THE MALTESE ECONOMY: STRUCTURE AND PERFORMANCE

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1. INTRODUCTION
The Maltese economy is one of the smallest in the world. In 2015 the Maltese gross domestic product (GDP) at market prices amounted to approximately €8,796.5m, equivalent to around 0.05% of the GDP of the European Union (EU), which Malta joined in May 2004, and around 0.07% of that of the eurozone.

Malta’s average GDP per head in 2015 amounted to approximately €20,400, leading to Malta being classified as a high-income country by the World Bank, and as a country with very high human development (in the top quartile) by the UN Development Programme.
LOCATION OF THE MALTESE ISLANDS
The population in Malta was estimated at 434,403 at the end of 2015, of which about 31 thousand were non-Maltese.

With a land area of around 316 sq km, the population density of the Maltese islands at the end of 2015 was about 1370 persons per sq km, which is one of the highest in the world for an independent state.

This excludes the relatively large inflow of tourists, which in 2015 amounted to some 1.7million persons with an average stay of about 8 days (equivalent to about 8.5 % of the total population)
2. RECENT ECONOMIC HISTORY
Before Malta attained political independence in 1964, the economy depended heavily on British military expenditure. An important change that occurred in the Maltese economy after 1964 related to the phasing out of the bases of the British forces stationed in Malta.

British military establishments reduced their share of GDP from an average of 22% in the second half of the 1950s to zero in 1979, the year that these establishments were totally dismantled, in line with the 1972–79 development plan. Another significant change was the rapid expansion of the manufacturing sector up to the end of the 1970s.
Manufacturing accounted for just 10% of GDP during the second half of the 1950s and increased to about 33% during the late 1970s. Since then there has been a decline in the GDP share of manufacturing; by 2015 its share had decreased to about 10% of GDP.

The manufacturing sector has also changed structurally since 1960, with the major change being that the clothing industry, which depended mostly on relatively low wage rates, has declined, while technologically based industries, with high per worker value-added, such as the electronic components industry, increased their relative share of the sector.
The services sector, including domestic property income, amounted to about 63% of GDP in 2015. As its share increased over the years, the structure of the sector changed, in that it became more export-oriented.

This was mostly due to the development of tourism, transportation, remote gaming and financial services.
Looking at Maltese foreign trade in general between 1960 and 2015, some tendencies emerge: essentially, Malta experienced a relatively large deficit in its merchandise trade and a positive, but smaller, surplus in its services trade. Thus, the balance between exports and imports of goods and services taken together (the resource balance) was generally negative.

This gap tended to increase into the 2000s, but had not threatened the stability of the exchange rate of the Maltese lira, when this was the domestic currency, due in part to net foreign currency inflows in the capital account of the Maltese balance of payments. With the growth of export-orientated services and the decline of the manufacturing industry, the resource balance narrowed and was mostly positive between 2011 and 2015.
Economic governance has also undergone major changes since independence. In the 1970s and the first half of the 1980s the country was administered by a socialist Government (led by the Malta Labour Party—MLP, which later changed its name to Partit Laburista—PL), with widespread state intervention and price and import controls.

After 1987 the Partit Nazzjonalista (PN—Nationalist Party) was returned to power and, although having a conservative ideology, ushered in a radical change in economic policy, based on liberalization in the domestic market, the removal of import controls and a policy of privatization.

The PL was returned to power in 2013, but the Government’s economic policies remained broadly the same as those pursued by the PN, but with more liberal and inclusive social policies.
A recent important development in Malta’s economic history was the country’s accession to the EU in 2004, together with nine other states (namely Cyprus and eight Central and Eastern European countries).

Malta had to adopt a body of EU legislation, which upgraded its institutional capacity, albeit at a significant cost. By joining the EU, access to the European market for Maltese exports improved.

This also led to the country adopting an economic strategy that promoted domestic competition and international competitiveness, leading to a more efficient allocation of resources. Furthermore, Malta benefited from EU regional funds for economic and social development.
Malta was one of the slowest-growing economies in the EU when it acceded to the Union in 2004, with real GDP growth standing at only 0.9%. This was mostly because of the difficult international trading environment, which Malta was not meeting with sufficient competitiveness, compounded by the short-term effects of fiscal consolidation.

