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**Assessment of the 2011 national reform programme and stability programme for  
MALTA**

*Accompanying the document*

**Recommendation for a**

**COUNCIL RECOMMENDATION**

**on the National Reform Programme 2011 of Malta and delivering a Council Opinion on  
the updated stability programme of Malta, 2011-2014**

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## **1. INTRODUCTION**

Malta's growth performance has been volatile, reflecting its vulnerability to external shocks. The global economic and financial crisis hit the Maltese economy mainly through the trade channel, but the subsequent rebound was strong as global demand strengthened. Boosting productivity levels together with tackling other structural bottlenecks, particularly in the areas of employment and education, would enhance growth potential and foster resilience to shocks. In order to address these challenges the Maltese government has updated its structural reform and fiscal consolidation strategies in the National Reform Programme (NRP) and the Stability Programme (SP) submitted to the Commission on 28 and 29 April 2011 respectively. These documents also reflect the short-term commitments that the Maltese government is undertaking under the Euro Plus Pact with the main objective of raising productivity to improve competitiveness.

## **2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK**

### **2.1. RECENT ECONOMIC DEVELOPMENTS**

Prior to the global economic and financial crisis, Malta experienced mixed economic fortunes. Having almost stalled during 2001-2004, reflecting adverse economic shocks, deteriorating international competitiveness and intensive industrial restructuring, the Maltese economy experienced solid growth between 2005 and 2008, averaging 4.1% per year. As the global crisis hit, real GDP contracted by 3.4% in 2009. The decline in exports, together with the sharp retrenchment of investment and the depletion of inventories, were the key drivers of this decline. The impact on the labour market was contained with employment only contracting mildly, also thanks to government assistance. Given the high government debt ratio (above 60% of GDP), however, the government did not undertake a large fiscal stimulus and the general government deficit in 2009 remained below that for the euro area as a whole. With exports and business investment picking up strongly in 2010, Malta experienced a strong rebound in economic activity in 2010. Average unemployment inched down as employment growth outpaced the expansion of labour supply.

A negative trade balance, in particular for goods, has been the main feature of Malta's external account deficit since 1995. This is due to the appreciation of the real exchange rate, driven by wage pressures and modest productivity growth, and steady losses in the market share of goods exports, particularly textiles. In recent years, however, the shrinking role of traditional, labour-intensive manufacturing in Malta's economy to the benefit of new high value-added activities, especially in the services sector, has supported exports while also leading to a structural decline in imports, due to the lower import-intensity of their production. The resulting improvement of the trade balance since 2006, however, has been partly offset by large net income deficits, which increasingly contribute to Malta's weak external position, reflecting the presence of many foreign-owned corporations, including banks.

Malta's financial sector has indeed grown very fast in recent years, with total banking assets currently exceeding 700% of GDP, more than two-thirds of which attributable to internationally-oriented banks. It was however not significantly affected by the international financial turmoil. No intervention by the Maltese government was required to support the banking sector, which remains well capitalised and whose share of non-performing loans (NPLs), at 3% in 2010, was broadly in line with that of the euro area average. That said, domestically-oriented banks have experienced an increase in the share of NPLs from 4.9% in

2008 to 7.3% in 2010. These remain vulnerable given the difficulties in the real estate market, namely the recent correction in residential property prices, the possible oversupply of housing units<sup>1</sup>, the predominance of floating-rate mortgage loans and relatively low coverage ratios.

## **2.2. OUTLOOK**

According to the Commission services' spring 2011 forecast, following the strong rebound in economic activity in 2010, real GDP growth is expected to decelerate in 2011-12. Investment, particularly public investment, is the main growth driver in 2011, while in 2012 private consumption is also expected to pick up as inflationary pressures subside and labour market conditions improve. Employment is expected to increase at a moderate pace, in line with labour supply, leaving the unemployment rate broadly stable over the forecast horizon. After remaining relatively subdued in 2010, wage growth is expected to become more dynamic, which, together with a moderation in productivity gains, is expected to push up Malta's unit labour costs above those for the euro area average. The general government deficit is expected to decline further to 3.0% of GDP in 2011 and remain unchanged in 2012 under a no-policy change scenario, while the debt ratio is not expected to head downward again within the forecast horizon.

In the medium term Malta is expected to see slightly lower growth than that prevailing in the past decade, mainly due to the fall in the average number of hours worked per person as women tend to take up part-time work.

## **3. MONITORING, PROCEDURAL ISSUES AND GOVERNANCE**

Malta's reform agenda is reflected in the National Reform Programme and Stability Programme submitted to the European Commission on 28 and 29 April respectively. Short-term commitments made by Malta under the Euro Plus Pact are reflected in a separate section within both documents. The reform agenda concentrates on three areas: fostering competitiveness, increasing employment and enhancing the sustainability of public finances.

The National Reform Programme was prepared in consultation with the social partners and the central bank, and was also open to online public consultation. Both the NRP and the SP were approved by the Cabinet of Ministers.

Malta has ensured coherence between its NRP and its SP by outlining in an integrated manner the fiscal consolidation efforts on the one hand and key structural reforms on the other. The NRP addresses the short-term priorities, reflected also in the Euro Plus Pact commitments, as well as the long-term strategy underpinning the EU2020 targets. The latter are presented in the table below.

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<sup>1</sup> Residential property prices have declined by more than 11% from 2007Q2 to 2009Q1, after having increased by 80.6% over the period 2000Q1-2007Q1. Recent data, however, suggest that prices have rebounded marginally, by 1.1%, in 2010 (Central Bank of Malta). In addition, the property market may be characterised by oversupply. Approximately 28% of the total dwelling stock in Malta was vacant in 2005 according to the Maltese statistical office but the data do not specify what share of these dwellings was still on the market for sale.

**Table 1: Maltese Europe 2020 targets**

Europe 2020 targets	Current situation in Malta <sup>2</sup>	Maltese Europe 2020 targets in the NRP
R&D investment (% of GDP)	0.55%	0.67%
Employment rate (%)	58.9%	62.9%
Early school leaving (%)	36.8%	29%
Tertiary education attainment (%)	21.1%	33%
Reduction of number of people in or at risk of poverty or exclusion	82 000	-6 560
Energy efficiency– reduction of energy consumption in Mtoe <sup>3</sup>		Reduction in energy consumption: 0.24Mtoe
Reduction in greenhouse gas emissions (from sources not covered by the Emissions Trading System)	+7% <sup>4</sup>	+5% <sup>5</sup>
Energy from renewables	0.2% (2008)	10% of energy from renewable sources in gross final consumption of energy

Malta has undertaken to carry out mid-year and end-of-year assessments of the implementation of the NRP. Each line Ministry and key public sector entity has a designated contact person who reports to the Ministry of Finance, the Economy and Investment on the progress of every measure falling under their respective responsibilities on a quarterly basis.

#### **4. POLICY CHALLENGES, AGENDA AND ASSESSMENT**

##### **4.1. CHALLENGES**

Various structural bottlenecks weigh on Malta's growth potential. These relate to the long-term sustainability of public finances; competitiveness; labour potential; the diversification of the economy; and the business environment and competition. Policy advice in these areas has been offered under the Stability and Growth Pact for public finances and through the ECOFIN Council's endorsement of the five major bottlenecks to growth. Tackling these challenges would be consistent with the policy priorities included in the Annual Growth Survey (AGS) adopted by the Commission in January 2011 and with the commitments under the Euro Plus Pact agreed in March 2011. These challenges, which are explained in greater detail below, are largely consistent with those identified by the Maltese authorities in the NRP. The main difference is that, in the area of fostering competitiveness, the NRP focuses on raising productivity, and does not recognise the need to revise the wage-setting mechanism in order to ensure alignment between wages and productivity.

