

European Semester

2012/2677(RSP) - 30/05/2012 - Follow-up document

CONTENT: draft Recommendation for a COUNCIL RECOMMENDATION on Malta's 2012 national reform programme and delivering a Council opinion on Malta's stability programme for 2012-2015.

BACKGROUND: the European Commission has adopted a **package of recommendations for budgetary measures and economic reforms** to enhance financial stability, boost growth and create employment across the EU.

The recommendations are **country-specific**, taking account of the individual situation of each Member State. The Commission has also issued recommendations for the euro area as a whole. The country-specific recommendations put forward by the Commission give operational guidance for Member States while preparing their budgetary policies and for economic reforms that should be enacted over the coming twelve months to boost competitiveness and facilitate job creation.

The adoption of the recommendations marks the **concluding of the second phase of the European Semester** of economic policy coordination, which was launched with the Commission's [Annual Growth Survey](#) on 23 November 2011.

The basis for these recommendations is a thorough assessment of the implementation of those adopted in 2011, combined with a detailed analysis of the national reform programmes and stability or convergence programmes that Member States submitted by 30 April 2012. The analysis underpinning the recommendations is presented in 28 Commission staff working documents.

CONTENT: on 30 April 2012, **Malta** submitted its 2012 stability programme covering the period 2012-2015 and, on 23 April 2012, its 2012 national reform programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Based on the assessment of the 2012 stability programme, the Council is of the opinion that the **macroeconomic scenario** underpinning the budgetary projections is **optimistic**, especially in the outer years of the stability programme period when compared with potential growth as estimated by the Commission.

The objective of the budgetary strategy outlined in the programme is to gradually reduce the deficit, to 0.3% of GDP in 2015, after the planned correction of the excessive deficit in 2011. The Commission notes that there are risks that the deficit outcomes could be worse than targeted, stemming from (i) lower revenue given the slightly optimistic macroeconomic scenario; (ii) possible overruns in current primary expenditure; and (iii) the ongoing restructuring of the national airline (Air Malta) and financial situation of the energy provider (Enemalta).

After peaking at 72% of GDP in 2011, the **general government gross debt ratio** is planned in the programme to start decreasing and to reach 65.3% of GDP in 2015 (still above the 60% of GDP reference value). According to the plans in the programme, Malta is making sufficient progress towards meeting the debt reduction benchmark of the Stability and Growth Pact at the end of the transition period (2015) but this assessment is subject to risks as the debt ratio could turn out higher than planned given the possibility of higher deficits and stock-flow adjustments.

According to the Commission, the **main policy challenges** for the country are as follows:

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- Malta remains at high risk as regards the long-term sustainability of its public finances, with a projected long-term increase in age-related expenditure exceeding considerably the EU average. Proposals for further pension reform in December 2010, including a link between the retirement rate and life expectancy, as well as the introduction of additional pillars to the pension system are under consultation. This has been subject to consultation with stakeholders but the government has yet to announce its position. Moreover, the National Reform Programme does not propose a comprehensive active-ageing strategy.
- The restructuring of Malta's economy has created a mismatch between demand and supply of skills, intensified by low tertiary education attainment and high early school leaving rates. Malta still exhibits a low participation rate in its labour market for women and older workers.
- Malta remains one of the few Member States with a generalised wage indexation system. While the mechanism has features that potentially mitigate its impact, it entails a risk of wage-price spirals, particularly because imported prices are not excluded from the index, and may hamper competitiveness, especially in labour intensive sectors.
- Energy supply in Malta remains almost fully dependent on imported oil, while the contribution of renewable energy sources continues to be marginal.
- The banking system in Malta is very large in proportion to the size of the economy, with total assets standing at around 800% of GDP. The sheer size of the sector implies that disruptions to financial stability could have a disproportionate impact on the domestic economy. The large exposure to the real estate market, which accounts for over half of all loans to domestic residents, is a source of vulnerability.

Recommendations proposed for Malta for the period 2012-2013:

Budgetary measures:

- reinforce the budgetary strategy in 2012 with additional permanent measures so as to ensure adequate progress towards the medium-term budgetary objective (MTO) and keep the deficit below 3% of GDP without recourse to one-offs;
- continue fiscal consolidation at an appropriate pace thereafter, so as to make sufficient progress towards the MTO, including meeting the expenditure benchmark, and towards compliance with the debt reduction benchmark, by specifying the concrete measures to back up the deficit targets from 2013, while standing ready to take additional measures in case of slippages;
- implement, by end-2012 at the latest, a binding, rule based multi-annual fiscal framework;
- increase tax compliance and fight tax evasion, and reduce incentives towards indebtedness in corporate taxation.

Pension system:

- take action, without further delay, to ensure the long-term sustainability of the pension system, comprising (i) a significant acceleration of the progressive increase in the retirement age compared to current legislation, (ii) a clear link between the statutory retirement age and life expectancy and (iii) measures to encourage private pension savings;
- take measures to increase the participation of older workers in the labour force and discourage the use of early retirement schemes.

Labour force:

- take steps to reduce the high rate of early school leaving;
- pursue policy efforts in the education system to match the skills required by the labour market;
- enhance the provision and affordability of more childcare and out-of-school centres, with the aim of reducing the gender employment gap, and at the same time reducing the effects of parenthood on female employment.

Wages:

- take the necessary further steps to reform, in consultation with social partners and in accordance with national practices, the system of wage bargaining and wage indexation, so as to better reflect developments in labour productivity and reduce the impact of prices of imports on the index.

Energy:

- in order to reduce Malta's dependence on imported oil, step up efforts to promote energy efficiency and increase the share of energy produced from renewable sources by carefully monitoring the existing incentivising mechanisms and by prioritising the further development of infrastructure, including by completing the electricity link with Sicily.

Banking sector:

- strengthen the banking sector, take measures to mitigate potential risks arising from the large exposure to the real estate market;
- take measures to further strengthen the provisions for loan impairment losses.

These recommendations should be endorsed by the European Council on 28-29 June 2012 and formally adopted by the Council in July 2012.