PRE-BUDGET DOCUMENT 2016

DELIVERING OUR VISION

MINISTRY FOR FINANCE

PRE-BUDGET DOCUMENT
2016

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MINISTRY FOR FINANCE

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Foreword

The last two years have been characterised by growing confidence and optimism in our ability to achieve economic and fiscal success. Government employed a growth-friendly consolidation approach which enabled Malta to progressively lower the fiscal deficit while at the same becoming one of the fastest growing economies in the Euro-Area.

While, understandably, we are proud of our achievement, we must resist the temptation to rest on our laurels and let the guard down. Competition will only intensify and we must continue to work hard. We must welcome investment and support initiatives that make us more attractive.

In the 2016 Pre-Budget Document, we are highlighting the importance of investment, both in enhancing human capital by providing training and education, as well as productive investment in terms of Foreign Direct Investment. We are confident that this vision is shared by the stakeholders and the overwhelming majority of the Maltese.

Hon. Prof. Edward Scicluna
Minister for Finance

01

MACROECONOMIC CONDITIONS

01.1
INTRODUCTION

During 2014, the rate of economic growth in Malta was almost three times the average growth for the EU. This momentum is set to continue in 2015, with the figures for the first quarters confirming a growth rate of 4.0 per cent compared with the EU average of 1.4 per cent.

This positive economic performance is being supported by a particularly buoyant labour market and a strong performance in the tourism sector. In addition, an increase in productive investment and the implementation of various structural reforms are also contributing to boost productive capacity with potential growth set to increase on average by 3.3 per cent per annum over the next four years.

The success of rebalancing the economy is evident in the current account surplus.

01.2

INTERNATIONAL SCENE

Economic Growth and Growth Prospects

The global economy continues to recover, with global economic growth rising to 3.4% in 2014. World trade slowed down in the last quarter of 2014, which in part was attributed to deceleration in the USA and Canada while weak imports in emerging market countries, in particular Russia and other oil producing countries, may have also contributed to the slowdown.

As global activity is set to rise moderately, this should give a further boost to the European Union's export markets. Economic growth within emerging markets is expected to remain generally steady in 2015 and to rise slightly in 2016. The USA continues to experience robust growth and is set to maintain this momentum fuelled by strong labour market and real income gains. In the meantime the European Commission foresees the global economy to grow by 3.5% in 2015 and 3.9% in 2016.

Towards the end of 2014, Europe's economy registered encouraging signs of recovery. Economic growth in the EU rose from a no growth state in 2013 to 1.4 per cent growth in 2014 whilst growth in the Euro Area recovered from a negative 0.4 per cent in 2013 to 0.9 per cent in 2014. This recovery was supported by the fall in the price of oil in 2014.

The European Central Bank's decision to implement Quantitative Easing in March 2015 also helped to maintain low financing costs and put downward pressure on the Euro against major currencies leading to competitiveness gains in exports.

The unemployment rate in both the EU and the Euro Area remained high even by historical standard albeit a slight decreased was registered in 2014. The European Commission expects the unemployment rate to continue to fall in 2016. However structural unemployment continues to be of major concern.

	2013	2014	2015(f)	2016(f)
Real GDP Growth (%)				
EU	0	1.4	1.8	2.1
Euro Area	-0.4	0.9	1.5	1.9
USA	2.2	2.4	3.1	3.0
Japan	1.6	0	1.1	1.4
Malta	2.7	3.5	3.6	3.2
Inflation (%)				
EU	1.5	0.6	0.1	1.5
Euro Area	1.4	0.4	0.1	1.5
USA	1.5	1.6	0.4	2.2
Japan	0.4	2.7	0.5	0.9
Malta	1	0.8	1.3	1.9
Unemployment (%)				
EU	10.9	10.2	9.6	9.2
Euro Area	12	11.6	11	10.5
USA	7.4	6.2	5.4	5.0
Japan	4	3.6	3.6	3.5
Malta	6.4	5.9	5.9	5.9
Employment Growth (%)				
EU	-0.4	1.0	0.9	1.0
Euro Area	-0.8	0.6	0.9	1.1
USA	1.9	2.3	2.5	1.9
Japan	0.6	0.4	0.2	0.1
Malta	4.2	4.2	2.4	2.4
General Government Balance (% of GDP)				
EU	-3.2	-2.9	-2.5	-2.0
Euro Area	-2.9	2.4	-2.0	-1.7
USA	-5.6	-4.9	-4.2	-3.8
Japan	-8.5	-7.8	-7.1	-6.5
Malta	-2.6	-2.1	-1.8	-1.5
General Government Debt (% of GDP)				
EU	87.3	88.6	88.0	86.9
Euro Area	93.2	94.2	94.0	92.5
USA	104.7	104.8	104.9	104.7
Japan	243.2	247.0	250.8	251.9
Malta	69.2	68.0	67.2	65.4

Table 01.1
Data Source: European Commission Spring 2015 Forecast

01.3

LOCAL SCENE

Economic Growth

Latest data released by the NSO confirms that in the first quarter of 2015, the Maltese economy expanded by 4.0 per cent in real terms, driven primarily by net exports. In nominal terms, total incomes grew by 6.0 per cent in the first quarter of 2015, driven by a positive performance in both gross operating surplus and compensation of employees, which expanded by 6.1 per cent (equivalent to €46.7 million) and 4.2 per cent (equivalent to €36.3 million), respectively. Net taxes also contributed positively to nominal growth as they increased by 13.2 per cent, or €27.9 million.

Real GDP Growth, 2013Q1-2015Q1

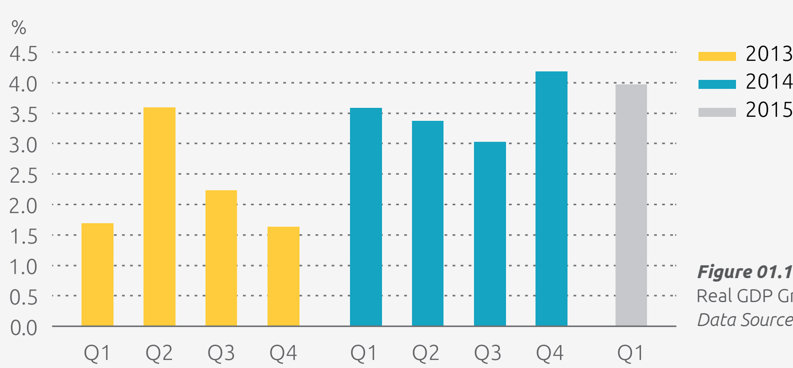

Figure 01.1
Real GDP Growth
Data Source: NSO

During the same period, total gross value added increased by €83.0 million, or 5.2 per cent, compared with a 3.8 per cent increase in the corresponding period of 2014. Growth was underpinned by an affirmative performance in nearly all sectors of the economy, particularly in finance and insurance (11.9 per cent), the professional, scientific and technical sectors (11.2 per cent), public administration and defence, compulsory social security, education, human health and social work sectors (6.3 per cent), real estate (5.7 per cent) and the agriculture (5.0 per cent).

Growth in Gross Value Added

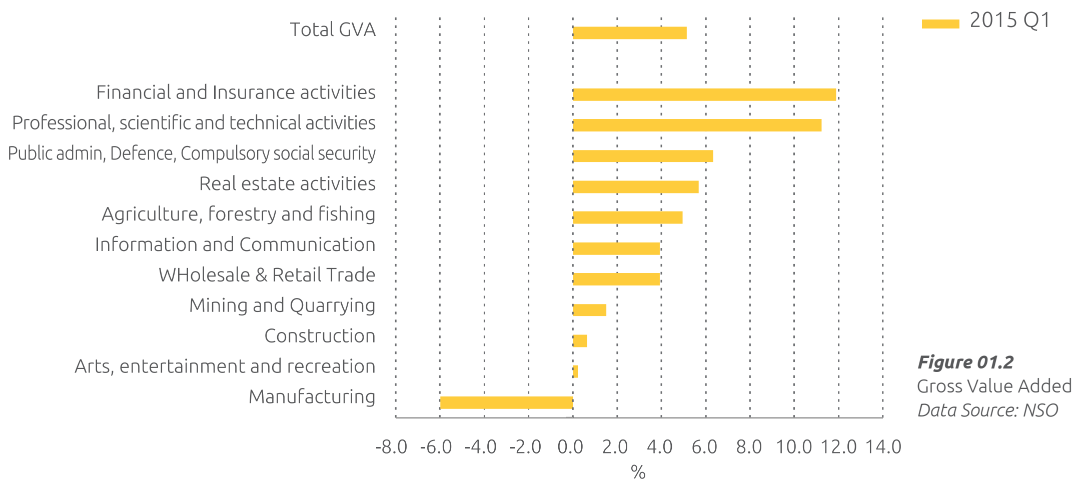

Figure 01.2
Gross Value Added
Data Source: NSO

Growth in Gross Value Added (Manufacturing)

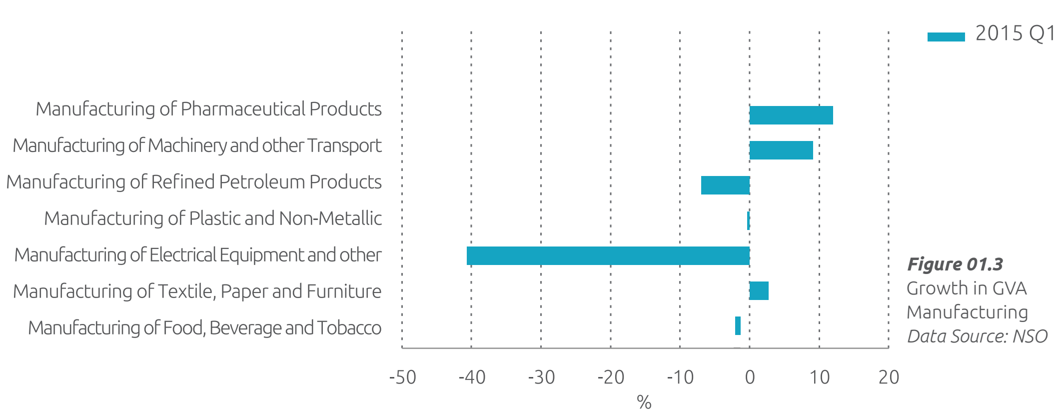

Figure 01.3
Growth in GVA
Manufacturing
Data Source: NSO

Of particular note is the fact that the financial sector, agriculture, forestry and fishing, and mining and waste management have all registered a positive turnaround in the first quarter of 2015. In addition, within manufacturing a number of sectors including furniture, pharmaceuticals and electronics registered robust growth rates in the first quarter of 2015.

Labour Market

The labour market has continued to perform strongly with increases in the activity rate translated into higher employment. As a result, the unemployment rate decreased to historical lows.

In 2014, employment increased by 3.1 per cent with approximately two-thirds of the increase being underpinned by increased female participation. Consequently, the employment rate – defined as the number of persons engaged in employment as a per cent of the population of working age – increased by 1 percentage points in 2014 compared to its previous year, with the female employment rate increasing by 1.6 percentage points and that of persons aged between 55-64 by 1.4 percentage points.

The unemployment rate continued its declining trend in the recent months, falling from 6.4 per cent in 2013 to 5.9 per cent in 2014 thus becoming the third lowest rate in the EU. Youth unemployment also fell to 11.8 per cent during the year and was also the third lowest rate in the EU. The decline in the unemployment rate corresponded closely with the decline in the estimated structural rate of unemployment (NAWRU) implying that the reduction in unemployment was supported by structural factors rather than by cyclical components.

Unemployment Rate

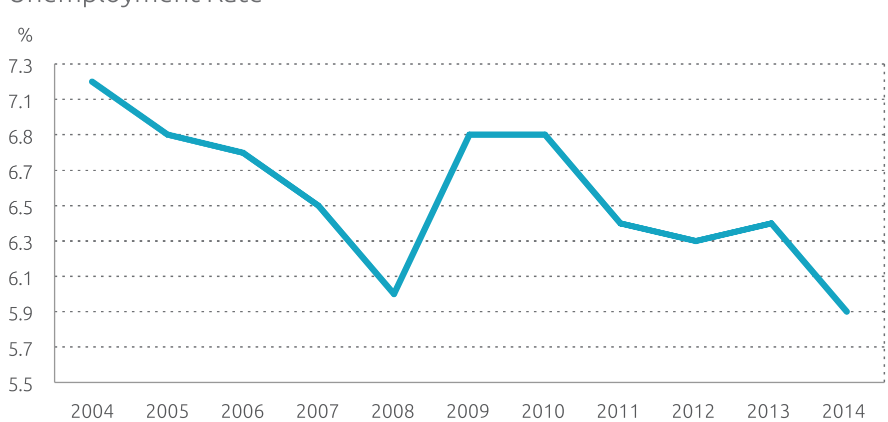

Figure 01.4
Unemployment Rate
Data Source: Eurostat

These positive developments were the result of an improved level of competitiveness in our economy as well as a series of reforms that encouraged participation in the labour market. Indeed, the various measures launched by the Government over the last two years intended to discourage welfare dependency and to make work pay through tapering of social benefits and in work benefits, have resulted in an increase in labour supply while at the same time, the private sector increased their labour demand.

Administrative data from ETC points towards an increased reliance on market services as the main generator of employment. The full-time gainfully occupied population increased by 6,115 to reach 165,443 at the end of December 2014. This was mainly due to an increase of 4.3 per cent in the private market services category and an increase of 1.6 per cent in the private direct production category. During December 2014, the share of the private and public sector in full-time employment remained relatively stable at 73.6 per cent and 26.4 per cent, respectively. This implies that for every four jobs created in the economy, three jobs were in the private sector while one was in the public sector.

Table 01.2 represents the main labour market indicators for the years 2014 to 2016. Employment is expected to continue growing in 2015 and 2016 albeit at a more moderate pace, with female participation remaining the main driver of growth. The unemployment rate is projected to remain below historical averages at around 5.8 per cent. Meanwhile, average wages are set to continue growing, with compensation per employee forecasted to grow by 3.1 per cent in 2015 and then to pick-up to 3.7 per cent in 2016.

Labour Market Indicators

	2014	**2015(f)**	**2016(f)**
Employment growth (Resident population concept, LFS definition) (%)	3.1	2.0	1.8
Labour productivity (% change)	0.0	1.8	1.5
Compensation of employees (% change)	5.2	4.7	5.3
Compensation per employee (% change)	0.7	3.1	3.7
Unemployment Rate (%)	5.9	5.8	5.7

Table 01.2
Labour Market Indicators
Data Source: Labour Force Survey, National Accounts & MFIN Spring 2015 Forecasts

Note:
Figures are not comparable with table 01.1 due to different sources and definitions

Inflation

The RPI index increased from -0.4 per cent in May 2014 to 1.6 per cent in April 2015. During the same period, the average HICP annual rate of inflation remained stable at around the rate of 0.6 per cent, with the annual rate increasing over the last few months set to reach 1.4 per cent in April of 2015. The reduction in electricity rates in April 2014 was the main driver behind the fall in the overall inflation rate in 2014. Unprocessed, processed food and the non-industrial goods components also contributed positively towards the overall decrease in price level.

Inflation Rates in Malta (Retail Price Index)

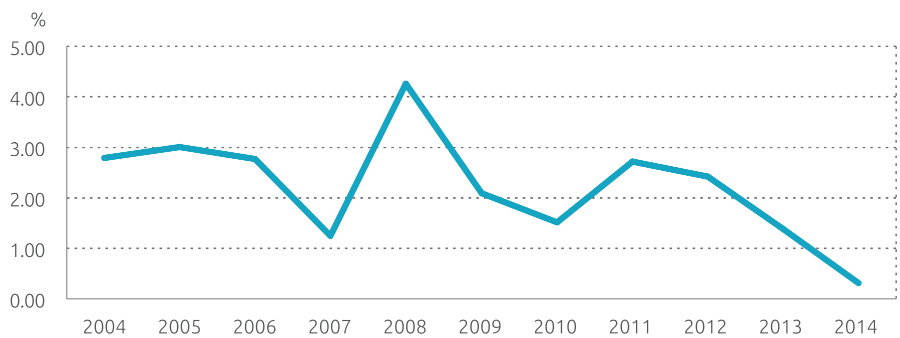

Figure 01.5
Data Source: NSO

HICP Inflation Components in Malta

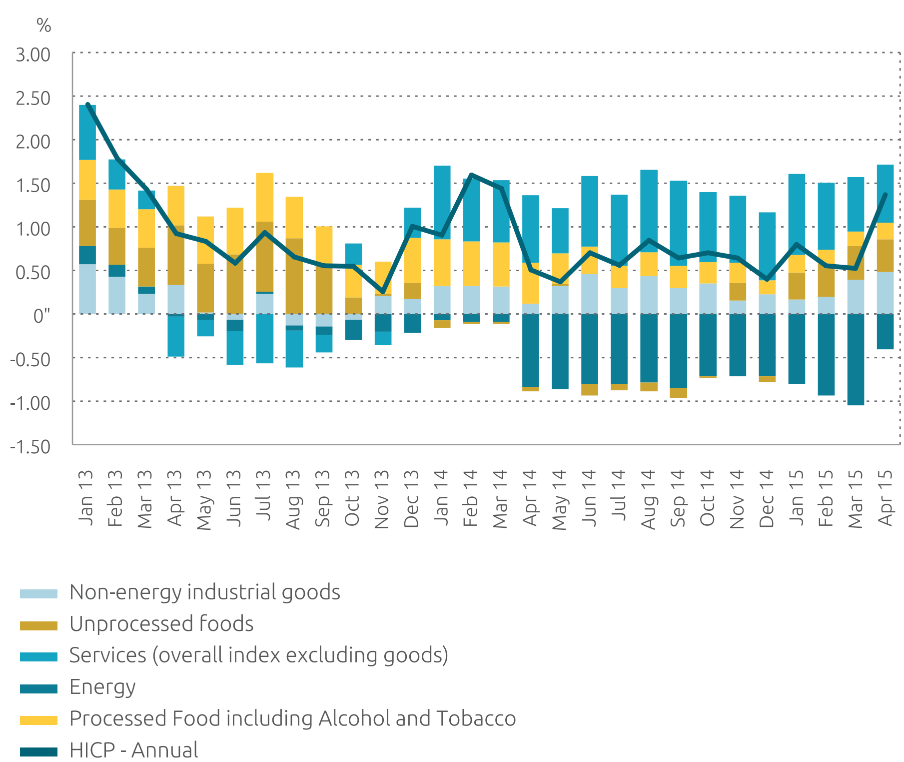

Figure 01.6
Data Source: Eurostat

International Trade

The current account, recorded positive developments during 2014. The surplus amounted to 2.7 per cent of GDP underpinned by positive contributions from both the goods and services account and the secondary income account.