However, there was an upturn in 2005–08, with real GDP growing at a rate of about 4% annually between 2005 and 2008, as supply-side policies were put in place to enable Malta to enhance its potential rate of growth and to converge with average EU levels. However, in 2009 the Maltese economy contracted by 2.7%, mostly owing to the effects of the global recession. It subsequently recovered, and grew in real terms at an average rate of about 3% per year between 2010 and 2012 and an average rate of 4.7% between 2013 and 2015.
On 16 July 1990 Malta formally applied for membership of the European Community (now the EU), receiving a favourable opinion (avis) from the European Commission in June 1993. Following the MLP’s electoral victory and a change of government in October 1996, however, Malta’s application was suspended.

The Labour Government lasted less than two years and, as a result of another change of government following the general election of September 1998, negotiations over accession to membership of the EU recommenced. In February 1999 the European Commission adopted a report updating the 1993 opinion on Malta’s application for EU membership, recommending that the Council approve the evaluation of the compatibility of Malta’s legislation with EU requirements, with a view to starting negotiations.
The monetary sector underwent significant development after 1994, driven by the move towards liberalization and the prospects of joining ERM II, which, as explained above, led to the adoption of the euro in 2008. Malta has developed a vibrant international financial centre by actively promoting its competitive advantages, including its pro-business legislative framework and the benefits of EU membership.

The domestic financial services sector is dominated by two relatively large banks, namely Bank of Valletta and a subsidiary of the UK-based HSBC group, with a number of smaller banks also operating in the domestic market. There are also a number of banks operating mostly in international finance.
Interest rates were fully deregulated in 1995, and controls on external capital flows were removed upon Malta’s accession to the EU. The 1990s and early 2000s witnessed significant development in the financial infrastructure of the Maltese economy, with legislation and regulatory practices being updated to meet EU standards prior to membership and the subsequent adoption of the euro.

Monetary policy in Malta was historically committed towards maintaining a low rate of inflation by defending a fixed peg for the Maltese lira. Since the adoption of the euro, monetary policy in Malta, as a member of the eurozone, has been set by the European Central Bank in Frankfurt.
3. STRUCTURE OF THE ECONOMY
An important characteristic of the Maltese economy is its degree of openness. Like many other small economies, Malta depends heavily on imports for its industrial supplies and consumer goods. The import content of total final sales was about 61% in 2015. At the same time, since the domestic market is extremely small, the economy relies to a large extent on exports of goods and services, which amounted to some 57.5% of total final sales in that year.

In 2015 about 10% of Gross value added was generated by the manufacturing sector, about 63% by the market services sector (including property income), about 2% by agriculture and fisheries, and about 4% by construction and quarrying. The remaining 21% represented the share of government.
For a nation of its size, Malta’s economy is relatively diversified, although there are a number of specific industries dominated by one, or a few large firms.

Exports of merchandise, excluding re-exports (mostly fuel), are dominated by fuel, are dominated by electronic and electrical equipment. Other important merchandise exports include chemicals, instruments and printing. In 2015 about one-third of Maltese exports of merchandise were directed towards the EU, primarily to France, Germany, Italy and the United Kingdom.

Exports of services are relatively diversified and consist principally of tourism, transportation, financial services, remote gaming, and information and communications technology (ICT) activities. Malta’s trade in services occurs mostly with the EU.
The Maltese islands have few natural resources, and most raw materials and industrial supplies have to be imported—with the exception of limestone, which is quarried and used in the building industry, although its availability is rapidly declining.

Petroleum exploration has been undertaken on several occasions, but, so far, its extraction has not been found to be commercially viable. Malta’s climate and its cultural and historical heritage are important resources for attracting tourists to the islands.
4. THE LABOUR MARKET
According to statistics based on administrative records of the Employment and Training Corporation, at the end of 2015 the total number of full-time gainfully employed persons was 173,474. An additional 34,608 persons were employed on a part-time basis (excluding those who had a full-time job also).

