

## Chapter 3

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# Extra-Budgetary Units



## 3.1 Introduction

**Extra-Budgetary Units (EBUs)** are entities which are classified as part of general government because they meet specific criteria. These entities are established by Acts of Parliament and are responsible to perform specialised public functions in areas such as education, health, administration, regulation and social policy. These institutions are legally required to prepare an annual set of audited accounts and their annual financial budget is approved by Parliament. The accounting system used by EBUs is accruals-based, in contrast with the cash-based system adopted for the Consolidated Fund transactions.

Although the Consolidated Fund covers most of the government's activities, the fiscal balance and public debt, measured on an ESA basis, are also impacted by the operations of those entities classified as EBUs.<sup>9</sup> Thus, establishing whether an institution is an EBU, and hence within the general government sector, or otherwise, is of critical importance, in order to give a complete perspective on the fiscal situation in the country and assess compliance with the fiscal rules.<sup>10</sup>

## 3.2 Classifying an Extra-Budgetary Unit

Entities are tested twice a year, to check their statistical status. This is carried out prior to the fiscal notification which the National Statistics Office (NSO) forwards to the European Commission in April and October each year. This notification transmits the official data on Malta's fiscal balance and public debt, necessary to verify ex-post compliance with the European fiscal rules.

For classification purposes it is first necessary to determine whether an entity is a **government-controlled institutional unit** or not.<sup>11</sup> A government-controlled institutional unit means that the entity is directly or indirectly controlled by the

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<sup>9</sup> ESA refers to the European system of national and regional accounts. The fiscal rules specified in the Fiscal Responsibility Act and the Stability and Growth Pact refer to the fiscal statistics compiled according to ESA.

<sup>10</sup> General government balance = Consolidated Fund balance + EBU balance + other statistical adjustments.

<sup>11</sup> An institutional unit has autonomy of decision in owning and exchanging goods and services; in taking economic decisions; in incurring liabilities or obligations; can enter into contracts; and draws up a complete set of accounts.

government. This happens when the Government enjoys any one of the following conditions: (1) rights to appoint, remove, approve or veto a majority of officers, board of directors, etc.; or (2) rights to appoint, veto or remove a majority of appointments for key committees (or sub-committees) of the entity having a decisive role on key factors of its general policy; or (3) ownership of the majority of voting interest. In case the assessment is inconclusive, other factors which impact the classification decision include: the rights to appoint, vet or remove key personnel; rights under special shares and options; rights to control via contractual agreements or from agreement/permission to borrow; or control via excess regulation.

If the government-controlled entity finances its operational activity through the sale of goods and services at economically significant prices then it is considered as a **market producer** and thus classified outside general government.<sup>12</sup> There are two main tests which are employed to verify this, a **quantitative test** and a **qualitative test**.

The quantitative test verifies whether sales cover more or less than 50% of the production costs. The general rule is that if sales cover more than 50%, the entity is not to be treated as an EBU. This condition normally needs to be satisfied for at least 3 years, to enable an entity to be considered outside general government. However, if the unit would have surpassed the 50% ratio in the previous year and it is strongly expected to hold it for near future, then the unit can also be classified outside general government (therefore not labelled as EBU). On the other hand, whenever an entity sells all its output to the government, such entity is automatically classified inside the general government sector (labelled as EBU).

In the case of newly established units, forward-looking business plans are normally used to base the decision of whether a unit would surpass or not the 50% benchmark. When the audited accounts for subsequent years become available, the NSO can then verify whether the initial classification was validated or whether a reclassification is necessary.<sup>13</sup>

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<sup>12</sup> An economically significant price is a price which has a substantial influence on the amounts of products the producers are willing to supply and on the amounts of products that the purchasers wish to acquire. An economically insignificant price is one which is completely unrelated to the cost of production of the good or service.

