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2017 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011

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EXECUTIVE SUMMARY

This report assesses Malta's economy in the light of the European Commission's Annual Growth Survey published on 16 November 2016. In the survey, the Commission calls on the EU Member States to redouble their efforts on the three elements of the virtuous triangle of economic policy — boosting investment, pursuing structural reforms and ensuring responsible fiscal policies. In so doing, EU Member States should focus on improving social fairness in order to deliver more inclusive growth.

Economic activity has eased somewhat, but remains buoyant. Real GDP growth was among the highest in the EU in 2014-15, reaching 7.9%, driven by strong net service exports, robust private consumption and a surge in investment, partly due to one-off factors. Growth eased somewhat in 2016, but is forecast to have remained strong at 4%. Positive developments have also been observed in competitiveness, the sustainability of the external position and private indebtedness. Moreover, employment growth is among the highest in the EU, in particular due to the services sector. The unemployment rate has dropped to a record low of below 5%. Net immigration flows helped to offset emerging skill gaps and labour shortages.

Public finances have also improved. Strong economic growth boosted tax revenues, in particular direct taxes. Some efforts on the expenditure side have also helped to reduce the structural budget deficit. The gross government debt is estimated to have dropped below 60% of GDP for the first time since 1998. Despite some progress, challenges concerning tax compliance remain.

Overall, limited progress has been made in addressing the 2016 country-specific recommendations. Measures have been taken to improve the sustainability of public finances, particularly regarding age-related budgetary costs. The full impact of these measures on public expenditure, however, is not yet certain. Some progress has also been made in strengthening labour supply by improving access to and participation in lifelong learning, with a focus on the low-skilled.

Regarding the progress in reaching the national targets under the Europe 2020 strategy, Malta has made progress towards its target on employment. However, there appears to remain a gap with respect to the targets for reducing greenhouse gases, raising R&D expenditure, increasing renewable energy provision, improving energy efficiency, reducing early school leaving, increasing the tertiary education attainment, and reducing poverty.

The main findings of the analysis in this report and the related policy challenges are as follows:

- **Despite the improvement in public finances, some risks to long-term sustainability remain.** The fiscal position has benefited from the strengthening of revenues. Corporate income taxes have a higher weight in tax revenues than in the rest of the EU, implying higher vulnerability to economic shocks In addition, in the medium to long-term horizon, international initiatives in the fight against tax avoidance could have an impact on tax revenues and the fiscal position of the country. On expenditure, sustainability challenges remain due to the projected increase in age-related budgetary costs, in particular in the healthcare and pension systems.

- **The financial system continues to face some structural challenges.** The system is characterised by a large number of foreign institutions attracted to Malta also by a favourable tax environment. The effective supervision of internationally-oriented business, however, creates some challenges. In the banking sector, asset quality and the flow of non-resident deposits may pose additional risks for profitability and liquidity management.

- **Positive labour market developments continue.** Employment growth is high, helping to reach the national Europe 2020 employment target, and pushing down unemployment to a record low level. Employment rates among women are increasing steadily, albeit from a low level. They remain low for older and low-skilled women, who constitute a substantial proportion of the labour force, but the employment rate for young women has risen above the EU average.

- **Poverty and social exclusion risks are declining but they remain substantial for children, the elderly and the low-skilled**. Malta is addressing the social challenges and strengthening policies for active inclusion. Income inequalities are rather stable and below the EU average thanks to low market inequalities and the possible redistributive impact of the tax and benefits system. The latter has improved as a result of recent reforms.

- **The skills supply does not yet adequately match labour market needs.** Access and participation in lifelong learning have generally improved, but labour market participation by the low-skilled remains low. While educational attainment is increasing, the rate of early school leaving remains high and basic skills attainment among young people is still weak. In response to tightness in the labour market, the reliance on foreign workers is increasing. This points to labour shortages across a broad spectrum of sectors and skills, possibly hindering investment.

- **Sustainability of productivity growth calls for a higher investment in both knowledge and intangible assets.** Major steps have been taken to strengthen the research and innovation system. Nevertheless, room for progress in filling knowledge and skill gaps is significant. In addition, infrastructure in general still faces challenges.

- **Financing conditions have improved, but access to appropriate financing instruments is needed to promote new investment**. The authorities have made available a broad range of mechanisms for alternative financing. Financing innovations in services and new business models require more diversified financing instruments and venture capital in particular. The Malta Development Bank is being set up to address these needs as well as long term investment projects.

- **Despite improvements, some inefficiencies in public administration remain.** The rolling out of e-government facilities and the reform of the planning authorisation process are expected to enable investment. Nevertheless, significant entry barriers for new firms remain. The regulatory environment for bankruptcy and a second chance for entrepreneurs in financial difficulties is still underdeveloped. Despite registering improvements in judicial system efficiency, there remains substantial room for improvement.

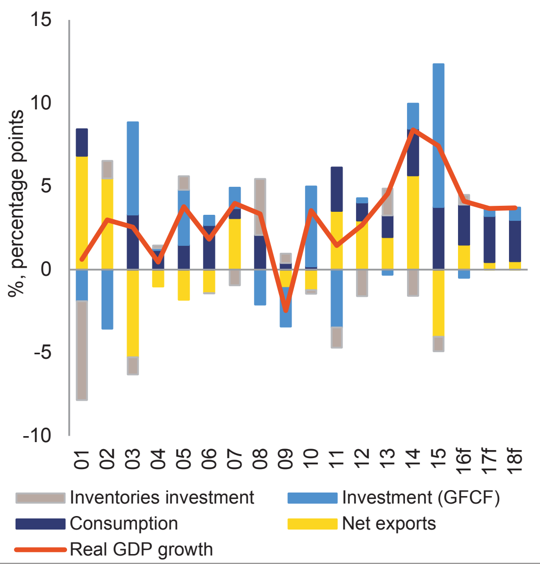
- **In view of natural resource constraints, current policies do not appear sufficient to achieve the goals related to green growth and a circular economy.** There are signs that the existing physical infrastructure may be insufficient to cope with the current pace of development. Despite improvements, the quality of road infrastructure remains a concern, leading to heavy congestion. This generates considerable costs to citizens' welfare, operating costs for businesses and environmental costs. The adoption of the National Transport Strategy with a 2050 horizon and the Operational Transport Master Plan 2025 is a welcome step to tackle the issues in transport. Similarly, in energy, the policy strategy has focused on securing supply and removing the dependence on imported oil, but the achievement of the national energy efficiency target remains a challenge. The promotion of renewable energy provides an opportunity to exploit domestic energy sources. Improving resource efficiency will be key for sustainable growth given the very limited available resources.

1. ECONOMIC SITUATION AND OUTLOOK

Economic growth and inflation

Malta experienced exceptional levels of economic growth in 2014 and 2015. Real GDP growth picked up in 2014-2015 reflecting also data revisions in net exports, in particular from the gaming sector (see also Box 1.1). The pace of growth is among the highest in the EU, exceeding significantly the pre-crisis period. The exceptional economic performance was driven by growing exports, supported by strong domestic demand. Investment activity was particularly dynamic, following a period of moderation that reflected the changing structure of the economy (see also Section 3.4). While its direct impact on GDP growth is limited due to its high import content, the increased capital stock also had a positive impact on the future growth outlook.

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

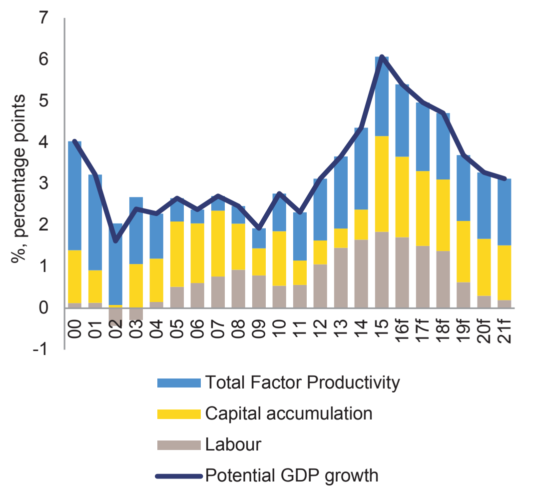


Source: European Commission

Growth has settled down, remaining buoyant in 2016. GDP growth is estimated to have moderated to 4.0 % in 2016 and to average 3.7 % in 2017-18. Private consumption is forecast to be the main driver of growth during the forecast horizon. Positive spillovers from ongoing structural reform, given adequate and timely implementation, on consumer confidence and investment could impact the medium-term outlook favourably. Given Malta's high trade openness, shocks to global trade could have a disproportionate impact on the domestic economy.

Over the medium-term, average potential real GDP growth is estimated to exceed pre-crisis performance. After the peak registered in 2014-2015, potential growth is projected to moderate, in line with real growth, and the output gap is forecast to close in 2018. Nevertheless, potential output growth is projected to average 4.0 % in 2017-2021, above the pre-crisis average due to gains in total factor productivity and substantial, albeit moderating, contributions from capital accumulation. These factors are estimated to more than offset a projected moderation in the growth of labour market participation.

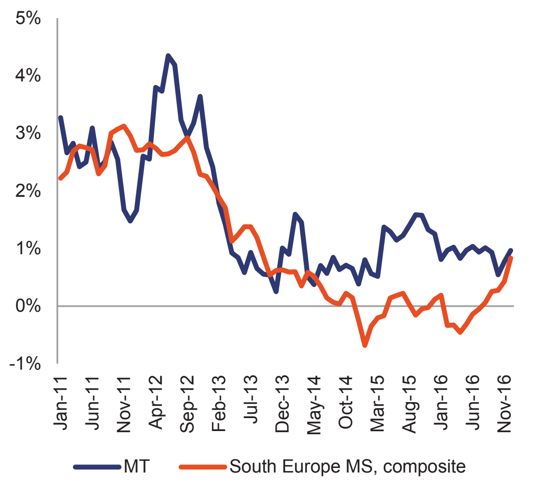
Graph 1.2: **Contributions to potential growth**



Source: European Commission

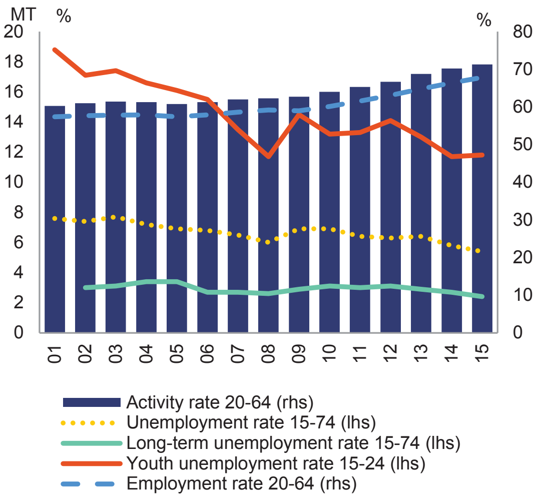
Price pressures are contained. Strong economic performance, leading to opening of the output gap after 2014, and low unemployment typically lead to upward pressure on prices through increasing aggregate demand. Indeed the Harmonised Index of Consumer Prices (HICP) in Malta has been higher than in neighbouring countries (see Graph 1.3). The inflation differential has been broad-based, reflecting more dynamic price developments in most categories. However, inflation pressures appear to have been broadly contained on the back of increasing productivity and low international commodity prices.

Graph 1.3: **Overall HICP inflation**



Source: European Commission

Graph 1.4: **Employment developments**



Source: European Commission

Labour Market

A number of positive labour market developments continued throughout 2016. In a context of sustained economic growth, the employment rate (20-64 years old) rose strongly to reach 69.8 % in Q3-2016, up by 1 pp. from Q3-2015. The unemployment rate decreased further to reach 4.6 % in Q4-2016, one of the lowest in the EU (see Graph 1.4) and the lowest level observed in Malta since accession to the EU. Strong employment growth reflects the creation of jobs, the take-up of economic opportunities by the growing working age population (partially due to migration inflows) and the rising labour force participation (especially for women, albeit from very low initial levels). However, the labour market is becoming increasingly tight, with rising incidence of both labour and skills shortages (see Section 3.3).

Social situation

Income inequality remains stable and below the EU average. The income of the richest 20 % of households was 4.2 times higher than that of the poorest 20 % in 2014, a ratio which is below the EU average of 5.2 ([1]). This is mainly thanks to a low level of market inequality — that is, inequality before taxes and benefits are taken into account. In 2014, market inequality was the fourth lowest in the EU. In recent years, the tax and benefits system helped to contain the increase in market inequality. In 2014, the disparity in gross hourly earnings between the top and the bottom decile ([2]) was one of the lowest in the EU-28. Nevertheless, in view of the fast economic growth there is a risk of future polarisation between high-skilled workers in well paid jobs and low-skilled work-poor households (see Section 3.3). At the same time, even if the impact of social transfers on the reduction of poverty was below the EU average in 2014, overall the system shows high coverage and adequacy of benefits and recent reforms are likely to further improve it. Latest available figures indicate that

([1]) As measured by the S80/S20 income quintile share ratio. This is the ratio of total income received by the 20 % of households with the highest income (top quintile) to that received by the 20 % of households with the lowest income (lowest quintile). Income must be understood as equivalised disposable income.

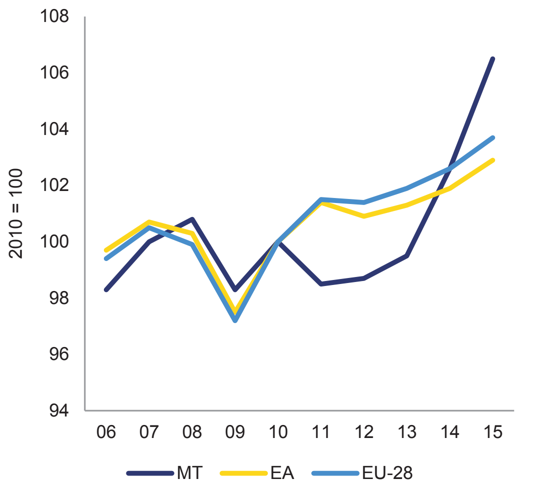
([2]) Measured by the D9/ D1 ratio, where D1 is the maximum gross hourly earnings received by the 10 % of employees earning least. D9 is the minimum gross hourly earnings received by the 10 % of employees earning most.

net wealth inequality (3) was within the range observed in other EU countries (ECB 2016).

Productivity and competitiveness

Recent data points to sharp improvement in labour productivity. As a result of the revised economic data, real labour productivity gains (4) have been among the highest in the EU since 2013. In the context of sustained job gains, this points to a positive productivity shock. This followed a period of muted productivity developments, reflecting the fact that employment dynamics tended to outpace economic growth (see Graph 1.5). Gains were registered across a range of sectors, mainly driven by gaming (see also Box 1.1) and IT in 2014, followed by construction and utilities in 2015.

Graph 1.5: **Real labour productivity per person**



Source: European Commission

The evolution of labour productivity has been closely linked to the structural transformation of the economy in recent years. The services sector has grown faster in Malta than in any other EU Member State between 2004 and 2014 (Central Bank of Malta, 2016a). Apparent labour productivity has grown thanks to sectors such as the 'Entertainment and recreational activities' and the 'Financial services sector'. The 'Professional, scientific and technical activities; administrative and support service activities' have more than doubled their contribution to gross value added in 2003-2016.

As a result, competitiveness developments have been favourable. As productivity outpaced wage dynamics, the nominal unit labour costs declined in 2014-15. The real effective exchange rate (5) depreciated in 2015, pointing to improvements in price competitiveness. The export market shares increased owing to the growing services sector. Nevertheless, goods exports continued to lose market shares.

The recent rapid growth of the service sector highlights the importance of reducing barriers to competition within the sector. The recent evaluation of restrictions in regulated professions shows that restriction levels in Malta exceed the EU average for four of the seven professions considered. In particular, this concerns civil engineers, architects, accountants and significantly so for tourist guides who have a reserved activity for "*guiding and interpreting the cultural heritage of Malta*". Barriers are slightly lower than average for lawyers and there are no restrictions for patent and real estate agents. (6)

Current account developments

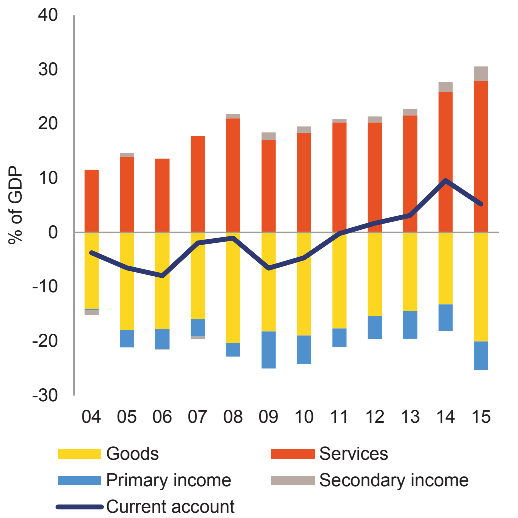
The current account balance reached a position of sizeable surplus. The external balance has been on an upward trend since 2009, driven by the improving balance in the trade of goods and services (see Graph 1.6). The surplus diminished somewhat in 2015 reflecting a surge in investment (see also Section 3.4). As the investment cycle normalises, the current account balance can be expected to improve. Indeed, in the first three quarters of 2016 the current account surplus increased in annual terms. This was mainly driven by the surplus in services, in particular transport business services and gaming, and lower imports of goods, due to moderating investment.

