



EVALUATING MALTA'S POLITICAL ECONOMY

OCCASIONAL PAPERS: 12

EVALUATING
MALTA'S POLITICAL
ECONOMY

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FOREWORD

APS Bank contributes to public education and debate by sponsoring seminars and their proceedings which expound topical themes of general or specific interest. In this way, it provides opportunities for the exchange of ideas in a structured and cohesive manner and makes them available to a wider audience. Occasionally the Bank also publishes studies which consider critically particular issues concerning the demographic, economic, social and political networks in the Maltese Islands and in the European Union. Such publications complement others which explore particular subjects related to Malta's rich cultural heritage.

Evaluating Malta's Political Economy is the 12th in the Occasional Papers Series. It presents an approach to Malta's future economic development and social cohesion in relation to the envisaged evolution of the European Union and, in particular, to the Economic and Monetary Union. The study relates this political, economic and monetary project to the well-being of every individual who lives and works under the EMU set of rules and obligations. The ultimate objective of all production and consumption activities is

personal welfare and satisfaction in a defined social context.

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E. P. Delia
Chairman, APS Bank

January 2017

EVALUATING AND ADDRESSING
SOCIAL AND ECONOMIC PHENOMENA
IN MALTA

Commenting in 2010 on the relationship between Catholic Social Teaching and the insights gained from the history of economic thought for the formation and implementation of policy in Malta (Delia, 2010: p. 234), this writer observed, *inter alia*, that:

‘The 30-40 year old cohorts have a challenge ahead. They have to prove that, notwithstanding the top-down system to which they have been exposed for so long, they can rise to the occasion and adapt the future of these islands to meet the challenges ahead. They have to show that the past decades have not cloned a managerial class that can only be adept at repetition. It can be innovative in its own way and in the interest of the elder and younger generations. Working for one’s fulfilment and for the well-being of the community – now stretched to incorporate the EU and eventually the Mediterranean basin – is the challenge ahead...

‘There is one important point of departure. Unless other human resources are harnessed from abroad, be they Maltese nationals or others, there are only 400,000 Maltese on whom to rely. The organisational structure has to be such as to account for this fact. It has to be simple, inter-related internally and inter-regionally, and effective. In this way, it gives scope for individual active

intervention in the productive process both within the Islands and 'outside' in the rest of the EU and beyond...'

These remarks emerged from an analytical evaluation of events taking place a decade ago. Such an exercise followed statements made by the leaders of the two main political parties represented in Parliament, Mr Lawrence Gonzi – at the time Prime Minister and leader of the Nationalist Party – and Mr Joseph Muscat – then Leader of the Opposition in Parliament and of the Labour Party. They were addressing issues raised by Pope Benedict XVI's encyclical *Caritas in Veritate* issued in June 2009. Both of them distinguished between principles and their applications; people may agree on basic principles but they may not propose the same strategies to attain a given set of objectives. Both speakers addressed the respective roles of the State and the Church in a modern democratic country which is also a member of the European Union. They upheld the crucial relevance of ethical behaviour in daily interpersonal relationships in the home, at work, and in carrying out business operations locally and internationally. And, they expressed their aim to strike the 'right' balance between markets and governments (fiscal pressure, direct controls and efficient administration) with the objective of promoting sustainable growth and a fair distribution of resources.

The 2010 publication spelled out several 'realities' which were bound to condition critically the development and implementation of policy measures. Foremost among these was the uneasy state of Economic thinking. What may be defined as 'economic theory' is actually an evolving process of ideas related to economic behaviour and absorbing insights from other disciplines, like ethics, psychology, anthropology and political science, with

the result that this corpus of ideas can never be definite. Even common text-book terms, like utility and values, prices and price changes, productivity, total domestic output, money supply and fiscal balances, are not readily defined. They are subject to different interpretations and measurement biases.

Besides, there are too many unknowns in the real world. So there is no 'ready-made, off the shelf' set of policies which will attain automatically the series of objectives announced in a government's political, economic and social programmes. In turn, some objectives may not always be compatible with others. This observation is particularly relevant where issues related to output creation and the resultant income and wealth distribution are at stake. They refer to the respective roles of government (the fiscal budget and its financing) and the private sector in wealth generation and redistribution, and to the promotion and security of personal liberties. Policies will bear on existing situations and allowed sufficient time to be effective and produce tangible results. In the process they could be expected to condition the potential future development path of a community at the same time that regional and global political and trade relations evolve.

Enhancements in technology may facilitate and speed up statistical data gathering and assessment. But they can never identify with certainty what may happen in the years to come. Although econometric simulations may set the background for decision making, and possibly offer competitive policy scenarios, in the end, it is up to policy makers to determine what to do and when. The content and timing of public policy programmes remain subjective and so a contributor to future uncertainty.

Secondly, the Maltese population was ageing fast with the result that problems being faced the world over related

to the longevity of a society and its impact on the labour market, health sector and the financing of age-related services had to be faced and addressed for the first time by the present generations. This factor had important implications not only for the range of services provided by the state but also for those services which historically have been supported by the Catholic Church institutions in the Maltese Islands. Since the clergy and religious populations were ageing faster than the general Maltese population, as a result of the sharp decline in the number of vocations, the support received from such sources was being jeopardised.

Thirdly, institutions in Malta seemed to be suffering not only from 'fatigue', wherein they were simply repeating what they had been performing in the past without questioning the suitability to today's environment of whatever they are doing. Some of them were indeed becoming 'mirages', where they are legally present, supposedly monitoring and regulating events in society or in the economy, but they will not be active in interpreting whatever data they are collecting, if any, and, more important intervene in time to rectify any positions that would be bound to deviate future performance away from a projected path.

When referring to 'mature democracies/economies', such a situation may be described as 'sophisticated state failure': state entities responsible for electoral systems, law and order, fiscal operations, public administration and international relations seem to be functioning as they should. But yet nothing (or very little) which is really valid and solid for long-term economic restructuring, social ordering and political accountability actually gets done.

The outcome of inertia in policy intervention over time will be a widening gap between what political

parties propose to their constituents and what they actually implement and attain once in government. Even official documents at that time suggested that policy programmes were not dynamic enough in their understanding of the needs of a community and failed to realise that once certain economic and social goals were attained they themselves will generate a new set of demands on both private and public sector resources. A failure to appreciate such a condition will generate a false sense of control and security. Consequently, it will misread the emerging future demand for goods and services (Delia, 2010: p.7–11). The close relationships that bound together changing demographic profiles, labour supply configurations by age and gender, output growth and sectoral diversification, accommodation issues and a sustainable, clean air and noise environment were not being adequately addressed.

Since the publication of this work, two key political events happened. In March 2013, the Nationalist Party lost its majority in parliament and was heavily defeated at the national polls. Conversely, the Labour Party, under Mr Muscat's leadership, won a resounding victory, giving the new government a majority of nine seats in a parliament of 69 members – a first in Malta's political history. (This electoral result was contested by the Nationalist Party in the Civil Courts. It retained that two parliamentary seats were allocated to the Labour Party following counting errors during the electoral process. Three years later, the Judge presiding the First Hall of the Civil Court in its Constitutional jurisdiction upheld the arguments and ordered the Electoral Commission to allocate two additional seats to the Opposition. The Government and the Labour Party appealed against the judgement. In November 2016, the Constitutional Court found in favour

of the Nationalist Party and granted it two additional seats in Parliament. The Maltese Parliament now has 71 seats, a new 'record'.)

This election was characterised by the formation of a 'Movement' encompassing participants from several political perspectives thus eschewing the historical 'class/voter' division, which faced a political formation still guided by the 'traditional' party set up.

However, within three years of that administrative change, there had been resignations by members of parliament from the two main political parties with the result that now there are two independent MPs. Another MP left politics. Additionally, there have also been two 'forced/voluntary' resignations of government ministers and of two Parliamentary Secretaries from their posts. And, to top it all, the names of a cabinet minister and several public officials appeared in the 'Panama Papers', a leak of 11.5 million files from Panamanian offshore law firm Mossack Fonseca.

Such a revelation had an immediate impact on the local debate regarding the appropriate behaviour expected from politicians and public officers to sustain a vibrant democratic approach to decision making in a European Union member state. And simultaneously the European Parliament set up a committee in June to investigate alleged contraventions and maladministration in the application by the European Commission or Member States of EU laws on money laundering, tax avoidance and tax evasion.

Such events reinforced the view held by the Maltese electorate that certain categories of people in office, politicians among them, were not to be trusted. They were considered to be 'corrupt' (Grech, Helena, 2016). This perception about corrupt practices arises from the way

in which decisions are made ruling new or amendments to legislation or the enforcement of existing laws. The emerging behavioural patterns reflect both the impact of organised pressure groups within specific economic and social sectors and the weak management of what are turning out to be ineffective sectoral regulators.

The presence of such views in today's society is a continuation of a sentiment already expressed seven years ago through various surveys (Delia, 2010: p.210-211). The percentage of Maltese who believe that corruption is prevalent in various strata of society and the economy is higher than the European average. Consequently, the influence of such practices on the performance of the economy, social welfare and personal well-being cannot be ignored. Their implications will have to be explored and addressed.

The present Maltese electorate is querying more strongly than in the past the relative merits of the electoral system in place (a proportional system of representation within electoral districts based on quotas and transferable votes). Over time, this system has generated a two-party structure with the alternation in government of the two main political parties. Under this set up, potential candidates compete for votes with other contestants seeking voters' allegiance on an electoral district both those coming from the same political party and those presenting themselves on behalf of another party.

Candidates are seen tempted to keep on making promises to the electorate in their electoral district 'in exchange' for votes, which goes beyond the drive to attract voters' attention at the national level through 'expansive' political programmes on fiscal matters (such as proposals to reduce tax burdens and to expand the range of public sector services or subsidies to privately generated

expenditures; and a more 'liberal' approach to gender and family related issues). Today's Maltese, especially the younger cohorts, are sympathetic to such positions on personal status and inter-personal relationships (Grech, Helena 2016a).

An offshoot of these reconsiderations has been the cry to set up another political party specifically to wrestle government control from the two-party structure that presently prevails. For several decades, the Maltese electorate resisted the idea of supporting effectively third political parties at the polls. But, apparently, the 'floating voters', who re-assess their political choices from one election to another, are not satisfied at all with the way public sector governance has been exercised at the national and the local domains. They seem to be arguing that the model of the political movement is once again shifting towards the two-party schedule. But such an arrangement with alternating governments competing for the votes of the centre groups has become dysfunctional since Maltese politics is no longer being structured on a one-dimensional spectrum from left to right. So something has to be done.

And, somewhat encouraged by this move, Gozitans are considering the revival of the Gozo Party. Their objective is to re-create a political vehicle which is 'strong enough to make a difference' and to have the Minister for Gozo 'appointed from among the elected members of their party'. (Azzopardi, J., 2016)

These series of events represent a 'political first' in the annals of Malta's Parliamentary history particularly in terms of the speed with which they occurred. One is therefore tempted to query whether the upcoming generation of policy makers has underestimated the task of understanding correctly the way in which the various

groups that make up Maltese society think, assess the past and present, project the future, and are prepared and willing to address the visible gap between where a society is and where it wants to be.

A failure to read correctly these situations will imply that decisions taken will not rectify perceived shortcomings or induce change in such a way as to prepare society for economic, financial and social eventualities. Political turbulence often leads to inertia in undertaking decisions that social units may have to take. Such positions will lead to inadequate legislation, if not outright irrelevant and possibly harmful; inefficient institutions ruling relationships in varied contexts; and the formation of a community that will be ill-equipped to face a fast-moving unstable global geo-political environment.

Such uncertainties are compounded by recent developments in the European Union and the euro-zone, and by the deteriorating political situations in the countries bordering the Mediterranean. Any decision – whether personal, industrial, commercial, or financial – is bound to be conditioned not only by the series of events happening around a person or a community but also by the degree of preparedness of single individuals or groups to face such events. It is the sum total of all such decisions, to act or not to act, that builds up the networks through which individuals or social/productive units operate.

Policy makers worldwide generally claim that success in the economies and societies in which they operate is the outcome of their leadership and foresight. Contrariwise, a failure to reach stipulated objectives – be these political, social or economic – is usually blamed on external factors. And they tend to focus on short-term horizons, being the time span between one general election and another, interspersed by the occasional poll which could be taken

to test public opinion. However periodic opinion surveys, now common in many countries attempting to chart popular sentiment on general or specific issues, may not always be as reliable as one would like them to be. This means that they could trigger unwarranted policy-related decisions which may end up doing more harm than good. Besides, such practice transforms representative democracy into populism.

The truth is that every day reality is much more complex than policy makers can imagine. And a piecemeal analysis of such situations does not contribute to a realistic evaluation of the true performance of an economy or of the evolutionary forces at work in every group or society. It becomes even more inappropriate when policy makers introduce considerations which are not directly related to the issues at hand, such as personal or country-specific gains which are not intended to account for the long-term development of the economy or community. Or when they fail to spell out clearly the parameters they aim to maximise: pecuniary objectives / rewards or other 'virtues' like personal development, multi-cultural society, the national heritage or the natural environment.

Societies' inability to identify a set of objectives and work consistently to achieve them is rendering long-term oriented policy making unattainable. It seems that human nature is driven by the urge to change position according to the needs of the time and of the occasion. At times we emphasise the economic achievement (expressed through, say, GDP growth figures, aggregate employment, or financial rewards to educational investment): this is a common yardstick in the Maltese Islands (e.g. Central Bank of Malta, 2016, p. 36-63; Malta Fiscal Advisory Council, 2015), and it has been the main thrust used by the British Government as an argument

for Britain to remain a member of the European Union during the Brexit Referendum campaign of 2016 (HM Government, 2016).

But when economic results for some reason do not fit the argument at hand, as may be the case following a global rise in temperature or an increase in the population at risk of poverty in a country, then the argument shifts over to non-monetary/material values such as the meaning of life and solidarity within the family and the community. Such duality of considerations is being applied also to education and health programmes.

For example, pursuing post-graduate studies is often promoted as a route to enhancing one's future income stream. But recent labour market research in the UK suggests that graduates from more than one in 10 universities have recorded lower earnings than non-graduates. And rising costs and alternative career paths have led would-be students to question the value of degrees in business administration, like the MBAs. At which point reference is made to the 'true worth of an educational programme', the formation of a human being rather than the pure pecuniary considerations which are generally promoted. One then claims as a failure of the educational system if 'virtues' are not imparted to the young (Rothwell, Nancy, 2016). Or one tends to extoll the virtues of education at 'the university of life' particularly if one is interested in setting up oneself in business (Moules, 2016).

This ambivalence of objectives may be one reason why certain issues are now coming to the fore much more forcefully than in the recent past. These include global and regional economic, financial and political order; climate change, environmental security and sustainability of natural resources; human rights, race and

gender emancipation and personal welfare development; and international migration especially mass human movements driven by political and economic instability that follows armed conflicts and natural disasters. And it also may explain why there is this global querying of the economic contribution to human development and welfare of the 'competitive fiscal regimes' that evolved gradually in various legal jurisdictions over the past half century.

As an offshoot of the revelations referring to a Swiss financial institution (the 'Swiss leaks') and to a Panamanian law firm (the 'Panama Papers') the topics under scrutiny have been extended. They now include: the economic significance of so-called 'efficient tax burden allocation' approach, which encourages the splitting of ownership titles-production-distribution of goods and services-allocation of ensuing surpluses among various jurisdictions to minimise the amount of tax paid; the long-term implications for local and global trade and wealth creation that follows directly from such an approach; and the moral obligation to pay one's taxes in the region/country where the economic activity and resultant profits are carried out. In turn such themes lead one to discuss also the role corruption may have in, firstly, undermining the formation of transparent and healthy interpersonal relationships in a community and, secondly, in international economic co-operation and trust.

Besides, the ensuing behaviour by all actors involved in such arrangements distorts the recording of trade and financial flows data on which policy analysts and decision-makers rely when drawing up their programmes for future consumption and investment. The share of the 'hidden economy' in periodic trade transactions tends to be substantial world-wide. In Malta, the 'shadow

economy' is estimated to have been between 20% - 30% of the officially recorded Gross Domestic Product for the past two decades (Grech, Aaron G, 2013; European Commission, 2012; Cassar, 2001).

This surge of global interest in the re-assessment of tax legislation is not the result of a crisis of conscience among policy makers. It is the fact that many governments are already heavily indebted and they are still hard pressed to raise resources to meet ever-rising commitments on several fronts: to revamp weakening internal social infrastructures; to enhance internal security and enforce law and order in the face of larger migratory movements; and to underwrite costlier and human resource consuming services related to ageing populations. Measures which contribute to a reduction of tax revenues are not considered favourably in the circumstances.

But this world-wide network of tax-favourable jurisdictions arose gradually over the past seventy years as a result of the uneasy relationship between two contrasting views on society and wealth creation and sharing. At times emphasis was made on state controls, collective ownership and 'punitive' taxation with high marginal rates of tax on income, profits and inheritance. At other times, the policy makers favoured the private sector to drive economic diversification and growth through privatisation measures, lower tax regimes and fewer controls on trade and service transactions both domestic and international.

However, at a time when public sentiment favoured a strong state, nationalisation of assets and high rates of tax on income and wealth, some legislators also enacted laws which facilitated the transfer of economic and financial transactions to other jurisdictions on

which their parliaments had some form of control or close relationship. The position of the United Kingdom and the various islands with which it is associated, like the Channel Islands and the British Virgin Islands is a case in point. France-Monaco, and Italy-San Marino-Switzerland are other examples. In time, these schemes have been reproduced in other jurisdictions until a global network flourished following the easing or elimination of trade and capital controls. Companies have an incentive to arbitrage differences between national tax codes just as they seek to benefit from various interest rate and exchange rate regimes.

In Malta, there were times when the state extended its domain through ownership of assets besides retaining high marginal tax rates on income. The highest marginal tax rate on income was 65% up to 1992. Public sector employment represented around 45% of gainful employment in the 1990s. And foreign exchange controls remained in force for the banking sector until Malta adopted the euro in 2008.

A different view was taken on private sector involvement in the economy and taxation in the past two decades. Various state-owned enterprises were privatised in whole or in part. The highest rate of income tax was reduced to 35% in 1992, while the tax-exempted base income increased. Income arising from listed securities on the Malta Stock Exchange and deposits with local banks is taxed at a fixed rate of 15%. Besides, financial and trade activity was encouraged further by offering income tax rebates to those foreigners who carried out their operations from Malta. Such differential tax treatment, by itself, is expected to influence the behaviour of Maltese taxpayers when considering their obligations under the local tax regime. Over time, they are bound to be encouraged to

seek for themselves similar advantageous tax treatment in other jurisdictions.

These positions reflect different underlying philosophical approaches to the relationship between the State and the Individual (whether person, household or firm). They also suggest the use of various state financing tools regarding appropriations, tax revenues and debt finance. And they influence the share of public sector employment in the total gainfully occupied population, meaning that employment will no longer be reliant solely on market forces but also dependent on political decisions to sustain, at least for some time, non-profitable industries.

