Malta: Annual Report 2021

In line with Article 41 of the Fiscal Responsibility Act

Ministry for Finance and Employment

June 2022

Contents

1. Introduction

The Annual Report is prepared in accordance with Article 41 of the Fiscal Responsibility Act (Cap. 534) and is the eight Report since the enactment of this Act.

This Annual Report provides information on fiscal developments in 2021 and compares the outcomes with the strategic objectives and priorities outlined in the 2020 Medium-Term Fiscal Strategy and the fiscal targets as updated in the Draft Budget Plan for 2021, with justifications for such deviations. Furthermore, the Report presents an analysis of developments in public finances in 2021 in consideration of the principles and rules stipulated in the Fiscal Responsibility Act and in the context of the Government's European commitments in terms of the Stability and Growth Pact.

The analysis of the 2021 fiscal performance against the original targets should be considered against the persistence of the COVID-19 pandemic which necessitated an agile fiscal policy stance with the extension of various measures to support the economic recovery in 2021. It is pertinent to note that in 2021 the economy expanded by 10.4 per cent, marginally exceeding pre-pandemic levels of output,. The expansion was stronger than anticipated and also one of the strongest recoveries experienced in the European Union Member States, suggesting that the fiscal support measures were successful in strengthening the economic recovery. This level of support came at a fiscal cost, with the deficit, albeit declining, still standing at 8.0 per cent of GDP. This fiscal expansion was possible also in view of the relatively low debt burden which remained below 60.0 per cent of GDP.

The Annex of this report also includes a statistical overview of the final execution data for the indicators provided in the 2020 Medium-Term Fiscal Strategy and the 2021 Budget.

2. The 2021 targets as established in the 2020 Medium-Term Fiscal Strategy and the 2021 Draft Budget Plan

The establishment of targets for 2021 in the 2020 Medium-Term Fiscal Strategy (2020 MTFS) and the 2021 Draft Budgetary Plan (2021 DBP) were presented in accordance with the European System of Accounts (ESA) 2010 and data may still be subject to further revisions. Given that in 2020 the 2020 MTFS was published in December, less than two months after the 2021 DBP, it presents identical targets to the DBP. A separate assessment is therefore not required in this year's Annual Report.

Macroeconomic forecast presented in the DBP/MTFS for the year 2021 together with the latest data available for the same year are illustrated in Annex Table 1 while Table 2 shows the Government's final fiscal position for 2021 along with DBP 2021 / MTFS 2020 estimated targets.

In Autumn 2020, the Maltese economy was projected to grow by 5.0 per cent in real terms during 2021. The expected modest recovery was based on the assumption of an effective roll-out of the vaccination plan throughout the first and second quarters of the same year. It reflected noticeable anticipated improvements in private consumption and investment with a minimal growth in public consumption expenditure. Both exports and imports were expected to turn to a positive growth in 2021 with exports offsetting the growth in imports. The tourism sector was anticipated to recover only partially from the pandemic effects. Furthermore, the growth outlook for 2021, was expected to be underpinned by a noticeable productivity gain, moderate wage growth, a gradual increase in inflation and a positive current account balance. Due to the expected resumption in economic activity and sustained Government policies supporting income and employment, the growth composition was expected to be favourable for direct taxes, reflecting expected robust growths in wages and employment. This was further supported by an assumed recovery in corporate profits following the decline witnessed during the previous year.

Similarly, the 2021 DBP was based on the Government's comprehensive recovery plan to regenerate the Maltese economy upon the gradual reopening of the economy. The 2021 Budget was geared towards this recovery plan seeking to ensure that Malta would return to the path of economic growth witnessed in previous years.