<sup>2</sup> Eurostat estimates 2009

<sup>3</sup> As estimated by the Commission.

<sup>4</sup> This quantity corresponds to the 2005-2008 evolution of the emissions not covered by the EU Emissions Trading System. As the scope of the Emissions Trading System evolved between 2005 and 2008, these emissions are estimated on the basis of the main relevant UNFCCC source categories (as opposed to the difference between total emissions and EU ETS verified emissions).

<sup>5</sup> The national emissions limitation target defined in Decision 2009/406/EC (or "Effort Sharing Decision") concerns the emissions not covered by the EU Emissions Trading System. It is expressed as the minimum relative decrease (if negative) or the maximum relative increase (if positive) compared to 2005 levels.

Ensuring the long-term sustainability of Malta's public finances is a challenge given a significant projected long-term increase in age-related expenditure (above the EU average), in particular in the areas of pensions and healthcare. The low participation of older workers and women in the labour market and the prevalence of undeclared work are likewise adding to the scope of the challenge. The implications of ageing will be felt in the coming decade when the working-age population is expected to start declining; this will also weigh heavily on growth potential. Fiscal consolidation and the achievement of the medium-term objective (MTO) for the budgetary position, which will also work towards improving long-term sustainability, would be fostered by a stronger, binding medium-term fiscal framework.

The steady appreciation of Malta's real effective exchange rate (ULC-based), relative to the most industrialised countries, over the past decade suggests misalignment of wages and productivity developments and thus competitiveness losses, affecting in particular the labour-intensive sectors. As also explained in the NRP, collective bargaining in Malta is mostly conducted at enterprise level, which allows for some flexibility in wage setting. However, wages are linked to a mandatory Cost of Living Adjustment (COLA) mechanism resulting in wage increases in line with past inflation developments though proportionately higher at the low end of the wage spectrum. As such, COLA may further hamper competitiveness in the labour-intensive sectors. The issue is particularly pertinent in view of the recent increases in energy prices in particular.

There are several challenges in the Maltese labour market and the utilisation of human capital. While Malta's unemployment rate remains relatively low, its employment rate currently stands at 59.9% making it among the lowest in the EU. The employment gap relative to the EU is particularly large for women (only 41.4% of women aged 20-64 years were working in 2010), mainly due to their low participation in the labour market, and older workers (the employment rate for people aged 55 to 64 was 30.2%). In addition, undeclared work is a widespread phenomenon. Further, addressing the existing skill mismatches<sup>6</sup> and raising the skills base more generally, namely by discouraging early school leaving and through enhanced life-long learning opportunities, would allow the workforce to be better prepared for structural changes in the economy.

The size of Malta's economy lends itself to market imperfections, with competition being very limited in some markets, leading to high mark-ups, for instance in the electricity sector<sup>7</sup>. In addition, administrative and regulatory burdens, particularly the inefficiencies in the administration of support programmes and the non-transparency of existing regulation, are weaknesses that characterise Malta's business environment.

The characteristics of Malta's energy system, in particular problems with meeting electricity demand, may pose obstacles to entrepreneurship and SMEs' competitiveness and may be a factor holding back FDI. The share of energy from renewable sources remains marginal, as energy supply relies heavily on imported oil, which makes the country particularly vulnerable to increases in oil prices. Exploring the potential to produce energy from renewable sources and improving energy efficiency could bring the double benefit of contributing to reducing losses in competitiveness and achieving the national energy and climate targets.

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<sup>6</sup> Approximately 46% of the low-skilled are in employment vis-à-vis 73% and 83% for medium- and high-skilled workers respectively.

<sup>7</sup> See the 2008 *LIME Assessment Framework (LAF) Country Case Study on Malta*

### **Box 1: The Euro Plus Pact (EPP)**

The NRP and SP contain an identical section dedicated to Malta's response to the EPP, which consists of nine measures. Eight of these aim to raise productivity, notably by improving the business environment and financing conditions for firms and enhancing competition in services, especially in telecommunications. These measures respond to the EPP call to foster competitiveness, but limited to the channel of raising productivity. Addressing the wage indexation mechanism to ensure a better alignment of wage and productivity developments is not envisaged, although this would have been in line with the EPP. The ninth measure is in the area of public finances, where the authorities are strengthening the accountability and transparency of the budgetary framework and are considering the introduction of mechanisms to increase discipline in budgetary execution. The Stability Programme states that the government is considering the introduction of a fiscal expenditure rule, without disclosing further details.

In addition to this direct response to the EPP, other measures discussed within the NRP can be considered to be broadly in line with the remaining EPP commitments to foster employment and reinforce financial stability.

## **4.2. ASSESSMENT OF THE POLICY AGENDA**

### **4.2.1. Macro economic policies**

#### **4.2.1.1. Public finances**

The macroeconomic outlook underlying the Stability Programme, which is the same as the one underpinning the National Reform Programme, projects economic growth in 2011 at 2.4%, somewhat higher than in the Commission services' spring 2011 forecast (2.0%) due to a larger contribution from net exports. For 2012, growth is in line with the spring forecast (2.3% vs. 2.2%) but again with a higher contribution from net exports. After the significant growth recorded in 2010, employment is projected to decelerate in 2011 at a faster pace in the programme than in the spring forecast. In 2012 the two scenarios project similar growth rates. Wage growth per employee is much less dynamic in the programme than expected in the spring forecast. HICP inflation is projected to peak in 2011 and ease as from 2012, with a similar path as in the spring forecast. After 2012 the programme projections for real GDP growth are above potential growth estimated by the Commission services. Overall, based on currently available information including the Commission services' spring forecast, the macroeconomic assumptions in the programme appear favourable in 2011 and in the latter years of the programme and plausible for 2012.

Cyclical conditions, as measured by the output gaps recalculated by the Commission services according to the commonly agreed methodology on the basis of the information in the programme, are projected to be slightly negative at the start of the period and to improve subsequently.

In 2010, the general government deficit reached 3.6% of GDP, better than the target set in the previous update of the Stability Programme (3.9%). The better-than-targeted outcome is essentially explained by significantly lower expenditure. In particular capital expenditure - net of EU grants - was around 1.3pp of GDP lower than planned, with more than 0.3pp due to the one-off sale of assets of Malta Shipyards Ltd. Current expenditure was also lower than planned but this was more than offset by a significant tax revenue shortfall (around 2% of GDP), as growth was less tax-rich than expected and the assumed tax buoyancy (0.8% of GDP) did not materialise. As a result, government gross saving, i.e. current revenues minus current expenditures, turned out more negative than budgeted (-2.0% of GDP vs. -1.0%).

For 2011 the deficit target in the previous programme was set at 2.9% of GDP, i.e. below the reference value of 3% of GDP under the 2011 deadline for the correction of the excessive deficit. The new programme sets a target of 2.8% of GDP, given significantly lower capital expenditure net of EU grants and a much smaller improvement in gross saving than in the previous programme: higher current revenue growth from the tax-increasing measures in the 2011 budget (see Box 2) is more than offset by the upward revision in current expenditure growth. The Commission services' spring 2011 forecast projects the 2011 deficit at 3% of GDP given less dynamic taxes and social contributions, which is partly offset by a lower figure for intermediate consumption growth than in the new programme. A risk to the programme target and spring forecast projection for 2011 is the upcoming restructuring of Air Malta, which might entail additional expenditure.