These on-going swings of policy formation and implementation are bound to influence behaviour, affecting differently the way upcoming cohorts think and plan their involvement in the various markets. In turn, these policy decisions condition the way in which market players plan and record their performance with the aim of maximising rewards, even if this involves the setting up of complex organisational structures. Such behaviour leads us to where we stand today, once these 'complex structures' become diffused over a large segment of the global trade participants.

And it takes a life of its own creating specific market structures which exploit the possibilities offered by new technologies supported by advances in encryption and network computing. New payment instruments, like the Bitcoin, attempt to re-introduce the use of private monies and, so, provide a competitive medium to national currencies which are regulated by Central Monetary Authorities and which also act as an international medium of exchange (Dowd, Kevin, 2014; Dong, He et al, 2016). In theory, instruments like Bitcoin could serve

as a 'common currency' in which payments for trade deals could be effected. But, to date, their applicability is somewhat restricted since they are energy-inefficient. Carrying out commercial activities is indeed becoming an art in complex dealings and organigrams.

This phenomenon is defined as 'corruption'. But, being complex, there is not presently an international consensus on how to define it. In the literature it is usually described as the misuse of public power for private gain. Such a definition may be useful for devising indices for measuring corruption by region, but it may be considered by some to be narrow and culturally biased. A report by the European Commission sees corruption as reducing the levels of investment, obstructing the fair operation of the Internal Market and producing a negative impact on government finances. The economic costs incurred by corruption in the EU are estimated to amount to around €120 billion per year (European Commission, 2012a: p.4). Corruption undermines confidence in, and the functioning of, democratic institutions.

Corruption may be seen as 'petty' or 'grand'. 'Petty corruption' is defined as street level, everyday corruption. It occurs when citizens interact with low- to mid-level officials like hospitals, schools, police department and other bureaucratic agencies. The scale of monetary transactions involved is small and impacts primarily individuals and disproportionately the poor. 'Grand corruption', sometimes used synonymously with 'political corruption', takes place at the policy formulation end of politics. It refers not so much to the amount of money involved as to the level at which it occurs, where policies and rules may be unjustly influenced. The kinds of transactions that attract grand corruption are usually large in scale (Rohwer, 2009).

'Grand corruption' falls in the category of economic activities which are defined in economic literature as '*directly unproductive profit seeking (DUP)*' (Delia, 2010: p. 86-87; Delia, 2012: p 1-37). They refer to those resources allocated for lobbying carried out to influence policies pressuring for quotas or tariffs, or to obtain a bigger share of government spending, or to create tax-avoidance categories, thereby escaping from paying tax. These lobbying activities are carried out at both the international and country levels. They refer not so much to the diffusion of ideas, as such, a process which by itself is positive, but which could be detrimental to long-term global/regional trade development if the lobbied views continue to be considered solely from narrow industry or country specific interests.

Besides, the expected benefits for many arising from trade, income and consumption expansion will not materialise on the envisaged scale. The 'trickling down' effect of economic growth will be distorted if not blunted outright as additional wealth is siphoned off into territories outside the hold of local tax authorities. It will 'trickle out' instead of 'down'. National income inequalities get wider as a result and this condition may lead to social and political unrest.

Malta is placed midstream in the Transparency International's 'Corruption Perception Index', with values in recent years (2012 -2015) ranging from 55 to 57. A value of 100 signifies 'very clean'; a value of 0 means 'very corrupt'.

These data are historical. They refer to the past, but they emerge from the perceptions of the present generations of Maltese who will be conditioned in their everyday dealings on a personal and company basis. It will be an interesting exercise to draw up and evaluate at

some length the main characteristics of the economic and social environment which are expected to influence the behaviour of the Maltese and the incoming migrants in the years ahead.

The section below outlines the performance of the Maltese economy in the recent past in the process identifying some areas of concern. These could offer an insight into the workings of both the economic sectors and social relations. It is considered more important for policy purposes to focus on these underlying forces at work than to keep quoting the rates of growth in output and employment. These latter statistics are surely useful for certain purposes, but they reflect in part decisions taken way back in time and may camouflage emergent signals which could prove to be decisive for economic growth and social well-being in the medium to the long term.

1.1 The Maltese Islands: Macroeconomic Performance, Dissonant Results and Ambivalent Policies

The recorded performance of the Maltese economy in recent years has been positive. It increased from €6.6 billion in 2010 to €8.8 billion in 2015. Aggregate economic activity has been expanding at comparatively high rates; the real rate of growth in 2015 was 6.3% and a buoyant 5% is projected for 2016. Employment data based on the Labour Force Survey suggest a more active population with gainful employment around 185,000 in 2015 out of a Labour Supply of 195,000. The number of those seeking work is given at around 11,000, representing 5.6% of the Labour Force. The Government's annual budget is envisaged to remain in deficit for the coming three

years, with Total Central Government Debt amounting at present to €5.6 billion; this amount is projected to keep on growing. On the external front, there continues to be a negative net trade balance which has been made up since 2013 by a net inflow in the Services account. So, overall Malta registered a positive external account balance.

Indeed, the most recent IMF Article IV Consultation Report is quite positive in its assessment of the macroeconomic performance of Malta, although it does throw in several observations which have to be expanded further. The encouraging comments refer to the very short term while the 'observations' have to do with the medium to long term. These refer to the challenge 'to preserve high and stable growth', to achieve debt reduction, to strengthen further fiscal governance and institutions, and to boost the resilience of the banking sector. In short, while the IMF report rests on short term results it is less sure on the economy's outcome in the long run. This outlook is partly influenced by the highly volatile times in which all countries are going through, but it is also partly affected by the fact that the Government's view of how to contain its expenditures and assist the generation of economic activity in Malta 'is not well specified at this stage' (IMF, 2016, p.2)

Therefore, it is useful to delve deeper and seek to identify the underlying structures that hold together Malta's economy and social fabric. More important, it is instructive to understand the emerging ideas that are conditioning the behaviour of the present and the upcoming Maltese generations. These are now being more influenced by the rising number of immigrants from the EU and elsewhere who are keeping this economy going. They contribute directly to aggregate demand for goods and services and augment the labour supply and the pool of skills in various economic sectors.

This study will be highlighting issues which tend to be either downplayed or even missed out completely in economic assessments of the Maltese economy. The aim is to trace the implications of such matters/considerations on the future organisational set-up and performance of the economy, on personal well-being and on social cohesion.

Some economic and social trends have already been noted way back in 2010 and these could have become more pronounced. Several of these features are summarised below.

- i) *As noted already above, the unrecorded level of economic activity carried out in Malta every year is estimated to be between 20% - 30% of the recorded Gross Value Added (GVA).* This means that the incomes generated throughout the various local sectors or via trade and investment activities in which Maltese nationals participate abroad are higher than those declared in official statistics. Indeed, what the Panama Papers and Swiss Leaks reveal are particular channels through which revenues accruing to Maltese or Malta-based operations are re-routed and do not find themselves reported in GVA data. Such incomes accruing to the ultimate beneficiaries every year, and the wealth accumulation over a time period that ensues therefrom, imply that the true value of the resources owned are greater than indicated. This discrepancy does not arise solely from deliberate under-declarations of assets or incomes, but it could be generated from the way in which international data compilation takes place. Suffice to point out that over the past two decades the system of accounting was changed twice, and every time Malta's Gross Domestic Product

(GDP) was revised upwards. Even in 2015, the data for one parameter, the Gross Fixed Capital Formation, was revised by €343.6 million, which represents around 19% of the value for capital formation for that year. The value for Imports was similarly revised (National Statistics Office (NSO), Malta, 2016, p.10). More recently, there has been an upward revision in the GDP of €333.4million, and of €122.1million in the Gross National Income (National Statistics Office,2016h).

- ii) *The value of Inventories and Statistical Discrepancy in the recorded data sets remains relatively high.* This is partly an outcome of the relatively high share of the unrecorded annual output, which could surface from year to year, or following changes in the compilation of the national accounts. These data determine the valuation of the recorded statistic for GDP and its respective components. If positive, they produce a higher GDP; if negative, they yield a lower value. These inventories/discrepancies amounted respectively to €87.6million, - €48.3million, €50.6million, - €70million and - €153.7million in the five years 2011-2015 (NSO, 2016h, p.5).
- iii) *The Maltese economy is today a predominantly digitalised Service economy.* Measuring productivity in a digital economy is even more demanding than deriving similar parameters for the Manufacturing or the Extractive/Agriculture and Fisheries sectors. The increased complexity of computing such parameters affect the robustness and credibility of the data and of the analyses that follow from them. But even in a sector which many may consider 'traditional' like Fisheries, it

has become harder to record the nominal worth of output following the introduction of fish farming, in particular the activity revolving around the penning of tuna and the value of tuna exported.

iv) *Malta's Gross National Income (GNI), which accounts for the net balance of the income flows received and payable to the rest of the world, remains lower than the GDP.* The net income from abroad measures the balance of net compensation to employees, EU-Malta transfers, and property/ investment earnings entering or leaving the economy. Out-payments exceed in-payments. This gap may grow further following the privatisation of more Malta government-owned companies and a re-assessment of Malta's entitlement to EU-funded projects in the coming allocation exercise due in 2020. The former will result in an initial inflow of funds (unless participants borrow locally and repay such loans over time) but will generate an outflow once dividends are paid or the investment is sold. The EU-Malta flows could turn negative if Malta becomes a net contributor member following new approaches to funds entitlement and contributions.

v) *The role of the Government in the economy cannot be assessed solely from the Public sector budget data.* Following the decision to extend private-public partnerships, and supporting private sector activity occasionally with government guarantees to selected projects, a parameter which reflects better these conditions will be one which consolidates these sub-items. This 'wider government involvement' will be made up of the items in the consolidated account, the positions of

government-owned industries and the values of government guarantees. For the year 2014, while the value of the national debt stood at €5.452billion, the aggregate debt, which includes also the debt of government corporations (€895million) and government guarantees (€1.335billion), would rise to €7.652billion. Macroeconomic projections which rely on the former instrument (the government revenue and expenditure accounts) will therefore yield misleading results. The revenue and expenditure streams change as one includes the payments and revenues of government-owned companies.

- vi) *While the ratio of Public Debt/GDP may be seen falling in recent years (it is projected to fall from 68.3% in 2014 to 59% in 2018), the aggregate Public Sector exposure/GDP ratio may continue to rise. Thus, the adjusted Public sector/GDP ratio is estimated to have been 95% of GDP in 2014 against the 68.3% recorded on the narrow definition.* Such parameters may be a better gauge of the significance of the public sector in Malta when undertaking public policy formation. The IMF report pointed out the critical roles of proper governance in the public sector and of the resilience of the financial sector for Malta's economic sustainability. And the Banking Regulator and the European Central Bank have been promoting the idea that national governments should be restricted in the amount of debt that they may be allowed to borrow from banks operating in their home territory. Such a ruling would change the spread of ownership of Malta government paper and could introduce an element of uncertainty and perhaps 'instability'

in the pricing of Malta government debt as the share of such instruments held by non-Maltese increases. Malta's financial institutions tended to purchase government bonds to hold, a praxis which introduced an element of stability in the local bond market. A marked shift in bond participation may induce a change in approach and potentially a break with the past.

- vii) *The allocation of income between Factor Labour (Employees' Compensation) and Factor Capital (Gross Operating Surplus and Mixed Income) in the Gross Domestic Product hovers around the 43%-44% for each of the two factors.* The remaining 12% represents the net difference between Industrial and import taxes less subsidies, and therefore accrues to Government. These ratios represent the point of departure for any policy decision regarding Wages and Profits distribution (Minimum wage, benefits like paid leave or sick leave, mandatory contributions to the state's welfare system or retirement pensions, Social minimum income/Basic income provision, tax rates on incomes/operational surpluses, capital gains and inheritance).

An Incomes Policy focuses on a base factor income share distribution and through a series of measures regarding wages, dividends and their distribution, and related taxes/charges/subventions aim to reshape the factor distribution to the desired configuration. This policy strategy may favour the owners of capital and restrain wage increases over time; or vice versa.

Such approaches to Incomes policy were common in various countries between the 1950s and

the 1980s. In Malta's case, there were commodity price, rent and wage controls for several decades. Today account has to be made for the observation introduced in point (i) above, namely, the extent of under-recording of incomes accruing to Labour or Capital or 'parked' directly in offshore accounts and accruing to both factors. Besides, there could be incomes which are recorded in Malta but which in reality accrue elsewhere; they are registered locally – via transfer pricing - because the net incomes thus generated receive preferential tax treatment under Maltese law. The revelations of the Swiss and Panama Leaks attest to these transfer instruments. In part these accounting behaviours may have arisen as an offshoot of a pervading State involvement in the economy in various countries. But such attitudes and stratagems tend to remain in place, indeed even accentuated, later on when the economic and state control restraints are greatly reduced or even withdrawn.

- viii) *The trend in the purchasing power of the average weekly wage per employee is ambiguous judging from recent data sets. This fact compounds the interpretation of such data for economic and social policy purposes.* One report presents only a marginal increase over the period 2011- June 2015: from €344.5 to €348.3, having recorded a peak of €349.5 in 2012. In nominal terms the average wage kept growing from €358.7 in 2011 to €380.1 in June 2015 (Ministry for Finance, Economic Policy Department, 2015: Table 2.5). But in another report (Ministry for Finance, Economic Policy Department, 2016a: Table 2.5) the values of the real wage per employee range from €347.7 in 2012 to

€370.9 in June 2016. In nominal terms the average wage increased from €371 in 2012 to €407 in June 2016. The significance of these contrasting trends – one rising slowly, another rising faster – cannot be underestimated both from a welfare perspective (purchasing power) and from a competitiveness viewpoint discussed below.

The value of the real wage is obtained by deflating the nominal wage with the Retail Price Index (RPI), which is considered as ‘the main measure of inflation in Malta’ and is representative of private households only (NSO, Malta, 2016b, p.6). In fact, the legislation ruling rent regulation and the mandatory Cost Of Living Adjustment (COLA) given to employees and social welfare benefit recipients refer to the RPI as the gauge for overall average price movements in Malta.

- ix) The RPI is a fixed weight and a fixed base index. The ‘average real wage,’ therefore, reflects the ability of a ‘representative’ average wage earner to sustain personal/household consumption and saving. However, wages are also a cost of production. *The above wage statistics exclude Employers’ national insurance contribution; they do not represent the cost of labour which is therefore higher and includes costs related to other benefits besides the social security contributions. Such wage levels may be sustained, or otherwise, depending on whether Maltese industry remains competitive.* To arrive at the sustainability of a particular operation or sectoral activity one has to account for three factors, namely, labour costs, labour productivity, and the rate of exchange of the Euro vis-à-vis other currencies in which

international trade is denominated. Such indicators are reflected in Unit Labour Costs indices which are designed to incorporate information referring to the three parameters.

But measuring labour productivity is not an easy task particularly in the Services sectors. And Malta has no influence whatsoever on the movements of currencies that determine the exchange rate of the Euro. Thus, the Euro was weaker when compared to the US dollar in 2015 than in 2010. Its average value for the year was 1euro = \$1.3257 in 2010; it was equal to \$1.1095 in 2015. And one also has to account for the efficient use of the capital resources at hand, which operation is conditioned by the quality of the labour supply.

- x) *In so far as Malta is concerned it continues to live daily the implication of the decision taken in 2008 when it adopted the euro at a rate of Lm1= €2.33. Industrial competitiveness continues to be conditioned by this rate of exchange, which cannot be undone unless Malta exits the euro area and re-sets the rate of exchange. Although there is no control whatsoever on the value of the euro, there is an element of control in the choice of the statistical parameter which is meant to reflect movement in the average price level.* Maltese legislators and representatives of employers and employees refer to the RPI. But the European Central Bank uses the Harmonised Index of Consumer Prices (HICP) and not the RPI when charting average price movements in order to trace Malta's competitive stand in international trade transactions. The HICP has a wider coverage base than the RPI. It covers private households, institutional households and

foreign visitors to Malta. It is a chain index whose weights are reviewed on an annual basis every January and allows the introduction of newly significant goods and services on an annual basis.

The rate of price movement in Malta, upward, recorded by the HICP has been higher than that obtained through the RPI formula. By itself these three rates – RPI result, Unit Labour Costs Indices, and HICP – are a sign of the complexity of understanding the forces at work in an economic and social system and the limitations imposed on one's judgement when adopting one particular statistic for analytical and commentary purposes (Delia, 2010: p. 130 -134). One fact emerges from the decisions taken: the rate of wage increases has been 'contained', even following the introduction of the mandatory COLA, because the rates of price increase under the RPI were lower than those obtained under the HICP. They were further subdued because the wage adjustment was not set as a percentage of the actual wage, but COLA was worked out as the change in the RPI Index applied to a hypothetical 'social wage'. It is the value of the compensation adjustment thus derived that was awarded to employees and welfare beneficiaries. One can claim that a sort of 'wage control' has been operated in Malta for the past twenty years.

Recent data on Harmonised Competitive Indices suggest a deterioration of Malta's competitive position on the international markets. Both the nominal and the real values of these parameters have been rising, meaning that the loss in competitiveness due to exchange rate movements has been amplified by changes in relative prices.

Conversely, the Unit Labour Cost Index registered a decline in the second quarter of 2016, following a series of rises for a number of quarters. This decline suggests an improvement in Malta's competitive position within the single currency area (Central Bank of Malta, 2016a: p.52-54).

- xi)* The average wage per employee for 2014 is given at €383 per week or €19,916 annually (Ministry for Finance, 2016a). This amount is less than the one derived from the survey on Statistics on Income and Living Conditions for 2013-2014 which gives two key indicators. One is the ratio of Employment Income to Gross Household Income: 75%. The other is Average gross Household Income for 2014, €29,948. Working on these statistics, the Survey gives a value to the at-risk-of-poverty threshold of €7,672, being 60% of the Median National Equivalised Income (NEI) (NSO, Malta, 2015). There were 65,987 persons, representing 15.9% of the population, with incomes below the threshold value. *These data suggest that the proportion of those persons considered relatively poor has kept on rising over time. They represented 15% in 2008 and numbered 59,498 when the poverty threshold limit was set at €5,728* (Delia, 2010, p.3). This value amounts to 75% of the limit set for 2014.

The above data are the aggregated averages for the entire population. But they differ for various sub-categories defined by age, gender or household category. *Such disadvantaged groups include young children, single parent households and the elderly. These last two categories are on the increase.*

- xii)* *This socio-economic phenomenon, whereby people in need keep on increasing as the total level of*

activity keep recording overall higher incomes, demands to be addressed further. And one has to transfer analysis from numbers to individuals and identify those factors which render people in need. Such factors may be standardised, but there are always elements within society that are constantly leading in a subtle way to the results registered above. Such phenomena may not be solely attributed to Maltese society but may be considered to be universal. If this is the case, then one has to assess the impact of economic and social policies implemented in a variety of countries to try to identify the reasons for such outcomes.

