BOX 2: SUPPORT MEASURES AND THEIR IMPACT ON PUBLIC FINANCES[1]

This box assesses the support measures, introduced between 2020 and 2022, to mitigate the impact of COVID-19 and high inflation on the Maltese economy. It updates and builds upon a similar analysis published in 2022.

Composition of support measures

Covid-19 support measures

COVID-19 support measures were introduced in 2020 and were mostly wound down in 2022. Measures affecting the government balance can be classified into four categories, depending on their stated function.[2] This classification is in line with the definitions used by the Maltese Government in its Stability Programme and Draft Budget Plans. The first category consists of economic support measures, which minimised the impact of COVID-19 on industries and employment. The second category refers to social measures providing additional assistance to vulnerable households. A third category of measures includes liquidity support to firms to bolster their working capital. The final set of measures reflects health-related expenditure.

According to the European System of Accounts (ESA) methodology, these measures were mostly classified as subsidies, social benefits, and intermediate consumption. Further details are available in the Box published in 2022.[3]

These measures amounted to 5.3% of GDP in 2020, and 4.6% of GDP in 2021 (see Table 1). The impact declined to 1.6% of GDP in 2022. This profile was mainly driven by economic support measures, which made up around 70% of the total impact in 2020, and around 80% of the impact in both 2021 and 2022. They amounted to 3.8% of GDP in 2020, 3.7% of GDP in 2021, and 1.3% of GDP in 2022.

The Wage Supplement Scheme constituted the largest measure within this category. Outlays on this scheme were highest in 2020, when the level of support for each firm was determined by the industry it operated in. During 2021, support started being determined by the declared loss in turnover compared with pre-pandemic times. From August 2021, the level of support for firms which reported relatively low losses in turnover was tapered down. The scheme was terminated at end-May 2022.

Health-related spending represents the second largest form of COVID-related spending, amounting to 1.3% of GDP in 2020, 0.7% of GDP in 2021, and 0.3% of GDP in 2022. Outlays were higher in 2020, due to one-off expenses related to orders for testing and

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[2] The tax deferral scheme and the Covid-19 Guarantee Scheme (CGS) are not covered in this assessment as these measures do not affect the budget balance. The general government accounts are adjusted for accruals and hence consider deferred taxes as part of tax revenue for the year in which they are due. Meanwhile, government guarantees do not affect the general government deficit unless they are called.

[3] See Attard and Farrugia (2022), "The Fiscal Response to the COVID-19 Pandemic", Box published in the *Quarterly Review* 2022:2.

Table 1
COVID-19 FISCAL MEASURES AFFECTING THE BUDGET BALANCE
% of GDP [(1)]

Classification	Measures impacting budget balance	ESA classification	Budgetary impact		
			2020	2021	2022
Economic support measures	Wage supplement scheme, support to workers in quarantine, distribution of vouchers to households, reduction of stamp duty on property purchases and schemes to facilitate investment in teleworking systems.	Subsidies, indirect taxes	3.8	3.7	1.3
Social measures	Additional social benefits to help working parents, the unemployed, persons with disabilities and persons classified as 'vulnerable' by the Superintendent of Public Health, extension of the In-work Benefit and a top-up of rent subsidies for low-income households.	Social benefits other than in kind	0.1	0.0	-
Liquidity support measures	Interest rate subsidy on CGS loans, subsidised commercial electricity bills for firms and a scheme to support business undertakings to provide training and development of their workforce.	Subsidies	0.1	0.1	0.1
Health-related measures	Cost associated with containment and treatment of the virus, testing, purchase of additional equipment, cleaning, cargo transportation, purchase and distribution of vaccines, other repatriation costs and the safe re-opening of schools.	Intermediate consumption, social benefits in kind, compensation of employees	1.3	0.7	0.3
Total impact			**5.3**	**4.6**	**1.6**

Source: Author's calculations.

[(1)] Calculations based on NSO *News Release* 095/2023 (published on 30 May 2023).

