

The Economy

Lino Briguglio

I. Introduction

The Maltese economy is one of the smallest in the world. In 1991, the Maltese GNP was approximately US\$25,000 million and the Maltese population was just under 360,000, occupying a land area of around 320 square kilometres.

In terms of GNP per capita, however, Malta is not on the low side by international comparisons. Although usually classified as a developing country, its average 1991 per capita GNP, amounted to approximately US\$7,000, which is higher than most third world countries. The World Bank, in its 1991 *World Development Report* classified the Maltese economy as an upper middle income one.

As is well known, GNP per capita has a number of shortcomings as an indicator of development, and sometimes other indicators are utilised for making development comparisons across nations. One such indicator is the percentage contributed by the manufacturing sector to GDP (see Table 1). In Malta this amounts to just under 30%, which compares well with the manufacturing percentage pertaining to developed countries.

Some social and educational indicators suggest that Malta is more akin to industrial market economies than to third world countries. Literacy rates, school enrolment rates, average life expectancy, the number of hospital beds and the number of physicians per head of population are very similar to the rates found in Western European countries (Briguglio 1988).

This paper gives a very brief overview of

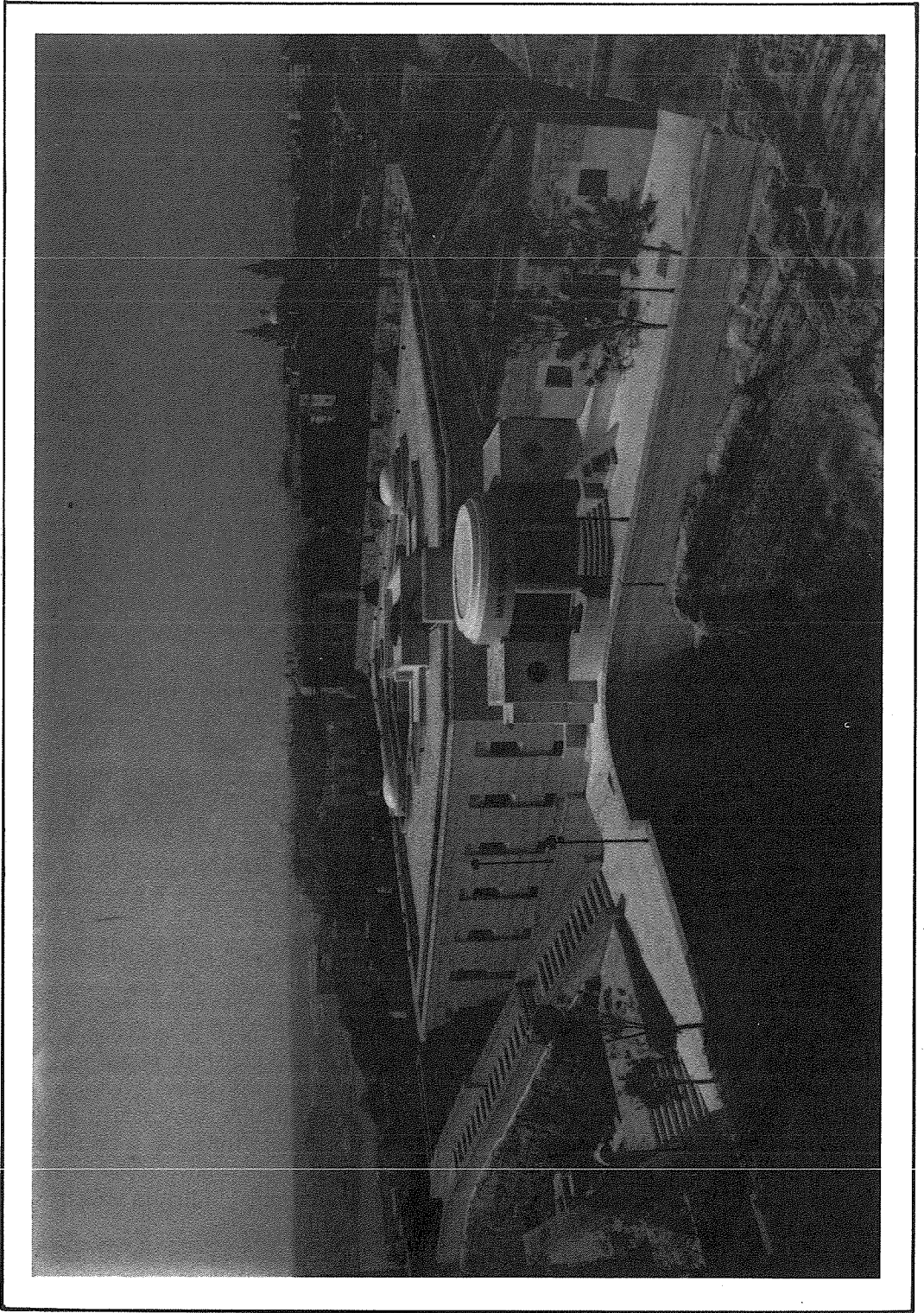
the structure and performance of the Maltese economy during the period 1960-1991. Following this introduction, a brief account of Malta's development planning, and its results, is given. Sections three and four give some details on cyclical and structural changes over time. The fifth section discusses changes in expenditure patterns, while section six deals with changes pertaining to the Maltese balance of payments. Section seven describes the most important weaknesses faced by the Maltese economy today, and section eight concludes the paper.

II. Maltese Development Planning

The most important change that has occurred in the Maltese economy during the past 30 years relates to the expansion of the manufacturing sector and the phasing out of the British forces bases in Malta.

Up to the fifties, the Maltese economy relied heavily on British military expenditure (up to 1964 Malta was a British colony). Exports of merchandize was minimal, and very little regard was given to international competitiveness. Every year, the Maltese government drew up a budget, asking for funds from Britain to balance its administrative accounts and to create employment in British military establishments in Malta.

During the second half of the fifties, it became manifestly obvious that changes in the British defence policies were going to result in massive rundowns of employment with the British services in Malta, and the



Malta's Central Bank in Valletta, with the suburb of Floriana and part of the Grand Harbour in the background

need was felt to implement a coordinated development plan to diversify Malta's economy (see Balogh and Seers, 1955, Stolper, 1964 and British Government, 1957, 1963).

