MFAC

MALTA FISCAL ADVISORY COUNCIL

ANNUAL REPORT AND STATEMENT OF ACCOUNTS 2017

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ANNUAL REPORT

AND

STATEMENT OF ACCOUNTS

2017

MALTA FISCAL ADVISORY COUNCIL

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28 March 2018

The Hon Prof Edward Scicluna B.A. (Hons) Econ, M.A. (Toronto),
Ph.D (Toronto), D.S.S (Oxon) MP
Minister for Finance
Maison Demandols
South Street
Valletta VLT 2000

Dear Minister

LETTER OF TRANSMITTAL

In terms of article 58 of the Fiscal Responsibility Act, 2014 (Cap 534), I have the honour to transmit to you a copy of the Annual Report of the Malta Fiscal Advisory Council for the year 2017.

In terms of article 56 of the Fiscal Responsibility Act, I am also transmitting a copy of the audited accounts of the Council for the financial year ended 31 December 2017.

Yours sincerely

Rene Saliba
Chairman

Vision

To contribute to stronger fiscal governance in Malta and offer assurance about the quality of the official economic and fiscal projections, and about fiscal sustainability, through independent analysis and advice.

Mission statement

The Malta Fiscal Advisory Council (MFAC) is an independent institution established under the Fiscal Responsibility Act (2014) which has the primary objective to contribute to sustainable public finances and sound economic policy making in Malta.

The MFAC seeks to carry out its statutory responsibilities by:

i. Assessing the plausibility of the Government's macroeconomic forecasts and fiscal projections and endorsing them as it considers appropriate;

ii. Assessing whether the fiscal stance is conducive to prudent economic and budgetary management;

iii. Assessing the extent to which the conduct of fiscal policy in Malta is consistent with the country's fiscal commitments as a member of the European Union;

iv. Assessing the extent to which the annual budgetary plan and medium term fiscal plan comply with the Fiscal Responsibility Act and the Stability and Growth Pact;

v. Assessing the extent to which the fiscal and economic policy objectives proposed by the Government are being achieved;

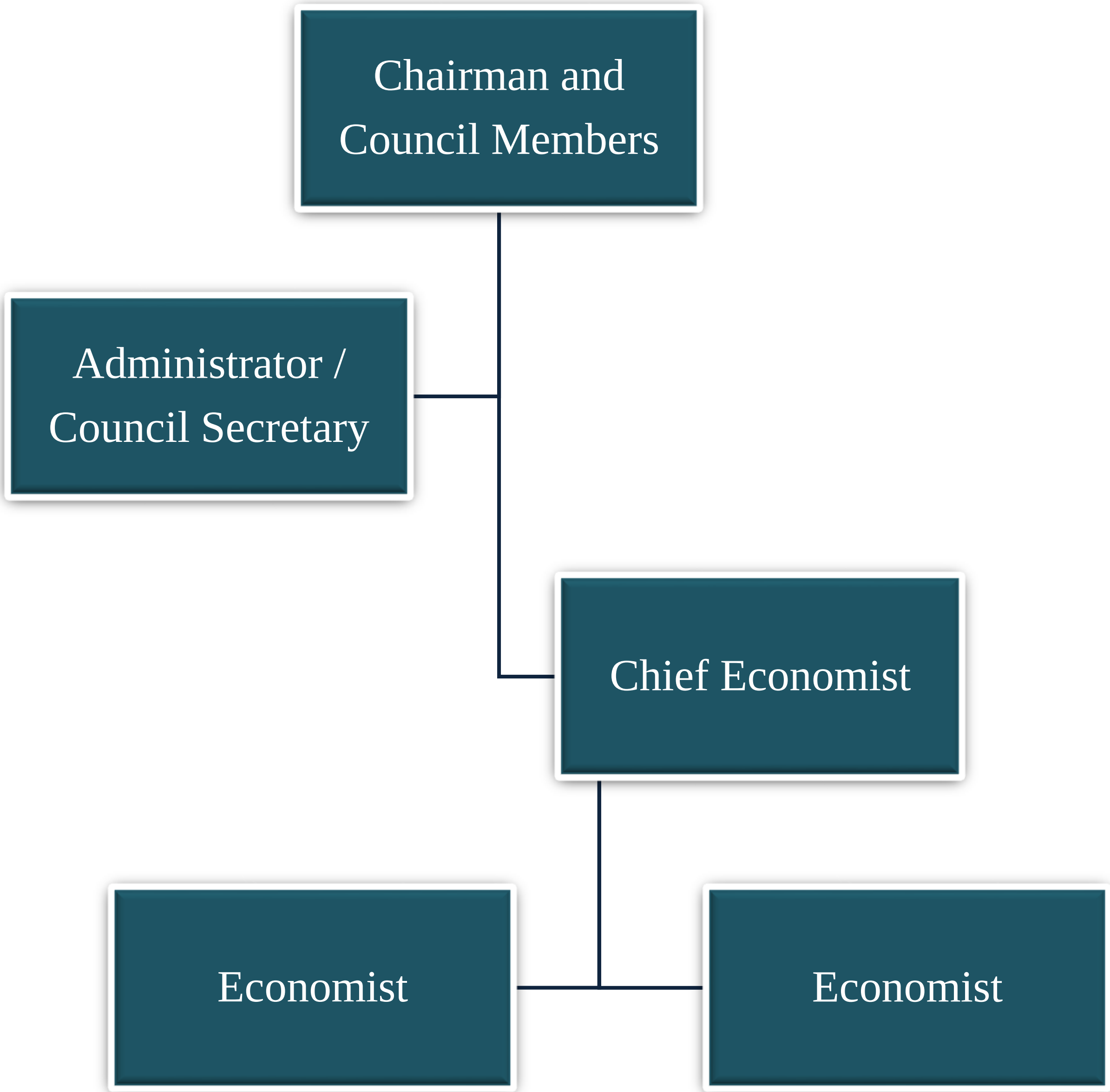
vi. Determining whether exceptional circumstances, which would allow for a departure from the announced fiscal plans, exist or have ceased to exist;

vii. Issuing opinions and formulating recommendations in the areas of public finances and economic management;

viii. Advising the Government and the Public Accounts Committee concerning the maintenance of fiscal discipline; and

ix. Disseminating information and analysis to the public to increase awareness and understanding of economic and fiscal issues.

Organisation chart



Council members and staff

From left to right: **Mr Malcolm Bray** (Chief Economist), **Dr Carl Camilleri** (Council Member), **Ms Doriette Camilleri** (Council Secretary), **Mr Rene Saliba** (Chairman), **Dr Ian Cassar** (Council Member), **Mr Kurt Davison** (Economist), **Mr Christian Xuereb** (Economist).

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Chairman's statement

I present with pleasure the third Annual Report of the Malta Fiscal Advisory Council (MFAC) which covers the activities performed during 2017. The Annual Report also provides an account of the state of play with respect to the MFAC's recommendations addressed to the Ministry for Finance. Moreover, two special themes in this year's edition focus on the new legislation on Government borrowing and on the pension system in Malta. I believe the content offers useful insight about issues which are relevant for the conduct of sound fiscal policy in Malta.

I am satisfied that the institution's output, governed by the Fiscal Responsibility Act, continues to be well received. This is confirmed by the increasing attention paid by the local authorities to the views of the Fiscal Council, and the due consideration given to the MFAC's perspectives by the international institutions.

Throughout 2017, the exchange of views with senior officials from the Ministry for Finance has become more regular, particularly through a calendar of regular dialogue meetings and exchange of correspondence. The Ministry has also forwarded its first official response to the recommendations made by the MFAC, first through verbal exchanges and later in writing, which is being reproduced in this Annual Report. The MFAC understands that the Ministry is also actively considering starting to publish its responses to the MFAC's recommendations in the Ministry's publications during the year. The Council believes that this process is another important milestone in Malta's fiscal governance and augurs well for greater fiscal transparency and accountability. Such regular meetings, coupled with the public reaction by the Ministry for Finance, would allow for a fruitful inter-organisational dialogue, with the primary aim being that of maintaining sustainable and high quality public finances.

The MFAC also continued to maintain regular dialogue with international institutions, such as the European Commission, the International Monetary Fund and credit rating agencies. It is with satisfaction that I note that notwithstanding its young history, the MFAC has quickly built a good reputation as being an authoritative institution in relation to the assessment of macroeconomic and fiscal developments in Malta, and the identification of key issues. The MFAC's professionality is supported by the MFAC's independence, granted to it by the legislation.

Through its participation in the activities of the Network of European Union Independent Fiscal Institutions and membership of the Network's working groups, the MFAC continues to gain further experience and improve its output, in line with international best practices relating to fiscal institutions. So far, the Council's work has focused mainly on the series of regular standard publications containing the analysis necessary to endorse the official macroeconomic and fiscal projections, and to issue an opinion on the thrust of fiscal policy. In this respect, it is positive to note that, to date, the macroeconomic and fiscal projections presented by the Government have always been considered as within the endorsable range of the MFAC. Plausible macroeconomic and fiscal projections are of paramount importance to ensure that policy making is tailored to the prevailing economic conditions. The Council also notes with satisfaction that the sustained policy of growth-friendly fiscal consolidation has resulted in the achievement of the Medium-Term Objective of a structural balance well before the target date of 2019.

Going forward, it is the Council's intention to expand its assessments further, and establish closer links across general government, with a view to deepening its insight on the state of public finances. The objective is to focus more on specific areas bearing important implications for fiscal sustainability in Malta. This on the back of the legal provisions enabling the Council to request data as necessary, to carry out its functions. The Council also looks forward to the possibility of assuming a more explicit role in the risk assessment of public finances, which is envisaged as part of forthcoming proposed amendments to the Fiscal Responsibility Act, to bring the local legislation fully in line with the requirements of the EU fiscal framework.

At the same time, the Council feels that although over the past years the amount of public information on the conduct of Malta's fiscal policy has expanded significantly, it seems that such information might not have filtered sufficiently across stakeholders. In this context, the MFAC believes there is scope for increasing the engagement with Parliament. At present, the MFAC's relationship with Parliament is manifested through the laying on the Table of the House of Representatives some of the MFAC's publications, as well as the possibility for the Chairperson of the Public Accounts Committee to request the Chairperson of the MFAC to give evidence. While this is a healthy process, there appears to be scope for greater interaction with Members of Parliament, particularly through Parliamentary Committees. The MFAC's independent analysis of macroeconomic and fiscal developments, as well as of near-term and long-term prospects can serve as a useful input in the discussions relating to economic and fiscal issues. This would also help raise more awareness about long term issues and contribute to orient fiscal policy towards a more structured medium-term framework, thereby facilitating better fiscal planning and more stability in public finances over the medium to long term horizon. This would also help to foster a more informed public opinion on fiscal policy issues.

The MFAC considers positively the higher number of invitations received from local media channels for the Council to express its views in relation to topics falling under its mandate. The co-organisation of a seminar with the European Commission Representation in Malta, in October 2017, is another example how the MFAC has tried to increase its visibility during the year and to communicate the importance of sound macroeconomic management and fiscal consolidation among relevant stakeholders. The Council intends to accentuate its efforts to do more in this respect. The MFAC appreciates that compliance with fiscal rules and procedures related to the European fiscal governance framework may be complex topics and still relatively new for Malta. To this effect, the Council intends to explore further ways how to increase awareness about these issues among stakeholders and the public in general, including possibly by holding training sessions with journalists to facilitate a better understanding of the EU fiscal framework and related policy issues.

The MFAC considers as very positive that the country has achieved its Medium-Term Budgetary Objective of structural balance well ahead of the original target set for 2019, and has also lowered the debt-to-GDP ratio significantly below the 60% threshold. The Council welcomes the full compliance with the national fiscal rules and the broad compliance with European fiscal rules. The Council invites the Government to aim for full compliance also with the European fiscal rules, particularly by focusing greater attention on the requirements of the expenditure benchmark in the budgetary process.

Looking ahead, it is important that such positive fiscal developments are not unwound, due to unsustainable expenditures. The Council invites the Government to remain vigilant, to ensure that the planned fiscal surpluses and further declines in the debt ratio, envisaged for the period 2018 to 2020, are indeed achieved. A consistent fiscal consolidation strategy and healthy public finances are key to a sustained strengthening of the country's economic fundamentals. The Council therefore joins other international institutions in advocating for the gradual build-up of fiscal buffers, in order to be better geared to adequately face future ageing related costs, as well as to withstand other possible fiscal shocks which may impact from time to time. The prevailing benign economic conditions should be used to intensify efforts to carry out further necessary structural reforms and to continue to lower the public debt. Such efforts will prove very instrumental in sustaining the country's resilience and will yield substantial long term benefits.

Finally, on behalf of the Council members, I wish to express my appreciation and gratitude for the support and collaboration extended by all stakeholders to facilitate the MFAC's activities. More specifically, the constructive dialogue with the Ministry for Finance and the information made readily available by the Economic Policy Department and the Budget Office of the Ministry as well as the National Statistics Office, have been very instrumental for the smooth preparation of the MFAC's regular reports. I would also like to thank my fellow members of the Council and the staff for their professional work carried out throughout the year. Through their dedication and effort, it was possible for the MFAC to carry out its functions effectively and efficiently.

On a personal note, 2017 will be the last full year of my service at the MFAC. During 2018 I will be relinquishing my role of Chair because I will be taking up another equally challenging role at a new public institution. The past three years have been a highly rewarding and learning experience for me. Setting up a new institution from scratch is never an easy task but the journey was made far easier through the extremely generous support and collaboration extended to the MFAC by various entities. In particular, I am deeply indebted to the Ministry for Finance, the Central Bank of Malta and the National Audit Office for their sustained support and assistance throughout the capacity building process. My sincere gratitude is also due to my fellow Council members and MFAC staff for their strong commitment and professionalism as well as their constant support and cooperation. The MFAC is still a young institution but I believe that the basis has been adequately set for it to grow in stature and competence and thus contribute more fully to better fiscal governance and sound policies for sustainable public finances.

Rene Saliba
Chairman

Chapter 1
Activities of the MFAC during 2017

Council meetings

In 2017, the MFAC held twelve formal Council Meetings to discuss various administrative and operational issues. These meetings mainly focused on the annual work programme, financial control, human resources, the planning of official travel and training programmes and the relative outcome. Extensive discussions were also held on the assessment of macroeconomic forecasts, the fiscal policy thrust and public finance conditions, as part of the endorsement process, as well as on the Council's recommendations to the Ministry for Finance regarding fiscal policy issues.

Other events and meetings in Malta

MFAC and European Commission workshop

In line with the objective of increasing transparency, providing information on fiscal policy and providing a means for the exchange of views across stakeholders, the Council, in collaboration with the European Commission Representation in Malta, held a conference on 23 October 2017, which focused on 'The Role of Fiscal Policy for Sustainable Economic Growth'. The Seminar provided the opportunity to discuss key issues relating to the conduct of fiscal policy and how these affect economic growth and sustainability. This was the first conference that the MFAC hosted since the start of its operation in 2015. The list of discussants and respective presentations given during the conference are shown in Box 1.1 together with photos taken during the event.

The event initiated with a welcome address by Dr Elena Grech, Head of the European Commission Representation in Malta and an opening address by the Honourable Prof Edward Scicluna, Minister for Finance. The Minister mainly advocated the important role of fiscal policy in determining growth and the importance of constant surveillance by independent bodies.

The first presentation was delivered by Mr Alfred Camilleri, Permanent Secretary of the Ministry for Finance, who gave an overview of the main goals of fiscal policy in Malta, and the salient features of Malta's budgetary framework with reference to recent changes aimed at strengthening adherence towards budgetary targets and achieving growth-friendly fiscal consolidation. Mr Ralph Schmitt-Nilson, from the Commission's Directorate General Economic and Financial Affairs, presented an overview of the fiscal rules under the Stability and Growth Pact and the European Commission's assessment of compliance with these rules for the euro area, focusing specifically on Malta.

Mr Rene Saliba, Council Chairman, gave an overview of the MFAC's assessment of the fiscal position and the fiscal risks as well as the challenges and opportunities as assessed by the Council. Then, Mr John Farrugia, Senior Economist and Mr Owen Grech, Coordinator Econometric Modelling, representing the Central Bank of Malta, discussed the medium-term sustainability of Malta's public debt.

The final presentation was by Mr José Luis Escrivá, Chair of the Network of Independent Fiscal Institutions (IFIs) and President of Spain's Independent Authority for Fiscal Responsibility (AIREF), which focused on the key deliverables of IFIs. In addition, he focused on the value added and comparative advantages of national IFIs, as well as the main challenges they face to perform their role within the EU's fiscal framework.

The final part was a panel discussion on the role of fiscal policy in structural reform process, particularly how it can be more efficient and effective as a tool to facilitate economic growth and sustainable public finances. Mr Malcolm Bray, Chief Economist at the MFAC, acted as the moderator in the discussion, while the panel members included; Mr Ralph Schmitt-Nilson, Mr José Luis Escrivá, Dr Philip Von Brockdorff (Head of Department of Economics University of Malta), Mr Godwin Mifsud (Director General Ministry for Finance) and Ms Stephanie Vella (Visiting Assistant Lecturer University of Malta).

Box 1.1 Presentations and photos during conference

Fiscal policy objectives and the budgetary process in Malta	Mr Alfred Camilleri
The European Commission's assessment of compliance with fiscal rules for the euro area countries	Ralph Schmitt-Nilson
Fiscal achievements and challenges – the view of the Malta Fiscal Advisory Council	Mr Rene Saliba
The sustainability of Malta's public debt	Mr John Farrugia and Mr Owen Grech
The role of National Independent Fiscal Institutions in the EU Fiscal Framework	Mr José Luis Escrivá
Panel discussion: The role of fiscal policy in the structural reform process, what can we do better?	Mr Ralph Schmitt-Nilson, Mr José Luis Escrivá, Dr Philip Von Brockdorff, Mr Godwin Mifsud and Ms Stephanie Vella

Honourable Prof. Edward Scicluna, Minister for Finance

Mr Alfred Camilleri, Permanent Secretary of the MFIN

Mr Ralph Schmidt-Nilson, Directorate General Economic and Financial Affairs

Mr Rene Saliba, Chairman of the MFAC

Mr Owen Grech, Coordinator Econometric Modelling at the CBM

Mr José Luis Escrivá, Chair of the Network of Independent Fiscal Institutions (IFIs) and President of Independent Authority for Fiscal Responsibility (AIREF)

Moderator: Mr Malcolm Bray, Panel: Ralph Schmidt-Nilson, Mr José Luis Escrivá, Ms Stephanie Vella, Mr Godwin Mifsud and Dr Philip Von Brockdorff

Ministry for Finance

Technical meetings were held with the Ministry for Finance to discuss and exchange views on the preliminary macroeconomic projections, as well as to help clarify the assumptions used. Other meetings were held to discuss recurrent fiscal issues.

Meetings were also held with the advisor to the Minister for Finance who was responsible for carrying out the Comprehensive Spending Reviews (CSRs). The objective was to share results and re-iterate the importance that the MFAC assigns to such exercises.

From an administrative perspective, meetings with other Ministry officials were held as part of the assistance with the updating of the MFAC's website, which is expected to be launched in 2018.

The MFAC and the Ministry for Finance also agreed to initiate a series of regular Dialogue Meetings to exchange opinions about the MFAC's public recommendations and it was decided that the Ministry should start to provide the MFAC with formal feedback on the Council's recommendations, in line with the so-called Comply-or-Explain principle. Other items discussed during these Dialogue Meetings included the proposed amendments to the legislation of the Fiscal Responsibility Act and updates in relation to the conditions when the contingency reserve may be resorted to.

European Commission

Two meetings were held with the European Commission officials during 2017. These were held in April, prior to the publication of the European Commission's assessment of Malta's Update of Stability Programme 2017-2020, and in October, mainly focusing on the Draft Budgetary Plan for 2018. During these meetings, the MFAC outlined its views on the current and projected macroeconomic and fiscal developments and related challenges and opportunities.

International Monetary Fund

As in previous years, in 2017, the MFAC again participated in the IMF's Article IV consultation mission. During these meetings, the MFAC and IMF discussed and exchanged their views about Malta's macro-economy, fiscal outlook and budgetary framework.

Credit rating agencies

The MFAC occasionally held meetings with credit rating agencies during their visits to Malta as part of their country rating assessments. During these meetings, the MFAC elaborated on its assessment of the macroeconomic and fiscal outlook as published in its various reports.

Public Accounts Committee

On 30 January 2017, the MFAC was convened to a meeting of the Public Accounts Committee, in terms of Article 57 of the FRA, for a discussion on the Council's overall assessment of the DBP for 2017 and the relative report published by the Council on 28 December 2016.

> **"There is general agreement that independent fiscal councils can play an important role in overcoming the commitment problems which often prevent governments from pursuing sound fiscal policies in a time-consistent manner."**
>
> Benoît Cœuré (2016)
> Member of the Executive Board of the ECB

International affiliations, meetings and seminars abroad

During the year the MFAC continued to develop further its links with foreign fiscal institutions, and other bodies abroad. Travel during 2017 included participation in seven official meetings while six were attendances to conferences and workshops (see Table 1.1). The MFAC maintained its active participation in the meetings and working groups of the Network of European Union Independent Fiscal Institutions, including the Working Group on the Output Gap and the Working Group on the Medium-Term Budgetary Framework.[1] The Network continued to hold regular meetings with the European Commission Directorate General Economic and Financial Affairs, both through seminars as well as bilateral exchanges by the Network's Committee for EU Affairs. The Network also established a working relationship with the European Fiscal Board which was set up in 2016, pursuant to the Five Presidents' Report of June 2015.

In 2017, the Chief Economist was invited as guest speaker at the Fiscal Policy Audit Seminar, hosted by the National Audit Office, within the framework of the Maltese Presidency of the Council of the European Union. His presentation was titled "Quality of Public Finances".[2] The National Audit Office also invited the Chairman and the Chief Economist to attend a seminar on the "Role and Contribution of the NAO in the implementation of Accrual Accounting across Government".[3]

[1] The presentation delivered at a seminar on the Medium Term Budgetary Framework held in Rome is available on http://www.upbilancio.it/wp-content/uploads/2017/09/MTBF_Malta_Rome_07_09_2017.pdf.
[2] Link to the press release issued by the National Audit Office in relation to this event https://gov.mt/en/Government/Press%20Releases/Pages/2017/May/30/PR171372en.aspx.
[3] Link to the press release http://nao.gov.mt/en/press-releases/4/153/role-and-contribution-of-the-nao-in-the-imple.