(3) Difference between total assets and total liabilities.
(4) Data presented using figures of persons employed. Source: European Commission

(5) Relative to the group of 37 industrialised countries; deflated with unit labour costs.
(6) The methodology applied is different to that used in the October 2015 evaluation presented in the Commission Staff Working Document accompanying the Single Market Strategy. This new methodology gives a more positive assessment of the situation in Malta. In October 2015, Malta was ranked third on the list of Member States with more severe restrictions in the four regulated professions considered at that time: architects, civil engineers, lawyers and accountants.

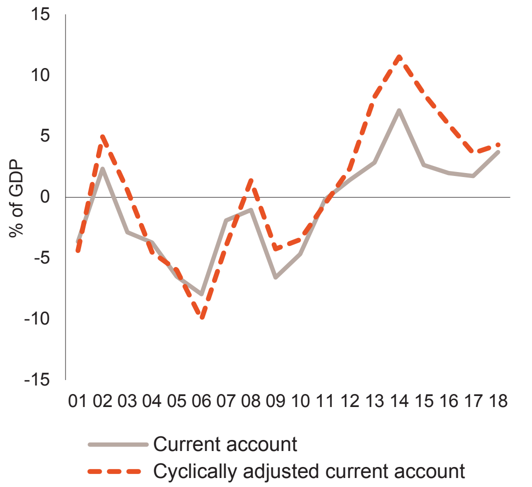
The improving external balance is due mainly to structural factors. The increasing importance of export-oriented and less capital-intensive services contributes to a lower import intensity of the economy, shifting the saving-investment balance (Central Bank of Malta, 2016d). As a result, most of the improvement in the external balance since 2009 has been structural (see Graph 1.7). Implementation of energy and transport reforms aimed at further lowering the energy intensity of the economy could contribute to further reducing the import-intensity of the economy and freeing up resources for investment (see also Section 3.5).

Graph 1.6: **Current account developments**



Source: European Commission

Graph 1.7: **Underlying current account balance**



Source: European Commission

Financial sector

Financial soundness indicators confirm the stability of the banking sector was preserved. The domestic banks increased their profitability during 2016, relative to a year ago. Nevertheless, return on equity came down substantially after the crisis, mainly due to the compressed interest rate margins. The domestic banking sector is well capitalised with an aggregate capital ratio (CET1) at around 13 % in September 2016 (see Table 1.1).

Table 1.1: **Financial soundness indicators, core domestic banks**

	2010	2015	2016q2
Non-performing loans (% of gross loans)	7.0	7.1	6.4
Non-performing loans, net of provisions, to capital	37.8	37.9	31.7
Tier 1 capital ratio	11.4	12.0	12.7
Return on equity	19.8	15.2	19.5

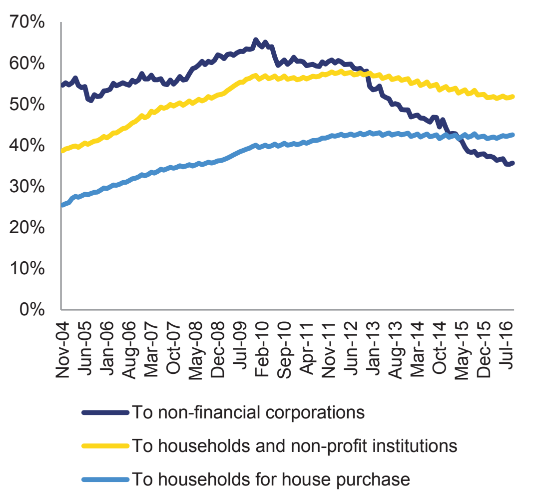
Source: Central Bank of Malta

Banks have significantly reduced lending to the corporate sector, but continue to offer credit to households. Overall, lending growth is weak with banks reducing their exposure to risky sectors, in particular the construction sector. This partly reflects recommendations by the supervisory authority given still elevated non-performing loans (NPLs) (see also Section 3.2). The total banks' exposure towards the construction sector has almost halved since 2010 and reduced to close to

10 % of their balance sheets. The exposure to government entities, both the Maltese sovereign and state-owned enterprises, has also diminished, also due to supervisory pressure. Mortgage lending is thus the main driver of lending growth and the banks project further increase in 2017 (see Graph 1.8).

Economic growth and the modest lending flows have contributed to resilience of private sector balance sheets. Both household and, in particular, corporate indebtedness declined, bringing the gross private sector debt down to 132 % of GDP in 2015. This is well below its peak of nearly 170 % of GDP in 2009. The net asset positions of both sectors, thus, improved, increasing their resilience to shocks. Nevertheless, the debt-to-equity ratio of non-financial corporations remains among the highest in the EU, indicating some vulnerability in case of unexpected developments.

Graph 1.8: **Trends in bank lending, % of GDP**

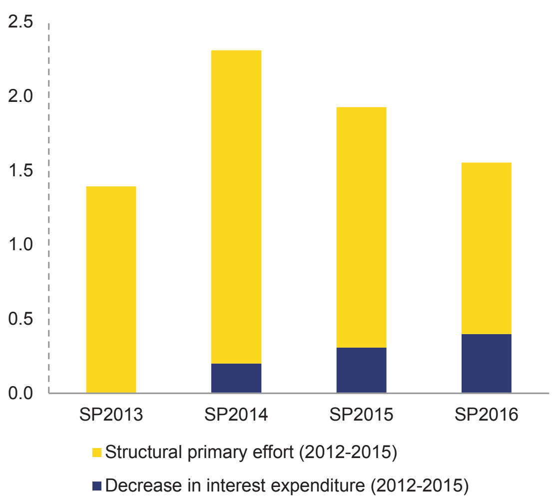


Source: Central Bank of Malta

Fiscal developments

The fiscal balance has improved in the recent years. After a decline in 2008-10, the primary balance has seen an upward trend, reaching 1.2 % of GDP in 2015 as rising primary revenue tended to outpace increases in spending. Thanks to both strengthened primary balances and GDP growth, public debt ratio has trended downward reaching 60.8 % of GDP in 2015. Based on the 2016 Stability Programme, interest rate savings are estimated to have contributed 0.4 % of GDP to the overall structural effort over 2012-2015 (see Graph 1.9). The decline in interest expenditure was generally offset by a decline in structural primary effort. In other words, the interest windfalls have been used to reduce the primary fiscal effort, rather than to accelerate the fiscal adjustment. At the same time, the maturity structure of government debt was lengthened during this period.

Graph 1.9: **Breakdown of improvement in structural balance, % of GDP**



Source: Stability programmes 2013-2016, European Commission calculations

Box 1.1: **The gaming sector**

Malta benefits from a first-mover advantage in the gaming sector. It was the first EU Member State to regulate i-gaming (2004). This attracted investors from several Member States, in particular from the UK, which helped local operators to develop skills and know-how in this innovative activity that expanded rapidly to reach an estimated turnover of 13.3 billion euro in 2015 in the EU.

Malta has developed a significant comparative advantage in gaming, especially in electronic or remote gaming. This advantage is based on the accumulated experience and expertise in this area as well as on an attractive regulatory and tax environment. The regulatory model in this area is relatively simple, effective and flexible. It has subsequently been replicated in other Member States. It is based on four different types of licenses for operators of online casino games, games of chance and games that use a random generator; the second licence type is for online sports and other forms of betting operators; licence class three is for advertisers and promotion companies

The geographic concentration of these activities can create important spillovers. First, know-how in this "greenfield" area was developing as the industry developed. Then, several IT companies producing hardware and software were also established to provide technical infrastructure and services. This created the right environment for further expansion of existing firms that attracted other newcomers.

Table 1:

Gaming sector indicators	**2014**	**2015**	**H12016**
Number of companies in operation	289	276	257
Gross value added (EUR mn)	795.3	899.6	502.7
% of total GVA	10.8%	11.1%	12.0%
Employment (end of period, full-time equivalent)	3,724	4707	6150
of which, land-based	16.7%	17.0%	13.9%
Gaming tax revenue (EUR mn)	52.6	55.1	28.0
% of total taxes on production and imports	4.8%	4.6%	4.9%

Source: Malta Gaming Authority

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

									forecast		
	2004-2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (y-o-y)	2.7	-2.5	3.5	1.4	2.7	4.6	8.4	7.4	4.0	3.7	3.7
Private consumption (y-o-y)	1.6	1.8	-0.2	3.2	-0.3	2.2	2.6	5.5	3.6	2.8	2.7
Public consumption (y-o-y)	3.3	-3.3	1.6	3.8	6.4	0.1	7.0	4.7	3.2	7.5	6.2
Gross fixed capital formation (y-o-y)	3.1	-11.8	26.4	-16.2	1.4	-1.7	8.8	49.8	-2.0	2.0	3.1
Exports of goods and services (y-o-y)	10.0	-0.4	6.9	1.8	7.2	1.0	5.1	4.3	1.5	3.7	3.9
Imports of goods and services (y-o-y)	10.2	0.3	7.6	-0.5	5.5	-0.2	1.5	7.7	0.5	3.6	3.7
Output gap	0.8	-2.2	-1.4	-2.3	-2.7	-1.8	2.0	3.3	1.9	0.7	-0.2
Potential growth (y-o-y)	2.5	1.9	2.8	2.3	3.1	3.7	4.4	6.1	5.4	5.0	4.7
Contribution to GDP growth:											
Domestic demand (y-o-y)	2.2	-1.9	5.0	-0.9	1.3	1.0	4.3	12.4	1.9	3.2	3.2
Inventories (y-o-y)	0.7	0.6	-0.2	-1.2	-1.6	1.6	-1.6	-0.9	0.6	0.0	0.0
Net exports (y-o-y)	-0.2	-1.1	-1.2	3.5	2.9	2.0	5.7	-4.0	1.5	0.5	0.5
Contribution to potential GDP growth:											
Total Labour (hours) (y-o-y)	0.6	0.8	0.5	0.6	1.1	1.5	1.7	1.8	1.7	1.5	1.4
Capital accumulation (y-o-y)	1.4	0.7	1.3	0.6	0.6	0.5	0.7	2.3	1.9	1.8	1.7
Total factor productivity (y-o-y)	0.6	0.5	0.9	1.2	1.5	1.7	2.0	1.9	1.7	1.7	1.6
Current account balance (% of GDP), balance of payments	-4.0	-6.6	-4.7	-0.2	1.7	2.8	6.7	5.2	.	.	.
Trade balance (% of GDP), balance of payments	-1.2	-1.2	-0.6	2.8	5.2	7.1	7.6	7.9	.	.	.
Terms of trade of goods and services (y-o-y)	0.0	-0.1	1.1	-0.1	-0.3	0.4	0.9	0.0	0.1	-0.1	0.2
Capital account balance (% of GDP)	1.9	1.2	2.0	1.2	1.9	1.7	1.7	1.8	.	.	.
Net international investment position (% of GDP)	25.4	12.6	12.1	6.3	19.6	20.4	39.6	49.9	.	.	.
Net marketable external debt (% of GDP) (1)	70.1	70.5	202.4	199.1	248.6	209.5	194.0	199.9	.	.	.
Gross marketable external debt (% of GDP) (1)	507.2	717.9	679.0	709.6	703.0	668.7	680.2	548.2	.	.	.
Export performance vs. advanced countries (% change over 5 years)	23.4	58.1	49.1	28.4	25.6	8.1	-10.4	0.01	.	.	.
Export market share, goods and services (y-o-y)	2.6	17.1	-10.8	-4.1	-1.2	0.4	-1.6	-2.5 c	.	.	.
Net FDI flows (% of GDP)	-121.4	-88.1	-68.3	-128.2	-126.0	-92.7	-78.9	-94.9	.	.	.
Savings rate of households (net saving as percentage of net disposable income)	.	.	.	.	.	.	.	.	.	.	.
Private credit flow, consolidated (% of GDP)	9.3	10.6	6.7	7.2	0.5	2.7	7.0	5.2	.	.	.
Private sector debt, consolidated (% of GDP)	140.1	167.6	162.0	159.4	154.6	147.3	140.9	132.1	.	.	.
of which household debt, consolidated (% of GDP)	48.3	59.9	59.0	59.9	60.3	59.1	57.6	55.5	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	91.8	107.7	103.0	99.5	94.3	88.2	83.3	76.6	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	.	.	.	.	.	.	.	.	.	.	.
Corporations, gross operating surplus (% of GDP)	24.4	24.3	25.5	.	.	.	.	.	.	.	.
Households, net lending (+) or net borrowing (-) (% of GDP)	.	.	.	.	.	.	.	.	.	.	.
Deflated house price index (y-o-y)	12.3	-6.2	-1.1	-3.5	0.5	-1.6	2.4	3.8	.	.	.
Residential investment (% of GDP)	6.6	4.3	3.4	3.4	3.0	2.6	2.5	3.2	.	.	.
GDP deflator (y-o-y)	2.5	2.7	3.8	2.1	2.0	1.9	1.9	2.2	1.7	2.1	2.4
Harmonised index of consumer prices (HICP, y-o-y)	2.6	1.8	2.0	2.5	3.2	1.0	0.8	1.2	0.9	1.6	1.8
Nominal compensation per employee (y-o-y)	3.3	3.0	2.0	3.3	3.6	2.0	1.4	3.8	3.0	2.9	2.8
Labour productivity (real, person employed, y-o-y)	1.1	-2.5	1.8	-1.5	0.2	0.8	3.1	3.8	.	.	.
Unit labour costs (ULC, whole economy, y-o-y)	2.2	5.6	0.2	4.8	3.4	1.2	-1.6	0.0	2.0	2.0	1.7
Real unit labour costs (y-o-y)	-0.3	2.8	-3.5	2.6	1.3	-0.7	-3.4	-2.1	0.3	-0.1	-0.6
Real effective exchange rate (ULC, y-o-y)	2.0	1.3	-3.1	4.2	-0.4	2.7	-1.9	-3.2	1.6	1.2	0.0
Real effective exchange rate (HICP, y-o-y)	1.6	0.8	-5.0	-0.8	-1.9	1.4	0.6	-2.2	1.6	-0.7	.
Tax rate for a single person earning the average wage (%)	17.7	16.5	16.9	18.1	19.2	19.8	19.1	19.2	.	.	.
Tax rate for a single person earning 50% of the average wage (%)	8.2*	7.7	8.4	9.4	9.8	10.2	9.8	10.0	.	.	.
Total Financial sector liabilities, non-consolidated (y-o-y)	41.5	3.8	12.9	11.0	5.8	1.9	6.4	0.7	.	.	.
Tier 1 ratio (%) (2)	.	14.1	13.3	13.3	12.7	12.5	12.1	15.5	.	.	.
Return on equity (%) (3)	.	11.7	12.1	5.8	14.1	9.8	4.6	9.3	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (4)	.	1.7	1.6	1.5	1.7	2.0	3.2	2.9	.	.	.
Unemployment rate	6.7	6.9	6.9	6.4	6.3	6.4	5.8	5.4	4.8	4.9	4.9
Long-term unemployment rate (% of active population)	3.0	2.9	3.1	3.0	3.1	2.9	2.7	2.4	.	.	.
Youth unemployment rate (% of active population in the same age group)	14.7	14.5	13.2	13.3	14.1	13.0	11.7	11.8	11.3	.	.
Activity rate (15-64 year-olds)	58.2	59.4	60.4	61.8	63.1	65.0	66.3	67.6	.	.	.
People at risk of poverty or social exclusion (% total population)	20.0	20.3	21.2	22.1	23.1	24.0	23.8	22.4	.	.	.
Persons living in households with very low work intensity (% of total population aged below 60)	9.4	9.2	9.2	8.9	9.0	9.0	9.8	9.2	.	.	.
General government balance (% of GDP)	-3.2	-3.3	-3.2	-2.6	-3.7	-2.6	-2.0	-1.3	-0.7	-0.6	-0.6
Tax-to-GDP ratio (%)	33.1	33.8	32.5	33.4	33.6	33.7	33.7	33.0	33.3	33.4	33.2
Structural budget balance (% of GDP)	.	.	-3.8	-2.0	-2.8	-1.9	-3.4	-2.9	-1.4	-0.7	-0.5
General government gross debt (% of GDP)	66.4	67.8	67.6	70.4	68.0	68.7	64.3	60.8	59.6	58.0	55.6

(1) Sum of portoflio debt instruments, other investment and reserve assets
(2,3) domestic banking groups and stand-alone banks.
(4) domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches.
(*) Indicates BPM5 and/or ESA95
Source: European Commission, ECB

2. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS

Progress with the implementation of the recommendations addressed to Malta in 2016([7]) has to be seen in a longer term perspective since the introduction of the European Semester in 2011.

