

## **Public Finances**

One of Government's main economic policy objectives remains that of adopting a stance that ensures the restoration of sustainability in public finances in the medium-term. This is warranted given that a sound fiscal position is a prerequisite for macroeconomic stability. Government is reviewing emerging trends in public finances with a view to adopt the necessary policy measures which restore the health of public finances at the least possible disruptions to the real economy. This should lead towards a situation where the levels of Government debt grow at a slower rate than economic growth.

## **Financial Year 2003**

### *The Consolidated Fund*

When this year's estimates were presented last November, the revised estimates for Financial Year 2002 were projecting a deficit of Lm78.5 million. Mainly due to lesser receipts than expected, 2002 closed with a financial deficit of Lm87.7 million. This factor contributed to variations in the original estimates for 2003 which forecast a deficit of Lm74.8 million. This was equivalent to 4.14% of the GDP, which was expected to reach Lm1.8 billion.

The Financial Deficit is now being estimated at Lm108 million. As the GDP is expected to be Lm1.7 billion the deficit would be equivalent to 6.3% of GDP. One should note that, were it not for a serious and timely cost cutting exercise that was made half way through the year, in the expenditure of Government Departments and Public entities, the deficit this year would have certainly gone up to 7.3% of GDP.

Other reasons that contributed to this year's deficit were:

- the local environment during the first five months of the year brought about by the referendum and the general elections;

- the relatively slow economic activity as a direct result of various international situations;
- the increase in the expenditure required on pensions and social benefits;
- the increase on public debt interest, mainly due to greater resort to Treasury Bills to meet the Treasury cash flow requirements as a result of lesser income and higher costs; and
- the recent restructuring of the shipyards and the early retirement of part of the labour force from these enterprises, and the substantial increase in the number of public transport buses that benefited from Government subsidy.

## **Revenue**

When the budget for this year was presented, we were expecting an income of Lm687 million in tax revenue and Lm84 million from other ordinary income, a total of Lm771 million. Total ordinary revenue is now expected to reach Lm741 million, of which Lm668 million will be proceeds from taxation and Lm73 million from other income.

While an increase of Lm4 million will result from income tax, there will be shortfalls of Lm9 million from social security contributions, Lm3 million from Customs and Lm6 million from VAT.

A shortfall of Lm11 million is expected under other ordinary revenue services mainly due to:

- grants amounting to Lm19 million that were expected under the fifth Italo-Maltese Financial Protocol and from the European Union flowing in next year together with the other receipts that were originally being expected for 2004. The equivalent adjustment is being made on the expenditure side; and
- an increase of Lm6 million in income as a result of the extended scheme on the Registration of Foreign Investments.

## **Recurrent Expenditure**

Recurrent Expenditure, including Public Debt Interest, was originally projected at Lm737 million. This amount is expected to increase by Lm5 million to Lm742 million.

While costs on Personal Emoluments and Operational and Maintenance Expenses of Government Departments were contained within the original projections, those on Programmes and Initiatives and Contributions to Public Entities are being revised upwards.

An increase of Lm5 million will be registered under Programmes and Initiatives mainly due to:

- an increase of Lm5 million in Treasury pensions, Lm7 million in social benefits, Lm3 million on the early retirement schemes that were launched last year for shipyard workers, and on subsidies on grains and public transport on the one hand; and
- a reduction of Lm5 million in social security contributions, and Lm5 million in EU pre-accession programmes, on the other. Expenditure on these programmes is now expected to be incurred next year together with original allocations for 2004.

Subventions to Government entities such as Malta Freeport, the Water Services Corporation, the Malta Development Corporation, and the Technology Venture Fund amounts to Lm4 million less than the original estimates.

Expenditure in respect of Public Debt interests payment, was increased by Lm3 million on the original estimates of Lm60 million, mainly due to increased issues of Treasury Bills and long term borrowing that was made this year.

## **Capital Expenditure**

The original estimate of Lm108 million is being revised downwards to Lm106 million. There was a substantial increase of Lm3 million in

subsidies for the purchase of new route buses, since vehicles that had originally been expected next year were instead imported in 2003. Expenditure in respect of Mater Dei Hospital, waste management, Malta Shipbuilding, and Government Investments increased by Lm7 million.