Table 1.1 Participation in international events during 2017

No	Place	Conference / Workshop	Dates
1	**Brussels**	Sixth meeting of the EU Network of the IFIs (EUNIFI)	**2 February**
2	**Helsinki**	Structural Balance - Uncertainty of Potential Output and Policy Implications	**3 March**
3	**Brussels**	11th meeting of the Network of Public Finance Economists in Public Administration	**28 March**
4	**Edinburgh**	9th Annual Meeting of OECD OF PBOs and IFIs / Informal Network IFIs	**6,7 April**
5	**Brussels**	IMF Workshop - Evolving Fiscal Policies in Europe	**5 May**
6	**Brussels**	7th Meeting of the EU Network of IFIs / Informal Network of IFIs	**27 June**
7	**Lisbon**	Workshop on Fiscal Structural Reforms	**3 July**
8	**Brussels**	Stability and Growth Pact (SGP) Technical Training	**10 July**
9	**Rome**	Medium-Term Budgetary Framework Working Group	**7 September**
10	**Vienna**	FISKALRAT - Fiscal Policy and Ageing Workshop	**6 October**
11	**Frankfurt**	Meeting of ECB, NCD and Network IFI	**19 October**
12	**Madrid**	Spanish Fiscal Council visit	**26 October**
13	**Madrid**	8th Meeting of the EU Network of IFIs / Informal Network of IFIs	**7 November**

Source: MFAC

Publications

In 2017, the MFAC published nine reports in line with its annual timetable. Table 1.2 lists these reports and their publication date together with a brief description of the content. The first report published by the Council was its Annual Report for 2016. The MFAC then issued three reports relating to the assessment of the Update of Stability Programme for 2017-2020 and another three reports on the assessment of the Draft Budgetary Plan for 2018. These reports related to the endorsement of the macroeconomic forecasts, the endorsement of the fiscal forecasts, and an overall assessment in terms of compliance with the fiscal rules. Two other reports where published during the year, which assessed the Ministry for Finance's Annual and Half-Yearly Reports.

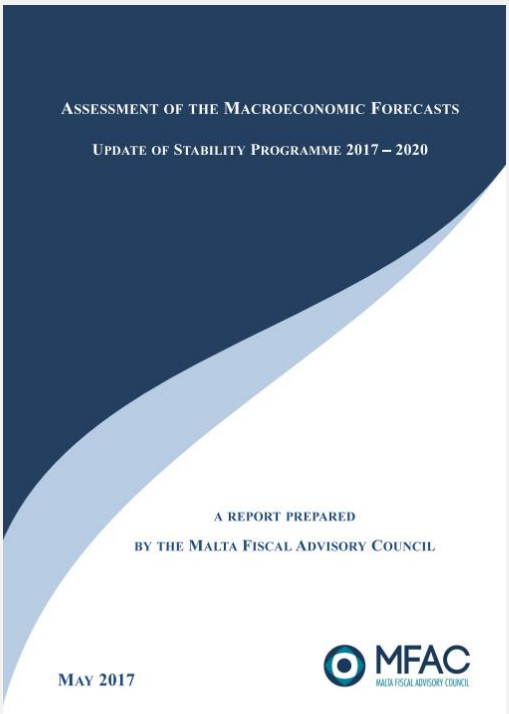
The MFAC also contributed a country note which forms part of the series of six-monthly regular country notes which started to be published by many IFIs in 2017 through the coordination of the EU Network of Independent Fiscal Institutions (EUNIFI). This note is published by the MFAC normally every January and June, to summarise the macroeconomic and fiscal outlook, as well as fiscal developments and possible risks, focusing on the Draft Budgetary Plan and the Update of Stability Programme.

Table 1.2 Reports published in 2017

1. Annual Report and Statement of Accounts 2016

Publication date: 30 March 2017

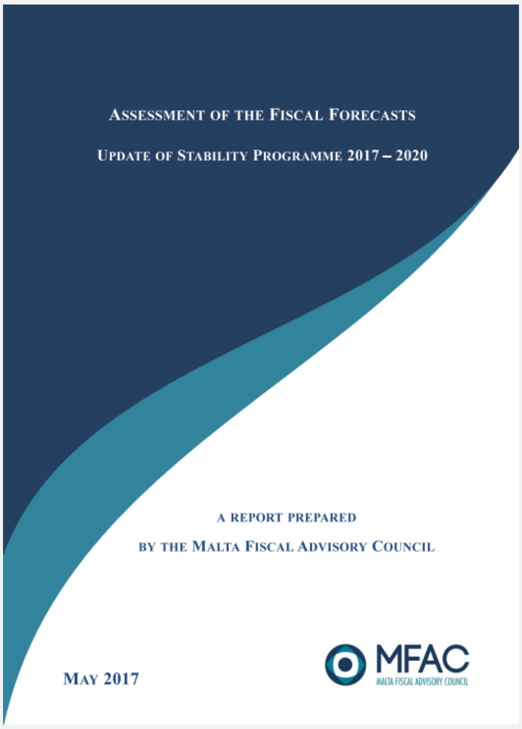
Description: The 2016 Annual Report provided a summary of the role and activities of the MFAC during that year, an update on the recommendations made in 2015 and a summary of those made in 2016. The special features of the Report were; an overview of the situation with respect to public finances in Malta and the euro area; fiscal risks with a focus on public debt sustainability and contingent liabilities; and a detailed description of the expenditure benchmark.



2. Assessment of the Macroeconomic Forecasts – Update of Stability Programme 2017-2020

Publication date: 2 May 2017

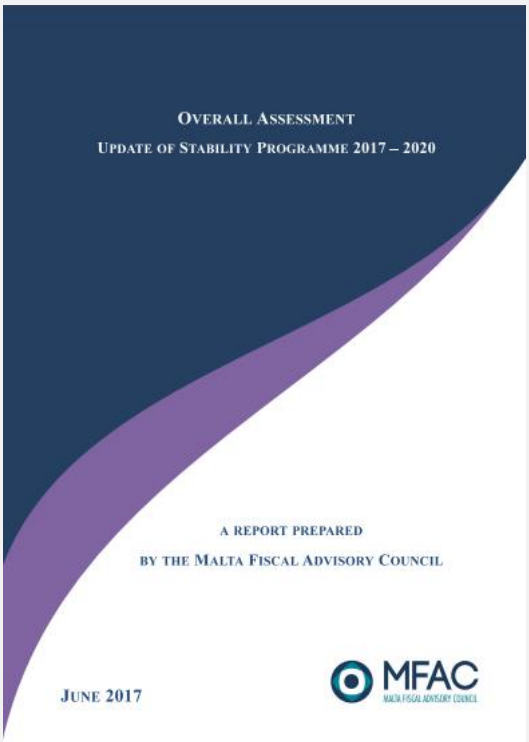
Description: The MFAC endorsed the macroeconomic forecasts prepared within the Update of Stability Programme 2017-2020. The MFAC considered that the growth forecasts for 2017 and the next three years to be plausible. The MFAC recognised there could be risks relating to investment and the performance of Malta's trading partners, but overall it noted the possibility of upside risks to the macroeconomic growth figures.



3. Assessment of the Fiscal Forecasts – Update of Stability Programme 2017-2020

Publication Date: 31 May 2017

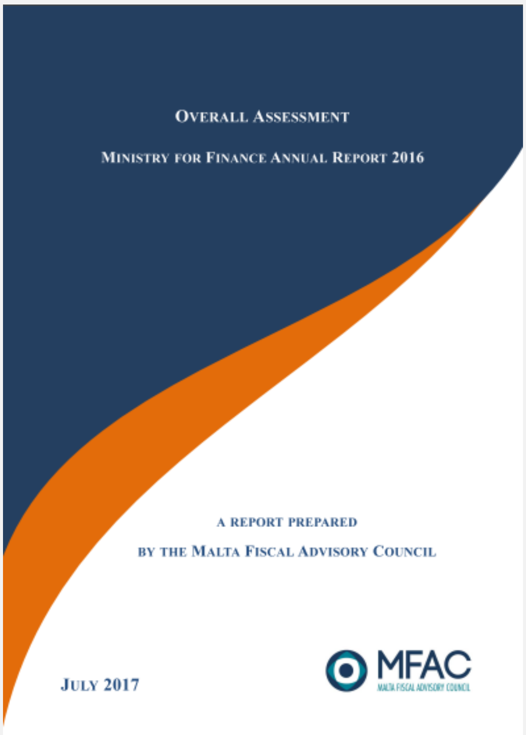
Description: The MFAC endorsed the fiscal forecasts prepared within the Update of Stability Programme 2017-2020. The Council viewed the possibility of upside risks to the revenue forecasts, which nevertheless were noted to be compensated for by the upside risks to the expenditure forecasts, thus exerting neutral risk on the fiscal balance.



4. Overall Assessment – Update of Stability Programme 2017-2020

Publication Date: 30 June 2017

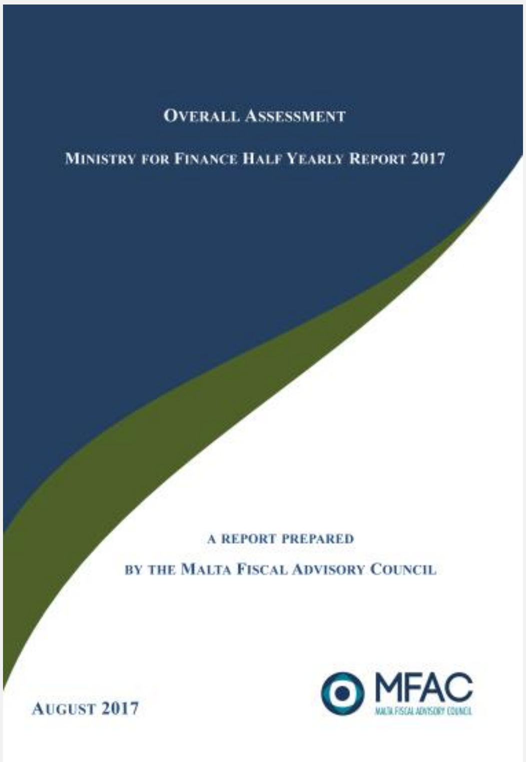
The MFAC welcomed the fact that in 2016 there was full compliance with the three fiscal rules. The attainment of Malta's MTO, ahead of the original plans was considered very positively by the MFAC, together with the fact that the Government aimed to maintain a fiscal surplus throughout the forecast horizon. The MFAC highlighted the importance that any new initiatives which could be considered over and above what is factored in the USP, do not derail the commitment to remain above the MTO. At the same time, it noted that it is important to maintain adequate fiscal buffers for times when economic conditions could be less favourable than at the time of publication.



5. Overall Assessment – Ministry for Finance Annual Report 2016

Publication Date: 31 July 2017

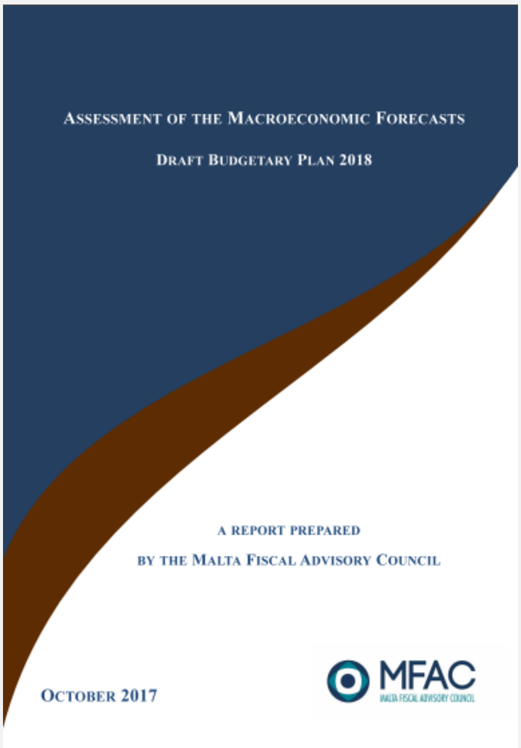
The MFAC considered the Annual Report to meet the requirements prescribed in Article 41 of the FRA. It noted overruns across many current expenditure components in 2016 which were however fully offset by the lower-than-anticipated expenditure on gross fixed capital formation. The MFAC encouraged the MFIN to explore more fully the reasons why certain fiscal targets have been missed or exceeded, to draw useful insight, thus improving the forecasting framework in future rounds. It noted compliance with both the budgetary and debt rule in 2016.



6. Overall Assessment – Ministry for Finance Half-Yearly Report 2017

Publication Date: 31 August 2017

On the basis of the information contained in the HYR, the MFAC considered that the macroeconomic forecasts (unchanged compared to the USP) and the slightly revised fiscal targets presented in the HYR (compared to those contained in the USP) were within the endorsable range of the MFAC. The MFAC considered important that the MFIN would remain vigilant, to ensure that expenditure targets, which in absolute terms have in many instances been exceeded, are indeed met, allowing for the possibility that any revenues above target to be channelled into a better fiscal balance.



ASSESSMENT OF THE MACROECONOMIC FORECASTS

DRAFT BUDGETARY PLAN 2018

A REPORT PREPARED

BY THE MALTA FISCAL ADVISORY COUNCIL

OCTOBER 2017

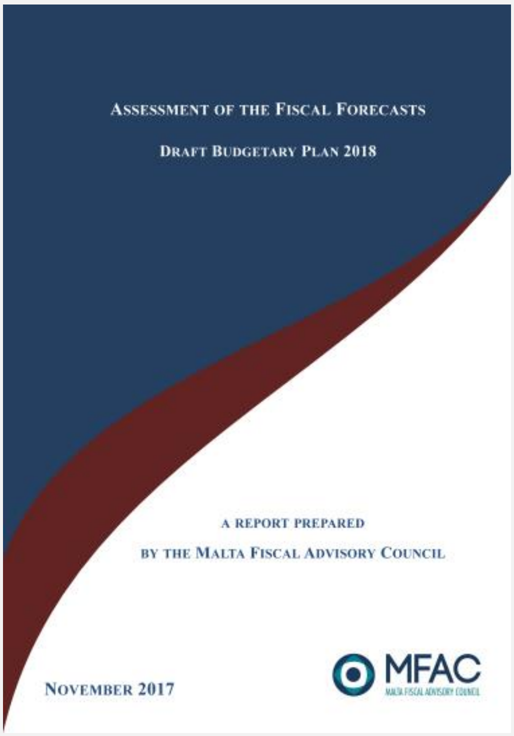
MFAC

MALTA FISCAL ADVISORY COUNCIL

7. Assessment of the Macroeconomic Forecasts - Draft Budgetary Plan 2018

Publication Date: 9 October 2017

The MFAC endorsed the macroeconomic forecasts prepared within the Draft Budgetary Plan 2018. The Fiscal Council viewed the balance of risks to GDP growth over both 2017 and 2018 as broadly neutral. The MFAC recognised there could be risks relating to investment and the expected contribution of the external sector to the overall growth in the domestic economy and from possible changes to the international economic scenario. Although noting that several factors posed downside risk, this could be mitigated by the upside risk present due to the underlying level of prudence shown by the assumptions underpinning the estimates.



ASSESSMENT OF THE FISCAL FORECASTS

DRAFT BUDGETARY PLAN 2018

A REPORT PREPARED

BY THE MALTA FISCAL ADVISORY COUNCIL

NOVEMBER 2017

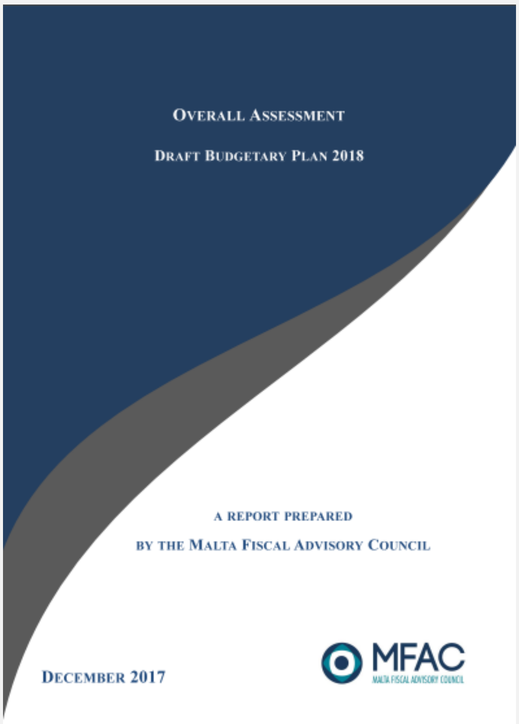
MFAC

MALTA FISCAL ADVISORY COUNCIL

8. Assessment of the Fiscal Forecasts - Draft Budgetary Plan 2018

Publication Date: 29 November 2017

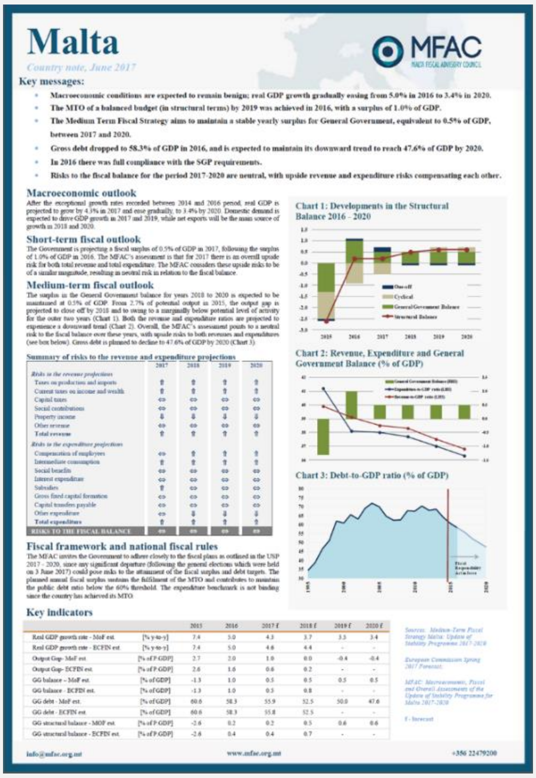
The MFAC endorsed the fiscal forecasts prepared within the Draft Budgetary Plan 2018. The Council viewed the possibility of upside risks to the revenue forecasts and downside risks to total expenditure, for both 2017 and 2018. Whereby, their combined effect translated into an upside risk for the fiscal balance across the forecast horizon.



9. Overall Assessment – Draft Budgetary Plan 2018

Publication Date: 29 December 2017

The MFAC welcomed the fact that the attainment of a fiscal surplus in 2016 was set to be followed by other fiscal surpluses in 2017 and 2018. The further decline in the debt ratio was also viewed positively, as this allows for the build-up of fiscal space, which is relevant in view of the anticipated higher age-related costs facing Malta in future years. The MFAC invited the MFIN to monitor expenditure developments carefully, not only to ensure full compliance with the SGP requirements, but also to maintain prudent fiscal policy. The MFAC also invited the MFIN to explore the possibility of introducing changes to the FRA, so that direct reference to the requirements of the expenditure benchmark is included in the legislation, irrespective whether the risk of deviation is significant or not.



10. EUNIFI, European Fiscal Monitor - Malta Country Note

Publication Date: June 2017

The country note prepared by the MFAC, outlined the salient features which it had published in its reports following the publication of the USP 2017-2020. This broadly outlined the macroeconomic outlook, the short-term and medium-term fiscal outlook, together with a summary of risks to the fiscal projections and the level of adherence to the fiscal framework and national fiscal rules. The country notes are made available on:

http://www.euifis.eu/eng/fiscal/174/european-fiscal-monitor

Public relations of the MFAC

The Council issued eight press releases during the year, in both English and Maltese and which are available on the MFAC's website (see table 1.4). The MFAC also featured several times in local newspapers, following the publication of its press releases. The Chairman and the Chief Economist also participated in TV and radio interviews and discussions during the year. The objective is to seek to enhance public awareness regarding relevant fiscal policy issues and information.

Table 1.3 Press releases issued during 2017

Date	Title
06/04/2017	Malta Fiscal Advisory Council publishes its Second Annual Report
04/05/2017	Malta Fiscal Advisory Council publishes its assessment of the Government's macroeconomic forecasts presented within the Update of Stability Programme 2017 - 2020
31/05/2017	Malta Fiscal Advisory Council publishes its assessment of the Government's fiscal forecasts presented within the Update of Stability Programme 2017 – 2020
03/07/2017	Malta Fiscal Advisory Council publishes its assessment of the Government's Medium Term Fiscal Strategy
02/08/2017	Malta Fiscal Advisory Council publishes its assessment of the Ministry for Finance's 2016 Annual Report
17/10/2017	Malta Fiscal Advisory Council publishes its assessment of the Government's macroeconomic forecasts which underpin the Draft Budgetary Plan for 2018
30/11/2017	Malta Fiscal Advisory Council publishes its assessment of the Government's fiscal projections presented in the Draft Budgetary Plan for 2018
08/01/2018	Malta Fiscal Advisory Council publishes its overall assessment of the Government's Budgetary Plan for 2018 and compliance with the fiscal rules

Human resources

During 2017, the MFAC's staff complement remained unchanged, consisting of three economists and an administrator. Two economists and the administrator continued to follow post-graduate studies in economics and Maltese, respectively, at the University of Malta, with financial assistance from the MFAC.

Three staff also attended two separate courses organised by the Institute for Public Services. The first was a four-day course on 'Taħriġ fil-Lingwa Maltija', while the other was a two-day course which related to EU Treaties. The MFAC staff also attended a one-day seminar on 'Team Building Skills and High-Performance Teamwork', organised by Global College Malta.

