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Country Report Malta 2019

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2019 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011

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EXECUTIVE SUMMARY

As Malta's economy continues to grow strongly, the main challenge is to ensure that its development is sustainable in the long term. In recent years, Malta has seen high GDP growth, strong employment growth, a budget surplus and a buoyant services sector. Economic growth appears to have been driven by structural changes, such as the shift towards the services sector, which are expected to continue in the short term. However, ensuring the sustainability of Malta's development remains a challenge. Risks to Malta's future growth and attractiveness to potential investors include infrastructure bottlenecks, constraints on natural resources, low skill levels, an ageing population and vulnerabilities in the governance framework ([1]).

Economic growth continued at a strong pace. GDP growth in 2018 is estimated at 6.2 %, based on strong domestic demand and, in particular, both private and public consumption. The internationally oriented services sector continues to underpin Malta's large current account surplus. Inflation has started to accelerate and is expected to pick up as wage pressures start gaining pace. In the short term, Malta's economic growth is projected to gradually moderate to an annual average rate of 5.2 % in 2019 and 4.6 % in 2020.

The budget position has improved significantly in recent years, with strong economic growth boosting tax revenues. The exceptionally high surplus in 2017 stemmed from the marked increase in current revenue which resulted from the tax-rich composition of growth, including high corporate profits, and higher-than-expected proceeds from the Individual Investor Programme (the citizenship scheme) in that year. The general government surplus is expected to decline from 3.5 % of GDP in 2017 to 1.2 % of GDP in 2019. Part of the decline in the budget surplus is driven by continued growth in spending. Gross government debt is below 60 % of GDP and is projected to continue falling.

The banking sector remains sound, but shortcomings in anti-money laundering enforcement also imply reputational risks. Overall, the banks remain profitable. Their capital base is sound, liquidity ample, and the credit risks have been further reduced. The soundness and resilience of Malta's banking sector were also confirmed by the comprehensive results of a stress test using the European Banking Authority's methodology. At the same time, recent investigations involving money laundering have revealed shortcomings in Malta's anti-money laundering enforcement.

Focussing investments on skills development, innovation, infrastructure and natural resource management would strengthen the sustainability of Malta's economic growth. The recent shift towards the services sector has helped boost productivity. Investment has stabilised at a relatively high level, supported in particular by construction. In the long run, the increased economic activity may exacerbate existing bottlenecks and put further pressure on natural resources and infrastructure, while labour shortages, low skill levels and low innovation reduce firms' growth prospects. Investment is needed to support environmental sustainability, enhance educational outcomes and skills, and improve the innovation framework. Annex D of this report identifies key priorities for support by the European Regional Development Fund, the European Social Fund Plus and the Cohesion Fund for the 2021-2027 period in Malta, building on the analysis of investment needs and challenges outlined in this report.

Malta has made limited progress in addressing the 2018 country-specific recommendations. ([2])

There has been limited progress in the following areas:

- Regarding the governance framework, some steps have been taken to strengthen financial

([1]) This report assesses Malta's economy in light of the European Commission's Annual Growth Survey published on 21 November 2018. In the survey, the Commission calls on EU Member States to implement reforms to make the European economy more productive, resilient and inclusive. In so doing, Member States should focus their efforts on the three elements of the virtuous triangle of economic policy — delivering high-quality investment, focusing reforms efforts on productivity growth, inclusiveness and institutional quality and ensuring macroeconomic stability and sound public finance.

([2]) Information on the level of progress and actions taken to address the policy advice in each respective subpart of a country-specific recommendation is presented in the overview table in the Annex.

supervision and anti-money laundering enforcement, but shortcomings in the anti-corruption framework persist.

- Efforts to ensure that the healthcare and pension systems are sustainable remain limited.

Regarding progress towards the national targets under the Europe 2020 strategy, Malta has met its targets on employment and tertiary education attainment and it appears to be on track to meet its renewable energy target. Additional efforts are needed to achieve the targets for raising R&D expenditure, reducing early school leaving, reducing poverty, reducing greenhouse gas emissions and improving energy efficiency.

Malta performs relatively well on the indicators of the Social Scoreboard supporting the European Pillar of Social Rights, although challenges remain. The overall employment rate is above the EU average and long-term unemployment rates are low. Nonetheless, Malta continues to face challenges regarding equal opportunities. The gender employment gap remains large and the gender pay gap is widening. The employment rate of older workers is particularly low. In addition, early school leaving is still very high, overall skills attainment is low and access to quality education uneven, disadvantaging lower socio-economic groups. Social and labour market outcomes are poor for people with disabilities.

Key structural issues analysed in this report, which point to particular challenges for Malta's economy, are the following:

- **The sound budgetary situation might hide the risk of financing permanent expenditure with potentially temporary revenue.** The budget has benefited from the increase of revenues. At the same time, the weight of corporate income taxes in total tax revenues implies that the budget is highly sensitive to economic shocks and to international initiatives in the area of corporate taxation. In addition, public expenditure is projected to increase faster than revenue in the next few years, due to higher public investment and higher current expenditure. This points to the possible risks of financing permanent expenditure increases from potentially temporary revenue flows.

- **The increase in age-related spending represents a substantial risk to the long-term sustainability of public finances.** Age-related public spending in the healthcare and pension systems is expected to increase significantly compared to other EU countries, indicating a risk of rising debt in the long term. Several measures aim at increasing the adequacy of pensions, and ongoing efforts have helped to increase labour supply and prolong working lives. Measures to decentralise services from hospitals to primary care and to improve the provision of long-term care services are ongoing. Their impact on fiscal sustainability has yet to materialise.

- **Malta's tax rules appear to be used in aggressive tax planning structures, but some steps are being taken to limit such practices.** Some elements that may facilitate tax planning include the absence of withholding taxes on interest, royalties and dividends or the residence and citizenship by investment schemes. However, Malta has taken steps to amend aspects of its tax system to curb aggressive tax planning, in particular by implementing European and internationally agreed initiatives.

- **Capacity for supervising the financial sector is improving, but risks and challenges are increasing.** A large number of financial institutions, both foreign banks and insurance companies mainly operating across borders, are registered in Malta. Efforts are ongoing to ensure proper supervision, but additional challenges for the financial supervisor have arisen. These are due to stricter international requirements to increase financial supervision, and the new tasks of granting new licences for crypto-currencies. A stronger supervisory framework is warranted to maintain Malta's reputation and attractiveness as an international financial centre.

- **Ensuring higher standards of anti-money laundering supervision and actual enforcement remains a challenge.** Malta has a growing reliance on service sectors that are considered particularly vulnerable to money laundering practices. Moreover, recent investigations involving money laundering have revealed serious shortcomings in Malta's anti-money laundering enforcement framework. Sanctions, however, are rarely imposed. While Malta is currently making improvements, the size of the challenges requires particularly high standards of anti-money laundering supervision and better enforcement.

- **The housing market remains buoyant and deserves continuous monitoring.** The housing market dynamism, reflected in increasing construction activity, rising house prices and lending, is likely to continue in the near future. While overall risks to financial stability from real estate remain contained, if recent trends continue they may lead to potential macro-financial imbalances. Action is being taken to regulate the rental market.

- **Labour market performance is solid, but some groups are disadvantaged and labour shortages persist.** Employment growth has been strong, with increasing labour market participation and declining unemployment. Recent reforms have improved the functioning of the labour market and increased labour supply. However, inactivity is comparatively high, the gender gap is still large and the employment rate of people with disabilities and older workers is low. Labour shortages across sectors continued to increase, contributing to increasing the reliance on foreign labour.

- **Poor educational outcomes may limit growth prospects.** In spite of high public investment in education, educational outcomes remain poor, with major disparities linked to socioeconomic background, disability status and type of school. Early school leaving is among the highest in the EU and participation of the low-skilled in adult learning remains low. The systematic identification of skill requirements to support the transition to a more sustainable economic development model is so far lacking.

- **Poverty and social exclusion decreased, but the large inflow of foreigners creates integration challenges.** The risk of poverty and social exclusion has fallen but remains at a high level for children, people with disabilities and non-EU migrants. Demographic trends are putting pressure on the provision of services, including education, housing, health and long-term care.

- **The research and innovation potential of Maltese firms remains limited.** Malta's innovation performance is gradually improving but remains relatively modest. R&D is largely dependent on foreign direct investment, while domestic innovation is lacking. Access to finance is more difficult for innovative firms without collateral. The effectiveness of existing measures to support home-grown research and innovation remains limited.

- **The mounting pressure on infrastructure creates sustainability challenges.** The increasing population, the growing demand in the housing market and the growth of tourism intensify pressure on land and scarce water resources. Heavy reliance on waste disposal exacerbates the challenge. Traffic congestion remains an issue, as it has significant economic, social and environmental costs. The impact of planned policy actions on modal shift from private cars remains limited as public investment in land transport is mostly focused on improving road quality. There is untapped potential to increase energy efficiency and to strengthen climate action. Targeted investment may contribute to the shift towards a more sustainable and resource-efficient economy.

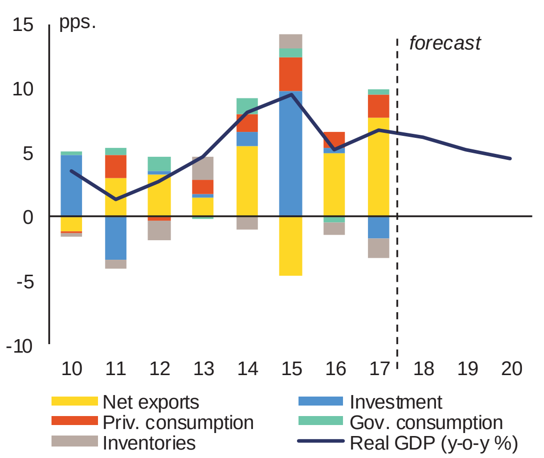
- **Shortcomings in the governance framework could weigh on the investment climate**. Survey indicators identify corruption and inefficiencies in the justice system as problematic factors in Malta. Recent reforms have yet to fully ensure the independence of the judiciary. The anti-corruption institutional framework has shortcomings, and there exists a risk of conflict of interest at various levels of government. The Economic Crimes Unit of the police is currently understaffed. A strengthened governance framework is a prerequisite to fully reaping the benefits of investment.

1. ECONOMIC SITUATION AND OUTLOOK

Economic growth

Malta's economy continues to grow at a sustained pace, amid long-term sustainability challenges. In recent years the economy has been characterised by high GDP and employment growth, a fiscal surplus and a buoyant services sector. Real GDP growth in 2018 is estimated at 6.2 %, moderating from the 6.7 % growth recorded in 2017. While net exports were the main growth driver in 2016-17, domestic demand is set to become the most important growth contributor in 2018 (see Graph 1.1). Private consumption, in particular, has grown robustly on the back of high employment growth and higher disposable income. Public consumption reflected higher compensation of employees in the public sector. Investment has started to recover, following the sizeable drop recorded in 2017. Private investment growth in the first half of 2018 was driven by residential construction and investment in machinery and equipment (see also Section 3.4). As the growth momentum continues, the main challenges concern the long-term sustainability of Malta's development.

Graph 1.1: **Demand components of GDP annual growth**



Source: European Commission

Economic growth is fuelled by the services sector. The Maltese economy has developed a vibrant, internationally oriented services sector. The tourism industry is one of the main pillars of the economy, with increasing numbers in both inbound visitors and tourist expenditure. The gaming sector has steadily increased its contribution to economic activity, and created around 11 % of the value added in 2017 (see also Section 3.4.2). Moreover, the gaming industry contributes to the economic performance of other major sectors, including professional services, ICT (information and communication technology), financial activities and real estate. Looking at the general performance of the services sector, in the first half of 2018 substantial gains were recorded in most areas. Gross value added from financial and insurance activities grew by more than 10 % over the same period of 2017. Business services, real estate activities and recreation activities (which include gaming) also showed sustained growth rates. The strong external dimension of the services sector reflects Malta's specialisation as an international services centre. In particular, financial and insurance operators, as well as remote gaming companies, serve almost exclusively foreign customers (see also Section 3.2).

Short-term growth is projected to moderate but to remain strong, supported by domestic demand. Growth is expected to gradually ease in the short-term, to an annual average rate of 5.2 % in 2019 and 4.6 % in 2020. Domestic demand is set to be the main driver of growth, supported by strong investment growth. Starting from 2019, investment growth is to be boosted by large-scale infrastructure projects in the health sector and investments in the tourism and real estate sectors. The public investment profile is expected to benefit from various investment projects co-financed by EU structural funds. Private consumption is projected to remain dynamic, on the back of increasing labour market participation and disposable income. Export growth is expected to slow down from the high growth rates registered in recent years, in line with the projected moderation in global demand, while imports are expected to rise, driven by investment growth.

Inflation

Inflation, previously subdued, has started to gradually accelerate. Average annual inflation in the period 2014-2017 was slightly above 1 %. Headline inflation began to accelerate in the second quarter of 2018 and reached 1.7 % by the end of the year, in line with the euro area average. In part, the acceleration reflects the statistical impact of the increase in the weight of accommodation services in the price index basket for 2018. Due to the combination of relatively high services inflation and low energy inflation (resulting from regulated electricity prices), average core inflation was slightly higher than headline inflation in the first three quarters of 2018, despite the international oil price increase.

Growth outlook and risks

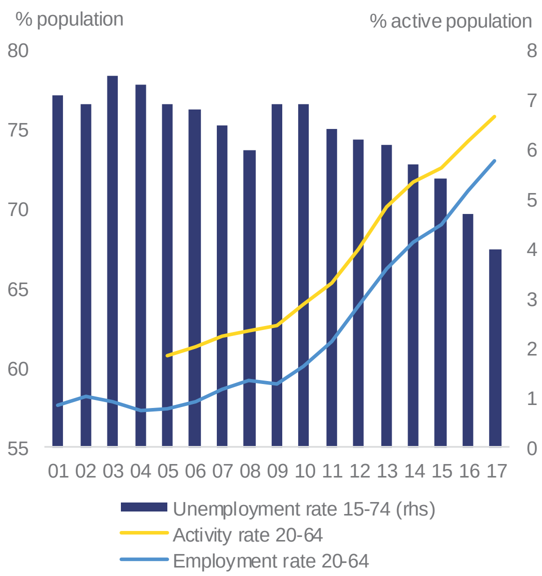
Short-term risks to the outlook are mainly linked to global trade demand. Further escalations in global trade tensions, intensification of geopolitical uncertainties and increasing protectionism could limit economic growth given Malta's small and open economy.

Existing investment bottlenecks may intensify and hamper growth in the long term. Given that the strong growth momentum appears to have been driven by structural changes, economic growth in the near term is expected to continue at a relatively sustained pace. In the long run, the increased economic activity may exacerbate existing bottlenecks and put further pressure on natural resources and infrastructure constraints (see Section 3.4). Persistent low skill levels and population ageing constitute additional challenges. Existing investment gaps in terms of human capital and innovation ecosystem (see Section 3.3 and 3.4), if not addressed, would weigh on the sustainability of Malta's development. Reducing the remaining fiscal risks and the reputational risks linked to the vulnerabilities of the governance framework (see Section 3.2. and 3.4), may further enhance the economy's resilience.

Labour market and social developments

On the back of strong and sustained economic growth, the labour market continues to perform well. The unemployment rate dropped to 4.0 % in 2017 and employment growth remained robust (see Graph 1.2). The employment rate (20-64) has risen above the EU average and reached 74.4 % in Q2-2018. The activity rate continues its gradual rise and labour migration inflows to fill vacancies remain substantial. Youth unemployment remains much below the EU average.

Graph 1.2: **Activity, employment and unemployment rates**

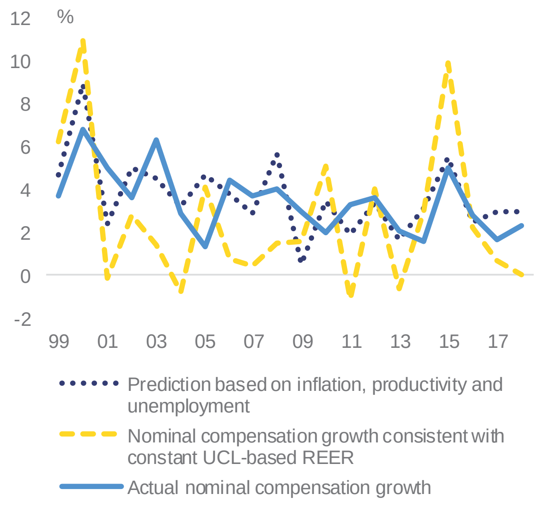


Source: European Commission

Nevertheless, labour and skill shortages can hamper growth and its inclusiveness. The share of employers reporting labour shortages has continued to increase across sectors. Although closing, the gender employment gap (24.1 pps in 2017), is still one of the largest in the EU, as shown in the indicators of the Social Scoreboard supporting the European Pillar of Social Rights. The participation of people with disabilities in the labour market also remains low. The high proportion of population with low skills and school dropout rates affecting children hamper efforts to reach sustainable and inclusive growth.

The tightening labour market is expected to result in increased wage pressures. In 2017, wage growth was contained by rising labour supply resulting from inflows of foreign workers and higher participation of women in the labour market. As a result, nominal compensation per employee increased moderately by 1.7 %, while real (GDP-deflated) wages declined by 1.1 %. Nominal compensation per employee is expected to increase faster, by 2.3 % in 2018 and 3.2 % in 2019. Combined with modest productivity growth, this is projected to lead to rising unit labour costs (1.9 % in 2018 and 2019). Overall, nominal wage growth in recent years has been broadly in line with macroeconomic developments. Given the observed changes in labour productivity, prices and the unemployment rate, nominal wages have grown slower than expected but are still higher than the rate which would be consistent with a stable cost competitiveness (see Graph 1.3) ([3]).

Graph 1.3: **Nominal compensation growth: actual and benchmarks**



Source: European Commission services calculations

Overall poverty and social exclusion is receding, but it is increasing for some groups. Poverty and social exclusion risks have declined (19.2 %, 2017) and compare favourably with 2008. However, children in single-parent, large, and low-to medium-skilled families are at greater risk of poverty. The large inflow of irregular migrants may create integration challenges, reflected in their high risk of poverty and social exclusion particularly in a context of increased housing costs.

Inequality in both income and wealth is moderate, but efforts on universal access to education need to continue. While the share of income held by the richest 20 % of households remains fairly stable, there is evidence of an increase in the richest quintile in 2017. Net wealth is also relatively evenly distributed, reflecting the even distribution of housing assets across the population.

Regional and local dimension

In terms of regional gaps, disparities exist between the island of Malta and the island of Gozo. The small island of Gozo, which is currently dependent on the sea transport link with the island of Malta, is less accessible, has scarce access to services and has fewer job opportunities than mainland Malta. GDP per capita in Gozo is 54 % of the EU average compared to 96 % in mainland Malta. The island of Malta offers better labour market opportunities that drive inter-island migration and a high level of work commuting: one in five employed people residing in Gozo works in Malta. Disparities between Malta and Gozo are also significant in terms of the proportion of young people living there, the tourism seasonality, and the prosperity of businesses and productivity (which stands at 70 % of EU average in Gozo against 92 % in mainland Malta). Depopulation due to the weaknesses listed could exacerbate this trend.

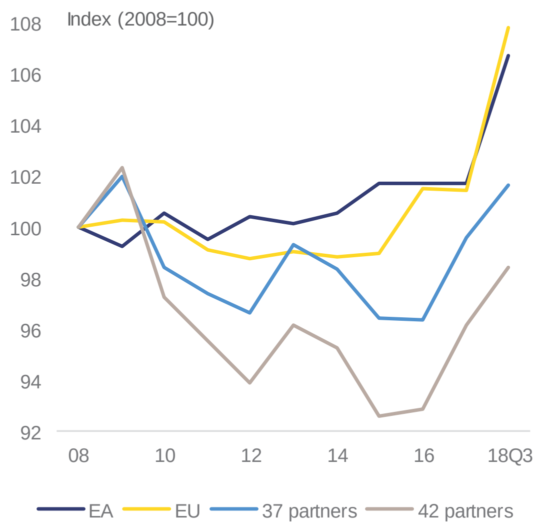
Competitiveness

Price growth and exchange rate movements have been dampening Malta's competitiveness in the external markets. Between 2008 and 2016, Malta's price competitiveness improved as the real effective exchange rate depreciated by almost 10 % compared to its top 42 trading partners, while it remained mostly unchanged within the euro area (see Graph 1.4). The trend reversed as of 2017, as a result of the euro appreciation against major currencies. In 2018, the depreciation of the British pound, together with pressures in the domestic labour market and in overall prices, has reduced Malta's external cost and price competitiveness.

Export performance in goods has been declining, reflecting strong specialisation in services. Malta's export market share for services (0.26 % of the world total in 2017) is around three times higher than its export market share for goods. However, from 2012 to 2017, its goods export market share decreased by 16.6 %.

([3]) The European Commission regularly assesses whether wage developments support macroeconomic rebalancing or, on the contrary, are a source of potential macroeconomic imbalances. The assessment relies on comparing actual wage developments with two hypothetical benchmarks consistent with Member States' internal or external economic equilibrium: (i) the wage growth which would be predicted on the basis of changes in labour productivity, prices and the unemployment rate; (ii) the wage growth which would be consistent with a constant real effective exchange rate based on unit labour costs.

Graph 1.4: **Real effective exchange rate, different trading partners**



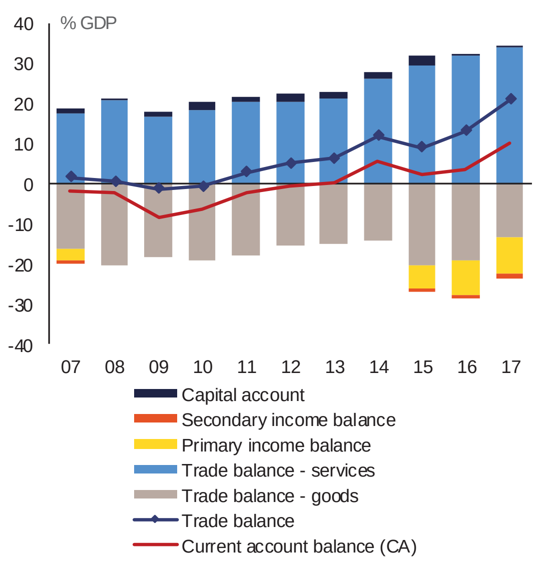
Deflator: Consumer Price Index
Source: European Commission

Overall competitiveness continues to be supported by favourable framework conditions, although certain barriers to investment persist. Malta ranked 36th out of 140 countries in the *2018 Global Competitiveness Report*, one position higher than the previous year. Its performance is remarkable in indicators such as macroeconomics (1st), trademark applications (2nd), active labour policies (19th) and ICT adoption (24th). According to a *Eurobarometer* survey (European Commission, 2018a), Malta performs well compared with the EU average on existing barriers to investment. However, the length of legal proceedings was identified as an obstacle to investment by around one third of the companies interviewed. Also, more than 60 % of companies reported the availability of adequate skills in the labour market as an obstacle to investment. In the long run, low skill levels and reliance on foreign labour could further curb the competitiveness of the Maltese economy.

