Bix-Xogħol ninvestu f'soċjeta' b'saħħitha

Għalik

PRE-BUDGET DOCUMENT 2012

Foreword

The pre-budget process is a unique opportunity for all of us, policy-makers, the social partners and, other stakeholders to critically evaluate our economic and social situation and, to discuss the policy problems and areas that need to be addressed in the coming years in order to steer our country forward.

Over the past decade, Malta's economy has undergone a major restructuring programme. This ambitious programme did not happen overnight, nor did it happen on its own. It took place amidst the spiralling cost of fuel and energy and against a backdrop of the world's biggest economic crisis in years. Despite this, we succeeded in sustaining our growth and create more and better jobs.

We managed to attract new players, new industry sectors, knowledge-based activities that barely even existed two decades ago, such as the pharma industry, remote gaming, information and communication technologies, aviation services and financial services that today form the industrial backdrop of our economy. At the same time we strengthened our efforts to support industry, tourism and small businesses. We need to keep investing where is needed to keep the momentum in the transformation of our economy.

To achieve such goals, we have invested subtantially, without jeopardising financial stability. Unfortunately, the experience of most of our European partners teach us a very tough lesson on why financial consolidation is essential. Financial responsability has allowed us to take decisions cautiously. We must not lose track of such targets as one day, as someone would have to pay the price.

Notwithstanding the above, we need to do more. In this Pre-Budget we are using statistics to take a picture of society, but we are going beyond numbers in our actions. We are keeping our families in mind. We have asked ourselves what future we want to give to our families, to our children, irrispective of their background. We strived to look at particular groups in our society – the elderly, women, young people, persons with a disability, the unemployed and came up with ideas to further facilitate their integration and improve their prospects towards social inclusion.

By investing futher in our social and educational programmes we want to ensure social mobility and cohesion. We want no one to lag behind and everyone to benefit from economic growth and job creation. Economic and social progress must walk hand in hand.

I encourage you to participate in the pre-budget consultation process and to put foward your ideas for the forthcoming Budget 2012.

Tonio Fenech
Minister of Finance, the Economy and Investment

Chapter 1

Economic and Financial Overview

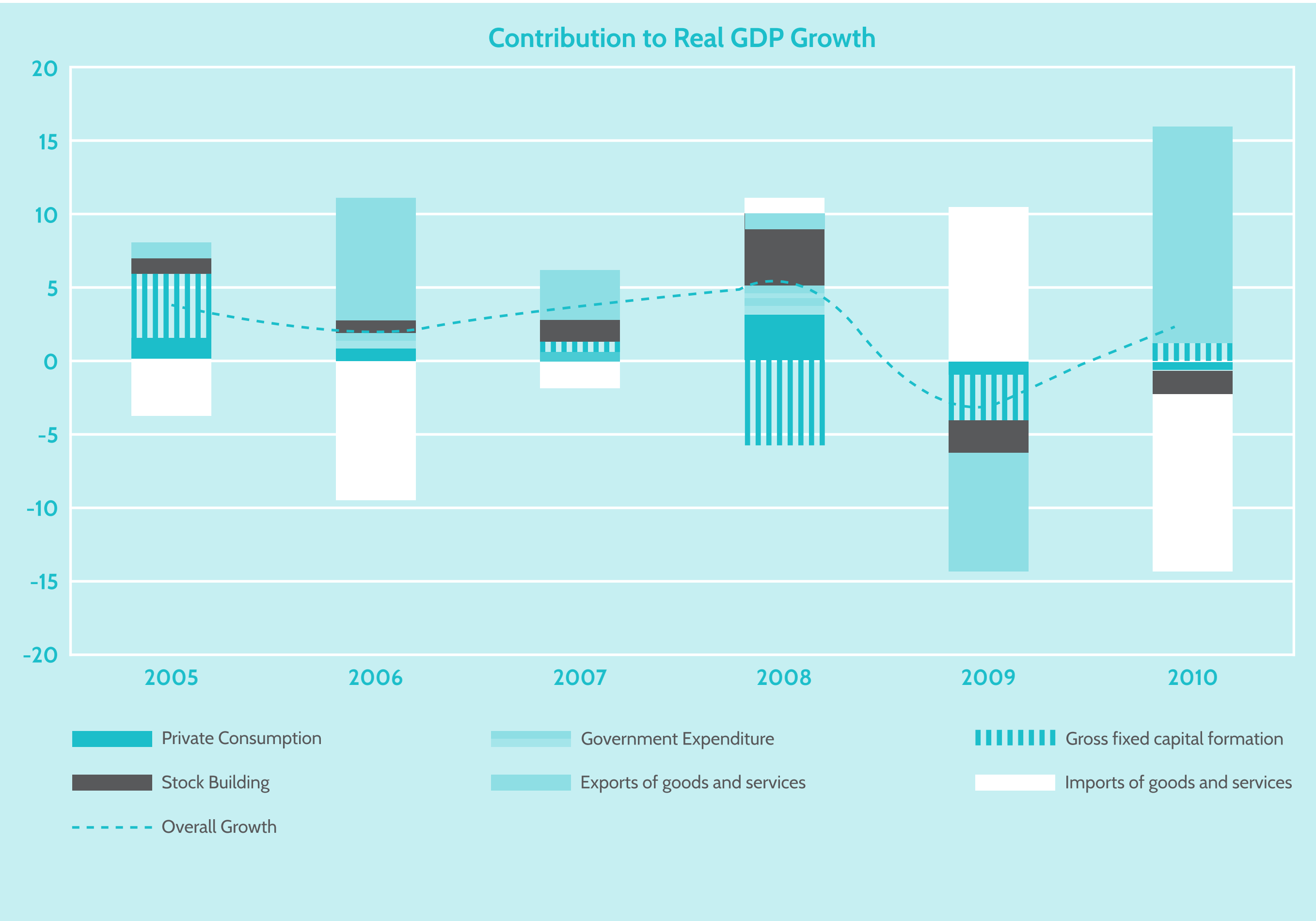
1.1 Economic Overview

Following the economic contraction in 2009, the Gross Domestic Product registered a growth of 3.2% in real terms in 2010, and 6.2% in nominal terms. On the back of a buoyant recovery in the international economy, especially in the first half of 2010, growth was mainly export driven, with net exports contributing 3.7 percent to real growth.

On the other hand, the domestic sector amounted to 1.2 percent during 2010. This was mainly attributed to a decline in real private consumption which declined by 0.8%. These developments mainly reflect a low level of consumer confidence as well as a rather subdued increase in the rate of growth in employee compensation.

Real Government Expenditure increased by 1.1% during 2010, following a decline of 1.3% in 2009, reflecting efforts by Government to enforce a fiscal consolidation strategy, whereby additional emphasis is being placed on the restraint of recurrent expenditure. Investment increased by 11.1% during 2010, following a strong increase in private investment. This increase should be viewed in the context of the sharp decline of 18.3% registered during the previous year. Gross fixed capital formation contributed 1.5 percent to growth during 2010, thus constituting the major source of growth in domestic demand.

Chart 1.1

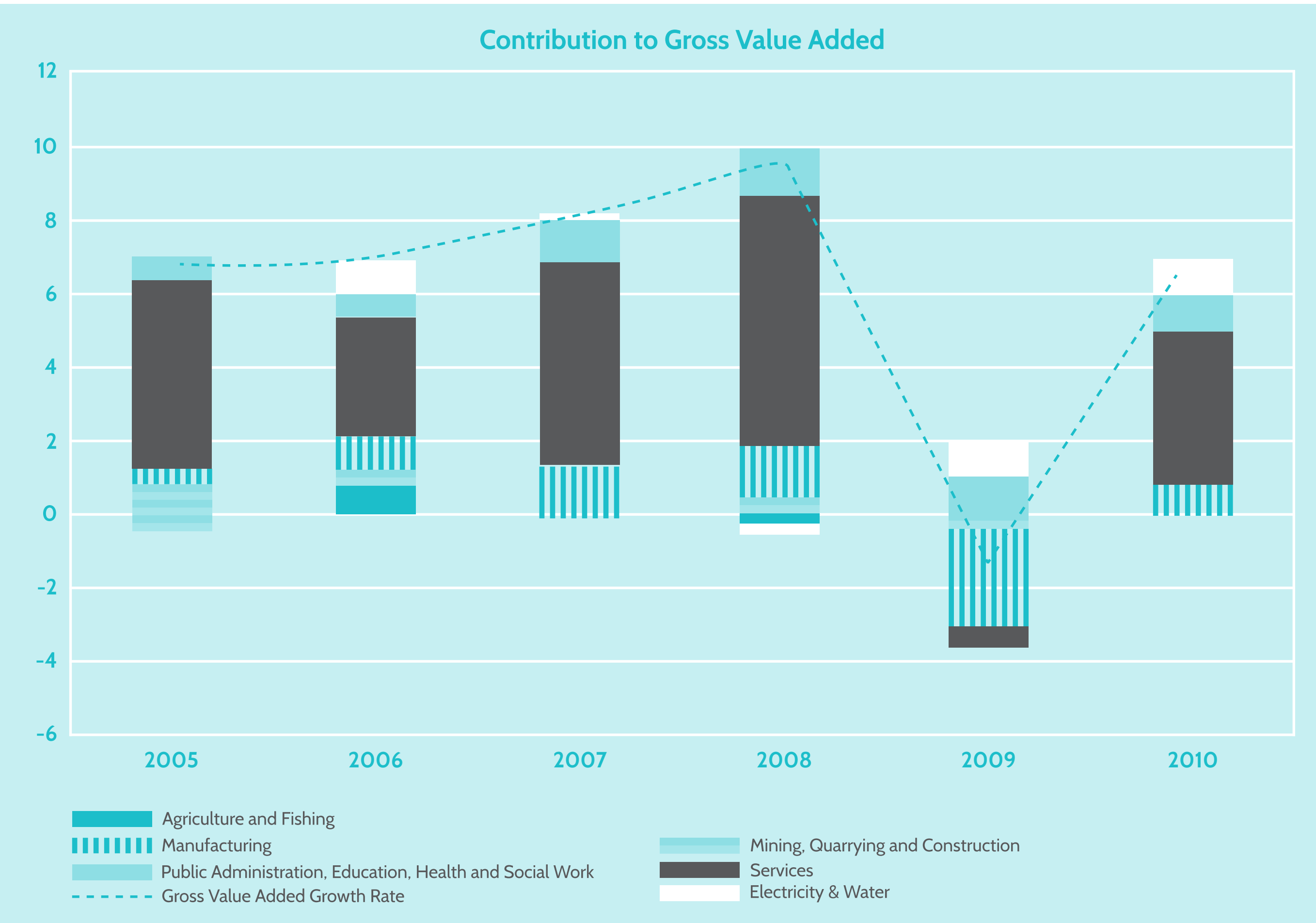


The upturn in international trade and a weaker Euro led to an increase in exports of 18.0% in 2010, compared with a decline of 8.6% registered during 2009. In turn, given the high import content of most of the exports, imports of goods and services increased by 13.2% during 2010. These positive developments in the external sector 3.7 percent to economic growth during 2010. Contributions to Real GDP growth for the period 2005-2010 are shown in Chart 1.1.

On the income side, growth for 2010 was largely driven by the expansion in operating profit, which showed an increase of 12.8% in 2010 compared with a decline of 5.2% in 2009. Growth in employee compensation was 1.0%, contributing to around 0.4 percent to overall growth.

From a sectorial perspective, a positive performance was registered in financial intermediation, other business services, hotels and restaurants and manufacturing sectors, with the latter mainly reflecting the expansion in electronics and furniture and other sub-sectors. The share of financial intermediation increased by 2 percent in 2010, contributing to around 37% of the total growth to Gross Value Added. Meanwhile, the manufacturing industry showed a positive contribution to total growth in Gross Value Added of 15% while the other business and hotels and restaurants sectors showed contributions to total growth of 9% and 8%, respectively. Figures for Gross Value Added are shown in Chart 1.2.

Chart 1.2



On a less positive note, the construction, and the wholesale and retail trade sectors showed a slight decline in their share of total gross value added. The construction sector continued to decline, albeit at a slower rate. The wholesale and retail trade sector contributed 3.5 percent to growth in total value added, with the growth in the wholesale trade sub-sector being partially off set by a drop in the retail trade sub-sector. Nevertheless the sector continued to underperform relative to the economy, with its share of gross value added declining.

Following the rebound in economic activity, employment increased by 2.2% during 2010 while unemployment declined from 7.0% to 6.7%. Inflation, as measured by the 12 month HICP moving average, was 2.0% in 2010. Over the recent months the rate of inflation edged up and reached 2.5% by March 2010. External factors underpin this recent rise in prices, with particular pressure emanating from rising prices in energy and food commodities.

1.2 Financial Overview

1.2.1 Financial Overview for 2010

As economic growth returned to positive territory in 2010, and as the recovery becomes more firmly established, The Government is aiming at the gradual but consistent reduction of the fiscal imbalance and at a reduction of the Government's indebtedness. Progress towards the correction of the excessive deficit and the attainment of sustainable public finances is important both in the context of the Ecofin Council recommendations, as well as in view of the prevailing developments in financial markets, which are strongly penalising countries with a significant fiscal imbalance and high indebtedness.

In 2010, the general Government deficit-to-GDP ratio declined to 3.6% of GDP, largely reflecting a decline in the expenditure ratio which more than offset the decline in the revenue ratio. Malta's fiscal policy for 2010 provided the necessary support to the economy, specifically through measures targeted at encouraging investment and supporting the labour market. Moreover, a number of fiscal consolidation measures designed to have minimal impact on economic activity were implemented.

During the same year, the general Government revenue-to-GDP ratio decreased to 38.8% from 39.3% in 2009. Lower ratios of direct and indirect taxation were partly offset by a higher ratio of receivable capital transfers. The decline in the ratio of taxes on production and imports mainly reflected lower receipts from the motor vehicle registration tax and eco-contribution, which in part was offset by higher proceeds from excise duty on cigarettes and petroleum. A decline was also recorded in the ratio of current taxes on income and wealth. Meanwhile, the ratio of the other component of revenue increased in 2010, mainly reflecting higher funds received under the EU Structural and Cohesion Funds 2007-2013 Programme. Both the ratio of revenue from property income to GDP and the ratio of social contributions remained relatively stable.

General Government expenditure decreased from 43.0% of GDP in 2009 to 42.4 % in 2010, on account of lower ratios recorded, particularly for employee and social transfers, which were only partly offset by the higher ratios of the 'other' expenditure category and intermediate consumption. The ratio of employee compensation to GDP declined by 0.7 percent to 13.4% in 2010, partly due to outlays recorded in

2009 with respect to payments to Malta Shipyard's employees (including part of the payments of the voluntary redundancy scheme), which did not feature in 2010. It is also worth noting that Government's policy to restrict recruitment in non-essential categories in the public sector also contributed to this decline. A lower ratio of social benefits and social transfers in kind also contributed to the decline in the expenditure ratio. Moreover, the ratio of subsidies to GDP declined marginally. On the other hand, the ratio of the 'other' expenditure category increased on account of higher current and capital transfers, the latter reflecting significant increases in projects related to education and the environment, in part financed from EU funds. Meanwhile, the ratio of intermediate consumption to GDP also increased, partly reflecting higher capital expenditure classified under this item.

In 2010, the ratio of Government debt increased to 68.2% of GDP, from 67.4% of GDP recorded a year earlier. The fiscal imbalance contributed to an increase in the debt ratio, in part offsetting the debt decreasing effect exerted by real GDP growth and inflationary pressures. Moreover, in 2010, Government debt increased by Malta's contribution towards the financing package for the Hellenic Republic approved by the Council of the European Union.

1.2.2 Latest Fiscal Developments January - May 2011

This section is based on the latest published fiscal data as classified in the statement of the Consolidated Fund pertaining to January-May 2011. Such data are defined on a cash basis rather than on accruals basis and should therefore be interpreted with caution. In the first five months of 2011, recurrent revenue increased by €131.6 million, whereas total expenditure declined by €5.8 million, such that the shortfall between recurrent revenue and total expenditure of Central Government amounted to €150.8 million, a difference of €137.4 million when compared to the corresponding period in 2010.

During the period under review, recurrent revenue increased to €980.8 million. These developments are mainly due to higher proceeds from Value Added Tax, which recorded an increase of €39.7 million, €27.5 million in revenue from customs and excise duties, €24.8 million from grants, and €20.3 million in social security contributions. Meanwhile, a decline of €3.2 million was recorded in proceeds from income tax.

Total expenditure declined to €1,131.6 million when compared to the first five months of last year, due to lower outlays on recurrent expenditure and on interest payments. The decline of €4.3 million in recurrent expenditure was mainly the result of lower contributions to Government entities, which declined by €11.6 million. Operational and maintenance expenditure and personal emoluments recorded marginal declines amounting to €1.9 million and €1.7 million, respectively. These were partly outweighed by higher outlays towards programmes and initiatives. The interest component of the public debt servicing costs for the period under review declined by €2.1 million. Meanwhile, capital expenditure remained broadly stable at €109.5 million.

1.2.3 The Short-Term Fiscal Adjustment Strategy

General Government Budgetary Plan for 2011

During 2011, Government is implementing a number of revenue-increasing measures, whilst also engaging in a series of growth-enhancing initiatives intended to strengthen Malta's international competitiveness through incentives to help the labour market support better the initiatives undertaken by private enterprise. Attention is also being devoted to assist in the country's effort to boost investment in education, research and development. In parallel, Government expenditure is being redirected towards ensuring a better quality of life by helping the economy to pursue more environmentally-sustainable development, even if this tends to increase costs over the short-term.

Table 1.1: General Government Budgetary Components

percent of GDP

	2009	2010	2011	2012
Revenue	39.3	38.8	40.2	39.9
Revenue Components				
Taxes on production and imports	13.8	13.4	13.9	13.9
Current taxes on income and wealth	13.6	13.0	13.0	13.1
Capital taxes	0.2	0.2	0.2	0.2
Social contributions	7.4	7.3	7.3	7.4
Property income	1.2	1.3	1.1	1.0
Other revenue	3.1	3.5	4.6	4.3
Expenditure	43.0	42.4	43.0	42.1
Expenditure Components				
Employee Compensation	14.1	13.4	13.1	12.6
Intermediate consumption	6.0	6.2	6.4	6.0
Social benefits and social transfers in kind	13.8	13.5	13.5	13.6
Interest expenditure	3.1	3.0	3.1	3.1
Subsidies	1.1	1.0	0.8	0.7
Gross fixed capital formation	2.2	2.1	3.3	2.7
Other expenditure	2.7	3.2	2.7	3.1
Deficit	-3.7	-3.6	-2.8	-2.2

Source: National Statistics Office Malta: Update of Stability Programme 2011 - 2014

As indicated in Table 1.1, the general Government deficit-to-GDP ratio is projected to decline from 3.6% of GDP in 2010 to 2.8% of GDP in 2011. This decline in the fiscal imbalance in 2011 mainly reflects a significant improvement in the revenue-to-GDP ratio, which is expected to increase from 38.8% in 2010 to 40.2% in 2011. Indeed, the ratio of taxes on production and imports is expected to increase, reflecting the impact of measures announced in the 2011 Budget, particularly the revision in the excise duty rates on fuel and the revision in the VAT rate on collective and private accommodation. Revenue raised from annual lease concession agreements as well as higher funds forthcoming from the EU under the 2007-2013 Financial Framework are also expected to contribute to the increase in the revenue-to-GDP ratio. However, the latter correspond to similar increases in outlays and thus have a neutral impact on the budget balance.

Meanwhile, the ratio of general Government expenditure to GDP is expected to increase from 42.4% in 2010 to 43.0% in 2011, mainly due to significant increases in gross fixed capital formation and in intermediate consumption. Nevertheless, as indicated above, higher expenditure related to capital projects financed by EU funds under the 2007-2013 Financial Framework is practically deficit-neutral since these amounts are offset by analogous increases in revenue. On the other hand, lower outlays towards the acquisition of property for public purposes and higher revenue from sale of land, as well as lower ratios of compensation of employees and subsidies are expected to contribute positively to the 2011 fiscal outcome.

The Fiscal Consolidation Strategy for 2012

In April 2011, the Government presented its short- and medium-term fiscal framework within the Stability Programme. This Update of the Programme was finalised prior to the formal commencement of the Budget consultation process undertaken with the general public and interested stakeholders. Indeed, this Pre-Budget document is the channel through which the strategic policy is to be translated into more specific budgetary measures.

The Government's objective in designing an appropriate fiscal consolidation strategy is to strike the right balance between expenditure-reducing and revenue-increasing measures. Expenditure cuts are more effective in a medium-term perspective than revenue increases, particularly in view of the Government's macroeconomic objective of improving national competitiveness levels. Furthermore, fiscal consolidation measures which cut Government expenditure tend to have fewer distortions on the workings of the economy. In line with these general principles, the Government's fiscal consolidation strategy for 2012 is largely expenditure-based.

During the next fiscal year, the general Government deficit is projected to decline by 0.6 percent of GDP from 2.8% to 2.2%. As indicated above, the more restrictive fiscal stance projected for 2012 is attributable to a decline in the expenditure-to-GDP ratio rather than revenue-increasing measures. Indeed, the ratio of total revenue to GDP is expected to decline marginally by 0.3 percentage points of GDP from 40.2% in 2011 to 39.9% in 2012, whereas the expenditure-to-GDP ratio is expected to decline by 0.9 percentage points of GDP to 42.1% in 2012.

Increases in the main items of tax revenue are expected to keep pace with the projected economic growth, such that the ratios of taxes on production and imports and of current taxes on income and wealth as a percentage of GDP are expected to remain relatively stable. Furthermore, marginal changes are expected in the ratios of social contributions and property income to GDP.

Nevertheless, the Government will be actively monitoring the performance of indirect tax revenue on the basis of the observed responsiveness of taxes on production and imports to consumers' expenditure growth over the past years. Indeed, the Government stands ready to act if preliminary indications suggest that revenue from taxes on production and imports in 2012 will fall short of the parameters set by the historical relationship between this item of revenue and consumers' expenditure growth.

Meanwhile, the Government will also be actively monitoring projected developments in 2012 of direct tax revenue on the basis of the observed responsiveness of current taxes on income and wealth to economic growth.

On the expenditure side, the Government will be pursuing its expenditure-based fiscal consolidation programme by intensifying its efforts towards improved efficiency in public spending. These measures underpin a targeted lower ratio of expenditure-to-GDP, which is projected to decline by 0.9 percent of GDP to 42.0% in 2012.

