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Country Report Malta 2015

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EXECUTIVE SUMMARY

In 2014, the economy and the labour market continued to perform well and the outlook for 2015-16 is favourable. Strong labour market fundamentals, with unemployment dropping below 6 %, recovering investment and an accommodative fiscal stance are projected to have resulted in real GDP growth of 3.3 % in 2014. Despite the challenging external environment and the high import-intensiveness of domestic demand, Malta's exports continued to outpace imports and the net external position is expected to have improved over the past year. Economic and employment growth are projected to continue to outpace the euro area average in 2015-16.

This Country Report assesses Malta's economy against the background of the Commission's Annual Growth Survey which recommends three main pillars for the EU's economic and social policy in 2015: investment, structural reforms and fiscal responsibility. In line with the Investment Plan for Europe, it also explores ways to maximise the impact of public resources and unlock private investment. The main observations and findings of the analysis are as follows:

- **Despite a lower budget deficit, the sustainability of public finances remains a challenge.** While Malta does not appear to face sustainability risks in the short term, these risks increase in the medium and long term due to the budgetary impact of population ageing. The high level of contingent liabilities presents an additional challenge. Insufficient tax compliance and instances of tax evasion are long-term challenges that distort the tax system and hinder revenue collection.

- **Over the past years, labour market participation of women and, to a lesser extent, older workers has improved but remains still considerably below EU average**. Care obligations, benefit design and insufficient flexible-work arrangements are key obstacles. Malta is currently designing and implementing a number of measures to increase the participation of women in the labour market. Policy efforts have also been dedicated to increasing the employment rate of older workers, focusing on increasing the effective retirement age and enabling workers to continue working beyond the statutory pensionable age. Shortcomings in the education system contribute to the low skills levels in the population.

- **To improve the energy security of supply and environmental performance, the authorities have focused efforts on reforming the energy sector to diversify the energy mix.** These measures are expected to bring an end to oil dependency of the electricity sector by 2016, although import dependency will remain high (for gas and electricity). The electricity generation system is also expected to become less carbon-intensive. As regards transport, although the public bus transport system has been privatised in an effort to promote a shift from individual to collective transport, the external costs caused by road traffic remain a challenge.

- **Despite improvements, Malta's competitiveness continues to be hampered by structural challenges in the business environment and the innovation framework.** The length of public procurement procedures has been reduced considerably but still remains somewhat above the average for the EU. Malta's knowledge-driven growth potential as a very small open economy has not yet been fully exploited and the reform of the judiciary has yet to adequately tackle inefficiencies in the system.

- **Investment has been muted, despite the favourable economic performance.** Limited capital accumulation to some extent reflected the changing structure of the Maltese economy towards less capital-intensive service activities. However, the analysis also pointed to a number of structural weaknesses that hinder private investment, such as difficulties in the access to finance and inefficiencies in the business environment also related to shortcomings in the energy and transport sectors. Investment is projected to rebound in the medium-term, although it is unlikely to reach its pre-crisis levels.

Overall, Malta has made some progress on addressing the Country-Specific

Recommendations issued by the Council in 2014. Some progress was made on improving the participation of women in the labour market and improving the quality of public finances. Progress was made on the fiscal framework reform, with the adoption of the Fiscal Responsibility Act and the appointment of the members of the Fiscal Council, but the concrete impact of the new set-up will take time to materialise. Some progress was also made on reducing reliance on imported oil, improving the links between the education system and the labour market, improving alternatives to debt financing for companies and improving the sustainability of the healthcare system. However, measures to reform the pension system to ensure its long-term sustainability are still lacking.

This Country Report reveals the policy challenges stemming from the analysis, namely:

- **Challenges remain with regard to the quality and the sustainability of public finances.** The tangible impacts of ongoing measures to improve tax compliance and fight tax evasion are not yet clear and their pace of is slow, notably on the merger of tax departments. Plans to examine possibilities to promote electronic payment systems are encouraging, but are still at an exploratory stage. Finally, long-term debt sustainability remains a challenge in view of the progress registered so far on the reform of the pension system and implementation of the healthcare reform .

- **Resource efficiency in the economy is hampered by weaknesses in the energy and transport systems.** The reform of energy system is in the process of implementation and the tangible benefits it could bring have yet to materialise. In the absence of more focused efforts on boosting domestic production of renewable energy and raising energy efficiency, however, Malta's energy import dependency will continue. Tackling road transport congestion also continues to be a challenge.

- **Despite some policy measures in this area, structural features continue to hinder the friendliness of the business environment.** A burdensome administration, slow public procurement proceedings, and an inefficient judiciary continue to represent challenges to Malta's attractiveness for foreign investors. A modest framework for research and innovation and difficult access to finance, particularly non-debt financing, add to the scope of the challenge.

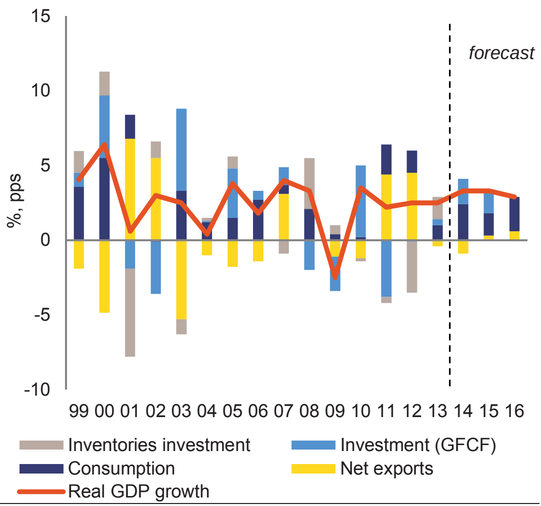
- **Labour market participation still represents a sizeable untapped potential for the domestic economy.** Labour market activity remains particularly low among women and older workers, reflecting not yet sufficient policy action in the areas of elderly care, reconciliation of work and family life and education and training, which are seen as key inhibiting factors.

1. SCENE SETTER: ECONOMIC SITUATION AND OUTLOOK

Growth, inflation and unemployment

Economic growth is projected to remain robust, supported by strong domestic demand. The Maltese economy is estimated to have expanded by 3.3 % in annual terms over 2014 and is expected to continue expanding at roughly the same rate over 2015-16 (see Graph 1.1). The main driver for growth is expected to be domestic demand, supported by growing disposable income of households, also reflecting the reduction of electricity tariffs, and investment in the large energy projects. Overall, average real GDP growth over 2014-16 is projected to reach the average for 2005-8.

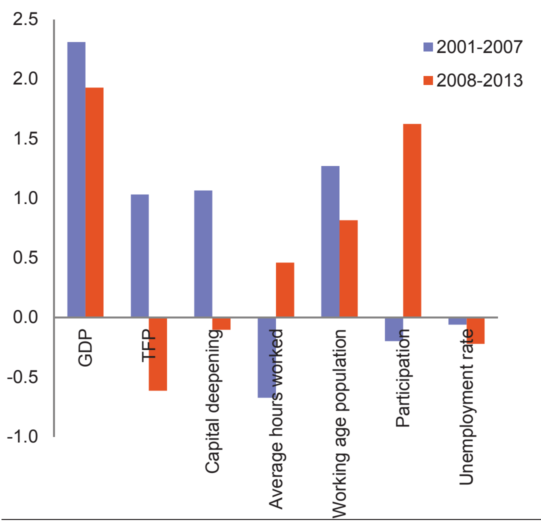
Graph 1.1: **External and domestic demand: contributions to GDP growth**



Source: European Commission

Labour market gains have been the main driver for growth in recent years. Starting from a low level in the middle of the previous decade, labour-market participation and employment rates in Malta have been much more dynamic than in the rest of the euro area. This mainly reflected higher labour-market activity, in particular by women, as well as favourable demographic developments, namely a higher increase in the working-age population also on the back of migration flows. The quality of human capital also improved over this period, as evidenced by the significant rise in tertiary education attainment, although this development is also starting from a very low base level (see Section 2.4 for a further discussion of labour-market and education and training issues). The economy has been able to fully absorb the increase in supply and the unemployment rate recovered to its pre-crisis low of 6 %, after reaching 6.9 % in 2009-10.

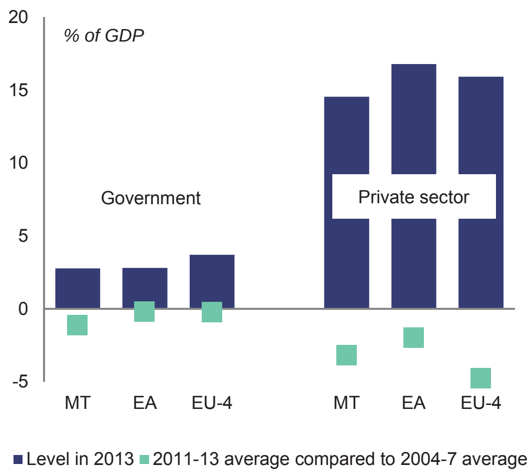
Graph 1.2: **Growth decomposition**



Source: European Commission, own calculations

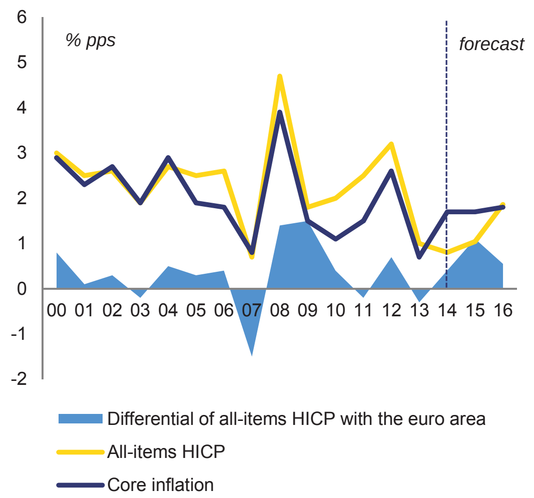
At the same time, investment stagnated. After being a prominent driver for growth in the first half of the past decade, capital deepening stagnated, particularly after the global financial crisis. This stagnation was driven by a pronounced slowdown in the construction sector, with housing investment declining particularly strongly, while equipment investment remained relatively stable. To some extent, the investment dynamics also reflect the restructuring of the economy towards more labour-intensive service activities as well as, to some extent, firms' preference to use their funds to rather retain personnel. As a result, the capital intensity of the Maltese economy is among the lowest in the EU. The decline in investment activity was more pronounced in the private sector, where it has fallen considerably below the euro-area average (see Graph 1.3). Investment is projected to rebound in the medium-term, although it is unlikely to reach its pre-crisis levels.

Graph 1.3: **Investment levels in selected countries**



EU-4 consists of EE, CY, LV and LU
Source: European Commission

Graph 1.4: **Price inflation in Malta**



Source: European Commission

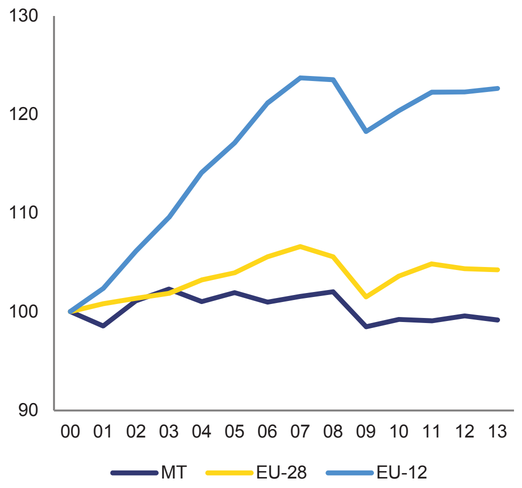
Price inflation is projected to remain moderate in historical perspective, but still higher than the average in the euro area. Deflationary pressures present across Europe are projected to be less pronounced in Malta. HICP inflation is forecast to remain below the long-term average at just above 1 %, despite the expiration of the base effect from the lowering of electricity tariffs for households. The normalisation of commodity price developments on global markets in 2016 is projected to result in consumer price inflation returning to its long-term average of around 2 %.

Productivity dynamics

Significant gains in employment have masked a sluggish productivity performance. Total factor productivity has stagnated since the beginning of the past decade, lagging behind the average for the EU and performing significantly below the average for the Member States that joined the EU in 2004 (see Graph 1.5). Indeed labour productivity in Malta in 2012 stood at only a third of the EU average ([1]). Sub-par productivity developments also reflect low expenditure on research and development (R&D) and a low proportion of turnover from new products out of the total turnover of enterprises ([2]). (See also Section 2.3). Wage developments have been relatively contained, but compensation per employee expressed in purchasing power standard (i.e. correcting for price differences across Member States) was around 80 % of the EU average in 2013, indicating that there is a misalignment between productivity and wages.

([1]) Labour productivity per hour worked in 2012, expressed in purchasing power standard. Source: Eurostat.
([2]) Turnover from innovation represented 7.4% of total turnover in Malta in 2010, compared to an EU average of 13.4%.

Graph 1.5: **Total factor productivity evolution, total economy**



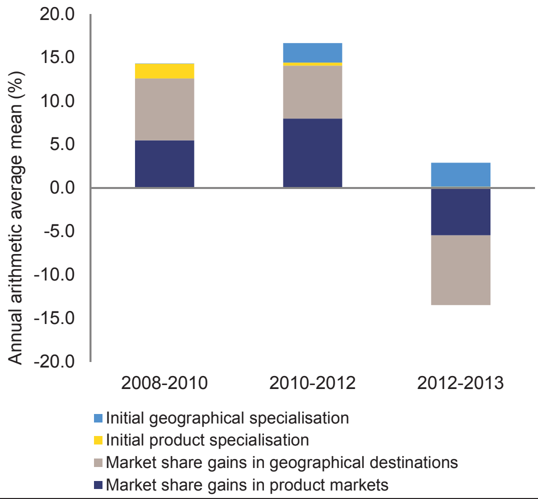
2000=100
EU-12 consists of BG, CZ, EE, CY, LV, LT, HU, MT, PL, RO, SI, and SK
Source: European Commission

External position and trade

The net external balance has stabilised at a moderate surplus, thus lending support to the sustainability of the economy's external position. Improvements in external trade and increased capital inflows resulted in a significant upward adjustment in the net external balance, which swung from a sizeable deficit before the 2009 crisis to a surplus position. This development also reflected the positive impact of rising employment on the savings of the economy, which added to the subdued demand for capital imports on account of the slowdown in investment. As a result, the net surplus balance of the international investment position was reinforced. The very large stock positions that make up the net balance, mainly on account of the financial sector, render the sustainability of the external position vulnerable to interest rate shocks. This risk is to some extent mitigated by the fact that the liabilities of the large international banks operating from Malta are largely linked to their assets.

Despite strong economic growth, Malta has lost export market shares. Declines have mainly been registered in goods exports, reflecting losses in both product and geographical markets (see Graph 1.6). These developments to some extent also reflect a slowdown in oil re-exports, which in the span of a few years grew to represent a significant portion of Malta's goods exports (over 30 % in 2011). Services exports, the main driver of the Maltese economy, also lost market shares in 2013. Despite the improving external trade balance, these developments may indicate that some sectors may be losing their competitive edge. Indeed, unit labour costs have increased more dynamically than in competitor countries, reflecting both higher domestic inflation and contained labour-cost developments in the competitors.