External position

Malta's exceptionally open economy shows a sizeable surplus in the current account balance. Malta's external performance in recent years has been characterised by a sizeable current account surplus, which rose to 10.4 % of GDP in 2017 and remained broadly stable in the first half of 2018. In particular, the solid performance of the export-oriented services sector is reflected in a gradually increasing trade surplus in services. The goods trade balance started to gradually improve in 2016 to further accelerate in 2017 and stabilize in the first half of 2018, following a peak in the goods trade deficit in 2015. Total exports in 2017 stood at around 135 % of GDP, while imports stood at around 116 %, making Malta one of the most open economies in the EU.

Graph 1.5: **Decomposition of current account**

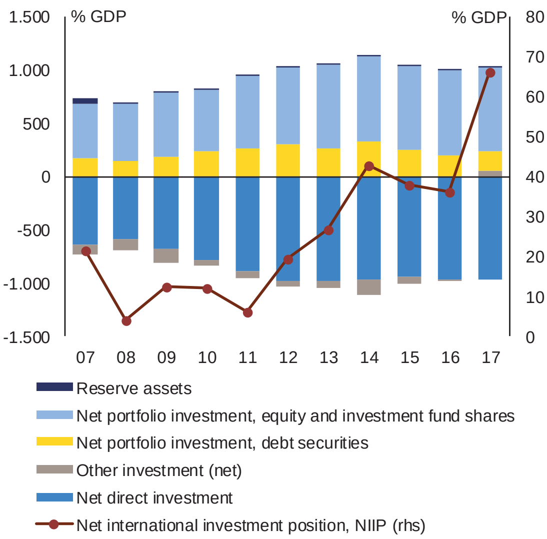


Note: Data on primary income and secondary income are not available for the period 2008-2014.
Source: European Commission

The current account surplus reflects the strong external performance in the services sector. The large current account surplus reflects a large surplus in the balance of services, which has grown substantially since 2014 to reach 34 % of GDP in 2017 (see Graph 1.5), slightly narrowing in the first half of 2018. Exports of services have been boosted predominantly by remote gaming activities and tourism. The external balance of the financial sector declined slightly but remained high, while that of the transport sector increased significantly. The present level of the current account surplus exceeds the current account norm estimated by the European Commission (Coutinho et al., 2018). According to the underlying calculations, about half of the excess current account surplus can be attributed to dynamics in credit and global factors. The large residual could be explained by the presence of large internationally oriented businesses and the growing importance of cross-border activities.

In terms of external financial assets and liabilities, Malta is a creditor country. Malta's net international investment position is strongly positive. Despite a slight decline in the first half of 2018 from 66.2 % to 63.9 %, the net international investment position remains among the highest in the EU as a share of GDP. In terms of geographical distribution, by mid-2018 EU Member States were the counterpart of respectively 65 % and 64 % of Malta's external financial assets and liabilities. The high volume of foreign direct investment in the Maltese economy (see Graph 1.6) is counterbalanced by net portfolio assets, in particular equity instruments. Banking and insurance activities contributed to 98 % of the total stock of foreign direct investment in Malta in 2017.

Graph 1.6: **Breakdown of net international investment position by instrument**



Source: European Commission

Financial sector

While the total banking sector narrowed, the part of the sector directly linked to the local economy further expanded. The assets of the total banking sector in Malta fell to 401 % of GDP by June 2018, from around 430 % at the end of 2017. The assets of core domestic banks, which have strong links with Malta's economy and are thus economically most relevant, increased by 1.5 % and, in terms of GDP reached 201.5 % in June 2018. Non-core domestic banks (with limited links to the domestic market) expanded their balance sheet by 18.8 %, to 22.5 % of GDP. By contrast, internationally oriented banks (those with no links to the domestic economy) saw their assets contracting by 28 pps in the same period, to 177.1 % of GDP. This decline, which has started in 2015, was interrupted in the last quarter of 2017 and resumed at the beginning of 2018. The drop in the first half of 2018 was driven mainly by a reduction in the assets of the three branches of foreign banks, while the downsizing of the other banks was limited.

Overall loan growth to domestic clients is in line with economic growth. The increase in domestic banks' assets was driven by faster loan growth, on the back of increased lending to households. Banks have continued to engage in mortgage contracts and now almost 60 % of resident loans are property-related. However, related risks seem limited as, by international comparison, banks apply a relatively stringent credit risk policy, with a 30 % haircut on the market value of the property. Furthermore, only 50 % of the mortgage market has been funded by banks' lending, while the other half comes from the households' resident and non-residents' savings. While lending to non-financial corporates remains weak, it started increasing in 2018. Meanwhile, the exposure to governmental entities was further reduced in 2018 ([4]).

On the liabilities side, domestic banks are highly liquid. Domestic banks fully rely on retail deposits, most of which are from domestic residents. The growth of deposits has continued to moderate in 2018, following years of steady rise. In June, residents' deposits grew by 3.2 %, down from 5.0 % at the end of 2017. Overnight deposits remained residents' preferred financial instrument. Non-residents' deposits have been declining, representing around 5 % of total deposits held in the domestic banking sector in June 2018 (against 15 % in 2017). For the sector as a whole, the loan-to-deposit ratio remained roughly stable at about 65 % in Q2-2018. For domestic banks, deposits cover the total loan portfolio, and the exposure to

([4]) Loans to the general government increased by 5.7 pps in June 2018 since end-2017, and represent 5.1 % of the total domestic banks' loan portfolio. In a similar vein, banks reduced their exposure to the Maltese sovereign, holding about EUR 1.5bn of short-term bills, representing 7.4 % of their total balance sheet.

European Central Bank (ECB) funding, at 0.2 % of their total funding needs, is marginal and has further decreased.

The banking sector has performed well despite new accounting rules that require extra provisioning. Overall, the banks preserved their profitability, their capital base is sound, liquidity ample, and the credit risk has been further reduced. Domestic banks have been able to maintain levels of profitability in line with their euro area counterparts during 2018 on an annual basis, supported by their ability to widen interest margins slightly. In 2018 interest income increased and net interest income remained the main source of income. The comprehensive results from a stress test using the European Banking Authority methodology confirm the soundness and resilience of the Maltese banks subject to the test, and highlight the resilience of Malta's banking sector.

Other financial institutions registered mixed developments. The domestic insurance sector further expanded, reaching 96 % of GDP in June 2018 from 88.3 % of GDP in 2017. By contrast, investment funds shrank in 2018, after the expansion experienced in 2017. This sector decreased from 89.5 % of GDP in 2017 to 73.9 % of GDP in September 2018.

The supervisory capacity is not fully in line with the size and international dimension of the financial sector. An effective supervisory framework is crucial to safeguard financial stability and protect Malta's attractiveness as an international financial centre. There are a large number of foreign banks and insurance companies registered in Malta. Recent investigations involving money laundering have exposed serious shortcomings in Malta's anti-money laundering enforcement framework. Also, the European Commission requires the anti-money laundering supervisor to step up supervision of banks. In addition, to secure access to the global financial network, ongoing compliance to international regulations remains essential.

Private sector debt

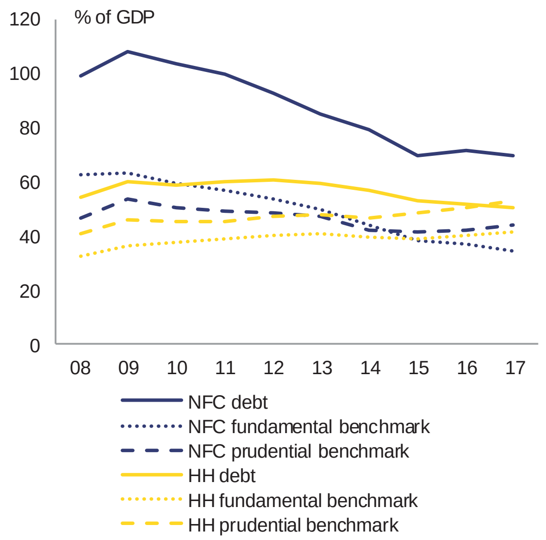
Private sector debt, albeit declining, is still high, in particular for the corporate sector. Private sector consolidated debt as a share of GDP has been declining from its 2009 peak, on the back of the sustained economic growth. However, European Commission debt benchmarks ([5]) suggest that both household debt and non-financial corporations debt remain high (see Graph 1.7). In particular, non-financial corporations consolidated debt reached 7.8 billion euros in 2017 (around 70 % of GDP), with loans constituting more than 90 % of consolidated non-equity liabilities. Meanwhile, household debt as a share of GDP stood at 50 % in 2017, slightly lower than previous year. ([6])

Businesses are increasingly financing their activities outside banking circuits, partially via intercompany loans. From 2007 to 2017, bank loans declined from 47 % to 23 % of total non-financial corporations debt. In addition, Malta is one of the EU countries with the highest difference between consolidated and non-consolidated non-financial corporations debt (see Graph 1.8). This large difference is linked to the presence of multinational companies and related intra-group cross-border lending activities. Debt securities represent a marginal but growing source of finance, as the value of bonds issued doubled between 2011 and 2017. As the Maltese capital market remains underdeveloped, companies often use intercompany financing, and in particular intra-group lending, as an alternative source. Between 2007 and 2017, intra-group loans increased from 19 % to 38 % of corporate funding (CBM, 2018a).

([5]) Fundamentals-based benchmarks are derived from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. Prudential thresholds represent the debt threshold beyond which the probability of a banking crisis is relatively high, minimising the probability of missed crisis and that of false alerts. Methodologies are described in European Commission, 2017a. Updates to the methodology have been subsequently proposed in European Commission, 2018b.

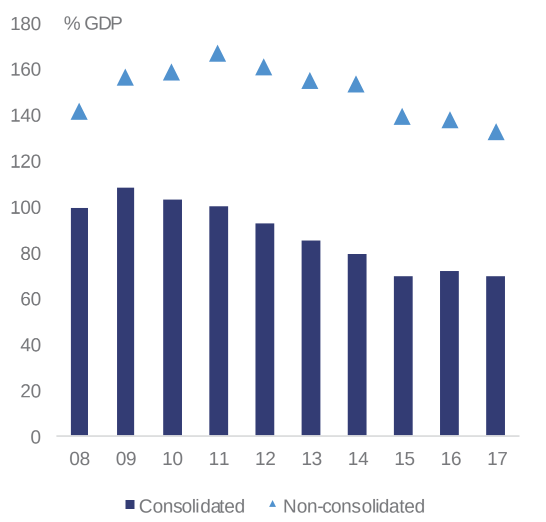
([6]) The analysis of Malta's private sector debt is constraint by data limitations (indicators such as household debt-to-gross disposable income or NFC debt-to-gross operating surplus cannot be calculated).

Graph 1.7: **Private sector debt: gaps to prudential and fundamental-based benchmarks**



NFC stands for non-financial corporations and HH for households. NFC data is referent to consolidated debt.
Source: European Commission

Graph 1.8: **Consolidated vs non-consolidated debt, NFC**



Source: European Commission

Public finances

The budget balance is expected to moderate in the next years, from the high surplus recorded in 2017. The fiscal position improved in recent times and turned into surplus in 2016. The general government surplus is expected to decline to 1.2 % of GDP in 2019 compared with a surplus of 3.5 % of GDP in 2017. In structural terms, the surplus is expected to decrease sizeably from 3.1% in 2017 and to stabilise at 0.9% of GDP in 2018-2019. The exceptionally high surplus in 2017 was the result of a (i) the high growth rate of current revenue resulting from the tax-rich composition of growth, and (ii) higher-than-expected proceeds from the Individual Investor Programme ([7]), at 2.2 % of GDP in that year.

Public debt has fallen sharply and is well contained in the short-to-medium term. After peaking at 70.1 % of GDP in 2011, public debt fell to 50.9 % of GDP in 2017, below the 60 %-of-GDP threshold and the euro area average (88.9 % of GDP). It is forecast to drop further to 42.1 % in 2020. However, contingent liabilities are significant in Malta. At the end of 2017, existing public government guarantees provided by central government for the debt of non-government units stood at 9.6 % of GDP.

Despite the improvement in public finances, risks to long-term sustainability remain. The fiscal position has benefited from the stronger revenues. Corporate income taxes make up a larger proportion of tax revenues than in the rest of the EU, implying greater sensitivity to economic shocks. In addition, in the medium- to long-term horizon, international initiatives in the fight against tax avoidance could have an impact on tax revenues and the fiscal position of the country. In addition, public expenditure is projected to increase at a higher rate than revenue in the coming years. The increase in expenditure is related to both public investment, which is closely related to the EU fund cycle, and current expenditure. This seems to point to possible risks associated with financing permanent expenditure increases from potentially temporary revenue flows. In addition, sustainability challenges remain due to the projected increase in age-related budgetary costs, in particular in the healthcare and pension systems (see Section 3.1).

([7]) The Individual Investor Programme was established by LN 47/2014. This scheme grants naturalisation to foreign individuals and their dependants following substantial investment and fulfilment of certain other criteria. In national accounts, it is recorded as both negative government expenditure and exports of services.

Table 1.1: **Key economic and financial indicators — Malta**

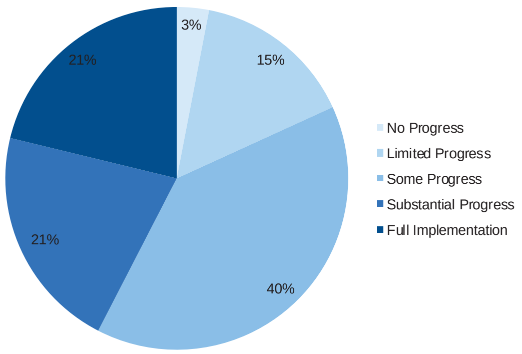
						forecast		
	2004-07	2008-12	2013-15	2016	2017	2018	2019	2020
Real GDP (y-o-y)	2,5	1,7	7,9	5,7	6,6	6,2	5,2	4,6
Potential growth (y-o-y)	2,5	2,4	5,4	6,9	6,8	6,1	5,4	5,2
Private consumption (y-o-y)	2,1	0,8	3,1	2,7	3,6	.	.	.
Public consumption (y-o-y)	1,0	3,8	3,3	-2,8	2,8	.	.	.
Gross fixed capital formation (y-o-y)	6,0	-2,9	18,8	-0,1	-7,7	.	.	.
Exports of goods and services (y-o-y)	7,4	6,7	6,5	4,4	5,3	.	.	.
Imports of goods and services (y-o-y)	7,6	6,2	5,8	1,4	-0,1	.	.	.
Contribution to GDP growth:								
Domestic demand (y-o-y)	2,8	0,6	5,8	0,8	0,3	.	.	.
Inventories (y-o-y)	0,0	0,3	0,3	0,3	-1,9	.	.	.
Net exports (y-o-y)	-0,3	0,8	1,6	4,7	8,2	.	.	.
Contribution to potential GDP growth:								
Total Labour (hours) (y-o-y)	0,5	0,6	2,1	2,9	3,5	3,1	2,3	2,1
Capital accumulation (y-o-y)	1,4	0,9	1,3	2,3	1,7	1,6	1,7	1,7
Total factor productivity (y-o-y)	0,6	0,9	2,0	1,7	1,7	1,4	1,4	1,3
Output gap	0,2	-1,3	0,9	1,6	1,5	0,9	0,4	-0,4
Unemployment rate	6,9	6,5	5,7	4,7	4,0	3,3	3,4	3,4
GDP deflator (y-o-y)	2,3	2,8	2,3	1,5	2,4	2,2	2,2	2,1
Harmonised index of consumer prices (HICP, y-o-y)	2,1	2,9	1,0	0,9	1,3	1,7	1,8	1,9
Nominal compensation per employee (y-o-y)	3,1	3,2	3,1	2,8	1,8	2,3	3,2	3,1
Labour productivity (real, person employed, y-o-y)	1,1	-0,3	3,5	1,5	1,2	.	.	.
Unit labour costs (ULC, whole economy, y-o-y)	1,9	3,5	-0,3	1,4	0,6	1,9	1,9	2,1
Real unit labour costs (y-o-y)	-0,4	0,7	-2,6	-0,1	-1,8	-0,3	-0,3	-0,1
Real effective exchange rate (ULC, y-o-y)	1,9	0,9	-1,5	0,4	1,4	2,1	-0,8	0,1
Real effective exchange rate (HICP, y-o-y)	1,0	-0,7	-0,9	1,5	1,3	2,1	-1,4	-0,3
Savings rate of households (net saving as percentage of net disposable income)	.	.	.	.	.	.	.	.
Private credit flow, consolidated (% of GDP)	9,8	7,7	3,1	11,1	2,8	.	.	.
Private sector debt, consolidated (% of GDP)	138,0	159,4	133,3	121,5	118,6	.	.	.
of which household debt, consolidated (% of GDP)	46,8	58,7	55,9	51,1	49,7	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	91,1	100,6	77,4	70,4	68,8	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (2)	1,7	1,6	2,7	2,4	2,0	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	.	.	.	.	.	.	.	.
Corporations, gross operating surplus (% of GDP)	.	.	.	.	.	.	.	.
Households, net lending (+) or net borrowing (-) (% of GDP)	.	.	.	.	.	.	.	.
Deflated house price index (y-o-y)	13,5	-0,7	1,5	4,8	4,1	.	.	.
Residential investment (% of GDP)	6,9	3,9	2,6	3,5	4,7	.	.	.
Current account balance (% of GDP), balance of payments	-4,7	-2,2	4,6	3,4	10,4	12,3	11,2	10,6
Trade balance (% of GDP), balance of payments	-1,6	1,4	8,4	11,6	19,5	.	.	.
Terms of trade of goods and services (y-o-y)	0,1	0,0	0,4	0,2	0,6	0,0	0,2	0,1
Capital account balance (% of GDP)	2,3	1,3	1,7	0,4	0,6	.	.	.
Net international investment position (% of GDP)	30,7	11,0	36,0	36,2	66,2	.	.	.
NIIP excluding non-defaultable instruments (% of GDP) (1)	87,2	172,6	211,7	208,0	245,4	.	.	.
IIP liabilities excluding non-defaultable instruments (% of GDP) (1)	454,5	713,5	631,6	456,3	419,6	.	.	.
Export performance vs. advanced countries (% change over 5 years)	.	36,9	3,2	6,3	19,2	.	.	.
Export market share, goods and services (y-o-y)	.	.	1,2	7,8	-0,4	.	.	.
Net FDI flows (% of GDP)	-155,4	-79,2	-88,1	-80,2	-80,9	.	.	.
General government balance (% of GDP)	-2,9	-3,1	-1,7	0,9	3,5	1,3	1,2	0,7
Structural budget balance (% of GDP)	.	.	-2,4	0,3	3,1	0,8	0,9	0,9
General government gross debt (% of GDP)	67,2	67,1	63,6	56,3	50,9	47,9	44,8	42,1
Tax-to-GDP ratio (%) (3)	33,0	33,4	33,2	32,6	33,4	33,6	33,7	33,8
Tax rate for a single person earning the average wage (%)	17,9	17,5	19,4	.	.	.	.	.
Tax rate for a single person earning 50% of the average wage (%)	8,3	8,6	10,0	.	.	.	.	.

(1) NIIP excluding direct investment and portfolio equity shares.
(2) Domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.
(3) The tax-to-GDP indicator includes imputed social contributions and hence differs from the tax-to-GDP indicator used in the section on taxation.
Source: Eurostat and ECB as of 31-1-2019, where available; European Commission for forecast figures (Winter forecast 2019 for real GDP and HICP, Autumn forecast 2018 otherwise)

2. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS

Since the start of the European Semester in 2011, 82 % of all country-specific recommendations addressed to Malta have recorded at least 'some progress'. 18 % of them recorded 'limited' or 'no progress' (see Graph 2.1). Substantial progress and full implementation have been achieved in the area of fiscal policy and fiscal governance as well as in certain areas of the labour market. Other areas with substantial progress have been the business environment and the energy sector.

Graph 2.1: **Overall multiannual implementation of 2011-2018 CSRs to date**



* The overall assessment of the country-specific recommendations related to fiscal policy exclude compliance with the Stability and Growth Pact.
** The multiannual CSR assessment looks at the implementation until the 2019 Country report since CSRs were first adopted.
Source: European Commission

Public finances have improved. The budget deficit averaged 3.2 % of GDP in 2004-2012. Since 2013, a continuing improvement in the budgetary situation has taken place, leading to a budget surplus of 3.5 % of GDP in 2017. The medium-term objective was achieved 3 years ahead of schedule and the government debt has fallen below the 60 %-of-GDP threshold. The improvement in the fiscal position was the result of both budgetary measures implemented in recent years, robust revenue growth supported by favourable macroeconomic conditions and by the strengthening of the fiscal framework. By contrast, limited progress has been achieved in improving the sustainability of public finances.

Despite substantial progress in diversifying the energy mix, dependency on oil products remains high. The completion of the electricity interconnector to Italy and the ongoing gasification of Malta's power plants represents important steps forward. Nevertheless, progress remains limited on energy efficiency, production from renewable sources and reduction of greenhouse gas emissions. The achievement of the EU 2020 energy efficiency target appears at risk. The promotion of solar energy and use of biofuels has allowed an increase in the shares of renewable energy in the energy mix, but further investment across the different sectors is lacking. Moreover, the country lacks a clear strategy to address its rising greenhouse emissions.

Efforts were made to target certain aspects of the business environment, but their impact appears still limited or difficult to assess. The implementation of judicial reforms in the area of civil, commercial and administrative justice is ongoing. It aims to improve the quality and efficiency of the justice system. However, shortcomings in the independence of the judiciary persist. The 2017 reform of the insolvency framework is expected to help reduce the costs and duration of relevant procedures, but it appears too early to assess its impact. Overall, policy measures put in place to improve access to finance for small and medium-sized enterprises and financed via EU funds appear adequate to addressing firms' needs. The financing schemes that will be managed by the Malta Development Bank are expected to provide a structural response to the financing gaps of riskier projects. On the other hand, market-based finance remains underexploited by small and medium-sized enterprises.