After correction of the excessive deficit in 2011, the Stability Programme plans gradual progress towards the medium-term objective (MTO) of a balanced position in structural terms. As in the previous update, the programme does not mention a target year for achievement of the MTO, which is to be reached after the programme period. The nominal deficit would improve from 2.8% of GDP in 2011 to 1% in 2014, while the primary surplus would strengthen to 2% of GDP by 2014. The programme affirms the Maltese government's commitment to ensuring a sustainable, largely expenditure-based consolidation but no details are provided on the broad measures underpinning the consolidation effort after 2011. In particular, compensation of employees and intermediate consumption are foreseen to decline as a share of GDP, aided by a continued policy to restrict recruitment in non-essential categories in the public sector and to ensure value for money in public procurement procedures in particular. Government investment would also fall from its 2011 peak. The decline in the revenue ratio in 2014 is not explained in the programme.

For 2012 the programme envisages a deficit of 2.1% of GDP, i.e. 0.7 pp lower than that in the previous programme. The improvement compared to 2011 mainly reflects a moderate increase in current primary expenditure (2.5% year-on-year), driven by a cut to intermediate consumption and a relatively low increase in compensation of employees (3% year-on-year compared to an average of 4% in the period 2004-2010).

In structural terms, the deficit targets for the period 2012-2014 correspond to an average annual structural effort of 0.5pp of GDP, as recalculated by the Commission services based on the information in the programme following the commonly agreed methodology; the effort is slightly front-loaded to 2012. Hence, taken at face value the budgetary stance in the programme is broadly in line with the Stability and Growth Pact provisions on the pace of adjustment towards the MTO. When assessed against the projected rate of potential medium-term potential output growth, expenditure targets seem to ensure an appropriate adjustment path towards the MTO.

The budgetary outcomes could, however, be worse than targeted throughout the programme period. The main reason is the lack of information on the broad measures behind the planned consolidation. In particular, notwithstanding the strong commitment to restrict recruitment in non-essential categories, there is a risk of slippages in the public sector wage bill also in the light of the collective agreement being negotiated in the course of 2011. In addition, expenditure overruns, linked also to weaknesses in the budgetary framework at execution stage, have occurred in the past especially in intermediate consumption given pressures in the health sector. In the absence of concrete measures the Commission services' spring 2011 forecast projects the 2012 deficit under a no-policy change assumption at 3% of GDP, reflecting a higher increase in current primary expenditure, especially in intermediate consumption and compensation of employees.

### Box 2. Main measures

The Stability Programme presents the main measures adopted in the budget for 2011, which are estimated to have a net deficit-improving impact amounting to 0.4% of GDP. No other concrete budgetary measures are put forward in the programme.

#### Main budgetary measures (% of GDP)

Revenue	Expenditure
2011	
<ul style="list-style-type: none"><li>• Increase in excise duty rates on fuel, alcohol and tobacco products (0.3%)</li><li>• Strengthening of efforts against tax evasion and avoidance (0.2%)</li><li>• Rise in the VAT rate on collective and private accommodation from 5 to 7% (0.1%)</li><li>• Annual lease concessions (0.1%)</li></ul>	<ul style="list-style-type: none"><li>• Incentives for industry and enterprises, tourism, research and innovation, employment and labour market (0.1%)</li><li>• Payments for expropriations of land under the Home Ownership Schemes and other expropriations (0.1%)</li><li>• Measures supporting social cohesion and promoting sustainable environment (0.1%)</li></ul>

*Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.*

The programme details the budgetary impact of the major structural reforms included in the National Reform Programme, especially those concerning research and development, renewable energy measures as well as education. They increase expenditure by 0.2% of GDP in 2011, 0.3% of GDP both for 2012 and 2013 and 0.1% of GDP in 2014.

After increasing by around 6pp of GDP in 2009, the general government debt ratio rose slightly further in 2010, reaching 68% of GDP. The programme plans the debt ratio to start decreasing as from 2011, as the primary balance turns positive and strengthens during the period. According to the Commission services' spring 2011 forecast, which assumes a no-policy change scenario for 2012, the debt ratio remains broadly stable until 2012 under a no-policy change assumption on account of worse projections for the primary surplus. The same risks highlighted for the budgetary targets apply to the programme's plans for the debt ratio. Unless these are addressed, the budgetary stance in the programme might not be sufficient to bring the debt ratio back down on a firmly downward path. In a context of relatively low interest rates, debt composition in recent years has to some extent shifted away from short-term instruments towards more medium- to long-term securities. The programme indicates that this trend will continue over the programme horizon and in 2014 short-term debt is planned to account for 4.4% of total debt (from 9.3% in 2010).

Malta is at high risk with regard to the long-term sustainability of public finances. The long-term cost of ageing is clearly above the EU average, with the increase in pension expenditure as a share of GDP accounting for more than half of the total age-related expenditure increase between 2010 and 2060, in spite of the gradual increase in retirement age enacted with the 2006 pension reform. The current budgetary position, as estimated in the programme, compounds the cost of ageing. Based on the current fiscal position, debt would increase to 117.4% of GDP by 2020. However, the full implementation of the programme would be sufficient to bring debt back to below 60% of GDP, by 2020. Ensuring high primary surpluses over the medium term and implementing reform measures that curb the projected increase in



age-related expenditure would contribute to reducing the high risks to the sustainability of public finances.

Malta's fiscal framework is on the whole flexible. While this may be a desirable feature in the context of a very small, very open economy, it also creates risks for expenditure overruns and the achievement of a sound fiscal position. A key weakness is the non-binding nature of the existing national medium-term budgetary framework, which also implies a relatively short fiscal planning horizon. The SP reports that the Maltese government is considering the introduction of numerical budgetary rules, in particular an expenditure rule, to complement efforts to enhance the accountability and transparency of the budgetary framework. However, the programme fails to provide concrete details on this plan.

#### **4.1.1.2. Financial sector**

The NRP reiterates plans, announced in the latest budget, to enter into talks with the authorities responsible for financial stability<sup>8</sup> in order to set up a mechanism similar to the European Systemic Risk Board at EU level which will be responsible for macro-prudential supervision in Malta. Given the size of the financial sector in Malta, this initiative seems appropriate but in the absence of details it is difficult to make an assessment. Pertinent issues will be the division of responsibilities between the different supervisory institutions and the scope of supervision (e.g. domestically-oriented financial institutions versus foreign-owned institutions and coverage of real-estate developments given the exposure of domestically oriented banks).

#### **4.1.1.3. Correcting macro-economic imbalances**

The NRP recognises the past competitiveness losses of the Maltese economy but highlights adverse productivity developments rather than wage dynamics as the main driver. The NRP does not regard the existing automatic wage indexation system (COLA) as a source of competitive pressures, especially in the labour-intensive sectors, based on the claim that the wage-bargaining framework introduces adequate wage flexibility through, for example, the opt-out clause allowing firms facing particular hardship not to award the COLA upon agreement with the trade unions. This opt-out clause has allegedly been used quite extensively during the economic downturn. The NRP, therefore, does not envisage reforming the wage-setting framework with a view to better aligning wage and productivity developments.

### **4.2.1. Labour market reform**

#### **4.2.1.1. Making work more attractive**

Malta has introduced a number of measures in recent years to encourage women to enter the labour market and return to work after childbirth. These include tax breaks for women who have had a child and choose to return to work, a reduction in national insurance contributions on part-time employment, measures targeting married female workers within small family businesses and the setting up of childcare facilities. While acknowledging that Malta's low female participation is largely due to cultural factors<sup>9</sup>, the Maltese authorities propose further

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<sup>8</sup> The authorities responsible for financial stability in Malta are the Malta Financial Services Authority, which is the single regulator for financial services, and the Central Bank, which contributes to the stability of the financial system through ongoing macro-surveillance of financial institutions and markets and assessment of the implications for financial stability of economic and financial developments.

