# An Assessment of the Fiscal Forecasts prepared by the Ministry for Finance and presented in the Draft Budgetary Plan 2016


An independent report prepared by the
Malta Fiscal Advisory Council


December 2015

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MALTA FISCAL ADVISORY COUNCIL

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2 December 2015

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Dear Minister

**LETTER OF TRANSMITTAL**

In terms of article 13 of the Fiscal Responsibility Act, 2014 (Cap 534), I have the honour of transmitting a report by the Malta Fiscal Advisory Council (MFAC) with regard to the assessment of the fiscal forecasts prepared by the Ministry for Finance (MFIN) for the years 2015-2016 presented within the Draft Budgetary Plan (DBP) 2016.

Overall, the MFAC considers that the fiscal targets presented in the DBP are attainable. On the basis of actual performance for January-June, the 2015 budgetary targets, set against a background of robust economic growth, appear achievable. This is also generally confirmed when taking account of relevant developments in cash fiscal data for the first nine months of the year. However, overall and especially for 2016, the budgetary projections, in particular on the expenditure side, are subject to some downside risks.

The MFAC notes that the methodological processes by which the fiscal forecasts presented in the DBP were estimated have remained largely similar to the methods adopted in earlier forecasting exercises carried out in recent years. Thus, the process has retained its positive characteristics, particularly the detailed level at which forecasts are generated as well as the involvement of experts from the entities involved. Furthermore, the alignment of Malta's budget process to the European Semester, through the bringing forward of the announcement of the Budget for 2016, increased the availability of granular data about fiscal measures, making it possible for the MFAC to analyse fiscal developments more thoroughly. However, the current process of firstly finalising forecasts on a cash basis and only subsequently transposing them into ESA 2010 methodology necessitated a number of underlying assumptions which tend to increase the risk of forecast errors. Moreover, the existing fragmented process, due to the involvement of different entities in the forecasting exercise, and the lack of formal methodological documentation, add a further element of possible forecast errors.

It was noted that the fiscal targets presented in the DBP are more ambitious than those presented by other entities, namely the European Commission (COM) and the Central Bank of Malta (CBM). It is, however, acknowledged that the fiscal forecasts in the DBP are based on updated information, including the discretionary measures announced in the 2016 Budget.

The fiscal targets presented in the DBP have remained unchanged from those presented in the April 2015 Update of the Stability Programme (USP) 2015-2018, despite the stronger macroeconomic scenario in the DBP. In absolute terms, in both 2015 and 2016, upward revisions in total revenue were partly offset by a higher level of total expenditure. Given the more favourable macroeconomic outlook and the associated expectations of higher revenues, the MFAC's view is that this scenario provided a good opportunity for further fiscal consolidation in relation to the USP targets.

The fiscal consolidation process is supported by cyclical tax revenue as well as the expiry of various one-time measures implemented in 2015, namely temporary social cohesion measures as well as the last equity injection in the national airline. At the same time, the Budget for 2016 announced various permanent deficit-increasing measures. Whilst this does not appear to pose a risk to the attainment of the budgetary targets for 2016, it raises some concerns on the medium term sustainability of the fiscal adjustment. Thus achieving the projected economic growth rates is critical to ensure the attainment of the budgetary targets and a sustained improvement in the fiscal balance.

The forecasts for tax revenue for 2015 appear plausible when compared to the actual performance registered so far. Furthermore, the assessment based on estimated tax elasticities indicates some element of prudence. This could reduce the risk from any slippages from attaining the projected economic growth rates and the repercussions on tax bases. Overall, the estimated fiscal impact of the discretionary revenue measures concerning revisions in excise duty seems plausible, but there is some uncertainty regarding the effect of the income tax reform measures. Furthermore, the fiscal adjustment in both 2015 and 2016 is significantly dependent upon substantial proceeds from the IIP. This introduces some risks in the projections as this source of revenue may be subject to some volatility.

As regards expenditure, the MFAC considers that there may be some risks of slippages, particularly in the wage bill and in social payments. The planned containment of recruitment below recent trends is subject to some uncertainty and in this context it will be important to assess the effectiveness of the new Directive 9 issued under the Public Administration Act (Cap. 497) with a view to keeping recruitment costs within the budgetary targets. In addition, outlays on social payments appear to be based on assumptions for the number of beneficiaries for some benefits which seem to be somewhat conservative when compared to recent trends. There is also some uncertainty regarding the estimated savings from the youth guarantee scheme.

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On the other hand, the MFAC acknowledges that on the expenditure side, the ongoing ministerial spending review, and in particular the implementation of the recommended measures in the health sector, as well as measures to address pension issues have prudently not been incorporated in the baseline projections. If these savings materialise, they would constitute a further improvement to the budget balance. It is also noted that the additional revenue from planned initiatives to boost tax compliance is not factored into the fiscal forecasts, thereby representing another element of prudence.

As regards debt indicators, the MFAC notes that the debt ratio for 2014 is marginally higher in the DBP compared to that in the USP, whereas the debt ratio for both 2015 and 2016 is lower.

Revisions in the expected level of nominal GDP contributed to these changes, whilst there were also revisions in the estimated stock flow adjustment for the forecast years. The MFAC considers that the justifications provided by the MFIN for these revisions are plausible, albeit the risk factors referred with to the budgetary forecasts also apply to the debt projections.
Finally, the MFAC would like to express once again its appreciation to the MFIN and NSO staff, for their full assistance and cooperation in providing the necessary information and support for the preparation of this assessment.
Yours sincerely

**Rene Saliba**
**Chairman**

c.c. Mr Alfred Camilleri, Permanent Secretary, Ministry for Finance

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## Abbreviations

| | |
|---|---|
| AMECO | Annual Macro-economic Database of the European Commission |
| BO | Budget Office |
| CBM | Central Bank of Malta |
| CHOGM | Commonwealth Heads of Government Meeting |
| COM | European Commission |
| DBP | Draft Budgetary Plan |
| EFSF | European Financial Stability Facility |
| EPD | Economic Policy Department |
| ESA | European System of National and Regional Accounts |
| ESM | European Stability Mechanism |
| EU | European Union |
| EUROPOP | Eurostat's Population Projections |
| GDP | Gross Domestic Product |
| GNI | Gross National Income |
| IIP | Individual Investor Programme |
| IRS | Investment Registration Scheme |
| MFAC | Malta Fiscal Advisory Council |
| MFIN | Ministry for Finance |
| NSO | National Statistics Office |
| USP | Update of Stability Programme |

## Executive Summary

As required by the Fiscal Responsibility Act (Cap. 534), this report presents an assessment of the main budgetary projections for 2015 and 2016 prepared by the Ministry for Finance (MFIN) and presented in the Draft Budgetary Plan (DBP) 2016, which was published on 15th October 2015. The entities within the MFIN involved in this forecasting exercise, namely the Budget Office (BO), the Economic Policy Department (EPD) and the Treasury, and the National Statistics Office (NSO) offered their full collaboration in this assessment exercise, providing comprehensive detailed information and data underpinning the projections as well as detailed replies to the queries and requests for clarification which emerged during the assessment exercise.

The methodological processes by which the fiscal forecasts presented in the DBP were estimated have remained largely similar to the methods adopted in earlier forecasting exercises carried out in recent years. Thus, the positive characteristics of the process, particularly the detailed level at which forecasts are generated as well as the involvement of experts from the entities involved, remain evident. The process of firstly finalising forecasts on a cash basis and only subsequently transposing them into ESA 2010 methodology however necessitated a number of underlying assumptions increasing the risk of forecast errors. In this respect the Malta Fiscal Advisory Council (MFAC) would suggest that explanations and justifications for such changes in methodologies are clearly outlined in order to enhance fiscal transparency.

Against a background of robust economic growth, the DBP projects the budget deficit to continue to decline, from 2.1 per cent of GDP in 2014 to 1.1 per cent in 2016. The fiscal targets presented in the DBP are more ambitious than those presented by other entities, namely the European Commission (COM) and the Central Bank of Malta (CBM). Such discrepancies may be the result of a different macroeconomic outlook, divergences in the impact of discretionary measures and/or different methodologies and assumptions underpinning the forecasts. Moreover, divergences in the fiscal outlook by these entities may also reflect the fact that the forecasts presented in the DBP include the impact of discretionary measures announced in the Budget for 2016.

The fiscal targets presented in the DBP have remained unchanged from those presented in the April 2015 Update of the Stability Programme (USP) 2015-2018, despite the stronger macroeconomic scenario in the DBP. In absolute terms, in both 2015 and 2016, upward revisions in total revenue were partly offset by a higher level of total expenditure.

In particular, for 2015, the DBP projects higher revenue from current taxes on income and wealth, sustained by the better than expected level of economic activity, and from the Individual Investor Programme (IIP). On the expenditure side, spending on the wage bill has been revised up considerably, whilst outlays on intermediate consumption and investment are also higher. On the other hand, lower expenditure is expected on subsidies and other current transfers payable. It is noted that the contingency reserve of 0.1 per cent of GDP, which constitutes the lower bound established by the Fiscal Responsibility Act, was included for 2015 and 2016 in the USP but only for 2016 in the DBP. In the discussions with MFIN staff it transpired that one could not rule out the possibility that recourse to this reserve is actually made in 2015. For 2016, the forecasted tax revenue is higher in the DBP, reflecting the stronger economic growth as well as new indirect tax measures announced in the Budget for 2016. On the other hand, the DBP includes also a number of deficit-increasing measures announced in the 2016 Budget, namely the revision of income tax bands for low income earners, the revision in the minimum pension and other social cohesion and environmental measures.

The debt ratio for 2014 is marginally higher in the DBP compared to that in the USP, whereas the debt ratio for both 2015 and 2016 is lower. Revisions in the expected level of nominal GDP contributed to these changes, whilst there were also revisions in the estimated stock flow adjustment for the forecast years. The MFIN provided plausible justifications for the latter revisions.

The decline in the deficit ratio presented in the DBP for 2015 is underpinned by an increase in the total revenue to GDP ratio and a decline in the total expenditure ratio. The expected increase in revenue is strongly dependent on the projected significantly higher inflows from the IIP. The MFAC acknowledges that 70% of the cash received from the IIP will be channelled into a National Development and Social Fund rather than wholly being used to finance the budget. However, for the purposes of meeting the Stability and Growth Pact (SGP) requirements, this Fund is treated as part of general government according to the ESA guidelines. The magnitude of this source of revenue and the possible volatility in its inflows, which depends on the number of applications for citizenship, are a source of some uncertainty regarding the projected revenue.

In 2016, both the total revenue and expenditure ratios are projected to decline, largely reflecting lower expected inflows of European Union (EU) funds and the corresponding decline in capital outlays, following the completion of the 2007-2013 financial programme. The expiry of one-time measures implemented in 2015, namely temporary social cohesion measures as well as the last equity injection in the national airline, contribute significantly to the fiscal consolidation effort. This does not constitute a risk to the attainment of the fiscal targets for 2016. However, it raises some doubts on the sustainability of the fiscal adjustment.

In both 2015 and 2016, the fiscal consolidation is supported by cyclical revenue and thus achieving the projected economic growth rates is critical to ensure the attainment of the budgetary targets. The MFAC's report assessing the DBP's macroeconomic forecasts had concluded that, the expected GDP growth rate in 2015 is feasible but there is an element of uncertainty concerning the projected large increase in investment. The MFAC considers the forecast for growth in 2016 as plausible but subject to downside risks, in particular as regards the expected improvement in export activity. These risks carry over to the fiscal projections.

According to the DBP, total revenue is projected to rise marginally in 2015 but fall relatively sharply in 2016. For 2015, the slight increase expected in the revenue ratio is reflecting an increase in the 'other' revenue category which more than offsets a drop in taxation. Similarly, the drop in the revenue ratio expected for 2016 is also on account of the same revenue category.

The ratio of current taxes on income and wealth is expected to drop in 2015 but remain relatively unchanged in 2016. Meanwhile, the ratio of taxes on production and imports is forecasted to remain stable. Similarly, no notable changes are expected in the ratios of social contributions, capital taxes and property income categories of revenue. On the other hand, developments in the 'other' category of revenue are noteworthy.

Also on the revenue side, an examination of the relationship between the main tax revenue presented in the DBP namely taxes on production and imports, current taxes on income and wealth and social contributions, and their respective forecasted tax base does not identify any particular risks. Indeed, the implied revenue elasticity compared with the corresponding elasticity registered over the past years for taxes on production and imports and current taxes on income and wealth indicate some element of prudence. Meanwhile, based on this same estimation of elasticity, forecasts for social contributions seem plausible. This could reduce the risk from any slippages from attaining the projected economic growth, and its drivers, which would highly impinge on the attainment of the revenue targets. This is also confirmed when looking at the actual outturn for the first two quarters of the year for the main tax components, which indicates that the attainment of the annual fiscal target is on track.