Some progress was achieved in improving human capital development and increasing labour market participation. The 'Make Work Pay' and pension reforms helped increase the labour supply. Women in employment is increasing although a large gender employment gap persists, working lives extending and reforms to attract older workers are beginning to bear fruit. A number of education and skills reforms were put in place to address human capital challenges, but their impact has not materialised yet. Early school leaving has declined considerably but remains high and educational outcomes are heavily influenced by socio economic background, type of school and disability status. Participation by the low-skilled in adult learning is low. Efforts to ensure people have the necessary skills to support the transition

Table 2.1: **Annual assessment of the 2018 CSRs**

Malta	**Overall assessment of progress with 2018 CSRs: limited progress**
CSR 1: *Strengthen the overall governance framework by enhancing the national supervision of internationally oriented financial businesses licensed in Malta, by ensuring the effective enforcement of the Anti-Money Laundering framework and by continuing to step up the fight against corruption.*	**Limited progress** on strengthening the overall governance framework.
CSR 2: *Ensure the sustainability of the healthcare and the pension systems, including by increasing the statutory retirement age and by restricting early retirement.*	**Limited progress** on ensuring the sustainability of the healthcare and the pension systems.

Source: European Commission

towards a greener and more circular economy are still limited.

Malta has made limited ([8]) progress in addressing the 2018 country-specific recommendations (see Table 2.1). There has been limited progress in strengthening the overall governance framework by enhancing the national supervision of internationally oriented financial businesses licensed in Malta, by ensuring the effective enforcement of the anti-money laundering framework and by continuing to step up the fight against corruption. In particular, some action has been taken to enhance the supervisory capacity and the performance of the financial regulator. However, no significant steps have been taken to strengthen enforcement of the anti-corruption framework. Progress in this area would also help to address issues from the 2018 Council Recommendation for the euro area on improving the business environment and the quality of institutions. The Maltese authorities have made limited progress in ensuring the sustainability of the healthcare and the pension systems, including by increasing the statutory retirement age and by restricting early retirement. It is not yet clear how the measures taken will affect the long-term fiscal sustainability outlook (see Annex A).

([8]) Information on the level of progress and actions taken to address the policy advice in each respective subpart of a CSR is presented in the Overview Table in the Annex. This overall assessment does not include an assessment of compliance with the Stability and Growth Pact.

Box 2.1: EU funds and programmes contribute to addressing structural challenges and to fostering growth and competitiveness in Malta

Malta receives up to EUR 828 million up until 2020 via the European Structural and Investment (ESI) Funds, representing 1.1 % of GDP annually over 2014-2020. The total amount of funding from the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund is EUR 727 million. By 31.12.2018, EUR 689 million (97.3 % of the total) has been allocated to concrete projects. In this context, over 2,900 firms have received support for new productive investment, 11,300 people benefited from training and support measures and almost 240 jobs are expected to be created. EUR 34 million will be delivered via financial instruments (more than a three-fold increase compared to 2007-2013). Malta also contributes EUR 15 million to the SME initiative. Out of the EUR 97 million that Malta receives from the European Agricultural Fund for Rural Development (EAFRD), EUR 57 million is allocated to agricultural and environmental investments. The European Maritime and Fishery Fund (EMFF) provides EUR 23 million contribution.

ESI Funds helps to address structural policy challenges and implement country-specific recommendations (CSRs). ESI Funds contribute to boosting investment in research and innovation and increasing the employment rate. Investments have been promoted to increase energy efficiency and to improve the water supply management system. A large number of measures taken in response to Malta's challenges and related CSRs are cofinanced by the ESF, with a particular focus on education and training, reducing early school leaving and improving the healthcare system.

Various reforms have been undertaken as preconditions for ESI Funds support ([1]). These include the timely transposition of the EU public procurement and environment directives into national legislation, structural reforms in research, development and innovation; transport infrastructure; education; employment and social inclusion; water supply. Many projects have been launched to stimulate private investments in key strategic areas, in line with the 'smart specialisation' strategy. These reforms prepared the ground for better implementation of all public investment projects. An important project for local transport (the Kappara junction) and two on cultural heritage (the restauration of the Manoel Theatre and MUZA, the Museum of Arts) have recently been inaugurated.

The Commission can provide tailor-made technical support upon a Member State's request via the Structural Reform Support Programme to help Member States implement growth-sustaining reforms to address challenges identified in the European Semester process or other national reforms. Malta, for example, is receiving support to develop capacity to carry out spending reviews. The Commission is also supporting the authorities to implement human resource changes in the public administration, develop a national energy and climate plan, and introduce the use of electronic payments in the economy. In 2018, work has started on improving the framework for the identification of students at risk of early school leaving, providing expertise to review existing processes and introducing recommendations to improve the public procurement system. Support measures are also under way to introduce digitalisation in the Maltese maritime sector.

European Fund for Strategic Investment (EFSI) financing in Malta amounts to EUR 11 million, which is set to trigger EUR 34 million in additional investments, with a particular focus on facilitating access to finance for small and medium-sized enterprises. In close cooperation with EFSI, additional support is provided by the European Investment Bank and the European Investment Fund (EIF). Examples include a project backed by the EFSI up to 5 EUR million, implemented by an intermediary bank. This project should trigger about EUR 17 million in investments and should allow 12 SMEs to benefit from improved access to finance. As an example of EIB financing, support was provided to STMicroelectronics to invest in research, development and innovation activities regarding the next generation of semiconductor devices.

Additional funding is provided under Horizon 2020, the Connecting Europe Facility and other funds directly managed by the EU. Under the calls launched within Connecting Europe Facility Transport, Maltese applicants submitted 14 eligible proposals; four projects were selected, with beneficiaries receiving EUR 45.1 million and investing EUR 56.9 million. Total investments from Horizon 2020 amount to EUR 20 million, with more than 800 applications submitted.

([1]) Before programmes are adopted, Member States are required to comply with a number of so-called ex-ante conditionalities, which aim at improving conditions for the majority of public investments areas.

3. REFORM PRIORITIES

3.1. PUBLIC FINANCES AND TAXATION

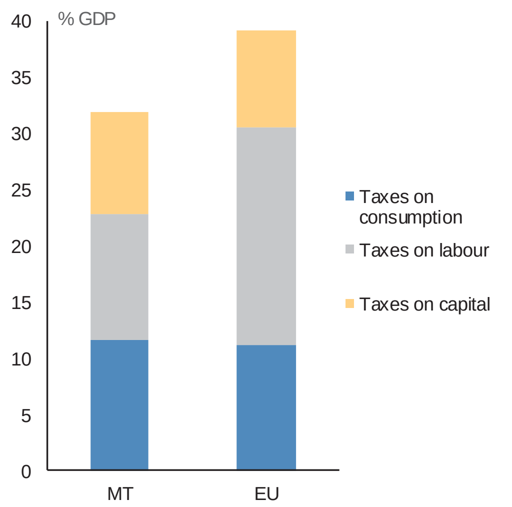
3.1.1. TAXATION

Policy measures and favourable economic conditions are supporting a fiscal balance. As described in Section 1, in 2016 Malta moved from a deficit to a surplus position, both in nominal and in structural terms. In addition, the debt ratio fell below the 60 %–of–GDP threshold in 2015. While the nominal surplus is set to decline to 0.7 % in 2020, the fiscal position is expected to remain sound in the short term. This improvement compared with 2015 is the result of both budgetary measures implemented in recent years and positive macroeconomic conditions boosting tax revenues.

Tax revenues remain low and are sensitive to economic and political developments. In 2017, Malta had an overall tax-to-GDP ratio of 31.9 % ([9]), well below the EU average of 39 % (see European Commission, 2019a). However, the share of corporate income ([10]) tax revenues in Malta's total tax revenue is one of the highest in the EU (20.3 % against an EU average of 7 %) and increasing. Consumption tax revenues are only slightly above the EU average (11.6 % of GDP against an EU average of 11.1 %). The country's taxes on labour (11.2 % GDP) and social contributions (5.3 % of GDP) are one of the lowest in the EU (19.4 % of GDP and 12.2 % of GDP, respectively) (see Graph 3.1.1). Given that capital and business income taxes are volatile over the businesses cycle, the high reliance on these taxes makes the fiscal position more sensitive to economic shocks and/or developments in the corporate tax framework for the EU and international tax reforms more broadly.

Several factors are expected to slowdown revenue growth in the medium term. Tax revenue growth is expected to slowdown from 11.9 % in 2017 to 7.0 % in 2020, following the moderation in economic growth. Also, measures supporting first-time and second-time buyers of residential property and decreasing direct taxation (in particular the tax rebate for pensioners and low income earners, the tax credit for education, and fiscal incentives for private pensions) are expected to reduce tax revenues. In addition, the directive on electronic commerce will reduce VAT revenues ([11]) by 0.2 % of GDP. Lastly, revenues related to the Individual Investor Programme are expected to fall from their 2017 peak to 1.5 % of GDP in 2018, and to stabilise at around 0.9 % of GDP in 2019.

Graph 3.1.1: **Tax revenue by economic function in 2017, Malta and EU**



Source: European Commission

High capital flows, coupled with the absence of withholding taxes on royalty, dividend and interest payments, may be an indication that tax rules are used in aggressive tax planning structures. Economic activity taking place in Malta only partially explains the country's high inward and outward foreign direct investment stock (IHS, 2018). Also, 'Special Purpose Entities'

([9]) Tax-to-GDP ratio differs from Table 1.1 as voluntary actual social contributions are not included.
([10]) Does not include revenues from capital stocks.

([11]) The measure refers to the loss of commission from the Mini One Stop Shop (MOSS), as per Council Implementation Directive (EU) No 1042/2013. The MOSS came into force on 1 January 2015 and replaced the former VAT on e-services. It allows taxable persons supplying telecommunication services, television and radio broadcasting services and electronically supplied services to non-taxable persons in Member States in which they do not have an establishment to account for the VAT due on those supplies via a web-portal in the Member State in which they are identified. VAT collected is eventually forwarded to the Member State where purchases are affected while a percentage of it is retained by the Member State. As from 2019, all VAT collected will be transferred and no more proceeds will be retained from this scheme.

continue to hold a large majority of foreign direct investment and there is a high level of dividends and royalty payments as a percentage of GDP (European Commission, 2018c). The absence of withholding taxes on outbound dividends, interest and royalty payments made by Malta-based companies may lead to payments escaping tax altogether, if they are not subject to taxes in the recipient country. Existing provisions in bilateral tax treaties between Malta and other countries in combination with some features of Malta's tax system, whereby a company being resident but not domiciled in Malta is taxed on a source and remittance basis ([12]) may be used for that purpose. According to the information available, Malta operates two residence and citizenship schemes: the Individual Investor Programme and the Residence and Visa Programme. Although these programs do not automatically grant residence for tax purposes, if requirements are met income may be exempt under the 'non-dom' regime (if income is not remitted to Malta) without substantial physical presence requirements. The documentation and status issued under these schemes may facilitate aggressive tax planning practices and they have been listed by the OECD as having a potentially high risk for being misused to circumvent the automatic exchange of financial account information by facilitating the concealment of the real jurisdictions of residence, effectively avoiding taxation. Finally, while the Notional Interest Deduction introduced in 2018 (European Commission, 2018c) is expected to significantly decrease Malta's previously high debt-bias (3.8 % ([13]) in 2017, the highest in the EU together with France), the scheme's anti-abuse rules, combined with its high return rate and non-incremental nature, warrant close monitoring. All the above elements suggest that companies and individuals might engage in tax avoidance by using Malta's rules.

Malta is acting to curb aggressive tax planning through the implementation of European and internationally agreed initiatives. In line with the rest of the EU, Malta is transposing into national law the two EU Directives on Anti-Tax Avoidance. Malta ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent the Base Erosion and Profit Shifting in December 2018 but has put reservations on numerous articles, although these are not minimum standard articles. The reservations significantly limit the effectiveness of implementation of the multilateral convention in Malta. A Competent Authority Agreement ([14]) between Malta and Ireland to make sure that the bilateral tax treaty between Ireland and Malta is not used for aggressive tax planning practices through the so-called 'Single Malt' structure has been published. Completing the merging of revenue departments ([15]) can help increase revenue collection and reduce tax avoidance. It will be key to assess to what degree these anti-abuse rules will limit the scope for aggressive tax planning. Finally, like other EU Member States already did, Malta is in the process of modifying its patent box regime according to EU and international standards. However, the current patent box is subject to grandfathering clause that lasts until June 2021.

Malta's VAT compliance gaps continue to decrease. In 2015, a significant drop in the VAT gap ([16]) in Malta resulted from the statistical reclassification of inputs (from non-deductible to deductible) to the financial sector. This decreased the estimated theoretical VAT total tax liability from the intermediate consumption of the financial sector from EUR 209 million to EUR 12 million, leading to a reduction in Malta's 2015 VAT gap ([17]) from 22.9 % to 3.4 %. In 2016, the country's VAT gap narrowed further to 2.7 % (CASE and IAS, 2018), significantly below the EU average (of 12.3 %).

The property tax system shows room for efficiency improvement. In 2017, property taxes

([12]) This refers in particular to the so-called 'Single Malt' structure: a tax arrangement that consists of having a firm registered in a given country but managed from Malta. If a company uses the 'Single Malt', its profits would, based on the tie-breaker rule in a number of double tax conventions, be taxed in Malta (where the effective corporate tax rate on foreign income can be between 0 and 5 %).

([13]) Malta's full imputation system may have partially offset its 2017 corporate debt bias.

([14]) The agreement aims to ensure that companies cannot use the bilateral tax treaty between Ireland and Malta for the 'Single Malt' structure.

([15]) Inland Revenue, VAT and Customs Departments, with the participation of the Tax Compliance Unit.

([16]) The VAT gap is the difference between the amount of tax actually collected and the theoretical net VAT liability for the economy, under the country's current VAT system.

([17]) The VAT gap is the difference between the amount of tax actually collected and the theoretical net VAT liability for the economy, under the country's current VAT system.

on immovable property represented 3.5 % of total tax revenues in Malta compared with 6.6 % in the EU. This gap is exclusively because Malta, together with Croatia, are the only EU Member States which do not have a recurrent tax on immovable property, though Malta does have a transaction tax on immovable property. Concerning the latter, Malta raised property tax revenues totalling 1.1 % of GDP in 2017 compared to the EU average of 2.6 %. A well-designed recurrent property tax would not be as detrimental to growth as other taxes (European Commission, 2018d) and is highly predictable. It could also, in association with removing exemptions to the transactions tax, offer potential for limiting 'boom and bust' cycles in housing prices, by dampening excessive price increases in the potential build-up phase (see also Section 3.2).

3.1.2. FISCAL FRAMEWORK

The fiscal framework is robust and many fiscal transparency practices are sound. Public finances have benefited from the strengthening of the fiscal framework due to the Fiscal Responsibility Act in 2014. A key element has been the creation of Malta's Fiscal Advisory Council, which has been endowed with a broad mandate, and its contribution to the public debate on fiscal developments. Fiscal reports now cover all general government entities and are published in a frequent and timely manner. Budget documentation provides a medium-term perspective to fiscal planning and clear fiscal policy objectives are embedded in legislation. The government discloses and assesses macroeconomic risks to the fiscal outlook and reports on risks to the government's debt portfolio e.g. in the Stability Programme and the Draft Budgetary Plans submitted to the European Commission. The National Audit Office, the Central Bank and the Treasury Department also report on these risks. These positive elements are also recognised by the International Monetary Fund's Fiscal Transparency Evaluation report for Malta (IMF, 2018) ([18]).

While strong overall, fiscal transparency could be further improved. As highlighted by the IMF, currently there is no fiscal report that provides a consolidated view of the performance of the public corporation sector and tax expenditures are not comprehensively reported. No full details are provided on the performance of different budget entities or on the revenue and expenditure of extra-budgetary units ([19]) and of public investment projects. The discussion of risks to the fiscal forecast presented in various reports currently focusses on risks stemming from the macroeconomic environment.

The implementation of expenditure reviews is ongoing. Since 2014 the authorities have performed a number of expenditure reviews covering amongst others social security, health and education (including the Malta College for Arts Science and Technology). The published reports included recommendations, some of which have already been implemented and some are in the process of being implemented. An additional review of the Management and Efficiency Unit within the Office of the Prime Minister was concluded in early 2018. In 2018, a Directorate was set up within the Budgetary Affairs Division in the Ministry for Finance that was tasked with planning and coordinating reviews in collaboration with the respective ministry, department, entity or cost centre, as required. Draft operational guidelines have been formulated and a training programme has been set up. Around 50 officials from various ministries, including the Ministry for Finance, will receive the training by the first quarter of 2019.

3.1.3. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

In the short to medium term, Malta faces low fiscal sustainability risks. As shown by the debt sustainability analysis as well as the short- and medium-term fiscal sustainability indicators S0 and S1 ([20]), Malta does not face significant fiscal

([18]) The report found that Malta meets the standard of good or advanced-level practice on 21 out of 35 principles in the IMF's Fiscal Transparency Code, and basic practice on a further 12 principles.

([19]) The extra-budgetary units have steadily increased in importance in recent years due partly to the proceeds of the Individual Investor Programme to the National Development and Social Fund.

([20]) The S0 indicator aims to provide early detection of fiscal stress stemming from risks up to 1 year ahead, making use of the signalling power of its components. The S1 indicator risks in the near future (European Commission, 2019b and Annex B). The low level of the general government debt, at 51 % of GDP in 2017, and the surpluses in the headline balance recorded since 2016 help explain these results.

The long-term sustainability of public finances remains a challenge, mainly due to ageing. The country is expected to face one of the sharpest increases in the EU in age-related costs until 2070 by 6.9 pps of GDP (European Commission, 2018e). This is driven by public expenditure on pensions (2.9 pps of GDP) and on healthcare and long-term care expenditure (4.1 pps of GDP). As a result, the sustainability gap indicator S2 ([21]) (3.3 pps of GDP) indicates medium fiscal sustainability risks for Malta in the long term.

Pension system

While policy action in the area of pension tries to improve adequacy and sustainability, the impact on the latter is so far limited. In 2018 a Pension Strategy Group was established. A report is expected by December 2020, outlining recommendations for improving the adequacy and sustainability of the pension system. In addition, efforts are continuing to diversify retirement income and reduce dependency on state pensions. The 2019 budget strengthens the fiscal incentives for private pension savings and voluntary occupational retirement pensions. Other measures complement on-going efforts to increase the labour supply and extend working lives, with a positive impact on employment rates for older workers. A first Commission assessment of these initiatives points to very little or no impact on the sustainability of the pension system, while possibly increasing non-pension income. Also, the impact of the recent migration flows on social protection financing and expenditure are difficult to predict in the long run, requiring close monitoring.

measures the required fiscal adjustment needed between 2021 and 2025 to bring the public debt ratio down to 60% of GDP by 2033.

([21]) The S2 indicator shows the adjustment to the current structural primary balance required to fulfil the infinite horizon inter-temporal budget constraint, including paying for any additional expenditure arising from an ageing population.

Healthcare and long-term care system

Demographic and non-demographic factors are expected to increase health expenditure. Due to population ageing, healthcare expenditure is projected to increase by 2.7 pps of GDP between 2016-2070, significantly above the projected EU growth of 0.9 pps of GDP. When taking into account the impact of non-demographic drivers on future spending, healthcare expenditure is expected to increase by 4.3 pps. of GDP by 2070 (EU: 1.6 pps.) (European Commission, 2018e).

Life expectancy is increasing, reflecting investments in care availability and quality. The Maltese population enjoys one of the highest life expectancies in the EU, at 82.6 years in 2016. In the past 5 years, life expectancy has risen by 1.7 years, twice the average increase in the EU. This increase is explained by significant reductions in the mortality rate from diseases of the circulatory system (which are now in line with the EU average) and in amenable mortality (which is now below the EU average). This reflects sizeable improvements in the quality and availability of care. In 2017, more than three quarters of the population reported being in good health, above the EU average (68 %). However, despite efforts to promote healthy lifestyles and reduce the incidence of chronic diseases, Malta still has one of the highest obesity rates in the EU for adults and children.

Health care services are widely accessible. Only 0.4 % of the population reported unmet needs for medical care in 2017 (EU: 2.9 %), with negligible variations based on socio-economic status. A high level of voluntary use of care services provided by private sector physicians explains the relatively high share of out-of-pocket spending in Malta (27 % vs. EU: 15 %) (OECD, 2017). While this high level of private health expenditure presents a marked contrast to the low level of unmet needs for care, it does not appear to pose a significant barrier for access to care in Malta. Out-of-pocket expenditure seems to be driven principally by societal preferences and outlays on pharmaceuticals not covered by the public system, for which measures to protect low-income households are in place.

Waiting times have improved but remain a long-standing challenge for some specialties.

Although a combination of investments aimed at boosting hospitals' activity and outsourcing procedures to the private sector has been undertaken, waiting times for certain specialties in outpatient visits at the Mater Dei Hospital are long and on the increase (NAO, 2017). Average waiting times for a first outpatient appointment were more than 250 days in 2016, with more recent data showing that as of March 2018 waiting times had increased to 278 days (ESPN, 2018). While current plans to expand the capacity of public hospital outpatient care can help in tackling waiting times, other measures to reduce unnecessary referrals to specialists and redirect inappropriate use of emergency care to outpatient care can include: a) strengthening the scope of service provision and prescription authority for general practitioners; b) better coordination of hospital and outpatient care, and c) more binding measures to redirect inappropriate use of emergency care to outpatient care. Action through this mix of policy levers can effectively help to shorten waiting times for outpatient specialist care and improve the efficiency and long-term sustainability of the health system.

Investments in primary care infrastructure are progressing. The decentralisation of services from hospitals to the primary care level continues, with a new concept for primary care centres and investments to gradually expand the use of eHealth being made. Rehabilitative and geriatric care capacity will increase by means of a public-private partnership between the government and a private hospital operator, which envisages the refurbishment, development and management of three public hospitals in Malta and Gozo. In light of this shift of responsibility for capital investment, it will be important to scrutinise how the rollout of this initiative will affect the accessibility and quality of care, as well as long-term fiscal sustainability.

Expenditure on long-term care is concentrated on institutional care. Public spending on long-term care in 2016 represented 0.9 % of GDP, below the EU average (1.6 %); it is primarily spent on institutional care. Public expenditure on home care services accounted for only 12% of total public spending on long-term care in 2016, (EU average of 28 %) (European Commission, 2018f). Reflecting increasing demand for long-term care, new types of community-based and home care services were introduced in 2017-2018, which could help ensure the fiscal sustainability of long-term care provision. Support for informal carers includes a combination of cash benefits, care leave and respite services provided through community services and the 'Community Care Unit' ([22]). However, respite services are limited and difficult to secure for those who care for elderly people, which restricts labour market participation of informal carers. In addition, support is limited for people with mental impairments.

