MALTA'S SECOND DEVELOPMENT PLAN: 1964-69

SOME COMMENTS

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AN assessment of the success of a Development Plan can be made in a number of ways. As a first step a clear statement of the aims of the plan can be compared with the results that were attained provided that account is also taken of the unexpected characteristics of the particular economy during the period under review. Assessments can also be attempted using international comparisons of similar countries.

It is difficult to find appropriate countries with which to compare Malta. In terms of population it is very small: the nearest comparable West European country is possibly Luxemburg with a similar population (just over 300,000) but this yardstick becomes unacceptable when it is recognised that Luxemburg is less independent, in terms of economic structure, than Malta. For example Luxemburg forms part of the Belgian-Luxemburg balance of payments area and has, even prior to the advent of the E.E.C., had a trading agreement with both the Netherlands and Belgium. Equally, none of the other Mediterranean islands provides a suitable yardstick, either because of population and size, because of integration with other larger countries (e.g. Sicily and Italy) or because of very different current standards of living. Cyprus comes closest, possibly, but is inadequate because of the lower current average standards of living and the greater proportionate importance of the agricultural sector in the build up of the Gross national product.

The following table illustrates some of these differences statistically.

Malta has certain unique characteristics which make international comparisons difficult (although not without value) and which alter the emphasis which is to be found in the development plan. Of prime importance amongst these characteristics are (i) the unusual development problem of replacing a predominant industry (the defence services) which is contracting as a result of political decisions taken in the United Kingdom and which, in contrast to the usual development problem of offsetting reductions in agricultural employment, is associated with relatively high average income levels and (ii) the existence, in Mediterranean Sea terms of a relatively high standard of living which, when considered with the absence of raw materials for industry and the problems of access, of a non-

INTERNATIONAL COMPARISONS

	POPULATION 1966 '000	DENSITY OF POPULATION* 1966	GROSS DOMESTIC PRODUCT PER CAPITA 1965 $
Malta	317	1,005	414
Neighbouring countries			
Cyprus	603	65	623
Greece	8,614	65	591
Italy	5,962	172	971
Libya	1,677	1	707
Tunisia	4,460	27	188
Other European comparisons			
Ireland	2,884	41	819
Luxemburg	335	130	1,773
Other countries			
Gambia	336	30	85
Guadeloupe	319	179	...
Hong Kong	3,732	3,610	305
Martinque	327	297	...
Singapore	1,914	3,293	529
Surinam	350	2	373
Swaziland	375	22	...
Zanzibar	347	131	107

Source: Population: UN Statistical Yearbook 1967
National income: UN National Accounts Yearbook 1966

* Per square kilometre of area

member, to the E.E.C. markets, has made the establishment of manufacturing industry relatively difficult. It is interesting to note that a very large proportion of the exports of firms newly established in Malta is directed to the United Kingdom. In comparison with the United Kingdom, Malta's wage rates offer significant advantages for the location of industry in the island and the reference to a 'high' local standard of living is inappropriate in this context.

The philosophy of the second Development Plan was based on the expansion of 'new' industry, tourism and horticulture'. As targets, the plan suggested that the Gross National Product over the plan period might fall by 3.4 per cent. This represented an expansion of the locally generated national product by 12 per cent which would not wholly offset the contraction caused by the reduction in the portion generated by the Defence sector. It was also suggested that emigration might average about 7,500 people per annum and that unemployment would not worsen over the plan period. About 7,000 people were unemployed at the beginning of the plan period.

In terms of these objectives the plan has proved to have been excessively pessimistic. By 1967-68, Gross national product, in money terms, had risen by about 30 per cent and the income in real terms was probably not less than 25 per cent higher. Excluding the Defence sector, the increase in money terms has been over 60 per cent. Emigration has been, in 1967, almost half the plan level and the numbers unemployed has fallen to just over 4,000.

If plans are to be judged on their ability to combine accurate forecasts of endogenous variables and suitable policies for the exogenous elements and then to produce a desired set of results, then the second Development Plan might be classified a failure. This is not an unpopular failure: in political terms a higher than expected standard of living would rarely be adjudged a failure; quite the reverse. The questions which arise in an assessment of the plan, and for the preparation of future plans, require that some explanation of this very acceptable failure should be provided.

In at least one respect the faster than planned rate of development has been achieved in spite of unexpected adverse factors. In 1966 it was announced by the United Kingdom Government that the Defence sector would be reduced more quickly than had earlier been planned. This accelerated rundown was viewed with such alarm that inter-Governmental discussions ensued which postponed its impact slightly.