The Government will sustain its policy of expenditure restraint as regards intermediate consumption and the general Government wage bill, which in total are expected to account for 0.6 percent of the decline in the expenditure-to-GDP ratio. The decline in the latter component of expenditure will be mainly brought about by restricting employment levels in non-essential categories. On the other hand, better conditions for public sector employees are envisaged within the new collective agreement being negotiated with trade unions. The public sector faces challenges in retaining skilled human resources and to address specific human resource shortages in specialised sectors of the public sector. The Government remains determined to attain an agreement with public sector trade unions which allows it to meet these strategic objectives, while curtailing overall payroll costs.

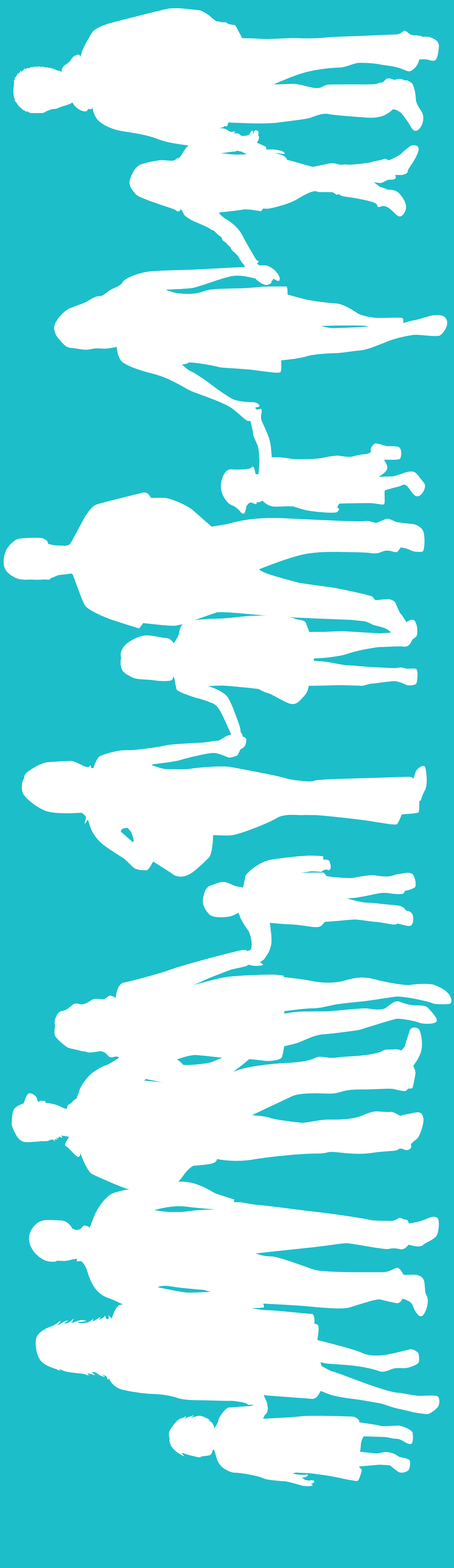
Meanwhile, the Government is actively examining the national budgetary framework in a bid to improve budgetary policy both at the design and implementation stages. In this regard, the Government expert advice on the design of a fiscal expenditure rule, whose specific objective would be to enhance fiscal discipline. Moreover, in view of the importance of the availability of financial statistics in the timely monitoring of budgetary outcomes, a new reporting system geared towards attaining real time financial data of Government entities has been launched. Furthermore, to entrench further fiscal discipline within line ministries, efforts will be sustained to stick to the rigours of a revamped procedure which ties Ministries' expenditure allocations closer to the quality of their respective plans for future years generates.

Debt Sustainability

The Government's main medium-term fiscal objective is to restore the trajectory of public finances to a sustainable path. In this regard, the attainment of sustainable public finances hinges not only on addressing the current imbalance in public finances but also on reducing the debt-to-GDP ratio at a satisfactory pace. The Government's debt strategy remains that of ensuring that the financing needs of the public sector are met at the lowest possible cost while minimising medium and long-term interest rate risk.

Indeed, after reaching 68.2% of GDP in 2010, gross Government debt is expected to follow a downward path, declining by 0.2 percent of GDP in 2011 mainly on account of a positive primary surplus, and by 0.8 percent to 66.9% of GDP in 2012.

Moreover, additional expenditure related to Malta's ageing population, including pensions, health and long-term care as well as other contingent and implicit liabilities, may entail upward risks for both the deficit and debt projections. In view of this, debt sustainability is vital particularly in view of the instability of the Euro Area and recent developments in the sovereign bond markets.



Chapter 2

Maintaining Fiscal Sustainability and Economic Stability

2.1 Macroeconomic Surveillance

The sustainable level of growth of the Maltese economy and standard of living enjoyed by the Maltese depends on long-term growth potential. The continuous implementation of structural reforms targeted to correct macroeconomic imbalances is of great importance. Indeed, the international crisis showed the extent to which unsustainable macroeconomic imbalances will expose the economy to serious risks and increase economic and financial vulnerability to adverse developments. An economy which is growing persistently above or below its potential eventually leads to macro economic imbalances which potentially lead to economic crisis and halt the economic and social development of a nation, possibly over a protracted period. Events in Portugal, Ireland and Greece are an example of the consequence of unbalanced growth. It is worth remembering that before the crisis erupted in Greece and Ireland, these two countries were both registering relatively high growth rates above their potential. On the other hand, Portugal, another country now facing financial difficulties, was registering growth rates significantly and persistently below its potential.

Excessive indebtedness and credit growth, persistent current account deficits, excessive inflation or deflation, property price bubbles, anaemic growth or persistent unemployment could all be signs of macroeconomic imbalances. The identification of possible macroeconomic imbalance can be captured through the use of indicators. This approach has been followed by Malta in the last two Pre-budget documents, predating the discussions at an EU level on a similar benchmarking exercise. The choice of indicators used in this analysis focuses on the most relevant dimensions of macroeconomic imbalances and competitiveness losses and is based on the discussions currently taking place at EU level. Further information on these discussions is provided in Box 1 below. The indicators cover external imbalances, internal imbalances as well as competitiveness positions. To assist in the identification of problematic areas, a threshold for each indicator is established. The value of each threshold can be based both on statistical inference following the distribution of the other EU Member States and on an economic analysis as documented in the literature.

Box 1: Excessive Imbalance Procedure

The recent international crisis has shown that insufficient attention was given to the large macroeconomic imbalances among Euro area countries. Large imbalances and wide and persistent divergences in competitiveness trends proved highly damaging to the European Union. For this reason, on 29 September 2010, the European Commission proposed an important package of five regulations plus one directive to strengthen the economic governance framework of the EMU covering both public finance sustainability and macroeconomic stability.

On 15th March 2011, the ECOFIN Council reached a general agreement on a Commission proposal for a Regulation on the prevention and correction of macroeconomic imbalances. This paved the way for the start of trialogue discussions with the European Parliament under the co-decision procedure.

The package contains three main elements: Firstly, on the fiscal side, a reinforcement of the regulations attached to the Stability and Growth Pact (SGP); secondly, also on the fiscal side, an important initiative to move national budgetary frameworks towards European needs; thirdly, a new European procedure, the Excessive Imbalance Procedure (EIP), intended to prevent and correct macroeconomic imbalances essentially among Euro Area Member States, but extendable to all EU countries.

The starting point of the Excessive Imbalances Procedure is an alert mechanism report to be prepared annually by the Commission consisting of a scoreboard, composed of a limited number of statistical indicators together with thresholds of macroeconomic imbalances combined with economic judgement. On the basis of this report, and having taken due account of discussions in the Council and Eurogroup, the Commission will decide upon a list of Member States where in-depth studies are needed to determine whether severe macro economic imbalances exist. It is these in-depth studies and not the scoreboard which will provide the analytical basis for possible policy recommendations under the preventive and corrective arm of the procedure.

Following this, if a Member State is put under EIP, the same Member States would have to present a corrective action plan that will be assessed by the Council, which will set deadlines for corrective action. Where the Council considers that the Member State has not taken the recommended effective action, the Council, on a recommendation from the Commission, shall adopt a recommendation declaring non-compliance and setting new deadlines for taking corrective action.

If a Euro Area Member State repeatedly fails to take effective action with regards to Council EIP recommendations to address excessive imbalances, it will have to pay a yearly fine equal to 0.1% of its GDP in the preceding year. For Malta this may exceed a fine of €6 million annually. Such a decision shall be deemed adopted by the Council unless it decides, by qualified majority, to reject the recommendation within ten days from the Commission adopting it. The Council may amend the recommendation acting by qualified majority. For the measures pertinent to fines, only members of the Council representing euro area Member States shall vote and the Council shall act without taking into account the vote of the member of the Council representing the Member State concerned.

The processes governing the prevention and correction of macroeconomic imbalances and the enforcement measures to correct excessive macroeconomic imbalances in the Euro Area form part of the legislative package set to reinforce economic governance. The process described above pertains to the text in the legislative package agreed to during Ecofin 15 March 2011. It is pertinent to note that since April, the legislative package has been up for discussion in the European Parliament (EP), which in turn is proposing several amendments to the said text. Negotiations are currently underway, so that a compromise text between the Council and the EP is expected, possibly by end of June 2011.

The analysis of macroeconomic imbalances which follows is based on current discussions on the scoreboard and EIP.

Box 2

2.2 External Indicators

Five indicators were chosen to monitor external imbalance: current account, net international investment position, real effective exchange rate, export share, and labour unit cost. Wherever possible , data cover the 1995-2010 period. However, due to data constraints, some indicators, namely net international investment position, real effective exchange rate, and export shares, were constrained to a shorter time coverage.

2.2.1 Current Account

A current account deficit measures the balance of trade in goods, services, investment incomes and transfers. A high and persistent current account deficit indicates that the economy is not saving sufficiently and therefore has to borrow to finance its investment. In other words it is living beyond its means. It is also interpreted as a sign of society's preference for current consumption over future consumption. However, current account deficits which finance high levels of productive investment are beneficial for economic development.

In this context, a temporary deficit is not generally viewed as a problem but a persistent deficit is indicative of a lack of investment or investment in non-productive activities in the past. Moreover, the sustainability of the current account also depends on the way it is financed. If a current account deficit is financed from stable, long term direct investment capital inflows then this can be beneficial for the economy and not necessarily destabilising. On the other hand, excessive reliance on short-term capital inflows can be destabilising in a period of economic uncertainty. Inward direct investment can increase the productive capacity of the economy and lead to technology transfer. In addition, productive investment activities generate a positive rate of return which in future can be a source of income to repay the initial debt, eventually generating enough income and savings to eliminate the current account deficit.

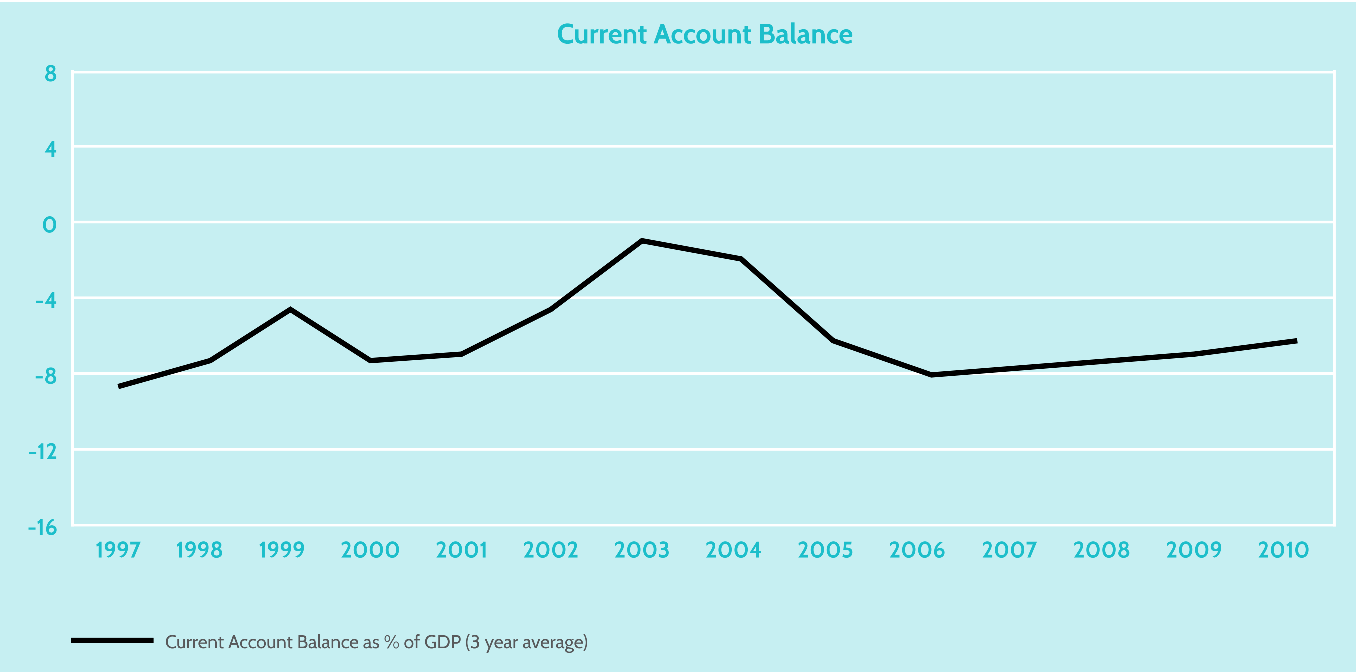
Furthermore, current external imbalances can reflect natural responses to changes in underlying structural characteristics and the related adjustment in saving and investment decisions. Hence it is not uncommon that converging economies display persistent current account deficits. These are not necessarily detrimental. However, they still imply an accumulation of foreign debt and therefore subject to the whims of the markets. On the other hand, countries with ageing populations may find it opportune to save today, i.e. run current account surpluses, to avoid a drop in consumption in the future. In this context mandatory and/or voluntary pension systems which augment the State PAYG pension are meant essentially to encourage savings.

In order to assess imbalances in the economy the dynamics of the current account ought to be observed rigorously. In this analysis, a threshold of +/- 4.0% is used. However, due to the above considerations, the results must be interpreted with caution.

Chart 2.1 shows the current account balance in Malta as a percentage of GDP. In order to control for short-term fluctuations of the annual figures a three years backward moving average is also presented. As can be observed, Malta has been experiencing a persistently negative current account balance since the mid 90s. This is partly a feature of a converging economy with the deficit during the last half of the 1990's being complemented by a high domestic saving rate, averaging around 16%. However, since the start of the 2000s the persistent current account deficits coincided with a slowdown in Malta's potential growth, a loss in export market shares, and a declining saving and investment rate. Over this period it is thus difficult to justify the current account deficit on the basis of economic convergence.

It is however worth noting that over time the external goods and services balance has improved, suggesting that the current account deficit in Malta is also a reflection of significant foreign ownership which implies that most profits generated are recorded as an outflow in the current account. However, a significant share of these profits is actually re-invested in the Maltese economy[1].

Chart 2.1



[1] The share of re-invested earnings fluctuates heavily and has decline since 1995 but still averaged around 20% in 2000.

2.2.2 Net International Investment Position

A country's net international investment position (NIIP) can be viewed as a balance sheet showing the total holdings of foreign assets by domestic residents and the total holdings of domestic assets by foreign residents at a point in time. In a way, the NIIP is the stock position of the financial account in the balance of payments. While the financial account balance consists of flow variables, the NIIP is a stock variable comprising the total value of assets and liabilities at a point in time.

A country's NIIP may either be in surplus, deficit or balance. If in surplus then the value of foreign assets (debt and equity) held by domestic residents exceeds the value of domestic assets held by foreigners. Alternatively we could say that domestic assets exceed domestic liabilities. This country would then be referred to as a creditor nation. If the reverse is true, so that domestic liabilities to foreigners exceed domestic assets, then the country would be called a debtor nation.

Asset holdings may consist of either debt obligations or equity claims. Debt and equity obligations always pose several risks. The risk with debt obligations is the risk of possible default (either total or partial), that is the risk that the borrower does not maintain the promise to pay back in full the debt. A default on the part of a borrower could severely restrict the ability to borrow funds in the future from international capital markets or to borrow at a reasonable interest rate. A default could be due to insolvency of the borrower, i.e. when over time the country cannot accumulate enough foreign assets to back its foreign liabilities. Persistent current account deficits will eventually lead to such a situation. A default could however still occur if the borrower is solvent but is not generating enough returns to meet its annual debt repayments at a point in time. This default is driven by liquidity constraints rather than solvency constraints. In practice it is often difficult to distinguish between the two.

The NIIP position is an important indicator of the net asset position of the domestic sectors of the economy with respect to the rest of the world, hence a good indicator of solvency. If the net foreign asset position is in large debt, the domestic sectors of the economy are likely to be heavily indebted. High debt is often associated with increasing vulnerability to financial markets. If it is funded by short term volatile capital flows, liquidity constraints can also arise. Moreover, if the debt is predominantly in a foreign currency, the country also becomes vulnerable to exchange rate risks.

It is very difficult to determine the size of external debt that can be considered problematic. Nevertheless, following the statistical analysis, a threshold of -35% of GDP was established as an indication of an imbalance. Data on the net international investment position are derived from the Balance of Payments statistics.

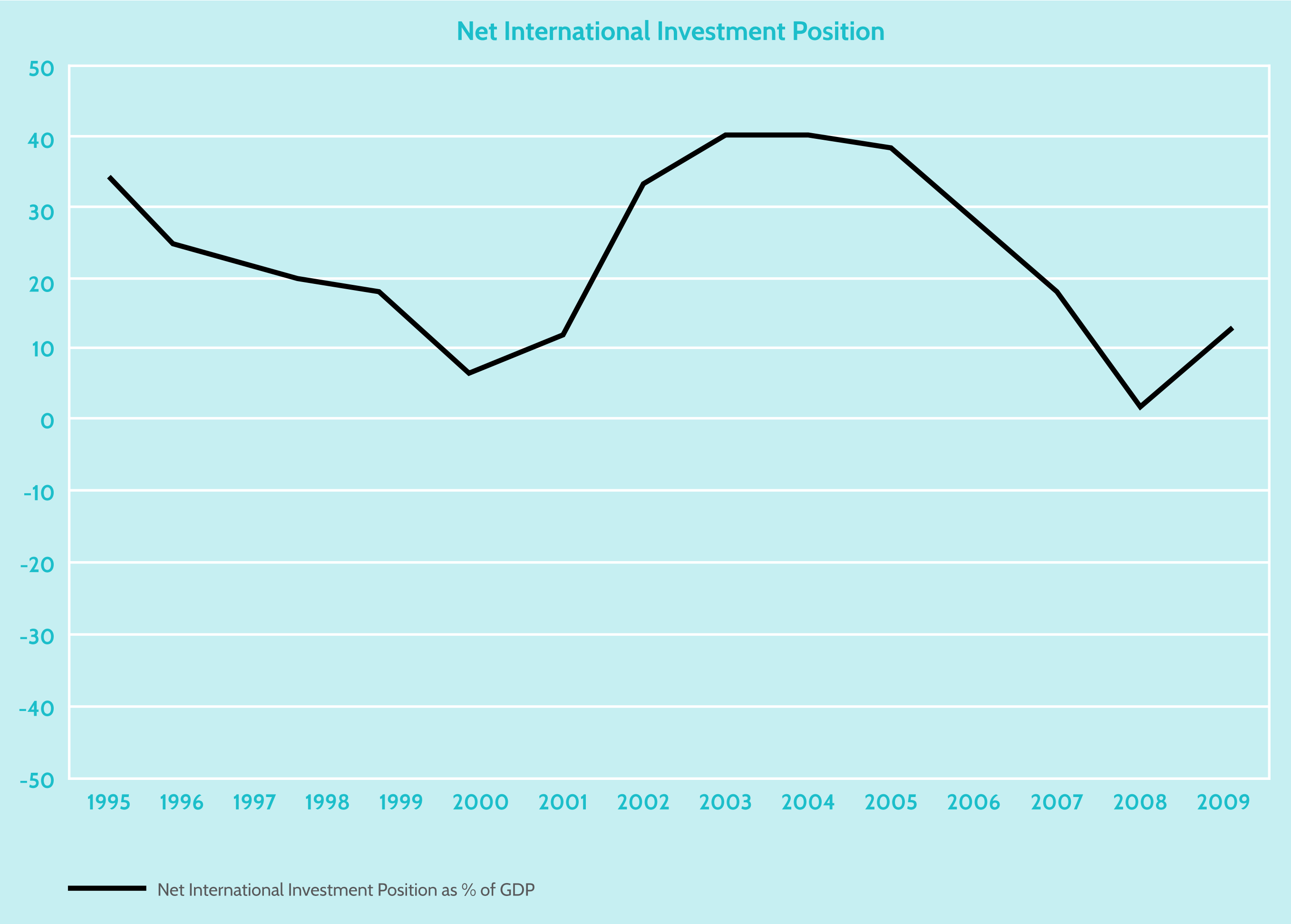


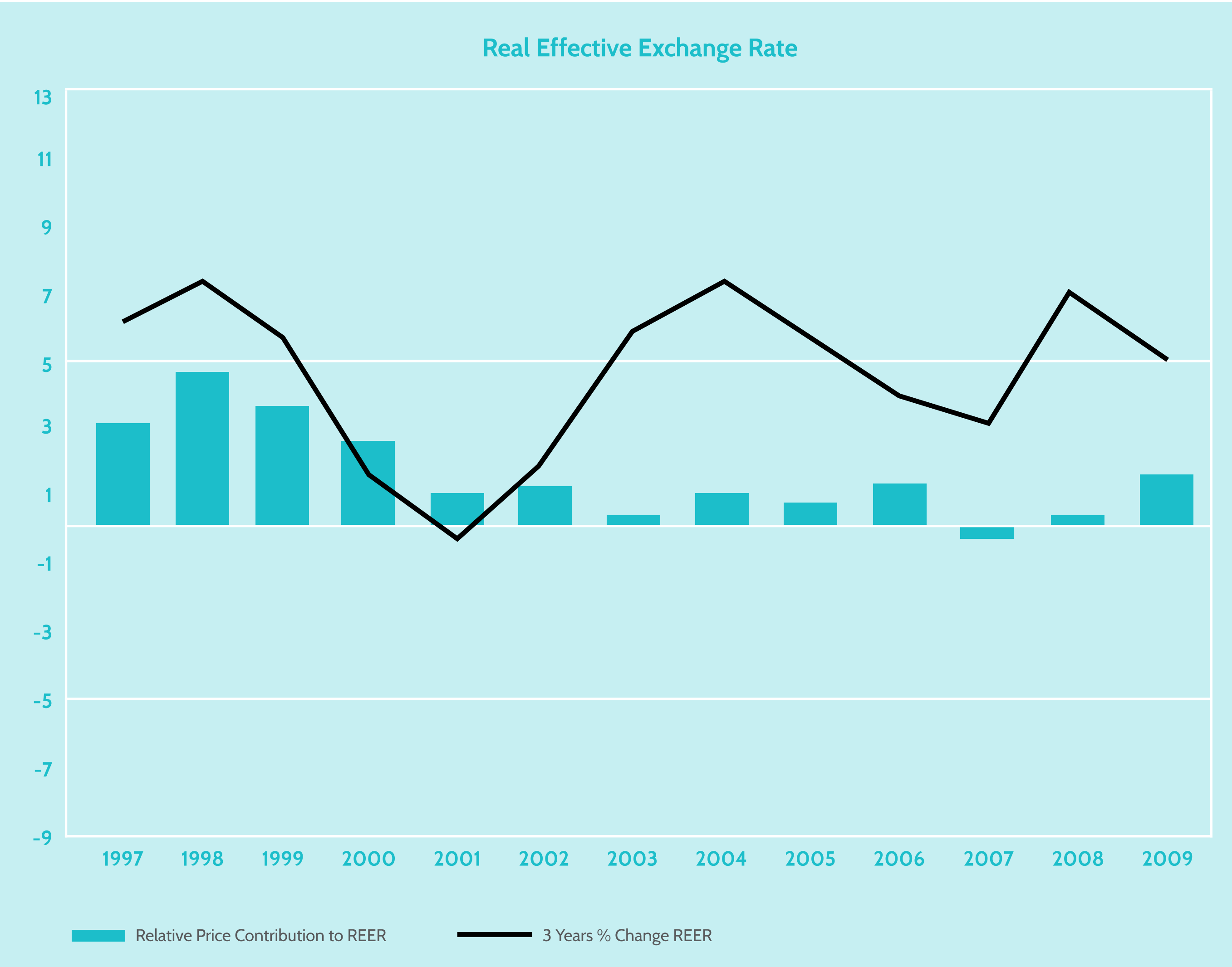
Chart 2.2

As indicated in Chart 2.2, Malta's NIIP has been positive throughout the last decades, although there where significant fluctuations in the net position across the years. Indeed, the NIIP declined during the end of 1990's, reaching a trough of 5.6% in 2000. Thereafter, the balance improved gradually, peaking at around 40% during 2003 and 2004. The NIIP's balance started to close down in 2005 becoming almost negligible in 2008 but recovering in the following year. This indicates significant inflows of foreign capital beyond what was required to finance recurring current account deficits along the years, leading to an accumulation of net foreign assets. It is worth noting that valuation changes can also be an important determinant of the net asset position especially if the value of domestic assets does not move in tandem with the value of foreign assets.