Based on the macroeconomic projections, the revenue ratio was expected to increase by 1.3 percentage points to 39.0 per cent of GDP, mainly due to higher revenue from taxes on production and imports as domestic demand was projected to start its recovery supported by a partial recovery in tourism spending. Tourism was anticipated to reach 30.0 per cent of 2019 levels by the end of 2021. The tourist recovery was expected to almost triple tourist spending and contribute to a strong recovery in taxes on production and imports. The ratio of general Government expenditure to GDP was expected to decline mainly reflecting the decrease in subsidies as Covid-19 related measures were assumed to gradually be phased out during 2021. This included the extension of the economic regeneration initiatives in place in 2020 which was assumed to be allocated up to March 2021, in particular, the wage supplement scheme and the re-issue of the economic regeneration vouchers, the increase in the minimum threshold for Value Added Tax (VAT) exempt trading to reduce the administrative burden on Small and Medium-Sized Enterprises (SMEs) and the extended concession on the stamp duty payable on the transfer of family businesses.

Indeed, the budget balance, which in 2020 was estimated to have reached 9.4 per cent of GDP, was expected to improve notably to a deficit of 5.9 per cent of GDP in 2021. This also included an allocation of over 5.0 per cent of GDP towards gross fixed capital formation. In structural terms, the general Government deficit was expected to reach 4.3 per cent in 2021.

The debt-to-GDP ratio was expected to increase thus reaching the rate of 58.6 per cent in 2021. This was attributed to the projected primary deficit, interest payments and the stock flow adjustment which outweigh the expected positive impact from nominal growth. Developments in gross Government debt and the contributors to developments in the debt-to-GDP ratio expectations in 2021 were mainly on the back of the positive primary balance together with an increase in interest expenditure and the stock-flow adjustment (SFA) which is mainly due to the contribution to the Malta Government Stock sinking fund.

In July 2020, the 2021 fiscal recommendation for Malta by the European Council proposed that the necessary actions be taken, in line with the general escape clause of the Stability and Growth Pact, to effectively address the Covid-19 pandemic, sustain the economy and support the ensuing recovery. It was also recommended that, when economic conditions allow, to pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment. In November 2020, the Commission concluded that the draft budgetary plan of Malta was overall in line with the fiscal policy recommendations set out in the Council Recommendation of July 2020, and that most of the measures included in the draft budgetary plan supported the economic recovery against the background of considerable uncertainty.

3. Fiscal Developments in 2021

As the economic fall-out from the Covid-19 pandemic persisted in 2021, the fiscal impact remained sizeable in 2021, with measures having to be extended beyond what was anticipated in the 2021 DBP and the 2020 MTFS in order to continue mitigating the associated economic, social and health risks faced during this period. Nonetheless, the general Government balance for 2021 has slightly improved from a deficit of €1,237.7 million in 2020 to €1,166.4 in 2021. Total revenue increased by €635.2million, while expenditure amounted to €6,614.9, increasing by €563.8 million. As a share of GDP, the general Government balance was equivalent to a deficit of 8.0 per cent, improving by 1.5 percentage points over the deficit of 9.5 per cent recorded in 2020. The General Government debt increased by €1,332.2 million over 2020 and stood at €8,097.4 million. As GDP sustained a stronger than anticipated recovery, reaching the rate of 11.3 per cent growth in 2021, the debt-to-GDP ratio increased to 57.0 per cent from 53.4 per cent in 2020.

The general Government revenue increased by 13.2 per cent. Following a weak start for the year 2021, due to a resurgence of Covid-19 infections and the introduction of some restrictions, private consumption bounced back strongly supported by a resilient labour market. By the end of the fourth quarter of 2021, most components of consumption were higher than the levels recorded in the fourth quarter of 2019. These developments, coupled with a strong performance in the property market had a major effect on revenue from taxes on production and imports, which recorded an increase of 12.9 per cent in 2021, with a slight increase in the ratio-to-GDP of 0.1 percentage points to 10.8 per cent. Furthermore, sustained Government support measures together with the economic recovery, resulted in higher than estimated income for household and corporations and had a positive impact on revenue from current taxes on income and wealth, which increased by 20.3 per cent in 2021. In addition, revenue from social contributions increased by 8.9 per cent year-on-year, with the ratio-to-GDP standing at 6.3 per cent. Meanwhile, property income decreased by 3.6 per cent.

