



Malta:

Draft Budgetary Plan

2018

Ministry for Finance
October 2017

The following symbols have been used throughout this document:

... to indicate that data are not available;

— to indicate that the figure is negligible;

0 to indicate that the figure is zero;

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

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

Figures may not add up due to rounding.

This document is based on statistical information available up to the
9th of October, 2017

1. Overall Policy Framework and Objectives

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The achievement of a budget surplus in 2016 after 35 years in deficit is certainly a milestone in Malta's economic history. Indeed, in 2016 Malta also over-achieved its Medium-Term Objective (MTO) reaching a budget surplus in structural terms as well. Furthermore, the medium-term budgetary projections and targets presented to Parliament in May 2017, as confirmed by the data presented in this Report, suggest that this positive balance is not just the result of cyclical condition but can be sustained over the medium-term.

The early achievement of this milestone brought to the fore a new kind of fiscal policy dilemma for the Government. A number of economic operators have encouraged the Government to continue with the pace of fiscal consolidation with a view to building significant buffers that can withstand future risks to the macroeconomic outlook, particularly given the openness of the Maltese economy. At the same time, the strong economic performance of recent years has created new challenges with the most pressing being the need to invest and upgrade the existing infrastructure in order to support the increased economic activity and pave the way for future growth. Equally, the Government remains committed to address any emerging social imbalances and to provide the necessary support to the most vulnerable and those in need in society, while at the same time, providing the opportunities for each and every individual to contribute to the social and economic wellbeing of this country. In essence, it is the resolve of this Government to create a balance between these objectives in the Budget for 2018.

1.1 Macroeconomic Scenario

The significant strengthening of potential economic growth from 2.7 per cent in the three years of recovery following the 2009 recession to an average annual potential growth of 5.4 per cent registered in the last four years justify the substantial upward revision in the macroeconomic outlook underlying the 2018 Budget. Economic growth is expected to reach 5.9 per cent in 2017 and to moderate slightly to 5.6 per cent in 2018. While there are always risks present in an economic outlook, our assessment suggests that the risk is more on the upside than the downside in the short-term.

1.2 Fiscal Policy Objectives

The Budget for 2018 targets a surplus of 0.5 per cent of Gross Domestic Product (GDP) and a structural budget balance that is consistent with Malta's Medium-Term Budgetary Objective. Government's commitment towards infrastructure is embedded in an average public investment spending of 3.2 per cent of GDP over the next three years, which is consistent with the average spending registered in the last four years but higher than the average spending of 2.8 per cent of GDP recorded in the four years following the 2009 recession. Amidst a continuation of strong economic activity, the achievement of the fiscal targets should bring the debt ratio very close to 50.0 per cent of GDP in 2018.

1.3 Fiscal Governance

The Fiscal Responsibility Act adopted by the Maltese Parliament in August 2014, marked a significant step in the strengthening of fiscal governance. Beyond the strengthening of the institutional aspects of the budgetary process, one of the cornerstones of this

Act has been the heightened level of transparency and accountability. Apart from the extensive reporting requirements under the Act, the establishment of the Malta Fiscal Advisory Council (MFAC) is resulting in enhanced accountability of fiscal policy making.

The further strengthening of the institutional capacity in Malta's fiscal framework has become a more significant priority now that public finances are in surplus. Indeed, the Medium-Term Fiscal Strategy submitted to Parliament in May 2017 had already envisaged a renewed emphasis on the quality of public finances rather than the quantity. This was confirmed by the European Council's country specific recommendation to Malta "Expand the scope of the ongoing spending reviews to the broader public sector and introduce performance-based public spending". The Maltese Government fully supports this recommendation even though it presents a formidable challenge that will involve a significant strengthening of existing institutions and their technical capacities and thus will take a number of years to address fully the challenge.

The Comprehensive Spending Reviews are a core element of the Maltese Government's strategy to ensure the achievement of a more effective approach to public spending, improving decision making and ensuring that public spending is meeting changing priorities and changing social needs. The Comprehensive Spending reviews, which started in 2014, have so far covered the Department for Social Security, the Mater Dei Hospital, Primary Health, Pharmacy of your Choice and the Ministry for Education and Employment. In response to the European Council's recommendation, efforts are underway to institutionalise the spending review function under a directorate tasked with public sector performance and evaluation being set up within the Ministry for Finance (MFIN). Furthermore, assistance has been sought under the Structural Reform Support Programme with the scope of improving human resource capacity, tapping expertise in the field and building networks amongst peers.

In addition, the MFIN has appointed a second Permanent Secretary in order to take charge of institutional reform within the Ministry especially where it concerns the Budget Office and the Revenue Department.

A wide financial management reform is also underway that includes the transition to accrual accounting and the implementation of a Corporate Financial management solution across Government, as well as the adoption and implementation of International Public Sector Accounting Standards (IPSAS).

The targets contained in this Plan fulfil the legal requirements established by virtue of the Fiscal Responsibility Act. In addition, the macroeconomic forecasts underlying this Plan and the 2018 Budget have been endorsed by the Malta Fiscal Advisory Council.

1.4 Conclusion

The strength and stability being exhibited by the Maltese economy, mainly underpinned by strong improvements in investment, continued positive developments in the labour market, and subdued inflationary pressures, are supported by the range of structural economic policies presented in various National Reform Programmes and budget measures. These structural reform measures are intended to address the country's main economic challenges, and in particular:

1. Continue to deliver Government's commitment of ensuring public finance sustainability in the short- to medium-term, while also addressing the long-term dimension in particular through reduction in Government Debt.
2. Raising potential output, in particular by continuing to increase the labour force participation, especially of women, raising skill and education levels, promoting lifelong learning and continue addressing labour market shortages.
3. Investing and upgrading the infrastructure in order to support the increased economic activity and pave the way forward for further sustainable growth.
4. Addressing other long-term challenges including in the transport, environment and housing sectors.
5. Enhancing competitiveness and transparency whilst strengthening consumer protection.
6. Continue reducing bureaucracy especially the length of the public procurement process, and ensuring that the public service is efficient and cost effective, including through the extension of one-stop shops.
7. Safeguarding the successes achieved by the Maltese financial sector by reducing macroeconomic imbalances related to the financial sector and ensuring it continues to follow rigorous practices.
8. Continue prioritising the promotion of a diversified and balanced economy through the creation of new sectors.

The Government is confident that in the current international economic climate, structural reforms have been key in ensuring that Malta continues to experience a sustainable rate of growth and achieve its fiscal targets in a sustainable manner. With this Budget, Government is further supporting this growth momentum and insulating the economy from major economic imbalances while also promoting long-term economic sustainability.

2. Economic Outlook

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2.1 The Short-Term Scenario

The Maltese economy continued to sustain its strong performance throughout the first half of 2017, registering a real growth rate of 6.3 per cent, equivalent to 8.3 per cent in nominal terms. This growth was the highest among European Union (EU) Member States, and stands well above the 2.2 per cent of the EU average. This robust growth rate hinges on strong external developments in conjunction with strong domestic private consumption.

During the first half of 2017, Gross Value Added (GVA) in the Maltese economy increased by 8.3 per cent. This growth was attributed mostly to the services sector which registered a contribution of 7.6 per cent, while the primary and secondary sectors also recorded positive contributions of 0.1 per cent and 0.6 per cent, respectively. Throughout the first half of 2017, the vast majority of sectors experienced growth over the corresponding period in 2016, with notable increases recorded in the professional, scientific and technical activities sector (23.8 per cent), the personal, cultural and recreational sector (9.9 per cent), the construction sector (9.4 per cent) and the information and communications sector (8.0 per cent). The manufacturing sector also reported a positive performance with an expansion of 5.2 per cent, contrasting the subdued growth rates that the sector experienced in previous years.

From an income perspective, both compensation of employees and gross operating surplus exhibited a positive performance, with the former growing by 6.0 per cent and the latter by 10.6 per cent. Meanwhile, taxes on production and imports increased by 7.5 per cent while subsidies on production and imports increased by 6.1 per cent.

Throughout the second half of 2017, the Maltese economy is expected to retain its growth momentum, as real Gross Domestic Product (GDP) is expected to increase by 5.9 per cent in real terms by the end of the year. Growth is expected to be driven by net exports, which is expected to contribute 6.0 percentage points to GDP growth.

Private consumption is expected to increase by 4.2 per cent in real terms, backed by positive developments in employment, moderate wage growth and contained inflation prospects. Projections for government consumption indicate an increase of 3.2 per cent in real terms. Behind this increase, relative to the first half of 2017 is a base effect emanating from the increase in the Individual Investor Programme (IIP) proceeds recorded in the second half of 2016, which is incorporated in market output and deducted from government expenditure accordingly. Gross fixed capital formation is forecasted to decline by 12.1 per cent in real terms, following a base effect related to extraordinary investment in transport equipment during 2016. It is worth noting, that when forecasting investment, economists within the Ministry for Finance (MFIN) take a relatively prudent approach, factoring in only those projects that have a strong political commitment or a high probability of realisation. Besides, a relatively high import content of investment is assumed.

From an external standpoint, exports are forecasted to increase by 2.2 per cent, driven by strong performance in the services sector, particularly in the remote and digital gaming, financial services, other business services and tourism. Export prospects for

2017 are also underpinned by stronger economic activity in main trading partners and take into consideration the effect of the appreciation of the Euro against a number of major currencies, including the Pound and the US Dollar. Further strengthening the net exports contribution in economic growth is the decline in imports of 2.2 per cent, primarily driven by the fall in investment, as already noted above.

From a socio-economic standpoint, the labour market is expected to continue yielding encouraging developments, as employment is expected to rise by 4.0 per cent whilst the rate of unemployment is forecasted to decline to 4.1 per cent by the end of the year. Prices are expected to increase by 1.3 per cent, reflecting higher growth in the prices of unprocessed food and energy components that is partially offset by lower growth in the non-energy industrial goods and services components.

During 2018, economic growth is expected to remain strong and become more balanced, reaching a rate of 5.6 per cent. As investment is expected to recover, domestic demand is expected to contribute more positively to growth. Domestic demand is also expected to be supported by a positive performance in both private and public consumption expenditure.

Imports are expected to recover by 1.7 per cent reflecting the renewed growth in investment activity. This underpins the lower contribution of net exports when compared to 2017. Despite the further strengthening of the Euro and the expected moderation in external demand conditions in 2018, exports are expected to grow at a real rate of

Main Macroeconomic Indicators

Table 2.1

	2014	2015	2016	2017 ⁽¹⁾	2018
GDP growth at current market prices (% change)	10.6	9.7	7.2	8.1	7.6
GDP growth at chain linked volumes (2010) prices (% change)	8.2	7.1	5.5	5.9	5.6
Expenditure Components of GDP					
at chain linked volumes (2010) prices (% change)					
Private final consumption expenditure ⁽²⁾	2.7	5.9	3.0	4.2	4.1
General government final consumption expenditure	6.5	3.7	-1.8	3.2	5.0
Gross fixed capital formation	7.4	48.4	-0.4	-12.1	7.8
Exports of goods and services	3.9	4.2	3.5	2.2	2.5
Imports of goods and services	0.5	7.6	0.8	-2.2	1.7
Contribution to GDP growth (in percentage points):					
Domestic Demand	4.0	12.1	1.0	0.0	4.2
Inventories	-1.3	-0.9	0.5	-0.1	0.0
Net Exports	5.4	-4.1	4.0	6.0	1.4
Inflation rate (%)	0.8	1.2	0.9	1.3	1.5
Employment growth (Resident population concept, LFS definition) (%)	5.1	3.9	3.7	4.0	3.8
Unemployment rate (Harmonised definition) (%)	5.8	5.4	4.7	4.1	4.2

⁽¹⁾ Forecasts from 2017 onwards

⁽²⁾ Includes NPISH final consumption expenditure

2.5 per cent. This positive development reflects structural developments in the Maltese economy particularly as a result of further strong performance in services sector activities such as remote and digital gaming, tourism, financial services and other business services. Tourist spending is expected to strengthen further and will be supported by the continued growth of international tourism worldwide, the added attractiveness of Malta as a result of Valletta as European Capital of Culture in 2018, efforts of the Malta Tourism Authority (MTA) in extending tourism growth over the twelve calendar months, the opening up of new source markets and the newly announced routes or increased frequencies on existing routes for 2018.

Table 2.1 presents the main macroeconomic indicators for the period 2014 to 2018. The figures for the 2014 to 2016 period are based on the latest data released by the National Statistics Office (NSO) under the European System of National and Regional Accounts (ESA 2010), whereas the figures presented for 2017 and 2018 are forecasts produced by the MFIN.

2.1.1 Assumptions for Projections

The macroeconomic forecasts presented in this Draft Budgetary Plan are based on the following assumptions:

1. Economic activity in Malta's main trading partners is expected to increase by 1.8 per cent in 2017 and by 1.7 per cent in 2018.
2. Oil prices are expected to average US\$51.59 per barrel in 2017 and to marginally increase to US\$52.50 in 2018.
3. The short-term interest rate is expected to remain at the current spot rate of 0.0 per cent in 2017 and to remain at the same level for 2018. On the other hand, the long-term interest rate is expected to average at 1.4 per cent in 2017 and to remain at the same level for 2018.
4. The USD/EUR exchange rate is expected to average 1.1446 in 2017 and 1.1710 in 2018, representing an appreciation of the Euro of 3.6 per cent in 2017 and 2.3 per cent in 2018. The STG/EUR exchange rate is expected to average 0.8893 in 2017 and 0.9163 in 2018, representing an appreciation of the Euro of 6.7 per cent and 3.0 per cent respectively.
5. It is assumed that, starting from the third quarter of 2017, changes in inventories will not contribute materially to GDP growth.

