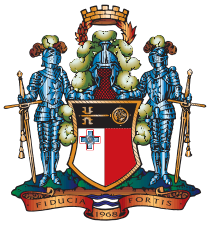

BANK ĊENTRALI TA' MALTA
EUROSISTEMA
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MALTA'S CLIMATE-RELEVANT FISCAL MEASURES

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BOX 3: MALTA'S CLIMATE-RELEVANT FISCAL MEASURES[1,2]

Climate change has become one of the greatest challenges facing economies in the twenty-first century and has come to the forefront of social and economic debate. Changes in weather patterns and extreme weather events can have a significant impact on economic activity and wellbeing, particularly in climate-sensitive sectors.

The EU has prioritised the response towards climate change by committing itself to an ambitious climate policy. The EU's main priority for the coming decades is to achieve carbon neutrality by 2050, a target that was set into binding legislation with the European Climate Law. To push the EU towards carbon neutrality, the 2030 greenhouse gas (GHG) emission reduction target of 40% was raised in December 2020 to a net domestic reduction of at least 55%.[3] This should promote green investments, spur more sustainable economic growth and create considerable health and environmental benefits for citizens. As an EU Member State, Malta is also committed to fulfil its obligation of becoming carbon neutral by 2050. To smoothen the transition towards a carbon-neutral economy, Malta has set a binding target to achieve a 19% reduction in emissions outside the scope of the EU's Emissions Trading Scheme (ETS) by 2030.

Fiscal policy has an important role when it comes to minimise the harmful effects of climate change and facilitate adaptation to it. Through targeted taxation and subsidies, fiscal policy can facilitate the shift to a greener economy and encourage investment in renewable energy or other climate-smart technologies. Government policies also help incentivise energy efficiency and cleaner modes of transport. In turn, these policies will help improve the long-term sustainability of public finances as the economy is less exposed to climate-related shocks. This Box outlines the main climate-relevant measures introduced in Malta and assesses their impact on the fiscal balance from an accounting perspective, through changes in government revenue and current expenditure. This analysis concludes with an overview of already established initiatives that aim to encourage less polluting behaviour and promote higher energy efficiency.

Existing fiscal policy instruments

Environmental taxes

The degree to which fiscal policy is climate friendly can be assessed through the lens of environmental tax data published by Eurostat.

Environmental taxes are one of the most common fiscal instruments used among EU countries to restrict the negative environmental impact of certain forms of production and

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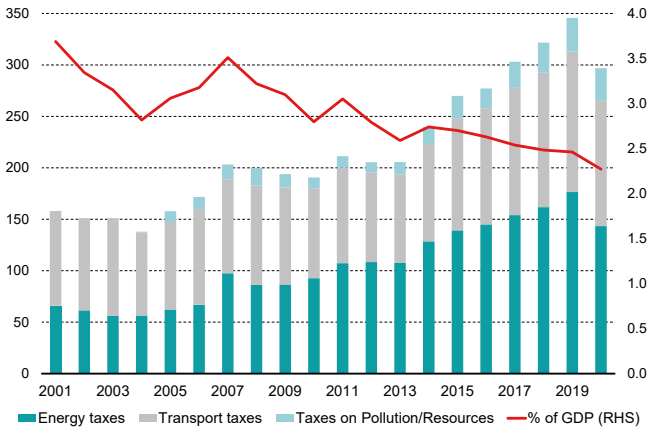
[1] Prepared by Juergen Attard and Larissa Vella, senior economist and economist, respectively in the Economic Analysis Department at the Central Bank of Malta. The authors would like to thank Rita Schembri, John Farrugia and Ian Borg for their helpful comments and suggestions. The views expressed are the authors' own and do not necessarily represent the views of the Central Bank of Malta.

[2] This box summarises the findings and, where available, updates the information provided in "The role of fiscal policy in climate change mitigation and adaptation in Malta", Central Bank of Malta, *Policy Note* (2022).

[3] More information on the EU's targets can be found on: https://ec.europa.eu/clima/eu-action/climate-strategies-targets/2030-climate-energy-framework_en.

consumption.[4] Overall, they can be grouped into three categories: energy, transportation and pollution and resources.[5] In level terms, revenue from environmental taxes in Malta followed an upward trajectory over the last two decades, reflecting growth in economic activity and the introduction of additional environmental taxes (see Chart 1). Revenue from environmental taxes reached record levels in 2019, before declining by 14.2% in 2020. The significant drop in 2020 largely reflects the contraction in economic activity caused by the COVID-19 pandemic and – albeit to a lower extent – fuel price cuts as part of the COVID-19 Economic Recovery Plan.