This result keeps emerging notwithstanding the massive interventions by governments over the past half century and the size of ever-rising national debts that were undertaken supposedly to curb such specific situations. *These data suggest that there may be inherent inconsistencies in the way in which policy programmes are projected and the manner in which they are implemented and monitored.*

- xiii) *The share of the elderly, 65 years and over, in the total population at risk increased from 14.9% in 2013 to 16.9% in 2014 representing 12,011 Maltese of whom 5,387 were males and 6,623 were females.* When referring to the elderly sub-group, one generally moves on to discuss retirement pensions and their role in sustaining a decent living in old age. This debate is bound to be ongoing. *One surely cannot ever state that the matter of generating a supply of resources (in cash and kind) to particular subgroups in the population can be 'resolved'.* This is especially

true in the case of the elderly population; the composition of the group is constantly changing. Life expectancy at birth is 79.8 years for males and 84.3 years for females; life expectancy at age 65 is 18.5 years for males and 21.7 years for females. Roughly, these figures give Maltese males and females another two years of life compared to the position in 2007. The costs of running a pension scheme based on the defined benefit principle are therefore increasing as a result. There are more Maltese entitled to receiving retirement pensions and they are living longer.

The costs of funding a pension scheme depends practically on four parameters: age and life expectancy and the retiring age limit (women live longer than men, on average); the number of years that one has to contribute to the social pension scheme to be eligible for a state pension; the inflation rate which will determine the purchasing power of the pension; and the rate of return which could be worked into the computations to derive the accumulated fund at the end of the contributory period. In macro terms, when referring to unfunded state pension programmes, these parameters will be represented by the number of contributors, the contributory period for eligibility, the retirement age and the gender of retirees, and economic growth which is reflected into incomes growth for all and higher revenues for the State.

- xiv) *The reduction, around forty years ago, in the age of entitlement for the retirement pension from 65 to 61/60 is a case of untimely public policy intervention.* Contributory pension schemes

were enacted for employees in 1956 and for the self-employed in 1965. Non-contributory, means-tested Old Age pensions were introduced in 1948 together with income taxation. The retiring age was initially set at 65 years; it remains so for the self-employed to this day. However for employees, this age was reduced gradually to 61 for males and 60 for females. This policy decision was taken because life expectancy for males was 66 years at that time. However, at the time that the eligibility age retirement limit was reduced, life expectancy started edging upwards moving gradually, within a forty year period, to the values recorded in recent years. For male retirees the difference amount to around 14 years. We have now started a reversal process for employees pushing up the retirement limit to 65 over a time period.

This age decision was a case of acting on short-term data without accounting for dynamic elements in society that go against the policy decision being considered. To avoid having a repeat in other matters related to the life of retirees policy makers have to constantly focus on the package of services on offer to retirees and their related prices. The pension amount and eligibility is only one component of this package. This is especially important because historically retirees were made eligible for certain services, like free medicines and medical care at home, subsidised meals, telephone services and home help. As the number of pensioners increases the cost of running such services rises, particularly since the upcoming class of pensioners is more demanding and technology has made available means which

could enhance one's life but which are at the same time expensive to sustain.

xv) *This same consideration refers to policy decisions regarding the other categories of disadvantaged persons, especially children who cannot take care of themselves and depend entirely on the support of their elders. There were 18,409 persons under 18 years who lived in communities whose incomes were below the stipulated relative-poverty level. They made up 24% of the at-risk-of-poverty population.* The number of marriage/relationships breakdown has been on the increase for the past two decades. The number of persons of all ages, but especially those of young age who may require special attention, is bound to increase. Their personal development will depend critically on such support (Delia, 2009). At the same time, the relatively strong immigration movement of the past decade could also contribute to an acceleration of the number of people who seek psychological and other kinds of assistance.

xvi) *The present set up of support services - be it educational institutions, welfare support agencies of various kinds both public and voluntary - may already be inadequate to meet the growing demand. This insufficiency refers to all types of resources be they physical infrastructures or personal skills.* To date the majority of support services were of the rehabilitation type; the upcoming generations need resources of the preventive type which can compensate effectively for shortcomings in the homes. Failure to implement such counter-measure programmes will impact the individuals themselves and those nearest to them. It will also

induce longer-run negative implications for the labour market, the rate of economic growth, fiscal sustainability, and future welfare programmes.

Witness the 'relative inadequacies' of various policy programmes to date from the following facts. Health wise the upcoming cohorts of Maltese children are still found to be obese and probably more susceptible to various non-communicable diseases in spite of several reports and action programmes specifically meant to educate the population, and reduce obesity, heart and respiratory problems.

Furthermore, many youngsters are still illiterate and play truant at school while the fluent bilingualism (Maltese, English/Italian) which Malta boasted of is probably no more. The upcoming generations are getting weaker in their abilities to speak fluently and write correctly in Maltese and other languages. These results are obtained notwithstanding the fact that classes have fewer pupils and capital investment in schools and tertiary educational facilities has been substantial over the years. And life skills, as reflected in the home and in the place of work, are surely at a premium. Leadership skills are in short supply and personal relationship issues are becoming more pronounced and on the rise. The future for young people with these health and intellectual characteristics could be compromised.

xvii) Such observations lead to the basic policy parameter on which all decisions are constructed: the size and age configuration of the Maltese population. There were 430,000 people living in Malta in 2014, around 15,000 more than in 2010.

Of these 400,000 are Maltese. In the past eight years, the Crude Birth Rate averaged 9.7 per thousand while the mean Crude Mortality Rate for the same period was 7.7 per thousand, yielding a 2 per thousand rate of natural population growth. (Ministry for Finance, Economic Policy Department, 2015: p. 191) These statistics lead one back to the opening paragraphs in this study. Population size is a strong limiting factor on which social and economic structures have to be designed and implemented.

Moreover the inverted pyramid configuration of this population age distribution, with a rising share of the 65+ and a shrinking share of the under 15 years will condition economic activity in the future. As the level of direct support by the young to their elderly parents or relatives reduces itself, both because the personnel are now fewer in number and because they are already committed to the productive sectors of the economy outside the home, society will have to re-organise its welfare support programmes. In the process this will involve immigration and the payment for services which traditionally have been given 'for free' by extended family members. *Malta's GDP will grow as a result. Caring services given by family members are not recorded in national accounts; they represent income in kind. But once such services are exchanged through the market, they will in future enter into Malta's output accounts. Recorded employment, both full time and part time, and national incomes will be higher. What happens to individual welfare is of course a different matter altogether.*

xviii) A 'relatively small population' does not imply that such communities cannot be competitive and sustain themselves over time. It signifies that they have to be constantly alert to the events occurring around them. They are bound to be supply-oriented because they cannot rely on domestic demand for long to sustain steady economic growth; they are 'export driven'.

To succeed in doing so, they have to be willing to change and adapt new technologies especially in the services sector. At the same time, they have to support those industries and personnel who are negatively affected by the change. It is this mixture of 'courage to change' and 'social solidarity' that can keep economic momentum steady in small communities, particularly in small island states.

And they have to put in place effective labour market policies covering strategy programmes based on education, on-the-place training, and migration. In turn, rising incomes and dynamic supply-side policies will induce cultural adaptations which impact on the way people think and behave in their private and public lives. Societies must prepare themselves for such cultural developments. Otherwise they will have to face unanticipated disruption in personal and social well-being.

When economic life is conditioned by conflicting policy decisions, or their offshoot, and policy inertia is followed by abrupt counter-decisions, the temptation gets stronger to think in terms of personal gain rather than in terms of the 'collective', where this latter term could stand for family, local community, ethnic groups, the nation

state, or wider unions like a federation of states. The phenomenon called 'Corruption' will turn out to be a 'natural' follow-up in such an environment. Corrupt practices will become a product of the economic and social system itself. There will not be inherent mechanisms to counter-balance them and rectify the situation. It will be left to external forces to re-address the position and re-channel behaviour in other directions.

1.2 Summary and Plan of this Analysis

In sum, the macroeconomic data for the Maltese Islands suggest a buoyant level of activity, with relatively high levels of employment and encouraging annual rates of output growth. But life is more complex than a few aggregates or averages make it to be. One has to understand the forces that actually condition the performance of the same 'buoyant' economy and society in the years ahead. One can address such queries from several perspectives. Priority will be given to the political and economic developments taking place in the European Union and in the Economic and Monetary Union, to which Malta belongs. This overall framework regulates behaviour at the political, financial, economic, social and personal levels in various ways. In turn, one can address the social phenomena that are being influenced by new codes of personal behaviour. Such unwritten codes of conduct are expected to influence strongly not only future economic growth but also collective welfare and personal happiness.

These themes are taken up below. Chapter Two reviews the significance of the European Union and the

Eurozone (Economic and Monetary Union - EMU) for Malta's economic development. Chapter Three assesses the present sectoral composition of Malta's economy and addresses the issue of the compatibility of such sectors with the evolution of the EMU. Such convergence is a key factor while reviewing the potential for future wealth and income generation in the Maltese Islands.

Chapter Four centres on the complementary policy consideration of income redistribution and personal welfare. Wealth creation is a means to enhance human well-being. This wealth-welfare relationship is still not well understood by many and it varies from one community to another. In Malta's present case, one has to identify the economic and welfare effects of an ageing but dynamic society which is experiencing both radical and rapid changes in its vision and interpretation of personal liberty, family support and social solidarity. These transformations are occurring in the context of an evolving EMU and a highly unstable political environment in countries bordering the Mediterranean. The EMU and the geopolitical upheavals in progress induce their own impact on wealth creation and well-being in the countries involved and spread such effects globally. Chapter Five summarises the main observations.

THE SIGNIFICANCE OF MALTA'S MEMBERSHIP OF THE EUROZONE

Malta became a member of the European Union in 2004 and adopted the euro as its currency in 2008. It abides by the rules and practices of these institutions, benefits from the various resource redistributive programmes and contributes its relative share to such initiatives. To date the Maltese Islands have been a net financial beneficiary from these relationships, a position which will be reviewed in 2020. Besides, Malta is a member of the British Commonwealth, participates actively in this organisation, benefits from several participatory programmes and contributes its relative share to their administrative gestation. In addition, Malta has other obligations arising from its membership of international organisations, such as the United Nations and affiliated agencies like UNESCO and the FAO; the International Monetary Fund and the World Bank. And, since becoming an independent state in 1964, Malta entered into a series of bilateral agreements with many countries on trade, sectoral co-operation, taxation, health, culture, and education.

It is this complex corpus of legislation and agreements that unknowingly for many enable economic activity in

the Maltese Islands to prosper, but at the same time be constrained by the obligations that emanate therefrom. Evidently, only specialised personnel in the respective sectors can fathom the true implications of these statutes on everyday life. But perhaps it is becoming imperative that the true significance of these memberships be identified, assessed and addressed. Because the potential challenges of such memberships may tend to be underestimated and as a result their full implications will remain hidden. Until one day society may have to face the critical step of having to make important decisions with little time to spell out and understand clearly the key tenets of the subject under analysis.

The experience of the British electorate when confronted by the referendum question regarding the membership of the United Kingdom in the European Union is a case in point. Malta is a member of the Eurozone, a position which imposes more onerous obligations than the United Kingdom has in the Economic Union, and is an island state with around 400,000 inhabitants as against the 60 million population of the British Isles. The British government admitted that it needs time to build up a proficient negotiating team to reach a deal in defining future relations between the UK and the EU. Malta will be participating in such negotiations as part of the EU bloc. But if Malta were to seek other arrangements which differ from those applicable to the other EU member states, the Maltese government will have to identify its own group of negotiators. The constraints dictated by the size of population, around 400,000 excluding the Maltese living abroad, should be glaringly evident.

The main issue that has been gradually becoming prominent in the European Union is a fact that there seems to be as many Unions as there are people in the 28 member

states that constitute the group. Every single 'citizen' has his or her vision of this bloc. The variability of visions is rendered possible by the sets of legislations/rules that regulate behaviour. This condition 'enables' all to make their preferences, select what suits them (is compatible with their immediate needs), and ignore the rest. It is this haziness of vision, and the seeming ability to reach political consensus by aiming for the highest common factor and allowing leeway for future interpretation and action, that seems to be the legal and political stratagem that has kept this disparate group together. So, for example, some refer to a 'union of states', others talk of 'a union of people', still others intend to create a unified, federal state of Europe. Such multiple scenarios mean that discussions are taking place at cross-purposes, terms do not have the same meaning for all, and all the time country negotiators are mentally referring to different models of economic, financial and political unions.

Thus, to refer once more to the UK example, the way relations between the UK and the rest of the EU were evolving implied that such relationships were not sustainable. Such arrangements could not be prolonged indefinitely. And the question regarding the role of the UK in a 'more integrated/federal Europe' was bound to arise. Similarly, seen from the UK side, it could well be that the euro-model developed over the past two decades was seen as unsustainable itself. And, therefore, there was hesitation on whether to make stronger commitments to a model that was considered 'doubtful' from its very inception. Similar reasoning is taking place in the four Eastern European member states (Buckley and Foy, 2016).

These types of considerations are hardly ever carried out in Malta. It is evident that the Maltese have their own model of the 'Union'; they do not spell it out but

they devise their economic policies on the implicit understanding that their 'model' will prevail. And so far the financial implications of joining have been positive, supporting an expansive fiscal stance without placing undue pressure on the indebtedness of the private and public sectors.

The Maltese think in terms of 'variable policy making'. They uphold that, for example, the 'one size fits all rule/principle' does not make economic and social sense; this will be unfair on small island states, especially if like Gozo they have to compete under 'double insularity conditions'. Again, they maintain that in terms of the fact that a community/economy is small it is not going to affect the overall scheme of economic, social and political events; therefore such communities should be treated differently. And they act in relation to these 'exceptions' without evaluating the long term repercussions of such positions for the future cohesion of the 'group' as a whole.

Every single EU member country still thinks in terms of its 'national interest'. The criterion for success, from a political and economic viewpoint, has been so far the growth of the national output and national employment, and a healthy balance of payments with the rest of the world following capital transfers from the rest of the EU. The idea of taking policy decisions based on the group's economic and social data is even a contentious one. Witness the exchange of views between the European Central Bank and the German government officials regarding monetary policy, quantitative easing, and negative interest rates. ECB officials keep referring to the 'zone'; German officials keep thinking in terms of the impact of such decisions on the German situation. An ambivalence of objectives will lead to hesitation and possibly conflicting policy decisions.

These positions are examined further below. First, we describe the three main groups or unions in operation. In turn, we focus on the proposed development of the Eurozone, since Malta is a member of this group, and identify certain key implications for macro-economic and sectoral development of such proposals. Finally, we develop further Malta's position regarding the EMU. Such a stand underlies policy decisions referring to sectoral development and income re-distribution programmes.

2.1 The three main types of relationships in the 'European Union'

The three sets of relationships being considered are the 'European Union' (EU), the European Economic Area (EEA), and the Economic and Monetary Union (EMU). The main features of these relationships are described first; their meaning for economic policy formation and implementation follows.

(i) The European Union (EU)

The **European Union** is characterised by an internal single market operational through a standardised system of laws that apply to all member states. EU policies aim to ensure the so-called 'Four Freedoms', namely, free movement of people, goods, services and capital within the internal market. They maintain common policies on trade, agriculture, fisheries, and regional development and enact legislation in justice and home affairs. Passport controls have been abolished within the Schengen Area.

There are presently 28 member states in the EU with an estimated population of around 508 million; the June referendum in the United Kingdom opted for a UK exit from the EU. The EU operates through a hybrid system of supranational and intergovernmental decision-making. The EU evolved from the European Coal and Steel Community (ECSC) and the European Economic Community (EEC) formed by the Inner Six countries in 1951 and 1958 respectively. It was established by the Maastricht Treaty in 1993 and introduced European citizenship. The latest major amendment to the constitutional basis of the EU, the Treaty of Lisbon, came into force in 2009.

The European Union started as an international organisation and gradually developed into a confederation of states. However since the mid-1960s it has also added several of the key attributes of a federation, such as the direct effect of the law of general level of government upon the individual and majority voting in the decision-making process of the general level of government, without becoming a federation as such. It may be described as an intermediate form lying between a confederation and a federation, being an instance of neither political structure. (However even this description may be considered as no longer valid.)

EU member states retain all powers not explicitly handed to the European Union. *In some areas the EU enjoys exclusive competence.* These are: the customs union; the establishing of the competition rules necessary for the functioning of the internal market; the monetary policy for the Member States whose currency is the euro;

the conservation of marine biological resources under the common fisheries policy; the common commercial policy; and the conclusion of certain international agreements.

In other areas the EU shares competence with Member States. These are the internal market; social policy for the aspects defined in the treaty; economic, social and territorial cohesion; agriculture and fisheries excluding the conservation of marine biological resources; environment; consumer protection; transport; trans-European networks; energy; the area of freedom, security and justice; and common safety concerns in public health matters, for the aspects defined in the Treaty.

The Union coordinates Member States policies ruling economic, employment and social policies as well as common foreign, security and defence policies. *Member States are not prevented from exercising their competence* in research, technological development, (outer) space, development cooperation and humanitarian aid.

The Union can carry out actions to support, supplement or coordinate Member States' actions in the protection and improvement of human health, industry, culture, tourism, education, youth, sport and vocational training, civil protection and administrative cooperation.

Two main objectives of the Union were the development of a single market and a customs union between its member states. The single market involves the free circulation of goods, capital, people and services within the EU, and the customs union entails the application of a

common external tariff on all goods entering the market. Once goods have been admitted into the market they cannot be subjected to customs duties, discriminatory taxes or import quotas, as they travel internally.

Free movement of persons means that EU citizens can move freely between member states to live, work, study or retire in another country. The free movement of services and of establishment allows self-employed persons to move between member states to provide services on a temporary or permanent basis. Free movement of capital is intended to permit movement of investments such as property purchases and buying of shares between countries.

Economic well-being is not evenly spread across and within EU countries. Indeed, there is a significant variance for Gross Domestic Product (Purchasing Power Parity) per head within individual EU states. The difference between the richest and poorest regions ranged, in 2014, from 30% of the EU28 average to 539%, or from €8,200 to €148,000. The introduction of the euro has not as yet delivered the 'convergences' that have been expected. The rates of economic growth, yearly average price changes, productivity per capita, and unemployment rates remain disparate throughout the member countries.

Structural Funds and Cohesion Funds are supporting the development of underdeveloped regions of the EU. Such regions are primarily located in the states of central and southern Europe. Several other funds provide emergency aid, and support for candidate members to transform

their country to conform to the EU's standard. EU research and technological framework programmes sponsor research conducted by consortia from all EU members to work towards a single European Research Area.