2.1.2 Employment Prospects

The Labour Force Survey (LFS) reported an employment rate of 67.0 per cent in the second quarter of 2017, one percentage point higher than the corresponding period last year. Growth in headcount employment is expected to remain strong and to increase by 4.0 per cent in 2017, while for 2018 it is expected to increase by 3.8 per cent. Moreover, the unemployment rate (based on the Harmonised definition) is expected to settle at 4.1 per cent in 2017 relative to 4.7 per cent in 2016. This unemployment rate is well below the EU average rate and reflects ongoing efforts in promoting and sustaining active labour market policies.

For 2017, all sectors are expected to register growth in employment with the highest rates of growth expected to be in the remote gaming and professional services sectors. The overall positive performance is expected to be largely supported by the inflow of foreign workers and a higher female participation rate, reflecting ongoing Government efforts to strengthen the labour market. These measures include measures to better address work-life balance, free child care services, the early opening of schools and provision of after-school child care services, the maternity leave reform, promotion of flexible working arrangements, in-work benefit and the tapering of benefits, lower taxes on labour and various tax incentives.

2.1.3 Inflation

The Harmonised Index of Consumer Prices (HICP) inflation rate (twelve-month moving average), which during 2016 stood at 0.9 per cent, remained subdued during the first eight months of this year and stood at an average annual rate of 1.2 per cent reflecting lower contributions from the non-energy industrial goods and the services component. On the other hand, relative to the first eight months of last year, the contributions to annual HICP rates from the unprocessed food and the energy component were higher. Inflationary pressures are expected to remain subdued, with the headline rate reaching 1.3 per cent in 2017. In 2018, oil prices are expected to increase marginally in relation to 2017. On the other hand, the appreciation of the Euro mitigates some of these effects with the inflation rate expected to rise to 1.5 per cent.

2.2 Comparison to Commission's Spring Forecast

Prior to comparing the MFIN's Autumn forecasts with those published by the European Commission (EC) in May, it is worth mentioning that the EC's Spring forecast does not include the latest national accounts data published by NSO, while the MFIN's forecasts do incorporate this data. Furthermore, given that the EC's projections were published in Spring, they do not feature the latest data in the external environment which is important for a small and open economy.

The EC Spring forecast projected a growth rate for Malta of 4.6 per cent and 4.4 per cent in 2017 and 2018, respectively, with domestic demand expected to be the main driver of growth in 2017 while external demand is expected to be the largest contributor to growth in 2018. Therefore, forecasts for real GDP growth presented in this Draft Budgetary Plan are 1.3 percentage points and 1.2 percentage points higher than the rate forecasted by the EC for 2017 and 2018, respectively. For 2017, the EC is expecting growth to be primarily driven by domestic demand and to a lesser extent by external demand. In contrast, the forecasts produced by the Maltese Government expect growth to be driven by the external side with no positive contribution from the domestic side in 2017. Furthermore, the MFIN expects a marginal negative contribution to growth from inventories, assuming that no growth emanates from the inventories component over the forecast horizon. Furthermore, while the EC is expecting economic growth to be primarily on the back of external demand and to a lesser extent domestic demand, the MFIN is expecting growth to be primarily driven by domestic demand and to a lesser extent by the external side of the economy.

Nominal GDP growth presented in this Draft Budgetary Plan is projected at 8.1 per cent and 7.6 per cent for 2017 and 2018, respectively. For 2017 and 2018, this represents a

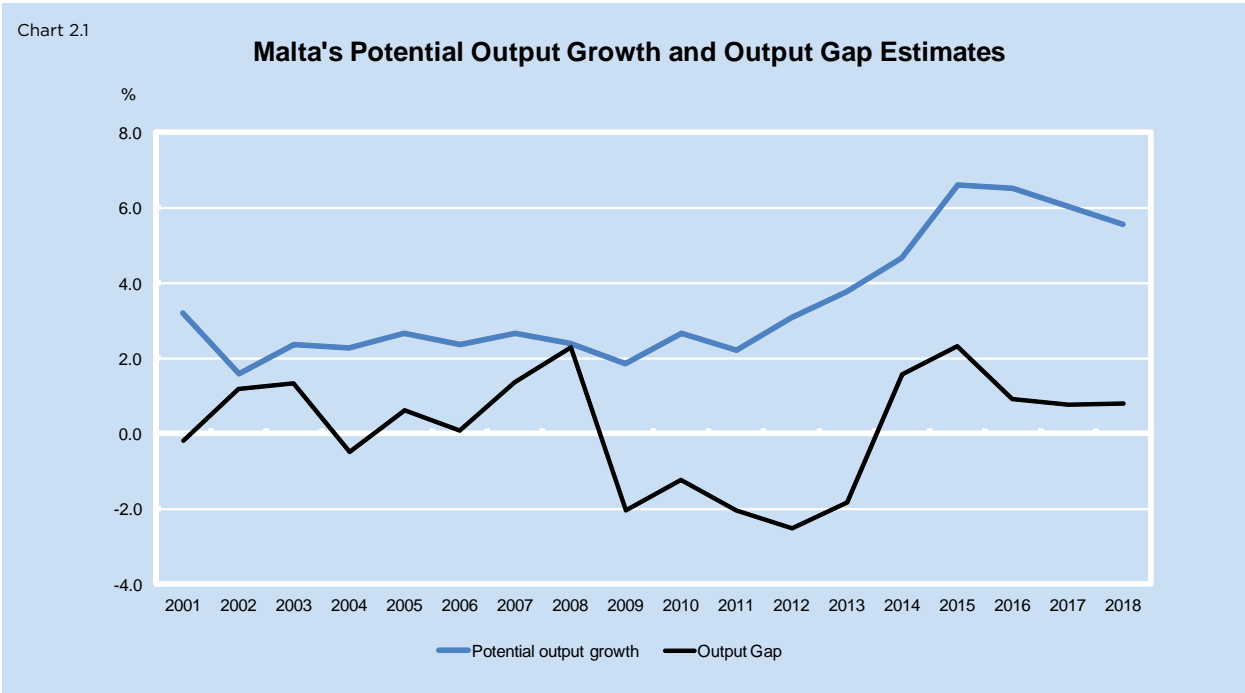
higher growth of 1.9 percentage points and 1.4 percentage points over the baseline presented by the EC in its Spring forecast, respectively. This is consistent with a higher growth in the GDP deflator projected by the MFIN after taking into consideration figures for the first half of 2017 which were not available to the EC at the time of the Spring forecasts. Employment growth is also more robust than what earlier forecasts indicated, supporting a stronger growth in private consumption.

2.3 Potential Output and the Output Gap

The average potential output growth stood at 4.5 per cent during the period 2011 to 2016. For 2017 and 2018, potential output growth is expected to increase to an average growth rate of 5.8 per cent, mainly underpinned by positive employment growth and higher labour market participation rates and improvements in the total factor productivity and, to a lesser extent by capital accumulation. The positive output gap for 2016 of 0.9 per cent is expected to decline marginally to 0.8 per cent for both 2017 and 2018. The developments in potential output and in the output gap, both historical and those expected over the forecast horizon are outlined in Chart 2.1.

2.4 Comparison with the Spring Forecasts

The economic outlook in this Draft Budgetary Plan has been revised upwards for both 2017 and 2018 when compared to the Spring round of forecasts. The contribution from the external side of the economy has also been revised upwards following stronger-than-anticipated growth in services exports during the first half of 2017 and supported further by a drop in imports stemming from an anticipated decline in investment. These factors are expected to be sufficient in offsetting the anticipated appreciation of the Euro against the Sterling and the Dollar. Furthermore, downward revisions in Government consumption and gross fixed capital formation led to a decrease in the contribution



to growth from the domestic side of the economy. Contrary to what was forecasted in Spring, gross fixed capital formation and public consumption are expected to register positive growth rates in 2018. Supported by modest growth in private consumption, the domestic side of the economy is expected to be the main contributor to growth. GDP growth in 2018 will also be supported by a positive contribution from the external sector, although to a lesser extent than what was forecasted in Spring. This is primarily due to a higher import associated with the surge in investment and a stronger appreciation of the Euro relative to Spring. Also, a substantial revision in national accounts between the first quarter and second quarter of 2017 resulted in a significantly stronger growth profile for the first months of 2017, which also explains the discrepancy between the MFIN's Spring and Autumn forecasts.

2.5 Sensitivity Analysis

In recognition of the risks surrounding macroeconomic forecasts, this section provides an assessment of forecast uncertainty and the balance of risk surrounding the macroeconomic forecasts in this Programme, in line with the requirements of Council Directive 2011/85/EU of the EU specifically, to guide their macroeconomic and budgetary forecasts by the performance of past forecasts and endeavour to consider relevant risk scenarios.

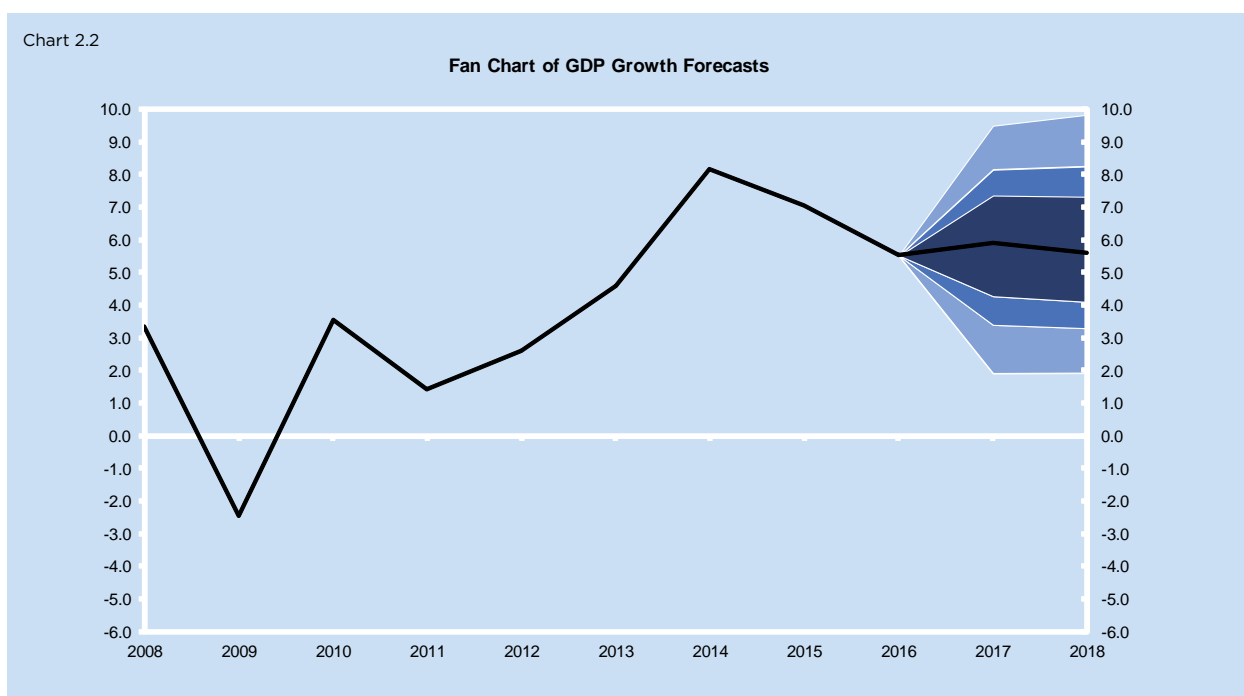
2.5.1 Assessing Past Forecasting Accuracy

The evaluation of the risk and uncertainty of the current macroeconomic projections underlying this Programme is based on the past forecast errors which determine the level of uncertainty and a number of alternative but plausible economic scenarios generated with the forecasting model¹.

An analysis of previous forecasting exercises reveals a recent tendency to underestimate growth, both as a result of prudence in macroeconomic forecasting at a time when fiscal consolidation was the main priority, and also due to past underestimation of economic activity in statistical releases. In addition, relative to previous analyses, the Root-Mean Squared Error (RMSE) has been increasing over recent years.

2.5.2 The Balance of Risks and Uncertainty Surrounding the Macroeconomic Projections

To determine the balance of risks surrounding the macroeconomic projections, a number of alternative model-based scenarios were carried out. These represent alternative scenarios, which economists within the MFIN judge to be plausible alternative scenarios to the baseline projections. These scenarios are selected by making reference to discussions with major stakeholders and regulators operating within the Maltese economy, as well as the constant monitoring of economic conditions prevailing at the time. The alternative scenarios present a wide range of views, ranging from the incorporation of alternative exogenous assumptions to sector-specific shocks. Chart 2.2 depicts a representation of the uncertainty and the balance of risk surrounding the macroeconomic forecast presented in this programme.



2.5.2.1 Model-Based Scenario

This scenario involves the removal of any form of expert 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 and still feature the one-off investment projects and their respective import content attributed to such projects that are presented in the baseline forecasts. The outcome of this scenario yields a significant decrease in Malta's GDP in 2017, followed by a marginal downward revision in real GDP of 0.1 percentage point in 2018.

2.5.2.2 Downside Risks in Global Economic Growth

Given the uncertainties surrounding the global economy and the external environment, this scenario models the impact of weaker than expected growth in Malta's main trading partners on the Maltese economy. The relatively lower expected economic growth for our main trading partners is based on the Consensus Forecasts September 2017 issue and assumes the low-end range survey growth figure for each trading partner for 2017 and 2018. The outcome of this scenario revises Malta's real GDP downwards by 0.1 percentage point in 2017 but revises growth downwards for 2018 by 0.8 percentage points.

2.5.2.3 Improved Global Economic Growth Scenario

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 based on the Consensus Forecasts September 2017 issue and assumes the high-end range survey growth figure for each partner for 2017 and 2018. The outcome of this scenario yields no change in Malta's expected growth for 2017 but marginally revises growth upwards in 2018.

2.5.2.4 Forecasts from Alternative Models

A study by experts within the Economic Policy Department (EPD) on the development of six alternative forecasting models, ranging from purely statistical models such as the Holt-Winters model to models which are more structural in nature such as VAR models, are being used as inputs in the alternative risk scenarios. It is noteworthy that the baseline real GDP growth forecasts are within the range of these alternative models in 2017, and only marginally higher than the simple average of all six alternative models for 2018.