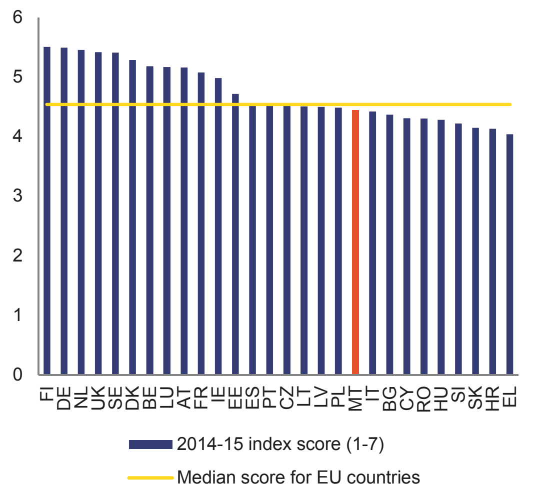
Graph 1.6: **Geographical and sectorial composition of nominal (USD) rate of change of exports of goods**



Source: COMTRADE data (HS 1992 Commodity Classification), European Commission calculations

International comparisons of Malta's competitiveness point to a number of areas for improvement. Malta's overall competitiveness score, according to the World Economic Forum's Global Competitiveness Report, is close to the median for the EU countries, suggesting that Malta has to some extent been successful in overcoming the limitation imposed by the small size of the domestic market. Besides market size, the main shortcomings identified by the report are innovation (see Section 2.3) and the efficiency of the labour market (see Section 2.4), even though these two categories registered gains in recent years. The quality of institutions is also seen as a key impediment, as also identified by the World Bank's Doing Business report (see Section 2.3).

Graph 1.7: **Global competitiveness index, EU countries**

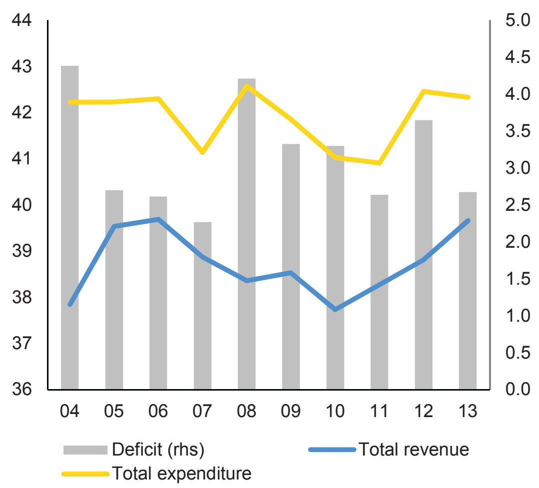


Source: 2014-15 Global Competitiveness Report

Public finance developments

Malta's budgetary performance over the past decade has exhibited varying trends, with some expenditure overruns, linked also to weaknesses in the budgetary framework at execution stage. In June 2013, some months after the abrogation of the previous Excessive Deficit Procedure, Malta was put back in the procedure for the third time since its accession to the EU. This reflected significant fiscal slippages in 2012 and the failure to ensure a sufficient pace of debt reduction towards the 60 %-of-GDP threshold in the Stability and Growth Pact. The absence of a binding fiscal framework in the past undermined the credibility of the government’s fiscal strategy and implied a short fiscal planning horizon. As a result of a very weak fiscal framework and despite repeated commitments to restraint current expenditure ([3]), slippages have occurred in the previous years, which have often been partly offset by lower-than-planned public investments. This was coupled with optimistic projections for economic growth and government revenue over the past decade. In 2000-07, Malta had one of the highest forecast errors among EU countries, while the projection errors have been smaller in countries where forecasts are produced or scrutinized by independent bodies ([4]). Forecast errors have decreased since then and the trend reversed in 2012-13, when current revenue outcomes turned out more positive than the projections, which compensated for some overruns in expenditure.

Graph 1.8: **Deficit, total revenue and expenditure (% of GDP)**



Source: European Commission

Malta’s government finances do not appear to face sustainability risks in the short term. The general government debt-to-GDP ratio increased to 69.5 % in 2013, also on account of a debt-increasing stock-flow adjustment due to some tax arrears from Enemalta (the public energy utility corporation). In 2014, the debt ratio is projected to decrease to 68.6 % of GDP and to decrease further in the following years, thanks also to favourable nominal GDP growth. However, a comprehensive assessment of fiscal sustainability should be based on the entire time horizon. Based on an overall assessment, the long-term sustainability of Malta’s public finances faces substantially-increasing risks in the medium and long term (see Section 2.1).

Financial stability

While deposits continued to increase at a robust pace, lending stagnated. Following a period of stagnation in 2009-10, household deposits began growing at an increasing pace thereafter reflecting

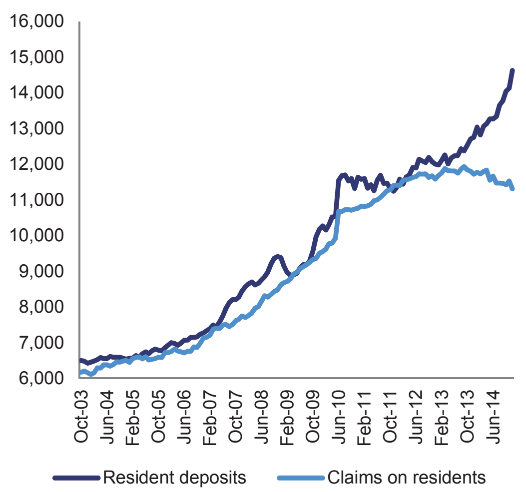
([3]) In particular, slippages seem to have been frequent in current expenditure, namely public wages, intermediate consumption and subsidies.

([4]) Source: European Central Bank Monthly Bulletin, Feb 2013.

also the improving labour-market conditions. In 2014, household deposits increased by 10 %, a growth rate significantly higher than the historical average. At the same time, lending has been weak, particularly to firms, pointing to a mismatch between credit demand and credit supply. This has resulted in an improving liquidity for the Maltese banks (see Graph 1.9) and contributed to the significant upward swing in the net external balance of the economy. According to the ECB's Bank Lending Survey, credit conditions improved in 2013 and the first half of 2014 on account of growing demand by small and medium enterprises (SMEs) and households. High interest rates for corporate loans and tight credit standards, however, continue to dampen demand for bank financing.

Aggregate financial soundness indicators remain robust but asset quality is deteriorating. The two leaders on the domestic retail market, Bank of Valletta and HSBC Malta, cleared the thresholds set in the comprehensive asset quality review and stress test by a comfortable margin, ahead of their joining the Single Supervisory Mechanism. In aggregate, the core domestic banks — the part of the banking sector whose main activity consists of servicing the domestic economy — are profitable and have maintained their capital adequacy. Asset quality, however, is deteriorating. On the one hand this points to difficulties in some sectors of the economy in servicing their loans despite the relatively positive macroeconomic environment. On the other, this could also indicate difficulties banks face in working out or writing off bad loans, in particular in the construction sector. Worsening asset quality also prevents banks from relaxing their credit standards and playing a more active role in supporting growth. Lending growth resumed in the second half of 2014, which may contribute to a stabilising or even declining ratio of non-performing loans to gross loans. Still high levels of corporate indebtedness, however, continue to limit the demand for new debt financing and underscore the importance of maintaining competitiveness to ensure that companies generate sufficient cash flows to service their liabilities.

Graph 1.9: **Banking sector exposure to Maltese residents**



Note: Claims on residents include loans, debt securities and equity and other shares
Source: Central Bank of Malta

Box 1.1: **Economic surveillance process.**

The Commission's Annual Growth Survey, adopted in November 2014, started the 2015 European Semester, proposing that the EU pursue an integrated approach to economic policy built around three main pillars: boosting investment, accelerating structural reforms and pursuing responsible growth-friendly fiscal consolidation. The Annual Growth Survey also presented the process of streamlining the European Semester to increase the effectiveness of economic policy coordination at the EU level through greater accountability and by encouraging greater ownership by all actors.

This Country Report includes an assessment of progress towards the implementation of the 2014 Country-Specific Recommendations adopted by the Council in July 2014. The Country-Specific Recommendations for Malta concerned the achievement of a timely and durable correction of excessive deficit in line with Excessive Deficit Procedure Council recommendation, ensuring the long-term sustainability of public finances, improving the utilisation of human capital, diversifying energy sources and maintaining competitiveness through tackling shortcomings in the business environment.

Table 1.1: **MIP scoreboard indicators**

Malta			Thresholds	2008	2009	2010	2011	2012	2013
External Imbalances and Competitiveness	Current Account Balance as % of GDP	3 year average	-4%/6%	-3.6e	-2.5	-3.9	-1.9	0.9	4.0
		p.m.: level year	-	-0.9e	-4.8	-5.9	5.0	3.6	3.2
	Net International Investment Position as % of GDP		-35%	4.5e	24.0	35.1	39.2	53.7	49.2
	Real Effective Exchange Rate (42 IC - HICP deflator)	% change (3 years)	±5% & ±11%	5.8	5.8	-0.7	-5.0	-7.6	-1.3
		p.m.: % y-o-y change	-	3.7	0.7	-5.0	-0.8	-2.0	1.4
	Export Market shares	% change (5 years)	-6%	*-4.9*	*10.4*	*16.4*	*10.6*	*5.2*	*-4.0*
		p.m.: % y-o-y change	-	*4.5*	*6.1*	*-3.1*	*-1.3*	*-0.8*	-0.2
	Nominal ULC	% change (3 years)	9% & 12%	9.5	11.2	9.2	10.1	8.7	9.5
		p.m.: % y-o-y change	-	3.2	5.6	0.2	4.0	4.3	0.9
Internal Imbalances	% y-o-y change in Deflated House Prices		6%	7.2	-6.2	-1.0	-2.3	0.5	-2.1
	Private Sector Credit Flow as % of GDP, consolidated		14%	22.7p	-1.6p	-5.0p	3.5p	-1.2p	0.4p
	Private Sector Debt as % of GDP, consolidated		133%	158.6e	164.8	160.4	156.8	145.6	137.1
	General Government Sector Debt as % of GDP		60%	62.7	67.8	67.6	69.8	67.9	69.8
	Unemployment Rate	3 year average	10%	6.4	6.5	6.6	6.7	6.5	6.4
		p.m.: level year	-	6.0	6.9	6.9	6.4	6.3	6.4
	% y-o-y Change in Total Financial Sector Liabilities		16.5%	11.5e	9.3e	2.7	8.7	5.8	0.7

Flags: e: estimated. p: provisional. na: not available.
Note: Figures highlighted are the ones falling outside the threshold established by EC Alert Mechanism Report. For REER and ULC, the first threshold concerns Euro Area Member States. (1) Figures in italic are according to the old standards (ESA95/BPM5). (2) Export market shares data: the total world export is based on the 5th edition of the Balance of Payments Manual (BPM5). (3) House Price indicator: e = Eurostat estimates. (4) Current Account Balance has been revised upwards following the incorporation of Special Purpose Entities data extracted from administrative records and national account estimates. (5) International investment position has been revised upwards following the incorporation of Special Purpose Entities data from administrative records and audited financial statements.

Source: European Commission, Eurostat and DG ECFIN (for the indicators on the REER)

Table 1.2: **Key economic, financial and social indicators - Malta**

	2008	2009	2010	2011	2012	2013	Forecast 2014	2015	2016
Real GDP (y-o-y)	3.3	-2.5	3.5	2.2	2.5	2.5	3.3	3.3	2.9
Private consumption (y-o-y)	-0.2	1.8	-0.2	2.5	0.4	1.6	2.3	2.3	2.4
Public consumption (y-o-y)	12.3	-3.3	1.6	2.8	6.3	0.5	5.8	1.2	4.9
Gross fixed capital formation (y-o-y)	-9.2	-11.8	26.4	-18.0	-0.5	2.3	10.0	8.0	0.0
Exports of goods and services (y-o-y)	19.4	-0.4	6.9	2.5	7.9	-1.2	1.0	4.7	5.2
Imports of goods and services (y-o-y)	19.5	0.3	7.6	-0.4	5.2	-1.0	1.7	4.7	5.0
Output gap	2.7	-1.7	-0.7	-0.4	-0.3	-0.3	0.2	0.4	0.5
Contribution to GDP growth:									
Domestic demand (y-o-y)	0.0	-1.9	5.0	-1.9	1.4	1.4	4.1	2.9	2.3
Inventories (y-o-y)	3.4	0.6	-0.2	-0.4	-3.4	1.5	0.0	0.0	0.0
Net exports (y-o-y)	0.0	-1.1	-1.2	4.4	4.5	-0.4	-0.9	0.3	0.6
Current account balance (% of GDP), balance of payments	-4.80*	-8.90*	-5.96*	-.79*	3.6	3.0	.	.	.
Trade balance (% of GDP), balance of payments	-1.95*	-2.28*	.09*	3.78*	6.8	7.2	.	.	.
Terms of trade of goods and services (y-o-y)	-0.5	-0.1	1.1	-0.3	-0.1	0.4	0.2	0.4	0.1
Net international investment position (% of GDP)	2.6*	12.6*	8.1*	6.8*	22.9*	71.8	.	.	.
Net external debt (% of GDP)	-71.1*	-82.2*	-161.0*	-153.0*	-171.6*	-115.5*	.	.	.
Gross external debt (% of GDP)	537.7*	503.2*	511.0*	502.6*	509.0*	886.9	.	.	.
Export performance vs advanced countries (% change over 5 years)	7.5*	20.5*	27.1*	21.2*	16.3*	2.8*	.	.	.
Export market share, goods and services (%)	0.0*	0.0*	0.0*	0.0*	0.1	0.1	.	.	.
Savings rate of households (net saving as percentage of net disposable income)	.	.	.	.	.	.	.	.	.
Private credit flow, consolidated, (% of GDP)	22.7	13.4	8.3	4.5	1.8	2.3	.	.	.
Private sector debt, consolidated (% of GDP)	158.7	164.3	158.7	155.6	150.5	143.0	.	.	.
Deflated house price index (y-o-y)	7.6	-6.8	-1.8	-1.0	0.9	-1.6	.	.	.
Residential investment (% of GDP)	5.6	4.3	3.4	3.4	3.0	2.9	.	.	.
Total financial sector liabilities, non-consolidated (y-o-y)	9.9*	-.2*	13.0	10.7	5.6	1.9	.	.	.
Tier 1 ratio[1]	.	.	.	.	.	.	.	.	.
Overall solvency ratio[2]	.	.	.	.	.	.	.	.	.
Gross total doubtful and non-performing loans (% of total debt instruments and total loans and advances)[2]	.	.	.	.	.	.	.	.	.
Change in employment (number of people, y-o-y)	2.5	0.0	1.7	2.8	2.3	4.0	2.7	2.0	1.9
Unemployment rate	6.0	6.9	6.9	6.4	6.3	6.4	6.0	5.9	5.9
Long-term unemployment rate (% of active population)	2.5	2.9	3.1	3.1	3.1	2.9	.	.	.
Youth unemployment rate (% of active population in the same age group)	11.7	14.5	13.2	13.3	14.1	13.0	12.7	.	.
Activity rate (15-64 year-olds)	59.1	59.4	60.4	61.8	63.1	65.0	.	.	.
Young people not in employment, education or training (%)	8.3	9.9	9.5	10.2	10.6	10.0	.	.	.
People at risk of poverty or social exclusion (% of total population)	20.1	20.3	21.2	22.1	23.1	24.0	.	.	.
At-risk-of-poverty rate (% of total population)	15.3	14.9	15.5	15.6	15.1	15.7	.	.	.
Severe material deprivation rate (% of total population)	4.3	5.0	6.5	6.6	9.2	9.5	10.2	.	.
Number of people living in households with very low work-intensity (% of total population aged below 60)	8.6	9.2	9.2	8.9	9.0	9.0	.	.	.
GDP deflator (y-o-y)	3.0	2.7	3.8	2.2	2.1	2.0	1.6	1.5	1.7
Harmonised index of consumer prices (HICP) (y-o-y)	4.7	1.8	2.0	2.5	3.2	1.0	0.8	1.0	1.9
Nominal compensation per employee (y-o-y)	4.0	3.0	2.0	3.6	4.3	-0.3	2.4	1.8	2.2
Labour productivity (real, person employed, y-o-y)	0.8	-2.5	1.8	-0.6	0.2	-1.5	.	.	.
Unit labour costs (ULC) (whole economy, y-o-y)	3.2	5.6	0.2	4.3	4.1	1.2	1.8	0.5	1.2
Real unit labour costs (y-o-y)	0.2	2.8	-3.5	2.0	1.9	-0.8	0.3	-1.0	-0.5
REER[3)] (ULC, y-o-y)	2.6	1.3	-3.1	3.9	0.0	2.8	1.1	-2.2	0.4
REER[3)] (HICP, y-o-y)	1.6	2.1	-3.0	-0.4	-1.0	0.8	1.2	-0.4	0.2
General government balance (% of GDP)	-4.2	-3.3	-3.3	-2.6	-3.6	-2.7	-2.3	-2.0	-1.8
Structural budget balance (% of GDP)	.	.	-4.3	-3.0	-3.9	-2.7	-2.7	-2.4	-2.2
General government gross debt (% of GDP)	62.7	67.8	67.6	69.8	67.5	69.5	68.6	68.0	66.8