During 2014, the trade surplus increased by 19 per cent over the level recorded a year earlier. This growth was primarily driven by net services exports, which increased by 7.5 per cent, as a result of 'other services net exports' and 'tourism net exports' which more than outpaced the increase recorded in 'transportation net imports'. Concurrently, net goods imports increased by 2.7 per cent over the level observed in 2013.

The tourism sector continued to register a strong performance with increases in expenditure, the number of inbound tourists, the number of nights spent, and hotel occupancy rates. Between January and April of this year, the total number of tourists visiting Malta increased by 5.7 per cent over the corresponding period in 2014. During the same period, total tourist expenditure increased by 6.8 per cent rising to €311.2 million, while the total number of nights spent in Malta increased by 3.5 per cent reaching 2.9 million nights.

01.4

GROWTH PROSPECTS

The Maltese economy is expected to continue to grow at a steady pace with real GDP forecasted to increase by 3.4 per cent in 2015 and 3.1 per cent in 2016. Economic growth is expected to be primarily supported by strong domestic demand. After registering a robust growth rate of 3.4 per cent, private consumption is expected to remain strong in 2015 reflecting strong labour market developments, moderate appreciation in wages, lower energy prices and lower effective income tax. In 2016, private consumption growth is expected to moderate slightly, consistent with developments in employment growth and in disposable income.

Growth in government final consumption is expected to be more moderate in the forecast horizon, reaching 0.6 per cent and 1.2 per cent in 2015 and 2016, respectively. Gross fixed capital investment is set to be the main factor of economic growth, increasing by a significant 23.6 per cent in 2015 and 13.1 per cent in 2016. These projections for investment reflect the materialisation of the large scale energy projects, namely the construction of a new power plant and the conversion of another plant to the use of natural gas for power production, as well as other private investment projects planned for completion over the same period. In addition, the budgetary measures announced for 2015 are expected to support further private investment.

For 2015 and 2016, exports in real terms are forecasted to increase by 2.8 per cent and 2.4 per cent, while the strong import-intensive domestic demand is expected to drive up real imports growth to 5.0 per cent and 3.5 per cent.

The current account balance is temporarily expected to record a deficit over 2015 and 2016, due to an expected increase in imports of capital goods as investment activity is expected to surge. Nonetheless, in the medium-term the current account balance is expected to revert back to surplus.

The tourism sector is expected to continue growing at more moderate rates, supported by the relatively weaker Euro exchange rate, as well as the increase in airline and cruise ship seat capacity and the numerous investments in hotels.

02

FISCAL SUSTAINABILITY

In 2014, Government reduced the deficit-to-GDP ratio to 2.1 per cent, a reduction of 0.5 percentage points from 2013. Moreover, the deficit is expected to decrease further to 1.6 per cent in 2015 and to 1.1 per cent of GDP in 2016. In order to ensure a healthy underlying budgetary position over the economic cycle, the Government aims to reach a Medium-Term Budgetary Objective (MTO), of a balanced budget, in line with the requirements of the Fiscal Responsibility Act and according to the calendar of convergence set out by the European Commission.

Public expenditure is expected to grow below the medium-term potential economic growth rate. The Government continues to be committed to gradually reduce the debt ratio to 60 per cent of GDP reference value.

02.1

FISCAL DEVELOPMENTS IN 2014

Correcting the excessive deficit

After reducing the deficit-to-GDP ratio from 3.7 per cent in 2012 to 2.6 per cent of GDP in 2013, the Government continued on the path of fiscal consolidation and further reduced the deficit to 2.1 per cent of GDP in 2014. Improvements were also made in structural terms, where the structural deficit fell from 3.7 per cent of GDP in 2012 to 2.7 per cent of GDP in 2014. The debt ratio also embarked on a downward trajectory declining from 69.8 per cent in 2013 to 68.5 per cent in 2014, as a result of which, the forward-looking debt reduction benchmark was fulfilled in 2014.

Based on these positive fiscal results and the Commission 2015 spring forecast, the Commission acknowledged that Malta has taken effective action to correct its excessive deficit and issued a Recommendation for a Council Decision abrogating the Decision of 21 June 2013 on the existence of an excessive deficit in Malta. On 19 June 2015, the Economic and Financial Affairs Council (ECOFIN) ratified the Commission's recommendation for the lifting of the excessive deficit procedure opened against Malta and as a result, the Excessive Deficit Procedure (EDP) for Malta was officially closed.

General Government Finances, 2014

% of GDP	Budgeted	Actual	Difference
Revenue	**42.2**	**42.0**	**-0.2**
Components of revenue			
Taxes on production and imports	14.1	13.7	-0.4
Current taxes on income and wealth	14.2	14.6	0.4
Capital taxes	0.2	0.1	-0.1
Social contributions	7.4	7.1	-0.3
Property income	1.2	1.2	0.0
Market Output	1.9	2.4	0.5
Current transfers	0.5	0.5	0.0
Capital transfers	2.6	2.4	-0.3
Expenditure	**44.3**	**44.1**	**-0.2**
Components of expenditure			
Compensation of employees	13.2	13.3	0.1
Intermediate consumption	6.5	6.6	0.1
Social benefits and social transfers in kind	13.5	12.7	-0.8
Interest expenditure	3.0	2.9	-0.1
Subsidies	1.5	1.3	-0.2
Gross fixed capital formation	3.2	3.8	0.6
Capital Transfers Payable	0.9	1.1	0.2
Current Transfers Payable	2.2	2.3	0.1
Other expenditure	0.2	0.0	-0.2
Deficit	**-2.1**	**-2.1**	**0.0**
Primary Balance	**0.9**	**0.8**	**-0.1**

Table 02.1
Data Source: Stability Programme Update April 2014 and April 2015, MFIN

Note
Actual data has been updated with GDP data per NSO News Release No 108 of 2015

Budget 2014 Outcomes against Targets

Government successfully reached the ambitious deficit-to-GDP target for 2014 of 2.1 per cent, in line with the deficit ratio projected in the previous estimates. Table 02.1 displays the Government's final fiscal position for 2014 compared to the targets revised in the 2014 Update of the Stability Programme.

In 2014, revenue from current taxes on income and wealth was 0.4 percentage points of GDP higher than expected, reflecting stronger than anticipated labour market conditions, salaries and corporate profits, enhanced efficiency in revenue collection and higher than expected proceeds from the Investment Registration Scheme. Revenue from market output and output for own final use was 0.5 percentage points of GDP higher than target largely due to higher than expected market output by EBUs. Moreover, income from the International Investor Programme launched in 2014 was also higher than expected.

In contrast, revenue from taxes on production and imports and from social contributions was 0.4 percentage points of GDP lower than forecasted for each component, as the strong growth in GDP outpaced the growth in these components of revenue. Capital transfers sourced from EU funds programmes were 0.3 percentage points of GDP lower than target. However, this had a predominantly neutral effect on the deficit since it was mitigated by an equivalent shortfall in public investment expenditure.

On the expenditure side, gross fixed capital formation (GFCF) was 0.6 percentage points of GDP above target. The revision in GFCF mainly reflects the methodology used to compile the expenditure component levels in ESA terms from Consolidated Fund data.

While this methodology can result in distortions at an expenditure component level when comparing forecast to actual data, it will not affect the comparison for aggregate expenditure in ESA terms. In addition, actual GFCF was higher than forecast due to the capitalisation of R&D expenditure attributed to the revision to ESA 2010. GFCF from EBUs was also higher than expected. Expenditure on capital transfers was 0.2 percentage points of GDP higher than target. On the other hand, expenditure towards social benefits and social transfers in kind and subsidies were 0.8 and 0.2 percentage points of GDP lower than target, respectively. Nevertheless, in nominal terms, expenditure for these two components was roughly on target.

As regards general Government public debt, the debt-to-GDP ratio was 1.4 percentage points lower than forecast, mainly reflecting a more buoyant macroeconomic environment in 2014.

02.2

CONSOLIDATING BUDGETARY TARGETS IN 2015

The Government remains committed to continue on the path of fiscal consolidation by gradually but consistently reducing the fiscal imbalance. In 2015, the deficit as a percentage of GDP is expected to decline by 0.5 percentage points to 1.6 per cent of GDP. The targeted reduction in the deficit-to-GDP ratio is the result of an expected increase in the revenue-to-GDP ratio of 0.9 percentage points, which will be in part offset by a forecasted marginal increase in the expenditure-to-GDP ratio of 0.4 percentage points. Figure 02.1 displays developments in the general Government balance.

General Government Balance, 2012-2018

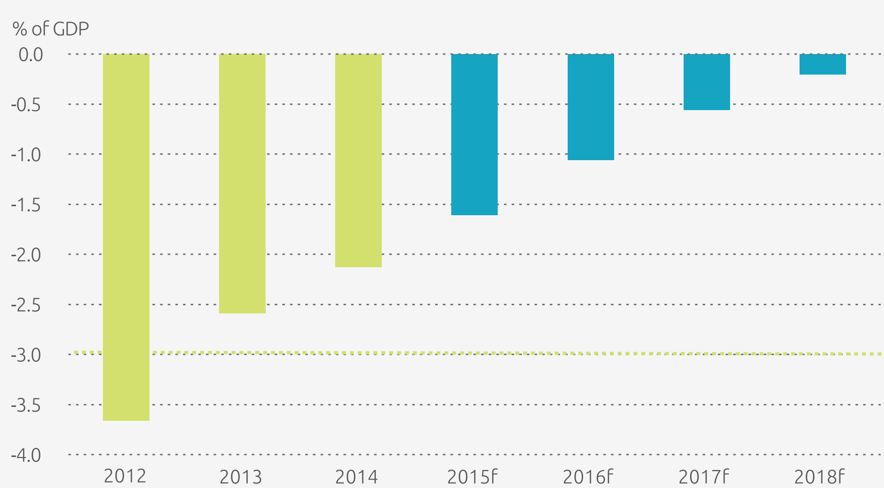

Figure 02.1
Data Source: NSO, Malta Update of the Stability Programme 2015 - 2018

General Government Finance, 2013-2015

% of GDP	2013	2014	2015f
Revenue	**40.0**	**42.0**	**42.9**
Components of revenue			
Taxes on production and imports	13.1	13.7	13.9
Current taxes on income and wealth	13.9	14.6	14.2
Capital taxes	0.2	0.1	0.2
Social contributions	7.0	7.1	7.2
Property income	1.3	1.2	1.2
Market Output	2.4	2.4	2.6
Current transfers	0.4	0.5	0.4
Capital transfers	1.8	2.4	3.1
Expenditure	**42.6**	**44.1**	**44.5**
Components of expenditure			
Compensation of employees	13.0	13.3	13.1
Intermediate consumption	6.3	6.6	6.8
Social benefits and social transfers in kind	12.8	12.7	12.5
Interest expenditure	2.9	2.9	2.7
Subsidies	1.1	1.3	1.5
Gross fixed capital formation	2.8	3.8	4.1
Capital Transfers Payable	1.3	1.1	1.4
Current Transfers Payable	2.4	2.3	2.3
Other expenditure	0.1	0.0	0.0
Deficit	**-2.6**	**-2.1**	**-1.6**
Primary Balance	**0.3**	**0.8**	**1.1**

Table 02.2
Data Source: Stability Programme Update April 2015, MFIN

Note
Data has been updated with NSO News Release No 108 of 2015

As illustrated in Table 02.2, the revenue-to-GDP ratio is forecasted to increase from 42.0 per cent in 2014, to 42.9 per cent in 2015. The increase of 0.9 percentage points is mainly attributable to an expected increase in the absorption of EU funds of 0.7 percentage points, and higher market output of 0.2 percentage points reflecting revenue generated from the International Investors Programme and greater efficiency in revenue collection. Taxes on production and imports are also expected to increase in 2015, whereas lower current taxes on income and wealth are forecasted reflecting the budget measures already in place to reduce the tax burden.

On the expenditure side, an increase in the expenditure-to-GDP ratio from 44.1 per cent in 2014, to 44.5 per cent in 2015 is projected. The increase of 0.4 percentage points primarily reflects higher public investment amounting to 0.3 percentage points, generated by higher expenditure on EU funded projects, and higher capital transfers of 0.3 percentage points, mainly reflecting a higher equity injection in Air Malta. The increases in expenditure are partly mitigated by the projected fiscal consolidation measures mainly involving the containment of public sector increases in compensation of employees, and savings in social benefits through the Youth Guarantee Programme and the tapering of social benefits.

Central Government Finances, January-June 2014-2015

Table 02.3
Data Source: NSO

Consolidated Fund Data	**2014**	**2015**	**2015**	
€000s	Actual	Actual	Forecast	Variance
Recurrent Revenue	**1,414,347**	**1,607,398**	**1,602,644**	**4,754**
Tax Revenue	**1,214,279**	**1,337,155**	**1,339,011**	**-1,856**
Customs and Excise Duties	69,457	112,531	111,369	1,162
Licenses, Taxes, and Fines	118,652	135,121	129,175	5,946
Value Added Tax	289,763	300,676	317,272	-16,597
Income Tax	425,554	464,415	458,575	5,840
Social Security	310,852	324,411	322,619	1,793
Non-Tax Revenue	**200,068**	**270,244**	**263,634**	**6,610**
Fees of Office	18,237	12,508	20,305	-7,798
Reimbursements	10,727	10,549	12,289	-1,740
Public Corporations	0	0	0	0
Central Bank of Malta	37,000	36,000	36,000	0
Rents	15,947	15,673	15,673	0
Dividends on Investments	3,731	8,698	8,698	0
Repayment of Interest on Loans	1,031	132	670	-538
Grants	100,954	157,090	157,090	0
Miscellaneous	12,440	29,595	12,909	16,686
Total Expenditure	**1,679,552**	**1,765,367**	**1,754,821**	**10,547**
Recurrent Expenditure	**1,376,797**	**1,443,162**	**1,432,615**	**10,547**
Personal Emoluments	321,604	341,193	331,536	9,657
Operations and Maintenance	69,095	77,306	77,570	-264
Programmes and Initiatives	852,374	881,106	890,622	-9,516
Contributions to Government Entities	133,725	143,558	132,888	10,670
Interest Payments	**111,215**	**116,164**	**116,164**	**0**
Capital Expenditure	**191,540**	**206,042**	**206,042**	**0**
Central Government Balance (Consolidated Fund Balance)	**-265,205**	**-157,969**	**-152,176**	**-5,793**

Developments during January-June 2015

Table 02.3 displays the central Government revenue and expenditure as reported for the first six months of the year for 2014 and 2015. Actual values are compared to the estimated monthly figures consistent with the respective budgetary annual targets using a set of monthly seasonal indices. The resulting variance is presented in the last column. It should be noted that with regards to non-tax revenues from Central Bank of Malta, rents, dividends on investment and interest payment will be accrued at end-of-year and hence the variance is set to zero. Also, since revenue from grants and capital expenditure tend to cancel each other, the variance of the two is not taken into account.

Recurrent revenue has outperformed targets by €4.8 million in the first six months of this year mainly on the back of higher-than-estimated direct tax revenue and non-tax revenue.