2.5.2.5 Further Appreciation of the Euro

Throughout 2017, the Euro strengthened in value relative to other key exchange rates reflecting a reassessment by market participants of global monetary policy prospects, stronger growth prospects in the Euro Area (EA) and the renewed certainty following several election outcomes. The strengthening of the Euro renders it more expensive in terms of other currencies, hampering price competitiveness, causing downward price pressures and negatively impacting real activity. However, to the extent that recent gains in the EA's nominal effective exchange rate reflect positive economic developments, the overall effect on prices and growth should be relatively contained. Thus, this scenario models the impact of further Euro appreciation on the Maltese economy. By assuming a 5.0 per cent appreciation in the nominal effective exchange rate throughout the forecast period, real GDP is expected to decline by 0.3 percentage points in 2017 and by 0.7 percentage points in 2018.

2.5.2.6 Lower Tourist Average Spending

This scenario models a weaker than anticipated growth in tourists' average spending in 2017 and 2018 driven by structural changes in tourist expenditure patterns. Under this scenario, growth remains at 5.9 per cent for 2017 but is revised downwards to 5.4 per cent in 2018.

2.5.2.7 US Protectionist Stance

In the United States (US), the new administration has suggested major shifts in trade, fiscal and immigration policies, which could in turn affect prospects for the US economy and its main trading partners. This includes the imposition of tariffs which would boost US production, income and prices. Policy makers would expect the Federal Reserve Bank (FED) to respond to higher inflation by increasing the Federal Funds Rate, which in turn means a stronger Dollar in the process. Despite these opposing forces, experts estimate an annual reduction of 0.1 percentage point in global GDP growth and an increase in US's GDP by 0.25 percentage points and 0.4 percentage points in 2017 and 2018, respectively. In response to the potentially higher price growth, experts also anticipate an increase in the Federal Funds Rate of 1.3 per cent and 2.2 per cent in 2017 and 2018, respectively, which could result in an appreciation of the US Dollar vis-à-vis the Euro of a similar magnitude. The effect of this scenario is a 0.1 percentage point increase in Malta's real GDP for 2017, along with a subsequent increase of 0.3 percentage points in 2018, primarily reflecting exchange rate movements.

2.5.2.8 Economic Spillovers Emanating from Brexit

Although there seems to be broad consensus that Brexit will eventually come into effect, there still remains speculation on the kind of relationship the United Kingdom (UK) will maintain with its EU partners. In the context of this uncertainty, it is assumed that further effects may be experienced as the type of relationship between the EU and

the UK becomes clearer over time. In this regard, two scenarios are modelled. The first scenario assumes a 'soft Brexit', where ties between the UK and the EU are assumed to remain as close as possible. This would have limited impacts on trade and the impact on the Pound will be contained. On the other hand, a "hard Brexit" assumes a situation in which the UK disassociates itself completely from the EU, granting it the control to draft new legislation and make new trade deals. Estimates of the Brexit's potential impacts on the global economy are derived from a recent study commissioned by the European Parliament entitled "An Assessment of the Economic Impact of Brexit on the EU27." Furthermore, the soft Brexit scenario assumes a 5.0 per cent depreciation of the Pound versus the Euro, while the hard Brexit scenario assumes a depreciation of 10.0 per cent over and above the baseline case. It is however worth noting, that these scenarios constitute the impact of changes in UK income prospects and exchange rate movements alone and do not incorporate other, potentially beneficial effects from relocation of activity to Malta, which may arise from Brexit. Nevertheless, some of these potentially positive effects are subsumed in the stronger financial sector growth scenario.

The soft Brexit scenario projects GDP growth to reach 5.8 per cent in 2017, down by 0.1 percentage point from the baseline scenario. In 2018, GDP growth decelerates to 5.3 per cent, which is 0.3 percentage points lower than the original projections. These results support the negative effects stemming from the potential decline in performance of the UK economy and the weakening of the Pound.

The hard Brexit scenario points toward a 5.8 per cent growth rate in 2017, which is 0.1 percentage point lower than the baseline scenario. However, in 2018, GDP growth recedes significantly by 0.7 percentage points, reaching 4.9 per cent. This result is mainly due to a lower contribution of net exports, which captures the effects of lower exports to the UK in view of the projected negative performance of the UK economy, and higher imports following stronger depreciation of the Pound.

2.5.2.9 Subdued Wage Growth

Under the baseline scenario, it is assumed that the compensation per employee will continue to grow at the historical average witnessed in recent years backed by active labour market policies and a higher share of medium-to high-skilled migration flows. Nonetheless, this scenario models a situation where compensation per employee will grow at a subdued rate of 1.0 per cent in 2017, which would result in weaker private consumption than that expected under the baseline scenario. Indeed, under this scenario, real GDP growth is projected to be 0.3 percentage points lower in 2017 and 0.5 percentage points lower in 2018.

2.5.2.10 Lower Import Content of Investment

When forecasting investment, economists within the MFIN adopt a relatively prudent approach by assuming that a substantial proportion of the investment is imported content. More specifically, 75.0 per cent of projects relating to construction and 95.0 per cent of the investment projects involving machinery are considered to be imported. However, a 75.0 per cent share import content for the construction part of the investment project could be on the high side, and a 50.0 per cent share for Malta is usually considered to be more realistic by other experts in the field. Under this scenario, a real GDP growth of 6.4 per cent is projected for 2017, which is 0.5 percentage points higher than the

baseline growth. Moreover, in 2018, real GDP growth would be 0.7 percentage points higher, reaching 6.3 per cent.

2.5.2.11 Long-Term Interest Rates to Increase in 2018 and Remain the Same Throughout

Long-term interest rates, which have been declining for most of 2016, have increased marginally since the beginning of 2017. This scenario thus estimates the effects of a continued rise in the long-term interest rate of 0.25 percentage points from 2018 onwards. This would revise investment growth in Malta downwards by 3.9 percentage points in 2018, leading to a subsequent downward revision in real GDP by 0.3 percentage points in 2018.

2.5.2.12 Stronger Financial Sector Growth Scenario

Based on meetings conducted with stakeholders in the financial sector, there is potential for this sector to keep growing substantially over the next years. This scenario assumes a stronger positive momentum for the rest of the forecast horizon, compared to a more prudent scenario foreseen in the baseline projections. Based on this assumption, GDP growth would strengthen throughout the forecast horizon, increasing by 0.3 percentage points in 2017 and by 1.5 percentage points in 2018.

2.5.2.13 Postponement of Investment

In the baseline scenario, the growth in investment in 2018 is backed by the commencement of a number of one-off projects, including significant investments in the health and education sectors. This scenario models the postponing of these one-off investments by six months such that these will start-off in the second half of the year. Under this scenario, growth in 2018 is revised downwards by 0.3 percentage points to 5.3 per cent.

2.5.3 Risks to Fiscal Targets

The alternative scenarios can influence the attainment of the budget targets reflecting alternative fiscal conditions. Chart 2.3 illustrates the range of possible budget balance outcomes conditional on these alternative scenarios. The balance of risk is tilted towards the upside in 2018. Under the worst possible scenario, the surplus would turn to a marginal deficit of 0.3 per cent of GDP in 2018 whilst under more favourable growth scenarios, the budget surplus could reach 0.8 per cent of GDP in 2018.

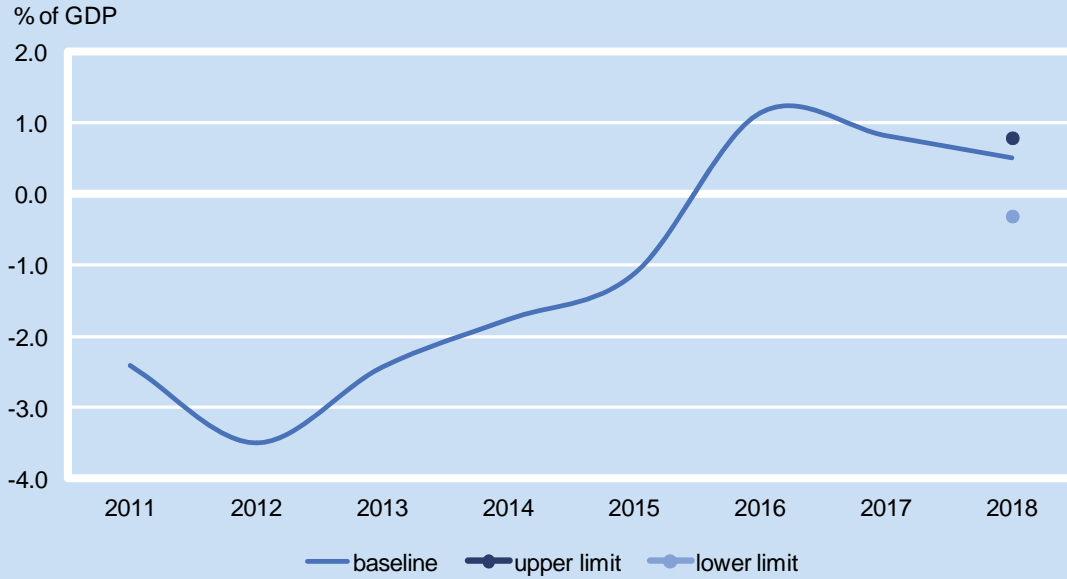
2.5.4 Alternative Output Gap Projections and Risks to Structural Fiscal Targets

This assessment has been extended to cover risks to the output gap projections and hence the structural commitments presented in this Plan. Alternative output gap projections consistent with all the above economic scenarios have thus been carried out, as illustrated in Chart 2.4. Compared to the baseline scenario, alternative output gap projections range from -0.3 in 2017 and 2018 under the lower-bound and from 0.8 in 2017 up to 1.4 in 2018 under the upper-bound scenario.

Consistent with the range of output gap projections, the structural budget balance (inclusive of the impact on the budget balance) could range from a structural surplus of 0.1 per cent of GDP to a structural deficit of 0.7 per cent of GDP in 2018. It is to be noted, that the lower-bound scenario contemplates a significant negative structural

Chart 2.3

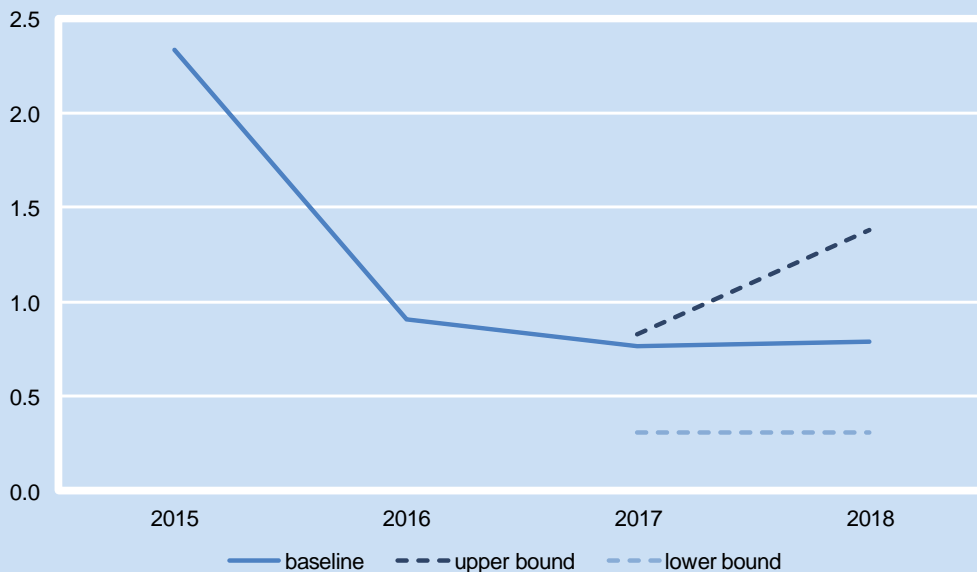
Risk Assessment of Budgetary Targets



impact on the budget balance in 2017 on the basis of a strong temporary slowdown in growth. According to this scenario, in 2018 the economy recovers whilst the budget balance improves only with a lag such that a temporary deterioration in the structural balance occurs.

