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COMPOSITION OF GOVERNMENT CAPITAL EXPENDITURE

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BOX 2: COMPOSITION OF GOVERNMENT CAPITAL EXPENDITURE[1]

Gross fixed capital formation and capital transfers are the main components of capital expenditure in the general government accounts. Their share in GDP is set to decline from their level in 2023. However, the ratio of these items in GDP is set to remain at or close to their long run average. These projections reflect the forecast path of projects financed from the EU and from own resources. This Box sheds light on the factors shaping the Bank's projections for capital expenditure.

Overview of EU-funded capital expenditure

The Bank forecasts the outlays on projects financed by grants from the EU's largest structural and investment funds. These include the European Regional and Development fund (ERDF), the Cohesion Fund (CF), and the Migration and Security Funds. The level of grants available to each EU member state is agreed at the start of a seven-year multiannual financing framework. In order to make full use of the available grants, projects need to be completed until three years after the end of the financing framework.

Besides the 2021-2027 budgeting framework, EU member states agreed on a temporary EU-wide stimulus package known as NextGenerationEU, to mitigate the economic and social impact of the COVID-19 pandemic. The largest fund in this package is the RRF. Member States are required to devote a large part of their allocated financing for projects related to the green transition and the digital transformation. RRF-financed projects must be completed by 2026.

Under the 2014-2020 financing framework, Malta received grants for projects completed by 2023. These included investment in roads, waste treatment, water distribution, the construction of new facilities at MCAST and the University of Malta, and the building of a new regional health hub.

Under the 2021-2027 framework, Malta will receive grants from the ERDF and CF for projects until 2030, which include investment in sustainable waste and water management, the development of a second electricity interconnector, and investment in healthcare and sustainable urban mobility. In addition, Malta is implementing institutional reforms and carrying out additional investment projects, financed by grants from the RRF. Projects mainly include investment in sustainable transport, the circular economy, digital transformation of the public administration and the legal system, renewable energy, and energy-efficiency in buildings.

Outcome in 2023

In 2023, government investment amounted to around 3.5% of GDP, broadly in line with the average share in the last ten years (see Chart 1). Capital transfers stood at 1.7% of GDP, significantly above its average in the last ten years. Outlays on domestically-financed projects constituted the largest part of capital expenditure.

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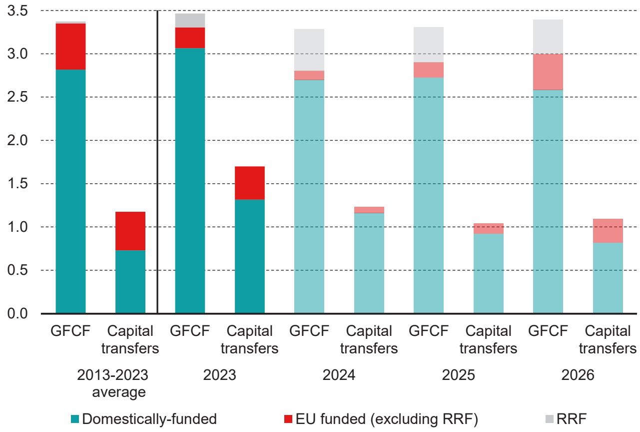
Domestically-financed investment stood at 3.1% of GDP, mainly due to outlays related to road building, the construction and restoration of buildings, and investment in IT systems and other equipment. Domestically-financed capital transfers amounted 1.3% of GDP, mainly due to spending on electricity distribution, water management, grants for electric vehicles, and energy efficiency schemes. It also reflects the impact of a scheme awarding grants to first-time buyers of residential property.[2] Both components had a higher share in GDP compared to the average share estimated in the last decade.

Chart 1
BREAKDOWN OF CAPITAL EXPENDITURE
(% of GDP)



Sources: NSO; Central Bank of Malta estimates.

Capital expenditure on EU-funded projects stood slightly below its average share in the last ten years. Outlays mainly reflected the completion of projects financed from the 2021-2020 framework, and progress in the implementation of the above mentioned RRF-financed projects. The latter is classified as part of government investment.

Decomposition of capital expenditure over the projection horizon

In the coming years, the Bank expects that Government prioritises the completion of EU-funded projects and large scale domestically-financed projects. Specifically, all RRF-financed projects and most projects related to energy distribution and waste management need to be completed within the forecast horizon to address infrastructure bottlenecks and to ensure full take-up of EU funds. The Bank expects relatively little progress on other initiatives until the above-mentioned projects are completed. Consequently, between 2024 and 2026, the level of domestically-financed investment is set to remain broadly unchanged, while the level of domestically-financed capital transfers is set to decline.

The share of domestically-financed investment in GDP is set to decline from 3.1% in 2023 to 2.6% by 2026, while that of domestically-financed capital transfers in GDP is set to decline from 1.3% in 2023 to 0.8% in 2026 (see Chart 1). In this period, the share of domestically-financed investment in total outlays is forecast to decline from around 88% to around 76%. Meanwhile, by 2026 locally-financed capital transfers are set to amount to around 75% of total outlays, only marginally down from around 77% in 2023.

[2] This scheme was announced in the 2023 Budget and applies to purchases of residential properties made from 2022 onwards. Applicants are awarded a €10,000 grant, in the form of €1,000 payments every year for ten years. According to ESA methodology, the impact of these grants is recorded in full in the first year of operation, and is classified as capital transfers paid.

According to the financial estimates accompanying the 2024 Budget Speech, the largest projects financed from domestic resources relate to road building, investment in ICT, and waste management.

Outlays on EU-funded projects not financed by the RRF are set to decline in level terms in 2024, but to rise again in 2025 and in 2026. This reflects the forecast profile of projects financed from the 2021-2027 framework. Work on the latter is expected to scale up in the coming years, now that projects funded by the previous financing framework have been completed.

Meanwhile, outlays financed by the RRF are set to increase in 2024, and to retain a broadly stable share in GDP thereafter. RRF-financed projects are expected to be completed by 2026.

The share of EU-funded investment (including RRF-financed projects) in GDP is set to increase from 0.4% of GDP in 2023 to 0.6% each year in 2024 and 2025, and to 0.8% in 2026. Meanwhile, the share of EU-funded capital transfers in GDP is forecast to decline from 0.4% in 2023 to 0.1% each year in 2024 and in 2025, and to rise to 0.3% in 2026.