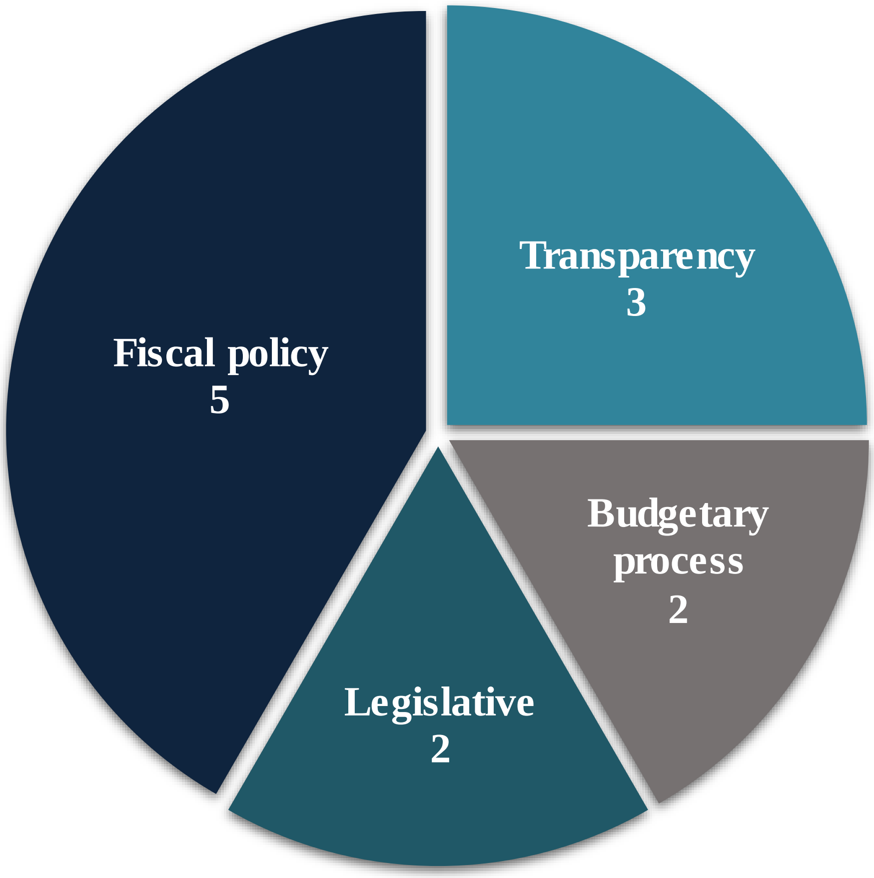
Chapter 2

New MFAC recommendations in 2017

Introduction

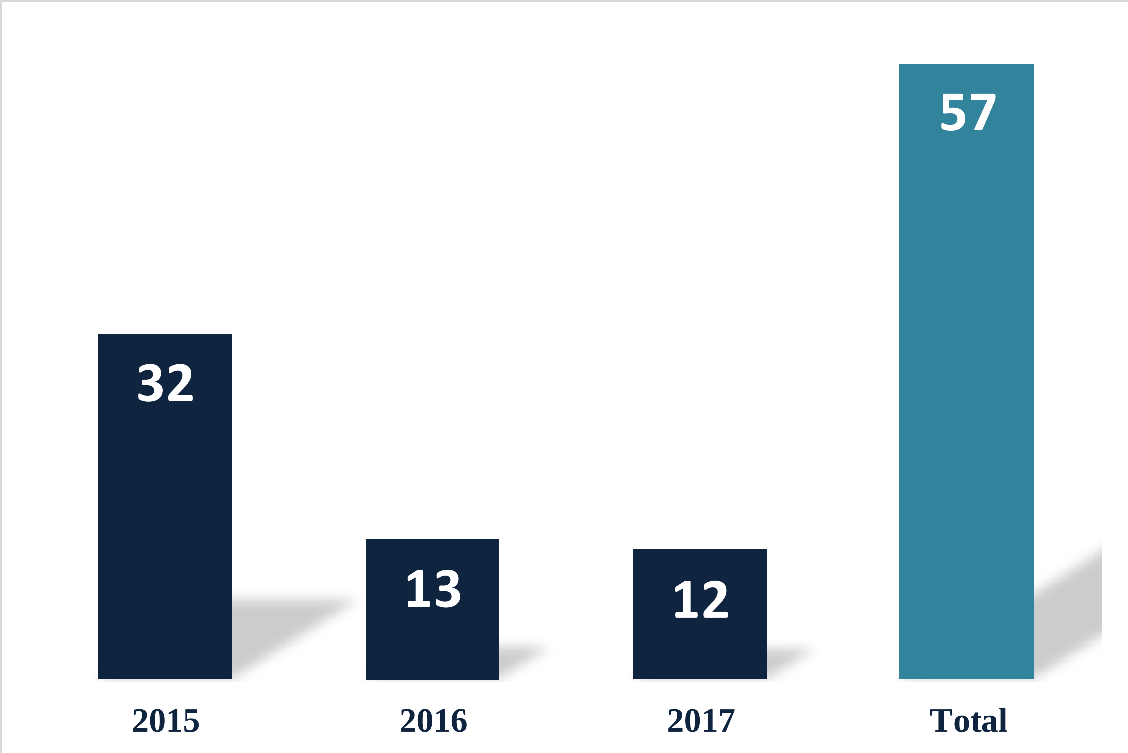
Apart from restating some recommendations addressed to the Ministry for Finance that had already been outlined in the previous two Annual Reports, the MFAC made 12 new recommendations in 2017 (see Chart 2.1). This brings the total number of recommendations to the Ministry, since the setting up of the MFAC in 2015, to 57 (see Chart 2.2 and Appendix A). As in previous years, the new recommendations made in 2017 focused on the conduct of fiscal policy (5 recommendations); enhancing fiscal transparency (3 recommendations); improving the budgetary process (2 recommendations); and proposals for legislative changes (2 recommendations). This chapter provides an explanation and the rationale for each new recommendation, grouped according to the category.

Chart 2.1 New MFAC recommendations in 2017 by type



Source: MFAC

Chart 2.2 Recommendations 2015 – 2017



Source: MFAC

> **“Engagement by national parliaments, national IFIs and all economic agents in each Member State is crucial for implementing a stability-oriented fiscal policy.”**
>
> José Luis Escrivá (2017)
> Chair of the Network of EU Independent Fiscal Institutions

Recommendations dealing with the conduct of fiscal policy

Maintain the Medium-Term Objective

Sustainable fiscal policy requires that in periods of strong economic activity, that is when the economy is operating above potential, a country achieves a fiscal surplus. On the other hand, during periods of low or negative economic growth, that is when the economy is operating below potential, it is possible for a country to run a fiscal deficit without breeching the fiscal rules. In this manner, fiscal policy would contribute to stabilise public debt over the economic cycle and ensure sustainability. This requires a structural balance throughout the economic cycle, where fiscal revenues and expenditures, net of the cyclical effects and one-off and temporary effects, would balance out on a yearly basis.

In 2016, a structural budget surplus was recorded, enabling Malta to satisfy its commitment to a Medium-Term Objective of structural balance. This was achieved three years ahead of the originally planned date. The Fiscal Responsibility Act and the Stability and Growth Pact require that the Medium-Term Objective continues to be satisfied. It is important that fiscal consolidation achieved over past years is not unwound in future through deficit increasing measures which result in a departure from the Medium-Term Objective of structural balance.

Monitor closely population trends and their implications

Population in Malta has been growing steadily in recent years due to a positive flow of net immigration. Such process is expected to persist at least in the short to medium run, resulting in further population growth and thus higher population density. This is the result of strong influx of workers from abroad, both from the European Union, as well as third country nationals. Such population developments contrast with the projections which were made a decade earlier, when the population was expected to decline in the medium term.

This phenomenon has rendered labour supply in Malta relatively elastic in various key sectors. It has contained average wage growth, keeping inflationary pressures under check, despite the very strong real GDP growth rates being recorded. Indeed, the influx of foreign workers lifted Malta’s potential output significantly.

At present, the expansion in the size of the population is contributing positively to economic growth. However, it is important to evaluate the policy implications of this phenomenon. Indeed, a larger population has implications on the transport infrastructure and the environment. It is also important to ensure the necessary resources are allocated such as for security, health and education. Expenditure plans prepared at a departmental and institutional level must adequately factor in the rising population, to ensure that the quality of public services remains intact. In this respect, it would be useful to regularly communicate population projections to the spending entities within general government, to ensure that their bottom-up plans adequately factor in the anticipated growth in the population.

Prioritise productivity gains through transferring best practices across departments

Over time efficiency gains have been achieved across specific areas of Government’s operations. This contributed to slow down the growth in Government expenditure than would have otherwise been the case. At the same time, Comprehensive Spending Reviews undertaken by the Ministry for Finance and audits undertaken by the National Audit Office have identified areas where inefficiencies exist. It may be possible to address some of these inefficiencies through measures which have already been implemented in other areas, where this is feasible. The achievement of productivity gains should be prioritised, to enable further expenditure savings or improvements in the quality of the Government’s output.

Introduce more effective medium-term policy framework

A medium-term budgetary framework is a fiscal arrangement that allows a government to extend the horizon for fiscal policy making beyond the annual budgetary calendar. Such framework integrates fiscal policy and budgeting over the medium term by linking a system of aggregate fiscal forecasting to a disciplined budget process and a set of institutional arrangements for prioritizing, presenting and managing revenue and expenditures in a multi-annual perspective.

A medium-term budgetary framework is intended to help governments to make sound fiscal policies by reflecting a proper balance between the objectives of sustainability of public finances in the medium term and macroeconomic stabilization in the shorter term. It can also help pursue a growth-enhancing budget composition. Furthermore, it guarantees a certain stability of revenue raising and spending decisions, which is crucial for giving more certainty to operators' expectations regarding the impact of the public sector in the economy. An effective medium-term framework could also make easier for budget execution to be in line with plans.

At present, the annual Update of Stability Programme only provides high level fiscal targets, without specifying the measures to be taken beyond the current year (which would have been specified in the Draft Budgetary Plan). It is important that the conduct of fiscal policy is geared more towards the medium and longer term. This would require a more effective transposition of a three-year policy framework, away from the tendency of yearly moving targets for the various revenue and expenditure components. Such a strategy would enhance the transparency, continuity and consistency of budgetary objectives.

Implement the necessary structural reforms

Structural reforms consist of measures that change the fabric of an economy, the institutional and regulatory framework in which businesses and people operate. They are designed to ensure the economy is fit and better able to realise its growth potential in a balanced way. Structural reforms work on the supply side of the economy. By tackling obstacles to the efficient and fair production of goods and services, they should help increase productivity, investment and employment.

The International Monetary Fund, in its 2017 Article IV Consultation Report, included the following policy recommendations addressed to Malta: “Increase the structurally-low female labour force participation further and expand technical and vocational training schemes to strengthen human capital. Improve infrastructure quality and enhance SMEs’ innovation, including by upgrading research infrastructure and upscaling the public-sector support for innovation”.

In 2017, the European Council’s country specific recommendations addressed to Malta were to “expand the scope of the ongoing spending reviews to the broader public sector and introduce performance-based public spending" and "ensure the effective supervision of internationally oriented business by financial institutions, licensed in Malta in cooperation with the host supervisors in the countries where they operate".

Such reforms should be easier to implement during a period of high economic growth and healthy public finances.

> **"Policymakers should use this moment to make the difficult structural and fiscal reforms that might not happen otherwise. This means taking steps to boost long-term growth, paying down debt in places where it is too high, and in other places, investing back into the economy through infrastructure and effective social spending."**
>
> Christine Lagarde (2018)
> Managing Director of the International Monetary Fund

Recommendations dealing with the budgetary process

Explore options to improve forecast accuracy

Forecasts are by their nature subject to uncertainty. Yet it is desirable that the macroeconomic and fiscal forecasts are as accurate as possible, to better guide policy making. Deviations between the actual and the forecast values can provide useful guidance to help identify biases within the forecasting process.

Fiscal forecasts whose deviations have been the more recurring and the larger in size could be areas where possible improvements could be explored by the Ministry for Finance. The baseline revenue and expenditure projections should be unbiased. The aim should be to avoid such large differences in future, especially in those areas which are relatively more under the control of Government such as public investment. The focus should not be limited to the fiscal balance, but rather to ensure that the forecasts for the main revenue and expenditure components are as close as possible to the actual turnout.

Monitor closely revenues derived from the Individual Investor Programme

Revenues derived from the Individual Investor Programme, together with the underlying benign economic conditions, have been instrumental in improving public finances in recent years. As such, it is useful to monitor such revenues monthly, as their uptake plays an important role in determining the eventual outcome for the yearly budget balance. Following closely the pending applications and the average length of processing could help improve the forecast accuracy for the expected intake from the Individual Investor Programme, while still acknowledging its inherent uncertainty.

Recommendations dealing with legislation

Ensure publication of the Half-Yearly Report by end July even when the Parliament is in recess

Article 39(7) of the Fiscal Responsibility Act specifies that the Half-Yearly Report which is prepared by the Ministry for Finance shall be tabled in Parliament by the end of July of each year. This may not be possible if the Parliament's summer recess takes place before the finalisation of the Report. This situation happened in 2017, with the Report being published when the Parliament reconvened. This resulted in delays in the publication of the Half-Yearly Report, together with the related assessment by the MFAC.

The Half-Yearly Report is meant to contribute to fiscal transparency, wherein the Government can update the macroeconomic and fiscal forecasts for the year, based on the developments during the first six months of the year. The publication of the Half-Yearly Report months after its finalisation reduces the value of such report. Hence it would be useful to amend the legislation to ensure that publication can take place even if for some reason the Report cannot be tabled in Parliament.

Consider introducing direct reference to the expenditure benchmark in the legislation

The expenditure benchmark establishes restraint on the yearly growth in government expenditure, unless matched by new revenue measures. Its main advantage is that it helps avoid situations where revenue windfalls are channeled into higher spending rather than used to improve the fiscal balance further.

At present the expenditure benchmark, which forms part of the Stability and Growth Pact, does not feature directly in the Fiscal Responsibility Act. It is only indirectly referred to in the eventuality that the European Commission address a warning of significant deviation, that is when there is a strong possibility that the European fiscal rules are breeched by a significant margin, both ex-ante or ex-post.

To catalyse greater attention on the need to control underlying expenditure growth in line with the economy's growth potential, which is what the expenditure benchmark tries to do, it would be useful to amend the Fiscal Responsibility Act. It is desirable that direct reference to the requirements of the expenditure benchmark is included in the legislation, irrespective whether the risk of deviation is significant or not.

This would ensure that the expenditure benchmark is elevated to the same status as the debt and the budgetary rule, even under Maltese legislation. It would also be in the same spirit as the opinion expressed by the Economic and Financial Committee of the European Union published on 29 November 2016, wherein there was an increased focus on the expenditure benchmark for assessing compliance with the European fiscal rules.

Recommendations dealing with transparency issues

Assume stable elasticities unless justified by specific factors

Revenue and expenditure forecasts are generally estimated on the basis of specific tax and expenditure elasticities, which show the empirical relationship between a budget component and its macroeconomic proxy base. In the absence of sufficient information, it is common practice for forecasters to assume that such variables remain stable over the forecast horizon. Variations in the elasticities are advisable only when there is specific information to back up such changes, such as more granular information about the underlying driver of future revenues and expenditures. In this case, it is also useful to provide clear explanations in the official documents, to justify such approach.

Provide a more detailed account of the absorption of European Union funds

Article 39(8)(h) of the Fiscal Responsibility Act states that the Half-Yearly Report published by the Ministry for Finance must include "data on the absorption of European funds, indicating the approved program, the results achieved in the first six months and an updated forecast for the entire year". Such information has been limited and fragmented, and not directly featured in the Report. To boost transparency and comply fully with the legislation, it is necessary that such information be published as from this year's Half-Yearly Report.

Publish more background information on the models used by the Ministry for Finance

The macroeconomic forecasts prepared by the Ministry for Finance are based on a suite of econometric models. Publishing the current suite of models being used, including the equations, diagnostic tests and accompanying explanations would enable the MFAC, as well as other institutions and analysts to better evaluate the macroeconomic forecasts, by pinning more precisely the drivers of such forecasts and the robustness of the results. This would also contribute to enhance transparency further.

Chapter 3

The reactions by the Ministry for Finance to the recommendations made by the MFAC between 2015 and 2017

The following is the feedback submitted to the Malta Fiscal Advisory Council by the Ministry for Finance on 12 March 2018 in relation to the various recommendations made by the Council since it was set up in 2015. Recommendations 1 – 32 were initially made in 2015; recommendations 33 – 45 were initially made in 2016; and recommendations 46 – 57 were made in 2017.[4]

1. Consider the publication of more timely official statistics

The Government considers that earlier submission is in most cases impossible as the political decision-making process needs to take its due course and in the circumstances, early submission can only take place at the expense of comprehensiveness. In addition, where statistical input is required, the timing is not within Government's control and early submission can only be achieved at the expanse of quality. The Government is committed to make every effort possible to reduce as much as reasonably possible the processing time from the receipt of statistical inputs and decisions to its translation into the information to be transmitted to the Fiscal Council, in full respect of the requirements of the Stability and Growth Pact and the Fiscal Responsibility Act.

2. Ensure closer synergy across government departments

The Ministry for Finance is committed to continue to improve the coordination of the work of the different entities involved in the budget process. Indeed, some success has already been achieved whereby the process of integrating the ESA and the cash data is now being carried out within the Ministry for Finance under the supervision of National Statistics Office. It is however being clarified that the conduct of fiscal policy and the setting of fiscal targets are carried out by Ministry for Finance in ESA terms. The fragmentation between the cash and accrual adjusted methodology, though arguably complicating the process, does not undermine the conduct of fiscal policy and the setting out of policy objectives in ESA terms, as required by the Stability and Growth Pact and the Fiscal Responsibility Act.

[4] Some recommendations were repeated in subsequent years.

3. Maintain detailed documentation on how the fiscal data is compiled

The methodology being followed is stated in the Eurostat's Manual of Debt and Deficit, and the ESA adjustments are broken down in detail. The degree of discretion at the ESA level is limited and is subject to Eurostat's review. The Ministry is considering publishing an article on its website explaining the process in general.

4. Provide detailed calculations of revenue measures

Various methodologies are used in the process and an explanation of every minute measure would render budget documents less accessible to the public. Nevertheless, the Ministry for Finance is investing in streamlining its methodologies, including econometric models and in the future one could consider publishing separately the technical details surrounding such models. At the same time, the Ministry has always submitted to the Fiscal Council the detailed estimates or explanations related to the quantification of measures when these were requested and indeed it is bound by the Fiscal Responsibility Act to do so.

5. Ensure higher consistency between the macro and fiscal forecasts

The Ministry for Finance makes every effort to ensure consistency, whilst noting that efforts in the past to achieve close to full consistency, came at the expense of timeliness of submission of information to the Fiscal Council itself, where the improvement in the projections due to this consistency was of second order. Over the years it has been agreed with the Fiscal Council that a high, even if not perfect, level of consistency is acceptable to ensure more timely delivery of information. The Ministry for Finance believes that this implicit agreement is desirable in the context of the complexity of the budget exercise and the endogeneity of macro and fiscal variables. It is also to be noted that the Ministry produces a very detailed and extensive macro risk assessment, which the Ministry believes to be one of the most transparent in the EU and, upon recommendation from the Fiscal Council, is now documenting the effect of this risk assessment on the fiscal target. At the same time, the Ministry takes note of the non-macro related risk to fiscal targets and usually relies on the Fiscal Council's own assessment which is in turn presented to Parliament as part of the Medium Term Fiscal Plan. The Ministry thinks that the Fiscal Council is in a better position to produce an independent and credible fiscal risk statement. As to the opposite feedback loop, from the fiscal variances to the macro economic forecast errors, the Ministry has already documented these ex-post, in its paper on forecast errors. However, the Ministry does not agree in principle to do this ex-ante because the budgetary process is an exercise in delineating policy at a political level and cannot be reduced to a pure forecast exercise.

6. Rationalise expenditure

This recommendation is in line with Government's policy. Until the MTO was reached, the Government has always targeted adherence to the expenditure benchmark, based on its own projections. It continues to do so now that the MTO has been achieved, though further discussions are needed were this to become a fiscal rule. At present, this requirement is not in the Fiscal Responsibility Act and the Ministry considers that it is debatable whether it is implied by the Stability and Growth Pact. On the other hand, the Ministry agrees with the Council's recommendation to add momentum to the Comprehensive Spending Review process and to expand the scope of the ongoing spending reviews to the broader public sector as well as to introduce performance-based public spending.

7. Ensure that the budget timetable is consistent with European Semester

It is the Ministry's view that the budgetary process is now fully aligned with the European semester and deadlines have always been respected at European Level for the last three years.

8. Provide details about fiscal measures for years t+1, t+2

Details are already provided when measures are known in advance, including the impact of measures beyond the year of implementation.

9. Consider a buffer over the minimum required structural effort

This recommendation has been complied with and the Ministry considers that it is no longer applicable, given that the MTO has been attained.

10. Maintain accurate estimates on ageing costs

The Ministry for Finance believes that its existing estimates in relation to ageing costs are sufficiently accurate.

11. Perform closer monitoring of output gap and its implications

The Ministry for Finance is now producing a risk assessment of the output gap projections, as recommended by the Fiscal Council. The implications on the structural budget balance of potential variations in the output gap are being captured in this risk assessment.

12. Raise awareness about the long term fiscal challenges

The Government agrees with this recommendation and considers that this is already the case, in practice.

13. Specify in greater detail how expenditure growth will be constrained

The chapter on the quality of public finances, which is included in the annual Update of Stability Programme, gives a very detailed overview of the spending reviews. Any specific expenditure saving measures are highlighted in the table delineating the budget measures, in both the Update of Stability Programme, and the Draft Budgetary Plan, which are submitted annually to the European Commission.

14. Consider new legislation to guide the issuing of government guarantees

This MFAC's recommendation was addressed in July 2017 when the Parliament enacted the Government Borrowing and Management of Public Debt Act (Cap. 575). This new legislation incorporates a section (Part IV) that deals with the (1) issuance; (2) assessment of requests for guarantees; (3) review; and (4) reporting of government guarantees. Although this section has not yet come into force and the plan is that it will come into force in coming months, the Ministry for Finance has in place a mechanism of scrutiny. It conducts due diligence tests and risk analysis on the financial position and the creditworthiness of the entities requesting guarantees, before a guarantee is issued. Moreover, once a guarantee is granted, the Ministry regularly reviews the financial position of the entities that benefited from the guarantee.

