June 16, 1999

Statement by Mr. Schlitzer on Malta
Executive Board Meeting
June 18, 1999

The Maltese authorities wish to express their appreciation to the staff for the excellent work done on the occasion of this consultation. They attach great value to the views and recommendations of IMF staff and broadly share those contained in the present report.

As the Maltese authorities are supportive of the Fund's approach towards greater transparency, they intend to participate in the pilot project on publication of Art. IV staff reports. Since Malta is on a 24-month cycle, it would be eligible to participate under the subcategory agreed upon by the Board for countries on a longer consultation cycle that would be unable to participate otherwise.

Since the last Art. IV consultation in 1997, Malta's policy performance has been mixed. However, following elections in September 1998 and the establishment of a new administration, Malta has initiated a new stage of stabilization measures and market-oriented reforms. The aim is to put the economy back on the high growth-high investment path experienced in the first half of the 1990s. The goal of EU membership, for which the new administration has reinstated Malta's application, is seen as instrumental to this. The working assumption is that Malta will be able to join the six "fast track" candidate countries and that accession could take place in January 2003.

Since 1996 a gradual deterioration of the public accounts has taken place due to the combination of increases in spending (mostly current expenditure) and shortfalls in revenues following the replacement of the VAT. The lack of fiscal discipline, coupled with a weakening of economic growth, pushed the deficit up to 10.4 percent of GDP in 1998. The new administration intends to put the public finances back on track and aims at reducing the fiscal deficit to 8.5 percent of GDP in 1999. For this purpose important measures are being implemented: (i) on the revenue side, a new VAT was introduced in January 1999 and a general reinforcement of the tax administration system is underway; (ii) on the expenditure side, the transfers to public companies through subsidies and lending is scheduled to be reduced by 1 percent of GDP and substantial further public savings will be made thanks to an employment freeze and a comprehensive civil servant wage restructuring.

It is important to note that for the first time a medium-term fiscal framework has been introduced, and this will reinforce Malta's fiscal credibility and buttress the prospects for EU

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membership. In particular, the authorities intend to scale down the fiscal deficit to 4 percent of GDP by the year 2004 (3.4 percent in the staff definition of fiscal balance). This deficit reduction path should be treated as a ceiling, and the authorities do not dismiss a priori that a stronger consolidation effort could be realized, as recommended by the staff.

The Maltese authorities are fully aware that the most appropriate way to achieve fiscal consolidation is through a structural reduction of spending. To this end, they intend to reduce permanently the heavy burden that public enterprises impose on public finances. A strong privatization program has been initiated. The main retail bank was fully privatized in May, and the government has announced that further privatization will take place in the coming year. A privatization unit, composed of senior representatives from the private and public sectors, was formed in March with the mandate of identifying public enterprises eligible for privatization and formulating appropriate methods and timing.

Concerning the tax system, as stated by the staff the reforms put in place during the 1990s have been quite successful and comprehensive. While further major changes are not necessary, some fine-tuning measures could be required in the future to put the system fully in line with EU standards and to enhance tax compliance.

The authorities intend to maintain the current peg arrangement, which they consider fully appropriate for a small, open economy like Malta's. In providing a useful nominal anchor, the peg has allowed Malta to afford relatively low inflation rates. The commitment to the peg will be firmly maintained amid continuing gradual liberalization of Malta's capital account, which will tend to prioritize long-term flows.

Malta's banking system and regulatory procedures are relatively sound. The regulatory regime, in particular, compares well to international standards, as concluded in 1997 by a mission of the Monetary and Exchange Affairs Department, after which further important improvements took place. This facilitates the task of the authorities, who intend to continue with orderly capital account liberalization, reducing the remaining controls as circumstances permit.