Chart 2.4

Output Gap: Risk Assessment



Footnote:

¹“Interpolating Forecast Errors for Assessing Uncertainty in Macroeconomic Forecasts: An Analysis for Malta.”
EPD Working Paper Series, No. 1/2015, March 2015.
http://mfin.gov.mt/en/epd/Documents/Working_Papers/Working_Paper_Full.pdf

**Macroeconomic forecasts
(Basic assumptions)**

Appendix Table 0.i

	Data Source	2016	2017	2018
Short-term interest rate (annual average)	ECB	0.00	0.00	0.00
Long-term interest rate (annual average)	ECB	0.90	1.40	1.40
USD/€ exchange rate (annual average)	ECB + Consensus Economics (September 2017)	1.105	1.145	1.171
STG/€ exchange rate (annual average)	ECB + Consensus Economics (September 2017)	0.834	0.889	0.916
Real GDP Growth of main trading partners	Eurostat + Consensus Economics (September 2017)	1.5	1.8	1.7
Nominal GDP Growth of main trading partners	Eurostat + Consensus Economics (September 2017)	2.0	3.4	3.3
Oil prices (Brent, USD/barrel)	US Energy Information Administration (EIA) + Consensus Economics (September 2017)	43.54	51.59	52.50

**Macroeconomic forecasts
(Macroeconomic prospects)**

Appendix Table 1.a		€000s CLV 2010 Prices	rate of change		
	ESA Code	2016	2016	2017	2018
1. Real GDP	B1*g	8,777.3	5.5	5.9	5.6
2. Potential GDP			6.5	6.0	5.6
contributions:					
- labour			2.4	2.6	2.0
- capital			2.0	1.3	1.4
- total factor productivity			2.1	2.1	2.0
3. Nominal GDP	B1*g	9,943.1	7.2	8.1	7.6
Components of real GDP					
4. Private final consumption expenditure	P.3	4,472.2	3.0	4.2	4.1
5. Government final consumption expenditure	P.3	1,518.2	-1.8	3.2	5.0
6. Gross fixed capital formation	P.51	1,928.1	-0.4	-12.1	7.8
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53		0.0	-0.2	-0.2
8. Exports of goods and services	P.6	12,509.3	3.5	2.2	2.5
9. Imports of goods and services	P.7	11,679.9	0.8	-2.2	1.7
Contributions to real GDP growth					
10. Final domestic demand		7,918.5	1.0	0.0	4.2
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		0.5	-0.1	0.0
12. External balance of goods and services (% of Nominal GDP)	B.11	829.4	4.0	6.0	1.4

Macroeconomic forecasts (Price developments)

Appendix Table 1.b	Index	rate of change			
	ESA Code	2016	2016	2017	2018
1. GDP deflator		113.3	1.6	2.2	2.0
2. Private consumption deflator		107.5	0.8	1.3	1.5
3. HICP		100.9	0.9	1.3	1.5
4. Public consumption deflator		111.0	1.7	1.6	2.0
5. Investment deflator		122.5	1.9	2.9	1.8
6. Export price deflator (goods and services)		110.9	0.8	2.3	1.8
7. Import price deflator (goods and services)		109.5	0.5	1.8	1.7

Macroeconomic forecasts (Labour market developments)

Appendix Table 1.c	€000s	rate of change			
	ESA Code	2016	2016	2017	2018
1. Employment, persons¹		203.2	3.7	4.0	3.8
2. Employment, hours worked ²		412,832.7	3.7	4.0	3.8
3. Unemployment rate (%)³			4.7	4.1	4.2
4. Labour productivity, persons⁴		43.2	1.8	1.9	1.8
5. Labour productivity, hours worked ⁵				1.9	1.8
6. Compensation of employees	D.1	4,182.0	6.5	6.0	6.5
7. Compensation per employee		20.6	2.7	2.0	2.6

¹ National accounts definition.

² National accounts definition.

³ Harmonised definition, Eurostat; levels.

⁴ Real GDP per person employed.

⁵ Real GDP per hour worked.

**Macroeconomic forecasts
(Sectoral balances)**

Appendix Table 1.d

% GDP

	ESA Code	2016	2017	2018
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	3.6	4.4	10.5
<i>of which:</i>				
- Balance on goods and services		4.9	6.3	12.0
- Balance of primary incomes and transfers		-3.2	-3.7	-3.2
- Capital account		1.9	1.7	1.7
2. Net lending/net borrowing of the private sector	B.9	7.8	0.5	11.2
3. Net lending/net borrowing of general Government	B.9	-3.5	-2.4	-1.8
4. Statistical discrepancy		-0.7	6.4	1.1

3. General Government Budgetary Developments

3. General Government Budgetary Developments

During the last four years, the Government managed to successfully consolidate public finances, turning a deficit of 3.5 per cent of Gross Domestic Product (GDP) in 2012 to a surplus of 1.1 per cent of GDP in 2016. The gradual but consistent improvement in the budget balance positively impacted the Government debt ratio which fell from 68.4 per cent in 2013 to below the 60.0 per cent target to 57.6 per cent of GDP in 2016. These developments were primarily supported by a strong and sustainable rate of economic growth and growing primary surpluses.

The budget surplus allows more room for manoeuvre to address structural challenges including infrastructural bottlenecks and further investments in human capital and technology, thus further strengthening potential growth and supporting the process of convergence to higher living standards. The Budget outlined for 2018 builds on the achievements of the past four Budgets, while also outlining new initiatives on infrastructure and other social investments. Over the medium-term, the level of investment in Malta's infrastructure will continue to increase to reshape and redefine road networks, and reduce the infrastructural bottlenecks to further economic growth. Public investment initiatives are also planned in health care, which will provide new health services for both Malta and Gozo, while investment in waste management, in water storage and in energy, will create a more effective use of these essential resources. Lastly, the Maltese Government is committed to higher investment in social housing and creating pathways towards affordable housing.

During the current fiscal year, the general Government balance is expected to remain in surplus. The data available up to September 2017 are broadly consistent with this target. It may be noted that between the Autumn of 2016 and the Spring of 2017, fiscal projections were already updated to take into consideration a considerably better fiscal outturn in 2016. In the main, these variances were reflected in the revisions undertaken for the Medium-Term Fiscal Strategy for Malta: Update of Stability Programme (USP) 2017-2020 that was published in May of this year and subsequently in the 2017 Half Yearly Report in line with Article 39(7) of the Fiscal Responsibility Act, which was presented in Parliament in July. It should also be noted that this target now includes the classification of 0.3 per cent of GDP in financial protection schemes for depositors and investors within general Government, in anticipation of a Eurostat decision on the same, which classification was not incorporated in either last year's Plan or the 2017 USP. The outlined fiscal developments are consistent with a structural balance of 0.6 per cent of potential GDP in 2017.

After correcting for the excessive deficit in 2013, and reaching the Medium-Term Objective (MTO) of a balanced budget in structural terms in 2016, the Maltese Government is targeting a stable general Government surplus over the medium-term at 0.5 per cent of GDP and a positive structural balance over the same period. Based on the outlined macroeconomic projections and estimates of the business cycle generated using the commonly agreed methodology, and expected developments in one-off and other temporary measures over the medium-term, the outlined trajectory is translated into a balanced budget in structural terms in 2018, increasing gradually to 0.5 per cent of potential GDP by 2020.

Meanwhile, the debt ratio is also expected to decrease by 2.7 percentage points of GDP to 54.9 per cent of GDP in 2017. 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. As a result, the debt-to-GDP ratio is expected to continue exhibiting a downward trajectory over the medium-term.

This Chapter provides an analysis of planned developments in revenue, expenditure and debt during 2018, including details of the main discretionary measures underpinning the expenditure and revenue targets for 2018, and is based on the European System of Accounts (ESA) 2010 methodology. Indeed, data provided in this Chapter covers the general Government sector, which is composed of the central and local Government subsectors. In turn, the central Government subsector comprises the operations of Government Ministries and Departments and of Extra Budgetary Units (EBUs). Appendix Table 6.b provides a list of established EBUs as at 31st December 2016, in line with the requirements of Article 14(1) of Directive 2011/85/EU on budgetary frameworks.

3.1 Budgetary Targets

For 2018, Government is aiming for a surplus target of 0.5 per cent of GDP, thus maintaining the target in this year's USP. Nevertheless, revisions were carried out to the components of both revenue and expenditure in 2018, compared to the projections outlined in the USP. Indeed, in 2018, in view of a more buoyant than expected macroeconomic environment and more representative elasticity assumptions, higher proceeds are expected from taxation. On the expenditure side, higher than expected outlays on intermediate consumption, social payments and compensation of employees are anticipated, as well as higher capital expenditure. In structural terms, the general Government balance is expected to decline from 0.6 per cent in 2017 to a balanced budget in 2018. General Government budgetary targets are outlined in Table 2.a.

The general Government gross debt ratio is expected to decrease by a further 4.2 percentage points in 2018, reaching 50.8 per cent of GDP. The projected reduction in the gross debt ratio is mainly driven by the primary surplus and the relatively high nominal growth scenario. Both components are expected to mitigate the upward pressure that interest expenditure and stock flow transactions are expected to have on the debt-to-GDP ratio, although it is worth noting that the expansionary contribution of stock flow transactions on the debt ratio is expected to be marginal in 2018. Developments in gross Government debt are presented in Table 2.b. A detailed account of the Stock-Flow adjustments can be found in Appendix Table 7.

3.1.1 Discretionary Measures

A list of the main discretionary measures included in the Draft Budgetary Plan and underpinning the expenditure and revenue targets for 2018 are presented in Table 5.a. The net impact on the budget balance of temporary and permanent discretionary revenue measures for 2018 (including those implemented in previous budgets but which will still have an impact in 2018) are estimated to be €116.5 million, equivalent to 1.01 per cent of GDP. Meanwhile, incremental discretionary expenditure measures (including those implemented in previous budgets but which will still have an impact in 2018), are expected to have a positive impact on the budgetary balance of 2018 of

Budgetary Targets (General Government Budgetary Targets broken down by subsector)

Table 2.a % GDP

	ESA Code	2017	2018
Net lending (+) / net borrowing (-) by sub-sector¹	B.9		
1. General Government	S.13	0.8	0.5
2. Central Government	S.1311	0.8	0.5
3. State Government	S.1312	-	-
4. Local Government	S.1313	-0.0	-0.0
5. Social security funds	S.1314	-	-
6. Interest expenditure	D.41	1.9	1.7
7. Primary balance ²		2.7	2.2
8. One-off and other temporary measures ³		-0.1	0.1
9. Real GDP growth (%) (=1 in Table 1.a)		5.9	5.6
10. Potential GDP growth (%) (=2 in Table 1.a)		6.0	5.6
11. Output gap (% of potential GDP)		0.8	0.8
12. Cyclical budgetary component (% of potential GDP)		0.4	0.4
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		0.5	0.1
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		2.4	1.8
15. Structural balance (13 - 8) (% of potential GDP)		0.6	0.0

¹ TR-TE= B.9.

² The primary balance is calculated as (B.9) plus (D.41, item 6).

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

€20.0 million, equivalent to 0.17 per cent of GDP. This is mainly due to the cessation of one-off intermediate consumption expenditure related to the Maltese Presidency of the European Council as well as the impact of the 2006 pension reform.

In the Budget for 2018, the Maltese Government continues to be committed to the principle that economic prosperity and wealth should be felt and enjoyed by all. A tax rebate will therefore be granted to persons in employment earning less than €60,000.0

**Budgetary Targets
(General Government debt developments)**

Table 2.b	% GDP	
	2017	2018
1. Gross debt ¹	54.9	50.8
2. Change in gross debt ratio	-2.7	-4.2
Contributions to changes in gross debt		
3. Primary balance	-2.7	-2.2
4. Interest expenditure	1.9	1.7
5. Stock-flow adjustment	2.5	0.2
p.m.: Implicit interest rate on debt ²	3.5	3.4

¹ As defined in Regulation 479/2009.

² Proxied by interest expenditure divided by the debt level of the previous year.

a year, with an estimated cost of around €10.6 million in 2018. Around 200,000 persons in employment are expected to benefit. Moreover, a tax credit will be awarded to MQF 7 and MQF 8 students.

Meanwhile, as part of the continued commitment to reduce bureaucracy, the Value Added Tax (VAT) exemption thresholds for some Small to Medium-Sized Enterprises (SMEs) will be revised and increased from the present €14,000.0 to €20,000.0.

In view of projected demographic developments over the coming decades, which are expected to result in higher outlays on pensions paid by Government, several reforms were enacted, aimed at enhancing the sustainability of the pension system while improving the adequacy of the pension enjoyed by retirees in the future. Nevertheless, pension reform in Malta is an ongoing process. A case in point is the further extension of the retirement age in 2018 by virtue of the 2006 pension reform initiatives which is expected to result in lower spending equivalent to 0.1 per cent of GDP. In addition, by means of the 2018 Budget:

- Pensions will be increasing by €2.0 per week.
- The Department of Social Security will once again waive €200.0 from the service pension when assessing the social security pension of service pensioners, such that service pensioners will benefit from an increase in their weekly rate of social security pension.

**Description of Discretionary Measures included in the Draft Budget
(Discretionary measures taken by General Government)**

Table 5.a

List of measures	Detailed description	Target (Expenditure / Revenue component) ESA Code	Accounting principle	Adoption Status	Introduced in Budget for...	Incremental Budgetary Impact	
						2017 % of GDP	2018 % of GDP
Impact on VAT revenue from revised Excise Duties	Impact on VAT from revisions in Excise Duties	D211 - R	Accruals	Permanent & Adopted	2017	0.02	0.00
VAT reduction for SMEs	Updating of VAT thresholds so that more businesses qualify as VAT exempt	D211 - R	Accruals	Permanent & Adopted	2018	0.00	-0.01
Duty on documents	The reduction in duty for first-time home buyers will also be granted to those buying their second home as well as to people with disabilities	D214 - R	Accruals	Temporary & Adopted	2014 - 2018	0.00	-0.05
Excise duty on fuel	Anti-abuse diesel measure	D214 - R	Accruals	Permanent & Adopted	2017	0.00	0.00
Revision in excise duty on cigarettes and tobacco	Increase specific excise by €0.14 & €0.10 minimum. Ad valorem decreased by 1.6%. Increase in price per packet is likely to be €0.30	D214 - R	Accruals	Permanent & Adopted	2017	0.05	0.00
Introduction of excise duty on construction-related material	Introduction of excise duty on precast concrete, steel structures, and mesh, bars and rods for construction	D214 - R	Accruals	Permanent & Adopted	2017	0.02	0.00
Excise duty on chewing gum	€9 excise per kg of chewing gum. Excise will bring an additional rise of around €0.06	D214 - R	Accruals	Permanent & Adopted	2016	0.00	0.00
Environmental Contribution	Environmental contribution including all type of accommodation (excluding under 18s)	D214 - R	Accruals	Permanent & Adopted	2016	0.03	0.00
Excise duty on non-alcoholic beverages	An increase of €0.02/ltr to €0.04/ltr on non-alcoholic beverages charged on the beverage volume	D214 - R	Accruals	Permanent & Adopted	2017	0.00	0.00
Excise duty on plastic bags, including black garbage bags	An increase of €0.012/bag in excise duty on black garbage bags, excluding biodegradable bags and bags used for recyclable waste	D214 - R	Accruals	Permanent & Adopted	2017	0.01	0.00
Eco-Contribution	Estimated Revenue lost from the phasing out of the Eco-Contribution	D214 - R	Accruals	Permanent & Adopted	2016	-0.01	-0.00
Toiletries and Washing Preparations	Introduction of excise duty on toiletries and washing preparations, including perfumes, deodorants, make up, shampoos, soap, hand and shower gels	D214 - R	Accruals	Permanent & Adopted	2017	0.01	0.00
Glass and ceramic tiles	Introduction of excise duty on glass of €0.016c/kg and on ceramic tiles of €0.0075c/kg	D214 - R	Accruals	Permanent & Adopted	2017	0.00	0.00
Stamp duty	Concessions on Stamp Duty for business inheritance	D214 - R	Accruals	Temporary & Adopted	2017	0.05	-0.04
	Income Tax Rebate for Pensioners	D5 - R	Accruals	Permanent & Adopted	2017 & 2018	-0.03	0.00
Income tax rebate	Income Tax Rebate for Master's and PhD graduates	D5 - R	Accruals	Permanent & Adopted	2018	0.00	-0.03
	Income Tax Rebate for persons in employment	D5 - R	Accruals	Permanent & Adopted	2018	0.00	-0.09
International Investor Programme	International Investor Programme	P10 - R	Accruals	Permanent & Adopted	2014	0.26	-0.78
EU Presidency	Intermediate consumption in respect of Malta's EU Council Presidency in 2017	P2 - E	Accruals	Permanent & Adopted	2016 & 2017	-0.14	0.23
Tourism Environmental Trust	Expenditure financed from the environmental contribution for the maintenance and upgrading of tourism areas	P2 - E	Accruals	Permanent & Adopted	2017	-0.03	0.00
Exam fees	Reduction in fees for MATSEC examination	P2 - E	Accruals	Permanent & Adopted	2018	0.00	-0.01
Pension reform initiatives	The pension reform initiative legislated in 2006 is expected to lead to lower pension expenditure primarily as the increase in retirement age leads to lower retirees	D6 - E	Accruals	Permanent & Adopted	2006	0.01	0.10
Assistance to the Elderly	Assistance to help the elderly live independently	D6 - E	Accruals	Permanent & Adopted	2012	-0.00	0.00
Free Child Care	Free child care for all children whose parents are working or still studying	D6 - E	Accruals	Permanent & Adopted	2014	-0.00	0.00
Tapering of Social Benefits	Tapering of Social Benefits given for a three year period to those beneficiaries who become engaged in employment or start working as self-employed	D6 - E	Accruals	Permanent & Adopted	2015	0.03	0.04
Youth Gaurantee	Youth Gaurantee is aimed at shifting young people on social assistance under the age of 23 to an ESF co-financed project	D6 - E	Accruals	Permanent & Adopted	2015	0.00	0.00