The attainment of the revenue targets also depends on the actualisation of the expected impact of discretionary measures. For 2015, one-quarter of the projected absolute increase in total revenue is expected to result from the impact of the revenue measures. Subsequently, in 2016, although the net impact of such revenue measures is a mere 0.1 percentage points of GDP, in absolute terms, half of the projected increase in total revenue is expected to result from the implementation of the measures on the revenue side of the budget. The main budget measures concern revisions in excise duty and the widening of the tax bands for low income earners. In case of the former, approximate calculations based on the data available indicate that the estimated impact of these measures seems plausible. However, with respect to the latter, very limited information was provided on the calculation of this impact.

The authorities explained that there are a number of initiatives planned to be undertaken during 2016 aimed to increase tax compliance and further reduce tax avoidance. As the additional revenue that may result from such efforts is not taken into account in the fiscal forecasts for 2016, an element of prudence is identified.

On the expenditure side, the DBP projects a decline in the ratio of social payments, compensation of employees and interest expenditure between 2014 and 2016. On the other hand, gross fixed capital formation is projected to increase strongly in 2015 and then decline in 2016, reflecting the expected implementation of EU-funded projects. Similarly, capital transfers are expected to increase in 2015 and then fall sharply in 2016, due to the timing of the equity injections in the national airline. The other categories of expenditure are projected to remain broadly stable over the forecast period.

Although the assumed new recruitment underpinning the projected compensation of employees is more plausible than that presented in the latest USP, it is still significantly below that recorded in 2013 and 2014. The authorities referred to Directive No 9 issued under the Public Administration Act (Cap. 497) which shall come into force on 1$^{st}$ February 2016 and which should contribute to keep recruitment within the budgetary targets. However, in light of past slippages, the forecasts for the wage bill are still subject to some uncertainty.

Similarly, outlays on social benefits are projected to grow at a slower rate than that registered in recent years. This reflects in particular, the conservative assumptions for the projected number of beneficiaries for social assistance both in 2015 and in 2016, whilst the assumed beneficiaries for short-term benefits and medical assistance also appear on the low side, particularly for 2015. There is an element of uncertainty surrounding the estimated fiscal impact of the youth guarantee scheme, which appears optimistic, given the actual number of participants in the scheme during 2015.

On the other hand, on the expenditure side, the ongoing ministerial spending review, and in particular the implementation of the recommended measures in the health sector, could generate additional savings, which the MFIN has prudently not incorporated in the projections and thus constitute a possible upside risk.

The above mentioned risk factors also apply to the debt projections presented in the DBP. In addition, the debt forecasts are subject to additional uncertainties reflecting a number of necessary assumptions which increase the risk of forecast errors. It is positively noted that the share of government guaranteed debt to GDP, which could emanate further risk to the debt projections, decreased in 2015.

Overall, this assessment exercise considers that the fiscal targets presented in the DBP are attainable. On the basis of actual performance for January-June, the 2015 budgetary targets appear achievable and this is generally confirmed when taking account of relevant developments in cash fiscal data for the first nine months of the year. However, overall and especially for 2016, the budgetary projections, in particular on the expenditure side, are subject to some downside risks.

## 1. Introduction: aims, methodology and limitations of this assessment

This report provides an assessment of the fiscal forecasts for 2015 and 2016 prepared by the Ministry for Finance (MFIN) and presented in the Draft Budgetary Plan (DBP) 2016, which was published on 15th October 2015. This report fulfils the requirement of Article 13 of the Fiscal Responsibility Act, 2014 (Cap. 534) that requires the Malta Fiscal Advisory Council (MFAC) to "endorse, as it considers appropriate, the macroeconomic and fiscal forecasts prepared by the Ministry for Finance, and provide an assessment of the official forecasts"[1].

The assessment of the budgetary forecasts presented in this report involves:

a) an assessment of the methodologies and processes used to produce the fiscal projections;
b) a comparison to the previous round of budgetary forecasts presented in the Update of Stability Programme (USP) 2015-2018 published in April 2015;
c) an assessment of the forecasts presented in the DBP, for the main revenue and expenditure categories, by considering their plausibility, taking into account the macroeconomic outlook, recent trends and other relevant available information, in particular:
    i. an assessment of the projections for the main tax revenue categories, on the basis of the implied elasticities for the forecast period, when compared to historical averages, taking into account the impact of discretionary measures and other relevant information;
    ii. an assessment of the forecasts for the main expenditure categories on the basis of projected growth rates compared to recent trends (2011-2014), and taking into account the impact of discretionary measures and other relevant information;
    iii. an assessment of the impact of the main discretionary measures, where possible, based on the methodology used to estimate their budgetary impact and other relevant information available;
    iv. a comparison of the annual fiscal targets for 2015 to the actual outturn available (January-June for ESA 2010 data and January-September for Consolidated Fund data) in the context of similar developments in recent years: this analysis was carried out for the main tax revenue categories and those expenditure components where outlays tend to follow a broadly stable pattern over the year;
d) an assessment of the macroeconomic risks surrounding the fiscal forecasts, based on the findings presented in the MFAC report of 15th October 2015;
e) a comparison of the fiscal forecasts with the forecasts published by the European Commission (Spring 2015) and the Central Bank of Malta (June 2015).

The fiscal projections were presented to the MFAC for review on 12th October 2015, whilst the DBP was available on its publication on the 15th October 2015[2]. Together with the fiscal

[1] The assessment of the macroeconomic forecasts included in the DBP is provided in a separate MFAC report: An assessment of the macroeconomic forecasts for the Maltese economy prepared by the Ministry for Finance in October 2015, A report prepared by the Malta Fiscal Advisory Council, 15th October 2015.

[2] Subsequently, on 20th October 2015, the MFIN informed the MFAC that certain expenditure discretionary measures (amounting to €5.805 million) were misclassified in Table 5a of the DBP, and on the 23rd October 2015, the MFIN informed the MFAC that a measure (amounting to €7 million) had not been included in the one-off measures in the DBP. Note was taken of these reclassifications, but the assessment exercise proceeded on the data as presented in the DBP.

projections for the main budgetary components, the MFIN and the National Statistics Office (NSO) provided to the MFAC detailed disaggregated data for each revenue and expenditure categories which permitted the assessment exercise to involve, where relevant, an in-depth analysis at individual budgetary item level. In the course of the assessment exercise, a number of supporting documents related to the key drivers of the main revenue and expenditure items were consulted. In particular, information on the discretionary measures was obtained from the Budget Speech 2016, the Budget 2016 Document, the Financial Estimates 2016 and the Budget 2015 Implementation. In this context, it is relevant to highlight that more streamlining in the budget documentation and publishing one single comprehensive list of all the budget measures would ensure more consistency and contribute to improve budgetary transparency.

During the course of the assessment exercise, a detailed list of additional data and information, as well as clarification on issues which arose during the analysis of the data, was requested to the MFIN in writing. A meeting was held with officials from the MFIN, namely the Budget Office (BO), the Economic Policy Department (EPD) and the NSO, to discuss pending requests for data and information, the impact of the main discretionary measures as well as to clarify any areas of uncertainty or concern which had emerged during the assessment exercise. The cut-off date for data and information included in this report was 28$^{th}$ October 2015. The focus of the analysis was on the fiscal projections for the general government sector in ESA 2010 terms, and a full assessment of the Consolidated Fund projections for central government and the transition from Consolidated Fund data to general government data in ESA 2010 terms was not carried out.

The MFIN, in particular the BO, the EPD and the NSO, offered their full collaboration in this assessment exercise, providing access to comprehensive detailed information and data and comprehensive responses to the requested clarifications. This year, the timing of the Budget has been shifted forward by some weeks, in order to better align the national budgetary process with the European semester. It is recognised that this has resulted in increased time pressures within the MFIN to coordinate the macroeconomic and fiscal forecasting exercises, whilst at the same time the Budget for 2016 was being finalised. Nevertheless, it is considered that the work on the assessment exercise could have been facilitated if the necessary data and information, even though provisional, had been provided to the MFAC in a more timely manner.

## 2. Assessment of the methodologies and processes used to produce the fiscal forecasts

Since the forecasting methodologies and processes by which the fiscal forecasts are estimated may be a source of risk of forecast error, an assessment of such methodologies and processes is considered as an important component of the assessment of the fiscal forecasts. To this end, this report starts with presenting an assessment of the methodologies and processes by which these fiscal forecasts are generated. This process of producing the fiscal forecasts is carried out jointly by a number of entities namely the BO, the EPD, the NSO and the Treasury.

During meetings held with the respective entities, it was ascertained that the methodological processes by which the fiscal forecasts presented in the DBP were estimated remained largely similar to the methods adopted in earlier forecasting exercises carried out in recent years.

The DBP, which was submitted on the 15th October, 2015, included statistical information available up to 12th October, 2015. Thus, fiscal projections for 2015 and 2016 presented in the DBP are based on updated actual fiscal data for 2014 and for the first quarter of 2015 published by the NSO[3] on the 9th July 2015[4]. These forecasts also take into account actual developments in cash data for the Consolidated Fund for January-September 2015.

The revenue targets for 2015 presented in the USP for Malta 2015-2018 were revised to reflect the actual outturn for 2014, the registered performance in revenue items over the first nine months of 2015, the macroeconomic scenario unfolding over the same period and also to take into account seasonal trends. These forecasts were also revised to reflect the implementation and updated information concerning fiscal measures announced in the Budget for 2015.

In line with previous forecasting exercises, the forecasts for 2016, on a cash basis and covering only central government, were generated by the BO on the basis of financial plans of the respective departments. The BO also takes into account past trends, updated data for the current year and any relevant updates on the budgetary measures. With regards to expenditure, the BO engaged in lengthy discussions with the line Ministries on their financial plans which serve as the basis of the projections. Subsequently, these forecasts were discussed with EPD. In the case of revenue projections, it was ensured that these reflect the forecasted macroeconomic scenario as well as to ensure that they are in line with revenue elasticities observed over past years. Moreover, the EPD also carries out consistency checks for specific items of expenditure namely social benefits and compensation of employees.

It is pertinent to note that, since this year the timing of the presentation of the Budget to Parliament was aligned with the submission of the DBP to the European Commission (COM), it was possible for the forecasts for 2016 to include the impact of the fiscal measures not merely at an aggregate level but in a detailed manner at each relevant subcomponent of revenue and expenditure.

A specific process which is vital for the generation of the fiscal forecasts is that whereby the NSO transpose the forecasts which are firstly prepared on a cash basis and covering only central government, to reflect the ESA 2010 methodology. The authorities have ascertained that, in line with past practice, this process necessitated a number of underlying assumptions[5]. As highlighted in earlier reports on the assessment of fiscal forecasts, these assumptions relate to relatively volatile items and therefore increase the risk of significant forecast errors. In this regard, it is positively noted that the process to implement full accrual accounting is underway.

The authorities also ascertained that the methodology used to break down expenditure forecasts in different items according to the ESA 2010 methodology also remained highly reliant on a number of assumptions[6], as in the recent past. Meanwhile, the authorities deemed some amendments to the assumptions as necessary. In particular, whereas in previous

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[3] NSO News Release 128/2015.

[4] NSO published updated fiscal data for 2014 on the 21st October, 2015, which was post the cut-off date of the 12th October.

[5] These assumptions concern the accruals adjustment, the time adjusted cash and the net borrowing/net lending of Extra Budgetary Units (EBUs).

[6] These assumptions are necessary since expenditure forecasts are firstly compiled on a cash basis and later transposed into accrual basis.

forecasting rounds, the capital expenditure category used to be broken down into different types of expenditure on the basis of ratios for the preceding three years, in this round of the forecast exercise, the ratio of the previous year only was used. Following extensive discussions between the entities involved in the forecasting exercise, this method was judged to be more appropriate given the rapidly changing profile for capital expenditure. While efforts to rethink these assumptions are welcome, the MFAC would suggest that explanations and justifications for such changes are clearly outlined in order to enhance fiscal transparency. The change in methodology regarding expenditure at a component level, does not however pose any risk of forecast error for aggregate expenditure.

As in earlier reports, the detailed level at which the fiscal projections are generated as well as the involvement of experts from the entities involved is positively noted. However, the process of firstly finalising forecasts on a cash basis and only subsequently transposing them into ESA 2010 methodology increases the risk of forecast error. Also, as highlighted in previous assessments, since a number of entities are involved in this process, the process is characterised by a degree of fragmentation and there is a need for a more streamlined process and a smoother forecasting exercise, which would have favourable repercussions on the quality of the forecasts. Moreover, the MFAC would like to encourage the introduction of formal methodological documentation in order to enhance the robustness of the exercise.