Although the ratio of general Government expenditure to GDP decreased by 0.8 percentage points to 45.5 per cent in 2021, aggregate expenditure has increased by €563.8 million. Expenditure increased over all components most notably towards compensation of employees, 'other' expenditure and intermediate consumption. The increase of 0.5 percentage points in the ratio of 'other' expenditure to GDP mainly reflects higher accrued EU Own Resources while the increase in intermediate consumption was largely due to higher intermediate consumption by EBUs, and additional spending in relation to elderly care and health care. Additionally, higher subsidies were allocated as energy support measures while social payments included measures started in the 2020 Budget to support pensioners by increasing their pension income, reducing tax on pensionable income and Government schemes to address past anomalies related to pensions. The increase in compensation of employees reflected both increases in EBUs and an increase in personal emoluments within central Government.

Table 3 disaggregates the changes to the 2021 forecasts between successive reports due to the impact of the actual outturn in 2020 (base effect) on tax revenue, the macroeconomic determinants (mainly the impact of the pandemic on the economy and the resultant budgetary impact), and other changes (mainly capturing the fiscal impact of Covid-related support measures).

3.1 Base effect from 2020

The expected turnout of 2020 tax revenue estimated back in Autumn 2020 turned out to be very close to actual developments as recorded in the most recent publication of public finance statistics. As a result, the base effect of 2020 on the fiscal variances between actual developments and the targets for 2021 presented in Autumn 2020 were relatively minor.

In 2020, the Government recorded a deficit of 9.5 per cent of GDP following a number of years in which the Government balance was in surplus with the latest being 2019 where a surplus of 0.6 per cent of GDP was recorded. As expected, the Covid-19 pandemic had a major impact on Government finances in Malta and necessitated a revised public finance strategy that resulted in higher than budgeted Government expenditure on subsidies and intermediate consumption in the form of health-related expenses and financial support to businesses to safeguard employment. On the other hand, the experienced decline in economic activity had a direct effect on revenue where income from all revenue components, other than property, were lower than originally Budgeted.

3.2 National policy response to Covid-19 and budgetary implications of economic developments

The stronger than anticipated economic recovery generally translated in a stronger than anticipated increase in tax revenue in 2021 compared to what was projected in Autumn 2020. This partly reflected a stronger than anticipated element of household consumption which bolstered taxes on production and imports. Furthermore, the buoyant property market activity was well beyond expectations in Autumn 2020 and contributed significantly to the higher than anticipated taxes on production and imports (namely due to the stamp duty on property) as well as to a stronger than anticipated capital gains which affected current taxes on income and wealth. Direct tax revenue in 2021 was also stronger than anticipated in Autumn of the previous year namely as a result of the stronger than anticipated recovery in corporate profits. Consequently, the better than expected economic recovery in Malta and abroad explains to a large extent the better than expected general Government revenue in 2021. It also contributed marginally to reduce expenditure pressures, namely in terms of lower unemployment benefits.

The worse-than-expected deficit outcome in 2021 is indeed predominantly explained by higher-than-projected expenditure mainly resulting from the extension of Covid-19 measures, in line with the recommendation of the European Council to support the economic recovery. Measures were extended as the second wave of the global virus hit the Maltese economy in the first half of 2021. In particular, measures relating to the settlement of deferrals of provisional tax, social security contributions of self-employed persons and VAT falling due in August 2020 up to and including December 2021 were extended, such that eligible taxes may be settled from May 2022 with no interest or penalties charged. Both the Covid-19 Business Assistance Programme and the reduced tax rates applicable on the transfer of immovable property were also extended and widened in scope. In addition, new incentives underpinning the Tourism Recovery Plan were put in place to support the tourism industry, which continued to be severely hit by the pandemic in 2021. The Government also continued supporting businesses by means of the wage supplement scheme. These measures translated into higher than anticipated expenditure particularly in intermediate consumption and subsidies. In addition, compensation of employees in General Government also exceeded budgetary targets, namely reflecting higher outlays by EBUs.

