COUNCIL RECOMMENDATION

of 9 July 2013

on the National Reform Programme 2013 of Malta and delivering a Council opinion on the Stability Programme of Malta, 2012-2016

(2013/C 217/15)

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 Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances [2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

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 jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which focuses 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, it adopted a decision on guidelines for the employment policies of the Member States [3], 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 Member States' 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 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 10 July 2012, the Council adopted a Recommendation [4] on Malta's National Reform Programme for 2012 and delivered its opinion on Malta's Stability Programme for 2012-2015.

(5) On 28 November 2012, the Commission adopted the Annual Growth Survey, marking the start of the 2013 European Semester for economic policy coordination. Also on 28 November 2012, the Commission, on the basis of Regulation (EU) No 1176/2011, adopted the Alert Mechanism Report, in which it identified Malta as one of the Member States for which an in-depth review would be carried out.

(6) The European Parliament has been duly involved in the European Semester, in accordance with Regulation (EC) No 1466/97, and, on 7 February 2013, adopted a resolution on employment and social aspects in the Annual Growth Survey 2013 and a resolution on the contribution to the Annual Growth Survey 2013.

(7) On 14 March 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.

(8) On 10 April 2013, the Commission published the results of its in-depth review for Malta, under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that Malta is experiencing macroeconomic imbalances, which deserve monitoring and require policy action. In particular, the banking sector and real estate market developments justify close monitoring. The long-term sustainability of public finances requires policy attention.

(9) On 30 April 2013, Malta submitted its 2013 National Reform Programme and its Stability Programme for the

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] Maintained for 2013 by Council Decision 2013/208/EU of 22 April 2013 on guidelines for the employment policies of the Member States (OJ L 118, 30.4.2013, p. 21).
[4] OJ C 219, 24.7.2012, p. 61.

period 2012-2016. In order to take account of their interlinkages, the two Programmes have been assessed at the same time.

(10) Based on the assessment of the Stability Programme pursuant to Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the Programme is plausible. The Council abrogated its decision on the existence of an excessive deficit in Malta on 4 December 2012 [1], on account of its correction in 2011, which based on the Commission services 2012 autumn forecast appeared durable. However, in 2012 Malta recorded a general government deficit of 3,3 % of GDP, again above the reference value of 3 % of GDP. The objective of the budgetary strategy outlined in the Stability Programme is to gradually reduce the deficit from 3,3 % of GDP in 2012 to 0,8 % of GDP in 2016, implying gradual progress towards the medium-term objective (MTO). The Stability Programme confirms the MTO of a balanced position in structural terms, which is more ambitious than required by the Stability and Growth Pact, but its achievement is not planned within the Stability Programme period. The 2013 deficit target in the Stability Programme relies on relatively high growth in tax revenues, which does not appear to be fully explained by the underlying macroeconomic scenario. In addition, it is not sufficiently supported by detailed measures, as is also the case for the subsequent years. As a result, the change in the planned (recalculated) structural balance is significantly higher than in the Commission services forecast. According to the latter, the structural balance improves by just ¼ percentage points of GDP in 2013 and only marginally in 2014, on a no-policy-change basis.

General government debt is projected to remain above the 60 % of GDP threshold over the whole Stability Programme horizon. The national authorities project the debt to increase to 74,2 % of GDP in 2014 and subsequently to start decreasing to 70 % by 2016. In the Commission services 2013 spring forecast, the debt-to-GDP ratio is expected to increase slightly faster, to 74,9 % in 2014, as the primary deficit is expected to continue expanding. Given the correction of the excessive deficit in 2011, Malta is in a three-year transitional period as regards the applicability of the debt reduction benchmark, starting in 2012. Malta did not make sufficient progress towards compliance with the debt criterion in 2012 and is not projected to do so in 2013-2014. While Malta's fiscal framework is quite flexible, its non-binding nature and the short horizon of fiscal planning are not supportive of a sound fiscal position. Directive 2011/85/EU [2] on budgetary frameworks has not yet been transposed and a structural budget balance rule, as provided for in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed on 2 March 2012 in Brussels, has not yet been introduced into national law. The Stability Programme states the intention of the Government to set up a Fiscal Council, but no concrete plans are laid out.

(11) Tax compliance and evasion continue to pose a challenge to the quality of public finances. The authorities have introduced a number of relevant measures and additional ones are in the pipeline, but implementation needs to be monitored closely as concrete results are yet to materialise. Tax incentives for companies to take on debt are still very high. In 2012, Malta stood out as the country with the second highest gap between the tax treatment of debt and equity financing of new investment. This debt bias may lead to excessively high corporate leverage and inefficient allocation of capital. Malta is among the few Member States without any provisions to counter the debt bias.

(12) Malta still faces challenges regarding the sustainability of its public finances in view of the budgetary impact of ageing which is projected to considerably exceed the EU average. The increase in pension expenditure accounts for more than half of the total projected increase in age-related expenditure, while when compared to other Member States the statutory retirement age remains low and the increase legislated with the 2006 reform is slow. A further reform is necessary to ensure sustainability while safeguarding adequacy and addressing intergenerational equity concerns. While discussions were held with social partners no concrete proposals for further pension reform were put forward. The employment rate of older workers is low and a comprehensive active ageing strategy has still to be finalised. Limited primary care provision, combined with the projected ageing of the population may lead to high healthcare costs in the long term. The administrative capacity in the area of public procurement is weak, leading to complicated and lengthy procedures.

(13) Measures taken to reduce the rate of early school leaving, including the recent launch of the preparatory process leading to an early school leaving strategy are welcome, also with a view to reducing the mismatch between the demand and supply of skills. The effectiveness of the policy efforts made will depend on proper and timely implementation which will have to be closely monitored. However, the insufficient link of education and training to the needs of the labour market is a major bottleneck. The envisaged creation of a single apprenticeship scheme

[1] Council Decision 2012/778/EU of 4 December 2012 (OJ L 342, 14.12.2012, p. 43).