15. Provide more information about government guarantees

The Government Borrowing and Management of Public Debt Act (Cap. 575) specifies the type of information which will be published once the relevant provisions come into force.

16. Provide quantitative estimates of the impact of assumptions used

The Government will consider ways of improving the presentation of fiscal risks.

17. Provide higher detail on the impact of statistical changes

The Ministry will introduce a dedicated line item in the relevant Tables, when necessary to clarify the impact of ESA adjustments. The Ministry further clarifies that the ultimate fiscal targets are based on ESA, in line with the requirements of the Fiscal Responsibility Act and the Stability and Growth Pact. The difference between the cash and ESA target is delineated in the Budget Speech.

18. Enhance the commentary on the drivers of variations in fiscal data

Typically, no explanations are published in the Financial Reports in relation to the expenditure variances. In the annual reports only the explanations to variations from the revenue side are published. At the same time, the Ministry remarks that a more detailed Stock Flow Adjustment Table is being published in the Draft Budgetary Plan and the Update of Stability Programme. In relation to elasticities, there is an element of judgement and precise elasticity point estimates can be difficult to justify. Internally the Ministry considers a range of plausible elasticity estimates based on alternative methodologies (e.g. model based estimates, econometric estimates, results from studies in the economic literature and historical performance and observations). Furthermore, the tendency is to allow a measure of prudence in these estimates. Some of that element of judgement is also driven by the experience of the Ministry and its detailed knowledge of specific conditions prevailing or expected to prevail in a given year, which in turn could influence revenue performance, irrespective of the macroeconomic conditions (e.g. collection of arrears, liquidity in the market). Besides, providing such an account would make the reports in question even more complicated. In the Ministry's opinion, the publication of a detailed Table on Stock-Flow Adjustments further provides maximum transparency. The Ministry also believes that the Half-Yearly Report provides sufficient details. At the same time, the Ministry reiterates its commitment to give detailed explanations to the Fiscal Council whenever these are requested.

19. Publish a dedicated section in the Annual Report explaining possible deviations in the fiscal strategy

The Ministry for Finance views that the present format is already capturing such deviations in detail.

20. State explicitly the reasons whenever the previous round of macroeconomic forecasts is retained

This recommendation was noted in the past and the most recent reports delineate more clearly why macroeconomic forecasts used for fiscal projections are not typically revised mid-year despite the availability of more recent macroeconomic data. It is recalled that unless the most recent macroeconomic data suggests a drastic change in macroeconomic conditions, fiscal data is usually more up to date and already incorporates the effect of more recent economic conditions which are unlikely to be captured by national accounts data which is usually published with a three-month lag. Fiscal data is also typically more reliable in the sense that it is subject to much less revisions whilst national accounts data is usually an estimate which is very often subject to substantial change particularly of the latest available quarter.

21. Address the specific issues raised by the Commission in its assessment of the Update of Stability Programme in the Ministry for Finance's publications

The Commission's assessment is usually undertaken in May, based on information which is less up to date than that considered in the Half-Yearly Report. Moreover, the focus of the Commission's assessment is mostly on the following year's budget targets to give advance direction for the forthcoming budget. At the same time, the Ministry is not completely averse to the recommendation, particularly in the case where the half-yearly fiscal performance could indicate that there are risks to the compliance with requirements of the Stability and Growth Pact and the Fiscal Responsibility Act, in terms of compliance with the fiscal rules.

22. Provide more details about the assumptions used to prepare the forecasts

Whilst the Ministry understands the rationale of this recommendation, this would unnecessarily complicate the presentation of the budget projections. Such information can however be requested by the Fiscal Council and the Ministry is bound to submit such information upon request, to allow the Fiscal Council to make such an assessment. The Ministry strives to ensure that the information provided is as comprehensive as possible, within timeframes prevailing and given resources, and existing modelling capabilities.

23. Revise historical data to ensure consistency with the latest published data

The Ministry takes note of this recommendation.

24. Achieve further progress in pension reform

The Ministry takes note of this recommendation.

25. Extend the average maturity profile of public debt

The Government has in recent years adopted a policy of gradually extending the maturity of its debt. Indeed, the maturity of the Malta Government Stocks has increased from 6.6 years at the end of 2010 to 9.5 years at the end of 2017. This was deliberate policy adopted over recent years mainly intended to bring about an easing in redemption profile, thus limiting roll-over risk, in a supportive domestic market environment. The aim of the strategy was also to achieve such goal at a reasonable premium. The Ministry also regularly looks at different indicators to assess roll-over risks as well as to communicate debt management strategies.

26. Use IIP funds cautiously

The Government has complied with this recommendation.

27. Sustain progress towards attaining the Europe 2020 targets

The invitation is noted by the Ministry, but the Government considers that this recommendation goes beyond the requirements of the Fiscal Responsibility Act.

28. Evaluate the economic efficiency of the current property-related taxation system

The invitation is noted but the Government considers that this recommendation goes beyond the requirements of the Fiscal Responsibility Act and the matter is considered a Government prerogative.

29. Use revenue windfalls primarily to build fiscal buffers

This recommendation has been complied through the series of fiscal surpluses which have been achieved.

30. Establish rigorous policies of how the Contingency Reserve can be resorted to

The Ministry's view is that the Fiscal Responsibility Act already stipulates the conditions supporting the use of the Contingency Reserve. The Ministry believes that when this Reserve was used, it was in line with the legal requirements of the Fiscal Responsibility Act.

31. Replenish the Contingency Reserve

This recommendation has been fully complied with.

32. Update the BO's methodologies to approximate better the ESA guidelines

The Ministry considers that its current methodologies conform with the ESA-based fiscal targets, as required by the Fiscal Responsibility Act and the Stability and Growth Pact.

33. Use consistent definitions and methodologies across forecast rounds

The Ministry has addressed this issue in the past and considers the recommendation no longer applicable.

34. Elaborate more on fiscal risks

The Ministry considers that the current risk assessment being published in the reports is already one of the most detailed assessments presented in the European Union. Indeed, there is scope to simplify the presentation of the assessment rather than complicate the exposition further as being suggested by the Fiscal Council. The methodology employed has also been published as a working paper. The Ministry also considers that in its Half-Yearly Report it adequately identifies possible risks. On the other hand, the Ministry can consider positively the recommendations to identify the specific risk scenario leading to the upper and lower bound limits, as well as the broadening of the fiscal risks that are evaluated. The Government will also be delegating to the Fiscal Council the risk assessment task, by revising the Fiscal Responsibility Act. The Government understands that the Fiscal Council agrees with the revised provisions which will soon be submitted to the Parliament for approval.

35. Focus greater attention on developments in the structural balance

The Ministry considers that this is already the case as the budgetary rule in the Fiscal Responsibility Act and the Stability and Growth Pact bind the Government to consider the structural balance as its ultimate target of fiscal policy. Having said this, it is to be noted that, as long as the MTO is exceeded, the fiscal rules targeting the structural balance are less binding from a legal perspective, though the Government remains committed to continue to consider further improvements in the structural balance, as one of its policy objectives.

36. Ensure technical issues are adequately addressed before announcing changes to tax or expenditure policies

The Ministry takes note of this recommendation.

37. Evaluate the economic efficiency of the tax framework

The invitation is noted but the Government considers that this recommendation goes beyond the requirements of the Fiscal Responsibility Act and the matter is considered a Government prerogative.

38. Ensure feasibility of expenditure restraint targets

Whilst providing for any in-year budgetary decisions that may need to be taken, and assuming that, line ministries (including their departments and entities) remain compliant with their budget allocations during the year, expenditure projections shall continue to be compiled as reliably as possible, based on the information made available.

39. Focus more attention on the expenditure benchmark outlined in the Stability and Growth Pact

With respect to the Ministry's Annual Report, Article 41(2)(e) of the Fiscal Responsibility Act requires the Ministry to "explain the outcome of the budget in the context of Government's European Commitments, in particular in terms of the SGP". Hence the Ministry confirms that it can comply with this recommendation.

40. Consider reacting publicly to the recommendations made by the Malta Fiscal Advisory Council

The Ministry took note of this recommendation and indeed it has forwarded its official response which will be included in the 2017 Annual Report of the Fiscal Council.

41. Establish clear guidelines on cash holdings

The Government's strategy for cash holding towards the end of the year has been to maintain an adequate closing cash balance sufficient to meet the payment commitments for the first part of January without relying exclusively on Treasury bills to meet the initial commitments. Its strategy is guided by the principle to minimize the level of cash balances and at the same time meet expenditure when it is falls due. It is noted that the cash holdings are affected by payment and processing lags, forecasting uncertainties and cash flow volatility, elements that have direct impact on the cash balance. All these elements are factored into the debt management strategy to secure adequate cash holdings to meet government expenditure when it falls due.

42. Maintain close monitoring and control on the Extra-Budgetary Units' activities which have fiscal implications

The Ministry for Finance remains committed to monitor closely the situation related to Extra-Budgetary Units to ensure that budgetary targets are adhered to.

43. Address revenue arrears more strongly

The Ministry agrees with this recommendation. Revenue arrears are monitored during the year, as provided for in the Fiscal Responsibility Act, with a corresponding annex included in the Financial Estimates and reported upon in the mid-year assessment.

44. Provide updates on the performance of fiscal measures announced in the Budget

The Ministry will be exploring the feasibility of implementing this recommendation. However, the Ministry believes that this should be limited to significantly large measures, as experience has shown that revisions, particularly in smaller measures are of second order. For larger measures, there is agreement that these will be reported to European Institutions and the Ministry finds no issues with sharing this information with the Fiscal Council and publishing any material revised estimates. This recommendation could be implemented next year by including a small section in Chapter 2 of the Annual Report as recommended by the Fiscal Council.

45. Safeguard the efficacy of fiscal policy

The Government believes that compliance with the fiscal rules is being done in a way which does not limit the efficacy and the meeting of fiscal policy objectives. Budgetary adjustments carried during the year do serve the purpose of safeguarding the effective functioning of government, through adoption of an element of flexibility, as permitted at law, in response to developments arising during the year, owing to the vastness and complexity of managing the annual budget comprising several ministries, departments and entities.

46. Explore options to improve forecast accuracy

The Ministry stresses that whilst providing for any in-year budgetary decisions that may need to be taken, and assuming that line ministries (including their departments and entities) remain compliant with their budget allocations during the year, the containment of expenditure remains a budget priority.

47. Assume stable elasticities unless justified by specific factors

The Ministry uses an element of judgement and precise elasticity point estimates can be difficult to justify. Internally the Ministry considers a range of plausible elasticity estimates based on alternative methodologies (e.g. model based estimates, econometric estimates, results from studies in the economic literature and historical performance and observations). Furthermore, the tendency is to allow a measure of prudence in these estimates. Some of that element of judgement is also devoted to the experience of the Ministry and the detailed knowledge of specific conditions prevailing or expected to prevail in a specific year. This could influence revenue performance irrespective of the macroeconomic conditions (e.g. collection of arrears, liquidity in the market). In this context, a mechanical rule as proposed by the Fiscal Council may not be appropriate, although the Ministry is not averse to minimise large variations in the assumptions when possible.

48. Maintain the MTO

The Government agrees with this recommendation.

49. Monitor closely population trends and their implications

The Ministry agrees with this recommendation.

50. Prioritise productivity gains through transferring best practices across departments

The Ministry agrees with this recommendation.

51. Introduce more effective medium-term policy framework

The Fiscal Responsibility Act already allows for a rolling three-year Medium-Term Budget Framework.

52. Provide a more detailed account on the absorption of EU funds

The Ministry will take action to ensure that the information provided is as comprehensive as possible, within timeframes prevailing and given resources, by consulting the EU funds managing authorities in this case.

53. Ensure publication of the HYR by end July even when the Parliament is in recess

The Ministry acknowledges the difficulty alluded to by the Fiscal Council. Nevertheless, an earlier submission by the Ministry of its Half-Yearly Report would undermine the objective of basing potential mid-year fiscal policy decisions on information covering the first six months of the year and/or would require a higher degree of provisional estimates. If this is deemed desirable at any point in time, Article 39(7) of the FRA already allows the submission of the Half-Yearly Report at an earlier date in July. In this context, the Ministry does not consider necessary to make changes to the Fiscal Responsibility Act.

54. Publish more background information on models used by MFIN

The Ministry agrees with this recommendation as it is a legal requirement of the Fiscal Responsibility Act and the Stability and Growth Pact.

55. Monitor closely revenues derived from the IIP

The Ministry agrees with this recommendation and indeed monitors revenues derived from the Individual Investor Programme on a regular basis.

56. Consider introducing direct reference to the expenditure benchmark in the legislation

The Ministry prefers to wait for possible developments at the European level before making any legislative proposals in this respect.

57. Implement the necessary structural reforms

The invitation is noted by Government and in fact in recent years it has undertaken a number of structural reforms, such as in the labour market and in relation to welfare benefits.

Chapter 4

Government Borrowing and Management of Public Debt Act, 2017

Introduction

The year 2017 marked an important milestone in the legislation regarding public finances, with the passing of new legislation in July entitled **Government Borrowing and Management of Public Debt Act, 2017** (Act No XXII – CAP 575). All the provisions of the Act came into force as from 1 September 2017 with the exception of certain articles (see Table 4.1).

This Act consolidated and rationalised different pieces of legislation related to Government borrowing, such as the Malta Treasury Bills Act, 1952, the Local Loans (Registered Stock and Securities) Ordinance, 1959, and the Development Loan Acts of 1971 and 1972. This legislation also introduced new features that were not covered by the previous legal framework, such as in relation to Government guarantees. The aim of the Act is to contribute to a stronger governance system, as well as more transparency and prudency in terms of the management of Government debt, its cash position and liquidity and the reserve funds.

Table 4.1 Legislative process for the enactment of the Act

Date	Details
24 June 2017	The Minister for Finance presented Motion Number 10 allowing for the first reading of the Government Borrowing and Management of Public Debt Bill.
28 June 2017	The first reading was held during sitting number 6 of the plenary session of the Parliament.
18 July 2017	The second and third readings were held through sitting number 19 of the plenary session of the Parliament.
19 July 2017	Act No. XX11 of 2017, entitled the Government Borrowing and Management of Public Debt Act, 2017, was published by means of a notification in the Government Gazette.
1 September 2017	Through Legal Notice 216 of 2017, the Minister for Finance has brought into force all the provisions of this Act, with the exclusion of articles 40 to 52 as well as paragraph (e) of article 71 which shall come into force at a future date to be established by the Minister for Finance.

Source: Parliament of Malta

Main features of the Act

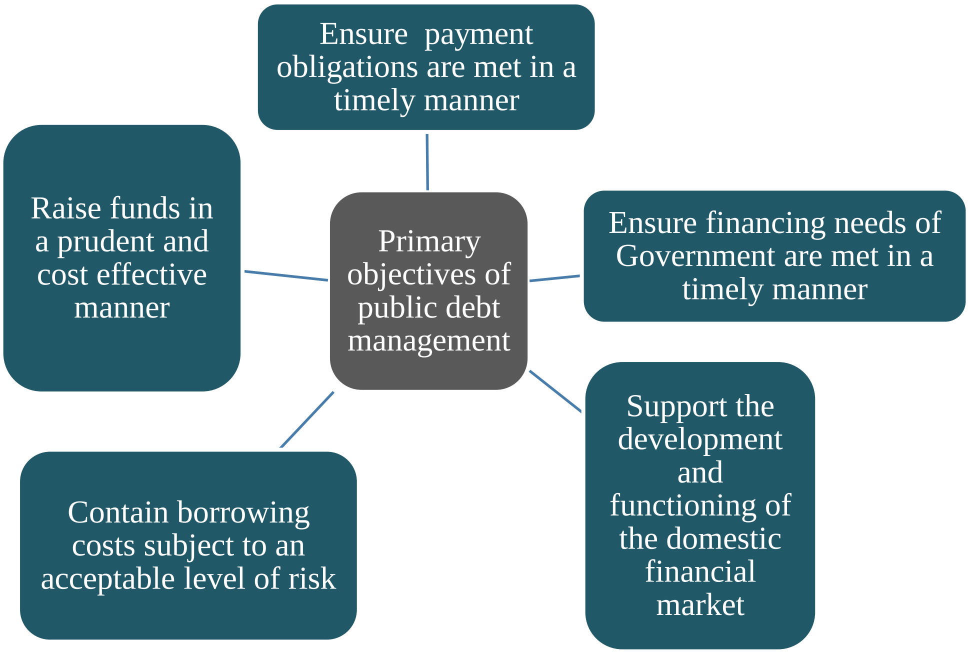
The salient characteristics of this new legislation are illustrated in Table 4.2 which lists some of the key articles of the Act, whose content is further elaborated in Diagram 4.1 and Tables 4.3 to 4.6.

Table 4.2 Specific key articles of the Act

Article number	Focus	Reference diagram / table
7	Underscores the primary objectives of public debt management in Malta	4.1
8	Specifies the reasons which permit the Minister for Finance to borrow funds	4.3
16 - 17	Sets out the requirements for a medium-term debt strategy	4.4
40 - 52	Sets out the requirements for the issuance of Government guarantees	4.5
68	Outlines the functions of the Public Debt Management Advisory Committee	4.6

Source: Government Borrowing and Management of Public Debt Act, 2017

Diagram 4.1 Primary objectives of public debt management in Malta



Source: Article 7, Government Borrowing and Management of Public Debt Act, 2017

Table 4.3 Permitted borrowing by Government

To finance the fiscal deficit
To maintain adequate liquidity and meet liquidity requirements
To form sinking funds
To finance prepayments of debt or future borrowing requirements
To fulfil financial obligations generating from Government guarantees
To refinance outstanding loans
To effect portfolio changes
To finance specific lending operations by the Government which are supported by a resolution or Act of Parliament
To raise a sum of money not exceeding 2% of the maximum amount that can be borrowed for that year, to finance on-lending operations of small amounts for the benefit of the Maltese economy and society
To directly protect the economy of Malta
To finance any other expenditure as the Minister may authorise from time to time

Source: Article 8, Government Borrowing and Management of Public Debt Act, 2017

Table 4.4 Features of the medium-term debt strategy

Is prepared annually with a minimum of a three-year rolling basis (that is, the current year and the two subsequent years).	Specifies underlying assumptions used to prepare the strategy.
Is recommended by the Public Debt Management Advisory Committee and approved by the Minister for Finance before being tabled in the House of Representatives.	Must be approved by the Minister for Finance no later than two weeks following the approval of the Government's medium-term fiscal strategy.
Takes into account future borrowing needs of Government.	Takes into account the medium-term outlook regarding macroeconomic and financial conditions and of exposure to possible shocks.

Source: Article 16, Government Borrowing and Management of Public Debt Act, 2017

One of the most important innovative features of this new legislation is Part V which deals with Government guarantees. To date, the Government's contingent liabilities were broadly governed by administrative controls rather than legislation. Thus, the new provisions will fill a very significant gap in the legislative framework regarding public finances. However, the relative articles 40 to 52 have not yet come into force, pending the finalisation of the necessary technical procedures.

The new legislation specifies that the Government, through the Minister for Finance, may provide financial guarantees to a third party for the benefit of the economy in Malta. Where a loan is guaranteed under this Act, the borrower shall, unless the Minister otherwise determines, pay to the Government a fee reflecting the credit risk at such rate and in such manner as may be prescribed in regulations made under this Act. The Treasury Department shall assess requests related to guarantees for the consideration of the Minister, accompanied by a specific statement regarding the assessment of the associated risks (see Table 4.5).

Table 4.5 Statement details in relation to Government guarantees

The Treasury must provide:
• the details of a risk assessment exercise undertaken with respect to the issue of the guarantee and a determination as to the quality and level of risk involved • an assessment of the financial risk for the Government stemming from the total outstanding amount in respect of all other guaranteed loans

Source: Article 46, Government Borrowing and Management of Public Debt Act, 2017

> **"To manage guarantees effectively, governments need to have a complete understanding of their portfolio of guarantees and associated risks; develop tools and techniques for evaluating guarantee proposals; consider appropriate risk mitigation measures; and adopt suitable budgeting, accounting, and disclosure practices."**
>
> IMF (2017)
> How to Strengthen the Management of Government Guarantees

The Act specifies that the ceilings on the issuance of Government guarantees shall be based on the medium term fiscal policy statement for the forthcoming budget year and two further years. The ceilings are conditional on the revenue forecasts and must be consistent with the fiscal rules as specified in the Fiscal Responsibility Act. The ceiling on government guarantees for the forthcoming budget year shall be included in the Budget Measures Implementation Act.

Table 4.6 Functions of the Public Debt Management Advisory Committee

Advise the Minister for Finance on policy issues regarding debt management strategic options and risk management framework.	Monitor the implementation of the annual debt management strategy and borrowing plan approved by the Government for the current financial year.
Advise on an indicative issuance programme for government securities.	Provide overall guidance to the Government borrowing programme.

Source: Article 68, Government Borrowing and Management of Public Debt Act, 2017

The MFAC's opinion regarding the Act

The Council welcomes this Act as it has many positive features. Besides contributing to consolidate and rationalise different pieces of legislation governing Government borrowing, the Act also provides for modern day exigencies of debt management that were not covered by the previous legislative framework. These include portfolio management operations such as repurchase and reverse repurchase transactions and securities lending.

More significantly, the Act introduces important measures that should contribute to a stronger governance system, better planning and more transparency. In particular, the Council notes with satisfaction the introduction of a more effective framework governing the issuance of Government guarantees, thereby facilitating better controls on the Government's outstanding contingent liabilities. As had been highlighted in an article on Fiscal Risks in the MFAC's 2016 Annual Report, the Government's contingent liabilities represent an additional risk to Malta's public finances, due to the marked sectoral concentration of Government guarantees and the relatively high level of such guarantees in proportion to GDP. Therefore, the Council considers the introduction of new legislation to govern guarantees as highly instrumental to contribute to a more robust fiscal governance mechanism. The MFAC therefore would like to encourage the Authorities to bring into force all the articles dealing with Government guarantees as early as possible.