2.2.3 Real Effective Exchange Rate (REER)

To monitor external imbalances and losses in competitiveness, a measure of the real effective exchange rate (REER) based on the harmonised index of consumer prices is used. This indicator monitors the persistent losses or gains in price competitiveness relative to the major trading partners of the respective country. Instead of assessing the relative competitiveness through relative production costs, this indicator allows us to account for broad measures of prices in order to give a more comprehensive picture of price competitiveness of domestic producers in a medium-term perspective. Thus it measures the relative developments in competitiveness between each country and its trading partners taking into account both the relative price developments and the relative appreciations or depreciations in exchange rate. It is also worth noting, however, that higher export prices may also be a sign of strengthening competitiveness rather than losses as the economy moves to high value added goods and services. It could also be the result of price convergence and Balassa Samuelson effects[2].

Chart 2.3



[2]The Balassa-Samuelson theory is used regularly by economists to explain the observation that price levels in wealthier countries are systematically higher than in less wealthy ones. Typically this analysis is carried out in terms of the real exchange rate, which compares the consumer price indexes of two countries converted to a common currency using the nominal exchange rate. It is also to be noted that a straightforward extension of the theory from levels to changes implies that countries with faster growth rates in the traded sector would have real exchange rates that are appreciating over time. This occurs because the low productivity sectors increase prices to maintain the relative price with the higher productivity sectors of the economy.

This measure of REER is defined as the 3 years percentage change relative to 35 other industrial countries. Such a data transformation reduces the bias caused by the trend appreciation that a catching-up economy might experience. It is also noteworthy that the thresholds used on the basis of the 3 years percentage change are +/-5% corresponding to the lower and upper quartiles of the distribution over the sample including only euro-area countries[3].

As can be noted in Chart 2.3 the REER measured for Malta over the period extending from 1995 to 2009 fluctuated within and above the threshold selected. Indeed, almost half of the time, the change in REER exceeding the threshold imposed. It is however worth noting that price levels in Malta are below those of the Euro Area average such that Balassa Samuelson effects cannot be excluded. This is also confirmed by looking at the difference in the change of the Nominal Effective Exchange Rate (NEER) and the change in REER, where the difference is a measure of the domestic inflation in relation to inflation of the trading partners. As such most of the movement in the REER in the last decade can be attributed to appreciation in the relative nominal exchange rate of Malta's trading partners. Nevertheless, it is noteworthy to add that as indicated in past Pre-Budget documents, market imperfections in specific sectors could also be contributing to persistently higher inflationary pressures in Malta than the Euro Area. Indeed Government has identified this as a bottleneck to growth in its National Reform Programme and measures to improve market functioning have also been included in the same Programme.

2.2.4 Export Share

The performance of each country in terms of export market share depends on numerous factors. Indeed, international competitiveness depends both on price competitiveness as well as non price competitiveness. The ultimate test of competitiveness rests on the ability to exploit new sales opportunities in the global economy. A country might lose export market share not only if exports decline but most importantly if its exports do not grow at the same rate as world exports and its relative position at the global level deteriorates. Therefore, the change in the export share of an economy is one indicator of external competitiveness, complementing the price competitiveness indicator captured by the real effective exchange rate. It is noteworthy that the Maltese economy is already one of the most open economies in the world with exports being close to the size of the economy.

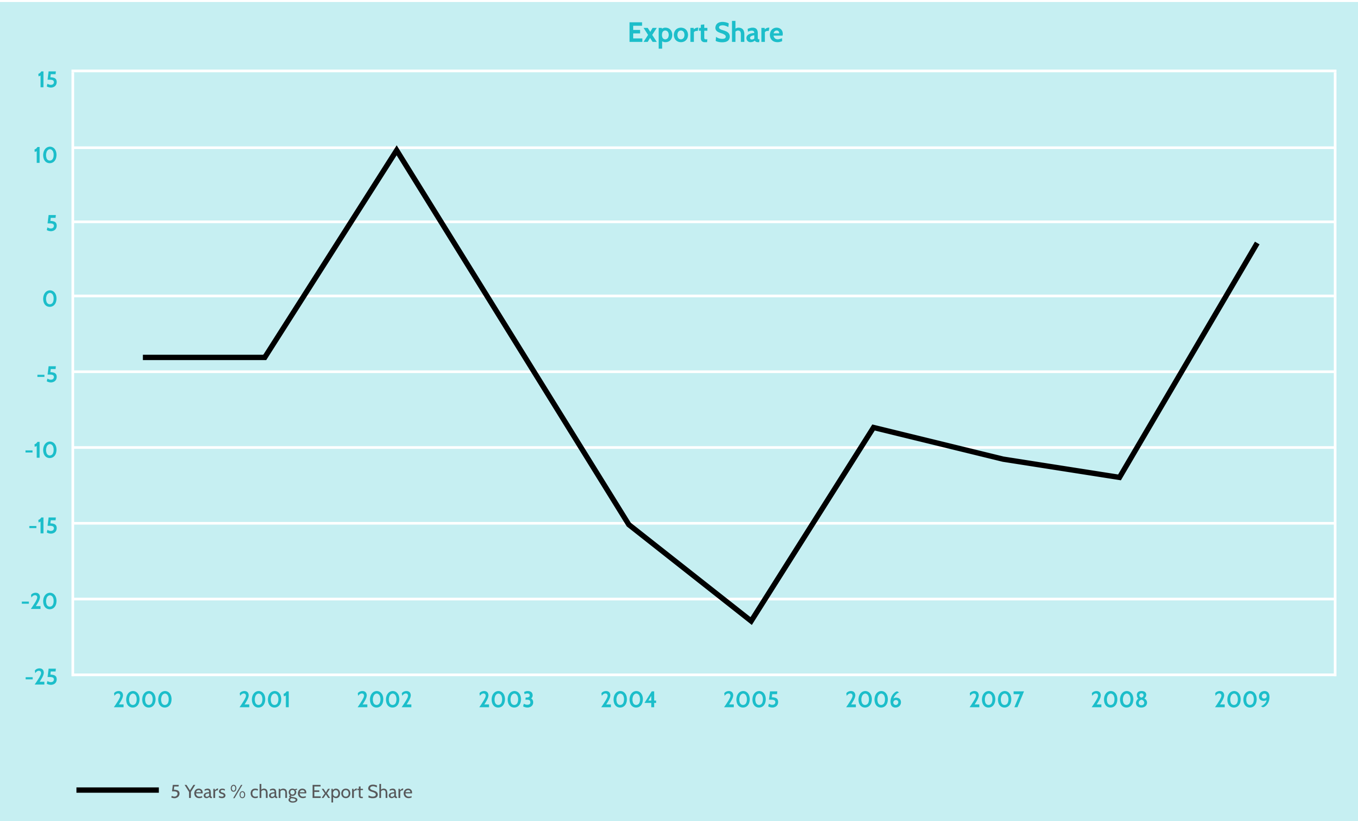
The export share is captured by estimating Malta's export share, both of goods and services, of the global economy. It is calculated as the share of the export revenues towards the rest of the world on total world export revenues in current prices. To capture the structural losses in competitiveness that can accumulate over longer time periods, the indicator is calculated as the percent variation over five years of the value of exports of goods and services of each country as a share of the world exports of goods and services.

[3] Different measure of prices used to calculate the REER, such as consumer price index, export prices, unit labour costs or the GDP deflator can give different results. Therefore the results must be interpreted with caution.

The statistical distribution of the indicator gives a lower threshold of -6%. Because values, rather than volumes, are being used, the terms of trade developments are also captured. In this context if Maltese exports move up the value added chain and are able to capture higher prices, an increase in export market share could result. This should also be an indication of competitiveness gains. It is worth noting that a similar indicator based on volumes rather than values would not be able to capture improvements in the terms of trade.

Chart 2.4 shows the changes in the export share of Malta during the period 1999-2010. As can be observed from the chart, the export share improved in 2001. Thereafter, the indicator turned negative, with the export share declining by over 20% in 2004. Nevertheless, the change in the export share recovered within the thresholds in 2009 and actually registered an increase.

Chart 2.4

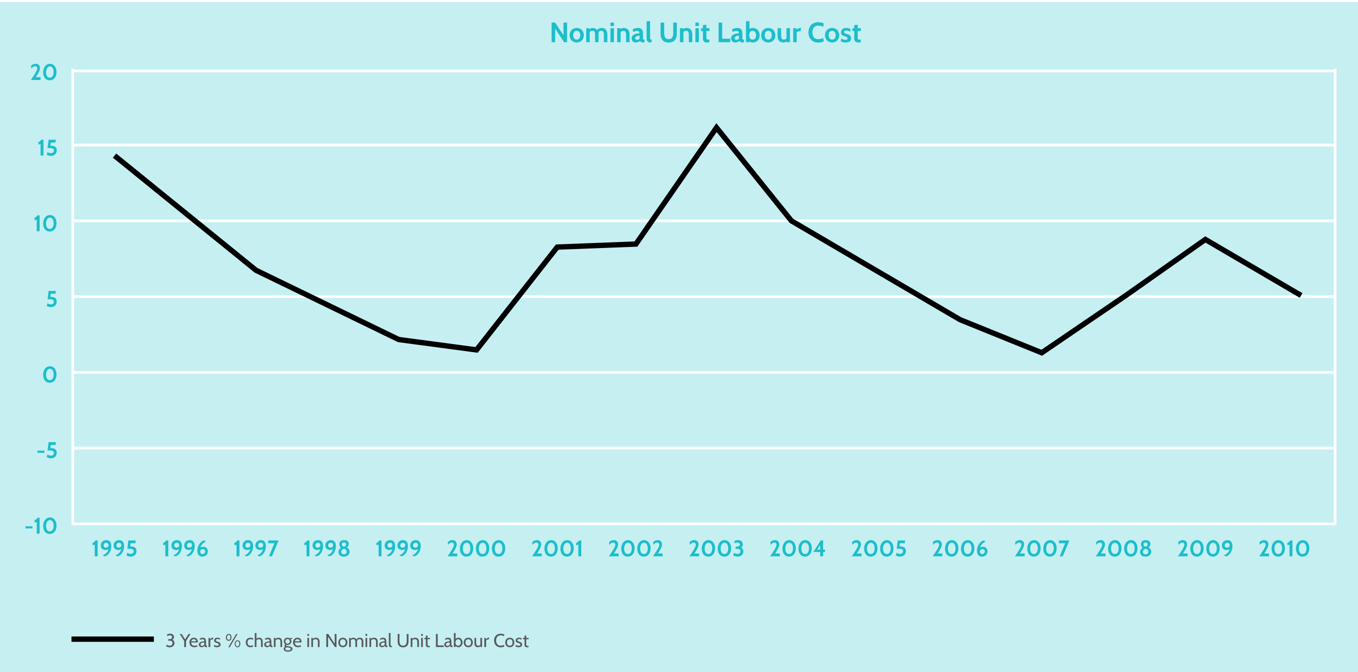


2.2.5 Labour Unit Costs

An increase in nominal unit labour costs either reflects a nominal increase in cost per unit of labour that exceeds the increase in productivity or a fall in output accompanied by a more contained decline in labour input. An excessive increase in unit labour cost is indicative of a loss in cost competitiveness of the economy. Thus, a measure of nominal unit labour cost is an important indicator of macroeconomic imbalances, as it provides a direct link between costs and productivity. This indicator must however be interpreted with caution. Catching up countries whose wage share as a per cent of GDP is relatively low are likely to experience a persistent increase in nominal wages in excess of labour productivity gains. This may also reflect the scarcity of human resource input with wages increasing rapidly acting as a signal for labour to enter the new growth sectors of the economy. Finally, a growing ULC may simply be the result of prices of goods and services produced rising faster than wages. This seems to be the case for Malta in the last five years. This is not necessarily an indication of competitiveness losses.

The unit labour cost indicator used in this analysis is calculated as the 3 year percentage change of the ratio of nominal compensation per employee to real GDP per person employed. The three year change controls for the cyclical behaviour of this indicator and keeps memory of the competitiveness losses building up more than the year-on-year variation. The threshold corresponding to the upper quartile of the statistical distribution over the sample of euro-area countries is 9%.

Chart 2.5



As can be observed from Chart 2.5, ULC measured as a 3 year percentage change was generally within the threshold for most of the period under consideration, with 1995 to 2007 period and 2003 and 2004, being the only exception. In 2010, the change in ULC was within the threshold with a registered increase of 5.2%.

2.3 Internal Indicators

Excessively high debt in both the private and public sectors of the economy increases the risks to growth and financial stability. During the last financial crisis countries experiencing high credit growth with a more leveraged financial system suffered significantly in terms of growth and exposure to the crisis. Indeed, Governments in several countries had to take on large contingent liabilities from the private sector, affecting in turn their debt levels and their creditworthiness.

Household's balance sheet position can be severely damaged by excessive changes in the price of real estate assets. Indeed, higher real estate prices led to higher value of real estate collateral and a consequent expansion in credit. If the expansion in credit is substantial, particularly if it is based on unrealistic expectations of capital gains from real estate, the solvency of household balance sheets becomes susceptible to sudden unpredictable downward corrections in prices. Housing bubbles can also distort the incentive to invest in productive activities thereby lowering the long term growth potential of an economy and exacerbating current account imbalances. Hence, the monitoring of private debt and public debt as well as developments in house prices is essential in order to avoid excessive macroeconomic imbalances.

2.3.1 Private Sector Debt

There is broad agreement that excessive private sector debt will lead to increased exposure to fluctuations in the business cycle and to changes in the interest rates. There are two main reasons why this may occur. First, borrowers will have to face increased difficulties to service debt leading to liquidity constraints and secondly the value of collateral may decrease in value and thus further increasing the risk of insolvency. A liquidity crisis could very quickly turn into a solvency crisis if financial sentiment deteriorates significantly and access to capital becomes very limited or expensive.

Private indebtedness can be measured as the sum of loans as a per cent of GDP. The data are derived from Central Bank annual financial accounts and balance sheets. The corresponding threshold of private sector debt[4] is 135% of GDP. These developments are illustrated in Chart 2.6.

[4] In the absence of non-consolidated data, the indicator analysed in this context uses consolidated which excludes a range of intra-enterprise and intra-group loans, positions, overdrafts and other balances.

Chart 2.6

During the period under observation, Malta's ratio of private sector debt was generally on an upward trend, though remaining below the threshold. In 2009, the ratio seems to have reached a peak which is very close to the threshold chosen as an indication of a macroeconomic imbalance. Nonetheless, in 2010, there was a drop of 4.3 percent in the ratio.

2.3.2 Public Sector Debt

The private sector debt ratio is complimented with public sector debt to ensure surveillance of the potential contribution of total debt to macroeconomic imbalances. The threshold follows the target of 60% of GDP established by the Stability and Growth Pact (SGP). It should be noted that within this context the ratio should not be viewed in terms of sustainability of public finances, but to be considered in conjunction with private sector debt in order to measure overall level of indebtedness in an economy.

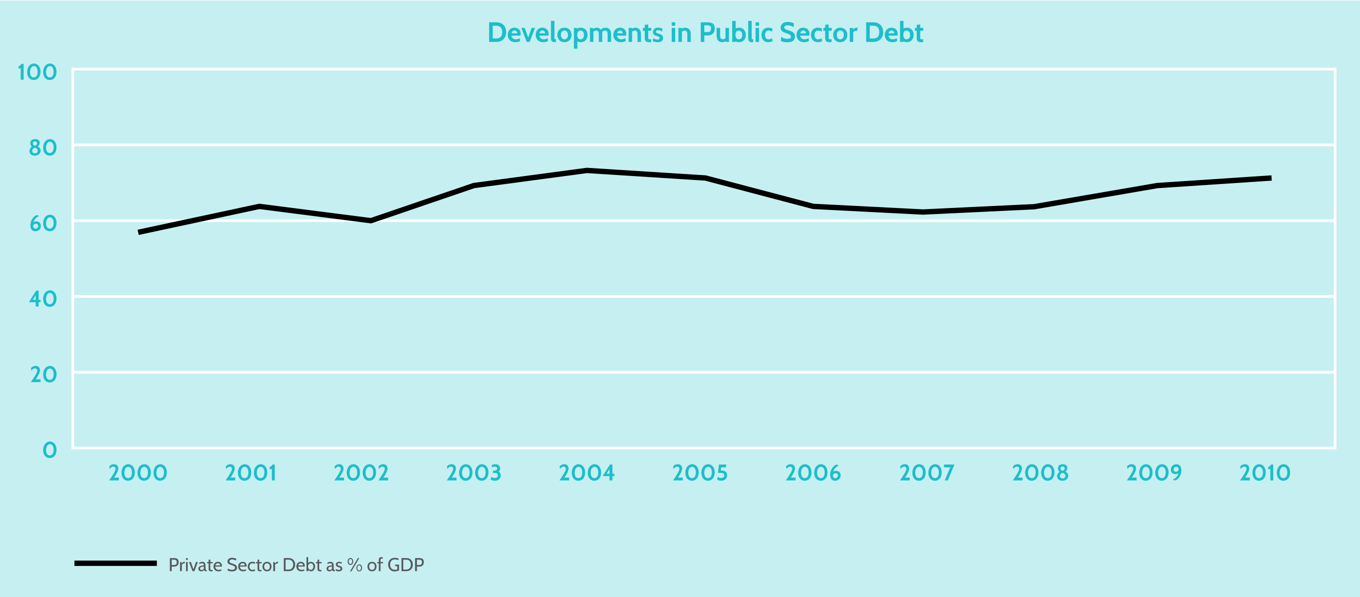


Chart 2.7

Chart 2.7 indicates that the ratio of public sector debt continues to exceed the threshold established under the Stability and Growth Pact. The threshold of the overall ratio of indebtedness is of 195% (135% + 60%). Malta's ratio was generally on an upward trend throughout the period, reaching around 194% in 2010, which is very close to the aggregate threshold. This suggests that private and public credit flows should be monitored closely to ensure that financial stability is maintained.

2.3.3 Private Sector Credit Flow

High credit growth is often associated with vulnerabilities in the banking system, house price bubbles and boom and bust cycles in asset markets leading to macroeconomic imbalances. This is often associated with capital inflows and widening current account deficits, which represent macroeconomic imbalances in their own right. Excess credit growth leads to a rise in household and corporate debt which also may result in macroeconomic imbalances, as explained in the preceding section. The situation is worse when the credit growth occurs mainly in the non-tradable sector, particularly housing, as it crowds out resources from the tradable sector and encourages the creation of housing price bubbles.

This indicator is measured as the year-on-year change in private sector debt as a per cent of GDP and is illustrated in Chart 2.8. The risks to macroeconomic balances are deemed to be significant when credit growth exceeds 8%. As can be seen, this indicator is quite volatile for Malta, and stood consistently above the threshold in the period to 2009. It should be pointed out though that the ratio was generally declining from the peak registered in 2006 and in 2010 the ratio stood well below the threshold.