<sup>9</sup> According to Eurostat, the employment rate of young women (aged 15-24) in Malta is significantly higher than the EU average (41.6% vs 31.8% in 2010). The female employment rate declines progressively in subsequent age groups. This seems to indicate that many women choose not to return to the labour market after childbearing, which suggests that the authorities' attention to reconciliation policies is well-placed.

measures in their NRP to address this issue. These include changes to means-testing regulations and national insurance contributions for self-employed women working part-time, free child care services for women starting a business, as well as the opening of new childcare facilities and afternoon school centres. While the creation of childcare places is under way, all these measures are expected to come into force in 2011.

In the light of the considerable progress achieved in this area over recent years, with the activity rate of women in the 20-64 age group in Malta having increased much faster than on average in the EU (6 pp over 2006-2010 as against 1 pp in the EU), the continued commitment shown in the NRP to tackle the issue is welcome.

As far as older workers are concerned, their low employment rates are the result of early exit from the labour market and low participation of older women. The early exit age is related to the frequent recourse to early retirement schemes as a labour market measure in the face of restructuring, particularly of large public-owned companies, and a still relatively low retirement age. This is expected to be remedied as a result of the 2006 pension reform, which gradually increases retirement age to 65 years for both men and women and extends the required length of contributions for full pension entitlement, although over a relatively long period of over 20 years (i.e. the reform will enter fully into force only in 2027). Other measures that can contribute to prolonging working lives are the legislation introduced in 2008 allowing persons of pensionable age to continue working without losing their pension entitlements and a stricter medical assessment that makes it harder to qualify for invalidity pension. Also as a result of these measures, the effective exit age in Malta has increased by nearly 2 years since 2007, reaching 60.3 years in 2010 against an EU average of 61.5 years. As the younger cohorts of women, who are more active on the labour market, approach pensionable age, the employment rate of older workers is bound to increase further. The NRP, however, does not introduce a comprehensive active ageing strategy to accompany the above-mentioned changes in pension legislation with adequate activation measures.

Undeclared work is recognised to be a relatively widespread phenomenon, particularly in sectors such as construction and personal and domestic services<sup>10</sup>. This phenomenon may also go hand in hand with long-term dependency on unemployment benefits, as the interaction of the tax and benefit system may discourage unemployed workers with low wage potential to return to work<sup>11</sup>. To curb undeclared work, the Maltese authorities have strengthened inspection and control activities and introduced tax incentives for SMEs and family businesses declaring their employees. New measures announced in the NRP target the abuse of benefits. They include tighter conditions for access to and receipt of disability pensions and unemployment benefits, as well as the launch of a campaign on the benefits of declared work.

#### **4.2.1.2. Improving education and the skills of the labour force**

Insufficient qualifications and training are another bottleneck in reaching the government's employment targets. Since Malta has few natural resources, economic growth is overwhelmingly dependent on its human capital. The notable discrepancy between demand and supply of skills in Malta suggests that there is a need to improve the skills base of the labour force in order to respond to the structural changes the economy has been undergoing since the beginning of the decade and to further attract foreign investment in high value added activities. The NRP describes a number of ongoing programmes aimed at raising the skills of

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<sup>10</sup> Although undeclared work is difficult to measure, the comparison of survey and administrative labour market data provides a picture that is consistent with this view.

<sup>11</sup> Even though the coverage of unemployment benefits in Malta is relatively low, data shows that unemployed persons with low wage potential in one-earner households are likely to be caught in an unemployment trap (Source: Joint European Commission-OECD project, using OECD Tax-Benefits models).

the labour force, namely apprenticeship and training schemes. The government also plans to invest further in its Scholarship Scheme, specifically in the area of science and technology, and to extend the existing post-graduate support programme to include post-doctoral opportunities to support research and innovation activities. In addition, skills shortages in specific high added-value areas have been partly addressed in further and higher education through the introduction of flexible courses in collaboration with industry and university-business forums.

The NRP outlines a number of measures to improve education outcomes with substantial budgetary allocations in 2011<sup>12</sup>. A major challenge in this area is the high rate of early school leavers, which the NRP sets out to address. Measures aim to improve social and educational student services in compulsory education and to introduce multi-disciplinary teams (including social workers, psychologists, counsellors, etc.) to help truant children and their families. In addition, to make education more attractive, the Maltese government will introduce vocational subjects in secondary school and extend the provision of vocational subjects at post-secondary level. Some measures are also envisaged to attract adults with lower than upper secondary education into higher education. The government also plans to set up a national system for accreditation of further and higher education programmes and the recognition of informal learning.

The set of measures that target education reflect the AGS priorities and should enable progress towards the national benchmarks within the Europe 2020 strategy. Nevertheless given the importance of higher education for certain high added-value sectors, for instance business and financial services as well as ICT, the NRP does not appear sufficiently ambitious in tackling the challenge of insufficient qualification and training. In addition, the NRP does not adequately analyse the sources of the high rate of early school leaving, which makes it difficult to properly address the problem in a comprehensive way. Malta's early school leaving rate is still the highest in the EU at 36.8% vs. 14.4% on average in the EU, despite of significant progress made in the past. If the same pace of progress is maintained in the decade ahead, the national target set by Malta for 2020 (29%) does not seem ambitious enough.

#### **4.2.1.3. Pension reform**

Given the projected unfavourable demographic developments, the pension system in Malta is putting pressure on public finances, entailing risks to their long-term sustainability. While the changes introduced by the 2006 pension reform, notably the increase in pensionable age and contribution period for full pension eligibility, contribute to lowering the projected rise in pension expenditure, changes to indexation arrangements and the introduction of the guaranteed national minimum pension contribute to increasing expenditure pressure, while enhancing pension adequacy.

A proposal for pension reform was submitted by an independent Pensions Working Group was submitted to the Maltese Parliament in December 2010. It includes establishing an explicit link between the retirement age and life expectancy, which is high in Malta especially for women<sup>13</sup>, as well as the introduction of a mandatory second pension pillar and a voluntary third pillar. The Maltese government has launched a public consultation on this study and is expected to announce its position shortly afterwards.

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<sup>12</sup> €340 million out of €2.9 billion an increase of €32 million over 2010

<sup>13</sup> Life expectancy in Malta stands at 82.72 years for women and 77.84 years for men.

#### **4.2.1.4. Poverty and social exclusion**

In 2009, 20% of the population were at risk-of poverty or exclusion in Malta (according to at least one of the three criteria defined by the European Council<sup>14</sup>), as against 23% in the EU<sup>15</sup>. More than two third of them are children (25%) or inactive adults (not retired) (40%), mainly women. This illustrates the importance of improving female labour market participation as a means to address poverty and exclusion in Malta. In the few years before the crisis, the at-risk-of-poverty and material deprivation rates increased, especially for children. At the same time, the share of working age adults and children living in jobless households decreased slightly to 8.4% in 2009, just below the EU average (9%).

The Maltese government aims to lift around 6,560 people out of the risk of poverty and exclusion, with a focus on three groups, namely children, the elderly and jobless households. In addition to the measures taken to improve female labour market participation (including in the area of child care), the social inclusion measures envisaged by the Maltese government, such as those targeted at lone parents, should contribute to improving the situation of children and their families.