Between 1959 and 1986, six development plans were launched (see Maltese Government, 1967, 1972, and Development Plans). Although during this time Malta had governments of different ideologies, the basic objective of successive plans was essentially the same, namely that of making Malta a viable economic unit, which by its own efforts would provide jobs for those who sought them.

To achieve this aim, steps were taken to increase the share of manufacturing, tourism and agriculture in the domestic product. Since Malta's internal market is very small, industrial expansion had to be sustained through increased reliance on the export market, and therefore the importance of competitiveness for attaining economic objectives was always stressed. All plans and strategies were based on the need for adapting attitudes and methods of production to the changing structure of the Maltese economy.

The major differences between the planning and strategic approaches under different governments were related to the role of the state in directly productive activities. The Nationalist governments (1962-71) believed that state organs should only take a supportive role in such activities, leaving the private sector to take business initiatives according to market forces. The Labour governments (1971-87) on the other hand, tended to base their economic policy on the tenet that the state should participate directly, especially where the private sector failed to take the initiative.

Since 1987, the year the Nationalist party (conservative with liberal economic orientation) was elected in government, no plan was published as such, but the market oriented strategy of the government was clearly expressed. Malta is at present seeking to join the European Community,

and reliance on international competitiveness has been emphasised more than ever due to the fact that as full EC member, Malta would eventually have to remove all import barriers on goods, services, capital and labour coming from and going to the other members of the community.

The development process in Malta was beset by a series of difficulties, which were not all of Malta's own making. These included the successive and sometimes unexpected decreases in the British defence expenditures during the sixties, the international energy crisis and unprecedented inflationary pressures during the seventies, and the international recession during the early eighties.

A satisfactory measure of success has however been achieved, and this is evidenced by the expansion of the manufacturing and the services sectors and the phasing out of dependence on British military service, the growth in the number of the gainfully occupied persons and the rise in real per capita national income.

III. Cyclical Changes

During the period under consideration, the Maltese economy experienced a cyclical pattern of change.

The economy grew at a very slow rate during the first half of the sixties. During this sub-period, emigration and unemployment reached very high rates. The trend was however reversed during the second half of the sixties, a sub-period characterised by very fast growth rates in GDP and employment.

The economy slowed down again during the first half of the seventies. Although between 1970 and 1974 GDP tended to grow, the number of persons employed did not grow significantly, and had employment not been created in government labour corps, the number of persons employed would have actually decreased. Again, this sub-period of

unsatisfactory economic performance was followed by fast growth rates in output and employment in the second half of the seventies.

Between 1982 and 1985 the Maltese economy performed at its worst. The rate of growth of GDP was a very slow one. Employment decreased at a very rapid rate – the fastest decline when all sub-periods are considered. Unemployment, on the other hand, increased and reached very high rates. Had the labour force not decreased, the official unemployment figures would have been much higher.

The economy picked up again after 1985, and GDP in real terms grew at a rate of about 6% per annum between 1986 and 1991. Between 1988 and 1991 unemployed averaged around 4%.

The fluctuations in the Maltese economy are reflected in the ups and downs of GDP and the rate of unemployment shown in Figures 1 and 2. Figure 1 gives the pattern of change of GDP compared to a 33 year trend and Figure 2 shows the ups and downs of unemployment and emigration. The figures show graphically that the economy performed at its best, in terms of rates of growth of GDP during the second half of each decade. The most rapid increase in GDP occurred between 1975 and 1979 and the lowest rates of unemployment occurred during the second half of the seventies and the second half of the eighties.

Probably the most important factors which accounted for the satisfactory performance of the Maltese economy during the second half of the sixties and of the seventies were the so-called construction boom during the sixties, and the rapid increase in tourism during the seventies. These two types of expenditures have relatively low import contents (see Briguglio, 1992 and Tarling and Rhodes, 1989 for the multiplier effects of tourism) and therefore also have relatively high multiplier effects on domestic value added and employment.

The rapid rate of economic growth

during the second half of the eighties and early nineties could be attributable to process of liberalisation introduced by the Nationalist government since 1987. There is considerable debate in Malta as to whether or not economic liberalisation is beneficial to the Maltese economy, but it appears that it has so far given good results in terms of growth of GDP and employment.

IV. Structural Changes

The patterns of change just described have been accompanied by changes in the composition of GDP. Table 2 presents data on the contribution of major sectors during the period under consideration.

It can be seen from this table that the fastest growing sector was manufacturing, which accounted for just under 17% in the early sixties and increased to about 33% during the late seventies. There was a decline in the percentage share of this sector during the eighties.

The manufacturing sector itself also changed structurally during the past thirty years. The textile and clothing sub-sector has tended to increase its share up to the seventies and to decline again during the eighties. The machinery sub-sector expanded its relative shares between 1960 and 1990. On the other hand, the transport equipment sub-sector (mainly representing shiprepair and shipbuilding) has experienced a decline in its share of the manufacturing sector.

An important sector during the sixties was the British military base. The data in Table 2 shows that this sector reduced its share of GDP from an average of 15% in the early sixties to zero during the eighties. As already explained, this was in line with the development strategy adopted in the Maltese development plans.

The changes in the shares of other economic sectors were not as dramatic as those pertaining to manufacturing and the British bases. During the thirty year period, construction and quarrying

Table 1 The composition of the Maltese gross domestic product, 1990

	<i>Lm million</i>	<i>%</i>
Agriculture and fishing	23.6	3.1
Construction and quarrying	24.9	3.3
Manufacturing	197.3	25.8
Market services	285.6	37.4
Domestic property income	55.2	7.2
Public sector ^a	177.1	23.2
Total	763.7	100.0

^a The public sector as defined here excludes limited liability companies with government majority shareholding.

Source: *Economic Survey*, 1992. (The average rate of exchange of the Maltese lira against the US dollar was Lm1 = \$3.15.)

