsible.

The Minister may in conjunction with the Minister for Finance provide for exemptions from income tax in respect of contributions made by any person to Third Pension funds. These funds will be governed by the MFSA, under the Special Funds (Regulation) Act or the Insurance Business Act (Cap. 403) as applicable.

Note:

[1] Pensions system deficit excludes the State's contribution, in accordance with the yardstick adopted by the World Bank.

7. Institutional Features of Public Finances

7. Institutional Features of Public Finances

The conduct of an appropriate fiscal policy with a view to attaining sound and sustainable public finances is a crucial element in Malta's economic policy making. In the short-run, fiscal policy plays an important role in achieving a growth supportive environment. In the long-term, fiscal policy coupled with adequate structural and labour market reform measures, helps to achieve national economic policy objectives. In this context, the Maltese Government is attaching importance to fiscal governance in order to ensure that appropriate budgetary policies are pursued.

Fiscal policy and budgetary surveillance are formulated on the basis of national objectives whilst at the same time recognising the importance of the EU dimension, particularly the adherence to the Stability and Growth Pact. Despite the fact that no fiscal rules are enshrined in Maltese law, fiscal targets on deficit and debt figures are set by Government, providing guiding principles for conducting fiscal policy. Moreover, fiscal targets are backed by political commitment and ownership from national political representatives and by appropriate monitoring and enforcement systems. This implies that expenditure commitments made by Government are consistent with the set fiscal targets.

The Maltese Government attaches importance to the efficiency and effectiveness of public expenditure. It also advocates the need of a consistent and transparent administration of public finances. To this end, appropriate planning of public expenditure and revenue takes place through three-year Business and Financial Plans prepared by Ministries and Government Departments in the context of Government's overall economic and social targets within the framework of the fiscal consolidation process. These Financial Business Plans are in turn reflected in the Budget presented and discussed on an annual basis in Parliament, with discussions leading to the approval of the Financial Estimates of the various Ministries.

Control and monitoring of public expenditure is also of paramount importance, particularly as Government pursues the fiscal consolidation programme. For this purpose, the Budgetary Operations Division, which incorporates the Budget Office within the Ministry of Finance, monitors the financial performance of Ministries and Departments as well as public sector organisations, in particular those that either depend on a Government subvention for their operations or contribute towards the Government Budget through part of their profits, in order to ensure that the annual planned contributions are efficaciously utilised. Meanwhile, the financial operations of public entities are supervised by a specific office namely the Financial Management Monitoring Unit, also within the Ministry of Finance.

The Budgetary Operations Division regularly monitors closely recurrent and capital expenditures and revenue collection performances with the aim that budgetary targets and projections are adhered to, making recommendations in order that Government may take corrective measures well in time where trends indicate overspending or revenue shortfalls by year-end. This is made possible through the monthly evaluation of financial reports of each Government Department and management accounts of public entities.

In order to further ensure strict adherence to the fiscal targets, the Prime Minister, in his capacity of the Minister of Finance, has instructed all Cabinet Ministers that requests by Ministries and Departments for additional funds have to be fully justified and considered only in respect of unforeseen and unavoidable circumstances. Furthermore, these requests would be followed up by a rigorous evaluation process by the Ministry of Finance and in respect of truly justified cases the Cabinet of Ministers will ensure that such requests are simultaneously neutralised either through a trade off with reduced expenditure elsewhere or through improvements in revenue collection.

Public funds are also managed and supervised by the Accountant General who is also responsible for the day-to-day cash-flow position of the operations of Government. Moreover, the system and procedure used in Government accounting within Ministries and Government Departments is scrutinized by the Internal Audit and Investigations Directorate. Furthermore, the accounts of all departments and offices of Government are audited and reported upon annually by the Auditor General to the House of Representatives. Further scrutiny on the financial conduct of Government Departments is exercised by the Parliamentary Standing Committee on Public Accounts, which is chaired by a member of the Opposition to ensure a more transparent scrutiny of how public finances have been utilised.

With regards to Public Debt, the Treasury implements the borrowing plan based on the strategy approved by Government and prepares debt sustainability analysis to assess the long-term sustainability of projected public sector borrowing levels.

With regards to fiscal institutions, as outlined above, an institutional set up is in place within the Ministry of Finance entrusted with the objective of pursuing sound and sustainable public finances. At this juncture, it is noteworthy to stress that as evident by the experience of a number of EU Member States, although independent fiscal institutions have made an important contribution to sound and sustainable fiscal policies, special status of fiscal institutions is not always a pre-requisite for ensuring independence which can also be achieved by a strong Government ownership and commitment to the duties assigned to the particular office.