([22]) This consists of nurses, physiotherapists, occupational therapists, social workers and carers who provide services to clients that are house-bound.

3.2. FINANCIAL SECTOR

3.2.1. FINANCIAL STABILITY

Core domestic banks further improved their capital position and leverage ratio. Throughout the first half of 2018, core domestic banks, i.e. banks mainly offering services to clients in Malta, strengthened their capital base through retained earnings and capital injections. This resulted in their total own funds expanding by 5.7 % by June 2018 and the total capital ratio reaching 17 %. This was mirrored in higher Tier 1 capital (+4.2 %) and the Tier 1 capital ratio improved by 0.1 pp. to 15.2 %, well above the minimum regulatory requirements. The enhanced capital position was also accompanied by a healthier leverage ratio, which increased to 7.1 %, significantly above the 3 % minimum requirement.

Domestic banks profits remain in line with euro area peers. In 2017 and the first half of 2018, core domestic banks posted lower profits due to one bank stepping up provisions. When adjusting for one-off events in 2016-2017 ([23]), profits would have increased by 12 %. As a result, the profitability of core domestic banks remained above peers in the euro area. Following the extensive engagement in financial intermediation activities ([24]), in 2017 net interest income (NII) increased by 4.1 % (with its share in gross income exceeding 70 %) and it increased further by 3.5 % in the first half of 2018. Meanwhile, the NII related to non-intermediation activities contracted substantially (by 18.8 % in 2017 and by 1.6 % in Q1-2018). The operational cost-to-income ratio increased substantially until June 2018, reaching 69.6 % (up by 12.6 pps. from 2017), reflecting the provisions by one bank. Excluding this operation, the ratio would have remained almost stable (at 56 %) and core domestic banks would have remained more efficient than or in line with other small banks in the euro area.

The dynamism of the construction sector is reflected in robust loan growth. Credit to residents accelerated in the first half of 2018, driven by both households and non-financial corporations. Growth in mortgage loans to households slowed but remained strong (at 8.2 %) in the first half of 2018. Mortgages granted at variable rates could pose challenges for borrowers once interest rates increase. However, the credit worthiness of households remained strong supported by their robust net financial wealth which exceeded three times the size of their debt ([25]). Growth in bank loans to the non-financial corporations showed signs of recovery and picked up in June 2018 (+5.6 %).

Table 3.2.1: **Financial soundness indicators, core domestic banks (%)**

	2010	2011	2012	2013	2014	2015	2016	2017	2018H1
Non-performing loans	7,0	7,1	7,8	9,0	7,6	7,2	5,4	4,1	4,2
Non-performing loans NFC	-	-	-	-	16,5	16,5	12,8	10,5	10,8
Non-performing loans HH	-	-	-	-	4,9	4,6	4,2	3,4	3,7
Coverage ratio	34,3	35,5	37,6	39,1	40,4	43,5	45,9	45,2	43,5
Loan to deposit ratio (customer)	72,8	74,1	72,1	67,8	64,0	58,2	56,0	58,9	61,1
Tier 1 ratio	11,4	11,8	12,1	12,9	11,5	12,2	13,6	15,2	15,3
Total capital ratio	14,8	15,5	16,1	16,5	14,4	15,0	16,2	17,3	17,0
ROA - Profit after tax*	0,9	0,8	0,9	0,9	0,7	0,7	0,8	0,7	0,6
ROE - Profit after tax (excl. branches)*	13,4	11,8	12,1	11,9	9,8	9,8	10,1	9,2	7,6

* For comparability purposes June 2018 figures are based on the fourth-quarter moving sum of the flow figures.
Source: Central Bank of Malta

Access to finance remains an issue for certain SMEs. Access to finance has become a lesser concern over time, but may still be difficult for innovative firms without collaterals and could represent a barrier to investment in the long term (EIB, 2017; CBM, 2017). In a context of reducing reliance on bank lending by multinational firms (see Section 1), bank finance remains the preferred channel for 74 % of SMEs.

Small improvements are taking place in terms of access to the capital market. The composition of corporate indebtedness has changed over time, with non-financial corporations slowly moving away from bank credit to intra-group lending. The Malta Stock Exchange, in line with the National Capital Markets Strategic Plan, is promoting the (still limited) role of corporate bond issuance and expanding its usage even to SMEs. One project is the SME Prospects, which allows SMEs to raise capital by issuing bonds or equity without the need for strict collateral requirements or a minimum initial public offering size. For a lasting success, it is key that final customers are aware of related risks. The number of the non-financial corporations having issued bonds at the Malta Stock Exchange increased from 18 in 2013 to 42 in

([23]) These include the sale of the Visa Inc. business line in 2016 together with the increased provisioning for brokerage remediation and collective agreement benefits by one bank in 2016 and to a lesser extent in 2017.

([24]) The average interest rate on deposits fell faster than that on loans, resulting in a marginal widening of the margin.

([25]) In June 2018, households' net financial wealth was 155.4 % of GDP, against household debt of 48.7 % of GDP. Households' financial wealth is predominantly in cash or quasi-cash assets.

September 2018, with outstanding debt increasing by around 134 %. However, Prospect issuance represents just about 2.5 % of total outstanding (non-bank) corporate bonds.

Despite new supervisory rules, non-performing loans have slightly increased due to household and non-resident exposure. Non-performing loans (NPL) for domestic banks increased slightly to 4.2 % in June 2018, with the current coverage ratio, representing provisions in total non-performing loans, at 43.5 % in Q2 2018. The marginal increase in non-performing loans was driven by the household sector. Resident corporate non-performing loans remained stable while those of resident household non-performing loans rose due to higher consumer credit non-performing loans ratio, in part attributable to the introduction of International Financial Reporting Standard 9.

The insurance sector is exposed to risks of passive supervision, where cooperation between domestic and external supervisors is essential. In contrast to the banking sector, subsidiaries in the insurance sector are subject to home supervision, i.e. insurance companies registered in Malta and writing business in other countries are under the direct supervision of the Maltese regulator. A large number of insurance companies are only registered in Malta but operating abroad, mainly in the EU. This number further increased in 2017 and insurance groups have moved headquarters to Malta. At the end of 2017, of the 63 insurance companies domiciled in Malta, only 8 underwrote risks in the country. In turn, 95 % of non-life insurance business and 93 % of life business registered in Malta were underwritten abroad. However, the supervisory capacity has not been sufficiently strengthened yet. The complexity of insurance business models and products with increased appetite for establishing and expanding specialised insurance vehicles calls for stringent supervision, as the concrete implementation of the new supervisory activity under the Solvency II regimes needs to be further examined.

Supervisory capacity is improving but risks and challenges increase as well. The Malta Financial Supervisory Authority (hereafter "the authority") is under strain from several directions: a) the high number of financial institutions, including foreign insurance companies; b) new challenges linked to international efforts to step up the effectiveness of supervision; and c) new challenges related to additional licences to be granted in the crypto-currency area. Staff capacity, skills and the available technology, which needs considerable investment, could constrain the ability of the authority to ensure proper supervision. Some steps have been taken (see Section 3.2.2). In particular, recruitment has accelerated, partly from foreign countries. The workforce is expected to grow over the coming 3 years to cover current resource shortfalls and cater for future growth (resulting in 150 vacancies). To attract staff, remuneration packages have to compete with those offered by other sectors (i.e. gaming, private financial services and professional and support services sectors). The authority is also offering continuous and intensive training to its staff, also in international programmes, to keep up with the evolution of financial markets and new directives.

3.2.2. COMBATING MONEY LAUNDERING

Recent investigations involving money laundering show serious shortcomings in Malta's enforcement framework. On 5 November 2018, further to the authority's proposal (of 30 June 2018) to the European Central Bank (ECB), the ECB decided to withdraw the banking licence of Pilatus Bank. In October 2018, the authority directed another small international bank to refrain from any type of business operations. The authority charged an auditing firm with taking control of the bank's assets and business. These measures were taken after a joint inspection by the authority and the Financial Intelligence Analysis Unit, Malta's anti-money laundering supervisor, found a number of shortcomings in the bank's procedures.

The European Commission requires the anti-money laundering supervisor to step up supervision of banks. On 11 July 2018, following a Commission request, the European Banking Authority (EBA) concluded that the Financial Intelligence Analysis Unit had breached Union law and issued a Recommendation. It considered that Malta failed to correctly supervise Pilatus Bank and ensure compliance with anti-money laundering rules. On 8 November 2018, building on the EBA Recommendation and acknowledging measures adopted by Malta in the meantime to address some of the shortcomings identified, the European

Commission adopted an opinion (European Commission, 2018g). The opinion requires the Financial Intelligence Analysis Unit to take additional measures to fully comply with its obligation under the fourth Anti-Money Laundering Directive to effectively supervise financial institutions, including an effective sanctioning regime.

Malta is currently undertaking improvements in its capacity to supervise anti-money laundering compliance. After conducting a National Risk Assessment to identify the main vulnerabilities and institutional weaknesses, in April 2018 the authorities adopted an integrated strategy to fight money laundering and combat the financing of terrorism. This strategy is to be implemented over the next 3 years. Measures recently implemented include: a) the setting up of a National Coordinating Committee on Combating Money Laundering and Funding of Terrorism, composed of representatives from government and relevant national authorities; b) the increase of resources within the Police Economic Crime Unit; and c) the start of a process to revise the implementing procedures on politically exposed persons. In addition, a memorandum of understanding between the authority and Financial Intelligence Analysis Unit to better coordinate and integrate their efforts has been established ([26]). This includes a joint team and the coordination of all phases of supervision on anti-money laundering and financing of terrorism. Other initiatives include investment in cutting-edge knowledge management tools, business intelligence, regulatory and supervisory technology tools and training programmes. The Financial Intelligence Analysis Unit has received additional human and financial resources and has been revising its procedures to ensure effective supervision.

While most on-site inspections find infringements, sanctions are seldom imposed. In 2017, the total number of on-site inspections of financial sector entities involving relevant issues was similar to 2016 (22 vs 23 in 2016). Preliminary data for the first quarter of 2018 point to a decline. Of the 22 on-site inspections carried, 21 infringements were found (19 out of 23 in 2016). In 2017 only two fines and one written warning were issued (in 2016: one fine and three written warnings).

Rising compliance costs and reputational risks could pose a challenge to retaining business relations with correspondent banks. Maintaining a strong relationship for international transactions with correspondent banks is becoming increasingly difficult, especially for smaller jurisdictions, as global banks are weighing their rising compliance costs against potential profits from this activity. Some of Malta's banks are also finding it increasingly challenging to clear US dollar transactions. While banks in Malta are reporting that alternative arrangements have been found and that they have developed new relationships with global institutions, the retention of correspondent relationships remains crucial.

The size of the gaming sector, efforts to attract crypto-currency operators and the Individual Investor Programme pose additional challenges to the anti-money laundering framework. Malta hosts one of the highest concentrations of online gaming licence-holders in the EU (see also Section 3.4.2). Moreover, Malta aims to establish itself as a leader in the use of distributed ledger technologies such as blockchain, where crypto-currency exchange is one of the most important applications (see also Section 3.4.2). If this initiative proves successful, it will result in a corresponding number of licence applications to be handled by the authority. In addition, as those sectors are considered particularly vulnerable to money laundering practices, their growing importance requires high standards in the regulatory framework.

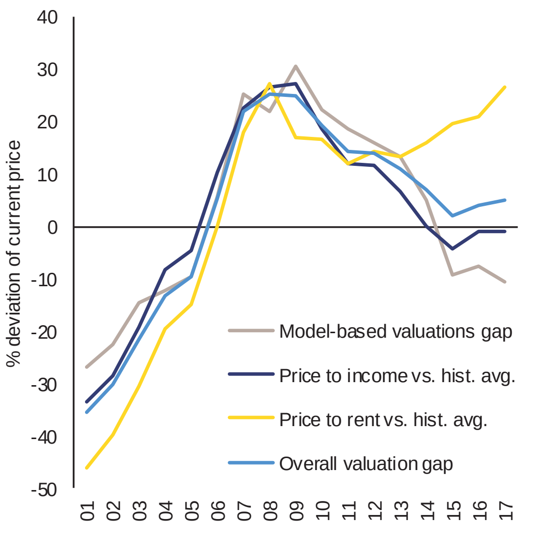
3.2.3. HOUSING MARKET

House prices continued to increase but real estate-related risks to financial sector stability remain contained. In 2017, house prices continued to grow above 5 % for the third consecutive year (5.6 % in the first half of 2018), although slowing gradually and with some regional differentiation (PwC, 2018). However, data are collected by unit of accommodation irrespective of size and anecdotal evidence indicates that the size of dwellings is on the decrease. This could imply a

([26]) The Memorandum of Understanding between the MFSA and FIAU entered into force on 20 August 2018. It reinforces the basis for supervisory cooperation, mutual assistance, exchange of information, due diligence cooperation and sanctions in the field of AML/CFT.

larger increase in the cost of property per square metre. Several factors, such as strong economic activity and labour market conditions, investment in real estate by non-residents and low interest rates, are driving the growth in house prices (European Commission, 2018c), in a context were recurrent tax on immovable property is not in place (see Section 3.1). According to the Commission's house price valuation benchmarks, there are mixed signals regarding possible overvaluation. The overall valuation gap was slightly positive in 2017 and the ratio of prices relative to income remained close to the historical average (see Graph 3.2.1). Thus, while overall risks to financial stability from real estate remain contained at present, an extension of recent trends may result in potential macro-financial imbalances.

Graph 3.2.1: **Valuation gap in house prices**



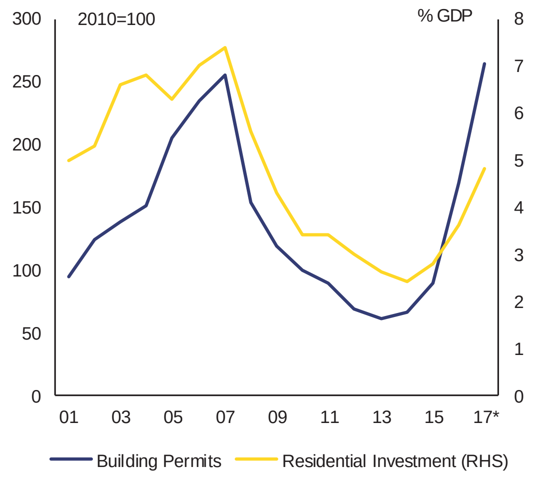
Source: European Commission services calculations

The housing market dynamism is also reflected in increasing construction activity. The rise in house prices has encouraged housing investment. In 2017, residential construction increased by 47 %, (the highest acceleration in the EU), reaching 4.8 % of GDP. The number of building permits continued to increase in the first half of 2018 and accelerated strongly in Q2-2018 (+75.7 % y-o-y). This acceleration suggests that supply faces difficulties to keep pace with demand. As a result, the housing market dynamism, reflected also in robust loans growth, is likely to continue in the near future. This is also thanks to 2019 budget measures, which extended the reduction of transaction taxes for first- and second-time property buyers.

The demand for rental units went up significantly and calls for closer regulatory scrutiny. The rental market has been growing, driven mainly by the increase in foreigners, separated people and young people who rent. As a result, in certain areas, the bulk of properties are sold as rental investments. According to the European Statistics on Income and Living Conditions survey, during 2017 about 82 % of families in Malta were homeowners, above the EU average of 70 %, 4.6 % lived in rented government housing and 13.5 % rented from the private sector. The share of households renting at market prices is increasing, but it remains below the EU average (20.5 %). Still, the affordability of rents for less advantaged people is a growing concern (see Section 3.3.3). In October 2018, the government launched a white paper to regulate the rental market. It proposes longer-term contracts, compulsory registration of rental contracts and a period of notice when the owner wants to terminate a lease, with the Housing Authority tasked with overseeing the rental market and enforcing rental regulation. The 2019 budget also proposed measures to support private rent housing ([27]). It remains to be seen whether these measures will be sufficient to address Malta's rental market challenges.

([27]) The new scheme aims to reduce the rental burdens by granting an aid of between €3,000 and €5,000 per year according to the circumstances of the household.

Graph 3.2.2: **Residential investment and building permits**



Source: European commission

3.3. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

3.3.1. LABOUR MARKET

Malta's labour market continues to perform well, in line with strong economic growth. Over the decade, Malta has had the largest employment rate increase (by 13.8 pps to 73 %) in the EU, exceeding their 2020 target and the EU average (72.1 %). The activity rate (75.8 %) rose but remains below the EU average (78 %). The unemployment rate (4 %) is well below the EU average, including for young people (15-24, 10.6 %) and for long-term unemployment (1.6 %).

Reforms contributed to these positive labour market outcomes. The structural reforms undertaken by Malta over the decade have been ambitious. The 'Make Work Pay' and pension reforms notably improved the functioning of the labour market and increased the labour supply. At the same time, the impact of education and skills reforms to address human capital challenges using national and EU funds has yet to fully materialise. The reforms are supported by strong tripartite social dialogue within the Malta Council for Economic and Social Development.

While buoyant economic activity provides an opportunity for society, not all groups have benefitted equally. Outcomes vary widely across groups: the gender employment gap is still the largest in the EU and the pay gap is widening, and the labour market performance of people with disabilities and older workers is among the lowest in the EU. Inactivity is high and the demographic dependency is projected to increase more strongly than in other EU Member States. Policies to address the persisting challenges of early school leaving and low adult participation in education require a boost if they are to make a dent in the high number of low-skilled working-age people.

Labour shortages across sectors and occupations continued to increase. In 2017, 38.4 % of employers in the industry, construction and services sector [28] stated that labour shortages limited their production. This share is one of the highest in the EU and has increased substantially since 2013. New job openings continued to increase overall, especially in services and sales and in elementary occupations (18 %) (Jobsplus, 2019). Skills shortages exist as employers report difficulties in finding high skilled people particularly in healthcare, finance and ICT, while vacancies are also hard to fill in clerical support, service and sales and for machine operators and assemblers.

Malta had the highest increase in female employment in the last decade but the employment gap is the largest in the EU. Female employment among 20-64 years-old has increased by 21.2 pps since 2008, nearly six times the EU growth level (3.6 pps). Despite these advances, the employment rate of women (60.6 %) in 2017 still lagged behind the EU average (66.4 %) and the gender employment gap is the largest in the EU,. The employment rate of women exceeds the EU average up to age 34 and declines sharply thereafter (see Graph 3.3.1). It has been increasing in standard contracts (full time and open ended) since 2014, while men part-time employment has been slowly increasing.

The gender pay gap, as a percentage of men's average gross hourly earnings, is widening. The gender pay gap in Malta of 11 % in 2016 was below the EU level (16.2 %). However, while the EU average has decreased slightly (0.6 pps) since 2011, it has widened in Malta by 3 pps. The gap for the 25-34 age group is lower (9 %) but widening (by 2.9 pps since 2014).

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(28) Average over the three sectors, weighted by their share in employment.

Box 3.3.1: **Monitoring performance in light of the European Pillar of Social Rights**

The European Pillar of Social Rights is designed as a compass for a renewed process of upward convergence towards better working and living conditions in the European Union. It sets out 20 essential principles and rights in the areas of equal opportunities and access to the labour market; fair working conditions; and social protection and inclusion ([1]).

Malta performs relatively well on the indicators of the Social Scoreboard supporting the European Pillar of Social Rights, although certain challenges remain . The employment rate is above both the national target and the EU average and unemployment is very low. Nevertheless, Malta still has the largest gender employment gap despite great advances in female employment. The free childcare scheme has substantially increased formal childcare participation, increasing female employment. However, the employment rate for older women remains low, reflecting limited support for informal carers. Employment of people with disabilites is still woefully low, compounded by limited social protection coverage.

SOCIAL SCOREBOARD FOR MALTA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Weak but improving
	Gender employment gap	Weak but improving
	Income quintile ratio (S80/S20)	Better than average
	At risk of poverty or social exclusion (in %)	Better than average
	Youth NEET (% of total population aged 15-24)	On average
Dynamic labour markets and fair working conditions	Employment rate (% population aged 20-64)	On average
	Unemployment rate (% population aged 15-74)	Better than average
	Long-term unemployment (% population aged 15-74)	Better than average
	GDHI per capita growth	N/A
	Net earnings of a full-time single worker earning AW	On average
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	On average
	Children aged less than 3 years in formal childcare	Better than average
	Self-reported unmet need for medical care	Better than average
	Individuals' level of digital skills	Better than average

Members States are classified according to a statistical methodology agreed with the EMCO and SPC Committees. The methodology looks jointly at levels and changes of the indicators in comparison with the respective EU averages and classifies Member States in seven categories (from "best performers" to "critical situation"). For instance, a country can be flagged as "better than average" if the level of the indicator is close to EU average, but it is improving fast. For methodological details, please consult the draft Joint Employment Report 2019, COM (2018)761 final.
NEET: neither in employment nor in education and training; GDHI: gross disposable household income.

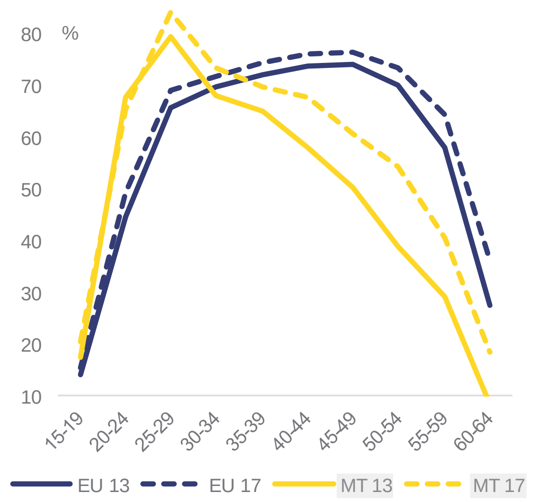
While general indicators on performance are good or show improvements, equality of opportunity appears particularly challenged. Outcomes in various dimensions of the Pillar are increasingly polarised for more disadvantaged groups. Women in work are increasing, but so too is the gender pay gap. Unequal access to quality education, thereby disadvantaging lower socio-economic groups and children with disabilities, is fuelling the high share of early school leavers and low overall skills attainment. This may also explain the relatively high average rate of young people not in education, employment or training despite low unemployment. Non-EU migrants experience much higher and widening poverty rates despite having higher education levels and employment rates. There is a high incidence of out-of-pocket healthcare costs causing inequality in waiting times and the gap in self-reported health by socio-economic status is wide and growing. Although the impact of social transfers on poverty reduction is around the EU average, some groups lack access to contributory schemes, for example working migrants.