The MFAC would also appreciate if the information passed to it, is presented in a way which facilitates the analysis, primarily by ensuring that all the historical data is revised in order to be consistent with the latest published data.

## 3. Overview of the fiscal targets presented in the Draft Budgetary Plan 2016

Against a background of strong economic growth, the DBP projects the budget deficit to continue to follow a downward path, declining from 2.1 per cent of the Gross Domestic Product (GDP) in 2014 to 1.1 per cent of GDP in 2016. The annual fiscal adjustment amounts to 0.5 percentage points of GDP in 2015 and just under 0.5 percentage points of GDP, in 2016.

In 2015, the adjustment in the fiscal balance reflects an increase in total revenue of 0.3 percentage points of GDP together with a decline in the total expenditure ratio of 0.2 percentage points of GDP. Discretionary measures on the revenue side contributed to improve the fiscal balance by 0.7 percentage points of GDP. On the other hand, the net impact of discretionary expenditure measures was deficit-increasing (0.3 percentage points of GDP) and the increase in the equity injection in the national airline worsened the deficit by a further 0.3 percentage points of GDP.

It is pertinent to point out that the bulk of the increase in revenue from discretionary measures resulted from the Individual Investor Programme (IIP). Indeed, the increase in proceeds generated from this programme accounted for around a quarter of the total revenue increase in 2015. Nevertheless, the magnitude of this source of revenue as well as potential volatility in the number of applications raises some concerns. The MFAC acknowledges that 70% of the cash received from the IIP will be channelled into a National Development and Social Fund rather than wholly being used to finance the budget. However, for the purposes of meeting the SGP requirements, this Fund is treated as part of general government according to the ESA guidelines.

| Table 3.1 Analysis of the Fiscal Adjustment | | | | | |
|---|---|---|---|---|---|
| | 2014 Actual | 2015 MFIN DBP Oct 2015 | 2016 MFIN DBP Oct 2015 | 2015 MFIN SP Apr 2015 | 2016 MFIN SP Apr 2015 |
| | | | per cent of GDP | | |
| **Fiscal balance** | -2.1 | -1.6 | -1.1 | -1.6 | -1.1 |
| One-off and other temporary measures[1] | 0.3 | 0.2 | 0.1 | 0.1 | 0.1 |
| | | | percentage points of GDP | | |
| **Adjustment in the deficit ratio** | 0.5 | 0.5 | 0.4 | 0.5 | 0.5 |
| **Change in revenue ratio** | 1.9 | 0.3 | -2.1 | 0.9 | -2.0 |
| *of which:* | | | | | |
| Discretionary measures[1] | 0.7 | 0.7 | 0.1 | 0.5 | -0.1 |
| **Change in expenditure ratio[2]** | -1.4 | 0.2 | 2.6 | -0.3 | 2.5 |
| *of which:* | | | | | |
| Discretionary measures[1] | -0.1 | -0.3 | 0.0 | -0.2 | 0.1 |
| Incremental impact of the equity injection in the national airline | 0.3 | -0.3 | 0.5 | -0.3 | 0.5 |

[1]A plus sign means a deficit-reducing impact

[2]A minus sign means an increase in the expenditure ratio, with a deficit-increasing impact

*Source: Malta Update of the Stability Programme 2015-2018, Ministry for Finance, April 2015; Draft Budgetary Plan 2016, Ministry for Finance, October 2015; NSO News Release 191/2015*

Higher revenue was also generated from various indirect tax measures (announced in the Budget for 2015) as well as from the impact of the 2006 pension reform which largely compensated for the loss of revenue from measures under current taxes on income and wealth. One-off and other temporary measures are estimated at 0.2 per cent of GDP in 2015, comprising of revenue from sale of land as well as revenue related to the government guarantee to a newly established company in the energy sector. This fee has already been paid to government, whilst the uncertainty associated with the materialisation of the projected revenue from sale of land is limited when considering the actual revenue generated up till the third quarter of the year.

In 2016, the DBP projects notable decreases in both the total revenue and total expenditure ratios, of 2.1 and 2.6 percentage points of GDP, respectively. These declines are significantly influenced by the lower expected inflows of European Union (EU) funds and the corresponding decline in capital outlays, as the 2007-2013 financial programme should be concluded by the end of the current year. As the last equity injection in the national airline takes place in 2015, this results in a further decrease in the total expenditure ratio of 0.5 percentage points of GDP. In 2016, the net impact of discretionary measures on the revenue side is deficit-reducing but, at 0.1 per cent of GDP, it is much smaller than that in 2015. On the expenditure side, the net impact of discretionary measures (excluding the incremental impact of the equity injection in the national airline) is deficit-reducing but very marginal at 0.04 percentage points of GDP. The expiry of one-time payments in 2015 was off-set by higher outlays on various social initiatives.

A number of other measures with minor fiscal impact were announced in the Budget for 2016 and their effect was embedded in the fiscal projections, but these were not specifically identified in the list of discretionary measures in the DBP.

**Table 3.2 Discretionary Measures underpinning the fiscal adjustment**

| | 2015 | 2016 |
|---|---|---|
| | Eur millions | |
| **Main revenue measures** | 65.5 | 16.3 |
| *of which:* | | |
| Taxes on Production and Imports | 27.6 | 20.6 |
| Current Taxes on Income and Wealth | -40.2 | -12.0 |
| Social Contributions | 11.7 | 2.7 |
| Other | 66.3 | 5.0 |
| **Main expenditure measures** | -51.1 | 45.5 |
| *of which:* | | |
| Social payments | -23.5 | 4.0 |
| Equity acquisition in national airline | -28.0 | 43.0 |
| Other | 0.4 | -1.5 |
| **Net impact of discretionary measures** | 14.4 | 61.8 |

Note: The budgetary impact is the incremental impact of measures. A positive sign implies that the budget deficit decreases as a consequence of the measure.

*Source: Malta Draft Budgetary Plan 2016, Ministry for Finance, October 2015*

In the DBP, one-off measures are projected to fall to 0.1 per cent of GDP in 2016 and comprise only of revenue generated from sale of land[7]. It is positively noted that the reliance of the fiscal adjustment on one-off measures is lower in 2016 than in the previous two years. On the other hand, the improvement in the fiscal balance in 2016 largely reflects the expiry of the one-time measures implemented in 2015 and the last capital injection in the national airline. Whilst not resulting in additional risks to the attainment of the fiscal targets for 2016, this dependence raises some concern on the sustainability of the fiscal adjustment.

## 4. Differences between the fiscal projections presented in the Draft Budgetary Plan 2016 and those presented in the Update of Stability Programme 2015-2018

This Section presents a comparison of the fiscal projections for 2015 and 2016 presented in the DBP with those included in the USP published in April 2015. This comparative assessment includes an analysis of any notable revisions in the 2014 outturn between the two

[7] On 23rd October 2015, the MFIN informed the MFAC that a deficit-increasing item of €7 million involving the retroactive impact 2014/15 extra payments consequent on the implementation of the 2014 Own Resource Decision was not classified as a one-off in the DBP although included in the fiscal projections. Accounting for this item as a one-off implies a revision from 0.1 per cent of GDP to a marginal 0.01 per cent of GDP. For the purposes of this assessment exercise, the analysis is based on the original 0.1 per cent as published in the DBP.

documents, differences in the macroeconomic scenario, changes in the discretionary measures and their impact as well as in other assumptions underpinning the budgetary projections. The two sets of forecasts are based on the ESA 2010 methodology and officials from the MFIN and the NSO have confirmed that the main methodologies and processes used to generate the fiscal forecasts have remained unchanged from those used to produce the forecasts included in the USP. However, as noted earlier, there has been a change in the ratios used to allocate the capital expenditure from the Consolidated Fund to the different expenditure categories under ESA 2010. This change affects the comparison of fiscal forecasts between the USP and the DBP for the categories of expenditure which include a component of capital expenditure, in particular gross fixed capital formation, intermediate consumption, subsidies and capital transfers.

**Table 4.1 Comparison of Fiscal Projections**

**Draft Budgetary Plan October 2015 - Stability Programme April 2015**

| | **2014** | **2015** | **2016** | **2014** | **2015** | **2016** |
|---|---|---|---|---|---|---|
| | **Actual** | **MFIN DBP Oct 2015** | | **MFIN SP April 2015** | | |
| | | | **per cent of GDP** | | | |
| General government balance | -2.1 | -1.6 | -1.1 | -2.1 | -1.6 | -1.1 |
| General government debt | 68.3 | 66.6 | 65.2 | 68.0 | 66.8 | 65.6 |
| | | | **Eur millions** | | | |
| Taxes on production and imports | 1097.8 | 1158.7 | 1235.8 | 1087.2 | 1155.1 | 1198.7 |
| Current taxes on income and wealth | 1155.4 | 1193.4 | 1266.3 | 1155.4 | 1173.6 | 1226.1 |
| Capital taxes | 11.8 | 13.2 | 13.5 | 11.8 | 12.7 | 12.8 |
| Social contributions | 560.3 | 594.9 | 619.5 | 560.3 | 594.9 | 616.4 |
| Property Income | 93.1 | 96.2 | 95.6 | 94.4 | 102.3 | 100.4 |
| Other revenue | 409.3 | 513.9 | 372.0 | 412.6 | 513.0 | 410.3 |
| **Total Revenue** | 3327.7 | 3570.4 | 3602.8 | 3321.8 | 3551.5 | 3564.7 |
| Compensation of employees | 1053.5 | 1106.9 | 1170.0 | 1051.9 | 1082.4 | 1123.3 |
| Intermediate consumption | 526.8 | 574.2 | 586.1 | 525.5 | 566.6 | 566.1 |
| Social payments | 1004.1 | 1037.6 | 1069.8 | 1008.4 | 1039.8 | 1062.9 |
| Interest expenditure | 230.9 | 223.0 | 218.4 | 230.2 | 222.9 | 227.0 |
| Subsidies | 105.0 | 111.3 | 106.9 | 103.6 | 128.3 | 125.7 |
| Gross fixed capital formation | 298.4 | 359.9 | 283.0 | 300.2 | 342.5 | 277.7 |
| Capital transfers | 92.5 | 116.4 | 79.0 | 88.6 | 113.5 | 79.7 |
| Other expenditure | 185.2 | 175.1 | 191.5 | 181.7 | 188.8 | 194.6 |
| **Total Expenditure** | 3496.3 | 3704.4 | 3704.8 | 3490.1 | 3684.6 | 3657.0 |
| **General government balance** | -168.6 | -134.0 | -102.0 | -168.3 | -133.1 | -92.3 |

*Source: Malta Update of the Stability Programme 2015-2018, Ministry for Finance, April 2015; Draft Budgetary Plan 2016, Ministry for Finance, October 2015*

At 2.1 per cent of GDP, the budget deficit ratio for 2014 has remained unchanged from that presented in the USP. In absolute terms, the revision in the budget deficit was very marginal, as a small upward revision in total revenue for 2014, mainly in taxes on production and imports, was offset by higher outlays on various expenditure components. The budget deficit as a share of GDP for 2015 and 2016 presented in the DBP also corresponds to that included in the USP. Although the macroeconomic scenario presented in the DBP is more favourable than that in the USP, the fiscal targets have not been revised. Given the more favourable macroeconomic outlook and the associated expectations of higher revenues, the MFAC's view is that this scenario provided a good opportunity for further fiscal consolidation vis-à-vis the USP targets. In absolute terms, the budget deficit was revised upwards marginally in

2015, but the scale of revision was larger in 2016[8]. In both years, upward revisions in total revenue were partly offset by a higher level of total expenditure.

In 2015, higher revenue than that projected in the USP is expected to be generated mainly from current taxes on income and wealth. The Budget Speech 2016 attributes the upward revision in the 2015 estimate for income tax revenue to stronger enforcement and economic activity Furthermore, an element of prudence was also included in the original fiscal projections. Proceeds from the IIP are envisaged to be higher than expected in the USP, whilst the DBP includes also the fee related to a sizable government guarantee, which did not feature in the USP. However, these additional proceeds, which are included under the other category of revenue, were completely offset by lower than expected capital transfers and investment grants receivable.

On the expenditure side, in 2015, the estimates for outlays on compensation of employees have been revised up considerably, reflecting the relatively strong growth registered in the first half of the year, primarily related to the health and education sectors. It is noted that the extent of the revision in the public wage bill exceeds the impact of the discretionary measure aimed to restrict recruitment in the public sector, which was included in the USP but does not feature in the DBP. Outlays on intermediate consumption and investment expenditure are also notably higher than envisaged in the USP. On the other hand, the outlays on subsidies, on current transfers payable and on acquisition of land have been revised down. Within the subsidies category, outlays related to the eco-reduction schemes are expected to be lower than in the USP, reflecting the expected utilisation by the end of the year. Within the category of other current transfers payable, the contributions towards the financing of church schools and EU own resources have been revised upwards, whilst the contingency reserve of 0.1 per cent of GDP, in line with the Fiscal Responsibility Act, was included in the USP but not in the DBP for 2015. In the discussions with MFIN staff it transpired that MFIN could not rule out the possibility that recourse to this fund is actually made in 2015.