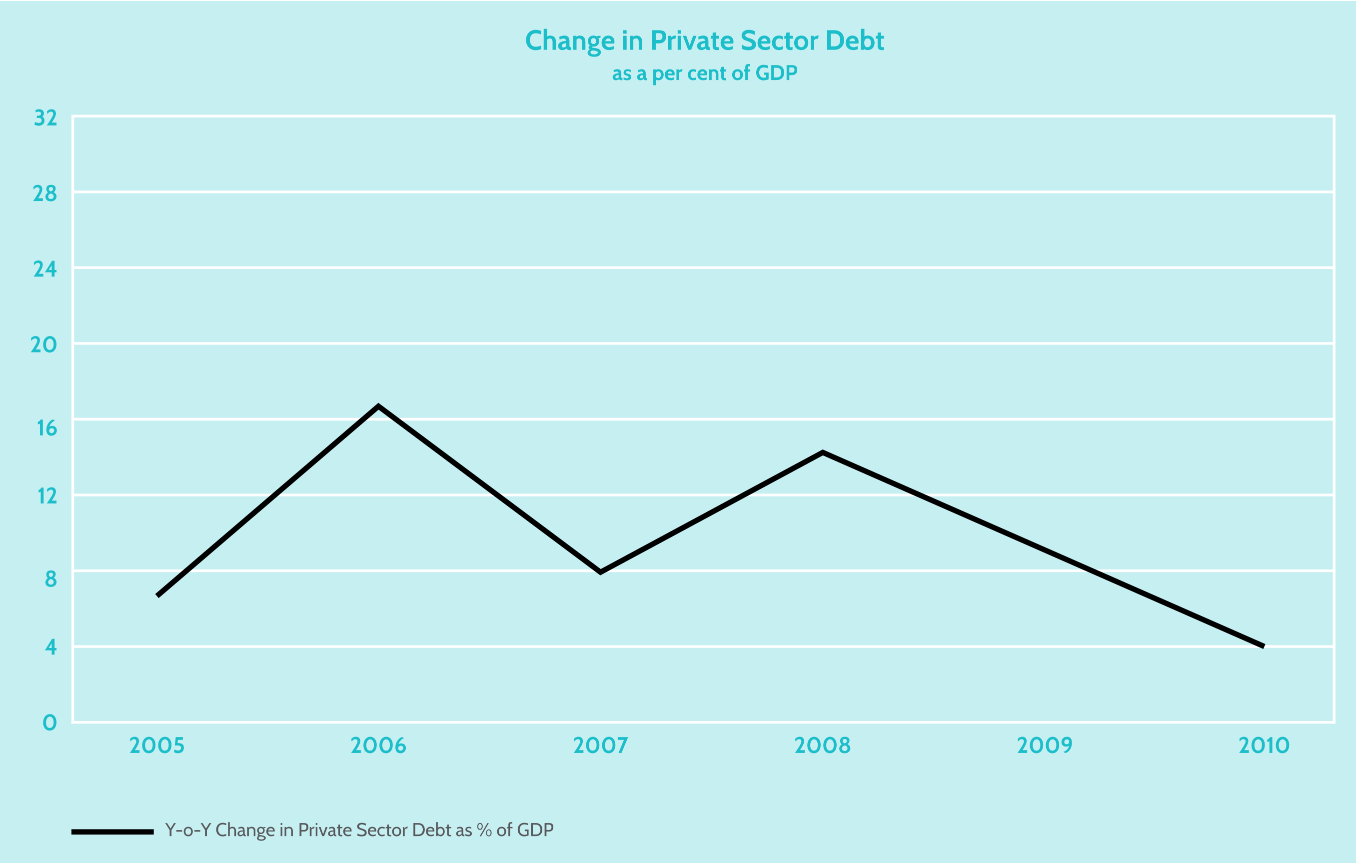


Chart 2.8

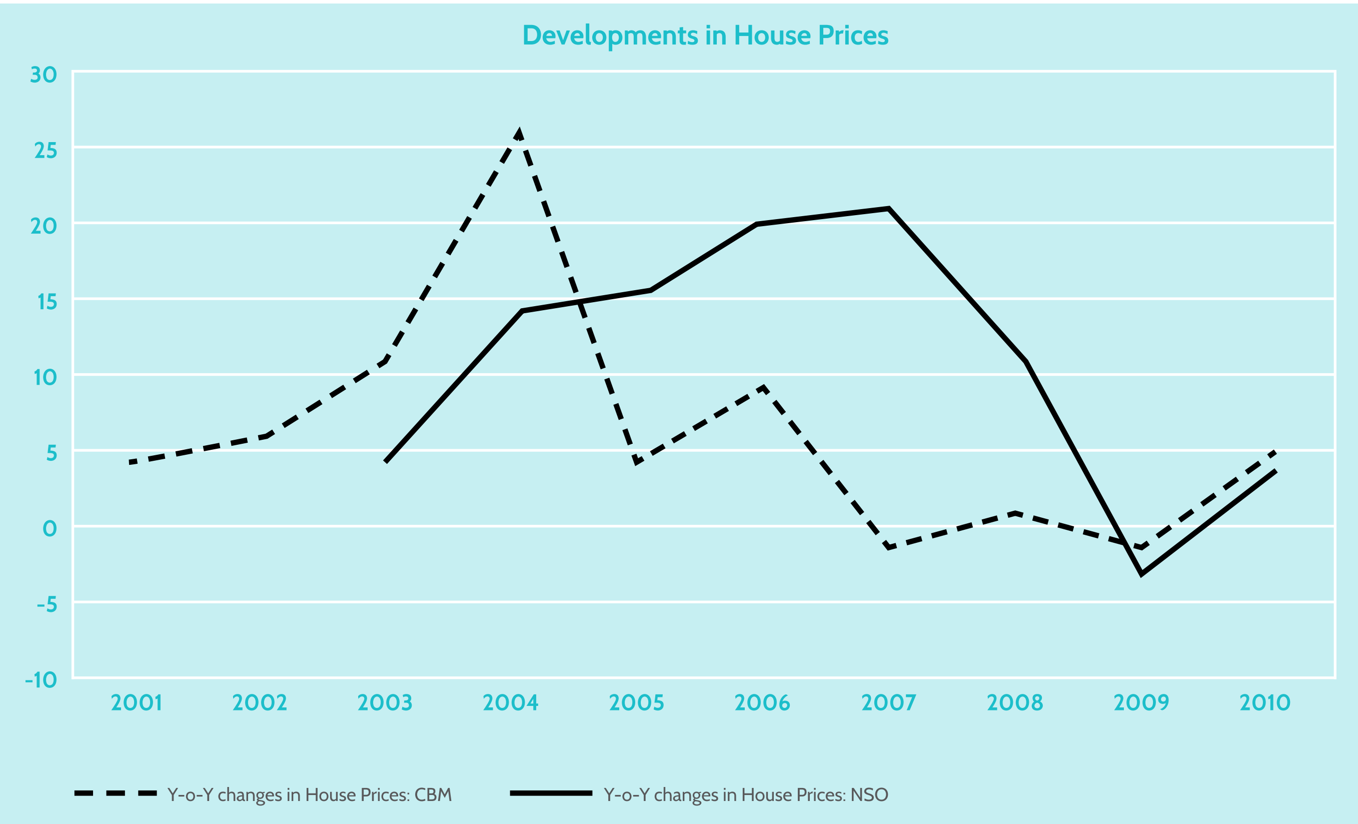
2.3.4 House Prices

House price developments present another indicator of macroeconomic imbalances. In the boom period, real estate price increases stimulate credit expansion and possibly raise unrealistic expectations of future capital gains. These factors support excessive housing construction, often leading to a substitution of investment from the tradable sectors to the non-tradable sectors. The lower share of investment in tradable sector eventually leads to a slowdown in economic activity and a correction in house prices, triggering a spiral of foreclosures, increasing non-performing loans and bankruptcy procedures. If the correction is significant, financial markets are often destabilised, as occurred on a global scale at the start of the financial crisis. Whilst the focus of this section is on house prices, similar dynamics can occur with other assets, including the stock market.

However, it is increasingly becoming evident that the consequences of a correction in house prices can often be more destabilising than say a correction following a stock-market bubble. This is probably due to liquidity constraints which characterise the real-estate market, the sophistication of investors involved, the wider ownership of real estate assets among the general population compared to financial assets and different objectives for holding real estate assets beyond financial purposes. However, these characteristics can vary from country to country.

Chart 2.9 shows both the Central Bank and NSO releases on house prices. The main difference between the two is that the Central Bank data is based on advertised prices whilst the NSO prices are based on contract price data. The threshold for house price growth rate was set at 6% based on findings in the literature on the subject.

Chart 2.9



The figures indicate that Malta experienced a property price boom in 2003 – 2005 with the NSO indicator suggesting that the boom continued until mid-2007. This coincided with the private credit boom suggesting that it may have been a contributing factor. The property boom also coincided with the inflow of capital from abroad upon the repatriation of Maltese resident's savings abroad during the process of Euro adoption. This one-time phenomenon possibly explains the continued increase in house prices observed in the latter years of the boom. Therefore one should be careful in projecting these trends forward. In any case, a correction occurred in 2009 and 2010, well synchronised with the global recession and correction in real-estate prices. In conjunction, investment in residential housing has also declined suggesting that investors have possibly reassessed their expectations of long-term capital gains towards more realistic and sustainable levels.

2.4 Financial Stability Considerations

A central and recurring theme that has been highlighted in the evaluation of macroeconomic imbalances is that of financial stability. Macroeconomic imbalances often lead to stress in the financial sector. At the same time, macroeconomic imbalances are often the result of an underestimation of financial risks. Hence it is inevitable that the analysis presented in this chapter is complemented by an equally important analysis of financial conditions.

Furthermore, it is worth noting that at EU level the discussions on macroeconomic imbalances are ongoing and it is not excluded that more specific indicators which are more directly linked to financial stability are identified in the future. It is not inconceivable for instance, that an indicator which monitors the growth in the financial sector is used as another indicator of macroeconomic imbalance. More specifically the discussions on the causes and consequences of the financial crisis have in part focused on the imbalances created by a financial sector growing excessively more than the real economy. If the discrepancies are strong, this could be an indication of a misallocation of resources possibly leading to higher indebtedness and the build up of asset price bubbles. In this context the growth of the financial sector in Malta should be critically analysed from a macro-prudential perspective, keeping in mind financial stability considerations.

A conservative banking strategy in Malta coupled with a tough, responsive regulator that is also approachable, meant that there was no need to shore up banks from public funds and the supply of credit to the economy was not negatively affected. This approach has to be sustained, and where possible, strengthened further. The recent Financial Stability Report (FSR) 2010 published by the Central Bank of Malta together with the analysis of macroeconomic imbalances provides a good starting point to guide policy makers to strengthen financial stability even further.

The creation of a forum for financial stability between the Central Bank of Malta, the Malta Financial Services Authority, the Government and the private financial market players constitutes a first step to the strengthening economic governance framework in Malta. This followed the call for the establishment of such a forum in the Budget Speech last November.

The aim is to enhance macro-prudential supervision and ensure it complements micro-prudential supervision so as to improve the identification, measurement and management of risks that could have a negative impact on the financial system. This framework could work in unison with the new supervisory architecture in the EU, which will be made up of the European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB). These will cooperate extensively, together with the national supervisory authorities, in the identification and analysis of systemic risks.

Since there are now 25 credit institutions registered in Malta with a significant stock of deposits (with more than half being foreign-sourced), it is important to assess the potential systemic risk posed to the Maltese economy. In its Financial Stability Report for 2010, the Central Bank of Malta identified 18 banks as being non-systemically important based on size of the institution in relation to the domestic economy, connectedness and substitutability criteria. Thus, these banks were assessed to pose relatively low systemic risks to the wider financial sector and the Maltese economy in general.

Nevertheless, the Deposit Compensation Scheme (DCS) was identified as a potential channel of contagion from these otherwise non-systemically important financial institutions. It is important to ensure that the DCS is adequately funded in order to further strengthen Malta's hard-earned reputation of a serious and reliable financial centre.

Moreover, an efficient cooperation framework with foreign authorities in the case of cross-border financial institutions is of paramount importance considering the current size of the financial sector in Malta relative to the size of the economy. Such a crisis management system would foster the attractiveness of Malta as a reputable growing financial centre while providing the necessary tools to be used if potential problems materialise, minimising the negative repercussions on the financial sector and the economy.

The rest of the banking sector, the systematically important domestic banks, was subjected to a thorough risk assessment, including stress tests. The FSR highlights a relatively high concentration risk on both sides of bank balance sheets, with a particularly significant exposure to the real estate sector, both in the form of loans and collateral held against them. In view of the risks posed by the property market to financial stability as identified by the FSR, it is imperative that a rigorous analysis of the property market be undertaken with a view to identifying the appropriate policy response to gradually and sensitively reduce the potential risk and exposure.

Stress tests were applied to the banking system to determine the potential risks involved. According to these tests, the banking system in Malta as a whole remains relatively resilient to the tested shocks. Adequate loan loss provisioning and a dividend policy that is more responsive to the new regulatory regime, which calls for higher levels and quality of capital would work towards ensuring that the banks remain strong and resilient.

The FSR also considers the potential risks, if any, posed by the large number of collective investment schemes and professional investor funds registered in Malta. The higher the share of funds invested in the local economy and the higher the share of funds gathered from local economic agents, the higher the potential risk to the real Maltese economy associated with a downturn in the performance of these funds.

The size of the fraction of investment funds whose majority of shareholder units is owned by Maltese residents consists of 11 Collective Investment Schemes (CIS) and 9 hedge funds, which remained very small and respectively accounted for around 5% and 1% of the financial sector's assets according to the CBM Financial Stability Report. These CIS and hedge funds invested around 63% and 46% of their total portfolio in domestic-quoted securities and shares respectively. Around half of the funds of CIS were channelled into Malta Government Stocks (MGS). The risk posed by the sector was assessed to be low considering its size, the low exposure of households to this sector, and the generally conservative business model adopted by most investment funds. However, a possible concern relates to the contagion risk between the investment fund sector and the banking sector in view of the fact that two major domestically-oriented banks manage 6 CIS through fund managers.

The drive to educate investors adequately should continue, pressing home the risk-return trade-off and the diversification principle. Financial literacy and education are paramount to ensuring that investments are made with due risk assessment. Incentives which encourage the sale of financial instruments to reap short-term profits without due consideration of the underlying risk should be discouraged through the appropriate corporate responsibility and possibly through prudential standards and regulatory oversight. Investments should also be adequately diversified to minimise non-systemic risk allowing investors to enjoy less variable returns.

2.5 Conclusion

The recent financial and economic crisis highlighted the need to further enhance the EU macroeconomic surveillance mechanism. One of the cornerstones of this surveillance is the analysis of any imbalances, through the use of a set of indicators, which might be present in the economy. Based on these indicators and on the established thresholds there is evidence that following the recent crisis much of the imbalances in the economy have been corrected. However, it is still too early to determine if such corrections are temporary or the result of a more permanent correction in the fundamentals.

The analysis above also showed that most of the imbalances in the external competitiveness of the Maltese economy have improved, although the need to further engage in enhancing productivity and competitiveness remains. In particular, debt and credit levels need to be monitored as the indicators used to monitor these imbalances are rather close to the threshold. Despite these positive developments in most of the indicators, constant monitoring of all the indicators is still of paramount importance, together with continued investment in productive sectors as well as further reforms in order to correct any remaining market imperfections.

Chapter 3

Enhancing Our Economic Growth

3.1 Introduction

Undeniably, the only way that the Maltese economy can retain and improve its position in the face of the ongoing globalisation process hinges on its success in attracting specific niches of activities that have the potential to create high value added activities and employment while ensuring that an appropriate and efficient risk management framework is in place. This would enable the economy to replace the stream of activities that are opting to move to cheaper locations as the Maltese economy improves its average earnings and living standards. Only in this manner can advances in living standards be rendered sustainable, and not give rise to economic imbalances.

The world economy is changing rapidly. New countries are emerging as major economic powers. Whole regions that were then under central and collective economic management have become free-market economies. Information Technology today permits people anywhere in the world to communicate and collaborate any time for any purpose. Wider and cheaper transportation systems and networks were developed and put in place. The financial system has become increasingly international. These advances have combined to make it possible to tap cheaper labour pools in emerging economies and for companies to outsource work or to relocate.

Technology, telecommunications and transportation innovations have dramatically altered relationships among people, businesses and countries. Malta is now competing with countries in the Mediterranean region, Eastern Europe and the far east especially China and India. Most of the barriers to profitable participation in the world's economy have been removed thereby allowing billions of people to enter the global marketplace and to compete for jobs, income, wealth and talent worldwide. We are now competing for investment and jobs with countries all over the world.

We must therefore adapt, compete and succeed in this knowledge-based global economy if our people are to continue enjoying continued opportunity and prosperity.

This Government is implementing Vision 2015 with the purpose of enhancing Malta's competitive advantage, and helping our people and enterprise strive for excellence in areas where we feel we have a comparative advantage. This Vision is meant to create more and better jobs, help entrepreneurs, and provide the wealth that our country needs in order to continue investing in its priority areas.

Government will therefore continue:

- focusing on its core functions while ensuring a competitive level playing field in the economy;
- creating the right conditions for people to make their choices, achieve their potential and excel;
- investing and seeking partnerships in key strategic areas to the economy including research and development, a clean environment and modern infrastructure; and
- creating the right business environment for enterprises to invest and grow.

3.2 Consolidating the Success of the Financial Services Industry

Over the last few years Malta has registered notable growth in the financial services industry. This growth has been consistent and sustained.

In recent years, an increasing number of multinational companies opted to relocate their business interests to Malta's jurisdiction. Such players include a wide array of financial services firms including financial and credit institutions, insurance companies, professional investor funds and investment services companies, and trustees and fiduciary services firms. During 2010, the first occupational retirement schemes were also authorised.

In this regard, the attractive and highly efficient licensing mechanisms applied in Malta combined with a strong yet accessible financial regulator and supervisor have undoubtedly played a fundamental role in attracting such activities.

The financial intermediation sector has important inter-linkages with other sectors of the Maltese economy. The registration of foreign-owned firms in Malta has helped to promote and further establish an important subsector in the Maltese economy, as such firms require notable legal, accounting, auditing as well as tax consultancy expertise. As a result, employment in other business activities[1] increased by 43.7%, while value added in the sector increased by 74.9% during the period 2004 - 2009, as outlined in Table 3.1. Such results compare favourably with the results registered by other small economies and with the European average. During 2010, steady growth was registered in this sector, with GVA registering an increase of 7.8%. Moreover as outlined in Chart 3.1, there remains considerable scope for further growth in this area.

Table 3.1

Other Business Activities						
	Growth 2004/2009	Employment - LFS Ratio of Sector to Total Employment 2004	Ratio to Sector to Total Employment 2009	Growth 2004/2009	GVA Ratio to Sector to Total GVA 2004	Ratio to Sector to Total GVA 2009
European Union[1]	25.0	6.9	6.6	26.7	7.3	8.4
Euro Area[1]	19.7	6.9	7.6	28.2	7.7	8.5
Cyprus	55.2	4.9	6.7	49.5	4.3	5.1
Luxembourg	38.5	6.7	8.1	78.5	7.0	8.4
Malta	43.7	4.0	5.2	74.9	5.0	7.5

[1] data for GVA pertains to 2008

[1] The sector incorporates: legal, accounting, book-keeping and auditing activities, tax consultancy, market research and public opinion polling, business and management consultancy, architectural and engineering activities, advertising, labour recruitment and investigation activities.

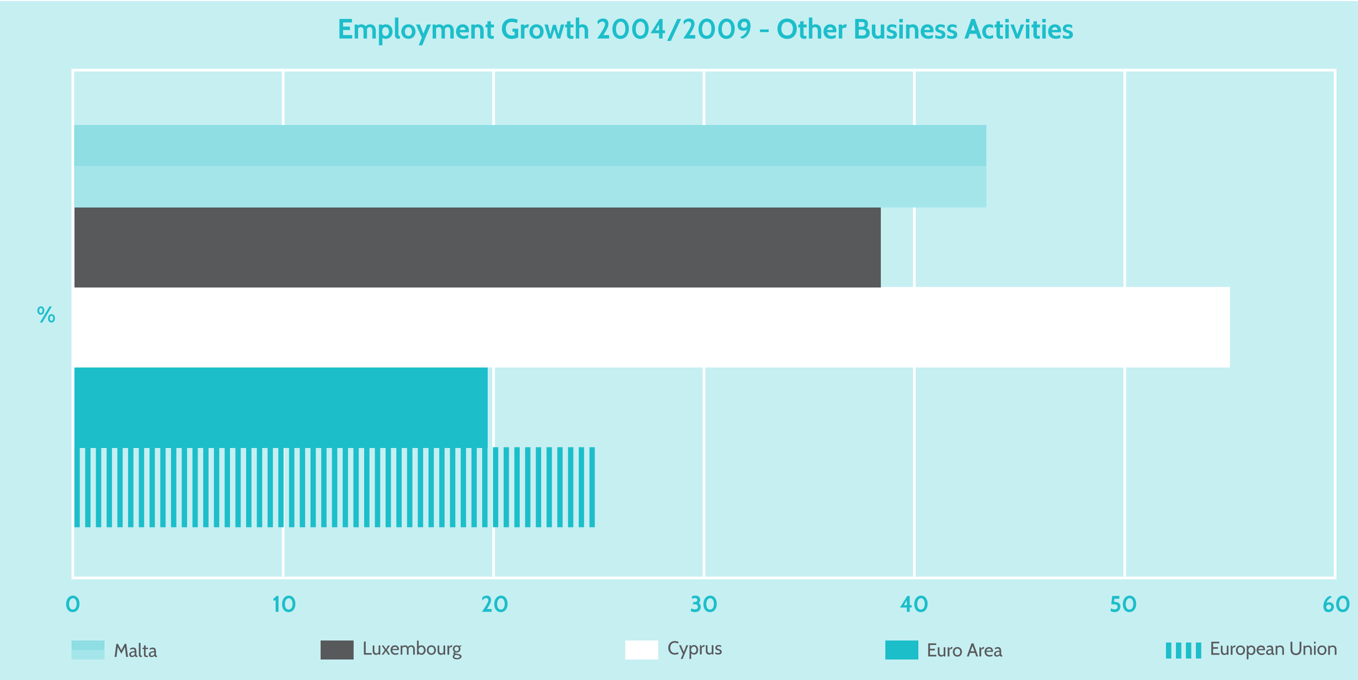


Chart 3.1

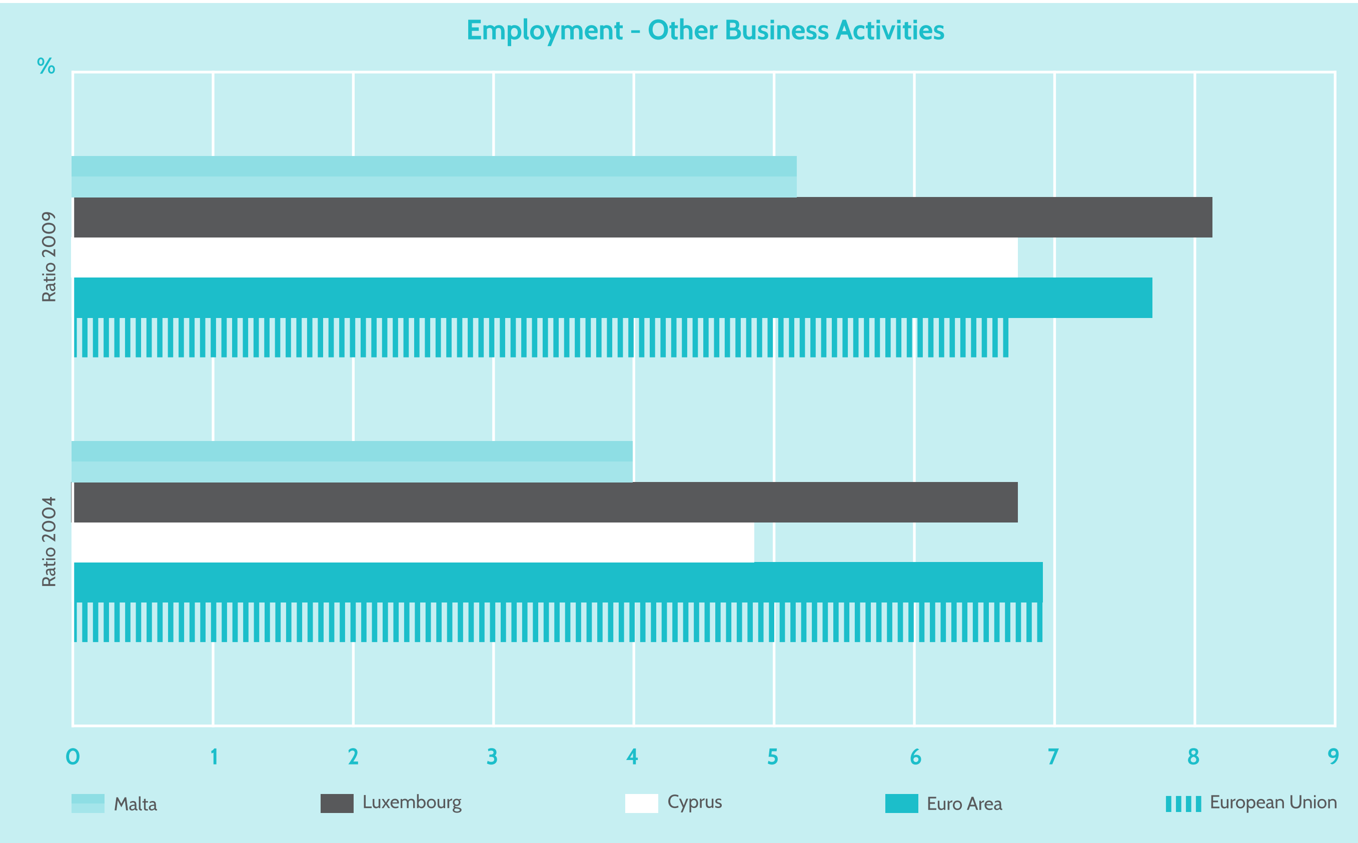


Chart 3.2

Similarly, activity in the financial intermediation sector was also very robust over the recent years. This sector comprises the activity of obtaining and redistributing funds other than for the purpose of insurance or pension funding or compulsory social security. There are 25 credit institutions licensed in Malta, with many having a significant foreign orientation. The financial intermediation sector (excluding insurance, pension funding, and auxiliary financial activities) too, has registered notable growth during the period 2004-2009 with employment increasing by 64.5%, whereas value added increased by 115%. During 2010, this growth in this sector was sustained with a growth rate of 35.2% being registered.