Indeed, direct tax revenue was around €7.6 million higher than estimated with both income tax and social security exceeding budgetary targets by €5.8m and €1.8m, respectively. Similarly, non-tax revenue was €6.6 million higher than expected with revenue from miscellaneous receipts being the main contributor to this increase outweighing the temporary lower than expected revenue from fees of office which is expected to recover in the coming weeks when payments owed to Government by Identity Malta will be affected.

On the other hand, revenue from indirect taxes was €9.4 million lower than expected mainly due to lower than estimated revenue from VAT, €16.6 million, which was partially offset by higher than expected revenue from Licences Taxes and Fines by €5.9 million and customs and excise duties by €1.2 million.

On the expenditure sides, higher than projected expenditure on contributions to Government entities and personal emoluments were partly litigated by lower than targeted expenditure on programmes and initiatives. Expenditure on operations and maintenance for the first half of 2015 was broadly on target. As a result, the central Government deficit for the first half of this year was broadly on target with a marginal negative variance of €5.8 million. Nevertheless, despite the positive performance so far, due to the inherent unique pattern of some cash transactions from year to year, Government will continue to monitor closely both the revenue and expenditure components in the coming months, so as to be able to take any corrective measures should Government identify any persistent deviations.

02.3

DEBT ON A DOWNWARD TRAJECTORY

Government debt reached a level of 68.5 per cent of GDP in 2014. The decrease of 1.3 percentage points of GDP from the debt level recorded in 2013 was largely attributable to a reduction in the stock-flow adjustment, which reached a level of 0.1 per cent of GDP in 2014. Furthermore, improvements in the primary balance and nominal GDP growth have also contributed to the improvements in Government debt.

The main stock-flow transactions during 2014 included contributions to a special Malta Government Stock sinking fund (0.6 per cent of GDP), ESM (0.2 per cent of GDP), and increases in accruals adjustment (0.2 per cent of GDP). These were largely offset by the payments made to Government for the accruals accumulated by Enemalta over the past two years (-0.7 per cent of GDP), re-investments in Malta Government Stocks (-0.3 per cent of GDP), and a decrease in the cash holdings on part of Government (-0.1 per cent of GDP).

In 2015, Government debt is forecasted to decrease by a further 1.2 percentage points reaching 67.3 per cent of GDP. Stock-flow adjustment contribution is expected to remain relatively stable in 2015, whereas interest expenditure as a ratio of GDP is expected to decrease. The primary surplus and nominal GDP growth are expected to continue to contribute positively to the reduction in the gross debt ratio.

Beyond 2016, the debt-to-GDP ratio is expected to maintain a downward trajectory to reach 61.6 per cent of GDP in 2018. This is expected to bring Government debt closer towards the 60 per cent debt limit in line with the requirements of both the Stability and Growth Pact and the Fiscal Responsibility Act. Stock flow transactions are expected to have a marginal expansionary impact on the debt ratio. The projected reduction in gross debt is mainly driven by a growing primary surplus and a relatively strong nominal growth scenario reflecting a buoyant macroeconomic outlook.

Developments in the gross Government debt are illustrated in Figure 02.2.

Gross Government Debt, 2012-2018

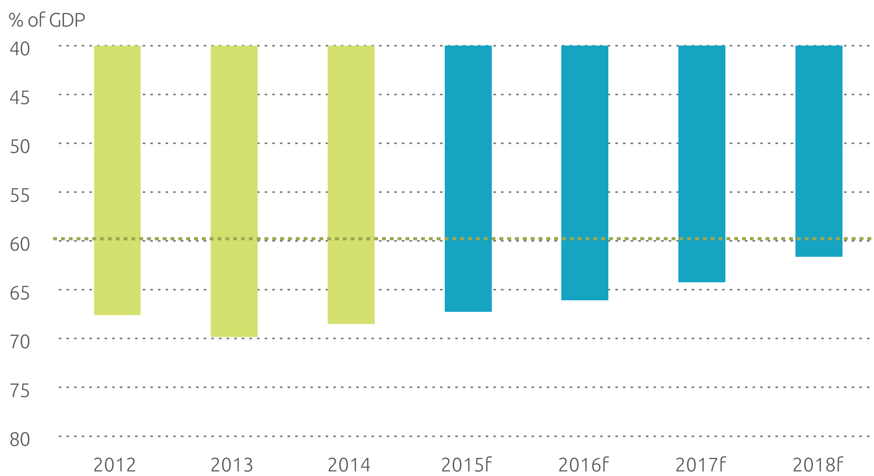

Figure 02.2
Data Source: NSO, Malta Update of the Stability Programme 2015 - 2018

02.4

MALTA'S MEDIUM-TERM FISCAL STRATEGY

In accordance with the requirements of the Fiscal Responsibility Act (Cap 534, 2014), in June 2015 the Ministry for Finance laid before the House of Representatives Malta's first Medium Term Fiscal Strategy . The Strategy, which includes a statement by the Prime Minister and Minister for Finance attesting to the reliability and completeness of information contained within, reflects Government's commitment to ensure further progress in reducing the structural deficit and the debt ratio whilst maintaining a healthy economic growth momentum.

Government's Medium Term Fiscal Strategy is formulated in the context of an economy which is growing strongly in line with its potential. Consistent with the requirements of the national fiscal rules, Government is aiming for a deficit target of 1.6 per cent of GDP in 2015 which will decline to 1.1 per cent of GDP in 2016, falling further to 0.2 per cent of GDP by 2018.

Based on realistic macroeconomic forecasts and assumptions and relatively prudent fiscal assumptions, revenue forecasts for the general Government are expected to increase temporarily by 0.9 per cent of GDP in 2015, followed by an expected decline to a ratio of 39.4 per cent of GDP by 2018. Expenditure targets have been set at 44.2 per cent of GDP in 2015. Furthermore, these are projected to decline to 41.7 per cent of GDP in 2016 and to 39.6 per cent of GDP by 2018.

The strength and stability being exhibited by the Maltese economy, mainly underpinned by strong improvements in investment, continued positive developments in the labour market, and subdued inflationary pressures, will be sustained by the range of structural economic policies presented in this year's National Reform Programme (NRP), intended to address the country's main economic challenges.

Government remains convinced that a prudent pace of fiscal consolidation is the best policy in order to successfully attain the Medium-Term Budgetary Objective (MTO) of a balanced budget. In this context, Government spending reviews will continue so as to ensure the achievement of improved efficiency in public spending.

This, in turn, will continue to increase financial discipline and fiscal accountability in the public sector. Moreover, Government is also consolidating the various functions of Government revenue through the merger of the main revenue departments, which will support its efforts towards increased efficiency in revenue collection. Meanwhile, the reforms in the energy sector are to contribute to the attainment of both the economic and the fiscal objectives by reducing Government exposures.

Nevertheless, Government recognises the importance of public investment in the overall economic strategy and is committed to maintain public investment in excess of 3 per cent of GDP over the medium-term. Domestic funds will mostly be targeted towards the strengthening of the public infrastructure, education and health infrastructure, waste management and environmental management. These will be complemented by the absorption of EU funds earmarked for the 2014-2020 period.

Evaluation and Endorsement of Macroeconomic and Fiscal Forecasts

The macroeconomic and fiscal forecasts underlying the Update of Stability Programme 2015-2018 and consequently the Medium Term Fiscal Strategy were submitted to the Malta Fiscal Advisory Council (MFAC) for evaluation and endorsement in line with the requirements of the Fiscal Responsibility Act. The MFAC considered the projections to be attainable although subject to some element of risk. Thus, both macro and fiscal forecasts were endorsed by the MFAC.

02.5

CONCLUDING REMARKS

Government managed to reduce the deficit-to-GDP ratio to 2.1 per cent of GDP in 2014. Furthermore, consolidated Central Government financial figures for the first half of this year indicate that the Government is broadly on track with respect to reaching the revenue and expenditure targets for 2015. The Government remains vigilant in its constant monitoring of public finances to continue ensuring that the deficit and debt follow a sustained downward trend in line with its targets.


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03

INVESTMENT, PRODUCTIVITY AND COMPETITIVENESS

The ability to compete in an increasingly global market depends on raising productivity and building competitive advantage in key sectors. The need to constantly innovate in order to achieve and sustain a competitive position is therefore central to economic policy making.

The argument for competitiveness has long been taken on board by stakeholders. Nowadays, 'competitiveness' has entered common parlance. However, definitions of productivity will always be contestable. Many observers have pointed out that it is firms that compete rather than nations. There is, however, more clarity on what factors improve both competitiveness and productivity: that is the ability and capacity to adapt to change through innovation, investment and achieving a presence in key strategic sectors.

03.1
INVESTMENT

There is wide acceptance that long-term economic growth is related with the flow of productive investment both in terms of physical, as well as, human capital.

Physical investment, in terms of Gross Fixed Capital Formation (GFCF), not only directly adds to the stock of capital that workers have available to them, but can also have an indirect impact on labour productivity through spill-over impacts. The average share of GFCF in GDP over the past 10 years has been about 21 per cent in the Euro-Area while in Malta it has averaged below 20 per cent.

Over the last 10 years, the share of GFCF as per cent of GDP in Malta lagged below that of the Euro-Area. The gap between Euro-Area and Malta between 2004 and 2013 appeared structural with the 2010 representing an exceptional year where the share in Malta surpassed that of the Euro-Area. This was due to a strong fall in GFCF in the Euro-Area coupled with one-off items in Malta. As illustrated in figure 03.1, the gap is structurally closing down with the share of investment being practically equal to the Euro-Area average in 2014.

Gross Fixed Capital Formations as Percentage of GDP

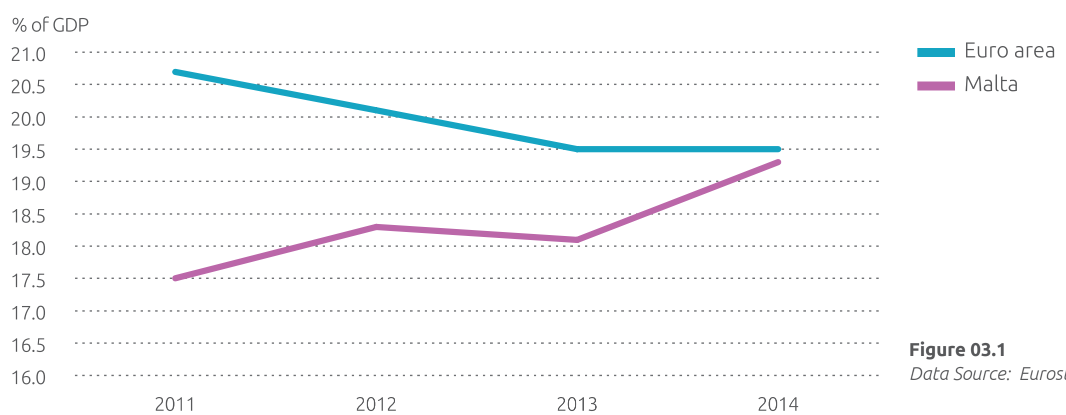

Figure 03.1
Data Source: Eurostat

A look at the type of investment offers encouraging signs in terms of the productive capacity of our economy. Data for the last 10 years points towards an increasing share of machinery and equipment as well as other buildings (excluding dwellings).

Gross Fixed Capital Formation by Asset Type

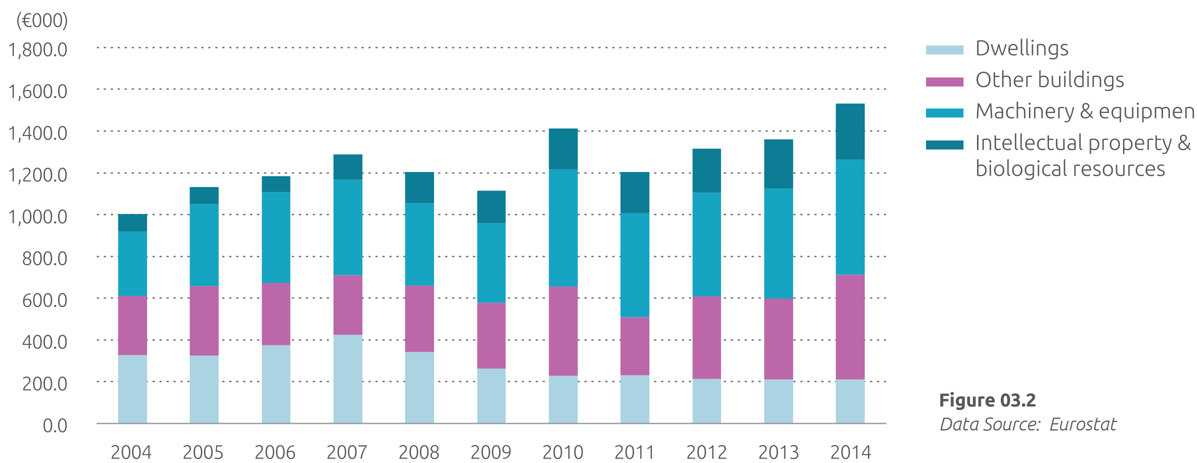

Figure 03.2
Data Source: Eurostat

The enhancement of the productive capacity of our economy is also confirmed in terms of the FDI flows. Latest data shows that in June 2014, the stock of foreign direct investment (FDI) in Malta stood at € 136.8 billion, of which the majority was related to financial and insurance activities. The stock of manufacturing amounted to almost €1 billion, an increase of €123 million over June 2013. During the same period, the FDI in professional, scientific and technical activities plus information and communication increased by €16 million.

Stock Position of Foreign Direct Investment in Malta (excluding Financial and Insurance)

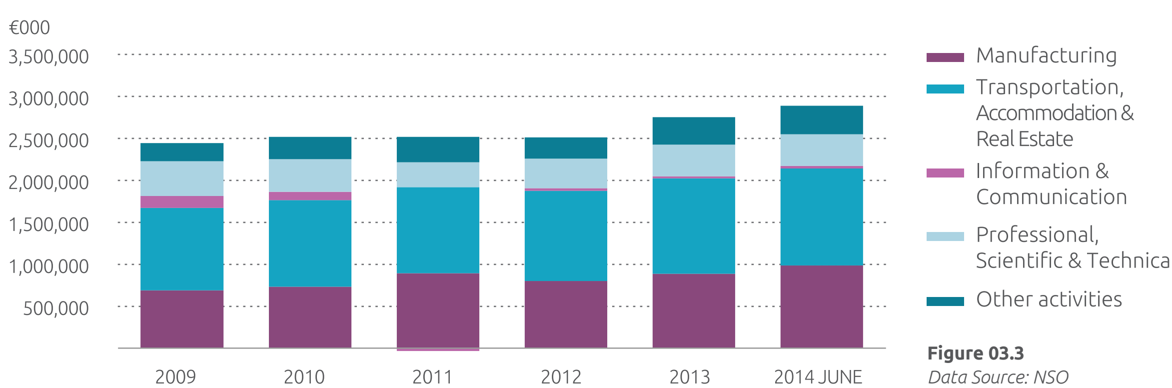

Figure 03.3
Data Source: NSO

Both Government and the private sectors have an important role in the generation of capital stock. While the private investors usually view investment as an entirely private matter, the public sector role is more complex with responsibility ranging from the provision of public goods to the creation of the right legislative environment that promotes productive investment.

03.2

UPGRADING SKILLS FOR IMPROVED PRODUCTIVITY

The productivity of individuals includes a series of indicators that include employment rates, wage rates and stability of employment while the productivity of enterprises is measured in terms of output per worker, market share and export performance.

Labour productivity is also highly influenced by education, training and core skills as well as experience. Skills are critical in the structural adjustment of an economy, with higher demand for technical, entrepreneurial, and social skills as the economy moves to a higher level of sophistication. Inability to learn new skills because of inadequate basic education or lack of opportunity slows this adjustment and might impede an economy from moving to higher value added activities. Thus, skills policies need to develop the relevant skills, promote lifelong learning, deliver high levels of competences and a sufficient quantity of skilled workers to match demand. Human capital investment is therefore intrinsically connected with improved labour productivity.

Employer surveys continue to confirm that around one in three employers have problems in filling vacancies due to skill shortages. A Euro-barometer (Employer's perception of graduate employability, 2010) found 47 per cent of employers in Malta identified a shortage of applicants with the right skills as their main challenge in filling vacancies. The Euro Area average was 33 per cent. Furthermore, the latest Eurostat data shows that Malta has the second highest job vacancies rate in the Euro-Area, second only to Germany.

While some qualification mismatch is due to people's preferences and/or personal circumstances or else is temporary, a persistent high level of mismatch reflects a lack of adequate skills in the labour force. Cooperation between governments, employers and unions in managing education and training system is key to meeting changing skill demands. The same Euro-barometer study found that Malta scored well above the average when asked about the level of cooperation between employers and higher education institutes in designing study programmes. Despite this, the mismatch remains. Better labour market intelligence to identify skills mismatches and anticipate future needs, should improve labour market relevance to education and training.