Table 5.a

continued

	Measures addressing pensioners, including reckoning contributions before age 19 & after retirement, increase in pension	D6 - E	Accruals	Permanent & Adopted	2016 - 2018	-0.02	-0.08
	Measures addressing the working poor, including an extension of the in-work benefit scheme	D6 - E	Accruals	Permanent & Adopted	2016 - 2018	-0.03	-0.00
Anti Poverty Strategy	Measures addressed to assist other vulnerable groups, including the Single Means Test, disability and supplementary allowances, and increases in Carers and Assistant Carers allowance	D6 - E	Accruals	Permanent & Adopted	2016 - 2018	-0.04	-0.01
	Measures addressing the high cost of rent	D6 - E	Accruals	Permanent & Adopted	2017	-0.02	0.00
Adoption grant	Grant to couples seeking adoption, as well as a rebate on travel expenses	D6 - E	Accruals	Permanent & Adopted	2018	0.00	-0.00
Compensation payments	Procedures and schemes to address past anomalies and injustices relating to former members of the labour corps, ex-port workers and police officers (overtime).	D7 - E	Accruals	Permanent & Adopted	2017	-0.05	-0.01
IIP expenditure	Projects financed from the National Development and Social Fund	D7 - E	Accruals	Permanent & Adopted	2017 & 2018	-0.07	-0.01
Housing Authority Schemes	Assistance for repairs to social housing, social loans, lifts in housing blocks	D7 - E	Accruals	Permanent & Adopted	2018	0.00	-0.03
Extention of Community Work Scheme		D7 - E	Accruals	Permanent & Adopted	2018	0.00	-0.02
Energy Efficiency Schemes	Investment in sustainable schemes towards hotels for schemes which render efficient energy consumption. A PPP will issue 'white certificates' depending on the amount of energy saved by the hotel as a result of the investment carried out. More info in Budget	D9 - E	Accruals	Permanent & Adopted	2016	-0.01	0.00
	Grant for electric vehicles, bicycles & motorcycles, wheelchair accessible vehicles	D9 - E	Accruals	Permanent & Adopted	2018	0.00	0.00
Equity acquisition in Airmalta plc	The investment was carried out in Air Malta to support the national airline's restructuring programme	D9 - E	Accruals	Permanent & Adopted		0.11	0.00
Ex-Gratia Payment	A grant given to those who paid extra registration tax when they registered their vehicle between 1 May 2004 and 31 December 2008	D9 - E	Accruals	Permanent & Adopted	2014	-0.00	-0.00
IIP expenditure	Projects financed from the National Development and Social Fund	P5111 - E	Accruals	Permanent & Adopted	2017 & 2018	-0.22	-0.02
Housing Regeneration works		P5111 - E	Accruals	Permanent & Adopted	2018	0.00	-0.02
						-0.08	-0.84

The impact is recorded in incremental terms - as opposed to levels - compared to the previous year's baseline projection. 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 positive. 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.

- Employees in the private sector may also be able to augment their rate of pension when they remain in employment after retirement and postpone the take up of their pension.
- Social Security Contributions (SSC) paid by employed pensioners after the award of their pension, will be reckoned.
- Pensioners who continue or re-enter employment as self-employed will be given the option to pay a contribution at a rate of 15.0 per cent of their actual earnings from their self-employment.

In continuing the fight against poverty, a continuation of the reform of the Disability Pension is planned to resume in 2018, including revised medical criteria to qualify for the allowance, an increase in the highest level of allowance, and a review undertaken in consultation with medical professionals to update the list of disability conditions falling under Article 2 of the Social Security Act. Other initiatives targeting poverty and social justice include, amongst others, an increase in the foster care allowance to €100.0 per week, and a €10,000.0 grant to couples who adopt a child and which would also cover legal and travel expenses. Meanwhile, the In-Work Benefit Scheme and the tapering of social benefits will be extended.

In applying the concept of 'Equal Pay for Equal Work', and in improving working conditions, the Maltese Government is increasing the rate of pay for workers registered in the Community Worker Scheme, while topping up wages for apprentices.

In a decisive attempt to ensure decent and affordable housing for everyone, the Maltese Government will continue to provide incentives for first-time home buyers and also introducing measures intended to assist households who sell their first home to buy another home to better reflect the needs of their family. Incentives are also being introduced to enable persons with disabilities to become homeowners.

In addition, Government is offering various incentives to increase and upgrade the stock of social housing improving their accessibility, maintenance and repair. Financial assistance will be provided for the restoration of old properties to be loaned for social housing. Furthermore, the Government is extending the reduced stamp duty rate for vacant properties in Urban Conservation Areas and properties bought in Gozo, while refunding the stamp duty for buyers who buy old properties for restoration. In addition, the Government will study as to how introduce equity release schemes and issue a white paper with proposals on enhancing regulation in the property market. The Government is introducing the concept of social loans to help more people become home owners.

As per the National Transport Master Plan 2025, the Government has introduced a number of measures which address public transport, collective transport and environmentally-friendly transport. Indeed, it is offering free public transport for students aged 16 to 20 years, abolishing the registration tax and granting a 5-year exemption from the annual circulation licence fee on electric vehicles and those powered by gas, as well as offering a grant for the purchase of such vehicles. It is also implementing a number of schemes aimed at encouraging the use of bicycles and motor cycles.

Contributions to the National Development and Social Fund, as required by applicants for the naturalisation of foreign individuals and their families who contribute to the economic development of Malta to qualify for citizenship, are expected to decline by €90.0 million in 2018, as the number of successful main applicants is assumed to moderate. As established by the National Development and Social Fund (Establishment as an Agency) Order of 2015, the funds received by the Fund shall be used for the advancement of education, research, innovation, social purposes, justice and the rule of law, employment initiatives, the environment and public health. Towards this end, Government has allocated €35.0 million in expenditure in 2018 for projects financed from the National Development and Social Fund, of which the absolute majority shall finance projects of a capital nature.

In terms and for the purposes of Article 31 of the Fiscal Responsibility Act, a 'Contingency Reserve' account was established within general Government (outside the Consolidated Fund). In 2017, €9.8 million were transferred into the above-mentioned account, in terms of Article 33 of the Fiscal Responsibility Act. In 2018, the annual contribution to the 'Contingency Reserve' account is expected to increase to €11.5 million. No activity may take place within this account unless duly authorised by the Permanent Secretary at the Ministry for Finance (MFIN), following a proposal from the MFIN and with the approval of the Prime Minister.

In addition, the MFIN has appointed a second Permanent Secretary in order to take charge of institutional reform within the Ministry especially where it concerns the Budget Office and the Revenue Department.

3.2 Expenditure and Revenue Projections under the No-Policy Change Scenario

In 2018, tax revenue is expected to broadly follow economic developments. Tax revenues are expected to grow at 8.5 per cent, with an implied elasticity of tax revenue to GDP under the no-policy change scenario estimated at 1.1. This is supported by historical developments in elasticity estimates for revenue components relative to their respective tax base and includes the lagged effects on income tax revenue from strong increases in corporate profits registered in previous years. As a result, the tax burden would increase marginally by 0.1 percentage point to 33.2 per cent of GDP under a no-policy change scenario, as shown in Table 3. This development mainly reflects a lower revenue ratio for taxes on production and imports in part offset by a higher ratio for current taxes on income, as capital taxes and social contributions are expected to remain relatively stable. At unchanged policies, 'other revenue' would remain relatively unchanged.

Total expenditure under the no-policy change scenario is expected to decline from 38.1 per cent of GDP in 2017 to 37.5 per cent in 2018. At unchanged policies, public compensation of employees as a share of GDP would decrease by 0.4 percentage points. These developments are mainly as a result of the agreed arrangements in the new collective agreement for the public service that came into effect on 1st January 2017, which foresee a lower wage growth compared to GDP growth, as well as the planned recruitment as envisaged in the Ministries and Departments' Business and Financial Plans, including HR Plans, within the parameters of the approved budgetary estimates. Meanwhile, social payments as a share of GDP would decrease by 0.3 percentage points, primarily reflecting low inflation and the expenditure-reducing effect of measures legislated in previous Budgets, in particular the impact of the extension of the retirement age mandated by the 2006 pension reform and the tapering of social benefits. Against the background of historically low interest rates, interest expenditure is also expected to decline by 0.2 percentage points of GDP. Such declines are expected to be in part offset by higher gross fixed capital formation, in order to address the infrastructural bottlenecks and further investments in human capital and technology outlined earlier on in this Chapter.

Expenditure and Revenue Projections under the no-policy change scenario ¹
(General Government expenditure and revenue projections at unchanged policies
broken down by main components)

Table 3

% GDP

	ESA Code	2017	2018
General Government (S13)			
1. Total revenue at unchanged policies	TR	38.9	38.8
Of which			
1.1. Taxes on production and imports	D.2	12.5	12.4
1.2. Current taxes on income, wealth, etc	D.5	13.9	14.2
1.3. Capital taxes	D.91	0.2	0.2
1.4. Social contributions	D.61	6.3	6.3
1.5. Property income	D.4	1.0	0.9
1.6. Other ²		5.0	4.8
p.m.: Tax burden		33.1	33.2
(D.2+D.5+D.61+D.91-D.995) ³			
2. Total expenditure at unchanged policies	TE ³	38.1	37.5
Of which			
2.1. Compensation of employees	D.1	11.8	11.4
2.2. Intermediate consumption	P.2	6.8	6.9
2.3. Social payments	D.6M	10.6	10.3
of which Unemployment benefits ⁴		0.3	0.3
2.4. Interest expenditure	D.41	1.9	1.7
2.5. Subsidies	D.3	1.2	1.1
2.6. Gross fixed capital formation	P.51	2.9	3.1
2.7. Capital transfers	D.9	1.1	1.0
2.8. Other ⁵		1.9	2.0

¹ Data for 2017 (current year) is equivalent to the data presented in Table 4.a. The no-policy change scenario for the forthcoming year (2018) involves the extrapolation of revenue and expenditure trends after deducting the impact of temporary measures of the current year and before adding the impact of the measures included in the forthcoming year's budget.

² P.10 + D.39rec + D.7rec + D.9rec (other than D.91rec).

³ Tax revenue, including those collected by the EU and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.

⁴ Includes cash benefits (D.621 and D.624) and in kind benefits (D.632) related to unemployment benefits.

⁵ D.29pay + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

3.3 Expenditure and Revenue Targets

General Government expenditure and revenue targets are presented in Table 4.a. Both the revenue and expenditure ratios to GDP are expected to decline in 2018, although a more pronounced decline in revenue is expected to result in an expansionary budget.

Expenditure and Revenue Targets
(General Government expenditure and revenue targets, broken down by main components)

Table 4.a

% GDP

	ESA Code	2017	2018
General Government (S13)			
1. Total revenue target	TR	38.9	37.8
Of which			
1.1. Taxes on production and imports	D.2	12.5	12.3
1.2. Current taxes on income, wealth, etc	D.5	13.9	14.1
1.3. Capital taxes	D.91	0.2	0.2
1.4. Social contributions	D.61	6.3	6.3
1.5. Property income	D.4	1.0	0.9
1.6. Other ¹		5.0	4.1
p.m.: Tax burden		33.1	33.0
<i>(D.2+D.5+D.61+D.91-D.995)²</i>			
2. Total expenditure target	TE ³	38.1	37.3
Of which			
2.1. Compensation of employees	D.1	11.8	11.4
2.2. Intermediate consumption	P.2	6.8	6.7
2.3. Social payments	D.6M	10.6	10.3
of which Unemployment benefits ³		0.3	0.3
2.4. Interest expenditure (= item 6 in Table 2.a)	D.41	1.9	1.7
2.5. Subsidies	D.3	1.2	1.1
2.6. Gross fixed capital formation	P.51G	2.9	3.1
2.7. Capital transfers	D.9	1.1	1.0
2.8. Other ⁴		1.9	2.0

¹ P.10 + D.39rec + D.7rec + D.9rec (other than D.91rec).