Table 2 Sectoral net output as a percentage of GDP at factor cost (averages for six sub-periods)

	1960-64	1965-69	1970-74	1975-79	1980-84	1985-90
Manufacturing	16.6	20.8	24.3	32.7	30.5	27.9
Construction and quarrying	4.4	4.4	4.2	2.9	5.0	4.1
Market services	33.7	33.3	30.4	30.9	34.3	34.4
Agriculture and fishing	7.3	7.2	7.2	5.3	4.2	4.1
Public sector ^a	17.9	19.8	21.8	19.8	18.7	21.8
British forces	15.1	9.5	6.3	2.3	—	—
Property income	5.0	5.0	5.8	6.1	7.4	7.8
Total	100.0	100.0	100.0	100.0	100.0	100.0

^a This covers public administration and public enterprise, but excludes companies with government majority shareholding.

Source: *National Accounts of the Maltese Islands*.

contributed an average of 4.2%, market services an average of 32.7% and the public sector an average of 19.5% of GDP. The share of agriculture and fishing averaged 6.1% but tended to decrease during the period under consideration.

Table 3 shows the changing pattern of the distribution of employment in different sectors. In general, with the notable exception of the public sector, the changes in employment shares reflected the changes in the shares of GDP. For example, the increasing share of the manufacturing output has increased employment in manufacturing from just over 18% of the gainfully occupied in the first half of the sixties to about 30% in the eighties.

The changing structure of the Maltese gainful employment is shown graphically in Figure 3, where the sectoral distribution in the early sixties is compared with that of the second half of the eighties. The growing share of the manufacturing sector and the disappearance of the British military sector in the eighties are clearly shown in the pie-charts.

As stated earlier, there was also a structural change within the manufacturing sector itself. Table 4 gives a breakdown of the percentage share of employment in some manufacturing sub-sectors. It can be seen that the textile and clothing sub-sector has increased its share of the manufacturing sector from 13% in the first half of the sixties to 30% during the second half of the seventies, and by the end of the eighties its share went down again to 25%. The machinery industries expanded their relative shares between 1960 and 1990. On the other hand, the transport equipment industry has decreased its share of the manufacturing sector from 39% in the first half of the sixties to 22% in the second half of the eighties.

Another interesting tendency, shown in Table 3, is that female employment as a percentage of total employment increased from just over 18% in the first half of the sixties to about 26% in the second half of the seventies. The percentage has decreased

slightly during the eighties. In recent years, the percentage of female employment has again started to increase reaching 26% in 1992.

Female employment tended to increase at a faster rate than male employment between 1960 and 1980. The bulk of the increases in female employment occurred in the manufacturing sector, mostly in the clothing, textile, and electrical machinery industries.

V. Changes in Total Final Expenditure

Total final expenditure is composed of consumption, investment, exports and government current expenditure. These represent all the possible expenditures on goods and services sold by domestic firms. These expenditures have an import content and a domestic value-added content. The latter is called the gross domestic product.

Aggregate expenditures in Malta have also tended to follow a cyclical pattern of change (see Figure 4). In general, these tended to increase rapidly during the second half of the sixties, of the seventies, and of the eighties and to increase slowly or even decline during the other sub-periods.

The type of expenditure that fluctuated most was that related to investment. Exports of goods and services also tended to fluctuate widely around the thirty year trend, with rapid growth rates during the second half of the sixties, seventies and eighties. Exports have tended to decrease during the early sixties and the first half of the eighties.

Imports, measured in real terms, tended to grow at a slower rate than total final expenditure during the seventies and the eighties. This means that the real import content of total final expenditure tended to decrease and the real domestic value added content tended to increase during these two decades. This tendency, shown in Figure 4, has been brought about by the policy of

Table 3 Sectoral employment as a percentage of total employment (averages for six sub-periods)

	1960-64	1965-69	1970-74	1975-79	1980-84	1985-90
Manufacturing	18.2	21.3	27.0	31.3	31.8	29.0
Construction and quarrying	8.6	10.7	8.0	4.2	5.8	5.5
Market services	28.4	29.8	30.4	30.8	32.7	33.3
Agriculture and fishing ^a	8.9	7.3	6.3	6.4	5.2	3.0
Public sector ^b	19.6	20.6	22.9	25.2	24.6	29.3
British forces	16.2	10.3	5.3	2.1	—	—
Total	100.0	100.0	100.0	100.0	100.0	100.0
Male	81.1	79.6	76.0	74.0	75.0	75.0
Female	18.2	20.4	24.0	26.0	25.0	25.0

^a This covers public administration and public enterprise, but not companies with government majority shareholding.

^b Agricultural employment statistics have been revised in the 1985-89 sub-period and are not therefore strictly comparable with previous sub-periods.

Source: Annual Abstract of Statistics.

Table 4 The composition of employment in the manufacturing sector (average percentage shares for six sub-periods)

	1960-64	1965-69	1970-74	1975-79	1980-84	1985-90
FBT	20.3	16.9	13.3	11.1	11.3	12.1
TC	13.1	18.0	22.0	29.9	28.6	25.3
MME	5.6	6.9	11.3	11.3	11.6	14.1
TE	39.2	32.9	24.2	19.9	20.8	21.5
OTHER	21.9	25.3	29.3	27.7	27.7	27.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

Legend: FBT: Food, Beverages and Tobacco
 TC: Textiles and Wearing Apparel
 MME: Metals, Machinery and Electrical Machinery
 TE: Transport Equipment (mostly ship repair/building)

Note: Figures are approximate.

Source: Annual Abstract of Statistics.

import substitution and import controls which have been resorted to with increased intensity since the seventies and up to 1987. The tendency was reversed somewhat after 1987, when a trade liberalisation policy was ushered in.

Measured at current prices, however, the Imports/Total Final Expenditure ratio did not exhibit a marked tendency to decrease or increase, fluctuating around 50%.

VI. The Maltese Balance of Payments

The balance of payments gives a picture of a country's transactions with the rest of the world. It is usually divided into three parts, namely the Current Account, the Capital Account and Official Financing Account.

Table 5 gives a summary of the main entries in the balance of payments during the 1960-1990 period. The data is presented as five-yearly annual averages, with the exception of the last sub-period which is a six-year average.

