



# **Medium-Term Fiscal Strategy for Malta:**

**Update of Stability Programme  
2016 - 2019**

The following symbols have been used throughout this document:

... to indicate that data are not available;

— to indicate that the figure is negligible;

0 to indicate that the figure is zero;

- to indicate that data are not applicable or cannot be determined;

n/c to indicate that there is no change in the data.

f to indicate that it is a forecast

Figures may not add up due to rounding.

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# Introduction

This Programme constitutes the eighth Update of Malta's Stability Programme, which was submitted in 2007. The first Update was submitted in December 2008. This Programme has been prepared in accordance with Council Regulation (EC) No. 1466/97 as amended by Council Regulation (EC) No. 1055/05 and Council Regulation (EC) No 1467/97 as amended by Council Regulation (EC) No. 1056/05.

This document is also in line with the new requirements of the Stability and Growth Pact, namely the amendments to Council Regulation (EC) No. 1466/97 by Council Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16<sup>th</sup> November 2011 and the amendments to Council Regulation (EC) No 1467/97 by Council Regulation (EU) No 1177/2011 of 8<sup>th</sup> November 2011. The programme also takes into account Council Directive 2011/85/EU of 8<sup>th</sup> November 2011 on the requirements for budgetary frameworks of the Member States.

The Stability Programme now also meets the reporting requirements under Article 15 of the Fiscal Responsibility Act and will thus constitute Malta's Medium-Term Fiscal Plan. It is the intention of the Government to lay this Plan on the table of the House of Representatives together with the fiscal risk assessment to be provided by the Malta Fiscal Advisory Council in line with Article 15(1) of the Fiscal Responsibility Act.

The document is in line with the 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 24<sup>th</sup> January 2012. Nevertheless, it contains additional information as required by the Fiscal Responsibility Act.

The Ministry for Finance compiled this document, with an important contribution from the National Statistics Office as well as from other Ministries and entities across Government. It was prepared on the basis of policies proposed in the 2016 Budget together with a number of additional expenditure consolidation measures and updated with the latest macroeconomic projections and more recent fiscal data.

The Programme includes seven chapters: Chapter 1 presents Government's Medium-Term Fiscal Policy Strategy including the expenditure priorities and the public investment programme in order to fulfil the requirements of Article 15(7) of the Fiscal Responsibility Act; Chapter 2 presents the main macroeconomic projections for the medium-term as well as the estimates of potential output and the output gap; Chapter 3 outlines the overall fiscal policy strategy and updated budgetary plans for the current year, followed by a presentation of the medium-term fiscal projections and debt developments; Chapter 4 contains an analysis of forecast uncertainty and the balance of risk surrounding macroeconomic projections and an evaluation of the risks to the achievement of fiscal targets conditional on alternative plausible macroeconomic conditions; Chapter 5 reviews the long-term sustainability of public finances; Chapter 6 analyses the quality of public finances, and finally Chapter 7 reviews the institutional features of public finances particularly the implementation of the Fiscal Responsibility Act.

The macroeconomic forecasts underlying this Programme have been submitted to the Fiscal Advisory Council for its endorsement. The Council concluded that "the projected increase in the headline real Gross Domestic Product figure for 2016 and the other forecast years may indeed be achievable". The fiscal projections underlying this Programme will be submitted to the Council for its evaluation and endorsement in line

with the requirements of the Fiscal Responsibility Act. This exercise is expected to be concluded in the coming weeks.



## **1. Medium-Term Fiscal Policy Strategy**

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# 1. Medium-Term Fiscal Policy Strategy

The policy objective remains the consolidation of the public finances to reach a balanced structural budget in the medium-term. Indeed, by the end of the forecast horizon contemplated in this Programme, Government aims to achieve its targets. Between the years 2012 and 2015, the general Government deficit as a percentage of Gross Domestic Product (GDP) has declined steadily, from 3.5 per cent in 2012 to 1.5 per cent in 2015 with the major contributory factors being increases in revenue streams and restraints in current expenditure growth.

In the context of the requirements of the Fiscal Responsibility Act, this Programme is being submitted to the Malta Fiscal Advisory Council (MFAC) for its endorsement, thus elevating it to the status of Malta's Medium-Term Fiscal Plan. The Medium-Term Fiscal Policy Strategy includes the expenditure priorities and the public investment programme highlighted in this chapter in order to fulfil the requirements of Article 15(7) of the Act. In the process of its assessment, the MFAC will carry out a fiscal risk assessment. Once this is completed, the report of the MFAC will be considered by Government and will then be submitted to Parliament in conjunction with the Stability Programme.

## 1.1 Economic Situation and Risks to the Outlook

The strong economic performance being registered by the Maltese economy is justifying the Government's prudent approach towards fiscal consolidation combined with an ambitious structural reform agenda. As a result, economic growth surged to 6.3 per cent in 2015 supported by an equally formidable surge in potential output growth of 4.5 per cent. This was mainly driven by domestic demand in 2015, largely on the back of Gross Fixed Capital Formation. Furthermore, growth from the output side was spread across most of the sectors of the economy. This in turn, supported a strong labour market performance, confirmed by the continued decline in the unemployment rate.

Whilst economic projections have been predicting a rebound in growth for some months now, the rate of economic expansion surprised all forecasting institutions on the upside. An analysis of the forecast performance against the actual economic performance suggests that while the growth in investment was on target, growth was more job rich and less import intensive than what was being predicted. The former strongly supported the formidable increase in household consumption beyond expectations, whilst the latter is consistent with the strengthening of the sectoral performance, particularly in services.

The absence of any major visible imbalances suggests that this economic performance is mostly permanent and possibly consistent with an even stronger rate of potential growth than is being estimated in this Programme. This same strong and sustainable economic performance also facilitated the fiscal consolidation process in 2015 which has seen the deficit continue to decline well below the 3 per cent of GDP threshold. This suggests that the fiscal consolidation is being supported by the structural economic reforms.

Over the forecast horizon, growth is expected to moderate, as the positive output gap registered in 2015 is expected to close gradually over a three year period. While employment growth is expected to remain robust compared to the historical average, growth is expected to moderate over the medium-term. This will support a corresponding moderation in household consumption expenditure, albeit remaining stronger than historical averages. Meanwhile, investment activity will continue to be supported by a number of relatively large scale projects particularly in energy, health, transport and

accommodation services. The increase in private sector profitability will also support a strong drive on private investment. Nevertheless, public investment is expected to moderate somewhat compared to the surge in predominantly European Union (EU) funded investment registered during 2015 with the 2007/13 EU budget reaching expiry. Meanwhile, the external contribution to growth is expected to strengthen in the short-term horizon, driven partly by the gradual, albeit fragile, growth in external demand, and the relatively competitive exchange rate. Over the medium-term, the external contribution to growth is also expected to remain positive. This reflects a rebalancing towards a more moderate expansion in domestic demand, which essentially comports an even weaker rate of growth in imports than the moderation in export growth.

The macroeconomic scenario underpinning this medium-term fiscal plan is based on rather prudent economic assumptions. There is a strong reason to believe that growth is likely to surpass the projections. However, it is now an established practice to base the fiscal targets on a measure of prudence in macroeconomic forecasting. Furthermore, the macroeconomic projections have been endorsed by the MFAC as directed under the Fiscal Responsibility Act.

This largely positive macroeconomic outlook is however subject to a measure of uncertainty. The baseline scenario underpinning this Programme has been subjected to a series of exogenous shocks producing alternative growth scenarios. Based on these scenarios and an evaluation of past forecast accuracy, the risks surrounding macroeconomic forecasts have been quantified. Based on the established methodology, this risk assessment suggests both upside and downside risks though the risk is balanced on the upside in the short-term and on the downside over the medium-term. The alternative macroeconomic scenarios have also been used to gauge the fiscal response to the materialisation of such risks. It is encouraging to note, that under the worst case, macroeconomic scenarios contemplated the deficit is not expected to exceed the 1.6 per cent of GDP, thus remaining well within the 3 per cent of GDP threshold of the Stability and Growth Pact.

## **1.2 Fiscal Performance and Stance**

The Ministry for Finance is pleased to note that over the last three years, the Government managed to reduce the value of the deficit by almost half, as the deficit fell from €256 million in 2012 to €129 million in 2015. Indeed, official figures published by Eurostat show that the general Government deficit as a percentage of GDP has been reduced to 1.5 per cent in 2015, which is marginally better than the target of 1.6 per cent outlined in the 2015 Budget. The gradual but consistent reduction in the deficit positively impacted the debt ratio which fell by 3.2 percentage points to 63.9 per cent in 2015, from 67.1 per cent in 2014.

Such positive developments were underpinned by strong increases in all revenue streams reflecting the sustained and robust performance of the Maltese economy, made possible through the structural reforms being undertaken. Fiscal measures also contributed to the decline in the deficit. Unfortunately, these were mitigated by unexpected temporary expenditure outlays in 2015, particularly the unexpected rise in the co-financing necessary to ensure the maximum absorption of EU funds possible and expenditure related to the EU-Africa Summit. Indeed, in their absence, Malta would have attained an even lower deficit outturn and a much stronger structural effort.

Government considers fiscal developments over the last three years as an important achievement, but there are still challenges ahead in order to ensure long-term public finance sustainability and recover the necessary fiscal space to allow fiscal policy to act in a countercyclical manner. Consistent with the requirements of the national fiscal rules, the Maltese Government plans to further reduce the deficit over the medium-term, with the attainment of a balanced budgetary position in structural terms by 2019.

Government is aiming for a deficit target of 0.7 per cent of GDP in 2016 which will decline to 0.6 per cent of GDP in 2017 and further down to 0.2 per cent of GDP by 2018. Based on the output gap projections, this translates into an average structural effort of 0.6 percentage points of GDP per annum between 2016 and 2019, with the adjustment being frontloaded in the early years of the Programme period. As a matter of fact, further to fiscal measures introduced and revised in the 2016 Budget, Government will implement additional consolidation measures in 2016. These measures are expected to sustain further the expenditure-based consolidation and ensure an improvement in the structural terms of 0.8 percentage points of GDP in 2016, or 0.2 percentage points of GDP more than envisaged in the 2016 Budget.

### **1.2.1 Government's Expenditure Priorities**

Government is committed to implement the provisions of the Electoral Manifesto over the coming years. It is also committed to make the best use of EU funds from the 2014-2020 Programming period. The medium-term expenditure priorities also include major commitments related to Malta's EU Presidency in 2017 and commitments related to Valletta 2018.

Health, Education and Social Benefits continue to be a priority in line with Government's commitment to improve the standard of living of the Maltese population, including the most vulnerable individuals and families which require a certain level of support whilst at the same time ensure equality of opportunities for everyone willing to further their education or to contribute directly in the labour market.

Whilst these three areas remain a priority area, structural reforms aimed at ensuring the best use of public resources in health, education and social benefits are required nonetheless. During 2014, the Spending Review focused on social benefits and identified ways and means of rationalising the use of scarce public resources whilst creating the right economic incentives and support measures to encourage employment and/or education enrolment. The current social security rules were amended to permit the tapering of social benefits in order to allow for the gradual reduction of benefit income upon entry into the labour market for those mothers who have been on social benefits for long periods. Coupled with free childcare, this initiative should encourage further labour market participation and the reduction in long-term unemployment. The Youth Guarantee Programme, proposed as an ESF co-financed project, provides a second opportunity to individuals with a low level of education to help them enter the labour market with the aim of retaining their employment and advance further in the employment ladder.

Government remains committed to continue with the pension reform process. As a continuation of the pension reform process, the Pensions Strategy Group submitted for the attention of Government, a post-consultation report which included final recommendations addressing either pension adequacy or sustainability. A number of these measures were adopted by Government as from the Budget for 2016. Furthermore, Government has introduced fiscal incentives with the aim of sustaining the policy

objective of diversifying retirement income through the taking up of voluntary third pillar pensions.

The conduct of comprehensive reforms in the public health system to ensure the delivery of a cost-effective and efficient service has been high on the political agenda over the past few years. This has been mainly driven by strategic investments to underpin the revision of existing processes, whilst shifting the focus of care away from hospital and towards the primary health care setting. Progress has also been registered with respect to strengthening health promotion and disease prevention. These developments reflect the adoption of a new National Health Systems Strategy covering 2014-2020 focusing on three pillars: Improving Governance; Health Promotion and Disease Prevention; and Strengthening of Primary Care. Following the finalisation and launch in 2014, a detailed action plan and a cost-benefit analysis were completed in January 2015. Government is also actively seeking the involvement of the private sector in the health sector. This should improve efficiency while easing pressures on public finances. A comprehensive spending review, similar to that undertaken in social security, was carried out at Mater Dei Hospital in 2015. The Review included a number of stakeholders in health services and was duly completed in October 2015. At present, the recommendations, which aim to reduce and contain costs through the introduction of internal control mechanisms and monitoring of operational costs, are in the process of implementation.

## **1.2.2 Public Investment Programme**

Malta's Partnership Agreement presents the overarching strategy and identifies the priorities in the allocation of EU funds. In this regard, the Partnership Agreement has identified three funding priorities which are considered as the main overarching objectives for the 2014-2020 programming period, namely:

1. Fostering competitiveness through innovation and the creation of a business-friendly environment;
2. Sustaining an environmentally-friendly and resource efficient economy; and
3. Creating opportunities through investment in human capital and improving health and well-being.

The main overarching objectives will be addressed through two Operational Programmes and their respective priority axis. The Priority Axes of the first Operational Programme are the following:

1. Investing in research, technological development and innovation;
2. Consolidating investment within the ICT sector;
3. Enhancing Malta's competitiveness through investment in SMEs;
4. Shifting towards a low-carbon economy;
5. Protecting our environment - investing in natural and cultural assets;
6. Sustainable Urban Development;
7. Shifting towards a more low-carbon transport sector;
8. Investing towards a more socially-inclusive society;
9. Developing our future through education, training and lifelong learning;
10. Investing in a more environmentally-friendly society;
11. Investing in TEN-T Infrastructure; and
12. Technical Assistance.

The second Operational Programme targets employment, education, social inclusion and health and is aimed at achieving inclusive growth. The priority axes of the second Programme are:

1. Investing in the employability and adaptability of human capital;
2. Towards a more inclusive society;
3. Investing in people through Education, Training and Life Long Learning;
4. Building the Institutional Administrative Capacity; and
5. Technical Assistance.

These objectives and priority axis in general also apply to the national funds earmarked for capital investment. In addition to the co-financing part EU-funded projects, local funds are mostly targeted to road, education and health infrastructure, waste management and environmental management.

### **1.3 Structural Reforms**

The strong economic performance registered in recent years is reflective of the policy reform programme implemented by the Government. Indeed, Government continues to monitor and address the challenges outlined in the Commission Staff Working Document with respect to taxation, quality of public finances and long-term fiscal sustainability, labour market, education and skills and social aspects, the business environment and competitiveness. The 2016 National Reform Programme and this Update of the Stability Programme outline Government's strategy and policy measures intended to address challenges in the structural and fiscal policy domains.

In addressing its policy objectives, Government is implementing a number of policies aimed at improving the supply-side of the economy while raising the country's potential output. In addition, the Government is attentive at ensuring responsible environmental management and safeguarding social cohesion. Earlier Budgets had the aim of making work pay and ensuring that the social security system positively incentivises work effort and discourages dependency. The 2016 Budget continued to build on the achievements of previous years with particular focus on improving the distribution of income especially the incomes of households defined as being at the risk of poverty. The 2016 Budget also highlighted the importance of investment in enhancing labour and capital productivity.

Government's policy programme remains firmly anchored around its commitment to attain its fiscal targets, and consolidate on the achievements in this area, following the closure of the Excessive Deficit Procedure on part of the European Council in May 2015. Government is also looking beyond the short-term fiscal targets but is viewing the issue of sustainability of public finances from a medium to long-term perspective. In this regard, Government welcomes the assessment of the European Commission in its Fiscal Sustainability Report 2015, which considered Malta as facing low risks over the short to medium-term and medium risks over the long-term. In this regard, Government has also introduced new measures to address the sustainability of public finances through the pension reform measures adopted as part of the Budget for 2016.





## **2. Economic Outlook**

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## 2. Economic Outlook

### 2.1 Economic Conditions in 2015

The Maltese economy was amongst the top performers of the European Union (EU) in 2015, with the latest National Statistics Office (NSO) release<sup>1</sup> showing a real economic growth of 6.3 per cent. This positive momentum was primarily driven by robust growth in domestic demand reflecting the positive increases in investment and consumption. Indeed, investment rose by 21.4 per cent on the back of various large-scale projects undertaken during the year, while household consumption expenditure increased by 4.9 per cent. The increase in the latter reflected the moderate appreciation in wages, lower marginal income tax rates, strong labour market developments and subdued inflation. The external side of the economy acted as a drag on economic growth as the growth in imports of goods and services outpaced the growth of exports. In fact, imports of goods and services increased by 3.0 per cent while the growth in exports of goods and services increased by 2.4 per cent.

The analysis of the output side confirms that Gross Value Added (GVA) at basic prices increased by 8.9 per cent from 2014 to 2015 with the majority of sectors recording positive growth. The most notable growth was recorded in the professional, scientific and technical activities sector which grew by 17.9 per cent. Growth in the financial services sector recovered and rose to 10.4 per cent. The real estate sector has also continued to recover, rising by 10.1 per cent in 2015. The retail and wholesale was another sector that recorded significant growth expanding by 9.6 per cent over last year's level. From a sub-sectoral level, the growth in the professional, scientific and technical sector was mainly seen in the legal and accounting activities, scientific research and development and veterinary services, while advertising and marketing activities saw a relatively sharp drop. Manufacturing was the only sector that registered negative growth in 2015; however, this was mainly overshadowed by manufacturing in computer, electronic and optical products.

On the income side in 2015, compensation of employees increased by 5.3 per cent, reaching €3,792.7 million, while the gross operating surplus and mixed income rose to €3,940.2 million, expanding by 12.9 per cent from the previous year's growth of 3.7 per cent. Meanwhile, subsidies on production and imports rose by €12.3 million, being equivalent to an increase of 10.1 per cent, while taxation on production and imports rose by €85.5 million or the equivalent of 7.7 per cent increase.

Global economic growth for 2015 is estimated by the International Monetary Fund to be 3.1 per cent and is set to increase to 3.4 per cent and 3.6 per cent in 2016 and 2017, respectively<sup>2</sup>. While advanced economies are expected to continue their modest recovery, emerging markets and developing economies will see their growth rates decline for the fifth consecutive year. Indeed, the slowdown and rebalancing of the Chinese economy was faster than expected, particularly in imports and exports, reflecting weaker investment and manufacturing. Such developments have the possibility of spilling over to other countries through trade channels and weak commodity prices, as well as through diminishing confidence and volatility in the financial markets. The European economy, however, still benefits from a number of positive conditions, namely the low price of oil, the Euro's relatively competitive exchange rate and low financing costs which have all helped the EU's exports and private consumption. The Eurozone's recovery remains moderate even with all the above mentioned tailwinds. Furthermore, these are expected to continue for a longer period than previously expected. The price of oil has fallen again and is now expected to remain low thus increasing consumers' spending power.

## 2.2 The Medium-Term Scenario

Throughout the forecast horizon, the Maltese economy is expected to continue growing at a moderate pace over the forecast horizon, though at a slower rate than that seen in 2015. Indeed, real GDP is forecasted to grow at 4.2 per cent in 2016 and 3.1 per cent in 2017. Growth for both years is expected to continue to be fuelled by domestic demand reflecting the projected increases in private consumption. With regards to investment, having reached growth rates of over 21 per cent in 2015, a slowdown is anticipated. However, investment is still expected to increase by 1.6 per cent and by 9.2 per cent in 2016 and 2017, respectively. In 2016, imports are forecasted to increase, though to a lesser extent than exports, which will positively contribute towards growth, but are expected to rise at a faster rate than exports in 2017, in line with investment, and then moderate again in the outer years of the forecast.

Chart 2.1 illustrates the projected growth rate of Gross Domestic Product (GDP) together with a detailed breakdown of the various expenditure aggregates. Table 2.1 presents the main macroeconomic indicators for the years 2014-2019. The figures for 2014 and 2015 have been published by the NSO, whilst figures for 2016 onwards are forecasts. The macroeconomic forecasts take into account the latest available data and are being provided in Table 1a, 1b, 1c and 1d of the Statistical Appendix.

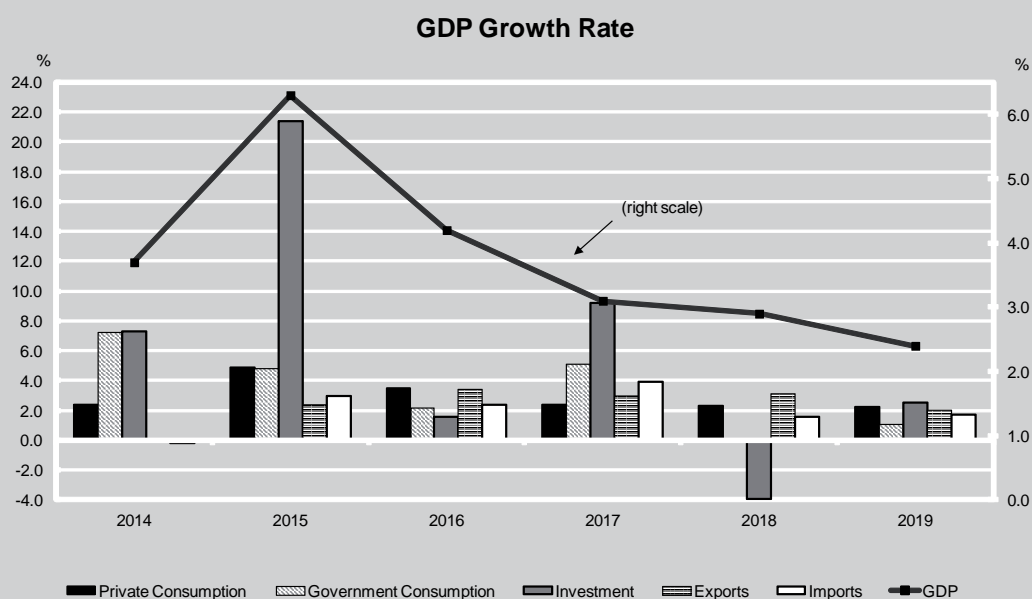
### 2.2.1 Assumptions for Projections

The macroeconomic forecasts presented in this Stability Programme are based on the following assumptions:

- Both short-term and long-term interest rates are assumed to remain stable during the forecast period with a uniform spread between the two.
- The growth of Malta's main trading partners is expected to remain stable at 1.6 per cent in 2016, rise slightly to 1.7 per cent in 2017 and remain constant until 2019.
- World prices are expected to start recovering but only after a contraction in 2016, and then stabilise at 1.2 per cent in 2017 and remain at this level throughout the forecast horizon.
- Oil prices are assumed to decline further in 2016 to reach \$38 per barrel, then moderate to \$42.9 per barrel in 2017 and stabilise at 44.7 in 2018 and 2019.
- The Dollar/Euro exchange rate is expected to continue to decline, from 1.11 Dollars per Euro in 2015 to 1.09 Dollars per Euro in 2016 and 1.08 Dollars per Euro in 2017 only to start slowly appreciating again to 1.11 Dollars per Euro in 2019.
- The Sterling/Euro exchange rate is expected to rise slightly to 0.76 Pounds per Euro in 2016 and stabilise around 0.74 Pounds per Euro throughout the rest of the forecast horizon.