² Tax revenue, including those collected by the EU and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.

³ Includes cash benefits (D.621 and D.624) and in kind benefits (D.632) related to unemployment benefits.

⁴ D.29pay + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

Total revenue is expected to decline by 1.2 percentage point of GDP, from 38.9 per cent of GDP in 2017 to 37.8 per cent of GDP in 2018, primarily reflecting developments in the 'other' revenue category.

Meanwhile, the ratio of general Government expenditure to GDP is expected to decline by 0.8 percentage points, from 38.1 per cent in 2017 to 37.3 per cent in 2018. The decline in the expenditure to GDP ratio is set to come from moderate increases in civil service salaries as agreed in the 8-year collective agreement signed last year and social payments as a per cent of GDP which, alongside lower expenditure on interest expenditure, are expected to more than offset higher capital expenditure. Increases in

capital expenditure will be devoted to roads, environment, health and education and include higher infrastructure expenditure financed from both the European Union (EU) and local funds.

**Expenditure and Revenue Targets
(Amounts to be excluded from the expenditure benchmark)**

Table 4.b	% GDP			
ESA Code	2016	2016	2017	2018
	Level (€ millions)			
1. Expenditure on EU programmes fully matched by EU funds revenue	39.4	0.4	0.8	1.1
1.a of which 'Investment fully matched by EU funds revenue	18.5	0.2	0.5	0.6
2. Cyclical unemployment benefit expenditure ¹	-2.6	-0.0	0.0	0.0
3. Effect of discretionary revenue measures ²	125.3	1.3	0.4	-1.0
4. Revenue increases mandated by law	-	-	-	-

¹ The cyclical unemployment benefit expenditure is calculated by multiplying the gap between the Non-Accelerating Wage Rate of Unemployment (NAWRU) and the unemployment rate (expressed in terms of the unemployment rate) by the total unemployment benefit expenditure. Data for the NAWRU and the unemployment rate is obtained from the latest update of the AMECO Database, while data for the total unemployment benefit expenditure is as defined in COFOG under the code 10.5.

² Revenue increases mandated by law is not included in the effect of discretionary revenue measures: data reported in rows 3 and 4 are mutually exclusive.

Divergence from latest SP

Table 7 % GDP

	ESA Code	2016	2017	2018
Target general Government net lending/ net borrowing	B.9			
Stability Programme		1.0	0.5	0.5
Draft Budgetary Plan		1.1	0.8	0.5
Difference		0.1	0.3	-
General Government net lending projection at unchanged policies	B.9			
Stability Programme		-1.5	-0.4	-0.2
Draft Budgetary Plan		-	0.8	1.3
Difference ¹		-	1.2	1.5

¹ This difference refer to both deviations stemming from changes in the macroeconomic scenario and those stemming from the effect of policy measures taken between the submission of the SP and the submission of the DBP. Differences are also due to the fact that the no-policy change scenario is defined differently for the purpose of this Code of Conduct with respect to the Stability Programme.

Stock Flow Adjustment Statement

Appendix Table 7

€ million

	2017	2018
Deficit (ESA)	-88.0	-54.0
EBUs Accrual Adjustment	-45.0	-9.5
Own Resources	4.0	1.0
Revenue Time Adjustments	17.9	20.0
TCF Advance & BL Accounts	20.4	20.0
Malta Shipyards Up Front	-2.0	-2.0
Maltco Concession Fee	3.9	3.9
IIP Revenue	140.0	77.0
IIP Expenditure	-32.0	-35.0
Others	9.8	-
Contribution to Sinking Fund (Local)	3.3	-88.4
Contribution to Sinking Fund (Foreign)	1.7	0.1
Contribution to Special MGS Sinking Fund	50.0	50.0
Early repayments of MGRSB		3.5
Equity Acquisition	32.6	2.6
EFSF/ESM Credit Line Facility	4.5	4.5
Stock Premium paid to Church	1.1	0.7
Repayment of Loans to Government	-0.0	-0.0
Sale of Assets	-0.9	-0.9
Sale of Non-Financial Assets	-	-
EBUs	16.1	0.0
Currency	8.1	7.2
Movement in Bank Account	-	-
Other Statistical Discrepancies	-	-
Increase/(Decrease) in Cash Balance	12.3	-11.2
Increase/(Decrease) in Non-Consolidated Debt	157.8	-10.5
<i>MGS Consolidation</i>	<i>19.7</i>	<i>-20.0</i>
Increase/(Decrease) in Consolidated Debt	177.5	-30.5
SFA	265.5	23.5

**Indications on how the measures in the DBP address CSR and
the targets set by the Union's Strategy for growth and jobs
CSR recommendations**

CSRs	Relevant measures
CSR 1: Expand the scope of the ongoing spending reviews to the broader public sector and introduce performance-based public spending	<p>Ensuring public finance sustainability in the short- to medium-term, while also addressing the long-term is a key Government objective.</p> <p>After a headline deficit of 1.3 per cent of Gross Domestic Product (GDP) in 2015, Malta achieved a surplus of 1.0 per cent of GDP in 2016. A structural budget surplus of +0.2 per cent of potential GDP was registered, from -2.6 per cent of potential GDP in 2015. In 2016, a fiscal adjustment of 2.8 percentage points of potential GDP materialised, well above the minimum required by the Fiscal Responsibility Act and the Stability and Growth Pact.</p> <p>Malta aims at maintaining the general Government balance in surplus at 0.5 per cent of GDP consistent with a structural budget surplus and to steadily bring down the debt-to-GDP ratio over the short- to medium-term.</p> <p><i>Conduct of comprehensive spending reviews in Malta</i></p> <p>Comprehensive Spending Reviews are a core element of the Maltese Government's strategy to ensure the achievement of a more effective approach to public spending, improving decision making and ensuring that public spending is meeting changing priorities and changing social needs. Indeed, as a result of these reviews processes are created that phase out unnecessary expenditure, reducing waste and inefficiencies and ensuring a better match between public programmes and policy outcomes.</p> <p>The Comprehensive Spending reviews, which started in 2014, have so far covered the Department for Social Security, the Mater Dei Hospital and the Ministry for Education and Employment. In 2017, two reviews were completed at Pharmacy of Your Choice (POYC), with a budget of €31 million and at Primary Health Care, with a budget of €23 million. Substantial savings have already been noted as a result of the review covering the Department of Social Security. In particular, expenditure on social benefits has declined from 12.9 per cent of GDP in 2012 to 10.9 per cent in 2016, and the trend is expected to be sustained over the medium-term.</p> <p>In 2015, the Comprehensive Spending Review was focused at the Mater Dei Hospital. The study was completed in September 2015 and had the following recommendations:</p> <ul style="list-style-type: none"> • 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. • Better liaison between the Pharmacy of your choice and the hospital will reduce the risk of over prescription of medicines. • 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. <p>Some of the recommendations outlined in the resulting reports have already been implemented, while others are underway. The implementation of decentralisation continues at Mater Dei Hospital. There is now a process to allow for the decentralisation of departmental budgets. This should increase transparency in decisions being made by clinical staff. A concept of national 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.</p>

The decentralisation of budgets includes seven departments: Medicine, Surgery, Anaesthesia, Pathology, Imaging, Cardiology and A and E.

In 2016, the Comprehensive Spending Review focused on Education. The review started in January 2016 and was completed in July 2016. The aim of the review was to make more transparent the outputs of both the primary and secondary educational system. One of the objectives of Government is to lower the number of early school leaving students and to encourage these students to stay within the educational system through the opening up of educational pathways that foster fulfilled individuals, empowered citizens and productive and creative workers.

The major recommendations were that the Ministry should focus on teaching and learning, allowing students to carry lower study workloads, introducing a system of prerequisite and option subjects. The review also recommended the expansion of vocational subjects as a way of increasing student choice. The review also recommended the decentralisation of budgets to college principals. A senior management team has now also started to meet at the Ministry of Education to deal with the recommendations of the Education Comprehensive Spending review.

During the period April to June 2017, the Comprehensive Spending review programme focused on the Ministry for Health. This included the Ministry for Health itself, Primary Care Services, POYC and the Contracts Procurement Services Unit (CPSU). Expenditure between these entities totals some €250 million. The panel focused on issues of procurement for medicines, contractual obligations including clerical support services, care workers, hospital cleaning services and security services. The Comprehensive Spending Review reports were completed between May and June 2017. In the meantime, the implementation of decentralisation continues at Mater Dei Hospital.

The main recommendation at POYC was to review the processes that would increase the efficiency in the distribution of medicines to patients entitled to free prescription drugs.

The review at Primacy Care concluded that there is the capacity to increase the functions at primary care and allow for patients to visit primary care rather than hospital outpatients.

In 2018, the Comprehensive Spending Review will focus on the Management Efficiency Unit (MEU) and the Malta College for Arts, Science and Technology (MCAST).

Further initiatives in the area of spending reviews

Efforts are underway to institutionalise the spending review function under a Directorate tasked with Public Sector Performance and Evaluation being set up within the Ministry for Finance (MFIN). Call for Director is underway. The core functions of this Directorate will include:

- Comprehensive Spending Review
- Value for Money
- Standard Costing
- CBA
- Base-line Costs
- Performance Indicators
- Programme Evaluation Capabilities

Furthermore assistance has been sought under the Structural Reform Support Programme with the scope of:

- Improving human capacity through consultancy and training
- Tapping expertise in specific fields, depending on the core business of the Ministry involved

- Financing to attend conferences on the comprehensive spending review process, build networks amongst peers and disseminate knowledge

Financial Management Reform

A wide financial management reform is underway that includes the transition to accrual accounting and the implementation of a Corporate Financial management solution across Government, as well as the adoption and implementation of International Public Sector Accounting Standards (IPSAS), namely:

- IPSAS 17: Property, Plant and Equipment
- IPSAS 21: Impairment of Non-Cash-Generating Assets
- IPSAS 21 & 26: Impairment
- IPSAS 31: Intangible Assets
- IPSAS 13: Leases
- IPSAS 16: Investment Property.

Long-term Sustainability

Reforming the first pillar pension

Following the submission of final recommendations by the Pensions Strategy Group (PSG), a number of these measures were adopted by Government as from the Budget for 2016 and also 2017. In this regard, Government has adopted reforms intended to lengthen careers, in particularly by raising the contributory period to 41 years for persons born after 1968 as well as entrenching in the legislation the requirement to review on regular basis the balance between the contributory period and the period spent in retirement. Government has also introduced an incentive mechanism intended to reward persons who defer their retirement through permanent increases in pensions.

Diversifying Retirement Income

With regard 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. In order to stimulate the take-up of these products tax incentives were introduced, covering also certain insurance products.

Furthermore, Government has introduced tax incentive mechanisms through (LN 228 of 2017) intended to spur the take-up of voluntary occupational pensions was announced in the Budget for 2017. In fact, in the case of the voluntary occupational pension plans, employees shall continue to benefit from the incentives announced for the third pillar pensions. At the same time, the employer shall consider expenditure related to investment to the occupational scheme as part of recurrent expenditure for company tax computation purposes. In addition, the company will be also receiving a credit of €150 for every €1,000 invested on behalf of its employees.

Financial Literacy

The post consultation strategy on the National Strategy for Retirement Income and Financial Literacy is now completed. The aim of this Strategy is to build a culture of saving for retirement as well as better money management during the lifetime. The strategy, launched on 25th January 2017, is now repositioned as Retirement and Financial Capability. An implementation vehicle, known as the Retirement and Financial Capability Working Group, constituted of Government and private sector representatives, is set up and is chaired by the Ministry for the Family, Children's Rights and Social Solidarity.

CSRs	Relevant measures
CSR 2: Ensure the effective national supervision of internationally oriented business by financial institutions, licensed in Malta by strengthening cooperation with the host supervisors in the countries where they operate.	<u>Regulatory Developments</u>
	<p>The Maltese Authorities have taken note of the Country Specific Recommendation requesting strengthening effective supervision of insurance companies carrying out cross-border business.</p> <p>The Insurance sector in Malta is growing in terms of its economic importance and this development reflects a number of key factors of competitive advantage, which include the use of English, the fact that legislation is in English and Maltese but the interpretation of the English text prevails, competitive costs of human resources and quality of staff. Innovation in regulation, particularly the introduction of the Protected Cell Company Regime, has also proved attractive for insurance companies. Malta is the only Member State to have such a regime which was recently peer reviewed by the European Insurance and Occupational Pensions Authority [EIOPA] and found to be compliant with the Solvency II Directive.</p> <p>A number of European Union (EU) countries, which include Malta, have a relatively large insurance sector which carries out its business solely on a cross border basis. Recently, because of issues that have arisen with these companies, EIOPA has directed that when a company applies to the home state regulatory authority to carry out cross border business, then the home state is obliged to enter into discussions with the host Member State before granting permissions. In this regard, the Malta Financial Services Authority (MFSA) is already engaging with other regulatory authorities to ensure compliance with the EIOPA Decision.</p>

Extra Budgetary Units as at 31 December 2016

Table 6.b

	NACE CODE		NACE CODE
Appoġġ	88	Malta Philharmonic Orchestra	90
Arts Council Malta	90	Malta Resources Authority	84
Bord Tal-Koperattivi	84	Malta Statistics Authority	84
Broadcasting Authority	84	Malta Tourism Authority	84
Depositor Compensation Scheme	64	Manoel Theatre Management Committee	90
Environment and Resources Authority	84	Medicines Authority	84
Environment Protection Fund	84	Mental Health Services	87
Fort Security Services Ltd	84	MSE (Holdings) Ltd	64
Foundation for Educational Services	84	National Audit Office	84
Foundation for Medical Services	84	National Commission Persons with Disability	84
Foundation for Tomorrow's Schools	84	National Development and Social Fund	84
Gozo Ferries Co. Ltd	77	Occupational Health and Safety Authority	84
Grand Harbour Regeneration Corporation	71	Office of the Ombudsman	84
Heritage Malta	91	Planning Authority	84
Housing Authority	84	Project Plus Ltd	84
Identity Malta	84	Projects Malta Ltd	84
International Institute on Ageing	85	Property Management Services	84
Investor Compensation Scheme	64	Protection and Compensation Fund	64
Jobsplus	78	Regulator for Energy and Water Services	84
Libyan Arab Maltese Holdings Ltd	64	Resources Support and Services Ltd	78
Malta College of Arts, Science and Technology	85	Sapport	88
Malta Communications Authority	84	Sedqa - Agency against Drug and Alcohol Abuse	88
Malta Competition and Consumer Affairs Authority	84	SportMalta	93
Malta Council for Economic and Social Development	84	St James Cavalier Creativity Centre	90
Malta Council for Science and Technology	84	Superintendence of Cultural Heritage	84
Malta Enterprise Corporation	84	The Rehabilitation Hospital Karin Grech	86
Malta Gaming Authority	84	Trade Malta Ltd	73
Malta Government Investments Ltd	84	University of Malta	85
Malta Government Technology Investments Ltd	84	Valletta 2018 Foundation	84
Malta Information Technology Agency	63	WasteServ Malta Ltd	38
Malta Investment Management Co. Ltd	84	Yachting Malta Ltd	73

Notes:

1. This list does not include entities which are already accounted for within the Departmental Accounting System (DAS) of Central Government.
2. General Classification of economic activities within the European communities. Industries are grouped into 64 categories (A64) based on NACE Rev 2.

