



**Malta:**

**Update of Stability Programme**

**2008 - 2011**

**Addendum:**

**Budgetary Stimulus Measures Proposed in the Framework  
of the European Economic Recovery Plan**

**Ministry of Finance, the Economy and Investment  
December 2008**



# 1. Economic Pretext

The key characteristics of the ongoing financial crisis are its intensity and its global dimension. Such characteristics are underpinned by the fact that the ongoing re-pricing of risk has been abrupt and unrelenting. The European Economic Recovery Plan proposed by the EU Commission is thus a welcome and timely tool in view of the fact that in the current circumstances, greater international macroeconomic cooperation is key. Nevertheless, although no country appears to be unscathed from such events, the severity of the impact differs on a cross-country basis. Such differences in macro-economic scenarios for respective Member States help shape the most appropriate fiscal responses by Governments. In addition the relative health of public finances in the period preceding the current turmoil should influence the design of the breadth and scope of fiscal stimuli by respective Governments.

Government has shaped the 2009 budget within such a framework, to appropriately address local challenges and peculiarities. The cautious and responsible approach to lending adopted by the domestic banking sector has implied that the domestic sector of the economy has not disproportionately suffered an explicit negative impetus from the financial crisis. Malta is currently reaping the advantage of a conservative banking approach that is not reliant on wholesale markets for its funding requirements. Furthermore macroeconomic indicators available thus far would point to a certain degree of resilience. Nonetheless these characteristics are partially offset by the high degree of openness of the local economy. To this effect, the 2009 budget provisions seek to strike a delicate balance between the need to provide an appropriate counter cyclical response to the unprecedented downside risks and the need to retain investor confidence in Government's commitment towards fiscal sustainability. Government firmly believes that the need of conducting this balancing act is even more compelling in view of Malta's highly small and open economy and the resulting risk dynamics. Market data suggests that in this volatile financial environment, market participants are exhibiting heightened risk aversion as evidenced by higher spreads. This implies that any market perception that authorities are attaching reduced importance to prudent financial management is bound to have serious and undesirable consequences on a sovereign's financing cost and funding availability.

It is relevant to highlight that the Government stands ready to take additional measures if warranted by changing circumstances.

## 2. The Maltese Government's Response to the Economic Downturn

Against the backdrop of a challenging environment for devising the most appropriate fiscal policy response, Government strived to provide higher levels of support to the local economy. In this context, the fiscal targets set out in the December 2007 Stability Programme have been revised. In the December 2008 Update of Stability Programme, a deficit of 1.5 per cent of GDP is being projected for 2009, compared to last year's target of a deficit of 0.1 per cent of GDP. Furthermore, the achievement of the medium term objective of a balanced structural budget has been delayed by one year to 2011.

### 2.1 Short-term Fiscal Measures

Government's economic policy is based on growth and stability oriented macroeconomic policies. Sound macroeconomic policies are essential to create an environment which is conducive to employment creation and growth. In the context of the present challenging international economic conditions, and taking into account the specific domestic situation, in its Budget for 2009, Government adopted a number of measures which aim to stimulate economic activity whilst at the same time addressing the challenges facing the Maltese economy, within the context of the renewed Lisbon Strategy.

Government's strategy is for a well-diversified, competitive and productive economy, which is able to withstand negative shocks from the external economic environment. In this context, Government attaches importance to knowledge-based activities across a wide variety of sectors, ranging from ICT and pharmaceuticals to financial services. Sustaining the tourism industry is another key priority given the multiplier effects of this industry on other sectors of the Maltese economy.

Within this context, as highlighted in Table 1, the Budget for 2009 comprised a fiscal stimulus based on the following main characteristics:

- i) an increase in public investment, especially outlays which aim to support the growth of economic activities, to develop the infrastructure and to improve the environment;
- ii) sectoral support, particularly to industry, tourism and small and medium sized enterprises, and measures aimed to support employability;
- iii) measures to support consumer expenditure and to improve the incentive to work; and
- iv) incentives earmarked to promote energy conservation and to reduce emissions.