These assumptions are outlined in Table 8 of the Statistical Appendix.

Chart 2.1



### Main Macroeconomic Indicators

Table 2.1

	2014	2015	2016f	2017f	2018f	2019f
GDP growth at current market prices (%)	5.7	8.8	6.8	5.6	4.8	4.5
GDP growth at Chain Linked Volumes by period (Reference year 2010) (%) <sup>(1)</sup>	3.7	6.3	4.2	3.1	2.9	2.4
<b>Expenditure Components of GDP</b>						
<b>at Chain Linked Volumes by period (Reference year 2010) (%)</b>						
Private final consumption expenditure <sup>(2)</sup>	2.4	4.9	3.5	2.4	2.3	2.2
General government final consumption expenditure	7.2	4.8	2.2	5.1	0.1	1.1
Gross fixed capital formation	7.3	21.4	1.6	9.2	-3.9	2.5
Exports of goods and services	0.1	2.4	3.4	3.0	3.1	2.0
Imports of goods and services	-0.2	3.0	2.4	3.9	1.6	1.7
Inflation rate (%)	0.8	1.2	1.6	1.9	1.8	1.7
Employment growth (National Accounts Definition, Domestic Concept) (%)	5.1	3.5	2.7	2.7	2.2	2.0
Unemployment rate (Harmonised definition, Eurostat) (%)	5.8	5.4	5.3	5.3	5.4	5.4
Compensation per employee (% change)	1.3	1.7	2.8	2.4	2.5	2.5
Labour productivity (% change)	-1.3	2.7	1.5	0.4	0.6	0.4
Nominal Unit Labour Cost (% change)	2.6	-1.0	1.4	2.0	1.9	2.1
Real Unit Labour Costs (% change)	0.6	-3.4	-1.2	-0.5	0.0	0.0
External Goods and Services Balance (% of GDP)	7.7	6.9	8.1	7.1	9.1	9.4

<sup>(1)</sup> Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

<sup>(2)</sup> Includes NPISH final consumption expenditure.

## **2.2.2 Risks to Outlook**

The medium-term outlook for the global economy is one of steady growth. Nevertheless, there are a number of factors that could boost or restrain growth prospects. These risk factors will be explored in more detail in Chapter 4. Nevertheless, it is worth mentioning at this stage that even judging the most recent forecasts for Malta published by independent institutions, these forecasts are considered prudent and the upside risks are deemed to be stronger than the downside risks over the short-term.

## **2.2.3 Private Final Consumption Expenditure**

Private final consumption expenditure spiked in 2015 reaching a growth rate of 4.9 per cent after growing by 2.4 per cent in the previous year. Growth in consumption was boosted by various factors, among which were the improvements in the labour market. Apart from having an employment growth of 3.5 per cent which was coupled with a historical low unemployment rate of 5.4 per cent, there were also Government initiatives which helped to increase the disposable income of households including the reductions in the tax burden and major increases in pensions for senior citizens. Furthermore, the rise in the compensation of employees of 5.3 per cent has also helped the increase in the private final consumption expenditure. Moreover, prices increased at a subdued rate of 1.2 per cent over the same period. Private consumption is expected to continue growing by 3.5 per cent in 2016 and by 2.4 per cent in 2017. Over the outer years, private consumption is expected to increase by an average rate of 2.3 per cent which is still higher than the long-term average.

## **2.2.4 General Government Final Consumption Expenditure**

In 2015, general Government final consumption increased by 4.8 per cent. This shows a slowdown in growth when compared with the previous year's growth of 7.2 per cent. In 2016, Government expenditure is expected to moderate further and grow by 2.2 per cent. It is then expected to rise slightly in 2017 to reach 5.1 per cent and stabilise for the rest of the forecast years to 0.1 per cent in 2018 and 1.1 per cent in 2019.

## **2.2.5 Gross Fixed Capital Formation**

Gross fixed capital formation was the main driver of Malta's economic growth in 2015, contributing 3.8 percentage points to growth. This year, gross fixed capital formation is expected to record a lower growth rate of 1.6 per cent, following the high base of the previous year. In 2017, gross fixed capital formation will rise again with a rather high growth rate of 9.2 per cent and then moderate in the outer years of the forecast horizon, falling by 3.9 per cent in 2018 and growing again by 2.5 per cent in 2019.

The sharp rise seen in 2015 was the result of a number of large scale projects, including the construction of a new power plant as well as other private investments. Furthermore, Government policy has facilitated further investment in construction both for tourism facilities as well as for residential dwellings. In tourism, the height limits for hotels have been increased to allow for further upward expansion. The temporary relief of stamp duty for first time buyers of residential property and the strong inflow of foreign workers and investors should also be contributing to further investment into residential construction.

It should be noted, that for the baseline scenario of this forecast a number of large scale projects were not taken into account, either due to the fact that there is a material risk of non-realisation or due to lack of available details regarding the particular project. This was done to ensure a prudent medium-term scenario which is not overly optimistic.

That said, other major investments that are considered to have a high probability of realisation, include the major investments in the health and educational sectors, further investments in the energy sector, the investments by Malta International Airport, the relocation of the Institute of Tourism Studies (ITS) and the redevelopment of the former ITS site have been taken into consideration.

### **2.2.6 External Balance of Goods and Services**

During 2015, exports recovered registering a growth of 2.4 per cent, in contrast with a 0.1 per cent growth recorded in the previous year. This upward trend is expected to be maintained in the coming years as exports are expected to grow by 3.4 per cent and 3.0 per cent in 2016 and 2017, respectively. In the outer years of the forecast horizon, exports are expected to continue growing maintaining a 3.1 per cent growth rate in 2018 and 2.0 per cent growth in 2019. Supported by strong domestic demand, imports expanded by 3.0 per cent in 2015, outpacing the growth in exports. However, this is forecasted to change in 2016 as exports are expected to rise by 3.4 per cent while imports are expected to grow by 2.4 per cent resulting in net exports and a positive contribution to growth of 1.6 percentage points. This positive net trade is set to be lost again in 2017 as it is forecasted that imports will rise by 3.9 per cent due to a sharp rise in investment with relatively high import content. This will again have a negative contribution to growth of -0.9 percentage points. In 2018, as investment adjusts from the base effect of the previous years, imports growth will moderate to 1.6 per cent. This means that 2018 will again see net exports and a positive contribution of 2.4 percentage points towards growth. This positive net trade position will continue in 2019, though to a lesser extent.

### **2.2.7 Productivity and Employment Prospects**

Employment fared well in 2015, where, according to the National Accounts definition, there was a 3.5 per cent growth. Indeed, this was the result of several structural reforms that the Government has embarked on since coming to office in 2013 including free child care services, providing before and after school child care services, reforming maternity leave and promoting flexible working arrangements. These initiatives have resulted in significant increases in the female participation rate where according to the Labour Force Survey, over the past three years it grew at an average of 3.5 per cent per year.

Employment growth is expected to remain a key economic supporter, while moderating somewhat in the outer years of the forecast horizon to edge closer to the long run average. In 2016, employment growth is expected to moderate and grow at 2.7 per cent and remain so for 2017. In 2018, employment growth is forecasted to slowdown to 2.2 per cent as it approaches the long run average and to grow by 2.0 per cent in 2019. Such growth is mainly supported by the increasing female participation rate as well as the inflow of foreign workers.

Compensation of employees increased by 5.3 per cent in 2015 and is expected to retain this momentum in this year and the next increasing by 5.6 per cent and 5.2 per cent, respectively. A marginal fall in the growth rate is expected in 2018 and 2019 as compensation for employees is expected to increase by 4.8 per cent and 4.6 per cent, respectively.

In 2015, real labour productivity increased by 2.7 per cent on the back of strong GDP growth. In the coming years, it is still expected to retain the positive trajectory as in previous years, although to a lesser extent than in 2015. Indeed, it is forecasted to fall in

line with GDP growth moderation, with labour productivity growth going down to 1.5 per cent in 2016 before it stabilises around 0.5 per cent in the rest of the forecast horizon.

Nominal unit labour cost has slipped into negative growth, falling by 1.0 per cent, due to the higher growth rates in GDP relative to the growth in compensation of employees. This, however, shall change in 2016, as unit labour costs are expected to increase by 1.4 per cent and stabilise around 2.0 per cent growth for the rest of the forecasting period. On the other hand, real unit labour costs have also declined in 2015 by 3.4 per cent and are forecasted to continue decreasing by 1.2 per cent and 0.5 per cent in 2016 and 2017, respectively. They are expected to remain unchanged for the outer years of the forecast.

Unemployment in 2015 was at a historical low of 5.4 per cent, well below the EU average of 9.4 per cent, reflecting Government's efforts in ongoing active labour market policies. For the rest of the forecasting period, unemployment is forecasted to remain below the historical average, averaging at around 5.4 per cent.

### **2.2.8 Inflation**

In 2015, Harmonised Index of Consumer Prices (HICP) inflation (which is calculated as a twelve-month moving average of the HICP) increased by 1.2 per cent. This was mainly driven by services' prices as well as increases in the price of unprocessed foods, although this was partly mitigated by a fall in energy prices. Inflation is expected to rise to 1.6 per cent in 2016 and 1.9 per cent in 2017. This will mainly be driven by the services prices as well as processed and unprocessed food prices. However, inflation is expected to fall marginally in the outer years, reaching 1.8 per cent and 1.7 per cent in 2018 and 2019, respectively. Thus over the forecast horizon, inflation is expected to be on average below the 2.0 per cent European Central Bank (ECB) benchmark of price stability.

### **2.2.9 Comparison with the Commission's Winter Forecast**

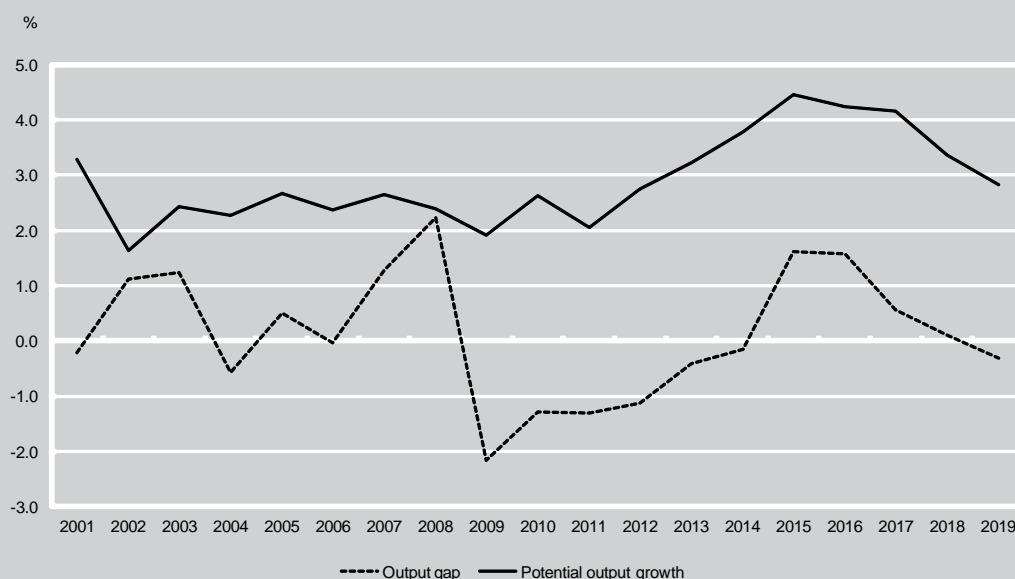
The European Commission's winter forecast for Malta and the forecasts presented here are rather similar both forecasting robust growth on the back of strong domestic demand and low unemployment. In 2016, the Commission is forecasting a real GDP growth of 3.9 per cent, being 0.3 percentage points below this forecast's expectations. The main difference here, is that forecasts by the Ministry for Finance (MFIN) are expecting household consumption to be slightly stronger than the European Commission. Similarly, MFIN is expecting positive growth in investment, while in its winter forecast the Commission expects investment to decline. In 2017, the Commission's winter forecast is expecting GDP to grow by 3.4 per cent while in this forecast GDP is expected to grow by 0.3 percentage points less. Here, the main differences lie in net exports, which the Commission sees to contribute positively to growth, while in this forecast imports are expected to grow at a larger pace than exports in 2017 due to the large scale investments planned, particularly the investments in the health and educational sector. That said, it is to be highlighted that the Commission's winter forecast does not use the latest statistical data and the forecasts are currently in the process of being revised.

## **2.3 Potential Output and the Output Gap**

The estimation of potential output and the output gap<sup>3</sup> within this Update of the Stability Programme is based on the commonly-agreed Production Function method. The main differences between the European Commission and the Government's estimation pertain to differences in the macroeconomic forecasts. Developments in the potential output and output gap are presented in Chart 2.2.



Chart 2.2

**Malta's Potential Output Growth and Output Gap Estimates**

Between 2002 and 2009, potential output growth averaged 2.3 per cent while it increased to 3.0 per cent in the following five-year period. In 2015, rate of growth of potential output climbed to 4.5 per cent while it is expected to stand around the 3.8 per cent level over the forecast period. This period is expected to be underpinned by higher labour market contribution resulting from positive developments in the labour market, largely through a higher participation rate, followed by higher contributions from the capital factor as a result of higher investment. Potential growth is expected to converge to 2.8 per cent in 2019.

The output gap is defined as the difference between actual and potential output, expressed as a ratio of potential output. The gap is indicative of the cyclical developments prevailing in the Maltese economy. With the exception of the year 2004, the period 2002-2008 has been a period where the Maltese economy operated above its potential level. However, following the international recession and the subsequent contraction of the domestic economy in 2009, the output gap turned negative and actual GDP dropped to 2.2 per cent below potential. The output gap has turned positive in 2015 and it is expected to remain positive in the subsequent years though closing gradually by 2018 and to turn slightly negative in 2019.

*Footnotes:*

<sup>1</sup> NSO News Release 041/2016, dated 8<sup>th</sup> March 2016.

<sup>2</sup> World Economic Outlook Update, January 2016.

<sup>3</sup> Defined as actual output less potential output as a per cent of potential output.



### **3. Fiscal Outlook and the Medium-Term Fiscal Strategy**

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### **3. Fiscal Outlook and the Medium-Term Fiscal Strategy**

Government's fiscal policy objective remains that of ensuring a sustainable fiscal position by gradually, but consistently reduce the fiscal imbalance, to reach a balanced budget in the medium-term. Fiscal consolidation is necessary to ensure the sustainability of the Government's fiscal position. In 2015, the general Government deficit to Gross Domestic Product (GDP) ratio fell to 1.5 per cent of GDP with further gradual reductions envisaged over the medium-term. Consistent with the requirements of the national fiscal rules, the Government is targeting an average structural effort of 0.6 percentage points of GDP per annum which foresees the attainment of the Medium-Term Budgetary Objective (MTO) by 2019. The structural effort is frontloaded in 2016 in view of the favourable economic conditions.

The envisaged fiscal consolidation will be supported through strong and sustainable economic growth. As documented in Malta's 2016 National Reform Programme, a number of ongoing and planned structural reforms will be contributing to potential economic growth, while ensuring fiscal sustainability. The Government spending reviews will continue to ensure improved effectiveness and efficiency through an input-output approach in spending decisions. In turn, this will ensure greater financial discipline and fiscal accountability in the public sector. Efforts towards curbing fiscal abuse and improving efficiency in revenue collection will continue with the consolidation of the various functions of Government revenue. In addition, the institutional fiscal framework introduced in 2014 through the Fiscal Responsibility Act will support the achievement of the fiscal targets contained in this Programme Update.

In 2015, the debt-to-GDP ratio declined to 63.9 per cent of GDP. Further improvements in the underlying debt dynamics are expected to be secured through an improvement in the primary surplus, positive growth prospects, sustained investor confidence, and an efficient and effective debt management system. In this respect, the debt-to-GDP ratio is expected to exhibit a downward trajectory and fall below the 60 per cent target by the end of the forecast horizon.

In line with the practice of the previous two Updates of the Stability Programme, the Government's medium-term budget framework as outlined in this Programme constitutes Malta's national medium-term fiscal plan as required by Article 4(1) of the European Union (EU) Regulation No 473/2013.

In addition to the 2016 Budget measures, Government is also committed to take additional consolidation measures amounting to €15 million. These expenditure-decreasing consolidation measures are expected to exert an improvement in the deficit-to-GDP ratio of 0.2 percentage points and should ensure an improvement in structural terms of 0.8 percentage points of GDP in 2016.

#### **3.1 Fiscal Developments in 2015**

In 2015, the general Government deficit-to-GDP ratio improved by 0.5 percentage points over the previous year, reaching 1.5 per cent of GDP.

### **3.1.1 General Government Revenue in 2015**

In 2015, the general Government revenue-to-GDP ratio increased by 0.7 percentage points to 41.9 per cent of GDP.

Higher tax revenues were recorded in 2015. However, the tax revenue ratio declined by 0.2 percentage points, from 28.0 per cent of GDP in 2014 to 27.8 per cent of GDP in 2015, partly as a result of the measures undertaken to reduce the tax burden. Furthermore, tax buoyancy was more moderate than historical performance due to growth composition being significantly influenced by less tax-rich components such as gross fixed capital formation and also due to the abnormal timing of Value Added Tax (VAT) refunds.

The ratio to GDP of current taxes on income and wealth decreased by 0.2 percentage points, mainly underpinned by the expiry of the temporary revenue measure of the Investment Registration Scheme in the end of 2014. Moreover, the decrease in the ratio of income tax paid by individuals was offset by a higher ratio from income tax paid by companies.

Taxes on production and imports registered a marginal 0.1 percentage point of GDP decrease in 2015. Although the growth in the tax base of indirect taxes grew relatively strongly in 2015, it was still less than the rate of growth in GDP. Both the VAT, and the excise and consumption taxes decreased by 0.1 percentage points in 2015, reaching 7.8 per cent and 2.9 per cent of GDP respectively. Nevertheless, they still remain an essential part of indirect tax revenue generation. VAT performance was in part influenced by the unusual timing of the payment of VAT refunds in January this year which had an effect on 2015 due to the time adjustment method used in accrual adjustment of VAT revenue data. These decreases were partly offset by a 0.1 percentage point increase in taxes on capital and financial transactions. Social security contributions registered a slight decrease of 0.1 percentage point of GDP in 2015.

Compared to 2014, the ratio of property income remained relatively unchanged, whereas 'other revenue' recorded an increase of 1.1 percentage points of GDP. This was mainly underpinned by higher receipts from capital transfers and investment grants, due to higher utilisation of the EU structural funds in 2015. In addition, higher receipts from Government market output were also a contributing factor to the increase in 'other revenue', as a result of the International Investor Programme (IIP) that was launched in 2014.

### **3.1.2 General Government Expenditure in 2015**

In 2015, the ratio of general Government expenditure increased by 0.1 percentage points of GDP from 43.2 per cent in 2014 to 43.3 per cent, reflecting higher ratios recorded for gross fixed capital formation, capital transfers and intermediate consumption. These were offset by lower expenditure ratios for social benefits and social transfers in kind, compensation of employees, interest expenditure and 'other' expenditure.

The increase in the ratio of gross fixed capital formation from 3.7 per cent of GDP in 2014 to 4.6 per cent of GDP in 2015 was mainly underpinned by higher expenditure for the acquisition of new and existing tangible fixed assets, notably in relation to the closure of the EU funds programming period 2007-2013. The closure of major projects that were in part financed from EU funds include the completion of infrastructure works at Mater Dei hospital's new wing near the Emergency Unit, the completion of the Oncology Hospital, the retrofitting of road and street lighting by smart lighting,

the restoration of forts and historical places, and the upgrading of ports and the Grand Harbour regeneration area. Other major increases due to EU funds were attributable to higher outlays by Extra Budgetary Units (EBUs), particularly in relation to acquisitions of new fixed assets. Other notable increases were also registered in the construction/upgrading of works and equipment, and road construction/improvement.

The ratio of capital transfers to GDP increased by 0.4 percentage points in 2015, mainly underpinned by the higher equity injection to the national airline as part of the ongoing restructuring process and to a lesser extent, due to increases in the investment towards reducing carbon footprints, and increases in the capital transfers towards the Water Services Corporation for works related to water quality and supply and the sewage system project. These were partly offset by lower financing towards renewable energy in domestic sectors.

The increase in the ratio of intermediate consumption from 6.5 per cent of GDP in 2014 to 6.8 per cent of GDP in 2015 was mainly underpinned by higher Operational and Maintenance expenses. These are primarily related to human health activities and to a lesser extent, towards residential care activities and public administration. Expenditure related to Programmes and Initiatives also contributed to a higher intermediate consumption ratio. These include increases in expenditure towards the free child care for all initiative, expenditure related to the EU Presidency for Malta in 2017, and outlays towards the Commonwealth Head of Governments meeting and the Valletta Summit on Migration between EU and African leaders, both held in Malta in November 2015. Expenditure related to medicines and surgical materials remains the largest outlay for Programmes and Initiatives; nevertheless, this has not increased halting the rising trend recorded in previous years. The intermediate consumption ratio also increased as a result of higher expenditure towards Engineering Resource Limited and EBUs, and due to increases in capital expenditure classified under this component of revenue.

The ratio of social payments in cash and in kind decreased by 0.7 percentage points in 2015, as social security expenditure increased less than economic growth. This was underpinned by lower non-contributory benefits primarily as a result of the extra payment of children's allowance in 2014 which was not repeated in 2015. These savings were partly offset by the one-time Child Supplement benefit and the In-Work benefit expenditures. Contributory benefits increased mainly due to a rise in pensions in respect of retirement. In 2015, social security contributory beneficiaries consisted mainly of people earning Two-Thirds pensions and sickness benefits. Whereas the former registered the largest increase, the latter benefits registered the largest decline in beneficiaries in 2015. In the non-contributory benefits category, the largest recipients of benefits were for children's allowance and supplementary allowance. The largest increase in non-contributory beneficiaries was attributable to unemployment assistance taper, whereas the biggest decrease was in social assistance beneficiaries.

The ratio of compensation of employees decreased from 13.0 per cent of GDP in 2014 to 12.7 per cent of GDP in 2015, reflecting the lower rate of growth in labour income paid by general Government relative to GDP growth.

The ratio of interest expenditure decreased by 0.3 percentage points in 2015, reflecting the lower levels of interest expenditure recorded in 2015. The ratio of 'other' expenditure to GDP decreased by 0.2 percentage points to 2.2 per cent, mainly due to a decrease in other current transfers, and to a lesser extent, an increase in the change of inventories and acquisitions which is recorded as negative expenditure under this component.

## 3.2 Extraordinary Factors Affecting the 2015 Outcome

Malta has managed to marginally outperform its deficit targets. In particular, the deficit in 2015 reached 1.5 per cent of GDP compared to the target of 1.6 per cent of GDP.

This was achieved despite a higher than anticipated budget to cover elements of national co-financing, non-eligible expenditure and funding gaps that were necessary in order to ensure that a strong rate of absorption of EU funds could be achieved. This amounted to a variance of €35 million (equivalent to 0.40 per cent of GDP) from the original November 2014 (for the 2015 Budget) projections. Additional expenditure related to the EU-Africa Summit and the Commonwealth Heads of Government meeting amounting to €5.1 million, equivalent to 0.06 per cent of GDP were also not foreseen in the original fiscal targets presented in the November 2014 Budget for 2015.

These variances, in total amounting to 0.46 per cent of GDP, are not expected to be repeated in the coming years and in their absence, Malta would have attained an even lower deficit outturn and a much stronger structural effort.