Chart 3.3

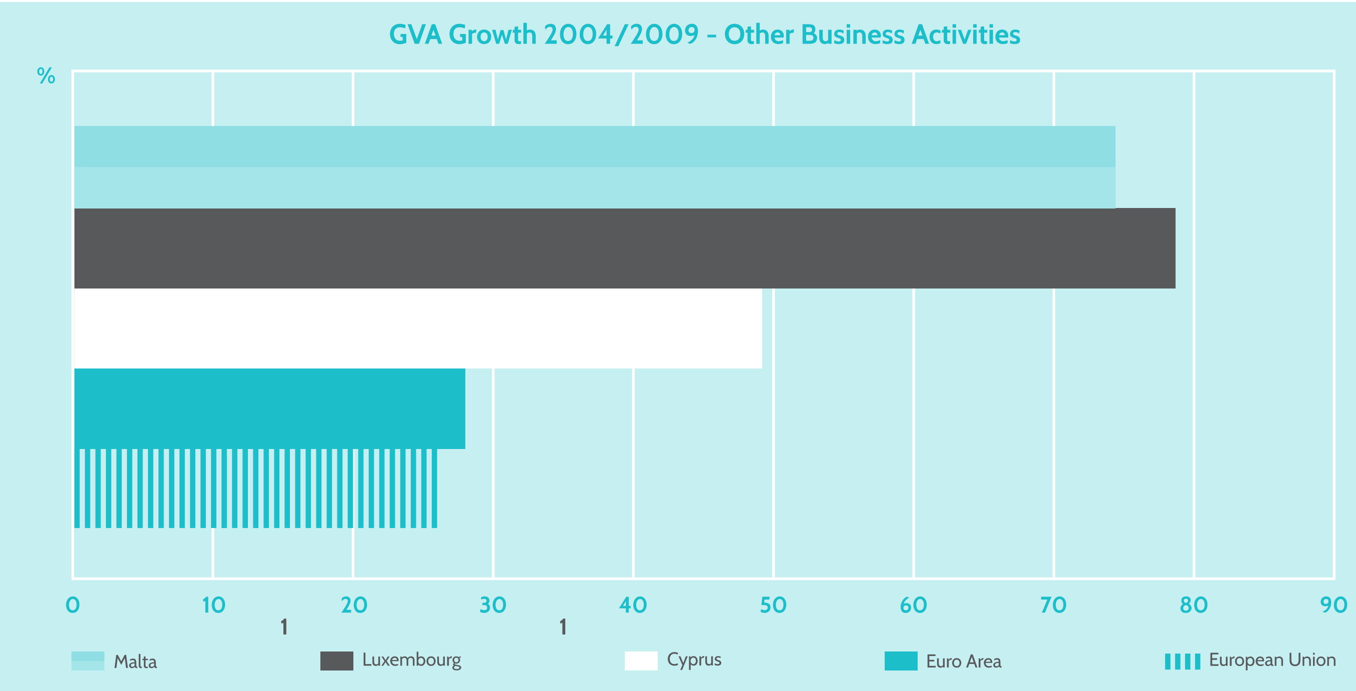


Table 3.2

Financial Intermediation, except insurance and pension funding						
	Growth 2004/2009	Employment - LFS Ratio of Sector to Total Employment 2004	Ratio to Sector to Total Employment 2009	Growth 2004/2009	GVA Ratio to Sector to Total GVA 2004	Ratio to Sector to Total GVA 2009
European Union[2]	22.8	2.0	1.9	15.0	3.7	3.6
Euro Area[2]	11.8	1.9	2.0	11.4	3.5	3.3
Cyprus	25.7	3.2	3.6	64.0	5.7	7.1
Luxembourg	35.0	8.7	10.2	72.0	14.9	18.3
Malta	64.5	2.1	3.2	115.0	2.9	4.8

[2] *data for GVA pertains to 2008*

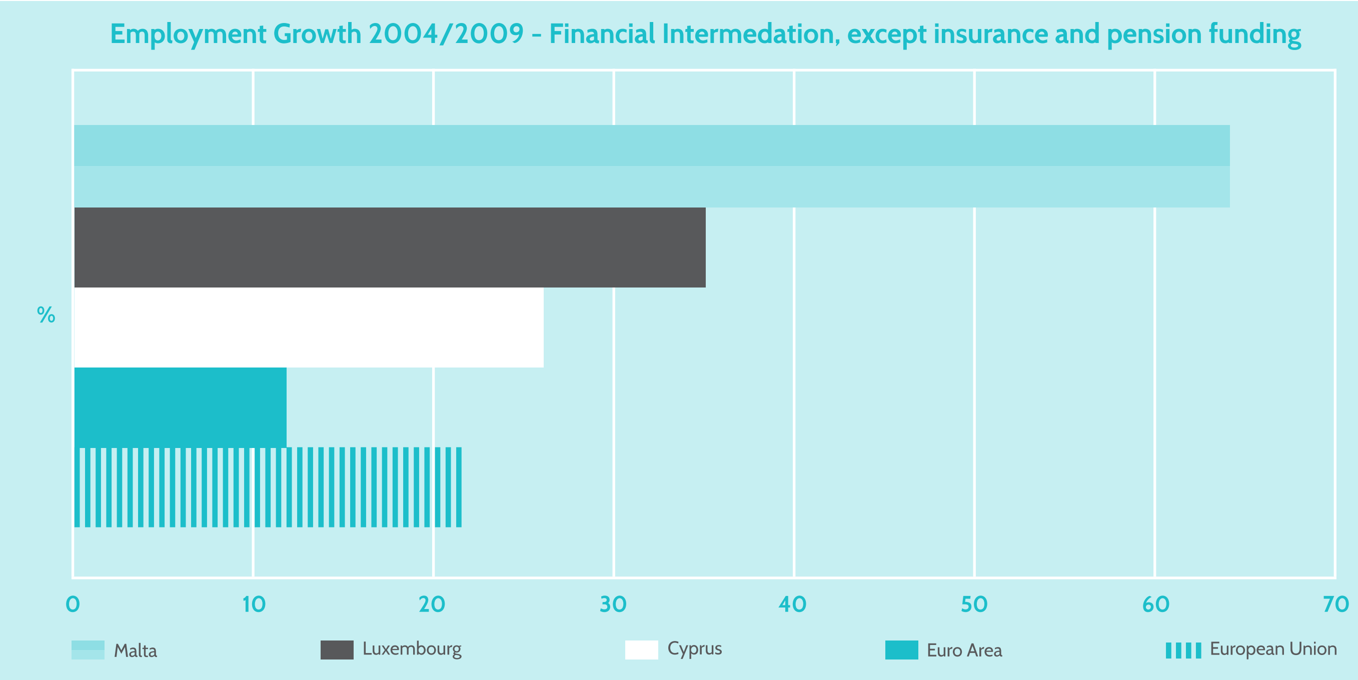


Chart 3.4

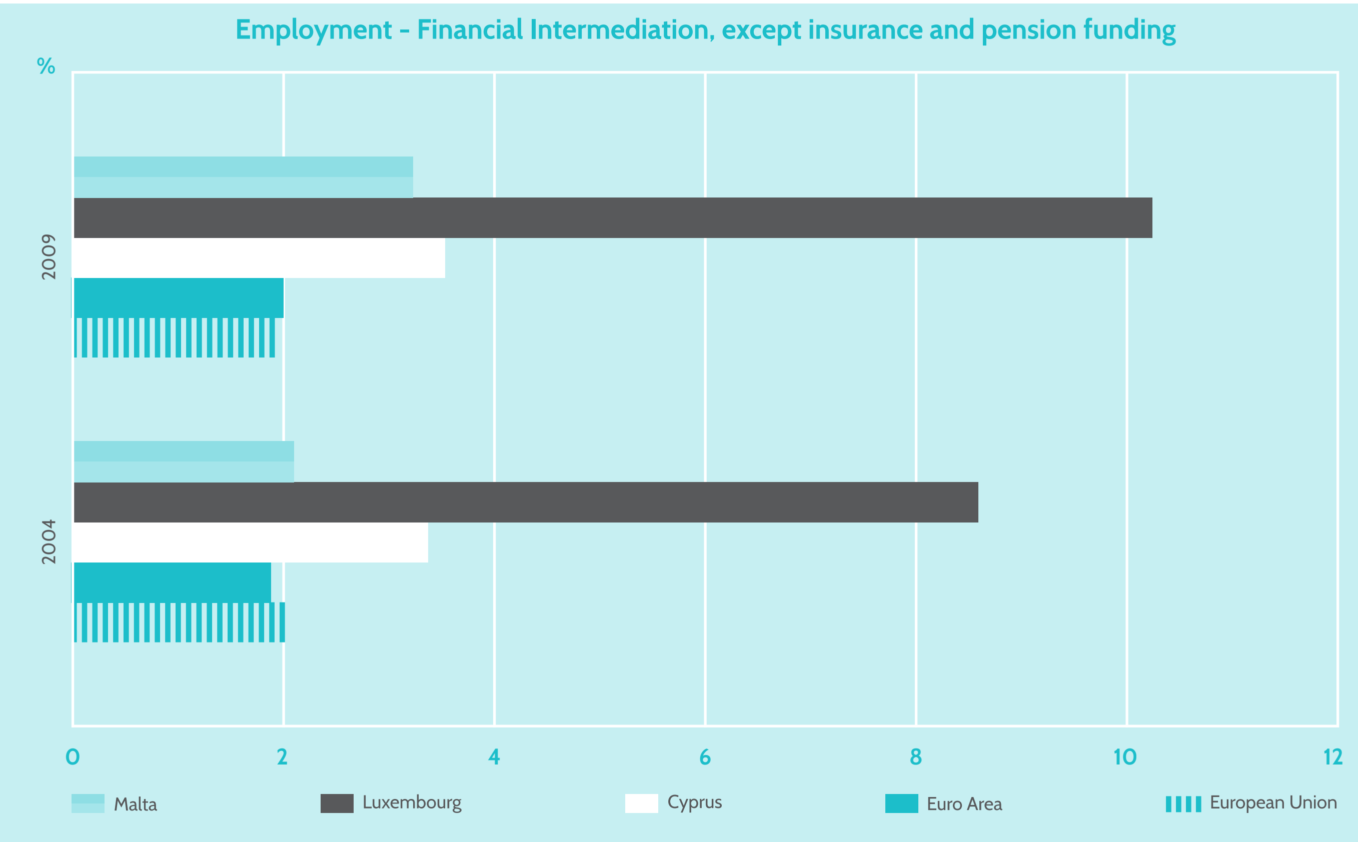


Chart 3.5

Malta can potentially consolidate its performance in the financial services sector and related activities by intensifying the attraction to the Maltese shores of other activities auxiliary to financial intermediation, such as asset and fund management, trusts, pension fund management and insurance and actuarial services. Such activities – similarly to corporate and fund registration and compliance activities – have considerable scope for expansion and growth within the local economy.

Issuance of Licences in Growing Niche Sectors			
	2009	2010	2011
Insurance Undertakings	45	50	52
Recognised Fund Administrators	13	18	21
Retirement Schemes, Administrators and Assest Managers	0	14	18
Authorised Trustees, Nominees & Trusts	249	258	260

Table 3.3

The inroads made in recent years in increasing the number of collective investment schemes and professional investment funds that are registered in Malta should be considered as a competitive advantage that can be used and exploited as an important stepping stone in seeking to attract more asset and fund management operations to Malta. Moreover, the development of a financial services industry and the accompanying services infrastructure has provided an important cluster that provides external economies of scale to other firms that would like to establish themselves in Malta.

The process of encouraging foreign financial services firms to relocate in Malta must be complemented with a longer term strategy of ensuring that the educational institutions produce the necessary human resource complement to service these emerging industries. In the absence of such a long term strategy the potential economic benefits to the Maltese population would not be maximised and possible labour market shortages could lead to excessive wage pressures which would quickly erode Malta's competitiveness in these sectors and impede their growth.

In this regard, it is pertinent to point out that services auxiliary to financial services tend to require individuals with academic as well as professional qualifications. Although the proliferation of professional qualifications in the accounting field is extensive in the local labour market, the proliferation of such qualifications in fund administration, insurance services, trusts and similar services is still very limited.

Data pertaining to wages and salaries over the recent past is portrayed in Table 3.4. Wage increases in the financial sectors have been considerably higher than those witnessed in the overall economy and quite close to developments in sectors that are known to exhibit skill frictions such as the health sector.

In order for such an industry to expand, a degree of synergy is required between education and regulatory authorities to ensure that the visibility of such qualifications is increased and hence ensure that the labour market has the necessary supply of individuals who would enable the economy to exploit the financial services sector.

Table 3.4

Index of Wages and Salaries in Different Sectors					
	Overall Economy	Computer & IT	Health	Financial Intermediation	Insurance
2005	100	100	100	100	100
2005	102	100	9	108	105
2006	107	106	103	115	109
2007	109	105	109	115	113
2008	113	108	121	121	116
2009	114	117	113	130	123
2010	115	113	123	128	140

As with the growth of any economic industry, the growth of the financial services industry entails certain risks that need to be properly identified, measured and monitored. Moreover, it should be outlined that if an industry becomes very successful and manages to achieve increasing shares in the gross value added produced within an economy, the degree of diversification within the economy would decline. As a result, the economy would become increasingly dependent on developments within this growing industry. This highlights the importance of strategies for the growth of other industries identified as having a competitive advantage, which would help to maintain an appropriate degree of economic diversification.

Recent Amendments in Local Tax Law intended to stimulate the Auxiliary Financial Activities Sector

The expansion of auxiliary financial activities in the local economy is an important goal for the Government. As outlined earlier, it is seen as having considerable potential in creating high value added employment. In this regard a recent amendment in the Income Tax Act will enable highly qualified expatriates that relocate from abroad to benefit from a 15% tax on income for a duration of between 4 to 5 years, on a minimum income of Eur75,000. The amendments outline specific professions which are eligible for this beneficial tax rate and include portfolio managers, senior analysts, chief investment officers, traders and chief underwriting officers. Given the right exposure by financial practitioners, this amendment should smoothen and increase the likelihood that foreign institutions and individuals alike would seek to relocate their analytical, and processing activities to Malta. Gradually, the Maltese workforce would learn the technical skills from the highly qualified expatriates - who are enticed to relocate to Malta due to the tax advantages - and hence would be in a position to eventually progress within such organisations. On the other hand, the firm would benefit, over the long run, through lower expenses when relocating analytical and back-office work to Malta as outlined earlier.

3.3 Sustaining the Tourism Industry

As tourism trends change, Malta needs to update itself to offer quality.

Beyond the sun, sea and sand, Malta is also being promoted in other niche markets, such as conference and incentive travel, English language teaching, diving and other sports training camps, weddings, health and wellness, film tourism and short-break holidays.

With its lower population density, cultural assets and ambience, Gozo has always played an important role in Malta's tourism offer. The Eco-Gozo concept is a great opportunity to have a tourist product which is above all environment-friendly.

The tourism industry has always been an important focus for Malta. The most significant was the effort to increase direct flights to the country at a lower cost. Additionally, the collaboration with cruise line companies is increasing Malta's attraction as a destination for cruises.

In keeping with EU and international trends, the average length of tourist stay in Malta decreased, mainly due to declines in tour operations business and summer holiday travel. However, tourism continued to increase to well over one million visitors per annum, or nearly three tourists per capita. Accommodation stands at approximately 40,000 beds and the services and amenities offered have generally improved. This has helped Malta move up the value chain to attract wealthier tourists.

While 30 years ago Malta was a mass tourism destination dependent on the UK as its source market, this started to change during the late 1980s and 1990s. Germany, France, Italy, Spain and the Netherlands became the additional major source markets. Other secondary source markets such as Scandinavian, Eastern European countries and long haul ones (e.g. China) are also being tapped.

The Government has identified a number of areas which can contribute towards a sustainable tourism industry.

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In Malta, funding for arts and culture initiatives is limited. Malta has a rich, arts and cultural base, but further investment is needed for facilities and the preservation of Malta's cultural assets.

The key to improving the quality of life and making Malta an attractive place to live in is enhancing the opportunities and investment for arts and cultural amenities by creating an arts and culture taskforce to determine specific funding needs.

The Government should also develop strategic alliances with leading medical service providers to expand Malta's health tourism offerings, while optimizing Malta's tourism opportunities and offerings.

Within this context, the provision of high quality, innovative tourism products and experiences, coupled with excellence in customer service, are essential to the Maltese tourism industry's performance against international competitors. Malta must strive to expand its tourism marketing approach from a regional to a global strategy especially in markets with a potential of larger disposable income like China, India, Russia and Brazil.

Hence, it is being considered to:

- increase the number of hotels with the Malta Tourism Authority eco-certification;
- expand Malta Tourism Authority quality-assurance schemes to improve tourism services;
- increase private investment for more public beaches;
- expand the English training role to technical and managerial training as well as educational; and
- establish formal academic relationships between Universitu of Malta and other European and US universities.

3.4 The Island of Gozo

Gozo's distinctive characteristics particularly, its attractive topography, relatively unspoilt environment, tranquillity and ambience, and flexible and diligent workforce offer significant potential for development. Nevertheless, the island faces a number of challenges mainly originating from its double insularity which impacts on all sectors of the economy and impacts the quality of life on the island, given the limitations on accessibility to important services such as education, specialised health care and employment opportunities. The challenges emanating from this island within an island reality are also reflected in a number of comparative disadvantages that Gozo-based economic operators face, when compared to their counterparts in Malta.

On the other hand, Gozo enjoys competitive advantage in the services industry, particularly in tourism, financial services and care. It is these sectors where Gozo has strong productivity advantages and which still account for a relatively small share of total employment when compared to Malta, that provide potential for growth.

It is in this regard that Government highlighted in various documents its commitment to transform Gozo into a sustainable reality, not only environmentally but also economically and socially. Within this context, Government is considering a number of initiatives directed towards the achievement of such long-term goals.

The generation of sustainable employment is high on Government's agenda. Whilst recognising that the socio-economic development of the island can be sustained by supporting relevant sectors, it is just as important to recognise the challenges faced by Gozo and thus to ensure that policies for Gozo are not just a replication of a 'one size fits all' approach, but take into account the specific needs of the island and its current level of development as a starting point.

As part of its efforts to continue to transform Gozo into an eco-island in concrete terms, Government is looking at measures to support the development of priority sectors which exhibit the potential to stimulate the island's socio-economic development while preserving its environment. These sectors include tourism, health and personal care, the environment as well as human resource development.

To exploit further this potential for Gozo as a distinct destination, Government is looking at a two-pronged approach:

- marketing efforts to attract both foreign and domestic tourism; and
- the upgrading of the Gozo tourism product.

In this regard, Government is committed to continue to invest in the:

- improvements to the basic infrastructure;
- upgrading of diving tourism related facilities;
- upgrading of existing as well as the creation of new country walks;
- upgrading including accessibility improvements to and interpretation of heritage sites; and
- upgrading and embellishment of popular tourism areas and areas of high landscape value.

In its endeavours to transform Gozo into an eco-island, Government believes that its policies should be tailor-made to address the specific needs of Gozo and that interventions are focused on those sectors which have shown significant potential for growth. These sectors include the services sector, notably tourism, health and personal care, as well as the environment. However, the realisation of the potential exhibited by these sectors necessitates the active involvement of the private sector as well as significant investment in human capital in order to ensure that these sectors find a readily available supply of the required skills both educational and technical to help realise their full potential.