Developments in capital outlays during 2009 mainly reflect the implementation of projects co-financed from EU funds under the 2007-2013 Financial Framework and thus correspond with corresponding increases in

Short-term Fiscal Measures with Direct Budgetary Impact						
Table 1						
Measure - title of the measure (package)  - status of the measure (undertaken, presented, announced)	(Planned) Date of adoption	Description of the measure  Describe verbally the magnitude and timing of the fiscal measure (i.e. beginning and, for temporary measures, the end date), its purpose (e.g. increase resilience, support aggregate demand, facilitate adaption to job losses)	Direct budgetary impact (in % of GDP)			
			2008	2009	2010	2011
Increase in public investment, especially outlays which aim to support the growth of economic activities, to develop the infrastructure and to improve the environment <i>Status: Announced</i>	2009	Higher outlays on urban regeneration and roads infrastructure, as well as enhancing maritime port facilities to support and facilitate the reorientation of the economy.	-	0.23	-	-
	2009	Increased investment outlays on environmental projects, largely including higher outlays on projects in the water and waste water sectors	-	0.14	-	-
	2009	Increased budgetary allocation for investment on projects related to education, mainly to increase the capacity of tertiary educational facilities in the ICT sector and of the vocational educational institution.	-	0.07	-	-
	2009	Increase in investment projects related to industry	-	0.09	-	-

Short-term Fiscal Measures with Direct Budgetary Impact						
Table 1						(cont.)
Sectoral support, particularly to industry, tourism and small and medium sized enterprises, and measures aimed to support employability <i>Status: Announced</i>	2009	Higher incentives for foreign direct investors and local enterprises, to support an increase in value added and employment and to improve the capacity to adapt to change.	-	0.20	-	-
	2009	Additional expenditure earmarked specifically to address the expected slowdown in tourist arrivals during 2009, particularly for a more resolute marketing of the local tourism product.	-	0.06	-	-
	2009	Additional expenditure for the construction, adaptation, refurbishment works and the purchase of equipment for vocational and higher educational institutions.	-	0.31	-	-
	2009	Additional expenditure is earmarked for training schemes provided by the Employment and Training Corporation.	-	0.03	-	-
Measures to support consumer expenditure and to improve the incentive to work <i>Status: Announced</i>	1-Jan-09	The revision of the income tax bands, including specific fiscal measures aimed to encourage higher female participation, is expected to encourage more work effort and further labour market participation. Moreover, it should boost disposable income, thus supporting consumption and ultimately, economic activity.	-	0.20	-	-
Incentives earmarked to promote energy conservation and to reduce emissions <i>Status: Announced</i>	2009	Measures aiming towards a more sustainable environment.	-	0.11	-	-
	1-Jan-09	The overhaul of the motor vehicle registration tax and annual circulation tax to one based on the polluter pays principle	-	0.08	-	-
	2009	Higher expenditure directed towards initiatives promoting sustainable development at a local level.	-	0.10	-	-

revenue. Additionally, several projects will be financed from local funds, including measures impacting both on revenue and expenditure.

### 2.1.1 Increase in Public Investment

Higher investment outlays are an important element in Government's fiscal response. In the December 2008 Update of Stability Programme, the ratio of gross fixed capital formation is expected to increase by 1 percentage point of GDP, from 3.4 per cent in 2008 to 4.4 per cent in 2009. Besides stimulating demand in the short term,

such outlays have been devised taking into account Government's long term public policy goals, including facilitating economic growth and development and addressing environmental challenges.