The Council also notes favourably the new role being assumed by the Treasury Department in terms of the Act to monitor more closely the situation regarding Government guarantees and to prepare risk management assessments in connection with such guarantees. The strengthening of the cash and reserve management operations within the Treasury Department is another positive development. Also noteworthy is the thrust being given by the new legislation whereby the Government's borrowing operations should be viewed within the context of a medium-term debt strategy.

The Council also considers positively the upgrading of the institutional status of the Debt Management function by providing a legal basis to both the Public Debt Management Directorate and the Public Debt Management Advisory Committee.

MFAC recommendations regarding the Act

While the MFAC views the Act as a highly positive development within the context of enhancing the fiscal governance framework, it feels that certain aspects of the legislation may need some additional clarification and could also possibly benefit from some slight legislative fine-tuning in due course, when the Act comes up for review. More specifically, the Council would like to present the following comments and proposals for the consideration of the Ministry for Finance.

(i) Article 8 of the Act authorises the Minister to borrow funds for two types of on-lending operations, namely lending operations in terms of Article 8(d) in accordance with Article 53, or lending operations of "small amounts for the benefit of the Maltese economy and society" in terms of Article 8(e). Whereas according to Article 8(d) operations are subject to express authorisations in terms of specific Resolutions or Acts of Parliament, it will be useful to clarify what sort of administrative controls will be in place in respect of Article (e) operations to ensure proper governance and adequate transparency.

(ii) Article 8(i) authorises the Minister to borrow funds "*to directly protect the economy of Malta*". This term appears to be somewhat too open ended. It is suggested to provide some additional clarification regarding the context where this sub-article could possibly be triggered off, such as in exceptional circumstances.

(iii) Article 12 provides that the limit on the debt burden (as specified in the Fiscal Responsibility Act) "*may not be met only as a result of exceptional circumstances*". It is suggested to clarify the meaning of "*exceptional circumstances*", such as by providing that "*exceptional circumstances*" would have the same meaning as in Article 2(1) of the Fiscal Responsibility Act.

(iv) Article 12 provides that in exceptional circumstances the debt burden limit may not be met. It would be useful to clarify what control mechanism will be in place to govern the amount by which the debt burden limit may not be met, for instance by qualifying that failure to meet the limit will not endanger fiscal sustainability in the medium term. The latter qualification would be reflecting the same principle that is specified in Article 8(4)(b) of the Fiscal Responsibility Act, and would thereby provide for greater clarity and better safeguards to fiscal soundness.

(v) Article 18(3) provides that the Government's annual borrowing plan shall include "*an indicative quarterly calendar for domestic market issuance of Government securities with maturities of more than one year.*" Currently the annual issuance calendar published by the Treasury Department also makes a reference to the Treasury Bill issuance programme. Moreover, the Treasury Department currently publishes on a monthly basis a calendar of weekly auctions of Treasury Bills showing the tenor, the auction date as well as the issue and settlement dates. The regular publication of this Treasury Bill calendar has proved very useful for money market participants. It is therefore suggested to include a reference also to a Treasury Bill issuance calendar in Article 18(3). For the same reasons, it is suggested to delete the words "with the exception of Treasury Bills" in Article 26(1).

(vi) Article 27 provides that the Treasury Department shall have the power to accept or reject tenders "*related to local market issuances*". This text might give the impression that such power of the Treasury Department to accept or reject tenders would be applicable only to local issuances and would not be available in the case of international issuance. It is suggested to clarify the position in order to facilitate that the Treasury Department would have sufficient flexibility in respect of all types of issuances, thereby also ensuring a level playing field.

(vii) Article 43(3) provides that "*the ceiling on government guarantees for the forthcoming budget year shall be included in the Budget Measures Implementation Act.*" While this is a welcome additional control mechanism, the Council would like to suggest that the way in which the guarantee ceilings will operate can be further clarified. In particular, it would be desirable to introduce a legally binding ceiling on the overall stock of outstanding guarantees to instil more discipline and greater commitment to keep within prudent exposure limits. This would foster stronger fiscal sustainability over the medium-term.

(viii) Article 48(1) provides that the Minister shall disclose the stock of outstanding guarantees at the time of the annual budget. It is suggested that this disclosure would include a full list of all the individual outstanding Government guarantees and letters of comfort and the relevant information rather than just one figure for the overall amount of outstanding guarantees.

(ix) Article 58 provides for the creation of sinking funds for the repayment of loans and the repurchase of debt securities. The Council would like to suggest that, in the event that an undue level of risk is identified on the basis of the risk assessment exercise conducted by the Treasury Department regarding Government guarantees in terms of Article 49, additional appropriations may be made by the Minister to the Contingency Reserve established in terms of Article 31 of the Fiscal Responsibility Act as a precautionary fiscal buffer.

(x) Article 60(1) refers to "*the special sinking fund*". It is suggested to clarify why the sinking fund under article 60(1) is being called "special" and whether the nature of this sinking fund is different from the sinking funds referred to in article 58 of the Act.

(xi) Article 68 provides for the establishment of the Public Debt Management Advisory Committee. The Council would like to suggest that the composition of this Committee would also be specified in the Act to ensure better accountability and transparency.

The Council would like to invite the Authorities to take the above proposals into consideration and in due course to study the possibility of legislative amendments at the opportune time in the future when the Act comes up for review.

Chapter 5
The pension system in Malta

Introduction

A pension system enables households to smoothen their consumption over their lifetime by permitting the transfer of income from the working age to the retirement age. It also offers insurance to cover the possibility that personal savings are outlived. As a result, governments typically play a significant role in the pension system, through the provision of state pensions, as well as legislation to regulate private pensions. The objective is to have a pension system which is **sustainable**, **adequate** and promotes **equality**.

A pension system which does not adequately address fiscal sustainability may lead to future strains on public finances. Fairness may also require a close relationship between the amount of social security contributions and pension entitlements. At the same time, it is desirable to have safeguards against individuals falling into poverty during old age. The existence of alternative pension options could also allow households to better tailor their pension commitments and entitlements to their individual preferences.

The assessment of a pension system hinges critically on the demographic projections and future economic growth projections, which in turn are based on economic models and assumptions. As such, periodic review and fine-tuning to the system is desirable and indeed necessary to reflect the most recent information available within the country.

This chapter provides a general overview of the pension system in Malta and its main features, in terms of the compulsory social contributions and the ensuing entitlements. It also provides a high-level comparison of Malta's pension system to that in other EU countries, to identify similarities and differences. This section concludes with some recommendations.

Pension reforms in Malta

Pension reform in Malta has been an evolutionary process. An important milestone was recorded in 2006 when the Government introduced a mechanism whereby a strategic review of the local pension system is to be tabled at the House of Representatives every five years. In this regard, a Pensions Strategy Group was set up to present policy recommendations, taking into consideration the current and future challenges of the pension system.[5] The main recommendations outlined in the last three reports by the Pensions Working Groups,

[5] The report prepared by the Pensions Strategy Group is discussed by the Social Affairs Committee of the House of Representatives. Over the years, members of the Pensions Working Group have changed.

respectively finalised in 2005, 2010 and 2015 are summarised in Box 5.1.[6] These reports have presented a thorough reassessment of pension design in Malta and put forward a host of recommendations which provided a strong basis for possible reform. The Government is not bound to accept such recommendations and indeed, over the years, whereas various recommendations have been implemented, others were not.

Box 5.1 Strategic reviews on the pension system in Malta (2005, 2010, 2015)

Main observations and recommendations of the 2005 Pensions Working Group:

- Maximum Pension Income: The Maximum Pension income was perceived as no longer adequate. Various ways of how this was to be changed were proposed.
- Pension indexation to wages: post-retirement pensions income should be automatically indexed to a mechanism that is constituted of 70% wages and 30% inflation.
- Increase in the statutory retirement age: A gradual increase in the statutory retirement age to 65 years was proposed, though there were concerns on the viability of such increment for manual workers.
- Changes to the accumulation and calculation parameters of the Two-Thirds Pension: departing from the final salary calculation to linking the calculation of the pension with the contributions paid over an individual's accumulation period.
- Private Pensions: The introduction of a Two-Tier Second Pillar Pension Scheme and a voluntary Third Pillar Pensions Scheme aimed at complimenting pension income.
- Channelling of Pensions Contributions to the Health Fund: The recommendation to channel part of the Two-Thirds Pensions contribution towards such fund needed to be reconsidered, despite acknowledging that health reform was necessary.

Main observations and recommendations of the 2010 Pensions Working Group:

- Age-longevity indexation: introducing an explicit link between retirement age and longevity though an indexation mechanism resulting in increases in retirement age whenever the longevity index rises.
- Notional Defined Contribution (NDC) Pension: appointing a working group to consider the possibility of transforming the Two-Third Pension into a NDC First Pension.
- Pension Pillars: recommended introducing the Third Pension framework as early as possible whilst introducing the mandatory introduction of the Second pillar which should be based on a national consensus.
- Regulated home equity release market: to examine the possibility of introducing Home Equity Release schemes for people who should they wish to, leverage their property investment into income during the retirement phase of their life cycle.
- Commission on Financial Literacy and Retirement Income: proposed that the Government establishes this Commission mandated to inculcate a culture of saving for retirement, to strengthen financial literacy and to disseminate within society information on how the State Pension works.

[6] Source: 2005 Report - https://socialsecurity.gov.mt/en/Pensions-Reform/Documents/2005-Pensions-Reform/frpensions.pdf; 2010 Report - http://family.gov.mt/financial-education/publications/Documents/Malta_Pensions_Strategic_Review_2010.pdf; 2015 Report - http://family.gov.mt/financial-education/publications/Documents/Pensions%20Report.pdf.

Main observations and recommendations of the 2015 Pensions Working Group:

- Incentivise the active participation of elderly: proposed the removal of the mandatory retirement age, removing the ceiling on payment of contributions beyond 65 years of age and provide economic incentives in terms of higher pensions for the extra years spent in the labour market.
- Does not reiterate the core recommendations in the 2010 report: considered it as risky to migrate to an NDC pensions architecture; rejected the introduction of an automatic indexation to longevity and did not recommend a second pillar of a mandatory nature.
- Guaranteed National Minimum Pension (GNMP): introducing it incrementally to all pensioners, with recommendations on how to do so. Recommended adjusting the minimum pension by the full Cost-of-Living Adjustment (COLA), also being in line with poverty threshold levels reflecting increases in wage growth and maintaining relativeness to other pensions and the maximum pension.
- Crediting contributions: recommend a series of reforms to strengthen the main supporting policies of fertility (demographics); interrupted career patterns (gender), life-long learning and retention in the labour market post retirement age and crediting higher education.
- Equity release schemes: The introduction of regulations with respect to home equity release schemes. The report provides proposals on the formalisation of such home equity market.

Types of pensions in Malta

The Maltese pension system is largely based on a Pay-As-You-Go system. The different types of pensions in Malta are outlined in Table 5.1.

Table 5.1 Pensions in Malta

Contributory retirement pension	Persons attaining their retirement age may be eligible to the contributory retirement pension, subject to satisfying a set of statutory conditions and contributory criteria during their working years. A two-thirds pension or a flat rate pension applies.
Contributory invalidity pension	This is granted to persons under retirement age who are no longer deemed as capable of performing full-time or part-time work. Applicants for this pension should have contributed at least 250 contributions and paid or been credited an average of 20 contributions per year from the age of 18 or 19 as the case may be, and who have been registering for work or been gainfully occupied over the previous year. With effect from 2018, applicants suffering from a terminally ill condition require a minimum of 50 contributions to qualify for the full rate. Different rates apply according to the yearly average of contributions paid and/or credited and the civil status of the claimant.

Contributory Widows pension	A contributory widows pension is awarded, if the deceased spouse meets the relevant contribution conditions. A widow's pension or a survivor's pension is awarded to those persons whose spouse was already in receipt of a Retirement or Two-Thirds Pension. An Early Survivor's Pension is awarded to those persons whose spouse was still under retirement age. Such pension is received in full even if the widow is in full time employment. When a widow re-marries, a flat rate widow's pension would be due. Furthermore, a widow who reaches pension age and is eligible for a retirement pension in her own right and such pension is lower than the widow's pension rate, the widow's pension rate is increased by 1/6.
Non-contributory age pension	Persons who attain retirement age without having made the required number of contributions are entitled to a non-contributory pension, subject to satisfying a capital and resources means test. Specifically, capital resources should not exceed €23,300 or €14,000 in the case of a married couple or in other cases respectively.
Non-contributory assistance for the visually impaired	Persons holding a medical certificate from a registered Ophthalmologist certifying visual impairment are eligible to an Assistance for the Visually Impaired pension whereby the beneficiary's income from employment is exempted from the means test.
Non-contributory carer's assistance	This assistance is payable to a person under retirement age who proves that he is regularly taking care of a relative, all by himself / herself, on a full-time basis and is living in the same household as that of such relative, provided that the latter exceeds certain medical parameters. To be credited social security contributions, the carer must have paid at least 156 contributions and a yearly average of at least 20 contributions since the age of 18 to be credited social security contributions. A means test is applied based on whether the person is entitled to a carer's allowance or to an increased carer's allowance which is not means tested.
Non-contributory disability assistance	An assistance for disability may be given if the beneficiary falls under the category of increased severe disability assistance, severe disability assistance or disability assistance.

Senior citizen grant	A yearly payment, currently of €300, is made to persons aged 75 years or older and who are still living in their own residence or with their relatives in Malta or Gozo.
Contributory retirement grant	Persons who have reached retirement age but do not qualify for a contributory retirement pension are entitled to a grant, currently of €150, every year until they qualify for the senior citizens grant provided they have paid between 50 and 259 contributions. Those who have paid 260 or more contributions are currently awarded €250 instead of €150 per year. At the age of 75 and forth, the senior citizens grant applies upon eligibility.

The retirement age

A main reform in Malta's pensions history was undertaken in 2006, when the statutory retirement age was raised. At that time, the statutory retirement age was set at 61 years for males and 60 years for females. Following the 2006 reform, the retirement age is being gradually raised to reach 65, for both males and females. This enables a gradual impact on government finances and a smoother transition to a retirement age which is more in line with the euro area average. The phased increase in retirement age was set so as to avoid significant discrepancies in pension benefits arising from variations in the date of birth due to being a day younger or a day older. The retirement age is calculated upon the year of birth of individuals (see Chart 5.1). Accordingly, the year of retirement was retained at 61 for those born in 1951 or before, and was increased step-wise to reach 65 for those born in 1962 or later. The current legislation specifies that from the year 2027 onwards, all cohorts that are to retire are subject to a statutory retirement age of 65.

The effective retirement age in 2018 is 62, and will increase to 63 in 2019, 64 in 2023 and 65 in 2027. However, a person who has attained the age of 61 years can currently opt for retirement as long as the person is not in any gainful occupation and has already paid or has been credited a certain number of contributions since reaching the eighteenth birthday as indicated in Table 5.2. The increase in the number of years of contributions from 40 to 41 was announced in the Budget for 2016 and enacted in the Social Security Act. This was done to stabilise the relation between the contributory periods and the periods of time during which it is expected that the individual shall be in receipt of a pension, due to the rising life expectancy.[7]

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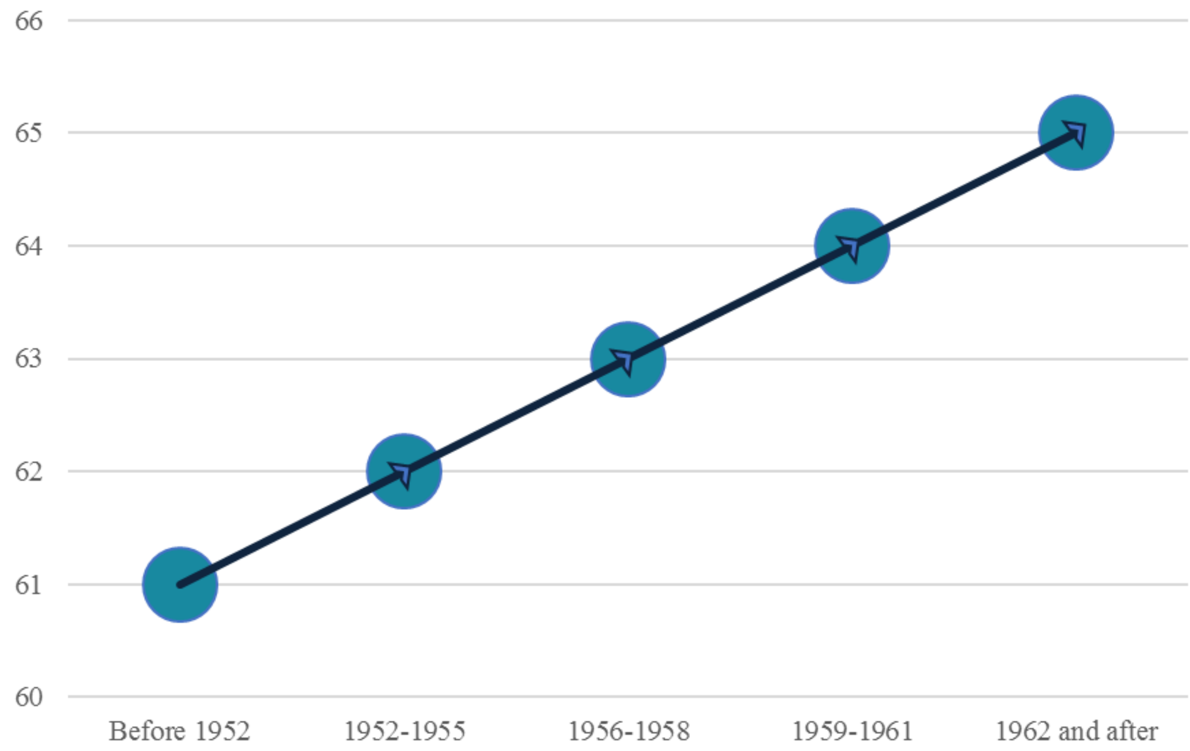
[7] The latest available statistics by the World Health Organisation (WHO) place the life expectancy at birth in Malta at 80 years for males and 84 years for females (based on 2015 data). Source: http://www.who.int/countries/mlt/en/.

Chart 5.1 The retirement age according to year of birth



Source: Social Security Act Cap. [318]

Table 5.2 Number of contributions required for earlier retirement

Year of Birth	No of contributions	Equivalent in years
1952-1961	1820	35
1962-1968	2080	40
1969 and after	2132	41

Source: Social Security Act. [Cap318]

Contributions

The social security contributions payable depend upon the class of the contribution, the contributor's income and the year in which the person was born, as laid out in the Social Security Act. Class One contributions are applicable to those persons who are employed, while Class Two contributions are in respect of persons who are either self-employed or self-occupied.[8]

[8] The Social Security Act defines a self-employed person as "a person who has not yet passed his sixty-fifth birthday, is ordinarily resident in Malta, and is not an employed person nor a self-occupied person". The

In the case of an employed person, the social security contribution is shared between the employee, the employer and the government. A rate of 10 percent of the basic weekly wage (or the equivalent of the basic monthly salary) applies to the employee, the employer and the Government. On the other hand, a cap applies in the case of persons born on or before 31 December 1961 and whose basic weekly wage exceeds €349.36. The cap applicable in 2018 limits the contribution to €34.94 per week. For those born on or after a January 1962, when the weekly wage exceeds €455.78, the applicable cap is currently €45.58. The increase in the highest contribution rate payable with effect from January 2018 is related to a guaranteed maximum pensionable income of €23,701 for persons born in 1962 or after. Some further adjustments apply to persons undertaking full-time studies or who are under 18 years of age.

For Class Two persons, the social security contribution is equivalent to a rate of 15 percent of their net annual income, apart from those whose net earnings do not exceed €10,194 who pay fixed rates. A threshold of €52.40 per week is applied for those whose annual net income exceeds €18,167 and were born on 31 December 1961 or before. A weekly cap of €68.37 is applied for those with a net income exceeding €23,701 and born after 1961. The same conditions apply for self-occupied persons, except farmers and breeders for whom lower rates apply. For persons earning less than €10,194 per year, a fixed weekly contribution of €29.41 applies.[9]

A contribution can also be credited rather than paid. A credited contribution is defined by the Social Security Act as "a contribution which is not paid by a person but is nonetheless accredited 'ope legis' to him". The Budget law for 2016 introduced a system which credits human capital development and lifelong learning. For every year of study associated with lifelong learning, one month for every year is credited. The amount credited for human capital development varies across levels of studies (from level 5 to level 8) in accordance with the Mutual Recognition of Qualifications Act and whether the individual was born prior to or after 1962.[10] Child rearing credits have also been strengthened in the same Budget law.[11]

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definition of a self-occupied person as per the Social Security Act is: "a self-employed person who is engaged in any activity which earnings exceeding €910 are being derived".

[9] For self-occupied persons, a rate of 15% applies if the person is a part-time self-occupied woman or a full-time student under the age of 24, or a pensioner, and who is also self-occupied on a part-time basis, with an earning not exceeding €10,194. In the case of self-employed, who are single and not self-occupied, and earning between €1,005 and €8,734 must pay a weekly rate of €25.19.

[10]An MQF level 5 refers to an undergraduate diploma/certificate or a Vocational Education and training (VET) Higher Diploma of Foundation Degree. An MQF of level 6 refers to a Bachelor's Degree; level 7 is in terms of a Master's Degree, a Post-graduate Diploma or a Post-graduate Certificate; and MQF level 8 refers to a Doctoral Degree.

[11] More detailed information on contributions and credits can be obtained as per Social Security Act (Chapter 318. of the Laws of Malta) and on the Government social security website: www.socialsecurity.gov.mt.

Pension entitlements

Two types of entitlements are attributed to pensioners, either a flat rate or a two-thirds pension. Flat rate pensions are awarded to pensioners who are also entitled to a service pension and those who at their pension age, have a sufficiently low, or do not exceed a threshold of pensionable income.

On the other hand, defined benefit entitlements are based on the pensionable income. The pensionable income varies between cohorts born in 1961, or before, and after 1961. For those born prior to 1962, the pensionable income is based on the yearly average of the best three consecutive calendar years within the last ten to thirteen consecutive years (depending upon the year of birth), immediately preceding retirement or invalidity. More specifically, ten years are used in the case of those born until the last day of 1951, eleven years for those born between 1952 and 1955, twelve for those born between 1956 and 1958, and thirteen years for those born between 1959 to 1961.