Another Lm4 million are being provided in connection with the early retirement of workers from both shipyards.

However, a reduction of Lm14 million was requested on projects funded under the Italian Protocol, which will come on board later than originally expected. Expenditure on similar projects financed from EU Pre-Accession Funds will be Lm1 million less than originally anticipated. These funds are also expected to be utilised next year.

Full details of revenue and expenditure, both recurrent and capital, for 2003 are being provided in statements attached to this Speech.

## **Financial Year 2004**

As already mentioned the Consolidated Fund is this year expected to end with a deficit of Lm108 million, or 6.3% of the GDP. Next year this deficit is expected to go down to Lm95 million, that is, a reduction of around 12%. This projected deficit is equivalent to 5.4% of the GDP.

### **Revenue**

Revenue will next year go up to Lm843 million, an increase of Lm102 million, of which almost 50% will come from Foreign Grants, Lm18 million under the fifth Italo-Maltese Financial Protocol, and Lm30 million from different sources as a result of the accession agreement reached with the European Union and to the fact that Malta will effectively form part of the Union next year.

While an increase of Lm21 million in VAT revenue is expected as a result of the increase in rates, Government will be registering Lm15 million less in receipts on a once-only basis, due to the fact that, as from 1<sup>st</sup> May 2004 VAT on EU imports will not be charged at entry stage. This will greatly assist the cash flow of importers not only for next year but also during the following years. It is expected that, as happened in previous years, an additional Lm9 million in revenue will be collected as a result of economic growth, the enforcement of legislation, and necessary investigations.

It is estimated that Income Tax would provide an additional Lm10 million as a result of increased earnings of individual taxpayers and companies as well as greater enforcement on the part of the Inland Revenue Department.

Social Security contributions are expected to yield an additional Lm5 million, of which around Lm2 million will be State Contribution. This increase reflects only the contribution payable on increased income that employees will benefit from next year.

Increased revenues of Lm6 million, that is, from Lm63 million to Lm69 million, are expected from Customs. The main reason for this increase is the adjustment in excise duty on cigarettes and tobacco. The annual increase registered as a result of increased importation and the greater value of imports is also reflected in the expected revenue for 2004.

Tax receipts, finally, include licences and miscellaneous services. From Lm87 million this year, we expect that next year receipts from these services will increase to Lm108 million, in increase of Lm21 million. This is mainly due to:

- Lm800,000 from TV licenses, which up to this year were retained by PBS Ltd;
- Lm12 million from taxes on gaming and lottery receipts part of which will be due for the operating license to be issued to the company that will run gaming in Malta;

- Lm10 million from duty on documents, as a result of increased activity in property transfers and the application of legislation governing companies and transfers;
- an increasing Lm2 million in vehicle registration tax as a result of an adjustment in the minimum rate paid on the importation of second-hand private vehicles;
- finally, it is estimated that Government will receive Lm4 million less because of the removal of levies on imports.

When one examines income from ordinary non-tax sources, one finds that next year's increase will be around Lm44 million. While income received this year under, for example, the Investment Registration Scheme will be Lm6 million less and profits from the Central Bank of Malta will be Lm8 million less, increases are expected as follows:

- Lm2 million as eco-contributions on certain containers;
- Lm1 million from the increase in contribution by residents in state homes for the elderly, against which there will be recurrent and capital expenditure for old people's homes;
- Lm1.5 million from Enemalta Corporation and Gozo Channel;
- Lm48 million, being the difference between Lm3 million last year and Lm51 million in 2004 as funds due under the Italo-Maltese Financial Protocol (Lm18 million) and from EU transition funds (Lm30 million). The amount of Lm51 million in income for next year consists of that part that is tied to projects and programmes, the cost of which appears under recurrent and capital expenditure of Lm18 million under the Italian Protocol and of Lm12 million in EU Funds, and part of EU transition funds amounting to Lm21 million.

An increase of Lm5 million is expected under miscellaneous revenue mainly from development projects and sale of property, such as the White Rocks Complex.

To finance the deficit, Government expects that next year, it would be in a position to receive Lm35 million from the privatisation of state enterprises and Lm9 million from sinking funds of converted loans.