Being an island at the periphery of the European Union, the infrastructure, including sea and air links, telecommunications, ports as well as roads, are crucial for the country's development. The infrastructural endowment should support and facilitate the reorientation of the economy. Indeed, in 2009, additional expenditure amounting to 0.23 percentage points of GDP is earmarked for urban regeneration and roads infrastructure, as well as for enhancing maritime port facilities. Furthermore, investment outlays on environmental projects are expected to increase by 0.14 percentage points of GDP. This largely includes higher outlays on projects in the water and waste water sectors. The shift of the economy towards higher value added activities requires the supply of appropriately skilled human resources. Thus, Government has increased the budgetary allocation for investment on projects related to education by 0.07 percentage points of GDP, mainly to increase the capacity of tertiary educational facilities in the ICT sector and of the vocational educational institution. In addition, in 2009, gross fixed capital formation on projects related to industry is projected to rise by 0.09 percentage points.

### **2.1.2 Sectoral Support**

The support of knowledge-based enterprise in order to create a more dynamic and flexible economy with an increased capacity to adapt to change has been intensified through higher incentives for foreign direct investors and local enterprises which demonstrate commitment towards growth in value added and employment. Enterprises engaged in manufacturing, ICT development activities, call centres, healthcare, pharmaceuticals and biotechnology, amongst others, may benefit from these incentives. Indeed, for 2009, capital outlays earmarked at supporting industry, including agriculture and fisheries, increased by 0.20 percentage points of GDP.

As one of the main pillars supporting the Maltese economy, Government will continue to invest further in the tourism sector with a view to ameliorate the local tourism product, as well as to address the expected slowdown in tourist arrivals during 2009. To this end, the 2009 Budget provides for additional expenditure to the effect of €3.5 million (0.06 percentage points of GDP) earmarked specifically for tourism related initiatives, particularly for a more resolute marketing of the local tourism product.

In addition to the gross fixed capital formation expenditure in support of education, the Budget for 2009 provides for additional expenditure for the construction, adaptation, refurbishment works and the purchase of equipment for vocational and higher educational institutions amounting to 0.31 percentage points of GDP. Moreover, additional expenditure is earmarked for training schemes provided by the Employment and Training Corporation amounting to approximately €3.1 million or 0.03 percentage points of GDP.

### **2.1.3 Measures to Support Consumption Expenditure and to Improve the Incentive to Work**

The 2009 Budget also provides for a number of counter-cyclical policy responses impacting adversely on general Government revenue, in particular the revision of the income tax bands which is expected to encourage more work effort and further labour market participation. Indeed, the broadening of the tax-free range of household income and of the income tax brackets in general should boost disposable income, thus supporting consumption and ultimately, economic activity. Moreover, the 2009 Budget also introduced specific fiscal measures aimed to encourage higher female participation. Cumulatively, these measures have an adverse budgetary impact amounting to 0.20 percentage points of GDP.

### **2.1.4 Environmental Sustainability and Energy Conservation**

The strive towards sustainability in all areas is characterised by a number of initiatives that should ease the transition to a greener economy. The 2009 Budget announced various measures aimed to improve the efficiency

of energy use and to promote the use of renewable sources of energy. A number of initiatives have been announced which will enable a wider number of firms and households to invest in environmental friendly technology, including solar water heaters and photovoltaic power generating systems. These measures are expected to have a budgetary impact of 0.11 percentage points of GDP. The overhaul of the motor vehicle registration tax and annual circulation tax to one based on the polluter pays principle has been implemented. This is estimated to have a negative fiscal impact amounting to €4.9 million or 0.08 per cent of GDP.

Government commitment to address environmental sustainability in a holistic manner is further expounded by higher expenditure directed towards initiatives promoting sustainable development at a local level in 2009 (0.10 percentage points of GDP).

## 2.2 Medium-term Measures Improving the Quality of Public Finances and the Long-term Sustainability

There is a growing recognition that ageing populations will pose major economic, budgetary and social challenges in the coming decades. In particular, ageing could lead to significant pressures to increase public spending, making it difficult to maintain sound and sustainable public finances in the long term.

