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Recommendation for a

**COUNCIL RECOMMENDATION**

**on the 2018 National Reform Programme of Malta**

**and delivering a Council opinion on the 2018 Stability Programme of Malta**

Recommendation for a

# COUNCIL RECOMMENDATION

## on the 2018 National Reform Programme of Malta

## and delivering a Council opinion on the 2018 Stability Programme of Malta

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 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester of economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Malta as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the recommendation on the economic policy of the euro area ('recommendation for the euro area').

[1] OJ L 209, 2.8.1997, p. 1.
[2] COM(2018) 417 final.
[3] P8_TA(2018)0077 and P8_TA(2018)0078.

(2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Malta should ensure the full and timely implementation of the Recommendation on the economic policy for the euro area, as reflected in the recommendations below, in particular (1). The 2018 country report for Malta[4] was published on 7 March 2018. It assessed Malta's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017, the follow-up given to the recommendations adopted in previous years and Malta's progress towards its national Europe 2020 targets.

(3) On 13 April 2018, Malta submitted its 2018 National Reform Programme and its 2018 Stability programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[5], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance[6].

(5) Malta is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the government plans to maintain a surplus in headline terms over 2018-2021. The medium-term budgetary objective — a balanced budgetary position in terms of GDP — continues to be met with a positive margin throughout the programme period. According to the Stability Programme, the general government debt-to-GDP ratio is expected to remain below the 60 %-of-GDP Treaty reference value and to gradually decline from 50.8 % of GDP in 2017 to around 36 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible for 2018-2019 and favourable for 2020-2021. Based on the Commission 2018 spring forecast, the structural balance is forecast to register a surplus of 0.6 % of GDP in 2018 and 1.1 % of GDP in 2019, above the medium-term budgetary objective. Overall, the Council is of the opinion that Malta is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019. At the same time, expenditure developments should be monitored carefully in the short and the medium term, especially in light of possible future risks to the robustness of revenues.

(6) As indicated in the 2018 euro area recommendation, the fight against aggressive tax planning strategies is essential to impede distortions of competition between firms, provide fair treatment of taxpayers and safeguard public finances. Spillover effects of taxpayers' aggressive planning strategies between Member States call for a coordinated action of national policies to complement EU legislation. The absence of

[4] SWD(2018) 216 final.

[5] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

[6] COM(2014) 494 final.

withholding taxes on outbound (i.e. from EU residents to third country residents) dividends, interest and royalty payments made by Malta based companies may lead to those payments avoiding tax altogether, if they are also not subject to tax in the recipient country. While Malta's new Notional Interest Deduction regime will help to reduce the debt equity bias, insufficient anti-abuse rules, combined with a relatively high rate and a stock-based regime, may provide opportunities for tax avoidance. The existence of some provisions in bilateral tax treaties between Malta and other EU Member States, coupled with Malta's tax system, where a company that is resident but not domiciled in Malta is taxed on source and remittance basis, may be used by companies to engage in tax avoidance practices. The Commission takes note of Malta's commitment to fight against taxpayers aggressive tax planning. Based on recent exchanges, the Commission will continue its constructive dialogue to fight against taxpayers aggressive planning strategies.

(7) The long-term sustainability of public finances in Malta remains a challenge. This is entirely driven by the budgetary impact of ageing-related costs, such as healthcare, long-term care and pensions. The pension system faces the dual challenge of achieving sustainability while ensuring adequate retirement incomes. The long-term sustainability prospects for pension expenditure have improved, mainly thanks to a more positive assessment of Malta's long-term growth potential. However, the measures introduced in the 2016 budget had only a limited impact on long-term sustainability of the pension system, which therefore remains a significant challenge. In addition, despite the introduction of measures to improve pension adequacy, the gender coverage gap in pensions remains high. The performance of the health system has improved and waiting times are being reduced. However, challenges remain in the redistribution of resources and activities from hospital to primary care. The institutional setting of primary healthcare provision puts pressure on both hospital and emergency care. Hospital and primary care are not well coordinated and emergency care remains inefficiently used. Access to innovative medicines remains a major challenge, also in budgetary terms. Initiatives were undertaken to cater for growing demand in the long-term care system, such as incentivising community-based and home care.

(8) Some progress has been made in improving cross-border cooperation. However, the Malta Financial Services Authority still appears understaffed and concerns remain on its capacity to supervise a large cross-border financial system, in particular its non-bank segment. In addition, while the services sector (in particular, the online gaming industry) has significantly contributed to the country's sustained economic growth, this may create challenges to the financial system's integrity, calling for a strong anti-money laundering framework. Malta has recently transposed the 4th Anti Money Laundering Directive; the effectiveness of its implementation remains to be assessed. In addition, following the transposition of the Directive into national law, Maltese authorities have recently presented an integrated strategy to fight money laundering and terrorist financing. Among other actions, a National Coordinating Committee on Combating Money Laundering and Funding of Terrorism, composed of representatives from Government and other relevant national authorities, will be set up. However, challenges remain on ensuring proper implementation and effective enforcement of the recently adopted regulatory framework.