Briefly, Malta has always experienced a relatively large deficit in its merchandise trade, as shown in the table, 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 negative during all sub-periods.

There has been major changes in the composition of Maltese exports of goods and services between 1960 and 1990, as shown in Table 6. It can be seen that during the sixties, the bulk of exports were associated with "other services" an item which mainly represented British military expenditure in Malta. During the seventies, this type of exported service declined in importance, whereas exports associated with tourism and with clothing and textiles increased their percentage share.

During the eighties, dependence on British military expenditure was phased out. The percentage share of exports

associated with tourism continued to grow, whereas exports of clothing and textiles experienced a decline. There was a marked increase in the share of exports associated with electrical machinery, mainly attributable to one company which produced electronic components.

Another important change associated with trade relates to its direction. Table 7 shows the direction of merchandise trade between 1960 and 1990. The table shows that the UK was Malta's main trading partner during the sixties with Italy taking second place. During the seventies, Germany emerged as Malta's most important export market, with the UK and Italy remaining Malta's most important sources of imports. Germany retained its dominant position as Malta's most important client during the eighties, with Italy taking second place and the U.K. third. Italy was also the most important source of imports during the same period.

The deficits which Malta experienced on trade in goods and services tended to be partially offset by investment income from abroad, the net inflows from which are shown in Table 5.

Another source of foreign exchange on Current Account are transfers which consist of remittances and pensions to households and foreign exchange grants to the Maltese government. Considering all these inflows and outflows of foreign exchange, the overall balance on Current Account was generally a surplus, with the exception of the last sub-period, as shown in Table 5. A closer look at the balance of payments statistics would indicate that, in many years, the Current Account surpluses would not have been possible without official transfers (grants).

With the exception of the first and the last sub-period, the Capital Account has tended to be in surplus, indicating that, on average, capital inflows from abroad offset capital outflows to foreign countries. The capital account includes borrowing from abroad by the government. Of interest in this regard is that Malta's external debt as

Table 5 Statistics pertaining to the Maltese balance of payments (annual averages for six sub-periods, Lm million)

	1960-64	1965-69	1970-74	1975-79	1980-84	1985-90
<i>Trade:</i>						
Merchandise trade	-22.9	-27.1	-42.9	-61.4	-116.5	-144.0
Services trade	16.6	13.3	15.9	37.8	62.2	76.2
Merchandise & services	-6.3	-13.8	-27.0	-23.6	-54.3	-68.8
Net investment income	3.7	5.2	8.6	17.1	41.4	36.1
Transfers	4.2	11.2	24.6	30.6	28.8	33.8
Current account balance	1.6	2.6	6.1	24.1	16.0	1.2
Capital account balance ^a	-1.9	3.7	5.8	11.0	17.7	-15.1

^a Includes net errors and omissions.

Source: *National Accounts of the Maltese Islands*.

Table 6 The composition of exports of goods and services (average percentage shares for six sub-periods)

	1960-64	1965-69	1970-74	1975-79	1980-84	1985-90
<i>Merchandise:</i>						
Primary Products	3.5	3.8	1.3	1.0	0.7	0.6
Food, Beverage, Tobacco	1.0	2.0	2.8	3.4	2.6	1.3
Clothing/Textiles	3.4	10.7	19.3	25.1	21.2	12.0
Electrical machinery	—	—	1.3	1.6	2.6	18.0
Ship repair/building	3.5	7.0	5.1	3.2	3.0	2.9
Other manufacturers	1.5	2.5	7.9	15.8	18.8	15.8
Re-exports	9.0	7.9	8.3	6.6	5.4	4.2
<i>Services:</i>						
Tourist expenditure	4.4	14.4	20.1	22.6	24.0	26.9
Transportation	11.6	15.6	16.1	12.1	14.6	12.7
Other services	62.1	36.1	17.8	8.6	7.1	5.6
Total	100.0	100.0	100.0	100.0	100.0	100.0

Note: Figures are approximate due to the fact that the classification of exports has been changed during the period under consideration.

Source: *Trade Statistics*.

a proportion of GNP is rather low by international standards. It should be noted also that the outflows of foreign exchange on Capital Account do not include those by the monetary authorities.

If we add the net surpluses (or deficits) of foreign exchange in the Current Account to the net surplus (or deficits) in the Capital Account we obtain the total net surplus (or deficit) in the balance of payments above "the line". This residual is computed after taking into account all foreign exchange transactions, with the exception of Official Financing.

During any one year, this residual broadly approximates the net additions (or reductions) of foreign exchange holdings of the monetary authorities. These official external reserves have tended to grow rapidly during the seventies and early eighties, as a result of the surpluses shown in Table 5.

As at 1990, the Maltese monetary authorities still held large amount of reserves invested abroad, in spite of the recent deficits in the balance of payments. The amount of Maltese official external reserves is very high by international standard, when measured in terms of monthly imports. It is much higher than the amount requested by law to serve as backing for the domestic currency.

VII. Major Problems of the Maltese Economy

Although the Maltese economy has grown at a relatively fast rate since 1960, it faced, and still faces, a number of weaknesses. These will be briefly discussed in this section. (More detailed analyses of problems facing the Maltese economy are given in Briguglio, 1988; Delia, 1988 and Scicluna, 1992).

Small Size

An obvious feature of the Maltese economy is its very small size in terms of its total GNP, land area and population.

Smallness does not necessarily render a country underdeveloped, since there are small countries, such as Luxemburg, Iceland and Cyprus that have done rather well in terms of economic development. However there are a number of drawbacks associated with small size.

Malta's small land area, coupled with its small domestic market, renders it difficult to reap the benefits of large scale production in domestically oriented industries. This tends to push up unit costs and inhibits the use of modern technology. For this reason, a large proportion of Malta's output has to be exported, giving rise to a very high degree of dependence on conditions in the rest of the world. Small size also reduces the possibilities for diversification in the economy.

Imports

Like other small countries, Malta depends to a large extent on imports, due to the lack of natural resources and limited variety of domestic production.