For self-employed or self-occupied persons, the yearly average of the net income in the last ten years is calculated in terms of pensionable income. If born between 1952 and 1955, the yearly average is calculated on the best 10 years of the last eleven; if born between 1956 and 1958, out of the last twelve; and if born between 1959 and 1961 out of the last thirteen.

For persons born on 1 January 1962 and after, the yearly average of the basic wage or salary, or the net income or net earnings during the best ten calendar years, within the last forty calendar years immediately preceding retirement or invalidity, is used as the measure of the pensionable income.

However, there exists a cap which the pensionable income cannot exceed. For those born prior to 1951, the maximum pensionable income is currently €17,470.30. For those born between 1952 and 1961, there is a limit of €20,964.36 upon which the pension is calculated, after including cost of living increases. With effect from 1 January 2014, for those born after 1962, a maximum pensionable income of €20,964.36 applies, which is then annually adjusted by such sum as corresponds to seventy percent of the percentage increase in the average wage for the previous calendar year (as published by the National Statistics Office) plus thirty percent of the inflation rate as published by the same authority for the previous calendar year.

The full rate of the Two-Thirds Pension shall be two-thirds of the pensionable income of the insured person who has paid or been credited with a yearly average of fifty contributions over a period of 35 years for persons born between 1952 and 1961; 40 years for those born during 1962 and 1968; and 41 years for those born on or after 1 January 1969.

Whenever beneficiaries do not meet the required threshold of contributions (lower than an average of 50 per year), the rate of pension payable per week is adjusted according to set adjustment ratios. The pension is reduced to 0.89 of the full applicable pension minus any increments granted, when the average contributions are between 40 and 50 for example. Rates of 0.69 and 0.49 apply to when average contributions are between 30 and 39, and between 20 and 29 respectively. The rates for a widow's pension are the same, but adjusted for a supplementary weekly pension allowance of €17.77. The guaranteed minimum level per week is also adjusted for the same contributory averages, but with adjustment factors of 0.94, 0.85 and 0.76 instead of 0.89, 0.69 and 0.49, respectively.

A National Minimum Pension also applies. The full rate of such pension is set at four-fifths of the National Minimum Wage in the case of a married person who is maintaining a spouse and at two-thirds of the National Minimum Wage in the case of any other person. Whenever the Government awards a cost-of-living increase in the rate of the National Minimum Wage payable to persons over 18 years of age, for any pension payable, that pension shall increase at an amount equivalent to two-thirds of the such cost-of-living increase, unless a higher increase is due.[12] In the case of a married person maintaining a spouse, this is adjusted by four-fifths of the increase.[13] The Social Security Act (Cap. 318) stipulates that the highest rate per week of a two-thirds pension is set at €234.25.

A flat rate applies to those also in receipt of a service pension. A service pension is a pension or other allowance given to an individual payable by, or on account of, his or her employer in terms of past services in the country or overseas. The rate depends on whether persons are paid a service pension by or on behalf of the Government of the United Kingdom or not, and on whether the person is maintaining a spouse or otherwise.[14]

Incentives for later retirement

Following the Budget for 2016, a system of incentives for retirement deferral has been adopted for those working in the private sector and who have paid at least 35 years of social security contributions and are eligible to retire between the age of 61 and 64. Table 5.3 shows the economic incentives in place when delaying retirement by one year, while Table 5.4 shows the incentives for delaying retirement by more than one year.

This scheme encourages private sector workers to continue working. Benefits are computed in such a way as to capture actuarial neutrality, meaning that benefits are adjusted as a function of remaining life expectancy, and thus compounded increments occur for each year of further delay. Voluntary schemes rather than mandatory increases in retirement age have various

[12] This excludes injury pensions assessed at 89% or less and any National Minimum Pension Additional Allowance.
[13] This subject to an automatic increase of only one pension if that person is entitled to two or more pensions, or a pension being supplemented by Social Assistance. In the case of an Increased Carer's Allowance, Increased Severe Disability Allowance, Severe Disability Assistance and Assistance for the Visually Impaired, the full cost-of-living increase is applied. A two-thirds increase is applied in the case of Carer's Allowance and Disability Allowance.
[14] More detailed information on entitlements and eligibility can be obtained as per Chapter 318. Social Security Act of the Laws of Malta and on the government social security website: www.socialsecurity.gov.mt.

benefits particularly in being able to better suit households' individual preferences.[15] They also help in mitigating possible labour shortages which might occur.

Table 5.3 Incentives for delaying one year to retirement

Retirement age	Opt to work till age	% increase in pension rate	Entitlement at age
61	62	5.0	62
62	63	5.5	63
63	64	6.0	64
64	65	6.5	65

Source: L.N. 289 of 2016

Table 5.4 Incentives for delaying more than one year to retirement

Retirement age	Opt to work till age	% increase in pension rate	Entitlement at age
61	63	10.5	63
61	64	16.5	64
61	65	23.0	65
62	64	11.5	64
62	65	18.0	65
63	65	12.5	65

Source: L.N. 289 of 2016

The three pension pillars

Pensions are generally categorised into three pillars. Malta's system incorporates the first and third pillars. The World Bank describes the three main pension pillars as follows:

- A mandatory **first pillar** links contributions to varying degrees of earnings with the objective of replacing some portion of lifetime pre-retirement income. They are typically financed on a pay-as-you-go basis.

[15] The OECD publication, 'Pensions at a Glance 2017', provides a comprehensive analysis of such schemes on incentives towards later retirement and disincentives associated with early retirement. Available on: www.oecd.org/publications/oecd-pensions-at-a-glance-19991363.htm.

- A mandatory **second pillar** pension is typically an individual savings account, that is a defined contribution plan, with a wide set of design options including active or passive investment management, choice parameters for selecting investments and investment managers, and options for the withdrawal phase.

- A voluntary **third pillar** pension can take many forms, such as individual savings for retirement, disability or death; employer sponsored; defined benefit or defined contribution; and is essentially flexible and discretionary in nature. [16]

In an effort to further encourage private saving, in 2014 the Government introduced incentives to enhance the appeal of a third pillar pension scheme. The scheme provides the opportunity to save for a pension through private pension packages offered by financial institutions, including banks and life insurance companies. It is formally referred to as the Personal Retirement Scheme, which is supplemented by the option of an Individual Savings Account. The Personal Retirement Scheme is the provision of an annual tax credit, with benefits of up to €300 per family, which benefits shall not start earlier than age 50, or later than age 70.[17] The Individual Savings Account (ISA), provides families the option to open a tax-free savings account with up to €2,000 per year per couple invested in such accounts. Individuals can withdraw funds from such accounts any time, similar to a savings account.[18]

In 2017, incentives were also introduced to encourage voluntary occupational pension schemes by employees and employers. Under this system, funds are put aside in an expense account by the employer, which is tax free. Furthermore, tax credits apply to employers and employees opting for such schemes. Should an employee change job, and the future employer would not be willing to offer such schemes, then an option would exist to transfer the account into a third pillar. This scheme is still not considered as a second pillar as it is totally on a voluntary basis, rather than mandatory.

Comparison with the pension systems across the European Union

Over the last two decades, the intensity of pension reform has been particularly strong across Member States of the EU, mostly in terms of eligibility for pension. Following the financial

[16] The World Bank also portrays a non-contributory 'zero pillar', which fiscal condition permitting, deals explicitly with the poverty alleviation objective in order to provide all of the elderly with a minimal level of protection. It also describes a 'fourth' pillar as one which include access to informal support (such as family support), other formal social programs (such as health care and/or housing), and other individual financial and non-financial assets (such as home ownership and reverse mortgages where available). Source: http://siteresources.worldbank.org/INTPENSIONS/Resources/395443-1121194657824/PRPNoteConcept_Sept2008.pdf.

[17] More information can be obtained as per Subsidiary Legislation 123.163 on Personal Retirement Scheme Rules, available on: http://justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=12264&l=1.

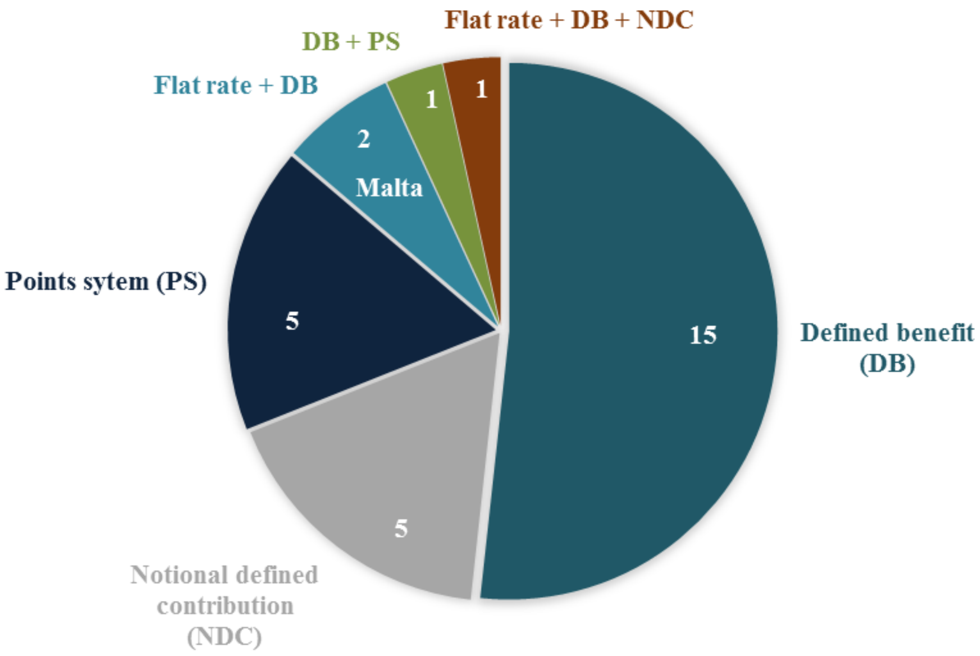
[18]More information can be obtained s per Subsidiary Legislation 123.164 on Individual Savings Account Rules, available on http://justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=12265&l=1.

crisis that hit most European countries, additional measures were enacted with the objective of enhancing the sustainability of the pension systems.

The European Commission classifies pensions systems as defined benefit schemes (DB), notional defined contribution schemes (NDC) or a points system (PS).[19] Simple DB plans are those which pay an average accrual rate for each year of service calculated upon average re-valued earnings. In NDC schemes, the financing inflow over the contribution period is given by wages multiplied by the contribution rate, with increments according to the interest rate. On retirement, the accumulated notional capital is divided by a notional annuity factor. In a PS system, the pension benefit depends on the value of points gained at the time of retirement, determined by earning per cost of a pension point.

Most countries within the European Union (15) have a defined benefit scheme in place, five operate a NDC scheme whilst another five operate a PS system (see Chart 5.2). The other countries have mixed schemes. Malta is classified as one of the latter countries, whereby the pension system offers either a flat rate scheme or a defined-benefit scheme. The flat rate basically applies to those on a low income or those also on a service pension, while the DB system refers to the two-thirds pension system in Malta.

Chart 5.2 Earnings-related state pension schemes across countries in the EU



Source: 'The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies'

The minimum pension, as defined by the European Commission, is means-tested and includes social allowance/assistance. This is comparable to many countries in the EU (see Table 5.5).

[19] Source: 'The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies', page 104, available on: https://ec.europa.eu/info/sites/info/files/economy-finance/ip065_en.pdf.

Table 5.5 Properties of public and private pension schemes across EU countries

		Public pensions[3]					Private pension scheme		
Country	Pension scheme	Minimum Pension[4]	Old-age pensions	Early retirement pensions	Disability pensions	Survivors' pensions	Occupational pension scheme	Mandatory private individual	Voluntary private individual
BE	DB	MT - SA	ER	ER	ER priv FR self-emp	ER	M* priv V* self-emp	X	Yes*
BG	DB	MT - SA	ER	ER	ER	ER	V*	Yes*	Yes*
CZ	DB	X	ER	ER	ER	ER	X	X	Yes*
DK	DB	FR & MT suppl.	FR & MT suppl.	V	FR	FR	Quasi M	X	Yes*
DE	PS	MT - SA*	ER	ER	ER	ER	V*	X	Yes*
EE	DB	MT - SA	ER	ER	ER	ER	M*	Yes*	Yes*
IE	Flat rate + DB	MT - FR & SA	FR	FR - MT	FR - MT	FR - MT	M pub V* priv	X	Yes*
EL[1]	Flat rate + DB + NDC	MT - FR	FR - ER	FR - ER	FR - ER	FR - ER	X	X	Yes*
ES	DB	MT	ER	ER	ER	ER	V	X	Yes
FR[2]	DB + PS	MT - SA	ER	ER	ER	ER	V*	X	Yes*
HR	PS	ER	ER	ER	ER	ER	M*	X	Yes*
IT	NDC	MT - SA	ER	ER	ER	ER	V*	X	Yes*
CY	PS	MT & ER	ER	ER	ER	ER	M* - pub V* - priv	X	X
LV	NDC	FR - SA	ER	ER	ER	ER	X	Yes*	Yes*
LT[6]	DB	SA	ER	ER	ER	ER	X	Quasi M	Yes*
LU	DB	MT - SA*	ER	ER	ER	ER	V*	X	Yes*
HU	DB	MT - SA	ER	ER	ER	ER	V*	X	Yes*
MT	Flat rate + DB	MT - SA	FR & ER	X	FR & ER	FR & ER	V*	X	Yes*
NL	DB	SA	FR	X	ER	FR	M	X	Yes*
AT	DB	MT - SA	ER	ER	ER	ER	V*	X	Yes*
PL	NDC	ER	ER	ER	ER	ER	V*	Yes*	Yes*
PT	DB	MT - SA[5]	ER	ER	ER	ER	M	X	Yes*
RO	PS	SA	ER	ER	ER	ER	X	Yes*	Yes
SI	DB	MT - SA*	ER	ER	ER	ER	V*	X	Yes*
SK	PS	MT - SA	ER	ER	ER	ER	X	X	Yes*
FI	DB	MT	ER	ER	ER	ER	V*	X	Yes*
SE	NDC	MT	ER	ER	ER	ER	Quasi M	Yes*	Yes
UK	DB	FR & MT - SA	ER - V	X	ER*	ER	V*	X	Yes*
NO	NDC	FR	ER	X	ER	ER	M*	X	Yes*

(1) The public supplementary pension fund is NDC since 2015.
(2) Point system refers to the ARRCO and AGIRC pension schemes
(3) Public pension expenditure include all public expenditure on pension and equivalent cash benefits granted for a long period, see Annex 2 for details on the coverage of the projections of public pension expenditure.
(4) Minimum pension corresponds to Minimum pension and other social allowances for older people not included elsewhere.
(5) Include all pensions of the non-earning related scheme such as old-age, disability and survivors pensions and the social supplement (equal to the difference between the guaranteed minimum amount and pension benefits calculated according to the rules) granted to the earning-related pensioners.
(6) The current DB system will be replaecd by a DB+PS system in 2018.
DB: Defined benefit system.
NDC: Notional defined contribution scheme.
PS: Point system.
MT - Mean-tested
FR - Flat rate
ER - Earnings related
SA - Social allowance/assistance
V - Voluntary
M - Mandatory
X - Does not exist
* Not covered in the projection

Source: Reproduced from 'The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies'

The old-age pension of nearly all EU countries is earnings-related. Malta is one of the few countries who apart from the earnings-related old-age pension has a flat-rate scheme in place. The same can be said for the disability and survivors' pensions. From Table 5.5, one can note that Malta is marked as not having an early retirement pension. Despite there being the option of retiring at a prior age of 61 years to the statutory age, this does not in itself qualify as a diversified pension plan to the state pension scheme.

In terms of national private pension schemes, Malta's occupational pension scheme is on a voluntary basis. Nearly half of the countries in the EU operate such schemes on a voluntary basis, whilst others have mandatory private pension schemes in place, quasi-mandatory, a mix of both or do not offer occupational pensions at all. On the other hand, voluntary private individual schemes are available in all countries across the EU except for Cyprus.

Pensionable earnings reference (pensionable income) is mainly calculated upon the full career of the beneficiary, for 19 out of 29 EU Member States (see Table 5.6). The rest of the countries adopt different kinds of pensionable earnings references. For example, in Malta earnings are related to the best ten years, or best three out of a number of years preceding retirement, according to the year of birth of the individual. As in all the countries in the EU, general valorisation variable(s) and general indexation variable(s) are applied to pensionable earnings.

Table 5.6 Pensionable earnings reference in the EU

Pensionable earnings reference	Number of Countries
Full career	**19**
Full career with a limit of years	**1**
Years of residence	**2**
Flat rate	**1**
Best Years / Best consecutive years	**3** (including Malta)
Wages	**1**
A number of years preceding retirement	**1**
Years of insurance contributions	**1**

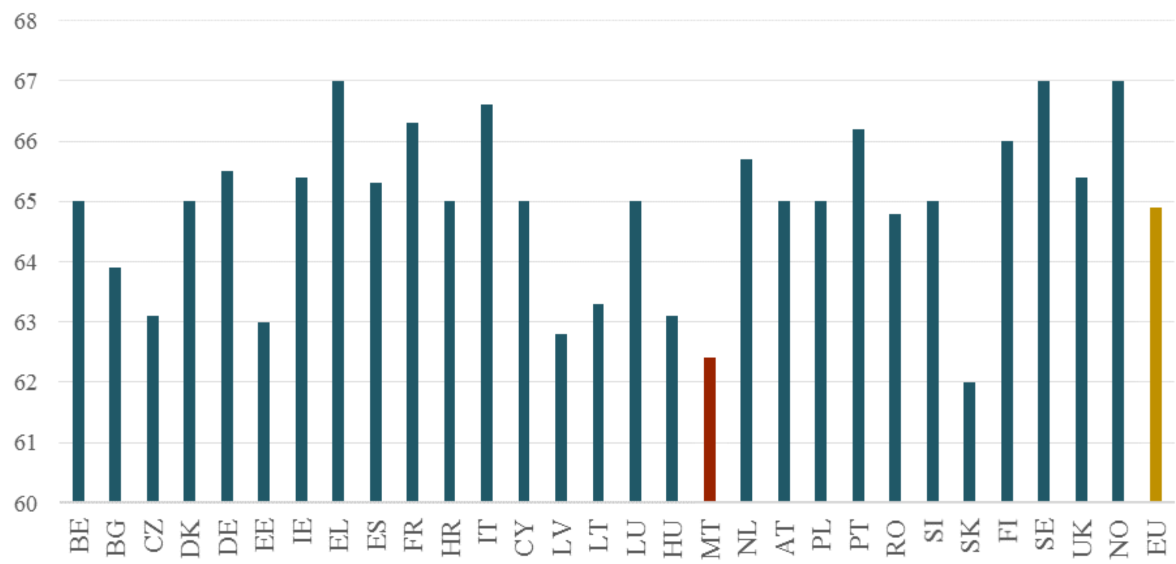
Source: The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies

Malta applies the cost of living as a general valorisation variable and prices and wages as a general indexation variable. Most countries also use prices and wages for both valorisation / indexation variables. Contribution rates on the other hand, vary by country, and are not always uniform for employees, the self-employed and employers.[20]

[20] A detailed summary of the contribution rates per country in 'The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies', Annex 2 page 149, available on: https://ec.europa.eu/info/sites/info/files/economy-finance/ip065_en.pdf.

The European Commission estimated that the average retirement age for males and females in Malta in 2016 was 62.4 years. (see Chart 5.3). It is the second lowest average retirement age in the EU amongst males. The average EU retirement age for males in 2016 was 64.9 years.[21] However, the retirement age in Malta is set to gradually increase to 65 by 2027, and will thus converge closer to the EU average, which is projected to increase to 66.1 in 2030. The latter also reflects the fact that certain countries have opted to link their retirement age to increased life expectancy.

Chart 5.3 Male retirement age across Europe



Source: The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies

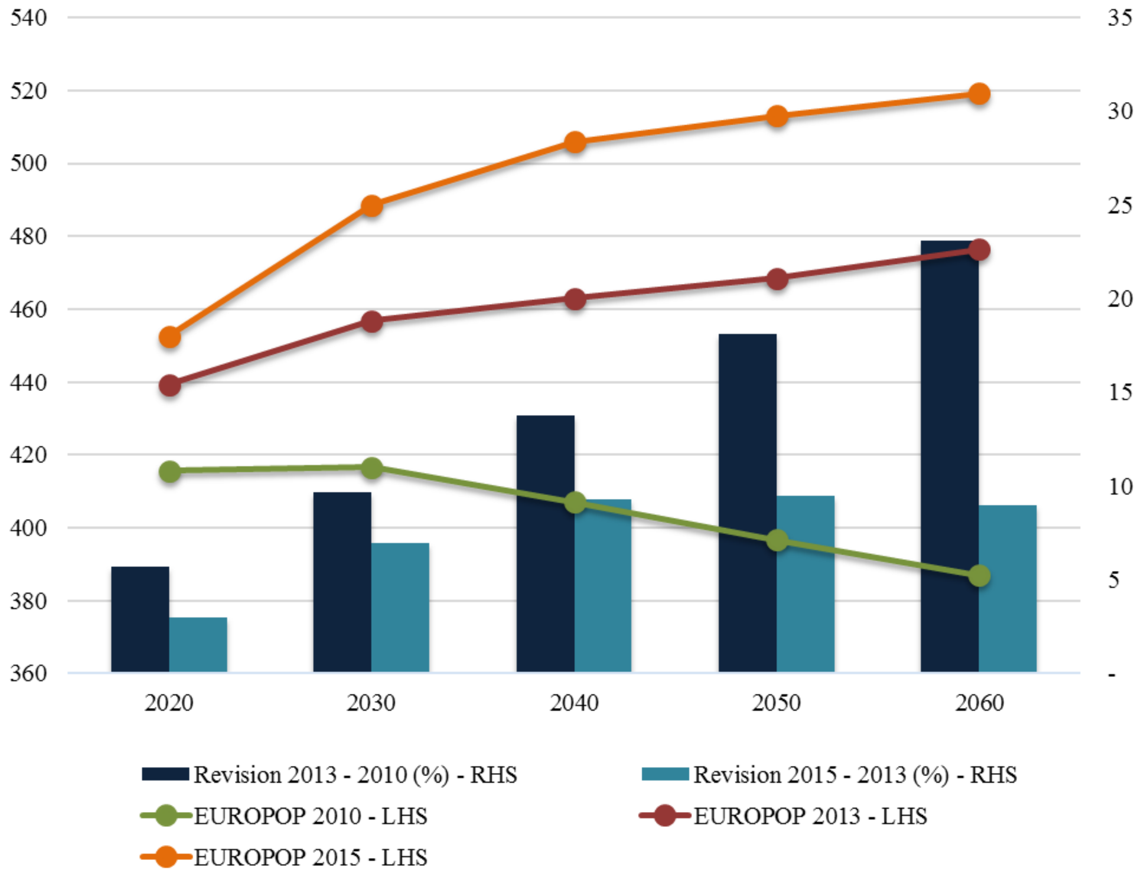
For certain countries in the EU, the retirement age for women is lower than that for males, and thus, if an overall average is employed, this would push the EU's average retirement age downwards. The average female retirement age in the EU stood at 63.8 in 2016. With respect to the early retirement age, in Malta this stands at 61 years, similar to the EU's average of 61.8 years.