## 3.3 Consolidating Budgetary Targets in 2016

Government remains committed to ensuring a sustainable fiscal position by gradually reducing the fiscal imbalance. During the current fiscal year, the general Government balance is expected to decline further from 1.5 per cent of GDP for 2015 to 0.7 per cent of GDP in 2016 consistent with an improvement in the fiscal position of 0.8 percentage points of GDP and an equal structural effort of 0.8 percentage points of GDP. Table 3.1 presents the main projections of Government, while Table 3.2 presents the measures supporting the fiscal consolidation envisaged over the medium-term.

### 3.3.1 General Government Revenue in 2016

As indicated in Table 3.1, the general Government revenue-to-GDP ratio is expected to decrease by 2.5 percentage points to 39.4 per cent of GDP in 2016, mainly attributable to a decrease in the ratio of the 'other' component of revenue of a magnitude of 2.1 percentage points. This mainly reflects lower EU funds following the final uptake of revenue from the 2007-2013 Financial Framework. Lower revenue from EU funds in 2016 will be translated in lower capital projects financed by EU funds, thus rendering such decline in revenue generally deficit neutral except for the co-financing element which was significant last year and which is expected to be more contained this year.

Marginal declines of 0.1 percentage points are expected in each of the property income ratio, the social contributions ratio and the total tax ratio. The decline in the latter is namely due to a lower current taxes on income and wealth ratio, partly as a result of measures in place to reduce the tax burden on labour (equivalent to 0.2 percentage points). When compared to historical performance, revenue forecasts for 2016 remain prudent as evidenced from the negative tax buoyancy. This is partly due to the composition of growth which is less tax-rich and partly due to prudent elasticity assumptions below unitary in the forecasts.

The incremental impact from measures of previous budgets together with the measures introduced in the 2016 Budget, where estimates were revised to take into account more up to date information, are expected to exert an improvement in the deficit-to-GDP ratio of 0.35 percentage points, namely due to an increase in revenue expected from the



## Main Fiscal Projections

(per cent of GDP)

Table 3.1

	2014	2015	2016 <sup>(1)</sup>	2017	2018	2019
<b>Revenue</b>	<b>41.2</b>	<b>41.9</b>	<b>39.4</b>	<b>39.3</b>	<b>38.8</b>	<b>38.4</b>
Components of revenue						
Taxes on production and imports	13.6	13.5	13.6	13.5	13.3	13.1
Current taxes on income and wealth	14.3	14.1	13.9	13.8	13.8	13.9
Capital taxes	0.1	0.2	0.2	0.2	0.1	0.1
Social contributions	6.9	6.8	6.7	6.5	6.4	6.4
Property income	1.2	1.1	1.0	1.0	0.9	0.9
Other revenue	5.1	6.2	4.1	4.4	4.2	4.0
<b>Expenditure</b>	<b>43.2</b>	<b>43.3</b>	<b>40.1</b>	<b>39.9</b>	<b>39.0</b>	<b>38.3</b>
Components of expenditure						
Compensation of employees	13.0	12.7	12.5	12.3	12.1	12.0
Intermediate consumption	6.5	6.8	6.5	6.5	6.2	6.0
Social payments in cash and in kind	12.4	11.7	11.3	11.1	11.0	10.9
Interest expenditure	2.9	2.6	2.3	2.2	2.2	2.1
Subsidies	1.3	1.3	1.2	1.2	1.1	1.1
Gross fixed capital formation	3.7	4.6	3.5	3.6	3.4	3.3
Capital Transfers Payable	1.1	1.5	0.5	0.7	0.7	0.7
Other expenditure	2.4	2.2	2.3	2.3	2.3	2.4
<b>Deficit</b>	<b>-2.0</b>	<b>-1.5</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.2</b>	<b>0.1</b>
<b>Primary Balance</b>	<b>0.8</b>	<b>1.1</b>	<b>1.6</b>	<b>1.7</b>	<b>2.0</b>	<b>2.2</b>

<sup>(1)</sup> Forecasts from 2016 onwards

International Investor Programme equivalent to 0.28 percentage points. Higher revenue from revenue increasing measures brought about by the various revisions in excise duties from cigarettes and tobacco, fuel, and cement are also expected to increase the revenue ratio. The latter, however, are being partially offset by the loss in revenue from the phasing out of the eco-contribution system. A list of the discretionary measures underpinning fiscal consolidation in 2016 is presented in Table 3.2.

### 3.3.2 General Government Expenditure in 2016

In 2016, the ratio of general Government expenditure to GDP is expected to decline by 3.2 percentage points of GDP from 43.3 per cent in 2015. As shown in Table 3.1, this development is mainly due to lower public investment, which is expected to decrease from 4.6 per cent of GDP to 3.5 per cent of GDP, primarily reflecting lower expenditure related to capital projects financed from EU funds received under the 2007-2013 Financial

### Discretionary Factors Underpinning Fiscal Consolidation

(Euro millions)

*Note: The impact of the measures is reported on accruals basis. The impact is recorded in incremental terms, as compared to the previous year's baseline projection. It also includes lagged incremental effects of previous budget measures. A positive represents a decline in the deficit.*

Table 3.2

	2013	2014	2015	2016	2017	2018	2019
<b>Main Measures Impacting on Revenue</b>							
Fiscal consolidation measures	<b>9.05</b>	<b>21.92</b>	<b>24.58</b>	<b>17.27</b>	<b>27.60</b>	<b>4.50</b>	<b>5.00</b>
Revision in excise duty on fuel <sup>(3)</sup>	3.90	7.65	4.13	8.85	—	—	—
Revision in excise duty on cement <sup>(3)</sup>	1.10	3.10	2.60	2.92	-0.77	—	—
Revision in excise duty on cigarettes and tobacco <sup>(3)</sup>	4.00	7.46	5.47	8.71	—	—	—
Revision in excise duty on mobile telephony	0.05	0.05	1.38	—	—	—	—
Revision in excise duty on beer, spirits and wine	—	1.45	1.90	—	—	—	—
Revision in the bunkering tax	—	0.61	—	—	—	—	—
An increase in fees of office	—	1.60	2.93	—	—	—	—
Cost recovery of current free banderoles	—	—	0.90	—	—	—	—
Introduction of new excise duties and licence fees to replace Eco-Contribution	—	—	4.07	3.69	—	—	—
Estimated loss of revenue from the phasing out of Eco-Contribution	—	—	—	-6.90	-0.63	-0.50	—
Revision in the duty on documents on insurance products	—	—	1.20	—	—	—	—
Other Revenue Measures <sup>(1)</sup>	—	—	—	—	29.00	5.00	5.00
Growth enhancing measures	<b>-35.06</b>	<b>12.50</b>	<b>-33.65</b>	<b>-13.00</b>	<b>0.75</b>	<b>0.00</b>	<b>0.00</b>
Widening of the income tax rates	-11.53	-13.20	-19.22	-11.30	—	—	—
Financial Support to First Time Buyers	—	-0.50	0.25	-0.50	0.75	—	—
International Registration Scheme <sup>(2)</sup>	—	31.80	-31.80	—	—	—	—
Widening of tax base due to International Registration Scheme	—	—	6.00	—	—	—	—
Efficiency in revenue collection	-23.53	-5.60	-1.95	-1.20	—	—	—
Anti Avoidance Measures	—	—	13.07	—	—	—	—
Measures promoting a sustainable environment	<b>-3.00</b>	<b>2.87</b>	<b>2.18</b>	<b>4.36</b>	<b>2.03</b>	<b>0.00</b>	<b>0.00</b>
Annual circulation licence fee	—	2.46	2.18	—	—	—	—
Revision in the driver's licence fee coverage	—	0.45	—	—	—	—	—
Reduction in the registration tax for motor vehicles <sup>(2)</sup>	-3.00	-0.04	—	—	—	—	—
Tourist Environmental Charge <sup>(3)</sup>	—	—	—	4.36	2.03	—	—
Social cohesion measures	<b>11.50</b>	<b>7.39</b>	<b>11.00</b>	<b>3.20</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
Pension reform initiatives	11.50	11.50	11.50	3.20	—	—	—
Revision in Income Tax Bands for Family Computation	—	-1.80	—	—	—	—	—
Tax Exempt COLA on minimum wage and pensions	—	-0.20	—	—	—	—	—
Tax incentive to take up private pension (third pillar)	—	-1.50	—	—	—	—	—
Tax Credit Extension for Child Care	—	-0.40	—	—	—	—	—
Income Tax Credits - School Transport Incentives	—	—	-0.50	—	—	—	—
Social Security Exemption for Carers	—	-0.21	—	—	—	—	—
Other measures	<b>-2.50</b>	<b>12.50</b>	<b>37.69</b>	<b>29.81</b>	<b>-42.40</b>	<b>0.00</b>	<b>0.00</b>
International Investor Programme <sup>(2)</sup>	—	12.50	37.69	29.81	-42.40	—	—
Removal of TV Licences	-2.50	—	—	—	—	—	—
<b>Total</b>	<b>-20.01</b>	<b>57.18</b>	<b>41.80</b>	<b>41.64</b>	<b>-12.02</b>	<b>4.50</b>	<b>5.00</b>

### Main Measures Impacting on Expenditure

Social cohesion measures	<b>8.06</b>	<b>-7.49</b>	<b>-22.23</b>	<b>8.55</b>	<b>5.04</b>	<b>3.64</b>	<b>3.59</b>
Conditional Children's Allowance <sup>(2)</sup>			-7.84	7.84	—	—	—
Pension reform initiatives	12.27	0.81	0.82	0.92	0.98	—	—
Revision in the minimum rate of children's allowance	-2.30	—	—	—	—	—	—
Extension of maternity leave	-0.50	—	—	—	—	—	—
Assistance to help the Elderly <sup>(2)</sup>	-1.40	-2.98	-0.45	-1.01	0.00	-0.50	—
Free Child Care Centres <sup>(2)</sup>		-5.32	-5.83	0.15	—	—	—
In Work Benefit <sup>(2)</sup>			-1.06	-0.94	—	—	—
Bonus for non-eligible pensions			-2.30	—	—	—	—
Elimination of Pension Anomalies (incl. ex Shipyard Employees)			—	—	—	—	—
Service Pension Adjustment			-1.60	—	—	—	—
One-Time Additional Bonus <sup>(2)</sup>			-7.18	7.18	—	—	—
Tapering of Benefits			1.56	3.36	3.63	4.31	3.75
Youth Guarantee			2.65	1.15	0.03	0.04	0.03
Minimum pension for married couples				-0.50	—	—	—
Minimum pension				-5.40	0.40	-0.20	-0.20
Widows pension				-1.70	—	—	—
Exclusion of child's income from means test for social assistance				-1.50	—	—	—
Live-in Carers Fund				—	—	—	—
Measures promoting a sustainable environment		<b>-0.53</b>	<b>-0.44</b>	<b>-0.83</b>	<b>-0.98</b>	<b>0.00</b>	<b>0.00</b>
Scrappage Scheme <sup>(2)</sup>		-0.53	-0.44	0.48	—	—	—
Hotel Energy Efficiency Scheme							
Grant for Electric Vehicles				-0.10	0.02	—	—
Environmental Scheme				-0.21	—	—	—
Other measures	<b>-20.00</b>	<b>21.83</b>	<b>-27.16</b>	<b>36.53</b>	<b>-0.60</b>	<b>-0.10</b>	<b>0.00</b>
Equity acquisition in Airmalta plc <sup>(2)</sup>	-20.00	25.00	-28.00	43.00	—	—	—
Ex-Gratia Payment on Car Registration Tax <sup>(2)</sup>		-3.17	0.84	-1.97	-0.60	-0.10	—
Expropriation Compensation				-4.50	—	—	—
<b>Total</b>	<b>-11.94</b>	<b>13.81</b>	<b>-49.84</b>	<b>44.26</b>	<b>3.46</b>	<b>3.54</b>	<b>3.59</b>

<sup>(1)</sup> Consolidation measures in 2017, 2018 and 2019 are still to be specified in the respective budget, including the decision whether to resort to revenue and or expenditure or a mix of both.

<sup>(2)</sup> The recorded budgetary impact for historical years for all measures is the ex-ante impact, except for the budgetary impact marked in (2), which is the ex-post impact.

<sup>(3)</sup> The budgetary impact for measures marked in (3) is an updated estimate than that contained in the Draft Budgetary Plan to take into account more up to date information.

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

Framework. Nonetheless, public investment financed through national funding is still set to increase.

Lower capital transfers, namely due to no further equity injections in Air Malta are also expected to contribute towards a lower expenditure ratio. It is being envisaged that the fact that there will be no further equity injection in Air Malta in 2016 when compared to 2015 will lower the deficit-to-GDP ratio by 0.5 percentage points.

Supported by the in-depth Comprehensive Spending Review on Social Protection expenditure, growth in social benefits expenditure is expected to be weaker than GDP growth. As a result, the ratio to GDP of social benefits is expected to decline by 0.4 percentage points.

Interest payments in 2016 are expected to be lower than those in 2015, underpinned by the ensuing low interest rate environment, such that interest expenditure as a percentage of GDP is expected to decline by 0.3 percentage points.

Intermediate consumption and compensation of employees are expected to grow at a slower pace relative to GDP growth. Consequently, intermediate consumption as a ratio to GDP is expected to decline by 0.3 percentage points, while the ratio to GDP of compensation of employees is expected to decline by 0.2 percentage points.

Moreover, as documented in the 2016 National Reform Programme and in Chapter 6 of this Update, reviews of Government spending will continue so as to ensure the achievement of improved efficiency in public spending.

### **3.4 Additional Consolidation Measures in 2016**

Further to the measures outlined in Table 3.2, the Government will undertake additional consolidation measures amounting to €15 million in 2016. These consolidation measures are expected to sustain further the expenditure-based consolidation and strengthen the improvement in the structural balance to 0.8 percentage points of GDP in 2016 compared to the effort of 0.6 percentage points of GDP contemplated in the 2016 Budget. By virtue of this Programme, these additional measures are being tabled in Parliament within Malta's National Medium-Term Fiscal Plan. These expenditure-decreasing measures are expected to exert an improvement in the deficit-to-GDP ratio of 0.16 percentage points.

As indicated in Table 3.3, Government is scaling back capital transfers. In total, these restrictions in capital transfers are expected to result in a consolidation effort equivalent to 0.09 percentage points of GDP.

Until such time as the planned recruitment becomes effective, after taking into account new guidelines on the submission and approval of Business and Human Resources Plans in terms of the Public Administration Act (Directive 10). Furthermore, after due consideration of the rolling three-year Business and Financial Plans submitted in part fulfilment of the requirements of the Fiscal Responsibility Act, savings are materialising. This is expected to improve consolidation by a further 0.04 percentage points of GDP.

Expenditure towards intermediate consumption will also be controlled and is expected to lower intermediate consumption by a further 0.02 percentage points of GDP.

## Further Expenditure Consolidation Measures Underpinning Fiscal Consolidation in 2016

(Euro thousands)

*Note: The impact of the measures is reported on accruals basis. The impact is recorded in level terms. These expenditure consolidation measures are additional to those included in Table 3.2*

**Table 3.3**

### Compensation of employees (ESA Code - D1)

Restriction in recruitment growth -4,100

### Intermediate consumption (ESA Code - P2)

Lower expenditure towards intermediate consumption -1,640

### Other current transfers, payable (ESA Code - D7)

A restriction in other current transfers to be paid by Government for 2016 -490

### Capital transfers, payable (ESA Code - D9)

Lower expenditure in capital transfers -8,770

**TOTAL -15,000**

**TOTAL (% of GDP) -0.16**

Government is also committed to a further consolidation of 0.01 percentage points of GDP through lower capital and current transfers.

## 3.5 Medium-Term Fiscal Strategy

Malta's medium-term fiscal strategy envisaged for the 2016-2019 period depends on the macroeconomic projections contained in this Programme. Over the medium-term, the Maltese economy is expected to continue growing at a moderate pace, though at a slower rate than that recorded in 2015, mainly fuelled by domestic demand reflecting the projected increases in private consumption. The rate of growth of potential output is also expected to moderate over the medium-term, such that the output gap is expected to remain positive though closing gradually by 2018 and to turn slightly negative in 2019.

Inflation is expected to pick up to its long-term average, before falling marginally in the outer years of the Programme period. Employment growth is expected to remain a key economic supporter, while moderating somewhat in the outer years of the forecast horizon edging closer to the long run average, while unemployment is forecasted to remain below the historical average. No major external imbalances are foreseen and the external balance of goods and services is expected to remain in positive territory.

In view of these developments, and in line with the requirements of the Fiscal Responsibility Act and the Stability and Growth Pact, the necessary structural effort shall be maintained over the medium-term.

### **Box 3.1**

#### **Output Gap Measurement Errors and Structural Fiscal Targets**

The Maltese Authorities use the commonly-agreed Production Function methodology in the estimation of potential output for Malta.

The latest estimates of the output gap for 2015 and 2016, based on the recent macroeconomic forecasts, are estimated at 1.6 per cent indicating that the Maltese economy is expected to operate at a rate of economic growth exceeding potential output growth.

Table 1 benchmarks the latest estimates of the Output Gap for Malta published by the IMF, the European Commission (EC) and the Stability Programme. It is evident that this measure is subject to significant variations and that a degree of caution is warranted in using the estimates of this indicator for policy purposes.

Macroeconomic evidence put doubts over whether the Maltese economy is operating beyond its potential. Indeed, the inflation rate averaged 1.0 per cent over the past three years and is forecasted to average 1.7 per cent over the period 2016-2019. Furthermore, increases in compensation per employee remained relatively muted in a low unemployment rate environment and is expected to remain so over the forecast period. Indeed, migration is contributing to contain increases in labour costs and addressing any emerging gaps in the skills set of the labour force.

Another factor affecting the measurement of potential output is the fact that the methodology does not take into consideration the full impact of structural reforms on potential output. Indeed as outlined in the National Reform Programme (NRP) for 2014, 2015 and 2016, Government is implementing a number of structural reforms that have contributed to raise potential output and whose impact is not completely being explicitly captured in the commonly-agreed Production Function methodology.

Table 2 below illustrates the likely economic impact of reforms in the energy sector, access to finance and active labour market policy based on modelling generated by the QUEST III model. These scenarios are outlined in greater detail in the NRP for 2015 and 2016. Other reforms impacting on potential output growth and outlined in detail in the NRP for 2014-2105 include policies addressing the skills gap and the Early School Leaving Strategy and measures to raise R&I expenditure. These scenarios support the view that increase in the rate of economic growth experienced in recent years has been substantively

### Alternative Output Gap Estimates

Table 1

Output Gap	2014	2015	2016	2017
IMF Article IV 2015	0.1	1.1	1.3	1.0
EC (Winter forecast)	0.3	1.0	0.9	0.6
Stability Programme 2016	-0.1	1.6	1.6	0.6

supported by the implementation of structural reforms as opposed to cyclical factors suggesting that the output gap estimates are at least partly overestimated.

The likely overestimation of the output gap is having an effect on the fiscal targets which are then the subject of fiscal policy decisions. Based on the current estimates of the output gap, Government is targeting a structural effort of 0.8 percentage points of GDP in 2016 following the absence of a structural effort estimated for 2015. Nevertheless, if one were to use the Winter Forecasts output gap projections of the EC, the structural effort rises to 0.4 percentage points of GDP in 2015 and remains at 0.8 percentage points of GDP in 2016. This clearly demonstrates the effect of the frequent revisions in the output gap projections and the implications for structural fiscal targets. It must be recalled that in an environment which is very dynamic and growth surprises have been significant, basing fiscal policy decisions on this indicator is challenging. In particular as early as February 2016, no institution was predicting such a rate of GDP growth for Malta. Also all institutions are probably underestimating to some extent Malta's potential growth and overestimating the output gap. In this context, one should always use a measure of caution in the interpretation of structural fiscal targets and even ex-post fiscal outcomes.

### Estimated impact on GDP

Table 2

Cumulative % changes from 2015	2015	2016	2018	2020
Energy reform	1.25	2.47	2.79	2.93
Access to Finance	n/a	0.21	0.57	0.84
<b>Cumulative % changes from 2014</b>				
Active labour market reforms	0.66	1.51	2.06	2.30

Source: National Reform Programme, Malta (2016)

### 3.5.1 Deficit Targets, Fiscal Rules and the Medium-Term Budgetary Objective

Consistent with the requirements of the national fiscal rules, the Government plans to further reduce the deficit over the period covered by the Stability Programme, with the attainment of a balanced budgetary position in structural terms by 2019. Indeed, Government would be close to its Medium-Term Budgetary Objective (MTO) of a balanced budget in structural terms already in 2018. Although this is consistent with the calendar of convergence established by the Commission for Malta, it is also worth noting that the MTO set by the Government is more stringent than that required by the Stability and Growth Pact.

Based on (i) the macroeconomic projections, (ii) the targeted structural adjustment path highlighted above and (iii) the expected one-off revenues of 0.1 per cent of GDP throughout the period under review, Government is aiming for a deficit target of 0.7 per cent of GDP in 2016 which will decline to 0.6 per cent of GDP in 2017 and further down to 0.2 per cent of GDP by 2018. A surplus of 0.1 per cent of GDP is expected in 2019. Based on the output gap projections, this translates into an average structural effort of 0.6 percentage points of GDP per annum between 2016 and 2019, with the adjustment being frontloaded in the early years of the Programme period. The analysis in the adjustment of the deficit-to-GDP ratio is found in Table 3.4 while further details on the fiscal consolidation strategy are illustrated in Table 3.5 and Chart 3.1.

The primary surplus is expected to gradually increase further from 1.1 per cent of GDP in 2015 to 2.2 per cent of GDP over the medium-term forecast horizon. Given a projected average annual growth rate of nominal GDP of 5.4 per cent, the primary surplus targets are consistent with a reduction in the debt-to-GDP ratio over the medium-term to fall below the 60 per cent of GDP reference value in line with the requirements of the Fiscal Responsibility Act (i.e. the Debt Rule). These projections are consistent with the forward-looking debt rule.