### **4.3. GROWTH ENHANCING STRUCTURAL MEASURES**

#### **4.3.1. Productivity and the business environment**

The NRP introduces measures to address imperfections in its business environment while targeting private investment. In order to reduce market imperfections, the government plans to set up a Malta Authority for Competition and Consumer Affairs, with the tasks of safeguarding competition and consumer welfare. Provided it is given adequate financial and human resources, the authority can effectively contribute to strengthening competition, thereby creating substantial benefits for consumers. The NRP also outlines plans to reduce the administrative burden on businesses by 15% by 2012. This includes the introduction of simplification measures in line ministries and the training of public officials in better regulation principles. The *Small Business Act Malta*, to be adopted in summer 2011, is expected to ensure a systematic screening of planned legislation so that it is less burdensome on SMEs. It is also expected to reduce bureaucracy by providing, among other things, improved access to on-line government services. Steps have also been taken towards the creation of two one-stop-shops for business in Malta and Gozo, which could help attract investment to Malta. The success of the measures will depend on monitoring of their implementation and outcomes, in particular since they are being introduced against a backdrop of repeated delays. The electronic Point of Single Contact under the Services Directive is operational but needs to be further enhanced, as it does not yet allow for online completion of procedures.

In addition, in order to encourage private investment, the government plans to introduce tax credit schemes, offer funds to help businesses develop their products and access export markets, offer training and consultancy programmes, and invest in industrial parks. The government also envisages revamping the existing business incubation centre in Kordin in order to facilitate the setting up of more innovative businesses in Malta. These measures are

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<sup>14</sup> People are considered at-risk-of poverty or social exclusion if they are at-risk-of poverty and/or suffering from severe material deprivation and/or living in a household with zero or very low work intensity.

<sup>15</sup> The 2009 risk of poverty and low work intensity indicators refer to the situation in 2008 (that is, before the crisis).

either ongoing or expected to be introduced shortly. Overall, these initiatives could help stimulate private investment in Malta, including from abroad.

#### **4.3.3. Research and innovation**

Difficulties pertaining to economies of scale have resulted in Malta relying almost exclusively on a cluster of large foreign-owned firms to bring know-how. In addition, the shortage of science and technology graduates, though having improved substantially over the last decade, could partly explain Malta's low R&D intensity.

The NRP confirms that the Maltese authorities, through Malta Enterprise, will continue to provide ERDF funded grant schemes till 2013 that target, among others, the promotion of R&D, innovation and eco-innovation. Health and biotechnology, energy and environmental technologies, ICT and high added-value manufacturing and services have been identified as potential niche areas. The process of smart specialisation will need to be further pursued by increasing financial resources devoted to R&D and innovation and boosting human resources in these niche areas of economic importance. The government also plans to set up a life sciences centre that is expected to be fully operational in 2013 in order for local enterprises and foreign investors to have the appropriate facilities available to support both their current operations and their needs for R&D and innovation. To raise private R&I investment, it will be crucial to create an enabling environment that nurtures innovation and entrepreneurship among business enterprises, including SMEs, as well as to foster demand for innovation through public procurement.

#### **4.3.4 Energy and climate change**

Malta's energy system is characterised by considerable dependence on imported oil. Issues pertaining to security of supply are being addressed in the NRP with plans to extend the power station at Delimara by 2012 and build an electrical interconnector with Sicily by 2013.

Moreover, the government aims to increase the share of energy from renewable sources, targeting more broadly greenhouse gas emissions, and energy efficiency. In addition to extending schemes to encourage solar water heaters and micro-generation from renewable sources in 2011, the government intends to support investment in renewable energy sources including through the introduction of a feed-in tariff system. The success of the latter largely rely on avoiding delays in the implementation of the renewable energy projects announced in the NRP and ensuring that the costs of support schemes remain limited. This can be done by, for instance, setting feed-in tariffs that can be adapted to technological progress. The NRP also announces a reform of the public transport system and other measures to improve energy efficiency.

Overall, the envisaged measures would help to reduce the country's vulnerability to oil price changes by reducing its dependency on oil imports and contribute to achieving the energy and climate targets. However, the success of these envisaged measures is hard to gauge ex-ante given the low level of progress in previous years.

The NRP contains neither an assessment of the ability of the existing and proposed emissions reduction measures to reach the 2020 target, nor operational targets (such as domestic targets, intermediate targets and/or sectoral targets). The latter would contribute to efficient monitoring of the progress made towards the 2020 target. Moreover, the NRP does not put sufficient emphasis on measures targeting the waste sector.

Malta's energy efficiency potential remains vastly untapped, although proposed measures aim to improve electricity generation efficiency by 10%, with a third of this expected to come

from the promotion of energy saving upon end-use consumption. Only 4.8% of Malta's total ERDF and Cohesion Fund allocation for the 2007-2013 programming period was dedicated to renewable energy and energy efficiency investments. The take up of these investments has been relatively high, however, especially under the ERDF Energy Grant Scheme for SMEs, where the initial allocation has already been increased by 50%. Using new possibilities for introducing financial engineering instruments<sup>16</sup> for energy efficiency and the use of renewable energy in buildings (including in existing housing) through the Structural Funds has until now not been exploited. Malta is in the process of preparing a second National Energy Efficiency Plan, due to be submitted in June this year, which should underpin the government's strategy on energy efficiency in a more comprehensive way.

In spite of the influence of the economic crisis, the recent evolution of the greenhouse gas emissions does not appear in line with the 2020 national target defined at the European level (+5% compared to 2005 levels), suggesting additional emissions reduction measures and/or the use of flexibility mechanisms may be required, especially in the road transportation and waste sectors given their weight in the national emissions and current trend.

## **5. SUMMARY**

Malta's Stability Programme plans to correct the excessive government deficit in 2011 and to bring the deficit further down subsequently. While the planned progress towards the medium-term objective (MTO) is appropriate, there are important risks to the achievement of the deficit and debt targets in the programme because the consolidation strategy after 2011 is not backed up with concrete measures and expenditure could overrun as has happened in the past. In addition, the non-binding nature of Malta's medium-term budgetary framework and the short fiscal planning horizon may not foster fiscal discipline. The SP presents initiatives to strengthen the framework and improve budgetary discipline, but details remain to be worked out. The relatively large long-term cost of ageing, particularly the high projected increase in pension expenditure, puts the long-term sustainability of Malta's public finances at high risk. This challenge is acknowledged in both the SP and the NRP, which refer to the ongoing public consultation on a new set of proposals for pension reform aimed at enhancing the sustainability of the pension system, while preserving its adequacy.

The National Reform Programme acknowledges the main structural challenges that Malta's economy is facing. On the whole, the programme is adequate, as policy efforts in areas such as the business environment and market functioning, research and innovation, and the labour market are significant. Nevertheless, important challenges such as reducing high early school leaving rates, ensuring a better link between the education system and the needs of the economy, as well as devising an active ageing strategy to foster labour market participation of older workers remain to be properly addressed. The NRP also includes measures to reduce the incidence of undeclared work which may also help ensure the long-term sustainability of Malta's public finances. In the field of energy, the envisaged measures appear appropriate, but the insufficient level of detail provided together with the low level of progress recorded so far makes it difficult to assess their (cost-)effectiveness and feasibility. With regard to the competitiveness of the economy, the measures to raise productivity levels are welcome, but the NRP does not acknowledge that the existing backward-looking wage-setting mechanism may hamper competitiveness.

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<sup>16</sup> Regulation (EU) No 539/2010 of 16 June 2010.