Source: EUROSTAT, ECB, AMECO

2. STRUCTURAL ISSUES

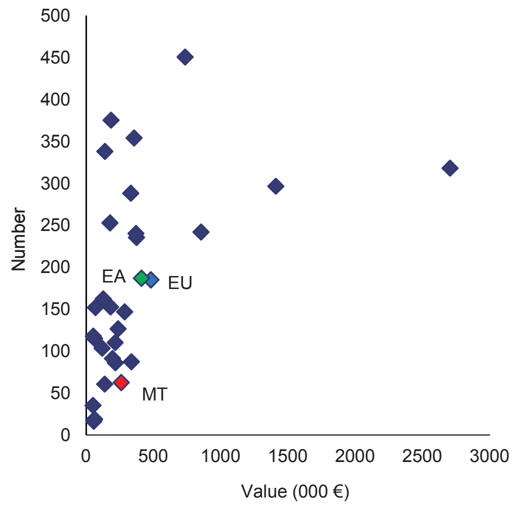
2.1. FISCAL RESPONSIBILITY

Taxation

Tax compliance and tax evasion represent a long-standing challenge in Malta. Malta has improved its budgetary situation over the last two years but still needs to continue its consolidation efforts. The fight against tax evasion and strengthening tax compliance assist the fiscal consolidation process thorough increasing tax revenues and ensures a fair, effective and efficient tax collection system. Malta displays a comparatively high level of undisputed tax debt as a proportion of net revenue collections (ranked 5th in the EU) ([5]). The gross closing balance of tax arrears ([6]) stood at 25.9 % of GDP in 2013, of which 12.4 % and 7.7 % of GDP respectively related to Value Added Tax (VAT) and income tax arrears ([7]). Out of this balance, around 5.5 % of GDP was considered as collectable, with collectable VAT arrears representing only 0.7 % of GDP. Findings from a recent study suggest that the VAT gap ([8]) is among the highest in the EU ([9]). Although no reliable estimates are available, a recent survey ([10]), indicates an important share of undeclared work in the Maltese economy ([11]). This may be driven by the prominence of 'sensitive sectors' such as construction, personal and domestic services, tourism, trade, crafts and catering, and by the high proportion of micro and small enterprises in manufacturing sector as well as a high incidence of illegal immigration (although recent increases in activity rates may partly reflect a decline in informality).

Electronic payments can enhance tax compliance but are still relatively underused in Malta. Electronic payments in Malta are below the EU average in per capita terms (EUR 261 000 per capita compared with an EU average of EUR 483 000) ([12]) (see Graph 2.1.1) and there are also no limits on cash payments in Malta.

Graph 2.1.1: **Electronic payments per capita (2013)**



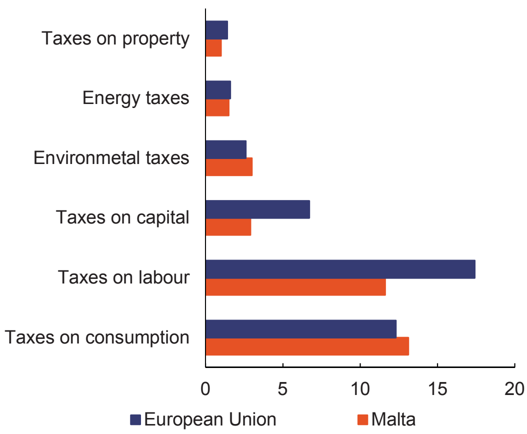
Source: European Central Bank

Malta is largely compliant with the guidelines issued by Organisation for Economic Cooperation and Development (OECD) ([13]). In terms of corporate tax, Malta's tax rate is one of the highest in the EU (35 %), but its full imputation tax system and associated refunds can reduce the effective tax rate to 5 or 10 %. There are also favourable regimes for intellectual property taxation, no withholding taxes on

([5]) OECD, Tax Administration 2013.
([6]) National Audit Office, 'Report by the Auditor General on the Public Accounts 2013'.
([7]) This is an increase compared to 2012: the gross closing balance of arrears in 2012 was 21.7% of GDP, of which VAT and income tax arrears were 9.7% and 7.3% of GDP respectively.
([8]) The difference between the amount of VAT actually collected and the amount that is theoretically collectable based on the VAT legislation.
([9]) The latest figures involve a large upward revision due to a correction for the calculation of gambling exports (which are VAT exempt, but for which input VAT is not recoverable). All Member States were involved in the process of compiling this report and reviewing the results prior to publication. However, the Ministry for Finance is currently re-examining the data and methodology in advance of the next edition of the report due in 2015. The study is available at: http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_gap2012.pdf
([10]) Eurobarometer survey, 'Undeclared Work in the EU', March 2014.
([11]) Comparatively high percentages of survey respondents said they had purchased undeclared goods or services in the past year and that they were employed without a formal written contract.
([12]) Source: European Central Bank. Figures cover credit transfers, direct debits and card payments.
([13]) Tax transparency 2014 : Report on Progress, OECD – Global Forum on Transparency and Exchange of Information for Tax Purposes http://www.oecd.org/tax/transparency/GFannualreport2014.pdf

outbound dividends, interests and royalties ([14]) to non-residents and limited anti-abuse.

Graph 2.1.2: **Taxes by function in % of GDP for the EU and Malta (2012)**



Source: European Commission

The Maltese authorities have taken a series of steps to deliver a fair tax system by fighting tax fraud, evasion and avoidance. One of the key measures involves merging revenue departments into a single authority in order to integrate VAT and income tax returns and streamline collection. This process is still ongoing and, in the 2015 Budget, the Government announced that the IMF's Fiscal department's specialists would be assisting with the ongoing merger of the tax departments. Malta has introduced a number of measures to improve compliance and recovery of amounts due including revisions to the penalties in its VAT legislation and the interest on taxes due. The 2015 Budget also introduced the requirement for everyone carrying out a commercial activity to be registered for VAT purposes, regardless of annual turnover. Regarding electronic means of payment, the 2015 Budget indicated that a Working Group will be set up to make recommendations to the government on how to increase the use of electronic payments at national level. It also announced the launch of a study to address the limit on the amount of cash for a single transaction. With regard to undeclared assets, Malta introduced a scheme (the Investment Registration Scheme), which provided individuals and companies resident in Malta with the opportunity to regularise their income tax position in relation to their holdings of eligible assets derived from undeclared income ([15]). In order to increase powers to obtain information on undeclared assets, Malta has recently signed a Multilateral Agreement on The Automatic Exchange of Tax Information under the aegis of the Organisation for Economic Cooperation and Development. With respect to the fight against undeclared work, there is a lack of a single body in charge. Responsibilities of labour inspections are dispersed across different bodies ([16]), each responsible for a specific domain (such as health and safety, labour law and employment standards, tax evasion, and abuses to the social benefit system).

([14]) This is the case for interest and royalties if the non-resident is not effectively connected with a permanent establishment.

Debt sustainability

The government debt ratio in Malta is lower than the euro area average but it has risen continuously since 2008, reaching almost 70 % of GDP in 2013 ([17]), due also to a higher-than-expected stock-flow adjustment. The debt is projected to have decreased to 68.6 % of GDP in 2014 according to the Commission 2015 winter forecast and to continue on a downward path by reaching 66.2 % of GDP in 2016.

The high level of contingent liabilities represents an additional risk for Malta's government finances. Government-guaranteed debt in Malta is high, following a substantial

([15]) The scheme attracted a total of 1469 valid registrations covering an aggregate of EUR 455.8 million worth of eligible assets.

([16]) The Department of Industrial and Employment Relations, the Occupational Health and Safety Authority, the Inland Revenue, and the Employment and Training Corporation.

([17]) Failure to ensure a sufficient pace of debt reduction towards the 60%-of-GDP threshold in the Stability and Growth Pact was a key reason for reopening of an Excessive Deficit Procedure against Malta in June 2013. The European Council requested that Malta achieve a nominal budget deficit of 2.7% of GDP by 2014, which corresponds to a cumulative improvement in the structural balance of 1.4 percentage points. of GDP in 2013 and 2014, while also ensuring that the gross debt ratio declines at a satisfactory pace. After correction of the excessive deficit, the Council recommended that Malta pursue the structural adjustment effort at an appropriate pace so as to reach the medium-term objective (MTO) of a balanced budget in structural terms by 2019.

increase since the start of the crisis, from 11.5 % of GDP in 2008 to 15.8 % of GDP in 2013 (which would imply a total public guaranteed debt of around 85.3 % of GDP in 2013). The bulk of these guarantees, more than 60 %, is accounted for by the energy sector in Malta. Hence, the current difficult financial situation of Enemalta, the energy provider, represents a challenge for government finances and it reflects the company's long-standing exposure to fluctuations in oil prices in combination with a lack of timely and cost-effective adjustment in electricity tariffs and inefficiency costs. The government has embarked on a large-scale energy reform plan (see Section 2.2), an essential part of which is the restructuring of Enemalta's debt.

Debt sustainability in the short term has benefited from efficient debt management. Spreads on Maltese sovereign bonds have not been significantly affected by the tensions generated by the sovereign-debt crisis. In spite of an increase in the debt ratio (around 7 percentage points. between 2007 and 2013), the apparent cost of debt (interest expenditure over total nominal debt) decreased to 4.2 % in 2013 (from 5.4 % over the period 2004-08). The maturity structure of government debt has been significantly lengthened since Malta's accession to the EU. The proportion of debt with long-term maturity has increased to 94.8 % in 2013 from 79.2 % in 2003 while short-term debt has decreased significantly (5.2 % of total government debt in 2013 from 20.8 % in 2003). This is expected to further reduce the impact of fluctuations in the interest rate on government in case of changes in market sentiment. In addition, government debt is almost entirely held by residents, with non-residents accounting for just 3 % of the outstanding debt stock. This has further protected sovereign debt against the tensions on international markets. However, the high interconnectedness between the government sector and the domestic economy, in particular the financial sector and households, implies that adverse developments in one of these sectors can have negative spillovers on the others.

Although some improvement in the outlook is expected, long-term sustainability of public finances remains a challenge. While Malta does not appear to face sustainability risks in the short term, these risks increase in the medium and long term, due to the budgetary impact of population ageing, in view also of the high increase of the total dependency ratio (see Graph 2.1.4). In particular, over the next 20 years, a large fiscal adjustment would be required to ensure medium-term sustainability in Malta. The risk increases when taking a longer-term view due to the budgetary impact of population ageing, namely in the areas of pensions and health care policies. New long-term projections of pension and healthcare costs are currently being prepared [18] and will be published in the first half of 2015. It is expected that, in the revised projections, Malta's position with respect to long-term sustainability will improve marginally, mainly due to a better demographic outlook and improved macroeconomic assumptions [19].Malta has not fully implemented the fiscal plans in the latest stability programme, which would help decrease the risk. These results are confirmed by a debt sustainability analysis, which shows that the debt declines below the 60 %-of-GDP if Stability and Growth Pact fiscal rules are complied with or if the fiscal measures planned in the stability programme are fully implemented. On the contrary, the debt would increase above 70 % of GDP in case of a structural primary balance that gradually reverts to its historical average, highlighting the importance of fiscal consolidation to bring the government debt onto a sustainable path in the medium term (see Graph 2.1.3).

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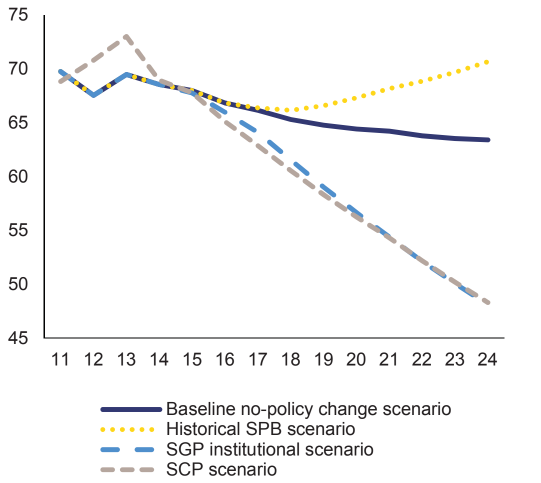
(18) Updated long-term projections of the cost of ageing components will be based on the latest demographic projections released by Eurostat (EUROPOP 2013).

(19) See the 2015 Ageing Report: underlying assumptions and projection methodologies, http://ec.europa.eu/economy_finance/publications/european_economy/2014/pdf/ee8_en.pdf

Graph 2.1.3: **Gross government debt as % of GDP**

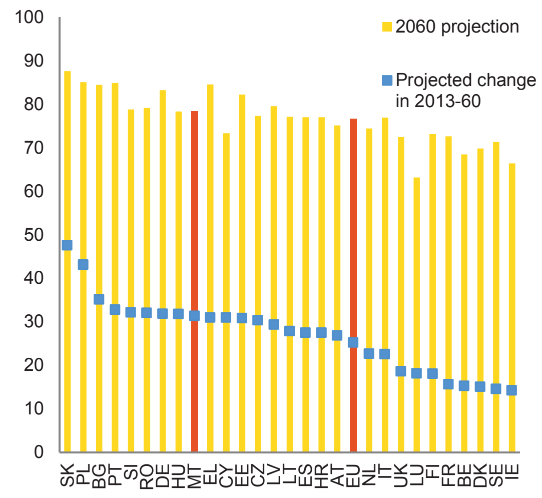


Source: European Commission

The Maltese pension system is confronted with the challenge of safeguarding the long-term sustainability of public finances while ensuring the provision of adequate retirement incomes. The Maltese public pension scheme is composed of a universal defined-benefit contributory pension, complemented by a means-tested minimum pension covering people with insufficient entitlements. The statutory pensionable age is being raised gradually for both women and men from 62 currently to 65 by 2027, but this progression is very slow and no further measures, such as linking the pensionable age with life expectancy, have been foreseen. While helpful, the current measures to improve the activity rates of older workers and females are not sufficient to ensure the long-term sustainability of the pension system.