4. Compliance with the provisions of the Stability and Growth Pact and the Fiscal Responsibility Act

Malta is subject to domestic fiscal rules, as set out in the Fiscal Responsibility Act 2014 (FRA), and the EU fiscal rules. Both sets of rules envision scenarios in which the Government needs to use fiscal resources to respond to circumstances beyond its control, or alternatively, respond to a severe economic downturn.

This report is drawn up in the context of a severe economic downturn brought about by exceptional circumstances surrounding the Covid-19 pandemic which persisted in 2021. The pandemic called for the activation of the general escape clause of the Stability and Growth Pact, which granted Member States budgetary flexibility to deal with the crises by allowing them to temporarily depart from the budgetary requirements that would normally apply.

4.1 Exceptional Circumstances under the Stability and Growth Pact

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the Covid-19 outbreak, the current conditions permit the activation of the clause. Subsequently, this view was then supported by the European Council on 23rd March 2020. Whilst the general escape clause does not suspend the procedures of the Stability and Growth Pact, it allows Member States to temporarily depart from the adjustment path towards their medium-term budgetary objective, provided this does not endanger fiscal sustainability in the medium-term while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

In June 2020, the Council recommended Malta to take all the necessary measures, in line with the general escape clause; to effectively address the Covid-19 pandemic, sustain the economy and support the ensuing recovery. The Council further recommended Malta to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment. Similarly, the Council Recommendation on the economic policy of the euro area indicated that fiscal policies should remain supportive in all euro area Member States throughout 2021 and that policy measures should be tailored to country-specific circumstances and be timely, temporary and targeted.

On 17 September 2020, the Commission, through its Annual Sustainable Growth Strategy announced that the general escape clause was to remain active in 2021 calling upon Member States to continue to provide targeted and temporary fiscal support throughout 2021 while safeguarding fiscal sustainability in the medium-term. After the submission of the 2021 Draft Budgetary Plans, the Commission established that the Draft Budgetary Plan of Malta was overall in line with the fiscal policy recommendations adopted by the Council on 20 July 2020, and that most of the measures included in the plan supported economic activity against the background of considerable uncertainty.

On 19 February 2021, the Recovery and Resilience Facility under the regulation (EU) 2021/241 came into force with the aim of providing financial support for the implementation of reforms and investment and to help public finances to return to more favourable positions in the near term. In return, the establishment of such facility will contribute to strengthening sustainable public finances, growth and job creation in the medium and longer- term.

5. Statistical Annex

Macroeconomic Forecast vs Estimates for 2021

(growth %)

Table 1

	DBP 2021/ MTFS 2020*	Actual 2021**
Gross Domestic Product (at current Market Prices)	6.4	12.4
Private Final Consumption Expenditure	5.0	8.0
General Government Final Consumption Expenditure	1.1	10.5
Gross Fixed Capital Formation	8.8	20.3
Exports of Goods and Services	6.8	10.2
Imports of Goods and Services	5.7	9.1
Compensation of Employees	4.8	8.1
Operating Surplus and Mixed Income	-2.2	15.2
Tourism Earnings	167.8	91.9
Employment	2.3	2.8
Inflation	1.3	0.7

*Source: 2021 Draft Budgetary Plan (October 2020) and Malta: Medium-Term Fiscal Strategy 2020-2023 (December 2020)

**Source: NSO News Release 097/2021 Gross Domestic Product Q1/2021

Actual Fiscal Developments vs Target for 2021

European System of Accounts

(Millions of Euro)