Digital skills are better than average. The Malta Communications Authority (MCA) aims to achieve widespread e-literacy and digital inclusion, by shifting the focus from digital access to internet use. eSkills Malta Foundation also plays a key role in improving digital skills, including by organising careers sessions for secondary school students, and training teachers and careers advisors. They are involved in various EU initiatives including the SCALE Project.

([1]) The European Pillar of Social Rights was proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission. https://ec.europa.eu/commission/priorities/deeper-and-fairer-economic-and-monetary-union/european-pillar-social-rights/european-pillar-social-rights-20-principles_en

Women's activity rate (25-54) lags significantly behind the men's rate. There was a 24.2 pps gender gap between men (96.2 %) and women in 2017. Activity rates are highest for high-skilled women. However, since 2008 low-skilled women have driven the significant increase in the activity rate while it slightly declined for high-skilled women.

Graph 3.3.1: **Increase in female employment rates, 2013-2017, Malta and EU**



Source: European Commission

The take-up of formal childcare has increased substantially, facilitating the employment of younger women. The provision of free childcare contributed to the steep increase in children's participation to 31.3 % in 2016, from 17.9 % in 2015. It also contributed to the high activity and employment rates of young women. By contrast, women aged 35-44 have comparatively high inactivity rates (28.7 % vs EU 18.7 %) and cite 'personal and family responsibilities' ([29]) as the main cause. This points to the lack of adequate support for older women as informal carers.

The low employment rate of older workers is driven by the very low employment rate of older women in Malta. While the employment rate for men aged 55-64 is well above the EU average, for women it was 29.9 % in 2017, compared with 50.8 % in the EU. This is exacerbated by women's low skills levels. Nonetheless, women aged 50-54 in Malta saw the largest employment rate increase (6.8 pps) in the EU in 2017. This highlights that reforms to pensions are starting to take effect but that overall more support is needed in upskilling and for informal carers.

The employment rate of people with disabilities remains low. While increasing, the employment rate for people with disabilities (29 %) remains one of the lowest in the EU. Since 2015, efforts to improve the rate have been directed mainly at employers and included, for example, pre-employment training (ANED, 2018). A new measure announced in the 2018 national reform programme aims to provide incentives to labour market activity by ensuring that disability pensions continue to be paid when people with disabilities start working. The 2018 report of the UN Convention on the Rights of Persons with Disabilities (UNCRPD, 2018) also recommends extending the quota system to employers with fewer than 20 employees.

The favourable labour market situation may be hampering efforts to reduce early school leaving. Compared to the EU, the employment rates of young people (15-24) in Malta are high (46.1 %), while unemployment (10.6 %) and the rate of young people not in education, employment or training (NEET) at 8.6 % are low. The high employment rates of low-skilled young people may act as a disincentive to studying longer, and combined with low participation in training over their careers, can weaken the country's human capital.

Skills shortages still challenge Malta's future growth. Under-qualification ([30]) in Malta is higher than average (26 % vs EU 22.8 %), after increasing by 3 pps since 2008, while it fell in most countries. This reflects a lack of applicants with the required skills mentioned by employers (56.2 %) in the National Employee Skills Survey. Since economic growth is increasingly linked to innovation, higher quality and added value investment in upgrading skills, qualifications and

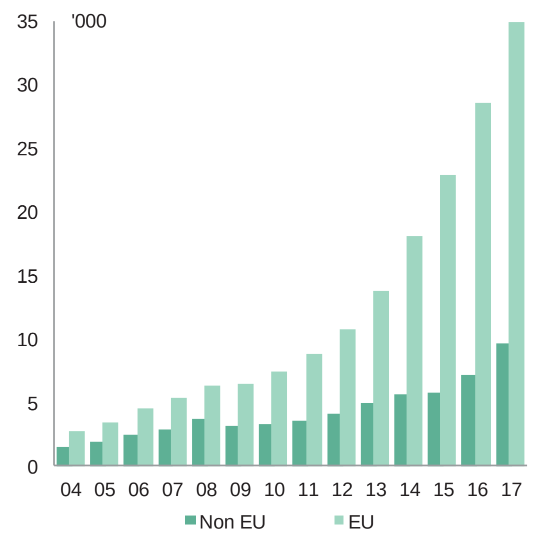
([29]) Own workings based on self-reported reasons in the EU Labour Force Survey.

([30]) Under qualification is the share of low-qualified and medium-qualified people (those with an education level up to upper secondary) who occupy jobs requiring high qualifications (tertiary education), according to the ILO (2007) classification of occupations (ISCO) and qualifications (ISCED).

education and specific actions to integrate young people, lower socio-economic groups, the low-skilled, people with disabilities and migrants remain crucial.

Reliance on foreign labour to address shortages has continued. The share of foreign workers rose rapidly from 5.6 % in 2008 to 19.2 % in 2017, growing by 3 pps in the latter year alone (see Graph 3.3.2). More than two thirds (69 %) are EU citizens. They work in professional, scientific, technical, administration and support services (22.2 %), the wholesale and retail trade, transportation and storage (18.3 %), the arts, entertainment and recreation (18 %) and accommodation and food services (15.7 %). On average EU nationals have a higher level of skills than the native population.

Graph 3.3.2: **Number of foreign workers**



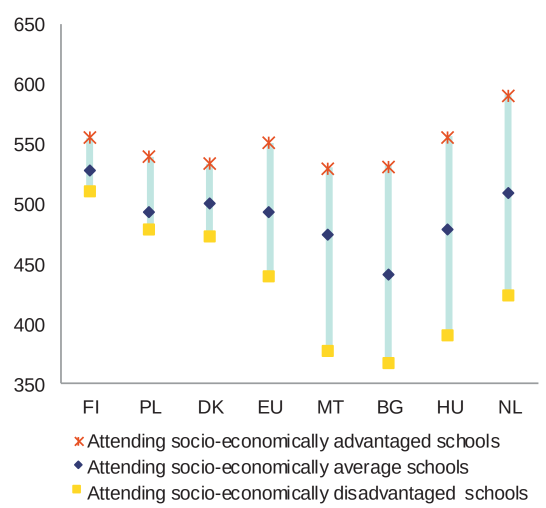
Source: Malta PES, Jobplus data.

3.3.2. EDUCATION AND SKILLS

High public investment in education is not reflected in educational outcomes. Government expenditure on education in 2016, as a proportion of GDP (5.4 %) and of total public expenditure (14.1 %), is well above the EU averages (4.7 % and 10.2 %). However, the performance of Maltese students in international assessments remains poor, with major disparities linked to socioeconomic background and type of school (see Graph 3.3.3) as well as disability.

High levels of early school leaving may be limiting economic growth prospects. In 2017, the early school leaving rate among 18-24 year-olds (17.7 %) was one of the highest in the EU (10.6 %). Despite their low education levels, the employment rate among early school leavers is the highest in the EU (71.5 %), highlighting that employment opportunities are among the factors drawing students away from school. However, participation in early childhood education is almost universal for 4-year-olds (98 % vs 95.3 % EU) and the proportion of children below 3 in formal childcare has risen significantly. National standards are being updated in line with the Quality Framework for Early Childhood Education and Care. Ensuring inclusive childcare with access for all, especially those from disadvantaged or migrant backgrounds or with lower socio-economic status requires dedicated investment. In addition, integrating people from diverse backgrounds narrows attainment gaps and drives up overall education performance.

Graph 3.3.3: **Students' socio-economic status and performance in science, by schools' socio-economic status**



A socio-economically disadvantaged school is in the second and third top quarter of the distribution of school-level PISA index of economic, social and cultural status within each country/economy.
Source: European Commission, OECD data

Malta aims to develop more student-centred education in order to achieve a more inclusive and high-performing education system. The new collective sectoral agreement for 2018-2022 includes a new Learning Outcomes Framework to be implemented in September 2019. It implies documenting the learning progress of every pupil and is targeted to the student's stage of development. The reform of the lower secondary school system, to be implemented in the 2019/2020 school year, will allow students to choose between general, vocational or applied subjects, beyond the core curriculum, thus better addressing different education needs. The aim is to tackle low school retention and reduce the differences in school outcomes between students attending different schools and from different socio-economic backgrounds. Implementing these measures relies on developing teaching and learning programmes that effectively upgrade teachers' competences and enable them to meet the new teaching needs.

Despite recent improvements, the tertiary educational attainment rate for 30-34 year-olds is still one of the lowest in the EU. In 2017, the rate improved by 1.5 pp. to 33.5 % vs an EU average of 39.9 %. The rate is higher for women (35 %) and foreign-born people (39.7 %). Several measures have been introduced to widen access to all, bolstering the number of enrolments by 9.5 % since 2013. In 2017, the employment rate of recent tertiary graduates was the highest in the EU (95.3 % vs 84.9 %). The share of science, technology and mathematics graduates was, on the other hand, one of the lowest in the EU (19.5 % vs 26 % in 2016). To better address skill needs, Malta is part of the pilot European graduate survey. By the end of 2019 it will provide a comparative assessment of graduate outcomes and valuable input on the quality of the higher education system.

Participation in vocational education and training remains low, despite the high employability it generates. The employment rate of vocational education and training graduates was 94 % in 2017, compared with 77 % in the EU. The proportion of upper secondary students (ISCED 3) in vocational education and training increased slightly from 12.7 % in 2015 to 15.4 % in 2016, but remained far below the EU average (49.3 %). The overall take-up of VET subjects in secondary schools increased from 327 students in 2014 to 2 759 in 2018.

Malta took measures to increase the attractiveness of vocational education and training and strengthen its role in the economic and innovation ecosystem. Vocational and applied subjects were introduced in secondary schools, adding over four subjects in the 2019-2020 school year with support from the European Social Fund (ESF). The number of apprenticeships increased by 100 students, in the 2017 academic year. Furthermore, the Malta College of Arts, Science and Technology engaged in 703 partnerships with local industries.

Enhanced career guidance and additional compulsory courses aim to support further education. Secondary schools now have qualified guidance practitioners and career advisers; they can organise one-week work experiences in a company for 15 year-old students and career guidance sessions for 16 year-old students. A new tax credit to pursue a vocational study programme is available through the 'Get Qualified' scheme. Moreover, since 2017 post-graduate students aged less than 40 are exempt from paying income tax for 2 years.

Participation in adult learning is increasing but is still low for the low-skilled. The share of 25-64 year-olds participating in education and training was 10.6 % in 2017, nearing the EU average (10.9 %). However, it remains weak for the low-skilled (3.7 % vs EU 4.2 %), which represent 49 % of the population. Participation in adult learning by employed people is slightly above the EU average (12.4 % vs 11.6 %) and increasing, but it is still low for inactive people (5.3 % vs EU 8.6 %).

The contribution of small and medium-sized enterprises to upskilling employees remains low. In 2015, training provided by businesses was below the EU average (61.6 % vs 72.6 %). This was due mainly to low participation by small and medium-sized enterprises. Reasons for not providing training included workload and staff turnover, as 38 % of private sector employees leave within a year. Following the success of an ESF funded project, Malta launched the Investing in Skills scheme in 2017.

New actions aim to improve skills assessment, validation and recognition for adult learners. In line with the EU Recommendation on Upskilling Pathways, a validation system is now in place for the following sectors: automotive, building and construction, hair and beauty, health and social care, hospital, tourism, and printing and digital media. Sectors are selected on the basis of market research and consultation with stakeholders. Individuals with a minimum of 3 years' experience can apply for validation.

Public employment services increased their focus on career guidance for jobseekers. The Work Programme Initiative and the NEET Activation Scheme II target the long-term unemployed and inactive people and personal employment advisers profile and create individual action plans. The new Occupational Handbook outlines occupational requirements for career advisers, educational institutions and individuals. However, measures to upgrade skill levels and employability lack evaluation, and attaining the 2020 target for adult learning of 15 % remains a challenge.

Several initiatives have contributed to mapping and anticipating skills needs, but they remain fragmented. The National Employee Survey and the Employability Index have widened the evidence base on skills mismatch. In 2017, the Maltese government collaborated with the Slovak Academy of Sciences to develop a mid-term skills and occupational forecasting model for Malta. The European Centre for the Development of Vocational Training (Cedefop) identified opportunities for people at all qualification levels up to 2030 (Cedefop, 2017). The National Skills Council is drafting a national skills strategy, identifying individual transversal skills to be integrated into education and training.

A systematic identification of skills to support the transition to a more sustainable economic development model is lacking. Although some measures back technical and highly qualified training and provision in environmental, engineering or ICT studies (e.g. Malta's College of Arts Science and Technology training programmes), they are modest in scope and budget. The majority of schemes (e.g. PhD support, Get Qualified scheme) are generic and they would benefit from targeting specific disciplines or sectors. In addition, systematic coordination between the different governmental bodies on this issue would benefit from further strengthening.

3.3.3. SOCIAL POLICY

Headline indicators on poverty and social exclusion show that Malta is benefiting from a flourishing economic climate. In 2017, the share of the population at risk of poverty and social exclusion (AROPE) declined from 20.1 % in 2008 to 19.2 %. However, the decline was not uniform for all groups. Also, as work income is rising faster than other incomes, the population at risk of relative poverty (AROP) is on an increasing trend, reaching 16.8 % in 2017. Flash estimates indicate that the trend has continued.

Single parents and large families in particular are still struggling. For large families with two adults and more than two dependent children, the risk of poverty and social exclusion is 38.8 %, 7.5 pps higher than a decade ago and 9.4 pps above EU average. By contrast, the poverty rate for single parents fell significantly over the decade by 19.3 pps to 50.2 %, although it remains above the EU average by 6.1 pps.

The risk of poverty for children remains a challenge. The risk of poverty for children whose parents are working declined from 17.8 % in 2013 to 15.3 % in 2017, possibly reflecting the increased participation of mothers in the labour market. However, children whose parents are low- or medium skilled face much higher poverty and social exclusion risks than in 2008. This is particularly important, as over three quarters of Maltese aged 25-64 possess low or medium skills. Moreover, it has negative consequences for their children's education outcomes.

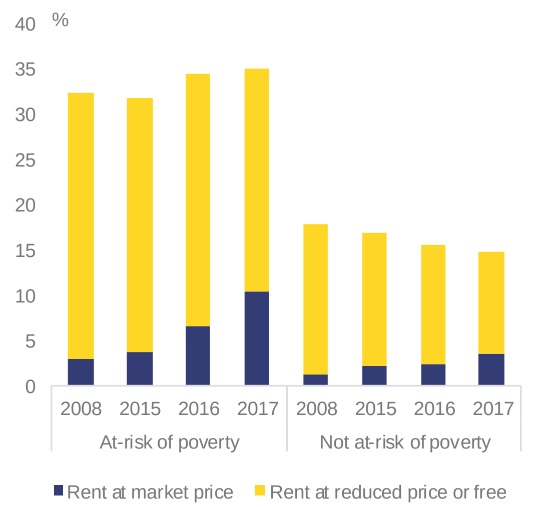
Poverty and social exclusion risks are high for people with disabilities. The AROPE rate gap between people with and without disabilities in Malta at 14.9 pps is well above the EU average (9.2 pps). Social transfers moderate the risk of poverty more than in other Member States, but less so for those with more severe impairments. In 2017 the disability pension for those who cannot work was increased. However, despite pension reforms the Severe Disability Allowance exclude groups with severe psychosocial, sensorial and intellectual impairments. Further, the existing household surveys miss a substantial number of people who are disabled (ANED, 2018).

A relatively large share of the population is foreign-born and facing high risks of poverty. In 2017, the foreign-born population was 15.1 % and almost equally split between non-EU born (7.8 %) and those born in other EU countries (7.3 %). However, the non-EU born face a much higher risk of poverty (28.9 %) than the native-born (15.2 %) despite their high employment rates (73.7 %) and their higher share of people with tertiary education (32.7 % v 20.4 % for the native-born). The government recently took measures to help the social and labour market integration of foreigners. However, the recent surge in house prices suggests that access to affordable housing and energy poverty are becoming growing concerns.

The social security system has gaps in its provision. Casual workers are not covered by unemployment benefits or old-age/survivors' pensions (European Commission, 2018h). Seasonal workers do not have access to unemployment benefits and people working under an agreement to perform a job do not have formal access to old-age/survivors' pensions. Some groups among the self-employed and foreigners (despite contributing) are excluded from unemployment benefit schemes. While the adequacy of minimum income benefits in Malta exceeds the EU average (European Commission, 2018i; 2018j), social support by the government does not fully mitigate the risk of poverty or social exclusion for people depending on social benefits.

The hike in house rents is affecting a growing number of low-income households. The share of people renting at market prices has increased, especially among low-income households (10.4 % in 2017 against 3.7 % in 2015). At the same time, market rents increased sharply, creating unprecedented difficulties for a growing number of households to access affordable housing. The increase in foreigners and the number of Maltese single households, together with the low replenishment of social housing and the liberalisation of market rents, have exacerbated the problem. The risk of poverty among tenants increased from 23.4 % in 2013 to 35.9 % in 2017.

Graph 3.3.4: **Population at risk of poverty by rent price**



Source: European Commission

Investment

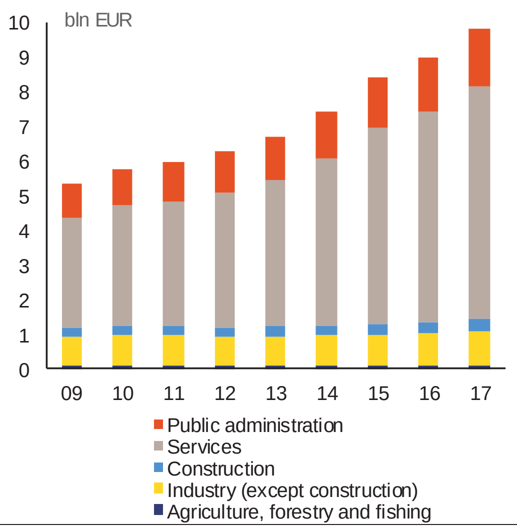
Increased investment in inclusive education and training, starting with early childhood education, is important to improve Malta's long-term growth. Employment rates for people with disabilities, women and older workers are low due to insufficient skills attainment. It is important to improve education outcomes for disadvantaged groups starting from early childhood (0<3 years), to improve alignment with labour market needs and to increase participation in adult learning. Improving access to employment for inactive people, integrated measures in housing and social services for non-EU migrants, modernising social protection and enhancing infrastructure for equal and timely access to quality and affordable health and long-term care services also require further investment.

3.4. COMPETITIVENESS AND INVESTMENT

3.4.1. PRODUCTIVITY GROWTH AND DRIVERS

The Maltese economy recently experienced a pronounced shift towards the services sector, coupled with productivity gains. From 2009 until 2017, gross added value increased at a pace that was almost four times faster than in the EU and accelerated from 2014 (see Graph 3.4.1). During this process, the contributions of different sectors to national production have changed in a remarkable way. Industry and construction shares fell significantly, while the service sector's contribution increased from 76.5 to 85 % (while the EU average is 73.4 %). Total factor productivity remained broadly stable in 2009-2014 and increased substantially starting from 2014. The structural shift towards higher value added services (such as professional services and remote gaming activities) contributes to explaining this change. Additional factors that supported productivity gains include a large-scale investment in the energy sector and the inflow of highly skilled foreign workers. Real labour productivity increased between 2014 and 2017 both in terms of hours worked and people employed ([31]).

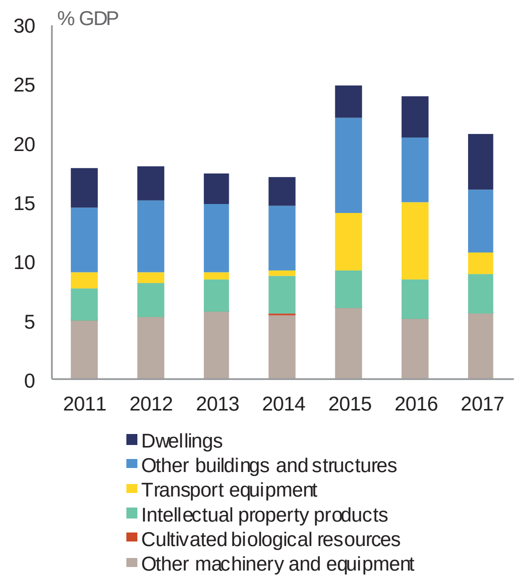
Graph 3.4.1: **GVA by industry breakdown**



Source: European Commission

Investment remained relatively high in 2017 and in the first half of 2018. Following a considerable increase in 2015, due to exceptional investment projects in the aviation and energy sectors, investment has stabilised at a relatively high level (see also Section 1). In 2017, investment accounted for 21.1 % of Maltese GDP, 0.9 pp higher than the EU average and 3.8 pp higher than in 2014 (see Graph 3.4.2). Construction investment (both dwellings and non-residential construction) remained particularly dynamic, followed by machinery and equipment. The first half of 2018 showed a similar pattern. According to surveys, only 8 % of firms experienced an investment gap in 2017 (CBM, 2018b).

Graph 3.4.2: **Gross fixed capital formation by asset**



Source: National Statistical Office

Small and medium-sized enterprises account for the great majority of firms. Small and medium-sized enterprises (SMEs) are particularly relevant in Malta, as they generate 81 % of value added and of employment, significantly higher shares than the respective EU averages of 56.8 % and 66.4 %. The majority of SMEs are represented in wholesale and retail trade, and in professional, scientific and technical activities (European Commission, 2018k).

Policy measures have been put in place to address financing difficulties of small and medium-sized enterprises. A number of financial instruments, grant schemes and tax incentives launched in the last decade by the government and co-financed by the EU aim at providing finance for

([31]) Following the Council Recommendation 2016/C 349/01, Malta is in the process of appointing the Malta Council for Economic and Social Development (MCESD) as National Productivity Board.

small and medium-sized enterprises (SMEs) and start-ups. In addition, SMEs are adapting slowly to market-based finance (see Section 3.2). The Malta Development Bank is expected to address persistent financing gaps for SMEs and to improve the take-up of the various EU financial and guarantee instruments. The Bank is currently defining priorities and tools for concrete action. The most advanced initiatives concern credit for family business transfers, for which the bank already signed an agreement, and two SMEs guarantees currently under negotiations.

Addressing investment gaps in infrastructure, innovation and skills would support the future growth and the long-term sustainability of the Maltese economy. Pressure on Malta's natural resources and infrastructure has been mounting with economic growth. Targeted investment to address environmental concerns and infrastructure bottlenecks would help secure sustainable long-term growth. Facilitating innovation, strengthening links between research systems and businesses, and helping firms climb up the added value chain would help boost productivity. In addition, labour and skill shortages are perceived in several sectors, with lack of staff with the right skills being mentioned as a barrier to investment by a large majority of firms. Investment aimed at upskilling the workforce may help tackle the challenge (see Section 3.3).