Note: Figures may not add up due to rounding. Zero values imply the impact of the measure is less than 0.1% of GDP. A '-' sign indicates the measure was not implemented in that year.

protective equipment, the repatriation of travellers, and the safe reopening of schools once containment measures were eased later on.

Overall, liquidity support and social support measures did not exceed 0.1% of GDP in each year between 2020 and 2022. In level terms, liquidity support measures were highest in 2021, and mainly reflected refunds to commercial rents and electricity bills, and subsidised interest on CGS loans.[4] Meanwhile, social support measures were highest in 2020, due to the introduction of benefits to parents who stopped working while their children were taught from home. Social support measures expired in 2021.

Compared with the 2022 study, the impact of support measures on the budget balance was revised up by around 0.3% of GDP each year in 2020 and 2021. This was due to revisions in the data, new information from parliamentary questions, and revised estimates for the

[4] At end-2022, outstanding government guaranteed CGS loans amounted to 0.9% of GDP.

impact of reductions in tax and stamp duty on the purchase of property, which were repeatedly extended.

Inflation mitigation support measures

Inflation-related support measures started being implemented at end-2021. Their impact on the budget balance amounted to 0.5% of GDP in 2021, and 2.5% of GDP in 2022 (see Table 2). These measures thus partly offset the deficit-reducing impact of the winding down of COVID-related support measures. The size and scope of these measures varies, depending on Government's stated aim.

In November 2021, duties on fuel products were reduced to the lowest permitted level in the EU. Through this measure, the retail price of products such as petrol and diesel remained unchanged. Although this reduction was initially intended to be temporary, it remained in effect as inflation rates remained elevated. This measure's impact on the budget balance is estimated at around 0.2% of GDP in 2022.

However, the largest measures consist of support to mitigate energy and other commodity price increases. These mostly take the form of subsidies, to cover increased operating costs of public sector entities, namely Enemalta, Enemed, and suppliers of liquid petroleum gas (LPG). They served to maintain fixed retail prices of electricity, fuel and LPG cylinders. On a cash basis, Government committed a significant level of support to these entities at end-2021 and made regular top-ups in 2022 as inflation rates continued to climb. However, according to the ESA methodology, the bulk of outlays were mostly due to operations carried out in 2022. These measures amounted to 0.5% of GDP in 2021, and 2.0% of GDP in 2022.

In addition, in March 2022 Government distributed a one-time cheque to all working citizens and pensioners due to the rising cost of living. In ESA terms, this measure is classified as current transfers paid. Its impact amounted to 0.3% of GDP in 2022.

Table 2
INFLATION MITIGATING MEASURES AFFECTING THE BUDGET BALANCE
% of GDP [(1)]

Measure	ESA classification	Budgetary impact 2021	Budgetary impact 2022
Lower duties on fuel	Indirect taxes	0.0	0.2
Support to mitigate energy and commodity prices	Subsidies, capital transfers	0.5	2.0
Economic stimulus payment to households	Current transfers	-	0.3
Social measure targeting vulnerable households	Social benefits	-	0.1
Total impact		**0.5**	**2.5**

Sources: Author's calculations; 2023 *Stability Programme Update;* 2023 *Draft Budget Plan.*

[(1)] Calculations based on NSO *News Release* 095/2023 (published on 30 May 2023).

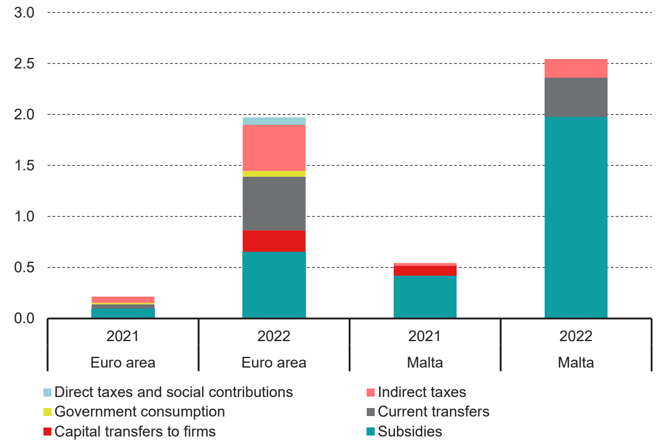
Note: Zero values imply the impact of the measure is less than 0.1% of GDP. A '-' sign indicates the measure was not implemented in that year.