The European Parliament and the Council of Ministers pass legislation jointly in nearly all areas under the ordinary legislative procedures. This also applies to the EU budget. The European Parliament is made up of 751 Members of Parliament (MEPs) elected directly every five years on the basis of proportional representation. The Council of Ministers consists of a government minister from each member state and meets in different composition depending on the policy area being addressed. It is considered a single body notwithstanding its different configurations. The European Commission acts as the EU's executive arm and is responsible for initiating legislation and the day-to-day running of the EU. The Commission is accountable to the European Parliament.

(ii) **The European Economic Area (EEA) and Association Agreements**

The **European Economic Area**, established in January 1994, comprises three member states of the European Free Trade Area (EFTA), namely, Iceland, Lichtenstein and Norway and 28 member states of the EU. It allows the EFTA-EEA members to participate in the EU's internal market without being members of the EU. They adopt almost all EU legislation related to the single market, except laws on agriculture and fisheries. They contribute

and influence the formation of new EEA relevant policies and legislation at an early stage as part of a formal decision-making process. Switzerland, also an EFTA member, has not joined the EEA but has a series of bilateral agreements, including a free trade agreement, with the EU. These four countries participate in the free movement of goods within the single market but not in the customs union.

EEA membership was not considered a viable option for the microstates of Andorra, Monaco and San Marino. Association Agreements were deemed a more feasible mechanism to integrate the microstates into the internal market.

The EFTA Surveillance Authority performs the European Commission's role as "guardian of the treaties" for the EFTA countries, while the EFTA Court performs the European Court of Justice's role for these countries.

(iii) **Economic and Monetary Union of the European Union (EMU)**

The **Economic and Monetary Union** is an umbrella term for the group of policies aimed at converging the economies of member states of the EU. Nineteen EU member states have adopted the euro as their currency, Malta included. Denmark and the United Kingdom, whose EU membership predates the introduction of the euro, have the legal opt outs from the EU treaties granting them an exemption from this obligation. The remaining seven non-euro member states are obliged to adopt the euro once they comply with all convergence criteria. Whether this will happen has to be seen, especially following the UK's referendum to exit

from the EU and the considerations surrounding the timing and format of the creation of the euro itself.

Membership of the Eurozone establishes a single monetary policy for the respective states. So they can no longer implement an isolated monetary policy such as monetising their national debt or devaluing their currency to regain lost competitive positions in international trade. Consequently, they have to adopt prudent fiscal discipline over time, reflecting their obligations under the Maastricht treaty. Failure to do so could eventually lead them to risk facing a sovereign debt crisis in their country without the possibility of monetising debt as an exit solution.

The EMU is an ongoing project. It is a programme phased in stages to reach an eventual goal of economic and political convergence. Two reports, *“Towards a genuine Economic and Monetary Union”* (European Commission, 2012b) and *“Completing Europe’s Economic and Monetary Union”* (European Commission, 2015) laid out an action programme meant to consolidate achievements to date and propel further developments.

The title of the 2012 implied that the existing arrangements under the EMU were ‘defective’; the existing Maastricht currency architecture was not sustainable. It needed to be reinforced through the introduction of a fiscal capacity of the EU, common debt management and a completely integrated banking union. Additionally, labour market reform in member states implying flexibility in wages and market conditions which were imposed at Union level was bound to be

resisted by member states as being a serious threat to Social Europe. So the 2012 plan for action was phased in three stages: Ensuring fiscal sustainability and breaking the costly link between banks and sovereigns (2012-2013); Completing the integrated financial framework and promoting sound structural policies (2013-2014); and Improving the resilience of EMU through the creation of a shock-absorption function at the central level (2015 and later).

It can be claimed that the targets set for stage 1 have been achieved. Those for stage 2 are half way through; those for stage 3 are still waiting. Their status is unknown.

The 2015 report also envisages three stages. The first is short and set for 2015-2017; the second builds on the targets reached and continues developing what is termed 'a deep and genuine EMU'. This implies the possibility of EU treaty changes. These three stages are meant to bring further progress on all four dimensions of the EMU. These are:

1. Economic union: Focusing on convergence, prosperity, and social cohesion.
2. Financial union: Completing the banking union and constructing a capital markets union.
3. Fiscal union: Ensuring sound and integrated fiscal policies
4. Political union: Enhancing democratic accountability, legitimacy and institutional strengthening of the EMU

The 2015 Report spells out clearly the role of the euro, which is more than simply a medium of exchange. It states:

'The euro is more than just a currency. It is a political and economic project. All members of our Monetary Union have given up their previous national currencies once and for all and permanently share monetary sovereignty with the other euro area countries. In return, countries gain the benefits of using a credible and stable currency within a large, competitive and powerful single market. This common destiny requires solidarity in times of crises and respect for commonly agreed rules from all members'. (p.4)

The Report points out in the Introduction that 'the process towards a deeper EMU is nonetheless open to all EU Members' (p.2) Since its publication, the United Kingdom voted to exit from the Union and gave rise to a series of valid questions which the paragraph above does not even consider; the Visegrad Four (Hungary, Poland, Slovakia and the Czech Republic) are pushing the demand for a looser bloc with some powers *returned* to nation states; and commentators have dared to propose that 'a split euro is the solution for the single currency' (Stiglitz, 2016) and that 'a two-tier model is needed to revive Europe' (Rachman, 2016). We also know that the Greek government was considering the re-introduction of the drachma in the event that bailout negotiations failed. These events and considerations point out that the EU project is truly a 'work in progress'. There are various issues of a political and social nature that have to be addressed before the economic and financial implications of the single currency/currency union can be seen through and integrated consistently into the economic and social policy formation for the entire euro area.

As the 2015 Report notes in its concluding paragraph ‘The Report offers a clear sense of direction for Europe’s EMU. This is essential for citizens and economic actors alike, and for their confidence in the single currency. *Translating these proposals into action will require a shared sense of purpose among all Member States and EU institutions*’. (p.18, italics added)

(iv) **Some observations**

Several observations arise from the above narrative. Firstly, there are high transactions costs associated with the way decisions are formed. There are many forms of associations operating at one go. Without a consensus for a clear vision of the final objectives – even the 2015 Report is presented as reflecting ‘the personal deliberations and discussions of the five Presidents’ (p.2) – there cannot be tangible progress on which the individual member states can work to build a unified euro economy.

Secondly, this situation is arising because there is not yet a determinate unit that can speak on behalf of the ‘people of Europe’, whoever they may be. The formulation of legislation is split between the European Parliament, with members elected directly by the public, and the council of ministers, in principle also elected by their respective constituencies. Some MEPs (referred to as Euro sceptic) strive to get their countries out of the EU framework.

In addition, many government ministers are challenged in their own countries for the views that they represent, so their action on the European fora may be construed at times of being against the interest of their own constituents. Witness

the position of the Greek government following the bail out talks with creditors, or of the British government during and after the vote for exit from the EU. In both cases there were members of the cabinet of ministers in Greece and the UK who did not share the same view on the issues involved, namely, fiscal measures to prod the Greek economy ahead and participation in an enlarged EU.

Thirdly, the ambivalence of the political objective is itself a matter that is bound to lead to strong compromises and therefore vague policy direction: a federal Europe, a Europe of nations, or a Europe of people. These are not semantic issues; they are real queries that have to be settled before one can proceed with furthering the European project. The experience of the United Kingdom after the June referendum result illustrates this point. The vote reflected the views of the 'British electorate'. But this view was dissected by geographical area. It resulted that in Scotland more voters wanted to stay in the EU; so did the majority of those who voted in the London area. So there was a proposal of Scotland taking up this matter with Westminster and Brussels so that the Scots will remain part of the EU (Sturgeon, 2016). So did apparently the voters in London and the electorate is Gibraltar.

It is already a matter of having the former Yugoslavia split up in various states, with every one of them entering the EU as an independent, voting member. It already happened for the former Czechoslovakia, with the Czech and the Slovak people now represented by two units. It could happen for Belgium, with Flemish and French and Brussels coming in as a third 'region'. So one

can presume that there will be nothing strange if the 'Greater London Area' were to be given some fancy name and separate itself from England; after all there are more people living there than in several EU member states put all together. And this trend could continue: Spain splits up, so does Italy and while we are at it why not Malta and Gozo. After all there has been the suggestion that it is in the interest of the people of Gozo (circa 25,000) to have a party of their own and hold the balance of political power in the Maltese Parliament. They may apply for an Associate Membership status with the EU like Andorra or Monaco.

The only member country that went against this trend is Germany. It moved for unification. Germany's case may be unique; and it had a strong economic effect not only on the former Western German society but also on other EU states. And it probably has been successful because of the Federal republican constitutional model. Deep down, German citizens may still consider themselves to be primarily 'regional' – Bavarian, Saxon, Prussian and so on – and then German. Perhaps this model may assist the political formation of a 'deeper European union' (to quote the 2015 Five Presidents' Report).

Country 'fragmentation' has its unintended political effects which tend to increase the transaction costs of decision making in the evolving EMU. Political 'agents' start operating within a multi-layered set up. They compete for voter allegiance (read votes) at the level of the local council, the regional government, and the EU institutions. There are specific programmes and

groups of voters at each of the three levels. Voters' deals will have to be struck at every political/administrative election, leading to promises for future political support and as a result to compromises. Experience shows that even involvement by outside interests (both private sector agents and governments) in influencing the outcome of these electoral contexts cannot be ruled out. The number of opportunities for those who plan to follow such a career is not small, there is a clear progression of duties and, possibly, economic rewards.

Electoral regions also gain from such a political schema through the central government resource redistributive mechanism. The allegiance of a region's voting college is secured by promises of transfer of aid to particular projects in the area or by the undertaking of infrastructural projects that generate employment and economic activity. Such projects may not be well-planned or even necessary and, at times, may remain incomplete or underfunded throughout their operational life. Such 'barter', at times referred to as 'log rolling techniques' in public choice models of political economy, are relatively easier to make when funds are coming from outside, like the EU structural funds. In this way regional economic activity may be boosted for some time, in the interest of the people but surely in the interest of the political groups which carry out the negotiations.

The conditions defined above lead to the state of 'corruption' described in Chapter One. The EU project has been evolving very slowly. So far it lacked a clear objective to be attained within a stipulated

time-frame; the 2015 Report aims to rectify this. So there are many opportunities for those who seek them to gain from the direct participation in the realisation of the euro project. Accountability measures within such an environment cannot ever be strong enough. And, anyway, the main political players alternate relatively quickly at several of the echelons of power-making and strategic decision taking. Such changes may tempt some agents to seek rapid enrichment at the expense of the many taxpayers whose resources are being redistributed through the many national and EU programmes.

Such programmes are inherently desirable provided they are channelled to areas where they can generate positive impacts. Funds allotted for regional and industrial regeneration schemes are considered to be effective when they produce sustainable, long-term results. Apart from any short term, social effects, like curbing unemployment by boosting aggregate regional demand for goods and services, financial transfers and capital injections can be the main instruments to encourage change in the productive capacity of a people. Economic development implies that certain industrial activities are replaced by new ones. But this could mean that some displaced workers or new entrants to the labour market may find it difficult to settle in the restructured work environment. They have to be assisted financially, technically and psychologically in their own personal interest and in that of the economy in which they operate. This is what is meant by 'social solidarity', a term introduced also in the 2015 EU Report. People have to be encouraged

to face economic change with determination knowing that in the transition period they are not left on their own but assisted all along. Accepting the consequences of economic change under such a scenario is relatively easier for all. It is in the best interest of the entire community.

At the same time, on a regional/national basis, decision makers are confident that whatever economic and technological restructurings are made will last. Unless there is this security, it does not make economic and social sense to specialise. Even a country/regional split after some three hundred years, like the case of Scotland from the rest of the UK, would lead to relatively strong economic imbalances. So no policy maker will recommend industrial specialisation in line with geographical resource endowment without the certainty that such industrial competitive configurations are meant to remain. Therefore market-induced future changes will have to be supported by an adequate redistribution of resources from the greater political-economic unit.

Fourthly, if Europeans continue to think in terms of regional splits as a basis for participation in the EU project, then the position of Turkey is automatically determined. Turkey is edging towards the 80 million population level. There is no place for such a massive demographic force in a 'fragmented' group of countries many of which have a population lower than, say, five million. Turkey's participation could be restricted to trade matters within the Single Market framework (free trade and customs union) but not within the EMU.

And, fifthly, at the same time Europe has to think in terms of its defence requirements. With the UK and Turkey out of the political context of the EU, the defences of Europe will have to either develop fast, committing military hardware and personnel on the required scale or continue to depend even more strongly than in the past on the support of outsider countries. Structures for defence do not come cheap. So there will have to be trade-offs for such 'security services' provided by non-member countries. In the modern world, just like in the old one, commercial stability and economic growth depend in part on a viable system of defence to safeguard the security of a people both inside and outside specified geographical boundaries.

The economic facets of the euro project are highlighted in Chapter 2 of the 2015 Report (p. 6 - 9). It is aptly entitled 'Towards Economic Union – Convergence, Prosperity and Social Cohesion'. In brief, this objective includes the following sub-headings: A new boost to convergence, jobs and growth; a stronger macroeconomic imbalance procedure; and, a stronger focus on employment and social performance. Further explanation of these titles indicates that we are facing the 'standard' economic issues related to Production and Distribution of resources. But whereas normally such analyses refer to particular countries, with their own resource endowments, political set ups, historical commitments and demographic configurations, in the case of the EU the 2015 Report is referring specifically to a political and economic Union in formation.

Standard economic analyses aim to trace the impact of particular decisions on the output and welfare of an industry, region or country. There is an authority responsible for maintaining law and order, monetary and economic exchanges under a set of rules, and a government with a clear mandate to implement existing rules and to promulgate new ones. Fiscal regimes are assumed given; these may be subject to rapid changes sanctioned by a recognised authority in a parliamentary democracy.

The availability of fiscal tools depends on historical circumstances. Thus, for example, in the United States of America the Federal Government raises its revenues from income and corporate taxation; in the EU member states contribute a percentage of the revenue raised through Value Added Taxes in the respective states. Income taxation remains entirely the domain of member states. The economic impact of taxes on income and taxes on expenditure on household and company consumption and investment is generally expected to be different. Analyses seek to trace such impacts on short term and longer term economic activity and social welfare.

The interrelationships that exist among the various economic, social and political goals expressed in Chapter 2 of the 2015 EU Commission's Report are described briefly and graphically in the following section. One may then draw the parallelism between the roles of a central government and a central monetary authority as expressed in macroeconomic models crafted for a national economy with the schema found in the

Five Presidents' Report. The latter projects the replica of a 'Central government' complemented by a Central Monetary and Regulatory Authority (the present European Central Bank and the Banking Regulator) supported by a centralised body representing the citizens of the EU (a revamped European Parliament elected directly by EU wide suffrage). One can see a replica for the role of the State and Monetary Authorities within the EU framework as had happened in national states during the last hundred years.

The main economic and social objectives are depicted graphically in section 2.2. The views of the Maltese electorate and political parties on such a political-economic model are addressed in section 2.3.

2.2 Macroeconomic and social objectives, and Market structures: a graphical presentation

The role of governments in a parliamentary democracy has evolved during the past hundred years. Historically, the main macro-policy objectives were limited to sustaining price stability or a restrained aggregate average price changes (upwards or downwards) and a balance in the external account. It was thought that under the gold standard, the inward/outward movement of precious metals, coupled to related expansion/contraction of credit and the money supply by the banking system would lead to full-employment of resources. The government's fiscal role was meant to be neutral since the private sector by itself could lead to the generation of employment for all those willing to work. Experience in the 1920's and 1930's

taught otherwise. And many feared that economies could be constrained to operate in a low-wage trap and high unemployment conditions.

Since then governments were encouraged to activate intelligently fiscal tools to stimulate economic performance in the short run and to address a society's shortfall in social capital (road, rail, harbour, airport infrastructure; power transmission; telecommunications; educational and health institutional infrastructure and supply of complementary services; social welfare networks and provision for old age). Budget activities assumed a dual role: to act as an economic stimulus and to perpetrate social cohesion through the redistribution of primary income to household and firms.

Such an approach resulted in a modified post-tax and income transfer disposal income for households and industry, which in turn affected consumption, saving and investment decisions. How large should be this 'fiscal activism' remains a moot issue; witness the difference of opinions within the present day EU decision making bodies regarding 'fiscal austerity', 'drive to economic growth' and 'social solidarity'. Such phrases find their place even in the 2015 Five Presidents' Report. The dialectic between theory and policy making cannot be sharper (at times verging on 'sour') than it is already (Vide: Spahn, 2016, Furman, 2016, and Hacche, 2016).

Under the term '**Production**' one can include Full Employment (a short term goal), Economic Growth (a dynamic, long term goal), Sustainable natural environment (on a local and global framework), and an External Account balance (wherein a country will generate enough foreign exchange earnings to pay for its imports). Under the '**Income Distribution**' goal one can insert the policy objective of relative Price stability (nowadays defined as

an annual overall average price increase around the 2% level), and a Fair Income distribution obtained through a redistribution of resources, via the government's budget and other voluntary donations in cash and kind. The share of the total output going to taxation and transfer of services depends on the social welfare model in operation. Such model reflects the underlying approach to social solidarity adopted by a community, which in turn determines the role of the market mechanism as an instrument for the allocation of resources.

EU countries, as a group, have registered economic growth year on year. But these gains were not distributed evenly. The income disparities within and between member-states kept widening. Income enhancements were mainly accruing to selected households/regions falling in the higher income category. The reasons for this state of affairs are various. But this result implies that the personal welfare of many citizens in the EU was falling behind; this was a negative result per se, and it could be a factor leading to social and political instability in future. The policy measures implemented to date did not produce the desired results on employment, income and personal welfare.

Indeed, there are calls for critical assessments of the 'austerity stands' imposed on EMU member-state governments (arising from the 'rigid' fiscal rules on budget deficits and national debt/GDP ratios). They do not seem to be effective in generating a strong, sustained output growth and in creating new employment positions, whether temporary or permanent.

In turn, the implementation of the Quantitative Easing programmes of bond purchases by the European Central Bank and other central banks have pushed interest rates in several countries into negative territory. Such

unorthodox monetary measures have generated around \$13trillion worth of sovereign and corporate bonds with negative nominal rates. This is around half of all western debt. It is an unprecedented phenomenon and it is affecting negatively the income of pension funds. The package of monetary and fiscal policies in place, superimposed on the various countries' embedded labour market and other administrative rigidities, is affecting negatively not only the upcoming young entrants to the labour market but also retirees' incomes and welfare.

These series of considerations are presented graphically below. Like all graphs the following figures have limitations: they are static descriptions of a highly complex world of exchanges. But they can be supplemented by brief commentaries to 'explain' dynamic conditions that prevail in the real world. And they suffice to elicit the main considerations on which certain policy decision orientation may be addressed. Diagram 1 presents several socio-economic parameters which pertain to decision-making in a modern market economy; they relate to the determinants of aggregate national demand and final output, rates of interest, employment, real wages, and factor (primary) income distribution.