Malta's dependence on imports has, during the seventies and the first half of the eighties, prompted the government to embark on a policy of strict import controls. This policy brought about a marked reduction in the import content of total final expenditure, but it had in many instances encouraged inefficient production and markedly reduced consumer choice.

There is an ongoing debate in Malta as to whether or not it is to Malta's benefit to abolish import controls. Since 1987, the government has adopted a more liberal trade policy, giving rise to more efficient forms of production and a wider variety of consumer products, but at the same time this aggravated Malta's balance of trade problems, as shown in Table 5. It has also resulted in a loss of jobs in domestically oriented industries which lost protection.

Unfortunately, a sizeable proportion of the manufacturing sector still depends on import controls for survival. A considerable amount of employment would

disappear if import controls are totally dismantled. This question is of utmost importance at present because Malta is aspiring to join the European Community as full member and this would necessitate the eventual complete liberalization of imports from the Community.

However, it appears that a more liberalized economic environment has, on balance, generated enough employment to absorb the loss of jobs in domestically oriented industries which were not able to withstand competition.

Exports

To finance a large import bill, Malta has to export a large proportion of its output. Moreover, given that its domestic market is very small and that certain types of production are only feasible on a relatively large scale, it follows that Malta has to rely on exports. About 45% of Malta's total final expenditure consists of exports, which is a very high percentage by international standards.

An area of concern is that Malta's range of exports is too narrow, with a very high percentage consisting of clothing and electronic components. In this regard, the advantages of specialization arising from concentration on a few products has to be weighed against the disadvantages of having too many eggs in one basket.

A related problem is that a very large percentage of exported services are connected with tourism. Tourism has had an important beneficial effect on the Maltese economy, in terms of foreign exchange earnings and employment. However, past experience has shown that excessive reliance on this type of service presents a danger in that the tourist industry tends to be volatile.

As regards exports in general, the major recurrent problem is the need to maintain competitiveness vis-a-vis foreign countries. This touches upon the question of exchange rate policy (see Scicluna, 1984; Briguglio, 1989 and Delia, 1991). The

Maltese Monetary Authorities have during the first half of the eighties adopted a policy of tying the Maltese lira to relatively strong foreign currencies. This policy has had beneficial as well as adverse effects on Malta's economy. It has helped to contain the disadvantages associated with imported inflation. But at the same time, it has adversely affected export competitiveness.

The international value of the Maltese lira is now based on a trade weighted basket of exchange rates, with the objective of attaining exchange rate stability with respect to the currencies of Malta's trade partners.

Terms of Trade

Another problem, which Malta used to face during the seventies, and which has emerged again during the late eighties (and will probably persist during the coming years) is a deterioration in the terms of trade. This means that the prices of Maltese imports rise faster than the prices of Maltese exports, so that every year the country has to export more to pay for the same quantity of imports.

A look at the Maltese balance of payments statistics would indicate that between 1970 and 1983 Malta has had a consistent deficit in its resource balance (see Table 5). This deficit would have been turned into a surplus in most years had the prices of imports not risen faster than the prices of exports, everything else remaining constant.

One possible reason for the deteriorating terms of trade is that Malta tends to export goods and services in competition with developing countries, and the prices of exports are therefore influenced to a high degree by this tendency. On the other hand, a large proportion of Malta's imports originate from developed countries, and the prices of imports therefore reflect this reality (see Briguglio, 1993).

The Manufacturing Sector

The Maltese manufacturing sector faces

Table 7 The direction of trade (average percentage shares for six sub-periods)

	1960-64	1965-69	1970-74	1975-79	1980-84	1985-90
<i>Exports:</i>						
UK	32.4	32.3	33.1	19.9	17.8	12.1
Italy	12.3	9.4	9.1	4.5	8.4	21.8
Germany	0.7	3.3	10.1	29.9	30.5	26.2
Belgium	0.9	2.2	7.1	4.5	5.2	2.2
Libya	9.5	6.7	4.5	9.3	6.1	6.0
USA	0.9	5.9	3.3	1.5	3.3	6.7
Others	43.3	40.2	32.8	30.3	28.7	25.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
<i>Imports:</i>						
UK	39.5	41.0	30.9	24.5	18.4	16.8
Italy	10.1	14.8	17.1	19.4	27.4	26.0
Germany	4.2	3.8	7.0	11.9	15.3	15.2
France	5.1	3.5	4.5	5.1	3.6	5.2
N'Lands	5.3	4.0	4.9	4.2	3.2	3.0
USA	2.0	3.1	5.4	7.5	7.6	6.1
Others	33.8	29.8	30.2	27.4	24.4	27.8
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: *Annual Abstract of Statistics*.

two distinct problems. The first is that many firms in the export oriented sub-sector, so far, enjoy a competitive edge in terms of wage rates, but still depend to a large extent on relatively old technology. The wage advantage is continually being eroded by new competitors from the developing world. In all probability, competing on the bases of cheap labour will no longer be an option for Maltese exporters within a few years, given that wage rates in Malta are rising much faster than those in many of its competitor countries. The alternatives include competing on the basis of technological advance, or specialising in up-market products and in "niche" markets. The objective would be to avoid dependence on low wage rates for attaining competitiveness.

The second problem is that the domestically oriented sub-sector is still heavily protected, despite the process of liberalisation that was ushered in after 1987. This situation cannot continue to exist if Malta joins the EC (see Coopers and Lybrind, 1991). It can be anticipated that the gradual liberalization of imports, in preparation for Malta's EC membership, would result in the closing down of a number of firms, which in 1991 employed around 7% of the Maltese gainfully employed population.

Although the two problems just described are distinct, they have a common solution, namely the attainment of competitiveness, through the upgrading of the manufacturing capital stock to allow for technologically advanced production processes and the seeking of "niche"

markets, which can be serviced without resort to large scale production.

Monetary Aspects

On the monetary side, the Maltese economy is characterised by (a) a very high proportion of currency in circulation to GNP, (b) a very high propensity to invest funds abroad and (c) an excessively regulated market (see Galdes, 1990 and Azzopardi, 1991).