For 2016, the magnitude of the revisions in total revenue and total expenditure are notably higher than in 2015. Considerably more revenue is expected from taxes on production and imports, partly reflecting the various new indirect tax measures announced in the Budget for 2016 as well as somewhat higher expected growth in nominal private consumption expenditure. The projection for current taxes on income and wealth was also revised up by a considerable margin, beyond the base effect from 2015. The inclusion in the DBP of a new deficit-increasing measure (the revision of income tax bands for low income earners) was more than compensated for by higher revenue resulting from the stronger rate of nominal GDP growth when compared to the USP. A further increase in proceeds is also expected to be generated from the IIP in 2016, whereas in the USP, revenue generated from this programme was expected to be lower than in the previous year. On the other hand, the DBP is projecting a significantly lower level of inflows of capital transfers and investment grants, reflecting more cautious assumptions on the implementation of EU-funded projects, especially from the 2014-2020 financial programme.

In terms of expenditure, the DBP is projecting a significantly higher public wage bill as well as increased outlays on intermediate consumption. Social payments have also been revised upwards, but the magnitude of this revision is smaller and largely reflects the new deficit-

[8] For 2016, the upward revision in the budget deficit in absolute terms was compensated for by a higher projected level of nominal GDP, thus resulting in an unchanged deficit ratio.

increasing measures announced in the Budget for 2016. The projections for capital outlays included in the DBP are also slightly higher than the forecast in the USP. In contrast, the projection for subsidies has been revised down, largely reflecting the base effect from 2015. The forecasts for interest expenditure are also lower than the corresponding projections included in the USP. The MFIN provided a detailed note, prepared by the Treasury Department, explaining the various factors underpinning the lower interest payments in the DBP, including the exceptionally low interest rate environment which has persisted in recent months and market developments both internationally as well as in the local primary and secondary markets. These justifications for the downward revision in interest payments are plausible. Outlays under the other category of expenditure have also been revised downwards, being influenced by different assumptions regarding the contribution to EU own resources and acquisition of land.

There have been some minor revisions in the debt ratio between the DBP and the USP. The debt ratio for 2014 is higher in the DBP compared to the USP, mainly reflecting the effect of a lower level of nominal GDP. On the other hand, both the debt ratio for 2015 and for 2016 is lower in the DBP, by 0.2 and 0.4 percentage points of GDP, respectively. In both years, the stronger nominal GDP growth rate exerted downward pressure on the debt ratio, but this impact was partly offset by a higher stock flow adjustment (SFA). In 2016, the base effect from 2015 as well as the revision in the budget deficit also had a material impact on the debt ratio. The MFIN provided plausible explanations for the higher estimated SFA in the DBP, namely revisions in the assumptions for cash balances, as significant inflows of EU funds reimbursements and the payment of arrears in the energy sector are expected towards the end of the year, and for the European Financial Stability Facility (EFSF) debt re-routing and the credit line facility in favour of the EFSF/European Stability Mechanism (ESM).

## 5. Assessment of risks to the budgetary projections

This Section first presents an assessment of the uncertainty surrounding the macroeconomic forecasts underpinning the fiscal projections and the spillover of these risks on the attainment of the fiscal targets presented in the DBP. Subsequently, the risks surrounding each main revenue and expenditure category are discussed. Where possible, an assessment of the impact of discretionary measures is also carried out. This Section concludes with an analysis of the specific risks surrounding the debt projections.

### 5.1 Macroeconomic risk

The assessment of the macroeconomic risk surrounding the fiscal forecasts is based on the report prepared by the MFAC: An Assessment of the Macroeconomic Forecasts for the Maltese Economy prepared by the Ministry for Finance in October 2015 (MFAC, 2015). This risk is particularly relevant in the assessment of the DBP's fiscal projections because, as highlighted in the DBP (p.21), the targeted improvement in the fiscal balance is "supported by buoyant economic growth".

According to the DBP, the robust economic growth registered in 2014 is expected to pick up further to 4.2 per cent in 2015. Real GDP growth is expected to decelerate slightly but remain strong at 3.6 per cent in 2016. In nominal terms, GDP is expected to increase by 6.5 per cent in 2015 and by 6.2 per cent in 2016.

In 2015, economic growth is expected to be driven by domestic demand, namely growth in private consumption and a sharp growth in investment, which includes the large-scale project in the energy sector. On the other hand, the external sector is expected to contribute negatively to economic growth as exports are projected to remain stable at the 2014 level in real terms, whilst imports are expected to increase, reflecting the import content of the investment activity.

On the other hand, the MFIN expects the external sector to be the main contributor to economic growth in 2016. A turnaround in export activity is expected in 2016, supported by an expected improvement in the economic outlook in Malta's trading partners as well as a persistently weak Euro. Exports are projected to increase by 3.9 per cent in real terms, whilst imports are expected to increase by 1.7 per cent. On the domestic side, private consumption growth is projected to remain relatively strong, at 2.9 per cent in real terms, whilst investment is projected to decline, reflecting the base effect from 2015.

The robust growth in private consumption expenditure expected during the forecast period is supported by a sustained positive performance in the labour market. Employment is expected to increase by around 2 per cent in both 2015 and 2016, whilst the unemployment rate is projected to fall further, from 5.9 per cent in 2014 to 5.6 per cent in 2016. Wage growth is also expected to be robust, at 2.7 per cent and 3.2 per cent in 2015 and 2016, respectively.

**Table 5.1 Macroeconomic Projections**

| | 2014 | 2015 | 2016 |
|---|---|---|---|
| | Actual | MFIN DBP Oct 2015 | |
| | | percentage change | |
| **At CLV (2010) prices** | | | |
| Private final consumption expenditure | 2.9 | 3.5 | 2.9 |
| General government final consumption expendiutre | 7.5 | 1.0 | 1.9 |
| Gross fixed capital formation | 9.1 | 21.4 | -8.0 |
| Exports of goods and services | -0.3 | 0.0 | 3.9 |
| Imports of goods and services | 0.6 | 1.4 | 1.7 |
| Real GDP | 3.5 | 4.2 | 3.6 |
| **At Current Prices** | | | |
| Private final consumption expenditure | 2.8 | 4.3 | 4.9 |
| General government final consumption expenditure | 8.9 | 2.9 | 5.2 |
| Gross fixed capital formation | 11.9 | 27.2 | -6.5 |
| Exports of goods and services | 0.1 | 2.5 | 5.7 |
| Imports of goods and services | 0.3 | 3.8 | 3.0 |
| Nominal GDP | 5.4 | 6.5 | 6.2 |
| Employment | 3.1 | 1.9 | 2.0 |

*Source: Malta Draft Budgetary Plan 2016, Ministry for Finance, October 2015; NSO Release 163/2015; An Assessment of the macroeconomic forecasts for the Maltese economy prepared by the Malta Fiscal Advisory Council in October 2015*

The MFAC report (p.3) assessing the macroeconomic forecasts presented in the DBP positively notes "the well documented and structured process used by the EPD within MFIN in the undertaking of the forecasting exercise", which ensures that all the available information to date is taken into account in the generation of the macroeconomic forecasts. The use of assumptions, primarily related to variables which describe external factors, based on the forecasts adopted by international reputable organisations is also considered as an element of good practice in the forecasting exercise. Thus, the MFAC report (p.21) considers "the forecasting framework as sound and the assumptions used to produce the forecasts as valid".

On the other hand, the MFAC report (p.6) noted the need for more coordination and planning between the entities responsible in providing inputs to the forecast exercise. This concern has emerged also in the assessment of the fiscal forecasts, given the interlinkages between the macroeconomic and fiscal projections, particularly as regards the forecasts for government consumption.

A comparison of the MFIN's macroeconomic forecasts to the most recent forecasts by the COM (Spring 2015) and the CBM (June 2015) shows that these institutions are expecting growth to be mainly driven by domestic demand. However, at 4.2 per cent, the MFIN's projected real GDP growth for 2015 is relatively higher than that of 3.6 per cent, expected by both the COM and the CBM. In its assessment, the MFAC (p.21) notes that the MFIN's forecasts "are based on more updated information than those of the other institutions and possibly on better knowledge about specific public sector projects". Thus, overall the MFAC's assessment (p.20) considers that "on the basis of the latest available information for 2015, the projected increase in the headline real GDP figure of 4.2 per cent for the current year may indeed be feasible". The main element of risk surrounding the projected economic growth in 2015 which is identified in the report concerns the expected strong increase in gross fixed capital formation over the rest of the current year. The historical volatility of this expenditure component, as well as the significant revisions in the projections for capital outlays from one forecasting round to another, add further uncertainty to the expected capital outlays.

Regarding the projected real GDP growth rate for 2016, the MFAC report (p.20) considers that "although plausible, this forecast is subject to downside risks and, in particular, depends critically on the expected performance of the external sector". Like the COM and the CBM, the MFIN expects that economic growth slows down slightly in 2016, but its real GDP growth forecast, at 3.6 per cent, is higher than that projected by the other two institutions, at 3.2 per cent and 3.0 per cent, respectively. The MFAC report notes that the MFIN, unlike the other institutions, is expecting an export-led growth scenario for 2016. Thus, the attainment of the projected economic growth rate for 2016 critically depends on the actualisation of the assumed growth in Malta's main trading partners. In turn, this is subject to an element of uncertainty due to possible "variations with respect to the assumed projected path for the Euro and the possible impact on trade and tourism which could be affected from possible changes in the international geopolitical scenario" (p.12).

The main element of risk identified in the MFAC's assessment of the macroeconomic forecasts involves investment for 2015 and exports for 2016. These are not considered as tax-rich components of GDP. Nevertheless, these identified downside risks to the macroeconomic projections still carry over to the fiscal forecasts, through the repercussions on other components of GDP and thus also on the various tax bases.

### 5.2 Assessment of revenue projections

This Section aims to identify the risks associated with the actualization of the revenue forecast presented in the DBP. This assessment of the revenue estimates was, in many instances, based on tests of plausibility and probability of the expected outcome. In particular, as noted earlier, the annual fiscal targets for 2015 are compared to the actual outturn available, also in the context of similar developments in recent years. Moreover, the expected outcome was assessed on the basis of the implied elasticities compared to historical averages. The estimated impact of the main discretionary measures is also assessed based on the relevant available information.

According to the DBP, total revenue is projected to rise by a low 0.3 percentage points of GDP in 2015, to reach 42.2 per cent of GDP. Subsequently, a relatively sharp fall of 2.1 percentage points of GDP is expected in 2016. For 2015, the slight increase expected in the revenue ratio is reflecting an increase in the 'Other' revenue category which more than offsets a drop of 0.6 percentage points in taxation. Similarly, the drop in the revenue ratio expected for 2016 is also on account of developments in the 'Other' category of revenue as the ratio of taxes to GDP is expected to remain stable.

In 2015, the ratio of current taxes on income and wealth is expected to drop by slightly less than 0.5 percentage points but remain relatively stable at 14.1 per cent of GDP in 2016. Meanwhile, the ratio of taxes on production and imports is forecasted to remain stable and hover around 13.7 per cent of GDP. While no notable changes are expected in the ratios of social contributions, capital taxes and property income categories of revenue, developments in the 'other' category of revenue are noteworthy. Indeed, the 'other' category of revenue is expected to increase by almost 1 percentage point of GDP in 2015 but decline by slightly less than 2 percentage points in 2016.

As noted earlier, the revenue forecasts are particularly contingent upon the actualization of the projected economic growth and its drivers. Thus, the assessment of revenue projections includes an examination of the relationship between the main tax revenue forecasts presented in the DBP and the respective forecasted tax base, that is, the elasticity. This implied elasticity is compared with the corresponding elasticity registered over the past years.

The estimation of elasticity highly depends on the adopted methodology which may differ on various fronts particularly with regards to the degree of simplification and the level of aggregation involved for the various tax revenue categories. For this reason, the assessment of the main tax revenue categories is not only based on elasticity analysis but is supplemented by other considerations as detailed later on in this section.

The attainment of the revenue projections also depends on the realization of the expected fiscal impact of the discretionary measures. Indeed, in 2015, one-quarter of the projected absolute increase in total revenue is expected to result from the impact of the revenue measures. Subsequently, in 2016, while the absolute increase in total revenue is expected to be relatively low, half of such increase results from the budgetary measures on the revenue side of the budget for that year.