**Analysis of the Adjustment in the Deficit-to-GDP Ratio**  
(percentage points of GDP)

Table 3.4

	2014	2015	2016	2017	2018	2019
<b>Change in Revenue Ratio</b>	<b>1.83</b>	<b>0.67</b>	<b>-2.43</b>	<b>-0.12</b>	<b>-0.47</b>	<b>-0.41</b>
Discretionary factors underpinning fiscal consolidation	0.69	0.39	0.35	-0.22	-0.03	-0.02
Tax revenue buoyancy	0.94	-0.35	-0.31	-0.58	-0.26	-0.19
Other revenue	0.20	0.63	-2.48	0.68	-0.19	-0.20
<b>Change in Expenditure Ratio</b>	<b>-1.26</b>	<b>-0.12</b>	<b>3.20</b>	<b>0.27</b>	<b>0.84</b>	<b>0.68</b>
Discretionary factors underpinning fiscal consolidation	-0.14	-0.24	0.03	0.05	0.04	0.04
Fiscal Consolidation Measures	—	—	0.16	-0.16	—	—
Incremental impact of the Equity Injection in the National Airline	0.34	-0.30	0.49	—	—	—
Change in Gross Fixed Capital Formation	-0.82	-0.90	1.13	-0.04	0.15	0.18
Other expenditure	-0.64	1.33	1.39	0.42	0.65	0.46
<b>Adjustment in deficit ratio</b>	<b>0.57</b>	<b>0.56</b>	<b>0.77</b>	<b>0.15</b>	<b>0.37</b>	<b>0.28</b>

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



**Fiscal Consolidation**  
(percentage points of GDP)

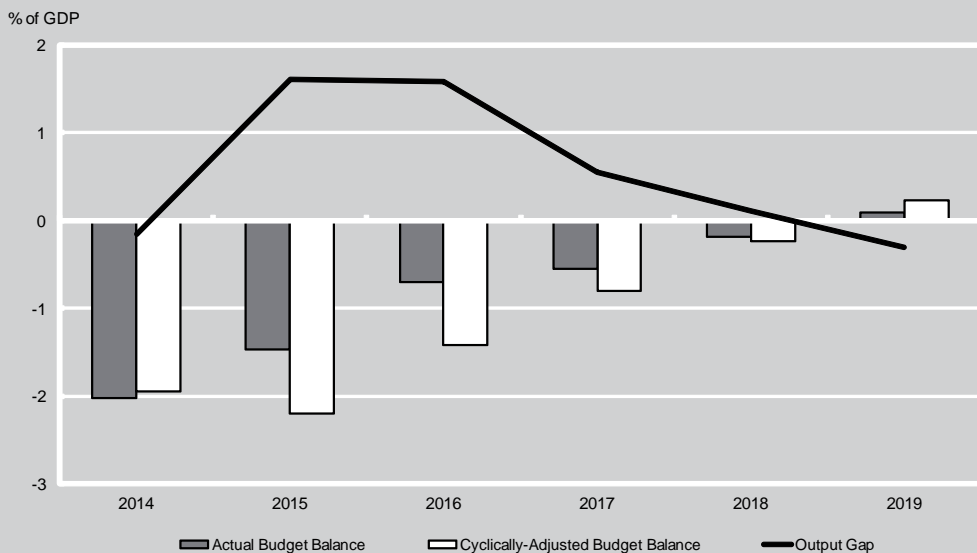
Table 3.5

	2014	2015	2016	2017	2018	2019
General Government Balance	-2.0	-1.5	-0.7	-0.6	-0.2	0.1
One-off and other temporary measures <sup>(1)</sup>	0.3	0.1	0.1	0.1	0.1	0.1
General Government Balance net of One-offs	-2.3	-1.6	-0.8	-0.6	-0.3	0.0
Output Gap Estimates	-0.1	1.6	1.6	0.6	0.1	-0.3
Cyclically-Adjusted Budget Balance	-2.0	-2.2	-1.4	-0.8	-0.2	0.2
Structural Balance	-2.3	-2.3	-1.5	-0.9	-0.3	0.2
Structural Adjustment	0.2	-0.0	0.8	0.6	0.6	0.5

<sup>(1)</sup> A plus sign means deficit-reducing one-off measures

Chart 3.1

**Actual and Cyclically-Adjusted Budget Balances**



### **3.5.2 Revenue Forecasts**

The Ministry for Finance prepares revenue forecasts for general Government based on the most plausible and prudent medium-term macroeconomic forecasts and assumptions. Due to lower EU-financed investments, a prudent elasticity assumption and a slower growth in the tax base than nominal GDP, as well as more moderate proceeds from the International Investor Programme, total revenue is expected to decline to a ratio of 38.4 per cent of GDP by 2019, from 41.9 per cent of GDP in 2015.

Tax revenue, including social security contributions, is expected to decline by a percentage point of GDP to 33.5 per cent of GDP by the end of the Programme period. Such developments are partly driven by conservative elasticity assumptions, despite relatively strong growth in consumption and tourism earnings, but also partly reflecting the measures in place to reduce the tax burden. Revenues from taxes on production and imports are expected to increase marginally in 2016 and to remain relatively stable in 2017, mainly supported by budgetary measures, and to decline over the medium-term to 13.1 per cent of GDP in 2019. The latter reflects a slower growth in the tax base than nominal GDP in the outer years of the forecast period. In the meantime, current taxes on income and wealth are expected to remain relatively stable over the Programme period. Social security contributions are also expected to remain relatively stable at around 6.5 per cent of GDP throughout the forecast period since income from employment is expected to move in line with nominal GDP.

Non-tax revenue, including property income and 'other' revenue, is set to decline from 7.3 per cent of GDP in 2015 to 4.9 per cent of GDP in 2019 as the revenue from the IIP moderates. Furthermore, 'other' revenue is significantly influenced by the absorption of EU funds and reflects the corresponding patterns in gross fixed capital formation and capital transfers. These dynamics have a favourable impact on the deficit represented by the co-financing element.

### **3.5.3 Expenditure Targets**

In line with its strategy of pursuing sustainability of public finances, and on the basis of the targeted structural effort and the revenue projections conditional on macroeconomic conditions and budgetary measures, expenditure targets have been set at 40.1 per cent of GDP in 2016 – 3.2 percentage points of GDP lower than the level recorded in 2015. In this context it is worth noting that in 2015, general Government expenditure was abnormally high on account of the extraordinarily high investment expenditure due to the high absorption intensity of EU-related investments in the last year of the Multiannual Financial Framework 2007-2013. As a consequence, a lower co-financing element equivalent to 0.6 percentage points of GDP is envisaged in 2016. Other temporary increases in expenditure, which will not be effected in 2016, mainly relate to the final equity injection in the national airline in 2015 equivalent to 0.5 per cent of GDP. Over the medium-term, the targeted general Government expenditure ratio is set to decline marginally to 39.9 per cent of GDP in 2017 and to 38.3 per cent of GDP by 2019.

Over the medium-term, the corrected Government expenditure aggregate, net of discretionary revenue measures is expected to increase by an annual average of around 3.2 per cent per annum.

As outlined above, the major decline in the expenditure to GDP ratio is set to come from lower EU-financed capital investment projects, as a result of which, the ratios to GDP of gross fixed capital formation and of capital transfers are expected to decline

significantly. Whilst such declines in outlays correspond to similar decreases in inflows and usually exert a predominantly neutral impact on the budget balance, on account of the extraordinarily high investment expenditure in 2015, a positive budgetary impact due to a lower co-financing element equivalent to 0.6 percentage points of GDP is envisaged in 2016. Meanwhile, developments in capital transfers are also affected by the impact of the restructuring of Air Malta towards which, a final capital injection amounting to 0.5 percentage points of GDP was made in 2015. As a result, the ratios to GDP of gross fixed capital formation and capital transfers are set to decline by 1.3 percentage points and 0.8 percentage points of GDP, respectively, by 2019.

Social payments in cash and in kind are set to continue on the declining trend relative to GDP recorded in recent years and are expected to decline by 0.8 percentage points of GDP over the forecast horizon. Such development reflects both the expiry of temporary measures in respect of a conditional supplementary child benefit in 2015, as well as savings in social benefits stemming from the Youth Guarantee, in-work benefit and the tapering of social benefits, which aim to incentivise and reward work effort as well as discourage dependency on the social security system. As a result, the ratio of social benefits and social transfers in kind is expected to decrease over the medium-term to 10.9 per cent of GDP in 2019 from 11.7 per cent in 2015. In this context, it is worth noting that the impact of the pension reform initiative legislated in 2006 over the medium-term projections contained in this Programme is expected to be marginal.

The ratio to GDP of intermediate consumption is also set to decline notably from 6.8 per cent in 2015 to 6.0 per cent in 2019. The drop in intermediate consumption partly reflects the expected positive impact from the ongoing Ministerial Spending Review. While this exercise was initiated in 2013, the positive impacts are expected to appear over a number of years as Government Departments and Line Ministries slowly adopt more stringent efficiency requirements and the benefits of the exercise gradually kick in. This decline also reflects the projected decline in expenditure in respect of the 2017 Council Presidency classified under intermediate consumption.

Compensation of employees is expected to decline by 0.7 percentage points of GDP to 12.0 per cent in 2019, mainly reflecting restraint on additional recruitment in the public sector whilst the growth in the average public sector compensation is expected to lag nominal GDP growth over the medium-term.

Meanwhile, a marginally lower ratio of subsidies is expected to be offset by a marginally higher ratio of 'other' expenditure, which is mainly explained by other current transfers payable. It is worth noting that the medium-term projections for other current transfers payable also includes an annual contingency reserve of 0.1 per cent of GDP which, in line with the Fiscal Responsibility Act 2014, has been established by Government to ensure that unforeseen expenditure or revenue slippages do not jeopardise compliance with the established fiscal rules. If unused, this will contribute towards further improvement in the budget balance and the structural balance beyond the targets included in this Update.

### **3.6 Debt levels and developments**

Government's core medium-term fiscal objective is that of restoring the trajectory of public finances to a sustainable path. This aim involves two main targets; addressing the current imbalance in public finances, and reducing the debt-to-GDP ratio at a satisfactory pace. Sustained economic growth and primary surpluses are expected to drive the Government debt to continue on a downwards trajectory from 63.9 per cent

of GDP in 2015 to 60.4 per cent of GDP in 2017, thereby approaching the 60.0 per cent debt-to-GDP target. Beyond 2017 the debt ratio is expected to fall below 60.0 per cent of GDP. Debt-to-GDP is expected to decrease further to 57.5 per cent of GDP in 2018 and 55.5 per cent of GDP in 2019. The projected decrease is expected to result from stable economic growth, primary surpluses, and improvements in the Stock Flow Adjustment (SFA).

Meanwhile, the Government's debt strategy remains that of ensuring that the financing needs of the public sector are met at the lowest possible costs, while simultaneously minimising medium and long-term interest rate risk. The Government's reliance on short-term funding remains marginal, in line with the dynamics exhibited in recent years. During 2015, short-term debt accounted for 4.0 per cent of total Government debt. The latter is expected to temporarily increase to 6.1 per cent in 2016 due to the financing of the projected increase in redemptions this year. Thereafter, short-term debt is expected to decline back to reach 3.4 per cent by 2019.

Moreover, the share of maturing stocks in total Government debt is expected to remain stable at around 6.7 per cent over the forecast horizon. Indeed, the ratio of maturing stocks in total Government debt is expected to increase marginally from a level of 6.2 per cent in 2015 to 7.1 per cent in 2016. Consequently, the proportion of maturing stocks in total Government debt is projected to embark on a downwards trajectory, with the ratio reaching 6.5 per cent in 2018. During 2019, the share of maturing stocks in total Government debt is expected to rise slightly to 7.2 per cent.

### **3.6.1 Projected Debt developments**

Developments in the debt ratio for the Programme period and the contributors to developments in the debt-to-GDP ratio are presented in Table 3.6 and Statistical Appendix Table 4. In this regard, the positive primary surpluses targeted in the coming years are expected to decrease the debt-to-GDP ratio throughout the forecast horizon. Furthermore, the contractionary impacts of the primary balance and the 'snowball effect' will more than offset the expansionary impact of the SFA on the debt-to-GDP ratio foreseen through the forecast horizon, with the exception of 2018, where a contractionary impact of the SFA on the debt ratio is envisaged.

Developments in the gross Government debt are illustrated in Chart 3.2. After declining from 67.1 per cent in 2014 to 63.9 per cent of GDP in 2015, the debt-to-GDP ratio is expected to decline further by 1.3 percentage points in 2016. The debt ratio is expected to continue to fall incrementally by 2.1 percentage points in 2017 and 2.9 percentage points in 2018, thus falling below the 60.0 debt-to-GDP target, and then continue on a declining path to reach 55.5 per cent of GDP in 2019. Over the medium-term horizon, the projected reduction in the gross debt is mainly driven by a growing primary surplus. In fact, the contractionary contributions of the primary balance are expected to reduce the debt ratio by almost an average of 0.3 percentage points each year throughout the forecast period. Furthermore the relatively high nominal growth scenario, especially between 2015 and 2017, will also contribute to the decline in the debt-to-GDP ratio.

Both components are expected to mitigate the upwards pressure that the interest, and to a lesser extent stock flow transactions, are expected to have on the debt-to-GDP ratio. The expansionary contribution of interest expenditure on the debt ratio is expected to fall throughout the forecast horizon, from 2.6 per cent of GDP in 2015 to 2.1 per cent of GDP in 2019.

### The Dynamics of Government Debt<sup>(1)</sup>

Table 3.6

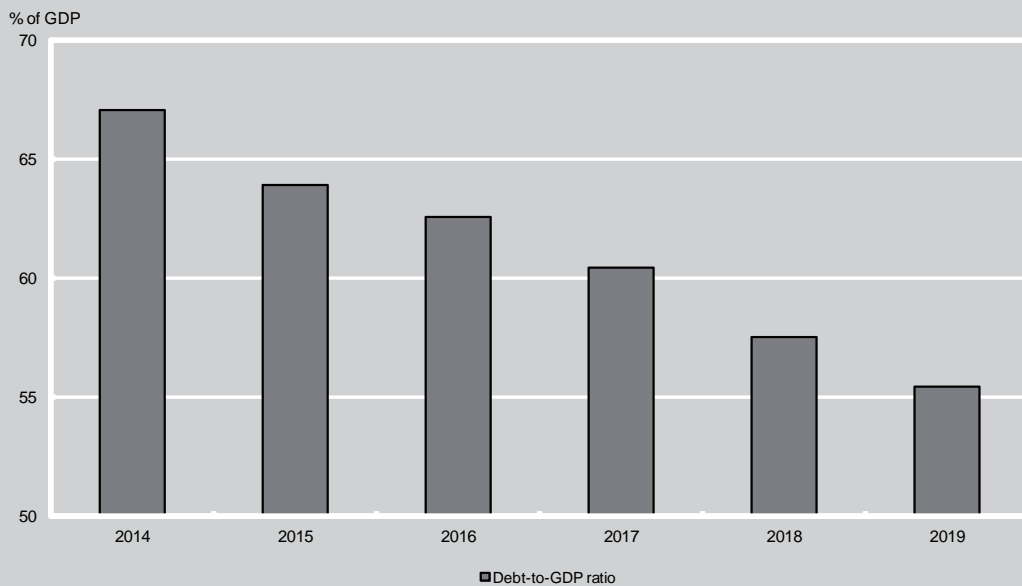
Percentage points of GDP	2014	2015	2016	2017	2018	2019
Gross debt (% of GDP)	67.1	63.9	62.6	60.4	57.5	55.5
Change in gross debt ratio	-1.5	-3.2	-1.3	-2.1	-2.9	-2.1
<b>Contributions to changes in gross debt</b>						
Primary balance	-0.8	-1.1	-1.6	-1.7	-2.0	-2.2
Snowball Effect	-0.8	-2.8	-1.8	-1.1	-0.6	-0.4
Interest expenditure	2.9	2.6	2.3	2.2	2.2	2.1
Real GDP growth	-1.4	-2.2	-1.1	-0.8	-0.8	-0.8
Inflation Effect	-2.3	-3.2	-3.0	-2.5	-2.0	-1.7
Stock-flow adjustment	0.2	0.8	2.0	0.7	-0.3	0.5
p.m. implicit interest rate on debt (%)	4.4	4.2	3.9	3.8	3.8	3.8

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

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

Chart 3.2

### Debt-to-GDP ratio



The other factors contributing to changes in the debt-to-GDP ratio are outlined by the estimated SFA. In 2015, the SFA is estimated to have resulted in a 0.8 percentage point increase in the debt-to-GDP ratio. This was mainly underpinned by the adjustments made to the deficit in ESA10 due to higher other accounts receivable and payable, primarily on account of higher EU funds receivable. The increase in the SFA in 2015 was partly offset by the repayment of loans to Government by Air Malta, from courts and other deposits, and by a decrease in the cash holdings on the part of Government. Over the forecast period, the SFA is projected to result in an expansion on the debt ratio of 2.0 percentage points in 2016 and 0.7 percentage points in 2017. These expansionary impacts are largely underpinned by an increase in the contribution towards a special Malta Government Stocks (MGS) sinking fund, increases in the EFSF/ESM credit line facility and, in 2016 a sizeable increase in the cash holdings on part of Government. Beyond 2017, stock flow transactions are expected to have a marginal impact on debt ratio. In fact, in 2018 the SFA is projected to have a contractionary contribution on the debt-to-GDP ratio. Further details on the SFA can be found in Annex Table 10.

### **3.6.2 Comparison with the April 2015 Update of the Stability Programme**

As illustrated in the Statistical Appendix Table 6, the ratios of general Government debt-to-GDP presented in this Programme are expected to be lower than those presented in the previous Stability Update. The expected improvement is largely attributable to a more favourable macroeconomic outlook for the period from 2015 to 2019 than that envisaged in the preceding Update, and a more beneficial 'snowball effect', especially between 2015 and 2017. Lower interest expenditure than that projected in the previous Update has also contributed, to a lower extent, towards this improvement in the debt ratio.

For 2015, the debt-to-GDP ratio was revised downwards by 2.9 percentage points to 63.9 per cent of GDP. This revision reflects a more buoyant macroeconomic environment than that expected in the earlier update. The debt-to-GDP ratios for 2016 and 2017 were revised downwards by 3.0 and 3.4 percentage points, respectively.

In the 2015 Update, the debt-to-GDP ratio was expected to follow a downwards path from a level of 66.8 per cent in 2015 to a level of 61.2 per cent in 2018. On the other hand, in this Update of the Stability Programme, the debt-to-GDP ratio is estimated to decline to a level of 57.5 per cent by 2018, thus achieving in the process the 60.0 per cent debt-to-GDP target set-out in the Stability and Growth Pact requirements.

## **4. Sensitivity Analysis**

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## 4. Sensitivity Analysis

Ensuring the accuracy of macroeconomic forecasts in an economy is highly important especially for Malta as a small and very open economy. Since macroeconomic forecasts are the foundation of Government economic policy making, formulation and analysis and decision-making process, the assessment of past forecasting performance is important to improve the accuracy of the forecasts to lend credibility to the forecasting exercise. While the Maltese economy has proved to be very resilient to the international economic crisis, Gross Domestic Product (GDP) forecast errors are relatively higher for Malta than those observed for larger and less open economies in the European Union (EU). However, on a more positive note, a study undertaken by the Economic Policy Department (EPD) within the Ministry for Finance (MFIN) shows no systematic or significant biases in real GDP growth projections. Furthermore, if one excludes the recession of 2009 (which bears a disproportionate weight in the small sample of observations) and the subsequent recovery in 2010, Malta's forecasting performance is comparable to larger and less open economies and becomes the best performer among small and open economies namely, Luxembourg and Ireland.

In recognition of the risks surrounding macroeconomic forecasts, this chapter provides an assessment of forecast uncertainty and the balance of risk surrounding the macroeconomic forecasts in this Programme. The analysis is in line with the requirements of Council Directive 2011/85/EU of the EU on the requirements for budgetary frameworks of the Member States.

### 4.1 The Accuracy of Past Forecasting Performance

The analysis does not find any systematic bias in the GDP growth projections carried out by the EPD within MFIN. In addition, the EPD forecasting accuracy is comparable with that of other institutions which carry out regular forecasts of the Maltese economy, including the European Commission and the Central Bank of Malta. Whilst the one-year ahead forecasts display a root-mean squared error (RMSE) of 2.4, it is notable that the sample size employed is rather small and the earliest forecast available is that of 2004. As a result of the sample size, the recession of 2009 and the subsequent recovery play an undue influence on this evaluation and limits comparability with the forecast accuracy displayed by other economies. Indeed, if these two years are excluded, the RMSE declines to 1.9 and is more comparable to that observed in other EU economies.

The evaluation of the risk and uncertainty of the current macroeconomic projections underlying this Programme is based on an *ex ante* analysis of past forecast errors which determine the level of uncertainty. *Ex post*, a number of alternative but plausible economic scenarios generated with the forecasting model used by the EPD to generate the same macroeconomic forecasts are also simulated to determine the balance of risks surrounding our baseline projections.

### 4.2 The Balance of Risks

To determine the balance of risks surrounding macroeconomic forecasts, sixteen alternative model-based growth projections were carried out. These represent alternative scenarios which the economists within MFIN judge to be plausible alternative scenarios to the baseline projections. Whilst a measure of economic judgement is deemed necessary in the choice of these scenarios, this is typically underlined by the constant monitoring

of economic conditions prevailing at the time and also informed by the various meetings carried out by the EPD with major operators and institutions within the Maltese economy.

#### **4.2.1 Model-Based Scenario**

The first scenario is a standard scenario involving the removal of any form of economic judgement underlying the baseline forecast thus, generating a purely model-based forecast. Nevertheless, the forecasts generated are still conditional on a number of exogenous assumptions such as world prices, international economic conditions, interest rates and exchange rates. Furthermore, this scenario still features the one-off investment projects and the respective one-off import content attributed to such projects which are present in the baseline forecasts. This scenario is underlined by stronger GDP growth in 2016 and a weaker growth for the outer years. Consequently, the budget balance would improve by 0.4 percentage points in 2016 but deteriorate over the outer years relative to the baseline scenario.

#### **4.2.2 Short-term Interest rates spot rates**

The short-term interest rate, which is based on the fixed interest rate of the main refinancing operations by the European Central Bank (ECB) is an exogenous variable in our macroeconomic forecasting methodology and is assumed to remain constant at the t-1 average level over the forecast horizon. Given that in March this was lowered to a zero level, this scenario quantifies the economic effects that arise from assuming that the short-term interest rate remains zero over the forecast horizon period. The effects of this scenario are expected to be an increase of 0.3 percentage points in real GDP in 2016 and 0.4 percentage points in 2017. Moreover, the effect on real GDP growth for the outer years is relatively more contained as real GDP growth is expected to increase by 0.1 percentage points in both years. Consequently, the budget balance would improve by 0.2 percentage points and by 0.4 percentage points in 2016 and in 2017, respectively. Moreover, the budget balance would improve concomitantly with improvements in economic growth over the 2018-2019 period.

#### **4.2.3 Stronger manufacturing Scenario**

At present, major operators remain upbeat about the prospects. However, risks in specific sub-segments of manufacturing still remain. The baseline forecast scenario takes a prudent stance. However, upside risks relative to the baseline scenario are acknowledged and are quantified accordingly. Two scenarios are assumed in this respect; a scenario where the manufacturing sector in 2016 remains at the same level as 2015 and another scenario which reflects the upbeats indicated by the major operators within the sector. Both scenarios depict a more positive outlook than the baseline scenario hence, *a priori*, they are expected to yield positive macroeconomic effects when compared to the baseline scenario.

In the former scenario, real GDP growth increases by 0.1 percentage points in 2016 and remains unchanged from the baseline scenario thereafter. In the latter scenario, real GDP growth also increases by 0.1 percentage points in 2016. Such contribution remains constant at 0.1 percentage points thereafter over the forecast horizon. It is worth pointing out that under the first scenario, the budget balance would remain unchanged when compared to the baseline whereas in the latter scenario, the budget balance would improve marginally by 0.1 percentage points in 2016 and remains unchanged thereafter.

#### **4.2.4 Weaker Tourism Growth Scenario**

The baseline projections underlying the Programme foresee an increase in the tourism sector even though this rate of increase is more prudent than that registered for 2015. Based on meetings conducted with major operators in the sector, they are envisaging a more conservative growth for the following years. In fact, they are expecting the shoulder months to be growing at stronger rates when compared to the same comparable period last year. However, the peak months are expected to grow at relatively weaker rates in the region of 2 per cent. Based on this scenario, GDP growth would decrease by 0.2 percentage points in 2016 and in 2017 when compared to the baseline forecast scene which in turn results in revising 2018 and 2019 downwards. This would result in a decrease in economic growth of 0.3 percentage points and 0.2 percentage points respectively. Based on this scenario, the budget balance would deteriorate by an average of 0.1 percentage points in each year over the 2016-2017 period, with the average deterioration increasing to 0.2 percentage points in the 2018-2019 period.