Quadrant I refers to the relationship between the commodity markets (**IS** schedule) – a community's aggregate expenditure on consumer and capital goods and services in the private sector economy - and the money market (**LM** schedule). Both graphs denote the aggregate demand for commodities and funds at different rates of interest (**r**) and aggregate output (**Y**). These interactions take place in the context of a given capital stock (**K**), money supply (**Ms**) and price level (**P**). Labour is a variable input; its demand depends on its productivity.

The volume of domestic commodities may be changed by imports (**M**), which augment local supply, and exports (**X**), which deduct the supply of locally produced goods and services for domestic consumption. International trade also introduces another parameter for consideration, namely, the rate of exchange of a currency (**ER**). And, the amount of resources will also change in volume once the public sector is introduced. (In which case, the **IS** schedule will have to be re-defined to show such an extension; it becomes $(\mathbf{I}+\mathbf{G}+\mathbf{X} = \mathbf{S}+\mathbf{T}+\mathbf{M})$, where **I** (Investment) and **S** (Saving) represent the private economy; **G** (Government expenditure) and **T** (Tax revenues) represent the public sector; and **X** (Exports) and **M** (Imports) represent the external sector).

The value of **r** in Quadrant I equates four important factors, namely, the monetary rate of interest; the 'real' rate of interest (equal to the money rate of interest less the rate of price change which is assumed zero in the model); the rate of return on investment; and the marginal rate of time preference, which reflects society's time preference between present and future consumption. In real life, these rates need not be equal one to another. For example, the monetary rate of interest is influenced also by tax considerations and perceived risk apart from the parameters referred to above.

Quadrant IV relates output to employment (**N**); the number of active workers (or man-hours worked) is determined by the combination of capital and labour inputs and the resultant productivity of the 'last worker taken on'. The slope of the output schedule in quadrant IV yields the demand for labour graph in quadrant III (**D**). The amount of workers seeking employment at different real wage levels is represented by the aggregate labour supply schedule (**S**). The average wage settled

under such conditions tends to W/P . In turn quadrant II represents the relationship between the return to factor Capital arising after the 'latest project' is carried out, and the return to factor Labour, once the marginal worker is engaged. The ratio (rK/Y) gives the total relative return to Capital, and the ratio $(W/P)N/Y$ represents the relative return to Labour; together they yield the Factor Share Distribution of a country's aggregate Income (Gross Domestic Product). This is an important economic parameter in itself and has significant policy connotations for a community's social cohesion.

Diagram 1 combines several key economic and social factors, namely: the resources available for consumption and capital accretion and their relative cost; the possibility of fiscal intervention, manner of financing and its related monetary cost and potential private sector displacement (crowding-out) effects; productivity of both the 'entire' capital stock and the marginal investment undertaken; the labour supply and marginal labour

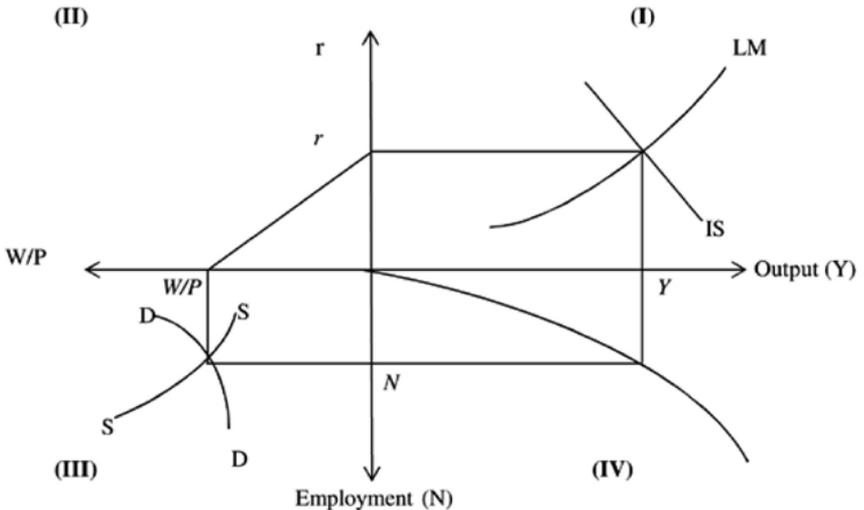


Diagram 1: Macroeconomic Relationships

output; the composition of the labour supply influenced not only by the wages offered and demanded but also by demographics and legislation ruling age and gender activity in the labour market; and the resultant distribution of the national output among the 'capitalists' (income from self-employment, rental income and profits) and 'workers'. In short, any decision regarding the allocation of new funds (**S**) in an economic activity that expands the capital capacity (**I**) will have to be guided by the above considerations, among others, if such a decision were to be efficient both from a profitability angle as well as from a social perspective.

Issues relating income distribution among households, social welfare and political decision making are synthesised graphically in Diagram 2 below.

Diagram 2 represents a two-person (two-group) model, with the welfare of person A traced on the vertical axis

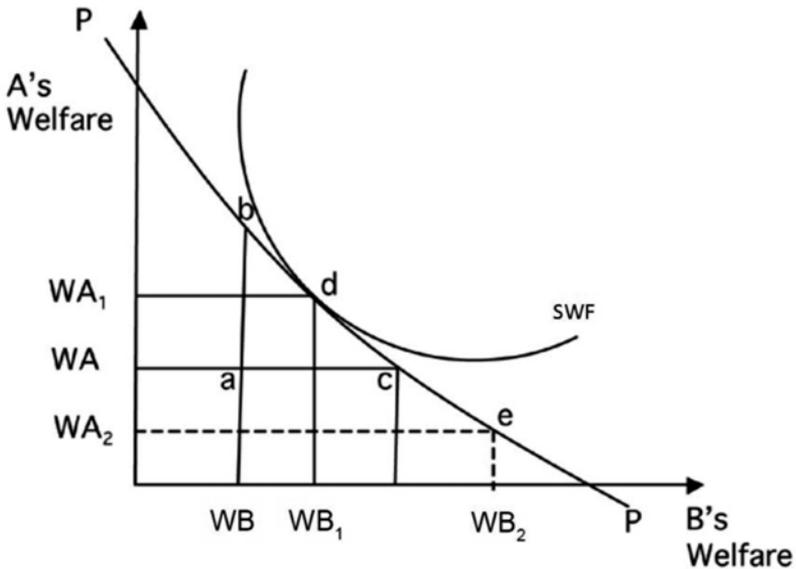


Diagram 2

and the welfare of person B on the horizontal. Curve PP is made up of a series of first-best combinations of goods and services, produced in the private and public sector, which emanate from the production possibilities open to firms that respond to the needs as reflected in effective demand by the two consumers A and B. These consumption decisions are the outcome of personal tastes, incomes and prices of goods and services. The SWF (social welfare function) represents the combined welfare level of A and B, being the 'society' in this model. It represents a given level of welfare, being one level of many that, together, give the welfare ranking of this two-person society. The SWF represents a value-loaded judgement, which is the outcome of a political process.

If the level of welfare is at point **a**, it is an indication that welfare can be enhanced through further output and consumption expansion up to the boundary represented by PP; position **a** represents a sub-optimal situation. If the SWF plateau is relocated to point **b**, then person (group) A will be better off without making B worse off; this movement generates a Pareto improvement, meaning a position where one person's welfare is enhanced without making someone else worse off. Point **b** is located on the PP frontier; hence it represents a 'first best' or optimal position. The same situation arises if the plateau shifts to point **c**; in this instance person B is better off, but A's welfare remains unchanged. By moving to point **d**, where the SWF is depicted being tangent to the PP curve, both A and B will be better off. Movements within triangle **bac** are tantamount to welfare enhancement for the group.

Issues referring to both resource allocation and equity (income distribution) arise if the SWF plateau is shifted outside the triangle **bac**, say to point **e**. At **e**, it is seen that B's welfare grows, but at the expense of A's welfare; the

former rises to WB2 while the latter falls to WA2. The decision to favour one person (group) at the expense of another is the outcome of the political market, the ballot box, reflecting voters' support for one programme rather than another. For example, raise income tax on certain income brackets and reduce VAT on goods and services consumed by families in lower income groups; or reduce benefits to farmers and raise those accruing to operators in the manufacturing sector; or raise retirement pensions while decreasing financial support to students.

But, within an EU context, group A may represent a member state and group B the other countries in the EU or in the Eurozone. There could be policy decisions in country A which benefit the citizens of A but to the detriment of the citizens in the other member states. Competitive tax-efficient programmes aimed at the citizens of other EU states, or conditions restraining the freedom of movement or employment of non-nationals will reduce the welfare of all those involved. Politically, such decisions may enhance the chances of re-election of a political party; hence they would be popular, vote-attraction, within a state. But they would not be taking into account the economic and welfare considerations of the entire group. In such instances, the SWF is being defined in terms of a particular political unit and not in terms of the entire euro-zone or the EU's single market.

Again, pressure may be exerted through the political decision making process in a member state or in the EU Commission or the European Parliament to influence legislation in favour of certain stakeholders, sectors or even countries. Such stakeholders may utilise the resources at their disposal to shift decision-making in their favour. Such considerations are illustrated in Diagram 3, which compares potential trade behaviour

under two distinct market structures, those represented by the perfect competitive (many buyers and sellers) and the monopoly (single seller) market structures.

A critique that is sometimes made of EU policies is that they tend to favour the big industry players – ranging from agriculture, fisheries, various sectors of manufacturing and distribution, and services. They give rise to economic rents for the limited number of relatively big producers. Consumers and small producers are thereby affected negatively as a result. Such accusations are also made to proceedings carried out through international fora; the outcome is often advantageous to the big conglomerates. Such units are well organised in putting forward their case by lobbying various international agencies and governments. The resources allocated for lobbying may at times be considered inefficient from a social welfare perspective. Their utility depends on the span of information that is distributed and on the transparency in carrying out such marketing activity. They may fall under the 'corrupt practices' classification.

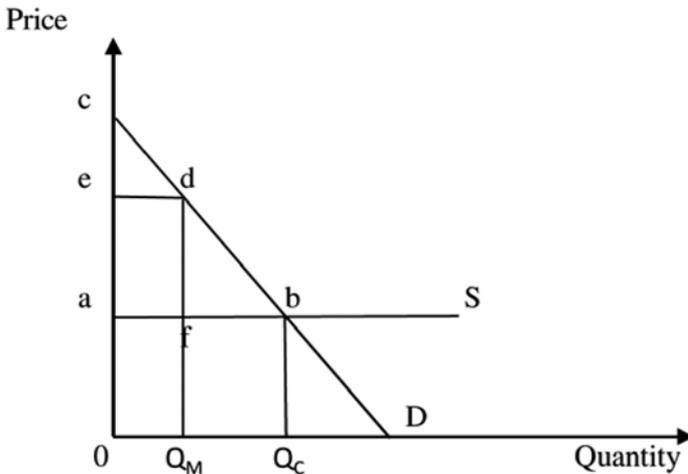


Diagram 3

In a 'perfectly competitive market situation', where the number of producers and buyers is very large, output is at Qc and exchange takes place at price Oa per unit, a combination arising from the intersection of the Demand (D) and Supply (S) schedules. Total expenditure/revenue is $Oa.OQc$. But the total worth to consumers is larger than this amount; additionally it includes triangle abc that approximates the value of a 'hidden surplus'. Its value is equal to $0.5(ac.OQc)$. If the market in question is supplied by one producer – a monopolist – the value of sales equals $Oe.OQm$. Of which $afde$ represents 'monopoly rent', that is profits that arise because of the market control exercised by the producer. Consumers still enjoy a surplus under these conditions, equal to ecd , which is less than that recorded under the perfect competitive market structure.

Two points relevant for policy considerations arise from such market conditions. One is the 'deadweight loss', represented by triangle fdb which is lost as a result of the changes in the market conditions. This loss arises from forced changes in the price regime which induces consumers to reconsider their requests for buying a particular good or service. Consumers also lose the value of the surplus represented by rectangle $aedf$, this is transferred to the producer. It is not lost but appropriated by someone else, the 'strong producers' referred to above.

A second consideration refers to the use of the resources valued at $aedf$; these may be allocated by the monopolist to lobby for action at local and international levels (e.g. influence trade policies, market regulation, government procurement processes, or tax concessions) to preserve the market control position and the concomitant economic rents. Such activities are sometimes referred to as '*directly unproductive profit seeking*' (*DUP*) as explained in Chapter 1 above. They are difficult to identify because they

often end up being hidden under a load of bureaucratic procedures. The Common Agriculture Policy (CAP) programmes of the EU may be cited as cases in point.

But, big producers do not always abuse of their market weight. The surplus funds which arise from the very nature of the market structure may be allocated, instead, for research or philanthropy. Such entrepreneurial behaviour, which may be considered laudable from a social perspective, falls under the heading of 'creative capitalism' or 'humanistic capitalism' (Delia, 2010:90-91).

Diagrams 1 to 3 highlight the missing elements in the EMU model: an area which is defined as the basic model on which welfare considerations are to be based; a fiscal authority which is recognised as the entity responsible for raising resources and distributing them according to set criteria and short-term needs; a monetary and financial authority with direct jurisdiction to act on a classified number of financial units; a Parliament which is accountable to a recognised electorate who also elects a government empowered to implement programmes. Such components make up the operational mechanism of a modern state. These factors are traced further below by the means of the parameters entered in the three diagrams above.

What are standard units in the macroeconomic decision making process will have to be replicated in the EMU. *Such a condition may be considered as unacceptable to a member country.* If this position is widespread in the EMU then the euro project will have to be re-evaluated. If this stand is taken by one or a few countries, then they will have to reconsider their participation in the euro project and rephrase their relationship with the EMU countries accordingly. That is what the United Kingdom is doing in relation to the EU; it is also what Greece was

about to do two years ago when it was considering the re-introduction of the drachma.

Reconsidering one country's position will at some stage lead to Article 50. Article 50 outlines the formal request procedures which member-countries have to follow when exiting from the EU group. But it omits several important considerations like timing, the re-thinking of position before formal exit, or prerequisites for a new application to re-join. Even the legal instruments with which member countries can implement their decisions are seen to be somewhat inadequate. So the EMU has to be considered truly 'work in progress'; comprehensive developments have to be agreed by the member states and registered on the political, economic, financial and social fronts.

Five such key elements are re-iterated below.

Firstly, there has to be a strong central fiscal authority to raise resources on the desired scale and redistribute them according to an agreed pattern and do so fast and effectively. This is the **(G-T)** in Diagram 1 and the **SWF** in Diagram 2. For this authority to be legitimate, it has to have its power emanating from the citizens of the participating member states (**Groups A and B** in Diagram 2). Budgeting is a continuous process. Funds will have to be allocated efficiently to build the necessary social and physical infrastructure to support an expanding, dynamic community based on a multicultural social fabric and an ageing population. This is the Europe of tomorrow. These transactions shift the **IS** function in Quadrant 1, the **Y** function in quadrant IV of Diagram 1; monetary easing shifts the **LM** function in Quadrant 1; support or otherwise to the labour market conditions the real wage (**W/P**) in quadrant II.

Secondly, identify clearly the geo-political boundaries of this European bloc. This constitutes the Output (**Y**) in

diagram 1 and the participating states that constitute the decision-making fiscal and monetary authorities (**G** and **M**). The EMU refers to the 19 member states that adopted the euro. Two issues are related to this project, namely, whether the 19 states intend to follow the schedule spelled out in the 2015 Five Presidents' Report and when will the other EU states plan to join (if at all). Such decisions will determine the number of participants in the single market and those in the EMU. Participation in the EMU demands participation in the single market; but not vice-versa.

The EMU is a fixed exchange rate regime with member states attached to the system at the value of their currency at the point of entry (**ER**). No single country can determine the value of the euro. It is given. Member states have to adapt their economic structure, via the key price parameters, to the value of the euro as this emerges from transactions on the international trade markets and from capital movements emanating from decisions to 'invest' in certain countries or currencies. The ECB and the other central banks may somewhat condition the value of the international currencies, via interest rates (**r** and **M**) and related capital movements in the short run (in the absence of exchange controls) and trade flows in the medium to the long run, but individual producers and consumers have to take the value of the euro (and other currencies) as given. Operational decisions will follow.

Eurozone states gave up their own currency and control over their money supply. So they cannot adapt their future competitive position in international trade markets by devaluing/revaluing the value of their unit of exchange. Similarly their control over the cost of capital is limited as the decisions on the prevailing interest rate structures are influenced by the policies pursued by the ECB. (Member countries recording an outflow from the money supply

in circulation may have to consider the introduction of exchange controls in abnormal situations.) So they have to continue having a comparative competitive edge, especially in intra-EU trade, by striving to continue re-creating a healthy labour market (through education, social policy programmes and effective migration movements) in order to generate a constant flow of skilled labour at the 'right' price. The Schengen mobility process has to be seen not only in terms of the ease with which one crosses from one country to the other but more so in terms of the resultant labour mobility that it encourages.

Thirdly, apart from labour market factors, euro-member states may compete through comparative income tax advantages. Income taxation falls under the domain of the national governments. As long as all taxpayers, irrespective of nationality, are treated the same for tax purposes then one cannot say that there have been unfair competitive practices. But the points made in the 2015 Report on tax convergence would lead to a quasi-synchronisation of the member countries' tax regimes. Such convergence will be squeezing any competitive edge arising from differential tax rates regimes.

Fourthly, decision making in parliamentary democracies tend to condition at all times, directly and indirectly, the composition of the central government budget and the allocation across regions. It is in totting up majorities in respective local, regional and national parliaments to enact legislation and implement decisions that policies ruling taxes and state expenditures are made. But there is also the basic issue of the degree of consensus one is after in such decisions. For certain cases, a simple majority suffices; for other decisions a qualified majority is called for – this is often set at two-thirds of the members. Qualified majorities are invoked in issues that are considered of

very special importance for the economic and social well-being of the community. Constitutional changes, certain treaties, impeachment of public officers are three such instances in Malta.

Another related issue is the right of the electorate to be consulted on particular matters. This consultancy takes place through the instrument of referenda. In some countries, the electorate has the right to be consulted on the formation of legislation before such laws are enacted; this is the consultative referendum. In other cases, the electorate has the right to abrogate legislation already in place. The Maltese electorate have the right to abrogate a law; but there is no provision for consultative referenda.

In international organisations (unions) members – or some of them usually the ‘founding members’- have the right to a veto. They can block decisions reached by the majority of the other members in the organisation. The right to veto exists in the EU, as well as the right to opt out from certain obligations. ‘Opting out’ was exercised by the UK and Denmark following the introduction of the euro; both countries are members of the EU but not of the EMU.

These electoral – decision making – provisions bear not only on fiscal matters but also on the quality of life of a community. They are reflected in the Social Welfare Function (SWF) represented in Diagram 2 above.

