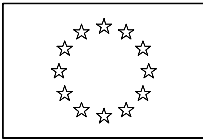

EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

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MALTA: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE FEBRUARY 2010 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called 'stability programme' for countries that have adopted the euro as their currency and 'convergence programme' for those that have not. The most recent update of Malta's stability programme was submitted on 19 February 2010.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission was finalised on 24 March 2010. Comments should be sent to Carmine Pappalardo and Vito Ernesto Reitano (Carmine.Pappalardo@ec.europa.eu; Vito.Reitano@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' autumn 2009 forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 24 March 2010. The ECOFIN Council is expected to discuss the opinion on the programme on 16 April 2010.

* * *

All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/sgp/index_en.htm

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1. INTRODUCTION

This document assesses the February 2010 update of the Malta's stability programme. It was submitted on 19 February 2010 and covers the period 2009-2012. It builds on and fully incorporates the 2010 budget. The latter was approved by the Government and presented to the national Parliament on 9 November. It was approved by the Parliament on 1 December 2009.

This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Malta. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the stability programme against the background of the Commission services' economic forecasts[1]. Section 4 analyses the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 0 discusses institutional features of public finances. Finally, Section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

[1] This assessment uses the Commission services' autumn 2009 forecast, published on 3 November 2009, as a benchmark. However, more recent information that has become available since then has also been taken into account to assess the risks to the programme scenario.

Table 1. Comparison of key macroeconomic and budgetary projections[1]

		2008	2009	2010	2011	2012
Real GDP (% change)	**SP Feb 2010**	**2.1**	**-2.0**	**1.1**	**2.3**	**2.9**
	COM Nov 2009	2.1	-2.2	0.7	1.6	n.a.
	SP Dec 2008	*2.8*	*2.2*	*2.5*	*2.8*	*n.a.*
HICP inflation (%)	**SP Feb 2010**	**4.7**	**1.8**	**1.7**	**2.0**	**2.0**
	COM Nov 2009	4.7	2.0	2.0	2.2	n.a.
	SP Dec 2008	*4.5*	*2.7*	*2.3*	*2.0*	*n.a.*
Output gap[2] (% of potential GDP)	**SP Feb 2010**	**1.3**	**-1.8**	**-1.7**	**-0.6**	**1.3**
	COM Nov 2009[3]	2.0	-1.0	-0.9	0.1	n.a.
	SP Dec 2008	*0.1*	*-0.3*	*-0.5*	*0.5*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Feb 2010**	**-4.9**	**-1.1**	**-3.6**	**-2.2**	**-1.4**
	COM Nov 2009	-5.1	-2.4	-1.8	-1.4	n.a.
	SP Dec 2008	*-5.1*	*-3.1*	*-2.7*	*0.7*	*n.a.*
General government revenue (% of GDP)	**SP Feb 2010**	**40.2**	**41.4**	**43.8**	**43.3**	**42.5**
	COM Nov 2009	40.3	41.2	41.9	42.1	n.a.
	SP Dec 2008	*40.6*	*41.7*	*41.8*	*41.9*	*n.a.*
General government expenditure (% of GDP)	**SP Feb 2010**	**44.8**	**45.2**	**47.7**	**46.3**	**45.3**
	COM Nov 2009	45.0	45.7	46.3	46.4	n.a.
	SP Dec 2008	*43.9*	*43.2*	*42.1*	*40.7*	*n.a.*
General government balance (% of GDP)	**SP Feb 2010**	**-4.7**	**-3.8**	**-3.9**	**-2.9**	**-2.8**
	COM Nov 2009	-4.7	-4.5	-4.4	-4.3	n.a.
	SP Dec 2008	*-3.3*	*-1.5*	*-0.3*	*1.2*	*n.a.*
Primary balance (% of GDP)	**SP Feb 2010**	**-1.4**	**-0.5**	**-0.6**	**0.3**	**0.4**
	COM Nov 2009	-1.4	-1.2	-1.2	-1.0	n.a.
	SP Dec 2008	*0.0*	*1.9*	*3.0*	*4.3*	*n.a.*
Cyclically-adjusted balance[2] (% of GDP)	**SP Feb 2010**	**-5.1**	**-3.1**	**-3.3**	**-2.7**	**-3.3**
	COM Nov 2009	-5.4	-4.2	-4.1	-4.4	n.a.
	SP Dec 2008	*-3.4*	*-1.4*	*-0.1*	*1.0*	*n.a.*
Structural balance[4] (% of GDP)	**SP Feb 2010**	**-5.4**	**-3.2**	**-3.5**	**-2.8**	**-3.3**
	COM Nov 2009	-5.0	-4.3	-4.1	-4.4	n.a.
	SP Dec 2008	*-3.7*	*-1.7*	*-0.2*	*0.9*	*n.a.*
Government gross debt (% of GDP)	**SP Feb 2010**	**63.6**	**66.8**	**68.6**	**68.0**	**67.3**
	COM Nov 2009	63.8	68.5	70.9	72.5	n.a.
	SP Dec 2008	*62.8*	*61.9*	*59.8*	*56.3*	*n.a.*

Notes:

[1]The Commission services' autumn 2009 forecast was prepared on a pre-budget basis.

[2]Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[3]Based on estimated potential growth of 1.3%, 0.8%, 0.6% and 0.6% respectively in the period 2008-2011.

[4]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.3% of GDP in 2008, 0.1% in 2009, 0.2% in 2010, 0.1% in both 2011 and 2012, all deficit-reducing according to the most recent programme, and 0.4% of GDP in 2008 deficit-increasing and 0.2% in 2009 deficit-reducing in the Commission services' autumn 2009 forecast.

Source:

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

This section describes recent economic and budgetary developments for Malta, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

Following a strong performance in the years preceding the global economic crisis, economic growth in Malta started to decelerate in the last quarter of 2008 (y-o-y) and contracted substantially in the first three quarters of 2009. According to estimates released by the statistical office on 11 March 2010, real GDP growth turned slightly positive in the last quarter. For 2009 as a whole, economic activity declined by 1.9%. The global crisis affected Malta, which is a very small and very open economy, primarily through the trade channel due to the lack of external demand. The two main exports sectors are exports of electronics, which were hit hard, and tourism, which suffered from fewer visitors from key source markets. Overall, the fall of foreign sales in 2009 was less negative compared to the sharp contraction in world trade. The external balance moved into positive territory for the first time since 2002 on the back of an even more notable drop in imports, reflecting the contraction in domestic demand and a lower oil import bill. Investment contracted sharply and acted as a major drag on domestic demand, as a result of lower construction activity and a decline in investment in equipment. By contrast, private consumption showed remarkable resilience in 2009, increasing by 1.2% in real terms, supported by lower inflation after the spike in 2008, growing wages, continuing expansion in consumer credit and some recovery measures in line with the European Economic Recovery Plan (EERP). The impact of the crisis on the banking system remained contained, reflecting the limited exposure to structured financial products, while the exposure to the real estate market points to some vulnerability.

With no need to directly assist the financial sector, Malta has adopted several measures to support the real sector and stem the negative impact of the international economic downturn. Most of the measures adopted in 2009 were aimed at increasing public investment on infrastructure and the environment. The provision of tailor-made financial assistance to manufacturing firms in economic difficulties in return for increasing investment, enhanced training of employees and ensuring the return to normal working hours was also aimed at cushioning the impact on the labour market by securing employment. Households' purchasing power was supported through a revision in the personal income tax brackets. The additional recovery measures planned in the 2010 budget are aimed at strengthening competitiveness as well as research and innovation. Measures to enhance investment mostly consist of providing support to SME liquidity through micro-credit schemes and tax allowances for investment. Given the already high general government deficit and debt ratios and a deteriorating competitive position implying limited room for fiscal manoeuvre, the recovery measures undertaken by Malta over 2009-2010 have been fully financed through both expenditure restraint and revenue-increasing measures.

The global and domestic slowdown has considerably weakened the budgetary position in 2008-09 compared to 2007. In 2008, the deterioration also reflected to a large extent some non-recurrent expenditure-increasing items. In 2009, while direct taxes were supported by the one-off proceeds of a tax amnesty on penalties for unpaid taxes and a relatively strong performance of income tax from international companies registered in Malta, the economic downturn weighed heavily on indirect taxation, including taxes on property transactions. Against this background, and taking into account the high debt ratio, the Council decided on 7 July 2009 that Malta has an excessive deficit. On 16 February 2010, it adopted a revised recommendation to correct this situation and extended the deadline for the correction by one year to 2011 (for details see Box 1).

Looking forward, in addition to restoring a sound fiscal position and improving long-term sustainability given the expected increase in age-related expenditure, Malta faces the challenge of strengthening competitiveness. Although euro area membership has cushioned the impact of the global recession by offering enhanced financial stability, the economy's resilience to future external shocks should be improved. This will require raising human capital and unlocking business potential, together with continuing efforts to move towards higher value-added activities in a context of diversification. Such efforts, which should foster productivity gains and export-led growth, need to be complemented by an efficient wage setting process that allows a close link between wage and productivity developments.

3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

According to the most recent update of the stability programme, Malta's real GDP is estimated to have declined by 2.0% in 2009 (-1.9% according to national accounts figures released on 11 March 2010), dragged down by the huge contraction in fixed investment and the depletion of inventories. Net exports contributed positively to output, as the fall of imports is expected to have largely exceeded the contraction of exports. The expected increase in domestic demand is the main force driving the recovery to positive growth in 2010, to 1.1%. The upturn in investment is projected to be significant while the rise in private consumption is more moderate. Despite the anticipated recovery of exports, net exports are set to contribute negatively to output growth due to the stronger rebound expected for imports. The latter appears consistent with the projected surge in investment. Real GDP is expected to accelerate in 2011 and further in 2012 (to almost 3%), as private consumption is projected to gain momentum, investment to remain dynamic and exports to consolidate their support to economic growth[2]. As regards cyclical conditions, the output gap as recalculated by the Commission services based on the information in the programme following the commonly agreed methodology is estimated to remain negative in 2009 and 2010 and expected to narrow in 2011 and turn positive in 2012.

The programme's real GDP outlook for 2009 is broadly in line with the Commission services' autumn 2009 forecast. As regards the composition of growth, the evolution of private consumption is less negative than in the autumn 2009 forecast while a deeper contraction of investment in the programme is expected to significantly contribute to the decline in economic activity. The programme's evolution of exports in 2009 appears plausible, while the steeper fall in imports assumed in the programme reflects the larger decline in investment. Therefore, in the programme the contribution of net exports to output turns out to be very positive (almost double that foreseen in the autumn forecast).