Whilst acknowledging that national institutions and fiscal rules can play an important role in the attainment of sound budgetary positions and can serve as a useful tool in meeting budgetary targets and supporting fiscal consolidation, the desirable characteristics of national fiscal rules and institutions depend on domestic circumstances, such as the institutional and political setting and the nature of fiscal problems. To this end, the Maltese Government is designing its fiscal governance setting in a way that best suits the national context, and also building upon experiences accumulated in recent years.

Statistical Appendix

Macroeconomic Prospects

Table 1a

Percentages unless otherwise indicated	ESA Code	2005(1)	2005	2006(2)	2007	2008	2009
1. GDP at constant (2000) prices	B1g	1,741.0	2.2	2.9	3.0	3.1	3.1
2. GDP at current market prices	B1g	1,941.1	4.3	6.7	6.0	6.1	6.2
Components of real GDP							
3. Private final consumption expenditure(3)	P3	1,178.6	2.8	2.6	2.7	2.8	2.7
4. General government final consumption expenditure	P3	357.9	0.6	0.4	0.2	0.3	0.5
5. Gross fixed capital formation	P51	366.3	7.4	10.3	6.8	0.8	1.3
6. Changes in inventories and net acquisition of valuables as a % of GDP	P52+P53	-	0.2	1.7	1.6	1.7	1.7
7. Exports of goods and services	P6	1,539.3	-6.2	1.9	2.3	4.1	4.6
8. Imports of goods and services	P7	1,704.9	-1.8	4.5	2.4	2.6	3.2
Contribution to real GDP growth							
9. Final domestic demand		-	3.5	4.0	3.4	2.1	2.2
10. Change in inventories and net acquisition of valuables	P52+P53	-	2.8	1.5	—	0.1	0.1
11. External balance of goods and services	B11	-	-4.1	-2.7	-0.4	0.9	0.8

(1) Lm million

(2) Forecasts from 2006 onwards

(3) Includes NPISH final consumption expenditure

Price Developments

Table 1b

Percentages unless otherwise indicated	ESA Code	2005[1]	2005	2006[2]	2007	2008	2009
1. GDP deflator		111.5	2.0	3.7	2.9	2.8	3.0
2. Private consumption deflator		110.4	2.5	2.8	2.3	2.2	2.0
3. Harmonised Index of Consumer Prices		100.0[3]	2.5	3.1	2.2	2.1	2.0
4. Public consumption deflator		118.9	1.6	1.9	2.1	1.9	1.8
5. Investment deflator		111.0	1.6	4.3	3.3	1.6	3.6
6. Export price deflator (goods and services)		91.4	2.1	6.1	3.8	2.2	1.5
7. Import price deflator (goods and services)		94.0	3.2	5.8	2.8	1.0	0.3

[1] Index (base 2000 unless otherwise indicated)

[2] Forecasts from 2006 onwards

[3] Average 2005=100

Labour Market Developments

Table 1c

Percentages unless otherwise indicated	ESA Code	2005	2005	2006[1]	2007	2008	2009
1. Employment, persons[2]		152.4[3]	1.5	0.9	1.1	0.9	0.9
2. Employment, hours worked		…	…	…	…	…	...
3. Unemployment rate[4]		-	7.3	7.0	6.5	6.4	6.2
4. Labour Productivity, persons[5]		11,422.5	0.7	2.0	1.9	2.2	2.2
5. Labour Productivity, hours worked		…	…	…	…	…	...
6. Compensation of employees (Lm million)	D1	899.8	2.0	2.2	2.6	2.5	2.5

(1) Forecasts from 2006 onwards

(2) National accounts definition

(3) Thousands

(4) Harmonised definition

(5) Real GDP per person employed

Sectoral Balances

Table 1d

Percentages of GDP	ESA Code	2005	2006	2007	2008	2009
1. Net lending/ borrowing vis-à-vis the rest of the world	B.9	-10.6	-	-	-	-
of which:						
Balance on goods and services		-10.1	-12.1	-11.3	-9.2	-7.1
Balance of primary incomes and transfers		-0.5	-	-	-	-
Capital account		3.5	-	-	-	-
2. Net lending/ borrowing of the private sector	B.9/ EDP B.9	-7.4	-	-	-	-
3. Net lending/ borrowing of general government	B.9	-3.2	-2.6	-2.3	-0.9	0.1
4. Statistical discrepancy		2.9	-	-	-	-