Finally, Diagram 3 refers to the potential distortion of competition that may come about as a result of corrupt practices. In a multi-tiered political regime, like the EU structure at present, there are several points of intervention where commercial interests can bear to exert influence on the formation of legislation, its enactment, and, more so, its implementation. While the formation of legislation may take place at international fora and in Brussels, the

national adaptation of these rules will be influenced at the national level. Still, the actual implementation of certain regulations will take place at the local or council level.

What was termed 'corruption' in Chapter 1 above has various shades and forms. The more prolonged is the process of convergence of fiscal parameters and integration of procedures, with split responsibilities for the drafting and administering of rules and regulations, and with lines of bureaucracy one on top of the other, the more opportunities that will arise to side-line funds or by-pass regulations. Ironically, the heavier is the official administrative burden, the greater will be the incentive to avoid it and short cut, at a cost, the process to decision making and action.

The above features outline the present situation in the EU and in the EMU. But what is Malta's position with regard to the above considerations? This stand is discussed below.

2.3 The view of the Maltese government and the Maltese on the further evolution of the EMU

There is no official formal analysis of the EMU model as applied to Malta. At least no such report has ever been made public. But still one can try to decipher the possible main strand of thought ruling such a Malta-EMU relationship from two approaches: (i) general statements made by politicians and (ii) the application of EU funding meant to enhance the networks in power supply, telecommunications, transport infrastructure and industrial development.

i) **Statements by Maltese policy makers**

Section 2.2 above argues that the 'deepening' of the EMU arises from the basic macroeconomic organisational infrastructure that is prevalent in modern parliamentary democracies. These refer to political, financial, economic and social institutions. Any country which wants to participate in such a structure will have to adopt these instruments as part of the working relationships. Failure to do so will eventually create a new form of relationship which, in time, will have to be addressed within the wider context. And decisions will be taken accordingly.

It may be claimed that an unwritten view adopted by Maltese policy makers all along in the search for a relationship with the expanding 'EU' was that such a relationship cannot be based on a rigid set of rules. It must be flexible sufficiently to account for particular conditions. There cannot be a 'one size fits all' mentality. It follows that if a country is conditioned by small size (area, population, consumption or supply) and, more so, if there are definite unavoidable costs like connection to a mainland – being a group of islands – then special considerations should be made. The principle of subsidiarity becomes even more relevant in such a context.

The EU project allows for such positions. Indeed, section 2.2 above outlines several main types of relationships: the EU, made up of 28 countries; the EEA made up of the EU member states and several other countries; Association Agreements between the EU and other small economies; and the EMU. All agreements have their own specific objectives

which are of mutual interest to the signatories. Countries may chose in which group they want to belong. But once they do that, they are expected to abide by the conditions on which such agreement has been reached. Malta decided to form part of the EMU and adopted the euro.

At the same time, like all other EU member countries, Malta continued developing its bilateral relations with other countries outside the EU and EEA blocs and participating actively within the British Commonwealth. Such a 'flexible' structure tends to go against the set of obligations imposed by a challenging political and economic model like the EMU. Such 'friction' in the reconciliation of economic and social objectives is prevalent in all EU member states.

This uneasy state of affairs is evident in the 2015 Five Presidents Report which is an attempt to spell out the true meaning of a single-market and single currency zone for Europe. Even the title is reflective of such a proselytising effort. Chapter 1 of the said document speaks of 'The Nature of a Deep, Genuine and Fair Economic and Monetary Union'. One would have thought that this 'nature' and its related commitments would have been well understood *before* joining the EMU and not after. Apparently this is not so. This factor could be the potential source for misunderstanding and weakening of trust in the EMU project.

Life gets more complicated because deliberations by government ministers are not solely influenced by the basic nature of the EMU but also by the election cycles in the respective member states. Elections for the choice of MEPs take place every

five years across the EU. But national elections do not coincide with them. The timing of national elections conditions a country's support or otherwise for policies under discussion. Politicians do not risk going against popular sentiment in their own countries, otherwise they jeopardise their position when seeking re-election. In such instances, personal interests will prevail over the national 'good' and, more so, over the European project. This latter may be considered to be 'outside' their immediate domain; interest in it arises once every five years.

The combination of these considerations – namely, a gradualist approach to the development of the EMU project; freedom for the member states to continue expanding their international relationships on bilateral basis; the sequential holding of elections for national parliaments – do not contribute to a unified vision regarding the EMU. And this uneasy state is reflected also in the views of Maltese policy makers.

Maltese politicians generally speak of the 'European Union'. Prime Minister Joseph Muscat, commenting in the aftermath of the Brexit referendum in June, noted that 'We need a more flexible, more realistic EU' while observing that 'all member states must accept all four freedoms, including freedom of movement' (Muscat, 2016). The reference to 'flexibility' is addressed to the so-called Maastricht fiscal parameters and relate to the EMU; the four freedoms emanate from the Single market model, the 'basic' EU relationships.

And while referring to the EU Commission's ruling ordering Ireland to recoup €13billion from

tech giant Apple, Mr Muscat ‘insisted that taxation issues should continue to be decided by national governments’. He pointed out that the Maltese government is ‘determined to preserve and keep our system, making it more competitive and *look forward to having a system that is compliant to EU and international laws*’ [Italics added] (Caruana, 2016). Since EU and international laws change or are interpreted differently over time, it follows that certain past decisions ruling business organisation and performance may have to be addressed in terms of the new legal context or in relation to the way such legislation is implemented. This consideration may call for a re-evaluation of a country’s basic model on economic development and growth.

Again, the Speaker of Malta’s House of Representatives, addressing the Conference of Parliamentary Speakers of EU Member States in Luxemburg in May 2016 expressed the view that ‘the problems which the EU is facing today cannot be avoided with a federation system or with higher levels of integration, citing as an example the call for a Fiscal Union. He stated that ‘being more European does not imply a step towards federalism, as this might lead to repercussions for Malta in the light of the disposition to neutrality in the Maltese Constitution. Further union must not directly imply a loss of sovereignty for member states’ (Farrugia, 2016).

And Malta is also “completely against” a proposal by the European Central Bank to reduce risk from banks buying government bonds, a move that could have significant implications

for European lenders, particularly Malta and its southern European neighbours. Speaking to the international press in Amsterdam in April 2016, the Minister for Finance, Edward Scicluna, argues that “Europe is seemingly aiming at creating problems where there have not even been during the worst of the financial crisis, and there are not today’ (Vella, 2016). Malta is not alone in taking this stand. Other European countries are even prepared to veto policy recommendations which condition the source of government funding by imposing capital requirements in the case of sovereign borrowing from local banks in excess of a stipulated percentage.

In short, local policy makers keep switching between the EU and the EMU. The ‘tight conditions’ arise from the EMU’s inherent structures as described in section 2.2 above. Hence, at some stage a decision will have to be made on whether the EMU governments – the Maltese government included - share the Five Presidents’ views and plans for ‘deepening’ the EMU in the coming years. If there is no such common view, then EMU policy makers have to reach an agreement on the future of the Euro. The report states categorically that “All members of our Monetary Union have given up their previous national currencies once and for all..” (European Commission, 2015, p.4). But if there is not the will to proceed with the plan as charted by the Report, then the matter will have to be re-opened.

In Malta’s case, if such a plan involves Constitutional considerations, as claimed by the Speaker of the House of Representatives, then

the Maltese electorate may have to be consulted through a referendum. Both main political parties in Malta agree on EMU membership. Now that this 'membership' is being specified in clear terms on what it means, they may argue that the envisaged commitments as laid down in recent EU Commission's documents demand a renewal of a national debate on the subject and possibly a consultative referendum. Although, the Prime Minister is quoted as claiming that "an EU referendum in Malta would be 'suicide'". (Muscat, 2016)

The way ahead for the EMU is crucial for all economic and policy decision taken in the member states. Hence, the membership composition of the EMU has to be completed, so that the participants will be known. Unless this basic matter is resolved, there cannot be advances on the EMU area and in the economies of its respective member-countries. And, as a consequence, there will be difficulties in arriving at a wider, global arrangement on trade in goods and services, like the Transatlantic Trade and Investment Partnership (TTIP). Individual member states will bear pressure on EU negotiators to stall discussion because of such unknowns. In this event it pays them to continue considering only their national interests, which may not necessarily coincide with those of a wider EMU geographical territory.

ii) **Allocation of EU funds for the restructuring of economic activities**

Another 'source' of information on Maltese perception on the EMU may be found in the way

they allocated resources arising from EU funding programmes. The Maltese Islands have been benefitting from external funding sources since Independence in 1964. For a number of years, until the closure of the British bases on the Islands in 1979, they received support under a Financial Agreement with the United Kingdom. Such resources aimed to redirect the Maltese economy from one based on military facilities to one geared to earn its living from the commercial use of its strategic positioning in the Mediterranean, and the setting up of viable enterprises in manufacturing and the leisure sector.

Since the 1980's, Malta gained from another form of financial support contributed primarily by Italy on behalf of a group of donor countries in exchange for Malta's neutrality status. This package was replaced by EU grants following Malta's membership of the EU in 2004. The end result of these programmes is seen in today's Malta: the island is unrecognisable both in terms of social infrastructure, built-up areas, and sectors of economic activity. Agriculture and Fisheries, Manufacturing and Ship repair and ship building, have seen a dramatic drop in their contribution to the economy. They were replaced over time by a services sector which includes the leisure industry, the financial services, e-gaming and is expanding further into education and health.

But one can query the long-term impact of the resources thus spent in terms of (i) creating balance between scarce open spaces, agricultural/afforestation/water reserves, and urban areas; (ii) developing a network of road/sea transport

facilities that precedes built-up areas aimed at housing a growing, ageing population that is made up of a larger number of smaller households; (iii) setting up a network of regulatory agencies that are deliberately limited in number but very effective operationally – such an institutional structure is meant to reflect a key restraining factor to growth which is scarce multi-skilled labour supply; (iv) recognising that society was gradually moving away from voluntary work in caring for its young and elderly at the parish/ local council level (the richness in social capital represented by organisations active in most towns and villages in the cultural, sport, and religious sectors) to market driven organisations and hence on families' ability to pay; (v) accounting for the presence of a more multi-ethnic community which a strong services economy generally drives into being especially in a small island; (vi) relying on competitive factors that expect and anticipate economic restructuring while relying unduly on tax and subsidy mechanism to support ongoing economic activity.

It seems that in various cases resources were not allocated according to a holistic plan but more so in terms of projects often undertaken in a piecemeal fashion constrained not by a long-term oriented programme but rather by a time limit within which funds have to be spent. Under such conditions, resource allocation of EU funds becomes time-constrained – spend the resources within x number of years otherwise they would be lost – rather than according to an agreed master plan which is being achieved in stages.

This approach had two effects. First, plans for sectoral restructuring and growth become inverted. Instead of identifying the projects first, carry out their economic and social viability, and then raise the necessary capital to implement them, the process worked in the opposite direction. Identify the funds that Malta would be eligible for and then come up with the projects to utilise them within the specified time frame and according to a series of set procedures.

Secondly, this inverted process made it possible for policy makers to reach other unrelated objectives besides the enhancement of economic and social units. They could use such funds to improve their probability of being re-elected. Resources would be allocated in such a way as to reach political goals by garnering votes. Instead of consolidating economic production within a sector, such an approach tended to sustain an obsolete and inefficient system of production and distribution. This resulted in short term artificial economic gains but in longer term unit closures and running down of sectoral economic activity. Agriculture, fisheries, energy renewals, and water reservation are cases in point. Funds were distributed with the aim of reaching as wide a number of beneficiaries as possible rather than used to re-organise the productive capacity of a sector by the formation of fewer but more efficient units. For example, the glaring failure of the revival of the co-operative sector into effective producer organisations in various areas attests to this approach.

More recent moves to introduce social enterprises, support 'family businesses', encourage

SMEs, set up a Malta Development Bank to encourage start-ups and a 'social bank' to support subsidised home loans (Gauci Cunningham, 2016) must be missing something for sure. There are too many institutions meant to be assisting entities – families or productive units – to do the same thing, namely, harness their talent to produce wealth, generate income, and redistribute such resources over a wider group of beneficiaries. Such policies go against a basic idea: where skilled resources are scarce, keep the organisational structure simple.

Besides, such initiatives do not make allowance for a future fiscal and competitive convergence as the 2015 EU Commission's Report is envisaging. This factor will be addressed further in Chapters 3 and 4 which assess sectoral development and personal and social well-being in the Maltese Islands. The considerations depart from the present socio-economic parameters presented in Section 1.1 above and relate to the political and economic landmarks laid down in the EU Commission's Report.

2.4 Summary

It seems that notwithstanding the fact that the concept of a 'Union' of some form among 'European states' has been discussed at length in many fora, including countries' parliaments, there is as yet not one acceptable vision across the continent. There are many 'unions' in the minds of Europeans and non-Europeans which have facilitated the formation of several sets of working relationships on trade, finance and related subjects. But there still remain

many doubts and uncertainties regarding the future of these 'unions'.

This chapter summarised briefly the main features of the EU's single market with its related four freedoms – people, goods, services and capital and the 'degrees' of such freedom, such as the abolition of passport controls within the Schengen Area. There is also the European Economic Area which brings together the 28 EU member states and some countries within the European Free Trade Area; special or associated agreement between the EU and other states are also in place. Additionally, there is the EMU, with its single currency, the euro, which reflects a stronger commitment to 'unity' since it is essentially a political and economic union. Malta belongs to this group of 19 countries.

The EMU is evolving. It is as yet incomplete. Over the past five years two main documents prepared by the European Commission have spelled out a plan for action which seeks to establish a banking, capital and fiscal union in the coming years leading ultimately, around the year 2025, to a political union.

Such vision is meant to be taken up by all EU member states 'once they are ready'. But it seems that the multi-vision prevalent in all member states for the EU's future is rendering such an objective difficult to attain. Besides, recent events in Greece – where there was a possibility of an exit from the EMU following a shortfall in its public sector finances which spread to the banking sector and thereafter to the rest of the economy - and the UK, following the June 2016 result of the consultative referendum on the country's membership of the EU, are once more highlighting the need to discuss in concrete terms the true meaning of an Economic and Monetary Union. The necessary institutional arrangements, with

their associated implications for the basic four freedoms, personal and social welfare, have finally to be spelled out unequivocally for all to understand.

So far the basic unit of account on which all considerations were hovering was a member country's aggregate output, its annual growth, employment, consumption, investment, and, as a result, its welfare. All parameters of real interest to national policy makers referred to their own regional and national domain. They think nationally. The EU Commission's reports are leading to the stance where it is the welfare of the entire EMU bloc which should be the object to be watched and maximised. And national development will occur within such a constraint. Such a view implies that member states will surrender their sovereignty over other matters besides those already delegated to the European Parliament and to the Council of Ministers.

Member countries are not yet ready to do so. And it is also Malta's position. Maltese policy makers are not in favour of further integration in the Union. They are against a fiscal union and have reservations regarding Malta's neutrality status when referring to a political union. Under such a scenario the participation in a single currency regime – where a country is supposed to give up its national currency for ever and adopt the 'group's currency' instead with all the related implications – becomes questionable. But if this is so, then planning ahead for industrial and services sectors in a small island economy becomes itself a point of interrogation.

The difficulties of such planning gets compounded when a country like Malta still enjoys close connections with another state which is planning to exit from the EU but belongs also to another group, the British Commonwealth. And it gets more complex still because

the idea itself which gave rise to the EU – expanding free trade geographically and globally over a wider domain of economic activity through such arrangements as the Transatlantic Trade and Investment Partnership – is being reconsidered in many countries. The era of a wider globalisation in economic activities may have come to an end and the world is heading again towards arrangements which rely more on regulations and controls.

In the absence of a clearly defined set of objectives which command a consensus among member states, the transaction costs of reaching agreement even on a set of limited targets and plans for achieving them are bound to remain high in the EU. In addition, the inverted priority of objectives, being primarily nation-centred rather than EU focused, tend to distort the long-term orientation of sectoral development. The allocation of structural funds could become biased towards seeking voter loyalty to ensure the electability of particular candidates or political party per constituency. Such use may not be compatible with the development of restructured sustainable economic sectors.

Such behaviour could even be described as ‘corrupt practices’. It tends to reduce the long term economic potential of a region or a country and it affects negatively personal and social well-being in the future. If such behaviour is widespread across the EU states, the stability of the euro project will be put at risk.

These issues will be addressed in Chapter 3.

WEALTH CREATION THROUGH
SECTORAL DEVELOPMENT IN A
'DEEPER EUROPEAN ECONOMIC AND
MONETARY UNION'

Elected governments have the responsibility to lead. To be effective, they generally seek consensus through consultation and debate on their political, social and economic programmes. Following which, they decide on those actions which seek to attain the objectives they are after. This logical sequence of policy formation and implementation will be disturbed if policy makers do not share a common vision or if they fail to adapt those policy measures, which, altogether, lead to the fulfilment of the identified projects. A clear sense of direction facilitates the process through which resources are channelled to where they can induce the best outcome for future economic growth and for a fair distribution of the resources thus created. Several developed economies may record favourable overall economic performance, but income and wealth inequality may get more pronounced over time. This seems to be the experience of the member countries of the European Union over the past decade.

In the post-1940s, 'economic planning' was a recognised tool for social management in many countries. 'Big government' was acceptable for societies either through free choice or by imposition. Indeed, planning was a fiscal

tool that seemed to have backing from operational models in political theory, economic counter-cyclical analyses, and ethical principles that gained prominence after the massive loss of human lives and social capital that followed the two world wars of 1914-1918 and 1939-1945. Detailed programmes of economic and social activities, with capital outlays and recurrent budgets, were the norm in public sector administration in countries of various political systems, from single-party communist regimes to multi-party parliamentary democracies.

Post-independence Malta based its economic restructuring primarily on private sector initiatives, with the government investing heavily in vital infrastructural projects linked to sea and air communications, power and water generation, and road networks. Government continued to support an annual smaller flow of emigration in order to ease the negative impact of massive discharges from the UK military sector on the Islands. This policy direction was changed throughout the 1970's and the 1980's when a more active intervention by the State was introduced. This approach centred on the public sector's role, now considered a prime mover of economic change and a generator of output and employment. By the year 1992, public sector employment amounted to around 44% of the gainfully occupied population (GOP). This resulted in part through the nationalisation of several key units in communications, telecommunications and the financial sectors.

But since then, following a series of fiscal and financial measures, which included the devaluation of the Maltese Lira by 10%, the public sector was projected to absorb a smaller share of manpower. The target was to reduce it to between 25%-30% of the gainfully occupied population (Delia, 2004: p. 5-6). Privatisation accelerated the pace

with which public sector intervention in the economy become more contained. Direct public sector employment at present amounts to 44,000 representing around 26% of gainful employment.

This statistic does not account for private sector workers who are regularly engaged in providing services in public sector institutions, such as hospitals, or in the private sector through private-public partnerships arrangements primarily in the social welfare sector. It excludes also training schemes for the long-term unemployed and unskilled youths which are administered by private foundations. These schemes are entirely government funded, but the participants are classified as private-sector employees (Miriam Dalli, 2016).