The programme's projection for economic growth in 2010 is higher than in the autumn forecast (+1.1% vs. +0.7%). Looking at the determinants of growth in 2010, the higher real GDP forecast in the programme is mainly driven by more positive domestic demand. In particular, the evolution of private consumption seems optimistic on the ground of still weak labour market conditions. In addition, compared to the autumn forecast, the rebound of investment expected in the programme appears favourable. On the other

[2] The programme's macroeconomic scenario uses the common external assumptions on extra-EU variables included in the Commission services' autumn 2009 forecast.

hand, consistent with the different outlook for domestic demand, the expected contribution of net exports to real GDP growth is more negative in the programme. Overall, the real GDP growth rate projected in the programme for 2010 appears plausible but the projected increase in domestic demand seems optimistic.

Table 2: Comparison of macroeconomic developments and forecasts

	2009		2010		2011		2012
	COM	SP	COM	SP	COM	SP	SP
Real GDP (% change)	-2.2	-2.0	0.7	1.1	1.6	2.3	2.9
Private consumption (% change)	-1.1	-0.8	0.4	1.5	1.1	2.4	2.4
Gross fixed capital formation (% change)	-8.0	-16.7	1.6	8.5	3.1	6.0	4.8
Exports of goods and services (% change)	-12.3	-11.7	1.6	2.3	2.8	3.0	2.7
Imports of goods and services (% change)	-13.7	-15.5	1.9	3.3	2.5	2.6	1.8
Contributions to real GDP growth:							
- Final domestic demand	-1.4	-2.3	0.9	1.9	1.5	2.0	2.2
- Change in inventories	-2.7	-4.2	0.2	0.0	0.0	0.0	0.0
- Net exports	1.9	4.4	-0.3	-0.8	0.1	0.3	0.7
Output gap[1]	-1.0	-1.8	-0.9	-1.7	0.1	-0.6	1.3
Employment (% change)	-0.6	-0.4	0.3	0.2	0.6	0.7	0.9
Unemployment rate (%)	7.1	7.1	7.4	7.4	7.3	7.2	6.7
Labour productivity (% change)	-1.6	-1.6	0.4	0.9	1.0	1.7	2.0
HICP inflation (%)	2.0	1.8	2.0	1.7	2.2	2.0	2.0
GDP deflator (% change)	1.9	3.0	2.3	2.4	2.4	2.7	2.1
Comp. of employees (per head, % change)	2.5	2.7	2.1	2.3	2.2	2.6	2.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.4	-1.1	-1.8	-3.6	-1.4	-2.2	-1.4

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source:

Commission services' autumn 2009 forecasts (COM); Stability programme (SP).

The programme foresees more favourable GDP growth for 2011 than in the autumn 2009 forecast (+2.3% vs. +1.6%), which is again mainly explained by more positive growth of domestic demand. The expected increase in private consumption (+2.4% against +1.1% in the autumn forecast) would be close to the average growth rate registered throughout the past decade. Net exports are expected to contribute positively (but not significantly) to overall growth in both the programme and the autumn forecast. In 2012, real GDP is according to the programme set to accelerate further, to +2.9%, a rate well above the estimated potential growth rate in the Commission services' autumn 2009 forecast. In terms of the determinants of growth, the very favourable pace of domestic demand, particularly of private consumption, does not appear to be fully consistent with the moderate increase of imports in both 2011 and 2012.

Overall, assessed against currently available information, the programme's macroeconomic assumptions appear favourable in 2011 and 2012. Hence, the programme's macroeconomic assumptions, especially for the outer years of the programme, do not appear to be a cautious base for the programme's budgetary plans.

Nonetheless, labour market conditions anticipated in the programme for the period until 2011, concerning both employment and unemployment developments, are in line with the Commission services' autumn 2009 forecast and thus appear plausible. Following the contraction in 2009, employment (measured both in terms of heads and hours worked) is set to mildly improve in 2010 (+0.2%), benefitting from the measures supporting the

labour market, and more considerably in 2011 given the expected recovery of the real economy. The unemployment rate is set to continue increasing in the coming months, mainly reflecting the lagged effects of the economic crisis on the labour market, so as to peak in 2010 (+7.4%) before starting to fall in 2011 and declining below the 2009 level in 2012. These developments are consistent with the improvement of the cyclical conditions of the Maltese economy assumed over the programme horizon, as signalled by the (recalculated) output gap. However, the decline in the unemployment rate projected for 2012 seems to be rather optimistic.

The updated programme projects more favourable developments of labour productivity compared to the Commission services' autumn 2009 forecast. Also the programme's projections for wage growth per employee are more dynamic than assumed in the autumn forecast. As a result, growth of unit labour costs projected in the programme for 2010 and 2011 is slightly lower than anticipated in the autumn forecast (around 1.2% on average vs. 1.5%). According to the programme, inflation is set to remain slightly below 2% in 2009 and 2010 and to moderately accelerate in 2011 and 2012. This path is similar to that projected in the autumn forecast even though at a lower pace. The increasing inflation rate in 2011 appears to be broadly consistent with the expected acceleration in private consumption. Overall, the inflation outlook in the programme appears to be on the low side. These developments are however consistent with the above-mentioned more favourable assumptions concerning unit labour costs. The projected evolution of the balance of goods and services in the programme appears optimistic as it is expected to remain positive over the 2009-2012 period, whereas the autumn forecast points to negative outcomes. However, over 2010-2011 the more negative outlook for the balance of primary incomes and transfers implies a worse external deficit in the programme relative to the autumn forecast[3].

The programme indicates that upside risks to the medium-term growth outlook relate to the policy measures taken so far to support the economy. On the downside, the programme acknowledges that labour market conditions could prove to be worse than expected and thus dampen private consumption. In addition to the risks indicated in the programme, uncertainties surround Malta's ability to benefit from the global upturn. The private sector needs to respond flexibly to the erosion of competitiveness witnessed in recent years and to the likely modifications in global demand for Malta's products. As a result, against the background of the projected recovery of world trade, exports might remain more subdued than currently anticipated.

4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

4.1. Budgetary implementation in 2009

In the programme the 2009 deficit outcome is estimated at 3.8% of GDP, i.e. significantly better than the 4.5% put forward in the Commission services' autumn forecast. The main differences with the autumn forecast reflect (i) 0.3 pp. of GDP higher

[3] In the programme, net lending by domestic sectors in the 2009-2012 forecast period does not add up to net lending by the total economy.

revenue, mainly due to higher income taxes from international companies registered in Malta, and (ii) 0.4 pp. of GDP lower expenditure related to less dynamic government consumption (both compensation of employees and intermediate consumption). However, even at 3.8% of GDP the deficit outturn would be much higher than the 1.5% deficit planned for 2009 in the previous programme. The latter already incorporated the budgetary impact of the stimulus measures adopted by the Maltese authorities in line with the EERP (around 0.7% of GDP, excluding measures financed from EU funds), which was, according to the authorities, more than offset by compensating measures (of around 1.7% of GDP). The improvement compared to 2008, when the deficit peaked at 4.7% of GDP, must be seen against the background of some non-recurrent expenditure-increasing items incurred in that year[4]. The headline deficit excluding these items widened in 2009 because of the impact of the crisis in particular on indirect tax revenue. In the programme, the 2009 primary balance is estimated to have remained negative (-0.5% of GDP after -1.4% in 2008).

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new stability programme with the targets from the previous update of the programme. Differences between outcome and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the 'denominator effect') are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme update) and the impact of differences in the revenue / expenditure growth rate from the planned growth rates[5].

Part of the worse-than-planned outcome in 2009 is explained by the final deficit outturn in 2008. The latter turned out 1.4 pps of GDP higher than anticipated in the previous programme mainly because of slippages in current expenditure that are only marginally related to exceptional items. The rest of the difference between the estimated deficit outcome in 2009 and the plans in the previous update is due to different expenditure and revenue growth in 2009 than planned. The contraction in real GDP in 2009, estimated at 2% in the programme, as compared with positive real GDP growth of 2.2% projected in the previous programme, contributes importantly to this (in nominal terms, GDP growth was revised down from 4.4% to just 1%).

Regarding revenue developments in 2009, the programme anticipates a revenue-to-GDP ratio outturn slightly lower than planned in the previous programme, reflecting the worse outcome recorded in 2008, because its increase relative to 2008 (+1.1 pps of GDP) is in line with plans. Nevertheless, revenue composition would be significantly different than planned, as the crisis seems to have particularly affected indirect taxes, including taxes

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[4] According to the programme, exceptional expenditure (not included in the programme's one-offs) represented 1.9% of GDP in 2008 and 0.3 % of GDP in 2009. In 2008, 1.1% of GDP of this exceptional expenditure is related to the reclassification of Malta Shipyards Ltd into the general government sector (including the voluntary redundancy scheme for shipyards employees) and 0.8% to a temporary subsidy granted to the energy utility operator. The previous programme already incorporated the impact of these exceptional items (then estimated at 1.7% of GDP in 2008). In 2009, the 0.3% of GDP exceptional expenditure is mainly related to the final outlays for Malta Shipyards' workers.

[5] Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^o - \rho^p = \underbrace{\frac{1+r^p}{1+g^p}\Delta\rho_{-1}}_{\text{Base effect}} + \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta r}_{\text{Revenue growth effect}} - \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta g}_{\text{Denominator effect}} + \underbrace{\frac{\rho^o_{-1}\left(r^o g^p - r^p g^o\right)}{(1+g^o)(1+g^p)}}_{\text{Residual}}$$

where r is the growth rate of revenue and g is the growth rate of GDP. The subscript -1 refers to the previous year's value. Superscripts o and p refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

on property transactions. As a result, in the programme indirect taxes are projected to fall by around 1 pp. of GDP relative to 2008. On the other hand, the programme envisages a sizeable increase in direct taxes as a share of GDP (+1.7 pps relative to 2008). This is in part explained by the above-mentioned (unexpected) higher income taxes paid by international companies registered in Malta and the (already planned) higher revenues from the annual circulation tax on households' vehicles. In addition, a tax amnesty allowing income tax defaulters to pay their dues without fines (not foreseen in the budget for 2009 and therefore unbudgeted in the previous programme) is estimated in the programme to have yielded more than 0.2% of GDP. Overall, in the programme revenues are anticipated to have increased by around 4% in 2009 relative to 2008, whereas the increase budgeted in the previous programme was more than 7%, consistent with the downward revision to nominal GDP growth mentioned above.