To reduce the impact of inflation on vulnerable households, the 2023 Budget introduced an extended COLA mechanism which acts as an additional social benefit. This benefit is given to low-income households during periods of high inflation.[5] It was first given out at end 2022 and amounted around 0.1% of GDP.

Comparisons with the euro area average

Overall, the impact of COVID-related support measures was higher in Malta compared with the euro area average. For further details, please refer to the 2022 Box.

Chart 1
INFLATION MITIGATION SUPPORT MEASURES
(% of GDP)



Sources: ESCB; author's calculations.

The impact of inflation mitigation measures implemented by the Maltese government was also higher than the euro area average, which amounted to around 0.2% of GDP in 2021 and around 2.0% of GDP in 2022 (see Chart 1).

The majority of inflation mitigation measures in the euro area were expenditure-based, mostly in the form of higher subsidies (through price caps), and current transfers. This is similar to the approach adopted by the Maltese government. At the same time, around a quarter of measures in the euro area during 2021 and 2022 were in the form of cuts in indirect taxes. In contrast, in Malta the impact of lower indirect taxes in these years was around 6% of the total impact. Within the euro area, support measures also took the form of higher government consumption and capital transfers, as well as cuts in direct taxes to mitigate the bracket creep effect.

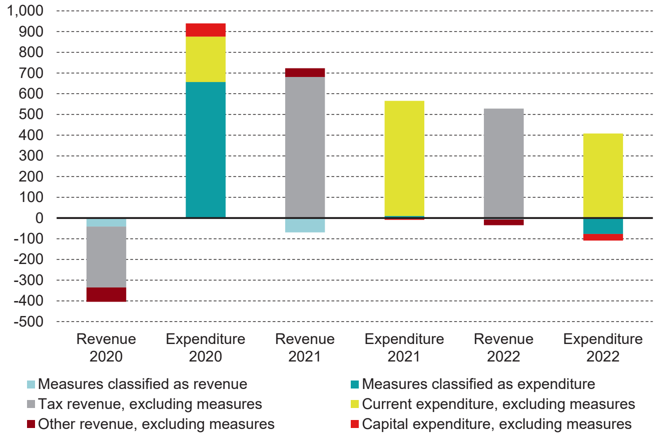
Impact on the fiscal balance

The general government balance deteriorated from a surplus in 2019 to a sizeable deficit in 2020, and remained in deficit, albeit declining, during 2021 and 2022. The impact of the above-mentioned pandemic and inflation support measures on the fiscal balance can be analysed in a number of ways.

5 A period of 'high inflation' is defined by two conditions. Firstly, overall inflation exceeds 2%. Secondly, the change in prices among at least three out of five components of the RPI index (food; housing; water, electricity, gas and fuels; household equipment and house maintenance cost; and personal health care) deemed to be essential for vulnerable households, exceeds their five-year rolling average increase. The eligibility of households is based on a formula which takes into account the number of persons in the household and their income relative to the median equivalised income. Further details are available here: https://parlament.mt/media/121288/01459.pdf.

Chart 2 shows year-on-year level changes in revenue and expenditure items, rather than differences in their share in GDP. This excludes the impact of the denominator effect in a period when GDP growth was strongly affected by COVID-related travel and social restrictions.

Chart 2
ANNUAL CHANGE IN FISCAL ITEMS
(year-on-year absolute changes in EUR)



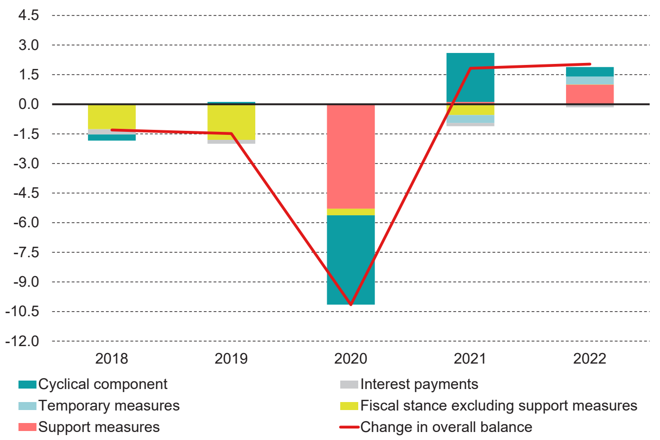
Sources: NSO; Central Bank of Malta.