3.5 Research and Innovation and Development

The new R&I Plan (2011-2020) will take full consideration of policy developments in other thematic areas and policy developments at national, European and international level. Particular attention is being given to the strategic approach adopted in the EU Innovation Union. The R&I Strategy 2011-2020 will give central importance to innovation (broad concept), framework conditions, societal challenges and the involvement of all actors. The new R&I strategic plan will provide a policy framework for the coming decade, and will take into consideration, among others, ongoing work in the preparation of thematic plans in several sectors, including health research, FP participation and value-added manufacturing. The plan will be based on strong stakeholder consultation. The new national R&I strategic plan is expected to be completed by the end of this year and it is foreseen that the new R&I plan may lead to the launch of new initiatives.

National R&I Programme Implementation and Extension towards Commercialisation

National funding for R&D is presently centred around the national R&I programme and R&D incentives for industry. Nonetheless, other funding sources (including, but not limited to, CIP and FP) will be looked into as possible supporting measures to realize the idea-to innovation approach. The national R&I programme aims to fund research projects of between €50,000 and €200,000 concentrating on technology transfer between academia and industry with specific focus on the four priority sectors identified in the R&I Strategy, namely Environment and Energy Resources, ICT, Value Added Manufacturing, and Health and Biotech. The R&I programme for the current year was launched in June 2010. The funding for the R&I Programme will be increased to €1.1 million in 2011. By 2012 the R&I Programme will be supplemented by the Commercialisation programme and the net budgetary impact is expected to reach €2.4 million in 2012. The net fiscal outlays for the programme could potentially reach €3.7 million by 2014.

Incentives for R&D in Industry

In 2009, Government launched an incentive package to support Industrial Research and Experimental Development. The incentive package incorporates eight incentives that provide assistance to increase the amount of research and development activities in Malta. The incentives are industrial research tax credits, experimental development tax credits, tax credits for patent registration by SMEs, R&D grants (funded through ERDF), support for participation in EUREKA projects, secondment of highly qualified personnel, support for undertaking technical feasibility studies, and support for the setting up of innovative clusters.

These incentives aim to help firms invest in R&D activities by supporting pre-R&D activities, industrial research, and SMEs in the patent registration of successful research projects. It is planned that work will be undertaken to identify and address gaps in funding and provide support for ideas to innovation, thus closing the cycle between the generation of a new idea and its realization as a new product/process on the market.

With the prospect of Smart City and a Life Sciences Park, Malta has a real opportunity to create collaboration between entrepreneurs, education and industry to spur new technologies and further establish Malta as a regional hub of innovation.

As Malta targets higher-tech, R&D and knowledge-based firms, collaboration will be crucial to ensure that MCAST and University of Malta contributions towards talent, research and spending are closely coordinated with employers' requirements.

Malta embarked on a number of European Regional Development Fund projects, which are expected to strengthen the University of Malta's research infrastructure capacity significantly. These initiatives will provide for the setting up or upgrade of various laboratories.

The feasibility of transforming the government farm in Gozo into state-of-the-art research laboratories to support the agricultural component of the Eco-Gozo vision has also been studied.

Bursaries for PhD research students were also established through a Government Scholarship Scheme (MGSS) and Strategic Educational Pathways Scholarships (STEPS). There is a special emphasis and supporting PhDs in science and technology.

Malta must develop programmes that encourage close collaboration between research institutions, business and education. In this respect, Malta will work to support and facilitate the establishment and operation of risk capital financing facilities based on models that suit the Maltese context and culture, which could include:

Proof-of-Concept grants to help the commercialisation of research projects that focus on Life Sciences, ICT and Creative Industries, Advanced Manufacturing, Renewable Energy and Financial Services;

Industry/Research Institution Infrastructure Development Grants to support partnership efforts between the Life Sciences industry and research institutions to build an infrastructure that supports the commercialisation of Life Sciences technologies in Malta;

- Availability of income tax credits for investors in qualified seed capital and venture capital funds that support the commercialisation of Maltese innovations; and
- Encouraging patent development through a Patent Income Tax Exemption.

It is also being considered that a committee, including local bankers, service providers, education leaders, and entrepreneurs, be developed. Malta would be well served by an equity capital fund connected to the target industries. It may also explore developing a revolving loan fund to provide small businesses with research and development support and long-term financing for fixed assets.

Further to this, given Malta's small size, the nation would be well served by launching an international externship programme, identifying local talent, placing them in high growth companies in Malta's target industries and then bringing back their experience and knowledge to Malta to launch new companies.

3.6 Business and Entrepreneurship

The entrepreneurial cycle needs three supporting pillars: information and technical assistance, training, and access to capital and networks.

Government is committed towards ensuring a competitive business environment and to this end it has embarked on a number of initiatives. Within its role to promote foreign investment and industrial development, Malta Enterprise administers a number of European Regional Development Fund (ERDF) initiatives.

- Support for entrepreneurship has also been provided through a number of European Structural Funds projects with the purpose of:
- empowering the use of ICT as an entrepreneurial tool;
- promoting an entrepreneurial culture among women through the provision of training in business skills, a mentoring skills course and a reference library for trainees; and
- organising entrepreneurship programmes for ex-Malta Shipyards employees interested in starting their own business.

Development of a Creative/Design Incubator

By developing a national creative/design incubator, Malta will be able to gain recognition as a country rich in creative and design skills. The concept embodies the spirit of a research institution but with a focus on education and innovation in design. It will bring together experts in ICT design, software design and artistic design to work jointly on innovation. It would illustrate that the essence of design skills apply to many disciplines and help Malta draw internationally renowned designers to Malta for study, business and conferences.

In this respect, Government will be completing the Creative Malta project, including identifying assets and determining ways to achieve synergies in engaging support resources, seeking funding for upgrading or constructing space for the incubator, and developing an informal network for design professionals to collaborate.

Coordination between Malta's Numerous Industry Groups

Many of Malta's targeted industries are highly interconnected. However, many of the industries largely operate in silos and are not aware of other industries' activities. In this context, targeted clusters not currently organised into industry marketing and support groups may form sector advisory groups under the Economic Development Coordinating Unit umbrella to help identify rapid industry shifts and opportunities.

3.7 Malta's Industrial Strategy

Whilst the focus of this chapter has been the services sector, this should not be interpreted as a sign that the Government no longer believes in the capability of Malta's manufacturing industry. Although undeniably the sector was negatively hit by the recession, it has also been one of the main drivers of Malta's economic recovery last year. In addition, during the last two Pre-Budget documents Government has increasingly voiced its belief in the sector, with the analysis suggesting that there is further scope for growth in manufacturing activity in Malta.

An analysis of small EU Member States with a similar level of economic development to Malta revealed that such countries managed to propel their manufacturing sector in conjunction with the growth in their services industry. In particular, the manufacturing performance of the Czech Republic is worth looking into as an example of best practice in this area. This, in itself, is a reliable indication that the potential of the manufacturing sector in Malta is not being fully exploited. Moreover, the manufacturing industry does not solely comprise the low-cost production aspect, but also high value added spheres such as those involving research and development, design, and maintenance of high technology equipment and machinery. As a country develops, recording increasing price levels and wages and salaries, becomes inevitable and hence becomes increasingly important to tap into such areas of manufacturing, which become very attractive to the country as compared to low-cost production.

A cursory look at the analysis undertaken in the Pre-Budget document 2010, the Czech Republic emerged as a country with extremely high educational attainment levels whilst hourly labour costs appeared amongst some of the most competitive. Malta's labour costs were almost as competitive, whilst labour productivity in Malta was also relatively high. This indicates that the educational attainment level is probably a main difference between Czech Republic and Malta. This highlights the relevance placed by Malta's National Reform Programme on low educational attainment as a major bottleneck to growth which needs to be addressed, in line with past policy initiatives in this field. The educational standards also allow the Czech Republic to invest more in R&D, with expenditure reaching 1.5% of GDP. This is a relatively high rate for a small economy.

Other important distinguishing features of the Czech economy which were identified were the higher investment activity and the lower price levels relative to Malta (except in case of communication services). Lower price levels applied to both goods and services. This could possibly be indicative of stronger, well functioning, markets. Undeniably the Maltese economy is smaller than the Czech economy with market structures possibly presenting a stronger challenge. Nevertheless both economies enjoy the benefits of the single market in the EU. A successful industrial strategy is one that ensures that market failures are addressed in order to ensure that cost structures do not hinder the competitiveness of the Maltese economy in general and manufacturing industry in particular.

Finally, in line with the above strategy of focusing limited resources on a few growth sectors in which Malta may have a competitive advantage, the same could apply to Malta's industrial sector. A few sectors could be identified, possibly in areas where Malta has demonstrated a consistent track record of success preferably in international export markets. Industrial champions could be identified, including successful Maltese expatriates, leading a tailor-made strategy for each sector and supported by the necessary resources.

Chapter 4

Optimising the Economic Contribution of Malta's Human Resources

4.1 Encouraging More Workers to Enter the Labour Market

It is a well known fact that the major resource that the Maltese economy is endowed with is its labour force. There is little doubt that over the past years the stock of human capital that the economy is endowed has improved notably with major advancements registered in the skills and education levels of the workforce. This is undeniably of fundamental importance in ensuring that the supply side of the economy can sustain the production and distribution of goods and services which would enable economic agents to attain the desired consumption trajectory sustainably. One should outline that the stock of tertiary and post-secondary educated workers is well balanced between the male and female cohorts. This necessitates that the economy should make optimal use of its entire human capital stock, and seek to increase the female labour participation rate further.

Post Secondary and Tertiary Education		
per cent		
Age: from 15 years to 64 years		
	2008	2009
Males	30.9	30.2
Females	26.4	27.3

Table 4.1

Female Employment Rate	
per cent	
Cohorts: 20-49 years	
Mediterranean Countries	64.6
European Countries	68.1
Euro Area	67.7
Malta	54.3

Table 4.2

In respect of female participation, Malta has registered notable improvements, although the level of female participation is still quite low when compared with European standards, and rather low even when benchmarked with other Mediterranean countries such as Cyprus, Greece, Italy, Portugal and Spain, whose culture is considerably similar to that of Malta.

In this regard, over the past six years, an extensive set of measures have been implemented in an attempt to increase the level of female participation further.

Measures focused on Increasing Female Employment in Previous Budgets	
2011	Self employed women working on a part-time basis were granted the option to pay a contribution rate of 15 per cent, instead of the minimum amount as stipulated by law.
2010	Extension of the afternoon school programmes to two other schools
2009	Commitment to have a child care centre within all the 10 colleges around Malta.
2007	Employed workers working on a part-time basis were granted the option to pay a pro-rata contribution rather than a minimum amount.
	Government started allowing parents to deduct Eur930 from the taxable amount to make good for part of the expenses incurred in licenced childcare services.
	In those cases where employers pay their employees for expenses related to childcare services, such expenses are considered as business costs and therefore are deductible from taxable income.
	In those cases were employees receive payment from their employer for expenses related to childcare services, such payments would no longer be considered as fringe benefits in the hands of the employee and will therefore no longer be taxable.
2005	The introduction of a childcare project intended to provide training and a package of incentives to companies to setup and run a child care facility for its employees.
	A couple opting for joint tax computation started benefiting from the possiblity of having the fixed income tax rate of 15% on secondary employment, up to a maximum of Eur6,988 applied to the part-time employment of both spouses.
	Women who have been absent for more than five years from work started benefitting from a tax exemption for the first year during which they return to work. This was later extended to those female employees that opt to remain in employment after giving birth.

Box 2

As outlined in Chart 4.1 such measures appear to have had a beneficial impact on the female participation rate in the Maltese economy. This is a very positive development in that for a number of years the female employment rate was nearly stagnant, and hence suggests that the measures implemented have had the desired impact. This conclusion has been confirmed statistically[1] . However, in the absence of other employment friendly policies, the rate of increases in female employment rates is likely to taper off as the impact of the introduced policy initiatives exhibit a diminishing influence. Without taking into account the possibility of such tapering off, if one were to assume that the average growth in the female employment rate that prevailed during the period 2005 – 2009 persists in the future, Malta's female employment rates in the 20-49 cohort would take nine years to catch up with Mediterranean countries and 11 years to catch up with Euro Area countries.

[1]The econometric technique used to analyze statistically the impact of the family friendly initiatives is the Difference-in-Difference estimation approach.

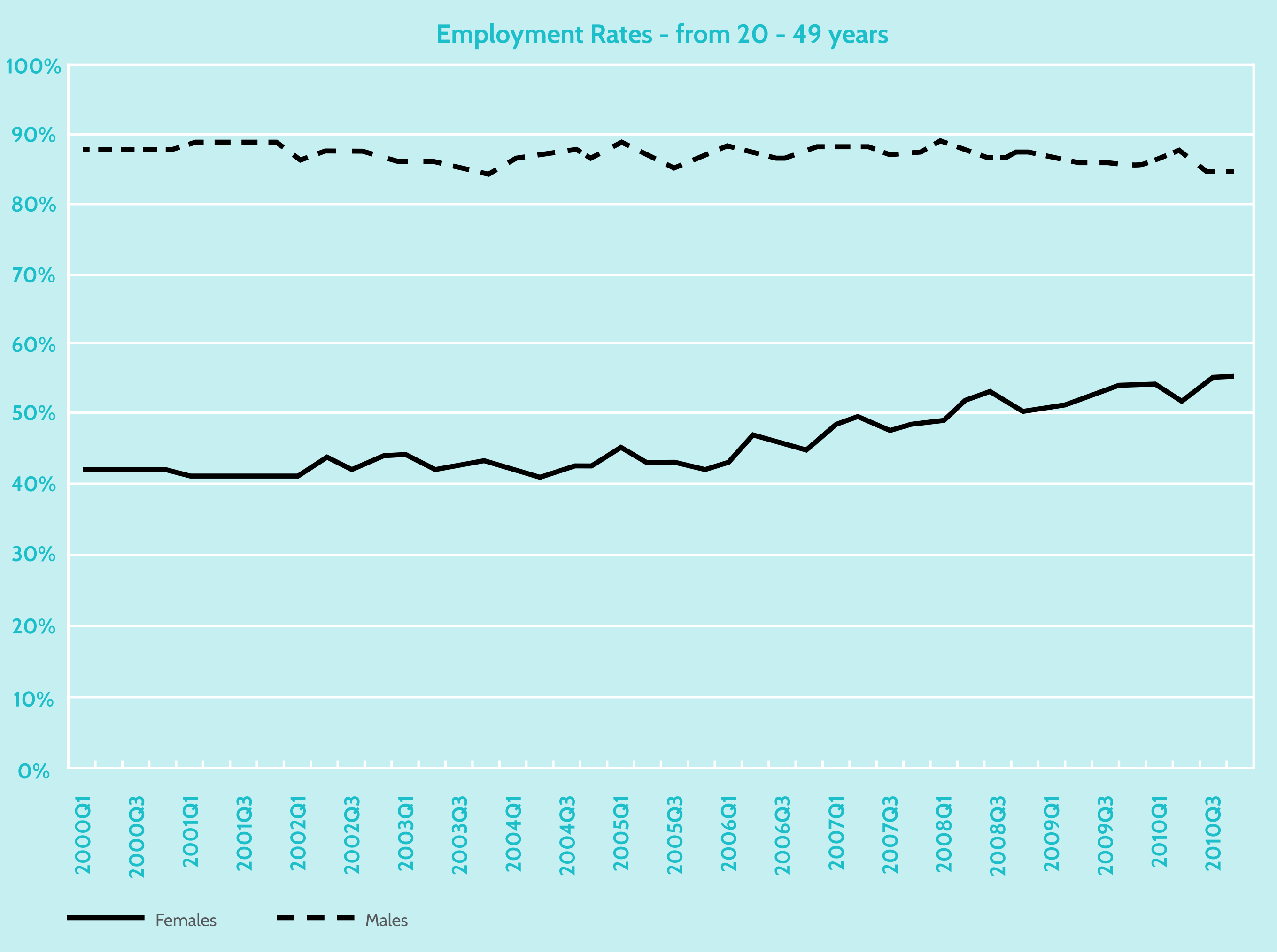

Chart 4.1

As outlined in Chart 4.1, the increases in the female employment rate registered in the past years have occurred in all the female population cohorts ranging from 20-49 years. However closer analysis suggests that the maximum employment rate is attained in the 25-29 years cohort, and that beyond this cohort a steady erosion in the female employment rate is evident. This steady erosion has persisted, notwithstanding the tax incentives and the introduction of child-care centres over the years.

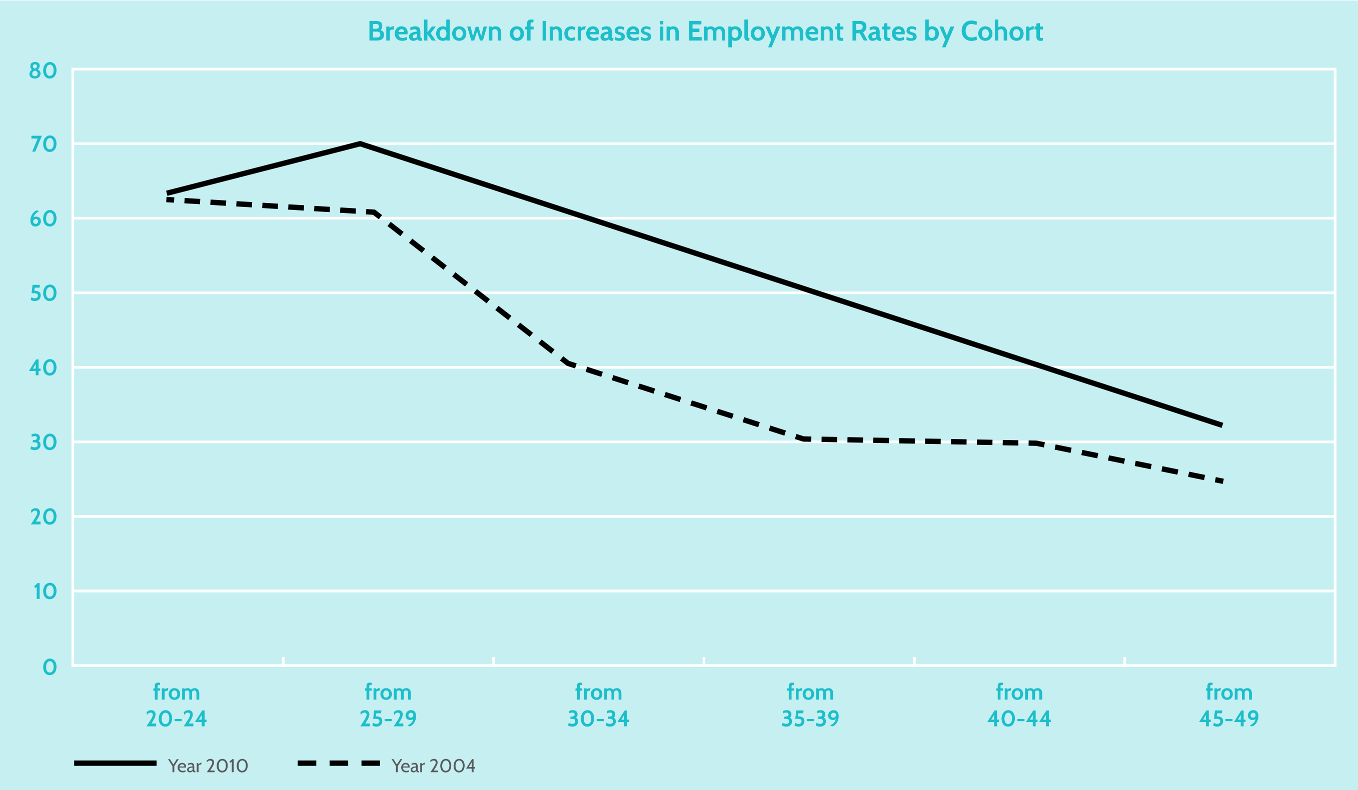

Chart 4.2

The lower female participation rate in Malta compared to other Mediterranean countries exhibiting rather similar cultural characteristics is worth investigating. It presents both a major policy challenge and an opportunity to exploit an under-utilised economic resource. As outlined in past pre-budget documents higher female employment is necessary in order to improve the living standards of Maltese households. The better utilisation of female human resources could also mitigate part of the pension sustainability challenges over the short to medium term. Moreover, better utilisation of labour resources could go a long way in addressing the inherent imbalances in the economy which are amply documented in this pre-budget document.

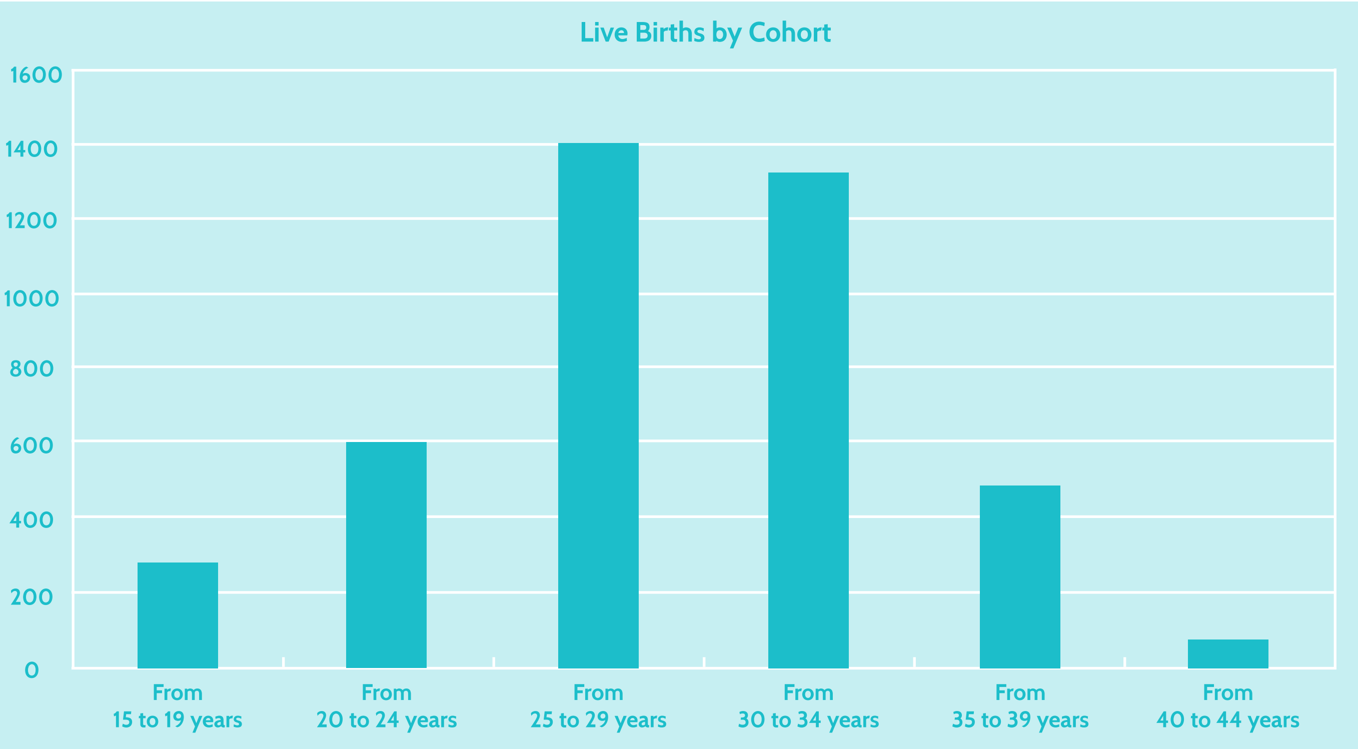

Chart 4.3

4.2 Investing in People

Economic and social growth implies an increased investment in human resources, and a strategic approach towards maximising the skills of individuals. At a time when societies are undergoing a number of challenges due to the economic turmoil experienced on a global level, sound national policies, which focus on the needs of the individuals and the industry, are decisive. It is for this reason that Government is determined to continue to strengthen its investment in the economy, by adopting an approach which puts the needs of the human capital and the economy at the forefront of its actions.