Table 3: Budgetary implementation in 2009

	2008		2009	
	Planned **SP Dec 2008**	**Outcome** **SP Feb 2010**	**Planned** **SP Dec 2008**	**Outcome** **SP Feb 2010**
Government balance (% of GDP)	-3.3	-4.7	-1.5	-3.8
Difference compared to target [1]	-1.4		-2.3	
Difference excluding denominator effect [1,2]			**-2.1**	
Of which: due to a different starting position end 2008			-1.3	
due to different revenue / expenditure growth in 2009			-0.8	
p.m. Residual [3]			0.0	
p.m. Nominal GDP growth (planned and outcome)			*4.4*	*1.0*
Revenue (% of GDP)	40.6	40.2	41.7	41.4
Revenue surprise compared to target [1]	-0.4		-0.3	
Revenue surprise excluding denominator effect [1,2]			**-1.6**	
Of which: due to a different starting position end 2008			-0.4	
due to different revenue growth in 2009			-1.2	
p.m. Residual [3]			0.0	
p.m. Revenue growth rate (planned and outcome)			*7.2*	*4.1*
Expenditure (% of GDP)	43.9	44.8	43.2	45.2
Expenditure surprise compared to target [1]	-0.9		-2.0	
Expenditure surprise excluding denominator effect [1,2]			**-0.6**	
Of which: due to different starting position end 2008			-0.9	
due to different expenditure growth rate in 2009			0.4	
p.m. Residual [3]			0.0	
p.m. Expenditure growth rate (planned and outcome)			2.7	1.8

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they usually largely cancel against each other.

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source: Commission services

In the programme, the expenditure ratio is anticipated to have increased by 0.4 pp. in 2009 relative to 2008, compared with the 0.7 pp. fall projected in the previous programme. The denominator effect, i.e. the lower-than-projected growth of nominal GDP, would explain entirely this difference. At the same time, after the large expenditure overruns recorded in 2008, the annual expenditure growth rate now estimated for 2009 would be more moderate than planned in the previous programme (1.8% vs. 2.7%). However, excluding the effect of one-offs and exceptional items, the annual increase in expenditure for 2009 projected in the programme would be in the order of 5%. In current expenditure, slippages seem to have occurred in compensation of employees, which is

now estimated at 14.4% of GDP vs. 13% of GDP planned in the previous programme. Of this overall 1.4 pp. of GDP higher-than-planned outturn, 0.5 pp. is explained by lower GDP (i.e. denominator effect), whereas the impact of unforeseen outlays for Malta Shipyards' workers would explain another 0.3 pp. (see footnote 3). The rest, some 0.6 pp. of GDP, seems to be due to spending overruns for personnel in most ministries and in particular in the health care sector. On the other hand, social spending is now estimated to have been less dynamic than planned[6].

The structural balance, as recalculated by Commission services based on the information in the programme following the commonly agreed methodology, is projected to have improved by more than 1¾ pps of GDP in 2009, after a similar deterioration estimated for 2008. This compares with the ¾ pp. of GDP improvement in the Commission services' autumn forecast for the same year.

Information that has become available after the submission of the stability programme point to the possibility of a lower deficit outturn than estimated in the programme. In particular, preliminary national accounts data for the year 2009 suggest the possibility of lower expenditure (both public investment and government consumption), while proceeds from the tax amnesty mentioned above may turn out somewhat higher than expected[7].

Box 1: The excessive deficit procedure (EDP) for Malta

On 7 July 2009 the Council adopted a decision stating that Malta had an excessive deficit in accordance with Article 104(6) of the Treaty establishing the European Community. At the same time, the Council addressed a recommendation under Article 104(7) TEC specifying that the excessive deficit had to be corrected by 2010. On 16 February 2010 the Council, following a recommendation by the Commission, considered that action had been taken in accordance with the recommendations, but unexpected adverse economic events with major unfavourable consequences for government finances had occurred after the adoption of the recommendation, and issued a new recommendation under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU) to correct the deficit by 2011.

In particular, the Maltese authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner. Specifically, to this end, the Maltese authorities should achieve the 2010 deficit target set in the budget, if necessary by adopting additional consolidation measures, and ensure in 2011 a fiscal effort of ¾ pp. of GDP. This should also contribute to bringing the general government gross debt ratio back on a declining path that approaches the 60% of GDP reference value at a satisfactory pace by restoring an adequate level of the primary surplus. The Maltese authorities should also specify the measures that are necessary to achieve the correction of the excessive deficit by 2011, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected. In addition, the Maltese authorities should seize any opportunity beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the 60% of GDP reference value. To limit risks to the adjustment, the Maltese authorities should strengthen the binding nature of its medium-term budgetary framework and improve the monitoring of budget execution throughout the year.

The Council set the deadline of 16 August 2010 for the Maltese government to take effective action to achieve the 2010 deficit target and to outline the measures that will be necessary to progress towards the correction of the excessive deficit.

[6] In the previous programme, exceptional outlays related to the early retirement scheme for Malta Shipyards workers (1% of GDP) were included in the "social payments" item, whereas in the new programme they are classified as "compensation of employees" (see also footnote 3).

[7] The final proceeds of this amnesty are now estimated at 0.6% of GDP.

The Maltese authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared in 2010 and 2011.

4.2. The programme's budgetary strategy for 2010

According to the updated stability programme, fiscal policy in 2010 is aimed at broadly stabilising the deficit ratio in 2010 and, at the same time, providing support to the still uncertain economic recovery and to employment. The general government deficit is accordingly targeted at 3.9% in 2010, thus increasing by 0.1 pp. of GDP compared to the estimated deficit ratio for 2009. The increase in 2010 is projected to result from an increase of the expenditure ratio slightly higher than that in the revenue ratio. With an interest burden that is expected to be stable as a share of GDP, the primary deficit also deteriorates by 0.1pp, to 0.6% of GDP. Taken at face value, the budgetary strategy for 2010 as announced in the programme is in line with the Council EDP recommendation under Article 126(7), which asked to achieve the 2010 deficit target set in the budget of 3.9% of GDP.

The measures announced in the budget, summarised in Table 4, have a broadly neutral impact on the overall budgetary position (expenditure +0.3% of GDP, revenue +0.2%). The budget envisages both fiscal consolidation and additional stimulus measures.

The latter include measures to support businesses through a reserve fund for enterprise aid and incentives administered by Malta Enterprise (0.1% of GDP) as well as increased incentives for the tourism sector, including an extension of the scheme to attract international conferences (0.1% of GDP). Support to households' purchasing power is provided through compensation for utility tariffs (0.2% of GDP), the removal of credit card fees and an increase in childcare benefits. Other measures, mainly tax allowances, provide support to SMEs' in order to enhance investment, R&D and innovation (0.1% of GDP). The budget also announced measures aimed at improving the quality of public healthcare services (0.1% of GDP) with allocations devoted to reducing waiting lists and the expansion of the list of medicines provided by the national health service. Overall, the recovery measures planned for 2010 amount to around 0.7% of GDP. Additional support schemes financed with EU structural funds amounting to 0.5% of GDP are expected to be neutral for the budget. They are earmarked to improving micro credit conditions for SMEs, enhancing investment spending related to the environment and providing resources for the implementation of the extensive programme for jobs and youth.

Among consolidation measures, the non-replacement of employees in non-essential categories of the public sector is projected to curb expenditure by almost 0.2% of GDP in 2010. On the revenue side, the programme mainly comprises deficit-reducing measures, namely (i) enhanced tax enforcement, especially addressing evasion of excise on petroleum (0.2% of GDP) and (ii) the increase of excise duties on tobacco products and of the registration tax on commercial vehicles (0.1% of GDP). Also included in Table 4 is the measure already taken in the budget for 2009 but with effect from April 2010 on a contribution per night spent in paid accommodation (0.1% of GDP).

In the programme, total revenue is set to increase by 2.4 pps of GDP in 2010 (see Table 5), driven by (i) assumed tax buoyancy (+0.8 pp.); (ii) a rise in the "other" revenue item (+ 1.2 pps); and (iii) the impact of the discretionary tax measures and enhanced tax enforcement mentioned above (+0.4 pp.). Concerning "other" revenue, the budgeted increase is projected to be underpinned by the rise in EU structural funds under the 2007-

2013 financial framework[8]. Tax buoyancy is assumed to affect mainly indirect taxes, which are anticipated to rise by 0.9 pp. of GDP (i.e. twice the amount explained by discretionary measures and tax enforcement), but also direct taxes on income and wealth as a share of GDP are projected to rise by 0.2 pp (even as the 2009 base was boosted by the tax amnesty mentioned in Section 4.1). Social contributions are projected to remain stable as a share of GDP.

Table 4. Main budgetary measures for 2010

Revenue measures[1]	Expenditure measures[2]
• Strengthening of enforcement, targeted against evasion of excise levy on petroleum (0.2% of GDP) • Increase of excise duty on cigarettes and other tobacco products and registration tax on commercial vehicles (0.1% of GDP) • Contribution per night spent in paid accommodation (0.1% of GDP)*	• Incentives to industry and enterprise (0.1% of GDP) • Measures for the promotion of the tourism industry (0.1% of GDP) • Compensation for utility tariffs granted to households (0.2% of GDP) • Measures to support investment (0.1% of GDP) • Measures towards improved healthcare services (0.1% of GDP) • Restrictions on recruitment of public sector employees (-0.2% of GDP)

Notes:

[1] Estimated impact on general government revenue
[2] Estimated impact on general government expenditure
[*] Measure taken in the budget for 2009 with effect from April 2010

Source: Commission services and 2010 budget

The expenditure-to-GDP ratio is projected to rise by 2.5 pps compared to 2009 essentially because of higher investment and the rise in the "other" expenditure item. More specifically, gross fixed capital formation is projected to increase by 1.1 pps of GDP in 2010 as a result of higher outlays following the implementation of investment projects financed with EU structural funds. As mentioned above, a fraction of the EU structural funds is also used to finance temporary measures targeted to support SMEs through capital transfers specifically earmarked to facilitate investment. In this context, the "other" expenditure item is set to substantially increase as a share of GDP in 2010 (by 1.7 pps), only a small part of which is explained by the above-mentioned budget measures supporting households' income and the tourism sector, both of which should be temporary. Intermediate consumption as a share of GDP is expected to rise marginally (+0.1 pp. compared to 2009), reflecting the temporary budget measures to support the labour market and improve healthcare services. The share of social payments in GDP is anticipated to rise as well (+0.2 pp.) because of the strong projected growth rate of pension expenditure (5.1%). On the other hand, subsidies are projected to marginally

[8] As there is a counter-entry on the expenditure side of similar size, they are expected to have a broadly neutral impact on the government balance.

decline (around -0.1 pp. of GDP) mainly as a result of the implementation of the public transport reform. According to the programme, the ratio of compensation of employees is anticipated to decrease by 0.5 pp. of GDP in 2010, primarily thanks to a favourable base effect (outlays in 2009 for Malta Shipyards' workers, see footnote 3). The programme states that in the absence of this exceptional item compensation of employees would have remained stable as a share of GDP compared to 2009, thus implying an underlying annual growth of around 3.5%, i.e. much more than projected inflation and remarkably high in view of the budget measure to restrict hiring of employees in non-essential services.