(9) In the context of strong economic growth and reforms supporting female employment and up-skilling of the workforce, Malta's labour market outcomes have further improved. However, high gender employment gaps and the low labour market

participation of women above the age of thirty and people with disabilities continue to be a challenge. The design of paternity leave and parental leave remains relatively weak but is important for gender-balanced caring responsibilities and greater support for women to work. Labour shortages are growing and skills mismatches persist. A substantial share of the Maltese labour force still has low qualifications, while the reliance on foreign labour to address the labour and skills shortages is increasing. The policy initiatives being implemented in the areas of labour market, skills and social inclusion are expected to continue further, but need to be informed by outcome- based monitoring and evaluation.

(10) At 18.6 % in 2017, the early school leaving rate remains the highest in the EU and with little improvement compared to the previous year. Malta also has the highest early school leaving rate for people with disabilities, which is at 50 %, double the EU average. Moreover, learning outcomes are strongly influenced by socioeconomic background, type of school and disability status. The gap in science performance between students from the bottom versus the top performing schools is among the highest in the EU and 1.5 times the average of the Organisation for Economic Co-operation and Development. The share of low achievers in maths, science and reading is the fourth highest in the EU. A comprehensive strategy to improve educational quality and reduce inequalities in educational outcomes between social groups and different school types is missing.

(11) Robust economic growth has increased pressure on infrastructure and natural resources. In particular, the road transport sector faces major infrastructure and long term sustainability challenges. Insufficient transport infrastructure and rising congestion costs are a barrier to investment. The increase in the number of vehicles and in traffic leads to rising greenhouse gas emissions and negatively affects air quality. They may also negatively impact tourism, which represents an important pillar of Malta's economy. Therefore, the need to tackle the infrastructure gap goes hand in hand with the need for clean transport solutions. In 2016, the government adopted a National Transport Strategy with a 2050 horizon and an Operational Transport Master Plan to 2025. It also announced a EUR 700 million project to upgrade the road network. Together, these measures are expected to reduce the economic costs of congestions by less than 20 %. Increasing economic activity may exacerbate existing infrastructure bottlenecks, putting even more pressure on environmental resources. In addition, the plan fails to set a clear target for the reduction of greenhouse gas emissions from transport and does not propose an effective monitoring system for implementation of the measures reported (besides a five-year review cycle). It is thus important to set targets and implement measures to substantially reduce congestion and greenhouse emissions from transport by 2025, allowing for periodic monitoring of progress.

(12) The challenges created by the country’s size and island status make the need to move towards a more circular economy particularly compelling. Smart investment can help to reduce pressure on the island's vulnerable natural resources. For instance, if not addressed, difficulties with disposal of construction and demolition waste might reduce the quality of environment and the country's attractiveness as a tourist destination. While Malta has remained in the bottom group for eco-innovation performance (26th in the EU in 2016 from 18th in 2013, according to the Eco-innovation index), it has the potential to mobilise investment to generate or adopt innovative solutions to improve resource and energy efficiency in construction, as well as the management of waste and waste water. In particular, improvements are needed

in the management of waste alongside investment in recycling facilities for construction and demolition waste and the implementation of controls to prevent illegal landfill or dumping at sea of construction and demolition waste.

(13) The justice system continues to face challenges with regards to its efficiency and a strengthened legal and institutional framework to fight corruption is necessary to ensure a high quality business environment. Governance shortcomings in the anti-corruption framework may adversely affect the business climate and weigh negatively on investment. The effectiveness of Malta's efforts to fight corruption needs to be further improved, especially with regards to the investigation and prosecution of corruption. Improving the governance framework is crucial to preserving Malta's reputation and attractiveness as an international investment destination

(14) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Malta's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme and the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Malta in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Malta, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(15) In the light of this assessment, the Council has examined the 2018 Stability Programme and is of the opinion that Malta is expected to comply with the Stability and Growth Pact.

HEREBY RECOMMENDS that Malta take action in 2018 and 2019 to:

1. Strengthen the overall governance framework by enhancing the national supervision of internationally oriented financial businesses licensed in Malta, by ensuring the effective enforcement of the Anti-Money Laundering framework and by continuing to step up the fight against corruption.

2. Ensure the sustainability of the health care and the pension systems, including by increasing the statutory retirement age and by restricting early retirement.

Done at Brussels,

*For the Council*
*The President*