With respect to current adequacy, Malta scores only slightly worse on average in terms of poverty prevention compared to the rest of the EU, but significant coverage gaps exist. The defined-benefit contributory pension (the so called ‘Two Thirds Pension’) is capped at a relatively low level, while the minimum pension currently stands at two thirds of the national minimum wage (four fifths for married couples). The relative income ratio of people aged 65+ compared to the working-age population is 0.79 ([20]) while the share of older people that are at risk of poverty or social exclusion (20.8 % in 2013) is 2.5 percentage points higher than for the EU average (yet lower than for the working-age population, at 22.5 %). These averages mask important differences, however, as women in particular experience significantly lower pension coverage than men: the gap for non-coverage in pensions between women and men is at 36.5 percentage points (vs. 6.8 percentage points for the EU). This is because, notwithstanding recent progress, Maltese women continue to have the shortest employment careers in the EU (23.7 years compared to an EU average of 32.2 years) as well as the lowest employment rate in old age (18.7 % compared to an EU average of 43.3 %). Because of insufficient contribution periods, women are often not entitled to their own contributory old-age benefits and depend on their spouses’ pensions or survivors’ benefits.

Graph 2.1.4: **Total dependency ratio ((0-14 plus 65+)/(15-64))**



Source: European Commission, The 2015 Ageing Report: Underlying Assumptions and Projection Methodologies

The build-up of complementary pension rights is being promoted with the introduction of third-pillar voluntary pensions, while a framework for establishing occupational pensions is still lacking. In order to encourage the provision of adequate retirement income, the government is introducing a ‘Third Pillar’ pension scheme whereby fiscal incentives are to be tied to private pension products offered by local banks and other financial institutions. In terms of adequacy, this initiative goes in the right direction

([20]) Compared to an EU average of 0.93.

of promoting the build-up of supplementary pension entitlements, which would grant higher replacement complementing the pension income provided by the public scheme. The coverage of these voluntary supplementary pensions will have to be closely monitored to assess its effectiveness in delivering higher retirement incomes in the future, including for lower income earners with a reduced propensity to save. No measures have been taken so far to develop a framework for second-pillar occupational pensions, which could provide more uniform coverage of the labour force.

Measures to improve pension adequacy and sustainability rely mostly on increasing labour market participation and redemption of missing contributions, but implementation is advancing slowly. In 2013, a National Strategic Policy for Active Ageing was launched to increase the activity rates of older workers, promoting longer working lives and reducing the gap between the effective and statutory retirement ages. Financial incentives have been introduced to encourage workers to remain in employment past the pensionable age and encourage employers to recruit older workers. Finally, for individuals approaching retirement but who do not have enough credited contributions to be eligible for the National minimum pension, the possibility of redeeming up to five years of contributions has been introduced to allow them to then qualify for the minimum pension upon retirement.

Due to population ageing, Malta records one of the highest projected increases in public health expenditure in the EU. Public health expenditure increases are also attributed to Malta's reliance on secondary and tertiary care and to the rapidly growing cost of medicines and surgical material, which has doubled in the last 10 years. Current inefficiencies and shortcomings in cost-effectiveness of the health system threaten its long-term sustainability. While general practitioners act as gatekeepers to specialist and hospital care, the system is often bypassed as patients have direct access to specialists in the private sector, leading to the private sector accounting for 70 % of primary health-care contacts. The health system also suffers from poor coordination between the public and private sectors, with negative impacts on effectiveness and efficiency gains.

The National Health Systems Strategy (2014-2020) was adopted in July 2014 and its implementation is starting. Malta is making efforts to contain costs by improving the governance of the system through the introduction of various internal control mechanisms and the implementation of financial governance. Improvements in procurement and distribution processes for medicines and medical devices have led to substantial savings. Furthermore, a pay per use system on high costs devices has reduced the holding of stock. Moreover, Malta has set up a health system performance assessment framework that would allow the regular and timely monitoring of a selected number of performance indicators. The government is continuing its efforts of restructuring health service provision with an emphasis on health promotion and disease prevention and primary health care. Investments in primary healthcare are being made, together with further recruitment of general practitioners and the offering of a broader scope of services at primary level. Besides this, the authorities have embarked on an investment programme for public primary healthcare: capital expenditure has been increased, a refurbishment programme for health centres has started and the screening and radiological capacities are being upgraded. Moreover, a number of services which were previously offered in the secondary care setting have been transferred to the primary health care sector. The government has also taken measures to strengthen the interaction between the public and private primary care provision. It is too early to assess the effects of these measures on the overall health system efficiency, and their implementation in 2015 needs careful monitoring to assess whether they are sufficiently ambitious to increase efficiency and compensate for the demographic and other internal and external pressures, and to ensure the long term sustainability of public health expenditure.

The demand for long-term care has increased as a result of population ageing as well as the reduced role of extended family and an increased labour market participation of women. An insufficient supply of long-term care has been shown to lead to situations where acute hospital beds are taken up inappropriately. Community-based care is still underdeveloped. The Lack of formal long-term care services may hinder progress in improving labour market participation of women, especially at older ages, as informal family care plays an important role in Maltese society and most informal caregivers are females aged between 40-59 (see Section 2.4). A number of initiatives have been undertaken to increase the availability of residential care and encourage independent living. In recent years, the government expanded residential care places and community-based services, including day care centres and has also set up contracts with private homes for the provision of services. While elderly residents in state homes contribute 60 % of their total income ([21]), private institutions are not affordable for many pensioners. Support measures offered to informal carers (usually family members) include a combination of cash benefits (which include the carer's allowance and the carer's pension) and care leave (which can be granted to public employees as 'responsibility leave' and up to a maximum of eight years over the person's whole career). Finally, a number of initiatives have been undertaken to encourage independent living in order to enable elderly people to manage without care, or with far less care, and reduce demand pressures.

Fiscal framework

In July 2014, the Maltese Parliament adopted the Fiscal Responsibility Act, with a view to transposing the requirements of the Directive 85/2011/EU on budgetary frameworks and the Fiscal Compact. The Fiscal Responsibility Act introduced a balanced-budget rule in structural terms and a debt rule whereby, if the debt-to-GDP ratio exceeds 60 %, the differential with respect to the reference value should be reduced at the three-year average rate of 1/20 per year as set out in the revised Stability and Growth Pact. The Act also established the introduction of a three-year rolling budgetary framework (National Medium-Term Fiscal Plan) which should enhance the predictability of the budgetary planning. In addition, the Act provided for the establishment of a Fiscal Council charged among others with endorsing the government's official macroeconomic and fiscal forecasts as well as ex-ante and ex-post monitoring of the respect of fiscal rules. The members of the Fiscal Council were appointed in January 2015. It is important that the functioning of the Council is fully operationalised without delay among others by setting up of a permanent bureau supporting the members in the execution of their duties.

Despite the approval of the Fiscal Responsibility Act, the budgetary process in Malta is not yet aligned with the European calendar. In particular, Malta is non-compliant with the information requirements specified in the Regulation (EU) No 473/2013, since in the last two years the Draft Budgetary Plan presented on 15 October did not provide sufficient details on the discretionary measures underpinning the budgetary targets. Malta is also in breach of the requirement of the Regulation obliging the euro area Member States to make public their draft annual budgets by 15 October every year. Both in 2013 and 2014, draft budgets containing all the necessary details for the concrete implementation of the planned measures were only presented in November ([22]).

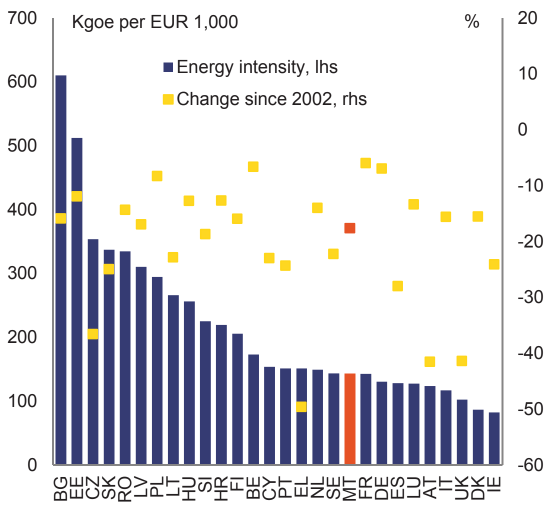
([21]) Provided they are not left with less than EUR 1 400 per year.

([22]) See http://ec.europa.eu/economy_finance/economic_governance/sgp/budgetary_plans/index_en.htm

2.2. RESOURCE EFFICIENCY

While the Maltese economy as a whole performs close to the EU average in terms of energy and carbon intensity, parts of it perform worse. The energy intensity of the economy (see Graph 2.2.1) reflects its structure, namely the absence of heavy industry activities, a higher focus on services and a more energy-efficient manufacturing sector, while the more energy-efficient households reflect Malta's geographical location. Nevertheless, key sectors such as energy and transport have very low energy efficiency, reflecting a number of structural features, which puts pressure on the competitiveness of the economy. Moreover, the carbon intensity of the energy sector (greenhouse-gas emissions per EUR 1,000) is among the highest in the EU, reflecting the poor environmental performance of the existing power generation capacities, leading to additional negative externalities for the economy.

Graph 2.2.1: **Energy intensity of the economy**

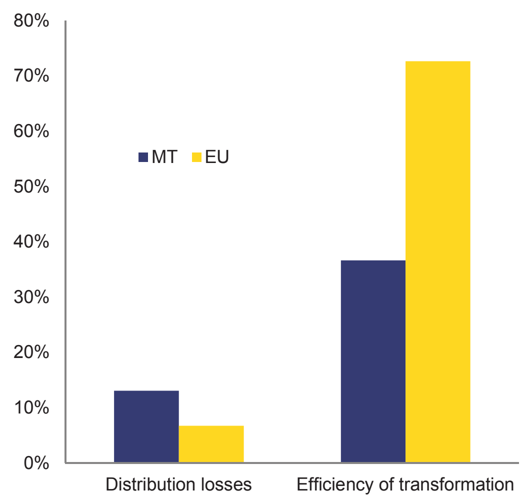


This indicator is the ratio between the gross inland consumption of energy and the gross domestic product (GDP) for a given calendar year. It measures the energy consumption of an economy.
Source: European Commission

Energy

The energy system is characterised by its near-full reliance on imported oil. Apart from a very marginal share of energy produced from renewable sources, electricity production on the island has been entirely dependent on imported heavy fuel oil. Besides putting pressure on the external trade balance, this, combined with inefficiencies in electricity generation and distribution (see Graph 2.2.2), has resulted in high electricity prices for end-consumers and discontent among consumers. ([23]) Political interventions led to tariff deficits (namely electricity tariffs not covering the costs of power production), resulting in the accumulation of a large debts by the state-owned power utility company Enemalta.

Graph 2.2.2: **The inefficiencies of Malta's electricity system, 2013**



Distribution losses: distribution losses divided by total net electricity production.
Efficiency of transformation: transformation output divided by transformation input.
Source: European Commission calculations

The authorities have launched a comprehensive reform of the sector. The electricity interconnector with Italy has been completed and is expected to start operating in the first half of 2015, including the commercial use of the optical fibres of the link. The interconnector is expected to help ensure the security of electricity supply by putting an end to Malta's situation as an energy island. In addition, a new gas-fired power plant and an existing power plant, converted to work with gas, are expected to be operational by the end of 2016. These projects are to be financed through public-private partnerships. These changes would effectively put an end to Malta's exclusive dependence on oil, although they will not remove

([23]) The World Economic Forum's 2013-14 Global Competitiveness Report ranks the perception of the quality of electricity supply in Malta 69th among 148 countries and 26th among the EU Member States.

its dependence on imported energy sources. Combined with planned investment in the distribution and transmission networks, the authorities would be able to discontinue operations in the older and less efficient plants at Marsa and Delimara I, resulting in a more efficient and less polluting energy system.

Electricity tariffs were reduced. The authorities frontloaded the potentially positive impacts of these changes on Enemalta's costs and reduced households' electricity tariffs significantly in 2014, while businesses are expected to benefit from a reduction in 2015. Decreases in production and distribution costs in the future, as a result of a more efficient infrastructure and access to potentially cheaper energy via the interconnector, are expected to offset the impact of these reductions on the company's revenues. Delays in the ongoing projects, however, would put pressure on Enemalta's profitability in the meantime. The company's still-high debt stock suggests that its financial performance will continue to require close monitoring. Going forward, the expected increase in the proportion of energy provided by renewable sources may exert an upward pressure on electricity production costs in case of domestic production, in case renewables are not promoted in a cost-inefficient manner. Well-designed support schemes providing sufficient incentives for investment but avoiding overcompensation are key. The use of cooperation mechanisms provides additional avenues for exploration.

Challenges remain in the areas of renewable energy and energy efficiency. Updated Eurostat figures show that Malta has made some progress on promoting the use of renewable energy sources (2.5 % of the energy consumed in 2013 came from renewable energy sources), making use of grant schemes, feed in tariffs and net metering to promote the use of photovoltaic installations. The authorities also supported the use of domestic solar heaters and the use of renewables in transport. Moreover, Enemalta is planning to launch a number of renewable energy pilot projects focusing primarily on photovoltaic land systems, including the installation of solar car parks where solar panels are installed on canopies built over parking bays, thereby using the limited space in the densely populated, urban environments of the Maltese islands. Even so, achieving the 2020 renewable energy target, namely a share of 10% final energy consumption, solely by increasing domestic production seems challenging in view of the serious geographical constraints i.e. the lack of space for large-scale installations. Nevertheless, developing renewable-energy capacities would be instrumental in lowering the import dependency of Malta's energy system. Although primary and final energy consumption decreased in 2005-2012, Malta is not on track to meet its 2020 national energy efficiency target for final energy consumption.

Transport

Significant traffic congestion and low efficiency in the transport sector entail high environmental and economic costs. Compared to the EU average, urban peak-hour congestion in Malta ([24]) (see Graph 2.2.3) constitutes a major problem, reflecting the significant number of cars in use ([25]), including a notable proportion of older and inefficient vehicles, and the prevalent lack of alternatives to transport with private cars aggravates the problem. The latter also renders transport the largest greenhouse-gas-emitting sector in Malta, outside of the scope of the Emissions Trading Scheme. The costs of congestion appear significant relative to other transport externalities (See Table 2.2.1). Considering the islands' insularity and the fact that road is the dominant mode for internal transport, a more efficient use of existing road infrastructure through promoting sustainable, collective public transport systems and dissuading the use of private vehicles is key. Road infrastructure presents an additional challenge, particularly with respect to road quality, while the limited size of the islands constrains the room for further expansion of the network ([26]).

([24]) Although not accurately reflecting whether a road is urban or not, the free flow speed can be a good proxy as regards its type and characteristics, free flow speeds below 50 km/h being a good proxy for urban roads.

([25]) On average, each driving licence holder owned 1.4 cars in Malta in 2012 and private cars were used for 71 % of all trips made by individuals.

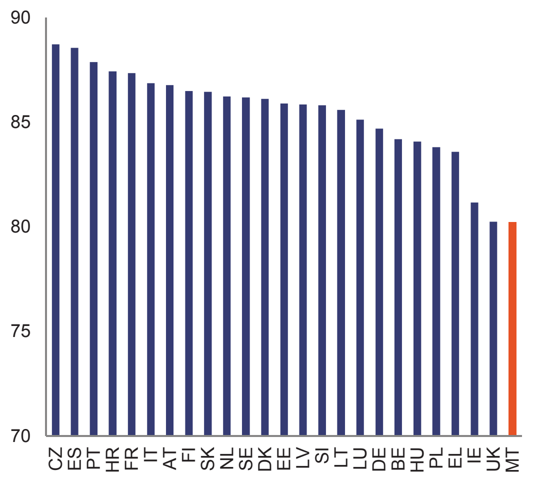
([26]) While the perception of the quality of port (ranked 20 in the 2014-15 Global Competitiveness Report) and air transport infrastructure (rank 30) are good, the quality of roads is lagging behind (rank 85).