According to the labour force surveys carried out every three months, between 2010 and 2015 Malta experienced relatively low unemployment rates, averaging about 6% of the labour force with a tendency to decline between 2013 and 2015.
The labour market is characterized by a low participation rate of women, standing at about 53.5% of the female working-age population in 2015—one of the lowest in the EU—although this participation rate is increasing rapidly as younger women replace ageing members of the labour force and labour market policies are put in place to attract women to the labour force.

The male participation rate was substantially higher, amounting to about 81% of the male working-age population in the same year. Another characteristic of the labour market is the large proportion of gainfully occupied persons in the public sector, which, at the end of 2015, stood at some 28%.
The distribution of employment in different sectors changed markedly from the 1970s, broadly reflecting the changes in the composition of GDP described above. Further important changes in the size and composition of the labour force are likely to occur, as a result of a continued increase in the female participation rate and an accelerated shift out of the labour force of older workers who were born in the aftermath of the Second World War, when there was a baby boom.

There is also the possibility of labour emigration now that Malta forms part of the EU single market, permitting ease of labour mobility, but this is likely to occur mostly in certain specialized professions that attract markedly higher remuneration in other EU countries.
At the same time, inward migration of workers in relatively low-paid jobs is likely to increase, particularly in hotels and restaurants, and in the construction industry.

Malta is likely to continue experiencing inflows of irregular immigrants, especially from Africa and the Middle-East, owing to the geographic position of the islands. This has created and is likely to continue creating financial and social problems for Malta’s small economy. On the other hand, this phenomenon may in the long term create a pool of manual labour, particularly in construction and environmental services, which could generate income and therefore revenue from tax and social security contributions.
5. MAIN PROBLEMS
SUMMARY AND PROSPECTS

The major problems faced by the Maltese economy relate to the very small size and insularity of the country—physical characteristics that will remain regardless of economic policy.

Other major difficulties, which depend to an extent on economic policy, relate to a growing merchandise trade gap, international competitiveness, female labour force participation, an aging population and education.
Problems associated with Malta’s small size include constraints relating to its limited ability to reap the benefits of economies of scale, its poor natural resource endowment and its limitations on the degree of domestic competition.

The country’s small size also leads to a very high dependence on imports and exports, rendering the economy highly exposed to external shocks. Insularity brings additional problems associated with international transport, which is a major concern given that Malta depends so heavily on foreign trade. These are permanent characteristics of the economy, and the best that policymakers can do is to mitigate the disadvantages associated with these features.
Imports of merchandise increased rapidly during the 2000s, leading to unprecedented merchandise trade deficits in absolute and relative terms. This was exacerbated by the low growth rate of exports of merchandise. However, growing reliance on services, rather than manufacturing, has resulted in a reduction in the ratio of imports to final sales, given that a large proportion of Malta’s imports are industrial supplies for the manufacturing sector.

It should be noted that, despite the relatively large gap in merchandise trade, the resource balance (i.e. the difference between exports and imports of goods and services) was mostly positive between 2010 and 2015, indicating that the surplus on services trade more than compensated for the deficit in merchandise trade.
A major challenge that needs to be addressed relates to the link between wage rates and productivity. If Malta is to increase its GDP per head, in order to, among other things, converge with the EU average, wage rates will have to increase, given that a large proportion of GDP is income from employment.

However, unless wage rate increases are matched by improvements in labour productivity, the end result will be an increase in per unit costs, leading to a loss of competitiveness.
Female Labour market participation in Malta is among the lowest in Europe. This represents one of the principal problems confronting the economy and, since Malta’s main resource is its workers, policies directed towards increasing labour market participation have been put in place with a degree of success, so much so that the participation rate of women increased from 42% in 2010 to 53% in 2015.

This issue is also particularly important given the underlying challenge that the economy faces from an ageing population. By 2030 the number of workers supporting one pensioner is expected to fall from the current figure of four persons to two, assuming current participation rates. Therefore, an increased participation rate of women in the workplace would also be desirable in this regard.
The Maltese population is an ageing one, and as a result the current ‘pay-as-you-go’ pension system (whereby retirees receive pension benefits out of contributions by current workers) is not sustainable. The options for reform range from extending the retirement age (a change that is already being implemented), requesting people to save more while they are still working, and directly tying current savings with future pension payments.