On the revenue side, support measures did not have a large impact on the balance. The profile of government revenue is mostly determined by tax revenue, which declined sharply in 2020 but grew strongly in 2021 and in 2022. This is in line with developments in domestic economic activity at the time, and the recovery in tourism activity once all travel restrictions were lifted.

Support measures contributed around 70% of the increase in expenditure in 2020. Since outlays remained at elevated levels thereafter – they averaged around €660.0 million each year in 2020 and 2021, and around €590.0 million in 2022 – they do not contribute strongly to expenditure growth in subsequent years. The profile of expenditure is also affected by higher outlays on other current expenditure items. This partly reflects spending on budget measures such as an increase in retirement pensions, health treatment excluding COVID, the extension of school transport, and the introduction of free bus usage. 2021 also saw one-off payments to the EU budget and backdated payments following the signing of collective agreements. One-off subsidies also took place in 2022, due to the restructuring of Air Malta.

Overall, support measures and cyclical factors largely explain the strong deterioration in the fiscal balance in 2020, and the reduction in the deficit ratio in 2021 and 2022 (see Chart 3). The impact of interest payments and temporary measures in this period was minimal.[6]

Chart 3
CONTRIBUTIONS TO CHANGE IN FISCAL BALANCE
(% of GDP; year-on-year changes)



Source: Author's calculations.

[6] The term 'temporary measures' refers to extraordinary measures beyond government control. As a result, from the one-off measures mentioned in the main text, only transfers to the EU budget fall in this category.

Support measures account for the expansionary fiscal stance in 2020, and the contractionary stance in 2022.[7] The stance in 2021 is slightly expansionary, driven by outlays other than support measures.

Implications for the medium term

According to the 2023 Stability Programme Update, Government expects to retain inflation-related support measures throughout the medium term (the Update includes fiscal forecasts until 2026). Government expenditure – particularly subsidies – is set to remain above pre-pandemic times in the coming years.[8]

In May 2023, the European Commission recommended that Malta winds down energy support measures by the end of the year and retain price support only to vulnerable households and firms.[9] This echoes similar recommendations made by the International Monetary Fund (IMF) in its 2022 Article IV consultation.[10]

In its proposed revamp of its economic surveillance framework, the Commission advocates for multi-year expenditure targets which will determine Member States' fiscal adjustment paths.[11] While these proposals are still being discussed in EU fora, there is broad agreement that adherence to expenditure targets, together with front-loaded consolidation efforts, is necessary to bring finances on a more sustainable footing. According to its latest debt sustainability analysis in the medium term, the Commission assigned a 'medium' risk level for Malta under a no-policy change scenario but considered risks to be 'low' in a scenario when the structural balance reverts to its historical average.[12]

Going forward, therefore, a review of the nature and composition of existing support measures is necessary in order to rebuild the fiscal buffers that can be utilised to stabilise the economy in the event of future shocks.

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7 The fiscal stance is defined as the annual change in the primary structural balance ratio. The structural balance is in turn defined as the general government balance, adjusted for the impact of the economic cycle and excluding temporary measures.

8 See also Farrugia (2023), "The Composition of Government Subsidies", Box published in the *Outlook for the Maltese Economy* 2023:2.

9 See https://commission.europa.eu/system/files/2023-05/COM_2023_618_1_EN.pdf.

10 See https://www.imf.org/en/Publications/CR/Issues/2023/02/07/Malta-2022-Article-IV-Consultation-Press-Release-and-Staff-Report-529430.

11 See https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2393.

12 For further details, refer to the 2022 Debt Sustainability Monitor.