Table 2.2.1: **External costs of transport in Malta, 2012**

	EUR million	% of GDP
Accidents	83.9	1.2
Air Pollution	14.3	0.2
Climate Change	46.8	0.7
Noise	11.0	0.2
Congestion	117.9	1.8
Total	274.0	4.1

Source: Study on the External Cost of Passenger and Commercial Vehicles in Malta, University of Malta, forthcoming

Graph 2.2.3: **Ratio of average speed to free-flow speed (roads with free-flow speed<=50km/h)**



Source: European Commission

The authorities have launched a new reform of the public transport. After a failed privatisation attempt, leading to temporary re-nationalisation, the public transport service is once again operated by a private company as of January 2015. The new provider will need to overcome the concerns over the quality and financial sustainability of the service, which led to the 2014 re-nationalisation in order to encourage a higher take-up of the service and thus a viable alternative to private transport.

The authorities have introduced incentive schemes to make the use of cars more sustainable and are investing in upgrading infrastructure. Measures include a minimum level of biofuels in petroleum fuels, a differentiated car registration tax, a car scrapping scheme and continued financial support for electric, hybrid and vehicles using liquefied petroleum gas. These will help diversification and decrease dependency on fuel imports. However, they are insufficiently ambitious when judged against the scale of the challenge. The national transport policy also aims at a more efficient use of the road network, through more public transport and intelligent transport systems. This should also provide more convenient routes for commercial and private vehicles that bypass urban centres and, in doing so, will alleviate congestion on urban roads caused by heavy longer distance traffic. Transport infrastructure projects feature prominently in the list of key investment projects that the authorities have identified in the context of the Investment Plan for Europe.

Given the severity of the challenges, key issues remain to be adequately addressed. Malta has made no substantial progress on promoting alternative modes of transport (e.g. more intensive use of collective public transport, including land and sea public transport, bicycles, including electric ones, scooters) in an efficient way with a view to tackling traffic congestion. Moreover, little has been achieved as regards energy efficiency in the transport sector, which suffers from complete dependence on imported fossil fuel and also low energy (fuel) efficiency and hence contributes significantly to greenhouse-gas emissions and air pollution in Malta.

2.3. BUSINESS ENVIRONMENT

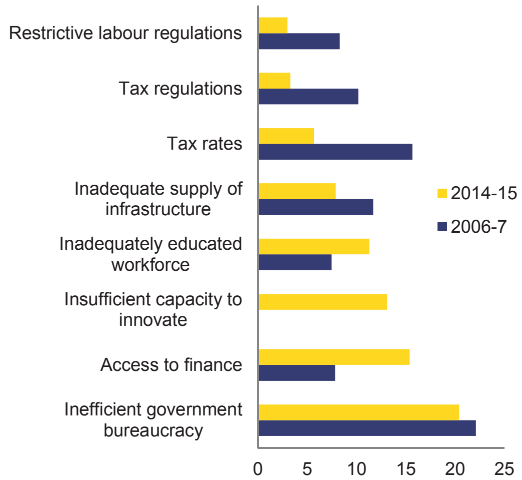
Inefficiencies in the public administration and the business environment hamper Malta's growth potential and attractiveness to investors. The majority of foreign investors present in Malta find the country attractive for foreign investment. The main pull factors are considered to be the stability of the social climate and the corporate taxation regime, followed by the political, legal and regulatory environment, the skill level of the labour force and the labour costs ([27]). The strong economic performance, however, masks important inefficiencies. The World Bank's Doing Business report highlighted the judicial system as a key shortcoming in Malta's business environment, affecting the speed of resolving insolvency, the rights of creditors in providing finance and the enforcement of contracts in general (see Graph 2.3.1). Moreover, the efficiency of the public administration is hampered by cumbersome procedures, including in the area of public procurement. Bureaucracy, alongside access to finance and the innovation capacity, have emerged as key impediments to doing business in the World Economic Forum's Global Competitiveness Report (see Graph 2.3.2). Some of these emerged only in recent years, as the economy evolved, and are likely to be key factors inhibiting growth in the near future.

Graph 2.3.1: **Distance to euro-area average (frontier = 100)**

Source: World Bank, 2015 Doing Business report

([27]) Source: Ernst & Young's 2014 Malta attractiveness survey

Graph 2.3.2: **The most problematic factors for doing business (% of responses)**



Source: World Economic Forum, Global Competitiveness Report

Public administration

Administrative simplification

Inefficient government bureaucracy is a significant impediment to doing business in Malta. A significant proportion of companies highlighted inefficient bureaucracy as the most problematic factor when doing business on the island ([28]). The government had put a 25 % reduction goal of the administrative burden in its election manifesto and the Commissioner for simplification is tasked with achieving this objective during the current legislature. The authorities have issued a string of initiatives, from meeting stakeholders to identifying specific burden reduction measures, a recent 'Repeal's day', on which the abolishment of a number of laws and regulations was announced, and the adoption of the 'one-in-one-out' principle. Concerning simplification, the "SME test" was implemented in January 2015 and therefore an assessment of its effectiveness is not possible yet. In terms of a better streamlining of procedures to obtain operating licenses for businesses, a reform of the Malta Environmental Planning Agency has been initiated with a view to turn it into a one-stop-shop for licensesby the end of 2015. As this process is

([28]) 2014-15 Global Competitiveness Report ongoing, its further progress needs to be closely monitored as regards its effects on shortening licensing procedures.

Public procurement

The average duration of public procurement procedures has declined significantly. While quick public procurement procedures may not be optimal as they may compromise on quality, excessively long procedures may result in inefficient allocation of resources. The length of procurement procedures is determined by a number of factors, such as the size and the subject matter of the particular contract and it is also affected by burdensome administrative procedures. Action taken by the authorities, in particular the – introduction of e-procurement (e-notification, e-access and e-submission), which is now applied for all projects over the EU thresholds has produced the expected results in terms of reduction of the duration of the procedures. The reform also had a positive impact on private sector interest with the number of registered economic operators increasing nearly three-fold over the course of 2013, suggesting that competition has increased, which can be expected to contribute to a better value-for-money for the government. Even though no quantitative target was set, the average duration remains somewhat above EU average (87 days). The additional measures announced for 2015 (in particular the recruitment of 11 additional civil servants and the introduction of a "tracking system") are expected to consolidate the achievements and reduce the duration a bit further.

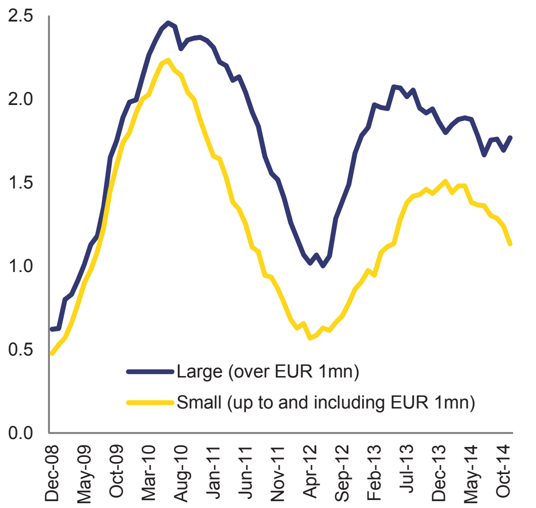
Functioning of the internal market

Administrative inefficiencies hamper the proper functioning of the internal market in Malta. The Annual Growth Survey highlighted the need to ensure that consumers across the EU are able to benefit from an integrated single market, while being able to rely on effective enforcement of consumer rights. Failure to enforce these principles can have negative consequences on consumer demand and, thereby, on growth. In spite of some progress towards eliminating discriminatory pricing in the transport and utilities sectors, such practices towards non-Maltese nationals remain in place in some sectors. As regards fostering competition, one of the key challenges for Malta still remains the need to strengthen the implementation and enforcement of competition law, namely through a bigger and more effective role and sufficient resources for the Competition Authority. Although some additional human resources have been made available, they are still insufficient.

Access to finance

A number of factors hinder firms' access to finance. The cost of financing in Malta remains high relative to the euro area for both small and large corporate loans (see Graph 2.3.3). As in other Member States, the corporate sector in Malta is predominantly constituted by SMEs (99.8 % in 2012). However, in the specific case of Malta, 95 % of SMEs are in reality micro-enterprises, a larger percentage that the EU average. SME financing in Malta is predominantly provided by the banking sector through loans. Recent studies indicate that whereas small, medium and large enterprises have good access to credit through the banking system, micro enterprises face significant difficulties in access to credit. Lack of collateral and limited financial literacy, combined with the small value of potential transactions seem to contribute to micro-enterprises' difficulties in accessing finance. On the other hand, equity financing, particularly for seed, early stage and growth funding through market operators are almost non-existent. Important gaps exist therefore regarding access to finance by the corporate sector, particularly in the case of micro-enterprises and prospective entrepreneurs. Indeed, prevalence of debt financing in the economy results high corporate leverage (ratio of debt to company equity), which pushes up the risk profile of borrowers and increases borrowing costs. Alternative sources of financing are relatively underdeveloped or are in early stages of development. Concerning access to seed capital, substantial progress seems to have been achieved with the introduction of the Seed Investment Programme. Moreover, the authorities announced intentions to introduce a scheme to incentivise equity investments in start-ups by amending the tax law to provide tax credits equivalent to investment up to a maximum of EUR 250,000. The measure is planned to be introduced by the end of 2015. The setting up of a development bank is also being considered. The idea is still in a nascent stage, however, and the authorities have yet to announce details about their intentions.

Graph 2.3.3: **Spread of corporate interest rates in Malta and the euro area**



Source: European Central Bank

Research and innovation

In spite of significant progress over the last few years, several structural challenges continue to hamper Malta's knowledge-driven growth potential as a very small open economy. These include very low R&D intensity (0.85 % of GDP in 2013, still some distance from the 2020 target of 2 % of GDP) with limited public spending (0.39 % of GDP), which positions Malta as 26th in the EU, a weak human resources base in science and technology ([29]), low levels of scientific excellence linked to the lack of critical mass in specific research areas ([30]), and declining innovation-based business performance ([31]). Many of Malta's key relative scientific and technological strengths depend on the build-up of capacity in these areas ([32]). Over the past decade (2004-13), the innovative performance of the business enterprise sector deteriorated significantly, with patent performance far below the EU average ([33]), and heavily shrinking licence and patent revenues from abroad ([34]). The Global Competitiveness Report identified the insufficient capacity to innovate as one of the most problematic factors in doing business in Malta and, thus, one of the key challenges the country's competitiveness. Tackling these issues requires a comprehensive effort to tune the framework conditions to better stimulate the emergence of cooperation between publicly-funded research organisations and businesses.

The authorities have launched a Research and Innovation strategy and are working on an implementation action plan. The Research and Innovation strategy was adopted in 2014, identifying seven thematic specialisation areas, while the action plan is expected to be finalised by mid-2015. In addition, Malta deploys particular efforts in the immediate and sustainable implementation of the new *Innovation Strategy for Smart Specialisation*, which contains tailor-made measures (i.e. actions, tools, platforms or incentives), to develop the Maltese R&I ecosystem in seven selected areas ([35]). Moreover, the country's priorities go towards: a) systemic evaluations of SME support; b) assessments of universities and public research organisations based on their performance, with a view to allocate some funding on the basis of excellence; and c) stimulating the transfer of knowledge between science and businesses. Malta offers tax incentives in the form of R&D tax credits, which target industrial projects to develop innovative products and solutions.

Justice reforms

The efficiency of the justice system continues to demonstrate shortcomings. The time needed to resolve civil, commercial and administrative cases in first instance courts remains the highest in the

([29]) Malta has only 0.21 new doctoral graduates per thousand population aged 25-34, compared to the EU average of 1.81, and a low performance (less than half the EU average) on new graduates in science and engineering.
([30]) The average performance of Malta as measured by the fraction of its scientific publications within the 10% most cited publications worldwide was 4.8% in 2009 compared to an EU average of 10.98%, and with a declining trend from 2005 to 2009.
([31]) Malta's score in the Innovation Output Indicator (23.3) is less than half of the EU average (47.8) and it is 22nd in the Innovation Union Scoreboard 2014.
([32]) The share of jobs in knowledge intensive activities (17% of total employment aged 15-61 compared to 13.9% EU average) is higher than the EU average.
([33]) Malta has 0.7 PCT patent applications per billion GDP in current PPS (EUR) in 2010 (EU average: 3.9).
([34]) Licence and patent revenues from abroad have fallen from 0.78% of GDP in 2005 to 0.21% of GDP in 2012.
([35]) Tourism product development, maritime services, aviation and aerospace, healthy living and active ageing, and e-health, resource-efficient buildings, high value-added manufacturing, and aquaculture.

EU ([36]) and has worsened in 2012-13. The rate of resolving administrative cases was the lowest in the EU in 2013 ([37]). The World Bank's Doing Business report also indicates shortcomings in insolvency procedures, which were estimated in this survey to take up to three years in 2013 and 2014. The tools in place to evaluate the judicial system are limited, since there is no regular evaluation system nor performance and quality indicators of courts' activities and Malta has not yet carried out surveys among court users and legal professionals. As regards training, Malta is one of the few EU Member States where there is currently no compulsory pre-service or in-service training for judges. Alternative Dispute resolution Methods and Mediation are still underused in Malta despite efforts to promote mediation (by the Mediation Centre).

The Justice Reform Commission, which was set up in March 2013, handed the government its final report on the reform of the sector on 2 December 2013. Concrete measures started to be implemented in 2014, aiming to substantially improve the efficiency and quality of the judicial system. The main measures concern extending the buildings policy, improving human resources in Court ([38]) and providing better services to citizens ([39]). In addition, in 2014, an independent Agency was created, with the double function of providing professional and high quality legal aid services and regulating all the relevant legal aid issues.

([36]) The time needed to resolve litigious civil and commercial cases in first instance courts fell from 849 days in 2010 to 685 days in 2012 and then rose to 750 days in 2013. Malta remains the country with the longest lenght of proceedings in this category. For administrative cases the length of proceedings dropped, from 2 758 days in 2010 to 1 457 in 2012 then rose to 2 036 days in 2013. The length of proceedings for administrative cases is the highest in the EU. Source: European Commission, *The 2015 EU Justice Scoreboard*.

([37]) The rate of resolving administrative cases stood at 40 % in 2012 and in 2013. Source: European Commission, *The 2015 EU Justice Scoreboard*.

([38]) Recruitment of 'jurists' (assistant judges) is planned for 2015.

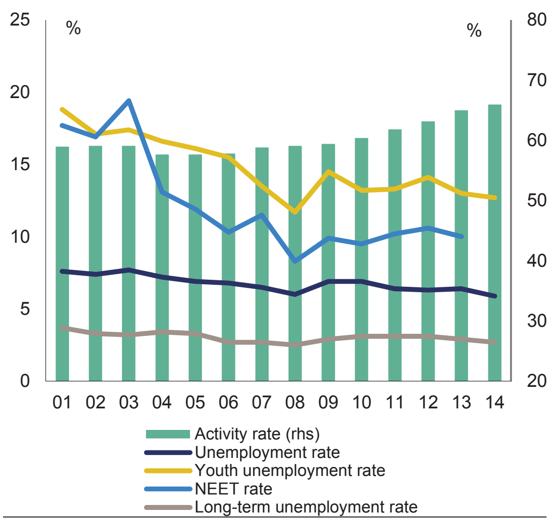
([39]) The following have been implemented or are planned: frontline assistance bureau to help citizens, ICT developments allowing claims to be submitted online, online payment of court fees and a better flow of information on case progression.