Chart 1
ENVIRONMENTAL TAXES IN MALTA
(EUR millions; % of GDP)



Source: Eurostat.

Environmental tax revenue in Malta mostly stems from taxes on energy and transportation. Excise duties on petroleum imports account for a large majority of energy taxes while the rest is composed of excise duties on electricity, tax on bunkering and revenue from auctions of Emission Trading Permits. Meanwhile, motor vehicle registration tax and motor vehicle licenses account for around 90% of transport tax revenue while the remainder is practically derived from the sale of car license plates, driving licenses and administration charges to test motor vehicles. Another source of environmental tax revenue are taxes on pollution and resources, though the share of this component – mainly consisting of excise duties on cement – is very low. Other revenue is derived from various excise duties on plastic bags, construction components, bottled water and non-alcoholic beverages.

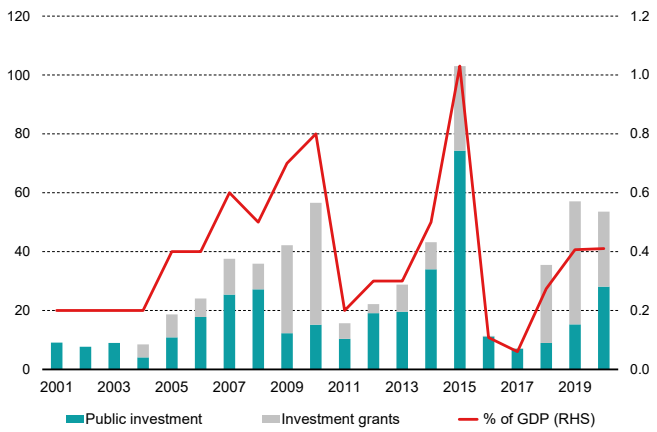
Expenditure-based fiscal instruments

Besides revenue-based instruments, the Maltese government allocates a proportion of its yearly budget spending on climate-relevant initiatives, some of which are co-financed by EU funds. These outlays include schemes that support the installation of photovoltaic systems and solar water heaters, favourable tariffs for the electricity produced by solar photovoltaic systems and eco reduction benefits to encourage less electricity consumption from non-renewable sources. Other schemes target firms, including initiatives that assist hoteliers to invest in energy efficiency projects, grants to facilitate investment in technological solutions that provide higher energy efficiency and other schemes for large renewable energy projects. Other climate-relevant spending includes initiatives to boost research and development (R&D) in cleaner and renewable energy technology, educational campaigns,

[4] Source:https://www.eib.org/attachments/thematic/the_eib_climate_survey_2020_2021_en.pdf
[5] For a detailed explanation on the statistical concepts and definitions of environmental tax revenues see: https://ec.europa.eu/eurostat/cache/metadata/en/env_ac_tax_esms.htm.

and afforestation initiatives.

Chart 2
CAPITAL SPENDING ON ENVIRONMENTAL PROTECTION IN MALTA
(EUR millions; % of GDP)



Source: Eurostat.

The government also allocates additional spending for climate-relevant capital outlays. This includes public spending and investment grants for environmental projects aimed at preventing, reducing and eliminating pollution while also enhancing the country's resilience to climate change. This spending, in the form of government investment and investment grants, is gauged from the Classification of the Functions of Government (COFOG). Capital expenditure on environmental protection amounted to €53.5 million or 0.4% of GDP in 2020, with expenditure nearly equally split between public investment and investment grants (see Chart 2). On average these outlays amounted to around 0.4% of GDP between 2001 and 2020. However, year-on-year climate-relevant capital expenditure is highly volatile, as this largely depends on the timing of individual projects. As an example, capital spending on environmental protection rose sharply in 2015, reflecting higher outlays on waste management projects and higher investment grants to waste water management projects. However, once such projects were completed, capital expenditure on environmental protection declined.

Climate-relevant measures and their fiscal impact

Over the last decade, the Maltese government has stepped up its efforts to address climate change by introducing several measures, with the primary motive of achieving climate change targets. Other measures introduced in this period could however be considered as less climate friendly.