Table 2

	DBP 2021/ MTFS 2020*	Actual 2021**
Revenue	**5,201.5**	**5,448.6**
Components of revenue		
Taxes on production and imports	1,663.3	1,575.7
Current taxes on income and wealth	1,857.5	2,029.8
Capital taxes	24.4	29.3
Social contributions	819.4	914.9
Property income	82.9	81.4
Market Output and Output for own final use	434.2	548.2
Other revenue	319.8	269.2
Expenditure	**5,994.0**	**6,614.9**
Components of expenditure		
Compensation of employees	1,667.7	1,769.6
Intermediate consumption	1,220.8	1,359.3
Social payments in cash and in kind	1,387.6	1,389.5
Interest expenditure	157.0	212.0
Subsidies	405.4	685.7
Gross fixed capital formation	676.5	607.4
Capital Transfers Payable	115.3	161.9
Other expenditure	363.7	429.6
General Government Balance	**-792.5**	**-1,166.3**
Primary Balance	**-635.5**	**-954.4**

*Source: 2021 Draft Budgetary Plan (October 2020) and Malta: Medium-Term Fiscal Strategy 2020-2023 (December 2020)
** Source: NSO NR 067/2022

General Government Budgetary Developments in 2021

Divergence from previous forecasts

(Millions of Euro)

Table 3

	ESA Code	Divergence due to outturn in *t-1*	Divergence due to updated macro-economic projections	Other revisions	**Total forecast revision**
		DBP 2021 compared to USP 2022			
Net lending (+)/net borrowing (-)					
1. **General Government**	S.13	**-23**	**305**	**-657**	**-374**
2. Central Government	S.1311	-23	305	-657	-374
3. State Government	S.1312	-	-	-	-
4. Local Government	S.1313	0	0	0	0
5. Social Security funds	S.1314	-	-	-	-
For the General Government					
6. **Total Revenue**	TR	**-23**	**282**	**-12**	**247**
Of which					
Taxes on Production and Imports	D.2	-36	81	-132	-88
Current Taxes on Income, Wealth, etc.	D.5	-18	240	-50	172
Capital Taxes	D.91	4	-30	31	5
Social Contributions	D.61	28	-9	76	95
Property Income	D.4	0	0	-1	-1
Other [(a)]		0	0	63	63
7. **Total Expenditure**	TE	**0**	**-23**	**644**	**621**
Of which					
Compensation of employees	D.1	0	0	102	102
Intermediate Consumption	P.2	0	0	139	139
Social Payments	D.6	0	-23	25	2
Of which		0	0	0	0
Unemployment expenditure		0	-23	0	-23
Interest Expenditure	D.41	0	0	55	55
Subsidies	D.3	0	0	280	280
Gross Fixed Capital Formation	P.51	0	0	-69	-69
Capital Transfers	D.9	0	0	47	47
Other [(b)]		0	0	66	66

Notes:

[(a)] P.11 + P.12 + P.131 + D.39rec + D.7rec + D.9rec (other than D.91rec).
[(b)] D.29 + D.4pay (other than D.41pay) + D.5pay + D.7pay + P.5M + NP + D.8.

Cyclical Developments in 2021

(percentage points of GDP [1])

Table 4

	DBP 2021/ MTFS 2020*	Actual 2021**
General Government Balance	-5.9	-8.0
One-off and other temporary measures[2]	0.1	0.0
General Government Balance net of One-offs	-6.0	-8.1
Output Gap Estimates	-3.5	-1.8
Cyclically-Adjusted Budget Balance	-4.3	-7.2
Structural Balance	-4.3	-7.2
Structural Adjustment	2.5	-0.9

(1) GDP for 2021 used in the 2020 MTFS and the 2021 DBP was an estimate, while GDP for 2021 used in the 2022 USP was actual

(2) A plus sign means deficit-reducing one-off measures

*Source: 2021 Draft Budgetary Plan (October 2020) and Malta: Medium-Term Fiscal Strategy 2020-2023 (December 2020)
** Source: Malta: Update of Stability Programme 2022-2025 (April 2022)

Consolidated Fund

Actual Fiscal Developments vs Budget Targets for 2021

(Millions of Euro)