Governance vulnerabilities contribute to constraining firms' growth. Structural weaknesses have been identified in relation to the governance framework. Survey indicators show that corruption and insufficient transparency of the political, legal and regulatory environment are perceived as a problematic factor for doing business in Malta (European Commission, 2017b; Ernst & Young, 2018). A strengthened governance framework, including effective judicial and anti-corruption enforcement, is a prerequisite to obtaining the full benefits of investment.

Research and innovation

Malta's innovation performance is moderate but gradually improving. Malta remains a moderate innovator, although its innovation performance has increased since 2010 (European Commission, 2018l). The country ranks seventh in the EU in terms of fast-growing firms in the most innovative sectors (Eurostat), it hosts over 200 foreign direct investment operations in niche sectors based on low volume/high value added operations (European Commission, 2019d) and it has experienced rapid development of the digital content and software development industry.

Low investment in intangibles assets such as R&D explains the modest research and innovation performance. R&D intensity remained flat in recent years (0.55 % of GDP in 2017 against 2.07 % for the EU) and the country is likely to miss its target of 2 % R&D intensity by 2020. The recent slight increase in public R&D intensity is partly explained by the significant inflow of structural funds. The low level of public R&D investment in the public science base limits the full usage of the country's scientific and technological potential. Although the University of Malta (the only public research performer in the country) has improved its scientific performance (Malta ranks 11th in the EU in terms of top scientific publications) with a relative specialisation in medical sciences, it currently does not receive dedicated institutional funding for conducting R&D.

Firms' limited capacity to engage in R&D hinders innovation creation and technological spill-overs. Business enterprise R&D expenditure intensity has declined since 2012 (0.34 % of GDP in 2017 against 1.36 % for the EU). Research-intensive sectors are heavily dependent on foreign investment (e.g. pharmaceuticals, medical devices, electronic components), which means that core R&D activities are undertaken at the multinationals' headquarters outside Malta. Surveys confirm that firms mainly engage in non-R&D-based innovation with a focus on design, process, organisational and market innovation (European Commission, 2018l; EIB, 2018). The limited R&D potential of domestic firms partly explains the lack of robust academia-business linkages and knowledge transfer activities.

The effectiveness of measures to support home-grown research and innovation remains limited. Despite the existence of sectoral strategies (e.g. on blockchain technologies, see also Section 3.4.2), the country has not yet set up a coherent and long-term competitiveness strategy for moving the domestic economy up the value chain. The Research and Innovation Strategy 2014-2020 has little visibility and its implementation is scattered between various governmental bodies ([32]) with limited coordination. It is unclear whether existing measures supporting business R&D investments, such as the two R&D tax incentives schemes ([33]) and the 2014-2020 Research and Development scheme, are effective, given their low uptake.

Environmental sustainability

Enhancing the environmental sustainability of Malta's growth model requires targeted investment. The dynamism of the housing market, the growth of tourism, the increasing inflows of foreign workers and investors put pressure on local land and water resources. As regards artificial land coverage, Malta ranks by far above the EU average (4.1 %) with 23.6 % of artificial land. Overdevelopment has been a consistent cause of loss of biodiversity, natural landscapes and agricultural land. Malta's inherent challenges linked to its limited space and natural resources are intensified by its high population density. Targeted investment would help tackle the challenge by promoting the shift towards a resource efficient economy.

Green and sustainable public procurement is underexploited. Green public procurement is a tool for encouraging new markets for innovative products in a low-carbon, circular economy. Yet, past targets were only partially met (European Commission, 2018c). No significant progress was made in this respect in 2018.

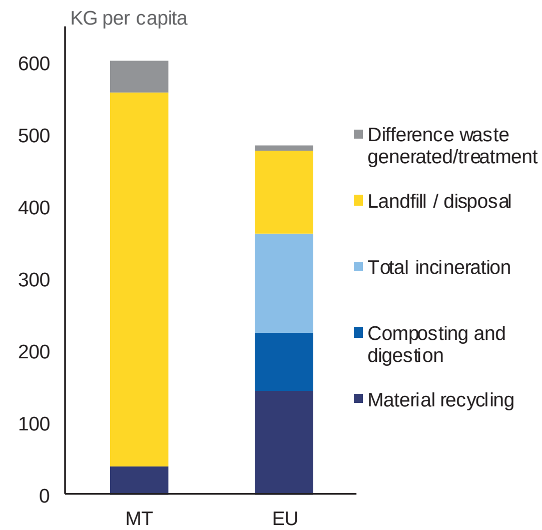
Water scarcity is a pressing concern. Many economic activities, including the tourism sector, industry and agriculture, are dependent on a reliable water supply. However, the current water scarcity, due to geographical factors, is likely to increase in view of climate change and demographic pressures. Diffuse water pollution from agriculture aggravates the problem. In Malta, in particular, investment targeted at improving the efficiency of water management and water use is key to ensuring sustainable economic development in the medium term.

([32]) These include the Malta Council for Science and Technology, Malta Enterprise, and the Support Division Unit in charge of ERDF funding, under the Office of the Prime Minister.

([33]) 'Aid for Research and Development Projects' and 'Tax credits for R&D and Innovation scheme'.

Malta's heavy reliance on waste disposal puts pressure on its limited land. The recycling rate for municipal waste is only 6 %, far below the EU average of 30 % and the 2020 target (50 %). Composting in Malta is practically non-existent (see Graph 3.4.3). Consequently, the landfill rate at 86 % is more than three times the EU average. Factors explaining the situation include the lack of infrastructure or collection systems for recyclables and bio-waste and the lack of economic incentives to prevent waste and improve recycling. Construction and demolition waste, too, is largely landfilled despite the surge in the amount of waste since 2011 (European Construction Sector Observatory 2018; data from Maltese authorities). Investments in waste management, including waste prevention, separate collection, recycling and bio-waste treatment, would contribute to moving away from heavy reliance on waste disposal.

Graph 3.4.3: **Municipal waste generated and treatment**



Source: European Commission

The potential role of innovative technologies in addressing sustainability concerns remains underexplored. There are currently no R&D funding or support measures to develop new/improved technologies addressing environment and climate change. Existing measures supporting R&D and technology development by firms (e.g. grants, tax incentives) remain general in scope and do not specifically target these priority areas. Several on-going initiatives aim at developing new or improved technologies in the transport sector. However, their scope and scale remain modest given the needs of the country. Funding for R&D projects is also modest, with less than EUR 1.5 million allocated to projects addressing energy efficiency and aquaculture/agriculture. In the tourism sector (which is a priority in the smart specialisation strategy), it remains unclear whether the two on-going projects (Mediterranean Centre and re-generation of lower Valletta) adequately address the issue of sustainability.

There is scope to increase environmental taxation. Malta has one of the lowest share in the EU of energy tax revenues within the environmental taxes, at 55 %, yet a high share of taxes on transport at 41 % in 2014 (EEA, 2016). In 2016 there was still a 16 % gap between petrol and diesel tax rates, making Malta increasingly an outlier with respect to favouring diesel technology via excise duties.

Transport and traffic congestion

Road congestion remains a major challenge. Due to road inefficiency and high car penetration, congestion remains one of the weakest aspects of Malta's business environment. The estimated costs of congestion (time spent in traffic, additional fuel costs, and accidents) are high and measures to reduce them have only partly been adopted (European Commission, 2018c). Air pollution from transport has considerable social and environmental impacts ([34]). Yet, the number of licenced vehicles continues to increase and electric and hybrid vehicles make up less than 0.5 % of the total fleet. The Maltese vehicle registration tax system has built-in features that lowers the tax rate for electric vehicles with low CO2 emissions, while the annual circulation tax is based on emissions and the vehicle's age.

Public investment is improving road quality, but modal shift is not yet visible. The implementation of the 2016 Transport Master Plan for the period to 2025 is in its early stage and its impact on modal shift – which would also have important benefits for congestion and greenhouse gas emissions – is limited. Free school transport was introduced in 2018 and the use of public transport is increasing slightly. However, the system is close to full capacity and consumer satisfaction low (European Commission, 2018m). In addition to the Master Plan measures, the 2019 budget allocates EUR 100 million for up-grading roads for which a dedicated agency, Malta Infrastructure, was set up in 2018. However, roads-widening works remain car-centred and may result in increased car usage.

Climate change resilience

Malta lacks an integrated approach to climate policy with a cross-sectoral focus. As a small island state, Malta is particularly exposed to the impacts of climate change. The most vulnerable sectors include water resources, infrastructure and land use (for example through floods), natural ecosystems, agriculture and fisheries, health and tourism. While Malta has the lowest greenhouse gas emissions per capita in the EU, the 2020 target under the Effort Sharing Decision is expected to be missed by a margin of 11 pps, according to the latest national projections submitted to the Commission, which takes all existing measures into account. In 2030, this gap with the effort sharing target is expected to rise to 46 pps. As its Low-Carbon Development Strategy has not been completed (to be finalised in the beginning of 2020), Malta does not yet have an action plan to reach its 2020 targets. In the longer term, transport modal shifts are essential, as almost 50 % of the increase in emissions come from the transport sector. The agriculture sector can also contribute to climate mitigation by building renewable energy capacity, for example installing solar panels and producing bioenergy from livestock waste. The newly adopted National Agricultural Policy for the Maltese Islands 2018 – 2028 addresses the areas of sustainable agriculture products, circular economy, mitigation through adaptation and soil management, whereas there is no measure directly seeking greenhouse gas emission reductions.

Malta is in the process of setting its targets and objectives for 2030. In its National Energy and Climate Plan to be adopted by 31 December 2019 in line with the Regulation on the governance of the Energy Union and climate action ([35]), Malta

([34]) The European Environment Agency estimated that in 2015 240 premature deaths were attributable to air pollution (EEA, 2018, p. 64).

([35]) Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action.

will provide an overview of its investment needs until 2030 for the different dimensions of the Energy Union, including renewable energy, energy efficiency, security of supply, and climate mitigation and adaptation. The information provided, including in the draft plan submitted on 21 December 2018, will further contribute to the identification and assessment of energy and climate-related investment needs.

Energy efficiency

Final energy consumption has increased, particularly in the transport sector. Final energy consumption slightly increased since 2016 (Malta's National Energy Efficiency Action Plan, 2017), putting the energy efficiency targets at risk ([36]). In particular, Malta's final energy consumption in the transport sector has been increasing over the last decade and at 55 % of total energy consumption remains well above the EU average of 33 %.

Attracting investment would contribute to further enhancing energy efficiency. Policies have been put into place to promote energy-efficiency in buildings, including through grant schemes for restoration of buildings, soft loans for energy efficiency investments and energy-efficiency awareness campaigns. A support scheme for vulnerable households is in place, under which old appliances are replaced by new efficient units. Energy efficiency in transport is being addressed according to the 2025 Transport Malta Master Plan while efforts to roll-out energy efficient street lighting continued. Further investment is needed to promote energy efficiency and achieve energy savings in buildings, transport and industry sectors.

While Malta remains above its trajectory on renewable energy use, further investments are needed to meet the envisaged targets. The share of renewables in the energy mix has increased, reaching 7.2 % in 2017, slightly above the 2017/2018 indicative trajectory level of 6.5 %. In recent years, Malta has focused on the promotion of solar energy and use of biofuels. Further investments across sectors need to be implemented in the short term in order to meet the 2020 target of 10 %.

([36]) See Annex A.

3.4.2. MARKET FUNCTIONING

Regulation in certain sectors appears restrictive. In 2016, retail activities involved about 5,800 firms in Malta accounting for about 4.7 % of added value. The Commission's Restrictiveness Indicator shows that Malta is among the ten most restrictive EU countries in this area (European Commission, 2018n). Simplifying procedures would favour competition, reducing mark-ups and increasing retailers' incentives to innovate and invest. It would also trigger growth in the logistics and warehouse sectors that are essential for on-line trade development. In addition, several market regulatory frameworks are more restrictive than most EU countries (OECD, 2015; European Commission, 2018c), for example in the area of professional services. This suggests there is scope for lifting unnecessary constraints.

The gaming sector continues to experience strong growth, generating spillovers. In 2017, gross added value in the gaming sector increased by 10 % and represented 11 % of total added value. In the same year, the number of remote gaming licences increased by 22 %. Employment increased by 8 %, with 90 % of employees in the sector working on remote gaming activities. The gaming sector also generates important spillovers in other economic sectors with high value added (see also Section 1). Further expansion of the sector is expected following the new regulatory framework adopted in 2018, which simplifies further the licensing process (Malta Gaming Authority, 2018). As the sector has been vulnerable to money laundering practices in the past, ensuring effective supervision is crucial, also in view of the strengthened obligations to prevent money laundering that recently came into force (see also Section 3.2).

Energy market

Due to its size and insularity, Malta has no wholesale and retail markets for electricity and gas. The state-owned energy company Enemalta remains the only enterprise with a licence to supply electricity to final customers, and therefore it is not possible to implement customer switching. Malta is proceeding with electricity smart meter roll out, with more than 90 % of final customers having an electricity smart meter.

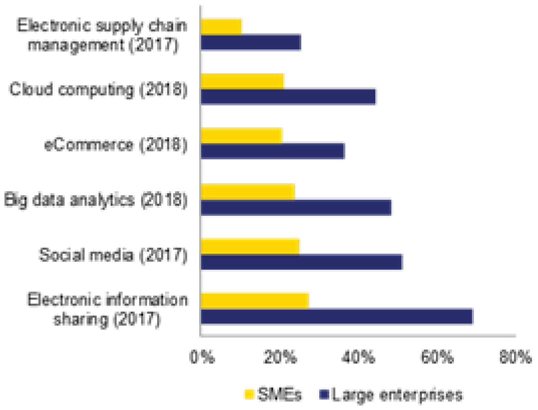
Substantial investments have been made to secure energy supply. The new interconnector between the electricity grid of Malta and Italy represents major improvement, increasing Malta's electricity interconnection level from 0 % to over 24 %. Additional investments to strengthen security of supply have been made, including a new gas fired combined cycle gas turbine plant, the conversion of an existing diesel-engine plant to run on natural gas and a liquid natural gas facility. In line with Malta's strategy to shift generation to natural gas, existing diesel-engine plants are being converted from the use of heavy fuel oil to natural gas. The entry into operation of a gas pipeline interconnector with Italy (an EU project of common interest), estimated for 2024, will be an important step toward increasing the security of gas supply.

Digital economy

Malta has recently introduced a new regulatory framework on innovative technologies, including blockchain. On 1 November 2018, a comprehensive legislative package, regulating the use of distributed ledger technology platforms, including blockchain, came into force. The distributed ledger technology platforms use independent nodes to record, share and synchronise transactions, instead of keeping data centralised as in a traditional ledger. The new regulatory framework comprises three acts, covering: (i) virtual financial assets, including crypto-currencies; (ii) innovative technology arrangements and services; (iii) the establishment of the Malta Digital Innovation Authority. Such legislation aims at promoting Malta as a digital innovation hub, as well as providing legal certainty in an area which is still mostly unregulated within the EU. In November 2018, the Authority started receiving applications for the new professional profiles of systems auditors and technical administrators, while the licensing of new technology arrangements is expected to start in January 2019. Making efficient use of the significant opportunities requires tackling associated risks, particularly in relation to financial supervision (see also Section 3.2).

Maltese small and medium-sized enterprises (SMEs) show a mixed performance in the area of e-commerce. A share of 20 % of SMEs sell online compared with 17 % in the EU, however e-commerce represents 7 % of SMEs turnover (below the EU average of 10 %). SMEs make far less use of key digital technologies than large enterprises and are also lagging behind in e-commerce (see Graph 3.4.4). At the same time, Malta scores well on big data analytics and cross-border sales of SMEs (9 %, compared to 8 % in the EU). In 2017, the Malta Communications Authority conducted a review of the National e-commerce Strategy, to help ensure that businesses have the necessary means and skills to capitalise on e-commerce opportunities.

Graph 3.4.4: **Integration of digital technologies in Malta**



Source: European Commission

The Maltese authorities are implementing initiatives to promote digital and emerging technologies. The Communications Authority aims to promote the importance of business process transformation and new technologies, such as internet of things, 'big data', quantum computing, cybersecurity and cloud computing. To incentivise digital entrepreneurship, the Malta Information Technology Agency Innovation Hub continued its accelerator programme, which provides seed investment to help early-stage start-ups validate, prototype, test and take their business idea to the market. At the end of 2018, the government also announced the creation of a dedicated task force, aimed at developing a national strategy on artificial intelligence.

3.4.3. GOVERNANCE/INSTITUTIONS QUALITY

Business environment

Indicators on the quality of the business environment provide a mixed picture. Malta performs better than the EU average in terms of internationalisation, ICT skills and growth rates. However, participation of small and medium-sized enterprises in public tenders appears to be low. In addition, resolving insolvency appears twice as difficult ([37]) in Malta as the EU average (European Commission, 2018k). The 2017 amendment of the Companies' Act should improve a company's chances of avoiding bankruptcy through restructuring and refinancing measures. However, its impact has yet to be assessed.

Business-to-business late payments remain an issue. At the end of 2017, the average payment delay across all Maltese business sectors was 82 days. In the construction sector the delay went beyond 90 days (Malta Association of Credit Management, 2018; European Construction Sector Observatory, 2018). Such practices penalise small and medium-sized enterprises in particular.

Justice system

The justice system continues to face a number of challenges and recent reforms have not fully ensured the independence of the judiciary. In December 2018, the Council of Europe's Commission for Democracy through Law (the Venice Commission) adopted an opinion on Malta ([38]). The Venice Commission raised, among others, concerns related to the independence of the judiciary, to judicial appointments and to the role of the Attorney General, making a number of recommendations to this end.

Some improvements were made to the efficiency of administrative justice. Disposition time remains high (1,147 days in 2017 compared to 1,464 days in 2016). However, the clearance rate for first instance administrative cases increased from 114 % in 2016 to 147 % in 2017 and backlogs decreased by 12.4 %. The performance of civil justice remained largely stable as regards the disposition time for first instance litigious civil and commercial cases, but the clearance rate for first instance litigious civil and commercial cases decreased from 107 % in 2016 to 97 % in 2017 and backlogs also increased slightly in 2017 (European Commission, 2019e).

Reforms to improve the efficiency and the quality of the justice system are ongoing. Judicial reforms are currently being implemented in order to promote further specialisation of courts, extend the use of mediation to some administrative cases, and enhance the administrative autonomy of the courts. In addition, an e-justice portal is now in place as the main one-stop mobile accessible service for legal professionals and citizens. The Ministry of Justice started working on a depenalisation project, to be finalised by end 2019, to lighten the overall caseload of magistrates. Training for judges and magistrates has been intensified in 2018 in various legal areas such as anti-money laundering, forensics, ethics and cybercrime.

Digital public service

Malta is a European leader in the provision of digital public services and continued to improve the user experience. It ranks first in the re-use of information across administrations to make life easier for citizens (pre-filled forms) and in the sophistication of services (online service completion), for both of which it has the maximum score (European Commission, 2018o). However, the use of eGovernment and eHealth by citizens is below the EU average. As part of the Mobile Government Strategy, the first wave of applications has been launched focusing on extending and complementing the existing communication channels between the government and citizens, targeting a variety of services, such as taxation, customs and health.

Fight against corruption

Weaknesses in the governance framework weigh on the investment climate. Survey results indicate insufficient stability and transparency of the political, legal and regulatory framework as

([37]) The assessment is based on the strength of insolvency framework index that looks at the four areas: commencement of insolvency proceedings, management of the debtor's assets, reorganization proceedings, and creditor participation in insolvency proceedings

([38]) Opinion No. 940 / 2018: "On constitutional arrangements and separation of powers and the independence of the judiciary and law enforcement".

one of the weakest links in Malta's capacity to attract investment. In 2018 the parameter fell for the third consecutive year (Ernst & Young, 2018). A *Eurobarometer* survey shows that 58 % of company representatives consider corruption a problem when doing business in Malta (European Commission, 2017b).

Lack of transparency, fragmentation of tenders and the number of direct grants may point to irregularities in public procurement. Reportedly, many public procurement contracts have been fragmented so that they fall below the threshold, or subject to other irregularities (European Commission, 2018p; NAO 2011, 2018a, 2018b). Data on public contracts, which should be accessible under the Freedom of Information Act, are regularly withheld. The Ombudsman is reported to have been denied access to important documents related to closed public tenders (Ombudsman's Annual Report, 2017).

There are risks of conflicts of interests at various levels of government. A high number of political appointees in ad-hoc positions were, for instance, not subject to scrutiny or integrity rules until November 2018, when the Standards in Public Life Act came into force. Part-time salaries received by members of Parliament (MPs) affect their ability to operate independently from the executive, and this practice was exacerbated by appointments of MPs to important paid posts such as heads of a public authority. Furthermore, the investor citizenship scheme has been designed and implemented by a contracted entity, which carries out due diligence, yet at the same time may advise individuals on their applications to the scheme. In terms of transparency, although there is a regulator for the investor citizenship scheme that publishes annual reports, the transparency and governance of the scheme could still be improved. In contrast, there is no regulator and very limited transparency as regards the Maltese investor residence scheme (European Commission, 2019c).

The anti-corruption institutional framework presents serious shortcomings. The Permanent Commission against Corruption conducts investigations either on its own initiative or following reports by anyone. However, structural flaws hinder its ability to fulfil its role independently and effectively. First, its membership and the appointment of special experts depend on the Prime Minister's decision. Second, the Permanent Commission against Corruption reports its findings to the Minister of Justice who does not have investigation powers and has not – with one exception – forwarded any report to the police in the last decade. It is unclear what follow-up measures have been taken on the Permanent Commission against Corruption reports or why only one case was forwarded to the police for further investigation. Also, there is no transparency as to what cases the Permanent Commission against Corruption investigates and what recommendations have been made. The Venice Commission was critical of this institutional set-up in its recent Opinion on Malta.

The accountability of the police and the Attorney General is deficient. The police, whose Commissioner is appointed by the government, is the primary authority investigating crimes and in part represents the prosecution. The police's Economic Crimes Units appears understaffed and a major reform is planned to increase its capacity by 2020. Reports on allegations related to money laundering, corruption, abuse of power, and crimes related to illicit trades received by the police are often not followed up by charges ([39]). The task of prosecution is split between the police and the Attorney General. The long standing double role of the Attorney General as an adviser/representative of the Government and as prosecutor is seen as problematic from the viewpoint of the principle of checks and balances and the separation of powers ([40]).

([39]) The Police Economic Crimes Squad investigated 20 bribery cases in 2016, 9 in 2017 and 8 until October 2018. Two people were indicted in 2016, one in 2017, and none in 2018.