Demographic Projections

The sustainability of a pension system is partly contingent on demographic developments, as the latter influences the amount of eligible persons, as well as the number of years over which disbursements are due. The instability in the forecasts for Malta's population, as part of the various EUROPOP projection vintages, thus adds an element of risk (see Chart 5.4).[22]

[21] The EU average is based on the arithmetic average of each Member State.
[22] EUROPOP projections refer to population projections published by the Eurostat.

Chart 5.4 Vintages of EUROPOP projections (000s)[23]



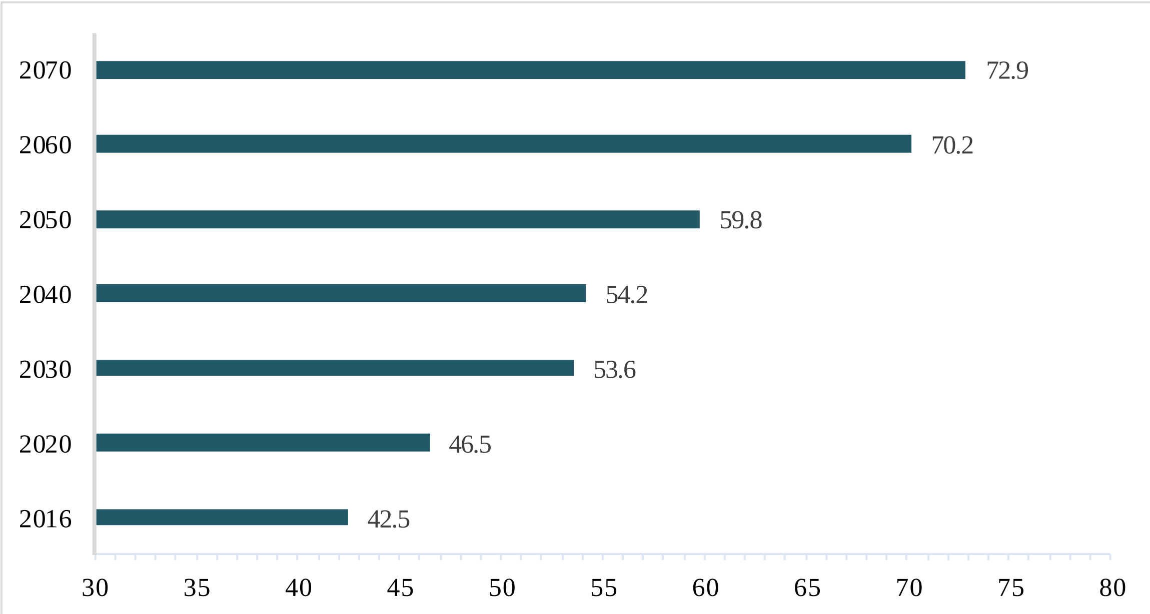
Source: Eurostat

According to the latest projections, on the basis of the policy currently in force, the economic old-age dependency ratio for Malta is expected to nearly double, increasing by 30.0 percentage points from 42.5% in 2016 to 72.9% by 2070 (see Chart 5.5).[24] The economic old-age dependency ratio represents the inactive population aged 65 and over as a percentage of the employed population between the age of 15 and 64. Unless adequately addressed, this may pose problems to the sustainability of the pension system, particularly given that Malta's system is heavily based on the Pay-As-You-Go arrangement.

With respect to Malta's retirement age, this is currently mandated to gradually rise to 65 and remain fixed at that level. In contrast, the retirement age in certain EU countries is set to increase further over the long-term (see Chart 5.6). Both the median and average age increase over successive 20 year periods.[25] The average European retirement age is projected to increase to around 66 in 2030, and is then expected to stabilise at around 67 in 2050 and at slightly more in 2070.

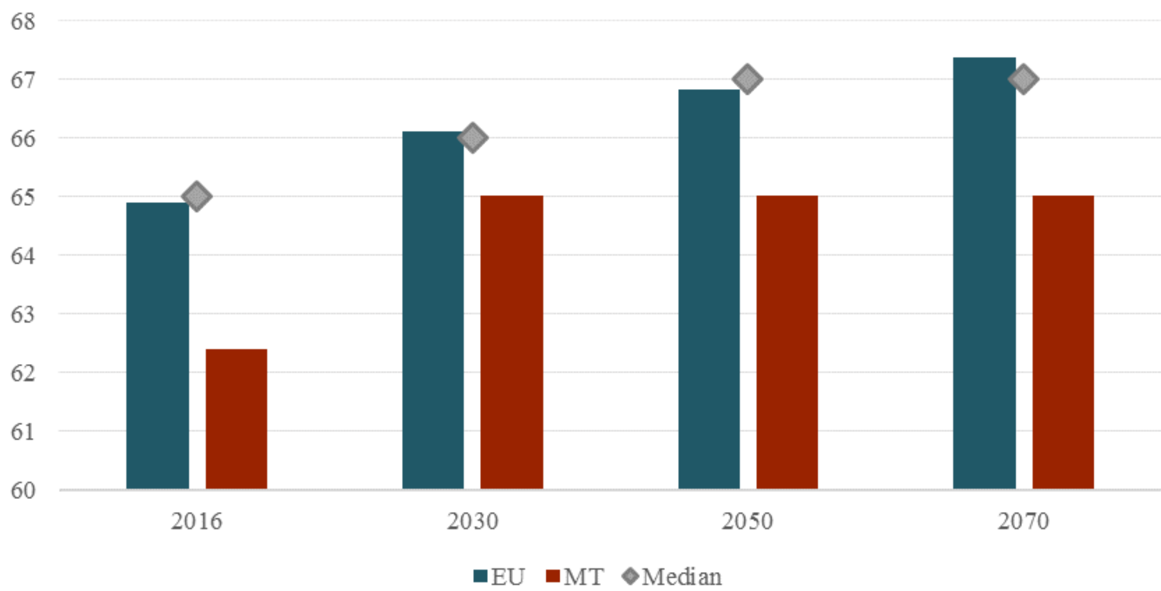
[23] The left-hand side axis represents the absolute population size in thousands whilst the right-hand side axis represents the percentage change in term of revisions to the previous population forecast.
[24] Source: 'The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies', available on: https://ec.europa.eu/info/publications/economy-finance/2018-ageing-report-underlying-assumptions-and-projection-methodologies_en.
[25] The median represents that country having the middle value.

Chart 5.5 Projected economic old-age dependency ratio in Malta



Source: European Commission – The 2018 Ageing Report

Chart 5.6 Projected retirement age in Malta and the EU



Source: European Commission - The 2018 Ageing Report

The forecasts relating to age-related expenditure in the latest Update of Stability Programme, show the increasing long-term pressure on public finances stemming from age-related expenditure (see Table 5.7).[26]

These are set to increase from around 22.6% of GDP in 2013 to around 29.2% of GDP in 2060. This is a main reason why achieving pension sustainability is important. A similar scenario was projected in the previous vintage of forecasts, whereby age-related expenditure was forecasted

[26] The forecasts for the long-term sustainability of public finances in the USP are based on EUROPOP 2013.

at 22.1% of GDP in 2020, rising gradually to 30.1% in 2060.[27] Pension expenditure, which includes the Two-Thirds pension expenditure, is according to the latest Stability Programme, set to rise from 9.6% to 12.8% of GDP over the long-term. Old-age and early pensions are expected to nearly double their share of GDP in 2060 when compared to 2013, whilst other pensions which include the disability and survivors' pensions are set to decline over the long-term.

Table 5.7 Long-term projections of age-related expenditure (% of GDP)

	2013	2020	2030	2040	2050	2060
Age-related expenditure	22.6	23.0	24.3	25.1	26.6	29.2
amongst which:						
Pension expenditure	9.6	9.8	9.7	9.7	11.0	12.8
Old-age and early pensions	5.3	5.8	6.1	6.7	8.3	10.3
Other pensions (disability, survivors, etc)	4.0	3.7	3.2	2.7	2.3	2.0

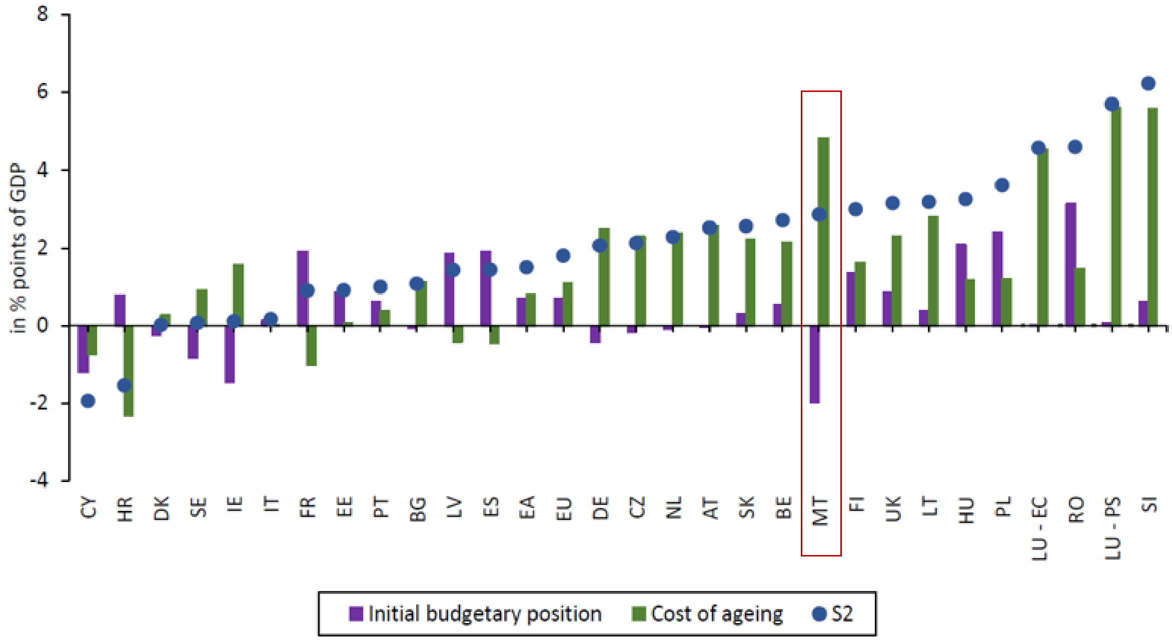
Source: Update of Stability Programme 2017-2020

To assess long-term fiscal sustainability of public finances, the European Commission uses the S2 indicator. This indicator shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, taking into account costs of ageing. Malta is classified as a medium risk country in this Report.[28] The main driver of such risk is the contribution of total cost of ageing to long-term sustainability risks. According to the European Commission, such contribution is considered as very significant for Malta as it stands at 4.6 pp of GDP, exceeding the reference rate of 2.0 pp of GDP, under a no-policy-change scenario. This results in one of the highest cost-of-ageing contributions towards the S2 indicator amongst European countries, which is to an extent compensated by the country's initial budgetary position (see Chart 5.8).

More specifically, 2.0 pp of the projected contribution of the total cost of ageing are attributed to pension expenditure, 1.4 pp to healthcare costs, 0.9 pp to long-term care and 0.4 pp to other expenditure. Being the main contributor towards long-term risk, the need for continuous review of the pension structure to minimise the effects of ageing on pension expenditure is necessary.

[27] The previous vintage of forecasts was based on EUROPOP 2010.
[28] Source: Debt Sustainability Monitor 2017. Available on: https://ec.europa.eu/info/sites/info/files/economy-finance/ip071_en.pdf.

Chart 5.7 Comparison of S2 indicator across Europe[29]



Source: The National Council of Public Finance (CNFP) - Luxembourg

Conclusion

Changing demographics and expected future economic conditions impact the sustainability of a pension system. Flexibility and periodic review are thus vital to ensure that the system can cope with the expected future outlays, while at the same time ensuring adequate safeguards against poverty.

The MFAC considers positively that the Government is obliged to lay on the Table of the House of Representatives, within intervals not exceeding five years, a report reviewing the state of play of the pension system and giving recommendations for possible strategic reforms in the system. An overriding objective of such reviews has been to strike the right balance between contributions and benefits across generations while keeping a stable proportion of contributory periods and life expectancy in retirement. Such reviews will need to be updated regularly with the most recent population forecasts and the most recent pension expenditure projections available. Such regular updating of forecasts will enhance the robustness and credibility of the periodic assessment of the sustainability of the pension system in Malta. This will also help the authorities carry out the necessary adjustments to the pension system, if and whenever needed, to ensure the sustainability, adequacy and equity of pension provisioning.

As was clearly highlighted in the 2015 Report by the Pensions Strategy Group, the State pension under the first pillar cannot remain the sole source of retirement income particularly

[29] This chart was reproduced from 'Assessment of Long-Term Fiscal Sustainability' – October 2017, published by the National Fiscal Council of Public Finance of Luxembourg. A Summary of the publication is available on: http://www.cnfp.lu/en/actualites/2017/sustainabilite_2017.html.

for future generations. It will need to be supplemented by additional alternative sources. The MFAC accordingly strongly supports the introduction of new instruments and innovative voluntary schemes to broaden the income base of persons reaching retirement age and to diversify the sources of retirement income. Recent measures which provided economic incentives for delayed retirement and the introduction of further incentives to augment the appeal of third-pillar pensions, were an important step in this direction.

Equally important have been measures to boost the adoption of voluntary occupational pensions through tax incentives as well as efforts to facilitate higher financial literacy to promote a stronger saving culture and to manage savings more wisely. With a high proportion of the elderly population being property rich but often with liquidity constraints, it will also be important to introduce new institutional arrangements that will encourage equity release to supplement pensions. Moreover, the recent reform implemented in 2016-2017 in the first pillar pension is a further measure to enhance the long-term sustainability of the system. The Council encourages a thorough ex-post assessment of these measures to gauge their effectiveness and also to serve as a benchmark for possible future policies of a similar nature. It will be essential to continue the momentum of introducing further incentives to diversify retirement incomes.

The regular review of an adequate minimum pension, as well as the maintenance of an appropriate stable relationship between the minimum pension and the national average wage level, could provide further safeguards to protect against individuals falling into poverty. At the same time, a stable level of entitlements, which are adjusted according to valorisation and indexation variables, will help to reduce contributor's uncertainty about future income adequacy and would allow for smoother lifetime consumption/saving planning.

The next pensions review, due in 2020, will be an interesting exercise to assess whether sufficient progress has been made in this respect, or whether more aggressive strategies might be necessary, factoring in the demographic and economic growth projections available at that time. The next review will also need to re-appraise the extent of pension adequacy, and in particular, whether the various poverty alleviation measures which have been implemented in recent years and which may be enacted by the time of the review, compounded with the possibility of home-equity release, will have adequately catered for pension adequacy, or whether more significant revisions will be necessary.

Finally, the MFAC notes that the rapid growth in the working age population in recent years, underpinned by the strong inflow of foreign workers and the hike in the female participation rate, has boosted social security contributions, thereby contributing positively to the sustainability of the welfare system. Still, it is not obvious that such high rates of growth in the active population can be sustained over long periods.

On the basis of the 2018 Ageing Report by the European Commission, the old age dependency ratio is projected to almost double by 2070. It will thus be important that the next pensions review analyses in depth these population projections, to ensure that estimates are as robust as possible, both in terms of forecast numbers and age profile, as these variables are critical for the sustainability of a pension system. Moreover, it will be important to encourage further take-up of the funded pensions pillars (occupational and personal pensions) to complement the mandatory pay-as-you-go first pillar. The appropriate design of the multi-pillar system is crucial to ensure that these three pillars are mutually reinforcing in such a manner to ensure the long-term sustainability of the system and to provide the necessary safety net to guarantee poverty prevention of the dependent population bracket.

Appendix A

Recommendations 2015 – 2017

Box B shows all the recommendations published to date by the MFAC organised according to the date they were published and colour coded according to what they relate to, that is, either **Fiscal Policy**, **Budgetary Process**, **Transparency** or **Legislative**.

The reaction of the Ministry for Finance to these recommendations is outlined in Chapter 3 of this Annual Report.

Box A. Recommendations published to date

Recommendations published in 2015

1. **Rationalise expenditure**
2. **Consider a buffer over the minimum required structural effort**
3. **Maintain accurate estimates on ageing costs**
4. **Raise awareness about the long term fiscal challenges**
5. **Achieve further progress in pension reform**
6. **Extend the average maturity profile of public debt**
7. **Use IIP funds cautiously**
8. **Sustain progress towards attaining the Europe 2020 targets**
9. **Evaluate the economic efficiency of the current property-related taxation system**
10. **Use revenue windfalls primarily to build fiscal buffers**
11. **Establish rigorous policies of how the Contingency Reserve can be resorted to**
12. **Replenish the Contingency Reserve**
13. **Consider the publication of more timely official statistics**
14. **Ensure closer synergy across government departments**
15. **Maintain detailed documentation on how the fiscal data is compiled**

16. Ensure higher consistency between the macro and fiscal forecasts

17. Ensure that the budget timetable is consistent with European Semester

18. Perform closer monitoring of output gap and its implications

19. Revise historical data to ensure consistency with the latest published data

20. Update the BO's methodologies to approximate better the ESA guidelines

21. Provide detailed calculations of revenue measures

22. Provide details about fiscal measures for years t+1, t+2

23. Specify in greater detail how expenditure growth will be constrained

24. Provide more information about government guarantees

25. Provide quantitative estimates of the impact of assumptions used

26. Provide higher detail on the impact of statistical changes

27. Enhance the commentary on the drivers of variations in fiscal data

28. Publish a dedicated section in the Annual Report explaining possible deviations in the fiscal strategy

29. State explicitly the reasons whenever the previous round of macroeconomic forecasts is retained

30. Address the specific issues raised by the Commission in its assessment of the USP in the MFIN's publications

31. Provide more details about the assumptions used to prepare the forecasts

32. Consider new legislation to guide the issuing of government guarantees

Recommendations published in 2016

33. Evaluate the economic efficiency of the tax framework

34. Safeguard the efficacy of fiscal policy

35. Use consistent definitions and methodologies across forecast rounds

36. Focus greater attention on developments in the structural balance

37. Ensure technical issues are adequately addressed before announcing changes to tax or expenditure policies

38. Ensure feasibility of expenditure restraint targets

39. Establish clear guidelines on cash holdings

40. Maintain close monitoring and control on EBU's activities which have fiscal implications

41. Address revenue arrears more strongly

42. Elaborate more on fiscal risks

43. Focus more attention on the expenditure benchmark outlined in the SGP

44. Consider reacting publicly to the recommendations made by the MFAC

45. Provide updates on the performance of fiscal measures announced in the Budget

Recommendations published in 2017

46. Maintain the MTO

47. Monitor closely population trends and their implications

48. Prioritise productivity gains through transferring best practices across departments

49. Introduce more effective medium-term policy framework

50. Implement the necessary structural reforms

51. Explore options to improve forecast accuracy

52. Monitor closely revenues derived from the IIP

53. Assume stable elasticities unless justified by specific factors

54. Provide a more detailed account on the absorption of EU funds

55. Publish more background information on models used by MFIN

56. Ensure publication of the HYR by end July even when the Parliament is in recess

57. Consider introducing direct reference to the expenditure benchmark is the legislation

Glossary

Budget balance: The difference between total government revenue and total government expenditure. A balanced budget occurs when expenditure is equal to revenue.

Budgetary rule: A rule, which sets limits on the conduct of fiscal policy such as for example by establishing, limits on the permissible annual fiscal deficit or the yearly expenditure growth.

Central Government: Consists of all administrative departments of the state and other central agencies whose responsibilities cover the whole economic territory of a country, except for the administration of social security funds.

Comprehensive Spending Review: Consists of a line-by-line analysis carried out by the Ministry for Finance of each ministry's expenditure inputs and outputs in order to determine the effective cost of government's activities. The objective is to prioritise expenditure and identify areas where savings can be attained.

Consolidated Fund: This fund is the government's main account and it captures the activities of the Government Ministries and Departments. This Fund records transactions on a cash basis. All allocations provided from the Consolidated Fund are either authorised by Parliament under an Appropriation Act, or are permanently appropriated by Parliament under other relevant legislation.

Contingency Reserve: A contingency reserve with the purpose of reducing the risks surrounding the attainment of the fiscal targets, and its utilisation is permitted on the basis of exceptional conditions, as specified in the Fiscal Responsibility Act.

Country-Specific Recommendations: Provide tailored advice by the European Council following a proposal by the European Commission to Member States on how to boost jobs and growth, while maintaining sound public finances.

Cyclically-adjusted budget balance: Computed as the difference between the actual balance-to-GDP ratio and an estimated cyclical component. It is the balance (deficit or surplus) that would exist if the economy were at potential.

Debt criterion: A country whose public debt-to-GDP ratio exceeds the 60% threshold must converge to this limit, at a satisfactory pace. This criterion is part of the corrective arm of the Stability and Growth Pact (also referred to as the Debt Rule).