# ANNEX

## Table I. Macro economic indicators

	1995-1999	2000-2004	2005-2008	2009	2010	2011	2012
<b>Core indicators</b>							
GDP growth rate	4.5	1.6	4.1	-3.4	3.7	2.0	2.2
Output gap <sup>1</sup>	0.2	0.6	-0.3	-2.5	-0.3	-0.1	0.2
HICP (annual % change)	3.3	2.6	2.6	1.8	2.0	2.7	2.2
Domestic demand (annual % change) <sup>2</sup>	1.9	1.7	4.0	-6.1	-0.1	2.2	1.6
Unemployment rate (% of labour force) <sup>3</sup>	6.0	7.4	6.7	7.0	6.8	6.8	6.7
Gross fixed capital formation (% of GDP)	22.5	19.8	20.9	15.0	16.3	18.0	18.5
Gross national saving (% of GDP)	15.5	13.4	13.1	9.2	12.3	13.4	14.1
<b>General Government (% of GDP)</b>							
<b>Net lending (+) or net borrowing (-)</b>	<b>-7.5</b>	<b>-6.6</b>	<b>-3.2</b>	<b>-3.7</b>	<b>-3.6</b>	<b>-3.0</b>	<b>-3.0</b>
<b>Gross debt</b>	<b>46.9</b>	<b>63.9</b>	<b>64.3</b>	<b>67.6</b>	<b>68.0</b>	<b>68.0</b>	<b>67.9</b>
<b>Net financial assets</b>	<b>n.a</b>	<b>-46.7</b>	<b>-46.9</b>	<b>-52.3</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Total revenue	34.7	37.6	40.6	39.5	38.7	39.7	39.4
Total expenditure	42.3	44.1	43.8	43.2	42.3	42.7	42.4
<i>of which: Interest</i>	2.8	3.5	3.4	3.1	3.0	3.1	3.0
<b>Corporations (% of GDP)</b>							
<b>Net lending (+) or net borrowing (-)</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
<b>Net financial assets; non-financial corporations</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
<b>Net financial assets; financial corporations</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross capital formation	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Gross operating surplus	n.a	26.0	28.4	n.a	n.a	n.a	n.a
<b>Households and NPISH (% of GDP)</b>							
<b>Net lending (+) or net borrowing (-)</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
<b>Net financial assets</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross wages and salaries	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Net property income	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Current transfers received	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Gross saving	n.a	n.a	n.a	n.a	n.a	n.a	n.a
<b>Rest of the world (% of GDP)</b>							
<b>Net lending (+) or net borrowing (-)</b>	<b>-6.8</b>	<b>-4.1</b>	<b>-5.4</b>	<b>-5.7</b>	<b>-2.8</b>	<b>-3.3</b>	<b>-3.0</b>
<b>Net financial assets</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net exports of goods and services	-9.0	-3.7	-4.7	-0.7	2.4	1.8	2.0
Net primary income from the rest of the world	0.2	-0.5	-4.1	-7.2	-6.9	-6.9	-6.9
Net capital transactions	0.7	0.5	1.9	1.2	1.3	1.4	1.5
Tradable sector	51.3	47.0	40.8	35.7	35.7	n.a	n.a
Non tradable sector	38.2	40.7	45.7	51.0	51.5	n.a	n.a
<i>of which: Building and construction sector</i>	3.9	3.5	3.6	3.3	3.1	n.a	n.a
Real effective exchange rate (index, 2000=100)	105.5	110.5	119.8	125.0	116.8	119.1	121.2
Terms of trade goods and services (index, 2000=100)	99.9	100.5	101.9	101.3	100.9	100.4	100.2
Market performance of exports (index, 2000=100)	111.0	97.6	85.8	90.0	95.8	96.0	96.0
<b>Notes:</b>							
<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2000 market prices.							
<sup>2</sup> The indicator on domestic demand includes stocks.							
<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.							
<b>Source:</b>							
Commission services' spring 2011 forecast							

**Table II. Macro economic scenario for the budgetary projections**

	2010		2011		2012		2013	2014
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	3.7	3.7	2.0	2.4	2.2	2.3	2.6	2.8
Private consumption (% change)	-0.7	-0.7	0.8	1.0	1.4	1.1	1.2	1.1
Gross fixed capital formation (% change)	10.0	10.0	11.0	8.0	3.0	0.3	2.8	2.9
Exports of goods and services (% change)	17.2	17.2	6.1	3.7	6.1	2.7	3.6	3.9
Imports of goods and services (% change)	12.6	12.6	6.4	3.5	5.6	1.0	2.4	2.4
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	1.0	1.0	2.2	2.1	1.6	0.6	1.3	1.2
- Change in inventories	-1.1	-1.1	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	3.7	3.7	-0.2	0.3	0.6	1.7	1.3	1.6
Output gap <sup>1</sup>	-0.3	-0.8	-0.1	-0.4	0.2	-0.4	0.1	0.6
Employment (% change)	2.2	2.2	1.3	1.0	1.4	1.5	1.3	1.1
Unemployment rate (%)	6.8	6.7	6.8	6.9	6.7	6.7	6.6	6.6
Labour productivity (% change)	1.4	1.4	0.7	1.3	0.7	0.8	1.3	1.7
HICP inflation (%)	2.0	2.0	2.7	2.7	2.2	2.1	2.0	2.0
GDP deflator (% change)	3.0	3.1	2.6	2.3	2.3	2.1	2.2	1.9
Comp. of employees (per head, % change)	-1.7	-1.7	2.0	1.0	3.0	1.6	2.0	2.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.8	-2.8	-3.3	-2.6	-3.0	-1.2	0.3	0.6
<p><u>Note:</u></p> <p><sup>1</sup>In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.</p> <p><u>Source:</u></p> <p>Commission services' spring 2011 forecasts (COM); Stability programme (SP).</p>								



**Table III. Composition of the budgetary adjustment**

(% of GDP)	2010	2011		2012		2013	2014	Change: 2010-2014
	COM	COM	SP	COM	SP	SP	SP	SP
<b>Revenue</b>	<b>38.7</b>	<b>39.7</b>	<b>40.1</b>	<b>39.4</b>	<b>39.9</b>	<b>39.8</b>	<b>39.3</b>	<b>0.6</b>
<i>of which:</i>								
- Taxes on production and imports	13.3	13.7	13.9	13.6	13.9	n.a.	n.a.	n.a.
- Current taxes on income, wealth, etc.	13.0	13.0	13.0	13.2	13.0	n.a.	n.a.	n.a.
- Social contributions	7.3	7.1	7.3	7.0	7.4	n.a.	n.a.	n.a.
- Other (residual)	5.1	5.9	5.9	5.6	5.6	n.a.	n.a.	n.a.
<b>Expenditure</b>	<b>42.3</b>	<b>42.7</b>	<b>42.9</b>	<b>42.4</b>	<b>42.0</b>	<b>41.4</b>	<b>40.3</b>	<b>-2.0</b>
<i>of which:</i>								
- Primary expenditure	39.3	39.6	39.8	39.3	39.0	38.4	37.3	-2.0
<i>of which:</i>								
Compensation of employees	13.4	13.3	13.1	13.2	12.9	12.6	12.3	-1.1
Intermediate consumption	6.1	5.9	6.4	5.9	6.0	5.8	5.6	-0.5
Social payments	13.5	13.5	13.5	13.6	13.6	13.5	13.3	-0.2
Subsidies	1.0	0.8	0.8	0.7	0.7	0.7	0.7	-0.3
Gross fixed capital formation	2.1	3.3	3.3	2.7	2.7	2.9	2.6	0.5
Other (residual)	3.2	2.8	2.7	3.2	3.0	2.9	2.8	-0.4
- Interest expenditure	3.0	3.1	3.1	3.0	3.1	3.0	3.0	0.0
<b>General government balance (GGB)</b>	<b>-3.6</b>	<b>-3.0</b>	<b>-2.8</b>	<b>-3.0</b>	<b>-2.1</b>	<b>-1.6</b>	<b>-1.0</b>	<b>2.6</b>
<b>Primary balance</b>	<b>-0.6</b>	<b>0.0</b>	<b>0.3</b>	<b>0.1</b>	<b>0.9</b>	<b>1.4</b>	<b>2.0</b>	<b>2.6</b>
One-off and other temporary measures	0.8	0.1	0.0	0.0	0.0	0.0	0.0	-0.8
<b>GGB excl. one-offs</b>	<b>-4.5</b>	<b>-3.1</b>	<b>-2.8</b>	<b>-3.0</b>	<b>-2.1</b>	<b>-1.6</b>	<b>-1.0</b>	<b>3.4</b>
Output gap <sup>2</sup>	-0.3	-0.1	-0.4	0.2	-0.4	0.1	0.6	0.9
Cyclically-adjusted balance <sup>2</sup>	-3.5	-3.0	-2.6	-3.1	-2.0	-1.7	-1.2	2.3
<b>Structural balance<sup>3</sup></b>	<b>-4.3</b>	<b>-3.1</b>	<b>-2.6</b>	<b>-3.1</b>	<b>-2.0</b>	<b>-1.7</b>	<b>-1.2</b>	<b>3.1</b>
<i>Change in structural balance</i>		<i>1.3</i>	<i>1.7</i>	<i>0.0</i>	<i>0.6</i>	<i>0.4</i>	<i>0.4</i>	
Structural primary balance <sup>3</sup>	-1.3	0.0	0.4	0.0	1.0	1.3	1.7	3.1
<i>Change in structural primary balance</i>		<i>1.3</i>	<i>1.8</i>	<i>0.0</i>	<i>0.6</i>	<i>0.3</i>	<i>0.4</i>	
<b>Notes:</b> <sup>1</sup> On a no-policy-change basis. <sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme. <sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.  <b>Source :</b> Stability programme (SP); Commission services' spring 2011 forecasts (COM); Commission services' calculations								