Substantial progress has been made in recent years in diversifying the energy mix. The electricity interconnector with Italy was completed, providing a link with mainland Europe. In addition, there have been notable investments in upgrading the energy infrastructure and switching electricity production from oil to natural gas. Nevertheless, progress with improving energy efficiency, strengthening energy production from renewable sources and containing greenhouse gas emissions is still limited.

There has been some progress with improving the business environment. The authorities have launched a comprehensive judicial reform with a view to tackle the inefficiencies in the judicial system. Various initiatives have been put in place, including non-debt instruments, to improve access to finance for SMEs. Substantial improvements were achieved in the public procurement system.

Some progress was also achieved in improving human capital development. Some progress has been made in reducing early school leaving, incentivising the professional development of teachers. Policies to improve the work-life balance and make work pay have helped to lower the gender employment gap, although it remains substantial.

Overall, Malta has made limited ([8]) progress in addressing the 2016 country-specific recommendations. There has been limited progress in improving the sustainability of public finances. The authorities have made some progress in strengthening labour supply by improving access and participation in lifelong learning, with a focus on the low-skilled.

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

Box 2.1: **CSR implementation table**

	Overall assessment of progress with 2016 CSRs: Limited
CSR 1: *In view of the high risk of a significant deviation, achieve an annual fiscal adjustment of 0.6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017, by taking the necessary structural measures.* *Step up measures to ensure the long-term sustainability of public finances.*	**Limited progress** in ensuring the long-term sustainability of public finances.
CSR 2: *Take measures to strengthen labour supply, in particular through increased participation of low-skilled persons in lifelong learning.*	**Some progress** on increasing participation of low-skilled persons in lifelong learning.

Box 2.2: Contribution of the EU Budget to structural change

Malta is an important beneficiary of European Structural and Investment Funds (ESI Funds) with an allocation of up to EUR 828 million till 2020. This is equivalent to around 1.3% of GDP annually (over 2014-2017) and 28% of national public investment[1]. Out of the EU financing EUR 34 million is planned to be delivered via financial instruments, which is more than a three-fold increase compared to the 2007-13 period. Malta also contributes EUR 15 million to the SME initiative. By 31 December 2016, an estimated EUR 156 million, which represents about 19 % of the total allocation for ESI Funds, have already been allocated to concrete projects.

Financing under the European Fund for Strategic Investments, Horizon 2020, the Connecting Europe Facility and other directly managed EU funds is additional to the ESI Funds. By end 2016, Malta has signed agreements for EUR 39 million for projects under the Connecting Europe Facility. The EIB Group approved financing under EFSI amounts to EUR 6 million, which is expected to trigger nearly EUR 17 million in total investments (as of end 2016)

ESI Funds helped progress on a number of structural reforms in 2015 and 2016 via ex-ante conditionalities[2] and targeted investment. Examples include the timely transposition of public procurement and environment directives, as well as structural reforms in the areas of research, development and innovation, transport infrastructure, education, employment and social inclusion. For example, smart specialisation strategies spur and coordinate innovation investments between public and private sectors, and transport plans provide a coherent framework to facilitate the implementation of more sustainable and efficient mobility measures, alongside with the development of mature transport infrastructure projects. These reforms prepared the ground for better implementation of public investment projects in general, including those financed from national sources and from other EU instruments. Fulfilment of ex-ante conditionalities is on track. In addition to the above, administrative reforms support is available through targeted financing under the European Social Fund, advice from the Structural Reform Support Service and, indirectly, through technical assistance

The relevant CSRs focusing on structural issues were taken into account when designing the 2014-2020 programmes. These include addressing the labour-market relevance of education and training, improving the labour-market participation, diversifying the energy mix by increasing the share of energy produced from renewable sources and supporting more sustainable and efficient mobility solutions in the transport sector.

In addition to challenges identified in the past CSRs, **ESI Funds address other structural obstacles to growth and competitiveness.** ESI Funds support contributes to increase the proportion of GDP invested in R&I from 0.72% to at least 2%, to preserve natural resources and to meeting EU targets for reducing greenhouse gases and use of renewable energy (to 10% of total energy consumption). ESI Funds support contributes also to increasing employment to 70 % of the working age population, and to attain a tertiary education rate of 33 %, reducing early school-leaving from 33.5 % to 10 %, and lifting around 6 560 people out of the at-risk-of-poverty-or-social-exclusion category.

https://cohesiondata.ec.europa.eu/countries/MT

[1] National public investment is defined as gross capital formation + investment grants + national expenditure on agriculture and fisheries

[2] At the adoption of programmes, Member States are required to comply with a number of ex-ante conditionalities. For Members States that do not fulfil all the EACs by the end 2016, the Commission has the possibility to propose the temporary suspension of all or part of interim payments. The analysis of the fulfilment of the EACs will be finalised in the course of 2017.

3. REFORM PRIORITIES

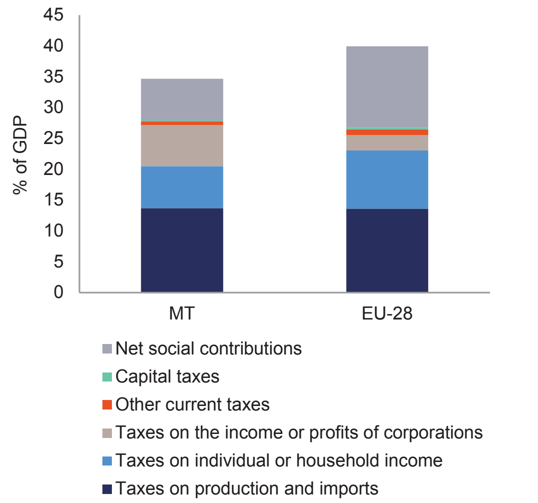
3.1. PUBLIC FINANCES AND TAXATION

3.1.1. RECENT BUDGETARY DEVELOPMENTS AND MAIN DRIVERS

The fiscal position improved over the last decade, following a strengthening of revenues, supported by favourable macroeconomic conditions. Public finances benefited from the favourable macroeconomic conditions. However, the latter's contribution to the improvements in public finances is expected to moderate in the medium-term, thus making the balancing of expenditure and revenue more challenging. Since Malta's accession to the EU, the average growth rate of tax revenue is above the EU average, and has been increasing in recent years. In particular, since 2013, the average growth rate of tax revenue in Malta reached twice the rate observed in the EU (8.0 % against 3.4 %). In addition, non-tax revenue recently increased substantially thanks to the proceeds from the International Investor Programme that was introduced in 2014. This programme gathered revenues of around 0.7 % of GDP in 2014-2015.

The reliance on corporate income taxes is higher than the EU average. While the share of taxes on production and imports is in line with the EU average, the share of current taxes on income is higher in Malta compared to the EU. Net social contributions represent a lower portion of tax revenues (see Graph 3.1.1) and the reliance on corporate taxation is much higher in Malta (almost triple) compared to the EU average. In terms of GDP, earnings related to corporate taxation have increased by 1 pp. in 2011-2014 (from 5.3 % to 6.3 % of GDP) while it remaining at 2.4 % of GDP on average in the EU. Corporate taxation therefore has stood out as a significant and growing source of tax revenue for Malta in the last few years. Risks to the resilience of tax revenues could come from economic shocks or changes in the area of corporate tax policy. The adopted corporate tax initiatives ([9]) aim to reduce tax avoidance (see also Section 3.1.2). However, in the medium to long-term horizon, it is unclear how these initiatives would impact on the fiscal position of the country.

Graph 3.1.1: **Breakdown of tax revenue by detailed tax categories in 2015, MT and EU28 (% of GDP)**



Source: European Commission

Public outlays have been increasing at a fast pace. Public expenditure in Malta stood at 41.2 % of GDP in 2015. On average, public expenditure increased by 5 % annually since Malta's accession to the EU, broadly in line with the average nominal GDP growth rate. The pace of expenditure accelerated recently, and total expenditure growth reached 7.6 % (against 1.8 % in the EU) over the last three years period, driven also by higher outlays for public investment.

In recent years, Malta has largely achieved fiscal consolidation without penalising public investment. In the past, government investment was used to compensate for slippages in budgetary execution. As a result, public investment as a share of GDP fell from 4.6 % in 2005 to 2.2 % in 2010. Over the past two years, however, government investment increased, reflecting also the necessity to shield EU-funded projects from cuts, which account for a large share of public investment. These projects include the completion of

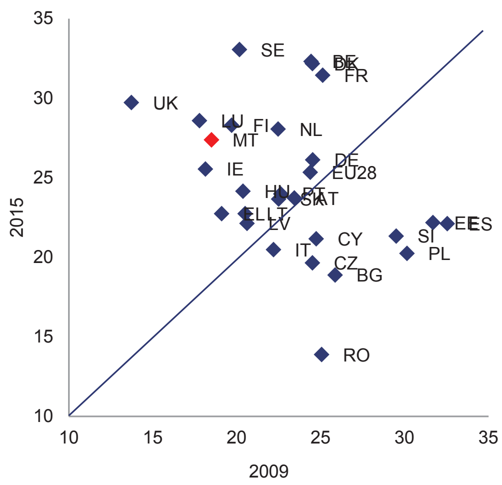
([9]) Several initiatives at EU level were adopted to boost tax transparency, with the automatic exchange of information on tax rulings and the introduction of country-by country reporting. Further initiatives were taken to ensure that taxes are paid where the value is generated, for example the Anti-Tax Avoidance Directive (ATAD) adopted by the Council in June 2016.

infrastructure works at the Mater Dei hospital's new wing, the completion of the Oncology Hospital, road improvement and street lighting, the restoration of historical places, the upgrading of ports and the acquisitions of new fixed assets. Consequently, capital spending exceeded the EU average in the past five years, reaching 4.3% of GDP in 2015, against 2.9 % in the EU. As a share of total government expenditure, public investment in Malta has exceeded the EU average, reaching 10.6 % in 2015, against 6.2 % in the EU ([10]).

At the same time, the share of public expenditure devoted to current expenditure also increased. The average increase of current expenditure since Malta's accession to the EU was higher (at 5.4 %) and even higher in the last three years (at 6.1 %). Also, the relative share of intermediate consumption and subsidies continued to increase. Nevertheless, some reductions took place in some categories, as the allocation of public spending to social protection decreased substantially (reflecting also the counter-cyclical nature of such spending) together with the share of public wages and interest expenditure. A consideration of the functional classification of expenditure, shows that social protection in Malta is among the lowest in the EU, at 13.7 % of GDP in 2014, and well below the EU average at 19.4 % of GDP, due also to the low unemployment rate. Wage bill reductions contributed to consolidation, despite the fact that general government employment levels are relatively high, exceeding the EU average and increasing at a faster rate (see Graph 3.1.2).

In terms of public expenditure by functional category, education and health spending increased the most. Public education spending in Malta is high relative to that in the EU (5.6 % of GDP, above the EU average of 5.0 % of GDP). Spending on tertiary education is partly responsible for this gap, somewhat at odds with demographic trends. In particular, student-teacher ratios have followed a decreasing trend and are among the lowest in the EU at all education levels. In addition, higher education spending has been driven by a high wage bill. While the current level of public health spending in Malta is below the EU average (at 5.7 % of GDP in 2014, against 7.2 % in the EU), the composition appears skewed toward wages, with the health wage bill at 3.3 % of GDP, against an EU average of 1.9 % of GDP. This is due to the high and increasing number of doctors, nursing professionals and midwives working in hospitals since 2010. In addition, capital spending in the health sector in Malta is higher than the EU average (0.6 % of GDP against 0.2 % of GDP in the EU in 2014), and spending in intermediate consumption is 0.2 pps. above the EU average. Overall, spending for wages in both the education and the health sectors has increased in Malta in the last five years, while on average in the EU it has remained overall stable or has slightly declined.

Graph 3.1.2: **General government employment, percentage of total employment**



Source: European Commission

The Comprehensive Spending review is ongoing. The review started in 2014 and has so far covered the Department for Social Security, the Mater Dei Hospital (in 2015), and the Ministry for Education and Employment (in 2016). Each review ended with the publication of a report which included recommendations in the area of social security and for the Mater Dei Hospital (among others, budget decentralisation in some departments and notional billing). Some of them have already been implemented and others are underway. The process of budget decentralisation is expected to be launched for the entire Mater Dei hospital during 2017 and a monitoring and evaluation team is being set up and will be launched during 2017. Overall, the spending

([10]) The share of capital transfers was above the EU average in 2013-2015. This was due also to capital injections into the national airline.

review is bringing results in terms of short-term savings, even if of limited amounts at first, while contributing towards increased effectiveness in public spending.

3.1.2. TAXATION

VAT tax compliance is improving in Malta, but some challenges remain. While the VAT gap ([11]) is relatively high in comparison with other EU Member States, a strong revenue performance helped to move it downwards in 2014. The gap declined from 39 % of the total liability in 2013 to 35 % in 2014 due to a 10.3 % increase in VAT revenues.

A number of relevant measures were taken to improve tax compliance and address the shadow economy. A new Joint Enforcement Task Force to enhance tax compliance and to combat the shadow economy was created to ensure further cooperation between different tax administration departments (Inland Revenue, VAT and Customs Departments, with the participation of the Tax Compliance Unit) and to facilitate information sharing among them ([12]). In the same vein, property lease and renewal agreements will need to be registered with the Inland Revenue ([13]).

Some of Malta's tax rules may be used in structures of aggressive tax planning ([14]) ([15]). The absence of certain anti-abuse rules ([16]) and the absence of withholding taxes on dividends, interests and royalties payments (European Commission, 2016b), vis-à-vis third countries are features of the tax system which may facilitate aggressive tax planning. In that respect, the very high level of inward and outward foreign direct investments (FDI) positions, the share of those FDI held by so-called 'Special Purpose Entities' (SPE) ([17]), but also the high level of dividends or royalty payments ([18]) as percentage of GDP suggest that the country's tax rules are used by companies that engage in aggressive tax planning. Within this context however, it is important to note that corporate tax initiatives (for example the amendment to the Parent-Subsidiary Directive or the Anti-Tax Avoidance Directive) will strengthen Member States' anti-abuse framework and boost tax transparency (for example through the automatic exchange of information on tax rulings or on country-by-country reports).

Malta has taken steps to adjust some of its tax rules facilitating aggressive tax planning. In line with Action 5 of the Base Erosion and Profit Shifting project (see OECD, 2015) as endorsed by the Code of Conduct for Business Taxation, Malta took measures to close the existing patent box regime.

([11]) The VAT gap represents the difference between the amount of VAT actually collected and the amount that is theoretically collectable based on VAT legislation.

([12]) Prioritising control and more frequent spot checks on employers recruiting unregistered workers, owners of rented property not declaring their income and a close monitoring of certain imported goods.

([13]) Such income is already subject to a reduced income tax rate of 15°%.

([14]) For an overview of the most common structures of aggressive tax planning and the provisions (or lack thereof) necessary for these structures to work, see Ramboll Management Consulting and Corit Advisory (2016), Study on Structures of Aggressive Tax Planning and Indicators, European Commission Taxation Paper n°61. It should be noted that country-specific information provided in the study gives the state of play by May/June 2015.

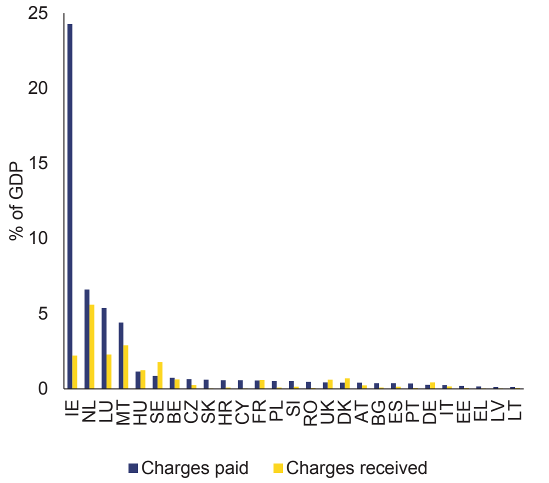
([15]) Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability (see Commission Recommendation of 6 December 2012 on aggressive tax planning (2012/772/EU)).

([16]) For more details, see European Commission, 2016a.

([17]) A special purpose entity is a legal entity that has little or no employment, operations or physical presence in the tax jurisdiction where it is located. It is related to another corporation often as a subsidiary, and is typically located in another tax jurisdiction.