General Government Budgetary Developments

Table 2

Percentages of GDP		ESA code	2005[1]	2005	2006	2007	2008	2009
Net Lending (EDP B9) by sub-sectors								
1.	General Government	S13	-61.8	-3.2	-2.6	-2.3	-0.9	0.1
2.	Central Government	S1311	-62.3	-3.2	-2.7	-2.3	-0.9	0.1
3.	State Government	S1312	-	-	-	-	-	-
4.	Local Government	S1313	0.5	–	–	-	-	-
5.	Social Security Funds	S1314	-	-	-	-	-	-
General Government								
6.	Total Revenue	TR	858.4	44.2	43.8	43.9	41.8	40.1
7.	Total Expenditure	TE	920.2	47.4	46.4	46.2	42.7	40.1
8.	Net Lending / borrowing	EDP B9	-61.8	-3.2	-2.6	-2.3	-0.9	0.1
9.	Interest expenditure (incl. FISIM)	EDP D41 incl FISIM	76.5	3.9	3.7	3.4	3.4	3.1
9a.	FISIM		1.3	0.1	0.1	0.1	0.1	0.1
10.	Primary Balance		14.7	0.8	1.1	1.1	2.5	3.2
Selected Components of Revenue								
11.	Total Taxes		542.9	28.0	28.2	28.7	27.9	26.9
11a.	Taxes on production and imports	D2	305.4	15.7	15.6	16.1	15.6	14.9
11b.	Current Taxes on Income, Wealth, etc.	D5	229.9	11.8	12.2	12.3	11.9	11.6
11c.	Capital Taxes	D91	7.5	0.4	0.4	0.4	0.4	0.3
12.	Social Contributions	D61	171.5	8.8	8.3	8.2	8.2	8.2
13.	Property Income	D4	29.7	1.5	1.1	1.0	0.9	0.8
14.	Other		114.4	5.9	6.2	6.0	4.7	4.2
15=16	Total Revenue	TR	858.4	44.2	43.8	43.9	41.8	40.1
p.m.	Tax Burden		714.4	36.8	36.5	36.9	36.1	35.1
Selected Components of Expenditure								
16.	Collective Consumption	P32	192.3	9.9	10.3	9.8	9.3	8.9
17.	Total Social Transfers	D62+D63	270.1	13.9	13.6	13.4	13.2	13.0
18=9	Interest expenditure (incl. FISIM)	EDP D41 incl. FISIM	76.5	3.9	3.7	3.4	3.4	3.1
19.	Subsidies	D3	40.0	2.1	1.9	1.9	1.6	1.3
20.	Gross fixed capital formation	P51	104.9	5.4	5.6	6.1	4.0	3.2
21.	Other		236.4	12.2	11.3	11.7	11.3	10.5
22=7	Total Expenditure	TE	920.2	47.4	46.4	46.2	42.7	40.1
p.m.	Compensation of employees	D1	286.7	14.8	14.2	13.5	12.9	12.5

[1] Lm million

General Government Expenditure by Function

Table 3

	Percentages of GDP	COFOG code	2004	2005	2006	2007	2008	2009
1.	General public services	1	8.5	7.8	8.0	7.5	7.0	6.8
2.	Defence	2	1.0	1.0	0.8	0.7	0.7	0.7
3.	Public order and safety	3	1.7	1.7	1.6	1.5	1.4	1.3
4.	Economic affairs	4	7.1	6.5	6.3	6.4	6.0	5.0
5.	Environment protection	5	1.0	1.1	1.3	1.6	1.2	1.1
6.	Housing and community amenities	6	1.1	1.2	0.6	1.1	0.9	0.8
7.	Health	7	6.4	6.9	6.7	6.2	4.8	4.4
8.	Recreation, culture and religion	8	0.6	0.7	0.7	0.6	0.6	0.5
9.	Education	9	6.0	6.1	6.2	6.3	6.0	5.7
10.	Social protection	10	14.3	14.3	14.2	14.2	14.0	13.7
11.	Total Expenditure	TE	47.9	47.4	46.4	46.2	42.7	40.1

General Government Debt Developments[1]

Table 4

Percentages of GDP	2005	2006	2007	2008	2009
1. Gross debt	74.2	68.3	66.7	63.2	59.4
2. Change in gross debt ratio	-0.7	-5.9	-1.6	-3.5	-3.8
Contributions to changes in gross debt					
3. Primary balance	-0.8	-1.1	-1.1	-2.5	-3.2
4. Interest expenditure[2] and nominal GDP growth	0.9	-0.9	-0.5	-0.5	-0.5
5. Stock-flow adjustment	-0.8	-3.9	—	-0.6	-0.1
p.m. implicit interest rate on debt	5.3	5.5	5.1	5.3	5.3

(1) Developments in the debt- to-GDP ratio depend on: $\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} \cdot \frac{i_t - y_t}{1 + y_t}\right) + \frac{SFA_t}{Y_t}$

where t denotes a time subscipt, D, PD, Y and SFA are the government debt, primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth.