In Malta, currency in circulation, in relation to the formal GNP is extremely high, amounting to around 50%. This is probably due to the tendency to settle certain transactions in cash to evade taxation. The high Currency/GNP ratio suggests that the underground economy is relatively large in Malta. The most important factors giving rise to this tendency are (i) tax rates in Malta rise very progressively, even though the maximum rate is 35% and (ii) the rate of interest on fixed deposits, which is related to the opportunity cost of holding currency, is relatively low, and regulated directly by the monetary authorities.

In Malta the personal sector, as well as the banking sector, tend to have a very high propensity to invest funds abroad. in spite of very rigid exchange controls. One reason for this would be that interest rates in Malta are relatively low. This propensity will most probably increase if foreign exchange control is relaxed. It is ironical that while Malta craves for investment, the Maltese people and their financial institutions look elsewhere to invest their money.

It appears also that Maltese financial institutions and Maltese households tend to consider investment in Malta as too risky compared to the cushy deposits in foreign banks, which carries with it a low risk and a relatively high interest yield. In this regard, the basic problem in Malta would not seem to be lack of funds, but the utilization of funds for Malta's own economic development. Fortunately, recent

institutional developments, in particular the establishment of the Stock Exchange, appear to be having a positive effect in channelling funds for investment in Malta.

The Labour Market

There are also a number of problems directly associated with the labour market. The major problem in this respect appears to be that of skill mismatches, causing a considerable amount of frictional unemployment. One solution is of course training and retraining schemes to develop and upgrade skills in line with the development needs of the Maltese economy.

Another problem is that a large proportion of the gainfully occupied (around 30% in government departments and corporations and around 40% in companies with government majority shareholding are included) are employed in the public sector. This sector tends to be characterised by low labour productivity in the lower grades, and a shortage of efficient and motivated personnel in the higher grades. The relatively large size of this sector in the Maltese economy is probably giving rise to inefficient use of resources, and creating an artificial labour shortage in the private sector. Many economic analysts are of the opinion that the Maltese public sector needs trimming down.

Integrating with Europe

The Maltese economy is to a very large extent tied to the European Community. The bulk of its merchandise and services exports are directed towards the EC. The EC is also the major supplier of Malta's imports.

The association agreement with the EC in the early seventies, had as one of its aims the eventual establishment of a Customs Union between Malta and the EC, which involved the gradual removal of Maltese import controls and the opening

up of Malta's market to European products. This objective was however abandoned by the Labour government. As a result, during the seventies and up to 1987, Malta remained a very heavily protected economy, with a non-tariff access to the European markets for most of its merchandise exports, while at the same time retaining the option of imposing import controls on goods originating from Europe.

As stated, a process of gradual liberalisation began in 1987, following a change in government. In July 1990, the Nationalist government lodged an application for Malta to join the European Community.

At present there are two major problems associated with this application. The first is that the process of adjustment involves a number of changes which are not easy to implement (Redmond, 1993). The major problems are those associated with Malta's small size, its regulated financial sector, and the proliferation of restrictive practices working against competition.

The second problem is that it is not certain that the Maltese economy would be better off if Malta joins the EC. The arguments for and against joining the EC have been aired in a number of publications in Malta (see for example EC Directorate, 1990; Pomfret, 1989; Frendo and Bonnici, 1990; and Malta Labour Party, 1990). The most important issue in this regard relates to the trade-off between protection and efficiency.

Those in favour of EC membership stress the need for competition and efficiency, and those against emphasise the inability of small enterprises to survive with the dismantling of import controls.

However, as indicated in many other parts of this paper, recent developments in Malta have shown that under a more liberalized structure, growth in the non-protected sectors of the economy – particularly services – has more than made up for the losses in the protected

sector, the end result being historically high rates of employment, low rates of unemployment and relatively high growth rates in GDP, during the past five years.

While it may be true that the existence of inefficient enterprises may be prolonged via protectionism, it is also true that the well-being of the economy cannot be fostered in a protective set-up. On a macroeconomic level, there is overwhelming evidence to suggest that countries which have embarked on a policy of protection, tend to end up using their resources inefficiently, and therefore have a much lower standard of living than other countries who utilise their resources efficiently to meet international competitiveness. This is especially so for small countries that have to rely on exports for survival.

VIII. Conclusion

This paper has given a brief overview of the patterns of change in the Maltese economy during the past thirty years and described some weaknesses inherent in the economy at present.

During the period under consideration, incomes have arisen substantially in real terms, and the Maltese population has enjoyed marked improvements in the standard of living. The economy has been restructured from one depending on expenditures related to British defence needs to one based on marketed exports of goods and services. It is now being again restructured to meet the challenge that will emerge from full EC membership.

The weaknesses in the Maltese economy described in this paper are formidable, but not insurmountable. Perhaps the most difficult ones to overcome are those associated with the dismantling of import and exchange controls. Suitable policies are called for to improve import and export competitiveness and to reverse the tendency of looking abroad for a good return on investment.

Statistical Appendix

Employment and Population in Malta December 1992

	Total	Males	Females
Labour Force	135,157	101,470	35,687
Employment	131,609	96,892	34,627
Unemployment	5,548	4,488	1,060
Population	362,900	179,400	183,500