4. Distributional Implications of Budget Measures

4. Distributional Implications of Budget Measures

During the previous legislature, Government succeeded to achieve a number of economic objectives, including a strong rate of economic growth, more people in employment, higher rates of investment, low inflation and a budget surplus. These important results reflect the implementation of structural reforms that aimed to raise potential output growth. These reforms complemented a series of policy measures aimed at improving the standard of living of the most vulnerable groups in society. The Government continues to show that promoting work and labour participation remains the best way to create a balance between growth and distributional objectives.

The successful legacy of the last legislature continues to shape and define present policy priorities. The strong economic performance of recent years brought about new challenges with the most pressing being the need to invest and upgrade the existing infrastructure in order to support the increased economic activity and pave the way for further growth. At the same time, Government remains vigilant and committed to address any emerging social imbalances. Looking ahead, the successes achieved need to be consolidated and sustained and in this regard the Budget for 2018 will form the basis for the economic transformation that shall deliver higher living standards during this legislature.

4.1 Government Initiatives in Recent Past Legislatures

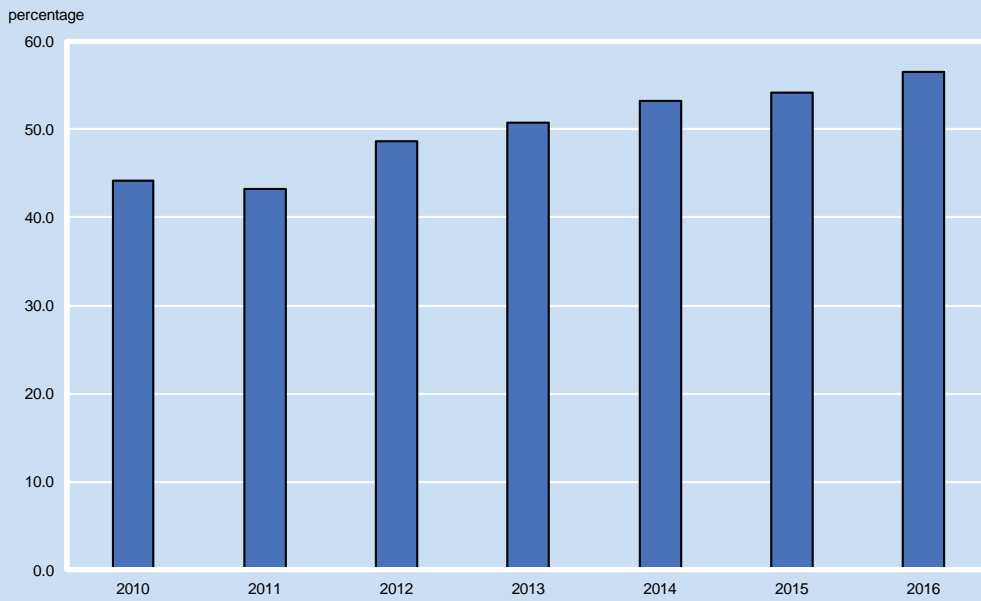
The Budgets for the period 2013 to 2016 established a number of measures intended to make work pay while also reducing benefit dependency. Indeed, as shown in Chart 4.1, the proportion of single parents in employment has risen steadily in recent years. Some of these policies included the introduction of the tapering of benefits and the in-work benefit scheme. Charts 4.2 and 4.3 illustrate the decline in unemployed and inactive persons in receipt of unemployment assistance and social assistance as a result of these two measures. Latest available figures for this year show that the number of persons shifting to the tapering of benefits amounted to around 2,750 persons. This means that these individuals became economically active while still receiving part of the benefit, as opposed to remaining wholly dependent on the benefit system.

Additional measures in the previous Budgets improved the income of low income groups by encouraging employment through reforms in social security benefits aimed at making work pay and initiatives that increase female participation in the labour market and also by reducing the households' expenses. The main measures included the reduction in utility tariffs, the provision of free childcare centres, the maternity leave fund, the reductions in the income tax rates and the widening of the non-taxable income tax bracket.

The April 2017 National Agreement on the Minimum Wage, seeks to balance competitiveness with greater social justice. The agreement stipulates that as from 2018, employees will be elevated from the minimum wage upon completion of the first year of employment with the same employer. The employee becomes entitled to mandatory increases of €3.0 per week during the second year of employment, and upon completion of the second year, to an additional €3.0 per week. Employees earning more than the basic minimum wage will still be entitled to the portion of increases during the second

Chart 4.1

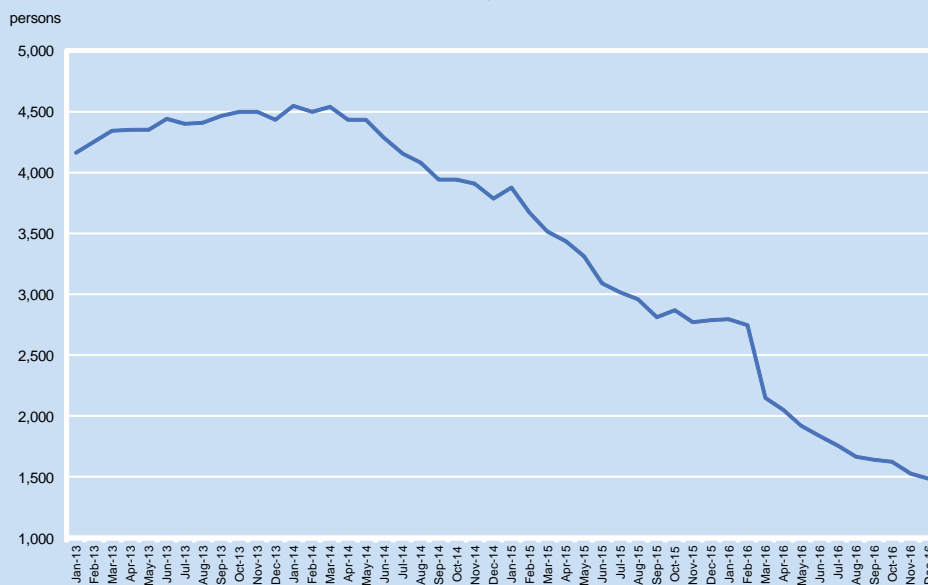
Employed Single Parents as a % of Total Single Parents



Source: Labour Force Survey

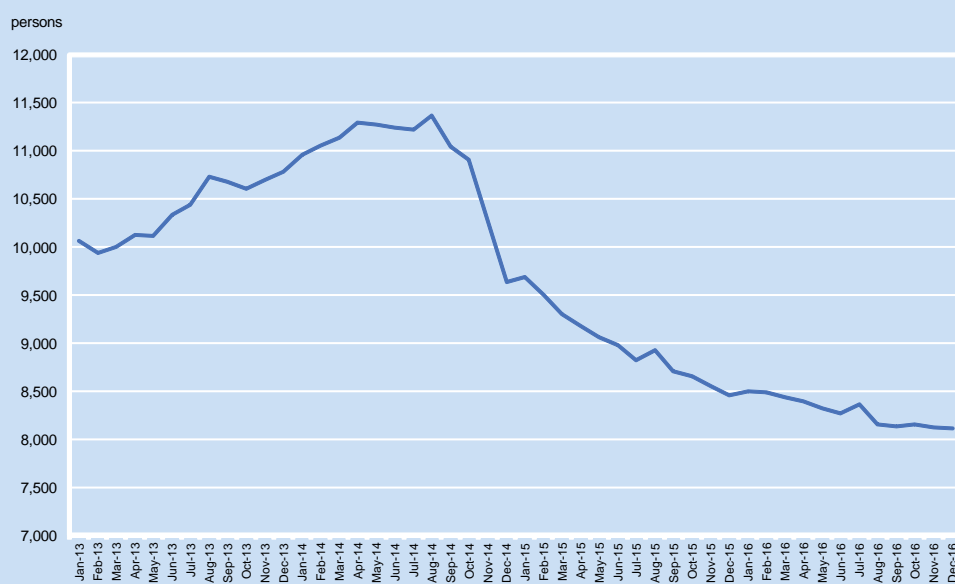
Chart 4.2

Persons on Unemployment Assistance



Source: Ministry for the Family, Children's Rights and Social Solidarity

Chart 4.3

Persons in receipt of Social Assistance Benefits

Source: Ministry for the Family, Children's Rights and Social Solidarity

and third year of employment. The agreement also stipulates that the weekly Cost of Living Adjustment (COLA) will be supplemented by €1.0 per week for 2018 and 2019.

Previous budgets also aimed to address social inclusion, by increasing the involvement of vulnerable people such as disabled persons who are willing and able to work, to enter into employment. In addition, the increases in pensions and the removal of tax on pensions up to a specified amount have increased the disposable income of the elderly reducing their risk of falling in poverty.

4.2 Indicators measuring Poverty, Social Exclusion and Inequality

The various reforms in social security during the period 2013 to 2017 have provided pathways for greater social solidarity and social inclusion while improving the quality of life of households. Two indicators used to obtain information on inequality include the at-risk-of-poverty or social exclusion (AROPE) indicator and the Gini coefficient¹. In calculating the basis of these indicators, all incomes are compiled as equivalised disposable income².

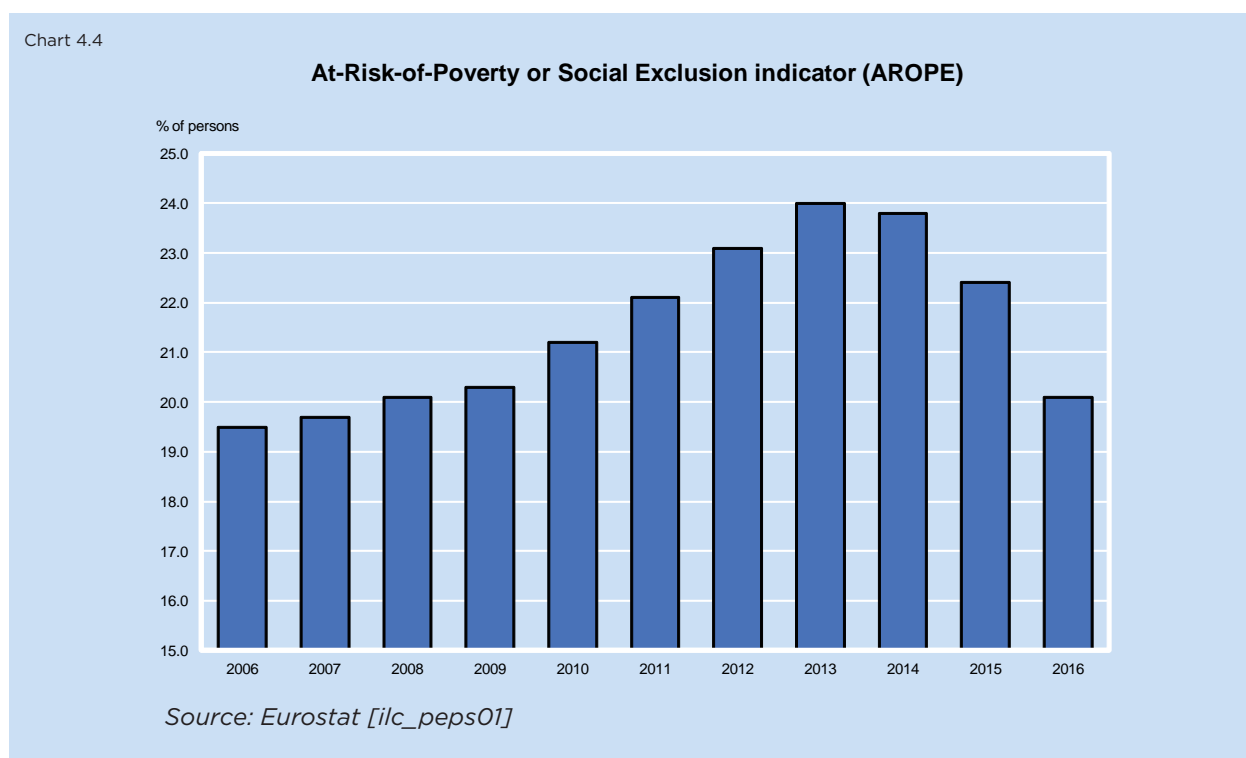
The AROPE indicator encompasses three indicators, namely the at-risk-of-poverty (ARP) indicator, the work intensity indicator and the severe material deprivation (SMD) rate. The Statistics on Income and Living Conditions (SILC) for 2016 confirm a drop in the people at-risk-of-poverty or social exclusion over the period 2015 and 2016 after constant increases from 2006 to 2013. Indeed, at 20.1 per cent, the AROPE indicator registered a decrease of 2.3 percentage points when compared to 2015 levels. The share of persons at-risk-of-poverty or social exclusion went down for those living both

in households without dependent children and with dependent children. Indeed, the AROPE rate among persons living in households with and without children decreased by 3.4 and 1.3 percentage points, to 20.5 and 19.6 per cent respectively. Chart 4.4 shows a ten-year trend of the AROPE indicator for Malta.

