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Recommendation for a

COUNCIL RECOMMENDATION

on Malta's 2014 national reform programme

and delivering a Council opinion on Malta's 2014 stability programme

{SWD(2014) 419 final}

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THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the resolutions of the European Parliament[3],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States, which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on

[1] OJ L 209, 2.8.1997, p. 1.
[2] COM(2014) 419 final.
[3] P7_TA(2014)0128 and P7_TA(2014)0129.

action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 9 July 2013, the Council adopted a recommendation on Malta's national reform programme for 2013 and delivered its opinion on Malta's updated stability programme for 2012-2016. On 15 November 2013, in line with Regulation (EU) No 473/2013[4], the Commission presented its opinion on Malta's draft budgetary for 2014[5].

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[6], marking the start of the 2014 European Semester of economic policy coordination. On the same day on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[7], in which it identified Malta as one of the Member States for which an in-depth review would be carried out.

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 5 March 2014, the Commission published the results of its in-depth review for Malta[8], under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that Malta is no longer experiencing macroeconomic imbalances in the sense of the Macroeconomic Imbalance Procedure. Although indebtedness remains high, risks to the sustainability of private and public sector debt and the stability of the financial sector appear contained, even if they deserve continued monitoring. In particular, financial stability indicators remain sound. Still, in light of the structural nature of the risks in the sector, a continuation of the current prudent supervisory and risk-taking practices is key. The housing market has stabilised and thus risks arising from over-exposure to property are limited. Private debt is on the decrease; the corporate deleveraging is taking place in an orderly manner and credit market pressures are limited.

(8) On 16 April 2014, Malta submitted its 2014 national reform programme which was updated on 8 May 2014 and on 30 April 2014 its 2014 stability programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(9) The objective of the budgetary strategy outlined in the 2014 Stability Programme is to correct the excessive deficit in a sustainable manner by 2014 and to gradually progress toward the medium-term objective of a balanced budgetary position in structural terms, which is more stringent than what the Stability and Growth Pact requires. However, the achievement of the medium-term objective is not planned within the programme period. In 2014, the planned (recalculated) structural adjustment is narrowly missing the recommended effort. After the planned correction of the excessive deficit, a small deviation from the adjustment path towards the

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4 OJ L 140, 27.5.2013, p.11.
5 C(2013) 8007 final
6 COM(2013) 800 final
7 COM(2013) 790 final
8 SWD(2014) 150 final

medium-term objective is planned in 2015. Thereafter, the planned annual progress towards the medium-term objective is broadly in line with the requirement of at least 0.5% of GDP. The programme projects that the government debt, at 73% of GDP in 2013, will be put on a downward path, compliant with the debt reduction benchmark, as from 2014. Overall, the programme objectives are largely in line with the requirements of the Stability and Growth Pact. The macroeconomic scenario underpinning the budgetary projections in the programme, which has been endorsed by an independent body (the National Audit Office), is plausible for 2014 and 2015 since the economic growth projections are marginally lower than those in the Commission 2014 Spring forecast for these years. However, risks to the budgetary targets are tilted to the down-side, as the structural revenue increase planned over the programme period is not fully underpinned by measures and expenditure overruns could require higher than budgeted disbursements. According to the Commission forecast, Malta is expected to sustainably correct its excessive deficit in 2014. At the same time, based on the Commission forecast, the fiscal effort over the period 2013-2014 falls short by 1.6% of GDP in terms of (corrected) change in the structural balance and by 1.25% of GDP in terms of the amount of required measures estimated as necessary at the time of the Excessive Deficit Procedure recommendation. While there is no margin with respect to the compliance with the debt reduction benchmark in 2014, risks to the debt scenario are tilted to the positive side. In 2015, there is a risk of significant deviation from the required progress towards the medium-term objective. Based on its assessment of the programme and the Commission forecast, pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that, while Malta's planned headline deficit and general government debt comply with the Excessive Deficit Procedure recommendation, additional efforts are needed to bring the structural adjustment in line with the recommended one in 2014 and to ensure an appropriate path towards the medium-term objective as of 2015.

(10) The non-binding nature of Malta's fiscal framework and the short horizon of fiscal planning are not supportive of a sound fiscal position. The adoption of the legislation meant to come into force by the end of 2013 and aimed at fulfilling the requirements of the Directive 85/2011/EU on budgetary frameworks and the Fiscal Compact has been delayed. However, according to the Stability Programme the Maltese government has recently endorsed a Fiscal Responsibility Act, which will be submitted for the parliament's approval. The draft act foresees the introduction of a balanced-budget rule in structural terms, a debt rule, a three-year rolling budgetary framework and a gradual set up of the fiscal council which would be charged with endorsing of the government's official macroeconomic and fiscal forecasts as well as ex-ante and ex-post monitoring of the respect of fiscal rules.

(11) Malta's revenue departments are due to be merged into a single authority, which would streamline tax collection processes and counter tax evasion. In order to improve tax compliance and encourage the recovery of amounts due, the penalties in VAT legislation and the interest on taxes due have been revised. Various other measures have been introduced that are also expected to consolidate Malta's tax system. These measures go in the right direction, but their impact has yet to become apparent.

(12) Despite still facing challenges regarding the sustainability of Malta's public finances, little progress can be registered as yet on its pensions system reforms and the sustainability of its healthcare services. While a Pensions Strategy Group has been set up to assess all options for reforming the pension system, the Maltese authorities

have given a commitment not to raise the statutory retirement age beyond the increases outlined in the 2006 pension reform. The statutory retirement age therefore remains disconnected from life expectancy, which poses a problem for the long-term sustainability and adequacy of pensions. While Malta intends to address these shortcomings with labour market measures and notably its recently adopted active ageing strategy, it is unlikely that this solves the problem. The sustainability of the healthcare system adds to the challenge in view of a projected increase in age-related expenditure. A draft national health systems strategy has just been launched, but it is unclear how this will be implemented and what gains it will bring in terms of cost-effectiveness and sustainability. There is a need to strengthen public primary care.