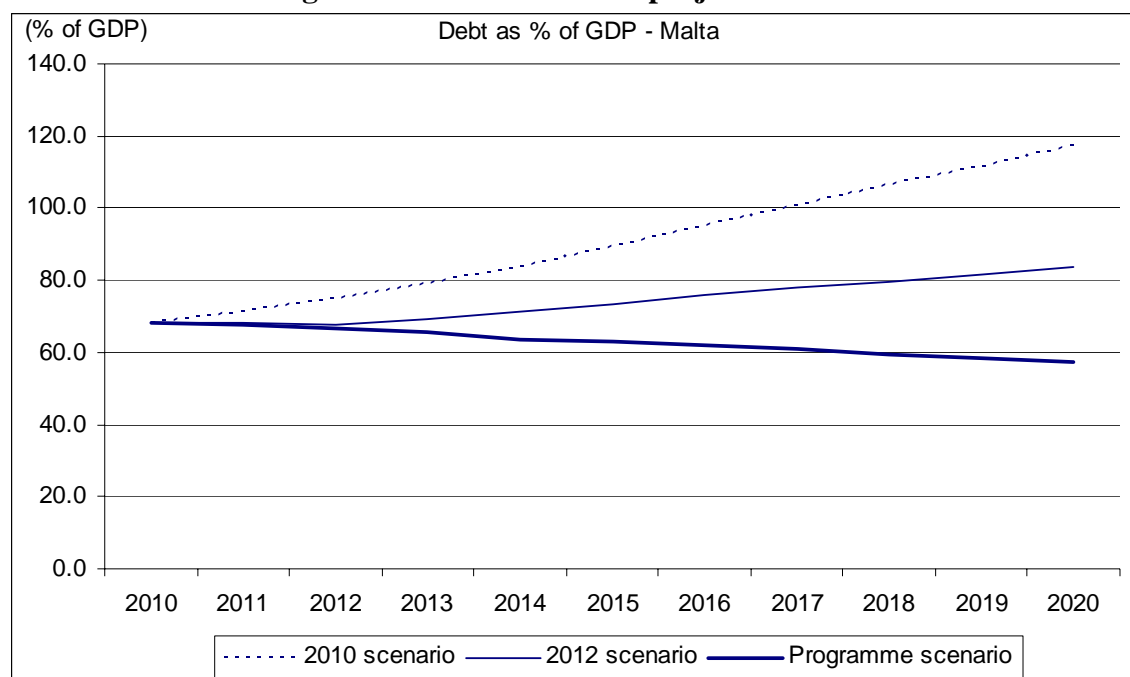
**Table IV. Debt dynamics**

(% of GDP)	average 2005-09	2010	2011		2012		2013	2014
			COM	SP	COM	SP	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>65.0</b>	<b>68.0</b>	<b>68.0</b>	<b>67.8</b>	<b>67.9</b>	<b>66.9</b>	<b>65.4</b>	<b>63.7</b>
Change in the ratio	-1.0	0.4	0.0	-0.2	-0.1	-0.9	-1.5	-1.7
<i>Contributions<sup>2</sup> :</i>								
<b>1. Primary balance</b>	<b>-0.1</b>	<b>0.6</b>	<b>0.0</b>	<b>-0.3</b>	<b>-0.1</b>	<b>-0.9</b>	<b>-1.4</b>	<b>-2.0</b>
<b>2. “Snow-ball” effect</b>	<b>0.0</b>	<b>-1.2</b>	<b>0.0</b>	<b>0.1</b>	<b>0.1</b>	<b>0.2</b>	<b>0.0</b>	<b>0.1</b>
<i>Of which:</i>								
Interest expenditure	3.4	3.0	3.1	3.1	3.0	3.1	3.0	3.0
Growth effect	-1.6	-2.3	-1.3	-1.6	-1.4	-1.5	-1.7	-1.7
Inflation effect	-1.7	-1.9	-1.7	-1.5	-1.5	-1.4	-1.4	-1.2
<b>3. Stock-flow adjustment</b>	<b>-0.8</b>	<b>1.1</b>	<b>0.0</b>	<b>0.1</b>	<b>-0.1</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.2</b>
<i>Of which:</i>								
Cash/accruals diff.	-0.7	-0.2	0.0		-0.1			
Acc. financial assets	-0.1	1.3						
<i>Privatisation</i>	-1.2	0.0						
Val. effect & residual	0.1	0.0						
<p><u>Notes:</u></p> <p><sup>1</sup>End of period.</p> <p><sup>2</sup>The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.</p> <p><u>Source :</u></p> <p>Stability programme (SP); Commission services’ spring 2011 forecasts (COM); Commission services’ calculations</p>								

**Table V: Long-term sustainability indicators**

Malta	Baseline scenario (2010)		Programme scenario	
	S1	S2	S1	S2
Value	5,8	8,0	2,3	4,8
of which:				
Initial budgetary position (IBP)	2,4	2,9	-0,8	-0,4
Debt requirement in 2060 (DR)	0,3	-	0,1	-
Long-term change in the primary balance (LTC)	3,0	5,2	3,0	5,2
	2010	2015	2010	2015
Debt as % of GDP	68,0	89,3	68,0	62,8
		2020		2020
		117,4		57,2

Note: The 'baseline' scenario (2010) depicts the sustainability gap under the assumption that the 2010 budgetary position remains unchanged over the medium-term (until the end of the period covered by the programme). The 'programme' scenario depicts the sustainability gap under the assumption that the budgetary plans of the programme are fully implemented.