#### **4.2.5 Stronger Remote Gaming Growth Scenario**

Based on meetings conducted with stakeholders in the remote gaming sector, a stronger than anticipated growth similar to that registered in 2015 is seen as a plausible scenario compared to the rather prudent scenario foreseen in these projections. Based on this alternative assumption, GDP growth could strengthen significantly in 2016 and in 2017, with the positive impact decelerating in the outer years. Consequently, the budget balance would strengthen by 0.3 percentage points and by 0.5 percentage points in 2016 and in 2017 respectively. Over the outer years, the budget balance would continue to improve by an average of 0.7 percentage points each year.

#### **4.2.6 Elevated risks in global economic growth**

Over the recent years, the Maltese economy has operated in an environment characterised by uncertainty. The economic recovery experienced by the main trading economies over the past few years has continued to slow down and is currently weak in light of the slow down in global growth and geopolitical tensions leading to a larger impediment to investment spending than expected.

In light of the aforementioned uncertainties, this scenario models the impact of weaker than expected growth in Malta's main trading partners on the Maltese economy. The relatively lower than expected economic growth for our main trading partners is taken from the Consensus Forecasts March 2016 issue by assuming the low-end range survey growth figure for each partner, for 2016 and 2017. The expected growth for 2018 and 2019 is assumed to remain the same as in the baseline scene. Based on this scenario, GDP growth would diminish by 0.2 percentage points and by 0.1 percentage points in 2016 and 2017, respectively. The impact on the budget balance would be negligible over the forecast horizon period.

#### **4.2.7 Improved global economic growth Scenario**

Although the probability of having an improved global economic growth over the forecast horizon is remote in light of the current world issues as outlined in scenario 4.2.6, this scenario models the impact of stronger than expected growth in Malta's main trading partners on the Maltese economy. The relatively higher than expected economic growth for our main trading partners is taken from the Consensus Forecasts March 2016 issue by assuming the high-end range survey growth figure for each partner, for 2016 and 2017. The expected growth for 2018 and 2019 is assumed to remain the same as in the baseline

scene. Based on this scenario, GDP growth would increase marginally by 0.1 percentage points in 2016 and remains the same in 2017. Consequently, the budget balance would improve marginally by 0.1 percentage points in 2016 and remain unchanged thereafter.

#### **4.2.8 Stronger Medium-Term Private Investment Scenario**

Following the base effect in gross fixed capital formation in 2015 due to a number of large scale projects, including the construction of a new power plant, the baseline projection is still expecting investment to increase marginally in 2016 and to increase by a stronger rate in 2017. Only investment projects for which there is either a clear political commitment or contractual obligations between private operators are being negotiated are included in the baseline. There are nevertheless other projects which have a positive probability of being implemented over the coming years, which are included as positive risk scenario. Under this scenario, GDP growth is projected to remain the same in 2016 and to increase marginally by 0.1 percentage points in 2017 when compared to the baseline scenario. The impact on the budget balance would be negligible in 2016 and in 2017 while for 2018 and 2019, the budget balance would improve by 0.1 percentage points in each year.

Another scenario simulated in this area has to do with the import content assumed for one-off investment projects. For one-off investment projects, the baseline scenario assumes a share of 95 per cent for the machinery component part and 75 per cent for the construction part as import content of any major investment project. As a result, the effect on GDP from any one-off investment project is limited as the MFIN also takes a prudent stance in this aspect. However, from discussions held with other major players undertaking macroeconomic forecasts, a 75 per cent share as import content for the construction part of the investment project is assumed to be on the high-side while a 50 per cent share would be more realistic. Under this assumption, GDP growth will increase by 0.5 percentage points in 2016 and by 0.3 percentage points in 2017. Consequently, the budget balance is expected to improve by 0.1 percentage points in each year over the 2016 to 2019 period.

Within the area of private investment, although there are no quantifiable measures of the likelihood impacts that the Investment Plan for Europe and the establishment of the development bank will have on the Maltese economy, for risk analysis simulations, it is assumed that together these will contribute to an additional increase of €100 million starting from 2017 onwards. Under this scenario, GDP growth will remain the same in 2016 and will increase by 0.3 percentage points in 2017. The impact on the budget balance is assumed to be negligible in 2016 and marginally positive by 0.1 percentage points in 2017.

#### **4.2.9 No structural changes in private consumption in the outer years**

Over the past two years, private consumption increased at a higher rate than the fundamental long-run average growth rate observed over the past fifteen years. This could indicate a permanent change in savings behaviour. A scenario quantifying the impact on economic growth, if private consumption had to return back to the long-run average growth rate in 2018 and 2019 is simulated. This would decrease GDP growth by 0.2 percentage points and by 0.1 percentage points in 2018 and 2019, respectively. As a result, the budget balance would remain fairly unchanged in 2016 and in 2017 but deteriorates by 0.1 percentage points in 2018 and by 0.2 percentage points in 2019.

#### **4.2.10 BREXIT – The consequence of leaving the EU**

In view of the referendum on EU membership in the United Kingdom (UK) scheduled for June 23<sup>rd</sup>, 2016, Consensus Economics in its April issue conducted a survey to assess the likelihood impact in the event of BREXIT on the UK economy. Likewise, Consensus Economics also surveyed what the impact would be for the Euro currency versus the UK pound in such an event. Given that the UK is one of Malta's main trading partners, a scenario on this has been simulated. Under this scenario, GDP growth is expected to remain the same in 2016 and to decrease marginally by 0.1 percentage points on average in each year over the outer years. Consequently, the change in budget balance is negligible for 2016 but deteriorates slightly by 0.1 percentage points in each year over the period 2017 to 2019.

#### **4.2.11 Alternative World Prices Scenario**

World prices is an exogenous variable to the MFIN macroeconomic projections which is proxied by the Producer Prices index weighted by the share of international trade of Malta's main trading partners. The assumptions of how World Prices are expected to develop over the forecast horizon are based on the Consensus Forecast March 2016 issue. To get an alternative view, a scenario incorporating the assumptions for World Prices based on the Consensus Forecast April 2016 issue is simulated. In such a scenario, world prices are expected to diminish further relative to the previous issue. In this case, GDP growth diminishes by 0.1 percentage points in 2016 and stays the same in 2017. As a result, the budget balance would move in tandem with the deterioration in economic growth, over the forecast horizon period.

#### **4.2.12 Exchange Rate Depreciation Scenario**

The uncertainty surrounding exchange rate movements can have a significant influence on an open economy such as Malta. This scenario contemplates exchange rates to remain at the spot rate observed in April 20<sup>th</sup>, 2016 from the ECB website for 2016Q2 rather than at the rate forecasted by Consensus Economics in their Consensus Forecast March 2016 issue. For the outer quarters, the same growth rates as expected by Consensus Economics are assumed. Under this scenario, GDP growth increases marginally by 0.1 percentage points in 2016 and remains the same thereafter. Consequently, the budget balance would improve by 0.2 percentage points in 2016 and remain unchanged on average over the outer years.

### **4.3 Uncertainty and the Balance of Risk Underlying the Macroeconomic Projections**

The uncertainty surrounding the macroeconomic projections is based on the past forecast error variance of GDP. This is equal to 2.1 for the current year forecast, 2.0 for the one-year-ahead forecast, 2.8 for the two-year-ahead forecast and 2.8 for the three-year-ahead forecast. The balance of risk is based on the Pearson skewness indicator of the model generating alternative forecasts for GDP documented above. On balance, the indicator shows upside risk in 2016 and downside risks in the outer years of the Programme period. Chart 4.1 depicts a representation of the uncertainty and the balance of risk surrounding the macroeconomic forecasts presented in this Programme.

Chart 4.1

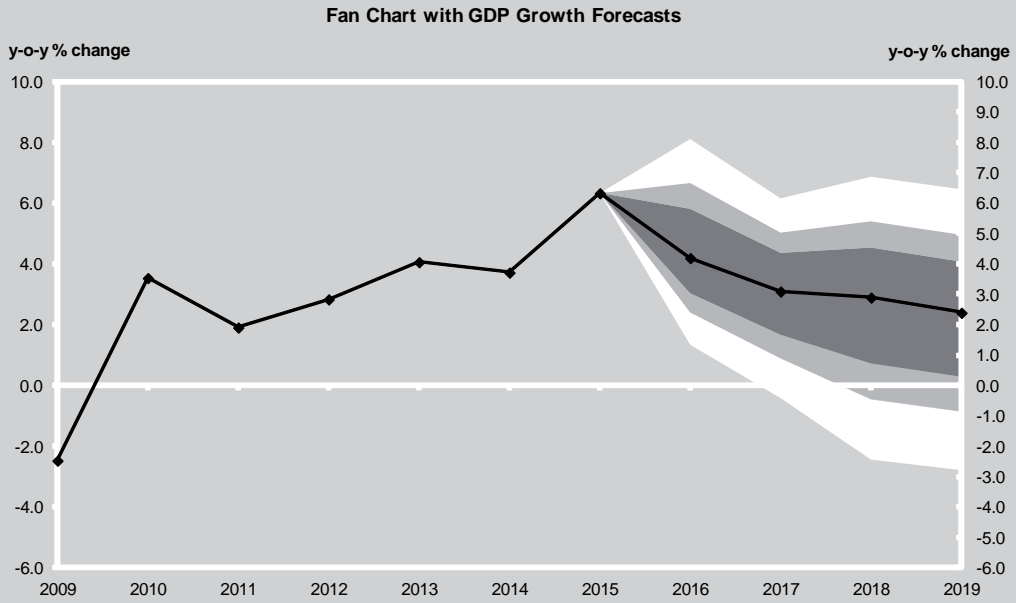
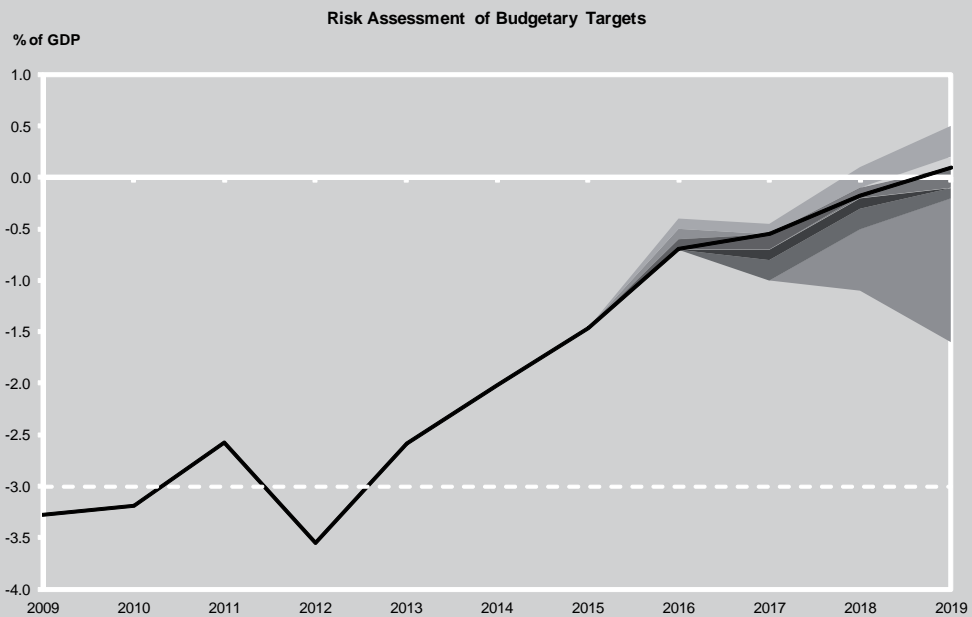


Chart 4.2



## 4.4 Risks to Fiscal targets

The alternative scenarios documented above, can influence the attainment of the deficit targets reflecting alternative fiscal conditions. Chart 4.2 illustrates the range of possible budget balance outcomes conditional on these alternative scenarios. Whilst the balance of risk is more favourable for 2016, it tilted towards the downside in the outer years of the Programme period. Under the worst possible cyclical scenarios contemplated, the deficit would still remain close to 1.0 per cent of GDP in the 2016-2017 period, respectively, whilst under more favourable growth scenarios, a budget surplus could be reached as early as 2018.





## **5. Sustainability of Public Finances**

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## 5. Sustainability of Public Finances

This Chapter provides an assessment of Malta's long-term sustainability of public finances for the period 2013-2060. This assessment is based on the expenditure projections from the Ageing Report 2015 which in turn reflect the population projections EUROPOP2013 carried out by EUROSTAT. This Chapter covers pension expenditure in Malta and health, long-term care, unemployment and education expenditure projections. These long-term projections provide an indication of the timing and scale of economic changes that would result from an ageing population in a 'no-policy change' scenario. The projections show where, when, and to what extent, ageing pressures will accelerate as the baby-boom generation retires and the average life span continues to increase. Hence, the projections are helpful in highlighting the immediate and future policy challenges posed for governments by demographic trends. It is to be noted that the Ageing Working Group (AWG) will work on the new round of long-term projections in the context of the next Ageing Report, which the ECOFIN mandated the Economic Policy Committee (EPC) to be endorsed and published by the autumn of 2018 at the latest. The macroeconomic projections based on the new set of population projections to be provided by EUROSTAT, are to be submitted to the EPC by Autumn 2017.

### 5.1 Long-Term Budgetary Projection Results for Malta

This section provides an analysis of the long-term sustainability of public finances for Malta for the period 2013-2060 on the basis of commonly agreed assumptions for the European Union (EU) Member States under the EPC AWG. The modelling work for pension outlays projections reflects as strictly as possible the pension rules, both current as well as those applying in future years following the reform law enacted in December 2006. It is to be noted that the modelling work covers only reforms introduced up to 2014. Later pension reforms not incorporated in the projections include the launching of the Third Pillar pension scheme, referred to as the Personal Retirement Scheme, and which is being supplemented by another scheme, the Individual Savings Account (ISA) as well as the pension reforms introduced in the 2016 Budget. These pension reforms will be addressed in more detail in Section 5.2 of this Chapter.

The model used in projecting pension expenditure is the World Bank's Pension Reform Options Simulation Toolkit (PROST 15). Statistical Appendix Table 7 shows the expenditure components of the long-term budgetary projections as a percentage of Gross Domestic Product (GDP) for the period 2013-2060 and the assumptions used.

#### 5.1.1 Demographic Projections

Population projections, EUROPOP2013 as published by EUROSTAT were used as a primary input in the long-term age-related expenditure projections used by the European Commission in the assessment of the sustainability of public finances. For Malta, this set of population projections led to significant differences in terms of the trajectory as well as the dynamics of population changes in comparison to the previous set of projections. As shown in Table 5.1, according to EUROPOP2013 total population is projected to increase to around 476,000 by 2060, compared to the absolute decline to around 387,000 in the previous round of projections. Furthermore, the old-age dependency ratio is expected to reach 50.9 per cent in 2060, around 5 percentage points lower than that projected in EUROPOP2010. EUROPOP2013 population projections have resulted in a relatively smaller increase of 2.0 percentage points of the GDP over the entire projection period in the age-related expenditure relative to the 2012 Ageing Report. These revisions were in line with similar revisions to the demographic projections of other EU Member States.

## EUROPOP2010 and EUROPOP2013 Population Projections

Table 5.1

	2013	2020	2030	2040	2050	2060
<b>EUROPOP2010</b>						
Total population	412,637	415,664	416,631	407,057	396,649	386,935
Old-age dependency ratio (65+ yrs/15-64 yrs)	25.3	32.2	39.3	40.4	46.9	55.9
<b>EUROPOP2013</b>						
Total population	422,556	439,341	456,792	462,995	468,528	476,383
Old-age dependency ratio (65+ yrs/15-64 yrs)	25.8	33.2	40.5	40.8	45.0	50.9

*Note: Figures may not add up due to the rounding*

*Source: Eurostat*

### 5.1.2 Assumptions Applied

In projecting pensions, the demographic assumptions reflect EUROPOP2013 projections by Eurostat, while the macroeconomic assumptions reflect the commonly agreed methodology in the EPC. The assumptions used include the real GDP growth rate, labour productivity (growth rate per hour), inflation rate, labour participation rate by age and gender, unemployment rate by age and gender, population (EUROPOP2013), fertility rate by age, mortality rate by age and gender, and net migration by age and gender. A number of variables included in the assumptions as provided by the AWG-EPC, were not incorporated in the PROST workings for the pension projections, primarily due to the fact that such variables are not required as PROST inputs.

As regards the demographic evolution, life expectancy at birth for men is assumed to rise by 6.4 years over 2013 to reach 85.1 years in 2060, while for women it is expected to reach 89.1 years, an increase of 6.3 years over 2013. This implies that despite some convergence, female life expectancy in 2060 is projected to remain 4 years higher than that of males. Meanwhile, life expectancy at 65 years for males is projected to increase by 4.3 years between 2013 and 2060, while for women it is projected to increase by 4.4 years. The fertility rate is projected to increase from 1.4 in 2013 to around 1.8 in 2060. Another important variable in the evolution of the demography is net migration, which is projected to remain consistent even if declining in importance, from an annual average of 1,600 in 2013 to 1,146 in 2060. As a share of total population, net migration inflows to Malta is projected to decline from 0.4 per cent in 2013 to 0.2 per cent in 2060. Net migration shall represent an important factor in determining developments in total population during the projection period as indicated by the ratio of net migration over population change, which is projected to increase from 0.5 per cent in 2013 to 3.6 per cent in 2040 and to decline to 1.7 per cent in 2060.

With respect to macroeconomic assumptions, potential GDP growth rate is assumed to increase from 1.7 per cent in 2013 to around 2 per cent by 2020 and then falling to 1.8 per cent by 2040. It is assumed to decline further to 1.4 per cent by 2060. The unemployment rate (15-64 years) is assumed to increase marginally from 6.5 per cent in 2013 to 6.7 per cent in 2060. The female participation rate (15-64 years) is assumed to increase from 50.2 per cent in 2013 to 66.9 per cent by 2050 and to remain relatively

stable at around that level by 2060. The male participation rate (15-64 years) is assumed to increase from 79.7 per cent in 2013 to 84.5 per cent by 2030 and to decline to 83.4 per cent by 2060.

### 5.1.3 Demographic Developments

Population projections (EUROPOP2013) indicate that the total population in Malta is projected to rise from around 423,000 in 2013 to around 457,000 in 2030, and to reach around 476,000 by 2060. As shown in Table 5.2, the age structure of the population is projected to change significantly. While the share of the very young people (aged 0-14 years) in the total population is projected to hover around the 15 per cent share, the share of the people aged 65+ is projected to increase from 17.5 per cent to 28.5 per cent. The most significant change in demography concerns the working-age population (aged 15-64 years), which reflects the share of the population that will bear the financial 'burden' of the elderly. From a share of 68.0 per cent in 2013, this ratio is projected to subsequently fall to 60.2 per cent by 2030 and to reach 56.1 per cent in 2060. By contrast, the share of the elderly population (aged 65+ years) in total population is projected to increase steeply from 17.5 per cent in 2013 to 28.5 per cent by 2060.

The dynamics of the ageing process could be better appreciated by analysing the developments in the relative share of the elderly to the working-age population. These dependency ratios relate the number of individuals that are likely to be "dependent" on the support of others for their daily living – youth and the elderly – to the number of those individuals who are capable of providing such support. Key indicators of age dependency presented in Table 5.2 are the: youth-dependency ratio (for individuals aged less than 15 years), old-age-dependency ratio (for persons aged 65 years and more)

**Total Population, by Selected Age Groups**

Table 5.2

Age	2013	2020	2030	2040	2050	2060
0-14 yrs	61,182	65,365	70,157	67,451	69,839	73,397
15-64 yrs	287,317	280,771	275,096	280,827	274,938	267,095
65+ yrs	74,057	93,205	111,540	114,717	123,751	135,892
Total	422,556	439,341	456,792	462,995	468,528	476,383
<b>Share (%)</b>						
0-14 yrs	14.5	14.9	15.4	14.6	14.9	15.4
15-64 yrs	68.0	63.9	60.2	60.7	58.7	56.1
65+ yrs	17.5	21.2	24.4	24.8	26.4	28.5
<b>Ratio</b>						
Youth dependency ratio (0-14 yrs/15-64 yrs)	21.3	23.3	25.5	24.0	25.4	27.5
Old-age dependency ratio (65+ yrs/15-64 yrs)	25.8	33.2	40.5	40.8	45.0	50.9
Total dependency ratio	47.1	56.5	66.0	64.9	70.4	78.4
Ageing of the Aged Ratio (80+ yrs/65+ yrs)	21.7	23.1	31.8	38.9	35.6	36.7
Support ratio (15-64 yrs/65+ yrs)	3.9	3.0	2.5	2.4	2.2	2.0

Note: Figures may not add up due to the rounding

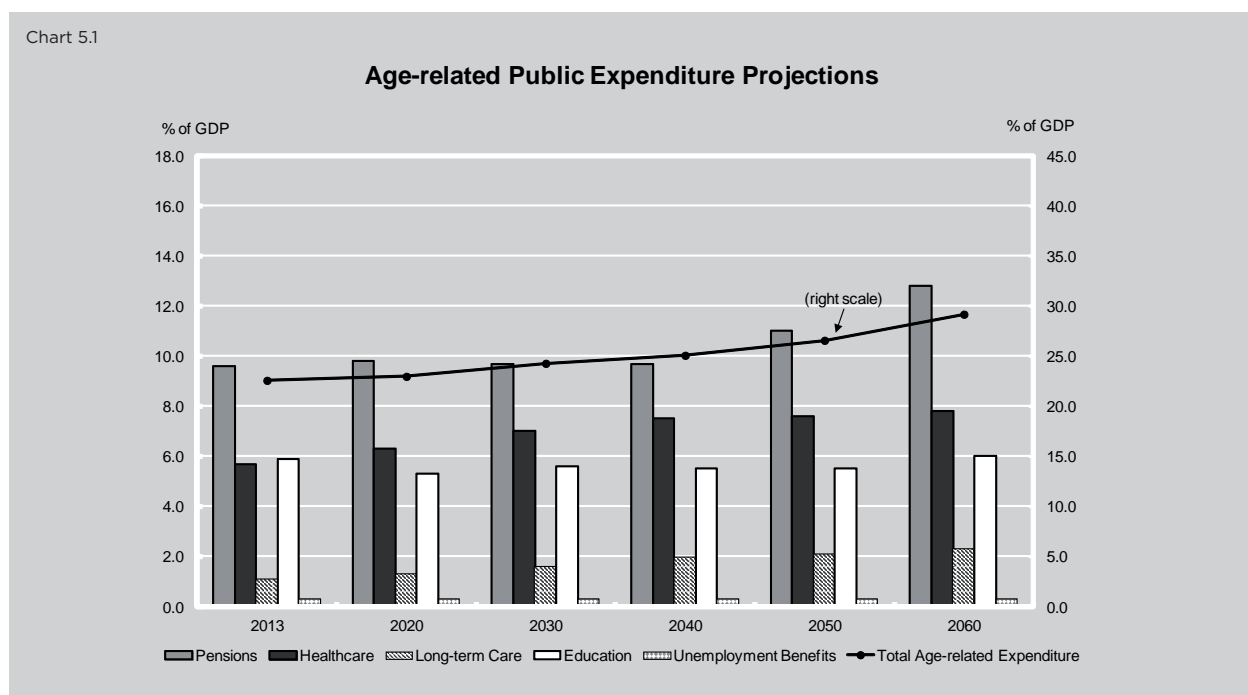
Source: EUROPOP2013, Eurostat

and the ageing of the aged ratio. The youth dependency ratio (0-14 year bracket as a percentage of the 15-64 year bracket) is expected to increase from 21.4 per cent in 2013 to 25.5 per cent in 2030 and to hover around that level until 2050, and increase to 27.5 per cent by 2060. The old-age dependency ratio (65+ year bracket as a percentage of the 15-64 year bracket) is projected to increase consistently from 25.8 per cent in 2013 to 50.9 per cent in 2060, an increase of 25.1 percentage points. Thus, by 2060, the total dependency ratio, which is the combined burden of these two components of the economically active population, will amount to 78.4 per cent. Meanwhile, the ageing of the aged ratio (80+ age bracket as a percentage of the 65+ age bracket), is projected to increase from 21.7 per cent in 2013 to 38.9 per cent in 2040, decline to 35.6 per cent by 2050 and increase to 36.7 per cent by 2060. As a result of these demographic developments, the support ratio (persons in the 15-64 years bracket as a proportion of persons aged 65+) is expected to decline from 3.9 per cent in 2013 to 2.0 per cent in 2060. This means that while in 2013 there were around 4 persons of working-age for every person that reached pension age, by 2060 this ratio is projected to decrease to around 2 persons of working-age for every person of pensionable age.