(13) Malta's early school leaving rate is still very high, but measures are being taken to reduce it and a comprehensive monitoring system is being set up. Basic skill attainment remains low, however, thereby contributing to low literacy and early school leaving. Proper implementation of the recently adopted National Literacy Strategy is expected to support efforts addressing this shortcoming. This is to be complemented by further measures, which are expected to increase the labour-market relevance of training and education. These include the reform of the apprenticeship framework, establishing a lifelong learning strategy, the introduction of work-based learning in vocational educational and training, and a specific programme financed through the European Social Fund.

(14) Malta is currently implementing a number of significant measures that seek to increase the participation of women in the labour market, notably through the provision of free child care services to households in which parents are in employment or pursuing further education. Effective implementation will be crucial. The authorities are also helping to provide after-school care and offering opportunities to send children to school before the stipulated opening hours, so that parenthood can be better reconciled with working life. Tax incentives are also envisaged to encourage parents to send children to childcare facilities already running under previous schemes. Little is being done, however, to provide and promote the use of flexible working arrangements, such as teleworking and flexitime, which would help the reintegration of women into the labour market.

(15) In order to further improve its international competitiveness, in addition to avoiding the potentially negative impact of a misalignment between wage and productivity developments, Malta still needs to address infrastructure shortcomings in the energy and transport sectors that dampen its potential, notably in view of elevated energy costs. The electricity interconnector with Italy is due to be completed this year, which will enhance security of supply and may contribute to the diversification of supply and the use of externally generated renewable energy. The planned link-up with the European gas network will also add to Malta's energy mix, making it less reliant on one main source of energy and thereby increasing its attractiveness as a place for business. Home-grown renewable energy sources, with the exception of some success as regards the use of photovoltaic energy, represent a potential that remains to be tapped.

(16) Certain public administration inefficiencies are limiting the further development of the business climate in Malta. While improvements in public procurement go in the right direction, procurement procedures remain excessively long, resulting in inefficient public expenditure. These measures are not accompanied by targets making an assessment of their effectiveness difficult. The lack of alternatives to debt financing leads to a high cost of funding for companies, which puts pressure on their

economic activity. This corporate debt bias may also lead to excessively high corporate leverage and insufficient allocation of capital. Further opportunities for non-debt financing therefore need to be pursued. The inefficiencies in the judicial system highlighted in the 2013 country-specific recommendations for Malta remain. While it is expected that a number of the numerous reform proposals delivered by the Commission for the Reform of Justice in November 2013 will be implemented by the end of 2014, a clear timeline and prioritisation of measures still needs to be announced. It also remains to be seen how these will address backlog, in particular as regards the shortcomings identified above.

(17) Malta has strengthened regulatory oversight to ensure the stability of the financial sector. Macro-prudential supervision has been added to the functions of the Central Bank of Malta, and special emphasis is being placed on financial stability issues, while the Joint Financial Stability Board is now enshrined in legislation. Satisfactory measures have been taken to improve loan-loss provisioning, mainly through the introduction of a revision of Banking Rule 9.

(18) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Malta’s economic policy. It has assessed the stability programme and the national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Malta but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (5) below.

(19) In the light of this assessment, the Council has examined Malta's stability programme, and its opinion[9] is reflected in particular in recommendation (1) below.

(20) In the context of the European Semester the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On the basis of this analysis the Council has issued specific recommendations for the Member States whose currency is the euro. Malta should also ensure the full and timely implementation of these recommendations.

HEREBY RECOMMENDS that Malta take action within the period 2014-2015 to:

1. Correct the excessive deficit in a sustainable manner by 2014. In 2015, significantly strengthen the budgetary strategy to ensure the required structural adjustment of 0.6% of GDP towards the medium-term objective. Thereafter, pursue a structural adjustment of at least 0.5% of GDP each year, and more in good economic conditions or if needed to ensure that the debt rule is met in order to keep the general government debt ratio on a sustained downward path. Finalise the adoption of the Fiscal Responsibility Act with a view to putting in place a binding, rule-based multiannual fiscal framework and establishing an independent institution charged with monitoring of fiscal rules and endorsing macroeconomic forecasts underpinning fiscal planning. Continue improving tax compliance and fighting tax evasion by ensuring the continued roll-out and evaluation of measures taken so far, while taking additional action, notably by promoting the use of electronic means of payment.

2. Step up the ongoing pension reform, notably by significantly accelerating the planned increase in the statutory retirement age and by consecutively linking it to changes in life expectancy. Ensure that a comprehensive reform of the public health

[9] Under Article 5(2) of Council Regulation (EC) No 1466/97.

system delivers a cost-effective and sustainable use of available resources, such as strengthening primary care.

3. Continue policy efforts to address the labour-market relevance of education and training and improve basic skills attainment by stepping up efforts on the overdue reform of the apprenticeship system. Further reduce early school leaving, notably by finalising and implementing the announced national literacy strategy. Further improve the labour-market participation of women, notably those wishing to re-enter the labour market by promoting flexible working arrangements.

4. Diversify the energy mix in the economy, including by increasing the share of energy produced from renewable sources.

5. Continue efforts to increase the efficiency and reduce the length of public procurement procedures; encourage alternatives to debt-financing of companies through facilitating access to capital markets and developing venture capital funds; and increase the efficiency of the judicial system by ensuring a timely and efficient implementation of the planned judicial reform.

Done at Brussels,

For the Council
The President