The European Centre for the development of vocational training produced a forecast giving insights on job opportunities up to 2025. The study estimates that in Malta, most job opportunities, around 26 per cent, will be for professionals (high level occupations in science, engineering healthcare, business and teaching). The demand for technicians and associate professionals (occupations applying scientific or artistic concepts, operational methods and regulations in engineering, healthcare, business and the public sector) is estimated to be around 9 per cent. The upgrading of skills, retraining and re-skilling of workers are essential elements of active labour market policies.

Investment in education and training for skills development is essential to boost growth and competitiveness: skills determine Europe's capacity to increase productivity. In the long-term, skills can trigger innovation and growth, move production up the value chain and stimulate the concentration of higher level skills shaping the future of a dynamic labour market.

03.3

STANDARD MEASURES OF PRODUCTIVITY AND COMPETITIVENESS

The various definitions that describe productivity and competitiveness suggest that these concepts are not linked solely with prices or cost but incorporate other elements such as structural factors and cross-border considerations.

Output per Hours Worked

One of the most widely used measures of productivity is Gross Domestic Product (GDP) per hour worked. Data from Eurostat indicate that output per hour worked for Malta is above the Euro-Area average. This positive gap has persisted since 2009 despite the strong reforms in the labour market that took place in the Euro-Area since the outbreak of the financial crisis.

Output per Hour Worked (2005=100)

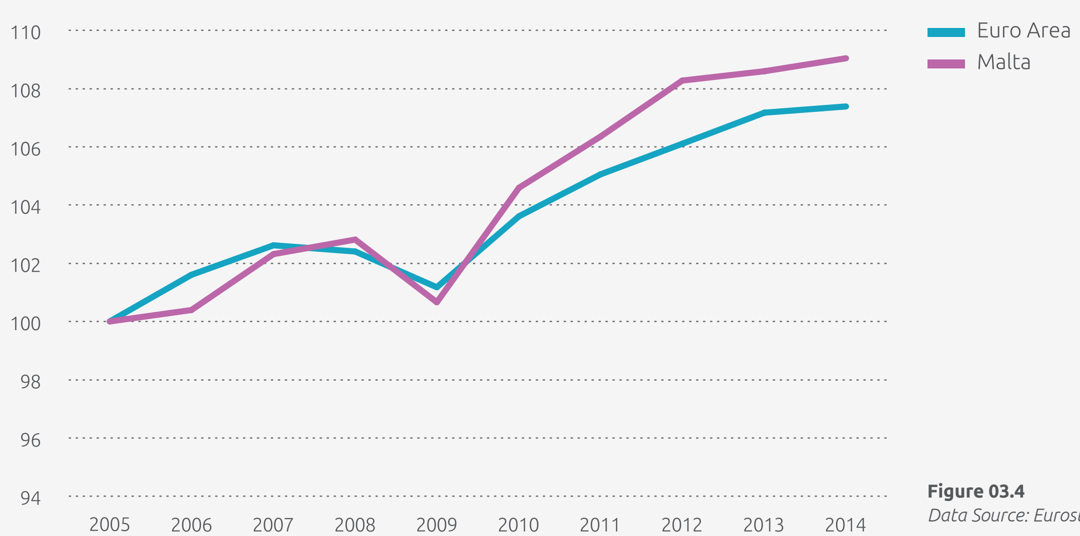

Figure 03.4
Data Source: Eurostat

The dynamics behind the output per hours worked should also be viewed against an increasing employment rate. Infact, Malta experienced increases in employment growth over the period 2005-2014, with particularly strong increases in 2013 and 2014, suggesting that growth in output more than kept pace with growth in employment.

Growth in Employment

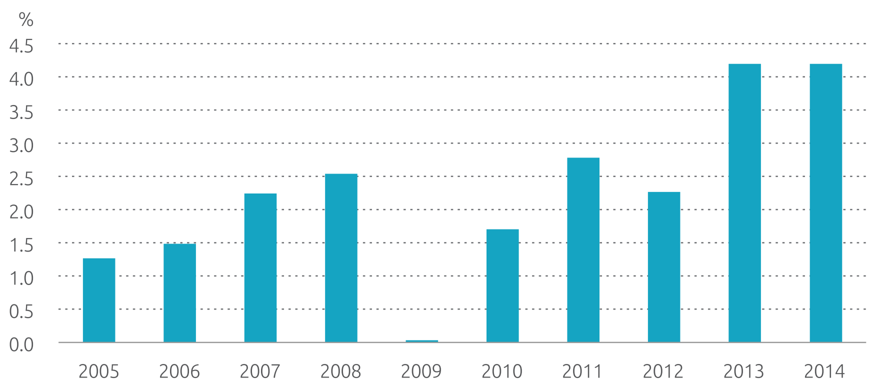

Figure 03.5
Data Source: Ameco

Nominal Unit Labour Cost

During the last decade, Malta experienced an increase in its nominal unit labour cost when compared with the Euro Area average. The increase in nominal unit labour cost in Malta exceeded that recorded in the Euro-Area with the gap becoming more accentuated between 2010 and 2012. The difference slowed down during the last two years, with the local and Euro Area average growth rates being equal for 2014.

It is noteworthy that the dynamics behind the growth in nominal unit labour cost is also influenced by a lower base effect for wages in Malta. Convergence to the Euro-Area average points towards a stronger growth in nominal wages in Malta which in turn put pressure on nominal ULC.

It is also important to note that the wage share as a percentage of GDP in Malta is considerably lower than the Euro-Area average. In Malta, it stands at roughly 50 per cent while the Euro-Area average exceeds 56 per cent.

Nominal Unit Labour Cost (2005=100)

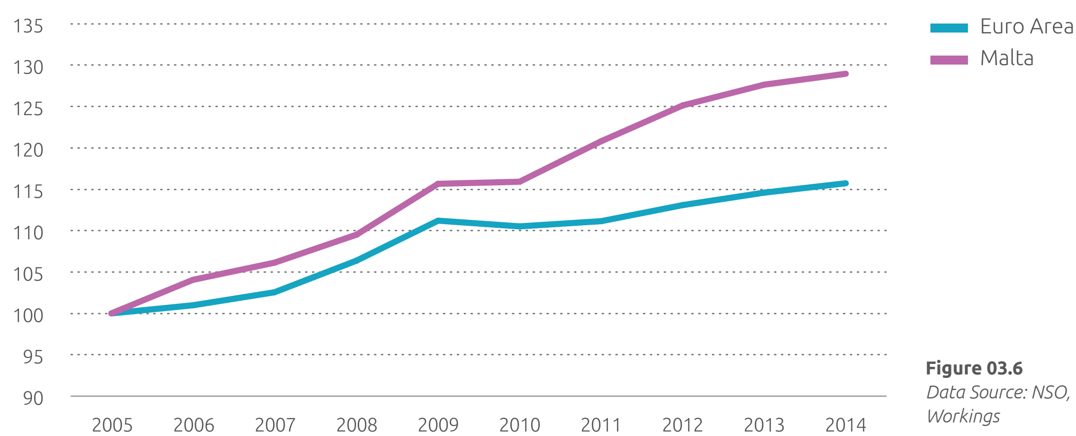

Figure 03.6
Data Source: NSO, MFIN Workings

Real Effective Exchange Rate

The Nominal Effective Exchange Rate (NEER) is essentially a trade-weighted average value of a country's currency relative to the exchange rate of its main trading partners, while the Real Effective Exchange Rate (REER) adjusts the NEER for the effects of inflation (Consumer Prices Index).

REER - CPI Deflated (2005=100)

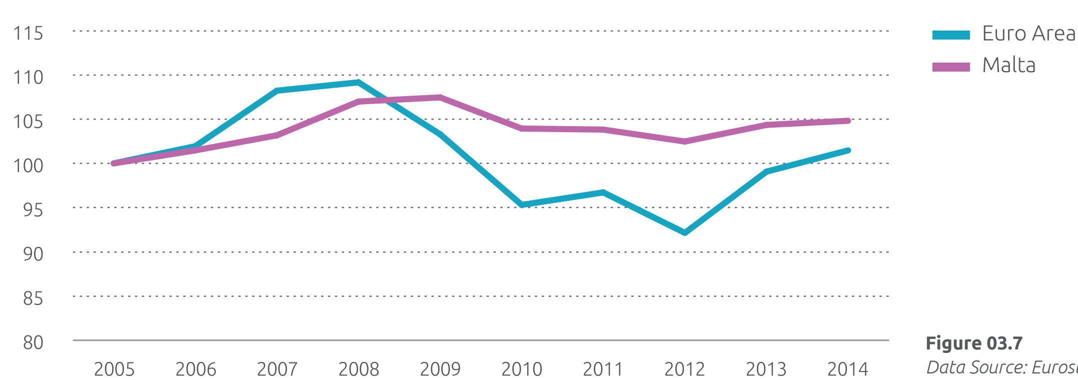

Figure 03.7
Data Source: Eurostat

Figure 03.7 depicts the real effective exchange rate deflated by the consumer price index of the 28 Area-Area and Malta. The change in REER is underpinned by the strengthening of the euro during the 2005-2008 period which led to an appreciation of the REER.

In the aftermath of the financial crisis, the REER depreciated which led to an increase in Malta's export market share, as Malta had relatively less expensive exports, contributing to making Malta's exports more competitive.

The Shift Share Analysis

In order to assess Malta's competitiveness at an industry level, the shift share analysis is adopted. The main intuition behind the shift share analysis is to extract the change in the output (or some other summary measure such as employment or exports) which is originating from the global industry itself and that which is originating from the increase in global economic activity. The remaining change in output is construed as a measure of industry competitiveness. In this context the change in output, export or employment is decomposed into three main components:

a. The Global Share component is the change in output, export or employment which is due to global demand conditions.

b. The Industry Mix component is the change in output, export or employment which is due to the global performance of the industry in question.

c. The Competitiveness Shift component represents the change in output, export or employment which is due to domestic performance and which cannot be explained by exogenous global conditions and therefore reflecting the gains in competitiveness.

Over the eight-year period until 2013 exports of Services increased by $3billion (or an average of 12 per cent per annum) of which $1.7billion is attributable to exogenous global trade in services whilst the remaining $1.3billion is attributable to gains in competitive advantage in services. Most of the competitiveness gain in services is attributable to the emergence of the remote gaming industry during this period. Further important gains were also registered in financial services and in tourism activity. These gains offset losses in competitiveness in other service industries, namely in transport, communications, IT, royalties and in other business services. Figure 03.8 shows the contribution of each component of the shift share towards export growth in the services industries.

Shift Share Components (2005-2013): Services

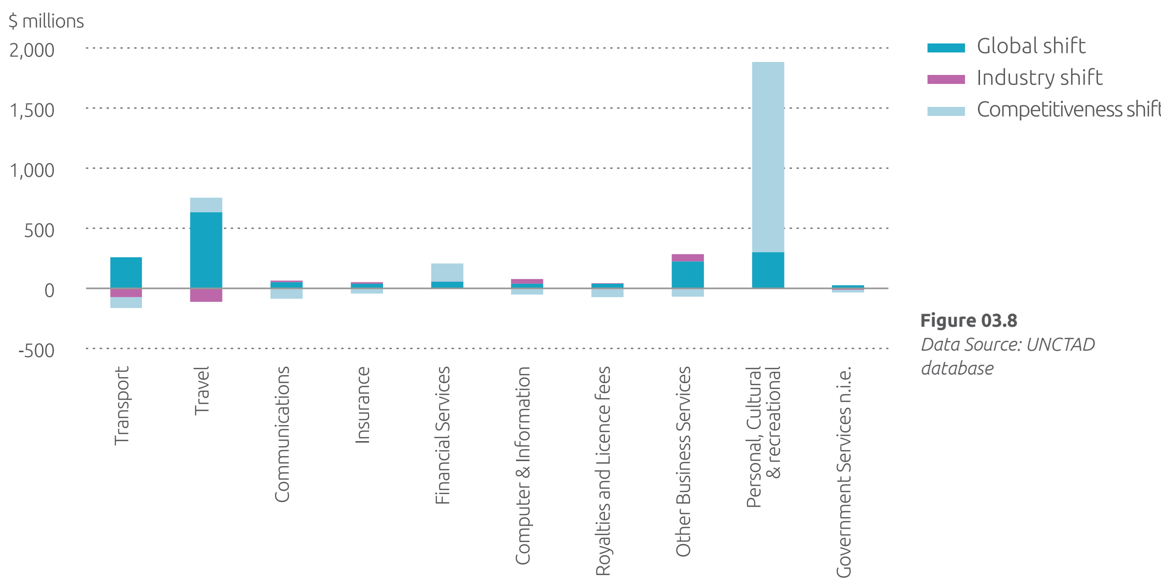

Figure 03.8
Data Source: UNCTAD database

Over the period 2011-2013 the rate of growth in services exports stabilised at an average of 2 per cent per annum. This increase was entirely attributable to exogenous gains in international trade in services. Between 2005 and 2013 exports of Goods increased by €810million (or an average of 1.2 per cent per annum) of which €758million was attributable to exogenous global trade in goods whilst the remaining €52million was related to gains in competitiveness in manufactured goods. In the product markets Malta's strength mainly lies in the pharmaceutical sector. Other sectors which gained competitiveness include the fisheries, and the toys and games, printed media and the export of aircraft parts.

Shift Share Components (2005-2013): Product Market

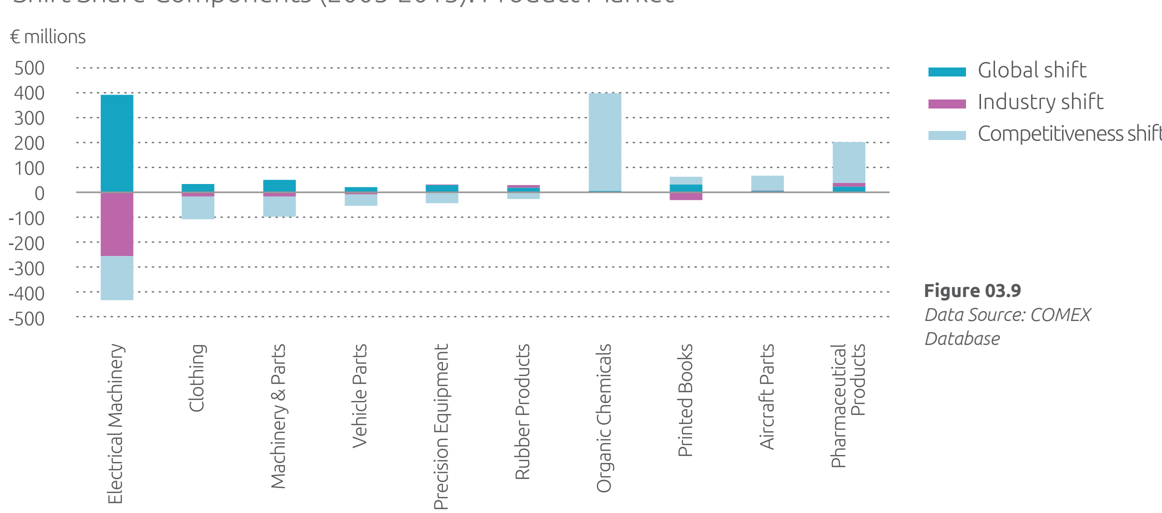

Figure 03.9
Data Source: COMEX Database

Overall Malta has made significant competitiveness gains over the period 2005-2013. From 2011 to 2013, manufacturing exports have not lost overall competitiveness with losses in some industries including electronics, clothing and aircraft parts being mitigated by gains in pharmaceuticals, toys and fisheries.

Total Factor Productivity

Another main contributing factor to economic growth is the total factor productivity (TFP) which is considered as another key indicator for competitiveness with an increase in TFP growth reflecting a more efficient use of resources.

TFP is the share of output of a firm, industry or national economy that cannot be explained by the amount of inputs such as labour and capital used in production, it is often interpreted as improvement in the institutional framework in an economy.

During the period of 2005 to 2009, TFP in Malta was significantly below the EU average. However, after 2009, Malta's TFP level improved significantly and outperformed the EU average. In 2014, Malta's TFP stood at 0.7 and was 0.3 percentage points higher than that of the EU average.

Given that the TFP growth reflects improvements to the institutional framework of a country, the improvements in Malta's TFP in the recent years can be attributed to the institutional reforms being undertaken by Government.