One way of reducing the dependency of the older segment of the population on the working age population would be to introduce a mandatory pension pillar to accompany the current pay-as-you-go system and gradually to phase out the existing system to one that directly links an individual’s pension to his or her savings during the working period. However, there is no consensus in Malta as to how the pension system is to be further reformed.
Malta faces major challenges relating to education. The percentage of early school-leavers is relatively high when compared to that of other EU member states. Early school-leavers tend to find it difficult to find employment and, if they do find a job, their earnings are likely to be relatively low.

Another challenge in the educational sphere is that in Malta enrolment rates in tertiary education are relatively low, when compared with other EU member states. As a result, the proportion of persons with tertiary education attainment is one of the lowest in the EU.

However, the Maltese authorities are addressing these problems and the rate of early school-leavers is falling as a result of policies adopted by the educational authorities. In addition, funded tertiary educational opportunities have significantly increased.
The fact that Maltese core banks rely mostly on deposits originating from Malta and government bonds are mostly purchased by Maltese resident individuals and institutions, renders Malta somewhat sheltered from external financial instability. In addition, the Maltese core banks are generally profitable, with high solvency and liquidity ratios. For these reasons, Malta was not highly exposed to the 2008-2009 financial turmoil.

The major element of riskiness in the Maltese financial system is that a very high proportion of the lending of the Maltese core banks is secured by real estate collateral, leading the system to depend very highly on the construction sector and on purchase of property. However, this risk is mitigated by the fact that rate of mortgage repayments in Malta is high. In addition exposure of banks to speculative property trading is very small as it is normal practice by Maltese banks to ensure that the value of the secured property exceeds the loan tied to it by a substantial percentage.
In Malta credit institutions are very underdeveloped and the cost of borrowing funds for business is high relative the euro area average, rendering it difficult for business, particularly smaller firms, to access credit. The IMF attributed this to various factors, including limited domestic competition and high rate of non-performing loans, which adds to cost of the lending agencies. Policies that encourage cross-border financing to stimulate competition among lenders and that lead to a reduction in the rate of non-performing loans are therefore called for to reduce rate of interest on lending.

Malta also lacks an institutional arrangement for long-term financing of risky projects. For this purpose the creation of a development bank could help in making available this type of lending.
A fairly recent development in Malta is the influx of irregular migrants mostly originating from Africa and more recently from the Middle East, most of whom reach Malta by sea via Libya. Legal migrants have also increased, either retiring in Malta or joining the labour force and therefore add to the productive capacity of the country, thereby also contributing to government finances. Irregular migrants, on the other hand, are often a burden on the economy, and, in addition create social problems mostly due to hurdles they encounter in properly integrating in society.

The Maltese government has often called for a fairer burden-sharing mechanisms within the EU, given that Malta is often considered as a stepping stone into the EU. Recent arrangements within the EU attempted to create a burden sharing arrangements, but there is no sufficient consensus between the EU member states on this matter.
6. CONCLUSION
This study has given an overview of the structure of the Maltese economy and discussed some of the major problem faced by the economy.

It has been shown that, overall, the economy has performed well since Malta joined the EU, and the outlook, according to the IMF and the European Commission, looks positive.

The major constraints facing the Maltese economy are associated with its very small size, rendering it very exposed to external shocks, and limiting its ability to reap the benefits of economies of scale. Other major challenges faced by the economy identified in this presentation relate to public financing, particularly given the difficulties in securing pension sustainability, and to the labour market, particularly the need to balance wage increases with labour productivity.
An important topic of discussion in Malta relates to whether Malta has, on balance, benefited from EU accession. To answer this question, one would have to compare what would have happened to the Maltese economy since 2004 with alternative scenarios, such as Malta as a non-EU country, or possibly a member of the EEA. Such an exercise is of course very difficult to undertake.

One thing that appears very probable is that the reform in economic and environmental governance which Malta undertook as a member of the EU, would probably not have been adopted if Malta did not join the Union.

Moreover, being part of a single market, Malta has benefitted tremendously in terms of access to export markets, something that could have been restricted had Malta not joined the EU.
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