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Recommendation for a

COUNCIL RECOMMENDATION

**on the 2019 National Reform Programme of Malta and delivering a Council opinion on
the 2019 Stability Programme of Malta**

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Malta as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 21 March 2019. On 9 April 2019, the Council adopted the recommendation on the economic policy of the euro area ('Recommendation for the euro area').
- (2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Malta should ensure the

¹ OJ L 209, 2.8.1997, p. 1.

full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) and (2) below.

- (3) The 2019 country report for Malta² was published on 27 February 2019. It assessed Malta's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and Malta's progress towards its national Europe 2020 targets.
- (4) On 16 April 2019, Malta submitted its 2019 National Reform Programme and, on 30 April 2019, its 2019 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council³, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance⁴.
- (6) Malta is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government plans a decrease in the headline surplus from 2% of GDP in 2018 to 0.9% of GDP in 2019, followed by a marginal increase to 1.0% of GDP in 2020 and further to 1.1% of GDP in 2021 and 2022. Based on the recalculated structural balance⁵, the medium-term budgetary objective — a balanced budget in structural terms — continues to be overachieved throughout the programme period. According to the Stability Programme, the general government debt-to-GDP ratio is expected to remain below the 60%-of-GDP Treaty reference value and to gradually decline from 46% of GDP in 2018 to around 33% in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 0.6% of GDP in 2019 and 0.8% of GDP in 2020, above the medium-term budgetary objective. Overall, the Council is of the opinion that Malta is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020. At the same time, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues.
- (7) The increase in age-related spending represents a risk to the long-term sustainability of public finances. Age-related public spending in the pension and healthcare systems is expected to increase significantly compared to other EU countries, indicating a risk of rising debt in the long term. Several measures aim to increase the adequacy of

² SWD(2019) 1017 final.

³ Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

⁴ COM(2014) 494 final.

⁵ Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

pensions also through strengthening incentives for private pension savings and voluntary occupational retirement pensions. Ongoing efforts have helped to increase the supply of labour and prolong working lives, with a positive impact on employment rates for women and older workers. In 2018, the government made adjustments to include contributions made after pensionable age and allowed self-employed and part-time working pensioners under 65 years to pay contributions proportionate to their earnings, thereby promoting longer working lives. However, the statutory retirement age, gradually increasing from its current level at 62 years, is set to remain unchanged after 2027 at 65 years despite a projected further growth in life expectancy. The Pension Strategy Group established in 2018 is expected to publish a report by December 2020, outlining recommendations for improving the adequacy and sustainability of the pension system. Regarding healthcare, measures to decentralise services from hospitals to primary care and to improve the provision of long-term care services are ongoing. Current plans to expand the capacity of public hospital outpatient care can help in tackling long waiting times for certain specialties. Nevertheless, other measures to reduce unnecessary referrals to specialists and redirect inappropriate use of emergency care to outpatient have so far not been fully used thus preventing improvements in efficiency of the system. A new concept for primary care centres and investments to gradually expand the use of eHealth are carried out with a view to decentralise services from hospitals to primary care level. Reflecting increasing demand for long-term care, new types of community-based and home care services were introduced in 2017-2018. Despite their potential, the impact of the measures in the area of pensions and healthcare on fiscal sustainability has yet to materialise.

- (8) In the last decade, Malta experienced a pronounced shift towards the services sector, with a strong focus on internationally oriented areas such as financial services, tourism and remote gaming. The expansion of the services sector contributed to fuel economic growth and to develop a large surplus in the current account. At the same time, the increasing reliance on sectors that are considered vulnerable to financial integrity risks creates challenges to the governance framework, putting pressure on the supervisory and enforcement capacity. In particular, the size of the financial and the gaming sector, the efforts to attract crypto-currency operators require an effective anti-money laundering enforcement. The recent increase in the human and budgetary resources of the Financial Intelligence Analysis Unit as well as the enhancement of its procedures and processes are positive steps. Governance shortcomings, particularly in the fight against corruption, may also adversely affect the business environment and weigh negatively on investment. In particular, there is a risk of conflict of interest at various levels of government. Furthermore, the police's Economic Crimes Unit is currently understaffed. In this context, it is important to couple a strengthened legislative framework with timely and thorough implementation. Improving the governance framework and ensuring an effective implementation is a key element to preserve Malta's attractiveness and protect the economy from reputational risks.
- (9) The insurance sector is exposed to risks of passive supervision, where cooperation between domestic and external supervisors is essential. In contrast to the banking sector, the supervision of subsidiaries in the insurance sector are subject to home supervision, i.e. insurance companies registered in Malta and writing business in other countries are under direct supervision of the Maltese regulator. However, the supervisory capacity has not been sufficiently strengthened yet. In addition, the complexity of insurance business models and products with increased appetite for

establishing and expanding specialised insurance vehicles, calls for stringent supervision.