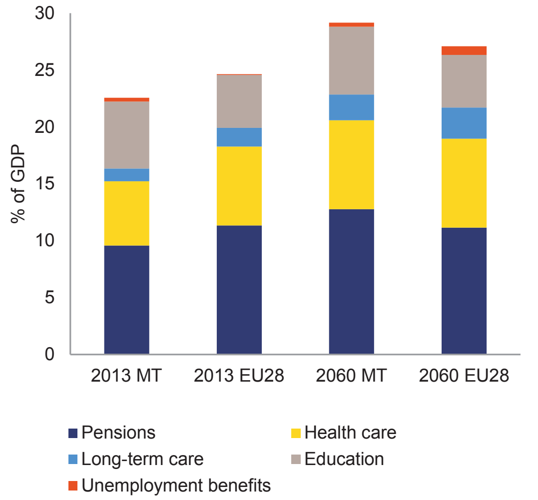
([18]) In 2015, the level of inward and outward FDI stock amounted respectively to 1646°% and 665°% of GDP. The share of inward and outward FDI stock held by SPE amounted respectively to 96°% and 98°% of GDP. The flows of dividends paid (calculated as net income on FDI) amounted to 90°% of GDP. The royalties paid and received in 2015 amounted respectively to 2.8°% of GDP and 4.2°% of GDP.

Graph 3.1.3: **Charges for the use of intellectual property, 2015**



Source: European Commission

Graph 3.1.4: **Components of total age-related expenditure**



Source: European Commission, 2015 Ageing report

3.1.3. FISCAL SUSTAINABILITY

Malta faces medium sustainability risks in the long term. With government debt below the euro area average and rapidly approaching the 60 % of GDP threshold, over the short term, Malta does not face significant fiscal risks. The same holds for the medium term. However, Malta appears to be at medium risk in the long term due to a relatively high value of the required long-term fiscal adjustment (4.4 pps. of GDP) needed to put its debt on a sustainable path (European Commission, 2015a). The projections of implicit liabilities related to the cost of ageing reflect the long-term challenges in terms of an ageing population. The steep increase in projected age-related expenditure is related to pension expenditure (3.2 pps. of GDP) but also healthcare and long-term care expenditure (respectively 2.1 pps. and 1.2 pps.).

Pension system

The authorities have put forward several measures to address challenges posed by the pension system. Some measures were introduced already with the 2016 Budget, targeted at addressing sustainability and adequacy. These measures followed the proposals of the Pension Strategy Group and entered into force in March 2016. A full assessment of the budgetary impact is still missing, but initial assessments show that measures to achieve sustainability are not yet as ambitious as to respond to the long term challenges.

Pension adequacy indicators indicate considerable room for improvement. The relative median income ratio of people aged 65+ at 0.75 is 18 pps. lower than the EU-28 average at 0.93 (in 2015). The at risk of poverty rate of older people at 21.0 % stands out both by being higher than for the rest of the population (15.3 %) and 6.9 pps. above the EU average at 14.1 % (in 2015). The percentage of women without pension entitlements (the gender coverage gap) at 36.5 is one of the highest in the EU, where the average is at 6.8 (2014) (see Section 3.3).

The Government has responded with several measures to improve pension adequacy, including through addressing the gender gap. According to national estimates, the measures introduced in the 2017 Budget ([19]) could lower the poverty risk for people aged 62+ by 1.3 pps. It could also improve the net replacement rate of the guaranteed minimum pension by almost 15 pps., up to 93.8 %. ([20]) In addition, in August 2016, the Maltese government introduced financial incentives to work longer in the private sector. These financial incentives are expected to improve pension adequacy by increasing replacement rates. For each additional year that the retirement is postponed beyond the current pensionable age the pension will be raised by between 5 % and 6.5 %. In addition, efforts to increase female labour market participation (see Section 3.3) through incentives for women, including revised child-bearing credits, are likely to mitigate current challenges.

Healthcare system

The recent reforms implemented in Malta are contributing to an increasing effectiveness of the healthcare system. Recent policy actions such as the Health Act, the Mental Health Act, the completion of the Health Systems Performance Assessment exercise, the National Health Systems Strategy, result in the strengthening of the national health care system. This, however, has been accompanied by an increase in total expenditure on health as a percentage of GDP over the last decade (from 8.1 % in 2003 to 9.8 % in 2014, according to World Health Organization data), slightly below the EU average of 10.0 % in 2014.

Private expenditure represents a relatively high share of total health expenditure. In 2014, private expenditure in Malta was 31 % of total health expenditure, above the EU average of 23 %. A significant part of private expenditure is out-of-pocket expenditure (31.5 % of total health expenditure in 2013, higher than the EU average of 14.1 %), which has increased since 2003 (29 %) (European Commission, 2016d).

Long-term care system

The Maltese long-term care system does not yet meet the growing demand, although numerous initiatives are being undertaken to cater for such a demand. At the end of 2014, the number of people in care homes financed by the government (both public and private) reached 3 147, complemented by private offer of 1 493 (European Commission, 2016e). Despite this, long waiting lists are reported (1 500 people at the end of 2015). As a result, the government is incentivising community-based and home care, which are deemed cost saving in comparison to institutional or hospital care. A pilot project to co-finance 50 % of the professional carer salary was launched in 2016 and 100 people from the waiting list, who employed a carer benefited from the scheme. As of 2017, according to the 2017 Budget speech, the scheme will be extended and elderly people who live at home and who are on the waiting list for residential care will receive a Carer at Home subsidy, with a maximum amount of 5 200 euros per year.

([19]) A tax exemption on pension income of up to EUR 13 000 per annum (plus an additional EUR 500 in 2017 and EUR 1,000 in 2018 from other income) has been introduced for married people with effect from 2017 while for single persons the tax exemption on pension income. will be gradually introduced in the next two years. In the latter case, the tax exemption will be on pension income up to EUR 10,500 in 2017, while in 2018 it will be on pension income up to EUR13,000. . The rate of the minimum contributory pension for married persons with a full contributory period will be raised from EUR 141.83 to EUR 147.58 (up by 3.9%) %). per week including the cost of living increase. A reform of the Supplementary Allowance will also benefit mostly married pensioners with income not exceeding EUR 13,000 per annum. .

([20]) EU peer-reviewed effects on the sustainability and adequacy of pensions are expected in early 2017.

3.2. FINANCIAL SECTOR

Financial services are one of the cornerstones of the Maltese economy. They accounted for 6.7 % of the gross value added in 2015, higher than the euro area average (4.9 %). The financial services sector is also one of the main employers, accounting for 5.2 % of total employment in 2015, two times higher than in the euro area.

The financial system is characterised by a significant number of foreign institutions also attracted by the favourable tax environment. Malta is relatively attractive as a domicile for foreign financial companies for various reasons, including: (i) it is the only EU Member State utilising the full imputation system of company taxation and it offers a refundable tax credit scheme, (ii) it has an extensive network of double taxation treaties, and (iii) it has an attractive tax residency status for individuals.

The supervision of the internationally-oriented business, however, is challenging. The financial sector carries out most of its activities outside Malta. The ability of a relatively small supervisory authority to oversee a large system, in particular in the insurance sector ([21]) but also in banking is under pressure. The Malta Financial Services Authority, in consultation with the ECB, has recently requested the withdrawal of the banking license of a small internet banking provider that collects deposits also outside Malta. Even if potential weaknesses in internationally-oriented institutions do not pose direct risks for domestic financial stability, the reputation of the jurisdiction could be put at risk.

Linkages point to a potential channel of contagion risk, in case of distress. The life insurance sector is dominated by two firms. One is a subsidiary of a core domestic bank, while the other is majority owned by another core domestic bank. These insurance companies account for 97 % of the assets of the life insurance sector and for 97 % of the total gross written premium by the sector operating in Malta. Interconnectedness is driven by ownership but also by operational processes and systems (e.g. banc-assurance in the life insurance sector). An additional contagion channel is the fact that over 10 % of insurers' assets consist of deposits held with the Maltese banks. In addition, 19 % of total investment assets of life insurance companies and 5% of the assets of non-life providers is exposed to the Maltese sovereign.

In the banking sector, risks to profitability remain. At 6.4 % at Q2 of 2016, the ratio of bank non-performing loans is close to the average of other euro area countries. Nevertheless, it constitutes a legacy burden for the core domestic banks in view of the high associated costs of managing them and of limitations imposed by the small size of the economy. Whereas the banks need to comply with the five-year targeting programme with respect to bad assets, strict supervisory actions and the proper legal framework should assure their further reduction. The largest stock of NPLs remains in the construction sector, which is a legacy from the crisis period. Protracted subdued credit developments in a low interest-rate environment put an additional strain on profitability.

Non-resident deposits could pose a structural challenge for liquidity management. Non-resident deposits coming from Libya have, in recent years, increased in the domestic banks. In some domestic banks they constituted a large share of new inflows. Although the total reliance of such deposits is still relatively low, it exposes the banks' funding to volatility risk, especially in case of intensified geopolitical tensions. Whereas the minimum capital and liquidity requirements for these banks are already higher than for others, the situation warrants the continued attention of the supervisor.

([21]) In the insurance industry, unlike in banking, the home supervisor remains solely responsible for the supervision of companies doing business abroad.

3.3. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

3.3.1. LABOUR SUPPLY

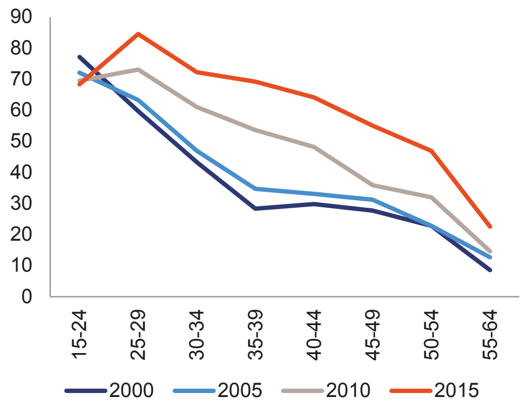
Labour market participation continues to improve. Malta is approaching its national Europe 2020 target employment rate of 70 %, largely driven by increases in female labour market participation and employment. This is a result of a long-term structural trend (see Graph 3.3.1) following changes in the societal structure and progress in female educational attainment. The latter have been reinforced by recent make-work-pay policies focused on activation (including the free child care scheme, tapering of benefits when taking up a job, and in-work benefits, see Box 3.3.1). Impact estimates by the authorities show that free childcare can be effective in facilitating a more rapid return to the labour market for mothers within the first three years of childbirth (see also European Commission, 2015b and European Commission, 2016a). Although the historically strong impact of motherhood on female employment is fading over time, stakeholders still report labour market obstacles for women with young children, resulting from a weak work-life balance. ([22])

A pronounced gender gap in employment persists, mostly driven by low-skilled and older women. Notwithstanding significant improvement in recent years, the gender employment gap (20-64) is the largest in the EU and stood at 27.8 % in 2015 ([23]). While employment of women with medium to high skills attainment exceeds EU averages, for the low-skilled employment remains low (see Graph 3.3.2). Employment rates of older and low-skilled women have improved notably in recent years, but they remain considerably below the EU average (*see section on Labour and skills shortages*). These groups make up a substantial share of the working age population (respectively 25 % and 17 % of age group 20-64) and could thus strengthen labour supply. The share of low-skilled single-earner households is high and these households experience a higher risk of poverty (see Section 3.3.3). In addition, low female employment restricts women's access to pension entitlements (see Section 3.1.3 and European Commission, 2016a) may constrain further progress in lower the poverty risk.

([22]) Insufficient flexible working arrangements in the private sector, parental leave design, incompatibility of working hours with school opening, etc.

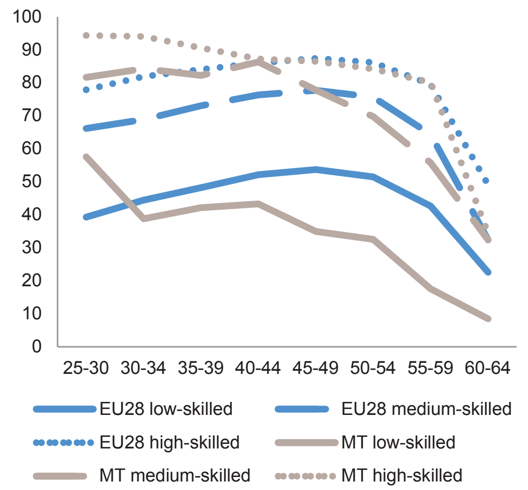
([23]) Defined as a gap in employment rates between men and women

Graph 3.3.1: **Time trends in labour market participation rates of women by age group**



Source: European Commission

Graph 3.3.2: **Female employment rates, 2015**

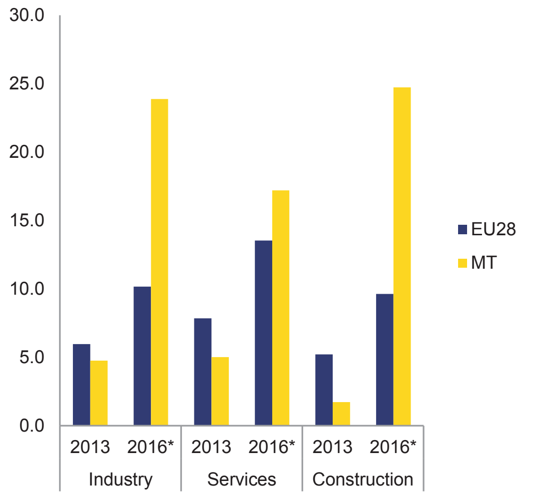


Source: European Commission

3.3.2. LABOUR AND SKILLS SHORTAGES

There are increasing signs of tightening in the labour market. In 2016, almost one fourth of all companies in the industry sector report that the low availability of labour is constraining their business. This is one of the highest shares in the EU, and it has increased significantly in recent years. At the same time, the number of new job openings is high (the vacancy rate was 3.1 % in the first quarter of 2016 the highest in the EU). ([24])

Graph 3.3.3: **Labour shortages as reported by the industry, services and construction sectors**



* 2016 average includes data until Q3
Source: European Business Surveys

Qualitative evidence points to skills shortages in many occupations. Particularly affected are high-skilled jobs in sectors such as healthcare, finance, and ICT. Shortages of skilled professionals reflect also the still-low share of tertiary level graduates (one of the lowest in the EU). In addition, unfilled vacancies are reported in the hospitality, tourism and social work sector. This might be partly due to relatively unattractive working conditions, including wages and working hours (see European Commission, 2016a). The recent National Employee Skills Survey ([25]) stresses the main difficulties in filling vacancies for clerical support workers, professionals and service and sales workers. Foreign companies also identify skills shortages as obstacles to expansion (Ernst & Young, 2016).

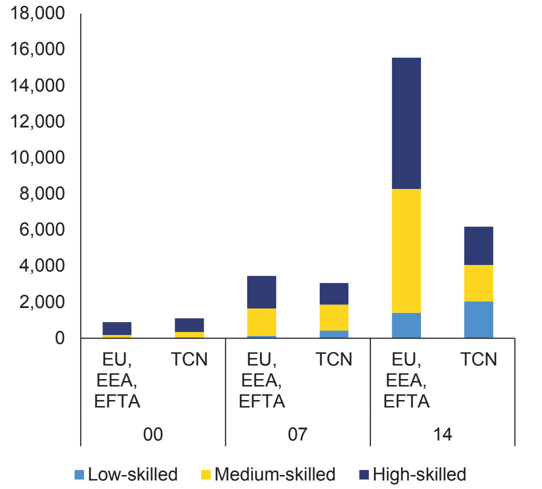
The government is taking measures to address growing labour shortages. Efforts are being undertaken to strengthen initial education, including by reducing dropouts (see Section 3.3.4) and on the upskilling and reskilling systems for adults. This is expected to help the unemployed find a job more easily, but also to support those who are currently inactive and would like to reintegrate into the labour market. The challenge of (re)activating is exacerbated by the strong gender, skills and age bias in the composition of the unemployed population: 36 % of all the unemployed in the age group 20-64 are women, 22 % are above 50 and 72 % have no upper secondary school qualification.

Employers are increasingly relying on foreign labour to address labour and skill shortages. The share of foreign workers rose from 1.3 % in 2000 to 14.7 % in 2015. ([26]) The share of EU citizens in particular surged (see Graph 3.3.4). While in the past most of the foreign labour force was employed in high-skilled jobs, an increasing share of foreigners are now taking up low-skilled jobs, pMalta is registering an increase in the share of foreign workers across all skill levels. An increasing share of foreigners are now taking up low-skilled jobs, pointing towards labour shortages across abroad skills spectrum. In 2014, the share of EU foreign workers in elementary jobs stood at 9 %, while the share of non-EU nationals in elementary jobs stood at 33 % ([27]). The government took actions to support the labour market inclusion of low-skilled non-EU nationals through tackling irregular forms of employment and precarious work conditions and facilitating the validation of qualifications in childcare and construction.