All the measures announced in the Budget for 2015 were implemented with the exception of a measure introducing excise duty on fish feed used in fish farms. This measure was replaced by the introduction of a fee on caging of Bluefin tuna. Amendments in these budgetary measures are not expected to exert a significant impact on revenue. Also, since the last forecasting exercise by MFIN, a noteworthy revision relates to the expected impact of the IIP whereby additional revenue of €25 million is expected.

Since, as mentioned earlier, the presentation of the Budget for 2016 to Parliament was rescheduled to be in line with the submission of the DBP, the budgetary measures incorporated in the revenue forecasts for 2016 have been announced in the Budget and are thus subject to less uncertainty than in previous years. Moreover, it has been the practice in previous years that a number of permanent discretionary measures planned to be implemented in the following year, though included in the fiscal forecasts, were not specified and detailed in the DBP since the submission of the DBP preceded the presentation of the Budget for the coming year in Parliament. This was addressed in this DBP as the fiscal measures for 2016 were specified in full detail in the Budget documentation presented in Parliament as well as in the DBP.

The authorities iterated their efforts to enhance the operation of revenue collection and to intensify the fight against tax evasion. Effective and efficient implementation of the budgetary measures is crucial in order to avoid shortfalls in revenue and slippages in attaining the fiscal targets.

In 2015, discretionary revenue-decreasing measures mainly relating to current taxes on income and wealth are expected to offset the higher revenue emanating from taxes on production and imports and social contributions. Discretionary measures related to current taxes on income and wealth are mainly the widening of the income tax bands and the base effect from revenue received in 2014 under the Investment Registration Scheme (IRS). With respect to social contributions, the main discretionary measure relates to the 2006 pension reform initiatives. Moreover, a substantial increase in revenue is also expected from the IIP. For 2016, the main revenue-increasing measures concern revisions in excise duties accounted for under taxes on production and imports. Revenue-decreasing measures relate to the revision of income tax bands for low income earners. Following substantial inflows in 2015, a minor increase in revenue is expected to be related to the IIP in 2016.

A number of discretionary measures aiming to improve labour market participation besides resulting in expenditure savings also have positive indirect impact on tax revenue by widening the tax base. The MFIN explained that this impact is incorporated in the tax projections through assumed higher employment levels.

Forecasts for tax revenue for 2015 included the impact of a number of measures aimed to strengthen tax compliance. As reported in the May 2015 Assessment, the plausibility of the estimated impact of these measures could not be assessed due to lack of information. However, the authorities ascertained that the respective tax departments expressed confidence that the fiscal target for each item of tax revenue for 2015 will be reached.

The MFIN highlighted that the government plans to enhance its efforts to improve tax compliance and curb tax evasion in 2016. Detailed information on the initiatives was provided and include amongst other objectives, strengthening of the Compliance and Investigations General Directorate as part of the process to merge the Revenue Departments.

The authorities specified that the outcome of these efforts are not reflected in the fiscal forecasts for 2016 and thus exert some element of prudence.

| Table 5.2 Main Components of Revenue | | | |
|---|---|---|---|
| | **2014** | **2015** | **2016** |
| | **per cent of GDP** | | |
| General Government Balance | -2.1 | -1.6 | -1.1 |
| Total Revenue | 41.9 | 42.2 | 40.1 |
| *of which:* | | | |
| Taxes on production and imports | 13.8 | 13.7 | 13.8 |
| Current taxes on income and wealth | 14.5 | 14.1 | 14.1 |
| Capital taxes | 0.1 | 0.2 | 0.1 |
| Social contributions | 7.1 | 7.0 | 6.9 |
| Property Income | 1.2 | 1.1 | 1.1 |
| Other revenue | 5.2 | 6.1 | 4.1 |

*Source: Malta Draft Budgetary Plan 2016, Ministry for Finance, October 2015*

Taxes on production and imports

According to the DBP, taxes on production and imports are expected to hover around 13.7 per cent of GDP in 2015 and 2016. The ratio of taxes on production and imports is estimated to be positively affected by discretionary measures generating additional revenue amounting to 0.3 per cent of GDP in 2015 and an additional 0.2 per cent of GDP in 2016.

In 2015, revenue-increasing measures consist mainly of revisions in the excise duty on cigarettes and tobacco, fuel, cement, wine, tyres, mobile telephony, revision in the road licence fee and revision in the duty on documents on insurance products. The budgetary impact from these measures is expected to remain unchanged from that presented in the USP in April 2015 and earlier in the DBP in October 2014. The estimated impact of these measures was assessed in November 2014[9] and considered plausible.

In the following year, as announced in the Budget for 2016, the excise duty on fuel, cement and cigarettes and tobacco is again revised upwards contributing to additional revenue. Moreover, in 2016, the revenue-increasing measures also include the introduction of excise duty on chewing gum, revision in excise duty on plastic, glass or metal beverage containers and the revision in excise duty on plastic bags. The latter revisions in specific excise duties related to the environment are to replace the phasing out of the eco-contribution. Moreover, an incentive scheme was introduced in 2015 and extended in 2016 in respect of a rebate of stamp duty on the first property purchased. Additionally, an environmental contribution is introduced on all holiday accommodation. Assessment of the impact of these measures was based on a comparison to similar measures introduced in previous years and using relevant statistical data. Based on the information available, the impact of these measures seems reasonable.

[9] An assessment of the main fiscal forecasts prepared by the Ministry of Finance and presented in the Draft Budgetary Plan 2015 of 11th November 2014.

It is pertinent to note that in 2014 and 2015, the forecasted revenue from excise taxes which are accounted for under taxes on production and imports reflect the repayment of accumulated arrears by the energy utility company. These arrears were partly paid in 2014 with the remaining balance to be paid to Government by the end of 2015. The Ministry confirmed that the energy utility company will settle all arrears by the end of 2015. Since fiscal data is recorded according to the ESA 2010 methodology and therefore on accrual basis, taxes on production and imports as presented in the DBP for 2015 is not impacted by this settlement of arrears. Therefore, this repayment of excise taxes emanates no downside risk on the attainment of the forecast for taxes on production and imports.

Excluding the impact of the budgetary measures, for 2015, the growth in the estimated revenue from taxes on production and imports is projected to increase at a lower rate than the expected growth in private final consumption expenditure, the latter considered as the relevant tax base. Meanwhile, in 2016, revenue from taxes on production and imports are expected to increase in line with the rate of growth of private final consumption expenditure. For both 2015 and 2016, the implied elasticity is below the average for the past years thus indicating an element of prudence.

The assessment of the forecast for taxes on production and imports for 2015 also involves a comparison to the performance registered in the first two quarters of the year. The annual target appears attainable and this was also confirmed in the context of cash data for January-September.

Current taxes on income and wealth

According to the DBP, current taxes on income and wealth are projected to decline to 14.1 per cent of GDP in 2015 and remain stable in 2016. This category of tax revenue is estimated to be negatively affected by budgetary measures in 2015 (0.5 percentage points of GDP) and to a lesser extent in 2016 (0.1 percentage points).

According to the DBP, the widening of the income tax bands is estimated to have a negative impact of 0.2 per cent of GDP in 2015. This is compounded by a negative impact of 0.4 per cent of GDP in 2015 which reflects the positive impact of the IRS in the previous year. Such a negative impact is only partly offset by the favourable impact of 0.1 per cent of GDP relating to the widening of the income tax base as a result of this Scheme and a similar impact from tax avoidance measures.

The authorities explained that, despite that the estimate of the fiscal impact of the widening of the income tax bands was carried out in 2014, no revisions or updates were carried out since then. A recent study by the CBM[10] using different assumptions for chargeable income shows a higher loss of revenue. Thus, there is some uncertainty regarding the impact of this measure in 2015. The projections for current taxes on income and wealth for 2015 also include the positive impact of 0.1 per cent of GDP anticipated from efforts to curb avoidance related to income tax and capital gains tax. The authorities were not in a position to specify details on the estimate of these measures and therefore the plausibility of their impact could not be assessed. Moreover, the authorities explained that no ex-post assessment of the impact of

[10] Grech, A. G. (2015) The macroeconomic impact of the income tax reductions in Malta, Central Bank of Malta Working Papers 2/2015.

measures was carried out, however, based on discussions with the respective department, the income tax revenue target is expected to be attained.

According to the DBP, in 2016, the only budgetary measure with an impact on this tax category relates to the revision in income tax bands for low income earners, which is expected to exert a negative impact of 0.1 per cent of GDP. Very limited information was provided on the calculation of this impact. Since the estimate was calculated on micro data based on past income, given that this measure affects low income earners, there might be some element of underestimation of the impact as individuals experiencing wage growth may no longer benefit from this measure.

The fiscal projections for 2015 may be assessed in view of the actual outturn registered so far. In particular, data in ESA 2010 methodology available to date indicate that the share of the fiscal outturn registered in the first two quarters of 2015 to the annual fiscal target is in line with that recorded in the corresponding quarters in previous years. Moreover, cash-based published data for the first nine months of 2015 also indicate that the fiscal target for 2015 is attainable.

Current taxes on income and wealth comprise taxes on individual income, taxes on corporate income and other current taxes. Since the first two major categories relate to personal income and corporate income respectively, these are assessed separately. For both 2015 and 2016, if one were to exclude the impact of the discretionary measures, the growth in taxes on individual income is expected to be slightly higher than the growth in the compensation of employees, the latter considered as its tax base. This elasticity implied by the projection of taxes on personal income for both 2015 and 2016 is below the historical average for the period 2001-2014.

Similar analysis of the income tax related to the corporate sector indicates that the projected corporate tax revenue increases by a similar rate to the operating surplus which is assumed as its tax base. This implied elasticity is well below the historical average for both 2015 and 2016. It is also pertinent to note that corporate tax revenue also reflects the performance of the international trading units and any future developments that may affect this sub-sector may impinge on the revenue forthcoming from corporate income tax.

Excluding the impact of discretionary measures, the growth in the overall revenue from current taxes on income and wealth is expected to grow slower than economic growth in 2015 but slightly higher in 2016. This implied elasticity is below that calculated for past years, thus indicating an element of prudence.

Thus, based on the above assessment overall no particular risks have been identified for this category of revenue and the implied elasticities indicate that the projections appear cautious.

Social contributions

Over the past years, developments in revenue from social contributions closely followed GDP growth with very minimal fluctuations recorded in its ratio to GDP. Similarly, social contributions are projected to hover around 7 per cent of GDP in 2015 and 2016.

The changes in the social security system emanating from the pension reforms of 2006 are expected to have a deficit-reducing impact of a mere 0.1 per cent of GDP in 2015 with an even lower impact in 2016. This impact remains unchanged from that estimated by the authorities in the USP, with a very minimal upward revision for 2016. Based on the information available no particular risks are associated with the estimate of this budgetary impact.

When one considers the projection of social contributions for 2015 in light of both the actual data on cash basis covering the first three quarters of 2015 as well as the data on accrual basis for the first six months of 2015, it is noted that if collection from this item of revenue keeps up the pace registered so far in 2015, the expected annual fiscal target will be attained.

Excluding the impact of the budgetary measures, the expected growth in the social contributions for both 2015 and 2016 is slightly lower than the growth in the compensation of employees which is considered as the tax base for this item of revenue. Moreover, this implied elasticity of social contributions is projected to be in line with the average for the past years, indicating that the projections are plausible.

'Other' components of revenue

According to the DBP, the ratio of the 'Other' category of revenue is expected to increase from 5.2 per cent of GDP in 2014 to 6.1 per cent of GDP in 2015 but decline to 4.1 per cent of GDP in 2016. In line with past years, the main items of revenue under this category are expected to remain capital transfers and market output.

The ratio of capital transfers is expected to increase to 2.7 per cent of GDP in 2015. Subsequently, this revenue component is expected to decline by 1.8 percentage points of GDP in 2016. This item of revenue is significantly influenced by changes in the expected inflows of EU funds. Indeed, the expected drop in 2016 reflects the fact that while revenue for 2015 includes EU funds forthcoming on the basis of the 2007-2013 programme as well as the 2014-2020 programme, revenue from 2016 includes only EU funds related to the latter programme. Nevertheless, since such changes in the inflows of funds from the EU are correspondingly reflected on the expenditure side of the budget no significant impact on the fiscal balance is exerted. Moreover, developments in the ratio of capital transfers also reflect adjustments, which, as the authorities explained, very often rely on own judgement. Thus, though to a limited extent, this introduces an element of uncertainty.