Lm12 million are being shown as a foreign loan from the Council of Europe Social Development Fund to finance expenditure on Mater Dei Hospital.

### **Recurrent Expenditure**

Recurrent expenditure, net of Contributions to Sinking Funds, will this year be Lm742 million. Although next year this figure is expected to go up to Lm811 million, an increase of Lm69 million, one should note that a substantial part of this increase is made up of Lm49 million for Government's Programmes and Initiatives, Lm7 million in contributions to Government Entities, Lm9 million in interest payments and Lm2 million in Social Security State Contributions.

With regard to Personal Emoluments, the estimated expense of Lm200 million for next year excludes Lm3.5 million in respect of workers in the Drainage Department, in Malta as well as in Gozo, who were previously engaged with the Ministry of Resources and Infrastructure and the Ministry for Gozo. This estimate, however, includes the effect of the 2002 Collective Agreement (Lm4.5 million) and increments (Lm2 million).

Under Operations and Maintenance Expenses for Government Departments an increase of Lm2 million is forecast for medicines dispensed in hospitals. However, since it is intended that greater controls be exercised on such expenditure, the global increase under this category will only amount to Lm1 million, and this when Departments will have to absorb the VAT increase next year.

Under the category for Programmes and Initiatives, as already indicated, the year-on increase amounts to Lm49 million. The main reasons for this increase in expenditure are:

- Lm18 million as Malta's contribution to EU Own Resources;
- an increase of Lm4 million in EU-financed programmes, against which revenue is recorded as grants;

- Lm7 million in Government compensation to counter the effects of the increase in VAT rates;
- Lm7 as subsidies on cereals, sugar, meat and milk products and semi-processed tomato products;
- an increase of Lm7 million in social benefits and Treasury pensions;
- recurrent costs amounting to Lm2 million for the implementation of the waste management strategy;
- an increase of Lm2 million in the State Contributions resulting from higher Social Security Contributions;
- an increase of Lm1 million in financial aid to farmers and herdsman which, amounted to Lm4.6 million in 2003 and will go up to Lm6 million in 2004;
- Lm1 million as payment of pensions under early retirement schemes for shipyard employees.

It should be observed that, under this Expenditure category, the EU will be funding no less than Lm6 million in programmes under various Ministries.

Although the Lm7 million increase under Contributions to Government entities may appear excessive, upon careful examination one finds that this is mainly the result of transfers of amounts that previously appeared under other categories. For instance, there are Lm8 million as a result of the amalgamation of the Shipyards. Lm4 million refer to the new Directorate for Drainage within the Water Services Corporation, which were previously shown under personal emoluments and operational expenses.

Lm2.5 million are being provided to meet the costs of the new Industrial Projects and Services Ltd. that has taken over those yard workers who no longer belong to Malta Shipyards Ltd. and who did not opt for early retirement.

A substantial increase of Lm1 million is being registered over the Lm2.6 million provided this year for the Malta College of Arts, Science and Technology. Lm1 million is being provided for the Technology Venture Fund, whilst an increase of Lm1 million is being

voted for the Malta Environment and Planning Authority so that it would be in a better position to undertake its obligations in the sensitive area of the environment.

Against these increases, there are reductions of Lm12 million in subsidies to Malta Drydocks next year.

Interests on public debt have increased by Lm9 million, from Lm63 million to Lm72 million, to enable payment of interests on Treasury Bills, Government Stocks issues this year and this year's withdrawals from the loan facility provided by the Council of Europe Social Development Bank for the Mater Dei Hospital project.

### **Capital Expenditure**

The increase of Lm21 million over this year's projections for capital expenditure is certainly exceptional. Next year's provision will amount to Lm127 million, as compared to Lm106 million this year. One, however, should emphasise the fact that a significant part of this increase is being funded by grants from foreign sources, as already explained.

Lm18 million worth of projects are being financed under the Italian Financial Protocol in order to finance projects for new roads (Lm8 million), the purification of waste water (Lm2 million), facilities at the civil abattoir (Lm2 million), maritime surveillance facilities for the Armed Forces (Lm4 million) and equipment for the Mater Dei Hospital (Lm2 million).