Dependency ratio: the sum of persons aged less than 15 years plus persons aged 65 years and over, expressed as a percentage of the working-age population, between 15 and 64 years.

Draft Budgetary Plan: A document which presents the Government's updated official macroeconomic outlook and the fiscal projections for the current and the following year, taking account of the new fiscal measures.

Europe 2020 targets: 10-year targets which were launched in 2010, as part of the EU's growth and jobs strategy. The targets relate to employment, R&D, emissions levels, renewable energy use, energy efficiency, early school leaving, tertiary education and population at risk of poverty.

European Semester: This is a yearly cycle of economic policy co-ordination, guidance and surveillance. It provides a framework and a binding annual timeline for managing pro-growth measures at the European level.

European System of National and Regional Accounts: The European accounting standard for the reporting of economic data by Member States in the EU. The ESA methodology is based on the accruals accounting concept.

Excessive Deficit Procedure: A procedure under the corrective arm of the Stability and Growth Pact. This is applicable to Member States judged to have an excessive deficit (above 3% of GDP) or public debt levels not diminishing at a satisfactory pace towards the 60% of GDP benchmark.

Expenditure Benchmark: A reference value for the permissible expenditure growth, which depends on the estimates for potential GDP growth. Any excess expenditure growth must be matched by discretionary revenue measures.

Extra Budgetary Units: entities forming part of General Government, but which are not accounted for within the Departmental Accounting System (DAS) of Central Government.

Fiscal Compact: Refers to the fiscal part of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union which is an intergovernmental agreement signed on 2 March 2012 and which introduced a stricter version of the SGP.

Fiscal consolidation: Governments' actions and policies to lower the deficit-to-GDP ratio in structural terms.

Fiscal deficit: A situation when government expenditure exceeds government revue.

Fiscal governance: Rules, regulations and procedures that influence how budgetary policy is planned, approved, carried out and monitored.

Fiscal policy: The act of regulating government revenue and expenditure to attain macroeconomic objectives.

Fiscal Responsibility Act, 2014: An Act approved by the Maltese Parliament on 8 August 2014 to provide for fiscal responsibility (Act No XXVII of 2014 – Chapter 534).

General Government: Includes Central Government and other activities such as those of Local Councils and Extra-budgetary units (which comprise institutional units under public control that are principally engaged in the production of goods and services not usually sold on a market and / or that are involved in the redistribution of national income and wealth).

Government guarantees: Financial Guarantees provided by the government to certain borrowers to enable them to obtain the necessary amount of funding and at interest rates that are more advantageous.

Gross Domestic Product: This represents the standard measure of economic activity carried out in a country, at quarterly or annual intervals. Nominal GDP measures activity at market prices while real GDP measures activity at chain-linked prices.

Gross Fixed Capital Formation: Consists of various types of investment, primarily in the form of dwellings, other building and structures, transport equipment, machinery and intellectual property products.

Independent Fiscal Institutions: Independent oversight bodies responsible for the monitoring of fiscal performance and adherence to fiscal rules in their respective country. Some countries are also mandated to provide forecasts and costing of fiscal measures.

Individual Investor Programme: The programme allows for the grant of citizenship by a certificate of naturalization to foreign individuals and their families who contribute to the economic development of Malta, as provided in the regulations contained in Legal Notice 47 of 2014.

Inflation: The general increase in the price of goods and services over time. The annual inflation rate measures the percentage change in the general price level compared to the previous year.

Maastricht criteria: Five criteria which must be adhered to by European countries in order to qualify for the adoption of the euro. The criteria relate to inflation, fiscal deficit, public debt, exchange rate and interest rates.

Medium Term Budgetary Objective: This is the budgetary target to be reached by a specific year, which is assigned to each EU Member State, in order to keep governments on track towards meeting their commitments to pursue sound fiscal policies.

Medium Term Fiscal Strategy: The Government's fiscal objectives, presented as part of a three-year rolling target for fiscal management.

One off and temporary measures: Budget items whose impact is constrained to one or few years.

Output gap: The difference between the level of actual and potential output expressed as a percentage of potential output.

Potential output: This is an estimate of the maximum output that an economy can produce, without creating inflationary pressures, when its resources are utilised in the most efficient manner.

Primary balance: The budget balance excluding interest payments.

Public debt: That amount of debt accumulated over time by the general government.

Revenue windfalls: Unexpected fiscal revenues accruing as a result of better-than anticipated economic developments or other special factors.

Sinking Fund: A fund formed by periodically setting aside money for the gradual repayment of a debt.

Six-pack: Five Regulations and one Directive which entered into force on 13 December 2011. It applies to all Member States with some specific rules for euro-area Member States. In particular, the six-pack reinforced both the preventive and the corrective arm of the Stability and Growth Pact.

Stability and Growth Pact: This is a set of rules aimed at assuring that countries in the EU pursue sound public finances and coordinate their fiscal policies. The Pact includes specific rules for countries under the preventive or the corrective arm.

Stock-flow adjustment: Stock flow adjustments relate to certain type of transactions, which create a difference between the annual change in gross debt and the budget deficit.

Structural budget balance: The actual budget balance net of the cyclical component and net of one-off and other temporary measures.

Structural effort criterion: The required annual improvement of the general government's fiscal balance measured in structural terms that should be achieved by each Member State following a fiscal adjustment path towards its Medium Term Objective.

Supply-side policies: Policies which aim to strengthen enhance the productive capacities of an economy while improving the quality and quantity of the four factors of production.

Tax elasticity: Measures the responsiveness of tax revenue to a change in the tax base.

Two-pack: Two Regulations which entered into force on 30 May 2013 in all euro area Member States providing for increased transparency on countries' budgetary decisions, stronger coordination in the euro area starting with the 2014 budgetary cycle, and recognising the special needs of euro area Member States under severe financial pressure.

Financial Statements

For the year ended 31 December 2017

Malta Fiscal Advisory Council
Report of the Council Members
For the year ended 31st December 2017

The Members of the Council present the annual report and the audited financial statements of Malta Fiscal Advisory Council (the "Council") for the year ended 31st December 2017.

Principal Activity

The Malta Fiscal Advisory Council ("the Council") was established by the Minister for Finance with effect from 1 January 2015 in terms of the Fiscal Responsibility Act, 2014, Cap 534. The Council's aim is to review and assess the extent to which the fiscal and economic policy objectives proposed by the Government are being achieved and thus contribute to more transparency and clarity about the aims and effectiveness of economic policy. The Council is independent in the performance of its functions.

Performance Review

The Council received €255,000 in Government Subvention during the year ended 31st December 2017 (2016: €253,000) in terms of the Fiscal Responsibility Act and incurred €244,569 in expenditure (2016: €229,761). The Council registered a surplus of €10,470 for the year ended 31st December 2017 (2016: €23,259) as shown in the statement of comprehensive income on page 6.

Post Balance Sheet Events

There were no particular significant events affecting the Council which occurred since the end of the accounting period.

Future Developments

The Council is not envisaging to change its principal activity.

Council Members

In accordance with the Fiscal Responsibility Act, the Council shall consist of the Chairman and two other members.

The Committee constitutes of the following members:

Mr. Rene Saliba – Executive Chairman
Dr. Ian Cassar – Executive Member
Dr. Carl Camilleri – Executive Member

Statement of Responsibilities of the Council

The Council members are required to prepare the financial statements for each financial year which give a true and fair view of the state of affairs of the Council at the end of the financial year and of the income and expenditure of the Council for that year:

In preparing these financial statements, the Council members are required to:-

- Adopt the going concern basis, unless it is inappropriate to presume that the Council will continue in business;
- Select suitable accounting policies and apply them consistently from one accounting year to another;
- Make judgement and estimates that are reasonable and prudent;
- Account for income and charges relative to the accounting year on the accruals basis; and
- Value separately the components of assets and liability items on a prudent basis.

Statement of Responsibilities of the Council (Cont'd)

The Council members are responsible for keeping proper accounting records which disclose with reasonable accuracy, at any time, the financial position of the Council and to enable them to ensure that the financial statements have been properly prepared. The Council members are also responsible for safeguarding the assets of the Council and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Disclosure of Information to the Auditors

So far as the Council Members are aware, all relevant information has been brought to the attention of the Council's Auditors.

Auditors

PKF Malta, Certified Public Accountants and Registered Auditors, have intimated their willingness to continue in office.

Approved by the Fiscal Council and signed on its behalf on 23rd February 2018 by:

Mr. Rene Saliba

Chairman

Dr. Carl Camilleri

Council Member

Dr. Ian Cassar

Council Member

Registered Office:
Malta Fiscal Advisory Council,
Pope Pius V Street,
Valletta

Report on the Audit of the Financial Statements

We have audited the financial statements of Malta Fiscal Advisory Council (the 'Council'), set out on pages 6 to 16, which comprise the statement of financial position as at 31st December 2017, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Opinion

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Council as at 31st December 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Council in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in accordance with the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued in terms of the Accountancy Profession Act (Cap. 281) in Malta, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

The Council is responsible for the other information. The other information comprises the Council Member's report. Our opinion on the financial statements does not cover this information, including the Council Member's report. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

In addition, in light of the knowledge and understanding of the Council and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the Council Member's report. We have nothing to report in this regard.

Responsibilities of the Council

The Council Members are responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as the Council Members determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Council Members are responsible for assessing the Council's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Council Members either intends to liquidate the Council or to cease operations, or has no realistic alternative but to do so.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Council Members.
- Conclude on the appropriateness of the Council Members' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Council's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Council to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Council Members regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Donna M. Greaves Bonello FCCA, MIA, ADIT, M.A. Financial Services
Certified Public Accountant and Registered Auditor
Warrant No: 11006
23/02/2018

Ms. Donna Greaves
For and on behalf of
PKF Malta
Certified Public Accountants and Registered Auditors
35, Mannarino Road,
Birkirkara BKR 9080,
Malta

23rd February 2018

Malta Fiscal Advisory Council
Statement of Comprehensive Income
For the year ended 31st December 2017

	Note	2017 EUR	2016 EUR
Income	3	255,000	253,000
Expenditure		(244,569)	(229,761)
Other Income		46	23
Surplus before tax		10,477	23,262
Taxation		(7)	(3)
Surplus for the year		10,470	23,259
Other Comprehensive Income for the year		-	-
Total Comprehensive Income for the year		10,470	23,259

The notes to the financial statements on pages 10 to 16 form an integral part of these financial statements.

Malta Fiscal Advisory Council
Statement of Financial Position
As at 31st December 2017

	Note	2017 EUR	2016 EUR
ASSETS			
Non-Current Assets			
Intangible Assets	7	1,333	2,346
Plant and Equipment	8	3,339	4,320
		4,672	6,666
Current Assets			
Other Receivables	9	605	8,330
Cash and Cash Equivalents	10	35,435	15,445
		36,040	23,775
Total Assets		**40,712**	**30,441**
CAPITAL AND LIABILITIES			
Capital and Reserves			
Accumulated Reserve – Recurrent vote and operating activities	11	39,390	28,920
Current Liabilities			
Other Payables	12	1,322	1,521
Total Capital and Liabilities		**40,712**	**30,441**

The notes to the financial statements on pages 10 to 16 form an integral part of these financial statements.

These financial statements were approved by the Fiscal Council, authorised for issue on 23rd February 2018 and signed on its behalf by:

Mr. Rene Saliba

Chairman

Dr. Carl Camilleri

Council Member

Dr. Ian Cassar

Council Member

Malta Fiscal Advisory Council
Statement of Changes in Equity
For the year ended 31st December 2017

	Accumulated Reserve EUR	Total EUR
Balance as at 31st December 2015	-	-
Plant and equipment acquired in 2015, Net	3,579	3,579
Intangible assets acquired in 2015, Net	2,082	2,082
Surplus for the year	23,259	23,259
Balance as at 31st December 2016	**28,920**	**28,920**
Surplus for the year	10,470	10,470
Balance as at 31st December 2017	**39,390**	**39,390**

The notes to the financial statements on pages 10 to 16 form an integral part of these financial statements.

Malta Fiscal Advisory Council
Statement of Cash Flows
For the year ended 31st December 2017

	Note	2017 EUR	2016 EUR
Cash flows from Operating Activities			
Surplus before tax		10,477	23,262
Adjustments for:			
Depreciation of intangible non-current assets	7	1,013	1,013
Depreciation of tangible non-current assets	8	1,607	1,490
Operating surplus before working capital changes		13,097	25,765
Movement in Other Receivables		7,725	(8,330)
Movement in Other Payables		(199)	1,521
Tax Paid		(7)	(3)
Net cash flow from Operating Activities		20,616	18,953
Cash flows from Investing Activities			
Purchase of Intangible Assets	7	-	(1,277)
Purchase of Plant and Equipment	8	(626)	(2,231)
Net cash used in Investing Activities		(626)	(3,508)
Movement in Cash and Cash Equivalents		19,990	15,445
Cash and Cash equivalents at start of the year		15,445	-
Cash and Cash equivalents at end of the year	10	**35,435**	**15,445**

The notes to the financial statements on pages 10 to 16 form an integral part of these financial statements.

1. Basis of Preparation

The principal accounting policies adopted in the preparation of these financial statements are set out below:

a) Statement of Compliance

The financial statements of Malta Fiscal Advisory Council for the year ended 31st December 2017 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

b) Basis of Measurement

These financial statements have been prepared on the historical cost basis.

c) Accounting Estimates and Judgements

The preparation of financial statements in conformity with IFRS's requires the Council to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimate and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that year or in the year of the revision and future year if the revision affects both current and future year.

During the year under review, the Council did not make use of significant judgements or accounting estimates.

d) Functional and Presentation Currency

The financial statements are presented in euro (€), which is the Council's functional currency.

2. Significant Accounting Policies

a. Intangible Assets

An acquired intangible asset is recognised only if it is probable that the expected future economic benefits that are attributable to the asset will flow to the Council and the cost of the asset can be measured reliably. An intangible asset is initially measured at cost, comprising its purchase price and any directly attributable cost of preparing the asset for its intended use.

Intangible assets are subsequently carried at cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated to write down the carrying amount of the intangible asset using the straight-line method over its expected useful life. Amortisation of an asset begins when it is available for use and ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) or the date that the asset is derecognised.

Computer Software is amortised over four years on a straight-line basis.

b. Plant and Equipment

Recognition and Measurement

The cost of an item of plant and equipment is recognised as an asset when it is probable that the future economic benefits that are associated with the asset will flow to the Council and the cost can be measured reliably. Plant and equipment are initially measured at cost comprising the purchase price and any costs directly attributable to bringing the assets to a working condition for their intended use. Subsequent expenditure is capitalised as part of the cost of plant and equipment only if it enhances the economic benefits of an asset in excess of the previously assessed standard of performance, or it replaces or restores a component that has been separately depreciated over its useful life.

After initial recognition, plant and equipment may be carried under the cost model, that is at cost less any accumulated depreciation and any accumulated impairment losses, or under the revaluation model, that is at their fair value at the date of the revaluation less any accumulated depreciation and any accumulated impairment losses.

After initial recognition plant and equipment are carried under the cost model.

Depreciation

Depreciation is calculated by writing off the cost of the non-current assets on a straight-line basis over the estimated useful lives of the assets concerned. The principal annual rates used for this purpose are:

	Years
- Furniture and Fittings	10
- Computer and Office Equipment	4
- Library Books	10

c. Financial Instruments

Financial assets and financial liabilities are recognised when the Council becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially recognised at their fair value plus directly attributable transaction costs.

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when the Council has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Financial assets are derecognised when the contractual rights to the cash flows from the financial assets expire or when the Council transfers the financial asset and the transfer qualifies for derecognition.

Financial liabilities are derecognised when they are extinguished. This occurs when the obligation specified in the contract is discharged, cancelled or expires.

i. Other Receivables

Other receivables are classified with current assets and are stated at their nominal value. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired.

ii. Other Payables

Other payables are classified with current liabilities and are stated at their nominal value.

d. Impairment

Financial Assets

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk circumstances. All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to profit or loss.
An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

Non-Financial Assets

The carrying amount of non-financial assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If such indication exists then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss.
The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

e. Cash and Cash Equivalents

Cash and cash equivalents comprise the bank balance as at the year ended 31st December 2017.

f. Income Recognition

Income comprises the Government Subvention available in terms of the Fiscal Responsibility Act to cover recurrent expenditure reflected in the income statement of the Council.

g. Going Concern

The financial statements have been prepared on the going concern basis, which assumes that the Government of Malta will continue to provide the subvention to the Council in accordance with Article 55 of the Fiscal Responsibility Act (Chapter 534 of the Laws of Malta) in the order to continue with the performance of its functions.

3. Income

Income represents the subvention voted to the Council by the Government of Malta and is analysed as follows:

	2017 EUR	2016 EUR
Government Subvention	255,000	253,000

The Government subvention as per Article 55 sub-articles (2), (4a) and (4b) of the Fiscal Responsibility Act amounts to not less than €250,000 annually and increases by the Index of Inflation as established and published by the National Statistics Office in each subsequent year.

4. Council Honoraria

	2017 EUR	2016 EUR
Honoraria	58,000	62,833
Number of Council Members	3	3

The total annual honoraria entitled to the Council Members' amounts to €58,000 in both years presented in the financial statements. The Honoraria for the year ended 31 December 2016 includes a sum of €4,833 relating to services rendered in December 2015 but paid in January 2016.

5. Salaries and Consultancy Fees

	2017 EUR	2016 EUR
Administrator & Other Consultancy Fees	-	14,868
Staff Gross Salaries and Social Security Contributions	120,493	89,895
	120,493	104,763
Average Number of Employees	4	3

6. Auditors' Remuneration

Total remuneration paid to the auditors during the year amounted to:

	2017 EUR	2016 EUR
Audit Fees	885	885
Other Non-Audit Services	-	-
Total Auditors' Remuneration	885	885

7. Intangible Assets

	Computer Software	Total
	EUR	**EUR**
Cost		
As at 1st January 2017	4,053	4,053
Additions	-	-
Disposals	-	-
As at 31st December 2017	4,053	4,053
Depreciation		
As at 1st January 2017	1,707	1,707
Charge for the year	1,013	1,013
Released on disposal	-	-
As at 31st December 2017	2,720	2,720
Net Book Value		
As at 31st December 2016	2,346	2,346
As at 31st December 2017	**1,333**	**1,333**

8. Plant and Equipment

	Fixtures & Fittings	Computer and Office Equipment	Library Books	Total
	EUR	**EUR**	**EUR**	**EUR**
Cost				
As at 1st January 2017	590	5,392	830	6,812
Additions	-	365	261	626
Disposals	-	-	-	-
As at 31st December 2017	590	5,757	1,091	7,438
Depreciation				
As at 1st January 2017	118	2,255	119	2,492
Charge for the year	59	1,439	109	1,607
Released on disposal	-	-	-	-
As at 31st December 2017	177	3,694	228	4,099
Net Book Value				
As at 31st December 2016	472	3,137	712	4,320
As at 31st December 2017	**413**	**2,063**	**863**	**3,339**

9. Other Receivables

	2017 EUR	2016 EUR
Prepayments	153	8,330
Other receivables	452	-
	605	8,330

10. Cash and Cash Equivalents

For the purpose of the cash flow statements, the year-end cash and cash equivalents comprise the following amounts:

	2017 EUR	2016 EUR
Bank Balances	35,435	15,445

11. Accumulated Reserve – Recurrent Vote and Operating Activities

The recurrent vote and operating activities represent the accumulated deficit or surplus resulting from operations.

12. Other Payables

	2017 EUR	2016 EUR
Creditors	114	98
Accruals	1,208	1,423
	1,322	1,521

13. Financial Instruments

Fair Values of Financial Assets and Financial Liabilities

At 31st December 2017 the carrying amounts of financial assets and financial liabilities classified with current assets and current liabilities respectively approximated their fair values due to the short-term maturities of these assets and liabilities.

Financial Risk Management

The exposures to risk and the way risks arise, together with the Council's objectives, policies and processes for managing and measuring these risks are disclosed in more detail below. The objectives, policies and processes for managing financial risks and the methods used to measure such risks are subject to continual improvement and development.

Financial Instruments (Cont'd)

Liquidity Risk

The Council monitors and manages its risk to a shortage of funds by maintaining sufficient cash and by monitoring the availability of raising funds to meet commitments associated with financial instruments and by maintaining adequate banking facilities.

Capital Risk Management

The Council's objectives when managing capital is to safeguard its ability to continue as a going concern.

The capital structure of the Council consists of cash and cash equivalents as disclosed in note 10 and items presented within the accumulated reserve in the statement of financial position.

14. Related Parties

Malta Fiscal Advisory Council is an independent fiscal institution and reports to Parliament on an annual basis. The Council Members are appointed by the Government of Malta. In terms of the Fiscal Responsibility Act, Council Members will not seek or receive instructions from public authorities or from any other institution or authority.

Transactions with Council Members which occurred during the years ended 31st December 2016 and 2017 are disclosed in note 4.

15. Comparative Information

Certain comparative information has been reclassified to conform to the current's year disclosure for the purpose of fairer presentation.

Recurrent Expenditure

		2017	2016
		EUR	EUR
Council Honoraria		58,000	62,833
Salaries and Consultancy fees		120,493	104,763
Audit fees	Note A	885	1,835
Telecommunication and Internet Costs		6,123	6,900
IT installation and Equipment Fees		-	39
Travel and Training costs		12,579	12,248
Local Conference costs		1,547	-
Recruitment costs		-	1,263
Rental fees		24,914	18,836
Premises Fees		5,182	3,918
Study loans		5,400	2,700
Photocopier lease expenses		1,804	1,857
Postage, Printing and Stationery		2,511	5,685
Insurance		1,125	827
Subscriptions		434	381
Hospitality costs		55	-
Depreciation of tangible assets		1,607	1,490
Amortisation of intangible assets		1,013	1,013
Sundry Expenses		848	3,146
Bank Charges		49	27
Total Recurrent Expenditure		244,569	229,761

Note A Audit fees for the year ended 31st December 2016 comprise of the fees incurred in relation to the services rendered for the year 2015 and 2016 in light of the fact that the accounts for the year 2015 were prepared on cash basis.

Schedule I does not form part of the audited financial statements.

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