Total Factor Productivity

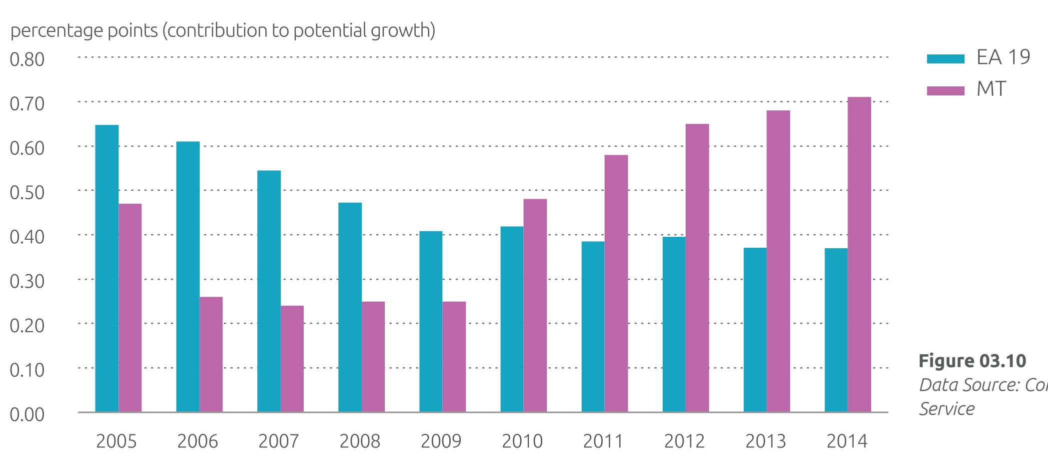

Figure 03.10
Data Source: Commission Service

Current Account

The sustainability of Malta's economic growth can be assessed by looking at the current account balance which provides information about the transactions of Malta with the rest of the world.

There has been a gradual reduction of the deficit since 2006, which eventually led to a surplus in the current account balance in 2012. The gradual reduction of deficit occurred as the negative balance on the goods and services account gradually converged to a positive balance in 2011. The current account remained positive at 2.7 per cent of GDP in 2014. This surplus resulted from the positive goods and services balance and positive secondary income balance, notwithstanding the increasing deficit in the primary income balance. In fact, the trade balance improved from €240 million in 2011 to €507 million in 2014.

The positive current account balance implies that Malta is earning more than it is spending abroad and is therefore a net creditor with the rest of the world.

Current Accounts as Percentage of GDP

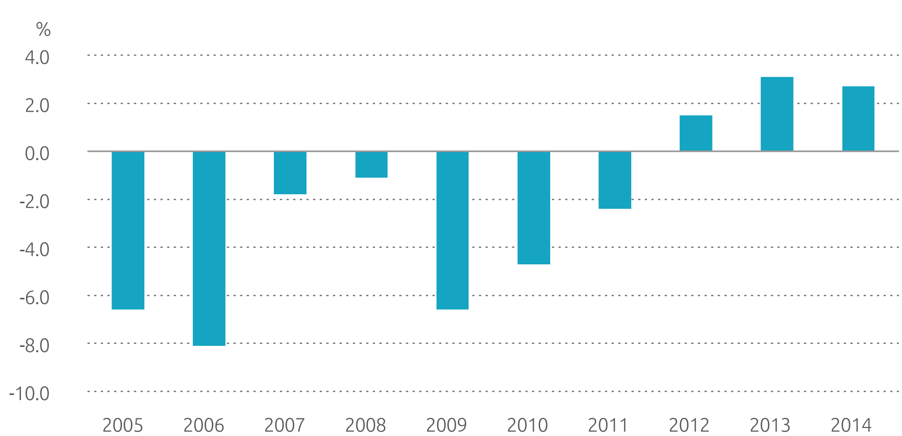

Figure 03.11
Data Source: Eurostat

03.4

BENCHMARKING COMPETITIVENESS

Doing Business Report 2015 – World Bank

The Doing Business Report sheds light on the ease of doing business in a particular economy, by focusing on eleven areas affecting the life cycle of a business. Each country is ranked according to its distance from the frontier based on a normalised common unit of various component indicators. A conducive environment for doing business ranking (1st is the highest ranking while 189th is the worst ranking) means the regulatory environment is more conducive to the starting and operation of a local firm. Malta's overall score improved from 61.91 percentage points in 2013 to 62.11 percentage points in 2014, whilst ranking 94th place out of 189 countries.

According to the report, in Malta's case, the areas which warrant the most attention include the starting of a business although the report acknowledged that reforms in this area have improved the ease of doing business, getting credit, getting electricity, obtaining construction permits and the enforcement of contracts. A breakdown of each of these areas reveals that the problematic areas surround issues related to excessive number and length of procedures.

For instance in starting a business, excessive amount of time is needed to register for VAT and obtain a trade licence. Getting electricity is also a lengthy process given the time taken to set up connection works, whilst the enforcement of contracts and obtaining construction permits are also held by excessive amount of procedures needed and the time taken by each of these procedures. On the other hand, Malta ranked well particularly in the areas of taxation payment, trading across borders and the protection of minority investors.

Rankings for Malta Doing Business Report 2015

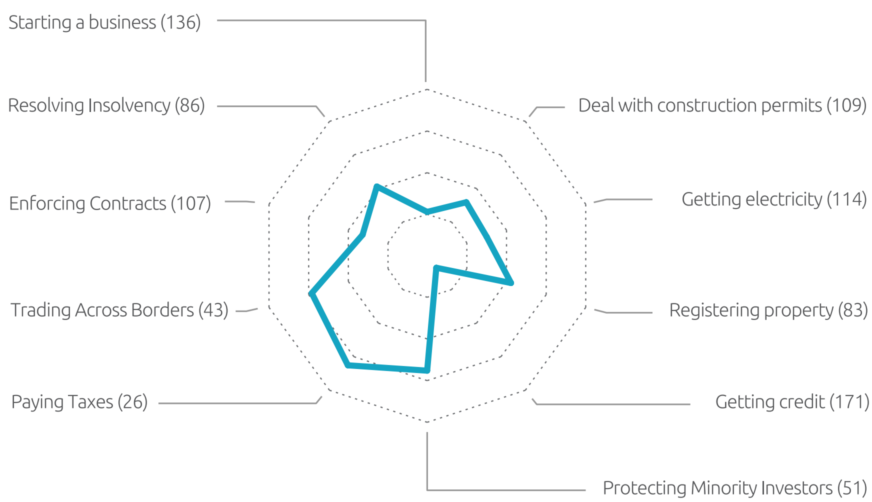

Figure 03.12
Data Source: Doing Business Report Malta

Comparison of Rankings on Ease of Doing Business

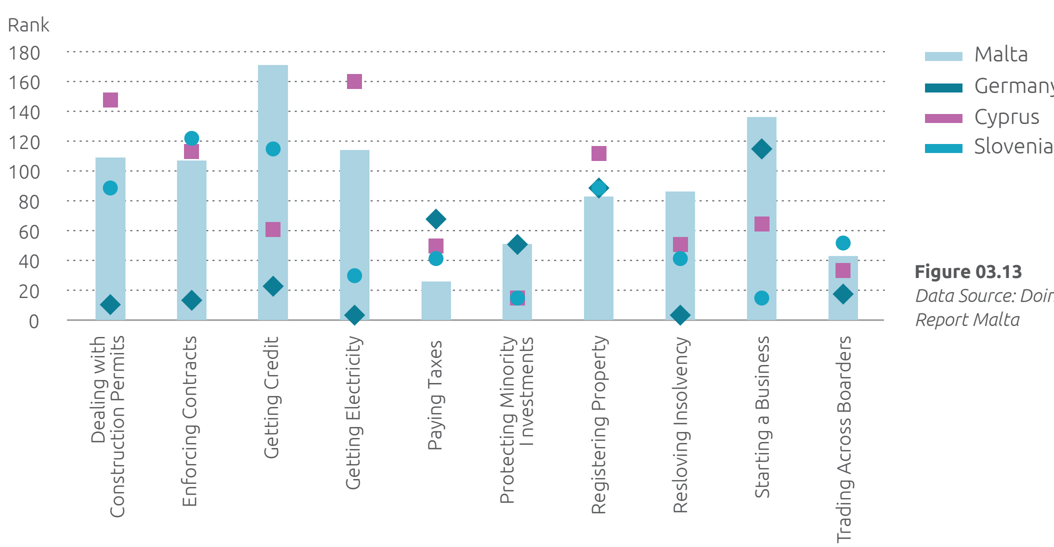

Figure 03.13
Data Source: Doing Business Report Malta

A comparative analysis with similar economies and Germany (acting as benchmark) shed light on some interesting points. While Malta ranked 94th in the overall ease of doing business ranking, Cyprus and Slovenia ranked 64th and 51th respectively. Both Cyprus and Slovenia seem to have similar issues to Malta with regards 'enforcing contracts' and 'dealing with construction permits' while they ranked positively in terms of 'paying taxes' and 'protecting minority investors'. However, Cyprus and Slovenia did not seem to have issues with 'starting a business'.

Global Competitiveness report 2014/2015– World Economic Forum

The Global Competitiveness Report analyses the productivity of a country through the global competitiveness indicator (GCI), which is based on 12 pillars that measure various aspects of competitiveness. The ranking includes 144 countries with the highest ranked country (1st place) being the most competitive. Over the period 2014-2015, Malta ranked the 47th country out of 144 countries, with a GCI score of 4.4 (out of a possible maximum 7).

Malta's main deficiencies seem to stem mainly from issues concerning inefficient government bureaucracy, problems associated with access to finance, the inability to innovate and the inadequately educated workforce. Further analysis of the subcomponents of the GCI reveal that, problems mainly lie in the cumbersome procedures to actually start a business, the ratio of women in the labour force to men and the domestic market size.

On the other hand, Malta seems to perform well in relation to public health, crime and theft and foreign currency regulations. Malta also performed well in education, financial market development and the technological readiness pillars. Figure 03.14 compares the problematic factors for doing business in Malta with that of three other European Union member states namely Germany (ranked 5th), Cyprus (ranked 58th) and Slovenia (ranked 70th). One can note that Cyprus' and Slovenia's main problematic factors where similar to those experienced in Malta with access to finance being however the most problematic factor in both countries followed by inefficient Government bureaucracy.

Responses on the most problematic factors in doing business

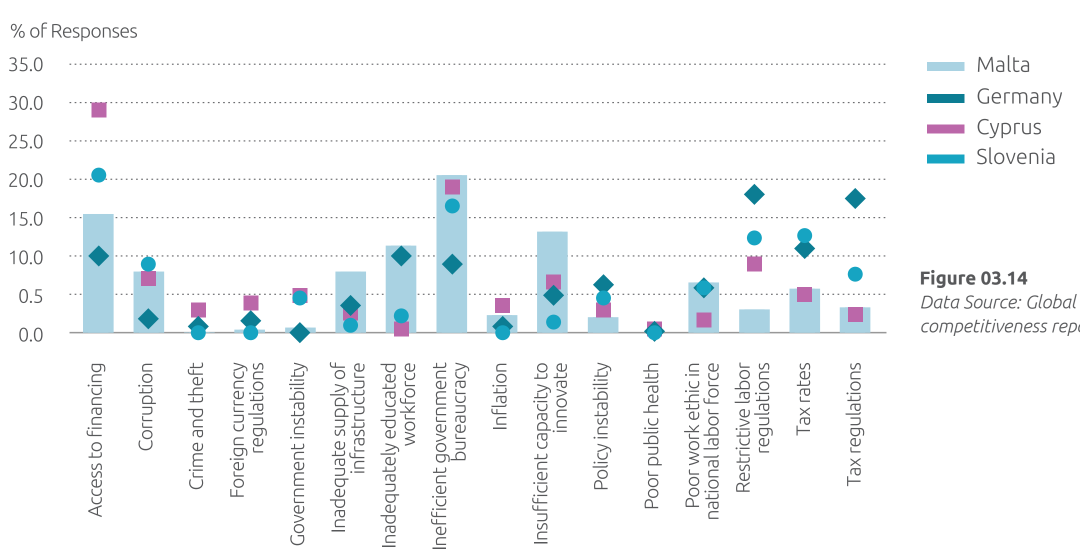

Figure 03.14
Data Source: Global competitiveness report

03.5

ACHIEVING AN ENABLING ENVIRONMENT

The strong economic growth rate recorded in recent years has contributed to Malta's convergence with the EU average GDP per capita. In fact, since Malta has joined the EU, Malta's GDP per capita as a share of the EU28 average has increased to 85 per cent in 2014. This performance was strongly underpinned by increases in contribution of labour through higher employment, higher participation rates and lower unemployment rates.

Notwithstanding the positive developments in the local economy, should Malta's economy continue to grow with the same pace as in the past ten years, Malta's convergence to the average Euro-Area GDP per capita will only occur in approximately 14 years. The convergence process would indeed be lengthier, should the Euro-Area return to its pre-crisis rates of growth. If the latter scenario materialises, Malta's growth rates would have to be on average 3.7 per cent to converge by 2030. This average growth rate is 0.9 percentage points higher than the average rate recorded over the past five years. These estimates are indicative of the importance of addressing bottlenecks to growth and to tap new sectors that can sustain the growth rates recorded in the last two years.

Achieving and maintaining competitiveness requires continuous improvements in productivity levels. It also requires constant adaptation to a changing economic environment. This involves new and better goods and services that capture market share, and improving ways of working, including management, to increase value added for given inputs of labour and capital.

Human capital is also a vital input into the productivity equation. High standards of education and health ensure that employees have the necessary skills, knowledge and capacity throughout their working lives especially in knowledge-intensive sectors. The attainment of these standards depends on adequate investment in training programmes and facilities.

A high level of strategic infrastructure is essential for enhancing productivity. Structures that improve productivity of workers and firms throughout the economy, by lowering the costs of combining different productive inputs and accessing markets and by increasing mobility and competition, are indispensable for sustainable growth.

Finally, the role of institutions cannot be underestimated. A competitive and flexible market, well-designed regulatory and taxation regimes and property rights that give firms the incentives to innovate are fundamental for an economy that aims to continue on its growth path.

04

AGEING AND THE LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES

Populations around the world are ageing. The general shape of the human population, characterised by an age pyramid with lots of children at the base, is shifting into one that will eventually have relatively older people at the top. Malta's population, similar to other developed and developing countries, will undergo dramatic changes in the coming decades due to low fertility, continuous gains in life expectancy and inward migration. The present demographic trends are expected to have wide-ranging and long-lasting economic effects and will induce significant macroeconomic structural changes especially on the labour market.

04.1

DEMOGRAPHIC DEVELOPMENTS

Population projections (EUROPOP2013) indicate that total population in Malta is projected to rise from around 425,000 in 2014 to around 457,000 in 2030, and to reach around 476,000 by 2060. As shown in Table 4.1, the age structure of the population is projected to change significantly. While the share of the very young persons (aged 0-14 years) in the total population is projected to hover around 15 per cent, the share of the people aged 65+ is projected to increase from around 18 per cent to around 30 per cent in 2060.

The most significant change in demography concerns the working-age population (aged 15-64 years), which reflects the section of the population that will bear the financial 'burden' of the elderly. From a share of 67.4 per cent in 2014, this ratio is projected to fall to around 56.1 per cent by 2060, while the share of the elderly population (aged 65+ years) in total population is projected to rise steeply from 18.2 per cent in 2014 to 28.5 per cent by 2060.

Dependency ratios

The dependency ratios relate the number of individuals that are likely to be "dependent" on the support of others for their daily living – youths and the elderly – to the number of those individuals who are capable of providing such support. Key indicators of age dependency presented in Table 4.1 are the youth-dependency ratio (for individuals aged less than 15 years), old-age-dependency ratio (for persons aged 65 years and more) and the ageing of the aged ratio.

The youth dependency ratio (0-14 year bracket as a percentage of the 15-64 year bracket) is expected to increase from 21.4 per cent in 2014 to 27.5 per cent by 2060, in reflection of the technical assumption of partial convergence in the fertility rates. The old-age dependency ratio (65+ year bracket as a percentage of the 15-64 year bracket) is projected to increase consistently from 27.0 per cent in 2014 to 50.9 per cent in 2060, an increase of 23.9 percentage points. Thus, by 2060, the total dependency ratio, which is the combined burden of these two components of the economically active population, will amount to 78.4 per cent. Meanwhile, the ageing of the aged ratio (80+ age bracket as a percentage of the 65+ age bracket), is projected to increase from 21.7 per cent in 2014 to 36.7 per cent by 2060.

Total Population in Malta, by selected age groups

Age	2014*	2020	2030	2040	2050	2060
0-14 yrs	61,162	65,365	70,157	67,451	69,839	73,397
15-64 yrs	286,334	280,771	275,096	280,827	274,938	267,095
65+ yrs	77,450	93,205	111,540	114,717	123,751	135,892
Total	**424,946**	**439,341**	**456,792**	**462,995**	**468,528**	**476,383**
Share (%)						
0-14 yrs	14.4	14.9	15.4	14.6	14.9	15.4
15-64 yrs	67.4	63.9	60.2	60.7	58.7	56.1
65+ yrs	18.2	21.2	24.4	24.8	26.4	28.5
Ratio						
Youth dependency ratio (0-14 yrs/15-64 yrs, %)	21.4	23.3	25.5	24.0	25.4	27.5
Old-age dependency ratio (65+ yrs/15-64 yrs, %)	27.0	33.2	40.5	40.8	45.0	50.9
Total dependency ratio	48.4	56.5	66.0	64.9	70.4	78.4
Ageing of the Aged Ratio (80+ yrs/65+ yrs, %)	21.7	23.1	31.8	38.9	35.6	36.7
Support ratio (15-64 yrs/65+ yrs)	3.7	3.0	2.5	2.4	2.2	2.0

Table 4.1
Data Source: EUROPOP2013, Eurostat. Note: Figures may not add up due to rounding

** For consistency purposes the 2014 figures are sourced from EUROPOP projections. The results of the 2015 Ageing Report are based on the demographic projections carried out by Eurostat*

As a result of these demographic developments, the support ratio (persons in the 15-64 years bracket as a proportion of persons aged 65+) is expected to decline from 3.7 per cent in 2014 to 2 per cent in 2060. This means that while in 2014 there were around 4 persons of working-age for every person that reached pension age, by 2060 this ratio is projected to decrease to around 2 persons of working-age for every person of pensionable age, thus underscoring the increasing burden of ageing populations for persons of working age. As indicated in Figure 04.1 and Figure 04.2, the trend towards a growing share of older people aged 65 years and above in the population and a shrinking working-age population is projected to accelerate in the future in all EU Member States.