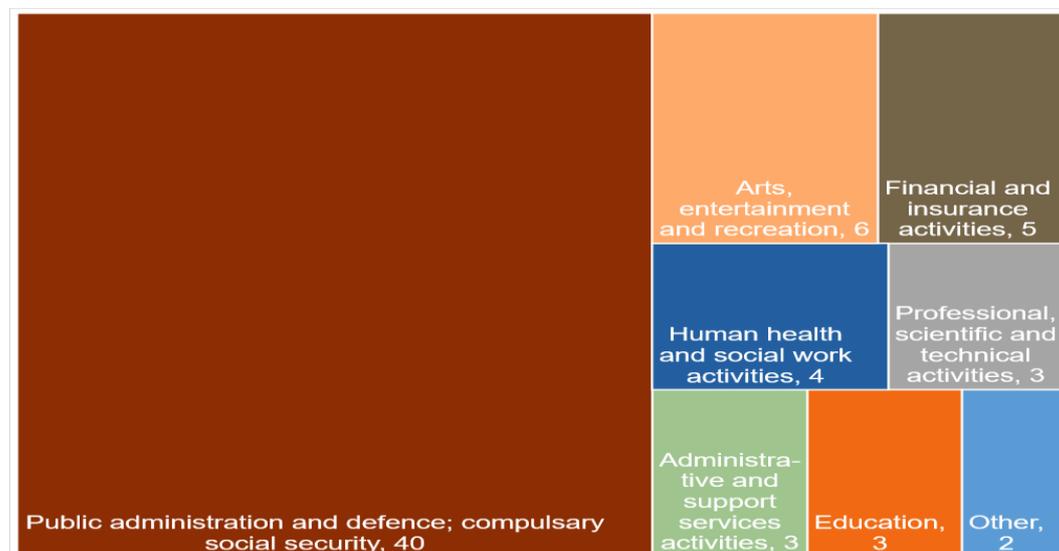
<sup>13</sup> Such reclassification would normally be backdated, thereby changing the time series for the fiscal balance and / or public debt.

Should a unit obtain a positive result in the **market test ratio**, because sales cover more than 50% of costs, the entity still needs to pass the qualitative test to qualify as a market producer, and hence fall outside general government. The qualitative test offers further guidelines how to treat specific type of entities and situations, such as hospitals, financial institutions and special purpose entities.<sup>14</sup>

### 3.3 The list of Extra-Budgetary Units in Malta

The list of EBUs is regularly published by the NSO.<sup>15</sup> The latest list shows the institutions classified as EBUs as at 31 December 2018.<sup>16</sup> Each EBU is categorised according to the **NACE** code.<sup>17</sup> The majority of EBUs, 40 entities, are classified under NACE section O, code 84 ‘Public administration and defence; compulsory social security’, with the other 26, spread under 8 different NACE sections (see Chart 3.1). The full list of entities classified as EBUs is presented in Table 3.1 and Table 3.2.

**Chart 3.1: EBUs by NACE**



Note: The area of each rectangle represents the number of entities in each category out of the total set of EBUs. Other includes NACE sections ‘E’ and ‘J’.

Source: NSO

<sup>14</sup> For further details refer to the Manual on Government Deficit and Debt 2019 Edition published by Eurostat.

<sup>15</sup> The list is available on:

[https://nso.gov.mt/en/News\\_Releases/View\\_by\\_Unit/Unit\\_A2/Public\\_Finance/Pages/General-Government-Balance-and-Debt-under-the-Maastricht-Treaty.aspx](https://nso.gov.mt/en/News_Releases/View_by_Unit/Unit_A2/Public_Finance/Pages/General-Government-Balance-and-Debt-under-the-Maastricht-Treaty.aspx).

<sup>16</sup> The cut-off date for information presented in this chapter is 21 February 2020.

<sup>17</sup> NACE is a coding system to classify economic activities in the EU. It is derived from the French term “nomenclature statistique des activités économiques dans la Communauté européenne”.

**Table 3.1: EBU's included under NACE section 'O' – Public administration and defence; compulsory social security' as at 31 December 2018**

Bord tal-Koperattivi
Broadcasting Authority
Environment and Resources Authority
Environment Protection Fund
Fort Security Services Ltd
Foundation for Educational Services
Foundation for Medical Services
Foundation for Tomorrow's Schools
Housing Authority
Identity Malta
Infrastructure Malta
Lands Authority
Malta Communications Authority
Malta Competition and Consumer Affairs Authority
Malta Council for Economic and Social Development
Malta Council for Science and Technology
Malta Enterprise Corporation
Malta Gaming Authority
Malta Government Investments Ltd
Malta Government Technology Investments Ltd
Malta Individual and Investor Programme Agency
Malta Investment Management Co. Ltd
Malta Residency and Visa Programme Agency
Malta Resources Authority
Malta Statistics Authority
Malta Tourism Authority
Medicines Authority
National Audit Office
National Commission Persons with Disability
National Development and Social Fund
Occupational Health and Safety Authority
Office of the Ombudsman
Planning Authority
Projects Malta Ltd
Projects Plus Ltd
Property Management Services
Regulator for Energy and Water Services
Selmun Palace Hotel
Superintendence of Cultural Heritage
Valletta Cultural Agency