Age-related spending mainly comprises public expenditure on pensions and healthcare. Government is committed to ensure that resources are employed in the most efficient manner. Indeed, increasing focus is being made on ensuring that expenditure on health services is spent effectively, efficiently and without any waste or abuse. To this end, the Budget for 2009 announced that a number of Cost Controllers will be entrusted with the task of ensuring that the health services offered to the public are cost-effective and efficient. This will result in the reallocation of resources towards more efficient uses enabling the provision of better health services.

Medium-term Measures Improving the Quality of Public Finances and the Long-term Sustainability		
Table 2		
Measure	(Planned) Date of adoption	Description of the measure
- title of the measure (package)  - status of the measure (undertaken, presented, announced)		Describe verbally the magnitude and timing of the measure (i.e. beginning and, for temporary measures, the end date), its purpose (e.g. improve the budgetary frameworks, ensure long-term sustainability of public finance) and the expected impact on public finances in the medium to long term
Cost controllers for health expenditure <i>Status: Announced</i>	2009	The recruitment of a number of cost controllers trusted with the task of ensuring the provision of a cost-effective and efficient public health service. This measure will result in the reallocation of resources towards more efficient uses enabling Government to provide better health services for all citizens.
Retirement pensions reform review to ensure long-term sustainability of public finances <i>Status: Ongoing</i>	2010	The Pension Reform Act of 2006 stipulated that the Minister in charge of the Department of Social Security will prepare a report reviewing the workings regarding the Retirement Pensions together with recommendations for achieving further adequacy, sustainability and social solidarity, within intervals not exceeding 5 years. The first report shall be submitted by not later than the end of 2010, and shall then be discussed by the Social Affairs Committee of the House of Representatives. The relevant technical work has been initiated in 2008 and is currently ongoing.

Furthermore, during 2008, technical work has been initiated relating to the forthcoming review of the workings regarding retirement pensions. The Pension Reform Act of 2006 provided for periodic reviews of the workings regarding retirement pensions and for recommendations for achieving further adequacy, sustainability and social solidarity. Such reviews should be made within intervals not exceeding 5 years, with the first review being due by not later than the end of 2010. The relevant technical work is currently ongoing.

Table 2 includes information on the main recent new measures aimed to improve the quality of public finances and long-term fiscal sustainability.

## **2.3 Structural Measures to Support Demand and Promote Resilience**

As a Euro Area Member State, it is important to have the capacity to ensure smooth adjustment to asymmetric shocks which may hit the Maltese economy. Government will thus continue to implement structural reforms which aim to improve the functioning of product and labour markets. Such structural reforms would also improve competitiveness and ensure the full realisation of growth potential. Table 3 includes details of the main structural measures which aim to support demand and improve resilience of the economy.

The small size of the domestic market tends to limit the scope for competition in a number of markets. In the presence of imperfect market structures, Government will be adopting more aggressive regulation and supervision of market players by strengthening competition policy and competition authorities. Government will also consider further liberalisation of economic sectors which can contribute to enhance the degree of competition in domestic markets.

In this context, the Public Land Transport reform has been identified as one of Government's priorities for Malta in the coming years. The liberalisation of taxis, mini buses and coaches operating within the unscheduled market will render these sectors more efficient and competitive thus contributing towards increased demand and expansion. In turn, the increased economic expansion in this area will lead to the creation of employment opportunities.

With regard to the Public Scheduled Transport, the Government intends to embark on this reform in order to increase the efficiency of this transport structure, which apart from offering a better service to users and increase employment, will also promote a modal shift from private to public transportation, thus reducing the number of vehicles in use concurrently on private roads. Moreover with liberalisation, this sector will be fully exposed to the competition forces, thus allowing market players to enter the market.

The Maltese Government believes that better regulation is a crucial element in improving Malta's competitiveness. Government's vision aims to eliminate "red tape" whilst supporting and encouraging the business community, reducing customer detriment and further developing an efficient and effective public sector.

An exercise involving major government stakeholders as well as constituted bodies will be carried out to identify those measures which are best suited to provide SMEs with the enhanced environment which is critical for their survival and growth. It will also look at refining and adjusting current initiatives to better reflect the changing scenario in which these enterprises operate. These measures will then be developed into a Small Business Act for Malta.