To date, there is no fully defined statistical methodology on the classification of climate-relevant fiscal measures, which could make their identification more subjective. Against this background, this analysis aims to identify the main climate-relevant fiscal initiatives and present an initial assessment of their impact on the fiscal balance. Therefore, this assessment takes an accounting perspective focusing on the incremental impact of climate initiatives on government revenue and expenditure. In this assessment, measures are only considered as climate relevant if they have a direct impact on carbon emissions, energy efficiency or the adaptation to climate change. Therefore, fiscal measures with broader environmental impacts are not considered as climate relevant.

The measures which satisfy the above-mentioned criteria are then either classified as 'green' or 'brown' measures. The measures which help mitigate climate change are labelled

as ‘green’, while those which affect the composition of environmental taxes and expenditure but go against climate targets are labelled as ‘brown’.

Government announcements, annual reports of public institutions and own calculations are used to gauge the impact of such measures. The assessment does not, however, include measures introduced by public sector entities which are not classified within general government. The cost of the conversion of power plants and the energy interconnector, for example, are not accounted for. Moreover, this assessment excludes the impact of EU-funded initiatives, as they have a budgetary neutral effect. Government investment in green capital projects and capital transfers are also excluded from this assessment. This is due to the difficulty of distinguishing between domestically funded and EU-funded components of such projects, as well as determining actual spending in specific years. This box also excludes the impact of government compensation for damages arising from natural events, which do not qualify as ‘green’ or ‘brown’ measures.

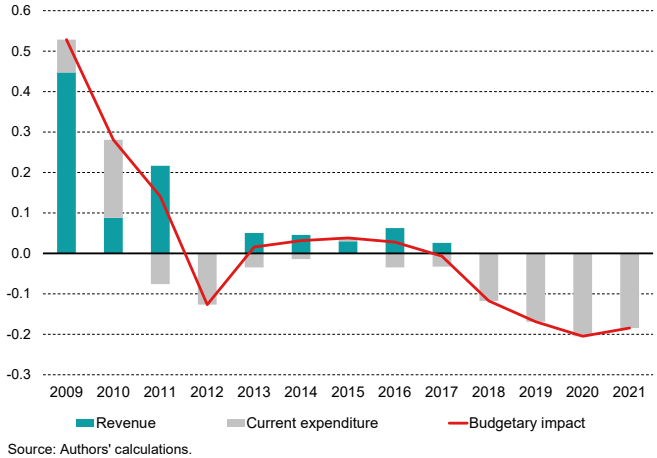
Green measures

Overall, the net impact of green measures on the overall budget balance since 2019 has been positive, as inflows from revenue-related measures outweighed expenditure initiatives. Their impact was mostly positive between 2009 and 2011, due to the revision to vehicle circulation taxes in 2009, the introduction of duties on cement in 2011 and a decline in subsidies on water and electricity production (see Chart 3).

The impact on the budget balance turned negative in 2012 mainly due to higher expenditure related to the Eco reduction scheme. This scheme offers a direct benefit to households to incentivise lower electricity consumption. In the same year, the feed in tariff scheme was introduced to offer subsidised rates on electricity generated from renewable sources of energy.

Over the 2013 and 2017 period, the impact of green measures on the budget balance was broadly neutral. Revenue-raising measures reflect successive increases in duties on petroleum up until 2016, and the introduction of duties on plastics and environmental contributions levied on tourist accommodation in 2016. Green expenditure measures include the introduction of the car scrappage scheme in 2014, with the aim of promoting the scrappage of older vehicles and replacing

Chart 3
BUDGETARY IMPACT OF GREEN MEASURES
(2009-2021; % of GDP)



Source: Authors' calculations.

them with cleaner or electric vehicles. Other climate-relevant initiatives include the frequent issue of schemes to help households and firms replace old energy inefficient electricity and hot water heating systems with newer energy efficient ones, and schemes which promote energy-efficient renovations of private buildings.

From 2018 onwards, the impact on the budget balance turned negative on the back of an expenditure-driven policy. In fact, spending on climate-related measures increased yearly throughout this period, due to the extension of existing initiatives to promote alternative sources of energy, the shift to greener transport and the introduction of other climate-related measures such the gradual introduction of free public transport from 2017 that will be fully implemented by October of 2022 and the extension of free school transport introduced in 2018. The impact of revenue measures remained unchanged in this period.