Source: NSO

**Table 3.2: EBUs included under other NACE sections as at 31 December 2018**

NACE section	
E	WasteServ Malta Ltd
J	Malta Information Technology Agency
K	Depositor Compensation Scheme
K	Investor Compensation Scheme
K	Libyan Arab Maltese Holdings Ltd
K	MSE (Holdings) Ltd
K	Protection and Compensation Fund
M	Grand Harbour Regeneration Corporation
M	Trade Malta Ltd
M	Yachting Malta Ltd
N	Gozo Channel (Holdings) Co. Ltd
N	Jobsplus
N	Resources Support and Services Ltd
P	International Institute on Ageing
P	Malta College of Arts, Science and Technology (MCAST)
P	University of Malta
Q	Foundation for Social Welfare Services
Q	Mental Health Services
Q	Sapport
Q	The Rehabilitation Hospital Karin Grech
R	Arts Council Malta
R	Heritage Malta
R	Malta Philharmonic Orchestra
R	Manoel Theatre Management Committee
R	SportMalta
R	St James Cavalier Creativity Centre

NACE sections: **E** – Water supply; sewerage; waste management and remediation activities; **J** – Information and communication; **K** – Financial and insurance activities; **M** – Professional, scientific and technical activities; **N** – administrative and support service activities; **P** – Education; **Q** – Human health and social work activities; **R** – Arts, entertainment and recreation.

Source: NSO

### 3.4 The financial performance of Extra-Budgetary Units

Between 2014 and 2018 EBUs registered a **surplus** in each year, as revenue always exceeded expenditure (see Table 3.3). The surplus increased significantly starting from 2016. In that year, the surplus recorded by the EBUs more than compensated for the deficit in the other components of general government, thus contributing to the

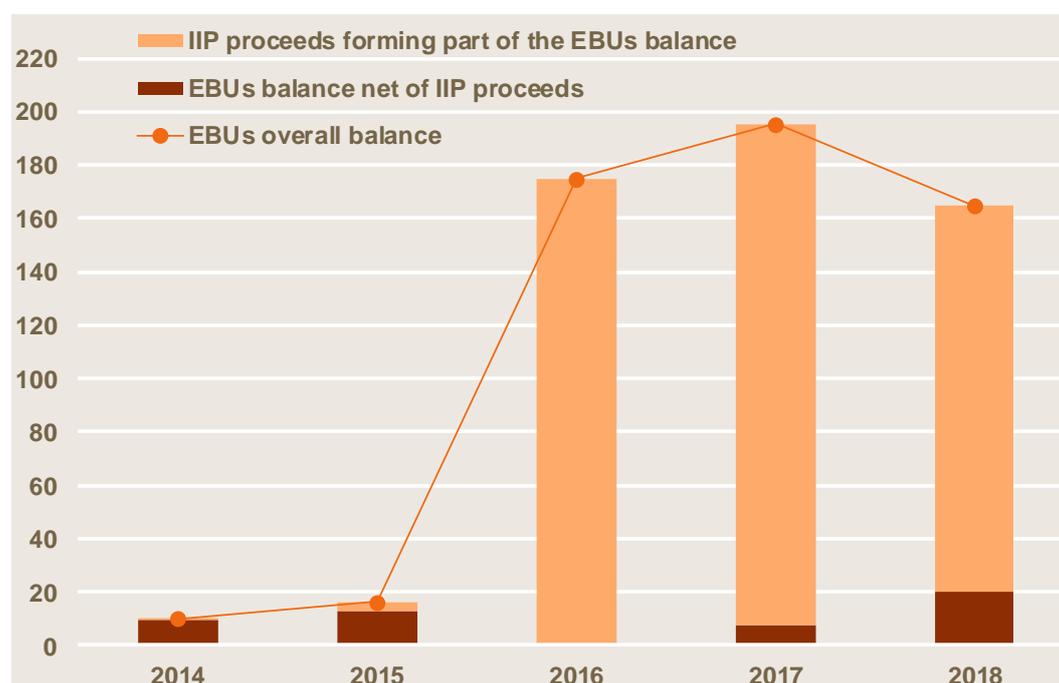
overall fiscal surplus on an ESA basis. In 2017 and 2018, the surplus generated by the EBUs supplemented the surplus recorded by the rest of general government. The significant improvement in the EBUs balance starting from 2016 was the result of the introduction of the **Individual Investor Programme (IIP)**.<sup>18</sup> In 2016, the National Development and Social Fund (NDSF) was set up, and this new EBU contributed to the significant increase in the aggregate surplus of the EBUs (see Chart 3.2).<sup>19</sup>

