BOX 2: THE COMPOSITION OF GOVERNMENT SUBSIDIES[1]

Historically, subsidies made up a relatively small share of government expenditure. Between 2000 and 2019, they amounted to around 3.2% of total spending, and averaged around 1.3% of GDP.

During this period, outlays were mostly in the form of recurring measures. These include spending on Public Service Obligation contracts, which are offered to public sector entities which deliver essential services (such as the Gozo ferry, the bus service and public broadcasting). The Maltese Government also covers interest payments on a debenture loan stock issued to Malta Freeport Corporation (which will mature in 2028). Through the route support scheme, it also subsidises landing fees for airlines which run underserved routes. Subsidies are also offered to the film industry, and for the provision of spare electricity capacity. Other subsidies affect residential utility tariffs (the eco-reduction benefit) and providers of electricity produced by solar photovoltaic systems (the feed-in tariff).

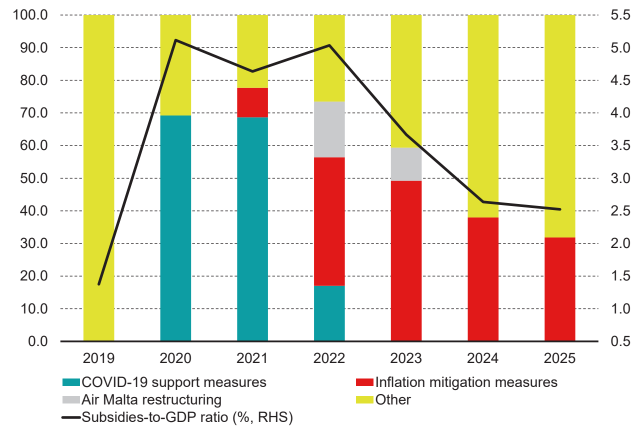
In recent years, outlays on subsidies surged and their share in GDP rose from 1.4% of GDP in 2019 to 5.0% by 2022 (see Chart 1). While outlays are forecast to decline in the coming years, their share in GDP is still expected to remain above 2019 levels by 2025. The share of subsidies in total expenditure is set to peak in 2023 at 12.3%, before declining to 6.6% by 2025.

This profile is driven by support measures, introduced between 2020 and 2022, to mitigate the impact of COVID-19 and of high inflation on the Maltese economy. The largest COVID-19 support measures classified as subsidies were the Wage Supplement Scheme, vouchers issued to households and subsidised interest payments on government guaranteed debt. Inflation mitigation measures include subsidies to public sector entities to maintain the retail prices of electricity, fuel and LPG fixed.

Additional support measures during 2022 were related to the restructuring exercise carried out by Air Malta. This included the launch of an early retirement scheme to employees.

Overall, most outlays on subsidies between 2020 and 2022 were in the form of support measures related to COVID and the energy price shock. In these three

Chart 1
COMPOSITION OF SUBSIDIES
(per cent of total)



Source: Author's estimates.

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years, such outlays averaged around 73% of total subsidies. Around 60% of the forecast level of spending on subsidies in 2023 is also due to such support measures. Outlays on recurring measures are forecast to once again make up the majority of subsidies in the outer years of the projection horizon. However, support measures are still set to amount to around 38% of subsidies in 2024, and around 32% in 2025.

COVID-related measures made up around 69% of total subsidies each year in 2020 and 2021. However, their share dropped to 17% in 2022, as these measures were unwound. During 2022 a significant increase in outlays related to inflation-mitigation measures, which started being implemented at end-2021. These measures made up around 9% of total subsidies in 2021, and around 39% in 2022. Although they are forecast to decline in level terms in 2023, their share in total subsidies is set to increase to around 49%. The share of these measures in total subsidies is then set to decline to around 38% in 2024, and around 32% in 2025, as energy prices are forecast to decline.

Meanwhile, support to Air Malta made up around 17% of total subsidies in 2022. The latest Stability Programme envisages the implementation of a second early retirement scheme in 2023. In the Bank's forecasts, this is set to account for around 10% of total subsidies.