Share of the population aged 65 years and over

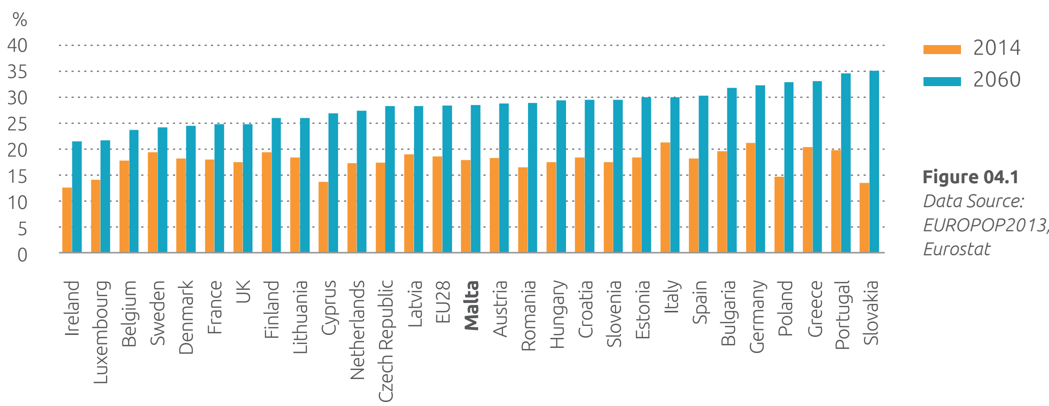

Figure 04.1
Data Source: EUROPOP2013, Eurostat

Old-Age Dependency Ratio in the EU Member States

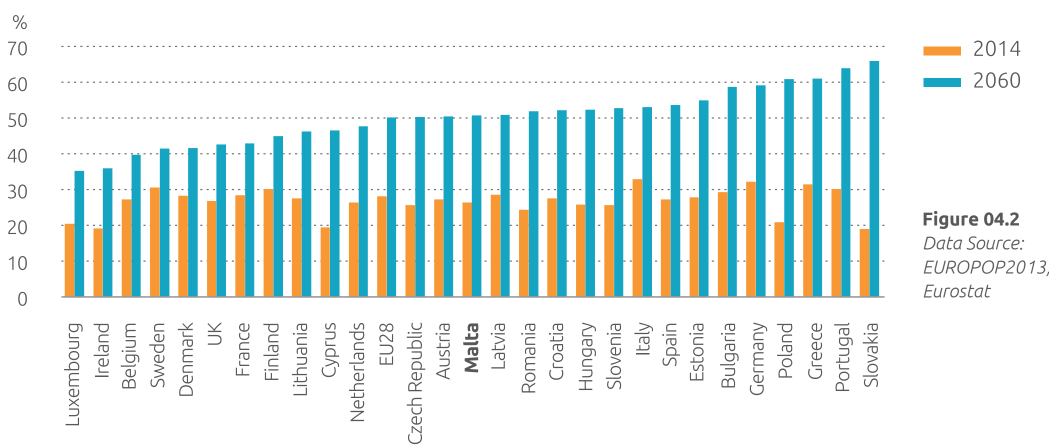

Figure 04.2
Data Source: EUROPOP2013, Eurostat

Life expectancy Developments

Medical progress and socioeconomic factors have reduced mortality in the past decades and are expected to continue to do so in the future. The impact of falling mortality rates of older people on the costs of public expenditure, especially public health, depends on their health status. If an extension in life expectancy at age 65 is linked to an increasing number of healthy life years, longevity does not automatically lead to higher public spending. However as shown in Figure 04.3, increases in the life expectancy over the past decade did not lead to a longer healthy life in all the EU Member States.

This was not the case for Malta as the increase in life expectancy at age 65 for men and women over the period 2005-2013 was accompanied by an increase in the number of years that a person at age 65 is still expected to live in a healthy condition.

It is to be noted that according to Eurostat, a healthy condition is defined by the absence of limitations in functioning/disability. This indicator is very important to note not only for the general well-being of older persons, but also due to its repercussions on health care policy and the duration of the working years.

Life expectancy and healthy life years at age 65, by sex, for Malta (years)

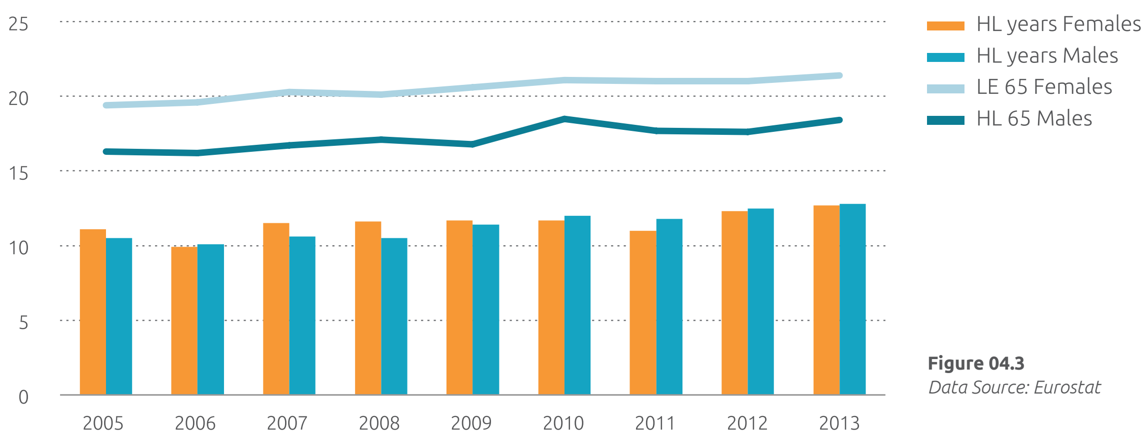

Figure 04.3
Data Source: Eurostat

As has been widely recognized, the elderly category of the population is not a homogenous category and the variability among the elderly increases with age, health, intellectual abilities and enterprise skills. One way of dealing with the irregularities and diversities among older people is to differentiate between the young-old (60-74 years old) and the old-old (75+ years), which allows a clear distinction not based solely on age but also on health and social characteristics. The former group (the young-old) seek meaningful ways to use their time, sometimes even opting to continue working, while some want to retire. They represent a great resource of talent to society, much of which is underutilised. On the contrary, the old-old are those persons who demand a wide range of supportive and restorative health and social services, whereby loss of family support may also increase dependency. For an increasing number of old, there is a lengthening period of dependency.

Labour Market Aspects

According to the European Commission (2014), the employment rate of older workers is a key indicator in relating labour market challenges to the sustainability of pensions. Furthermore, PAYG pension schemes require a good balance between contributory years and retirement years, which is not affected just by the employment rate at the end of the working life. One needs also to take into consideration entry ages and the stability of employment over the working life.

Employment rate

As shown in Table 4.2, the proportion of the population in employment decreased considerably between the ages of 55 and 64. Furthermore, across EU Member States, employment rates of older workers in 2014 ranged from 34.0 per cent in Greece to 74.0 per cent in Sweden. This discrepancy between countries is the result of several factors such as different employment sectors, retirement ages and policy initiatives. Variations in policy reforms may also help to explain the differences. Incentives to work longer, the retirement age, opportunities for early and partial retirement and retention of older workers are some of the impacts explaining the different employment rates of older workers between countries.

Furthermore, many Member States focused on continuous skills development (employability) and provided incentives to employees and employers to ensure lifelong learning.

In Malta, the employment rate of older workers in 2014 remained well below other age groups. While the employment rate for the older workers was less than 40 per cent in 2014, the employment rate of prime-aged workers (aged 25-49) was almost 78.4 per cent, a percentage point higher than the EU28 rate of 77.7 per cent. Focusing on the older workers cohort, in 2014, 37.7 per cent of the 55 to 64 year olds in Malta were in employment compared with 32.5 per cent in 2003. As shown in Figure 04.5, the positive trend has materialised over the years for both men and women post-2009. The employment rate for older women increased from 13.6 per cent in 2003 to 19.8 per cent in 2014. Over the same period, the rate of working men aged between 55 to 64 years increased from 52.5 per cent to 55.7 per cent.

Malta's Employment Rate in the 55-64 year age bracket

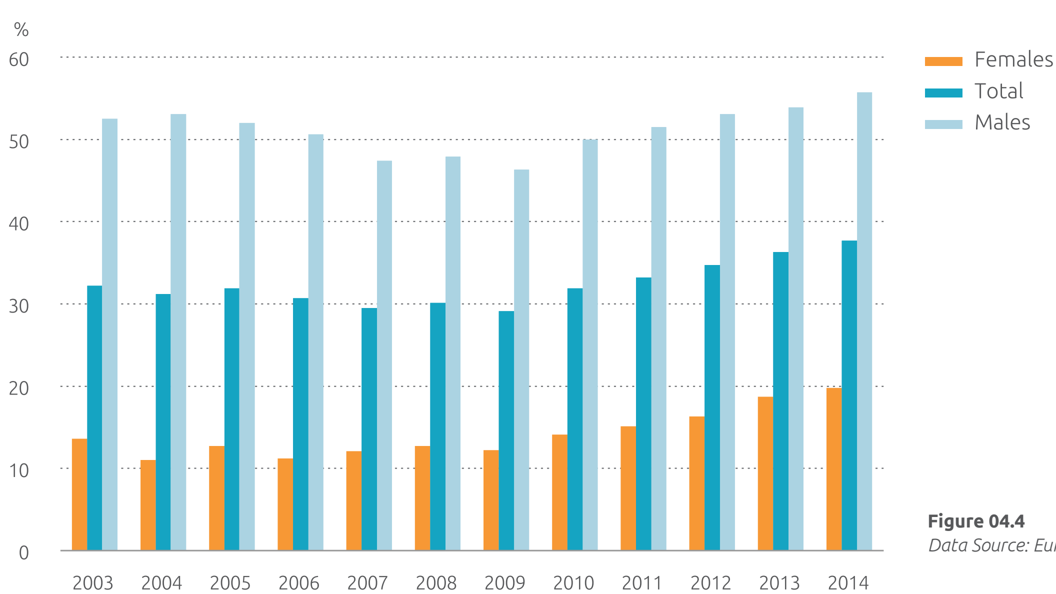

Figure 04.4
Data Source: Eurostat

Table 4.3 shows the different pensionable ages in EU Member States. Large differences in pension legislation can be observed with respect to the official retirement ages and incentives to postpone retirement. As a result of recent reforms in many Member States, retirement ages for males and females will gradually converge for all Member States except for Bulgaria and Romania. In almost every Member State, statutory retirement ages and effective exit ages from the labour market will rise substantially until 2060, with major steps often taking place within this decade.

Pensionable ages in EU Member States

	Male				Female			
	2013	**2020**	**2040**	**2060**	**2013**	**2020**	**2040**	**2060**
BE	65.0	65.0	65.0	65.0	65.0	65.0	65.0	65.0
BG	63.7	65.0	65.0	65.0	60.7	62.7	63.0	63.0
CZ*	62.7	63.7	66.5	69.3	59.7	61.7	66.5	69.3
DK*	65.0	66.0	70.0	72.5	65.0	66.0	70.0	72.5
DE	65.3	65.8	67.0	67.0	65.3	65.8	67.0	67.0
EE	63.0	63.8	65.0	65.0	62.0	63.8	65.0	65.0
IE	65.0	66.0	68.0	68.0	65.0	66.0	68.0	68.0
EL*	67.0	67.0	69.9	71.9	67.0	67.0	69.9	71.9
ES	65.0	65.8	67.0	67.0	65.0	65.8	67.0	67.0
FR	65.8	67.0	67.0	67.0	65.8	67.0	67.0	67.0
HR	65.0	65.0	67.0	67.0	60.8	62.5	67.0	67.0
IT*	66.3	66.8	68.4	70.0	62.3	66.8	68.4	70.0
CY*	65.0	65.0	67.0	69.0	65.0	65.0	67.0	69.0
LV	62.0	63.8	65.0	65.0	62.0	63.8	65.0	65.0
LT	62.8	64.0	65.0	65.0	60.7	63.0	65.0	65.0
LU	65.0	65.0	65.0	65.0	65.0	65.0	65.0	65.0
HU	65.0	64.5	65.0	65.0	62.0	64.5	65.0	65.0
MT	62.0	63.0	65.0	65.0	62.0	63.0	65.0	65.0
NL*	65.1	66.3	69.3	71.5	65.1	66.3	69.3	71.5
AT	65.0	65.0	65.0	65.0	65.0	65.0	65.0	65.0
PL	65.3	67.0	67.0	67.0	60.3	62.0	67.0	67.0
PT*	65.0	66.4	67.7	68.8	65.0	66.4	67.7	68.8
RO	64.7	65.0	65.0	65.0	59.7	61.4	63.0	63.0
SI	65.0	65.0	65.0	65.0	63.5	65.0	65.0	65.0
SK*	62.0	62.8	65.4	67.8	58.3	62.8	65.4	67.8
FI	66.0	66.0	66.0	66.0	66.0	66.0	66.0	66.0
SE	67.0	67.0	67.0	67.0	67.0	67.0	67.0	67.0

Table 4.2
Data Source: 2015 Ageing Report, European Commission

**Countries where statutory retirement age is legislated to increase in line with increase in life expectancy.*

Duration of working life

Figure 04.5 shows the duration of working life measured in years in 2000 and in 2013. Malta's total duration of working life increased from around 29 years in year 2000 to around 33 years in 2013 while the overall duration of working life in the EU27 countries increased from around 33 years in 2000 to around 35 years in 2013.

Duration of Working Lives (in years) 2000 and 2013

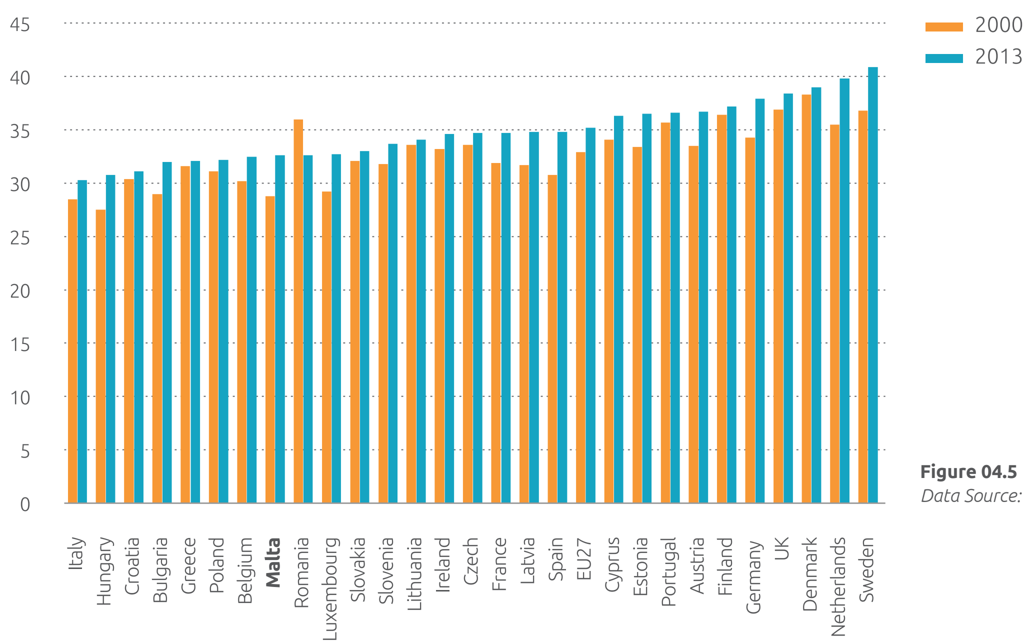

Figure 04.5
Data Source: Eurostat

Figure 04.6 shows the change in the duration of working lives by gender between 2000 and 2013. It is interesting to note that in Malta, there was an increase of around 8 years for the number of years that females are expected to be active in the labour market throughout their life, whereas the male segment registered only a slight increase of 0.1 in the number of years.