The drop in the AROPE indicator was driven by two factors: the drop in the severe material deprivation rate and the drop in people living in households with very low work intensity. It is worth noting, that among the factors which contributed to the decline in severe material deprivation, one notes an increase in households who can afford a one week holiday away from home, who can keep their homes adequately heated and who can afford a meal with meat, chicken, fish or vegetarian equivalent every second day.

Within the domain of material deprivation, an indicator measuring economic strain is the 'Inability to make ends meet' indicator. This indicator is based on the self-reported difficulty of the household to make ends meet and provides a measurement of poverty in terms of the household's experienced feeling of poverty. In 2012, 17.0 per cent of households believed they were making ends meet with great difficulty. Declines were observed since 2013 onwards, such that in 2016, the number of households who reported that they were making ends meet with great difficulty was down to 6.6 per cent.

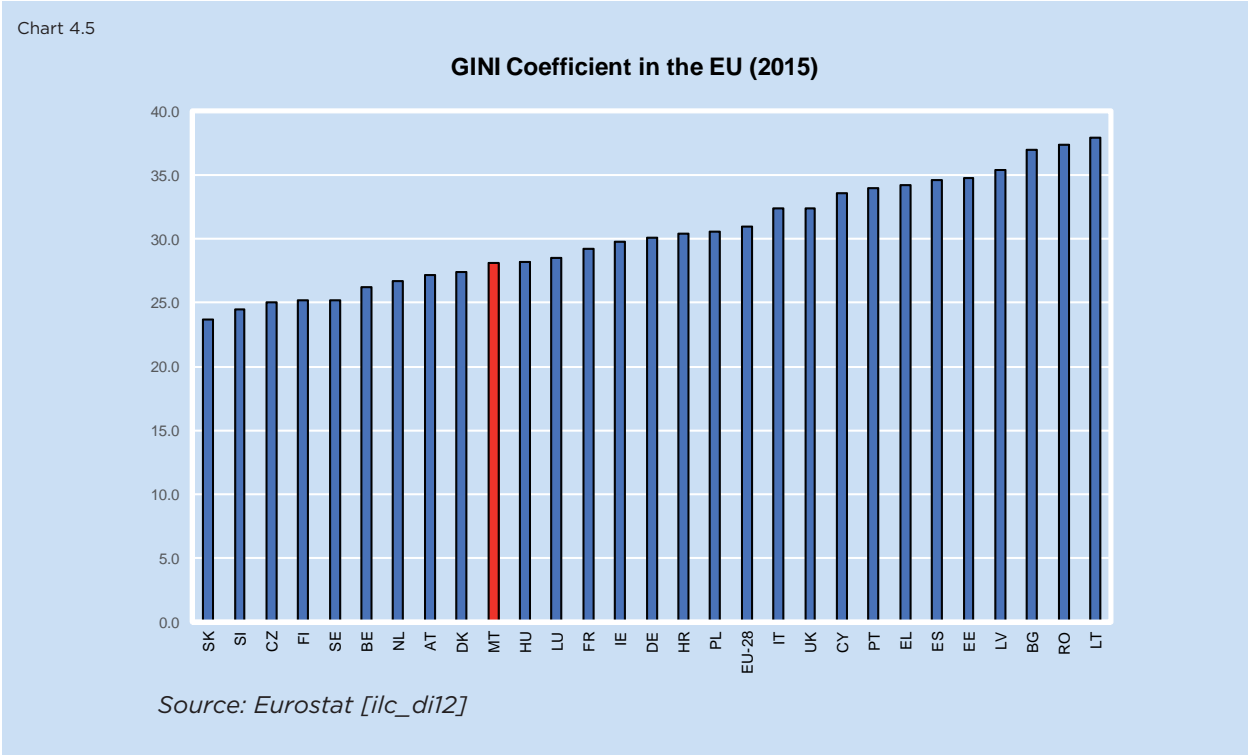
Two factors are worth highlighting in this context. First, at the very low end of the distribution, a shift towards the median income is evident as the number of persons in households earning below the 50th percentile has declined whilst the number of persons earning between the 50th percentile and the median income has increased. Furthermore, there was a decline in the ARP rate for households with very low work intensity and households with dependent children, including single parent households. These improvements are consistent with the various measures addressing the working



poor and benefit dependency. Secondly, the ARP rate before social transfers and old age benefits increased, indicating a rise in market income inequality. Combined with the fall in material deprivation, this suggests that although the standard of living of very low income earners has improved, middle and high income earners have experienced an even stronger improvement in their income which translated into a marginal rise in the overall inequality.

Whilst the marginal increase in inequality is certainly undesirable, it is important to frame this in a context where the Gini coefficient for Malta remains one of the lowest in Europe as shown in Chart 4.5. In addition, this development reflects also the rapid pace of economic transformation, in particular the emergence of high productivity and high pay occupations especially in the services sector, in a context where households with at least one adult beyond the age of 65 years are typically not in employment and as a result, did not directly benefit from the positive redistributive effect brought about by employment creation and the rise in female participation.

It is also worth noting that Malta’s system of social protection is effective in mitigating increases in market income inequality arising from economic outcomes. Indeed, as shown in Table 4.1, whereas the ARP rate when social transfers and old-age benefits are excluded rose by 0.4 percentage points, the ARP rate when old-age benefits are included with disposable income rises only marginally by 0.1 percentage points. The increasingly positive redistribution effect of old-age benefits is consistent with recent policy initiatives aimed at increasing the minimum pension and other initiatives supporting pensioners. Indeed, the latest SILC indicators do not yet incorporate the impact of more recent measures benefitting pensioners.



At Risk of Poverty Rate by Type of Equivalised Income

Table 4.1

Computation of NEI based on ...	EU-SILC 2015EU-SILC 2016	
	%	%
Total disposable household income	16.3	16.5
Disposable household income excluding social transfers but including old-age benefits	23.7	23.8
Disposable household income excluding social transfers and old-age benefits	37.5	37.9

Source: National Statistics Office

4.3 Measures targeting Social Justice in the 2018 Budget

As stated earlier, the Budget for 2018 aims to consolidate and continue to build on the initiatives taken so far. At the same time, Government wants to ensure that measures intended to address the poverty trap remain effective.

Tax Refunds

The Government is committed to redistribute the wealth created by the economy in an equitable manner. A measure which is being proposed with the specific aim of addressing inequality in the distribution of income is the provision of tax refunds in the form of cheques for all wage earners including those that do not pay income tax. In 2018, these refunds will range from €40.0 to €68.0 per annum, depending on the level of income, on the applicable tax category and computation. Lower income bands will benefit the most from an increased tax rebate in order to achieve a higher degree of equality.

A simulation was carried out to illustrate the distributive effects of this measure. From the exercise, which was based on the tax rebate values and corresponding declared incomes recorded by the Inland Revenue Department, it emerged that this measure is likely to have a positive effect on income inequality in Malta as measured by the Gini coefficient. Indeed, preliminary estimates based on administrative data covering taxpayers, indicate that the full implementation of the tax rebates is likely to reduce the Gini coefficient by 0.04 points when incomes after tax are considered. This result supports the claim made earlier that the measure is likely to bring about a higher degree of income equality when it is implemented in its entirety.

Housing

The Government recognises that the recent increases in property prices and rental rates, arising from increases in tourism and foreign labour, are creating challenges for some groups in society.³ For this reason, this Budget is outlining a number of measures

grouped under two distinct categories, social housing and affordable housing, with the aim of increasing the housing supply.

In order to continue addressing issues related to social housing, the 2018 Budget is extending the eligibility threshold for the rent subsidy and the rent to assist scheme. In addition, the Government will provide financial assistance to persons who restore old properties to rent them to Government at market rents and then for the Housing Authority to rent these to individuals who are at present on social housing waiting lists. Furthermore, funds are being allocated for the introduction of lifts in housing blocks with the aim of making them more accessible to all tenants. More funds are also being voted to accelerate the maintenance of social housing.

To address those families who do not fall under social cases but are genuinely finding it less affordable to buy or rent a property due to their low income, the Government is implementing a series of measures which aim to make housing more affordable. While retaining the measure intended to assist first-time buyers, in the 2018 Budget will also increase efficiency in the property market by assisting second-time buyers of residential property who for various reasons, such as changes in the family size, would like to sell their house and move to another home. Moreover, properties purchased by persons with disability and if they still reside with their parents, will also be eligible to a refund on the stamp duty. Furthermore, the Government is extending the reduced stamp duty rate for vacant property in Urban Conservation Areas and properties bought in Gozo, as well as the refund for buyers who buy old property and restore it. In addition, the Government intends to introduce equity release schemes and issue a white paper with proposals on enhancing regulation of the property market.

Working Families

This Budget will be introducing an adoption grant of €10,000.0 to help families adopting children from abroad and will cover both travel and legal fees. In addition, the Government will also be increasing the foster care allowance from €70.0 to €100.0 per week to sustain families of foster children, by reducing the burden of the additional financial responsibilities faced by these households. This measure also benefits homes and institutes that provide residential services for children. The eligibility age of both the orphan's allowance and the orphan's supplementary allowance will be increased to 21 years and will also be extended to orphans who are gainfully occupied, serving as an increased incentive for orphans to pursue employment.

Following the success of the tapering of benefits scheme, the Government is proposing to include within the scheme social assistance beneficiaries who find employment and had been on social assistance for at least 52 weeks in the last three years, instead of the current two years. Another success story has been the introduction of the in-work benefits with a substantial number of families already benefiting from this initiative. Based on this positive response, the Government will be further improving the rates payable to families where one of the parents is in employment to increase the disposable income of such households.

The Elderly

The Budget for 2018 will once again target the elderly and will renew the Government's commitment in improving the quality of life for senior citizens. The main measure being proposed is the increase in pensions of €2.0 per week, excluding the €1.75 COLA

increase per week, which will benefit all pensioners. The Government is also extending the possibility for private sector and self-employed persons to augment their future rate of pension if they remain in employment after retirement and postpone taking up their pension. Linked with this, a new measure is being introduced that provides for the reckoning of National Insurance contributions paid by employed pensioners after they start receiving their pension. This will give them the possibility to enhance their pension rate through re-assessment of their contributions when they reach retirement age.

As an incentive for pensioners to continue in employment, the Government is also proposing the option for pensioners to continue or re-enter employment as self-employed to pay contribution at a rate of 15.0 per cent of their actual earnings from their self-employment. The proposed measure addresses an anomaly affecting self-employed pensioners who have to pay social security contributions higher than their actual earnings.

In cases where persons are certified to be terminally ill, the Government will be assigning the Invalidity pension at the highest weekly rate, irrespective of the contribution record of the persons.

Other Vulnerable Groups

As from 2018, alimony will no longer be accounted for as income in means test assessments. This measure aims to address cases where persons paying alimony are excluded from free medical aid as the alimony amount is still considered as income. The Government is introducing a measure whereby an employed widow receiving a widow's pension would also be entitled to receive the sickness benefit in addition to the pension, in order to help employed widows maintain their standard of living. Married persons that are in receipt of Social Assistance and Unemployment Assistance shall also be eligible for the Increased Carers allowance, provided that the beneficiary is not receiving any other benefit under the Social Security Act. The number of carers is expected to increase significantly, thus alleviating the pressure on institutional care by encouraging community care.

The Budget for 2018 is also enhancing the Increased Severe Disability allowance, an allowance targeting persons who cannot be gainfully occupied as determined by the Barthel Index. Moreover, the medical criteria to qualify for this allowance will be increased from the current range of 0 to 4 on the Barthel Index to a range of 0 to 8, meaning that more will be eligible for this benefit. Furthermore, a review will be carried out during 2018 with the aim of updating the list of disability conditions falling under Article 2 of the Social Security Act to ensure that this list remains relevant and consistent with the needs of the present Maltese society.

The Government is raising the Drug Addicts assistance, which is received by persons following drug or alcohol rehabilitation therapeutic programmes, from a weekly rate of €30.0 to a rate of €40.0 per week. The bi-polar and depression by psychosis conditions shall be introduced to form part of Schedule 5 of the Social Security Act and, thus increasing the number of persons people eligible to apply under Schedule 5. Moreover, single unemployed persons living with parents, who are in receipt of a pension and suffer from one of these two conditions, would also be eligible to apply for Social Assistance. Once the means test is satisfied, the applicant would be eligible to receive 50.0 per cent of the Social Assistance weekly rate.

Footnotes:

¹ The Gini coefficient is a measure of the distribution of income where 0 represents a situation where all households have an equal income and 1 indicates that one household has all national income. The Gini coefficients presented here are on the basis of equivalised household income.

² To take into account the impact of differences in household size and composition, the total disposable household income is “equivalised”. Equivalisation adjusts household income on the basis of household size and composition. Eurostat uses a scale of 1 for the first person aged 14 or more, 0.5 for subsequent adults and 0.3 for children (aged under 14). In this way, the income of all households is expressed in the same terms. A single adult household with an actual income of 100 ($100 \div 1 = 100$) is said to have the same equivalised income as a two adult household with an income of 150 ($150 \div \{1+0.5\} = 100$).

³ The rental market is estimated at 16.0 per cent of total housing. Thus, 84.0 per cent of households own their own property.