Market output is projected to increase to 2.6 per cent of GDP in 2015, declining marginally to 2.4 per cent in 2016. Developments in this category in 2015 reflect the expected increase in revenue from the IIP whereby Maltese citizenship is granted to foreign individuals and families if they satisfy a number of conditions. Indeed, this Programme is estimated to have a positive incremental impact of 0.7 per cent of GDP on the fiscal balance in 2015. The data made available indicates that in the first nine months of 2015 only around 40 per cent of the expected revenue from the IIP for 2015 was received. Nevertheless, the authorities ascertained that the annual estimate is considered attainable as it is based on reliable information on the submitted applications. This is particularly relevant since the incremental impact of this measure accounts for around one-fourth of the total revenue increase for 2015. However an element of uncertainty prevails in view of the lack of detailed information made available in respect of pending applications. Other items which contributed to the increase in market output for 2015, though to a much lesser extent than the IIP, included the market-oriented guarantee fee related to the energy sector.

Market output is projected to decrease by a mere 0.2 percentage points of GDP in 2016 mainly reflecting the guarantee fee mentioned earlier. The Ministry explained that this guarantee fee, amounting to 0.1 per cent of GDP, is a market-oriented fee in return for the temporary guarantee provided by government to the company. Meanwhile, in 2016, an increase of 0.1 percentage point is expected in the 'Other current transfers' reflecting additional EU funds related to the Internal Security Fund and the Asylum Migration Fund.

### 5.3 Assessment of expenditure projections

The total expenditure ratio is projected to decline marginally from 44 per cent of GDP in 2014 to 43.8 per cent in 2015. The DBP projects lower ratios to GDP for compensation of employees, social payments, interest expenditure and the other category of expenditure in 2015. These declines are partly offset by a notable rise of 0.5 percentage points of GDP in gross fixed capital formation as well as by increases in intermediate consumption and capital transfers as a share of GDP. In 2016, the total expenditure ratio is expected to decrease sharply to 41.2 per cent of GDP, mainly reflecting developments in investment outlays as well as in capital transfers. All the other categories of expenditure are also projected to decline as a share of GDP in 2016, except for the 'other' category of expenditure which is expected to remain stable.

In 2015, the net impact of discretionary expenditure measures (excluding the impact of the equity injection in the national airline) is expected to be deficit-increasing (0.3 percentage points of GDP), mainly reflecting the impact of the conditional children's allowance[11], the one-time additional bonus (targeted to individuals who did not benefit from the reduction in the income tax rates) and higher outlays on free child care centres. Increased expenditure, resulting from these and other measures, more than offsets the savings in social benefits resulting from measures earmarked to shift targeted groups from dependency on social benefits to employment. Additionally, the larger equity injection in the national airline (compared to 2014) has a further deficit-increasing effect of 0.3 percentage points of GDP in 2015.

In 2016, overall, discretionary expenditure measures[12] are expected to have a very marginal deficit-reducing impact (0.04 percentage points of GDP). This results mainly from one-time measures implemented in 2015, namely the conditional children's allowance and the one-time additional bonus. The measures aimed to increase labour market participation also result in additional savings in 2016. On the other hand, additional outlays are expected on various social cohesion, environmental and other measures announced in the Budget for 2016, whilst higher outlays are also projected on some initiatives introduced in the previous years. Since the last equity injection in the national airline is foreseen to take place in 2015, this has a deficit-reducing impact of 0.5 percentage points of GDP in 2016.

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[11] In the USP, this was considered as a permanent measure but is considered as a temporary one in the DBP as new measures were introduced aimed at the same target groups.

[12] Following the publication of the DBP, the MFIN informed the MFAC that some discretionary expenditure measures had been correctly classified in the fiscal projections but erroneously listed under social payments in Table 5a of the DBP. These measures have an incremental deficit-increasing impact of 0.06 percentage points of GDP and should be classified under capital transfers (0.01 percentage points of GDP) and the other category of expenditure (0.05 percentage points of GDP).

The outlook for developments on the expenditure side of the budget could also be influenced by the ongoing spending review being undertaken in different ministries and departments.[13] The MFIN highlighted that following the first comprehensive review of social security expenditure, which was reflected in measures announced in the Budget for 2015, a second major review was completed in 2015 focusing on another important expenditure component – the operations of Mater Dei Hospital. A number of recommendations have been made, aimed to contain the wage bill and certain components of intermediate consumption, and their implementation is currently under discussion. MFIN stated that the fiscal projections do not include the impact of these measures and thus any savings which materialise constitute an upside risk to the attainment of the expenditure targets.

**Table 5.3 Main Components of Expenditure**

| | 2014 | 2015 | 2016 |
|---|---|---|---|
| | per cent of GDP | | |
| Total Expenditure | 44.0 | 43.8 | 41.2 |
| *of which:* | | | |
| Compensation of employees | 13.3 | 13.1 | 13.0 |
| Intermediate consumption | 6.6 | 6.8 | 6.5 |
| Social payments | 12.6 | 12.3 | 11.9 |
| Interest expenditure | 2.9 | 2.6 | 2.4 |
| Subsidies | 1.3 | 1.3 | 1.2 |
| Gross fixed capital formation | 3.8 | 4.3 | 3.2 |
| Capital transfers | 1.2 | 1.4 | 0.9 |
| Other | 2.3 | 2.1 | 2.1 |

*Source: Malta Draft Budgetary Plan 2016, Ministry for Finance, October 2015*

Compensation of employees

In contrast to the increases registered in recent years, the DBP projects compensation of employees as a share of GDP to follow a gradual downward trend over the forecast period, from 13.3 per cent in 2014 to 13 per cent in 2016. The DBP does not include any discretionary measures under this expenditure component.

The MFIN officials explained that in line with previous practices, the forecasts for the wage bill reflect the BO's projections and targets for outlays on personal emoluments, which in turn are derived from micro data obtained at a departmental level. The EPD carries out a validation exercise of these projections, at an aggregate level, based on assumptions for the level of general government employment and for average wage growth, with the latter being based on information from collective agreements for employees within the general government sector. The EPD's projection thus constitutes a robustness check of the forecasts produced by the BO and this is considered as important, particularly given the large share of compensation of employees in total expenditure.

[13] For further details refer to box 1 in the MFAC Report entitled "An Assessment of the Medium Term Fiscal Strategy 2015-2018, Annual Report 2014 and Half Yearly Report 2015, published by the Ministry for Finance".

Based on the available information on actual developments in compensation of employees during January-June, the targeted wage bill for 2015 appears to be achievable. Similar conclusions are derived when comparing the actual cash outlays on personal emoluments for the first nine months to the corresponding annual target. The assumptions for average wage growth in 2015 and 2016, underpinning the projected wage bill, also appear to be reasonable in the context of the estimated impact on collective agreements. The forecasts for the wage bill are underpinned by increases in the employment level both in 2015 and 2016, with a larger increase expected in 2016. One expects additional human resources for Malta's EU Presidency in 2017. In the DBP, this is estimated to increase the wage bill by 0.04 percentage points of GDP. However, it was not possible to assess whether this provision is attainable due to lack of detailed information.

Overall, the assumed new recruitment in the general government sector in 2015 and 2016 is more realistic than those underpinning the forecasts presented in the USP and is broadly in line with the historical average increase. However, it is lower than that recorded in 2013 and 2014. The MFIN referred to a new Directive under the Public Administration Act (Cap.497)[14], which delegates authority for the filling of vacancies in the public service, and explained that this will also contribute to keep recruitment within the targets for the wage bill. This Directive should come into force on 1 February 2016. Given past slippages, some uncertainty still remains regarding the expected containment of new recruitment below that registered in the past two years.

Intermediate consumption

Intermediate consumption is projected to increase from 6.6 per cent of GDP in 2014 to 6.8 per cent in 2015, but then is expected to fall to 6.5 per cent in 2016. There are no discretionary measures included under this category of expenditure. The trajectory for intermediate consumption is distorted by the assumed developments in the capital expenditure component.

The projected increase in intermediate consumption in 2015 is somewhat higher than the average for the recent years, reflecting, amongst others, increased outlays on the child care for all initiative and on medicines and surgical materials, as well as in connection with the Commonwealth Heads of Government Meeting (CHOGM), the EU-Africa Summit and Expo-Milan 2015. Furthermore, a new expenditure item is included as from 2015 related to cover the outlays relating to the subcontracting of workers previously employed in the energy corporation, to work within government ministries and departments.

Based on the available information for actual developments in intermediate consumption over the first half of the year, the annual target for 2015 seems achievable. This is confirmed when comparing the actual outlays on operational and maintenance expenditure on a cash basis for the first three quarters to the corresponding target for 2015.

In 2016, the growth in intermediate consumption is expected to slow down, reflecting the base effects from 2015 of the aforementioned expenditure items as well as lower expenditure on electoral commission activities. These declines are partly offset by higher outlays related

[14] Directive No 9 Delegation of authority to conduct selection processes and make appointments in the Malta public service.

to Malta's EU Presidency 2017 as well as a further increase in the allocation for the subcontracting of workers in the energy sector.

Social payments[15]

Whereas between 2011 and 2014, the share of total social payments in GDP has remained broadly stable, a significant decline is projected over the forecast period from 12.6 per cent in 2014 to 11.9 per cent in 2016, thus providing an important contribution to the fiscal adjustment. This trajectory reflects developments in social benefits in cash, which accounts for around 95 per cent of total social payments. On the other hand, social transfers in kind are projected to remain broadly stable over the forecast period at around 0.6 per cent of GDP. The annual 2015 target for total social payments appears achievable in the context of actual developments during the first half of the year.

The social payments category includes various discretionary measures in both 2015 and 2016. The net impact of measures is deficit-increasing (0.3 percentage points of GDP) in 2015 but deficit-reducing (0.1 percentage points of GDP) in 2016. In 2015, the main deficit-increasing measures are the conditional children's allowance, the one-time additional bonus and higher outlays on the child care for all initiative. Other social cohesion measures, such as adjustments in certain pensions and the introduction of an in-work benefit, targeted to low-income households with children where both parents are working, also resulted in additional outlays on social payments. On the other hand, the new measures aiming to shift targeted groups from dependency on social benefits to employment (namely the tapering of social benefits and the youth guarantee scheme) together are expected to generate savings of 0.05 per cent of GDP in 2015.

In 2016, the expiry of temporary measures exerts a deficit-reducing impact of 0.2 percentage points of GDP. Furthermore, the tapering of benefits and the youth guarantee schemes are projected to generate additional savings of 0.05 percentage points of GDP. The impact of these measures is however partly offset by the deficit-increasing impact of various measures announced in the Budget for 2016, including the revision in the minimum pension, other adjustments in various pensions, the exclusion of children's income from means testing for social assistance, the extension of the eligibility for the in-work benefit, measures targeting the elderly who live independently, a hotel energy efficiency scheme, car-related environmental schemes and compensation to expropriation cases (involving amounts up to €50,000). In both 2015 and 2016, the impact of the 2006 pension reform is deficit-reducing but very marginal.

The Budget Speech for 2016 announced new measures affecting pensions, namely an increase in the contributory period from forty to forty-one years for people born after 1968 and incentives for private sector employees to continue working and forego their pension on retirement age, in return for an annual percentage increase in their pension rate for the rest of their life. The former measure has an impact in the long run, but the latter measure, once implemented, can result in immediate savings in pension outlays. The MFIN explained that the fiscal impact of this measure was not included in the forecasts presented in the DBP and thus this constitutes some upside risk.

[15] Includes also element related to the environment.

The MFIN explained that the fiscal impact of the measures affecting social benefits has been estimated on the basis of micro data from the Ministry for the Family and Social Solidarity, whilst the estimated impact of the energy efficiency and environmental schemes has been generated by the Ministry for Sustainable Development, the Environment and Climate Change and the Government Property Department has provided the estimate of the impact of the expropriation compensation initiative.

The fiscal impact of the conditional children's allowance has remained unchanged from the previous round of forecasts and as in the previous assessments seems reasonable in the context of data on persons under 18 years of age who are at risk of poverty. Similarly, the impact of the assistance to help the elderly live independently appears to be plausible given the demographic projections for the targeted cohorts. The impact of the tapering of benefits measure, the in-work benefit, the revision in the minimum pension and the expropriation compensation initiative are consistent with the estimated number of beneficiaries included in the Budget Speech for 2016. Further data to allow a more in-depth assessment of these measures was not available. The Ministry confirmed that the budgetary allocation for the live-in carers fund as well as for the car-related environmental schemes will be capped, which reduces significantly the risk surrounding these measures.

On the other hand, there is some uncertainty regarding the fiscal impact of the youth guarantee scheme. The MFIN provided details on the number of participants in the scheme, which is part-financed by the EU. There seems to be some overestimation of the fiscal impact of this measure, given the number of participants in the scheme during 2015. The MFIN explained that besides the direct effect of savings in social benefits from the participation of unemployed persons in the programme, the scheme also has an indirect effect through claimants who were not genuinely unemployed and who do not remain registered as unemployed in order to avoid participating in the scheme. The MFIN provided an estimate of this impact out of the total number of persons who left unemployment assistance to start employment during the year. However, there is some level of uncertainty surrounding this estimate. Furthermore, the implied number of additional participants in the scheme in 2016 may be ambitious. Thus, there is some risk that the expected savings generated from the youth guarantee scheme do not materialise fully.