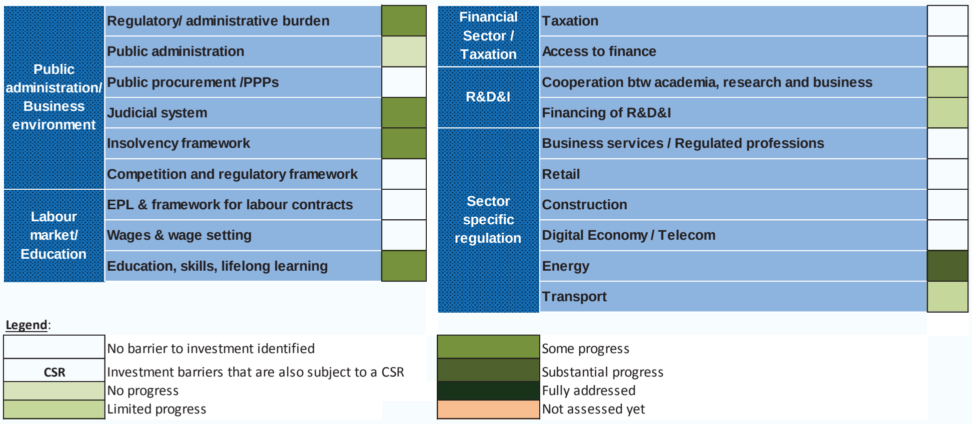
([40]) The Venice Commission report of December 2018 states: "this is problematic from the viewpoint of separation of powers, notably taking into account the method of appointment of the AG and the Police Commissioner, which makes it open to criticism when considering politically controversial or sensitive prosecutions".

Box 3.4.1: **Investment - challenges and reforms in Malta**

Section 1. Macroeconomic perspective

After reaching around 160 % of its pre-crisis level in 2015 and 2016, partly due to exceptional investment growth in the energy and transport sectors, aggregate investment in real terms declined in 2017, despite a significant expansion of residential construction investment. Provisional data from 2018 point to a further slight investment contraction in real terms. In particular, construction investment remained stable; transport investment fell, while machinery and equipment investment rose. Looking ahead, a strong recovery in the investment outlook is expected to start in 2019, on the back of both public and private investment growth (see Section 1).

Section 2. Assessment of barriers to investment and ongoing reforms



In a context of strong GDP growth and a favourable investment climate, a number of investment challenges persist in Malta. Weaknesses in the governance framework, especially in relation to the judicial system and anti-corruption enforcement, affect the business environment (see Section 3.4). Labour and skills shortages still weigh on firms' investment decisions, with the lack of availability of skilled staff resulting in significant reliance on foreign labour (see Section 3.3). Infrastructure bottlenecks, including severe traffic congestion, are often perceived as a barrier to investment. In addition, insufficient innovation and limited capacity to scale up R&D activities still represent a challenge to firms' growth (see Section 3.4).

Main barriers to investment and priority actions underway

- Vulnerabilities in the governance framework, in particular in relation to the judicial system and anti-corruption enforcement, weigh on the investment climate. Survey indicators identify corruption, the length of legal proceedings and lack of legal and political transparency as barriers to investment. In addition, existing shortcomings in the anti-money laundering framework pose reputational risks to the entire economy. A number of judicial reforms to enhance the efficiency of the justice system are being implemented. The Maltese authorities have also recently adopted an integrated strategy to strengthen the anti-money laundering framework (see Sections 3.2 and 3.4).
- Availability of skilled staff is seen by firms as one of the main barriers to investment. Skills shortages, in particular in the service sector, remain a challenge as the demand for skilled labour continues to outstrip supply. While recent policy initiatives aim to upgrade skill levels and better align education and business needs, their effects have not been felt yet (see Section 3.3).

The public Malta Development Bank was established in November 2017. It plans to focus activities on complementing and supplementing the operations of market players in the provision of financing facilities, particularly to small and medium-sized enterprises, infrastructure projects that contribute to national or regional development, and projects which are socially oriented, energy efficient and environment friendly.

ANNEX A: OVERVIEW TABLE

Commitments	Summary assessment([41])
2018 country-specific recommendations (CSRs)	
CSR 1: Strengthen the overall governance framework by enhancing the national supervision of internationally oriented financial businesses licensed in Malta, by ensuring the effective enforcement of the Anti-Money Laundering framework and by continuing to step up the fight against corruption.	Malta has made **limited progress** in addressing CSR1. Some steps have been taken on financial supervision and against money laundering. The MFSA has introduced a number of strategic initiatives aimed at enhancing its supervisory capacity and regulatory performance. No significant steps have been taken to strengthen the anti-corruption framework. In particular, the police still appears understaffed. A reform is planned to increase the capacity of the Economic Crimes Squad by 2020. Also, the Permanent Commission against Corruption (PCAC) conducts investigations either on its own initiative or in response to reports by anyone. However, structural flaws hinder its ability to independently and effectively fulfil its role.
CSR 2: Ensure the sustainability of the healthcare and the pension systems, including by increasing the statutory retirement age and by restricting	Malta has made **limited progress** in addressing CSR2. In the area of pensions, a Pension Strategy Group

([41]) The following categories are used to assess progress in implementing the 2017 country-specific recommendations (CSRs):

No progress: The Member State has not credibly announced nor adopted any measures to address the CSR. This category covers a number of typical situations, to be interpreted on a case-by-case basis taking into account country-specific conditions. They include the following:
no legal, administrative, or budgetary measures have been announced
in the national reform programme,
in any other official communication to the national Parliament/relevant parliamentary committees or the European Commission,
publicly (e.g. in a press statement or on the government's website);
no non-legislative acts have been presented by the governing or legislative body;
the Member State has taken initial steps in addressing the CSR, such as commissioning a study or setting up a study group to analyse possible measures to be taken (unless the CSR explicitly asks for orientations or exploratory actions). However, it has not proposed any clearly-specified measure(s) to address the CSR.

Limited progress: The Member State has:
announced certain measures but these address the CSR only to a limited extent; and/or
presented legislative acts in the governing or legislative body but these have not been adopted yet and substantial further, non-legislative work is needed before the CSR is implemented;
presented non-legislative acts, but has not followed these up with the implementation needed to address the CSR.

Some progress: The Member State has adopted measures
that partly address the CSR; and/or
that address the CSR, but a fair amount of work is still needed to address the CSR fully as only a few of the measures have been implemented. For instance, a measure or measures have been adopted by the national Parliament or by ministerial decision, but no implementing decisions are in place.

Substantial progress: The Member State has adopted measures that go a long way towards addressing the CSR and most of them have been implemented.

Full implementation: The Member State has implemented all measures needed to address the CSR appropriately.

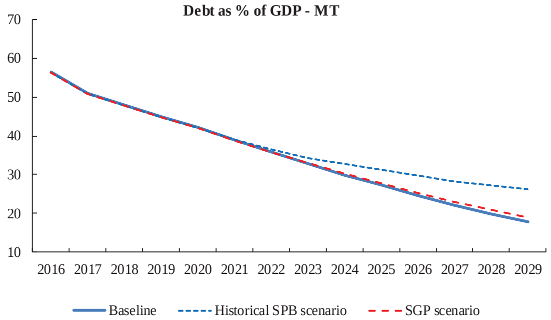
early retirement.	was established in 2018 and a report is expected by December 2020, outlining recommendations for improving adequacy and sustainability of the pension system. Efforts are continuing to diversify retirement income and reduce dependency on state pensions. The 2019 budget strengthens the fiscal incentives for private pension savings and voluntary occupational retirement pensions. The authorities are also incentivising older workers to return to work and stay in work longer, through changes to contributions paid, and addressing low education attainment levels to increase activity, employment and productivity of the population. A first assessment of these initiatives points to very little or no impact on the sustainability of the pension system, but possible increases in non-pension income. In the area of health, services are continuing to be decentralised — from hospitals to the primary care level — with new regional primary care centres being built and investment made to gradually expand the use of eHealth. Acute and geriatric care capacity will increase by means of a public-private partnership between the government and a private hospital operator, which provides for the refurbishment, development and management of three public hospitals in Malta and Gozo. While these initiatives seem to go into the right direction, it is not yet clear how they will affect the Maltese health system's long-term fiscal sustainability.
Europe 2020 (national targets and progress)	
Employment rate target set in the NRP: 70 %	The employment rate in Malta stood at 73 % in 2017 (an increase of 13.8 pps since 2008), higher than EU average and above the 70 % EU2020 target.
Early school leaving target: 10 %	Malta has made significant progress towards achieving this target. The share of early leavers from education and training decreased to 17.7 % in 2017 but it is still well above the EU average and one of the highest in the EU.
Tertiary education target: 33 %	Malta met its target in 2017. The share of people aged 30-34 with tertiary education attainment was 33.5 in 2017, still below the EU average, but signalling a steady increase over the last decade.

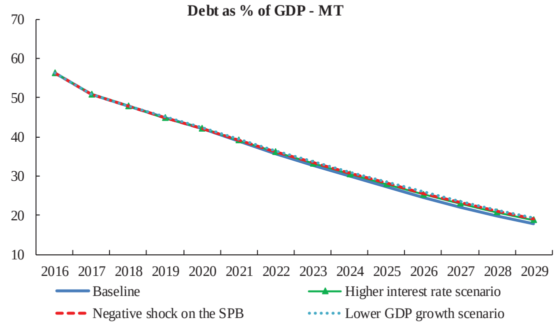
At risk of poverty target in numbers of people: Lifting 6,560 individuals from the risk of poverty or social exclusion	In 2017, there were 83,000 at risk of poverty or social exclusion, a decrease of 5,000 people since 2017. In absolute terms, 2,000 more people are at risk of poverty or social exclusion in 2017 compared to 2008.
Greenhouse gas (GHG) emissions target: + 5% in 2020 compared to 2005 (in sectors outside the scope of the Emissions Trading Scheme).	According to the latest national projections submitted to the Commission, the 2020 target under the Effort Sharing Decision is expected to be missed by a margin of 11 pps.
2020 Renewable energy target: 10 % of gross final energy consumption	The share of renewables in Malta was 7.2 % in 2017, slightly above the indicative trajectory level of 6.5 %. In view of rising energy consumption and the steeper trajectory towards 2020, further investments in the renewable energy sector are required to meet the 2020 target of 10 %.
The 2020 indicative energy efficiency target (absolute level of energy consumption in 2020) is: - 0.823 Mtoe expressed in primary energy consumption, and - 0.623 Mtoe expressed in final energy consumption.	Progress is still limited as regards improving energy efficiency. Malta should increase its efforts to decrease its primary and final energy consumption in order to ensure that its indicative national 2020 energy efficiency targets are met. Malta managed to reduce its primary energy consumption (from 0.916 Mtoe in 2005 rising up to 0.970 Mtoe in 2012 and then falling to 0.723 Mtoe in 2016). Indicators for 2017 show an increase to 0.823 Mtoe.. However, Malta's final energy consumption is continuously increasing over the last years (from 0.464 Mtoe in 2005 up to 0.623 Mtoe in 2017), with the transport and the services being the most consuming sectors.
R&D target: 2 % of GDP	R&D intensity stood at 0.55 % of GDP in 2017. Malta is unlikely to reach its target by 2020. In 2017, Malta’s R&D intensity was composed of 62% private investment (0.34%of GDP) and 38% public investment (0.21%of GDP).

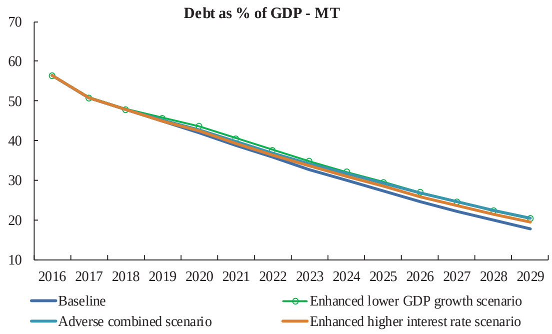
ANNEX B: COMMISSION DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

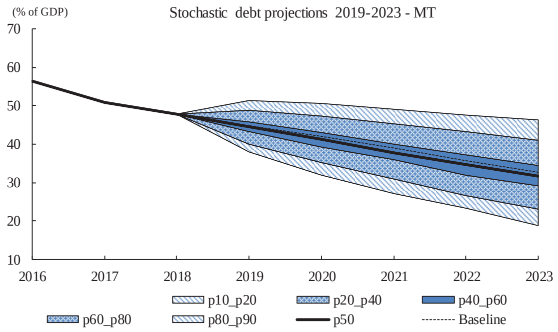
General Government debt projections under baseline, alternative scenarios and sensitivity tests

MT - Debt projections baseline scenario	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Gross debt ratio	**50.9**	**47.9**	**44.8**	**42.1**	**38.9**	**35.8**	**32.8**	**30.0**	**27.3**	**24.6**	**22.2**	**19.9**	**17.8**
Changes in the ratio (-1+2+3)	*-5.4*	*-3.0*	*-3.1*	*-2.8*	*-3.2*	*-3.1*	*-3.0*	*-2.8*	*-2.7*	*-2.7*	*-2.5*	*-2.3*	*-2.1*
of which													
(1) Primary balance (1.1+1.2+1.3)	**5.4**	**2.9**	**2.6**	**2.0**	**2.0**	**2.1**	**2.2**	**2.1**	**2.0**	**2.1**	**2.0**	**1.9**	**1.8**
(1.1) Structural primary balance *(1.1.1-1.1.2+1.1.3)*	***4.9***	***2.5***	***2.4***	***2.2***	***2.1***	***2.2***	***2.2***	***2.1***	***2.0***	***2.1***	***2.0***	***1.9***	***1.8***
(1.1.1) Structural primary balance (bef. CoA)	*4.9*	*2.5*	*2.4*	*2.2*	*2.2*	*2.2*	*2.2*	*2.2*	*2.2*	*2.2*	*2.2*	*2.2*	*2.2*
(1.1.2) Cost of ageing					*0.1*	*0.0*	*0.0*	*0.1*	*0.1*	*0.1*	*0.2*	*0.3*	*0.4*
(1.1.3) Others (taxes and property incomes)					*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
(1.2) Cyclical component	***0.7***	***0.4***	***0.2***	***-0.2***	***-0.1***	***-0.1***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***
(1.3) One-off and other temporary measures	***-0.3***	***0.0***	***0.1***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***
(2) Snowball effect (2.1+2.2+2.3)	**-3.0**	**-2.0**	**-1.7**	**-1.5**	**-1.2**	**-1.0**	**-0.8**	**-0.7**	**-0.7**	**-0.6**	**-0.5**	**-0.4**	**-0.4**
(2.1) Interest expenditure	*1.8*	*1.6*	*1.5*	*1.3*	*1.2*	*1.1*	*1.1*	*1.0*	*0.9*	*0.9*	*0.8*	*0.7*	*0.6*
(2.2) Growth effect	*-3.4*	*-2.6*	*-2.2*	*-1.8*	*-1.6*	*-1.3*	*-1.2*	*-1.1*	*-1.0*	*-0.9*	*-0.8*	*-0.7*	*-0.6*
(2.3) Inflation effect	*-1.4*	*-1.1*	*-1.0*	*-0.9*	*-0.9*	*-0.8*	*-0.7*	*-0.6*	*-0.6*	*-0.5*	*-0.5*	*-0.4*	*-0.4*
(3) Stock-flow adjustments	**2.9**	**1.9**	**1.3**	**0.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**









Short term	Medium term	S1	Debt sustainability analysis (detail)	Baseline	Historical SPB	Lower GDP growth	Higher interest rate	Negative shock on SPB	Stochastic projections	DSA	S2	Long term
LOW (S0 = 0.1)	LOW	LOW (S1 = -4.7)	Risk category	LOW	LOW	LOW	LOW	LOW	LOW	LOW	MEDIUM (S2 = 3.3)	MEDIUM
			Debt level (2029)	17.8	26.3	19.3	18.8	19.2				
			Debt peak year	2018	2018	2018	2018	2018				
			Percentile rank	23.0%	35.0%							
			Probability debt higher						8.1%			
			Dif. between percentiles						27.5			

Note: For further information, see the European Commission Fiscal Sustainability Report (FSR) 2018.

[1] The first table presents the baseline no-fiscal policy change scenario projections. It shows the projected government debt dynamics and its decomposition between the primary balance, snowball effects and stock-flow adjustments. Snowball effects measure the net impact of the counteracting effects of interest rates, inflation, real GDP growth (and exchange rates in some countries). Stock-flow adjustments include differences in cash and accrual accounting, net accumulation of assets, as well as valuation and other residual effects.

[2] The charts present a series of sensitivity tests around the baseline scenario, as well as alternative policy scenarios, in particular: the historical structural primary balance (SPB) scenario (where the SPB is set at its historical average), the Stability and Growth Pact (SGP) scenario (where fiscal policy is assumed to evolve in line with the main provisions of the SGP), a higher interest rate scenario (+1 pp. compared to the baseline), a lower GDP growth scenario (-0.5 pp. compared to the baseline) and a negative shock on the SPB (calibrated on the basis of the forecasted change). An adverse combined scenario and enhanced sensitivity tests (on the interest rate and growth) are also included, as well as stochastic projections. Detailed information on the design of these projections can be found in the FSR 2018.

[3] The second table presents the overall fiscal risk classification over the short, medium and long-term.

a. For the short-term, the risk category (low/high) is based on the S0 indicator. S0 is an early-detection indicator of fiscal stress in the upcoming year, based on 25 fiscal and financial-competitiveness variables that have proven in the past to be leading indicators of fiscal stress. The critical threshold beyond which fiscal distress is signalled is 0.46.

b. For the medium-term, the risk category (low/medium/high) is based on the joint use of the S1 indicator and of the DSA results. The S1 indicator measures the fiscal adjustment required (cumulated over the 5 years following the forecast horizon and sustained thereafter) to bring the debt-to-GDP ratio to 60 % by 2033. The critical values used are 0 and 2.5 pps. of GDP. The DSA classification is based on the results of 5 deterministic scenarios (baseline, historical SPB, higher interest rate, lower GDP growth and negative shock on the SPB scenarios) and the stochastic projections. Different criteria are used such as the projected debt level, the debt path, the realism of fiscal assumptions, the probability of debt stabilisation, and the size of uncertainties.

c. For the long-term, the risk category (low/medium/high) is based on the joint use of the S2 indicator and the DSA results. The S2 indicator measures the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical values used are 2 and 6 pps. of GDP. The DSA results are used to further qualify the long-term risk classification, in particular in cases when debt vulnerabilities are identified (a medium / high DSA risk category).

ANNEX C: STANDARD TABLES

Table C.1: **Financial market indicators**

	2013	2014	2015	2016	2017	2018
Total assets of the banking sector (% of GDP)[1)]	658,7	621,6	497,6	454,6	431,3	386,7
Share of assets of the five largest banks (% of total assets)	76,5	81,5	81,3	80,3	80,9	-
Foreign ownership of banking system (% of total assets)[2)]	74,9	71,4	66,5	59,6	57,9	55,7
Financial soundness indicators:[2)]						
- non-performing loans (% of total loans)	-	6,0	5,1	4,1	3,1	3,2
- capital adequacy ratio (%)	46,4	25,1	21,2	20,2	21,1	21,8
- return on equity (%)[3)]	3,7	4,4	6,3	8,1	7,2	4,1
Bank loans to the private sector (year-on-year % change)[1)]	-7,4	10,1	0,7	5,8	8,5	6,4
Lending for house purchase (year-on-year % change)[1)]	6,2	9,6	8,6	7,5	7,5	8,2
Loan to deposit ratio[2)]	-	54,2	49,1	56,3	61,4	66,1
Central Bank liquidity as % of liabilities[1)]	-	0,9	0,3	0,4	-	0,2
Private debt (% of GDP)	143,9	135,7	122,5	123,5	120,2	-
Gross external debt (% of GDP)[2)] - public	8,5	7,0	6,3	6,5	6,7	6,2
- private	705,7	684,0	634,6	596,2	569,7	543,4
Long-term interest rate spread versus Bund (basis points)*	179,3	144,8	99,2	79,6	96,4	97,1
Credit default swap spreads for sovereign securities (5-year)*	215,8	208,5	208,5	208,7	208,7	208,7

(1) Latest data Q3 2018. Includes not only banks but all monetary financial institutions excluding central banks.
(2) Latest data Q2 2018.
(3) Quarterly values are not annualised.
* Measured in basis points.
Source: European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators).

