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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

{SWD(2012) 321 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,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, 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 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[4], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

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1 OJ L 209, 02.08.1997, p. 1
2 COM(2012)321 final
3 P7_TA(2012)0048 and P7_TA(2012)0047
4 Council Decision 2012/238/EU of 26 April 2012

(3) On 12 July 2011, the Council adopted a recommendation on Malta's national reform programme for 2011 and delivered its opinion on Malta's updated stability programme for 2011-2014.

(4) On 23 November 2011, the Commission adopted the second Annual Growth Survey, marking the start of the second European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy. On 14 February 2012, the Commission, on the basis of Regulation (EU) No 1176/2011, adopted the Alert Mechanism Report[5], in which it did not identify Malta as one of the Member States for which an in-depth review would be carried out.

(5) On 2 March 2012, 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.

(6) On 2 March 2012, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments in time for inclusion in their stability or convergence programmes and their national reform programmes.

(7) 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.

(8) Based on the assessment of the 2012 stability programme pursuant to Council Regulation (EC) No 1466/97, 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 programme confirms the previous medium-term budgetary objective (MTO) of a balanced position in structural terms, which is to be achieved beyond the programme period. The MTO adequately reflects the requirements of the Stability and Growth Pact. 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). Based on the (recalculated) structural budget balance[6], annual progress towards the MTO is planned to be in line with the 0.5% of GDP benchmark in the Stability and Growth Pact. Using the Commission's identification of the one-offs included in the budgetary targets, average progress towards the MTO is slightly higher (¾% of GDP) but spread very unevenly, with no progress in 2012 followed by an effort of 1¼% in 2013. According

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5 COM(2012) 68 final

6 Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology.

to the information provided in the programme, the growth rate of government expenditure, taking into account discretionary revenue measures, would be in line with the expenditure benchmark of the Stability and Growth Pact throughout the programme period. The risks to the budgetary targets imply, however, that the average adjustment towards the MTO could be slower than appropriate. 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. Malta's medium-term budgetary framework remains non-binding, implying a relatively short fiscal planning horizon. The programme announces that the Maltese government is considering reforms to the annual budgetary procedure, including timelines, and introducing a fiscal rule embedded in the Constitution, including monitoring and corrective mechanisms, in line with recent changes to the euro area governance framework.

(9) 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. A very low activity rate of older workers, including of older women; a relatively low exit age; and recourse to early retirement schemes add to the scope of the challenge. An independent Pensions Working Group submitted 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. 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. While noting the measures introduced by Malta to combat undeclared work, its incidence also risks exerting undue pressure on the sustainability of public finances.

(10) 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. Efforts to improve links between the education system and labour market needs need to be maintained to ensure lasting results. Malta is expected to present a strategy to tackle early school leaving by end of 2012. There is moreover no comprehensive system for collecting and analysing information on the phenomenon.

(11) Malta still exhibits a low participation rate in its labour market for women and older workers. Malta is taking steps to bring women back into the labour force. However, the gender employment gap and the impact of parenthood are particularly negative for women, primarily due to the lack of affordable childcare and accessible after-school facilities, coupled with a low uptake of family-friendly measures like flexitime and teleworking.

(12) 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. The authorities have undertaken a review process, but the results are not yet available, and debate on concrete reform proposals has yet to begin.

(13) Energy supply in Malta remains almost fully dependent on imported oil, while the contribution of renewable energy sources continues to be marginal. High electricity tariffs may hamper the competitiveness of its small and medium-sized enterprises. Addressing shortcomings in energy efficiency could bring the double benefit of improving competitiveness and achieving energy and climate targets. A number of initiatives in these areas have been undertaken such as encouraging the generation of photovoltaic power and developing wind farms, building an electricity interconnector with Sicily and promoting the use of fuel-efficient cars. However, it is still too early to see the eventual impact of these initiatives so their implementation needs to be closely monitored.

(14) 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 global economic downturn brought about an increase in problematic loans, which however has not been accompanied by an increase in provisioning. In particular the large exposure to the real estate market, which accounts for over half of all loans to domestic residents, is a source of vulnerability especially as a further downward correction in property prices cannot be excluded, while housing units may currently be in oversupply.

(15) Malta has made a number of commitments under the Euro Plus Pact. The commitments, and the implementation of the commitments presented in 2011, relate to improving competitiveness, fostering employment and fostering the sustainability of public finances. The Commission has assessed the implementation of the Euro Plus Pact commitments. The results of this assessment have been taken into account in the recommendations.

(16) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Malta's economic policy. It has assessed the 2012 stability programme and the 2012 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 (6) below.

(17) In the light of this assessment, the Council has examined the 2012 Malta's stability programme, and its opinion[7] is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Malta should take action within the period 2012-2013 to:

1. 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

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

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.

2. 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.

3. 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.

4. 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.

5. 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.

6. To strengthen the banking sector, take measures to mitigate potential risks arising from the large exposure to the real estate market. Take measures to futher strenghten the provisions for loan impairment losses.

Done at Brussels,

For the Council
The President