A proper assessment of the fiscal impact of some measures could not be carried out due to lack of data. In particular, the number of beneficiaries for the one-time additional bonus, the child care for all initiative and those affected by the exclusion of children's income from means testing for social assistance was not available, whilst very scarce information was available on the hotel energy efficiency scheme.

As regards the methodology used to produce the projections for social benefits, the MFIN explained that as in previous years, forecasts on a cash basis are generated by the Ministry for the Family and Social Solidarity based on micro data. These projections are validated by the EPD using an alternative, more aggregate, approach, based on the number of beneficiaries and the average benefit rate, including the cost of living adjustment. Eurostat's population projections EUROPOP2013 are used as a basis for the assumptions for the number of beneficiaries. Such consistency checks are considered as a good practice and enhance the robustness of the budgetary projections, which is particularly important for major expenditure categories such as social benefits. As in the previous assessment of fiscal forecasts, the EPD provided a technical note explaining the main methodology and assumptions used to derive their projections for outlays on social benefits. Such documentation is also considered positively as it improves the transparency of the fiscal forecasting exercise and should be applied also for the forecasts of other major expenditure components.

Over the forecast period, social payments in cash are expected to grow at rates which are notably more contained than in recent years. The projected increases in retirement pensions and widows' pensions, which account for more than half the total social benefit outlays, are broadly in line with recent trends. Excluding the impact of the one-time payment of conditional children's allowance in 2015, outlays on children's allowance are projected to remain stable, which may well be plausible given demographic developments. On the other hand, the forecasts for outlays on social assistance seem conservative when compared to recent trends, due to the assumptions for the number of beneficiaries both in 2015 and in 2016. The assumed number of beneficiaries of short-term benefits and medical assistance also appear to be on the low side, when compared to the previous years, particularly in 2015. These assumptions reflect the optimism in the expected impact of the schemes aiming to increase labour market participation, particularly the youth guarantee scheme as discussed above. On the other hand, taking into account the cost of living adjustment, the assumptions for the average benefit rate for the different types of social benefits appear to be plausible.

Interest expenditure

Interest expenditure is projected to decline gradually from 2.9 per cent of GDP in 2014 to 2.4 per cent of GDP in 2016. The implicit interest rate on debt is expected to decline from 4.4 per cent in 2014 to 3.9 per cent in 2016. This is in line with the prevailing assumptions for interest rates underpinning the macroeconomic forecasts. As interest rates are expected to remain low risks emanating from rolling over of maturing stock and the new issue of debt is limited. The Treasury provided a very detailed note explaining latest international and local market developments on which the assumptions underpinning interest payments are based.

Based on the information provided, the projections for interest expenditure appear plausible.

Subsidies

Outlays on subsidies can be very volatile as they are highly influenced by government decisions on public service obligations and the restructuring of government-owned companies. The assessment of this component of expenditure was thus based on known risk factors, rather than a comparison to past trends. The DBP includes a discretionary measure under subsidies, namely the car scrappage scheme, with a minor deficit-increasing impact of 0.01 per cent of GDP in 2015[16]. Outlays in connection with this scheme are projected to fluctuate slightly between 2014 and 2016. Being a capped scheme, the risks associated with the impact of this measure are very much limited.

In absolute terms, subsidies are projected to increase in 2015, with the ratio to GDP remaining stable at 1.3 per cent. Based on actual developments in subsidies during the first six months of the year, the annual 2015 target for this expenditure category appears achievable. In 2016, subsidies are expected to fall slightly both in absolute terms as well as a share of GDP. This decline mainly reflects fluctuations in the capital component included under this expenditure category.

[16] This measure has been included with the discretionary measures for the first time in the DBP. In the USP, a provision for this scheme was included in the projections but it was not listed as a discretionary measure.

As in the USP, as from 2015, the projections include an allocation of 0.2 per cent of GDP reflecting the service level agreements with the energy utility for the provision of spare capacity for electricity. Another important subsidy item is the public service obligation related to public transport, which amounts to around 0.3 per cent of GDP during the forecast period. In absolute terms, subsidies related to public transport are expected to decrease in 2015, when the new private operator took over the service, and to increase in 2016. The provision for spare capacity for electricity and the public service obligation for public transport reflect the contractual agreements between government and the respective operator, thus limiting the uncertainty surrounding the forecasts for these subventions.

Other notable changes within the subsidies category during the forecast period concern outlays on the eco-reduction and agriculture support schemes. The provision for the eco-reduction scheme for 2015 is lower than in 2014. The MFIN explained that this is based on the expected utilisation by year end and is reflected into the 2016 forecasts, whilst the agriculture support scheme expires in 2015.

Overall, based on the available information, no specific risks were identified for the projections for subsidies.

Gross fixed capital expenditure

The DBP projects a sharp increase in capital outlays from 3.8 per cent in 2014 to 4.3 per cent in 2015, and a notable decline to 3.2 per cent in 2016. The capital expenditure component constitutes a major component under gross fixed capital formation.

The expected developments in capital outlays are highly influenced by the assumptions regarding the utilisation of EU funds. The increase in expenditure in 2015 reflects the final efforts to absorb the funds under the 2007-2013 financial programme which must be concluded by the end of the current year, and to a lesser extent the start of the implementation of projects financed from the 2014-2020 programme. Activity on the latter is expected to pick up significantly in 2016, whilst outlays on capital projects financed from national funds are also expected to be higher, but these only partly compensate for the closure of the previous EU financial programme.

The projected level of capital outlays for 2015 is very high compared to past trends, suggesting some risks of absorption capacity. Actual developments for gross fixed capital formation during the first six months are in line with the annual target, but using more updated data for capital expenditure from the Consolidated Fund for January-September indicates some downside risks. However, the MFIN has confirmed its expectation that all the allocated EU funds under the 2007-2013 programme will be fully utilised by the end of the year. If this does not materialize, it could have negative fiscal repercussions during the current year, since this constitutes the deadline for closure of the 2007-2013 programme.

Capital transfers payable

The capital transfers payable category is characterised by significant volatility and hence, the assessment of the plausibility of the projections for this expenditure component was made on the basis of known risk factors, rather than a comparison to past trends. It is pertinent to note that this expenditure category is also influenced by the apportionment of capital expenditure using past ratios.

Capital transfers payable are projected to increase by 0.2 percentage points to 1.4 per cent of GDP in 2015, and to decline to 0.9 per cent in 2016. These developments mainly reflect the transactions related to equity injections in the national airline. The capital injection in the national airline in the current year is substantially higher than in 2014, resulting in a deficit-increasing impact of 0.3 percentage points of GDP. Since this constituted the final equity injection, there is an incremental deficit-reducing impact of 0.5 percentage points of GDP in 2016[17]. Part of a loan granted to the airline in 2012, amounting to 0.1 per cent of GDP, is expected to be converted into equity in 2016. As in previous forecasting exercises, the MFIN does not expect this loan conversion to have any adverse impact on the general government budget deficit, on the assumption that the company successfully implements its restructuring plan. Otherwise this transaction could constitute an element of budgetary risk.

The DBP includes the discretionary measure related to the ex-gratia payment in relation to registration tax paid on imported vehicles for personal use between 1 May 2004 and 31 December 2008. Disbursements of this payment started in 2014, and amounted to 0.04 per cent of GDP. The remaining dues will be paid out to the eligible beneficiaries over a number of years, with the impact of this measure fluctuating slightly in 2015 and 2016.

Other category of expenditure

The share of the other category of expenditure in GDP is projected to decline from 2.3 per cent of GDP to 2.1 per cent in 2015 and to remain stable in 2016. The share of this component of expenditure in GDP has fluctuated between 1.8 per cent and 2.5 per cent in recent years. The other category of expenditure mainly consists of other current transfers payable. It also includes other marginal components, including acquisitions less disposals of non-financial assets. Revenue from sale of land, which is included as a one-off measure in the DBP, is recorded as negative expenditure under this item. The DBP does not include any discretionary measures under the other category of expenditure.

Major outlays included under other current transfers payable are the contribution towards the financing of church schools and EU own resources. The former is projected to follow a gradual upward trend over the forecast period, which is broadly in line with past trends. The EU own resources component is projected to increase in 2015 and also, but more gradually, in 2016. In 2014, these outlays include a one-off deficit-increasing item, amounting to 0.2 per cent of GDP, reflecting the higher contribution to the EU budget following the revision in historical Gross National Income (GNI) data. The 2016 projections include another transaction, with a deficit-increasing impact amounting to 0.1 per cent of GDP, resulting from the retroactive impact for 2014/15 extra payments consequent on the implementation of the 2014 Own Resource Decision.

Actual outlays on current transfers payable for the first half of the year indicate that the annual 2015 target is plausible. However, there is still a degree of uncertainty surrounding the projections for this category, as EU own resources are subject to some volatility and are influenced by revisions in GDP data and other factors beyond the control of government.

[17] The equity injections amounted to €15 million in 2014 and €43 million in 2015.

The projections for other current transfers for 2016 include a contingency reserve of 0.1 per cent of GDP, which satisfies the lower limit as set out in the Fiscal Responsibility Act. The aim of the contingency reserve is to reduce the risks surrounding the attainment of the fiscal targets, and its utilisation has to follow established procedures as set out in the Act. A provision for the contingency reserve had been included in the USP for 2015 but it is not included in the DBP. In the discussions with MFIN staff it transpired that MFIN could not rule out the possibility that recourse to this fund is actually made in 2015.

## 5.4 Assessment of debt projections

According to the DBP, the general Government gross debt is projected to decline from 68.3 per cent of GDP in 2014 to 66.6 per cent of GDP in 2015 and further down to 65.2 per cent of GDP in 2016.

The fall in the debt ratio expected in 2015 is projected on the basis of an expected nominal GDP growth rate that exceeds the projected growth in the debt level. The interest expenditure is expected to contribute to an increase of 2.6 percentage points to the debt ratio which is only partly offset by a primary surplus that exerts a downward pressure on the debt ratio of 1.1 percentage points. Additional upward pressure on the debt ratio is exerted from a positive stock-flow adjustment (SFA). However, these upwards pressures on the debt ratio are more than offset by the favourable impact on the debt ratio exerted from the projected economic growth.

**Table 5.4 Debt Dynamics**

| | **2014** | **2015** | **2016** |
|---|---|---|---|
| | | **per cent of GDP** | |
| General Government Gross Debt | 68.3 | 66.6 | 65.2 |
| change in the ratio | -1.4 | -1.7 | -1.3 |
| Contributions: | | | |
| 1. Primary Balance | -0.8 | -1.1 | -1.3 |
| 2. 'Snow-ball' effect | -0.7 | -1.5 | -1.5 |
| *of which:* | | | |
| Interest expenditure | 2.9 | 2.6 | 2.4 |
| Growth and inflation effect | -3.6 | -4.2 | -3.9 |
| 3. Stock-flow adjustment | 0.1 | 0.9 | 1.4 |

*Source: Malta Draft Budgetary Plan 2016, Ministry for Finance, October 2015*

As noted above, the SFA is expected to have an expansionary effect on the debt ratio in 2015. Since 70 per cent of the contribution of the IIP will be made to the National Development and Social Fund (rather than the Consolidated Fund) a positive SFA results. Moreover, the SFA also reflects the contribution to a special Malta Government Stocks Sinking Fund which exerts additional upward pressure on the debt. A similar effect on the SFA and the debt ratio is exerted from the assumption of an increase in aggregate cash balances by Government at the end of 2015 which reflects the expected timing of receipts in respect of EU grants. On the other hand, the expected repayment of part of a loan by the National Airline exerts a downward pressure on the debt ratio.

In 2016, the expected decline in the debt ratio also highly hinges on the expected growth in nominal GDP. Indeed, as in 2015, the nominal GDP growth rate is expected to put downward pressure on the debt ratio by around 4 percentage points. On the other hand, this is partly offset by a positive SFA as well as by the general Government deficit (as interest expenditure more than offset the primary surplus) which exert upward pressure on the debt ratio. The SFA is expected to have a relatively significant effect on debt developments for 2016. In fact, the SFA includes the contribution of the IIP to the National Development and Social Fund and the contribution to a special Malta Government Stocks Sinking Fund. These are not expected to be offset by other major items so that overall the SFA is expected to exert an upward pressure on the debt ratio of 1.4 percentage points of GDP.