2.4. LABOUR MARKET, SOCIAL POLICIES AND EDUCATION

Labour market

The Maltese labour market still features very low activity rates and important labour market challenges persist. The gap in total activity compared to EU average is high. After four consecutive years of growth exceeding the euro-area average, the Maltese economy continued expanding at a robust rate in the first half of 2014 (see Section 1). Against this background, the unemployment rate has fallen below 6 %, youth unemployment below 11 %, the share of long-term unemployed over total unemployment remains stable. While the active population continues growing steadily, overall labour market participation is still low due to low activity rates of women and older workers. People with disabilities are not well integrated in the labour market, and while youth unemployment is low, integrating the inactive and non-registered young people remains important.

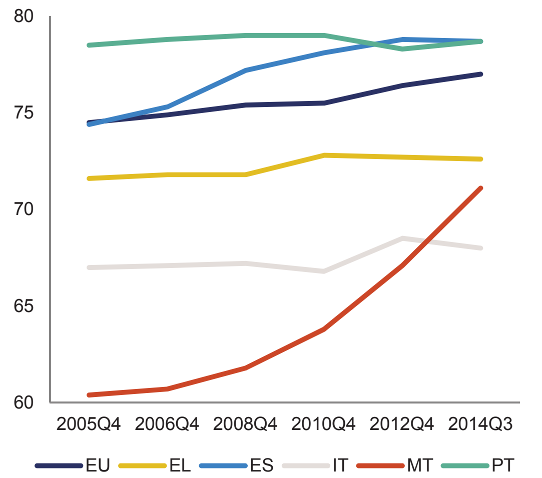
Graph 2.4.1: **Main labour market indicators**



Note: Activity and long-term unemployment rates for 2014 refer to the average over the first three quarters
Source: European Commission

In spite of the gains recorded over the past years, labour-market participation continues to be among the lowest in the EU. Although the latest demographic projections depict a less worrisome scenario compared to previous estimates (thanks in particular to higher fertility rates and positive net migration), the working-age population is still forecast to decline between 2014 and 2030 and the old-age dependency ratio to increase considerably ([40]). Labour market activity in Malta improved considerably over the past decade (see Graph 2.4.2), particularly reflecting remarkable gains achieved in female participation (see Graph 2.4.3). Nevertheless, while the activity rate of men is close to 85 % (well above the EU average), female activity and employment rates, at around 50 %, are among the lowest in Europe, and are particularly low for women above 40 years. Similarly for old-age employment, average working life duration is increasing but remains well below the EU average, with a striking gap for women where the figures report a distance of 8.5 years to the EU average ([41]). In addition, despite the overall low unemployment rate, activation support through active labour market policies is limited.

Graph 2.4.2: **Trends in total activity rates in selected countries**

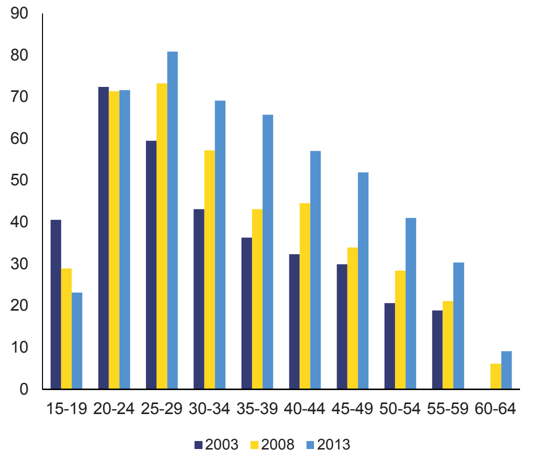


Note: Age 20-64
Source: European Commission

([40]) According to EUROPOP2013 projections, the population aged 15-64 is bound to decrease by more than 4 % between 2014 and 2030, while the ratio between the population aged 65+ and 15-64 is expected to rise from 26.4 % to 40.5 %, one of the largest increases in the EU.

([41]) The average duration of working life stood at 31.6 years in 2012 (increasing by 3.3 years from 2008) compared to an average of 35 years in EU. For women, is was 23.7 in 2012, compared to 32.2 for the EU.

Graph 2.4.3: **Female activity rates by age group, 2003-2013**



Note: Data for age group 60-64 in 2003 is unreliable
Source: European Commission

Women's and older workers' participation in the labour market

The still unsatisfactory outcomes on labour market participation reflect a combination of factors. More generally, these include care obligations, benefit design and insufficient flexible work arrangements, notably in the private sector. The employability of older workers and the length of the working life have implications for the adequacy of pensions and the long-term sustainability of the pension system (see also Section 2.1). Among the reasons for the very low female employment there are family obligations related to care of dependants, but financial disincentives may also play a role. The culture of long working hours and the limited availability of flexible and reduced-hours opportunities deter women from participating in the labour market and limit men in sharing family obligations. Malta has one of the highest shares of women in the EU that report "other family or personal responsibilities" as a reason for being inactive on the labour market ([42]). After giving birth, more women retain current jobs in medium-to high skills occupations, while women with lower qualifications face high risks of labour market detachment ([43]). Finally, Malta's activation support through active labour market policies is also limited.

Policy efforts by the authorities focused on promoting the reconciliation of work and family life. They have gone in the right direction as evidenced by the positive developments in labour market participation rates. The measures focus mainly on financial incentives to make employment more attractive to further stimulate employment and limit the extent of current inactivity traps which are considerable at the lower incomes (See Graph 2.4.4). The continuation of the provision of free childcare services to households in which both parents are in employment or pursuing further education, the introduction of tapering of social assistance benefits and the planned reforms to the maternity benefit system, as well as putting in place tax incentives and wage subsidies for inactive women above the age of 40 who enter the labour market are examples.

Flexible working arrangements have been introduced in the public sector, while their take up in the private sector is still limited, owing also to its composition as the majority of business entities are SMEs and microenterprises ([44]). Planned measures include putting in place a toolkit to support private employers in the implementation of flexible work and family-friendly measures ([45]) on a case-by-case basis. Preliminary assessment gives positive indications in terms of increasing female participation in the labour market and improving work-family balance. Although there are already measures aiming at labour market integration of women having childcare obligations, attention to those having other dependants is still lacking. To support employment and reduce disincentives to work for single parents on social assistance, the tapering of benefits will be extended in 2015 for this target group, but the system is expected to be changed so as to increase smooth transitions from

([42]) While inactivity due to childcare or care of incapacitated adult is reported by women in 17.2 % (below the EU28 of 18.4 %), 40 % inactivity is reported due to other family or personal responsibilities (12 % in EU28), EUROSTAT

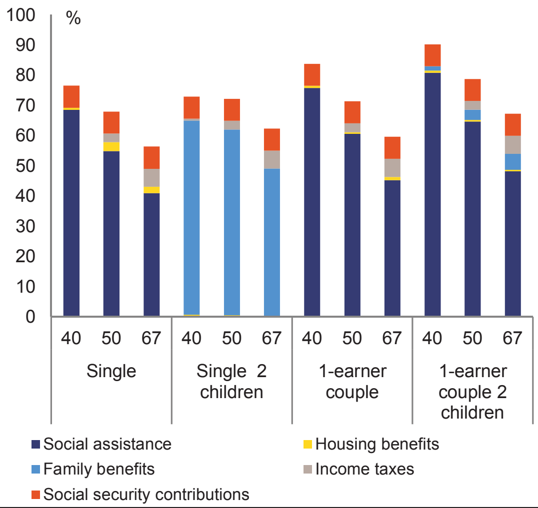
([43]) Malta: the National Employment policy 2014, p 77 ff.

([44]) Under a project of the Malta Business Bureau, Supporting Human resources In Family-friendly Training, a toolkit to support private employers in the implementation of flexible work and family-friendly measures will be delivered and advisory services on the implementation of flexible working arrangements are planned to be provided on case-by-case basis.

([45]) Project of the Malta Business Bureau: Supporting Human resources In Family-friendly Training.

social assistance to employment. To address inactivity traps and to improve the situation of low-income households, an in-work benefit scheme is planned to be introduced in 2015 targeting low-to-medium income families where both spouses (or single parent) are in employment and have dependent children up to 23 years of age.

Graph 2.4.4: **Inactivity traps for low-wage earners, % of gross earnings, 2013**



Note: The inactivity trap is defined as the percentage of gross earnings that is taxed away when moving from inactivity to employment, due to taxes and withdrawal of benefits. Earnings levels at 40%, 50% and 67% of the average wage, assuming full-time work. The 40% level corresponds to the minimum wage.
Source: European Commission-OECD Tax and Benefit database

Several measures aimed at increasing the employment rate of older workers are being implemented. These focus on raising the effective retirement age and enabling workers to continue in working beyond the statutory pensionable age. The National Strategic Policy on Active Ageing for the years 2014-2020, based on three pillars: increasing active participation in the labour market, enhancing participation in society and promoting independent living, was launched in November 2013 and an Active Ageing Unit was set up for the policy implementation. Besides gradually increasing in the statutory retirement age, tax incentives aimed at attracting older workers to the labour market have been set up, both in the form tax deductions for older employees, as well as tax incentives for enterprises to recruit and train older workers.

Youth and people with disabilities

Youth unemployment and the employment of persons with disabilities present additional challenges. Although concerns about these two groups are less acute, they also show vulnerabilities. The self-reported employment rate of persons with disabilities in Malta is very low, standing at 21.4 % ([46]) for those aged 20-64 in 2012 compared to the EU average of 48 %. The employment gap with respect to people without disabilities is also significant (at 43 percentage points against 23.6 percentage points for the EU average) and it has significantly widened since 2009. A benefit trap may contribute to this problem. Persons with disabilities are entitled to a disability pension equivalent to around 55 % of the minimum wage, which is fully subject to means-test, implying a one-to-one reduction in the disability pension for labour incomes above the minimum wage. As regards young people, the youth unemployment rate is lower than the EU average, but the deviation between the youth and adult unemployment ratios is among the highest in the EU.

The authorities have put in place targeted measures to support the implementation of these groups into the labour market. To support the integration of people with disabilities into the labour market, the government introduced a law whereby 2 % of persons employed by companies (employing more than 20 employees) must be persons with disabilities. Future policy plans focus around the new National Policy on the Rights of Persons with Disabilities, launched in December 2014. To address benefit traps, disability pensions will be reformed with a view to keeping entitlements even if undertaking gainful employment. As regards young people, the implementation of the Youth Guarantee focuses on the inclusion of inactive, non-registered youths that are not in education, employment or training, balancing adequately preventive and remedial action.

Wage bargaining

([46]) Source: EU-SILC 2012. EU-SILC is based on different methodology than the Labour Force Survey, and thus these two surveys are not comparable.

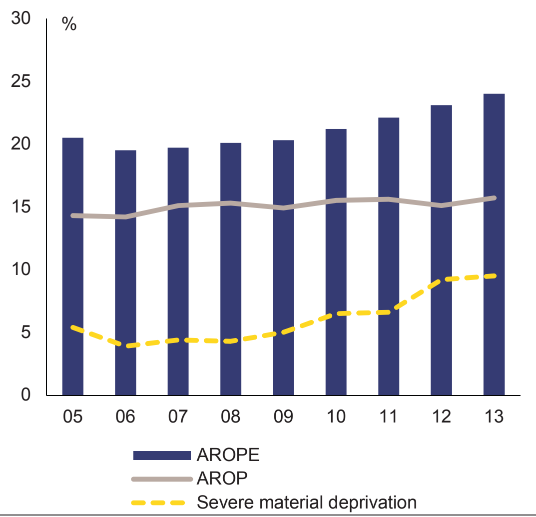
The wage bargaining framework has helped containing wage developments, but some institutional features call for monitoring. Malta has a decentralised collective bargaining framework, which has proved stable and effective in providing a high degree of flexibility. Increases in the statutory minimum wage are limited to the increase in the Cost of Living Allowance, an automatic wage indexation mechanism providing (partial) compensation for past inflation ([47]). The same absolute increase is also granted to all wage earners in the economy and is calculated on the basis of a 'base wage', which is only about 60 % of the average wage. This means that the Cost-of-Living Allowance is significant for those receiving less than the average wage, but its impact would be smaller for the higher-paid workers. Given the currently very subdued price developments, wage increases linked to the granting of Cost-of-Living Allowances have been modest (EUR 0.58 per week in 2015). Albeit partial, however, wage indexation could still exert potentially negative effects on competitiveness by causing a misalignment between wage and productivity developments, in particular in the case of a surge in inflation due to external factors. Further in the same vein, the extent to which the Cost-of-Living Allowance is incorporated in the collectively-agreed wage increases also affects the potential for misalignment between wage and productivity developments. No steps have been taken to limit such possible risks.

Social Policies

Malta seems to be moving away from its 2020 poverty-reduction target. The share of persons at risk of poverty and social exclusion is lower than the EU average, but it has increased by four percentage points between 2008 and 2013 reaching 24 %, while severe material deprivation more than doubled (see Graph 2.4.5) over the same period despite the favourable economic and labour market conditions. The share of persons at risk of poverty and social exclusion is higher than the EU average for children (32 % vs 27.6 %), in particular for those living in single-parent households (41.9 % vs 31.8 %). Poverty among the elderly is also higher than EU average (20.8 % vs 18.3 %), and is closely related to low pension adequacy. Risk of poverty or social exclusion is also significantly higher for persons with only basic educational attainment (ISCED 0-2), with the ratio standing at 18 % as opposed to only 3 % for persons with tertiary education.

In order to improve efficiency and effectiveness of the social protection system in preventing and reducing poverty, Malta has announced several reforms. Although starting from low levels of social expenditure, Malta has registered progress with a considerable increase in expenditure in child day care, education and, to a lesser extent, for activation measures ([48]). Moreover, a strategic Framework for Poverty Reduction and for Social Inclusion, setting out policy to reduce poverty and social exclusion, was launched in December 2014. The efforts to support employment and reduce disincentives to work are expected to further contribute to reduce the share of population at risk of poverty.

Graph 2.4.5: **Poverty indicators, % of total population**



Note: AROPE - At risk of poverty or social exclusion, AROP - At risk of poverty
Source: European Commission

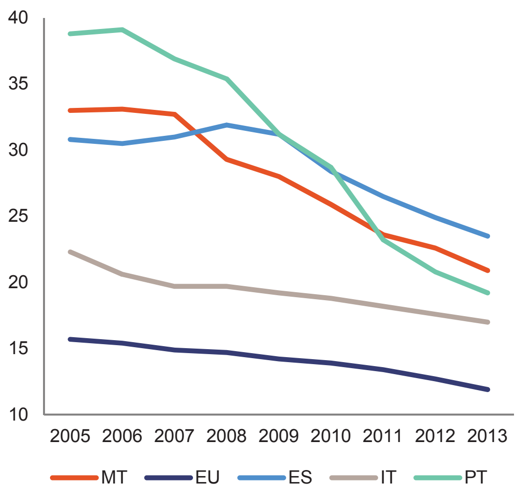
([47]) The statutory minimum wage, which amounted to EUR 165.68 per week in 2014, has been adjusted marginally in 2015 by the Cost of Living Allowance to EUR 166.27 per week.

([48]) Employment and Social Developments in Europe 2014 [http://europa.eu/rapid/press-release_IP-15-3321_en.htm

Education and Skills

The skills levels of the workforce will not be improved in the long-term without addressing the bottlenecks of the education system. Despite significant investments in recent years, Malta still faces challenges related to basic skills attainment, the early-school-leaving rate (see Graph 2.4.6) and adjustment of skill to the labour-market requirements. Higher educational attainment also improves the labour market participation and employability of workers. In 2014, the government received a Country-Specific Recommendation to that effect.