According to the programme, one-off measures for 2010 are projected to amount to 0.2% of GDP, up from 0.1% in 2009. These one-offs consist of the deficit-reducing proceeds from the sale of government property.

After the significant improvement projected in 2009 (1¾ pps of GDP), the structural balance, as recalculated by Commission services based on the information in the programme following the commonly agreed methodology, is set to worsen by ¼ pp. of GDP in 2010, pointing to a broadly neutral fiscal stance. Hence, the overall improvement in the structural balance projected for the period 2009-2010 is of 1½ pp. of GDP.

4.3. The programme's medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with the one in the previous update - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

The programme plans to correct the excessive deficit in 2011, in line with the revised EDP recommendation under Article 126(7) issued by the Council on 16 February 2010 (see Box 1). The headline deficit is projected to reach 2.9% of GDP in 2011, i.e. 1 pp. of GDP below the level targeted for 2010, and to broadly stabilise at 2.8% of GDP in 2012.

Box 2: The medium-term objective (MTO) for Malta

As noted in the Code of Conduct[9], the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically-adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

Specifically, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

[9] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council on 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

As communicated by the authorities, the MTO of Malta is a balanced position in structural terms. In view of the new methodology and given the most recent projections and debt level, the MTO reflects the objectives of the Pact.

The structural balance, as recalculated by Commission services based on the information in the programme following the commonly agreed methodology, is set to improve by ¾ pp. of GDP in 2011; taken at face value, this is in line with the revised EDP recommendation. However, the structural balance is projected to worsen again in 2012 (by ½ pp. of GDP). Hence, after the correction of the excessive deficit, the programme plans the structural balance to move further away from, instead of making progress towards, the medium-term objective (MTO) of a balanced position in structural terms (see Box 2). The programme does not mention a target year for achieving the MTO.

Table 5: Composition of the budgetary adjustment

(% of GDP)	2008	2009		2010		2011		2012	Change: 2009-2012
	COM	COM	SP	COM[1]	SP	COM[1]	SP	SP	SP
Revenue	**40.3**	**41.2**	**41.4**	**41.9**	**43.8**	**42.1**	**43.3**	**42.5**	**1.1**
of which:									
- Taxes on production and imports	14.6	14.5	13.7	14.4	14.6	14.5	14.3	13.9	0.2
- Current taxes on income, wealth, etc.	13.1	13.8	14.8	14.7	15.0	14.9	15.2	15.2	0.3
- Social contributions	7.6	7.6	7.6	7.6	7.6	7.5	7.6	7.5	-0.1
- Other (residual)	5.0	5.3	5.3	5.2	6.5	5.2	6.2	5.9	0.6
Expenditure	**45.0**	**45.7**	**45.2**	**46.3**	**47.7**	**46.4**	**46.3**	**45.3**	**0.1**
of which:									
- Primary expenditure	41.7	42.4	41.9	43.1	44.4	43.1	43.0	42.1	0.2
of which:									
Compensation of employees	14.6	14.7	14.4	14.8	13.9	14.6	13.6	13.3	-1.1
Intermediate consumption	6.7	7.0	6.8	7.0	6.9	7.2	6.5	6.2	-0.7
Social payments	13.3	14.2	14.0	14.5	14.2	14.6	14.1	14.1	0.0
Subsidies	2.1	1.3	1.3	1.3	1.1	1.2	1.1	1.0	-0.3
Gross fixed capital formation	2.5	3.3	3.5	3.4	4.6	3.4	4.4	4.2	0.8
Other (residual)	2.3	2.0	1.9	2.1	3.6	2.1	3.3	3.3	1.4
- Interest expenditure	3.3	3.3	3.3	3.2	3.3	3.3	3.3	3.2	-0.1
General government balance (GGB)	**-4.7**	**-4.5**	**-3.8**	**-4.4**	**-3.9**	**-4.3**	**-2.9**	**-2.8**	**1.0**
Primary balance	**-1.4**	**-1.2**	**-0.5**	**-1.2**	**-0.6**	**-1.0**	**0.3**	**0.4**	**0.9**
One-off and other temporary measures	-0.4	0.2	0.1	0.0	0.2	0.0	0.1	0.1	0.0
GGB excl. one-offs	**-4.3**	**-4.7**	**-3.8**	**-4.4**	**-4.1**	**-4.3**	**-3.0**	**-2.8**	**1.0**
Output gap[2]	2.0	-1.0	-1.8	-0.9	-1.7	0.1	-0.6	1.3	3.1
Cyclically-adjusted balance[2]	-5.4	-4.2	-3.1	-4.1	-3.3	-4.4	-2.7	-3.3	-0.1
Structural balance[3]	**-5.0**	**-4.3**	**-3.2**	**-4.1**	**-3.5**	**-4.4**	**-2.8**	**-3.3**	**-0.1**
Change in structural balance		*0.7*	*1.8*	*0.2*	*-0.3*	*-0.2*	*0.7*	*-0.5*	
Structural primary balance[3]	-1.7	-1.0	0.1	-0.9	-0.2	-1.0	0.5	-0.2	-0.2
Change in structural primary balance		*0.7*	*1.8*	*0.1*	*-0.3*	*-0.1*	*0.7*	*-0.6*	

Notes:

[1]On a no-policy-change basis, and on a pre-budget basis.

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

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

Source:

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

In the programme, the planned 1 pp. of GDP reduction in the headline deficit in 2011 is achieved thanks to a reduction in the expenditure ratio by 1.5 pps relative to 2010, which would more than offset the projected 0.5 pp. fall in the revenue ratio. The latter is not related to concrete measures, but seems to be explained by a negative contribution from tax revenue buoyancy and enforcement (after the very high contribution expected in

2010) and a reduction in "other" revenue. For the rest, revenues are expected to follow the developments of the related tax bases. As a result, overall revenue growth in 2011 is projected at 3.9% mainly thanks to the favourable nominal GDP growth assumption (5%). Expenditure restraint is due to the projected moderation in annual expenditure growth (1.8%, after 9.3% in 2010) combined with the assumed favourable nominal GDP growth (denominator effect). Table 5 shows that all expenditure components (bar subsidies and interest expenditure) contribute to the cut in the expenditure ratio. In terms of growth rates, compensation of employees is planned to increase by 2.7% (above the 2% projected HICP inflation), while intermediate consumption is set to fall by around 2%. In addition, public investment growth is planned to decelerate markedly (only +0.6% after +39% in 2010) and the "other" expenditure item is set to fall. Social transfers other than in kind are, on the other hand, projected to continue increasing at an annual rate of around 5%.

The planned near-stabilisation of the headline deficit ratio in 2012 is the result of the projected fall in both the revenue and the expenditure ratios (-0.9 pp. and -1pp. respectively). At 2.9%, projected revenue growth is significantly more moderate than the assumed nominal GDP growth (5%), implying at first sight cautious assumptions about tax elasticities. In particular, indirect taxes are projected to rise by only 1.8%, whereas nominal consumption - the relevant tax base – is assumed to increase by around 4.5% relative to 2011. "Other" revenue is also targeted to post another fall as a share of GDP. The annual increase in expenditure is planned at 2.7%, mainly driven by the further increase in compensation of employees (2.8%) and the steady rise in social transfers other than in kind (4.7%). On the other hand, public investment is projected to remain broadly stable as a share of GDP.

Overall, the 1 pp. of GDP reduction in the headline deficit in 2011 to achieve the 2.9% of GDP target and the broad stabilisation of the deficit in 2012, together implying a 2½ pps cut in the expenditure ratio over the two years, do not seem to be sufficiently underpinned by concrete measures. In this context, the withdrawal of the temporary stimulus measures adopted for 2010 is projected to reduce expenditure by just 0.4 pp. of GDP in 2011. In addition, the programme mentions that hiring restrictions in the public sector would remain in place throughout the programme period, while the government remains "committed to contain the growth of intermediate consumption". The strong dynamics of social transfers, owing mainly to pensions, would be somewhat counteracted by provisions to curtail benefit fraud, but no details or quantifications are provided. The programme states that the government relies on the assumed pick-up in economic growth to adopt the "aggressive" consolidation stance needed to achieve the planned budgetary target for 2011.

4.4. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2011, Table 5 compares the detailed revenue and expenditure projections in the Commission services' autumn 2009 forecast, which are derived under a no-policy change scenario (and elaborated on a pre-budget basis), with those in the updated programme. Although the assessment uses the Commission services' forecast as a benchmark, it also takes explicitly into account all available information about more recent developments.