Post-1992 the Maltese government once again leaned towards a facilitating and supportive stand to prod private sector initiatives. This position is still applicable today following a series of decisions which implemented the privatisation of various enterprises in which the Malta government was the sole or major shareholder. Besides, the public-private partnership model was extended to several sectors, including that of welfare and health. Even the new building which houses the Maltese Parliament is now owned by a public-private financial vehicle and rented to Malta's House of Representatives.

Such a switch of policy direction meant that the local private sector entrepreneurs had to be encouraged to continue considering Malta as their productive base. And foreign private investors had to be enticed to transfer their operations, or parts thereof, to Malta. This attraction or pull factor usually took the form of fiscal measures aimed to reduce the initial capital outlays, support efficient operations and, as a result, improve the final rate of return on private capital injected in the project. Such incentives

were complemented by administrative measures meant to simplify the realisation of a project. These schemes primarily targeted the manufacturing and the tourism sectors.

At the same time, government harnessed the resources set aside by Maltese households through their relatively high saving rates by mobilising such funds for the financing of its capital budget. These assets complemented the financial resources and assistance in kind obtained through various agreements with the UK and other countries. Maltese households became the mainstay of Malta's national debt, a factor still prevalent to this day.

More recently, such an approach was also extended to foreign direct investment (FDI) in services. Programmes for domiciliation of operational facilities spanning several sectors, like Finance, e-gaming, aircraft and sea-vessel registration, aircraft and sea-vessel/oil rig maintenance and servicing, were enticed in part through relatively attractive corporate and income tax schedules. These replicated the operational thrust which supported entrepreneurs under the Aids to Industries Ordinance pre-Independence and later on through Industrial, Agricultural and Tourism capital investment schemes for many years. In a sense the present tax and sector-related support schemes are a variant of those operated since the 1950's. They emanated from a model, or line of thinking, which has prevailed for more than half a century.

In the 1950's the biggest financial incentives were channelled to Maltese families in the form of heavily-subsidised organised-emigration schemes to Australia, the United Kingdom and North America (Delia, 2006, p. 92-116, 142-167). Family emigration was encouraged to contain population growth and avoid heavy unemployment, with the concomitant effects on family

well-being, in the after-war economically unstable world environment. Malta's economy was still heavily dependent on the United Kingdom's military expenditure mainly centred round the naval yard, a prime provider of jobs and technical skill formation at that time. Around 150,000 Maltese, representing one half of the population recorded in the 1948 census, emigrated between 1948 and 1975.

At present, there are no subsidised emigration programmes. Instead, investment in human resources takes the form of expenditure on the supply of health and education facilities and recurrent services; these are publicly funded for all Maltese citizens. Such public-sector set-ups are complemented by fee-paying services produced by private entrepreneurs, thereby offering households a certain degree of freedom in their choice of education and health services. The private sector has been engaged to assume bigger responsibilities in the production of these two services on the Islands. The Maltese government is now acting more as a guarantor for the sustainability of demand for the new range of services and enabling the supply facilities by the series of industry-friendly programmes in place.

It is this established model of private-public sector balance that has to be reconciled with the 'deepening' of the EMU. Even under the present conditions regarding fiscal constraints under the EMU and state aid and the single market, the prevailing model of encouraging economic growth based on continuous sectoral evolution and restructuring may be at risk. The Irish experience in relating tax regimes to Foreign Direct Investment, though not identical to the Maltese, may be taken to be a case in point. The EU Commission's findings on the relationship between the presence in Ireland of the technology giant

Apple and the incentive packages meant to attract FDI calls into question the Republic's economic development model (Boland, 2016).

This case is still under the scrutiny of the European Court of Justice. But it may be instructive if such positions are considered, even as hypothetical scenarios, when assessing the way ahead for economic growth and social cohesion in the Maltese Islands.

Besides, in a related matter – the context of fiscal consolidation in the respective member states individually and collectively – the EU Commission reviews annually the degree of divergence between imputed VAT revenue and actual sums collected by the individual member states. Such consideration has several effects. The VAT revenue raised bears on the state of government's finances in the individual countries, which in turn also impinges on the amount of public sector borrowing requirements. But these sums also condition the amount of funds transferred to the EU itself for its own budget financing. The higher the revenue collected from VAT in member states, the higher the absolute amount of funds transferred to the EU budget. Hence member states/EU fiscal requirements are inter-related.

And considering that such resources also reflect themselves, ultimately, in a country's borrowing needs, they also bring in EU interest in the operation through the supply of euros in circulation. They impinge on the Money Supply in the EMU. Thus VAT issues are not purely fiscal in nature; they bear also on other matters such as the creation of euro supply by the European Central Bank and the convergence of capital markets in the EMU.

In a recent report on this VAT consideration, the Commission's estimates present Malta as the third member country with 'missing' tax revenues. This position is being

contested by the Maltese government (Sciicluna, 2016). But this issue once more highlights the need to address matters related to fiscal matters from other perspectives than those to which analysts of the Maltese economic and social situation are accustomed to carry out. Ultimately, they must refer to the main tenets of the European Economic and Monetary Union agreement besides the competition rules and customs union arrangement of the European single market.

Recent documents which assess the Maltese economy's future development and growth abstain from considering such positions (e.g. Malta Chamber of Commerce, Enterprise and Industry, 2016; Ministry for Finance, 2016b). Their writers implicitly assume that the prevailing economic model based on attracting FDI to boost exports and government revenue, besides generating employment and income for private individuals, will endure for ever. The fact that the EMU is still incomplete (i.e. 'work in progress') is not even considered. It is the evolution of the EMU which will be conditioning the political and economic future of the entire EMU area and, as a result, of the Maltese Islands.

Linked with this evolution is that of globalisation. The effects of the liberalisation of trade and capital on incomes and welfare worldwide are not well understood. At times they are said to have been on the whole negative, in the sense that they widened income differentials globally and regionally. And this outcome is sometimes put forward as being inevitable: the incomes of the working and middle class of richer countries are 'bound' to remain contained. But recent studies seem to shed doubts on such a generic position (Corlett, 2016). Domestic policy choices are seen impacting income distribution even in mature economies.

However, because of the prevailing views on globalisation, the tendency for countries to open up further their economies for trade in services may be held on hold if not reversed. Global trade growth is slowing down. And countries may try to countervail such a trend by protecting their own industries and boost domestic production and consumption. To achieve these objectives policy makers generally refer to existing legislation or at times introduce new standards on encryption and labelling. In this digital age, protectionism becomes harder to identify and measure. But it could affect negatively global growth (Donnan and Hornby, 2016).

The EMU's future development will partly reflect such world perceptions and the policies implemented in many countries regarding the freedom of movement of goods, intellectual property and labour. For, although the world economy is more open to trade exchanges than it was some 50 years ago, the brakes being put in place may already be bearing their effects on future growth. There could be legal or political impediments to further trade liberalisation within the EMU countries.

Thus, in October 2016, the German Constitutional Court laid out strong conditions binding the German government when considering adhering to the terms of the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada. The Court ruled that the provisional implementation of the agreement, before it officially takes effect, must not cut across areas related to national competences. And in the same week, the parliament of the francophone Belgian region of Wallonia voted to block the deal, thus making it legally impossible for the Belgian government to give its assent to the provisional application of CETA. The Wallonian members of parliament reconsidered their position a

week later. But the point that matters is that decisions which bind specific EMU member states to act in one way and not in another will in turn condition the development of the region as a whole. Income growth and distribution are thereby affected as a result.

Another factor bearing on this income growth and distribution phenomenon is population. Population size is determined by all those conditions that bear on the rates of birth and mortality as well as on net migration movements. In turn, these factors influence also the age distribution of the population, as well as its skill content. Thus they affect both the level and composition of aggregate demand for goods and services in an economy as well as the supply of skills on which the output of goods and services critically depend.

Age distribution is also impacting on the electoral process, the themes put forward by political parties, and the interpretation given to electoral results. The share of the 60 year plus cohorts in the Maltese population has been steadily rising over the past three decades. It now represents 26% of total Maltese population. As a consequence, the share of such cohorts on the electoral register has become even more pronounced at 32%: one in three voters is over 60 years of age (NSO, Malta, 2016c, Table 1.9). The views of these age cohorts are becoming more articulated, pronounced and decisive for political decisions in various countries. For example, the recent consultative referendum on Brexit in the UK may be interpreted to have followed the age and regional divide in that country. Similar experiences could happen elsewhere, Malta included.

In order to balance such an influence on the electoral decision-making process, both at the national and at the local council levels, the two main political parties are

proposing to extend the right to vote to Maltese over 16 years. Such a move will reduce the share of the 60+ in the electoral register to 31%. But it implies that 16-year-olds are being tasked to decide on their own and the country's future. And therefore they have to be prepared to exercise that right correctly.

Such considerations point at a basic fact ruling the analysis and interpretation of economic and social phenomena. There are several forces at work bearing their influence on individual decision making and group dynamics in a community. They affect the way people think, plan and act. In the process they condition the composition and volume of economic value added, household incomes, the formation of productive and social networks, and, in the end, personal satisfaction and well-being.

The following sections examine such relationships in terms of sectoral composition of demand and factor supply while their impact on personal and social well-being is addressed in Chapter Four below. They build on the ideas expressed graphically in Diagram 1 introduced in Chapter 2 above. Aggregate demand refers to private households (their incomes, consumption, saving and investment); the government sector (tax revenues, non-tax incomes, recurrent expenditure, capital outlays, and public sector borrowing); and the external sector (exports and imports of goods and services; capital outflows and inflows).

These parameters were summarised in the equation: $I+G+X=S+T+M$. The first three factors, Private Investment (I), Government expenditure (G), and Exports (X) promote domestic production, just as private sector Consumption (C) which is the equivalent of $1-S$. Household saving (S), Taxes (T) reduce the sum of resources available for

household consumption and investment. Imports (M) boost the quantity of resources available for domestic consumption or re-export but, in the case of imports 'consumed' locally, they do not generate demand of resources for their production.

3.1 Considerations relating to Aggregate Demand Factors: Household Income, Consumption and Saving

Aggregated data on Maltese households' income are published annually in the survey on Statistics on Income and Living Conditions (SILC), introduced in 2005. These data refer to households' revenues accruing from economic activity, investments, and benefits arising from various government schemes. Households' disposable income is derived in turn by deducting taxes on income and social security contributions and other households' regular payments.

Households' income increased from €2.773billion in 2005 to €5.117billion in 2015, while their disposable income rose from €2.310billion to €4.226billion over the same period. These represent growth rates of 84% and 83% respectively over the ten year period. Income per household in 2015 was estimated to be €31,429 up from the €29,948 valued for 2014, a rise of 4.9% (National Statistics Office, Malta, 2016d).

The Survey refers also to income distribution and to the income limit representing the threshold to measure the number of families living 'at-risk-of-poverty'. Their number kept rising in 2015: with a monetary-at-risk-of-poverty-threshold set at €8,096, there were 68,858 persons, or 16.3% of the population, whose income fell below that level. These data suggest that the number of households

at risk continued to rise. As pointed out in section 1:1, paragraph (xi) above, the number of persons at risk was 59,498 in 2008 and 65,987 in 2014, representing 15% and 15.9%, respectively of the population.

But the SILC survey does not refer to household consumption and saving. The SILC refers to what it terms 'Deprivation items'. These outline certain amenities and services which households cannot purchase, such as household white goods, a car, or an annual holiday – such 'deprivation' may suggest relative poverty status but not necessarily absolute needs. A different position emerges with regard to a household's inability to pay rent and/or utility bills, or to meet an unexpected financial expense. Such conditions signify that such households are short on income in relation to their needs. The 'real poor', which would include the elderly and the unemployed, are fewer than those considered 'at-risk- of- poverty'. One researcher puts their number at 9,200 in 2015 (Vella, Matthew, 2016a).

Research targeting households' consumption and saving is an on-going exercise. This means that the data sets which are used to statistically measure the relevant parametric values of the consumption/saving equations have to be reliable and readily available. And these data sets must refer to factors which are considered relevant to an understanding of the forces at work which condition personal expenditure on consumption and saving. Indeed, the Central Bank of Malta has been grappling with issues related to disposable income (Grech, Owen, 2013), the determinants of household saving behaviour (Gatt, 2014), and profiles of household saving behaviour (Gatt, 2015)

The basic data on which these studies are carried out present the researcher with a highly volatile parameter. "The aggregate household saving rate in Malta fluctuated

significantly over the past thirteen years. It rose from 6.4% in 2000 to 10.3% in 2002, fell significantly to 4.1% by 2006, doubled to 8.4% during 2007 and stabilised between 5% and 7% in the years 2008 to 2012. Such wild swings warrant an investigation" (Gatt, 2014:p.4). But instead of evaluating the reliability of the data sets themselves, the author went on to try and 'explain' such 'wild swings' by relating 'savers' behaviour' to several parameters such as the wealth-income ratio, the budget balance and the unemployment rate.

Three considerations are pertinent to this research. Firstly, statistical correlation is not equivalent to causality: which factors influence other factors. Mr Gatt argues that Maltese households save (that is, do not spend on consumer goods and services the entire income registered during a time period) in order to, say, take account of a rising public sector debt and the possibility of future tax rises/charges for state-provided services to turn a budget deficit into a surplus, or to adjust their wealth (a stock) to income (a flow) ratio following reductions in the value of their assets. And it is being contended that such considerations may be contributing to the observed 'wild swings' in the households' saving ratio parameter in the Maltese Islands.

Indeed, Maltese households seem to be a stable source of bond buyers in the local stock market. In fact this is the Maltese government's argument that the local debt is domestically owned and therefore it is not a potential source for financial instability in Malta. The Maltese decide to buy government paper from their savings (i.e. accumulated past saving flows) taking into account foreign exchange and country risks (which are set to zero) as well as the coupon rate and the marketability of the stock. They often buy stock to hold to maturity and they

do not consider at all the future generations' duty to 'pay back the debt'. They are not yet sensitive to the Ricardian observation regarding debt repayment; they seem to think more in terms of debt rolling both for government stock as well as for private companies' bond issues.

People do register 'forced saving' in relation to the repayment programmes to which they commit themselves such as mortgage payments. Their periodic commitments are deducted from their monthly incomes and so, would be considered to be 'saved' (not available for consumption over the period).

Secondly, every single variable referred to in Mr Gatt's paper – saving, wealth, income, budget balance, unemployment rate – is itself subject to definitional queries and the selection of the appropriate data sets. What the data suggest is that the Maltese private sector is estimated to have recorded a saving rate of around 6%. This statement leads one to query the methodology through which this saving rate is derived.

Saving data are a 'residual': they represent the portion of disposable income that is not spent on consumer goods and services, locally and abroad, during a time period. So any statistical error that arises from the under- or over-estimation of all the variables included in the computation (income, taxes, government transfers to households in cash and kind, consumption expenditure locally and abroad) will be reflected in the residual value for saving. The ratio is then derived by dividing this amount by income (Delia, 2006: p.271-284; Delia 2010: p.136-141).

However, one can query the reliability of the income variable. If the underground economy is estimated to be around 20%-30% of the estimated GDP, then the amount of resources put aside will be greater than the measured amount. In which case, Maltese households, as a group,

are in a healthier position to face the future with a greater stock of savings. It could be a different matter altogether for individual households since participation in the underground economy is not uniformly spread across the economy.

Thirdly, this saving rate relates to the entire population. But as the data referring to the profile of different households' saving patterns suggest (Gatt, 2015), the ability of a household to save varies with income and the socio-economic profile of households. Having information on the age and skill composition of the population and of net migration, as well as the social movements going on all the time within a society – e.g. the formation or the breaking-up of groups like the family or other units of personal support – assists the interpretation of social, economic and financial data.

Deriving and interpreting a saving ratio series is not an easy task. But its reliability in terms of its approximation to the true situation is crucial for the formation of economic and social policy measures, especially those policies related to employment and family welfare. Decisions related to mandatory pension schemes, like the proposed second-pillar, are actually 'forced saving' schemes. Their viability and true functionality depends on households' ability to save and still command enough resources to live reasonably in comfort. After all, that is the objective of many households in mature economies.

The expenditure patterns of Maltese households are derived from household budgetary surveys; the results of the most recent survey are awaited. Apart from relating consumption expenditure patterns to incomes by socio-economic household categories, such surveys provide the basic data bases on which the consumer price and volume indices may be constructed. The Retail Price Index and

the Harmonised Index of Consumer Prices rely on such information flows as explained in observations marked (viii) and (x) in section 1.1 above. The relative weights given to categories of expenditure are constructed on these data.

Thus, presently, 'Food' carries a weight of 21.23% in the expenditure basket, while 'Transport and Communication' bears 22.76%. The lowest weighting is given to 'Water, electricity, gas and fuels', 3.36% (National Statistics Office, Malta, 2016b, Table 1). It has to be seen how the information being assessed will influence these relationships because the structure of the price index will determine in various ways several factors: measured price changes, mandatory adjustments to rents and wages, retirement pension rates arising from the social security system, policy ruling particular product support (if permissible under EU competition rules), and taxation on goods and services. Evidently, the bigger the share of the group of commodities in the basket the greater will be the impact of price movements on a household's expenditure.

Such price changes may induce decisions to alter one's consumption pattern in order to make ends meet. Indeed, this seems to be the thrust of the call for a reconsideration of policies related to the national minimum wage and a related living or family-related wage/income guarantee. A recent report calls for the consideration of 'a minimum essential budget for a decent living – 2016' (Caritas, Malta, 2016). Social policy tends to become entwined with economic considerations related to product and industry competitiveness and viability. This topic will be addressed in Section 4.1.2 below.

The SILC results suggest that 75% of households' income emanate from employment. Old age benefits account for 14% of all income. These two sources represent

89% of Maltese households' sources of revenue. Therefore decisions relating to eligibility to social security pension and the possibility of continuity in employment would give rise to another category of income generation. It will no longer be an either-or (work or retirement incomes) situation but a combination of the two. This condition could prove to be beneficial for labour supply and aggregate demand for goods and services. A wage-cum-pension enables receivers to sustain demand for goods and services while continuing to save. They will thus extend their savings or wealth which would serve them better when they retire completely from wage income-generating economic activities.

The share of employment income in the GDP is roughly identical to the share of income accruing to 'Capital' (Income received from dividends, rents and interest rates and to the income of the self-employed). As pointed out in Section 1.1 point xii above, the shares of 'factor Labour' and 'factor Capital' are around 44% each of Malta's Gross Domestic Product measured at factor cost. Decisions ruling the labour market (such as, wage determination, mandatory contributions to social security programmes and retirement age limit, gender issues, and 'family-friendly' measures) are ideally synchronised with decisions referring to efficiency in capital utilisation. Both skilled labour and capital resources may be in short supply in the Maltese economy, depending on the time frame under consideration.

The Maltese economy has been relying more heavily than in the past on immigration in sustaining recent years' economic expansion. Malta is new to this demographic phenomenon. Immigrants supply skills, but they also boost aggregate demand for goods and services provided by both the private and the public sectors. The former

includes housing, the latter incorporates health and educational services.