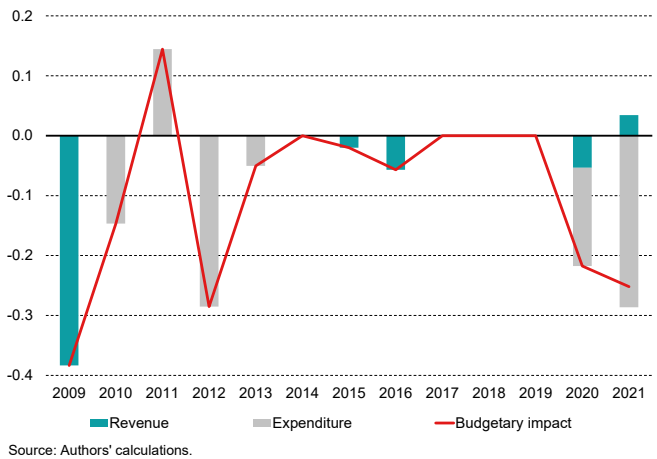
The budgetary impact of green revenue measures between 2009 and 2021 amounted to 1.0% of GDP. Meanwhile, new climate-relevant expenditure measures, excluding government investment and capital transfers, had a negative impact on the budget balance of 0.7% of GDP in this period. However, due to their budgetary neutral effect, this estimate does not include the impact of EU-funded initiatives.[6] Thus, the green measures considered in this exercise overall had a deficit reducing impact of 0.3% of GDP between 2009 and 2021.

Brown measures

Overall, brown measures had a fiscal balance-worsening impact and mainly took the form of expenditure measures (see Chart 4). These measures were originally designed for other purposes, such as competitiveness, and thus the potential climate impact was not factored in.

On the revenue side, measures mainly reflect the implementation of a lower vehicle registration tax in 2009, the elimination of VAT on motor registration and the eco contribution tax in 2009 and 2015 respectively. In June 2020, as part of the COVID-19 recovery plan, fuel prices were cut. Moreover, duties on petrol and diesel were reduced in 2020 and 2021 to keep pump prices unchanged.

Chart 4
BUDGETARY IMPACT OF BROWN MEASURES
(2009-2021; % of GDP)



Source: Authors' calculations.

[6] These include schemes to promote the use of renewable energy, capital projects related to water treatment, the Zero Impact Utility Project, the Grand Harbour Clean Air project, flood-prevention infrastructure, the Multi Material Recovery Facility project and the Grand Harbour Clean Air Project. Other smaller EU-funded projects were carried out by ERA, ECO-GOZO and Ambjent Malta.

Meanwhile, on the expenditure side, brown measures consist of support related to electricity prices. This includes one-off transfers to households to offset increases in energy tariffs in 2010 and support to Enemalta to mitigate rising commodity prices in 2012, 2013, 2020 and 2021.

Overall, brown-revenue measures had a negative impact of 0.5% of GDP on the budget balance whilst the impact of brown-expenditure measures stood at around 0.8% of GDP. Thus, overall, brown measures had a negative impact of 1.3% of GDP on the budget balance during the period under consideration.

New initiatives and other major green projects

The government's response to climate change is expected to increase over the coming years. This is exemplified by the green initiatives as announced in the 2022 Budget and under the Recovery and Resilience Facility (RRF).

The 2022 budget includes several measures intended to reduce carbon emissions and to enhance the transition towards a green economy. The budget lists several projects which are set to take place over the medium term. This includes an afforestation project in Inwadar Park, which is expected to cost €20.0 million (0.1% of GDP) over a period of 5 years, and the regeneration of green parks including the transformation of Schreiber's ground. The government also announced the gradual introduction of free public transport for all, which is expected to cost €21.0 million (0.1% of GDP) over the next three years. The extension of electric car charging points, increased grants on electric-powered cars or Plug-In Hybrids, a new scheme for the installation of photovoltaic panels on vehicles, valley rehabilitation, the launch of a carbon farming initiative, the extension of full VAT refund on the purchase of bicycles and electronic bicycles and the introduction of smart bins are examples of other initiatives outlined in the budget. The budget also lists a number of urban green initiatives including green roofing, vertical green walls and the setting up of a Local Council Urban Greening scheme.