In addition, another Lm5 million in EU funds will finance infrastructural projects in the transport, environment, education and training, agriculture and fisheries, industry and tourism sectors. These funds are divided as to Lm1 million in pre-accession funds and Lm4 million is Structural and Cohesion Funds.

One cannot but mention the increase of Lm15 million in the Mater Dei outlay of which Lm12 million will be financed under the Italian

Protocol. This increase is necessary due to the fact that the project is now at an advanced stage and has reached the plant installation phase. Of course, Government will continue to maintain the other health institutions and, for this purpose, it is providing around Lm1 million.

On the other hand there will be Lm9 million less in the provision for the Ministry for Information Technology and Investment, mainly due to a lesser outlay than this year's for the shipyards. Around Lm3 million less will be spent next year as the subsidized purchase of the majority of route buses was advanced to this year.

Other one-off outlays, which amount to Lm3 million, fall under the Ministry of Finance and Economic Affairs, the Ministry of Justice and Home Affairs and the Ministry of Foreign Affairs.

### **The Consolidated Fund**

Therefore, as already stated, the deficit next year will be managed at Lm95 million, which amounts to 5.4% of GDP. This deficit is expected to go down by Lm20 million annually for the following two years so that by 2006 it will reach Lm52 million, that is, just under 3% of GDP.

### **General Government**

As distinct from the other Funds and Accounts held and/or administered by the Government, the Consolidated Fund incorporates all moneys belonging to the Government. This Fund provides for a system of accounting and control for the collection of revenue and the administration of expenditure appropriated by Parliament. Parallel to the receipts and payments of Central Government registered in the Consolidated Fund, importance was also given to their classification under the European System of Accounts (ESA '95). Moreover, the projections I spoke about earlier are being computed to reflect further refinements in the application of this international methodology which is widely being adopted by many governments.

These adjustments would lend themselves to reflect not only those of the Government, which we may call Central Government but also an extended Government or one that is known as General Government. Accounting for extended or General Government transactions includes also the financial balances of revenue and expenditure and the resulting deficits and debt levels of a number of public entities that would fall as an integrated part of Government. I am referring to those public entities with no less than 50% of their revenues coming from Central Government.

These public entities include Local Councils as well as a large number of other entities which range from those of an administrative or regulatory function, such as boards, commissions, and tribunals, to those of a commercial or quasi-commercial nature.

The revenue and expenditure of all these public entities was projected on an annual basis for 2004 to 2006 and the resulting balances were added on to those of the Consolidated Fund. In this way, the balance for the extended or General Government resulted providing a more wholesome scenario of its deficit and debt levels.

In absolute terms, the deficit of extended General Government, is expected to be Lm109.7 million in 2003, and is expected to decline to around Lm58.6 million in 2006. This deficit as a percentage of the Gross Domestic Product is expected to decline gradually from 6.4% in 2002 to around 3.0% in 2006. This will happen as a result of reflecting both the expected growth of the local economy as well as the control on public expenditure and higher receipts. As already stated, the upward trend in interest payments that is expected to take place will be maintained during the medium-term period. This will impact on a higher level of gross Government debt.

The table below provides the transition between the deficit in the Consolidated Fund and the extended or General Government deficit:

<b>Transition between Consolidated Fund Deficit and General Government Deficit</b>					
	<i>(Lm '000s)</i>				
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Structural Deficit of Consolidated Fund transactions</b>	<b>-87,675</b>	<b>-107,624</b>	<b>-94,805</b>	<b>-73,316</b>	<b>-52,218</b>
Adjustments to the Consolidated Fund:					
Loans granted	9,539	9,000	4,100	3,600	3,300
Loans repaid	0	0	0	0	0
Acquisition of shares	35	35	35	35	35
Sales of equities	0	0	0	0	0
Other financial transactions	-397	0	0	0	0
Other accounts receivable(+)/payable(-)	-803	0	0	0	0
Difference between interest paid(+) and interest accrued(-)	361	0	0	0	0
<b>Net Borrowing(-)/net lending(+) of public entities forming part of Central Government</b>	<b>-11,123</b>	<b>-14,721</b>	<b>-14,721</b>	<b>-14,721</b>	<b>-14,721</b>
Other adjustments(+/-)	-127	-200	1,200	1,200	1,200
	4,245	3,000	3,000	3,000	3,000
	2	2	0	0	0
	11,287	0	0	0	0
<b>Deficit of Central Government (-)</b>	<b>-105,720</b>	<b>-11,508</b>	<b>-11,191</b>	<b>-80,202</b>	<b>-59,404</b>
Local Government	890	850	850	850	850
<b>Deficit General Government</b>	<b>-104,830</b>	<b>-109,658</b>	<b>-100,341</b>	<b>-79,352</b>	<b>-58,554</b>
GDP	1,680.40	1,705.06	1,764.74	1,826.50	1,899.56
<b>Deficit/GDP</b>	<b>6.24%</b>	<b>6.43%</b>	<b>5.68%</b>	<b>4.34%</b>	<b>3.08%</b>