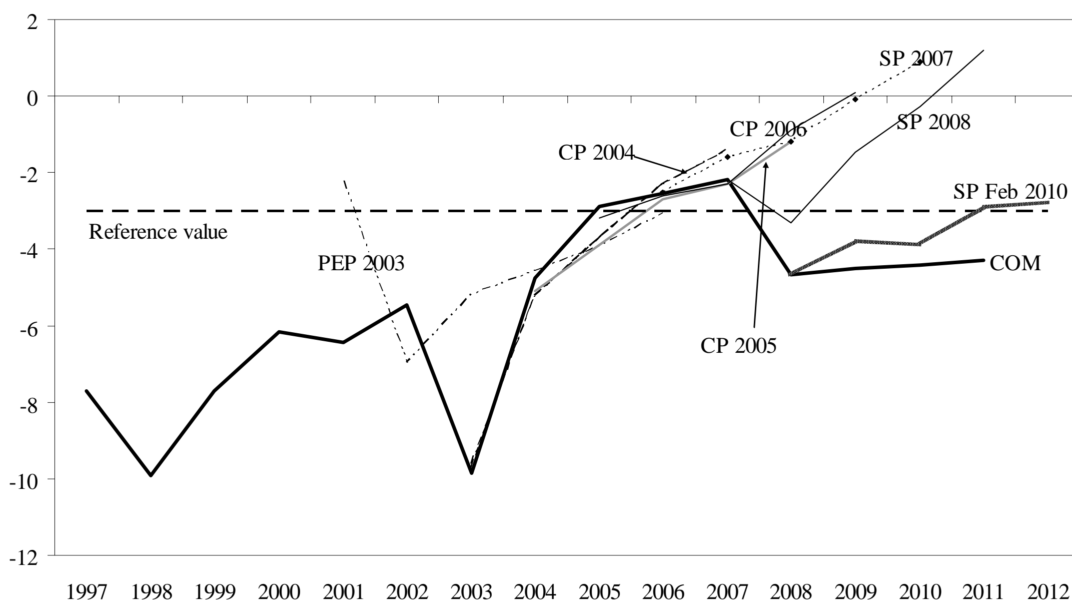
The following risk factors are relevant in the assessment of the Maltese stability programme update.

First, as mentioned in Section 3 above, assessed against currently available information, the increase in domestic demand seems to be on the high side in 2010 and, regarding

2011 and 2012, the programme's macroeconomic assumptions appear favourable. Hence, the programme's macroeconomic scenario, especially for the outer years of the programme, does not appear to be a cautious base for budgetary plans. This translates into a risk that the budgetary outcomes will be worse than targeted in the programme.

Second, the Commission services' forecast projected a near-stabilisation of the deficit ratio in 2010 on a pre-budget basis. With the total impact of measures taking effect in 2010 planned to be broadly neutral (see Section 4.2 above), an adjustment to the Commission services' forecast post-budget might be expected to confirm the projected near-stabilisation of the deficit ratio. However, tax revenue buoyancy and enhanced tax compliance are expected in the programme to generate some 1% of GDP, which must be considered as relatively uncertain sources of revenue. The budgeted sizeable increase in the tax ratio in 2010 (from a level boosted by the one-off tax amnesty in 2009) thus seems optimistic, based on an assumed higher tax-intensity of economic activity than foreseen in the Commission services' autumn projections on a pre-budget basis, especially for indirect taxes. While the tax revenue ratio is planned to moderate somewhat over the remainder of the programme horizon, reflecting low tax elasticities in a favourable macroeconomic context (see Section 4.3), a sizeable gap with the Commission services' forecast remains in 2011. The budgeted rise in the tax ratio in 2010 thus represents a risk to the programme's tax projections throughout the period.

Figure 1: Government balance projections in successive programmes (% of GDP)



Source: Commission services' autumn 2009 forecast (COM) and successive stability (SP) /convergence (CP) programmes

Third, while also for 2011 the Commission services' forecast projected a near-stabilisation of the deficit ratio on a pre-budget basis, the programme plans a significant narrowing, to below 3% of GDP. As argued in Section 4.3 above, however, the scale of this adjustment is insufficiently underpinned by concrete measures. The same applies to the planned stabilisation of the deficit ratio and implied further cut in the expenditure ratio in 2012.

Fourth, although over the period 2004-2007 expenditure outturns have been below budgeted amounts, the more recent track record points to a risk of expenditure overruns, linked also to the weaknesses in the budgetary framework at execution stage (see Section

6.1 below). This risk applies throughout the programme period and seems especially pronounced for the outer years as the primary expenditure ratio is planned to be cut by more than 2 pps of GDP between 2010 and 2012. Slippages have occurred in recent years in the public sector wage bill, which is planned to make a sustained contribution to expenditure containment throughout the programme period based on restrictions on recruitment. Additional pressures could arise from the renewal of the public sector wage agreement expected in the course of 2011 and the possible demonstration effects from the recently concluded agreements in the health and education segments of the public sector. Achieving the envisaged restraint in intermediate consumption after 2010 might also be difficult given recent slippages in outlays on healthcare (medicines).

Overall, budgetary outcomes could be worse than targeted in the programme from 2010 onwards. It is noted that, for 2010, the programme states that "close monitoring of emerging developments in revenue and expenditure components will be made and additional measures will be adopted as necessary".

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

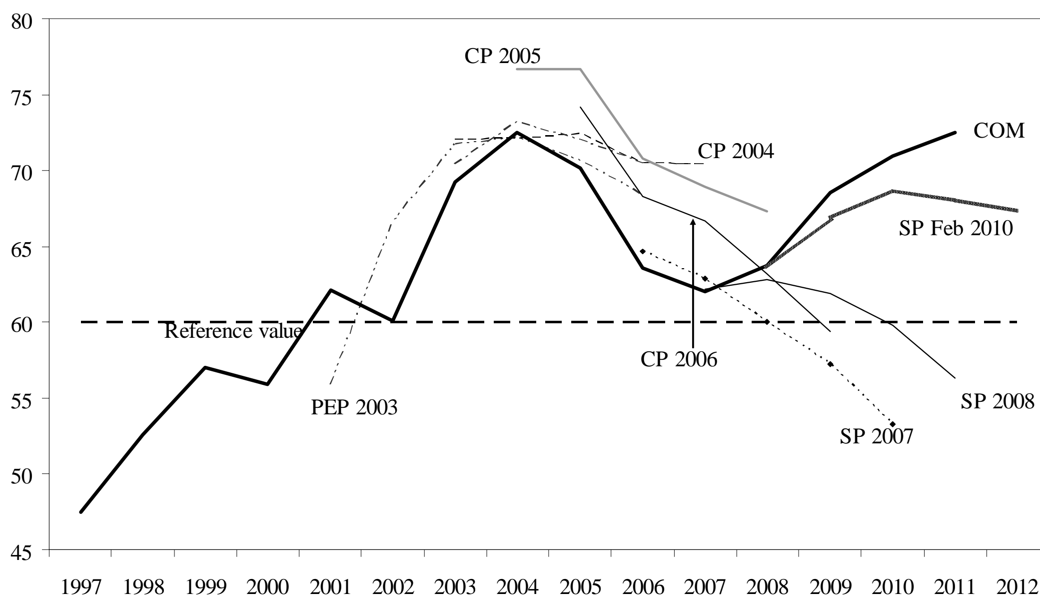
This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

Figure 2 shows that the gross government debt ratio has remained above the 60% of GDP reference value since 2001.

Figure 2: Debt projections in successive programmes (% of GDP)



Source: Commission services' autumn 2009 forecast (COM) and successive stability (SP) / convergence (CP) programmes

From a peak of 72.5% in 2004, the debt ratio declined by more than 10 pps over 3 years, reaching 62% in 2007, also thanks to sizeable privatisation proceeds. It started increasing again in 2008 mainly because of the deteriorating budgetary position, with a large debt-increasing contribution provided by the primary deficit. In the programme, the debt ratio is estimated to have increased further in 2009 (by 3 pps) to around 67% of GDP. This increase is mainly driven by the relatively large "snow-ball" effect due to the real GDP contraction. The estimated 0.5% of GDP primary deficit further increased the debt. The Commission services' autumn 2009 forecast shows an even higher increase in the debt ratio in 2009 (by more than 4.5 pps). This is because the debt-increasing contributions of both the primary deficit and the "snow-ball" effect are higher (see Table 6), with the latter mainly related to lower growth in the GDP deflator assumed in the autumn forecast.

In the programme, the debt ratio is projected to increase further in 2010 (by 1.8 pps), as the debt-reducing contribution from the return to positive real GDP growth is moderate so that the "snow-ball" effect remains significantly debt-increasing. In addition, no improvement is planned in the primary deficit. By contrast, in 2011 and 2012 the programme's assumed economic recovery entails a neutral "snow-ball" effect. This, together with the planned small primary surpluses in these two years, entails some decline in the debt ratio in both years, also supported by a slightly negative stock-flow adjustment. Debt would be at some 67% of GDP at the end of the programme period, still above the reference value.

Table 6: Debt dynamics

(% of GDP)	average 2003-07	2008	2009		2010		2011		2012
			COM	SP	COM	SP	COM	SP	SP
Gross debt ratio[1]	**67.5**	**63.8**	**68.5**	**66.8**	**70.9**	**68.6**	**72.5**	**68.0**	**67.3**
Change in the ratio	0.4	1.7	4.7	3.0	2.4	1.8	1.6	-0.6	-0.7
Contributions[2]:									
1. Primary balance	**0.9**	**1.4**	**1.2**	**0.5**	**1.2**	**0.6**	**1.0**	**-0.3**	**-0.4**
2. "Snow-ball" effect	**0.4**	**0.7**	**3.5**	**2.6**	**1.2**	**1.1**	**0.6**	**0.0**	**0.0**
Of which:									
Interest expenditure	3.5	3.3	3.3	3.3	3.2	3.3	3.3	3.3	3.2
Growth effect	-1.5	-1.3	1.4	1.3	-0.5	-0.7	-1.1	-1.5	-1.9
Inflation effect	-1.6	-1.3	-1.2	-1.9	-1.5	-1.5	-1.6	-1.7	-1.3
3. Stock-flow adjustment	**-0.9**	**-0.3**	**0.0**	**-0.1**	**0.0**	**0.1**	**0.0**	**-0.3**	**-0.2**
Of which:									
Cash/accruals diff.	-0.6	0.8	0.0	n.a.	0.0	n.a.	0.0	n.a.	n.a.
Acc. financial assets	-0.2	-1.5	0.0	n.a.	0.0	n.a.	0.0	n.a.	n.a.
Privatisation	-1.1	-0.1	0.0	n.a.	0.0	n.a.	0.0	n.a.	n.a.
Val. effect & residual	0.0	0.4	0.0	n.a.	0.0	n.a.	0.0	n.a.	n.a.

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:
Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

5.1.2. Assessment

The stabilisation of the primary deficit ratio between 2009 and 2010 in the Commission services' autumn 2009 forecast (based on a no-policy-change and pre-budget scenario) at a higher level than foreseen in the programme explains the larger increase in the debt ratio relative to the programme. The achievement of the 2010 deficit target set in the

budget for 2010, in line with the revised EDP recommendation (see Box 1), appears thus essential to curb the rise in the debt ratio this year.