Graph 2.4.6: **Trends in the rate of early school leaving, %**



Source: European Commission

Education outcome and early-school leaving

International studies show that basic skills attainment is rather poor. The performance of 15-year olds in the OECD Programme for International Student Assessment 2009+ tests was among the worst in the EU ([49]). This was coupled with the largest gender gap among EU countries, with girls strongly outperforming boys in all tested fields (reading, mathematics and science). Similarly, the performance of 10-year olds' in the 2011 Progress in International Reading Literacy Study and Trends in International Mathematics and Science Study ([50]) was very weak, with Malta being the worst performer among EU countries in most fields.

Despite the improvement in recent years and the putting in place of targeted policies to tackle it, early-school leaving remains a major problem for the education system. The early-school-leaving rate fell by 12 percentage points between 2007 and 2013. Despite this recent progress, the rate is still the second highest in the EU (20.8 % in 2013), with a significant gender gap (23.2 % for males compared with 18.4 % for females). The authorities' efforts to tackle the issue have been in the right direction. The Early School Leaving Strategy ([51]) was published in June 2014 and an Early-School-Leaving monitoring system has been established at the end of the year. An Early-School-Leaving Monitoring Unit within the Ministry of Education and Employment has been set up and an inter-ministerial committee to steer and coordinate policy actions on early school leaving started its work in July 2014. Moreover, efforts are being made to provide quality second chance education for target groups, i.e. persons with disability. Proper implementation of the National Literacy Strategy for All ([52]), launched in June 2014, supported with adequate funding, may help address literacy problems. The overall purpose of the strategic framework is to promote and enhance high quality literacy practices among children, youths, adults, third-country nationals and persons with learning difficulties, as well as to improve literacy outcomes. The current basic skills programmes will be consolidated and extended further in order to make them more effective.

Further progress reducing early school leaving, as well as in basic skills attainment, will strongly depend on quality of teaching ([53]). As some major changes have been going on in the

([49]) http://www.oecd.org/pisa/keyfindings/pisa2009keyfindings.htm. Malta did not participate in PISA 2012.

([50]) http://timssandpirls.bc.edu/.

([51]) Ministry for Education and Employment (2014), A strategic plan for the prevention of early school leaving in Malta, http://education.gov.mt/ESL/Documents/School%20Leaving%20in%20Malta.pdf.

([52]) Ministry of Education and Employment (2014), *A national literacy strategy for all in Malta and Gozo 2014-2019*, http://education.gov.mt/en/Documents/Literacy/ENGLISH.pdf.

([53]) See European Commission (2012), Supporting the Teaching Professions for Better Learning Outcomes, SWD (2012) 374.

school sector in Malta (e.g. the introduction of mixed ability classes, benchmarking examination and e-learning tools), a lack of sufficiently qualified and skilled teachers can be a bottleneck in promoting student-centred learning. Both the Early School Leaving Strategy and the Literacy Strategy acknowledge the need for improving professional development of teachers at all career stages. So far, the main envisaged measure is setting up an Institute for continuous professional development of teachers in 2015. As measures to improve quality of teaching necessarily require a medium- to long-term policy perspective, enduring commitment in the coming years will be key.

Providing labour market skills

The supply of skills has not yet adjusted to the labour-market requirements. Bottlenecks have been identified across the entire skills spectrum ([54]). Due to the small size of the economy, there is the structural challenge for employers to recruit specialised profiles with relevant work experience. Among the highly skilled sectors, health care, finance and IT stand out as those where demand considerably exceeds supply. Maltese employers have resorted to recruit skilled workers from abroad, but foreign labour tends to be more difficult to retain. Moreover, despite increased take-up of vocational education and training ([55]), there remains scope for strengthening the governance and partnerships between providers and employers. Malta has not yet developed an integrated information system, collecting systematic data on vacancies across the whole economy, nor a clear framework for monitoring and skills anticipation ([56]). Still-limited participation in lifelong learning ([57]) also constrains the employability of Maltese residents, in particular among the low skilled workers ([58]) and among older workers, whose skills are often out-dated and employability is at stake.

The authorities' approach in this area is multifaceted but policies are in early stages of implementation. After consultation with social partners, the Government is in the process of creating a single national apprenticeship scheme**.** The scheme will cover a larger number of qualification levels and occupations and also includes a system of tax deductions introduced by the 2014 budget ([59]). More vocational courses are being introduced, covering additional subjects, and the number of apprenticeships has gone up in order to meet the high demand. Moreover, the National Commission for Further and Higher Education is aiming to introduce a national system for validation of informal and non-formal learning, aligning with the Malta Qualifications Framework. Malta also plans to set up a Skills Council to better align educational outcomes with labour market relevance ([60]) while a 'virtual labour market' is meant to facilitate the matching of skills with work placements. As regards lifelong learning, the authorities have designed a Lifelong Learning Strategy with a view to increase participation and have set aside dedicated funding for employers to train their employees through the European Social Fund Operational Programme 2014-2020. The policy response seems to go in the right direction. The involvement of enterprises in the design of more attractive and higher quality apprenticeships still seems to be insufficient and so far demand for apprenticeships exceeds supply.

([54]) Mapping and analysing bottleneck vacancies on EU labour markets, 2013.
([55]) According to national information 75 % of graduates are finding full-time employment after completion of apprenticeship.
([56]) Coverage of vacancies by the Maltese PES is only partial.
([57]) Participation stands at 7.5 % in Malta vs. 10.5 % in EU28.
([58]) Malta is among the MS with a high share of workforce (25-29) having low qualifications (ISCED 0-2).
([59]) Ministry for Finance (2013), Budget Speech 2014, https://mfin.gov.mt/en/TheBudget/Documents/The_Budget_2014/Budget2014_Speech_EN.pdf
([60]) Malta: The National Employment Policy, May 2014.

ANNEX A
Overview Table

2014 commitments	Summary assessment
Country-specific recommendations (CSRs)([1])	
CSR 1: Correct the excessive deficit in a sustainable manner by 2014. In 2015, significantly strengthen the budgetary strategy to ensure the required structural adjustment of 0.6 % of GDP towards the medium-term objective. Thereafter, pursue a structural adjustment of at least 0.5 % of GDP each year, and more in good economic conditions or if needed to ensure that the debt rule is met in order to keep the general government debt ratio on a sustained downward path. Finalise the adoption of the Fiscal Responsibility Act with a view to putting in place a binding, rule-based multiannual fiscal framework and establishing an independent institution charged with the monitoring of fiscal rules and endorsing macroeconomic forecasts underpinning fiscal planning. Continue improving tax compliance and fighting tax evasion by ensuring the continued roll-out and evaluation of measures taken so far, while taking additional action, in particular by promoting the use of electronic means of payment.	Malta has made **substantial progress** in addressing CSR 1 (this overall assessment of CSR 1 excludes an assessment of compliance with the Stability and Growth Pact). Malta **fully addressed** the recommendation on the the fiscal framework. In July 2014, the Maltese parliament adopted the Fiscal Responsibility Act. It envisages the establishment of a Fiscal Council that would endorse the macroeconomic and fiscal projections prepared by the Ministry of Finance. In the first year following the adoption of the Act, its functions are carried out by the National Audit Office. The Fiscal Council has been formally appointed on 16 January 2015. Malta has made **some progress** in strengthening tax compliance and fighting tax evasion, but the tangible impacts of ongoing measures are not yet clear. Recent steps are proceeding in the right direction, but the pace of change could be accelerated, notably for the merger of tax departments. The first efforts to explore the promotion of electronic payment systems are encouraging, but as yet are restricted to the payment of taxes.
CSR 2: To ensure the long-term sustainability of public finances continue the ongoing pension reform, such as by accelerating the already enacted increase in the statutory retirement age and by consecutively linking it to changes in life expectancy. Ensure that a comprehensive reform of the public	Malta has made **limited progress** in addressing CSR 2: Malta has made **no progress** on the pensions system reform to accelerate the increase in the statutory retirement age and consequently linking it to changes in life expectancy. Malta has made **some progress** in improving the

health system delivers a cost-effective and sustainable use of available resources, such as strengthening primary care.	cost-effectiveness of its health system. The authorities reacted positively to the recommendations and increased their effort towards reform with some measures already giving positive results. The National Health Systems Strategy and subsequent action plans on the Maltese health system provide a sound basis for a comprehensive reform. To ensure sustainability of the health system it is important that the extensive measures which have been planned and initiated in governance, health promotion and disease prevention and primary care continue to be implemented with the same momentum.
CSR 3: Continue policy efforts to address the labour-market relevance of education and training by stepping up efforts on the reform of the apprenticeship system. Further improve basic skills attainment and reduce early school leaving, in particular by finalising and implementing the announced national literacy strategy. Further improve the labour-market participation of women, in particular those wishing to re-enter the labour market by promoting flexible working arrangements.	Malta has made **some progress** in addressing CSR 3: **Some progress** in creating a single apprenticeship scheme has been done. A new Apprenticeship Unit has been created within the Malta College of Arts, Science and Technology as a single body responsible for the apprenticeship scheme. Further efforts are necessary in order to facilitate a prompt match of skills with the employers' needs. Malta has made **some progress** on measures to further improve basic skills attainment and reduce early school leaving. The National Literacy Strategy for All was launched in June 2014. The Early School Leaving Strategy was published in June 2014. An Early School Leaving Monitoring Unit within the Ministry of Education and Employment has been set up and an inter-ministerial committee to steer and coordinate policy actions on early school leaving started its work in July 2014. **Some progress** in addressing the female labour market participation through favouring work-family balance is visible. Some steps to introduce flexible working arrangements in the private sector have been taken and measures targeting women with childcare obligations are being introduced. Improving participation of older women, both in terms of facilitating retention and reintegration into the labour market, as well as in terms of skills adjustments, needs further attention. Although some measures are being implemented, such as tax

	incentives and wage subsidies to inactive women above 40 who enter the labour market, their impact on employment needs to be further monitored. Limited attention has been given to measures for women who have other dependents such as elderly or people with disabilities. Overall, a positive result in terms of increasing female participation in the labour market and improving work-family balance is observed.
CSR 4: Diversify the energy mix in the economy, including by increasing the share of energy produced from renewable sources.	Malta has made **some progress** on diversifying the energy mix by completing the construction of the electricity interconnector to mainland Europe and taking first steps to shift electricity production away from oil as well as on measures to increase energy efficiency
CSR 5:	Malta has made **some progress** in addressing CSR 5:
Continue efforts to increase the efficiency and reduce the length of public procurement procedures;	Malta has made **substantial progress** on measures concerning public procurement procedures. The actual length of procurement procedures has dropped significantly from 191 days in 2013 (233 days in 2009) to 115 days in 2014. This reduction results notably from the introduction of mandatory e-procurement (e-notification, e-access and e-submission) since January 2013. In addition, the relevant government departments have been strengthened. The announced additional administrative capacity increase should consolidate the gains and reduce the duration of the procedure a bit further, thereby bringing Malta closer to the EU average.
encourage alternatives to debt-financing of companies through facilitating access to capital markets and developing venture capital funds;	Malta has made **some progress** on measures to encourage alternatives to debt-financing of companies. A review of the start-up scheme by Malta Enterprise in ongoing. The authorities have launched a venture capital platform to help start-ups and announced the Seed Investment Programme (to provide tax credits equivalent to investment made in start-ups).
and increase the efficiency of the judicial system by ensuring a timely and efficient implementation of the planned judicial reform.	Malta has made **limited progress** on measures to increase the efficiency of the Maltese judicial system which remains a challenge. Judicial reforms are planned but most of them are not yet implemented. They could be expected to produce positive effects in the medium and long term but this remains to be confirmed by the facts on the

	ground.
Europe 2020 (national targets and progress)	
Policy field target	**Progress achieved**
National employment target (70 %)	66.1 % (first nine months of 2014), 64.8 % (2013) – the old national target was reached, and progress was made towards reaching the new 2020 target.
National target for expenditure on research & development (2 % of GDP)	Malta's R&D intensity stood at 0.85 % of GDP in 2013, very low compared to the EU average of 2.02 %, while the 2020 national target of 2 % is far from being met.
National target for reducing greenhouse-gas emissions falling under sectors outside the scope of the Emissions Trading Scheme (+5 % compared to 2005 level)	Non-ETS greenhouse gas emissions decreased by 4% between 2005 and 2013. According to the latest national projections and taking into account existing measures, the target is expected to be achieved: +4 % in 2020 compared to 2005 (with a margin of 1 percentage points).
Renewable energy target (10 %)	2.5 % share of renewable energy in 2013 (EurObserv'ER)
National energy efficiency target (reducing primary energy consumption to 0.825 Mtoe and final consumption to 0.493 Mtoe)	Malta's 2020 energy efficiency target was lowered from 0.8 Mtoe to 0.7 Mtoe expressed in primary energy consumption (0.5 Mtoe expressed in final energy consumption). When comparing the trend of primary energy consumption with the GDP development over the past decades, it can be seen that there is evidence of a strong decoupling of both since 2005.
National early-school-leaving target (10 %)	22.7 % in 2011, 21.1 % in 2012, 20.8 % in 2013. Some progress towards achieving the target.
National target for tertiary-education attainment (33 %)	23.4 % in 2011, 24.9 % in 2012, 26 % in 2013. Some progress towards achieving the target.
National poverty target (lifting 6,560 individuals from the risk of poverty or social exclusion)	Malta committed to reduce by 6,560 the number of people at risk of poverty and social exclusion from the 2008 figure of 81,000. However, those at risk of poverty and social inclusion have continued to increase and in 2013, the figure stood at 99,000.

ANNEX B

Standard Tables

Table AB.1: **Macroeconomic indicators**

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015	2016
Core indicators									
GDP growth rate	4.5	2.1	2.0	2.2	2.5	2.5	3.3	3.3	2.9
Output gap [1]	-0.1	-0.2	0.4	-0.4	-0.3	-0.3	0.2	0.4	0.5
HICP (annual % change)	n.a.	2.5	2.4	2.5	3.2	1.0	0.8	1.0	1.9
Domestic demand (annual % change) [2]	3.6	1.4	2.2	-2.2	-2.1	3.1	4.4	3.1	2.5
Unemployment rate (% of labour force) [3]	6.3	7.4	6.6	6.4	6.3	6.4	6.0	5.9	5.9
Gross fixed capital formation (% of GDP)	23.2	20.0	20.7	17.6	17.3	17.3	18.1	18.7	18.0
Gross national saving (% of GDP)	16.9	15.2	15.1	17.5	16.5	17.9	21.4	22.2	21.6
General government (% of GDP)									
Net lending (+) or net borrowing (-)	-7.2	-5.5	-3.1	-2.6	-3.6	-2.7	-2.3	-2.0	-1.8
Gross debt	51.9	68.0	65.0	69.8	67.5	69.5	68.6	68.0	66.8
Net financial assets	n.a.	n.a.	-46.1	-49.4	-48.5	n.a.	n.a.	n.a.	n.a.
Total revenue	34.1	37.0	38.6	38.3	38.8	39.7	40.7	41.6	40.9
Total expenditure	41.4	42.5	41.8	40.9	42.5	42.3	43.0	43.6	42.8
of which: Interest	3.0	3.7	3.4	3.2	3.0	2.9	2.8	2.8	2.7
Corporations (% of GDP)									
Net lending (+) or net borrowing (-)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net financial assets; non-financial corporations	n.a.	n.a.	-84.9	-70.7	-56.8	n.a.	n.a.	n.a.	n.a.
Net financial assets; financial corporations	n.a.	n.a.	-10.4	-5.5	0.6	n.a.	n.a.	n.a.	n.a.
Gross capital formation	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross operating surplus	n.a.	23.9	25.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Households and NPISH (% of GDP)									
Net lending (+) or net borrowing (-)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net financial assets	n.a.	n.a.	167.9	157.1	159.5	n.a.	n.a.	n.a.	n.a.
Gross wages and salaries	n.a.	n.a.	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.	n.a.	n.a.
Current transfers received	n.a.	n.a.	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.	n.a.	n.a.
Rest of the world (% of GDP)									
Net lending (+) or net borrowing (-)	-6.9	-2.6	-5.1	-0.7	2.7	2.6	5.4	5.5	5.5
Net financial assets	n.a.	n.a.	-25.4	-29.8	-53.2	n.a.	n.a.	n.a.	n.a.
Net exports of goods and services	-5.3	0.0	-1.1	3.2	7.2	7.1	6.2	6.9	7.4
Net primary income from the rest of the world	-0.9	-0.9	-3.6	-3.6	-5.1	-5.0	-3.8	-4.0	-4.4
Net capital transactions	0.7	1.0	1.5	1.1	1.9	1.7	2.1	2.0	1.9
Tradable sector	53.0	45.7	40.1	38.2	37.8	37.9	n.a.	n.a.	n.a.
Non-tradable sector	36.8	42.4	47.3	49.0	50.0	49.8	n.a.	n.a.	n.a.
of which: Building and construction sector	5.0	6.5	4.5	4.1	3.9	3.7	n.a.	n.a.	n.a.