**Figure: Medium term debt projections for Malta**

**Table VI. Financial sector indicators**

	2006	2007	2008	2009	2010
Total assets of the banking sector (% of GDP)	590.4	638.7	699.3	714.3	783.9
Share of assets of the five largest banks (% of total assets)	70.9	70.2	72.8	72.7	...
Foreign ownership of banking system (% of total assets)	38.0	42.6	40.7	38.0	...
Financial soundness indicators:					
- non-performing loans (% of total loans) <sup>1)</sup>	5.9	5.1	4.8	5.6	7.2
- capital adequacy ratio (%) <sup>1), 2)</sup>	15.0	14.7	14.6	15.9	15.3
- profitability - return on equity (%) <sup>3)</sup>	15.4	14.1	-3.4	20.3	12.7
Private credit growth (annual % change)	14.4	12.8	22.1	6.2	4.1
Residential property prices (y-o-y % change)	3.5	1.1	-2.7	-5.0	1.1
Exposure to countries receiving/repaying official financial assistance (% of GDP) <sup>4)</sup>	...	...	...	...	...
Private debt (% of GDP)	143.9	150.6	170.5	170.4	167.2
Gross external debt (% of GDP)					
- Public	...	...	5.2	4.0	3.6
- Private	...	...	44.3	42.3	47.6
Long term interest rates spread versus Bund (basis points)*	55.6	50.8	82.3	131.9	144.4
Credit default swap spreads for sovereign securities (5-year)*	...	...	...	...	...
<p>Notes:</p> <p><sup>1)</sup> Domestic banks dealing only with residents.</p> <p><sup>2)</sup> The capital adequacy ratio is defined as total capital divided by risk weighted assets.</p> <p><sup>3)</sup> Net income to equity ratio. Domestic banks dealing only with residents.</p> <p><sup>4)</sup> Covered countries are IE, EL, PT, RO, LV and HU.</p> <p>* Measured in basis points.</p> <p>Source:</p> <p>Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission services (long-term interest rates), World Bank (gross external debt), Eurostat (residential property prices) and ECB (all other indicators).</p>					

**Table VII. Labour market and social indicators**

<b>Labour market indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Employment rate (% of population aged 20 - 64)	57.9	57.6	58.5	59.1	58.7	59.9
Employment growth (% change from previous year)	1.5	1.3	3.2	2.6	-0.4	2.2
Employment rate of women (% of female population aged 20 - 64)	35.1	35.4	37.4	39.3	39.6	41.4
Employment rate of men (% of male population aged 20 - 64)	80.6	79.2	78.7	78.2	76.9	77.7
Employment rate of older workers (% of population aged 55 - 64)	30.8	29.8	28.5	29.2	27.9	30.2
Part-time employment (% of total employment)	9.6	10.0	10.9	11.5	11.3	12.4
Fixed term employment (% of employees with a fixed term contract)	4.5	3.7	5.1	4.3	4.9	5.7
Unemployment rate <sup>1</sup> (% of labour force)	7.2	7.1	6.4	5.9	7.0	6.8
Long-term unemployment <sup>2</sup> (% of labour force)	3.3	2.8	2.6	2.5	3.1	3.1
Youth unemployment rate (% of youth labour force aged 15-24)	16.2	16.5	13.8	11.8	14.4	12.9
Youth NEET <sup>3</sup> rate (% of population aged 15-24)	11.9	10.3	11.7	10.4	10.1	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	38.9	39.9	38.3	39.0	36.8	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	18.4	21.6	21.5	21.0	21.1	:
Labour productivity per person employed (annual % change )	3.2	0.8	1.2	2.6	-3.1	1.4
Hours worked per person employed (annual % change)	-0.7	-1.5	1.0	0.3	-3.1	-1.3
Labour productivity per hour worked (annual % change; constant prices)	3.9	2.3	0.2	2.3	0.0	2.8
Compensation per employee (annual % change; constant prices)	-1.3	0.6	-1.6	2.2	0.3	-4.6
Nominal unit labour cost growth (annual % change)	-1.9	2.8	0.3	2.3	6.1	-3.1
Real unit labour cost growth (annual % change)	-4.4	-0.2	-2.8	-0.4	3.5	-5.9
<b>Notes:</b> <sup>1</sup> According to ILO definition, age group 15-74) <sup>2</sup> Share of persons in the labour force who have been unemployed for at least 12 months. <sup>3</sup> NEET are persons that are neither in employment nor in any education or training. <b>Sources:</b> Comission services (EU Labour Force Survey and European National Accounts)						

**Table VII. Labour market and social indicators –continued**

<b>Expenditure on social protection benefits (% of GDP)</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Sickness/Health care	5.58	5.45	5.20	5.20	5.53
Invalidity	1.22	1.19	1.12	1.13	1.10
Old age and survivors	9.19	9.38	9.39	9.31	9.63
Family/Children	1.25	1.17	1.11	1.05	1.26
Unemployment	0.67	0.63	0.61	0.50	0.51
Housing and Social exclusion n.e.c.	0.55	0.44	0.49	0.60	0.61
<b>Total</b>	<b>18.5</b>	<b>18.3</b>	<b>17.9</b>	<b>17.8</b>	<b>18.6</b>
of which: Means tested benefits	3.45	3.23	3.17	3.12	2.57
<b>Social inclusion indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Risk-of-poverty or exclusion <sup>1</sup> (% of total population)	20.6	19.0	19.1	19.5	20.2
Risk-of-poverty or exclusion of children (% of people aged 0-17)	24.8	22.2	22.8	24.6	25.6
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	24.0	22.2	21.9	23.7	21.8
At-Risk-of-Poverty rate <sup>2</sup> (% of total population)	13.7	13.6	14.3	14.6	15.1
Value of relative poverty threshold (single HH per year) - in PPS	6612	7020	7296	7596	7716
Severe Material Deprivation <sup>3</sup> (% of total population)	5.5	3.7	4.2	4.0	4.7
Share of people living in low work intensity households <sup>4</sup> (% of people aged 0-59 not student)	9.6	9.2	9.2	8.2	8.4
In-work at-risk-of poverty rate (% of persons employed)	4.8	4.5	4.4	5.1	6.0
<p><b>Notes:</b></p> <p><sup>1</sup> People at-risk-of poverty or social exclusion (AROP): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).</p> <p><sup>2</sup> At-risk-of poverty rate: share of people with an equivalised disposable income below 60% of the national equivalised median income.</p> <p><sup>3</sup> Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone</p> <p><sup>4</sup> People living in households with very low work intensity: Share of people aged 0-59 living in households where the adults work less than 20% of their total work-time potential during the previous 12 months.</p> <p><b>Sources:</b> For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.</p>					

**Table VIII. Product market performance and policy indicators**

<b>Performance indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Labour productivity <sup>1</sup> total economy (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity <sup>1</sup> in electricity, gas, water (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %) 5	0.1	0.0	0.0	0.0	0.1	n.a.
Patent intensity in manufacturing <sup>2</sup> (patents of the EPO divided by gross value added of the sector)	0.6	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Policy indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Enforcing contracts <sup>3</sup> (days)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Time to start a business <sup>3</sup> (days)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
R&D expenditure (% of GDP)	0.4	0.6	0.6	0.6	0.6	n.a.
Tertiary educational attainment (% of 30-34 years old population)	14.4	21.6	21.5	21.0	21.1	n.a.
Total public expenditure on education (% of GDP)	5.0	n.a.	n.a.	n.a.	n.a.	n.a.
	<b>2003</b>	<b>2005</b>	<b>2006</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Product market regulation <sup>4</sup> , Overall (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Product market regulation <sup>4</sup> , Retail (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Product market regulation <sup>4</sup> , Network Industries <sup>6</sup> (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

**Notes:**

<sup>1</sup>Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

<sup>2</sup>Patent data refer to applications designated to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.

<sup>3</sup>The methodologies, including the assumptions, of this indicator is presented in detail at the website

<http://www.doingbusiness.org/methodology>.

<sup>4</sup>The methodologies of the Product market regulation indicators are presented in detail at the website

[http://www.oecd.org/document/1/0,3746,en\\_2649\\_34323\\_2367297\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html). The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.

5 Nace Revision 2 definition.

6 Aggregate ETCR.

\*figure for 2007.

**Source :**

Commission services, World Bank Doing Business (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).