In 2011, the Commission services' forecast entails a further large increase in the debt ratio, whereas a slight decline is projected in the programme. More specifically, the primary deficit in the autumn forecast increases the debt ratio by 1 pp., while the programme plans a 0.3% of GDP primary surplus (i.e. debt-decreasing). Moreover, more cautious real GDP growth in the autumn forecast implies a debt-increasing "snow-ball" effect (0.6 pp. of GDP), which compares with the zero "snow-ball" effect projected in the programme.

The same risks highlighted in Section 4.4 for the budgetary targets apply to the programme's projections for the debt ratio, so that the evolution of debt is likely to be less favourable than projected in the programme. In particular, the programme's favourable economic growth assumptions for 2011 and 2012 (see Section 3) not only help to achieve the planned small primary surpluses (i.e. debt-reducing) but also imply more favourable "snow-ball" effects.

5.2. Long-term debt projections and the sustainability of public finances

5.2.1. Long-term debt projections and the sustainability of public finances

This section presents sustainability indicators based on long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology[10].

Table 7 shows that age-related spending is projected to increase by 9.2 pps of GDP between 2010 and 2060, significantly higher than the EU average (4.6 pps). Sustainability indicators for two scenarios are presented in Table 8. The '2009 scenario' is based on a no-policy-change assumption and the 2009 structural primary balance as a starting point, while the 'programme scenario' takes into account the consolidation planned in the programme up to 2012 and is based on the projected 2012 structural primary balance as a starting position.

Table 7: Long-term age-related expenditure: main projections

(% of GDP)	**2007**	**2010**	**2020**	**2030**	**2040**	**2060**	**Change 2010-60**
Total age-related spending	**18.2**	**19.2**	**20.5**	**21.7**	**23.8**	**28.4**	**9.2**
- Pensions	7.2	8.3	9.3	9.3	10.5	13.4	5.1
- Healthcare	4.7	4.9	5.6	6.4	7.2	8.0	3.1
- Long-term care	1.0	1.0	1.2	1.6	2.0	2.6	1.6
- Education and unemployment benefits	5.3	5.0	4.3	4.2	4.1	4.3	-0.7
Property income received	1.4	1.3	1.3	1.2	1.2	1.2	-0.1

Source: Economic Policy Committee and Commission services.

Including the impact of age-related expenditure and assuming that the structural primary balance remained at its 2009 level, the sustainability gap (S2)[11] would amount to 6.4% of

[10] Economic Policy Committee and European Commission (2009), '2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (2008-60)', *European Economy* No. 2/2009. European Commission (2009), 'Sustainability Report 2009, European Economy No. 9/2009. European Commission (2008), 'Public finances in EMU – 2008', *European Economy* No. 4/2008.

GDP, about 5½ pps more than in last year's assessment, which is due to both a lower estimated structural primary balance in the starting year and a higher rise in age-related expenditure in the 2009 projections. The starting budgetary position is not sufficient to stabilise the debt ratio over the long term and entails a risk of unsustainable public finances even before considering the long-term budgetary impact of ageing.

The 'programme scenario' is based on the structural primary balance at the end-of-programme, which is slightly worse than in 2009. This scenario shows an increased gap, indicating increased risks to long-term sustainability of public finances.

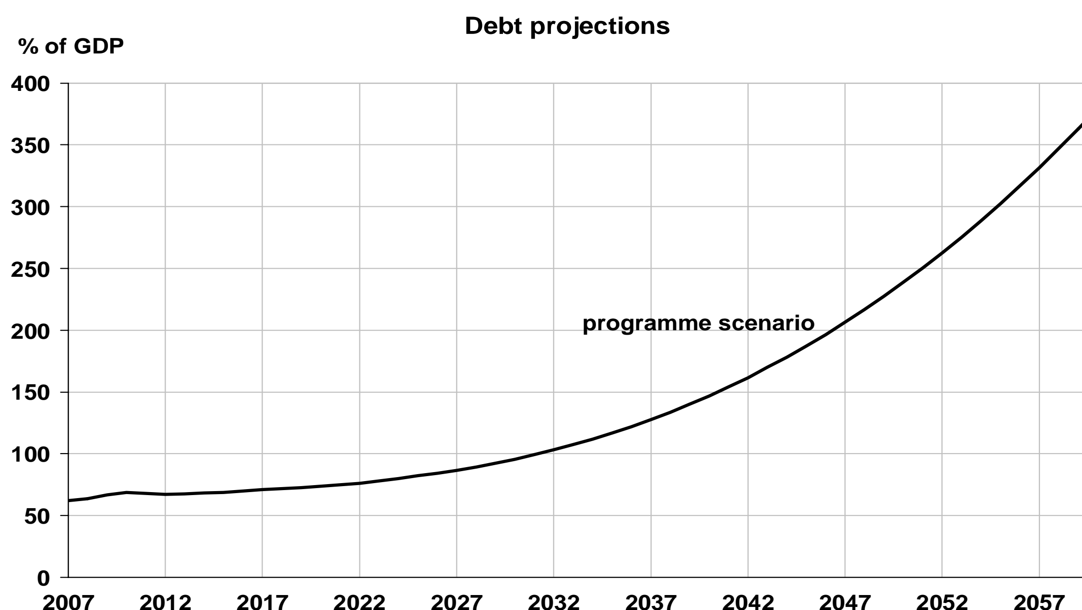
Table 8: Sustainability indicators and the required primary balance

	2009 scenario			Programme scenario		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	4.0	6.4	6.1	4.3	6.6	6.1
of which:						
Initial budgetary position (IBP)	0.9	1.1	-	1.1	1.3	-
Debt requirement in 2060 (DR)	0.1	-	-	0.1	-	-
Long-term change in the primary balance (LTC)	3.1	5.3	-	3.1	5.3	-

Source: Commission services.

Based on the assumptions used in the projection of age-related expenditure and the calculation of the sustainability indicators, Figure 3 displays the long-term projection for the debt ratio.

Figure 3: Long-term projections for the government debt ratio



Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.
Source: Commission services.

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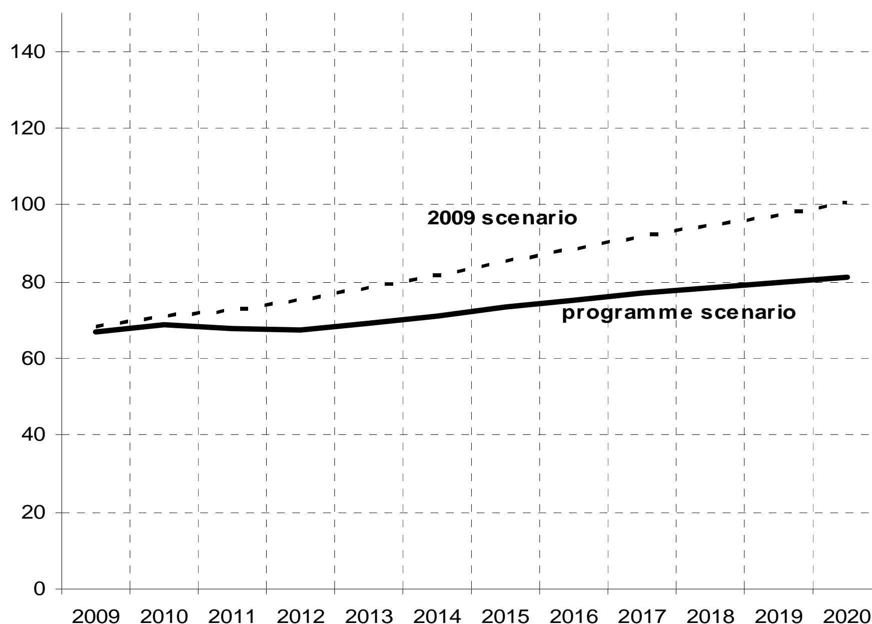
[11] The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

Medium-term debt projections until 2020 that assume GDP growth rates will only gradually recover to the values projected before the crisis and tax ratios will return to pre-crisis levels as presented in the Commission services' autumn 2009 forecast publication[12] are shown in Figure 4. The budgetary strategy laid down in the programme for the period until 2012, taken at face value, would not be enough to stabilise the debt ratio by 2020.

Figure 4: Medium-term projections for the government debt ratio



Source: Commission services.

5.2.2. Additional factors

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account. As shown in Table 9, none of these factors have an effect on the overall assessment of Malta.

An ongoing review of the pension system in Malta has been provided for in the 2006 pension reform. The programme announces that, in the course of 2010, the first such report ("reviewing the state of pensions in Malta together with recommendations for achieving further adequacy, sustainability and social solidarity") will be submitted to parliament.

5.2.3. Assessment

The long-term budgetary impact of ageing in Malta is significantly higher than the EU average. The budgetary position in 2009 as estimated in the programme compounds the budgetary impact of population ageing on the sustainability gap. Ensuring high primary surpluses over the medium term and implementing reform measures that curb the projected increase in age-related expenditure would contribute to reducing the high risks to the sustainability of public finances. Medium-term debt projections until 2020 that

[12] Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009. This economic scenario assumes that the output gap caused by the crisis will be closed by 2017.

assume GDP growth rates will only gradually recover to the values projected before the crisis and tax ratios will return to pre-crisis levels show that the budgetary strategy laid down in the programme for the period until 2012, taken at face value, would not be enough to stabilise the debt ratio by 2020.

Table 9: Additional factors for the assessment of long-term sustainability risks

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2011 in COM Autumn 2009 forecast	na
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	na
Difference between S1 and S2	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability.
'na': not applicable.

Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".

An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.

Source: Commission services.

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES

6.1. Fiscal framework

As discussed in Section 4.4, although over the period 2004-2007 expenditure outturns in Malta have been below budgeted amounts, the more recent track record is characterised by expenditure overruns. Slippages have occurred in particular in the public sector wage bill, which is planned to make a substantial contribution to expenditure containment over the programme period, and in outlays on health care, particularly medicines.

Such expenditure overruns are related to some important weaknesses in Malta's fiscal framework[13]. A key weakness concerns the absence of binding expenditure ceilings, which is reflected in Malta's very low score in the Commission services' database on fiscal frameworks for the 27 EU countries[14] with respect to the strength and quality of national fiscal rules. Also budgetary execution shows shortcomings, as intra-year monitoring of adherence to the budgetary targets included in the budget is not accompanied by corrective action in case of deviations from the targets, the Government has the authority to increase/reduce spending even after the budget has been approved by the Parliament and the multi-year expenditure targets are revised annually and might be substantially changed in subsequent budgets. There is no independent institution

[13] An invitation to strengthen the domestic fiscal framework was issued by the Council in its opinion on the previous stability programme, as also recalled in the revised recommendation under Article 126(7) of 16 February 2010.