**Table 3.3: General government and EBU balances (EUR millions)**

	2014	2015	2016	2017	2018
General government balance net of EBUs	-157.7	-114.4	-80.7	190.0	71.1
EBUs balance	9.9	16.2	175.0	195.3	164.5
General government balance	-147.8	-98.2	94.3	385.3	235.6

Source: NSO

**Chart 3.2: EBUs balance (EUR millions)**



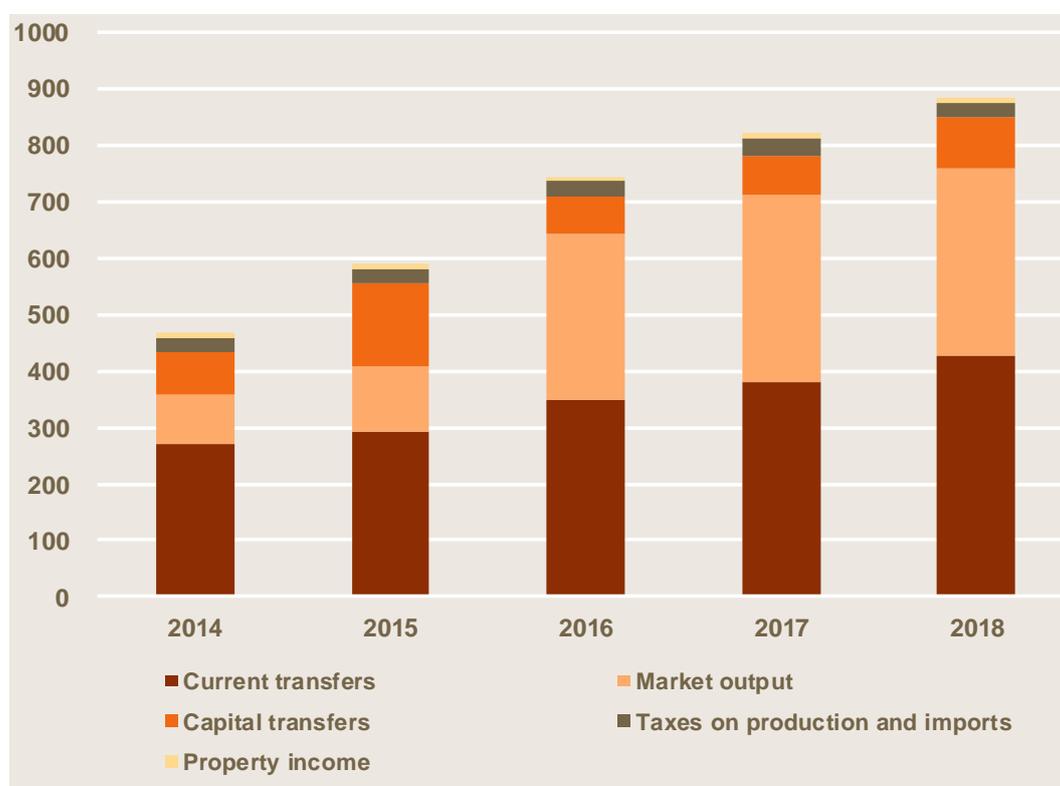
Source: NSO

<sup>18</sup> Out of the total proceeds generated by the IIP, 90% accrues to general government, 6% is retained by Identity Malta (classified as an EBU), whilst 4% is paid as commission to a private unit. In turn, out of the 90%, 30% is transferred to the Consolidated Fund, whilst the other 70% is transferred to the National Development and Social Fund (classified as an EBU).

<sup>19</sup> The proceeds generated from the IIP in 2014 and 2015, which were due to the NDSF were transferred to the NDSF in 2016. Such transfer was however balance neutral with respect to general government.

The aggregate **revenue** generated by EBUs doubled between 2014 and 2018 (see [Chart 3.3](#)). The bulk of revenue is in the form of current transfers, which mostly represent direct transfers from other units of government. In this case the overall impact on general government of such amounts is neutral on the fiscal balance as these funds are also recorded as expenditure by the entity providing such funds (within the Consolidated Fund). The second largest component, which in effect has contributed mostly to the observed growth in total revenue over these years is market output. The latter includes the revenues generated by the IIP.