### 5.1.4 Age-Related Public Expenditure

Age-related spending including on pensions, health care, long-term care, education and unemployment benefits is projected to increase by 6.6 percentage points of GDP over the period 2013-2060, as opposed to an increase of 8.6 percentage points outlined in the 2012 Ageing Report. Chart 5.1 shows the age-related public expenditure as a share of GDP for this projection period.

Public expenditure on pensions is presently the most important age-related government expenditure item, and is projected to remain so also in the future. The pension projection exercise covers contributory and non-contributory old-age pension paid under the social security scheme. The coverage of pension schemes includes also the expenditure on non-contributory old-age pension together with the share paid on the contributory and non-contributory bonus payment. At present, private pensions play a rather minor role as regards pension provision for old-aged persons, even if their importance is expected



to rise in future. Over the projection period, pension expenditure is projected to increase from 9.6 per cent of GDP in 2013 to 12.8 per cent of GDP by 2060, an increase of 3.2 percentage points (as opposed to an increase of 5.7 percentage points in the 2012 Ageing Report). The increase in pension expenditure primarily reflects the expenditure on old-age pensions which will increase from 5.3 per cent of GDP in 2013 to 10.3 per cent in 2060. The increase in old-age pension expenditure is driven by the ageing process, in reflection of projected demographic developments. Furthermore, while the increase in the pension age and the contribution period for full pension eligibility and the changes to the benefit formula contribute to lower the projected increase in pension expenditure, the more dynamic indexation of the ceiling on pensionable income, the statutory changes to indexation for old-age pensions and the introduction of the guaranteed national minimum pension for persons retiring from 2027 onwards contribute to increase expenditure pressure.

The decreasing contributions of Disability Pensions, Survivors' Pensions and Other Pensions (includes top-ups and treasury pensions) reflect a combination of factors. The expenditure on Disability Pensions is projected to decline marginally to 0.3 per cent of GDP and expenditure on survivors' pensions is projected to decrease from 1.6 per cent of GDP to 1.3 per cent of GDP. Similarly, expenditure on Other Pensions is projected to decrease from 2 per cent of GDP to 0.5 per cent of GDP. The decreasing contributions of such pensions reflect a combination of factors. The invalidity pension contributes negatively to the rise in expenditure in reflection of the demographic developments as well as the indexation to the Cost Of Living Adjustment (COLA). The survivors' pension contribution reflects the ageing process as well as its indexation that is similar to old-age pensions. The 'top-up' pension, which falls under the Other Pensions category, covers benefits currently payable to persons in receipt of service pensions which includes former servicemen in receipt of overseas pensions. This expenditure category is projected to decrease in importance over time in line with the life expectancy of the recipients of this pension. Similarly the Treasury Pension, also included in the Other Pension category, is projected to decrease in importance over time given that it has been closed to new Government employees since 1979.

Another important contributor to the increase in age-related spending is healthcare. Projections indicate that Malta is now expected to record an increase of 2.1 percentage points of GDP in health care (compared to 2.6 percentage points in the 2012 Ageing Report) and an increase of 1.2 percentage points of GDP in long-term care (as opposed to an increase of 0.8 percentage points in the 2012 Ageing Report) during the period 2013-2060. This increased spending on health care and long-term care is primarily due to an ageing society and an increase in life-expectancy at birth over the projection period. Government is aware of the challenges posed by these demographic developments on healthcare and hence it is actively working on implementing a holistic strategy that will ensure the long-term sustainability of the health sector.

On the other hand, public spending on unemployment benefits as a share of GDP is projected to remain unchanged at 0.3 per cent between 2013 and 2060. Additionally, the 2015 projection exercise aimed at assessing the impact of demographic changes per se on the general government education expenditure. The results showed that education spending is projected to increase by 0.1 percentage points of GDP during the projection period (compared to a decrease of 0.6 percentage points of GDP in the 2012 Ageing Report).

## 5.2 Focus on Pension Reforms

Although the new projections present a relatively better outlook with regards to pension expenditure as well as pension sustainability and adequacy, when compared to the previous projections presented in the 2012 Ageing Report, the projected demographic developments will still cause the outlays on pensions paid by Government to rise over the coming decades. Medium sustainability risks appear for Malta over the long run, where these risks seem to be entirely related to the strong projected impact of age-related public spending (notably pensions, healthcare and long-term care).

As already stated these projections reflect the reforms enacted up to 2014. It is to be noted that in December 2006, the House of Representatives adopted a series of parametric reforms (Act No. XIX of 2006) to the definition of pension age, retirement before pension age, the full rate of two-thirds pension, calculation formula, the maximum pensionable income and the crediting of contributions as provided for under the preceding legislative framework. The reforms were aimed at enhancing the sustainability of the pension system whilst improving the adequacy of the pension enjoyed by retirees in the future.

As a continuation of the pension reform process, following the set-up of the new Pensions Strategy Group (PSG) to continue the work of the previous Working Group, a report presenting pension reform recommendations was finalised in June 2015. Subsequently, the Group prepared a post-consultation report that took into consideration the feedback received (till the end of August 2015) from social partners, political partners and the general public. The post-consultation report, including the final recommendations, was eventually submitted by the Group for the attention of the Government in September 2015. A number of these measures were adopted by Government as from the Budget for 2016, together with measures addressing either pension adequacy or sustainability. Box 5.1 presents the interim financial impact of the lengthening of the contributory period and the linking of the contributory period to the period spent in retirement.

Measures addressing adequacy included the measure on the Minimum Pension, better credits, reform on the service pensioners as well as on survivors' pension. With regards to the Minimum Pension, it is to be noted that as from 2016, the Minimum Pension for a person with a full contributory record shall be no less than €140 per week. A pro-rata increase will be given to persons who do not have the full amount of contributions. Married pensioners in receipt of the Minimum Pension who do not benefit from this measure will receive a flat increase of €4.15 per week (including the COLA). This measure will contribute to address the problem of poverty amongst the elderly.

Furthermore, better credits for child rearing and family growth were introduced in the 2016 Budget as well as the introduction of credits for human capital development and lifelong learning. Besides, service pensioners will continue to be given a €200 annual additional abatement while survivors' pensioners, if they are entitled to a contributory pension in their own right, will be entitled to the highest full pension, whether it is their own pension or the pension of their deceased spouse.

Measures addressing sustainability included changes in the contributory period as well as the introduction of an appropriate incentive mechanism for the deferring of the pension. In order to ensure a fair balance between the contributory period and the period spent in retirement across generations, as from the 2016 Budget, the contribution period for a full pension will be based on a stable proportion between years of contributions and



years drawing pension. Consequently, the contributory period is being raised from 40 to 41 years for persons born after 1968. Furthermore, under the new legislation, the Minister responsible for pensions shall, within intervals not exceeding the period of five years, lay on the Table of the House of Representatives a report. This report will present recommendations with a view of achieving further adequacy, sustainability and social solidarity, with the objective of maintaining a stable proportion between the contribution periods and the periods of time during which it is expected that the pension be paid.

With regards to the third pillar pensions in Malta, it is to be noted that the first pension products were launched on the market during November 2015. Furthermore, the tax benefits for third pillar pensions have been extended to be applicable to certain insurance products in order to incentivise providers. Accordingly, there are now a number of providers offering personal pension plans. Providers beneath this new framework are now able to include the tax benefits within their existing products without investing heavily in new products. Savers undertaking these plans can receive tax rebates on their savings for retirement.

In the Budget for 2016, the Government announced that a Working Group shall be set up with the scope of bringing to the consideration of Government, proposals relative to the introduction of fiscal incentives for employers that opt to introduce occupational pensions on voluntary basis.

It is to be noted that the Retirement Pensions Act (Chapter 514 of the Laws of Malta) came into force on 1<sup>st</sup> January 2015. The new Regulations and Pension Rules also came into force on 1<sup>st</sup> January 2015. A new set of Regulations and Pensions Rules have been issued under the Act to supplement the legal framework for the licensing and regulation of Retirement Schemes (both Occupational and Personal), Retirement Funds and Service Providers related thereto, as well as for the requirement of recognition for persons carrying on back-office administrative services. In addition, the pension reforms introduced in the 2016 Budget have been adopted by the House of Representatives (Act No. XV of 2016) in March 2016 with the exception of the incentive mechanism for persons to defer their pensions that has been publicly announced on the 22<sup>nd</sup> March with legislation to follow during the course of 2016.

## Box 5.1

### An interim impact of pension reform measures addressing sustainability

This Box presents an interim impact of two pension reform measures aimed at addressing sustainability, namely, the lengthening of the contributory period and the linking of the contributory period to the period in retirement. The impact of the incentive mechanism to defer pensions is not being modelled in this instance. In addition, it should be noted that the impact of these measures is being illustrated on the basis of the work of the Pensions Strategy Group (PSG).<sup>1</sup>

The PSG in their report listing the recommendations for pension reform assessed a scenario where the accrual rate was linked to life expectancy. The accrual rate reflects the number of years of contributions for full pension eligibility. The scenarios in Table 1 present the impact of linking the accrual to future gains in life expectancy for persons born after 1962, starting from 2026. Two scenarios are being presented, illustrating the implications of behavioural changes relative to the decision to retire. Table 1 shows that linking the accrual rate to life expectancy, results in an improvement in the pension system balance of 0.5 percentage points of GDP, with the strongest gains being noted in the scenario allowing for changes in the retirement behaviour. In fact, under the assumption that the changes in the accrual rate lead to later retirement, the pension system balance improves by 1.7 percentage points of GDP relative to baseline projections. It is to be noted that the measure adopted in the Budget for 2016 is slightly different from that recommended by the PSG.

#### Deviations from the baseline in p.p. of GDP

Table 1

	2013	2020	2030	2040	2050	2060
<b>Linking Accrual Rate to Life Expectancy (assuming no behavioural change)</b>						
Total Revenue	-	-	-	-	-	-
Total Expenditure	-	-	-	-0.10%	-0.20%	-0.50%
Balance	-	-	-	0.10%	0.20%	0.50%
ARR for OAP	-	-	-0.10%	-0.60%	-1.70%	-2.60%
<b>Linking Accrual Rate to Life Expectancy (assuming changes in retirement patterns)</b>						
Total Revenue	-	-	0.10%	0.20%	0.50%	0.70%
Total Expenditure	-	-	-0.10%	-0.30%	-0.60%	-0.90%
Balance	-	-	0.10%	0.60%	1.00%	1.70%
ARR for OAP	-	-0.10%	-0.30%	-0.30%	-0.50%	-0.70%

Source: Pensions Strategy Group (2015)

#### Footnote:

<sup>1</sup> Now that the pension reform measures have been adopted by the House of Representatives, the Maltese Authorities look forward to present an updated set of budgetary projections to EPC Ageing Working Group following a discussion on the assumptions to be adopted.

## **6. The Quality of Public Finances**

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## 6. The Quality of Public Finances

The Maltese Government is committed to continue improving the quality of public finances. To this end, the Government has directed its efforts towards ensuring a more efficient use of public finances, whilst concurrently reviewing its expenditures to focus more on productive spending. This enables it to be in a better position to face the economic challenges in health, education, labour participation, ageing, income distribution and environmental development. The Government is also committed to continue improving the level of efficiency of the taxation system.

### 6.1 Improving the Quality of Public Expenditure

#### 6.1.1 Composition of Public Expenditure

In 2015, total public expenditure by the general Government in Malta reached €3.8 billion, equivalent to 43.3 per cent of Gross Domestic Product (GDP). In 2013, total spending stood at 42.0 per cent of GDP and for 2014 this rose to 43.2 per cent of GDP. As can be seen in Chart 6.1, total general public expenditure in 2014 was below the European Union (EU) average of 48.2 per cent. Growth in public spending has been fairly stable and since 2005 it generally fluctuated between 41 per cent of GDP and 43 per cent of GDP.

General Government expenditure broken down by the main socio-economic function according to the Classification of the Functions of Government (COFOG), available with a lag of twelve months after the end of the reference period, indicates that Government's high spending programmes include Social Security, which totalled €1.1 billion in 2014, and Health and Education, which totalled €951.1 million. Further details are portrayed in Chart 6.2.

Moreover, Charts 6.3 shows historical developments until 2014 in general Government expenditure as a percentage of GDP, broken down by COFOG on health, education and social protection.

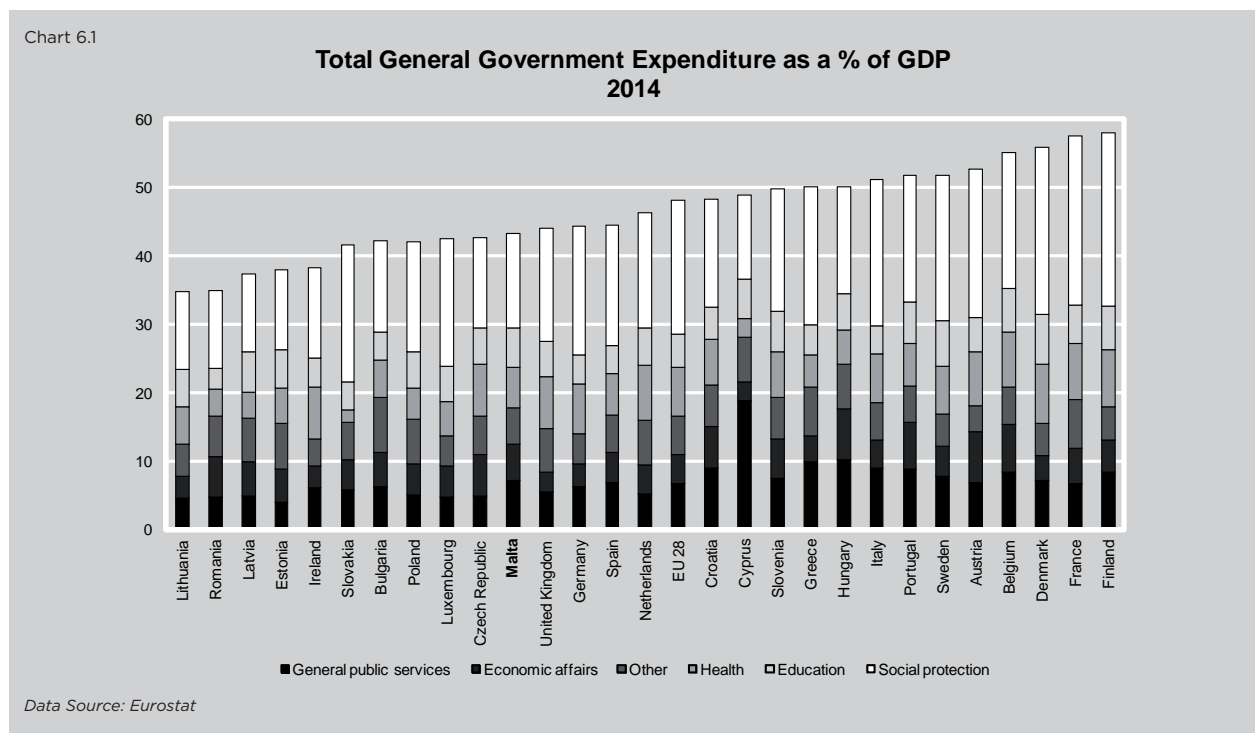
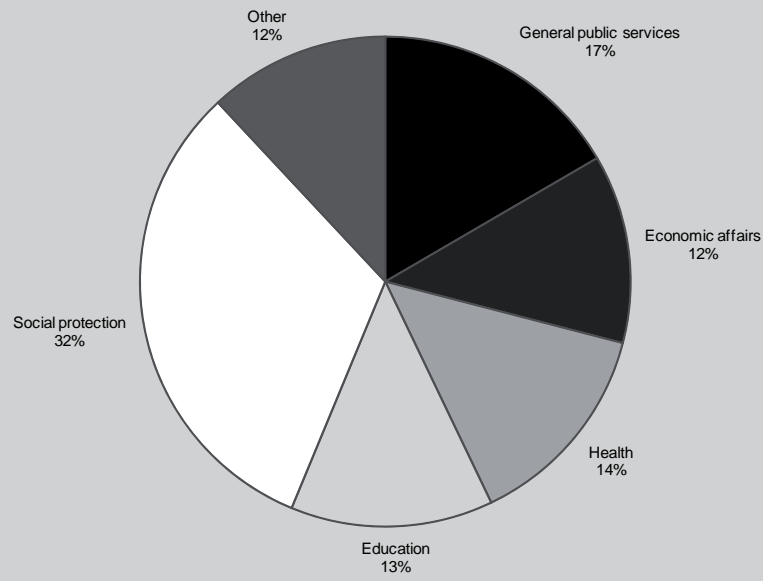


Chart 6.2

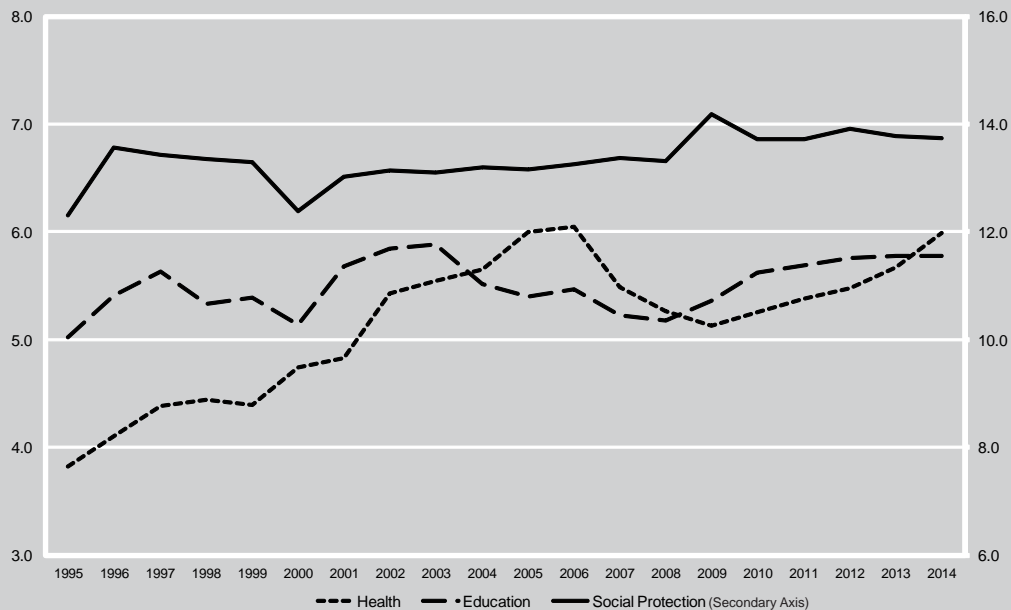
### Spending Priorities - Contribution of each COFOG category in Total Expenditure in 2014



Data Source: Eurostat

Chart 6.3

### General Government Expenditure as a % of GDP



Data Source: Eurostat

These spending programmes include a mixture of entitlement and means tested social benefits and the provision of education and health. In 2015, there were some 225,000 beneficiaries (for contributory and non contributory benefits) in the benefit system ranging from pensions to sickness and disability benefits and social assistance. Given that individual beneficiaries could be benefitting from more than one benefit, this figure is being slightly overestimated. In health, the universal health service seeks to provide health care according to need, with the aim being to always provide high quality health care to vulnerable patients. Education spending aims to provide resources to invest in human capital but also for education itself to enable students to find avenues to explore their capacities and capabilities.

In social security, the Government's priority is founded on the concept of making work pay and thus reducing dependency on the benefit system. The concept underpinning social welfare is that it has to target those who are in need whilst employment remains, for those who are able to work, the main path out of the risk of poverty.

## **6.1.2 Enhancing the Efficiency and Efficacy of Expenditure**

The Government is committed to keeping public expenditure in check through improved efficiency in public spending, as Government is aware that high quality public services contribute towards a just society. In this regard, the Comprehensive Spending Review (CSR) is one of a series of policy instruments the Government is utilising to ensure that public spending is effective, continues to meet changing social needs and is continuously under review. The review process in Malta is founded on a dual approach; that of having an annual Ministerial review of line items, whilst also including in-depth reviews of Government departments.

### **6.1.2.1 The Annual Ministerial Reviews**

The CSR methodology seeks to provide an input-output model for public spending. The aim is to shift the focus from expenditure inputs towards the idea of outputs. The CSR is a process where outputs are properly identified and assessed.

The annual review process was launched during 2014 with a series of outreach presentations held between the spending Ministries and teams from the Budget Affairs Department within the Ministry for Finance (MFIN). These presentations sought to connect Government's macroeconomic and fiscal strategy with departmental spending plans. They also aimed to ensure that such plans coalesced with targets for Government spending.

The four components of Government's recurrent expenditure include Personal Emoluments, Operation and Maintenance, Contributions to Government Entities, and Programmes and Initiatives, with the latter component amounting to about 60 per cent of total recurrent expenditure. More efficient expenditure under Programmes and Initiatives provides pathways for making decisions that ensure spending decisions reflect Government priorities. In this regard, there is now a line by line analysis for each line item of Programmes and Initiatives for all the Ministries. This enables the Finance Minister to review spending decisions prior to the bilaterals with the various spending Ministries.

The line by line analysis allows for the possibility of zero budgeting since departments are continuously being asked to review and also to consolidate line items to prevent repetitions of similar initiatives. The line by line analysis is also allowing for the review of outputs and for these outputs to evolve. However, the most important development

is that this analysis allows for a change of language and a change of focus, from a discussion of additional spending to a discussion relating spending with policy outputs. The CSR is bound to evolve over time.

### **6.1.2.2 The In-Depth Reviews of Government Departments**

The in-depth reviews consist of a series of hearings between stakeholders and a panel of experts from within and from outside the MFIN. The stakeholders are asked to produce policy statements that relate to their budget responsibility. The documents are read by the panellists who ask the stakeholders to expand and explore policy issues. On average, there are about twenty hearings with stakeholders, with MFIN and the Permanent Secretary also attending some of the hearings. After the hearings, a report is written by the chairperson of the hearings and also includes individual chapters written by the panellists. The final report is then presented to the Ministers involved.

### **Social Security Benefits**

General Government expenditure on Social Protection according to COFOG expenditure in 2014 totalled 13.7 per cent of GDP. As seen in Chart 6.1, compared to the expenditure level of advanced economies in Europe ranging between 16 and 25 per cent of GDP, Malta's benefit system seems to be contained.