[14] See DG Ecfin database on fiscal governance at: http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/index_en.htm , and for a discussion of this database, see Public Finances in EMU 2009, chapter II.4, available at: http://ec.europa.eu/economy_finance/publications/publication15390_en.pdf.

involved in the formulation of the macroeconomic assumptions underlying the budgetary projections and in the budgetary process. Finally, there is scope for improvement in the accounting system.

The programme acknowledges the importance of strong fiscal governance as a condition for ensuring the achievement of sound and sustainable public finances and that this is particularly relevant in the current juncture "when space for fiscal manoeuvre is limited". According to the programme, the government is actively looking into ways to improve the fiscal institutional framework. To this purpose, it has sought the expert technical advice of international institutions with practical experience in the design, implementation and reform of national fiscal frameworks. Improvements introduced so far are relatively limited in scope. They concern the administration of the provision of public services and the management methods in public administration. The introduction of the Public Administration Act and its enactment in 2009 is expected to lead to an improvement in the legal and administrative framework for fiscal management. It is also planned to introduce a new accounting system for Government.

6.2. Quality of public finances

There appears to be scope for improving public spending efficiency in Malta, particularly in the areas of education, health, R&D, public infrastructure and general services. In particular, the findings of a recent study[15] show that education expenditure in Malta is inefficient at the tertiary level and that a more efficient transformation of spending into tertiary educational output could result in higher attainment levels. The study also confirms that the efficiency of health care spending in Malta is low since the same level of output could be attained with lower outlays.

Increasing spending efficiency becomes particularly important when trying to contain expenditure growth without compromising the level of services provided. Success in the effort of containing growth of expenditure while increasing its efficiency would allow reallocating resources towards growth-enhancing expenditure categories, thereby supporting Malta's growth potential, and increase the effectiveness of the fiscal policy instrument to respond to changing macroeconomic circumstances. The expenditure cuts envisaged in the programme, particularly in the area of compensation of employees and intermediate consumption, are generally intended to rationalise expenditure without affecting the level and quality of services provided, but this will be challenging to achieve.

In view of the recent experience whereby companies facing liquidity problems could delay payment of tax dues, tax compliance and enforcement should be enhanced. The programme confirms the government's commitment to intensify efforts to fight tax evasion and abuse in social transfer claims. Regarding the former, it intends to continue fighting evasion of indirect taxes (excise levy on petroleum and the illegal importation of cigarettes and alcohol) and strengthen coordination between tax collecting agencies, particularly as regards the settlement of tax refunds. A reform of the single means-testing mechanism and changes in the organisation of the relevant administrative units should help tackle benefit fraud.

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[15] I. Ebejer. and U. Mandl (2009), 'The efficiency of public expenditure in Malta', *ECFIN Country Focus*, Vol. 6 Issue 2. (Brussels: European Commission).

7. OVERALL ASSESSMENT

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the Council recommendations under Article 126(7) of 16 February 2010 with a view to correcting the excessive deficit and the budgetary objectives of the Stability and Growth Pact, against the background of the current economic situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

As mentioned in Sections 4.2 and 4.3 above, the budgetary strategy for 2010-2011 laid down in the programme taken at face value can be regarded as in line with the Council's EDP recommendations. However, the deficit outcomes could turn out worse than projected in the programme. In particular, the macroeconomic scenario underlying the budgetary projections appears favourable, especially after 2010. The expected contribution from tax buoyancy and enhanced tax compliance to the budgeted increase in the tax ratio in 2010 seems optimistic and represents a risk for the tax projections throughout the programme period. In addition, expenditure overruns cannot be excluded given recent slippages, the scale of the envisaged retrenchment and the lack of information on concrete measures underpinning the targeted cut in the spending ratio over the period 2010-2011. It is noted that, for 2010, the programme states that "close monitoring of emerging developments in revenue and expenditure components will be made and additional measures will be adopted as necessary".

Overall, in 2010 the budgetary strategy set out in the programme is broadly consistent with the Council recommendations under Article 126(7). However, in 2011, taking into account the risks to the deficit targets, the budgetary strategy may not be consistent with the Council recommendations. In particular, while the planned structural improvement amounts to the recommended ¾pp. of GDP, the consolidation plans for 2011 should be backed up by concrete measures and sufficiently strengthened to address the risks from less favourable GDP growth and revenue developments and from possible slippages on the expenditure side.

According to the programme, gross government debt is planned to peak at nearly 69% of GDP in 2010 and to decline marginally to 2012, mainly due to assumed strong nominal GDP growth and the planned return to a small primary surplus in the outer years of the programme period. Upward risks to the debt targets stem from the risks to the deficit targets spelled out above, while weaker-than-projected economic growth would have an additional unfavourable effect on debt via the denominator effect. Provided these risks are adequately addressed and the consolidation plans fully implemented, the budgetary strategy seems to be sufficient to bring the government debt ratio back on a declining path in 2011-2012, broadly in line with the Council recommendations.

For the outer year 2012, when growth is projected to be close to 3%, the programme envisages a move further away from the MTO rather than gradual progress towards its achievement, which is not in line with the requirements of the Stability and Growth Pact[16]. This conclusion is reinforced when considering that there are risks of a worse deficit outcome, owing to the assumed favourable macroeconomic scenario and the possibility of expenditure slippages, especially as concrete measures underlying the targeted further cut in the expenditure ratio in 2012 are not spelled out. The budgetary strategy after the correction of the excessive deficit therefore needs to be revised

[16] The Stability and Growth Pact requires Member States to make progress towards their MTO (for countries in the euro area or in ERM II, this has been quantified as an annual improvement in the structural balance of at least 0.5% of GDP as a benchmark). In addition, the structural adjustment should be higher in good times, whereas it may be more limited in bad times.

substantially in order to show a pace of consolidation towards the MTO in line with the Pact's requirements.

From a broader perspective, a more ambitious pace of consolidation than foreseen in the programme would also be warranted in view of the high risks to the long-term sustainability of the public finances from the expected change in age-related expenditure in the medium term and the high debt ratio. Measures to strengthen the intra-year monitoring of public finances as well as the medium-term budgetary framework (see also Section 6.1) could help contain the risks to the deficit targets mentioned above.

* * *

ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct), (iii) the follow-up to the Council's recommendation to report on progress made in the correction of the excessive deficit in a separate chapter of the programme; and (iv) other information requirements is concerned.

(i) Model structure

The programme update broadly adheres to the code of conduct model structure. The programme uses the broad section outline with subsections corresponding to the model structure.

(ii) Data requirements

As regards the code of conduct data requirements, all compulsory data have been provided (with the exception of one detail in Table 2 - General Government budgetary prospects: Social security funds).

Gaps in optional data remain as follows: Table 4 (decomposition of stock-flow adjustment; liquid financial assets and net financial debt). Figures for the following variables related to long-term sustainability of public finances are missing throughout the years: total expenditure, social security pension, occupational pensions, interest expenditure, total revenue, pension reserve fund assets.

The tables on the following pages show the data presented in the February 2010 update of the stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

(iii) Separate chapter on progress made in the correction of the excessive deficit

In its revised recommendations under Article 126(7) of 16 February 2010 with a view to bringing the excessive deficit situation to an end, the Council also invited Malta to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the stability programmes. Malta partly complied with this recommendation. In particular, the broad measures behind the 1 pp. of GDP budgetary consolidation needed to correct the excessive deficit by 2011 are not fully spelled out.

(iv) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

* * *

The SCP…	Yes	No	Comments
a. Involvement of parliament			
… mentions status vis-à-vis national parliament.	X		
… indicates whether Council opinion on previous programme has been presented to national parliament.		X	
b. Economic outlook			
… (for euro area and ERM II Member States) uses "common external assumptions" on main extra-EU variables.	X		
… explains significant divergences with Commission services' forecasts[1].		X	
… bears out possible upside/downside risks to economic outlook.	X		
… analyses outlook for sectoral balances and, especially for		X	

The SCP…	Yes	No	Comments
countries with high external deficit, external balance.			
c. Monetary/exchange rate policy			
… (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.			Not applicable
d. Budgetary strategy			
… presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
… (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.			Not applicable
… (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).	X		
… backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.	X		Only for 2010
… specifies state of implementation of measures.	X		
e. "Major structural reforms"			
… (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.			Not applicable
… includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.			Not applicable
f. Sensitivity analysis			
… includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	 X X X		 Not applicable
… (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.			Not applicable
g. Broad economic policy guidelines			
… provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.	X		
h. Quality of public finances			
… describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
i. Long-term sustainability			
… outlines strategies to ensure sustainability.	X		
… includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		
j. Other information (optional)			
… includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		

Notes: SCP = stability/convergence programme; CP = convergence programme
[1]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.

Source:
Commission services

Tables from Annex 2 of the code of conduct

Table 1a. Macroeconomic prospects

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	*4601.2*	2.1	-2.0	1.1	2.3	2.9
2. Nominal GDP	B1*g	*5702.7*	4.5	1.0	3.5	5.0	5.0
Components of real GDP							
3. Private consumption expenditure	P.3	*3043.7*	4.9	-0.8	1.5	2.4	2.4
4. Government consumption expenditure	P.3	*940.6*	12.6	0.2	-1.1	-1.9	-0.7
5. Gross fixed capital formation	P.51	*701.1*	-21.8	-16.7	8.5	6.0	4.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*155.1*	3.4	-0.8	-0.8	-0.8	-0.8
7. Exports of goods and services	P.6	*4046.4*	-5.4	-11.7	2.3	3.0	2.7
8. Imports of goods and services	P.7	*4285.7*	-5.8	-15.5	3.3	2.6	1.8
Contributions to real GDP growth							
9. Final domestic demand		-	1.2	-2.3	1.9	2.0	2.2
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.2	-4.2	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	0.7	4.4	-0.8	0.3	0.7

Table 1b. Price developments

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		*123.9*	2.4	3.0	2.4	2.7	2.1
2. Private consumption deflator		*118.1*	3.0	1.7	1.7	1.9	2.0
3. HICP[1]		*108.1*	4.7	1.8	1.7	2.0	2.0
4. Public consumption deflator		*129.3*	4.5	3.6	3.4	2.8	2.6
5. Investment deflator		*127.8*	5.0	1.9	3.5	3.4	2.8
6. Export price deflator (goods and services)		*114.9*	0.5	-2.1	0.4	1.3	1.6
7. Import price deflator (goods and services)		*112.8*	1.6	-3.4	0.4	0.7	1.6