(2) Including FISIM

Cyclical Developments

Table 5

Percentages of GDP	ESA code	2005	2006	2007	2008	2009
1. Real GDP growth (%)		2.2	2.9	3.0	3.1	3.1
2. Net lending of general Government	EDP B.9	-3.2	-2.6	-2.3	-0.9	0.1
3. Interest expenditure (incl. FISIM)	EDP D.41 incl. FISIM	3.9	3.7	3.4	3.4	3.1
4. Potential GDP growth (%)		2.0	2.3	2.4	2.0	1.9
5. Output Gap		-2.5	-1.9	-1.4	-0.3	0.9
6. Cyclically budgetary component		-0.9	-0.7	-0.5	-0.1	0.3
7. Cyclically-adjusted balance (2-6)		-2.3	-1.9	-1.8	-0.8	-0.3
8. Cyclically-adjusted primary balance (7-3)		1.7	1.8	1.6	2.6	2.8

Divergence from the December 2005 Update of Convergence Programme

Table 6

Percentages of GDP	ESA code	2005	2006	2007	2008	2009
GDP growth (%)						
previous update		0.9	1.1	1.2	2.0	…
latest update		2.2	2.9	3.0	3.1	3.1
Difference		1.3	1.8	1.8	1.1	-
Actual budget balance	EDP B.9					
previous update		-3.9	-2.7	-2.3	-1.2	…
latest update		-3.2	-2.6	-2.3	-0.9	0.1
Difference		0.7	0.1	0.0	0.3	-
Gross debt levels						
previous update		76.7	70.8	68.9	67.3	…
latest update		74.2	68.3	66.7	63.2	59.4
Difference		-2.5	-2.5	-2.2	-4.1	-

Long-term Sustainability of Public Finances

Table 7

Percentages of GDP	2004	2010	2020	2030	2050
Total Expenditure	-	-	-	-	-
of which: age-related expenditures	18.2	19.1	20.4	20.0	18.5
Pension expenditure	7.4	8.8	10.2	9.1	7.0
Social security pensions*	-	-	-	-	-
Old-age and early pensions	3.8	5.2	7.0	6.9	6.5
Other pensions (disability, survivors)	3.6	3.6	3.2	2.2	0.5
Occupational pensions	-	-	-	-	-
Health care	4.2	4.5	5.0	5.5	6.1
Long-term care	0.9	0.9	0.9	1.0	1.1
Educational expenditure	4.4	3.7	3.2	3.3	3.3
Other age-related expenditures - unemployment benefit spending	1.2	1.2	1.0	1.0	1.0
Interest expenditure	-	-	-	-	-
Total revenue	-	-	-	-	-
of which: property income	2.8	1.2	1.1	0.7	0.3
of which: from pensions contributions	7.1	6.8	5.9	4.7	3.3
Pension reserve fund assets	-	-	-	-	-
of which: consolidated public pension fund assets	-	-	-	-	-
of which: consolidated public pension fund assets	-	-	-	-	-
			Assumptions		
Labour productivity growth	1.4	0.9	2.4	2.7	1.7
Real GDP growth	1.9	2.5	2.7	3.1	1.7
Participation rate males (aged 16-61)	84.2	85.8	86.3	86.4	86.4
Participation rate females (aged 16-60)	40.9	48.1	55.3	57.8	58.3
Total participation rates (aged 16-61)	62.6	66.7	70.4	71.6	71.7
Unemployment rate (aged 16-61)	9.0	9.4	9.0	8.8	8.6
Population aged 61+ over total population	15.9	18.9	23.8	26.0	29.6

* Malta's two-thirds pension included under the pension expenditure category

Note: Figures may not add up due to rounding

Basic Assumptions

Table 8

	2005	2006	2007	2008	2009
Short-term interest rate	3.3	3.5	3.5	3.5	3.5
Long-term interest rate	4.4	4.3	4.3	4.3	4.3
USD/EUR exchange rate (level)	1.2	1.3	1.3	1.3	1.3
Nominal effective exchange rate (annual averages)	1.1	1.1	1.1	1.1	1.1
World GDP growth, excluding EU	5.1	5.7	5.2	5.2	5.2
EU-25 GDP growth	1.7	2.8	2.4	2.4	2.4
Growth of relevant foreign markets	1.1	2.3	1.9	2.1	2.1
World import volumes, excluding EU	7.3	8.8	8.2	7.7	7.7
Oil prices, (Brent, USD/barrel)	53.4	66.5	67.2	68.8	68.8