Employment remains the main path out of the risk of poverty, with social welfare focusing on those mostly in need. Through enacted policy initiatives taken by Government, such as, the tapering of social benefits, the youth guarantee programme and the in-work benefit, Government wants to ensure that individuals face clear incentives to work and contribute to society, while steering them away from dependency. Government's priority is founded on the concept of making work pay and thus reducing dependency on the benefit system.

The first in-depth study which was initiated in February 2014, was that of the Vote on Social Security Benefits. This was duly completed in September 2014, after which a number of recommendations were outlined and these were then announced in the Budget for 2015. The main recommendations included:

- The Tapering of Benefits Scheme
- The In-Work Benefit Scheme
- The Youth Guarantee Scheme

The tapering of benefits (UAT) scheme was introduced in mid-2014 and allowed persons in receipt of Unemployment Assistance (UA), Social Assistance (SA) and Social Assistance for Single Unmarried Parents (SUP) for more than two years to have their benefits tapered down gradually over a period of three years when they get employed, instead of losing entitlement to social benefits immediately (as long as they earn the national minimum wage or more). The scheme was also extended to persons benefitting from social assistance for single unmarried parents who get married or form a civil union with a person in employment. Moreover, the 2016 Budget extended this scheme to single parents with children under the age of 23 years who become engaged in employment as long as they work for at least 10 hrs per week earning the hourly rate equivalent to the national minimum wage.

The in-work benefit (IWB) scheme was introduced in the 2015 Budget and targeted low-to-medium income families with dependent children who have not reached the age



of 23 years. Employed parents whose combined annual earnings lies between €10,000 and €20,400, benefit from a maximum annual grant of €1,000 per child given that both spouses are in employment and that the earnings of one of them is not less than €3,000 per year. On the other hand, single parents were to be paid a maximum annual grant of €1,200 per child if they earn between €6,600 and €15,000 annually. In the 2016 Budget, this scheme was extended to cater for families with one income earner earning between €6,600 and €12,700, where they benefit from a maximum of €150 per child.

The Youth Guarantee Scheme was introduced in the 2014 Budget and focused on improving the employability and further educational prospects of youths. The Youth Guarantee focused mainly on the NEET group (youth who are not in employment, education and training). This group is considered to be most at-risk of detachment from education and the labour market, and consequently at-risk of poverty and social exclusion. The Youth Guarantee Programme was divided into a number of schemes, with the main ones being the NEET Activation Scheme, Work Exposure Scheme (WES), Alternative Learning Programme (ALP), and Traineeship Scheme. Through the NEET Activation Scheme, NEETs between the age of 16 and 24 were individually profiled and received forty hours of direct contact with a youth worker and another eighty hours of training intervention covering motivational and behavioural training, guidance on employment, communication skills and CV writing skills. Following the training phase, youths were offered the opportunity to benefit from twelve weeks of work exposure (WES Scheme), and up to six months traineeship leading to a qualification (Traineeship Scheme). Others were encouraged to read for vocational education (ALP Scheme). These schemes offered a combination of both off-the-job and on-the-job training so as to allow trainees to better understand the demands requested by the industry and potential employers whilst equipping them with soft skills such as working in a team and communication skills. Moreover, the youth guarantee scheme required all young people under the age of 23 to move to a youth guarantee pathway rather than social security. In addition, the programme offered free SEC (secondary education certificates) revision classes to youths who failed to pass one of the main SEC subjects in order to improve the employability prospects of such youths.

Throughout 2015, MFIN monitored and evaluated the progress of these policy initiatives so that by 2016 the following results could be observed. The 2015 Budget estimates were based on the presumption that 800 claimants shifted to the tapering of social benefits. By the end of 2015, around 1,200 claimants (both single parents and single unmarried parents) had left social assistance. Of these, 1,079 had gone into employment and took advantage of the tapering of benefits scheme. The latter savings partly reflected the strong increase in labour demand owing to the favourable economic conditions and were also the result of better efficiency in tackling benefit fraud. Moreover, around 200 young people who would have joined social assistance are now on youth guarantee. In addition, another 1,000 claimants have left unemployment assistance, of which 650 had engaged in employment after being unemployed for more than 2 years and thus are also benefitting from the tapering of benefits scheme.

With regards to the in-work benefit, it is estimated that this scheme has led to a 1.8 percentage points decline in the overall poverty rate, with much of the drop being attributed to households with dependent children (3.68 percentage points)<sup>1</sup>. The scheme shall also incentivise single parents to stay in employment rather than leaving the labour force and get back to living on social benefits once all the tapering benefits will be phased out. Furthermore, there are now another 2,000 people paying national insurance contributions and therefore, contributing towards their future pensions and finding routes out of the risk of poverty. A number of these are probably the result of the new work incentives emerging out of the CSR.

## **Health - Mater Dei Hospital**

General Government expenditure on Health according to COFOG expenditure in 2014 stood at 6.0 per cent of GDP. Compared to the advanced economies in Europe with expenditure levels ranging between 7 and 8 per cent of GDP, Malta seems to be achieving highly effective health services. According to Eurostat statistics, in 2014, life expectancy at birth in Malta (84.2 years for women and 79.8 years for men) was above the EU-28 average ( 83.6 years for women and 78.1 years for men). Healthy life year expectancy was significant, with 72.7 years for women and 71.6 for men in Malta, when compared to 61.8 years and 61.6 years for women and men respectively in 2013 in the EU. The infant mortality rate of 6.7 per cent was above the EU average of 3.9 per cent in 2013, having remained relatively constant throughout the last decade. However, caution needs to be exerted when interpreting such figures, in view of the fact that termination of pregnancy is illegal in Malta. The two major components of health spending are compensation of employees of outpatient and hospital services, which constitutes about 50 per cent of total spending, and intermediate consumption towards outpatient and hospital services, which makes up about a further 25 per cent. Intermediate consumption and social transfers in kind towards medical products, appliances and equipment make up a further 7 per cent.

Most of the health financial resources are directed to the State hospital, Mater Dei Hospital. This necessarily reflects the importance of efficient and effective management of the hospital.

The in-depth review panel at Mater Dei Hospital was established during April 2015. The panellists participated in various hearings from stakeholders involved in the hospital operations including clinicians, nurses, nurse managers, the voluntary sector, senior managers and finance officers. The study was completed in September 2015 and had the following recommendations:

- Better scrutiny of the payroll system, working overtime, sick leave and allowances. It is noteworthy, that as from this year the cost of overtime has fallen because of improvements in processes.
- In a bid to reduce expenditure in medicines and medical supplies, new technology is being introduced at the hospital to allow for single dosage dispensing to patients in a bid to reduce the expiry of drugs.
- Mechanisms have been set up to ensure contracts are being adhered to whilst ensuring that Government achieves value for money for these contracts.
- The repairing process of medical equipment is being reviewed.

There is now a process to allow for the decentralisation of Departemental budgets. This should increase transparency in decisions being made by clinical staff. A concept of notional billing is being introduced between departments to increase awareness for the costs of pathology and imaging services. This will enable departments to become more aware of their staffing costs.

## **Education**

In 2014, general Government expenditure on Education according to COFOG expenditure reached 5.8 per cent of GDP, which despite being at the same level as that recorded in many EU countries, was slightly higher when compared to the advanced economies in Europe. In Malta, out of a total student population of 60,000, there are a total of 33,000 students in state schools. In December 2013, Malta confirmed that it aims to reduce

the rate of early school leavers (ESL) to 10 per cent by 2020. Provisional figures for 2015 indicate that the rate for ESL in Malta stood at 20.1 per cent of the total student population, slightly down from 20.3 per cent recorded in 2014. In addition, the share of the 30-34 year old population having completed tertiary education is to be increased to 33 per cent by 2020. Malta's provisional rate recorded for 2015 stood at 27.0 per cent, which is still below the EU2020 benchmark of 40.0 per cent.

The in-depth review in Education was established in January 2016. There are five panel members from within the Education Department as well as external consultants. To date, the panel has met with civil servants responsible for developing policy frameworks in Education and have also met college principals. Regular meetings are also being held with the Minister and the Permanent Secretary for Education.

Primary and secondary schools in Malta are grouped in ten clusters each headed by a College principal and include key support staff comprising social services, career services and school counselling services. The students have several opportunities to become acquainted with the culture of their college. Furthermore, teachers and principals have the time and space to know the students under their care. At present, the study can already highlight some very encouraging and important initiatives that may improve primary and secondary education.

With regards to the curriculum, there are advanced discussions with the University of Malta to introduce a system of continuous assessment so that students are not assessed solely on their examination performance. Continuous assessment should allow for better diagnostic learning and for a better learning process. The Education Department has already introduced five vocational subjects including hospitality, engineering, technology, IT and retailing, while it will be introducing five additional subjects including artisanship, construction, hairdressing and textile design. These vocational routes will be given the same weighting as the other classical subjects, thus providing students with more choices of subjects while also widening pathways in education.

The panel has also met with the Quality Assurance Team and a number of new initiatives have been suggested to ensure better connections between the quality assurance teams and internal quality assurance within schools. In the next phase of the in-depth review, the panel will be meeting with approximately 40 heads of schools so as to involve all stakeholders.

The series of initiatives recently introduced in education are still in their infancy stage, and should start yielding benefits in the next five years. These initiatives, which need to be consolidated in the forthcoming years include:

- Free child care for all, which means that children at a very young age enter the learning environment and should therefore be more school ready.
- A breakfast club in each state school, allowing children to attend school early in a friendly environment before the start of official school hours.
- The 3 to 16 club, which allows children to stay at school beyond the end of the school day to do homework and other extra-curricular activities.

Each year there is a cohort of 4,000 students who sit for the MATSEC examinations. These examinations provide the pathways of entry into Post Secondary school and subsequently, provide potential access to tertiary education. Out of these 4,000 students,

48 per cent pass their examinations, 32 per cent attain school leaving certificates, while the rest, totalling about 800 students (20 per cent of students), fail and define the ESL described earlier. Government aims to reduce the ESL rate by half, to 10 per cent by 2020. The new pathways being created in vocational education and also in applied studies will provide the new opportunities.

### **6.1.3 Conclusions**

The CSR is one of the many instruments available to Government to ensure more effective public spending that reflects changing needs. Through techniques, such as line by line analysis, zero budgets and outputs for lines of expenditure, the CSR changes the language from expenditure inputs to a focus on defining policy outputs. The in-depth CSR has provided the Government with a series of policy recommendations and pathways that seek to improve the policy process. In social security, the results are tangible savings in the social security budget. However, beyond the short-term savings, the reforms are targeting savings in the long-term whilst contributing towards increased effectiveness in public spending so as to reach the dual goal of sustainable growth and a more just society. In health, decentralisation of budgets, better management of payroll and contractual services should also free financial resources that could be utilised elsewhere within the health budget.

## **6.2 Improving the Structure and Efficiency of Revenue Streams**

The Maltese Government, in line with its pledge to further the efficiency and efficacy of the Maltese taxation system, has been striving to modify such system in a sound and incremental manner. Action was taken in varied forms; however these projects can be mainly grouped in four areas, all of which aim at increasing taxation efficiency. These areas are:

- Shifting the tax burden away from labour;
- Widening the tax bases;
- Simplification of the taxation system; and
- Fighting tax evasion and avoidance.

### **6.2.1 Shifting the Tax Burden away from Labour**

It is commonly agreed that high levels of taxation on labour have detrimental effects on growth and employment in general. As such, over recent years, the focus in the EU and elsewhere has been to shift the burden of taxation away from labour and onto consumption. Having reduced taxation on labour in the previous three years, the Government has this year continued to make work pay by increasing the ceiling of the tax-free income bracket. This measure is expected to affect some 117,000 beneficiaries while covering some 160,000 people.

Notwithstanding the above, it is acknowledged that apart from shifting the tax burden away from labour, an economy also necessitates a sound fiscal stance. In this context, through the 2016 Budget, Government increased the excise duty on certain goods harming health or the environment. In the second quarter of this year, Government will also be introducing an Environmental Contribution to be levied on tourists.

## **6.2.2 Widening Tax Bases**

It has been widely acknowledged that tax base expansion is the way forward in increasing taxation revenue without causing possible disruptions or hindrance to economic growth. With regards to labour taxation, this means that Government needs to encourage people to join the labour force and thus be eligible tax payers.

In line with this policy stance, during 2015, the Government introduced the In-Work Benefit Scheme which encourages single parents and couples who have children to re-join the labour force. In this year's budget, the Government extended this benefit to families where only one person is in employment. Meanwhile, female participation in the labour force continued to feature strongly in Government's policies. In fact, the Maternity Fund was a particularly important measure as it seeks to end discrimination at the place of work, while at the same time encouraging women to find work. Female participation in enterprise was also incentivised through a tax credit of up to €50,000 for self-employed women or businesses with a female majority shareholding.

Other measures that aimed to widen the tax base include changes in the taxation on leased property. While in 2015 property owners were given the opportunity to pay a 15 per cent Withholding Tax, this year, this concession was extended to include commercial properties and companies as well. Furthermore, in a bid to discourage undeclared employment of migrant workers, an Immigration Work Office was set up where migrants and employers can find their counterpart in a legal and safe manner. This initiative aims to reduce abuse, tackle tax evasion and remove competitive distortions in the labour market created by such abuse.

## **6.2.3 Simplification of Taxation System**

A taxation system which is complex and hard to understand will discourage compliance, at times leading to unintentional evasion. Furthermore, a simple tax system is usually much easier to maintain, control and administer and thus making the revenue stream more efficient in itself.

In this respect, Government is moving away from capital gains taxation towards the simpler and more straightforward Final Withholding Tax system. Indeed, it should be noted that Malta's tax system is already relatively efficient. For example, it takes on average 139 hours to prepare, file and pay taxes in Malta, while the EU average stands at 185.6 hours<sup>2</sup>. Administrative costs, which can reflect the complexity of the tax system, are relatively low, representing 0.95 per cent of net revenue collections<sup>3</sup>. The provision of pre-filled tax returns and a variety of e-services are further testament of the Government's commitment to simplify the tax system.

## **6.2.4 Fighting Tax Evasion and Avoidance**

The Maltese Government is committed to stop the injustice resulting from tax evasion and avoidance while ensuring that everyone pays their fair share of tax. Government set up a Risk Analysis Unit, autonomous from the Tax Compliance Unit, so that, through a risk-based approach, it can identify risks in a bid to efficiently and effectively allocate resources. Furthermore, a call to increase the number of qualified auditors has been made to better equip the Tax Audits Section. Exchange of information between different Government Departments, including the Department for Social Security, Value Added Tax (VAT) and Inland Revenue Departments, also been increased, both as part of the ongoing merger of the different departments as well as to clamp down on illegalities and non-compliance in a more effective manner. In this respect, Government is currently in

the process of assessing the recommendations of the in-depth International Monetary Fund (IMF) report on the merger of the different revenue departments.

A Joint Enforcement Task Force (JETF), which is being set up under the MFIN, will support the efforts of existing fiscal evasion units, combine the full powers at law of such institutions as well as take on additional ones so as to be better placed to push for the effective prosecution of operations related to fiscal evasion proliferating in the underground economy. The JETF will act as a central coordination unit, supporting increased cooperation between the different departments and agencies, facilitating the sharing of information between the various departments and agencies and spearheading its own risk assessments, investigations and enforcement initiatives.

In addition, an enhancement of the refund check mechanism was also carried out so as to ensure that refunds are not issued, where reasonable evidence exists, that a refund is not due. Furthermore, a study is being carried out in preparation of a revision in the penalty system with the aim to make a proper distinction between tax evaders and pure non-compliance (that is, late filing, interpretation errors and genuine mistakes).

*Footnotes:*

<sup>1</sup> The distributional impact of the in-work benefit scheme was estimated using EUROMOD. EUROMOD is a static micro simulation model aimed at assessing the impact of redistributive measures on the economy using SILC data. The model applies user-defined tax and benefit policy rules to harmonise micro-data on individuals and households in order to calculate their effects on household income by producing an output at a micro level.

<sup>2</sup> World Bank, 2016. Doing Business 2016: Measuring Regulatory Quality and Efficiency. Washington, DC: World Bank.

<sup>3</sup> OECD (2015) op cit.

## **7. Institutional Features of Public Finances**

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## 7. Institutional Features of Public Finances

The Fiscal Responsibility Act, enacted by Parliament on 8<sup>th</sup> August 2014 led to significant reforms in Malta's budgetary system and processes. The emphasis is now more focused on medium-term planning as well as on a more synchronised and transparent budgeting process.

Procedures are now established for the independent assessment of macroeconomic and fiscal forecasts and the independent monitoring of compliance with fiscal rules. The rules bind national fiscal authorities in achieving a balanced structural budget, or in its absence, converge towards the medium-term budgetary objective. The aim is to maintain the public debt at sustainable levels over the medium and long-term. While fiscal rules ensure adequate fiscal discipline in good times, the Act allows for a measured level of flexibility when needed, identifying and defining 'exceptional circumstances' on the basis of which fiscal policy can be allowed to deviate from the fiscal rules.

The Fiscal Responsibility Act also establishes rolling three-year business and financial plans. Statements showing the three-year revenue and expenditure projections for 2016-2018, at Ministry level, were integrated in the 2016 Financial Estimates presented to Parliament in October 2015. The Ministries' 2017-2019 Business and Financial Plans shall serve as the parameters within which the business and financial planning exercise for 2017 and the years that follow, is to be undertaken. Indeed, they serve as the basis for the 2017 Budget preparation and Government's medium-term financial plan. The latter, which is outlined in this Stability Programme, sets forth the Government's fiscal objectives, strategic priorities and a three-year rolling target for fiscal management together with a description of any underlying assumptions.

Another medium-term planning instrument relates to the required submission of Human Resources (HR) plans. The HR Plans aim to entrench a holistic approach to HR requirements through forward-planning reflecting changing priorities while ensuring more effective and efficient use of human resources.

Through the top-down budget approach and the establishment of a spending ceiling the medium-term budgetary framework also strengthens the role of the Ministry for Finance (MFIN). In the course of the budget year, no new or additional expenditures can be made or committed to in excess of the appropriated budgetary allocation. Demands for additional expenditures will need the approval of the Minister for Finance while ensuring adherence to fiscal rules. The Act also requires that all collective agreements and pay negotiations in the public sector obtain the prior approval of MFIN.

The flexibility instruments, such as virements between votes within the same department, re-allocation of expenditure within the same Ministry and the contingency reserve, also reduce the risk of non-compliance with the Act, improve the credibility of the fiscal rules and promote efficiency in budget execution.

The regular monitoring of the budgetary performance provided for by the Act, especially the mid-term review, allows Government to take remedial action. It also increases the level of accountability on fiscal matters. In addition, the Fiscal Responsibility Act provides for the publication of a draft budgetary plan before the actual budget and for the regulation of the annual budget to ensure conformity with the provisions of the Act.

The Act establishes the Fiscal Council tasked with assessing and endorsing macroeconomic and fiscal forecasts, securing compliance with fiscal rules, determining the existence of exceptional circumstances (when relevant) and assessing progress in the corrective action plan implementation (where relevant). The Fiscal Council is also entrusted with the ex-ante and ex-post assessment of the budgetary performance against the fiscal rules and targets, and in particular issue opinions and recommendations on the Half-Yearly and Annual Report published by MFIN.

## **7.1 Ministries' Business and Financial Plans, including HR Plans**

In terms of the Fiscal Responsibility Act, Ministries and Departments are required to prepare rolling three-year business and financial plans which are based on the (most recently announced) medium-term fiscal strategy.

In this regard, in 2015, MFIN issued circular MF1/15 (2016-2018 Business and Financial Plans). Each Ministry/Department/Entity was asked to submit the Business and Financial Plans, including also the HR Plans, to MFIN. Following receipt, the plans were studied by MFIN and the necessary proposals were outlined. The business plans, as approved by MFIN, complied with the Government's fiscal strategy.

Along the budgetary process, two rounds of bilateral inter-Ministerial meetings, both at Permanent Secretary and at Ministerial levels were held to discuss in further detail until such time that the projections were ultimately consolidated and eventually reflected in the financial estimates.

Following the issue of Directive 10, which aims at enabling the streamlining of procedures and processes for the formulation of business plans, and the optimisation of the HR function for enhanced effectiveness, Ministries and Departments were bound to provide (by mid-January 2016) MFIN with a revised version of the HR Plans for 2016 based on the budget allocations provided for in the financial estimates. Public Entities were also obliged to provide their revised HR Plans by mid-April.

In March 2016, MFIN asked Ministries, Departments and Entities that are in receipt of a Government subvention to collate their Business and Financial Plans for the period 2017 to 2019. The Plans were due for submission during April 2016.

Following the necessary consideration from a budgetary perspective, MFIN will communicate its feedback on the business and financial plans, including the HR plans, as and where required. The feedback may include amendments to the original submission. Along the budgetary process, a series of bilateral meetings both at Permanent Secretary and Ministerial levels will be held. The line Ministries, Departments and Entities will have until the first week of September to endorse such feedback or make written representations with MFIN over any disagreements with the latter's proposals. Failure to reply by this deadline will be construed as a prima facie agreement with MFIN's revision.

## 7.2 The Malta Fiscal Advisory Council

The Malta Fiscal Advisory Council (MFAC) was formally established on 1<sup>st</sup> January 2015 through the publication of Government notice number 33, published in the Government gazette on 16<sup>th</sup> January 2015. All members of the Council are on an executive basis, the chairman being on a full time basis.

The Council met twelve times during 2015, to discuss both internal administrative issues as well as reports assessing the macroeconomic and fiscal projections, which were also approved for publication during these meetings. During the year, the MFAC members and staff also held a number of external meetings with public officials, foreign delegations, and consultants.

During its first year of operation, the MFAC developed a number of formal and informal links with other Independent Fiscal Institutions (IFIs) and international institutions related to fiscal surveillance. These included the Network of the European Union (EU) IFIs established by the CION, the Informal Network of EU IFIs, the OECD meetings of Parliamentary Budget Officials and IFIs (as observer), the Economic and Financial Affairs Directorate of the CION and a number of IFIs in the EU. Moreover, the MFAC members attended a number of meetings and seminars organised by these entities abroad, which served to establish closer co-operation with the fiscal councils in Europe and OECD countries and to build a platform of regular dialogue on fiscal issues and formal communication channels particularly with the CION and some of its Committees.

The MFAC featured a number of times in the local press during the year. Nevertheless, its visibility in the media was rather limited due to the fact that the MFAC was still in transition. In 2016, the MFAC intends to improve its visibility through further development of its website, educational articles in the press, presentations to University students, seminars to selected audiences and more interaction with stakeholders.

In terms of the FRA, the MFAC is required to submit its assessment of all MFIN reports to the Minister for Finance as soon as is practicable and to publish such assessments within ten days after submission to the Minister. Since its establishment, the MFAC has published six reports through its website launched on 30 July 2015. The Council produced four reports assessing the macroeconomic and fiscal forecasts.

### 7.2.1 Assessments and Observations

During the first year, the reports issued by the MFAC contained a number of different but inter-related observations including on the conduct of fiscal policy and the budgetary process, ranging from proposals on public expenditure control to pension reforms and the public debt.

MFIN has taken note of many of the MFAC proposals. The Ministry has also held preliminary discussions with the MFAC to exchange views on these observations and further meetings are envisaged to ensure continued progress.

It is also worth noting that the MFAC (including the NAO when it was temporarily acting as a fiscal council) has so far endorsed all the macroeconomic and fiscal projections. Moreover, the MFAC identified the risk factors surrounding the fiscal projections and targets. Indeed the fiscal risk assessment provided by the MFAC was endorsed by

Government and included in Malta's Medium-Term Fiscal Strategy 2015-2018 which was submitted to Parliament on the 3<sup>rd</sup> June 2015.