Endowing citizens with opportunities to access the labour market and upgrading their skills through training and education prospects is a priority which this Government has focused on, notwithstanding the difficulties faced by the economy in the last years. Government believes that a sound economy needs a dynamic workforce which can adapt to changes. For this to be possible, national action plans had to respond in a flexible way to the identified needs of the formal economy.

Through the EU 2020 Strategy and the National Reform Programme emanating from it, Member States have made a commitment to work towards ensuring that labour markets are competitive, sustainable and inclusive, and that they are centred on the abilities of the individuals. The progress recorded by Malta to this effect is considerable. Malta registered an overall 2.2% employment growth rate in 2010 when compared to the previous year, whereas the average employment growth over the same period in the EU27 was -0.5% . The unemployment rate decreased from 7.2% in April 2010 to 6.2% in April 2011, while the EU27 unemployment rate stood at 9.4%.

Government's employment policy aims at increasing employability prospects, as well as the incentive to work in the formal economy. Through this framework, Government is taking active steps to ensure that an adequate environment is created for people to be active in the labour market. The concepts of flexicurity, equal opportunities, and making work pay, which are well ingrained in Malta's employment strategy, are to be further developed in the coming years, through concrete measures which complement the existing ones. Moreover, Government is committed to continue to invest in measures which promote the reconciliation of professional and family life. It is recognised that incentives to employment should go hand in hand with family needs. Moreover, Government is determined to continue to encourage workers and employers to acquire new competencies, and to upgrade their skills as is required in dynamic and diverse societies.

The NRP presents a number of tangible measures and initiatives aimed at promoting smart, sustainable and inclusive growth. The Programme aims to raise labour productivity by focusing on education, investment, research and development, and improving market functioning.

The NRP identifies a number of bottlenecks, focusing on productivity and on structural impediments to growth, and which need to be addressed:

1. Ensuring the Long-Term Sustainability of Public Finances in View of Ageing of Population;
2. Ensuring that Productivity Growth Underlines Wage Developments to Safeguard Competitiveness;
3. A Further Move to Higher Value-Added Activities by Raising Investment in New Areas of Growth;
4. Ensuring Better Utilisation of the Economy's Labour Potential, in particular that of
5. Women and Older Workers, and Improving the Skills Base of Labour Force; and
6. Addressing the Weaknesses in the Business Environment and Enhancing Competition.

[2] Eurostat, 2011. Employment growth and activity branches - Annual averages
[3] Eurostat, 2011. Euro area unemployment rate at 9.9%. 76/2011 - 31 May 2011

4.2.1 Key Measures to Reach the National Targets

The National Reform Programme has set a number of measures targeted to reach the National Targets.

Malta has set its employment rate target at 62.9% by 2020 which implies that there will be an annual increase of 0.26% in female participation for women in the 20-64 age bracket between 2009 and 2020. Their employment rate will increase by 2.9%, i.e. from 39.8% in 2009 to 42.7% by 2020. An employment growth of 2.3% per annum for women in the 35-64 age bracket is required resulting in 0.7% annual increase in employment rate of 7.7% absolute increase over 11 years, i.e. from 27.2% in 2009 to 34.9% by 2020.

Achieving an employment rate of 62.9% by 2020 implies an increase of 4.5% over the projected rate for 2010. The targeted increase of 4.5% is almost three times more than the increase Malta achieved between 2000 and 2008. Malta recognises that these are ambitious targets given its socio-cultural factors. Yet, it also considers them as realistic and achievable targets and Government is investing and will continue to invest heavily to reach these targets.

Malta will be guided by five priorities that address the bottlenecks being faced and which are aimed at increasing the aggregate employment rate:

- Increasing the participation of women in the labour market;
- Increasing the employment rate of older workers;
- Activating vulnerable groups;
- Improving the employability of the workforce; and
- Maintaining efforts to tackle undeclared work.

4.3 Active Labour Market Policies

Active labour market policies have a prominent role to play in addressing the financial challenges emanating from the economic crisis, as well as in dealing with the effects of globalisation, demographic, technological, and environmental changes. Such transitions necessitate an enhanced investment in skills matched with social demands. Opportunities for access into the labour market and for the acquisition of key competencies are necessary for employment and inclusive growth. This Government believes that the effects reaped from investing in the potential of individuals are directly linked to the nation's competitiveness.

The National Reform Programme focuses on active labour market policies as central components to reach the EU headline targets set to increase employment and reduce the risk of poverty. It is acknowledged that society's development depends on the well-being of the individual members, as well as on the economy's state of being. This relationship entails that governments across nations focus their resources on policies which create incentives for active participation, and which break the passive spells emanating from unemployment and inactivity. Employment creation for a diverse workforce necessitates a labour market which recognises the need for improved competencies, and the importance of life-long learning, as well as equal opportunities, and support mechanisms. Such approach denotes a dynamic workforce which is adept to transitions.

The link between education and work is crucial in labour market policies particularly in two dimensions. First, the State is to ensure that individuals are well-prepared for the transition from education to work. This necessitates a continuing commitment of the education system to work in close collaboration with the needs of the market, as well as a sound preparation for students to the skills needed at the workplace. Secondly, work structures are to embrace the concept of life-long learning at all levels of the employment sector. It is Government's aim to encourage provision of learning and training embedded in a work context. Skills improvement is essential both for the employee and for the economic industry. The State, in close collaboration with the social partners, the local community and the labour market is to invest in workers and to continue incentivising work, in order to attract and retain employees.

In this context, Government is analysing a number of proposals, some of which include:

- the introduction of a pilot project involving a number of job creating and sheltered work ventures for persons with disability;
- the introduction of a scheme for unemployed 21 to 29 year olds which focuses on their respective skills and the labour market opportunities;
- the revision of the present Community Work Scheme aiming to include more people, and to ensure that the needs and difficulties experienced during the first phase of the project are met;
- the continued training of low-skilled employees in various sectors, so that they improve their chances of upward job mobility;
- the introduction of more initiatives to encourage more individuals of retirement age to remain active in the labour market;
- the continuation of apprenticeships and training programmes which are seen as a direct investment in the human capital and in the needs of the economy; and
- further investing in equal opportunities in the workplace between men and women.

4.4 Balance between Family and Work

Employment patterns, family structures and demographic trends necessitate a concrete and coherent framework establishing initiatives with the aim of reconciling work and family life. It is acknowledged that within societies, achieving a better balance between careers responsibilities and familial duties is a central theme for a range of other inherent social issues.

Malta's female employment rate has been steadfastly growing in the past years. Such changes in the composition of the workforce, as well as the symmetrical roles being undertaken in the distribution of caring of offspring, is leading to a more deserved attention on the commitment to increase support to both men and women within work and family life. Family-friendly measures have thus become an instrument of family and employment policies. Government has introduced a number of measures in the Public Sector along the years, aiming at the reconciliation of family and work. Between 2006 and the first quarter of 2010, the number of persons in the public sector, who have availed from such services more than doubled, from 1,432 to 3,079. Moreover, Government's investment in childcare centres and the provision of after-school programmes, as well as fiscal incentives, with over 7,000 mothers benefitting from such initiative have been major contributors in ensuring that a balance between work and family is found.

In this respect, affordable, accessible and adequate quality child-care centres are crucial for the reconciliation between family and work. The positive outcomes yielded from the investment in child-care centres are two-fold:

- they are a means which allows parents to be involved in active employment, whilst their children are taken care of by professional staff; and
- they are central for the notion of the child's development in the early years as they are founded on the notion of educare.

Government's plan is to further increase the provision of child-care through the availability of more centres around Malta and Gozo. Currently there are fourteen child care centres which are operated by Government. It is projected that between the period of 2011-2013 at least another five centres are established.

Further to this, the programme Klabb 3-16 is presently offering after-school hours care services for children between 3 and 16 years of age, who attend State, Church or Independent schools. This service bridges the gap between the time when school finishes to the time when parents finish work. The service also provides care during out of school holidays. Children participating in this programme are given appropriate adult supervision, and are provided with a planned programme of activities which involves homework, play, and participation in organised activities. Currently, Government operates three centres in Birkirkara, Mosta and Fgura. To cater for needs of the families across different localities, it is acknowledged that another nine centres are required.

It is also being recommended that employers in private companies are encouraged to develop more family-friendly measures. The Employment and Training Corporation will be providing audits to companies, guiding and counselling them on the measures which can be adopted in their workplace, to find reconciliation between family and work. Participating companies who after such exercise prove to be implementing good practices related to family-friendliness will be accredited with a quality label, and will be given awards for the introduction of such arrangements.

Chapter 5

Developing Malta's Human Resource Potential through Education and Training

5.1 Introduction

Malta's policies in education and training are centred around two crucial targets, those of reducing early school-leaving and increasing tertiary education attainment. These are part of Malta's vision to develop a knowledge-based and creative economy built on developing the high potential of Malta's human capital.

Recent trends show vast improvements in these two areas. Throughout the period 2000-2008, from amongst the EU-27 Member States, Malta registered the largest decrease in percentage of early school leavers between the age of 18 to 24, and the largest increase in the tertiary educational attainment of 30-34 year olds. Related trends also show the following:

- an increase in 16-year olds sitting for SEC (Secondary Education Certificate) examinations and an increase in their success rate;
- an increase in 18-year olds sitting for Matriculation Certification examinations and an increase in their success rate; and
- an increase in the participation rate of 17-year olds participating in post-secondary education, reaching a record level of 73% in 2010.

The progress achieved over the period 2000-2010 is attributed to a number of factors which the Government will keep building up in the coming years.

5.2 Compulsory Education

Education and lifelong learning are the best path to ensure a better quality of life. Government is investing and will continue to invest to ensure quality education for all. Education is essential for our children and young people but also important for all our citizens. Providing the best education in our country is investing in our human resource which is the pride of our nation. Expanding the potential of our human resource will increase investment, growth, attractiveness, competitiveness and efficiency. Through various learning experiences, Government wants all citizens to attain more knowledge and better skills to improve the quality of jobs and the quality of life.

Opportunities in education lead to better employment opportunities and enhances the social cohesion of all people whatever their age, gender, background or status. People have different ways of learning and creating opportunities at every level facilitates how each person can develop their knowledge and skills to good of society. Learning opportunities promote social inclusion for those most in need and can lead to further enrichment of our society.

5.2.1 Starting Off

It is being proposed to study further ways of assistance and support for families to a good start for their children, which is crucial. Evidence affirms the importance of the first years of life for the developing child. Everyone has an important role to play – parents, grandparents, relatives, schools, communities, professionals, businesses – by working together we can help our children to grow up healthily, creatively and happily. Government has already taken various measures and projects to provide for a vibrant start for young children. *Homestart, Smartkids, The Early Intervention Service, Parentcraft,* and *Programm Ulied Darna* are among the various services which address the needs of families with pre-school age children.

The *Schoolstart* project, which is expected to be introduced for the scholastic year 2012/2013, will continue to add value to families and their children in achieving the aims of the new curriculum. Government has lowered the age of entry to kindergarten class to two years nine months and, for first time the review of the curriculum includes the early years. Children from a young age are encouraged to use Information Technology. Computers have been introduced in every kindergarten classroom and also in government operated child care centres. It is planned that interactive whiteboards will be introduced from the next scholastic year.

It is also being proposed to extend schools to provide a wider access to activities and interventions that children need, and which is important in achieving a more holistic approach to the education of our children. The Colleges and schools are offering various extended opportunities such as sports, arts, music, drama, scouts and girl guides, breakfast clubs, homework clubs, and parenting programmes. These activities can boost achievement and help children and young people to be successful at school.

5.2.2 Curriculum Review

An essential part of the educational reform which aims to ensure that all children succeed is the curriculum review. Improving the quality of life, attaining employability skills, and lifelong learning are at the centre of the new draft National Curriculum Framework.

5.2.3 Vocational Subjects

The new National Curriculum Framework proposes a wider spectrum of educational opportunities to cater for the interests and aptitudes of all students in compulsory education. In order to address these interests, the National Curriculum Framework aims at introducing vocational subjects as options in Form 3. The vocational option envisages the adoption of innovative learning/teaching strategies assessed in an ongoing manner, predominantly through coursework. These work-related subjects include underpinning skills and knowledge as well as practical competence.

5.2.4 E-Learning

As from the next scholastic year, it is planned that every classroom in state schools will be equipped with an interactive whiteboard with a total investment of €3.3 million through an EU funded project under European Regional Development Fund. Also, from 2012, a LAN network will be installed and upgraded for the introduction of the eLearning Solution in Primary and Secondary schools with an investment of €8 million.

5.2.5 Investing in the Infrastructure

Government has continued to invest in the building of new schools and in the upgrading of our existing schools through refurbishment works. New schools have been opened in Kirkop, Verdala, Handaq, Gozo and Pembroke with state of the art facilities. Government is committed to continues to invest in new schools by building a new school every year and at the same time continue with its refurbishment programme of other schools. This year, the Boys' Secondary School in Mosta will be completed. Works are underway in the first girls' secondary school in St. Ignatius College, Handaq. This is scheduled to open in 2012. Plans are being drawn up for St. Benedict's Girls' Secondary School in Kirkop to open in 2013. The Foundation for Tomorrow Schools is committed to continue Government's plan to open other new schools in Paola and Hamrun and build an extension to the San Gwann Primary School.

5.3 Lifelong Learning

Lifelong learning has been at the core of national policy for the past years. It is recognised that comprehensive and lifelong education policies are directly linked with employment opportunities and the formal economy. Educational attainment and continuous training are two elements that are fundamental for the active participation of people. Statistics indicate that higher education reduces the risks of unemployment. Malta is committed to continue investing in structured learning with the objective of promoting increased competencies and opportunities for employability in later years in life through the adequate supply of skills to match demand in the labour market, by means of a combination of key competences acquired through basic education and second-chance opportunities.

Government has so far targeted its efforts in encouraging more adults to persue their education. This has attracted 7,258 adults in 2008, and increased to 9,932 adults in October 2008. 66% of thes were females. Although many attend such courses for personal fulfilment, some of these courses are serving as their second chance for education. A number of adults are thus attaining the entry qualifications to enrol in higher education institutions, thus increasing the national share of 30-34 year olds with tertiary educational attainment.

In order to enhance Lifelong Learning, a wider and more structured adult learning network was created in the community with the direct involvement of the Local Councils.

5.3.1 Lifelong Learning Strategy

Government is working on the publication of a framework of the Lifelong Learning Strategy for consultation. The Strategy should set a number of targets to ensure that our country becomes a centre of excellence as defined in Malta's Vision for 2015.

5.3.2 Improving the Quality of Adult Learning

In line with the EU Action Plan on Adult Learning, tailor-made responses to the individual needs to reduce the chances of poverty and social exclusion among marginalised groups and people with intellectual disability will be created. In this regard, the Directorate for Lifelong Learning, in collaboration with a number of NGOs, embarked on a number of projects to address this challenge. One of the projects being proposed to be developed during 2012 is with persons with intellectual disability.

5.3.3 Lifelong Learning Guidance and Counselling

Guidance and counselling have been in place within the compulsory educational sector as well as in such institutions as the University and MCAST. Efforts at providing a service with regard to the educational and training needs of adults have been made by the ETC and MCAST. This type of professional service is not widespread throughout the various sectors of adult learning in Malta and Gozo and no structure exists for such an important provision. Since the issue of the role of lifelong learning guidance in supporting adults is becoming crucial, it is the intention of Government to work towards addressing this gap.

5.4 Further and Higher Education

Over the past decade, a number of developments have taken place in higher education.

These developments include the establishment of the Malta College of Arts Science and Technology (MCAST) and the general expansion in the provision of vocational and professional education and training at all levels of education.

Increased investment in local infrastructure and education and research programmes, as well as opportunities for individuals to pursue their studies further locally and abroad, contributed to an increase in educational attainment at the level of tertiary education. The Strategic Educational Pathways Scholarships (STEPS) and the Malta Government Scholarships Scheme (MGSS) have vastly increased opportunities for students who wish to further their studies after obtaining their first degree.

With the establishment of the Malta Qualifications Recognition Information Centre (MQRIC), the Malta Qualifications Council (MQC) and the National Commission for Higher Education, the qualifications sector, as well as the further and higher sector, including vocational education and training, have benefitted from enhanced and research policy direction and concerted efforts across all areas with a view to the further strategic development of these areas.

In the development of these areas, Government has implemented a national qualifications framework for Malta, which is crucial for the mutual recognition qualifications obtained locally and abroad within and beyond EU borders. It has also exploited, multiplied and developed the use of vocational training as an important vehicle in attracting more students to continue their education beyond school-leaving age and to develop their true employment potential. It has higher education research and policy to professional level, with a view to enhancing the statistics base of this sector and to informing policy decisions in a technical and scientific manner.

In the coming years, Government will be intensifying its efforts to consolidate these achievements and to further invest and strengthen Malta's further and higher education provision and to widen participation. Government will also use the expertise that it has built in this area to further regulate the sector with a view to fostering both public and private provision of further and higher education, to certify all types of learning that take place within further and higher education and to validate the knowledge, skills and competences that individuals are able to show that they possess, transforming these into qualifications for use within the labour market or for the purpose of further study.

Government efforts will be centred around the following proposals for the coming years:

- The consolidation the work of MQRIC, MQC and NCHE;
- The operation of a system for the licensing, accreditation and quality assurance of public and private providers of further and higher education;
- The development of a framework for the validation of non-formal and informal learning;
- The implementation of an updated version of the Malta Qualifications Framework;
- The adoption of an enhanced mechanism for the regulation of the teaching of English as a Foreign Language (EFL);
- The introduction of changes to the national examination system;
- The creation of a new legal framework for the Institute of Tourism Studies (ITS);
- The continued increase of the student population within MCAST;
- The focus on upgrading the facilities and infrastructure for students at the University of Malta;
- The expansion and increase in the number of types of courses offered to disabled students at post-secondary level;
- The provision of support to people with intellectual disability and other learning difficulties to access courses provided by entities such as the Foundation for Educational Services, the Employment and Training Corporation, and the Lifelong Learning Directorate; and
- The reduction of the gap in post-secondary provisions for students with individual educational needs in Gozo, especially those with intellectual disability who reached the end of their compulsory schooling and need further preparation in order to be able to benefit fully from vocational training.

The post-graduate programme of the ongoing Malta Government Scholarship Scheme and the ESF funded STEPS project (ongoing until 2013) have both yielded important results in enlarging the pool of Malta's researchers, especially in areas which have been identified as priority research areas in the 2007-2010 national R&I strategic plan.

It is planned that the schemes which are currently in place are to be expanded. These included:

- Post-doctoral opportunities undertaken both in Malta and abroad;
- More opportunities to scholars who are willing to use their capacity in Research and Development in high priority areas for our knowledge-based economy; and
- More opportunities for individuals undertaking lifelong learning or following programmes at postgraduate level in Malta or abroad on a full-time, part-time or distance learning basis.
- In pursuing with these scholarship schemes, Government intends to achieve the following objectives:
- A highly skilled workforce which is more flexible and better responds to threats in order to change them to new opportunities;
- The development of new academics and fields of study and research;
- The development of more research activity in growing or innovative fields of study; and
- Significant impact and social benefit of groundbreaking discoveries which lead to greater competiveness in a globalised world economy which is volatile.

Table 5.1 below shows the number of participants in each scholarship scheme for every year.

Table 5.1

Scheme	Level	2006	2007	2008	2009	2010	2011
Malta Government Scholarship Scheme - PG	Doctoral	13	13	13	32	32	
	Masters	20	33	25	28	32	
Strategic Educational Pathways Scholarships	Doctoral	-	-	-	36	39	12*
	Masters	-	-	-	142	182	87*
Malta Arts Scholarships	Masters	-	-	-	-	2	
	Under Graduate	-	-	-	-	11	
Malta Government Scholarshps Schme - UG	Under Graduate	-	25	169	122	136	

Scholarships awarded during 5th Call. Scholarships awarded for 6th Call which will be announced in September 2011, are not included.

5.5 Continued Investment in Youth

Our vision for youth is that young people become active citizens whilst being eager to succeed and live in solidarity with other members of the community. The goal of our mission is to improve our young people's quality of life by involving them more in the decision making process, providing access to opportunities and by giving them the necessary support to face the transition from adolescence to adulthood.

Government sees young people as partners in the development of our society. Whilst youth represent society's future they are also able to contribute towards the shaping of tomorrow's society through their current activity.

Government must ensure that young people are well prepared to face the responsibilities, opportunities and challenges in their, job, social and personal life, by assisting them with the tools and skills they need to succeed.

As a result of this, earlier this year, Government has set up *Aġenzija Żgħażagħ*. The agency will further develop and enhance youth initiatives and services and mainstream youth related issues so as to maximize the benefits for young people. It will enable further investment in resources and services for young people to support and encourage them to achieve their full potential both as individuals and citizens, and contribute to the development and well being of their communities and society in general.

Government will continue working with stakeholders in this sector and develop partnerships that promote the welfare of young people, conducting research related to this sector, supporting and promoting the work of local youth groups, providing a youth empowerment programme which increases the capacity of young people and develops a strategy for young peoples' involvement in decision making processes, and raising awareness about the role of youth work by promoting good practice.

- In this respect, it is being proposed to strengthen further the institutional capacity of *Aġenzija Żgħażagħ*, increase inter-agency coordination and collaboration, and address other youth issues relating to the promotion and support of youth initiatives.