Change in the Duration of Working Lives by Gender, 2000-2013

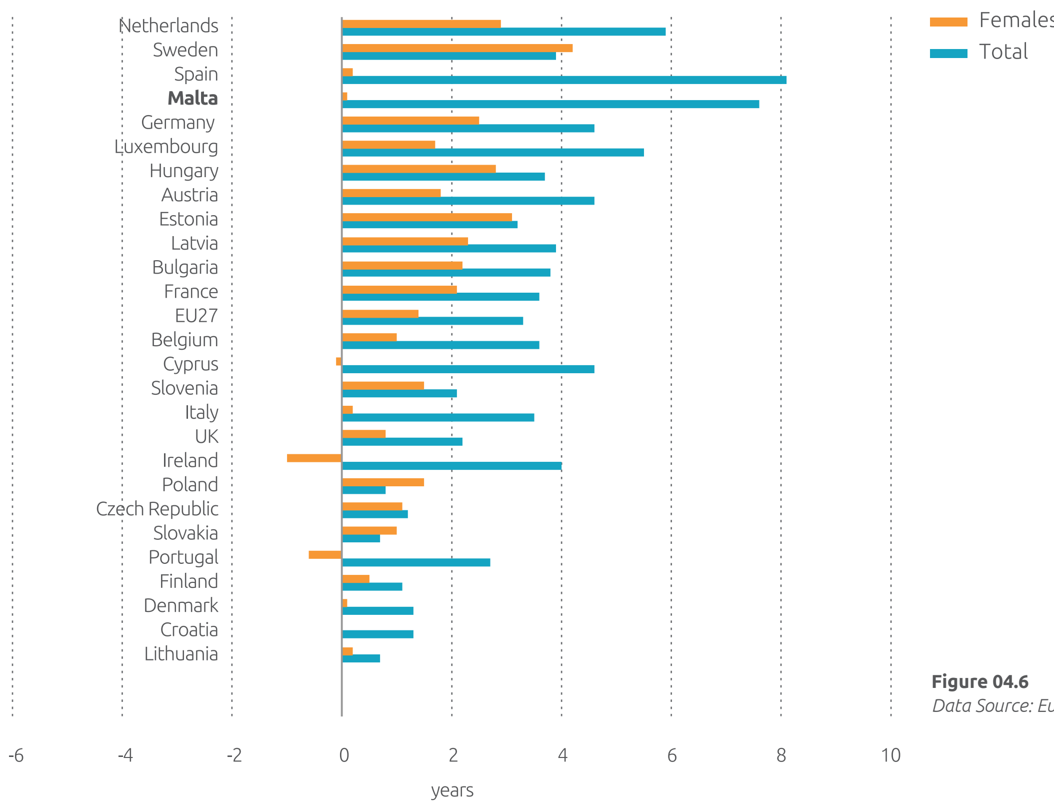

Figure 04.6
Data Source: Eurostat

04.2

LONG-TERM AGE-RELATED EXPENDITURE PROJECTIONS

This section provides an analysis of the long-term age-related spending for Malta in comparison to the EU Member States for the period 2013-2060. These projections are published in the 2015 Ageing Report by the European Commission, on the basis of commonly agreed assumptions for the EU Member States agreed by the EPC Ageing Working Group.

Demographic and Macro-Economic Assumptions

As regards the demographic evolution, life expectancy at birth for men is assumed to rise by 6.4 years over 2013 to reach 85.1 years in 2060. For women it is expected to reach 89.1 years, an increase of 6.3 years over 2013. This implies that despite some convergence, female life expectancy in 2060 is projected to remain 4 years higher than that of males. Meanwhile, life expectancy at 65 years for males is projected to increase by 4.3 years between 2013 and 2060 to 22.4, while for women it is projected to increase by 4.4 years to 25.7 in 2060. The fertility rate is projected to increase from 1.4 in 2013 to around 1.8 in 2060. Another important variable in the evolution of the demography is net migration, which is projected to remain a strong positive contributor even if it is projected to decline from an average of 1,600 in 2013 to 1,146 in 2060.

With respect to macroeconomic assumptions, potential GDP growth rate is assumed to increase from 1.7 per cent in 2013 to around 2 per cent by 2020, then declining to 1.8 per cent by 2040. It is assumed to decline further to 1.4 per cent by 2060. The unemployment rate (15-64 years) is assumed to increase marginally from 6.5 per cent in 2013 to 6.7 per cent in 2060. The female participation rate (15-64 years) is assumed to increase from 50.2 per cent in 2013 to 66.9 per cent by 2050 and to remain relatively stable at around that level by 2060. The male participation rate (15-64 years) is assumed to increase from 79.7 per cent in 2013 to 84.5 per cent by 2030 and thereafter decline to 83.4 per cent by 2060.

Age-Related Expenditure Projections

As shown in Table 04.3, age-related spending including pensions, health care, long-term care, education and unemployment benefits in Malta is projected to increase by 6.6 percentage points of GDP over the period 2013-2060 (as opposed to an increase of 8.6 percentage points in the 2012 Ageing Report). It is to be noted that the revised demographic and macroeconomic projections have resulted in a relatively smaller increase in the age-related expenditure relative to the 2012 Ageing Report, of 2.0 p.p. of the GDP over the entire projection period.

However, as shown in Table 04.3, the fact that Malta was not alone in benefiting from the revisions to the demographic projections, as other countries also benefitted from improved projections reflecting the structural reforms implemented in such countries, led Malta to remain classified amongst the EU Member States with the projected highest increases in age-related expenditure. This section will address briefly the major expenditure categories.

Change between 2013 and 2060 as a percentage of GDP (percentage points)

	Pensions	Health-care	Long-term care	Education	Strictly age-related items	Unemploy-ment benefits	Total age related items
HR	-3.9	1.7	0.1	-0.4	-2.5	-0.3	-2.8
EL	-1.9	1.3	0.4	-1.1	-1.4	-0.9	-2.3
FR	-2.8	0.9	0.8	-0.2	-1.3	-0.4	-1.7
LV	-3.1	0.6	0.1	0.8	-1.6	-0.2	-1.7
CY	-0.1	0.3	0.2	-1.2	-0.8	-0.6	-1.4
DK	-3.1	0.9	2.0	-0.7	-0.9	-0.5	-1.4
IT	-1.9	0.7	0.9	-0.2	-0.5	-0.3	-0.9
ES	-0.8	1.1	1.4	-0.8	0.8	-1.7	-0.8
BG	-0.4	0.4	0.2	0.4	0.5	-0.2	0.3
PT	-0.7	2.5	0.4	-1.0	1.3	-0.9	0.3
EE	-1.3	0.6	0.7	0.8	0.6	0.0	0.6
SE	-1.4	0.4	1.5	0.2	0.7	-0.1	0.6
HU	-0.1	0.8	0.4	-0.2	0.9	-0.1	0.8
PL	-0.7	1.2	0.9	-0.1	1.3	-0.1	1.3
EU	-0.2	0.9	1.1	0.0	1.8	-0.4	1.4
IE	1.1	1.2	0.7	0.0	3.0	-1.1	1.9
LT	0.3	0.1	0.9	0.9	2.2	-0.1	2.1
RO	-0.1	1.0	0.9	0.4	2.1	0.0	2.1
UK	0.7	1.3	0.4	0.0	2.4	-0.1	2.3
FI	0.1	0.7	2.1	0.3	3.2	-0.4	2.7
AT	0.5	1.3	1.3	0.0	3.1	-0.2	2.9
CZ	0.7	1.0	0.7	0.7	3.1	0.0	3.0
NL	0.9	1.0	3.0	-0.5	4.4	-0.8	3.6
SK	2.1	2.0	0.4	-0.4	4.1	-0.1	4.0
DE	2.7	0.6	1.5	0.3	5.1	0.0	5.0
BE	3.3	0.1	1.6	0.3	5.3	-0.2	5.2
LU	4.1	0.5	1.7	0.2	6.4	-0.2	6.2
MT	3.2	2.1	1.2	0.1	6.6	0.0	6.6
SI	3.5	1.2	1.5	0.8	7.0	-0.2	6.8
NO	2.5	0.9	3.6	-0.1	6.9	0.0	6.9

Table 04.3

Data Source: 2015 Ageing Report, European Commission

Pension expenditure

An important factor of age-related public spending is the expenditure on pension systems. With the ratio of elderly people to the working age population projected to increase, pension expenditure is expected to have an even stronger impact on total public expenditure. Public expenditure on pensions is presently the most important age-related government expenditure item, and is projected to remain so also in the future.

Over the projection period, pension expenditure in Malta is projected to increase from 9.6 per cent of GDP in 2013 to 12.8 per cent of GDP by 2060. The increase in pension expenditure is primarily attributable to an increase in expenditure in old-age pensions that increases from 5.3 per cent of GDP in 2013 to 10.3 per cent in 2060. Expenditure on Disability Pensions is projected to decline marginally to 0.3 per cent of GDP and expenditure on survivors' pensions is projected to decrease from 1.6 per cent of GDP to 1.3 per cent of GDP. Similarly, expenditure on Other Pensions is projected to decrease from 2 per cent of GDP to 0.5 per cent of GDP.

Expenditure on pensions is projected to be relatively stable till around 2040, increasing progressively thereafter thus giving rise to concerns on the long term sustainability of public finances. In this regard, the Pensions Strategy Group has drawn a comprehensive strategy that was launched for public consultation in June 2015.

The strategy contains a set of reforms to the current pension system directed to secure adequacy, sustainability and solidarity over the long term, without changing the mandatory retirement age or social security contribution rate. [1]

Health Care Expenditure and Long-term Care Expenditure

Demographic changes will have significant consequences for the local economy and for public spending, particularly on healthcare. Unlike public spending on pensions, which is solely determined by demographic developments and the institutional setting of the pension scheme, expenditure on health care is driven by a complex set of interrelated demand and supply side factors.

As argued by the European Commission (2010), health care and long-term care are closely connected. While health care focuses on improving the health status of patients, long-term care focuses on improving the quality of life of people with chronic conditions. Public expenditure on both of them is driven by a series of factors that affect their demand and supply. Population size, age distribution, health and disability status, the individual and national income and provisions regulating access to health care goods and services are key determinants of demand.

[1] *The set of reforms recommended by the Pension Strategy Group can be viewed online from the following link: http://mfss.gov.mt/en/public-consultations/pensions/Documents/Pensions%20Report.pdf*

Supply side determinants include the availability and distance to health care services, technological progress and the institutional framework regulating the provision of those goods and services. This section will present the health care and long-term care projections up to 2060 as provided by the European Commission.

Health Care Expenditure

The projections for public expenditure on health care as prepared by the European Commission indicate that Malta is projected to record an increase of 2.1 percentage points of GDP in health care (compared to 0.9 per cent for the EU). Government is aware of the challenges posed by these demographic developments on healthcare and hence it is actively working on implementing a holistic strategy that will ensure the long-term sustainability of the health sector.

Long-term Care Expenditure

Similar to the health care expenditure projections, the methodology to project long-term care (LTC) expenditure is based on a simple macro-simulation model. The model is based on the assumption that the whole population is divided into groups which are assigned certain characteristics (e.g. age, gender, per capita expenditure, health status and type of care). When over time the (relative) size or features of these groups change, the long-term care expenditure changes in line with the change of those characteristics.

According to the 2015 Ageing Report, an increase of 1.2 percentage points of GDP is projected in long-term care for Malta (very close to the 1.1 percentage points for the EU) as opposed to an increase of 0.8 percentage points in the 2012 Ageing Report) during the period 2013-2060. This increased spending is primarily due to an ageing society and an increase in life-expectancy at birth over the projection period.

04.3

CONCLUDING REMARKS

Ageing is an important demographic and economic phenomenon with important implications for the sustainability of public finances. Malta, similar to other advanced economies, is also facing a demographic challenge with the dependency ratio expected to double over the next five decades. In the context of increasing life expectancy, it is evident that raising potential output, particularly through higher labour participation across all cohorts, and improving the productive capacity of the economy, plays key roles in supporting the welfare system in Malta. Thus Active Labour Market Policies, alongside pension reforms aimed at incentivising later retirement, without rising the pension age, play a key role in enhancing the sustainability of pensions over the medium to long term. It is also evident that Malta is facing important sustainability challenges in the areas of health and long-term care. In this regard, the implementation of comprehensive reforms in the public health system aimed at ensuring the delivery of a cost-effective service and sustainable use of available resources, has been high on the agenda of Government.

05

INVESTING IN PRIORITY SECTORS

The past two years have been characterised by growing economic and financial well-being. This was the result of financial stability and fiscal certainty which spurred confidence and optimism which in turn attracted investment. Overarching reforms were launched, ranging from the energy sector to active labour market policies.

Supported by an ongoing stable development on the job market with increasing incomes and employment, Malta is on a solid path of growth. GDP is expected to continue to grow in the coming years. However, economic success cannot be taken for granted. Constant vigilance to ensure the attainment of the medium term fiscal targets is therefore essential to ensure the quality of public expenditure while the sustainability of long term public finances necessitates periodical reviews. Investments in education and science, in infrastructure and health remain important aspects to ensure long-term sustainable development.

Seeking the achievement of sustainable development is a process. Demography, emerging socio-economic realities, and increasing environmental awareness all require timely and targeted actions to guide progress.

The Government is committed to provide additional resources for education, employment and health as such expenditure is viewed as an investment that empowers and enables our citizens, increase the economy's output potential while contributing to our competitiveness in the global community.

The ongoing reforms to Malta's institutional framework seek enhanced governance whilst the specific policies, plans and regulatory instruments map the necessary steps needed to be taken. Specific attention will be given towards the mainstreaming of environmental objectives and meeting the EU2020 targets. Government is determined that all these actions are undertaken within a regulatory framework that safeguards the environment and its natural resources.

05.1

REFORMING INSTITUTIONS: MAKING AND REFLECTING MODERN SOCIETY

In these last two years, this Government has shown great determination and leadership to champion wide-range institutional reforms including the enactment of the Civil Union Act during the first months of this legislature.

Major reforms of the justice system are also underway. Government is currently implementing the reform measures as proposed by the Commission for the Holistic Reform of the Justice System. A bill regulating the administration of justice, reflecting the recommendations of the Commission for the Holistic Reform in the Justice system is currently being reviewed. Another measure which shall be introduced in the near future is the introduction of full time lawyers, seconded to Judges and tasked with the aim of alleviating the Courts' work load.

Acts of Parliament, including the removal of prescription for persons in political offices and the protection of the Whistleblower Act have been already been enacted. Party financing legislation has also been approved. Legislation has also been introduced to de-penalise minor offences regarding possession of small quantities of prohibited drugs for personal use and assist users to rehabilitate from drug abuse.

Important steps have been made with regards public procurement. The advanced stage of the transition to e-procurement on a national scale is on track. This will improve the way Government purchases goods and services from the market and will further provide access to private operators as well as decrease cost related to procurement.

Following the performance in Green Public Procurement, improvements to mainstream the administrative procedure across Government were recently introduced. Complementing these measures, training courses were held to increase awareness and improve implementation amongst the public sector. This action reflects Government's commitment to its leadership role towards the gradual transformation to a greener economy.

Private enterprise will also be assisted by the adoption of a more flexible approach to retail towards retail opening hours outside the standard business hours. These amendments are expected to stimulate the retail sector whilst facilitating shopping opportunities for both tourists and local residents. The finalised proposals have also been published for consultation with constituted bodies, the private sector and the general public.

Reforms have also been enacted within the financial sector. The Financial Services Arbiter has been launched and will have the function to investigate, and the legal power to grant execute ruling, on complaints concerning financial natures as well as decide on disputes between investors and financial institutions.

Moreover, a number of measures to easing access by SMEs to capital markets and venture capital funds are being developed. Government is currently evaluating the proposal by the Malta Stock Exchange to develop a National Capital Markets Plan called 'PROSPECTS' that aims to achieve improved economic growth at a lower cost of capital by developing the Maltese Capital Markets.

Work on the establishment of the Malta Development Bank (MDB) has reached an advanced stage. The aim of the MDB is to foster stronger economic and social development in Malta and to fill an institutional gap by providing credit and other financial services for viable eligible projects where commercial banks are unwilling or unable to provide such facilities. The MDB will thus be complementing and supplementing the operations of commercial banks rather than competing with them. The MDB will also seek to act as a catalyst in the implementation of projects envisaged under the Investment Plan for Europe launched by the Juncker Commission.

In addition to existing measures, opportunities to facilitate increased public participation in the decision-making process have been supported by the introduction of an ad hoc on-line central portal for emerging legislation and policies by Government. Enhanced access encourages civil society to contribute towards a more transparent more accountable and overall improved governance.

05.2

EMPLOYABILITY THROUGH EDUCATION: ENHANCING SKILL LEVELS

Today's labour market is constantly shifting from the traditional jobs towards ones that require a constantly growing skills base. Education and training make possible the enhancement of skills increase labour flexibility, contribute to productivity and to economic prosperity.