Any risk factors emanating on the fiscal balance also apply to the actualisation of the debt projections. In particular, as developments in the debt ratio are highly dependent on the expected growth in nominal GDP, any macroeconomic risks also apply to the projected debt trajectory. Moreover, the SFA constitutes significant items exerting pressure both to increase as well as to decrease the debt ratio. As most of these items reflect a number of assumptions, there is an element of uncertainty to the realization of the debt ratio projections.

On a positive note, the share of government guaranteed debt to GDP, which adds an element of further risk to the debt forecasts, decreased from 16.8 per cent in 2014 to 14.3 per cent in the second quarter of 2015. On the other hand, a shift was noted from guarantees to the public sector to the non-public sector reflecting developments in the energy sector.

## 6. Comparison of MFIN budgetary forecasts with the fiscal projections generated by the European Commission in its Spring Forecast 2015 and the Central Bank of Malta in June 2015

This Section presents a comparison of the main fiscal projections presented in the DPB with those generated by the COM for 2015 and 2016 as published on the 5th May 2015[18] (Spring 2015 forecasts). The Ministry's fiscal projections are also compared with the most recent fiscal projections generated by the CBM and published in its Quarterly Review 2015:1 in June 2015[19].

Comparison with the COM Spring Forecasts 2015

While the COM's forecasts are based on the macroeconomic and fiscal data published by the NSO in March 2015 and April 2015 respectively[20], the forecasts generated by the MFIN take into account more updated national accounts and fiscal data, including revised data for 2014, GDP data for the second quarter of 2015 and fiscal data on a cash basis for the first nine months of the year. This may contribute towards divergences between the COM's and MFIN's budgetary projections for 2015 and 2016. In addition, differences between these two sets of budgetary forecasts may also result from different methodologies and assumptions

[18] European Economic Forecast Spring 2015, European Economy 2/2015, European Commission
[19] Central Bank of Malta, Quarterly Review 2015:1, pp. 81-85
[20] News Releases 46/2015 and 76/2015

used in the generation of these forecasts by the two institutions, including divergences in the underlying macroeconomic outlook underpinning the fiscal projections. Moreover, discrepancies in the projections for 2015 may also arise from variances in the estimated impact of discretionary measures announced in the Budget for 2015. Divergences in the 2016 projections also reflect the fact that the COM's fiscal projections are based on a no-policy change scenario while the MFIN projections take into account the discretionary measures included in the DBP.

Both the MFIN and the COM expect the budget deficit to decline between 2014 and 2016. However, the COM is projecting a more gradual downward trend, anticipating a deficit ratio which is 0.2 and 0.4 percentage points of GDP higher in 2015 and 2016, respectively, in relation to the MFIN forecasts. For 2015, this discrepancy reflects the COM's higher absolute level of deficit as well as a lower nominal GDP level. For 2016, the gap is explained by the discretionary measures and stronger economic growth underpinning the deficit ratio in the DBP.[21]

**Table 6.1 Comparison of Fiscal Projections**
**MFIN DBP Oct 2015 - COM Spring 2015**

| | 2014 | 2015 | 2016 | 2015 | 2016 |
|---|---|---|---|---|---|
| | Actual | MFIN DBP Oct 2015 | | COM Spring 2015 | |
| | | **per cent of GDP** | | | |
| General government balance | -2.1 | -1.6 | -1.1 | -1.8 | -1.5 |
| General government debt | 68.3 | 66.6 | 65.2 | 67.2 | 65.4 |
| | | **Eur millions** | | | |
| Taxes on production and imports | 1,097.8 | 1,158.7 | 1,235.8 | 1,164.3 | 1,218.0 |
| Current taxes on income and wealth | 1,155.4 | 1,193.4 | 1,266.3 | 1,213.6 | 1,264.4 |
| Social contributions | 560.3 | 594.9 | 619.5 | 583.8 | 607.5 |
| Capital transfers receivable | 203.4 | 243.7 | 94.8 | 239.9 | 168.8 |
| Other revenue | 310.8 | 379.7 | 386.3 | 353.8 | 331.8 |
| Total revenue | 3,327.7 | 3,570.4 | 3,602.8 | 3,555.3 | 3,590.5 |
| Compensation of employees | 1,053.5 | 1,106.9 | 1,170.0 | 1,096.5 | 1,140.4 |
| Intermediate consumption | 526.8 | 574.2 | 586.1 | 570.0 | 604.0 |
| Social payments | 1,004.1 | 1,037.6 | 1,069.8 | 1,048.0 | 1,086.0 |
| Interest expenditure | 230.9 | 223.0 | 218.4 | 227.0 | 231.5 |
| Gross fixed capital formation | 298.4 | 359.9 | 283.0 | 320.0 | 240.0 |
| Subsidies | 105.0 | 111.3 | 106.9 | 133.6 | 141.6 |
| Other expenditure | 277.7 | 291.5 | 270.6 | 313.0 | 280.0 |
| Total expenditure | 3,496.3 | 3,704.4 | 3,704.8 | 3,707.9 | 3,723.0 |
| General government balance | -168.6 | -134.0 | -102.0 | -152.5 | -132.5 |

*Source: Malta Draft Budgetary Plan 2016 and General Government data, Ministry for Finance, October 2015; European Commission's AMECO*

[21] The MFAC notes that in its Autumn Fiscal Forecasts, the COM has revised downwards its fiscal deficit-to-GDP projections for 2015 and 2016 respectively to 1.7% and 1.2%. However, this revision has not been incorporated in this assessment.

The following comparative analysis of the differences between the two sets of forecasts at a component level is conducted in absolute terms rather than as a share of GDP in order to eliminate the discrepancies that may arise as a result of a divergent macroeconomic outlook.

For 2015, the COM expects a lower level of total revenue than the MFIN coupled with a slightly higher level of expenditure. For the following year, the gap in the absolute level of deficit is wider between the two sets of forecasts as the COM forecasts a lower level of revenue as well as a significantly higher level of expenditure.

On the revenue side, for 2015, despite similar growth rates in nominal private final consumption expenditure, the COM forecasts a higher level of taxes on production and imports reflecting a higher implied elasticity than that underpinning the forecast by MFIN. Similarly, the COM's forecast for current taxes on income and wealth is substantially higher than that by MFIN, reflecting a higher implied elasticity which was also accentuated by the effect of a lower nominal GDP growth. In contrast, the COM projects lower social contributions when compared to MFIN projections, notwithstanding that both institutions expect developments in the labour market to follow similar paths.

On the expenditure side of the budget, for 2015, the COM projections for capital outlays and compensation of employees are notably lower than those of the MFIN. One notes that the gap in the forecasts for capital outlays exceeds that for capital transfers receivable indicating that the discrepancy does not only result from different assumptions concerning the absorption of EU funds but also for nationally-funded projects. On the other hand, the COM projects higher forecasts for subsidies and social payments as well as outlays under the 'other' category.

In 2016, the COM projected lower revenue from taxes on production and imports but a similar level of revenue from current taxes on income and wealth. In the case of the former, the discrepancy is explained by the fact that the projections by MFIN include the impact of discretionary revenue-increasing measures whereas projections by the COM reflect a no-policy change scenario. In the case of the latter, the stronger economic growth underpinning the MFIN's forecasts compensated for the impact of revenue-decreasing measures. For social contributions, the COM's lower forecasts are partly explained by revenue-increasing measures incorporated in MFIN projections and there are also some slight differences in expected labour market assumptions.

On the expenditure side, in 2016, the COM is projecting higher outlays for all main categories of expenditure accept for compensation of employees and gross fixed capital formation. The lower wage bill in the COM's forecasts reflects a base effect as well as more contained increase in 2016. For capital outlays, the difference is attributable to the base effect from 2015 as both institutions are expecting a similar contraction in investment spending. The COM is projecting a higher increase in intermediate consumption and social payments. The MFIN is projecting minor falls in subsidies and interest payments contrasting increases in these items of expenditure projected by the COM.

Both the MFIN and the COM expect the debt ratio to decrease in the forecast period. Nevertheless, the COM's debt ratio is expected to be 0.6 percentage points of GDP higher in 2015. This discrepancy fully reflects the COM's lower nominal GDP estimate which is used to compute the debt ratio. For 2016, while the MFIN projects the debt ratio to fall to 65.2 per cent, the COM expects a similar ratio of 65.4 per cent. This minor discrepancy reflects a lower absolute increase in the debt level projected by the COM which is offset by an anticipated lower nominal GDP growth.[22]

Comparison with the Central Bank of Malta fiscal projections June 2015

As in the case of the COM's forecasts, the CBM's forecasts are based on slightly less updated macroeconomic and fiscal data than those presented in the DBP and furthermore, discretionary measures for 2016 are not included[23].

At the back of a relatively more modest macroeconomic outlook for 2015 and 2016, the CBM is projecting a more gradual decline in the deficit ratio. Indeed, while MFIN is forecasting an improvement in the deficit ratio of 1 percentage point of GDP over 2015 and 2016, the CBM is projecting an improvement in the deficit ratio of 0.4 percentage points over this two-year forecast period. Similarly, the debt ratio is projected by the CBM to decline more cautiously to 66.1 per cent by 2016 compared to the MFIN's projection of 65.2 per cent, a gap amounting to nearly 1 percentage point of GDP.

## 7. Conclusion

The methodological processes by which the fiscal forecasts presented in the DPB were estimated have remained largely similar to the methods adopted in recent years. Thus, the positive characteristics of the process, namely the detailed level at which forecasts are generated, noted in earlier assessments remain evident. Nevertheless, there is scope for improvement particularly by addressing the significant fragmentation and disaggregation in the process which can lead to inconsistencies and increase the risk of forecast errors. Furthermore, the importance of formal methodological documentation explaining the methodologies and processes behind the fiscal projections is also iterated.

Against a background of strong economic growth, the DBP projects the budget deficit to decline from 2.1 per cent of GDP in 2014 to 1.1 per cent in 2016. The MFIN's fiscal targets are more ambitious than those presented in the COM's and the CBM's latest projections. However, the fiscal forecasts included in the DBP are based on updated information, including the discretionary measures announced in the Budget for 2016.

The MFAC report assessing the DBP's macroeconomic forecasts considers the projected growth for 2015 as feasible, but identifies the expected large increase in investment as the main element of uncertainty surrounding this forecast. The projected economic growth for 2016 is considered as plausible but subject to downside risks, in particular as regards the expected improved performance in exports. These risks may spillover to the fiscal forecasts.

It is noted that the fiscal consolidation presented in the DBP depends on cyclical tax revenue as well as the expiry of one-time measures implemented in 2015. At the same time, the Budget for 2016 announced various permanent deficit-increasing measures. Whilst this does not pose a risk to the attainment of the budgetary targets for 2016, it raises some concerns on

[22] The MFAC takes note that in its Autumn Fiscal Forecasts, the COM has revised downwards its public debt-to-GDP projections for 2015 and 2016 respectively to 65.9% and 63.2%. However, this revision has not been incorporated in this assessment.
[23] CBM's forecasts were published in June 2015 with a cut-off date of 20th May, 2015, while MFIN's forecasts were generated based on data available up to the 12th October, 2015.

the sustainability of the fiscal adjustment. Thus, the materialisation of the expected economic growth is critical to ensure a sustained improvement in the fiscal balance.

Furthermore, the fiscal adjustment in both 2015 and 2016 is significantly dependent upon substantial proceeds from the IIP. This introduces some risks in the projections as this source of revenue may be subject to some volatility.

On the other hand, the forecasts for tax revenue for 2015 appear plausible when compared to actual performance registered so far. Furthermore, the assessment based on estimated tax elasticities indicates some element of prudence. This could reduce the risk from any slippages from attaining the projected economic growth rates and the repercussions on tax bases. Overall, the estimated fiscal impact of revenue discretionary measures seems plausible, but there is some uncertainty regarding the impact of the income tax reform measures.

As regards expenditure, there are some risks of slippages, particularly in the wage bill and in social payments. The planned containment of recruitment below recent trends is subject to some uncertainty. In addition, outlays on social payments are based on assumptions for the number of beneficiaries for some benefits which appear to be conservative when compared to recent trends. There is also some uncertainty regarding the estimated savings from the youth guarantee scheme.

On a positive note, there may be some upside risks from the implementation of measures to combat tax evasion and to address pension issues as well as from the recommended measures resulting from the spending review in the health sector.

These risk factors also affect the assessment of the debt projections. In addition, the debt trajectory is underpinned by a number of assumptions which exert further uncertainty to its realisation. The share of guaranteed debt, which could constitute additional risk to the debt projections, has declined in 2015, but a shift was noted from guarantees to the public sector, to the non-public sector, reflecting development in the energy sector.

Based on this assessment exercise, the fiscal targets presented in the DBP are considered to be attainable. The 2015 targets appear achievable on the basis of actual performance during the year. However, overall, the projections, especially for 2016, are subject to some downside risks, particularly on the expenditure side of the budget.