Table C.2: **Headline Social Scoreboard indicators**

	2013	2014	2015	2016	2017	2018 [6]
Equal opportunities and access to the labour market						
Early leavers from education and training (% of population aged 18-24)	20,8	20,9	20,2	19,2	17,7	:
Gender employment gap (pps)	28,6	26,8	26,8	25,5	24,1	22,2
Income inequality, measured as quintile share ratio (S80/S20)	4,1	4,0	4,2	4,2	4,2	:
At-risk-of-poverty or social exclusion rate[1] (AROPE)	24,0	23,8	22,4	20,1	19,2	:
Young people neither in employment nor in education and training (% of population aged 15-24)	9,9	10,3	10,5	8,8	8,6	:
Dynamic labour markets and fair working conditions						
Employment rate (20-64 years)	66,2	67,9	69,0	71,1	73,0	74,7
Unemployment rate[2] (15-74 years)	6,1	5,7	5,4	4,7	4,0	3,9
Long-term unemployment rate[3] (as % of active population)	2,8	2,7	2,4	1,9	1,6	1,0
Gross disposable income of households in real terms per capita[4] (Index 2008=100)	:	:	:	:	:	:
Annual net earnings of a full-time single worker without children earning an average wage (levels in PPS, three-year average)	21404	21284	21218	21243	:	:
Annual net earnings of a full-time single worker without children earning an average wage (percentage change, real terms, three-year average)	2,0	-0,7	-0,2	0,4	:	:
Public support / Social protection and inclusion						
Impact of social transfers (excluding pensions) on poverty reduction[5]	32,6	33,2	31,2	30,7	29,1	:
Children aged less than 3 years in formal childcare	20,0	18,2	17,9	31,3	39,6	:
Self-reported unmet need for medical care	0,9	1,1	0,8	1,0	0,2	:
Individuals who have basic or above basic overall digital skills (% of population aged 16-74)	:	:	53,0	50,0	57,0	:

(1) People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in households with zero or very low work intensity (LWI).
(2) 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.
(3) Long-term unemployed are people who have been unemployed for at least 12 months.
(4) Gross disposable household income is defined in unadjusted terms, according to the draft Joint Employment Report 2019.
(5) Reduction in percentage of the risk of poverty rate, due to social transfers (calculated comparing at-risk-of poverty rates before social transfers with those after transfers; pensions are not considered as social transfers in the calculation).
(6) Average of first three quarters of 2018 for the employment rate, unemployment rate and gender employment gap. Data for unemployment rate is seasonally adjusted.
Source: Eurostat

Table C.3: **Labour market and education indicators**

Labour market indicators	2013	2014	2015	2016	2017	2018 [4]
Activity rate (15-64)	66,3	67,8	68,9	70,6	72,2	:
Employment in current job by duration						
From 0 to 11 months	10,3	9,9	10,3	12,4	13,9	:
From 12 to 23 months	9,9	10,7	10,1	11,6	12,4	:
From 24 to 59 months	16,7	18,9	19,7	18,7	19,6	:
60 months or over	61,4	59,4	59,0	57,3	54,0	:
Employment growth* (% change from previous year)	3,7	5,1	3,9	4,2	5,3	5,3
Employment rate of women (% of female population aged 20-64)	51,7	54,3	55,3	58,0	60,6	63,2
Employment rate of men (% of male population aged 20-64)	80,3	81,1	82,1	83,5	84,7	85,4
Employment rate of older workers* (% of population aged 55-64)	37,1	39,5	42,3	45,8	47,2	49,1
Part-time employment* (% of total employment, aged 15-64)	14,0	15,3	14,3	13,9	13,7	13,3
Fixed-term employment* (% of employees with a fixed term contract, aged 15-64)	7,6	7,7	7,5	7,6	6,0	7,5
Participation in activation labour market policies (per 100 persons wanting to work)	5,4	16,0	11,5	8,2	:	:
Transition rate from temporary to permanent employment (3-year average)	31,6	12,7	14,9	:	:	:
Youth unemployment rate (% active population aged 15-24)	12,7	11,7	11,6	10,7	10,6	8,5
Gender gap in part-time employment	19,3	21,2	20,1	19,9	18,3	17,0
Gender pay gap[1] (in undadjusted form)	9,7	10,6	10,4	11,0	:	:
Education and training indicators	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Adult participation in learning (% of people aged 25-64 participating in education and training)	7,7	7,7	7,4	7,8	10,6	:
Underachievement in education[2]	:	:	29,1	:	:	:
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	28,7	28,6	29,1	32,0	33,5	:
Variation in performance explained by students' socio-economic status[3]	:	:	14,5	:	:	:

* Non-scoreboard indicator
(1) Difference between the average gross hourly earnings of male paid employees and of female paid employees as a percentage of average gross hourly earnings of male paid employees. It is defined as "unadjusted", as it does not correct for the distribution of individual characteristics (and thus gives an overall picture of gender inequalities in terms of pay). All employees working in firms with ten or more employees, without restrictions for age and hours worked, are included.
(2) PISA (OECD) results for low achievement in mathematics for 15 year-olds.
(3) Impact of socio-economic and cultural status on PISA (OECD) scores. Values for 2012 and 2015 refer respectively to mathematics and science.
(4) Average of first three quarters of 2018. Data for youth unemployment rate is seasonally adjusted.
Source: Eurostat, OECD

Table C.4: **Social inclusion and health indicators**

	2012	2013	2014	2015	2016	2017
Expenditure on social protection benefits* (% of GDP)						
Sickness/healthcare	5.9	6.0	5.9	5.5	5.4	:
Disability	0.7	0.7	0.7	0.6	0.6	:
Old age and survivors	10.2	9.8	9.3	8.6	8.7	:
Family/children	1.1	1.2	1.3	1.1	1.0	:
Unemployment	0.5	0.6	0.5	0.5	0.4	:
Housing	0.1	0.1	0.1	0.2	0.2	:
Social exclusion n.e.c.	0.3	0.3	0.3	0.2	0.2	:
Total	19.0	18.7	18.1	16.9	16.5	:
of which: means-tested benefits	2.4	2.4	2.3	2.2	1.9	:
General government expenditure by function (% of GDP, COFOG)						
Social protection	14.0	13.8	13.1	12.4	12.0	:
Health	5.5	5.7	5.7	5.8	5.6	:
Education	5.8	5.8	5.6	5.5	5.4	:
Out-of-pocket expenditure on healthcare (% of total health expenditure)	:	:	:	:	:	:
Children at risk of poverty or social exclusion (% of people aged 0-17)*	31.0	32.0	31.3	28.2	24.0	22.8
At-risk-of-poverty rate[1] (% of total population)	15.1	15.7	15.9	16.3	16.5	16.8
In-work at-risk-of-poverty rate (% of persons employed)	5.2	5.9	5.7	5.4	5.8	5.9
Severe material deprivation rate[2] (% of total population)	9.2	9.5	10.2	8.1	4.4	3.3
Severe housing deprivation rate[3], by tenure status						
Owner, with mortgage or loan	1.1	0.7	1.0	0.9	0.5	0.2
Tenant, rent at market price	3.4	4.9	8.0	4.1	10.1	4.1
Proportion of people living in low work intensity households[4] (% of people aged 0-59)	9.0	9.0	9.8	9.2	7.3	6.7
Poverty thresholds, expressed in national currency at constant prices*	6116	6259	6554	6863	6823	7223
Healthy life years (at the age of 65)						
Females	12.3	12.7	13.7	14.0	12.9	:
Males	12.5	12.8	13.3	13.4	12.8	:
Aggregate replacement ratio for pensions[5] (at the age of 65)	0.5	0.6	0.6	0.5	0.5	0.6
Connectivity dimension of the Digital Economy and Society Inedex (DESI)[6]	:	:	54.4	62.9	66.1	67.9
GINI coefficient before taxes and transfers*	44.4	45.5	45.7	45.6	45.6	45.1
GINI coefficient after taxes and transfers*	27.1	27.9	27.7	28.1	28.5	28.3

* Non-scoreboard indicator.
(1) At-risk-of-poverty rate (AROP): proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.
(2) 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.
(3) Percentage of total population living in overcrowded dwellings and exhibiting housing deprivation.
(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) Ratio of the median individual gross pensions of people aged 65-74 relative to the median individual gross earnings of people aged 50-59.
(6) Fixed broadband take up (33%), mobile broadband take up (22%), speed (33%) and affordability (11%), from the Digital Scoreboard.
Source: Eurostat, OECD

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

Performance indicators	2012	2013	2014	2015	2016	2017
Labour productivity per person[1] growth (t/t-1) in %						
Labour productivity growth in industry	:	:	:	:	:	:
Labour productivity growth in construction	:	:	:	:	:	:
Labour productivity growth in market services	:	:	:	:	:	:
Unit Labour Cost (ULC) index[2] growth (t/t-1) in %						
ULC growth in industry	:	:	:	:	:	:
ULC growth in construction	:	:	:	:	:	:
ULC growth in market services	:	:	:	:	:	:
Business environment	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Time needed to enforce contracts[3] (days)	505	505	505	505	505	505
Time needed to start a business[3] (days)	38,5	38,5	33,5	28,0	26,0	16,0
Outcome of applications by SMEs for bank loans[4]	:	0,68	0,58	0,40	0,17	0,47
Research and innovation	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
R&D intensity	0,83	0,77	0,72	0,75	0,58	0,55
General government expenditure on education as % of GDP	5,80	5,80	5,60	5,50	5,40	:
Employed people with tertiary education and/or people employed in science and technology as % of total employment	38	40	40	41	41	44
Population having completed tertiary education[5]	17	18	19	20	20	22
Young people with upper secondary education[6]	75	76	75	77	77	78
Trade balance of high technology products as % of GDP	1,83	-1,10	-3,42	-3,46	-5,84	-1,08
Product and service markets and competition				**2003**	**2008**	**2013**
OECD product market regulation (PMR)[7], overall				:	:	1,57
OECD PMR[7], retail				:	:	1,09
OECD PMR[7], professional services				:	:	1,66
OECD PMR[7], network industries[8]				:	:	2,28

(1) Value added in constant prices divided by the number of persons employed.
(2) Compensation of employees in current prices divided by value added in constant prices.
(3) The methodologies, including the assumptions, for this indicator are shown in detail here: http://www.doingbusiness.org/methodology.
(4) Average of the answer to question Q7B_a. "[Bank loan]: If you applied and tried to negotiate for this type of financing over the past six months, what was the outcome?". Answers were codified as follows: zero if received everything, one if received 75% and above, two if received below 75%, three if refused or rejected and treated as missing values if the application is still pending or don't know.
(5) Percentage population aged 15-64 having completed tertiary education.
(6) Percentage population aged 20-24 having attained at least upper secondary education.
(7) Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are shown in detail here: http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm
(8) Aggregate OECD indicators of regulation in energy, transport and communications (ETCR).
Source: European Commission; World Bank — Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators); SAFE (for outcome of SMEs' applications for bank loans).

Table C.6: **Green growth**

Green growth performance		2012	2013	2014	2015	2016	2017
Macroeconomic							
Energy intensity	kgoe / €	0,14	0,12	0,11	0,09	0,08	0,09
Carbon intensity	kg / €	0,47	0,40	0,37	0,26	0,21	-
Resource intensity (reciprocal of resource productivity)	kg / €	0,63	0,54	0,67	0,72	0,70	0,64
Waste intensity	kg / €	0,21	-	0,21	-	0,22	-
Energy balance of trade	% GDP	-12,2	-9,0	-14,9	-8,8	-8,7	-8,8
Weighting of energy in HICP	%	7,31	7,57	8,05	7,40	7,16	6,61
Difference between energy price change and inflation	%	-2,0	-1,6	-17,0	-8,7	-1,9	-1,1
Real unit of energy cost	% of value added	18,8	16,6	14,8	14,6	14,4	-
Ratio of environmental taxes to labour taxes	ratio	0,26	0,24	0,26	0,27	0,25	-
Environmental taxes	% GDP	2,9	2,7	2,8	2,8	2,7	2,7
Sectoral							
Industry energy intensity	kgoe / €	-	-	-	-	-	-
Real unit energy cost for manufacturing industry excl. refining	% of value added	9,1	9,6	8,9	8,8	8,7	-
Share of energy-intensive industries in the economy	% GDP	-	-	-	-	-	-
Electricity prices for medium-sized industrial users	€ / kWh	0,18	0,18	0,18	0,15	0,14	0,14
Gas prices for medium-sized industrial users	€ / kWh	-	-	-	-	-	-
Public R&D for energy	% GDP	0,00	0,00	0,00	0,00	0,00	0,00
Public R&D for environmental protection	% GDP	0,00	0,00	0,00	0,00	0,00	0,00
Municipal waste recycling rate	%	9,7	8,1	7,4	6,7	7,0	6,4
Share of GHG emissions covered by ETS*	%	61,8	57,6	55,7	39,2	30,3	-
Transport energy intensity	kgoe / €	-	-	-	-	-	-
Transport carbon intensity	kg / €	-	-	-	-	-	-
Security of energy supply							
Energy import dependency	%	101,0	104,2	97,7	97,0	100,6	102,8
Aggregated supplier concentration index	HHI	0,0	0,0	0,0	0,0	0,0	-
Diversification of energy mix	HHI	0,98	0,97	0,96	0,71	0,60	0,41

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2010 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.
Weighting of energy 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).
Real unit energy cost: real energy costs as % of total value added for the economy.
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2010 EUR).
Real unit energy costs for manufacturing industry excluding refining : real costs as % of value added for manufacturing sectors.
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 500–20 00MWh and 10 000–100 000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of recycled and composted municipal waste to total municipal waste.
Public R&D for energy or for the environment: government spending on R&D for these categories as % of GDP.
Proportion of GHG emissions covered by EU emissions trading system (ETS) (excluding aviation): based on GHG emissions (excl land use, land use change and forestry) 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 2010 EUR).
Transport carbon intensity: GHG emissions in transport activity divided by gross value added of the transport industry.
Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels.
Aggregated supplier concentration index: covers oil, gas and coal. Smaller values indicate larger diversification and hence lower risk.
Diversification of the energy mix: Herfindahl index covering natural gas, total petrol products, nuclear heat, renewable energies and solid fuels.
* European Commission and European Environment Agency.
Source: European Commission and European Environment Agency (Share of GHG emissions covered by ETS); European Commission (Environmental taxes over labour taxes and GDP); Eurostat (all other indicators)

ANNEX D: INVESTMENT GUIDANCE ON COHESION POLICY FUNDING 2021-2027 FOR MALTA

Building on the Commission proposal for the next Multi-Annual Financial Framework for the period 2021-2027 of 2 May 2018 (COM (2018) 321), this Annex presents the preliminary Commission services views on priority investment areas and framework conditions for effective delivery for the 2021-2027 Cohesion Policy. These priority investment areas are derived from the broader context of investment bottlenecks, investment needs and regional disparities assessed in the report. This Annex provides the basis for a dialogue between Malta and the Commission services in view of the programming of the cohesion policy funds (European Regional Development Fund, Cohesion Fund and European Social Fund Plus). ([42])

Policy Objective 1: A Smarter Europe – Innovative and smart industrial transformation
Malta's research and innovation performance has improved but the proportion of innovative enterprises is still lagging behind. Priority investment needs ([43]) have therefore been identified to **strengthen research and innovation performance and foster productivity growth by identifying smart specialisation areas on the basis of national and regional needs and potential** and in particular to: • promote business investment in research and innovation science-business cooperation and enhance research and development capacity in sectors linked to the smart specialisation; • enhance development and provision of key digital technologies; • support networking, clusters, cooperation, joint cross-regional and interregional projects; • promote the development of innovative firms in the smart specialisation areas; • improve energy and resource efficiency, water-management cycle, waste management and sustainable mobility, such as for instance in the shipping industry; • foster investment in eco-innovation. Even though Malta scores well on broadband coverage, investment needs are identified to **reap the benefits of digitisation for citizens, companies and governments**, including: • Information and Communication Technologies up-take in small and medium sized enterprises, including infrastructures and services; • e-government, including the take-up of Europe-wide interoperable services. Small and medium enterprises have experienced significant growth, both in terms of added value and employment. However, the limited natural resources of the country may limit their potential. Therefore, investment needs are identified to **enhance growth and competitiveness of medium-sized enterprises** by helping them to turn environmental challenges into opportunities, in particular in order to: • foster the creation of new firms, growth of start-ups/scale-ups, accelerators; develop and implement new business models for medium sized enterprises that address country's environmental challenges in the areas; • encourage the entrepreneurial ecosystem, including development of industrial clusters and enhanced cooperation between medium sized enterprises and universities/research centres, particularly in the areas of green economy, circular economy, resource efficiency; • facilitate access to finance and advanced services for medium sized enterprises; • increase medium sized enterprises competitiveness and internationalisation by moving up in the global value chain. High priority investment needs are identified to **enhance skills for smart specialisation, industrial**

([42]) This Annex is to be considered in conjunction with the Proposal for a Regulation of the European Parliament and of the Council on the European Regional Development Fund and on the Cohesion Fund COM(2018) 372 and the Proposal for a Regulation of the European Parliament and of the Council on the European Social Fund Plus COM(2018) 382, in particular as regards the requirements for thematic concentration and urban earmarking outlined in these proposals.
([43]) The intensity of needs is classified in three categories in a descending order – high priority needs, priority needs, needs.

transition and entrepreneurship, especially having regard to sustainability issues in particular to:

- promote innovation and eco-innovation management in medium sized enterprises; promote specific training and reskilling for smart specialisation areas and eco-innovation;
- strengthen the integration of education and training institutions within innovation, technology diffusion and skills development ecosystems;
- develop skills for higher education and research institutions to increase the commercial viability and market as well as sustainability relevance of their research projects.

Policy Objective 2: A low carbon and greener Europe – Clean and fair energy transition, green and blue investment, circular economy, climate adaptation and risk prevention

Malta's economy is relatively energy intensive. Energy efficiency and transition to domestic energy generation from renewable and local sources are essential to address climate change and environmental challenges. In this respect, the "Clean Energy for EU islands" initiative sets a framework to generate sustainable low-cost energy while exploiting cooperation opportunities. High priority investment needs are identified to **promote energy efficiency measures** in particular through:

- energy efficient renovation of public and residential buildings, with focus on tackling energy poverty;
- energy efficient public lighting, including street-lighting;
- energy efficiency in medium sized enterprises and in the industrial sector.

Malta is on track to reach the 10% target for renewable energies. However, Malta should continue integrating energy efficiency and renewable technologies as a strategic instrument to decarbonise the economy and secure sustainable energy. Priority investment needs are identified to **promote renewable energy** in particular through:

- deployment of small-scale renewable electricity capacities, owned by energy communities, medium sized enterprises or individual energy consumers;
- transition to renewable energies in heating and cooling, including district heating and small-scale installations linked to buildings outside central heating network;
- development of smart energy systems, grids and storage at local level.

Given its small size, high density of population, and scarcity of natural resources, Malta is faced with significant environmental challenges. In addition, as a water-stressed country, one of Malta's most urgent priorities is to improve the efficiency of its water management system. Priority investments needs are identified to **promote sustainable water management**, in particular through:

- efficient drinking water supply following the water hierarchy, including leakage reduction of water networks and other efficiency measures;
- development of a complete water cycle, including utilisation of treated waste- and runoff- water for non-drinkable purposes for both non-domestic and agricultural use;
- storm-water management (storm water tanks, separate collection systems, natural water retention).

Significant improvements are needed to bring waste management in line with EU targets, in particular as regards recycling, composting, landfilling and municipal waste generation. High priority investments are needed to **improve resources efficiency and waste management,** in particular to:

- support waste prevention, reuse and recycling as well as separate collection systems; awareness-raising campaigns and support sustainable consumption practices;
- upgrade existing recycling and waste treatment infrastructure and adaptation of existing waste management infrastructure to the new long-term recycling targets;

- support capacity-building for stakeholders involved in the transition to circular economy;
- support alternatives to raw materials and the use of recycled materials as raw materials.

Malta is particularly vulnerable to climate change (by way of, for example, sea-level change) and has had problems with floods. Investment needs are identified to **promote climate change adaptation, risk prevention and disaster resilience, including through prevention and preparatory actions**, targeting sectors that are deemed particularly vulnerable to climate change impacts, in particular water management, infrastructure and land use, natural ecosystems, agriculture and fisheries, health, tourism.

Policy Objective 3: A more connected Europe – Mobility and regional Information and Communication Technologies connectivity

Traffic congestion on the road network continues to be a major challenge due to limited scope for alternative modes of transport and lack of road public transport infrastructure. Motor vehicle penetration remains very high as fiscal measures fail to discourage private vehicle use. High priority investment are needed to **develop a sustainable, climate resilient, intelligent, secure and intermodal Trans-European Transport Network** in particular through:

- support to local mobility, through the development of sustainable and accessible modes of transport (public transport, multi-modal, cycling, dedicated bus lane) and intelligent transport systems to reduce dependency on private cars, in the framework of existing Sustainable Urban Mobility plans;
- deployment of infrastructure to support digitisation and decarbonisation of road and maritime transport (e.g. digitally connected roads, alternative fuels infrastructure);
- measures to improve safety and energy efficiency across all transport modes, and to increase the share of renewable energy sources in the transport sector.

Policy Objective 4: A more social Europe – Implementing the European Pillar of Social Rights

The activity rate remains below EU average and the gender employment gap high in the context of a tightening labour market. Investment needs are therefore identified **to improve access to employment of inactive people and promote women's and people with disabilities labour market participation,** and in particular to:

- enhance outreach measures for low activity groups and engage with civil society working with groups furthest from the labour market; and promote elderly-friendly forms of work organisation;
- support more work-life balance and informal carers' in-work policies, and tackle gender stereotypes.

Education outcomes are poor, with an important link to the socioeconomic background and disability status; A large share of the population is low-skilled. High priority investment needs are therefore identified to **promote equal access to, and completion of, quality and inclusive education and training** and **to promote lifelong learning, notably flexible upskilling and reskilling, including through infrastructure**, and in particular to:

- strengthen inclusiveness, effectiveness and labour market relevance of education and training at all levels, also by developing education staff competences;
- support better anticipation of new skills requirements, including those linked to energy and resource efficiency, water management cycle, waste management and sustainable mobility;
- promote participation of workers in training; support small and medium sized enterprises in developing human capital, using tools and systems for workforce management and training.

The large inflow of foreigners poses challenges for their socio-economic integration. There are gaps in the coverage of social security. Waiting times for outpatients from lower socio-economic groups are significant. Investment needs are therefore identified to **promote the socioeconomic integration of third country nationals; to enhance access to quality services, including healthcare and long-term care, and to modernise social protection,** targeting in particular disadvantaged groups such as people in poverty or extreme poverty, people with disabilities, migrants, etc.**;** and in particular to:

- eliminate housing and labour market discrimination and enhance refugees' labour market and social outcomes ensuring individualised counselling and access to adult education and training;
- enhance social inclusion measures targeted to the most deprived, including by ensuring access to social protection and by preventing homelessness and socio-economically integrated housing investment;
- promote inclusion by ensuring that services such as childcare include a cultural, ethnic and socio-economic mix;
- strengthen disease prevention through primary and community care services;
- strengthen outpatient care capacity, especially for specialist services, including through infrastructure, to provide cost-effective alternatives to acute care;
- improve patient flow in the care pathway (hospitalisation to community); ensure sufficient capacity to meet projected demand in residential, home and community care services, shifted from hospital care, including for people with mental health issues.

Policy Objective 5 – A Europe closer to citizens by fostering the sustainable and integrated development of urban, rural and coastal areas and local initiatives

Considering its small size, Malta is not affected by substantial regional gaps. However, double insularity, territorial imbalances and regional differentiation have a stronger impact on Gozo, especially in terms of depopulation. Investment needs are identified to **fostering the integrated social, economic, cultural and environmental development and security in urban areas**, in particular to:

- reduce inequalities between Malta and Gozo/Comino, including as regards access to services;
- invest in selected urban areas on the basis on integrated territorial development strategies, giving priority to such sectors as social inclusion, energy efficiency, environment, and waste management.

Factors for effective delivery of Cohesion policy

- improve the capacity of managing authorities and implementing bodies to implement EU funds in a transparent, coordinated and simplified manner;
- dedicate adequate resources in order to attract, retain and train staff working on the implementation of EU funds;
- increase capacity to assess policies' effectiveness and conduct timely and quality evaluations;
- increase the capacity and involvement of intermediate bodies, local authorities, social partners and final beneficiaries in the preparatory and implementation phases of projects;
- improve public procurement performance, in particular with regard cooperative procurement, efficiency of procedures, award criteria, decision speed, and procurement divided into lots;
- put in place efficient measures to prevent and address conflict of interest, fraud and corruption;
- make broader use of financial instruments and contributions to a Malta compartment under InvestEU for revenue-generating and cost-saving activities;
- promote transnational and cross-border cooperation.

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