Adjustments are being made to the Consolidated Fund as follows:

- loans made under the Consolidated Fund to the Shipyards (up to 2003) and to Gozo Ferries Co. Ltd. so that the latter can pay its liabilities with regard to the purchase of material and equipment for the building of the three ferry boats for Gozo Channel. The loans to the Shipyards will cease as from next year while subsidies will continue on a reduced basis;
- the deficit of public entities that are part of General Government;
- transactions under Treasury Clearance advances which still need to be processed by the Treasury;
- the surplus enjoyed by the Local Councils together.

From this, the General Government deficit for this year will go up to Lm109.7 million, for 2004 to Lm100.3 million, for 2005 to Lm79.3 million and for 2006 to Lm58.6 million.

As a percentage of the Gross Domestic Product in 2003 the General Government Deficit will be 6.43%, next year 5.68%, in 2005 it will be 4.34% and in 2006 it will be 3.08%.

### **Financing the General Government**

The way in which Government deficits are financed is of relevance for the assessment of fiscal policy stance since each method of financing has particular macro-economic effects and costs.

In Malta, Government finances the deficit by the issuing of domestic public bonds: foreign borrowing constitutes a relatively low share. Indeed, the share of foreign borrowing makes up around 4%.

As indicated earlier, domestic borrowing allows the Government to sustain a deficit without increasing the monetary base or depleting national reserves. Moreover, it is an effective way to avoid both inflation and pressures on the external reserves.

The deficit of General Government is primarily expected to be financed out of asset-sale proceeds which, in 2004 are expected to amount to around Lm35 million. Further plans, announced by the Government for the subsequent years are expected to provide an amount of Lm50 million for each of the next two years. Another financing source is the transfer of unutilised balances in sinking funds of converted loans.

These total incomes will bring down Government's borrowing needs.

In this way, the net borrowing needs of General Government is expected to amount to Lm70 million next year, Lm38 million in 2005 and Lm16 million in 2006.

As may be seen from this table, Public Debt balances are expected to reach Lm1.2 billion in 2004, Lm1.3 billion in 2005 and will be remain at this level also in 2006.

Hence, Public Debt ratio to GDP from 68.9% this year, to 70.5% in 2004 and 2005 and will go down to 68.4% in 2006.

	2002 <sup>(A)</sup>	2003 <sup>(R)</sup>	2004 <sup>(P)</sup>	2005 <sup>(P)</sup>	2006 <sup>(P)</sup>
Deficit General Govt.	104.830	109.658	100.341	19.352	58.554
Financing					
Foreign Loans	(3,991)	(5,845)	(7,396)	(7,297)	(6,749)
Local Loan	(6,908)	(6,571)	(6,372)	(5,281)	(4,811)
Asset Sales	27,341	0	35,000	50,000	50,000
Sink Funds of Govt. Loans	13,250	4,600	9,000	4,000	4,000
<b>TOTAL</b>	<b>28,745</b>	<b>8,816</b>	<b>30,232</b>	<b>41,422</b>	<b>42,440</b>
PSBR	76.085	100.842	70.109	37.930	16.114
<b>Public Debt balances</b>		<b>1,175.215</b>	<b>1,245.324</b>	<b>1,288.254</b>	<b>1,299.368</b>
GDP		1,705.060	1,764.740	1,826.500	1,899.560
<b>PSBR/GDP</b>		<b>68.9%</b>	<b>70.56%</b>	<b>70.50%</b>	<b>68.4%</b>