Furthermore, the Better Regulation Unit intends to review the customer care systems within the public administration and the enforcement regimes currently utilised with a view to further promote and protect the interests of the businesses, citizens and consumers. Other better regulation initiatives include the formalisation of consultation guidelines within the public administration in line with Government's established system of securing intensive dialogue between interested stakeholders in the decision-making process amongst others.



**Structural Measures to Support Demand and Promote Resilience**

Table 3

Measure		Description of the measure
- title of the measure (package)  - status of the measure (undertaken, presented, announced)	<b>(Planned) Date of adoption</b>	Describe verbally the magnitude and timing of the measure (i.e. beginning and, for temporary measures, the end date), its purpose (e.g. directly support demand, improve the functioning of key markets, address competitiveness problems, facilitate labour market transitions, reduce regulatory and administrative burden)
Address competitiveness issues <i>Status: Announced</i>	Ongoing	Reforming Public Land Transport. The liberalisation of taxis, mini buses and coaches operating within the unscheduled market will render these sectors more efficient and competitive thus contributing towards increased demand and expansion.
Reduce regulatory and administrative burden <i>Status: Announced</i>	Ongoing	Setting up of a one-stop-shop for the licensing/registration of commercial activities
	2009	The drafting of the Small Business Act, in order to simplify the regulatory framework for small enterprises while bolstering the entrepreneurial environment in which they operate.
	2009	The introduction of General Accounting Principles for Small Enterprises, in order to alleviate undue burdens imposed on such enterprises by the International Financial Reporting Standards.
	1-Jan-09	Revision of penalty rates related to income tax and VAT, aimed towards encouraging timely, complete and accurate submissions, as well as timely payments. The interest rate on late tax payments shall be reduced to 0.75 per cent monthly, from 12 per cent to 9 per cent per annum.
	Q1 2009	Carry out a review of the enforcement regime(s) which will contribute to identify options to streamline enforcement, ensure synergies and better value-for-money, introduce more risk-based approaches and make certain that appropriate guidance is given to citizens and businesses.
Q2 2009	Put in place consultation guidelines and better practice for use within the public administration	
Facilitate labour market transitions <i>Status: Announced</i>	Ongoing	Implement Malta's Flexicurity Roadmap to ensure an adequate supply of skills in emerging high-skill sectors of the economy while ensuring that those at the lower end of the skills spectrum are sufficiently skilled and motivated to take up work in the formal economy and to progress within it.

In order to further improve the framework and environment within which small and medium enterprises operate, a one-stop shop for the provision of enterprise-related assistance and services will be set up, whilst General Accounting Principles for Small Enterprises will be introduced in order to alleviate undue burdens imposed on such enterprises by the International Financial Reporting Standards. Moreover, the 2009 Budget revised the penalty rates for late income tax and VAT payments, aimed towards encouraging timely, complete and accurate submissions, as well as timely payments. Indeed, as from 1 January 2009, the rates will be reduced to 0.75 per cent monthly, from 12 per cent to 9 per cent per annum.

The implementation of labour market policies is an important element to enhance labour market flexibility in Malta as it addresses the ability of the labour force to increase productivity in the presence of exogenous

shocks. Malta's flexicurity strategy will instil further flexibility in the labour market by seeking to attract more people in the labour market, principally women and older workers, tackle undeclared work and make declared work more attractive, raise educational attainment and ensure that labour market legislation is consistent with a flexible and dynamic labour market.

### **3. Fiscal Consolidation Strategy Remains Paramount Objective**

It is increasingly being acknowledged that the financial turmoil that is currently prevailing is very serious and hence demands a degree of flexibility on the part of the fiscal policymaker. Notwithstanding, the current international economic downturn should not be a catalyst that triggers a detraction on the part of Government's commitment to pursue fiscal consolidation. Indeed, recent events have accentuated the importance of prudent fiscal rules and a stable macroeconomic framework.