Number of persons employed by sector

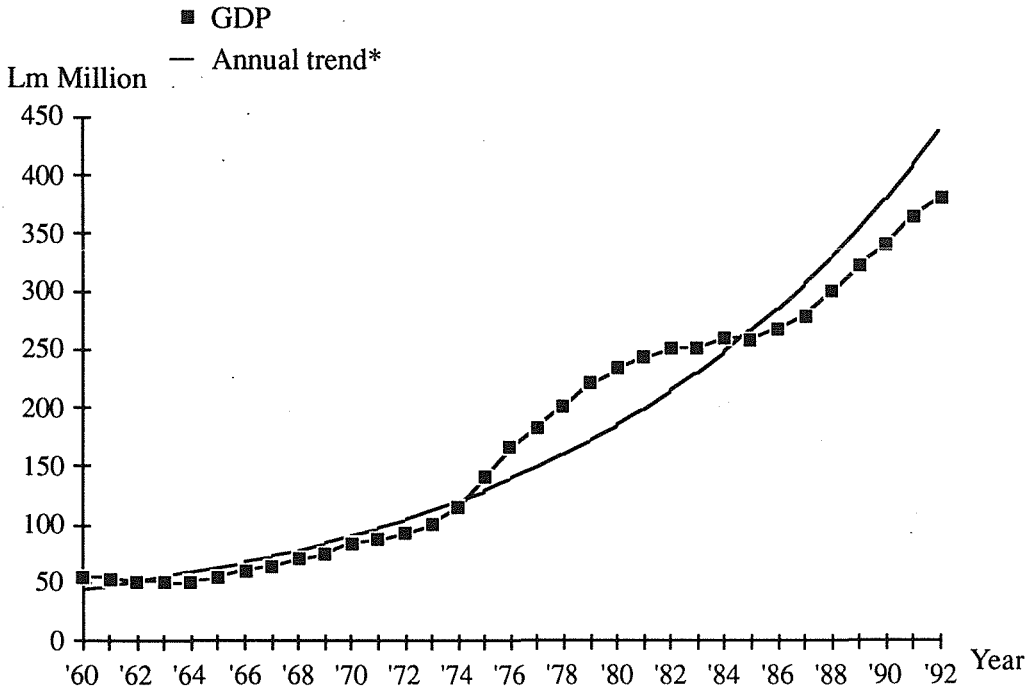
	Number	Percentage
<i>Private direct production</i>	37,952	28.8%
of which:		
Agriculture and fishing	3,210	2.4%
Quarrying and construction	5,436	4.1%
Manufacturing	29,306	22.3%
<i>Private market services</i>	37,485	28.5%
of which:		
Wholesale and retail	13,814	10.5%
Insurance and real estate	1,454	1.1%
Transport and communications	5,780	4.4%
Hotel and catering	7,683	5.8%
Others	8,754	6.7%
<i>Public sector</i>	51,276	39.0%
of which:		
Government departments	30,452	23.1%
Armed forces and airport	1,691	1.3%
Public corporations	9,325	7.1%
Govt/MDC controlled companies ^a	9,808	7.5%
Temporary employment ^b	4,896	3.7%
Total Employment	131,609	100%

Source: *Economic Trends*.

^a Employment in government controlled companies includes direct production employment (3,217 persons) and market service employment (6,591 persons). In some official publications, such employment is listed with the private sector.

^b Temporary employment includes apprentices and trainees, pupil and student workers.

Figure 1. The Gross Domestic Product at 1973 Prices compared to a 33 Year Trend.



* The annual trend is based on an exponential growth equation, estimated by the Least Squares Method.

Figure 2. The Rate of Unemployment and of Emigration.



* Only those emigrants who were members of the labour force (i.e. were employed or registering for employment) before they emigrated are considered here.

Figure 3. Sectoral Composition of Gainful Employment

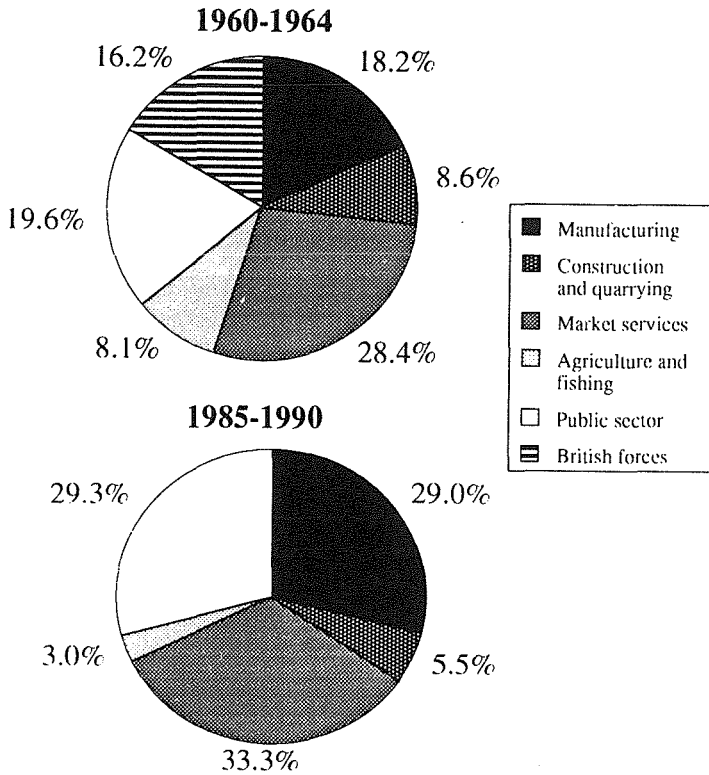
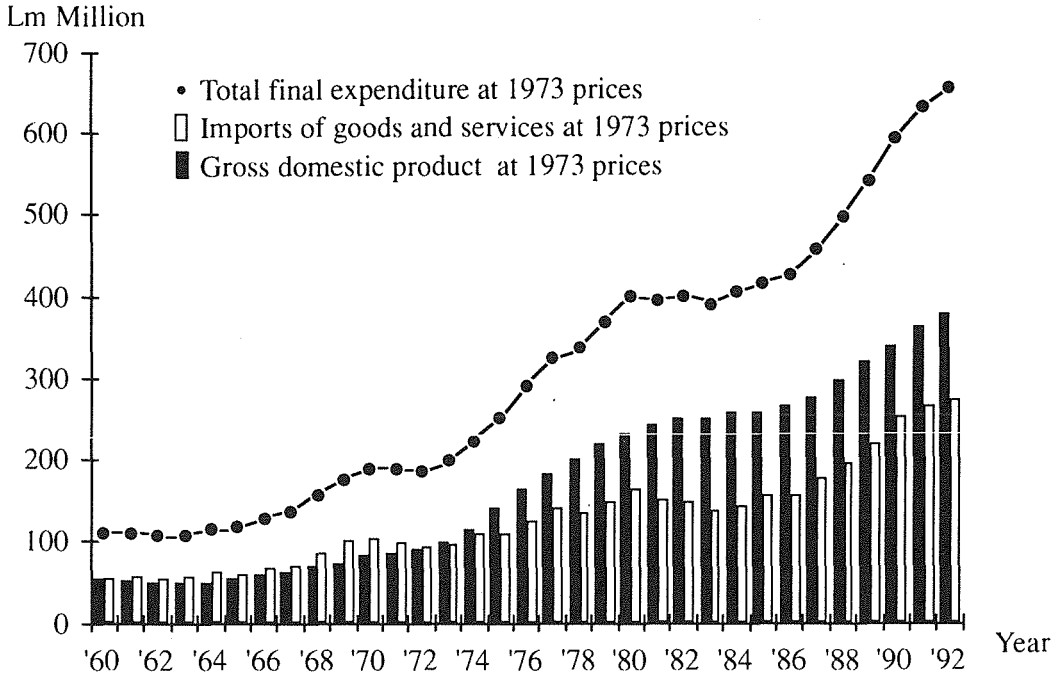


Figure 4. The Import Content and the GDP Content of Total Final Expenditure.