Government is committed to continue raising labour market participation amongst all groups but especially amongst women young people older workers and the long-term unemployed. The last two budgets focused on increasing employment and reducing unemployment through making work pay, creating opportunities and reducing unnecessary dependencies. The benefit design of the labour market will also be sustained following the introduction of schemes which include the tapering of benefits. In the 2015 Budget, the Government launched the in-work benefit scheme open to low-to-medium income families where both spouses are in employment and have dependent children as well as to single parents in employment. This scheme will provide financial support to these families and incentive the uptake of more work-hours.

Addressing skill mismatches is one of the key policy priorities for this Government. This is being addressed by targeting specific hurdles that are impede working and/or studying parents from increasing their works hours and/or engaging into further education and training. The provision of free childcare facilities, opening schools earlier, providing after-school care services, and extending the tax deduction for parents sending their children to private childcare centres will also offers a more conductive environment for this aim.

Furthermore measures that address skills shortages and skills gaps in the labour market, include the unrolling a series of reforms tackling the reduction of early school leavers, absenteeism, prioritising learning of mathematics, ICT and science subjects. This is expected to enhance the required skills for the introduction and application of new technologies and towards a shift to a low-carbon and resource efficient economy.

To assure the relevance of formal education and training, the educational authorities are strengthening collaboration with industry. The Malta College for Arts, Science and Technology (MCAST) in collaboration with Malta Enterprise are offering new courses on aviation. MCAST has implemented the National Apprenticeship Scheme. The Institute of Tourism Studies (ITS), in collaboration with Malta Enterprise and the Employment and Training Corporation (ETC), launched the 'Foundation in Tourism Studies' course that will train students in the necessary skills to open their own business or become employed in the tourism sector, and provide weekly placements in the tourism industry.

To offer more guidance to students on the choices of jobs that are available for the various lines of studies, an Employability Index is being development. This will help provide signalling and help channel human resources towards priority sectors in our economy. Government has also continued to issue calls under the Malta Government Scholarship Scheme both at undergraduate as well as postgraduate levels. During this year, further scholarships, at levels 7 and 8, were launched under the ENDEAVOUR scheme as well as a Post-Doctoral Grant scheme called 'Reach High Scholars Programme'. Additional funds were provided to strengthen the Youth Guarantee project which will provide traineeships and work trials during 2015.

Government is fully aware of the evolving tertiary educational sector, where emerging institutions often offer a small number of highly technical programmes. There are 4.5 million students studying in overseas campuses and it is Government policy to attract this market niche to Malta. Success in this area will not only strengthen our present educational institutions but will contribute towards sustainable economic growth.

05.3

ENVIRONMENT: TOWARDS A GREENER ECONOMY AND FOSTERING STEWARDSHIP

Malta, being a small archipelagic State with one of the highest population densities in the world, faces significant challenges when it comes to environment protection. The requirements of a safe, healthy and secure environment for its population are similar to those of much larger States, but need to be accommodated on 315 square kilometres of land.

Whilst the environmental acquis alone provides a formidable legal arsenal for environment protection, its effectiveness depends upon having comprehensive resource management plans dealing with matters such as land use, air quality, water and waste management that are implemented by well resourced governing institutions. In guiding actions for the public and private sectors alike, with continuous involvement of all stakeholders, such plans pave the way further towards the effective transformation to a greener and a more sustainable economy.

Against this background, a number of measures are underway. Government is currently finalising the drafting of a Green Economy Strategy and Action Plan. In this context, the green economy will provide opportunities strengthen the relationship between economic growth and environmental stewardship. It is envisaged that the public consultation on this strategy will be undertaken in the last quarter of this year.

As part of the implementation of its environmental stewardship, extensive work will need to be undertaken in Malta in 2016 to implement the Management Plans of the Natura 2000 sites and to launch monitoring programmes in the marine environment.

The ongoing MEPA demerger process is also intended to give strength and impetus to Malta's environmental agenda and the upcoming period is seen as fundamental to ensure that the new environment authority is adequately equipped and resourced to ensure effective delivery of environmental protection.

A review of Malta's National Renewable Energy Action Plan is at an advanced stage and will soon be open to public consultation. This action plan will review the way by which the 2020 renewable energy targets will be reached. It will mark a step away from a small number of major projects towards smaller capacity sources of renewable energy distributed across the Maltese Islands with priority given to solar photovoltaic systems and solar water heating. In addition, a public consultation on a draft solar farm policy was held earlier this year to set up the fundamental criteria to guide the planning and consideration of solar farm development.

Government, through the Building Regulation Office, has completed and submitted studies for setting Energy Performance requirements. These studies will be used to update the existing national minimum requirements of buildings as regards to energy efficiency. The revision of the minimum requirements shall be completed by January 2016.

A draft national plan for increasing the number of nearly zero-energy buildings is completed and consultations are currently underway. The Government is also setting up of a framework for Energy Auditor Certification, guidance for the implementation of Energy Audits by non-SMEs and a quality verification system for Energy Audits by non-SMEs. This measure will also contribute towards the promotion of Energy Audits in SMEs.

A holistic strategy that includes both fiscal incentives and investment in infrastructure has been put forward in the Malta National Electromobility Action Plan, which aims to accelerate the uptake of electromobility. To further improve energy efficiency in transport and reduce emissions, Government is providing individuals, NGO's and business with financial incentives to purchase electric vehicles.

The Government is also in the process of launching a fully-fledged comprehensive medium to long-term strategy that covers all sectors contributing to national greenhouse gas emissions. This should bring Malta's mitigation strategy in line with current and future commitments in respect of greenhouse gas emission limitation or reductions. To streamline Malta's commitments on climate change on both main fronts of climate action, namely mitigation and adaption in a legally binding framework, the Government has adopted a Climate Action Act. This Act aims to instil ownership amongst stakeholders with a view to ensure effective climate action within an overarching governance framework. Throughout 2016, the necessary structures provided for in the Act will be created to ensure its implementation.

In line with the Climate Action Act, Malta is working on the development of a Low Carbon Development Strategy with various sectors already undertaking studies that will feed into the strategy, including an 'Energy Roadmap 2050' study that will determine a cost-effective path towards decarbonisation of the energy sector. Measures taken for environmental protection are always aimed to bring about change to those socio-economic practices identified as creating a negative impact on the environment. A key element to support this change is to work towards a long term societal transformation from a traditional heritage of resource exploitation to enhancing environmental stewardship where respective responsibilities are undertaken by all.

Action to increase producer responsibility and participation in waste separation amongst the general public complemented by necessary improvements of infrastructure, have continued in line with the National Waste Management Plan. The waste sector directly impacts on the socio-economic context of Malta. Recognizing the need to shift towards a circular economy, the Government is committed to increase efforts to manage waste in line with the waste hierarchy. This includes better separation at source and support to business, local authorities and third sector organisations to improve integration in the circular process. To move in this direction, we will continue working on improving its waste collection system in 2016, mainly by introducing new initiatives to ensure the country's recycling potential, thereby minimising costs for business, industry and households.

The implementation of the new programmes for rural development and fisheries management are expected to further the need for environmental stewardship amongst farmers and fishers working with natural resources on a daily basis.

The spatial challenge to accommodate the necessary development needs required to not only maintain Malta's competitiveness but secure a better quality of life in a healthy environment has been undertaken with the adoption of the Strategic Plan for Environment and Development in July 2015. The holistic approach adopted enables greater synergy between the various national plans and policies with a view to use land and sea resources sustainably.

05.4

ENERGY: LOOKING AHEAD WITH CONFIDENCE

This Government inherited an energy sector which was becoming a burden on the Maltese families and businesses. Mindful of the need to restructure this sector, this Government made energy reform a policy priority. The main pillar of its strategy rested on lowering the cost of electricity generation by reducing the dependence on oil imports and diversifying the energy matrix, improving energy efficiency and significantly reducing greenhouse gas emissions.

As a result, Malta's energy industry has witnessed one of the most significant foreign direct investments in the Maltese Islands. The investment transaction involved the inclusion of a strategic partner in Enemalta as well as the collaboration of Shanghai Electric Power in the renewable energy and energy servicing fields.

As part of Government's energy plan to switch from heavy fuel to natural gas for the generation of electricity, the ElectroGas Malta Consortium will be building and operating a Combined Cycle Gas Turbine plant and a Liquified Natural Gas facility. This new energy source is expected to reduce Malta's dependency on electricity generated through oil-fired sources.

To continue diversifying the energy mix, Malta this year got connected to the European energy grid as the electricity interconnector was put in operation and the Maltese grid was synchronised with the Italian grid for the first time. In addition, Government is also working on a connection to the trans-European Natural Gas Network via an approximately 155 kilometre pipeline in Sicily to deliver natural gas for the generation of electrical power and addressing the needs of a future Mediterranean Gas Hub.

With regard to renewable energy, Government is prioritising solar photovoltaic systems and solar water heating in order to achieve its committed renewable energy target in line with relevant EU Directives.

Looking ahead, this Government is envisaging Malta as a hub for energy-related services. Our geographical location provides us with an ideal platform to service Europe and North Africa. Shanghai Electric Ltd intends to set up in Malta an energy service centre which will service their operations in Europe as well as Africa and Turkey.

From a liability, the energy sector was transformed into a driver of economic growth. The restructuring of the energy sector has already borne fruit as families and businesses are now benefitting from significantly lower utility rates. Moreover, it is also estimated that the shift to gas will result in 50 percent less emissions, 90 percent less particulate matter coming out of the chimneys, and elimination of sulphur. The decommissioning of the Marsa Power Station also marks another significant milestone. These measures are expected to result in improved air quality which is an integral prerequisite for a healthy environment for everyone, in particular for those families and communities previously impacted by the emissions from these plants.

05.5

HEALTH: TURNING CONSTRAINTS INTO OPPORTUNITIES

Government's vision in the healthcare sector is to ensure the efficient delivery of high quality free and universal healthcare services. It also envisages Malta becoming a healthcare cluster in the centre of the Mediterranean able to attract high quality healthcare investment from overseas catering for private medical tourism.

Towards this end, we will continue to direct our efforts towards the implementation of comprehensive reforms in the health care system driven by new strategic local and foreign private sector investment as well as by increased public investment in existing processes.

The coming years will see the launching of various projects in the health care setting including the new hospital in Gozo operated by Barts and the London School of Medicine and Dentistry, the restructuring of Karin Grech hospital and the new private hospital and Nursery school within St Luke's hospital. In addition, Synesis Limited together with Johnson and Johnson will be investing in a new private hospital at Smart City aimed at attracting medical tourism and hence, promoting Malta as a medical hub.

In order to optimise resources and shift care towards the primary health care setting, Government is strengthening the provision of services in this sector. Projects include the setting up the new anticoagulant clinic, the Chronic Kidney Disease Protection Clinic, the Orthopaedic outpatient outreach clinic, the new Chronic Disease Management Clinic and the new Ophthalmology clinic.
Progress has also been made with respect to the strengthening of health promotion and disease prevention through the implementation of a number of strategy and policy documents.

The cancer prevention programmes were also strengthened in recent years by increasing investment in cancer treatment services, including investment in specialized equipment. Over the coming four years, free breast cancer screening to women over 60 will be expanded while the colorectal cancer screening programme will be further consolidated.

The Government has successfully reviewed and reformed the medicines and medical devices procurement, management and distribution processes. This led to minimal stock holding and efficiency gains which contributed to Government efforts to put resources to their optimal use.

05.6

GOZO: CONTRIBUTING TOWARDS NATIONAL PROSPERITY

Traditionally, Gozo has been viewed as simply being a quiet backwater of Malta. Regional disparity was clearly evident, in terms of both the unemployment and the number of people gainfully occupied. Displaying a persistently higher unemployment rates in age groups 20-24 and 25-29 is a strong indication that Gozo offers less employment opportunities to the younger generation. Economic productivity, measured in per capita GDP, standing at around 75 per cent to that for Malta clearly shows a long term issue with development.

This Government is committed to reverse this trend. It is committed to make the necessarily investment in the human, infrastructural and institutional capital to enhance the potential of Gozo. It is Government's aim to see Gozo as a net contributor to the National development. During the last two years, a considerable number of initiatives have been launched to enable Gozo achieving its potential. The announcement of the Bart Barts and the London School of Medicine and Dentistry in Gozo will have a profound long term positive impact on the economic development of the Island. Further more the foreign direct investment by RS2, a global provider of card payment services, IT consultancy and related services, has provided more work opportunities for Gozitans. Overall such initiatives are expected to have a positive spill over in other areas and send a strong message that productive investment can be attracted to Gozo.

The Government is also actively working towards addressing the seasonality that characterises Gozo. This is being addressed by strengthening the physical accessibility through the maritime sector. The process for the adjudication of the cruise liner terminal is in its final stages while technical studies are underway in preparation of a new buoy in Xlendi. Preparatory works are ongoing with regards to the green airfield in Gozo which will further improve the physical accessibility of Gozo.

Government's commitment to the continuous promotion of Gozo as a prime tourist location will be intensified. The recent filming of 'By the Sea' has given Gozo a great deal of international media exposure which augurs well for the film and tourism industry on the island.

Initiatives to support the training of the workers in the tourism industry will shortly be announced. These complement other training support schemes that have already been launched. In addition, strengthening the role of tertiary and vocational education and lifelong learning in Gozo remain a priority in view of their function as drivers of productivity.

05.7

SOCIAL INCLUSION: NOT JUST EQUALITY OF OPPORTUNITIES

This Government is guided by values and principles of social justice. It is an administration that is committed to pursuing political and economic policies which provide for the vulnerable members of the society with the aim of building a community based on solidarity and social inclusion.

To achieve this aim, Government has launched a policy against poverty and social exclusion consisting of a multidisciplinary strategy founded on solidarity, dignity and equality which will provide direction for the next ten years. The strategy seeks to target segments that are at the highest risk of poverty by focusing upon the modernisation and effectiveness of social services and by providing a solid platform that ensures not just opportunities but also positive discrimination towards the most vulnerable.

The Government has also implemented various measures to help vulnerable persons, combat poverty and social exclusion. Various initiatives focused on reducing child poverty with one of the main measures being the annual child supplement. It is estimated that 22,000 children in 9,000 families are benefitting from this measure. In addition, the free childcare services introduced by this Government were also extended.

Conscious of the fact that education is one of the principal means to combat poverty by facilitating social mobility, this Government has also increased expenditure on education by ten per cent and has modernised the schools' infrastructure and the overall schooling system.

In order to address poverty experienced by the elderly, Government is sustaining its efforts to ensure adequate and sustainable pensions for current and future pensioners, as addressed in the ongoing pension reform process. During the last two budgets, several measures were announced aimed at addressing poverty experienced by this vulnerable section of our society. These include a lump sum of money to persons born between 1941 and 1953 who have paid social security contributions but did not qualify for a contributory or non-contributory pension.

It has also provided the opportunity for those persons who are still in employment but by the time they reach their retirement age will not have made enough contributions, to qualify for a contributory retirement pension, to pay back a maximum of five years contributions and hence be entitled for a retirement pension.

Renewing investment in social housing is another social policy priority for Government. In view of the increasing demand for subsidised private rental residences, the Housing Authority allocated €1 million for this purpose in 2014, thus resulting in an increase of around 26 per cent over 2013.
Another priority for this Government is to ensure that persons with disability and special needs lead a life with dignity. Towards this end, the 2015 Budget announced various measures aimed to minimise poverty experienced by such vulnerable persons and eliminate obstacles inhibiting them from integrating at work and in society in general. Indeed, as from this year, disabled persons in employment who earn more than the National Minimum Wage will still receive a full disability pension. Additionally, a number of fiscal incentives for Trusts and Foundations were also set up to help disabled persons. Furthermore, to reduce barriers of entry in the labour market for such persons, the 2015 Budget emphasised the enforcement of the 1967 law regarding the recruitment of disabled persons and introduced the fiscal incentives for employers employing disabled persons.

Additionally, the Government has adopted the concept of user involvement whereby every public institution and, in particular, those that provide direct services to persons with a disability, need to have a structure in place that engages the users of the respective services in the design, planning, implementation and evaluation of the programmes provided. Through this measure, the involvement of disabled persons in the country’s governance will be strengthened while at the same time concrete activism is promoted among disabled persons.

05.8

A POSITIVE OUTLOOK

Social and economic indicators point towards a progressive improvement in our well-being. There is broad consensus that the Maltese are more positive about the economic state in Malta as well as their own financial situation.

The climate of certainty and stability fostered by this Government during the last two and a half years is leaving its mark. The fiscal deficit has been lowered to the lowest level on record while the debt-ratio is projected to continue declining. The various budget measures aimed at making work pay, coupled with increasing disposable income and robust performance in most of the economic sectors resulted into record growth in employment.

Still several challenges remain. Addressing the challenges faced by an ageing population, seeking sustainable development, and addressing bottleneck to growth remain priority areas.

As a Government, we are confident that the present positive momentum can be sustained. However, to ensure this, we need to go the extra mile. As a nation, we must continue with our institutional reforms, restructuring government owned entities, and pro-actively seeking to attract investment into new growth sectors. We must continue to invest into our most precious resource: ourselves. This will contribute to the enhancement of our human capital, improving our productiveness and ensuring we remain competitive.