A further factor which might have been expected to limit the rate of development during the second plan period is the shortfall in the actual public capital expenditure when compared to the initial projections. This shortfall in public investment expenditure is of further interest because in 1963, before the Plan was accepted, Professor Stolper (as a visiting United Nations Advisor) suggested that, because of limited local capacity to invest, the public sector should limit its plans to £26m. over the five years. The Plan rejected this conclusion and was based on an expenditure of £39m. in real terms. Allowing for price rises, the actual and estimated expenditures to March 1969 may be approximately £32m. in 1964 prices.

Even if Professor Stolper is partially vindicated by these figures, he is open to the same criticism as the Plan in his calculations relating the level of investment and increases in gross national product. He suggested that a public investment of £26m. would, inter alia, be associated with a sharp fall in G.N.P. It is to be suspected that the Plan, and Professor Stolper, both underestimated the buoyancy of private investment expenditure implied by the possible success of the leading growth sectors mentioned below.

At this stage it is appropriate to suggest factors which have caused the unexpected acceleration in the rate of economic development. Assuming that the economic arithmetic of the plan was not seriously at fault, the main factors giving this result were, probably,

(i) the imposition by the United Kingdom of travel expenditure restrictions outside the Sterling Area from November 1966
(ii) the emergence in recent years of a significant demand by non-Maltese for permits to settle in Malta
(iii) the enlarged demand, by non-Maltese, for private property in Malta as a holiday centre
(iv) the faster expansion of aided industries than was forecast.

All four of these factors would have resulted in an added demand for the output of the construction industry and this is consistent with the rapid growth in employment which has occured in this industry. Only the first of these could, however, be described as completely exogenous to the plan. For the next two, the controls affecting the availability of non-sterling currencies for property purchase outside the United Kingdom by United Kingdom nationals are not new and the encouragement of non-Maltese to settle in Malta was already enshrined in the income tax exemptions introduced in the early 1960's. (Income Tax was assessed at 6d. in the £ provided that, originally, annual income from non-Maltese sources exceeded £800 per annum, or capital remitted to Malta exceeded £16,000. These figures have since been raised to £1,400 and £28,000 respectively). Surprisingly, although the settlers permits legislation was already in existence, no mention was made in the second plan of this being likely to contribute significantly to the work load of the building industry.

The expansion of the aided manufacturing firms at a faster rate than was forecast has not been a significant factor in causing divergences from the original planning arithmetic. Employment looks like being within 500 of the original plan targets. However, since aid to manufacturing firms is endogenously determined, this flow is, to some extent, a variable which can be affected by local policy decisions and, for the future, some assessment of the role of manufacturing in contributing to further growth and the cost of the inducements needed will be required.

If an enlarged manufacturing sector is in the long-term interests of future economic development, then it can be argued that policy decisions should reflect this priority in an attempt to attract further manufacturing development through greater cash inducements and extra efforts to ensure that building capacity is available to construct the factories required. In practice the cash inducements have remained stable in recent years and the factory building programme has found itself in competition with other sectors for output from an over-extended construction industry. If an enlarged manufacturing sector is not necessary or relatively more expensive than other alternatives for the achievement of economic development, then, for future plans, a shift of Government resources may be possible. It is possible, if indeed it is not probable, that, in terms of a cost-benefit study, which takes into account the elasticity of demand for Maltese goods and services and the effects of rising European living standards on these demands, the marginal cost of aids to manufacturing employment may be greater than the marginal costs to Government of a much expanded tourist industry. In this writers opinion, this argument would be reinforced, rather than weakened, by the conclusion of a successful agreement placing Malta within the economic framework of the E.E.C. This is not to say that manufacturing employment should be disregarded. Without any aids to encourage the expansion of manufacturing employment some new projects would continue to be sited in Malta. (The recent study of aided industry by Mr. J. Dowdall of the Department of Economics of the Royal University of Malta seems to provide strong support for this suggestion).

In summary, therefore, the main divergences from the plan, in terms of the growth of G.N.P. have been:-

(1) the accelerated reduction in Defence sector employment
(2) the expanded employment in tourism and industry
(3) the increased volume of private investment which (2) has generated in the construction industry
(4) the increased private investment to provide housing for settlers
(5) the combined effects of (1), (2), (3) and (4) on other industries.

Items (2) – (5) have all been larger than the second Development Plan had anticipated.

For future development in Malta, certain features of the present situation may merit further comment.

Firstly, there is the problem of ensuring that the construction industry is not a limiting factor in further development programmes and, also, if its capacity does increase, that the demands upon it do not fluctuate widely. In htis area the second Plan has shown how inadequate were the forecasts of the consequences of expansion in other sectors on this sector. For the future, more accurate anticipation of demand is desirable and also the ability to make policy decisions which will regulate that demand so that increases in capacity can be based on some measure of stability of demand. Any slowing down in the *rate* of increase in G.N.P. contains the possibility that the existing boom conditions could be quickly reversed.

