

Box 3: The required structural effort

Fiscal consolidation efforts have enabled Malta to exit from the Excessive Deficit Procedure (EDP) under the corrective arm of the Stability and Growth Pact (SGP) in June 2015. As part of the preventive arm of the SGP, Malta must now reach its Medium Term Objective (MTO). Article 5 of Regulation (EU) No 1175/2011 stipulates that a Member State following a fiscal adjustment path towards its MTO should achieve an annual improvement of its general government fiscal balance measured in structural terms (that is the cyclically-adjusted balance, net of one-off or other temporary measures). For Member States whose debt ratio is below 60% of GDP and are not facing sustainability risks, the annual structural effort in normal times has to be at least equivalent to 0.5% of GDP, which is the set benchmark rate. With respect to Member States that are not yet at their MTO and whose debt level is greater than 60% of GDP or which face sustainability risks, the European Council may consider whether the structural effort needed should be higher than the 0.5% benchmark. Indeed, the required structural adjustment is contingent upon the economic conditions of the Member State, based on output gap estimates, that is, the difference between the level of actual and potential output expressed in percentage points in terms of the potential output. The structural effort should be higher in ‘good’ economic times and lower in ‘bad’ economic times. This implies that the larger the positive (negative) output gap, the greater (lower) the required fiscal adjustment effort.

In this respect the European Council recommended that Malta should realise a structural adjustment of 0.6% of GDP in 2015 and 2016. The higher required effort is determined by the fact that Malta has a debt level higher than 60% of GDP and the country is considered to be in ‘normal times’ (the shaded cell in the Table below).

	Condition (figures in pp of GDP)	Required annual fiscal adjustment*	
		Debt below 60 % and no sustainability risk	Debt above 60% or sustainability risk
Exceptionally bad times	Real Growth < 0 or output gap < -4	No adjustment needed	
Very bad times	- 4 ≤ output gap < - 3	0	0.25
Bad times	- 3 ≤ output gap < -1.5	0 if growth below potential, 0.25 if growth above potential	0.25 if growth below potential, 0.5 if growth above potential
Normal times	-1.5 ≤ output gap < 1.5	0.5	> 0.5
Good times	Output gap ≥ 1.5	> 0.5 if growth below potential, ≥ 0.75 if growth above potential	≥ 0.75 if growth below potential, ≥ 1 if growth above potential

The Table is reproduced from a document ‘Making the best use of flexibility within the existing rules of the Stability and Growth Pact’, available on http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/2015-01-13_communication_sgp_flexibility_guidelines_en.pdf