Meanwhile, the 2022 Budget Speech also makes an allowance for additional outlays in 2022 to combat rising energy prices. Contrary to the measures mentioned above, these initiatives will have a negative effect on climate targets and are thus regarded as brown measures. According to the Bank's June 2022 projections, these initiatives are set to have a net deficit increasing impact over the 2022 to 2024 period, amounting to around 0.5% of GDP.[7]

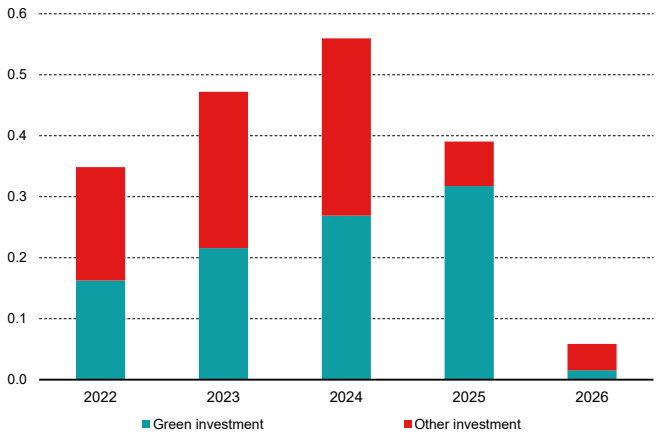
Malta's Recovery and Resilience Plan (RRP), endorsed by the European Commission in September 2021, is the key recovery instrument for mitigating the impacts brought about by the COVID-19 pandemic and for making EU economies more sustainable and resilient. Under this facility, the Maltese government plans to allocate around €170.0 million on climate change initiatives over the 2022-2026 period.[8] This represents 54% of the allocated funds, exceeding the minimum requirement of 37% set out by the European Commission.

[7] The Bank's latest projections are available on: https://www.centralbankmalta.org/economic-projections.

[8] Malta's RRP is available on: https://eufunds.gov.mt/en/Operational%20Programmes/Documents/Malta%27s%20Recovery%20%20Resiliance%20Plan%20-%20July%202021.pdf.

Malta intends to use such funds on several green transition reforms and investments, including projects related to energy-efficient renovations of private and public buildings, the decarbonization of transport, the renovation and greening of public hospitals and schools, the construction of a carbon-neutral school, enhanced investment in renewable energy in roads and public places, the construction of a new ferry landing to promote alternative modes of transport as well as other initiatives to enhance the uptake of electric vehicles. According to own estimates, outlays on these green initiatives are set to reach around 0.2% of GDP in 2022 (see Chart 5). Subsequently, outlays are set to increase gradually and peak in 2025 before declining sharply in 2026.

Chart 5
PUBLIC INVESTMENT FUNDED BY RRF
(% of GDP)



Sources: RRP and authors' own calculations.

Apart from the above-mentioned climate-relevant investment under the RRF, the Maltese government is expected to complete other two major green projects, these being the Eco-Hive and the shore-to-ship power infrastructure project. The former is a waste management facility, composed of a waste-to-energy plant, a new plant for the management of dry recyclables and a plant to treat organic waste to extract energy and produce compost for agriculture. Overall, this project is expected to cost around €390.0 million (2.7% of GDP), and the plants are expected to start operating by end 2023. The shore-to-ship power infrastructure will cost around €50.0 million (0.3% of GDP) and is expected to be completed by 2023. This project will drastically reduce pollution over the Grand Harbour and the surroundings. Additionally, the Maltese Government is also undertaking a project to construct a gas pipeline that will connect the island with the European Gas network, which will ultimately contribute towards the reduction of GHG emissions by delivering natural gas more efficiently.

The measures outlined above will help towards smoothening Malta's transition to a carbon neutral economy. However, the European Commission's 2022 country report for Malta identifies some areas for improvement in its climate efforts.[9] The document mentions Malta's traffic congestion issues, which are exacerbated by a lack of soft mobility infrastructure and a relatively low density of public charging stations for electric vehicles. Malta's low use of renewable energy in comparison to other EU countries is also highlighted.

[9] The Commission Staff Working Document's 2022 Country Report on Malta is available at: https://ec.europa.eu/info/system/files/2022-european-semester-country-report-malta_en.pdf.

Furthermore, in its opinion of the 2022 Stability Programme, the Commission invites Malta to proceed with the implementation of the RRP and reduce overall reliance on fossil fuels by encouraging the use of renewable sources of energy and by promoting investment in wind and solar technology renewable-energy investments that could enhance Malta's solar and wind energy potential.[10] The Commission also invites Malta to reduce energy demand through improved energy efficiency in residential buildings. Finally, the Commission mentions the required improvement in the quality of public transport, the deployment of IT services such as intelligent transport systems and further investment in soft mobility infrastructure.

[10] The Council Recommendation is available at: https://ec.europa.eu/info/system/files/2022-european-semester-csr-malta_en.pdf