Sustaining the Sport and Physical Activity

Government intends to continue sustaining sport and physical activity because it strongly believes that sports enhances one's personal development, sustains a physically and mentally healthy society, and contributes to the island's economy.

Hence, Government will continue to instigate a sports culture amongst the Maltese population, enhancing accessibility to all, irrespective of age, sex, social status and physical abilities. Government also believes that it should assist through the complete sport spectrum right from grassroot levels up to elite status levels where athletes are to be assisted in order to maximize their potential to the full.

In this context, Government will be focusing on strengthening the role of the *Kunsill Malti għall-iSport*, promoting sport through various sports programmes, investing in new sports facilities whilst improving the existing ones, enhancing assistance and incentive schemes to sports organisations, and maximising the use of the available resources and the creation of an economic niche around sport.

It is thus being proposed that a new Sports Policy is published. Further to this, following the launch of the Child Protection in Sports Guidelines earlier this year, sports registered organisations will be asked adhere to the guidelines and to follow, as much as possible, the best practices documented in the guidelines.

A National Anti-Doping Agency will soon be launched and will start promoting doping free sports as well as performing routine tests amongst athletes.

Government will also continue to encourage the introduction of more courses with the aim of targeting the professional development of sport administrators, coaches and officials.

It is also being proposed that the Fundamental Basic Sports Skills Programme, which provides compulsory gymnastics and athletics for Year 3 and 4 State Primary School pupils in 5 out of 9 colleges in Malta and swimming for all Year 5 pupils be extended to cover all state-run Primary Schools.

Chapter 6

Social Inclusion

6.1 Strengthening Our Communities

Government recognises that the family and the social dimensions characterising society are the foundations for a strong community. Fostering a caring society which values inclusion, solidarity and social equity has been entrenched in Malta's development of the social welfare model. It is Government's mission to ensure that all people, notwithstanding their different characteristics, succeed and are endowed with the opportunities needed to have a good quality of life.

In considering the proposals to safeguard families and strengthen communities, attention is to be given to the economic dimension witnessed on a multi-national scale. Government is committed to continue investing in people. This entails the creation of more opportunities, an increased thrust in the potential of individuals, and a sound framework which assists families and those individuals who are experiencing situations of vulnerability.

The demographic changes, as well as the technological advances and the effects of globalisation, are resulting in transitional changes which families and society at large are subjected to. Population ageing, an increase in life expectancy, a decline in fertility rates, postponement of marriages, technological progress and different expectations are producing significant social and economic implications. As a result, societies are facing changes in family structures with the gender roles becoming more symmetrical, as well as changing social realities, such as the impact of consumerism and cultural diversity, which communities must adhere to and address.

Social Protection

It is Government's mission to ensure that social solidarity is maintained and that a social safety-net is provided for those who are in need. The welfare of the individual and the well-being of society are at the forefront of Government's social policy. Government is thus committed to continue to provide an equitable safety net which is centred on inclusion and cohesion, and which minimises the risks of poverty and social exclusion. For this to be possible, it is recognised that active inclusion policies, which combine adequate and sustainable social protection systems, with access to inclusive labour markets and quality social services are a necessity for society.

Societies around Europe are undergoing profound demographic changes, generating pressure on institutions to address such transitions, as well as effectively adapt benefits and policies according to such changing demands, through adequate structures and support mechanisms. Government is thus committed to ensure that social security provisions enhance social protection, as well as guarantee adequate life-long opportunities for the development of the individual. The social protection provisions will continue to complement other support systems, as well as address the priority needs materialising from different social patterns, social structures and demographic realities. In safeguarding the interests of those families whose situation puts them at risk, and in ensuring that vulnerable persons are given the support needed, the social welfare system shall continue to strengthen its protective role through provisions which encourage a contributory framework, rather than a culture based on dependency, through the social and economic integration of beneficiaries. This is in line with the belief that given the appropriate conditions, every person is equipped with the potential to develop the talents and further the opportunities for development.

In this context, Government intends to continue working on the proposed comprehensive pension reform programme, aiming at its gradual and successful implementation for the benefit of individuals and society.

Government is also looking at how social obligations can be strengthened to sustain further the respective beneficiaries. Particularly, Government is looking at implementing once more the measure to waive off part of the service pension from the calculation of the social security pension.

Further to this, Government is also looking at a number of other social proposals, including:

- the pension for prisoners with the aim of addressing the percentage rate of entitlement of spouses to a portion of their spouses' pension;
- extending the entitlement of the widows' pension with dependent children over 21 years of age, where the dependant children are either still studying in a recognised educational institution, or unemployed and have never worked before, and are therefore not entitled in their own right to any social benefits;
- a reform of the non-contributory disability pension system to address those some forms of disability which are not provided for in this benefit, and to encourage the independence of its beneficiaries;
- strengthening social security entitlements to single parents with the aim of ensuring that lone parents whose youngest child is aged 7 years or over are moved from income support to a trainee's allowance, where these persons are provided with training opportunities to enhance their skills;
- encouraging the care of dependants needing full-time assistance by their families for further effective support and to enable these families to cope with informal care demands; and
- review of the supplementary assistance mechanism for the 65+ where the household income falls between the national median equivalised income levels.

Social Cohesion

Social cohesion and formation entails that individuals are included in all spheres of social life. For this to be possible, it is necessary that the adequate background is built for families and individuals to actively participate in society. This means that individuals, who for some reason or other are marginalised from mainstream society, are to be helped to be reintegrated. It is for this reason that Government is committed to strengthen the support structures and the accessibility to such services.

It is acknowledged that social welfare entities play a crucial role in ensuring that people do not drop out from the social system. Through empowerment strategies and effective support provisions, these entities aim to facilitate people's reintegration in society. Government is thus committed to continue investing in social welfare entities and in more comprehensive policies which mainstream the well-being of the individual and the family. This also entails investing more in early intervention and preventive services. Government is also committed to continue to uphold a culture which is centred on the family as the microcosm of society. For this to be possible, it is to be ensured that the variables which are hindering the stability of the family are coherently understood and strategically addressed through concrete measures. Government's aim is to continue to strengthen the family, irrespective of its financial and social status. Whereas the well-being of the family will continue to be a horizontal priority, targeted and specialist services will continue to be offered to those families who are most in need.

In this respect, Government is studying how we can enhance our support to families:

- the Child-in-Care Benefit with the aim of supporting further Looked After Children Services needs;
- the Embark for Life project which focuses on helping young people between 16 and 24 years of age to develop social and other skills, and to find employment;
- After Care Services for Looked After Children with the aim of taking the role of a corporate parent for these young adults;
- increase in opportunities for the socially disadvantaged to integrate better with other children with the aim that these children also succeed in life; and
- investment in the development of the provision of services for children who are not living with their own families

Support Mechanisms for Persons with Disability

Ensuring equity and a better quality of life for persons with disability is a priority which Government is determined to deliver. The inclusion of persons with disability is at the forefront of the national agenda. It is recognised that the fundamental concepts of equity and equal opportunities should be the guiding principles for all policies across all sectors, and should be reflected in everyday life. It is, therefore, to be ensured that socio-economic welfare of persons with disability is safeguarded through concrete measures which focus on the ability of the individual.

The work done in the past years by the entities responsible for disability issues, by voluntary organisations and by the National Commission for Persons with Disability is to be acknowledged and highly praised. Their efforts in eliminating the barriers faced by persons with disability, as well as the support mechanisms they offer and the opportunities they seek to achieve for the advancement of persons with disability are reaping the desired results. It is acknowledged that much more needs to be done, but Government is convinced that the approach adopted is leading to positive outcomes. Moreover, it is to be ensured that parents and carers of persons with disability are given the required assistance and support needed. The work they do for the Maltese community is indispensable, and should thus be acknowledged.

In this context, Government will be looking at the following social obligations:

- services for disabled children at risk;
- day service for young adults to encourage them to move into mainstream further education or supported employment;
- investment in more individualised day services;
- expand further Sapport's services;
- support services for families of disabled people; and
- Disability-in-Care Benefit for families taking care of their offspring, who need full-time assistance because of their severe disability.

6.2 Housing

The opportunity to live in decent and affordable housing is a right which this Government upholds. As the mission of the Housing Authority states '*decent housing strengthens communities and provides a better setting in which to raise our children*'. The role of the Housing Authority is crucial in ensuring that individuals and families who are in need are supported through the various available schemes and initiatives to facilitate their access in the housing sector.

One of the primary obligations is the promotion of home ownership. In line with such obligation, Government assists and encourages people through different schemes to buy their own property. Such measures include subsidies, grants for restructuring or rehabilitation, and sale issues. Furthermore, the Housing Authority has rental stock for those individuals who for some reason or other cannot afford or choose not to buy a home. One of the priorities of the Housing Authority is the improvement of housing conditions in Malta. Conscious of the problems that exist, Government is committed to continue to work towards addressing the problems related to substandard housing. Moreover, the Housing Authority is also active in ensuring that accessibility barriers are eliminated from the dwellings and social housing property. Guaranteeing that homes are congruent with the needs of the individual is a priority which this Government is determined to achieve. The Housing Authority is actively promoting environmentally friendly buildings through more investment in energy saving and energy efficient measures. These priorities highlight Government's objectives in ensuring that people are given the necessary support to have adequate accommodation.

Conscious of the problems which still persist in this area, Government is committed to continue to invest in the housing sector through a number of initiatives which are crucial to meet the meet society's needs.

Housing Schemes

The Housing Authority has conducted a thorough exercise, where an analysis and evaluation of the existing schemes was prepared. In this respect, the Authority is working on proposals to better meet the demands of the clients requesting alternative accommodation or any other services. These proposed amendments are intended to increase social inclusion, and to assist families and persons who are in vulnerable circumstances.

Government is also considering new schemes, focusing on the priority needs of the individuals and families requiring their service, and the new socio-economic realities of the country. These include schemes that:

help the elderly and disabled vulnerable people carry out the necessary adaptation works to their residence to render it more accessible;

recognise tenants of Government owned property who can purchase the rented property at subsidies prices;

focus on assisting voluntary organisations who provide social welfare services and foster families whose role in society is instrumental for the well-being of children in care;

Chapter 7

Infrastructure, Transport and Communication

7.1 Introduction

The movement of goods, services and information is vital to the functioning of a modern economy. Over the past three years, Government has worked on projects which have led to tangible improvements in the quality of life. These include the reform of public transport and other transport sectors, rebuilding of roads (residential and arterial), public transport infrastructure, City Gate project, Baracca lift project, Cirkewwa Terminal, and Dock 1 Project in Cottonera.

Government is also working to reduce the digital gap, increase employability in ICT for young workers, and increase the range of government services available online.

7.2 Public Infrastructural Projects

According to the Stability Programme, General Government gross fixed capital formation is expected to increase from 2.1% of GDP in 2010 to 3.1% of GDP in 2011. This increase of around 1 percentage point of GDP will supplement private investment levels without undermining the fiscal consolidation targets. Although General Government gross fixed capital formation is expected to decline gradually to 2.6% of GDP by 2014, this is still higher than the 2009/10 ratios. In addition, other infrastructural projects will also contribute to the increase in investment activity. This increased investment expenditure will include major infrastructural projects such as the building of the extension of the power station, the inter-connector project between Malta and Sicily and the continued introduction of smart meters. Other increases relate to the environmental and resources sector including investment in renewable energy sources, waste, the management of water resources and water treatment and also in the maritime and ports sector. Some of these measures are included in the thematic aspects of the NRP. Whilst additional public investment by Government would be desirable in order to achieve higher growth targets and a faster convergence process, fiscal constraints limit the room for manoeuvre. In this context, the use of EU funds in both current and future Financial Perspectives, which will assist in addressing Malta's bottlenecks, will add value to both National and European level.

7.3 Capital Projects

7.3.1 Valletta Project

Our capital city is the country's gateway, and Government is committed to making it worthy of the title of 2018 European Cultural. Malta's primary urban area will be modern and accessible. Work on a new bus station (€3.5milllion) will be concluded this summer. A €3 million project will see the area from City Gate to the Grand Master's Palace transformed into a pedestrian zone. The whole City Gate Project (€80 million) is making rapid progress. Shops around Freedom Square and City Gate have been demolished, and works on the substructure have been completed while construction of superstructure should be completed by the year's end.

Parliament is Malta's highest institution. It deserves a building which is in keeping with its function. The new parliament building will provide modern facilities and much-needed space for our Members of Parliament, parliamentary committees and their staff. The space vacated at the Grand Master's Palace will be integrated into the existing museum complex, which includes the Armoury and State Rooms.

Other projects linked to Valletta include the Baracca Lift which will provide direct access from the Grand Harbour to Valletta's City Centre, and Dock No. 1 Project for stronger Cottonera Communities.

7.3.2 Cirkewwa Terminal

The link between Malta and Gozo needs an improvement in efficiency and security. A €12 million project to construct a new ferry terminal in Cirkewwa is being co-financed by the Maltese Government and the EU.

7.4 Transportation

Over the coming year, Government will pursue the improvement of Malta's public transport network. Our keywords are quality, efficiency and accessible pricing. Government provides €6.4 million in transport subsidies, mainly for children, students and the elderly. Thanks to the reforms undertaken, Malta finally has a modern public transport service committed to the highest standards.

7.4.1 Roads

Several residential and arterial roads are being built or rebuilt in 2011. 50 out of 202 roads have already been completed.

Work has started on four arterial roads forming part of the TEN-T Network with a total investment of €40 million. Government is also proposing the rebuilding in 2012 of 70 link roads which are usually too costly for Local Council budgets. Other major road projects make up an expenditure of €3.5 million. Government is also financing a €2 million project to resurface a number of streets in Valletta, including pedestrian areas.

7.4.2 Aviation and Maritime Registration

There is a focus on a growth strategy in ship and yacht registration, by concentrating on potential market niches, while increasing Malta's global market share for merchant shipping and super yachts and their related management companies.

Shipping is part of Malta's heritage and maritime industries have been an essential part of its economy for millennia. The country continues to serve as an important part of the Mediterranean hub and remains a top five flag for merchant shipping. In addition to its strong maritime presence, Malta also has developed a strong air service. With direct flights to most major cities in Europe as well as the Middle East and North Africa, it is centrally located for two of the fastest growing markets and is well established for connecting passengers to Europe.

As regards the future outlook, the focus is on a growth strategy in ship and yacht registration, by concentrating on potential market niches, while increasing Malta's global market share for merchant shipping and super yachts and their related management companies.

The other sub-sector where Malta has made important steps ahead is air transport. Outsourcing of key infrastructure has been completed (e.g. airport, air traffic management) to encourage private business to maximise further the use of the assets through increased volumes of passengers and cargo.

In this respect, Government intends to continue pursuing logistics opportunities in the oil and gas sector within the Mediterranean, encourage more young people to enter the maritime industry with more navigation and engineering courses, enhance direct yachting towards higher value added opportunities (super-yachts, ship building and modification), and market Malta's yachting services as a complete package (registration, finance, tax, ship modifications).

7.5 ICT Tools

Government is working to improve education and information sharing through ICT. The Malta Information Technology Authority is working on a number of initiatives and projects which include an advertising campaign to encourage further use of e-Government services, a virtual learning environment in primary and secondary schools, a centralised administrative system for patient records to enhance the service provided at Mater Dei and government health centres, improving efficiency, data security and access to information, and the implementation of electronic identity cards for every Maltese resident which will include information otherwise unavailable on a paper document.

The Malta Communications Authority is also working on a set of initiatives and projects in this area. The Authority is working with other entities to provide training in internet use for parents and their children. The project includes a hotline where harmful internet content can be reported. This will contribute to the EU's URL database, and also includes a call centre for technical assistance.

The MCA has also completed a two-year study on a national eCommerce trust mark. This is an excellence label for Maltese products or services sold online, which should raise their profile in the global online marketplace. MCA is also implementing recommendations on promoting foreign investment in Maltese eCommerce.

Other initiatives include a training scheme for SME owners, teaching administration and personnel management, and the provision of training courses for the elderly in computer and internet use.

Another important initiative includes a thorough feasibility study on a fibre optic network which was launched in 2010. If carried out, the installation of FFTH would enable broadband data transfer rates of up to 100 megabit per second. Government intends to finance this critical ICT infrastructure project through a private-public partnership.

Chapter 8

Greening Our Economy

8.1 Introduction

Economic growth is strongly correlated with environmental quality. Investing in our environment is therefore an investment in our economy. Some of an economy's resources are environmental in nature and most are linked or dependent on the quality of our environment. Yet our methods of production, consumption and distribution processes and decisions result in resource utilisation which depletes natural processes and limited resources. In this context, we need to manage human activities to ensure the sustainability of natural resources on which the availability of fresh water, food and good air quality, ecosystems and biodiversity depend and in turn upon which our quality of life depends. Therefore to achieve long term economic growth it is important to improve environmental quality which would result in tangible social and environmental benefits, improved wellbeing and social equity; reduced environmental risks and ecological scarcities.

The transition to a green economy, tapping into the environmental opportunities which also present economic opportunities, coupled with resource-efficiency is seen as the way to achieve such economic growth and create jobs that can withstand the economic and resource challenges facing us now and in the future.

This objective needs to be shared by the various players, including Government, regulatory and implementing entities, industry, environmental non-government organisations, tourists and residents of Malta as we all have a key role to play in realising the economic opportunities arising from our environment.

The move towards a green economy and increased resource efficiency requires a change in behaviour, in choices and in decisions relating to production, consumption and distribution systems. To address improvements in these systems we will employ market-based policy instruments to internalise environmental costs. Specifically for production systems we will primarily focus on enabling the private sector to embrace opportunities associated with the green economy and achieve resource-efficiency, and on promoting eco-innovation and green technologies, and incentivising the green jobs sector. In parallel, Government's consumption will become characterised by green public procurement whilst its policy-making and decisions will involve integrating environmental considerations into economic development planning. Throughout this transition, we will mobilise finance for the green economy.

8.2 Addressing Production, Consumption and Distribution Systems

8.2.1 Market-based Instruments

Malta has already taken several steps to use market-based instruments for this aim. Environment-related fiscal policy consists of two types, both of which have already been introduced in Malta. These may either be based on the 'polluter pays' principle, whereby producers or consumers are charged at the point where the pollution is caused, or 'user pays', through which the focus is on the use or extraction of natural resources. In the category of polluter-pays instruments, Malta has introduced an eco-contribution on a number of commodities (for instance plastic bags, batteries, television sets and white goods). In the category of 'user pays', Malta has reformed the vehicle registration and annual circulation tax to environmental performance, based primarily on carbon dioxide emissions for passenger cars and Euro standards for commercial vehicles. On the other hand, incentives direct behaviour towards positive environmental performance.

Further instruments are being considered. These include:

- A fiscal incentives scheme to promote restoration and maintenance of scheduled properties aimed at promoting ownership and restoration of scheduled buildings; and

- The provision of incentives for young people, associations and small scale creative industries (and which do not cause disturbance to residents) to move to urban cores, utilising existing buildings and investing in retrofitting for energy and water efficiency and reduced resource utilisation.

In order to assist with the transition to zero-carbon buildings, Government will also modify in the coming years the transaction tax on buildings depending on their energy-performance class. At this stage, this is being announced with a view to encouraging such transformation and retrofitting of buildings.

8.2.2 Enabling the Private Sector

There is much room for the private sector to take the initiative with regard to environmental improvements. For the transition to a green economy to take place, and also in view of increasing competitiveness and corporate social responsibility (CSR) as well as increased consumer awareness, it makes good business sense for enterprises to decrease the environmental consequences of their activities and take positive environmental initiatives. These activities may relate to investment, production, consumption and the placing on the market of products. An important and well recognised avenue through which the private sector can improve its environmental performance is through voluntary environmental schemes such as the MTA Accommodation Eco-Certification Scheme, the EU eco-label, EMAS and ISO targeted mainly at manufacturing and service industries as well as LEED certification system in the construction sector.

8.2.3 Resource Efficiency

Malta believes that the greatest potential for resource efficiency lies in those sectors which are most resource intensive and where therefore more efficient use can be visible and measured more easily. In the case of Malta, where raw materials are extremely limited, close to non-existent, stone is our natural resource, a resource which is utilised particularly for construction and restoration. The aim is to address the efficient use of resources in the construction sector, targeting particularly demonstration projects, stone recycling, and retro-fitting existing building to improve their energy and water efficiency. It is also essential to conserve our stone resource in view of future demand for restoration of properties.

Land use is a further resource which Malta, given its highly limited land area, values not only because it is used for food production, energy, housing, tourism and other activities, but also because it supports biodiversity and provides ecosystem services. In this regard Malta is also working to seek the best use of its land resource through a strategic plan for environment and development which balances spatial requirements.

8.2.4 Promoting Eco-innovation

Environmentally-friendly innovation (or eco-innovation) is considered to be a key driver of the green economy since it promotes economic growth, while limiting the burden on the environment. New environmental technologies offer businesses opportunities in national and international markets.

Government wants to encourage all sectors to take advantage of environmental innovation as a business opportunity. To this end, Government will promote a positive climate for eco-efficient innovations through various means. In order for new technologies to become viable, as well as to be adapted to the Maltese environment, a high level of research and development (R&D) and innovation is required.

To further support eco-innovation and green technologies, financial assistance for eco-innovative start-ups, businesses implementing eco-innovative solutions, and companies bringing the innovations to market will be formulated. Particular attention will be given to reduce water and/or energy consumption. In addition, where cleaner technology or production processes by larger enterprises are implemented well in advance of any obligation and whose existing processes account for a large share of pollution source/resource take-up and which results in a highly significant positive impact aiding Malta achieve its obligations on time. We will also explore the possibility of easing certain regulatory burdens on such eco-innovative or green firms whilst also facilitating start-ups and promoting best practices.

These initiatives will further contribute to incentivising the green jobs sector. An incubator for business start-ups in the environmental field will also be set up, which will dovetail with existing Malta Enterprise initiatives.

8.2.5 Greening Public Procurement – Leading by Example

Like any other economic activity, the public sector's purchasing decisions bear consequences on the environment. Public procurement, which represents a significant proportion of Malta's GDP, has its environmental footprint. The negative aspects of this footprint, such as those associated with materials and resources use and the resulting waste will be reduced, whilst the positive aspects will be promoted. This will be achieved with the help of Green Public Procurement (GPP), which is an instrument designed to promote environmentally-positive procurement practices. GPP targets have been established for eighteen product and service groups ranging from paper to vehicles and construction works. Government tenders for the procurement of these products and services will be required to incorporate environmental specifications and standards. The targets set out in the National GPP Action Plan are incremental, in order to avoid potential market distortions and to allow sufficient lead time for the market operators to adapt to the new government purchasing policy. GPP guidance and training will be provided to government procurers and suppliers.

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