[2] Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p. 41).

covering more qualification levels is also expected to contribute to fostering a workforce geared to the needs of the labour market.

(14) Malta has also taken significant steps to increase participation by women in the labour force, mainly aimed at improving reconciliation of work and family life. Also benefitting from a favourable cohort effect, the employment rate of women continues to rise. However, there is room for improvement: the employment rate of women still remains low, parenthood still has a significant effect on the participation of women on the labour market, and the gender employment gap is the highest in the Union. Reinforcing the promotion of flexible working arrangements and increasing the provision of affordable childcare and afterschool facilities to a wider segment of the population can contribute to further increasing the employment rate of women.

(15) Malta's cost-of-living adjustment mechanism has specific characteristics which appear to mitigate its negative effect on overall labour-market performance and wage adjustment: the mechanism grants a fixed amount increase, thus representing only partial compensation for inflation to wages above the 'reference' basic wage, micro- and macro-level derogation clauses are available, and wage bargaining is fully decentralised. Nevertheless in the event of very adverse phases of the economic cycle, the system still poses a potential challenge to the flexibility of real wages, thereby hindering labour market adjustment and hampering competitiveness. The volatility of prices of some components of the price index used in the mechanism, in particular energy prices could put pressure on inflation through wage-price spirals. Therefore, the collection of wage and productivity data on sectoral level, and a close monitoring of the impact of the wage indexation system will be essential to mitigate potential risks. The Maltese authorities should closely monitor the impact of the mechanism on the economy and stand ready to reform it as appropriate.

(16) Malta's competitiveness remains at risk in view of the very limited diversification and poor environmental performance of its energy supply leading to high electricity tariffs. The dire financial state of the main energy provider (*Enemalta*), adds to this insecurity, but the electricity connector with Sicily is expected to provide relief after 2014. While a number of initiatives have been further pursued, such as the uptake of photovoltaic power, the share of renewable energy sources remains particularly low and the feasibility of major projects, such as the development of wind farms, seems to be at stake. Progress was registered in energy efficiency, notably for public buildings, supported through Union funding. The environmental performance of Malta's transport system is also poor. Malta would benefit from a comprehensive transport strategy that seeks to improve public transport, the road network, the system's carbon performance and to further encourage the use of other types of transport than passenger cars.

(17) The banking sector in Malta is very large when compared to the domestic economy. While this is notably due to non-core domestic and international banks, which have limited exposure to the domestic economy, continued strict supervision of them is justified to prevent negative impact on financial stability from their activities. Domestic banks remain highly exposed to the property market while specific loan-loss provisions are relatively low. Policy discussions have taken place but this still has to translate into appropriate regulatory action. The judicial system suffers from inefficiencies that pose a further risk to financial stability. The long time needed to resolve insolvency cases obstructs the efficient enforcement of collateral rights. In times of economic stress, this may additionally burden banks' balance sheets and increase losses, resulting in recapitalisation needs.

(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 National Reform Programme and the Stability Programme, and has presented an in-depth review. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Malta but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the 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 the Stability Programme, and its opinion [1] is reflected in particular in recommendation (1) below.

(20) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (2) and (5) below.

(21) 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 this basis the Council has issued specific recommendations addressed to the

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

Member States whose currency is the euro [1]. As a country whose currency is the euro, Malta should also ensure the full and timely implementation of those recommendations,

HEREBY RECOMMENDS that Malta take action within the period 2013-2014 to:

1. Specify and implement the measures needed to achieve the annual structural adjustment effort set out in the Council recommendations under the excessive deficit procedure in order to correct the excessive deficit by 2014 in a sustainable and growth-friendly manner, limiting recourse to one-off/temporary measures. After correcting the excessive deficit, pursue the structural adjustment effort at an appropriate pace so as to reach the MTO by 2019. Put in place a binding, rule-based multiannual fiscal framework in 2013. Ensure concrete delivery of measures taken to increase tax compliance and fight tax evasion, and take action to reduce the debt bias in corporate taxation.

2. To ensure the long-term sustainability of public finances, continue to reform the pension system to curb the projected increase in expenditure, including by measures such as accelerating the increase in the statutory retirement age, increasing the effective retirement age by aligning the retirement age or pension benefits to changes in life expectancy and by encouraging private pension savings. Take measures to increase the employment rate of older workers by finalising and implementing a comprehensive active ageing strategy. Pursue healthcare reforms to increase the cost-effectiveness of the sector, in particular by strengthening public primary care provision. Improve the efficiency and reduce the length of public procurement procedures.

3. Continue to pursue policy efforts to reduce early school leaving, notably by setting up a comprehensive monitoring system, and increase the labour-market relevance of education and training to address skills gaps, including through the announced reform of the apprenticeship system. Continue supporting the improving labour-market participation of women by promoting flexible working arrangements, in particular by enhancing the provision and affordability of childcare and out-of-school centres.

4. Continue efforts to diversify the energy mix and energy sources, in particular through increasing the take-up of renewable energy and the timely completion of the electricity link with Sicily. Maintain efforts to promote energy efficiency and reduce emissions from the transport sector.

5. Take measures to further strengthen the provisions for loan-impairment losses in the banking sector to mitigate potential risks arising from exposure to the real estate market. Maintain policy effort to ensure strict banking sector supervision, including for the non-core domestic and internationally-oriented banks. Improve the overall efficiency of the judicial system, for example by reducing the time needed to resolve insolvency cases.

Done at Brussels, 9 July 2013.

For the Council

The President

R. ŠADŽIUS

[1] See page 97 of the current Official Journal.