([24]) See Eurostat variable jvs_q_nace2
([25]) National Employee Skills Survey 2016, joint project of the National Commission for Further and Higher Education, Malta Enterprise and Jobsplus

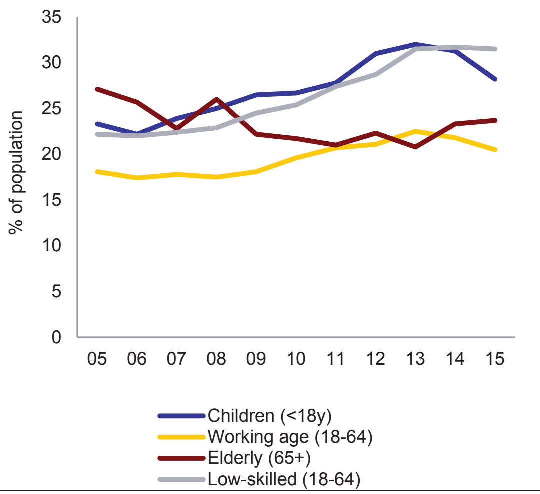
([26]) Based on data from the Employment and Training Corporation. In the regular Labour Force Survey of the same year however, the figures appear to be underestimated.
([27]) Elementary jobs comprise simple and routine tasks, requiring hand-held tools and some physical effort. http://www.ilo.org/public/english/bureau/stat/isco/isco88/9.htm

Graph 3.3.4: **Foreign employment, by occupational level**



ILO classification of occupations: ISCO 1-3 high skilled; ISCO 4-8 medium-skilled; ISCO 9 low skilled.
TCN - Third country nationals
EEA – European Economic Area
EFTA – European Free Trade Association
Source: National data - Jobsplus

Graph 3.3.5: **At-risk-of-poverty-and-social-exclusion rate, different groups**



Source: European Commission

3.3.3. SOCIAL POLICY

The overall risk of poverty and social exclusion decreased in 2015, but remains high for elderly, children, the low-skilled and people with disabilities. Monetary poverty for people over 65 years continued to increase in 2015 for both men and women (see also Section 3.1.3). Child poverty, despite an overall decline in 2015, has increased in single-earner households ([28]) while for children with low-skilled parents, this has decreased. Poverty and social exclusion risks of the low-skilled, where there is a high concentration of single-earner households, have also increased steadily in recent years. The low-skilled are three times more likely to face in-work poverty than the medium-skilled. ([29]) In addition, Malta has one of the lowest employment rates of people with disabilities in the EU, with only 28.2 % in 2014 (against EU average of 48.7 %). Although educational attainment among people with disabilities is increasing, the majority are low-skilled.

Social transfers remain important to reduce poverty. The impact of social transfers was below the EU average in 2015 but recent reforms are likely to improve it. The adequacy of income support for the working age population with the lowest incomes and for minimum income earners in particular remains above the EU average. Nevertheless, given the rise in labour earnings at the higher-end of the income spectrum, the relative adequacy of minimum income ([30]) and other out-of-work benefits slightly declined in recent years.

Malta is placing emphasis on raising active inclusion and addressing current social challenges. Policy actions, extended under the 2017 Budget, include the making-work-pay package (see European Commission, 2016a), housing support, a new proposal for a comprehensive national child policy, efforts to upgrade skills levels of the population and recent measures to improve pension adequacy (see Section 3.1.3). Efforts to invest in child care are bearing fruit, but uneven geographical coverage of child care facilities and lack of outreach notably for children from low socio-economic background remains an issue. The progress in upgrading skills levels will further contribute to improving social outcomes, in particular by preventing the intergenerational transmission of poverty.

([28]) Households with medium work intensity (0.45<WI<=0.55)
([29]) In-work poverty: 10.2 % for those with education attainment ISCED 0-2, 2.7 % for ISCED 3-4 and 0.6 % for ISCED 5-8

([30]) The adequacy of MI support measured relative to the poverty line set at 60% of the national median equivalised disposable income.

Moreover, the increasing availability of care services and financial support to home care for the elderly is expected to ease the family responsibilities of women. In addition, a special policy focus is directed to people with disabilities (see European Commission, 2016a) to improve their employment and social status.

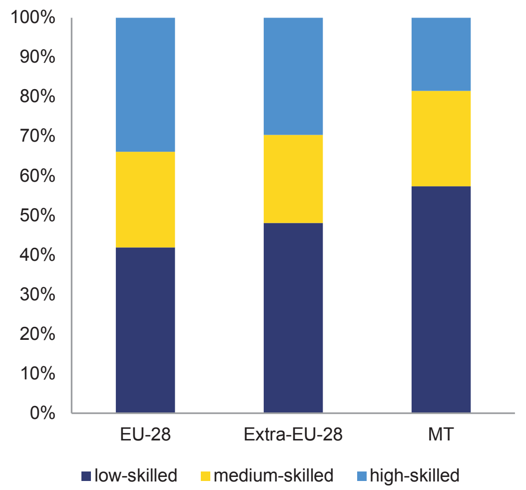
3.3.4. EDUCATION AND SKILLS

Despite significant investment in the education system, basic skills attainment among young people remains weak. The performance of 15-year olds in the OECD Programme for International Student Assessment (PISA) 2015 tests remained below the EU average, despite an improvement on 2009 levels. ([31]) However, since performance also worsened in most EU countries, the gap with the EU average shrank in reading and science. Socio-economic status is found to strongly influence student performance (OECD, 2016; European Commission, 2016a). Performance is also clearly related to the type of school, with 'independent' (i.e. private) school students performing the best. They are followed by Church school pupils and then State school pupils. Another 2015 international survey on 13-14-year olds - Trends in International Mathematics and Science Study (TIMSS) - confirmed these findings (Ministry for Education and Employment, 2016). This may suggest a persistent fragmentation of the education system and a lack of inclusiveness of vulnerable children, in particular from poorer and low-skilled families.

Drop-out rates from the education system remain high. The early school leaving rate has fallen significantly in recent years, from 27.2 % in 2008 to 19.8 % in 2015. However, this remains one of the highest in the EU. The gender gap is more than double the EU average. Moreover, activation for early-school leavers remains a challenge and translates into a high share of inactive young people who are neither in employment nor in education or training. Subsequently, leading to high inactivity rates among adults. Policy actions focus on strengthening basic skills programmes and extending opportunities for a 'second-chance education'. The 'Alternative Learning Programme' and other preventive and compensatory measures aim at addressing early school leaving . The 2014 Early School Leaving Strategy is under revision focusing on new vulnerable groups. Moreover, the updated Youth Guarantee Scheme targets potential school dropouts through a combined programme of mentoring and traineeships. All of these policy measures are welcome.

Despite significant progress, the qualification level of adults remains low. The share of low-qualified adults is the highest in the EU - 56.5 % in 2015 (25-64). Only about 20 % of adults have tertiary education attainment and 22.7 % are medium skilled. In addition, the share of low-qualified youth (25-34) is among the highest in the EU (37.1 % vs. 16.6 %), which is driven by the high rate of early school leavers. In comparison to the native population, the foreign-born population has on average a higher level of skills. In 2015, 45.7 % of foreigners living in Malta were low-skilled (ISCED 0-2) and 31.3 % had tertiary education (ISCED levels 5-8), compared with 57.4 % and 18.5 % of the native population, respectively. As a result, they are able to take up higher-skilled jobs, thus filling skill shortages.

Graph 3.3.6: **Population distribution by educational attainment and country of birth**



Source: European Commission

([31]) Compared to 2009, performance significantly improved in maths while it remained broadly stable in reading and science.

Box 3.3.1: **Selected highlights making-work-pay measures**

The package of making work pay measures has been implemented since 2014. It is targeting mainly women to address the challenge of low participation, which was a subject of country-specific recommendations in 2012, 2013 and 2014. In these years, Malta registered one of the lowest employment rates of women and the highest gender employment gap in the EU. The make-work-pay policies focus on facilitating (re)entry into the labour market, and reinforcing changes in the societal structure and progress in women's educational attainment.

The free childcare scheme: Introduced in April 2014 the scheme aims to exploit the full potential of each household member whilst finding an adequate work-life balance. Free childcare services for children aged 0-3 years old are delivered for families where both parents are in employment, in education or actively seeking a job. Free childcare is also provided to single-parent households given that the same conditions (employment, education) are met. In addition, tax deductions for parents choosing to send their children to private childcare were introduced.

A gradual tapering of benefits for those entering into employment: retaining 65% of a benefit in the first year of employment and 45% and 25% in the following years, aiming at limiting dependency on social benefits and providing more security while (re)entering the labour market.

In-work benefits: introduced in 2015 to address inactivity traps and to improve the situation of low-income households, targeting low-to-medium income families where both spouses (or single parents) are in employment and have dependent children up to 23 years of age. The scheme was further extended, under the 2016 Budget, to one-earner households, however with a much smaller yearly benefit. The in-work benefit is calculated on net income and does not result in a reduction of any other benefit that a family is entitled to, such as Children's Allowance.

The success of the package can be attributed to both, the effective targeting and the comprehensiveness of the package which consists of several interconnected policy measures. The total budgetary cost of the package is rather limited, amounting to around 0.06% of GDP in 2014 and 2015 each. According to national estimations, the three reforms have encouraged 2,032 persons to engage in employment by the end of 2015, relative to 2013, leading to: (i) a 0.07 pps. increase in the employment rate; (ii) a 0.40 pps. decline in the unemployment rate; and (iii) a 0.63% increase in real GDP

Table 1:

Labour market indicators	2013		2015	
	Malta	EU	Malta	EU
Employment rate (20-64 years old)				
1. Female	49.8	62.6	53.6	64.3
2. Male	79.4	74.3	81.4	75.9
3. Gender employment gap (2-1)	29.6	11.7	27.8	11.6
4. Unemployment rate	6.4	10.9	5.4	9.4

Source: European Commission

The provision of skills does not adequately match those demanded by the labour market. The economy is registering a high growth in ICT services, but the share of graduates in Science, Technology and Mathematics is still lower than the EU average — 1.5 % compared to 1.8 %. While ICT specialists represent a relatively high and increasing share of the workforce (4.6 % compared to 3.7 % in the EU), only 52 % of the population had at least basic digital skills (EU average 55 %) in 2015. In addition to the gap in professional and technical skills, employers stress the weakness in soft/transversal skills, such as communication, English language, team work, problem-solving, customer handling, etc. (National Employee Skills Survey, 2016).

Although the government is enabling access to lifelong learning and second-chance education programmes, participation remains low. Overall, the low participation rate in further education and training is mainly driven by the very low attendance of the low-skilled. Older cohorts are also characterised by lower participation in comparison to younger ones (European Commission, 2016a). At all ages, the participation of women is slightly higher than that of men. Education and lifelong learning systems are strengthened through the implementation of the Lifelong Learning Strategy. Efforts to improve the Vocational Education and Training system are complemented by strengthening work-based learning and partnership with employers. Vocational subjects introduced in the national curriculum of secondary schools are now accepted to fulfil the criteria to start a post-secondary course. ([32]) The offer and the quality of apprenticeships and traineeships are improving. ([33]) Moreover, a harmonised legal framework 'Workbased Learning and the Apprenticeship Act' is being finalised, and it will provide a framework for Work-Placements Apprenticeships. In addition, JobsPlus offers trainings for upgrading job-related skills for both the unemployed and employees.

Malta makes particular efforts in building a national framework for the validation of non-formal and informal learning and a skills forecasting and anticipation system. In addition to significant institutional changes, there have been major legislative developments related to validation of informal and non-formal learning, such as the set-up of a Sector Skills Council and Sector Skills Units. Moreover, skills profiling is introduced as one of the assessment steps for unemployed people at the JobsPlus. The skills forecasting and anticipation system has not yet been consolidated, but Malta is currently working with the European Centre for the Development of Vocational Training - Cedefop on developing a suitable skills forecasting model, including through a comprehensive skills anticipation review. In the meantime, a number of surveys were conducted by different institutions to form the basis of any future framework. In 2016 the National Commission for Further and Higher Education, in collaboration with JobsPlus and Malta Enterprise, conducted an employee skills survey looking at the current and future supply and demand for workers in different sectors (see Section 3.3.2). In addition, the National Skills Council was set up in December 2016.

([32]) Agribusiness, engineering/technology, health/social care, hospitality and ITC

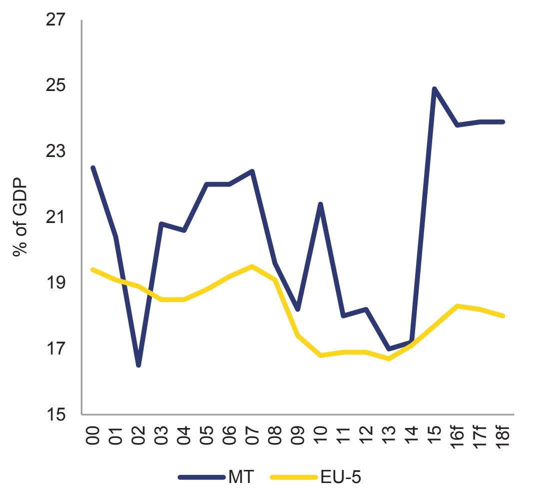
([33]) MCAST developed partnerships with almost 900 companies to organise work-based programmes and almost 500 of them are currently engaged in sponsorships.

3.4. INVESTMENT

3.4.1. INVESTMENT OVERVIEW

Investment was the main contributor to economic growth in 2015. Following a period of moderating shares of investment relative to GDP, there has been a spectacular increase in 2104-2015. In particular, gross fixed capital formation (GFCF) surged by a record-high 52 % year-on-year in 2015. While investment in the EU has not recovered pre-crisis levels, GFCF in Malta is currently well above its 2007 peak. Taking into account the structure of the domestic economy, investment has generally been more dynamic than in other EU economies with similar specialisation into business and recreational services (see Graph 3.4.1). Available data for 2016 already points to a slowdown as the peak has passed and investment is starting to decrease.

Graph 3.4.1: **Investment dynamics in selected Member States**

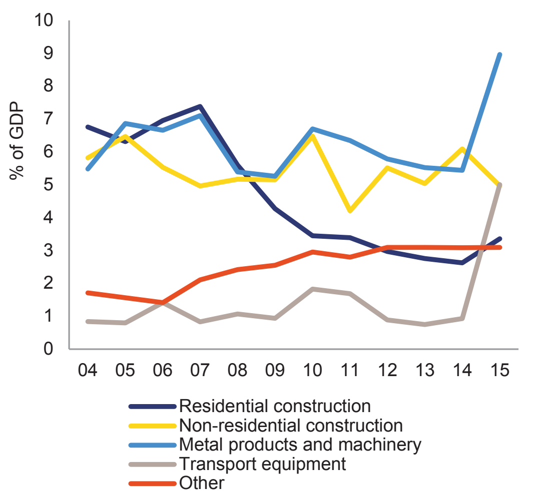


EU-5: Ireland, Cyprus, Luxembourg, Netherlands, UK
Source: European Commission

The recent investment surge reflected both one-off and structural sector-specific factors. Public investment surged reflecting the conclusion of projects financed under the 2007-2013 EU Budget framework. A number of large projects in the energy sector boosted investment in 2014-2015 (See European Commission, 2016a). With the latter nearing completion, their temporary boost to investment should dissipate. The new, more efficient capital stock put in place, however, should contribute to more vigorous economic activity, provided that the efficiency gains trickle down to the rest of the economy. Meanwhile, 2015 also saw the introduction of very capital-intensive activity in the transport sector. ([34]) While the latter leads to a higher investment ratio, the phenomenon is rather specific to this particular sector. The capital intensity ([35]) of the rest of the economy has remained broadly unchanged.

Recent years have brought about a rearrangement of the components of investment. Residential construction investment has shrunk considerably since its peak in 2007. Despite a modest improvement in 2015, it has become among the least dynamic components of investment. It was gradually replaced by non-residential construction and metal products and machinery, notwithstanding the temporary spike in the latter (see above). Investment in transport equipment also appears to have become a major component, reflecting recent developments (see above). While improving, other investment remains relatively low, reflecting still limited R&D expenditure (see section on Research and Development).

Graph 3.4.2: **Main components of investment in Malta**



Source: European Commission

Infrastructure across Malta still poses considerable challenges. The situation varies considerably across areas. Malta ranks 25th of the world in the 2016-2017 Global Competitiveness report in port infrastructures and 26th in air

([34]) A large aircraft leasing company relocated to Malta in 2015.

([35]) The ratio of gross fixed capital investment to gross value added.

transport infrastructures but only 100th in road transport infrastructures. Investment in infrastructures has increased considerably, especially road infrastructures with important singular investment projects such as the Kappara Junction project started in 2016. Despite some fluctuations, the number of projects increased by 139.8 % between 2008 and 2014. Labour and skill shortages are particularly important for this segment, given that it employs the majority of workers in the construction sector (89 % in 2013, European Commission, 2016i).