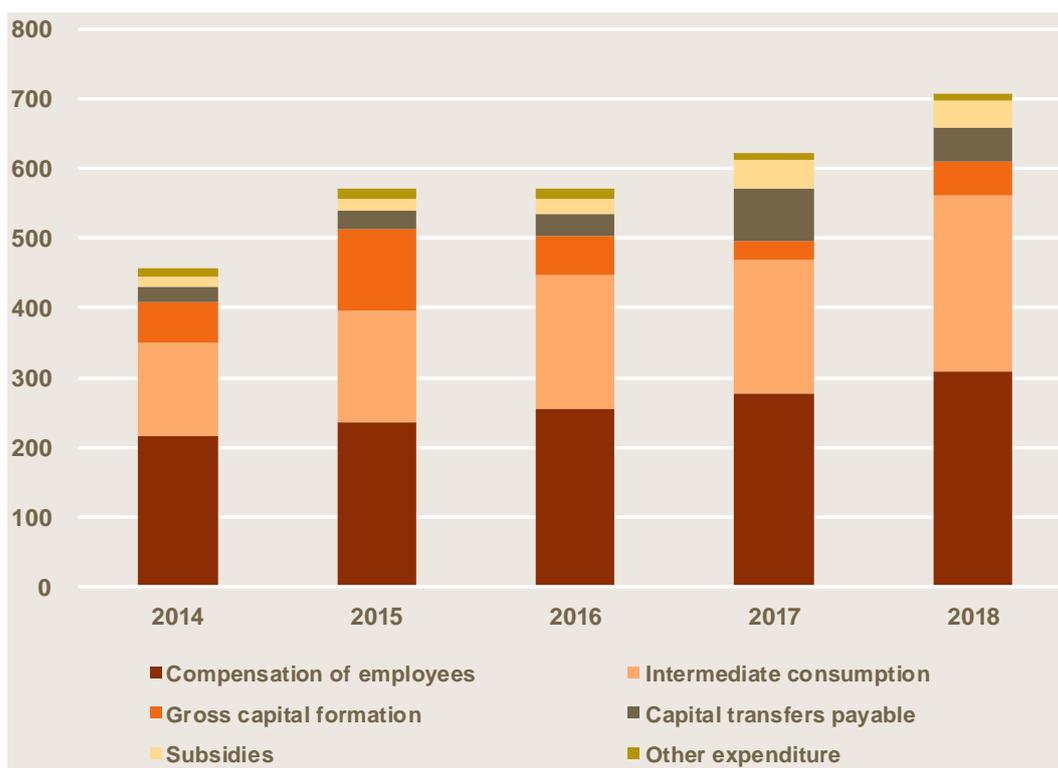
**Chart 3.3 Breakdown of the EBUs aggregate revenue (EUR millions)**



Source: NSO

On the other hand, the bulk of **expenditures** incurred by EBUs, is channelled towards compensation of employees and intermediate consumption (see [Chart 3.4](#)). In 2018, these accounted for 79.4% of total expenditure by EBUs, slightly higher than in 2014, when such ratio stood at 76.6%.

**Chart 3.4: Breakdown of the EBUs aggregate expenditure (EUR millions)**



Source: NSO

### 3.5 Conclusion

The setting up of EBUs can serve special purposes such as to improve the delivery of service, to improve efficiency, for independence purposes or delegation of power. Over the years, EBUs have been expanding. Whereas as at end 2014 the list consisted of 50 entities, it expanded to 66 as at end 2018.

The fact that EBUs have on aggregate recorded a surplus between 2014 and 2018 helps to attenuate the overall fiscal risks posed by these entities. At the same time, it is important to evaluate closely the implications on the fiscal balance and public debt of such arrangements. For example, one needs to evaluate the extent to which EBUs may eventually need additional financing or give rise to new contingent liabilities.

Methodological rules at European level may change over the years and this may be the cause that entities which were originally classified outside the general government would end up inside general government. Another fiscal risk which needs to be monitored carefully is the possibility that a new entity originally meeting the criteria to

be classified outside general government (not an EBU), eventually fails to meet the necessary criteria and is reclassified as an EBU at a later stage, thereby adversely impacting the fiscal balance and / or public debt. Under both scenarios, this would imply that the balance of such an entity would be added to the general government balance, and in the eventuality that such entity incurred a loss, it would contribute to a deterioration in the overall fiscal balance.

It is thus very important that when a new entity is considered, a business plan is provided to the NSO to ensure the correct sector classification (whether inside or outside general government) and fully evaluate the fiscal implications of such initiative.