- (10) Reforms aimed at continuing to improve independence of the judiciary and the justice system are ongoing. This includes, in particular, the establishment of a new prosecution service, independent from the Attorney General and the police as also recommended by the Council of Europe's Commission for Democracy through Law (the Venice Commission) in an opinion on Malta, adopted in December 2018. Moreover, a strengthened governance framework, including effective judicial and anti-corruption enforcement, is a prerequisite to obtaining the full benefits of investment.
- (11) The proportion of innovative enterprises is still lagging behind. Research and innovation performance need to be strengthened by smart specialisation so that this may contribute to growth in productivity. Malta has not yet set up the formulation of a coherent, comprehensive and long-term competitiveness strategy for moving the domestic economy up the value chain. Given Malta's specialisation in fast-growing services and its aspirations for block chain technology, it is critical to invest even more in administrative and supervisory capacity. In addition, increasing Malta's innovation performance will require further investments in intangible assets including research and development, addressing skills deficits and gaps and facilitating science-business links, all within more effective governance of the research and innovation system.
- (12) Malta needs to promote the shift towards a more sustainable and resource-efficient economy, for example by investing in the untapped potential for energy efficiency and renewables, water-management cycle, waste management, tackling the growing emissions from air conditioning, climate action and sustainable mobility that will contain emissions from road transport. Due to limited transport and commuting alternatives to driving as well as high car penetration, road congestion is one of the weakest aspects of Malta's business environment and remains a major challenge. Moreover, greenhouse gas emissions from road transport have increased over the last 5 years. The share of renewables in the energy mix has increased to 7.2% in 2017, slightly above the 2017/2018 indicative trajectory level of 6.5%. However, Malta's final energy consumption is continuously increasing. Further investments across sectors are needed in the short term in order to meet the 2020 national renewable energy and energy efficiency targets. Research and development funding or support measures should be implemented to develop new/improved technologies addressing environment and climate change. The environmental and social costs of the housing boom require closer monitoring. Circular economy principles should be applied to the disposal of construction waste to limit its environmental impact. The economic and social consequences of the increase in the cost of housing require attention.
- (13) The employment rate in Malta, now above EU average, is still increasing. A special emphasis in this regard could benefit people with disabilities. The gender employment gap remains the largest in the EU and women's participation in the labour market declines strongly from their mid-thirties, largely due to caring responsibilities. More labour market support for unemployed informal carers could address this gap. The increasing reliance on foreign labour to address the labour and skills shortages creates social and sustainability challenges. Policy initiatives in the areas of labour market, skills and social inclusion could benefit from better monitoring and evaluation.
- (14) Malta invests relatively high amounts in education and training but this is not yet reflected in better outcomes for all. The investment strategy would benefit from further focus on correcting social disadvantage, to be in line with the Social Pillar principle on

quality and inclusive education. Despite measures to tackle early school leaving, the rate is still one of the highest in the EU. Recent measures also seek to improve the inclusiveness of tertiary education, but attainment at this level remains below the EU average and results in skills challenges. Participation in adult learning is increasing but is still low for the low-skilled and the inactive.

- (15) The fight against aggressive tax planning is essential to make tax systems more efficient and fair as acknowledged in the 2019 euro area recommendation. Spillover effects of taxpayers' aggressive tax planning strategies between Member States call for a coordinated action of national policies to complement EU legislation. Malta has taken measures against aggressive tax planning, but the high level of royalty and dividend payments as a percentage of GDP suggests that Malta's tax rules are used by companies that engage in aggressive tax planning. The absence of withholding taxes on outbound (i.e. from EU residents to third country residents) dividends, interest and royalty payments made by Malta based companies may lead to those payments avoiding tax altogether, if they are also not subject to tax in the recipient country. While Malta's Notional Interest Deduction regime will help to reduce the debt equity bias, the scheme's anti-abuse rules, combined with a generous rate and a stock-based regime, warrant close monitoring to prevent any misuse for aggressive tax planning. Although Malta Individual Investor Programme and Malta Residence and Visa Programme do not automatically grant residence for tax purposes, if requirements are met, income may be exempt under the 'non-dom' regime, if income is not remitted to Malta, without substantial physical presence requirements. They may facilitate aggressive tax planning practices and have been listed by the OECD as having a potentially high risk for being misused to circumvent the automatic exchange of financial accounts
- (16) The programming of EU funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the country report⁶. This would allow Malta to make the best use of those funds in respect of the identified sectors.
- (17) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Malta's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme and the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Malta in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Malta, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (18) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion that Malta is expected to comply with the Stability and Growth Pact.

HEREBY RECOMMENDS that Malta take action in 2019 and 2020 to:

1. Ensure the fiscal sustainability of the healthcare and the pension systems, including by restricting early retirement and adjusting the statutory retirement age in view of expected gains in life expectancy.
2. Address features of the tax system that may facilitate aggressive tax planning by individuals and multinationals, in particular by means of outbound payments.

⁶ SWD(2019) 1017 final.

Strengthen the overall governance framework, including by continuing efforts to detect and prosecute corruption. Continue the ongoing progress made on strengthening the anti-money laundering framework, notably regarding enforcements. Strengthen the independence of the judiciary, in particular the safeguards for judicial appointments and dismissals, and establish a separate prosecution service.

3. Focus investment-related economic policy on research and innovation, natural resources management, resource and energy efficiency, sustainable transport, reducing traffic congestion and inclusive education and training.

Done at Brussels,

*For the Council
The President*