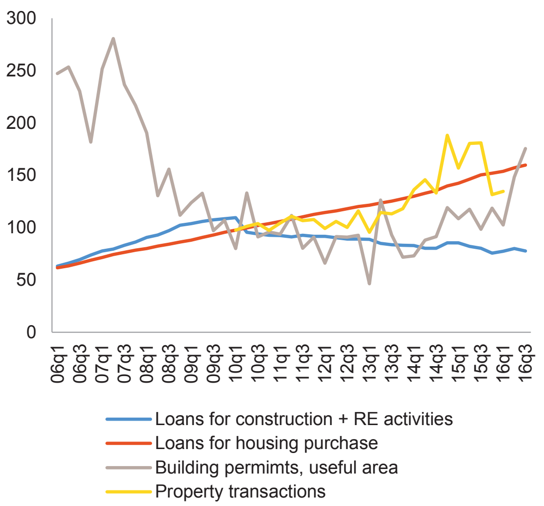
3.4.2. CONSTRUCTION AND HOUSING MARKET

The housing market faces a range of supply constraints. Construction is naturally limited by the availability of development zones on the islands. ([36]) Real estate development should also be seen in a broader policy context, taking into account also environmental and transport aspects (see section Sectoral Policies). Apart from this structural constraint, external financing is limited due to tighter lending standards by banks. Skills and labour shortages in the construction sector are emerging as a major problem despite the increase in engineering and architecture students in recent years, reflecting also growing labour market tightness. Time and costs of obtaining building permits and licenses pose additional barriers to construction.

At the same time, the demand for housing remains strong. Population growth has picked up since 2012, reflecting strong net immigration. The steady upward trend of mortgage loans points to a sustained demand for housing. The share of buy-to-let purchases is also on the rise. Housing demand has also been encouraged by fiscal policy, such as incentives for first-time buyers, schemes to attract high net-worth individuals as well as the citizenship programme.

Notwithstanding the constraints, recent trends point to a rebound in supply. Despite the burdensome procedures, building permits have been on a rapid recovery path since 2014. In particular, the average of issued permits over 2016 has recovered to its 2009 levels. The volume of property transactions was also very dynamic in 2014 and 2015. The results of the survey of factors limiting construction also reflect these developments. The share of companies that did not indicate any constraining factors has increased notably since 2014.

Graph 3.4.3: **Construction sector indicators**

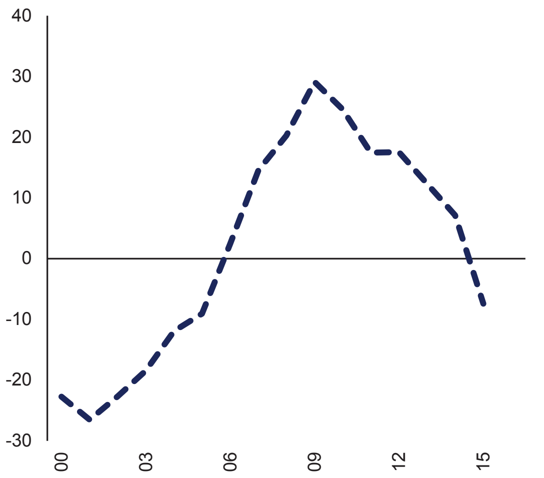


Source: European Commission, Central Bank of Malta, National Statistical Office

The housing market is currently close to balance currently, but the ongoing trends may lead to upward pressure on prices. Current estimates show that the excessive price growth prior to 2008 has corrected and there does not appear to be overvaluation of house prices (see Graph 3.4.4 and Central Bank of Malta, 2016e). This also reflects the strong income growth in recent years. The current policy stance is assessed as appropriate (ESRB, 2016). Nevertheless, while housing demand appears to be growing at a steady pace, income growth is projected to slow down. The main risks are faced by households, in view of their increasing ratio of debt to income and a high debt service ratio, and by banks, in case of a sudden drop in the value of their collateral.

([36]) In addition, there is a significant number of vacant properties. Not all of them, however, can be considered to be on the market. The authorities are introducing fiscal incentives for the restoration of dwellings in urban conservation areas.

Graph 3.4.4: **Housing price overvaluation gap with respect to main supply and demand fundamentals**

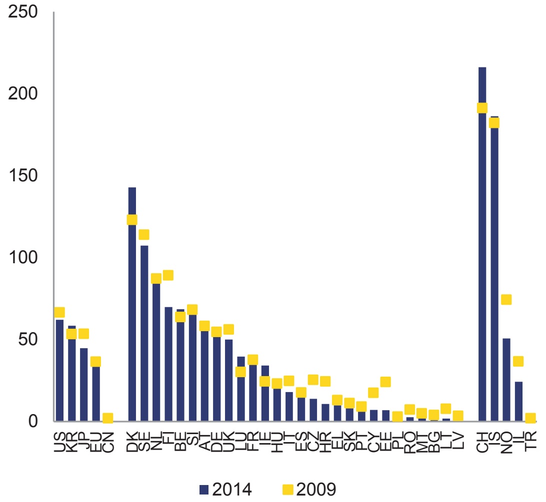


A Vector Error Correction Model has been estimated for a panel of 21 EU countries, using a system of five fundamental variables; the relative house price, total population, real housing investment, real disposable income per capita and real long-term interest rate. A country-specific estimation on top of the panel estimates is conducted whenever the time series allow for a sound econometric analysis, leading to a valuation gap calculated as a simple average of the individual and the panel estimate.
Source: European Commission

3.4.3. RESEARCH AND DEVELOPMENT

Important steps have been taken to strengthen the research and innovation (R&I) system. R&I performance has improved, leading to a narrowing of the innovation gap with the EU average, as measured by the European Innovation Scoreboard (EIS) ([37]). R&D investment, in particular by the public sector, has grown considerably in recent years leading to higher-quality scientific output. ([38]) This notwithstanding, R&D investment, both public and private, remains low, the quality of scientific and technological output, and the availability of researchers underperform the EU average. Finally, some other challenges remain, in particular in areas where progress until now has been limited like in science-business linkages (see figure 3) or the share of enterprises collaborating with a university or public research centre.

Graph 3.4.5: **Number of public-private co-publications per million population**



Source: European Commission

The structural changes that the Maltese economy is undergoing require more investment in knowledge and intangible assets to sustain productivity growth in the future. However, Malta has one of the lowest levels of Business Expenditure in R&D in the EU, at just 0.5 % of GDP in 2014. In addition, venture capital markets are underdeveloped and the ease of doing business in Malta, as measured by the World Bank, is one of the lowest in the EU. The key policies in this respect are the Smart Specialisation Strategy and the alignment of the National R&I Strategy, which are in the process of implementation. This includes the mobilisation of additional financing for research towards the seven key areas identified under the Smart Specialisation Strategy. Timely and efficient implementation would contribute to building the R&I eco-system in Malta.

3.4.4. ACCESS TO FINANCE

Favourable economic conditions contribute to favourable financing conditions. According to the Survey of Access to Finance of Enterprises (SAFE), a quarter of the polled firms recognise that the availability of external financing has improved owing to improving macroeconomic conditions. This ratio is about a third higher than

([37]) http://ec.europa.eu/DocsRoom/documents/17848. Malta is classified into the "moderate innovator" group.
([38]) Scientific quality is measured as a percentage of total scientific publications of the country within the 10% most cited scientific publications worldwide. It increased from 4.2 % in 2000 to 7.9 % in 2013.

the average for the EU. The financing structure of businesses remains based mainly on bank credit and 72 % of firms indicate preference for bank financing if external funding is needed. The positive financing conditions make firms highly confident that they will get bank credit: 84 % of Maltese businesses are confident that their banks would provide the financing they need if they approached them. This compares very positively with the EU average 67 %.

Nevertheless, the authorities have identified market failures in bank lending that obstruct firms' access to financing. Estimates by the Central Bank of Malta point to a credit gap ([39]) of 15 %-18 % of the credit stock in Q3 2014 (Central Bank of Malta, 2016c). The credit gap has been projected to continue growing - a view that is corroborated by the subdued lending developments in 2015-2016. This reflects market failures stemming out of high concentration in the banking sector and asymmetric information available to market participants (Central Bank of Malta, 2015). The apparent under-provisioning of credit, however, reflects also interplay of demand and supply factors. Despite the relatively stable financial stability indicators, lending standards are tight on account of stricter regulatory and collateral requirements as well as tough risk assessment. High corporate indebtedness generally reduces firms' credit worthiness and companies are showing increasing reliance on internally-generated funds.

The Malta Development Bank is being set up to address these failures. This new, fully state-owned credit institution is expected to have an authorised capital of 100 million euro within five years that could go up to 200 million (of which 30 million euro will be the initial paid up capital). Credit activity is to target SMEs, who are usually most affected by the market failures. In addition, 25 % of the value of operations will be invested in infrastructure projects either co-financed with private investors or under Market Equivalent Operator conditions. The new bank could increase the supply of public financial support by 800 million to one billion euro in the form of loans, equity support or guarantees. At this stage, there is little public information available on how exactly the Development Bank will ensure the efficient transfer of the funds to the potential recipient businesses, while also avoiding crowding out private initiatives. It is also crucial that efficient and arms-length risk management is ensured to avoid piling up bad assets on the government's balance sheet.

The authorities have also made a diversified range of alternative mechanisms of financing available. They aim to foster investment (soft loans, rent and interest rate subsidies, loan guarantees), SMEs and SME growth, the upgrading of the qualifications of personnel, R&D and start-up firms (Business Start and Start-up Finance). In addition, Malta has signed three financial instruments worth EUR 32 million with the European Investment Bank ([40]) during 2016. These horizontal measures may be complemented by new sectoral measures that have been announced in the 2017 budget aiming at specific activities such as hospitality services. However, this year's SAFE survey shows a sharp increase in the importance attached by business to the administrative difficulties found when trying to have access to public support measures for financing (over two and half times higher compared to 2015).

([39]) The difference between the actual loans to non-financial corporations and the predicted level.

([40]) Innovfin Large: 20 millions euros loans guaranteed; SME Initiative supports Banif Bank to provide around €6 million of new loans to SMEs in Malta, over the next two years; and SME Guarantee: 6 million euros of guarantee on loans for innovative SMEs in Malta approved through APS Bank.

Box 3.4.1: **Investment Box - Malta**

Section 1. Macroeconomic perspective

Investment has been strong, following period of stagnation. The economy entered into a strong investment cycle in 2014 on the back of both the private sector and the government. Although the business sector remains the main driver of investment, public sector capital spending has contributed to the increase in investment in the last two years reflecting the finalisation of projects funded by the 2007-2013 EU financial framework. For more information on the investment trends, refer to Section 3.4.

Section 2. Assessment of barriers to investment and ongoing reforms

Table 1:

Public administration/ Business environment	Regulatory/ administrative burden		Financial Sector / Taxation	Taxation	
	Public administration			Access to finance	
	Public procurement /PPPs		R&D&I	Cooperation btw academia, research and business	
	Judicial system			Financing of R&D&I	
	Insolvency framework		Sector specific regulation	Business services / Regulated professions	
	Competition and regulatory framework			Retail	
Labour market/ Education	EPL & framework for labour contracts			Construction	
	Wages & wage setting			Digital Economy / Telecom	
	Education	CSR		Energy	
				Transport	

Legend:

	No barrier to investment identified
CSR	Investment barriers that are also subject to a CSR
	No progress
	Limited progress
	Some progress
	Substantial progress
	Fully addressed

Barriers to private investment in Malta are reflected in the European Commission's assessment of investment environments ([1]). Some reforms have been adopted or are in the pipeline, in particular in the areas of the judicial system and skills mismatches, but some barriers remain to be addressed.

Main barriers to investment and priority actions underway

- Regulatory and administrative burden hampers the business investment. Simplified procedures have been introduced with a view to tackle the administrative hurdles in the creation and registration of firms, getting electricity and obtaining construction licenses. As regards the judicial system, new measures on second chance and insolvency have been proposed by the government. (see Section 3.6).

- Skill shortages across a wide spectrum of sectors weigh on investment. There are increasing signals of tightness in the labour market, constraining firms' expansion plans and growth prospects. Increasing reliance on foreign labour to some extent helps to ease the impact of this challenge (see Section 3.3).

- The insufficient capacity to innovate continues to hamper private investment. The R&D and innovation environment is among the least attractive aspects for foreign investment of Malta's business environment. R&D investment, both public and private, remains low. The quality of scientific and technological output, and the availability of researchers underperform the EU average. Key challenges to be tackled include a weak human resources base in science and technologies and the lack of critical mass in specific research areas. The key policies in this respect are the Smart Specialisation Strategy and the alignment of the National R&I Strategy, which are in the process of implementation (see Section 3.4).

([1]) See 'Challenges to Member States' Investment Environments', SWD (2015) http://ec.europa.eu/europe2020/challenges-to-member-states-investment-environments/index_en.htm and 2016 Country report for Malta.

3.5. SECTORAL POLICIES

There are signs that the current physical infrastructure may be insufficient to cope with the current pace of development. Despite ongoing improvements, the overall quality of the existing road network remains of insufficient quality. ([41]) The rapid increase in the use of cars over the years has brought about a steep rise in traffic congestion. Success in maritime trade has reflected an efficient service provision. However, as the current trade offering and spare capacity approach their limits, bottlenecks at the ports may jeopardise future economic growth. Anecdotal evidence suggests that planned large-scale urban development in densely-populated regions is expected to put a further strain on the already overworked utilities, including the sewer system.

A comprehensive approach towards achieving green growth has particular benefits. The islands face geographical isolation and very limited availability of natural resources and land in a context of an increasing population ([42]) and growing economic activity. The structure of the economy to some extent takes account of these factors (European Commission, 2016a). Established patterns of growth, infrastructure and consumption, however, may create path dependencies that accentuate the risks for the environment. The absence of a comprehensive, long-term approach could intensify the resource bottlenecks and the impact of climate change, therefore also hindering growth prospects. The potential benefits of the transition towards a circular economy were highlighted also in the 2017 Annual Growth Survey.

3.5.1. CLIMATE

Meeting the national 2020 target for climate remains a challenge. Malta is the only EU Member State that has missed its target for reducing greenhouse gas emissions outside the Emissions Trading System for 2013, 2014 and 2015. ([43])([44]) This is due to a dramatic increase in emissions from hydrofluorocarbons and a marked increase of greenhouse gas emissions from the transport sector in the context of economic and population growth. Developments in transport have had a particularly significant impact, since it represents half of the total emissions covered under the Effort Sharing Decision (406/2009/EC), while also showing one of the most dynamic increases in emissions. In this context, Malta may have to update its projections for 2020 based on recent emissions data.

3.5.2. ENERGY

The policy strategy has focused on tackling security of supply and dependence on imported oil. The fuel import dependency ratio is 97.3 % in 2015, translating into one of the largest energy trade deficits in the EU (9.3 % of GDP). The national authorities' strategy has focused on diversifying the sources of energy and upgrading the energy infrastructure to improve security, lower costs, and reduce carbon and non-carbon emissions. While not fully implemented yet, these measures have already resulted in lower electricity tariffs for households and businesses. In addition, the state power utility, Enemalta turned profit in 2016, thus improving its debt-repayment capacity. ([45])

Achieving the national energy efficiency target remains a challenge. The measures that would have the highest impact on lowering generation costs have already been taken. From this point on, improving energy efficiency will have the highest potential to further reduce energy costs and raise competitiveness and disposable income. The national energy efficiency target for 2020 has been relaxed so as to account for the high economic growth. Malta reduced its primary energy consumption by 15% from 2014 to 2015. Final energy consumption increased by 5% from 2014 to 2015, partly as a result of buoyant economic activity, making the achievement of the indicative national 2020 energy efficiency targets more challenging.

([41]) Malta ranks 91st for quality of road infrastructure in the 2015-2016 WEF Global competitiveness report

([42]) Malta is by far the most densely populated island in the EU.

([43]) Figures for 2015 are still only estimates.

([44]) According to the 2016 Eurostat Energy, Transport and Environment Indicators yearbook, Malta is the EU Member State with the highest increase in greenhouse gases emissions since 1990, while the EU as a whole has reduced emissions by over 22 %.

([45]) Enemalta's debt is the largest contingent liability of the government.

The promotion of renewable energy provides an opportunity to exploit domestic energy sources. The national authorities have put emphasis on the promotion of solar energy. Furthermore, heat pumps are used to cover heat demand in winter and biodiesel is used in transport. Starting from a very low level, Malta succeeded in increasing its renewable energy share to 4.7 % in 2014, largely supported by EU-funded photovoltaic schemes. These schemes will continue through to 2020. This is above the indicative trajectory towards the 2020 target but significant further renewables deployment will be needed to achieve the target. Malta has launched a process to update its National Renewable Energy Action Plan accordingly. The consultative document prepared for the action plan, however, points to a limited domestic potential for renewable energy.