Table 5

	Approved Estimate*	Actual**	Variance
Recurrent Revenue	**5,198.0**	**5,394.5**	**-196.5**
Tax Revenue	**4,599.0**	**4,896.7**	**297.7**
Indirect Tax Revenue	*1,719.0*	*1,606.4*	*-112.6*
Customs and Excise Duties	344.0	300.3	-43.7
Licences, Taxes, and Fines	381.0	336.1	-44.9
Value Added Tax	994.0	970.0	-24.0
Direct Tax Revenue	*2,880.0*	*3,290.3*	*410.3*
Income Tax	1,793.0	2,090.8	297.8
Social Security	1,087.0	1,199.5	112.5
Non-Tax Revenue	**599.0**	**497.8**	**-101.2**
Fees of Office	122.0	92.4	-29.6
Sales	42.1	36.5	-5.5
Reimbursements	4.6	4.0	-0.5
Central Bank of Malta	33.0	33.0	0.0
Rents	33.7	31.2	-2.5
Dividends on Investments	44.1	55.3	11.2
Repayment of Interest on Loans	0.3	0.0	-0.3
Grants	263.5	160.4	-103.1
Miscellaneous	55.7	84.9	29.2
Total Expenditure	**5,954.5**	**6,636.8**	**682.2**
Recurrent Expenditure	**4,971.9**	**5,718.1**	**746.2**
Personal Emoluments	1,042.9	1,097.1	54.2
Operations and Maintenance	245.8	279.5	33.7
Programmes and Initiatives	3,042.3	3,653.7	611.3
Contributions to Government Entities	640.9	687.8	47.0
Interest Payments	**189.8**	**183.8**	**-6.0**
Capital Expenditure	**792.8**	**734.9**	**-57.9**
Government Consolidated Fund Balance	**-756.5**	**-1,242.3**	**-485.7**

*Source: Financial Estimates 2021, Ministry for Finance and Employment; as announced in October 2020

**Source: NSO News Release 053/2022 - Government Finance Data: January-December 2021

Actual General Government Public Debt vs Budget Targets for 2021

(Millions of Euro)

Table 6

	Approved Estimate*	Actual**	Variance
General Government Public Debt	**8,562.4**	**8,284.4**	**-278.0**
Composition of Gross Public Debt			
Malta Government Stocks	6,530.8	6,265.1	**-265.7**
Malta Government Retail Savings Bonds	476.0	474.9	**-1.1**
Treasury Bills	582.0	576.9	**-5.1**
Domestic Loans with Commercial Banks	0.0	0.0	**0.0**
Foreign Loans	420.7	420.7	**0.0**
EBU's/Local Councils	167.6	168.8	**1.3**
Currency	100.4	93.5	**-6.9**
ESA Re-Routed Debt	284.9	284.4	**-0.5**

*Source: Treasury

**Source: Treasury / NSO News Release 070_2021

The Dynamics of Government Debt for 2021

(percentage points of GDP [1])

Table 7

	DBP 2021/ MTFS 2020*	Actual 2021**
Percentages of GDP		
Gross debt	58.6	56.4
Change in gross debt ratio	3.6	12.7
Contributions to changes in gross debt		
Primary balance	4.7	6.5
Snowball Effect	-2.1	-4.4
Interest expenditure	1.2	1.4
Real GDP growth	-2.6	-5.0
Inflation Effect	-0.7	-0.9
Stock-flow adjustment	1.1	1.0
p.m. implicit interest rate on debt	2.3	3.0

Developments in the debt- to-GDP ratio depend on:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} \cdot \frac{i_t - y_t}{1 + y_t} \right) + \frac{SFA_t}{Y_t}$$

where t denotes a time subscript, D, PD, Y and SFA are the government debt, primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth.

[1] GDP for 2021 used in the 2020 MTFS and the 2021 DBP was an estimate, while GDP for 2021 used in the 2021 USP was actual

*Source: 2021 Draft Budgetary Plan (October 2020) and Malta: Medium-Term Fiscal Strategy 2020-2023 (December 2020)

** Source: Malta: Update of Stability Programme 2022-2025 (April 2022)