References

- AZZOPARDI, P., "Interest Rate Liberalisation in Malta", *Bank of Valletta Review*, Autumn 1991.
- BALOGH, T., and SEERS, D., *The Economic Problems of Malta – An Interim Report*, Malta, Government Printing Office, 1955.
- BRIGUGLIO, L., "The Impact of a Devaluation on the Maltese Trade Balance with Special Reference to Price and Income Reversal Effects", *Applied Economics*, 1989, Vol. 21, pp.325-338.
- The Maltese Economy – A Macroeconomic Analysis*, Malta, 1988, David Moore Publishing.
- "Tourism Multipliers in the Maltese Economy" in *Perspectives on Tourism Policy*, P. Johnson and B. Thomas (Eds), U.K., Mansell, 1992.
- "The Terms of Trade and the Direction of Trade in the Maltese Economy", *World Development*, 1993, Vol. 21, No.2.
- BRITISH GOVERNMENT, *Defence White Paper*, Command 124, London: HMSO, 1957.
- The Next Five Years – Statement on Defence*, Command 1639, London: HMSO, 1963.
- COOPERS & LYBRAND EUROPE, *The Effect of EC Membership on Industry in Malta*, Malta Federation of Industry, 1991.
- DELIA, E.P., *The Task Ahead – Dimensions, Ideologies and Policies*, Malta Confederation of Private Enterprise, 1988.
- "Malta's Trade Account, Labour Cost and the Rate of Exchange of the Maltese Lira: An Overview", *Central Bank Quarterly Review*, September 1992.
- DEVELOPMENT PLANS
- Development Plan for the Maltese Islands 1959-1964*, Malta: Department of Information, 1959.
- Development Plan for the Maltese Islands 1964-1969*, Malta: Department of Information, 1964.
- Third Development Plan for the Maltese Islands 1969-1974*, Malta: Office of the Prime Minister, 1970.
- Development Plan for Malta 1973-1980*, Malta: Office of the Prime Minister, 1974.
- Supplement Plan for Malta 1973-1980*, Malta: Office of the Prime Minister, 1977.
- Guidelines for Progress – *Development Plan 1980-1985*, Malta: Office of the Prime Minister, 1981.
- Development Plan for Malta, 1986-88*, Malta: Economic Division, Ministry of Trade and Economic Planning, 1986.
- GALDES, A.P., "Malta's Financial Market in Transition", *Central Bank Quarterly Review*, Malta, June 1990.
- "Conditions for Further Development of the Financial Sector in Malta", *Central Bank Quarterly Review*, Malta, December 1990.
- EC DIRECTORATE, Malta, *Report by the EC Directorate to the Prime Minister and Minister of Foreign Affairs regarding Malta's membership of the European Community*, Department of Information, 1990.
- FRENDO, M. and BONNICI, J., *Malta in the European Community*, Malta Chamber of Commerce, Malta, 1989.
- MALTA LABOUR PARTY, *Malta and the EEC: Economic and Social Aspects*, Malta Labour Party, Senglea, 1990.

- MALTESE GOVERNMENT, *Joint Mission for Malta Report*, Malta, Department of Information, 1967.
- Agreement between the Government of Malta and the Government of the United Kingdom*, Malta, Department of Information, 1972.
- METWALLY, M.M., *Structure and Performance of the Maltese Economy*, Aquilina, Malta, 1977.
- POMFRET, R., *The European Community: Three Issues*, European Documentation Centre and the Chamber of Commerce, Malta, 1989.
- ROBENS REPORT (See Maltese Government, 1967).
- REDMOND, J., "The European Community and the Mediterranean Applicants: Malta, Cyprus and Turkey", *Bank of Valletta Review*, No.7, Spring 1993.
- SCHUSTER REPORT (See British Government, 1950).
- SCICLUNA, E.S., *Export Competitiveness and the Maltese Lira*, Malta Federation of Industry, 1984.
- The Outlook for the Maltese Economy in 1992 and Beyond: A Sober Assessment*, Malta Federation of Industry, 1992.
- STOLPER, W.F., HELLBERG, R.E.R. and CALLENDER, S.O., *Economic Adaptation and Development in Malta*, United Nations Commission for Technical Assistance, Department of Economic and Social Affairs, 1964.
- TARLING, R.J. and RHODES, J., *A Study of the Economic Impact of Tourism on the Economy of Malta*, Malta, P.A. Cambridge Consultants for the Ministry of Tourism, 1989.

Additional Literature on the Maltese Economy

The most important sources of statistical data are the *National Accounts of the Maltese Islands*, and *Annual Abstract of Statistics*, both published by the Central Office of Statistics, Malta. The Economic Planning Division of the Office of the Prime Minister also publishes a quarterly *Economic Survey*.

A number of journals on topical issues are published in Malta. Two publications of this type are *The Central Bank Quarterly Review* and *Bank of Valletta Review*. The former is a good source of monetary data and contains articles on monetary issues and the latter contains articles on a wide variety of topics related to the Maltese Economy.

Some Maltese business and professional bodies also publish material with information about the Maltese Economy on a macroeconomic level. Two publications of this nature are the *Industry Trends Survey*, published by the Malta Federation of Industry and *The Commercial Courier* published by the Malta Chamber of Commerce.