(1) The output gap constitutes the gap between the actual and potential gross domestic product at 2010 market prices.
(2) The indicator of domestic demand includes stocks.
(3) Unemployed persons are all those 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.
Source: European Commission 2015 winter forecast; European Commission calculations

Table AB.2: **Financial market indicators**

	2009	2010	2011	2012	2013	2014
Total assets of the banking sector (% of GDP)1)	696.8	777.0	767.4	777.1	697.1	705.0
Share of assets of the five largest banks (% of total assets)	72.8	71.3	72.0	74.4	76.5	n.a.
Foreign ownership of banking system (% of total assets)	36.1	34.9	33.1	30.9	24.3	n.a.
Financial soundness indicators:						
- non-performing loans (% of total loans)2)3)	6.2	7.4	7.3	8.2	9.2	9.5
- capital adequacy ratio (%)2)3)	13.5	12.9	13.5	14.1	14.9	14.9
- return on equity (%)2)3)	18.3	19.1	20.0	24.7	19.8	16.2
Bank loans to the private sector (year-on-year % change)1)	-2.8	2.9	3.0	3.5	-7.4	4.8
Lending for house purchase (year-on-year % change)1)	10.0	8.6	8.6	6.8	6.2	8.9
Loan to deposit ratio1)	106.6	103.8	94.5	89.8	73.7	69.5
Central Bank liquidity as % of liabilities4)	3.6	2.9	1.3	1.1	0.5	0.5
Private debt (% of GDP)	164.8	160.4	156.7	145.5	137.1	n.a.
Gross external debt (% of GDP)5) - public	6.6	5.8	6.3	8.6	9.0	7.2
- private	49.1	51.4	55.3	62.9	56.0	54.8
Long-term interest rate spread versus Bund (basis points)*	131.9	144.4	188.1	263.1	179.3	144.8
Credit default swap spreads for sovereign securities (5-year)*	104.8	149.5	253.2	346.2	215.8	208.5

(1) Latest data November 2014.
(2) Latest data Q2 2014.
(3) Domestic banks dealing only with residents.
(4) Latest data September 2014.
(5) Latest data June 2014. Monetary authorities, monetary and financial institutions are not included.
* Measured in basis points.
Source: IMF (financial soundness indicators); European Commission (long-term interest rates); World Bank (gross external debt); ECB (all other indicators).

Table AB.3: **Taxation indicators**

	2002	2006	2008	2010	2011	2012
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	30.0	33.0	33.0	32.2	33.0	33.6
Breakdown by economic function (% of GDP)[1]						
Consumption	11.8	13.7	13.4	12.8	13.3	13.1
of which:						
- VAT	6.2	7.9	7.7	7.5	7.8	7.8
- excise duties on tobacco and alcohol	1.3	1.5	1.2	1.3	1.2	1.3
- energy	1.3	1.3	1.4	1.5	1.6	1.6
- other (residual)	3.0	3.1	3.0	2.6	2.6	2.4
Labour employed	10.2	10.3	9.4	9.5	10.0	10.4
Labour non-employed	0.9	1.1	1.0	1.1	1.1	1.2
Capital and business income	5.1	5.8	7.5	7.3	7.2	7.5
Stocks of capital/wealth	2.0	2.1	1.7	1.6	1.5	1.5
p.m. Environmental taxes[2]	3.3	3.3	3.4	3.0	3.2	3.0
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	54.9	58.3	57.6	56.9	59.6	59.6

(1) Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.
(2) This category comprises taxes on energy, transport and pollution and resources included in taxes on consumption and capital.
(3) VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative scale of cross-border shopping (including trade in financial services) compared to domestic consumption also influences the value of the ratio, notably for smaller economies. For a more detailed discussion, see European Commission (2012), Tax Reforms in EU Member States, and OECD (2014), Consumption tax trends.
Source: European Commission

Table AB.4: **Labour market indicators**

	2008	2009	2010	2011	2012	2013	2014
Employment rate (% of population aged 20-64)	59.2	59.0	60.1	61.6	63.1	64.8	66.1
Employment growth (% change from previous year)	2.5	0.0	1.7	2.8	2.3	4.0	3.4
Employment rate of women (% of female population aged 20-64)	39.4	40.0	41.6	43.8	46.6	49.8	51.6
Employment rate of men (% of male population aged 20-64)	78.5	77.5	78.2	79.0	79.2	79.4	80.2
Employment rate of older workers (% of population aged 55-64)	30.1	29.1	31.9	33.2	34.7	36.3	38.1
Part-time employment (% of total employment, age 15 years and over)	11.5	11.5	12.4	13.4	14.1	15.2	16.1
Part-time employment of women (% of women employment, age 15 years and over)	25.4	23.8	24.9	25.9	26.5	26.8	28.6
Part-time employment of men (% of men employment, age 15 years and over)	4.5	5.3	5.9	6.7	7.0	8.2	8.4
Fixed term employment (% of employees with a fixed term contract, age 15 years and over)	4.3	5.0	5.4	6.6	6.8	7.5	7.8
Transitions from temporary to permanent employment	62.7	66.6	10.0	67.2	2.2	25.4	n.a.
Unemployment rate[1] (% of labour force, age group 15-74)	6.0	6.9	6.9	6.4	6.3	6.4	5.9
Long-term unemployment rate[2] (% of labour force)	2.5	2.9	3.1	3.1	3.1	2.9	2.7
Youth unemployment rate (% of youth labour force aged 15-24)	11.7	14.5	13.2	13.3	14.1	13.0	12.7
Youth NEET rate (% of population aged 15-24)	8.3	9.9	9.5	10.2	10.6	10.0	n.a.
Early leavers from education and training (% of pop. aged 18-24 with at most lower sec. educ. and not in further education or training)	27.2	27.1	23.8	22.7	21.1	20.8	n.a.
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	21.0	21.9	20.6	23.4	24.9	26.0	n.a.
Formal childcare (from 1 to 29 hours; % over the population aged less than 3 years)	10.0	4.0	7.0	8.0	16.0	n.a.	n.a.
Formal childcare (30 hours or over; % over the population aged less than 3 years)	5.0	4.0	4.0	3.0	1.0	n.a.	n.a.
Labour productivity per person employed (annual % change)	0.8	-2.5	1.8	-0.6	0.2	-1.5	0.6
Hours worked per person employed (annual % change)	-0.5	0.8	-0.9	6.0	-1.7	-0.8	-0.4
Labour productivity per hour worked (annual % change; constant prices)	1.3	-3.3	2.7	-6.2	1.9	-0.7	1.0
Compensation per employee (annual % change; constant prices)	1.0	0.3	-1.8	1.4	2.1	-2.3	0.9
Nominal unit labour cost growth (annual % change)	2.8	6.0	-0.5	2.9	4.2	0.8	n.a.
Real unit labour cost growth (annual % change)	-0.2	3.1	-4.4	0.7	2.0	-1.3	n.a.

(1) Unemployed persons are all those who were not employed, but 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. Data on the unemployment rate of 2014 includes the last release by Eurostat in early February 2015.
(2) Long-term unemployed are persons who have been unemployed for at least 12 months.
Source: For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC

Table AB.5: **Product market performance and policy indicators**

	2004-08	2009	2010	2011	2012	2013	2014
Labour productivity1 in total economy (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity[1] in manufacturing (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity[1] in electricity, gas (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity[1] in the wholesale and retail sector (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity[1] in the information and communication sector (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Patent intensity in manufacturing[2] (EPO patent applications divided by gross value added of the sector)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Policy indicators	**2004-08**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Enforcing contracts[3] (days)	n.a.	n.a.	n.a.	505	505	505	505
Time to start a business[3] (days)	n.a.	n.a.	n.a.	40	40	40	35
R&D expenditure (% of GDP)	0.5	0.5	0.6	0.7	0.9	0.9	n.a.
Total public expenditure on education (% of GDP)	5.9	5.3	6.7	8.0	n.a.	n.a.	n.a.
(Index: 0=not regulated; 6=most regulated)	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Product market regulation[4], overall	n.a.	n.a.	n.a.	n.a.	n.a.	1.57	n.a.
Product market regulation[4], retail	n.a.	n.a.	n.a.	n.a.	n.a.	1.09	n.a.
Product market regulation[4], professional services	n.a.	n.a.	n.a.	n.a.	n.a.	1.66	n.a.
Product market regulation[4], network industries[5]	n.a.	n.a.	n.a.	n.a.	n.a.	2.28	n.a.

(1) Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.
(2) Patent data refer to applications 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.
(3) The methodologies, including the assumptions, for this indicator are presented in detail here: HYPERLINK "http://www.doingbusiness.org/methodology" .
(4) Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are presented in detail here: HYPERLINK "http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm"
(5) Aggregate OECD indicators of regulation in energy, transport and communications.
Source: European Commission; World Bank — Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators)

Table AB.6: **Social indicators**

	2007	2008	2009	2010	2011	2012
Sickness/healthcare	5.1	5.3	5.9	5.5	5.4	5.7
Invalidity	1.1	1.0	0.9	0.8	0.8	0.7
Old age and survivors	9.1	9.3	10.1	10.4	10.1	10.6
Family/children	1.0	1.2	1.2	1.2	1.2	1.2
Unemployment	0.5	0.5	0.6	0.5	0.5	0.6
Housing and social exclusion n.e.c.	0.2	0.2	0.2	0.2	0.2	0.1
Total	17.5	17.8	19.3	18.9	18.5	19.2
of which: means-tested benefits	3.1	2.5	2.6	2.5	2.5	2.5
Social inclusion indicators	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
People at risk of poverty or social exclusion[1] (% of total population)	20.1	20.3	21.2	22.1	23.1	24.0
Children at risk of poverty or social exclusion (% of people aged 0-17)	25.0	26.5	26.7	27.8	31.0	32.0
Elderly at risk of poverty or social exclusion (% of people aged 65+)	26.0	22.2	21.7	21.0	22.3	20.8
At-risk-of-poverty rate[2] (% of total population)	15.3	14.9	15.5	15.6	15.1	15.7
Severe material deprivation rate[3] (% of total population)	4.3	5.0	6.5	6.6	9.2	9.5
Proportion of people living in low work intensity households[4] (% of people aged 0-59)	8.6	9.2	9.2	8.9	9.0	9.0
In-work at-risk-of-poverty rate (% of persons employed)	5.1	5.4	5.9	6.1	5.2	5.9
Impact of social transfers (excluding pensions) on reducing poverty	33.2	34.9	34.0	32.8	37.1	32.6
Poverty thresholds, expressed in national currency at constant prices[5]	5963.7	5978.5	5832.3	5949.2	6117.0	6259.5
Gross disposable income (households)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Relative median poverty risk gap (60% of median equivalised income, age: total)	20.3	16.2	17.3	17.7	16.1	19.1
Inequality of income distribution (S80/S20 income quintile share ratio)	4.3	4.0	4.3	4.0	3.9	4.1

(1) People at risk of poverty or social exclusion: individuals who are at risk of poverty and/or suffering from severe material deprivation and/or living in households with zero or very low work intensity.
(2) At-risk-of-poverty rate: proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.
(3) Proportion of people who experience at least four of the following forms of deprivation: not being able to 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.
(4) People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20 % of their total work-time potential in the previous 12 months.
(5) For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices (HICP) = 100 in 2006 (2007 survey refers to 2006 incomes)
(6) 2014 data refer to the average of the first three quarters.
Source: For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

Table AB.7: **Green growth**

Green growth performance		**2003-2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Macroeconomic							
Energy intensity	kgoe / €	0.19	0.18	0.16	0.17	0.16	0.15
Carbon intensity	kg / €	0.60	0.56	0.56	0.54	0.54	0.55
Resource intensity (reciprocal of resource productivity)	kg / €	0.79	0.59	0.64	0.53	0.68	n.a.
Waste intensity	kg / €	n.a.	0.44	n.a.	0.24	n.a.	0.26
Energy balance of trade	% GDP	-3.4	-2.4	-0.1	1.1	-2.9	-12.7
Energy weight in HICP	%	5.1	5.8	6.5	6.3	6.7	7.3
Difference between energy price change and inflation	%	6.9	14.3	9.9	27.1	0.4	-2.0
Ratio of environmental taxes to labour taxes	ratio	29.9%	32.3%	29.7%	28.4%	28.4%	25.7%
Ratio of environmental taxes to total taxes	ratio	10.2%	10.2%	9.8%	9.4%	9.6%	8.9%
Sectoral							
Industry energy intensity	kgoe / €	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Share of energy-intensive industries in the economy	% GDP	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.14	0.14	0.19	0.19	0.19
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public R&D for energy	% GDP	n.a.	0.00	0.00	0.00	0.00	0.00
Public R&D for the environment	% GDP	n.a.	0.00	0.00	0.00	0.00	0.00
Recycling rate of municipal waste	ratio	13.1%	3.3%	4.1%	5.2%	13.1%	12.6%
Share of GHG emissions covered by ETS*	%	n.a.	66.0	63.4	62.7	63.8	65.4
Transport energy intensity	kgoe / €	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Transport carbon intensity	kg / €	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	99.9	99.9	99.9	99.1	100.7	100.5
Diversification of oil import sources	HHI	1.00	1.00	1.00	1.00	0.93	0.50
Diversification of energy mix	HHI	n.a.	1.00	1.00	0.99	0.99	0.98
Renewable energy share of energy mix	%	0.1	0.2	0.2	0.3	0.4	1.0

Country-specific notes:
2013 is not included in the table due to lack of data.
General explanation of the table items:
All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)
Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
Resource intensity: Domestic material consumption (in kg) divided by GDP (in EUR)
Waste intensity: waste (in kg) divided by GDP (in EUR)
Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Energy weight in HICP: the proportion of "energy" items in the consumption basket used for the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)
Environmental taxes over labour or total taxes: from DG TAXUD's database 'Taxation trends in the European Union'
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices for medium-sized industrial users: consumption band 500–2000MWh and 10000–100000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of recycled municipal waste to total municipal waste
Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP
Proportion of GHG emissions covered by ETS: based on greenhouse gas emissions (excl LULUCF) as reported by Member States to the European Environment Agency
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2005 EUR)
Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector
Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels
Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin
Diversification of the energy mix: Herfindahl index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
Renewable energy share of energy mix: %-share of gross inland energy consumption, expressed in tonne oil equivalents
* European Commission and European Environment Agency
** For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.
*** For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.
Source: European Commission unless indicated otherwise; European Commission calculations