3.5.3. TRANSPORT

Despite improvements, road infrastructure is under heavy pressure and often highly congested. Congestion is a major challenge to sustainable development in Malta. The external cost of traffic congestion has been estimated at 274 million euros per year for 2012 (University of Malta, 2015) and projected to rise significantly if there are no policy changes (Transport Malta, 2016a and 2016b) ([46]). In addition, this situation has considerable environmental impacts as well. The authorities have introduced relevant measures, such as stimulating public transport usage, incentives for cleaner cars and addressing school transport, however congestion remains high.

The government adopted an ambitious National Transport Strategy with a 2050 horizon and an Operational Transport Master Plan to 2025. The estimated budget is 231 million euros for 2016-2020 and an additional 397 million euros for 2021-2025. The adoption of the Strategy and Master Plan was an ex-ante conditionality for unlocking ESIF funding to the transport sector. The Strategy and Master Plan are comprehensive while also putting significant emphasis on the challenges of road congestion and climate change (see Table 3.5.1). The documents include (the continuation of) a diverse set of measures such as infrastructure works, intelligent transport systems, fleet renewal, modal shift and incentives for behavioural change. While these measures are projected to make significant improvements compared to business as usual, congestion is still projected to rise and greenhouse gas emissions from transport to decrease only modestly until 2030. ([47])

Table 3.5.1: **Selected targets of National Transport Strategy and Operational Transport Master Plan**

	Starting point 2015	Master Plan 2025	Strategy 2030
TEN-T core network	14.4km	19km	20.8km
TEN-T Comprehensive network	29.8km	46km	60.9km
Bus average speed at AM peak	14.8km/h	17.5km/h	20km/h
Conventionally-fuelled cars	99.9%	80%	50%
Non-ETS GHG emissions from transport*	532 $ktCO^2$ equiv.	527 $ktCO^2$ equiv.	525 $ktCO^2$ equiv.
Share of car drivers (relative to 1990 level)	57%	47%	41%
Modal share of non-motorised trips	8%	11%	15%
Road accident grievous injuries	292 (2014)	235	204

* still subject to change due to ongoing analysis of CO2 emissions from transport
Source: Transport Malta

3.5.4. ENVIRONMENT AND RESOURCE EFFICIENCY

Improving resource efficiency is key for sustainable growth given the very limited available resources. ([48]) Both water and waste management are urgent concerns. There is ample scope to improve waste performance since the waste recovery rate is still one of the lowest in the EU ([49]). The Commission has provided a roadmap for compliance in which economic instruments

([46]) This includes the opportunity costs of time and fuel wasted in congested traffic, accidents, air pollution, greenhouse gas emissions and noise.

([47]) It should be noted that there are several other measures contained in the Transport Master plan which would also have a positive impact on GHG reduction. These measures could not be inputted into the Transport Model in order to quantify their individual and cumulative impacts because the respective policies or measures had not been developed to a sufficient level of detail to enable accurate modelling.

([48]) Malta has announced that it will contribute towards the circular economy and sustainability agendas, and is currently implementing its Green Economy Strategy and Action Plan of Malta (adopted December 2015).

(49) At the same time, the share of toxic waste in total waste remains well below the EU average. The landfilling rate of municipal waste (88 %) is much higher than the EU average of 28 %. In addition, the recycling and composting rate of municipal waste (12%) remains below the EU average (44 %) and the 2020 target (50 %) (Eurostat, http://ec.europa.eu/eurostat/web/waste/transboundary-waste-shipments/key-waste-streams/municipal-waste).

play a crucial role ([50]). The government is also taking up the challenge of sustainable water management, in particular on addressing the over-abstraction from the scarce water reserves and nitrate pollution. ([51]) Important economic activities on the islands, such as tourism, crucially depend on a stable water supply.

(50) Support to Implementation – Municipal Waste, available at http://ec.europa.eu/environment/waste/framework/support_implementation.htm

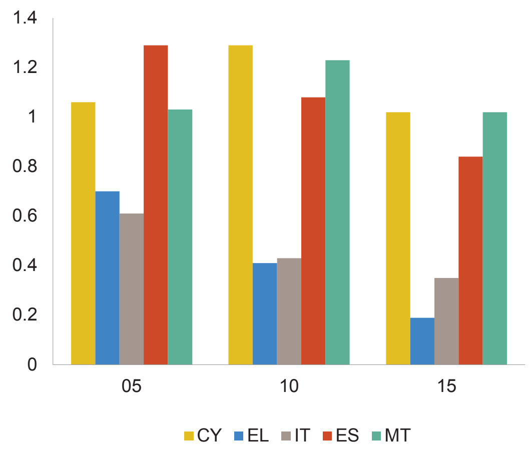
(51) In 2014-2020 the European Structural and Investment Funds will contribute some 87 million euro for improving the efficiency and quality of the water supply and water management and conservation system.

3.6. PUBLIC ADMINISTRATION

3.6.1. EFFICIENCY OF THE PUBLIC ADMINISTRATION

Public sector efficiency is higher than neighbouring Member States, but performs below potential and the EU average. According to the Institutional Delivery Indicator ([52]), Malta performs relatively well compared with other neighbouring Member States although it has not showed a net improvement in the last ten years (see Graph 3.6.1) ([53]). Still, an overall average rating on public administration, as per the 2016 Small Business Act Fact Sheet, suggests that Malta is performing well below its potential, especially given its small size without a complex regional set-up.

Graph 3.6.1: **Institutional delivery indicator, Malta and neighbouring Member States**



Source: World Bank Governance Indicators

The business environment continues to be burdened by inefficient administrative procedures. ([54]) According to the 2017 World Bank Doing Business report, starting a new business is hampered by numerous procedures, even though the actual cost does not seem excessively high. As a result, the environment for starting a business ranks 132nd position out of 190 countries, worsening marginally compared to the previous year (where it ranked 131st). Other administrative obstacles to the operation of businesses include getting electricity connections, despite recent improvements, and construction and other permits. The relative ranking of dealing with construction permits worsened, despite some improvement in terms of costs. The procedures are relatively cumbersome and numerous. Altogether, there are 15 procedures and they take an estimated 167 days to complete them.

Malta is a leading EU Member State in the supply of e-government facilities. There is a broad range of services offered to citizens to interact with the national administration. This is in contrast with the relatively high complexity and burdens that certain administrative procedures entail. In addition, Malta compares favourably in other aspects that are important for business such as tax procedures and the predictability of the national administration.

Several measures were recently implemented to simplify the procedural burden of starting new businesses (European Commission, 2016g). ([55]) In the first half of 2016, the national authorities implemented the first and second phases of a radical simplification reform of the bureaucratic processes for entrepreneurs. This reform entails the identification and simplification of all administrative processes from the start-up phase to closure through internet-based applications. The first phase targets specifically the setting up of a business by a self-employed or a company. As a result, new companies could start operating within two or three days by filling out a short electronic form on an online portal following a two-steps procedure ([56]). Also the total cost for the applicant

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(52) The Institutional Delivery Indicator is an arithmetic average of four components of the Governance Indicators: Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption as defined by K. Masuch, E. Moshammer, B. Pierluigi (2016). The indicator, which takes values between +2.5 and -2.5, captures how well national administrative and governmental institutions are able to deliver a level playing field for all economic actors.

(53) This evolution is consistent with the findings of Fernandez-Villaverde (2013) who concludes that the windfall gains of EMU accession and the inflows of capital they imply, discourage the introduction of new reforms.

(54) The effective impact of these barriers on the birth rates is hard to measure. Until 2013, Malta presented a low firm birth rate (Eurostat, 2016a) but a new time series shows considerable differences with the past figures for 2014. It is also worth noting that Malta has the highest rate of firms with high-growth potential in the EU (Eurostat, 2016b).

(55) These reforms are not included in the Starting a business indicator of the World Bank Doing Business Indicators since they were introduced after June 2016, the reference date for the 2017 publication.

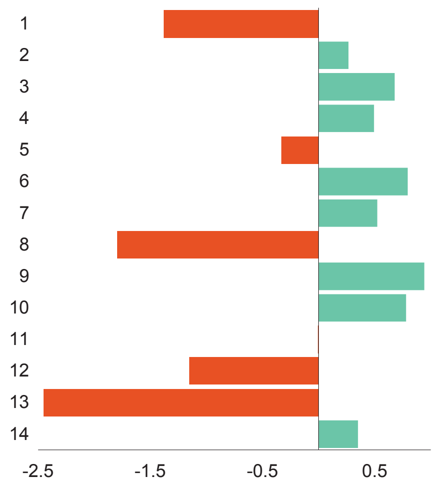
(56) This implies a considerable reduction in the procedural burden as, according to the World Bank 'Doing Business'

is reduced to 100 euros. In addition, Maltese residents setting up as self-employed could start operations by following a simple, no cost one-step procedure on the start-up portal that takes only one day. The second phase of the reform extends these facilities to foreign nationals and partnerships. This simplification includes repealing the requirement of a Trade Licence and a significant reduction of the time to obtain services (estimated at around 50 %). A third phase, which should be completed by the first quarter of 2017, will focus on the tail-end of the life of a business, implying further simplification.

A second important simplification measure followed the effective introduction of a College of Regulators. This new body is directly attached to the Office of the Prime Minister. It was announced in 2011 but became fully operational only recently with the appointment of the Members of the Board. Among other functions, it will conduct *ex post* audits to verify that simplification reforms are effective and inform on new proposals ensuring the systematic application of the SME test. The government committed only in 2015 to subject all relevant legislative acts to a SME test, although the test was already enshrined in the 2011 Malta Small Business Act. Since then, the number of fully executed tests has been very limited and not all relevant legislations - such as those announced in the annual budget speech - are subjected to the test.

Structural changes were introduced to increase the efficiency of the planning authorisation process. This is achieved mainly by splitting the Malta Environment and Planning Authority (MEPA) into two agencies: one dealing with environmental protection and the other with spatial planning ([57]). As mentioned before, the impact of construction permits and licenses was identified as a barrier to investment in construction. The de-merger of the MEPA is already effective and aims at reducing the time for planning applications from over 210 to 100 days. In the first few months since the split, this target has been achieved as the actual average number of days for authorisations is 100 days. When legal periods of inactivity and the time that applications remain suspended by the applicant / architect are removed, this would result in an even shorter processing timeframe. .

Graph 3.6.2: **Public Administration Responsiveness to SME needs - Malta 2015 -Variation with respect to EU average (in number of standard deviations)**



Data bars pointing right show better performance than the EU average; data bars pointing left show weaker performance than the EU average
1 - Time to start a business
2 - Cost of starting a business
3 - Paid-in minimum capital
4 - Time required to transfer property
5 - Cost required to transfer property
6 - Number of tax payments per year
7 - Time it takes to pay taxes
8 - Cost of enforcing contracts
9 - Fast-changing legislation and policies are a problem for doing business
10 - The complexity of administrative procedures is a problem for doing business
11 - SMEs interacting online with public authorities
12 - Licenses and permit systems
13 - Start-up procedures
14 - Burden of government regulations
Source: European Commission (2016b)

3.6.2. JUDICIAL SYSTEM

Rigid insolvency regulations hinder the quality of the business environment. The cost of enforcing contracts, the cost and duration of insolvency and bankruptcy procedures and the lending rights are included in a second main group of issues that still harm the quality of the business environment in Malta. These problems stem from regulations, institutional weaknesses and administrative practices. Minor improvements were registered in the resolution for insolvency

report and to the SBA Factsheets (European Commission, 2016h), the number of procedures to start a new business in Malta was 10.
(57) The two agencies are the Planning Authority (PA) and the Environment Resources Authority (ERA).

and no progress in contract enforcements. The legal framework on restructuring proceedings is ineffective and does not permit a timely intervention and early restructuring. These deficiencies have a negative impact on the entrepreneurship capacity of local firms by limiting the options for a second chance to those firms that encountered difficulties in the past. This places Malta at the bottom of the EU ranking in this area according to the EU Annual report on European SMEs 2015-2016 and the 2017 World Bank Doing Business report. Malta presents very low recovery rates as a percentage of the total assets, a weak legislation and very long time delays for the resolution of insolvency proceedings.

New measures on second chance and insolvency have been proposed by the government. To address the shortcomings, a draft amendment to the Companies act introducing considerable changes to the legal framework on insolvency, such as the possibility of mediation, was tabled and is currently being considered by the national Parliament. The proposed initiative includes the creation of a fund that will finance certified controllers under a well-defined system- registry- that will assist the reconstruction of a company. The appointment of the controller will be by the judiciary. This will allow for a mechanism of early intervention for companies in difficulties that will reduce the burden of costly bankruptcy procedure rules, especially to SMEs. The impact of these changes in their final scope and formulation remains to be analysed.

There have been improvements in the efficiency of the judicial system. According to the 2017 EU Justice Scoreboard, clearance rate for administrative cases increased from 28.6 % in 2010 to 410.7 % in 2015. Disposition time for both first instance administrative cases and for total of first instance (other than criminal) cases decreased respectively from 2 758 days in 2010 to 495 days in 2015 and from 866 days in 2010 to 447 in 2015. However, disposition time for these cases and litigious civil and commercial cases remain high. These positive developments are also reflected in the reduction of backlogs: in first instance courts in 2014 the number of (other than criminal) pending cases was 10 845, reduced to 9 459 in 2015. On the quality of the justice system, there is room for improvement on the training for judges. Many aspects of the civil procedure have been modernised by the adoption of Act IV in September 2016. ([58]) The system of Court Attorneys for assisting judges is almost fully operational one year following its adoption and, according to Maltese authorities, it started having a positive effect including on the further reduction of backlogs.

The implementation of judicial reforms has continued. The reform aims to improve the system of the appointment of judges and remedy the persisting shortcomings of the judiciary, in particular lengthy procedures and backlogs. A law was adopted on 5 August 2016 on the appointment and disciplinary procedures of the members of the judiciary. The law establishes a Judicial Appointment Committee that scrutinises the nomination of a candidate to be made Magistrate or Judge. The Cabinet retains discretion over whose appointment to propose to the President of the Republic, as long as the candidate is deemed suitable by the Judicial Appointment Committee. The composition of the Judicial Appointments Committee comprises one out of the five members drawn from the judiciary, while the independence of two other Members (the Ombudsman and the Auditor general) is safeguarded. ([59]) The functioning of the new system in practice will need to be followed.

(58) This Act aims at increasing the competence of the Courts of Magistrates, increasing the competence of the Small Claims Tribunal, extending possibilities for summary procedures as regards claims and simplifying the service of documents including by electronic means and modernising appeal proceedings

(59) Until that point, there was no judicial appointment committee and judges were appointed directly by the President of the Republic on the advice of the Prime Minister.

ANNEX A

Overview Table

Commitments	**Summary assessment**(60)
2016 country-specific recommendations (CSRs)	
CSR 1 • In view of the high risk of a significant deviation, achieve an annual fiscal adjustment of 0.6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017, by taking the necessary structural measures. • Step up measures to ensure the long-term sustainability of public finances.	Malta has made **limited progress** in addressing CSR1 (this overall assessment of CSR 1 does not include an assessment of compliance with the Stability and Growth Pact). • Malta has made **limited progress** in improving the sustainability of public finances. The Draft Budgetary Plan reports on the initiatives to address the fiscal structural country specific recommendations, although no new elements are reported compared to the situation in spring. In particular, in the area of pension reform, some measures were introduced already with the 2016 budget, targeted at addressing sustainability and adequacy. A full assessment of the budgetary impact is still missing, but initial assessments show that measures to achieve sustainability are not yet as ambitious as to respond to the long term challenges. In addition, the 2017 budget introduced a number of new measures targeted at increasing pension income. Policy action to improve the sustainability of the healthcare system is ongoing. However, it is uncertain whether these measures are sufficient to cope with the challenge of long-term sustainability. An estimate of their potential impact to be incorporated into the long-term budgetary projections is still

(60)The following categories are used to assess progress in implementing the 2016 country-specific recommendations:

No progress: The Member State has not credibly announced nor adopted any measures to address the CSR. Below a number of non-exhaustive typical situations that could be covered under this, to be interpreted on a case by case basis taking into account country-specific conditions:

• no legal, administrative, or budgetary measures have been announced in the National Reform Programme or in other official communication to the national Parliament / relevant parliamentary committees, the European Commission, or announced in public (e.g. in a press statement, information on government's website);

• no non-legislative acts have been presented by the governing or legislator body;

• the Member State has taken initial steps in addressing the CSR, such as commissioning a study or setting up a study group to analyse possible measures that would need to be taken (unless the CSR explicitly asks for orientations or exploratory actions), while clearly-specified measure(s) to address the CSR has not been proposed.

Limited progress: The Member State has:

• announced certain measures but these only address the CSR to a limited extent;

and/or

• presented legislative acts in the governing or legislator body but these have not been adopted yet and substantial non-legislative further work is needed before the CSR will be implemented;

• presented non-legislative acts, yet with no further follow-up in terms of implementation which is needed to address the CSR.