## Macroeconomic Prospects

Table 1a

Percentages unless otherwise indicated	ESA Code	Level 2014 <sup>(1)</sup>	Percentage change over previous period					
			2014	2015	2016 <sup>(2)</sup>	2017	2018	2019
1. Real GDP	B.1g	7,466.3	3.7	6.3	4.2	3.1	2.9	2.4
2. Nominal GDP	B.1g	8,084.1	5.7	8.8	6.8	5.6	4.8	4.5
<b>Components of real GDP</b>								
3. Private consumption expenditure <sup>(3)</sup>	P.3	4,106.2	2.4	4.9	3.5	2.4	2.3	2.2
4. Government consumption expenditure	P.3	1,524.4	7.2	4.8	2.2	5.1	0.1	1.1
5. Gross fixed capital formation	P.51	1,258.7	7.3	21.4	1.6	9.2	-3.9	2.5
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53		0.7	0.3	0.3	0.2	0.2	0.2
7. Exports of goods and services	P.6	11,107.4	0.1	2.4	3.4	3.0	3.1	2.0
8. Imports of goods and services	P.7	10,592.2	-0.2	3.0	2.4	3.9	1.6	1.7
<b>Contribution to real GDP growth<sup>(4)</sup></b>								
9. Final domestic demand		6,889.3	4.0	7.5	2.6	4.0	0.5	1.9
10. Change in inventories and net acquisition of valuables	P.52+P.53	51.6	-0.6	-0.5	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	515.2	0.4	-0.6	1.6	-0.9	2.3	0.5

<sup>(1)</sup> € million

<sup>(2)</sup> Forecasts from 2016 onwards

<sup>(3)</sup> Includes NPISH final consumption expenditure

<sup>(4)</sup> Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. This non-additivity, similar to that in other countries' national accounts, is due to mathematical reasons and reflects the fact that chain-linked volumes are calculated by separately extrapolating both totals and their sub-components.

## Price Developments

Table 1b

Percentages unless otherwise indicated	ESA Code	Level	Percentage change over previous period					
		2014 <sup>(1)</sup>	2014	2015	2016 <sup>(2)</sup>	2017	2018	2019
1. GDP deflator <sup>(3)</sup>		108.3	1.9	2.3	2.6	2.5	1.9	2.1
2. Private consumption deflator		106.3	0.1	1.1	1.5	1.9	1.8	1.6
3. HICP		107.7	0.8	1.2	1.6	1.9	1.8	1.7
4. Public consumption deflator		105.3	1.3	1.6	1.8	2.0	2.4	2.4
5. Investment deflator		115.2	3.0	5.2	3.5	3.0	2.8	2.9
6. Export price deflator (goods and services)		107.8	0.4	1.6	0.1	1.3	1.0	1.5
7. Import price deflator (goods and services)		107.1	-0.3	1.4	-0.2	1.2	0.9	1.5

<sup>(1)</sup> Index (base 2010 unless otherwise indicated)

<sup>(2)</sup> Forecasts from 2016 onwards

<sup>(3)</sup> Users should note that chain-linking gives rise to components of GDP not adding up to the aggregate real GDP series. Indeed, summing up the deflators of the components of GDP would not add up to the actual GDP deflator observed for the year.



## Labour Market Developments

Table 1c

Percentages unless otherwise indicated	ESA Code	Level	Percentage change over previous period					
		2014	2014	2015	2016 <sup>(1)</sup>	2017	2018	2019
1. Employment, persons (National Accounts Definition, Domestic Concept)		188,369	5.1	3.5	2.7	2.7	2.2	2.0
2. Employment, hours worked (National Accounts Definition, Domestic Concept) ('000s)		368,217	5.1	3.5	2.7	2.7	2.2	2.0
3. Unemployment rate (Harmonised definition, 1,000 persons)		11,000	5.8	5.4	5.3	5.3	5.4	5.4
4. Labour Productivity, persons (Real GDP per person employed)		39,637	-1.3	2.7	1.5	0.4	0.6	0.4
5. Labour Productivity, hours worked (Real GDP per hour worked)		20.3	-1.3	2.7	1.5	0.4	0.6	0.4
6. Compensation of employees (€ million)	D1	3,602.8	6.4	5.3	5.6	5.2	4.8	4.6
7. Compensation per employee (€)		19,126	1.3	1.7	2.8	2.4	2.5	2.5

<sup>(1)</sup> Forecasts from 2016 onwards

## Sectoral Balances

Table 1d

Percentages of GDP	ESA Code	2014	2015	2016	2017	2018	2019
1. Net lending/ borrowing vis-à-vis the rest of the world	B.9	5.1	11.6	9.0	8.4	8.7	9.1
of which <sup>(1)</sup> :							
Balance on goods and services		7.9	6.9	7.9	7.1	8.8	8.9
Balance of primary incomes and transfers		-4.5	2.9	-0.3	-0.0	-1.3	-1.0
Capital account		1.7	1.8	1.4	1.3	1.3	1.2
2. Net lending / borrowing of the private sector	B.9	6.6	13.1	9.4	8.6	8.6	8.7
3. Net lending / borrowing of general Government	EDP B.9	-2.0	-1.5	-0.7	-0.6	-0.2	0.1
4. Statistical discrepancy		0.5	-0.0	0.4	0.4	0.4	0.4

<sup>(1)</sup> Figures may not add up due to rounding.

**General Government Budgetary Prospects**

Table 2a

Percentages of GDP		ESA code	2014 <sup>(*)</sup>	2015 <sup>(*)</sup>	2014	2015	2016	2017	2018	2019
<b>Net Lending (EDP B9) by sub-sector</b>										
1.	General Government	S13	-163.4	-129.0	-2.0	-1.5	-0.7	-0.6	-0.2	0.1
2.	Central Government	S1311	-165.5	-130.1	-2.0	-1.5	-0.7	-0.5	-0.2	0.1
3.	State Government	S1312	-	-	-	-	-	-	-	-
4.	Local Government	S1313	2.1	1.1	0.0	0.0	-0.0	-0.0	-0.0	-0.0
5.	Social security funds	S1314	-	-	-	-	-	-	-	-
<b>General Government</b>										
6.	Total revenue	TR	3,330.3	3,683.1	41.2	41.9	39.4	39.3	38.8	38.4
7.	Total expenditure	TE	3,493.8	3,812.1	43.2	43.3	40.1	39.9	39.0	38.3
8.	Net lending / borrowing	B9	-163.4	-129.0	-2.0	-1.5	-0.7	-0.6	-0.2	0.1
9.	Interest expenditure	D41	230.8	227.6	2.9	2.6	2.3	2.2	2.2	2.1
10.	Primary balance <sup>(1)</sup>		67.4	98.6	0.8	1.1	1.6	1.7	2.0	2.2
11.	One-off and other temporary measures <sup>(2)</sup>		25.9	9.8	0.3	0.1	0.1	0.1	0.1	0.1
<b>Selected Components of Revenue</b>										
12.	Total Taxes (12=12a+12b+12c)		2,265.0	2,441.7	28.0	27.8	27.6	27.4	27.3	27.1
12a.	Taxes on production and imports	D2	1,097.8	1,189.1	13.6	13.5	13.6	13.5	13.3	13.1
12b.	Current Taxes on Income, Wealth, etc.	D5	1,155.4	1,237.6	14.3	14.1	13.9	13.8	13.8	13.9
12c.	Capital Taxes	D91	11.8	15.0	0.1	0.2	0.2	0.2	0.1	0.1
13.	Social Contributions	D61	560.3	596.3	6.9	6.8	6.7	6.5	6.4	6.4
14.	Property Income	D4	93.0	99.8	1.2	1.1	1.0	1.0	0.9	0.9
15.	Other <sup>(3)</sup>		412.0	545.3	5.1	6.2	4.1	4.4	4.2	4.0
16=6.	Total Revenue	TR	3,330.3	3,683.1	41.2	41.9	39.4	39.3	38.8	38.4
p.m.:	Tax Burden (D2+D5+D6111+D6131+D91-D995) <sup>(4)</sup>		2,747.6	2,962.0	34.0	33.7	33.5	33.3	33.0	32.7
<b>Selected Components of Expenditure</b>										
17.	Compensation of employees + intermediate consumption	D1+P2	1,573.4	1,712.9	19.5	19.5	19.0	18.8	18.3	18.0
17a.	Compensation of employees	D1	1,048.6	1,116.4	13.0	12.7	12.5	12.3	12.1	12.0
17b.	Intermediate consumption	P2	524.8	596.5	6.5	6.8	6.5	6.5	6.2	6.0
18.	Social payments (18=18a+18b) of which <i>Unemployment benefits</i> <sup>(5)</sup>		1,004.1	1,033.2	12.4	11.7	11.3	11.1	11.0	10.9
			30.1	30.3	0.4	0.3	0.3	0.3	0.3	0.3
18a.	Social transfers in kind supplied via market producers	D632	40.4	46.8	0.5	0.5	0.5	0.5	0.5	0.4
18b.	Social transfers other than in kind	D62	963.7	986.4	11.9	11.2	10.8	10.6	10.5	10.5
19=9.	Interest expenditure	D41	230.8	227.6	2.9	2.6	2.3	2.2	2.2	2.1
20.	Subsidies	D3	105.0	110.6	1.3	1.3	1.2	1.2	1.1	1.1
21.	Gross fixed capital formation	P51G	297.1	402.3	3.7	4.6	3.5	3.6	3.4	3.3
22.	Capital transfers	D9	91.9	129.6	1.1	1.5	0.5	0.7	0.7	0.7
23.	Other <sup>(6)</sup>		191.4	195.8	2.4	2.2	2.3	2.3	2.3	2.4
24=7.	Total Expenditure	TE	3,493.8	3,812.1	43.2	43.3	40.1	39.9	39.0	38.3
p.m.:	Government consumption (nominal)	P3	1,605.6	1,704.1	19.9	19.4	18.9	19.2	18.8	18.6

<sup>(\*)</sup> € million

<sup>(1)</sup> The primary balance is calculated as (B9, item 8) plus (D41, item 9)

<sup>(2)</sup> A plus sign means deficit-reducing one-off measures

<sup>(3)</sup> P10 + D39rec + D7rec + D9N (ie D9 other than D91rec)

<sup>(4)</sup> Including those collected by the EU and including an adjustment for uncollected taxes and social contributions D995), if appropriate

### No policy change projections

Table 2b

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Percentages of GDP	2015 <sup>(1)</sup>	2015	2016	2017	2018	2019
1. Total revenue at unchanged policies	3,641.3	41.5	39.1	39.5	38.9	38.4
2. Total expenditure at unchanged policies	3,762.3	42.8	40.7	39.9	39.1	38.4

<sup>(1)</sup> € million

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### Amounts to be excluded from the expenditure benchmark

Table 2c

Percentages of GDP		2014 <sup>(1)</sup>	2015 <sup>(1)</sup>	2014	2015	2016	2017	2018	2019
1.	Expenditure on EU programmes fully matched by EU funds revenue	175.89	253.14	2.18	2.88	1.17	2.01	2.00	2.00
1a.	<i>of which</i> Investment fully matched by EU funds revenue <sup>(2)</sup>	118.22	151.87	1.46	1.73	0.66	1.14	1.13	1.13
2.	Cyclical unemployment benefit expenditure <sup>(3)</sup>	-	-1.60	-0.00	-0.02	-0.01	0.00	0.01	0.00
3.	Effect of discretionary revenue measures	57.18	41.80	0.71	0.48	0.44	-0.12	0.04	0.05
4.	Revenue increases mandated by law	-	-	-	-	-	-	-	-

<sup>(1)</sup> € million

<sup>(2)</sup> Based on an estimate of Gross Fixed Capital Formation financed from EU funds

<sup>(3)</sup> The cyclical unemployment benefit expenditure is estimated based on the difference between the unemployment rate and NAWRU. Data for the total unemployment benefit expenditure is defined in COFOG under the code 10.5

## General Government Expenditure by Function

Table 3

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<b>Percentages of GDP</b>	<b>COFOG Code</b>	<b>2014</b>	<b>2019</b>
1. General public services	1	7.2	6.3
2. Defence	2	0.8	0.7
3. Public order and safety	3	1.4	1.3
4. Economic affairs	4	5.4	4.5
5. Environmental protection	5	1.6	1.4
6. Housing and community amenities	6	0.3	0.3
7. Health	7	6.0	5.4
8. Recreation, culture and religion	8	1.1	0.9
9. Education	9	5.8	5.5
10. Social protection	10	13.7	12.0
11. Total Expenditure	TE	43.2	38.3

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## General Government Debt Developments

Table 4

Percentage points of GDP	ESA Code	2014	2015	2016	2017	2018	2019
1. Gross debt (% of GDP)		67.1	63.9	62.6	60.4	57.5	55.5
2. Change in gross debt ratio		-1.5	-3.2	-1.3	-2.1	-2.9	-2.1
Contributions to changes in gross debt							
3. Primary balance		-0.8	-1.1	-1.6	-1.7	-2.0	-2.2
4. Interest expenditure	EDP D.41	2.9	2.6	2.3	2.2	2.2	2.1
5. Stock-flow adjustment		0.2	0.8	2.0	0.7	-0.3	0.5
p.m. implicit interest rate on debt <sup>(1)</sup> (%)		4.4	4.2	3.9	3.8	3.8	3.8

<sup>(1)</sup> Proxied by interest expenditure divided by the debt level of the previous year.

## Cyclical Developments

Table 5

Percentages of GDP	ESA Code	2014	2015	2016	2017	2018	2019
1. Real GDP growth (%)		3.7	6.3	4.2	3.1	2.9	2.4
2. Net lending of General Government	EDP B.9	-2.0	-1.5	-0.7	-0.6	-0.2	0.1
3. Interest expenditure	EDP D.41	2.9	2.6	2.3	2.2	2.2	2.1
4. One-off and other temporary measures <sup>(1)</sup>		0.3	0.1	0.1	0.1	0.1	0.1
5. Potential GDP growth (%)		3.8	4.5	4.2	4.2	3.4	2.8
contributions:							
- labour (hours)		1.6	1.7	1.8	1.7	1.4	1.0
- capital		0.7	1.3	1.2	1.4	1.1	1.1
- total factor productivity		1.4	1.4	1.2	1.0	0.8	0.7
6. Output Gap		-0.1	1.6	1.6	0.6	0.1	-0.3
7. Cyclical Budgetary Component		-0.1	0.7	0.7	0.3	0.1	-0.1
8. Cyclically-Adjusted Balance (2-7)		-2.0	-2.2	-1.4	-0.8	-0.2	0.2
9. Cyclically-Adjusted Primary Balance (8+3)		0.9	0.4	0.9	1.4	1.9	2.3
10. Structural Balance (8-4)		-2.3	-2.3	-1.5	-0.9	-0.3	0.2

<sup>(1)</sup> A plus sign means deficit-reducing one-off measures



## Divergence from the April 2015 Stability Programme

Table 6

Percentages of GDP	ESA Code	2014	2015	2016	2017	2018	2019
<b>Real GDP growth</b>							
Previous update		3.5	3.4	3.1	2.8	2.8	...
Current update		3.7	6.3	4.2	3.1	2.9	2.4
Difference		0.2	2.9	1.1	0.3	0.1	-
<b>General Government net lending</b>							
	EDP B.9						
Previous update		-2.1	-1.6	-1.1	-0.6	-0.2	...
Current update		-2.0	-1.5	-0.7	-0.6	-0.2	0.1
Difference		0.1	0.1	0.4	0.0	0.0	-
<b>General Government gross debt</b>							
Previous update		68.0	66.8	65.6	63.8	61.2	...
Current update		67.1	63.9	62.6	60.4	57.5	0.0
Difference		-0.9	-2.9	-3.0	-3.4	-3.7	-

## Long-term Sustainability of Public Finances

Table 7

Percentages of GDP	2013	2020	2030	2040	2050	2060
Total Expenditure	-	-	-	-	-	-
of which: age-related expenditures	22.6	23.0	24.3	25.1	26.6	29.2
Pension expenditure	9.6	9.8	9.7	9.7	11.0	12.8
Social security pensions*	-	-	-	-	-	-
Old-age and early pensions	5.3	5.8	6.1	6.7	8.3	10.3
Other pensions (disability, survivors)	4.0	3.7	3.2	2.7	2.3	2.0
Occupational pensions	-	-	-	-	-	-
Health care	5.7	6.3	7.0	7.5	7.6	7.8
Long-term care	1.1	1.3	1.6	2.0	2.1	2.3
Educational expenditure	5.9	5.3	5.6	5.5	5.5	6.0
Other age-related expenditures: (Unemployment benefits)	0.3	0.3	0.3	0.3	0.3	0.3
Interest expenditure	-	-	-	-	-	-
Total revenue	-	-	-	-	-	-
of which: property income	1.9	1.9	1.9	1.8	1.8	1.7
of which: from pensions contributions	8.6	7.6	7.8	7.7	7.6	7.4
Pension reserve fund assets	-	-	-	-	-	-
of which: consolidated public pension fund assets	-	-	-	-	-	-
Labour productivity growth	-0.7	1.3	1.5	1.7	1.7	1.5
Real GDP growth	1.7	1.9	1.9	1.8	1.4	1.4
Participation rate males (aged 20-64)	84.7	86.1	89.7	88.9	88.6	89.0
Participation rate females (aged 20-64)	52.8	60.9	69.1	70.8	71.0	71.4
Total participation rates (aged 20-64)	69.0	73.8	79.6	80.1	80.0	80.4
Unemployment rate (aged 15-64)	6.5	6.6	6.7	6.7	6.7	6.7
Population aged 65+ over total population	17.5	21.2	24.4	24.8	26.4	28.5

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

Note: Figures may not add up due to rounding

### Basic Assumptions

Table 8a

	2014	2015	2016 <sup>(f)</sup>	2017 <sup>(f)</sup>	2018 <sup>(f)</sup>	2019 <sup>(f)</sup>
Short-term interest rate (annual average)	0.18	0.05	0.05	0.05	0.05	0.05
Long-term interest rate (annual average)	2.60	1.60	1.80	1.80	1.80	1.80
USD/EUR exchange rate (value at end of period)	1.329	1.107	1.094	1.076	1.098	1.106
GBP/EUR exchange rate (value at end of period)	0.806	0.729	0.765	0.740	0.736	0.738
Malta's main trading partners growth	1.3	1.6	1.6	1.7	1.7	1.7
Oil prices, (Brent, USD/barrel)	99.02	48.70	38.00	42.90	44.70	44.70
World prices weighted by main trading partners (y-o-y % change)	-1.3	-1.9		1.2	1.2	1.2

## Basic Fiscal Assumptions

Table 8b

	ESA Code	2014	2015	2016 <sup>(9)</sup>	2017 <sup>(9)</sup>	2018 <sup>(9)</sup>	2019 <sup>(9)</sup>
<b>Implied Elasticity with respect to respective Tax Base</b>							
Taxes on Production and Imports	D2	1.3	0.9	0.8	1.0	0.6	0.6
of which Value Added Taxes	D212	2.9	1.4	0.8	1.4	1.0	1.1
Current Taxes on Income, Wealth, etc. [Personal]	D5	1.7	0.8	1.5	1.3	1.3	1.3
Current Taxes on Income, Wealth, etc. [Corporate]	D5	2.1	1.4	0.7	0.5	0.8	1.1
Net social contributions	D61	0.8	0.8	0.8	0.7	0.7	0.8
<b>General Government Adjustments (€millions)</b>		<b>-40.6</b>	<b>103.9</b>	<b>82.0</b>	<b>18.2</b>	<b>13.2</b>	<b>8.2</b>
Time adjusted cash Reg 2516/2000		13.5	-3.8	10.0	10.0	10.0	10.0
Other accounts payable and receivable		-62.5	107.9	28.0	10.0	10.0	10.0
Treasury Clearance Fund & Good Causes Fund		27.7	20.5	20.0	20.0	20.0	20.0
Air Malta Adjustment		-15.0	-43.0	0.0	0.0	0.0	0.0
Social and Investment Fund - IIP - Revenue		8.3	35.0	56.0	26.3	26.3	26.3
Social and Investment Fund - IIP - Expenditure		0.0	0.0	-28.0	-35.0	-40.0	-45.0
Others		-12.5	-12.8	-4.0	-13.1	-13.1	-13.1
<b>Social Security Benefits</b>							
COLA (€)		3.49	0.58	1.75	1.92	5.24	5.24
Contributory Benefits (€ millions)		645.6	668.2	699.4	729.8	764.8	804.5
Number of CB Beneficiaries (persons)		109,371	110,844	114,010	116,382	116,060	116,646
Non-Contributory Benefits (€ millions)		207.3	201.2	199.3	204.4	210.6	217.8
Number of NCB Beneficiaries (persons)		115,486	113,686	114,919	116,037	115,373	115,347
<b>Public Sector Employment Targets (persons)</b>		<b>39,387</b>	<b>39,839</b>	<b>40,671</b>	<b>40,510</b>	<b>41,034</b>	<b>40,670</b>

## Contingent liabilities

Table 9

% of GDP

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	2014	2015	2016	2017	2018	2019
<b>Public guarantees</b>	16.5	16.0	15.9	11.9	11.9	11.8

*Note: The data for Contingent liabilities for 2014 to 2015 is actual, while data for 2016 to 2019 is an estimate*

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## Stock Flow Adjustment Statement

Table 10

Millions of Euros	2015	2016	2017	2018	2019
<b>General Governemnt deficit (-) / surplus (+) (ESA10)</b>	<b>129.0</b>	<b>65.7</b>	<b>54.8</b>	<b>19.0</b>	<b>-9.9</b>
ESA Adjustments	131.7	82.0	18.2	13.2	8.2
Contribution to Sinking Fund (Local)	3.3	3.3	3.3	-81.3	0.0
Contribution to Sinking Fund (Foreign)	6.5	6.5	4.7	0.1	0.1
Contribution to Special MGS Sinking Fund	25.0	50.0	50.0	50.0	50.0
EFSF Debt re-routing	-10.6	-	-	-	-
EFSF/ESM Credit Line Facility	0.0	4.5	4.5	4.5	4.5
Courts and other deposits	-51.6	-	-	-	-
Stock Premium paid to Church	0.1	0.3	1.1	0.7	1.4
Repayment of Loans to Government	-40.4	-12.0	0.0	0.0	0.0
Sale of Assets	-0.7	-0.9	-0.9	-0.9	-0.9
Acquisition of Assets	1.1	14.6	2.6	2.6	2.6
EBUs	5.1	-	-	-	-
Currency	7.5	9.6	9.7	10.9	12.4
Movement in Bank Account	18.6	-	-	-	-
Increase/(Decrease)in cash balance	-24.9	35.5	-10.5	-7.2	-0.2
<b>Increase/(Decrease) in Non-Consolidated Debt</b>	<b>199.7</b>	<b>259.0</b>	<b>137.5</b>	<b>11.6</b>	<b>68.2</b>
MGS Consolidation	-0.1	-1.3	-15.9	-25.4	-23.3
<b>Increase/(Decrease) in Consolidated Debt</b>	<b>199.6</b>	<b>257.7</b>	<b>121.6</b>	<b>-13.8</b>	<b>44.9</b>
<b>SFA</b>	<b>70.6</b>	<b>192.1</b>	<b>66.8</b>	<b>-32.8</b>	<b>54.8</b>