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*163.4*	2.5	-0.4	0.2	0.7	0.9
2. Employment, hours worked[2]		*331336*	2.5	-0.4	0.2	0.7	0.9
3. Unemployment rate (%)[3]		*10.1*	5.9	7.1	7.4	7.2	6.7
4. Labour productivity, persons[4]		*28113*	-0.4	-1.6	0.9	1.7	2.0
5. Labour productivity, hours worked[5]		*13.9*	-0.4	-1.6	0.9	1.7	2.0
6. Compensation of employees	D.1	*2481.4*	5.8	2.1	1.0	3.2	3.8
7. Compensation per employee		*17251*	3.4	2.7	2.3	2.6	2.9

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2008	2009	2010	2011	2012
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-4.9	-1.1	-3.6	-2.2	-1.4
of which :						
- Balance on goods and services		-3.1	1.6	1.0	1.6	2.2
- Balance of primary incomes and transfers		-2.4	-3.2	-5.4	-4.8	-4.7
- Capital account		0.5	0.5	0.8	1.0	1.1
2. Net lending/borrowing of the private sector	B.9	-0.2	4.7	-0.4	1.3	2.1
3. Net lending/borrowing of general government	EDP B.9	-4.7	-3.8	-3.9	-2.9	-2.8
4. Statistical discrepancy		0.0	-2.0	0.8	-0.6	-0.7

Table 2. General government budgetary prospects

	ESA Code	2008 Level	2008 % of GDP	2009 % of GDP	2010 % of GDP	2011 % of GDP	2012 % of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	*-265.4*	-4.7	-3.8	-3.9	-2.9	-2.8
2. Central government	S.1311	*-265*	-4.6	-3.8	-3.9	-2.9	-2.8
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-0.3*	n.a.	n.a.	n.a.	n.a.	n.a.
5. Social security funds	S.1314	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
General government (S13)							
6. Total revenue	TR	*2291.5*	40.2	41.4	43.8	43.3	42.5
7. Total expenditure	TE[1]	*2556.9*	44.8	45.2	47.7	46.3	45.3
8. Net lending/borrowing	EDP B.9	*-265.4*	-4.7	-3.8	-3.9	-2.9	-2.8
9. Interest expenditure	EDP D.41	*187.7*	3.3	3.3	3.3	3.3	3.2
10. Primary balance[2]		*-77.6*	-1.4	-0.5	-0.6	0.3	0.4
11. One-off and other temporary measures[3]		*15.6*	0.3	0.1	0.2	0.1	0.1
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		*1588.1*	27.8	28.8	29.9	29.7	29.2
12a. Taxes on production and imports	D.2	*830.2*	14.6	13.7	14.6	14.3	13.9
12b. Current taxes on income, wealth, etc	D.5	*742.8*	13.0	14.8	15.0	15.2	15.2
12c. Capital taxes	D.91	*15.1*	0.3	0.2	0.2	0.2	0.2
13. Social contributions	D.61	*432*	7.6	7.6	7.6	7.6	7.5
14. Property income	D.4	*72.6*	1.3	1.2	1.0	0.9	0.9
15. Other[4]		*198.9*	3.5	3.9	5.3	5.1	4.8
16=6. Total revenue	TR	*2291.5*	40.2	41.4	43.8	43.3	42.5
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]		2047.5	35.9	37.0	38.0	37.8	37.3
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	*1214.6*	21.3	21.3	20.8	20.1	19.5
17a. Compensation of employees	D.1	*831.9*	14.6	14.4	13.9	13.6	13.3
17b. Intermediate consumption	P.2	*382.6*	6.7	6.8	6.9	6.5	6.2
18. Social payments (18=18a+18b)		*758*	13.3	14.0	14.2	14.1	14.1
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*31.7*	0.6	0.7	0.6	0.6	0.6
18b. Social transfers other than in kind	D.62	*726.3*	12.7	13.3	13.6	13.5	13.5
19=9. Interest expenditure	EDP D.41	*187.7*	3.3	3.3	3.3	3.3	3.2
20. Subsidies	D.3	*121.7*	2.1	1.3	1.1	1.1	1.0
21. Gross fixed capital formation	P.51	*141.9*	2.5	3.5	4.6	4.4	4.2
22. Other[6]		*133.1*	2.3	1.9	3.6	3.3	3.3
23=7. Total expenditure	TE[1]	*2556.9*	44.8	45.2	47.7	46.3	45.3
p.m.: Government consumption (nominal)	P.3	*1217.6*	21.4	22.0	21.7	20.8	20.2

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

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

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

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2007	2012
1. General public services	1	6.3	8.1
2. Defence	2	0.7	0.8
3. Public order and safety	3	1.5	1.7
4. Economic affairs	4	5.9	5.2
5. Environmental protection	5	1.5	1.4
6. Housing and community amenities	6	0.7	0.5
7. Health	7	5.8	5.7
8. Recreation, culture and religion	8	0.6	0.6
9. Education	9	5.4	6.3
10. Social protection	10	14.1	15.1
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	42.5	45.3

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	2008	2009	2010	2011	2012
1. Gross debt[1]		63.6	66.8	68.6	68.0	67.3
2. Change in gross debt ratio		1.7	3.2	1.8	-0.5	-0.7
Contributions to changes in gross debt						
3. Primary balance[2]		1.4	0.5	0.6	-0.3	-0.4
4. Interest expenditure[3]	EDP D.41	3.3	3.3	3.3	3.2	3.2
5. Stock-flow adjustment		-0.3	0.0	0.1	-0.2	-0.2
of which:						
- Differences between cash and accruals[4]		n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets[5]		n.a.	n.a.	n.a.	n.a.	n.a.
of which:						
- privatisation proceeds		n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other[6]		n.a.	n.a.	n.a.	n.a.	n.a.
p.m.: Implicit interest rate on debt[7]		5.6	5.2	5.1	5.0	4.9
Other relevant variables						
6. Liquid financial assets[8]		n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

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

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2008	2009	2010	2011	2012
1. Real GDP growth (%)		2.1	-2.0	1.1	2.3	2.9
2. Net lending of general government	EDP B.9	-4.7	-3.8	-3.9	-2.9	-2.8
3. Interest expenditure	EDP D.41	3.3	3.3	3.3	3.3	3.2
4. One-off and other temporary measures[1]		0.3	0.1	0.2	0.1	0.1
5. Potential GDP growth (%)		1.4	1.3	1.1	1.1	1.2
contributions:						
- labour		0.6	0.8	0.4	0.3	0.2
- capital		0.4	0.1	0.2	0.3	0.4
- total factor productivity		0.4	0.4	0.5	0.6	0.6
6. Output gap		1.2	-1.5	-1.6	-0.4	1.4
7. Cyclical budgetary component		0.4	-0.5	-0.6	-0.1	0.5
8. Cyclically-adjusted balance (2 - 7)		-5.1	-3.2	-3.4	-2.8	-3.3
9. Cyclically-adjusted primary balance (8 + 3)		-1.8	0.1	-0.1	0.5	-0.1
10. Structural balance (8 - 4)		-5.4	-3.3	-3.6	-2.9	-3.3

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

Table 6. Divergence from previous update

	ESA Code	2008	2009	2010	2011	2012
Real GDP growth (%)						
Previous update		2.8	2.2	2.5	2.8	n.a.
Current update		2.1	-2.0	1.1	2.3	2.9
Difference		-0.7	-4.2	-1.4	-0.5	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		-3.3	-1.5	-0.3	1.2	n.a.
Current update		-4.7	-3.8	-3.9	-2.9	-2.8
Difference		-1.4	-2.3	-3.6	-4.1	n.a.
General government gross debt (% of GDP)						
Previous update		62.8	61.9	59.8	56.3	n.a.
Current update		63.6	66.8	68.6	68.0	67.3
Difference		0.8	4.9	8.8	11.7	n.a.

Table 7. Long-term sustainability of public finances [1]

% of GDP	2007	2010	2020	2030	2040	2050
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	18.2	19.2	20.5	21.7	23.8	25.8
Pension expenditure	7.2	8.3	9.3	9.3	10.5	12.0
Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Old-age and early pensions	4.2	5.3	6.4	6.7	8.0	9.6
Other pensions (disability, survivors)	3.0	3.0	2.8	2.6	2.5	2.3
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	4.7	4.9	5.6	6.4	7.2	7.6
Long-term care *(this was earlier included in the health care)*	1.0	1.0	1.2	1.6	2.0	2.2
Education expenditure	5.0	4.6	4.0	3.9	3.7	3.7
Other age-related expenditures	0.4	0.4	0.3	0.3	0.3	0.3
Interest expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: property income	1.4	1.3	1.3	1.3	1.2	1.2
Of which : from pensions contributions (or social contributions if appropriate)	5.9	5.8	6.0	6.0	6.0	5.9
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions						
Labour productivity growth	1.5	2.2	2.7	1.8	1.7	1.7
Real GDP growth	2.9	2.6	2.7	1.7	1.2	0.8
Participation rate males (aged 20-64)	82.2	82.3	84.6	87.7	87.9	87.9
Participation rates females (aged 20-64)	40.7	41.9	45.6	47.9	48.1	48.1
Total participation rates (aged 20-64)	61.8	62.4	65.5	68.2	68.4	68.3
Unemployment rate	6.2	6.3	6.2	6.2	6.2	6.2
Population aged 65+ over total population	14.3	14.8	20.3	24.2	25.7	

[1]Data provided in the SP are for years 2007, 2010, 2020, 2030, 2040, 2050 instead of 2000, 2005, 2010, 2020, 2030, 2050.

Table 8. Basic assumptions

	2008	2009	2010	2011	2012
Short-term interest rate[1] (annual average)	4.6	1.3	1.5	2.5	2.5
Long-term interest rate (annual average)	4.3	3.2	3.5	3.8	3.8
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.47	1.39	1.48	1.48	1.48
Nominal effective exchange rate	4.4	2.7	1.6	0.0	0.0
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	3.8	-0.4	3.8	4.1	4.1
EU GDP growth	0.8	-4.1	0.7	1.6	1.6
Growth of relevant foreign markets	0.3	-4.1	1.0	1.6	1.6
World import volumes, excluding EU	4.6	-12.6	4.6	5.0	5.0
Oil prices (Brent, USD/barrel)	40.0	61.3	76.5	80.5	80.5

[1]If necessary, purely technical assumptions.