Secondly, the effects of the Financial Agreement with the United Kingdom government now need to be assessed and evaluated. The second Development Plan was launched in 1964 with the unique characteristic that all the funds for the public sector investment programme were virtually assured under this agreement. However, these funds have been provided by adding to the external assets of the monetary institutions of the local economy and the problems of relating these funds to the availability of domestic capacity have apparently been underestimated. Thus Government capital expenditure has been largely met by external grants and loans and the use of these to provide payment for the use of domestic resources may, in the case of the construction industry, not have been fully tempered by the shortage of domestic capacity. Some policy issues may have been underestimated by the joint consideration of financing policies and the availability of domestic resources.

Thirdly, although Malta is a relatively small unit in which to create a full range of intermediaries, Malta still has a large outflow of private capital which has been largely unaffected by the (smaller) inflow of private capital, for industry, tourism and property, and the inflow of Government capital. In recent years (1962-1966) Malta has been one of only a small number of countries (less than 20) in the world which have consistently recorded a net outflow of private capital. This is one characteristic that Malta has in common with the United Kingdom, U.S.A., Switzerland and Japan. To this can be added the fact that Malta has one of the highest (if not the highest) ratios of personal saving as a proportion of personal income in the world. These factors indicate some scope for a larger deflection of domestic savings into domestic investment.

Fourthly, Malta has, in the period at least until 1975, got little reason to expect her development to be restrained by a shortage of foreign exchange reserves. Not only are the existing reserves very high, in terms of the conventional measure of reserves as a proportion of imports, but these reserves are growing rapidly. To some extent this is a further reflection of the workings of the Financial Agreement with the United Kingdom. This is an almost unique position for a developing country and avoids the reserve restraints imposed by foreign exchange shortages in other countries. The following table illustrates this position.

COMPARISON WITH THOSE COUNTRIES EXPERIENCING THE LARGEST NET INCREASE IN THE CAPITAL ASSETS OF THEIR MONETARY SECTORS.
(BASED ON 1965 AND 1966: FIGURES IN $m.)

	IMPORTS (1)	INCREASE IN MONETARY SECTOR ASSETS (2)	(2) AS A % OF (1)
Malta	180	30	17
Brazil	2,244	720	32
Libya	731	167	23
Jordan	244	42	17
Vietnam	1,028	172	17
Italy	14,035	2,190	16
Thailand	1,612	236	15
Saudia Arabia	1,052	156	15
Cyprus	258	35	14

Source: IMF. Balance of Payments Yearbook No. 19.

Fifthly, although during the period covered by the second Plan the proportion of Government tax revenue to G.N.P. has not increased, (although there was a significant increase in the years 1960-64), in view of the need to make provision for the termination of the assistance from the United Kingdom and therefore presumably to make increased provision for a Government surplus on current account, this proportion may have to increase. Marginal tax rates, related to increases in G.N.P. (not necessarily personal income), may have to increase from the current level of about 20 per cent. This comparison over time and with other countries in 1965 is illustrated below. Tax revenue excludes social security contributions.

Sixthly, although Malta's fortunes have in the past been largely bound up with the level of Defence employment, the second plan has seen this sector become an even smaller part of the structure of the local economy. Ten years ago the Defence sector provided 59 per cent of the G.N.P.: now it has fallen to 20 per cent and, if alternative forms of development continue to expand, the complete withdrawal of Defence employment will no longer threaten economic ruin to the Islands. This should give greater

GOVERNMENT TAX REVENUE AS A PROPORTION OF GROSS NATIONAL PRODUCT

	%
Malta	
1964	19.4
1965	18.1
1966	19.2
1967	19.4
Ireland	26.7
Italy	21.6
Jamaica	18.1
New Zealand	28.2
Tunisia	24.0
United Kingdom	29.2

Source: Malta National Income Accounts and U.N. National Accounts Yearbook 1966

scope in forthcoming Development Plans to look for faster increases in living standards and employment levels where their predecessors had to be content with objectives registered in terms of only offsetting the changes in the Defence sector.

In conclusion, it would be convenient to be able to say that the results achieved to date meant that economic viability has been secured. Certainly results have exceeded expectations and the prospects are, in the short run, still favourable.

However, for the third Development Plan, Malta still faces the uncertainties of her relationships with the European Economic Community, the European Free Trade Area and, in particular, the United Kingdom. There is still the need to create greater financial independence through the establishment and functioning of adequate institutions as well as the need to avoid the emergence of inflationary forces within the economy. With adequate foreign exchange reserves and a much diminished dependence on Defence employment, the forecast of a period of 15 years or more to achieve economic viability, made by Professor Stolper in 1962, may prove to have been over pessimistic.