Some progress: The Member State has adopted measures that partly address the CSR

and/or

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

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

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

	missing.
CSR 2 • Take measures to strengthen labour supply, in particular through increased participation of low-skilled persons in lifelong learning.	Malta has made **some progress** in addressing CSR2. • Malta has made **some progress** in strengthening labour supply by improving access and participation in lifelong learning, with a focus on the low-skilled. The National Lifelong Learning Strategy is under implementation, with relevant upskilling and reskilling initiatives. Literacy, numeracy and IT courses are offered in the community, including through cooperation with Local Councils and LEAP centres. ( ) Free of charge revision classes are provided to those who failed or were absent for their examination. Besides the Alternative Learning Programme, two other programmes are offered to students who at the end of compulsory education acquire no or minimum qualifications: 'Youth Inc.' and 'GEM16+'. Malta is working to increase access to second chance education for those with no formal secondary education certificate, through the Malta College of Arts, Science and Technology (MCAST). In 2016 a programme called Skills Kits which offers more flexible and customised pathways was launched. Counselling and orientation is provided for students in education through VET and higher education. In addition services are available to unemployed within Public Employment Services. However, less attention is given to those already in employment.
Europe 2020 (national targets and progress)	
Employment rate target: 70%	67.8% in 2015, up from 66.4% in 2014.
Early school leaving target: 10%	19.8% in 2015, down from 20.3% in 2014.
Tertiary education target: 33%	27.8% in 2015, up from 26.5% in 2014.
At risk of poverty target in numbers of persons: Lifting 6,560 individuals from the risk of poverty or social exclusion	94,000 at risk of poverty or social exclusion, a decrease of 5,000 persons in comparison to 2014 In absolute terms – 14,00 more people are at risk of poverty or social exclusion in 2015 than in

	2008
Greenhouse gas (GHG) emissions target: + 5% in 2020 compared to 2005 (in sectors outside the scope of the Emissions Trading Scheme)	**2020 target**: +5% According to the latest national projections submitted to the Commission, and taking into account existing measures, it is expected that the target will be achieved: **-16%** in 2020 as compared with 2005 (margin of 21 percentage points) **Non-ETS 2015 target**: 6%. Greenhouse gas emissions from sectors not covered by the Emissions Trading Scheme increased by 25% between 2005 and 2015.
2020 Renewable energy target: 10% of gross final energy consumption	4.7% in 2014, up from 3.7% in 2013. Preliminary estimates for 2015 indicate appropriate progress towards the 2020 target, putting the ratio at 5.3%.
National energy efficiency target: reducing primary energy consumption by 0.726 Mtoe and final energy consumption by 0.547 Mtoe	Malta reduced its primary energy consumption by -14.9% from 0.88 Mtoe in 2014 to 0.75 Mtoe in 2015. Final energy consumption increased by 5% from 0.54 Mtoe in 2014 to 0.57 Mtoe in 2015
R&D target: 2% of GDP	0.77% of GDP in 2015 (provisional data) Notwithstanding the efforts made, Malta has moved away from its 2020 target in recent years, partly due to the increasing GDP.

ANNEX B
MIP Scoreboard

Table B.1: **The MIP scoreboard for Malta**

			Thresholds	2010	2011	2012	2013	2014	2015
External imbalances and competitiveness	Current account balance, (% of GDP)	3 year average	-4%/6%	-4.1	-3.8	-1.1	1.4	3.8	4.3
	Net international investment position (% of GDP)		-35%	12.1	6.2	19.5	20.2	41.3	48.5
	Real effective exchange rate - 42 trading partners, HICP deflator	3 years % change	±5% & ±11%	-0.7	-5.0	-7.6	-1.3	0.1	-0.2
	Export market share - % of world exports	5 years % change	-6%	38.3	18.2	13.0	-0.7	-16.6	-8.8
	Nominal unit labour cost index (2010=100)	3 years % change	9% & 12%	9.2	10.5	8.0	9.0	7.2	3.9
Internal imbalances	Deflated house prices (% y-o-y change)		6%	-1.1	-3.5	0.6	-1.5	2.4	2.8p
	Private sector credit flow as % of GDP, consolidated		14%	6.8	7.2	0.4	2.7	7.4	5.4
	Private sector debt as % of GDP, consolidated		133%	162.0	158.5	153.6	146.6	146.7	139.1
	General government sector debt as % of GDP		60%	67.6	70.0	67.6	68.4	67.0	64.0
	Unemployment rate	3 year average	10%	6.6	6.7	6.5	6.4	6.2	5.9
	Total financial sector liabilities (% y-o-y change)		16.5%	12.4	10.9	6.2	1.7	6.3	1.3
New employment indicators	Activity rate - % of total population aged 15-64 (3 years change in p.p)		-0.2%	1.6	2.7	3.7	4.6	4.5	4.5
	Long-term unemployment rate - % of active population aged 15-74 (3 years change in p.p)		0.5%	0.4	0.4	0.2	-0.2	-0.3	-0.7
	Youth unemployment rate - % of active population aged 15-24 (3 years change in p.p)		2%	-0.3	1.6	-0.4	-0.2	-1.6	-2.3

p: provisional. na: not available.
Source: European Commission, Eurostat and Directorate General for Economic and Financial Affairs (for Real Effective Exchange Rate), and International Monetary Fund

ANNEX C
Standard Tables

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

	2011	2012	2013	2014	2015	2016
Total assets of the banking sector (% of GDP)	746.9	742.5	656.2	650.4	539.3	496.7
Share of assets of the five largest banks (% of total assets)	72.0	74.4	76.5	81.5	81.3	-
Foreign ownership of banking system (% of total assets)	33.1	30.9	24.3	17.7	17.3	-
Financial soundness indicators:(1)						
- non-performing loans (% of total loans)	1.5	1.7	2.0	3.2	2.9	2.8
- capital adequacy ratio (%)	54.6	51.9	46.4	25.1	21.2	23.2
- return on equity (%)(2)	3.2	4.7	3.7	4.4	6.3	4.3
Bank loans to the private sector (year-on-year % change)	3.0	3.5	-7.4	10.0	0.7	6.3
Lending for house purchase (year-on-year % change)	8.6	6.8	6.2	9.6	8.6	7.0
Loan to deposit ratio	94.5	89.8	73.7	66.4	63.0	62.9
Central Bank liquidity as % of liabilities	2.6	2.5	1.9	0.9	0.3	0.1
Private debt (% of GDP)	159.4	154.6	147.3	140.9	132.2	-
Gross external debt (% of GDP)(1) - public	6.1	8.2	8.5	7.3	6.7	6.9
- private	702.3	713.2	708.5	716.4	688.1	628.6
Long-term interest rate spread versus Bund (basis points)*	188.1	263.1	179.3	144.8	99.2	81.6
Credit default swap spreads for sovereign securities (5-year)*	253.2	346.2	215.8	208.5	208.5	208.7

(1) Latest data Q2 2016. (2) Quarterly values are not annualised. * Measured in basis points.
Source: European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators).

Table C.2: **Labour market and social indicators**

	2011	2012	2013	2014	2015	2016 [4]
Employment rate (% of population aged 20-64)	61.6	63.1	64.8	66.4	67.8	69.4
Employment growth (% change from previous year)	2.9	2.5	3.7	5.1	3.5	3.5
Employment rate of women (% of female population aged 20-64)	43.8	46.6	49.8	52.0	53.6	55.2
Employment rate of men (% of male population aged 20-64)	79.0	79.2	79.4	80.4	81.4	83.0
Employment rate of older workers (% of population aged 55-64)	33.2	34.7	36.3	37.8	40.3	43.7
Part-time employment (% of total employment, aged 15-64)	12.6	13.2	14.2	15.5	14.5	14.0
Fixed-term employment (% of employees with a fixed term contract, aged 15-64)	6.5	6.8	7.5	7.7	7.4	7.4
Transitions from temporary to permanent employment	67.2	2.2	25.4	10.6	8.6	-
Unemployment rate[1] (% active population, age group 15-74)	6.4	6.3	6.4	5.8	5.4	4.9
Long-term unemployment rate[2] (% of labour force)	3.0	3.1	2.9	2.7	2.4	2.0
Youth unemployment rate (% active population aged 15-24)	13.3	14.1	13.0	11.7	11.8	10.6
Youth NEET[3] rate (% of population aged 15-24)	10.2	10.6	9.9	10.5	10.4	-
Early leavers from education and training (% of pop. aged 18-24 with at most lower sec. educ. and not in further education or training)	22.7	21.1	20.5	20.3	19.8	-
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	23.4	24.9	26.0	26.5	27.8	-
Formal childcare (30 hours or over; % of population aged less than 3 years)	4.0	1.0	3.0	6.0	-	-

(1) The unemployed persons are all those who were not employed but had actively sought work and were ready to begin working immediately or within 2 weeks.
(2) Long-term unemployed are those who have been unemployed for at least 12 months.
(3) Not in education employment or training.
(4) Average of first three quarters of 2016. Data for total unemployment and youth unemployment rates are seasonally adjusted.
Source: European Commission (EU Labour Force Survey).

Table C.3: **Labour market and social indicators (continued)**

Expenditure on social protection benefits (% of GDP)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Sickness/healthcare	6.0	5.8	5.9	6.0	6.2	:
Disability	0.8	0.7	0.7	0.7	0.7	:
Old age and survivors	10.2	9.9	10.2	9.8	9.7	:
Family/children	1.2	1.2	1.1	1.2	1.2	:
Unemployment	0.5	0.5	0.5	0.6	0.5	:
Housing	0.2	0.2	0.1	0.1	0.1	:
Social exclusion n.e.c.	0.3	0.3	0.3	0.3	0.3	:
Total	19.1	18.6	18.8	18.6	18.8	:
of which: means-tested benefits	2.5	2.5	2.4	2.4	2.5	:
Social inclusion indicators	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
People at risk of poverty or social exclusion[1] (% of total population)	21.2	22.1	23.1	24.0	23.8	22.4
Children at risk of poverty or social exclusion (% of people aged 0-17)	26.7	27.8	31.0	32.0	31.3	28.2
At-risk-of-poverty rate[2] (% of total population)	15.5	15.6	15.1	15.7	15.9	16.3
Severe material deprivation rate[3] (% of total population)	6.5	6.6	9.2	9.5	10.2	8.1
Proportion of people living in low work intensity households[4] (% of people aged 0-59)	9.2	8.9	9.0	9.0	9.8	9.2
In-work at-risk-of-poverty rate (% of persons employed)	5.9	6.1	5.2	5.9	5.7	5.4
Impact of social transfers (excluding pensions) on reducing poverty	34.0	32.8	37.1	32.6	33.2	31.2
Poverty thresholds, expressed in national currency at constant prices[5]	5832	5949	6116	6259	6554	6863
Gross disposable income (households; growth %)	:	:	:	:	:	:
Inequality of income distribution (S80/S20 income quintile share ratio)	4.3	4.0	3.9	4.1	4.0	4.2
GINI coefficient before taxes and transfers	44.2	43.8	44.4	45.5	45.7	:
GINI coefficient after taxes and transfers	28.6	27.2	27.1	27.9	27.7	:

(1) People at risk of poverty or social exclusion : individuals who are at risk of poverty and/or suffering from severe material deprivation and/or living in households with zero or very low work intensity.
(2) At-risk-of-poverty rate : proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.
(3) Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.
(4) People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20 % of their total work-time potential in the previous 12 months.
(5) For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices = 100 in 2006 (2007 survey refers to 2006 incomes)
Source: ESSPROS (for expenditure for social protection benefits), EU-SILC (for social inclusion)

Table C.4: **Product market performance and policy indicators**

Performance indicators	2010	2011	2012	2013	2014	2015
Labour productivity (real, per person employed, year-on-year % change)						
Labour productivity in industry	-	-	-	-	-	-
Labour productivity in construction	-	-	-	-	-	-
Labour productivity in market services	-	-	-	-	-	-
Unit labour costs (ULC) (whole economy, year-on-year % change)	-	-	-	-	-	-
ULC in industry	-	-	-	-	-	-
ULC in construction	-	-	-	-	-	-
ULC in market services	-	-	-	-	-	-
Business environment	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Time needed to enforce contracts(1) (days)	-	505.0	505.0	505.0	505.0	505.0
Time needed to start a business(1) (days)	-	38.5	38.5	38.5	33.5	28.0
Outcome of applications by SMEs for bank loans(2)	-	0.69	-	0.68	0.58	0.40
Research and innovation	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
R&D intensity	0.62	0.67	0.83	0.77	0.75	0.77
Total public expenditure on education as % of GDP, for all levels of education combined	6.74	7.96	6.76	6.89	-	-
Number of science & technology people employed as % of total employment	33	36	37	38	37	37
Population having completed tertiary education(3)	14	15	16	17	18	18
Young people with upper secondary education(4)	73	74	76	77	76	78
Trade balance of high technology products as % of GDP	0.64	0.03	1.83	-1.10	-3.45	-3.49
Product and service markets and competition				**2003**	**2008**	**2013**
OECD product market regulation (PMR)(5), overall				-	-	1.57
OECD PMR(5), retail				-	-	1.09
OECD PMR(5), professional services				-	-	1.66
OECD PMR(5), network industries(6)				-	-	2.28

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

Table C.5: **Green growth**

Green growth performance		2010	2011	2012	2013	2014	2015
Macroeconomic							
Energy intensity	kgoe / €	0.14	0.14	0.14	0.12	0.11	0.09
Carbon intensity	kg / €	0.55	0.56	0.56	0.48	0.44	-
Resource intensity (reciprocal of resource productivity)	kg / €	0.51	0.65	0.73	0.62	0.78	0.81
Waste intensity	kg / €	0.24	-	0.25	-	0.25	-
Energy balance of trade	% GDP	1.1	-2.8	-12.2	-9.2	-14.9	-
Weighting of energy in HICP	%	6.28	6.65	7.31	7.57	8.05	7.40
Difference between energy price change and inflation	%	27.1	0.4	-2.0	-1.6	-17.0	-8.7
Real unit of energy cost	% of value added	4.8	6.4	6.5	5.7	5.4	-
Ratio of environmental taxes to labour taxes	ratio	0.28	0.28	0.26	0.24	0.25	-
Environmental taxes	% GDP	2.9	3.0	2.8	2.7	2.9	-
Sectoral							
Industry energy intensity	kgoe / €	-	-	-	-	-	-
Real unit energy cost for manufacturing industry excl. refining	% of value added	5.9	10.0	9.4	9.7	8.0	-
Share of energy-intensive industries in the economy	% GDP	-	-	-	-	-	-
Electricity prices for medium-sized industrial users	€ / kWh	0.18	0.18	0.18	0.18	0.18	0.15
Gas prices for medium-sized industrial users	€ / kWh	-	-	-	-	-	-
Public R&D for energy	% GDP	0.00	0.00	0.00	0.00	0.00	0.00
Public R&D for environmental protection	% GDP	0.00	0.00	0.00	0.00	0.00	0.00
Municipal waste recycling rate	%	5.2	11.4	12.1	8.1	7.4	6.3
Share of GHG emissions covered by ETS*	%	60.6	60.2	61.8	57.6	55.7	39.2
Transport energy intensity	kgoe / €	-	-	-	-	-	-
Transport carbon intensity	kg / €	-	-	-	-	-	-
Security of energy supply							
Energy import dependency	%	99.0	101.3	101.0	104.1	97.7	97.3
Aggregated supplier concentration index	HHI	0.0	0.0	0.0	0.0	0.0	-
Diversification of energy mix	HHI	0.99	0.98	0.98	-	-	-

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2005 prices)
Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
Carbon intensity: greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
Resource intensity: domestic material consumption (in kg) divided by GDP (in EUR)
Waste intensity: waste (in kg) divided by GDP (in EUR)
Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Weighting of energy in HICP: the proportion of 'energy' items in the consumption basket used for the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)
Real unit energy cost: real energy costs as a percentage of total value added for the economy
Environmental taxes over labour taxes and GDP: from European Commission's database, 'Taxation trends in the European Union'
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)
Real unit energy costs for manufacturing industry excluding refining : real costs as a percentage of value added for manufacturing sectors
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices for medium-sized industrial users: consumption band 500–20 00MWh and 10 000–100 000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of recycled and composted municipal waste to total municipal waste
Public R&D for energy or for the environment: government spending on R&D for these categories as % of GDP
Proportion of GHG emissions covered by EU Emissions Trading System (ETS) (excluding aviation): based on greenhouse gas emissions
(excl land use, land use change and forestry) as reported by Member States to the European Environment Agency.
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2005 EUR)
Transport carbon intensity: GHG emissions in transport activity divided by gross value added of the transport sector
Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels
Aggregated supplier concentration index: covers oil, gas and coal. Smaller values indicate larger diversification and hence lower risk.
Diversification of the energy mix: Herfindahl index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
* European Commission and European Environment Agency

Source: European Commission (Eurostat) unless indicated otherwise

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