In sum, macro-data referring to households' incomes, consumption and saving are a useful starting point in any discussion on aggregate demand for goods and services in the Maltese economy. Such data, in all economies, are sensitive to both the methodology and the reliability of the data sources available to statisticians. Households' income in Malta depends primarily on employment; around 75% of income is generated from work. Another 14% arise from benefits accruing from pension benefits. Households are estimated to save around 6% of their disposable income.

Such data can guide decision-making regarding labour market policies, especially those related to the demographics of both Malta and Gozo. Such policies impinge on the potential labour supply with its ramified skills and on aggregate demand for goods and services and thus on housing, education, health and leisure facilities. And, such policies cannot be devised in isolation of what is presently happening in the EMU, but, more important, in the envisaged evolution of the EMU for the coming decade. It is this overall objective that should condition such a debate.

3.1.1 Considerations relating to Aggregate Demand Factors: Taxation, Government Expenditure, Public Sector Borrowing and Transfers from Abroad

The presence of Government in the Maltese economy is a dominant factor. The choice of political representatives through respective elections at local, national and European Parliament levels tends to keep political

debate on-going. This process brings the potential political representatives face to face with the electorate. Such encounters lead to the identification of individual households' aspirations and needs which are, in turn, reflected in the general economic and social policy programmes of the various political parties. Over time, depending on the performance of the economy and the ability of previous administrations to garner international financial support to local projects, the annual government budgets will attempt to balance present needs (through the recurrent tax and expenditure structures) and future development (through the capital budget and overall net budget balance).

The role of the Maltese government in the local economy has been outlined in the previous section. And its presence in the economy is not limited to the structure of taxes and expenditures as set in its annual budget. It ramifies itself further through the private sector's reactions and pre-emptive measures taken both in the short and in the long term. Measuring the public sector's role in an economy is not an easy task. There are basic conceptual issues related to the identification of the statistical parameters to be used. For example, should one use the GDP data at factor cost or GDP at market prices as the base? Since the second is greater than the former, it will produce smaller values for the respective tax/GDP and expenditure/GDP coefficients over time. But 'reliable' statistical data referring to price deflators may be available only for the expenditure components of the GDP. The availability of data conditions analytical assessments.

We limit our commentary to trends that try to circumvent such interpretative issues. But one cannot omit referring to different impacts that government intervention may have in an economy: it impacts aggregate output and

incomes; and it affects differently personal and group (household) welfare. Thus, government expenditure on particular projects will increase incomes and employment, but it may affect negatively the quality of the natural environment. How does one 'balance' the net contribution of an initiative in this case?

Or, a government legislates in favour of certain economic measures, like establishing a national minimum wage. Thereby it boosts the income, possibly consumption of specified subgroups. But it is not 'evident' that the subgroups' welfare is also positively affected. Thus, for the families concerned welfare changes depend on the goods consumed and the individuals' future performance in the labour market. If they spend the additional income on lotteries or fattening food, or if they avoid skill enhancement programmes as a result of the marginal increases in their income, then one cannot refer to such policy decisions as being socially beneficial from a welfare standpoint. Such distinctions may be made for all policy measures introduced.

A financial analysis of the Malta government's annual budget since 2010 reveals the features described below (Central Bank of Malta, 2016a: p.113-117; Ministry for Finance, 2016a: p178). The government's budget is based on a cash-flow basis. Revenues due to government in unpaid income taxes, social security contributions, VAT or other duties are not included. Nor are payments due by government to private households and firms, such as compensation for expropriated land, which are as yet on hold. Both types of entries could be substantial as reports by the National Audit Office testify.

For example, the Inland Revenue Department reported a gross arrears balance of €910.5million for the year ended 2014. Of these, €671.4million were considered as

not collectable, thus resulting in net collectable arrears of €259.2million (National Audit Office, 2015:p.307). The gross arrears represent 53% of total revenue from income tax and social security contributions in 2014; the collectable amount makes up 14%. The impact of these flows on private sector present activities and future initiatives may be identified following negotiations between the respective government departments and the private sector regarding the amount and method of payment, the latter may include the offsetting of mutual dues.

And these data do not in any way shed any insight into the mechanics of how revenues are collected or expenditures made. The annual Reports by the Auditor General on Public Accounts turn out to be a litany of the many shortcomings in the various government departments and projects assessed. The latest report for 2015 confirms this embedded tendency. A reference to the Press Release by the NAO amplifies this statement (Department of Information, Malta, 2016).

The data below are based on the Government Budget reports.

- i) For the years 2010 to 2013, Recurrent Revenue fell short of Recurrent Expenditure. This negative feature was reversed from 2014 onwards. This means that the Maltese government was borrowing to finance its recurrent commitments. It is now generating a surplus on the current account, which surplus goes to finance in part the government's capital outlays. In 2010, there was a negative net balance of - €104million; in 2015 the net balance of the recurrent account is set at €95million. This represents a swing of €199million over 2010. It is projected to be €234million in 2017.

- ii) The Capital account also registered negative net balances. They increased over time, from - €106.5million in 2010 to - €224million in 2015. In the year 2016 Capital expenditure was reined in: it fell from €525million in 2015 to €365million and it is projected to remain at around that level for 2017.
- iii) Overall, the net result of these two trends has been a negative budget balance. The annual deficit varies but it is still there. It was €210million in 2010, €167million in 2016 and it is projected to be €128million in 2017. Total general government debt, excluding Government guaranteed debt, increased from €4,463.3million in 2010 to €5,621.3million in 2015, by €1,158million or 26% in five years.
- iv) The public sector borrowing requirement will depend on two factors: the amount of resources transferred from the EU support programmes, the value of government stocks maturing in one year, and the amount of a particular year that government will be financing in that year once the public sector commitments are consolidated. Indeed, a major share of the capital outlay has been generally financed from EU sources in the past twelve years. The bigger share of these funds is allotted in the first 3-4 years in which they accrue. This means that there will be less capital resources available in the remaining 4-3 years. Capital transfers increased annually from €101.9million in 2010 to €285.6million in 2015. They represented 4.1% of government revenue in 2010 rising to 5.8% in 2014 and to a high of 7.75% in 2015.
- v) The balance in the Consolidated Account registered a declining trend over 2010–2015: it fell from - €272million to - €157million. Government

borrowed to reduce this negative gap. But it went up again to - €288million in 2016 and it is projected to be - €280million in 2017. These negative balances have to be cleared before one can truly speak of Government 'saving' arising from a budget surplus.

- vi) The sum of capital transfer and overall budget deficit represents the annual resource injection by the Maltese government into the economy. In 2015, this combined sum amounted to €414million (€129million in deficit and €285million in transfers). It makes up 10.8% of total expenditure. Capital transfers represent 7.7% of total government revenue in the same year. This pattern of net resource injection has been going on for many years. Budget policy has been consistently expansionary.
- vii) Taxes transfer resources from the private sector to Government while Government expenditure re-injects such resources back into the economy. So one gauges the role of government in the economy in terms of these two flows by relating them to the total value added per year, namely GDP at market prices. And then compare the ratios thus derived to those obtained for other countries. Strictly speaking such comparisons can only be taken as rough guides, because the 'social contract' between a State and its Citizens differs from one country to another. (Economic theory puts forward several theories referring to the rates of tax, the size of the economy, and the maximisation of government revenue. The Critical Limit Hypothesis and the Laffer Curve Tax rate-tax revenues relationship are two such

theories. Other propositions, like Wagner's Law of Increasing Government Expenditure, address the contribution of the State's expenditure budget on economic output and growth. See Delia, 2010: p 124-130)

- viii) The OECD average ratio for 'Government Expenditure/GDP at market prices' was 46% in 2010 and 44.9% in 2015. For Malta the respective ratios were 41% and 43.4%. This means that the share of government activity in the Maltese economy has increased over the past six years. And it moved into an opposite direction from that recorded, on average, in the OECD countries. In this latter case, 'government involvement' is seen declining. Indeed, Malta moved from a position where it was 5 percentage points below the OECD average to one where it was in 2015 only 1.5 percentage point below.
- ix) Judged from a tax perspective, Malta has kept pace with the mean tax/GDP ratio for the OECD countries. The mean 'Tax/GDP at market prices' ratio for the OECD group was 32.8% in 2010 and 34.4% in 2015. For Malta it was 32.4% and 34.6%. This means that on this measurement, the Maltese government has been moving in the same direction as the 'average' for the OECD group. But it was marginally below the mean value in 2010 and marginally higher in 2015.
- x) This expansionary stance of the Maltese government, as measured by the Tax and Expenditure flows for any given year, does not account for what is actually happening in reality. Because in recent years the role of Government has been 'edited' through the extension of the private-

- public partnership model and the use of government guarantees even to private sector investment. Thus, Government guaranteed debt increased from €779 million in 2010 to €1,404.2 million in 2015. Historically, such guarantees used to be given to parastatal companies. But following the extensive privatisation programme, they are now being given also to certain private sector projects.
- xi) Such policy decisions reduce the direct involvement of the Maltese government by transferring the demand for capital from the public to the private sector with the government buying services for a stipulated time period. Capital outlays are private. And public sector purchasing of services stretches over the coming decades. This approach is being used in the health and energy generating sectors. But this implies that there are commitments which may have to be undertaken by the Maltese government if the project, as is, turns out to be non-compatible with certain EU competition rules (such consideration was for a time relevant to a project in energy generation) or not sustainable (as, say, the case of private health service provision in the 'former state' hospitals). Cash flow budgeting does not account for such commitments.
- xii) Similarly, there are other non-tax revenues which have not been totally recorded to date in the revenue flows. One example is the income accruing under the Individual Investment Programme scheme, which is reported to have generated €330 million up to October 2016, most of which will accrue to government. But so far, only €43.3 million were recorded in the Consolidated Account for fiscal years 2014-2016.

- xiii) There has been a consistent pattern in the way government outlays were allocated by function. There are five areas which take up, altogether, around 87% of total expenditure. These are Social Protection (32%), General Public Service (16.5%), Health (13%), Education (14%), and Economic Affairs (11.5%). Environment absorbs around 4%; Public Order and Security takes 3%, Research and Culture and Defence take 2% each, while Housing and Community amenities are allocated around 1%. These relative shares remained unchanged for the period 2010-2015. (A Spearman Rank Correlation coefficient for the distributions by function for 2010 and 2015 yields a value of 0.9757. A value of 1 implies a perfect fit.)
- xiv) These results suggest that the Malta government's budget allocation is turning out to be an exercise of marginal adjustments in absolute terms for funds allocated by function. The relative distribution of funds is practically constant. There does not seem to have been any major radical shift in priorities. The commitments, especially for the first five categories in particular for Social Protection, are real and do not leave much space for financial manoeuvring. Every category of expenditure is absorbing more funds, some of which are tax financed others are funded from transfers from abroad or borrowing. As pointed out in paragraph (i) above, until 2013 recurrent revenue fell short of recurrent expenditure.
- xv) These expenditure and revenue outlays lead directly to matters related to the effectiveness of such expenditures in enhancing labour and capital productivity and personal welfare. It is definitely

not enough to refer to financial flows and their estimated impact on the respective components of aggregate demand. Future economic growth in a small, open economy with an ageing population depends critically on the upgrading of the capital stock and the improvement of the various technical and soft skills of the labour force. This includes also the creation of an environment which encourages enterprise in identifying and undertaking sustainable economic activities.

- xvi) 16% of government outlay goes for General Public Service. The efficiency of the public administrative sector not only improves the quality of services, in terms of time and costs, but also spills into the efficiency of the private sector. Often, public choice economic theory assumes that productivity enhancement per worker in the public sector is zero. This was an argument used to suggest privatisation of enterprises, because it is held that private sector productivity per employee is greater than zero, and so it leads to higher output in the future, better wage income, greater profits and more tax revenue for government. But this need not be so. An increase in productivity by public sector (and other) employees will be represented by an upward shift of the output curve in Figure 1, quadrant IV. Depending on the results thus obtained, such productivity shifts could lead to both higher wage and non-wage incomes.
- xvii) Such considerations apply to the improvements made to human skill formation by the expenditure on law and order, health and education. It is not enough to measure the commitment of the State to personal welfare by the amount spent

on education, health, culture and law and order. The impact over time of such outlays has to be monitored, measured, and the results acted upon. Thus, educationalists in Malta are not happy with the academic results of the upcoming cohorts of students and the present educational set up in terms of its contribution to a holistic personal development. The same could be said about the health condition of the Maltese, in particular when referring to obesity and related diseases. Health expenditure is seen primarily as being remedial; more resources could be allocated to prevention to contain the growth of remedial intervention in future. And such reasoning could be extended to the prevention of crime and violence which results reflect behavioural relationships in the home, at work and in the rest of society. The expenditure outlay on Law and Order may be taken to be only an indicator of the potential engagements of personnel and equipment but not of the organisational effectiveness of such resources.

- xviii) Research at times tends to focus on macroeconomic relationships, like fiscal multipliers. Indeed, under the heading 'The Role of Government in Malta', a recent Central Bank of Malta publication refers only to 'Fiscal multipliers in the Maltese economy' (Grech, Aaron, editor, 2016). Surely, the role of the Maltese government in the economy cannot be restricted to and encapsulated in 'fiscal multipliers'. It is much more complex and affects directly personal welfare and output both in the short and, more so, in the long run.

In sum, data referring to the flows of revenues and expenditure by the Maltese government

during the six years 2010-2015 indicate several important features. The recurrent budget was in deficit up to 2013, but since then recurrent revenues exceeded recurrent expenditure. The capital budget relied heavily on capital transfers from the EU programmes and borrowing for its financing throughout the period. This notwithstanding, overall the government budget remains in deficit, which means that the general government debt has kept rising. Equally rising was the sum of loans guaranteed by government. Over that time, the government reinforced the switch to private-public partnerships. The private sector committed itself to carry out main projects in, say, energy, communications infrastructure or health and caring services facilities. The Maltese government bound itself for a set time period to buy the output produced by such organisations.

The tax ratio increased from 32.4% to 34.6%, in line with the trend reflected in the OECD average, but it exceeded marginally the average for the year 2015. The share of government expenditure in the GDP approached the limit attained by the OECD group in 2015. It was 43.4%. This means that government intervention is getting stronger in Malta.

The relative allocation of government expenditure by function remains unchanged. Around 87% of expenditure goes for Social Protection, Public Administration, Health, Education and Economic Affairs. This means that there has not been any radical change of policy with regard to the various functions. Or, it is deemed that there is no room for adjustments. So while in absolute terms, the

respective financial outlays increase, yet in relative distributional terms they move within narrow margins. Therefore it is in terms of the impact such outlays have on personal development and skill formation, apart from enhancing the efficiency of capital, that these outlays have to be considered. Not solely in terms of their 'fiscal multipliers'. Every year the government budget has been expansionary, injecting more resources in the economy than withdrawing through taxation, utilising EU funds and borrowing to support such a position.

3.1.2 Considerations related to Aggregate Demand Factors: Trade in Goods and Services, Industrial Structures and their Sustainability

In addition to a fiscal deficit, Malta registered also an external payments deficit in 2010 and 2011. In those years, the positive net balance recorded in the Services sector was not sufficiently large to offset a negative balance in Trade. Such negative results continued to be registered in Trade, but the net balance obtained in the Services sector wiped this net shortage in currency earnings post-2012.

The values of the net Trade exchange balance varied yearly; it fell from -€1.25billion in 2010 to - €775million in 2012 but rose again to a high of -€1.75billion in 2015. Conversely, the net balance in the Services account kept increasing steadily and robustly from €1.21 billion in 2010 to €2.03billion in 2015, an increase of 68% over the period.

It was this positive performance of the Services sectors which brought about the present results. One therefore

has to identify those factors which contributed to this performance both in Trade and in the Services industries. For the recorded net balance in external payments has hovered in the €500million-€650million in 2012-2014 but slumped to around €280million in 2015. The gains in the Services sector payments may peak out; if the balance in trade worsens it may wipe out, once again, such positive surpluses.

This could happen, say, as a result of a rising price of oil or a depreciation of the euro in relation to the US dollar. One factor that contributed to a containment of import value was the falling price of oil on the international markets in the past few years. The bill for 'Fuel and Lubricants' imported in 2014 amounted to €2.56billion; the value of Fuel and Lubricants exported was €1.608billion leaving a positive residual of €953million which could have been consumed locally or stored for future consumption or export. In the first nine months of 2016, the recorded imports of Fuel reached €1.263billion while exports were valued at €655million. These flows yield a balance of -€608million for the period.

Exchange rate variations will also affect the external sector performance. Thus a weaker euro vis-à-vis the US dollar will mean that oil imports will be more costly. 1 euro averaged \$1.3295 during 2014 but it registered a mean of \$1.1095 in 2015. Similarly, euro-yen changes will affect the net value added of another sector, the aquaculture industry, particularly that related to Tuna farming. In the past four years, 2012 -2015, unfavourable exchange rate differences reduced this sector's net value added by €3.6million, €3.4million and €0.157million in 2012, 2013 and 2015. In 2014, favourable exchange rate movements added €4.7million instead. The Euro/Japanese Yen rates of exchange averaged JPY102.49, 129.66, and 134.31 in

2012, 2013 and 2015; the mean Euro/Yen rate for 2014 was JPY140.3 (National Statistics Office, Malta, 2016e).

Exports from Malta to the euro zone increased during 2010-2013, reaching a high of €1.04billion but declined thereafter to around €800million in 2015. In relative terms, the share of the euro zone's demand for Maltese goods fell from 32% of total exports to 23%. Similarly, the value of exports to the EU area peaked in 2011 at €1.3billion, falling thereafter to €1.08billion in 2015. Percentage-wise, exports to the EU dropped from 41% to 30% of total exports.

Trade with the USA also fell from €196million to €135million over the five year period. This means that Maltese exports are at present distributed over a wider geographical territory which makes their sustainability both sounder but at the same time also more demanding to support.

Imports from the euro zone averaged 48% of total for 2010-2015; those from the EU area reached 59%. But such data would include products which originate outside the EU but which are turned into finished products inside the EU. And under the Intrastat Supplementary Declaration as the source document of trade statistics, it is no longer possible to disaggregate total exports into domestic exports and re-exports. This data compilation methodology affects the information for Maltese exports and, also, of imports coming from within the EU states.

Maltese exports are dominated by three main sectors, namely, Mineral fuels, oils and products; Pharmaceuticals; and Electrical machinery. These three areas record annual exports' values in excess of €500million. The sectors of 'Games/toys', and 'Aircraft/spacecraft and parts thereof' are steadily gaining in their relative importance, exceeding the €100million level. The other 14 classified sectors are equally important in their own right, but

exports are below the value of €50 million annually. The relative importance, by value, of these 19 classified sectors remained practically unchanged in the past few years. The trade distribution for January-September 2015, 2016, for example, yields a Spearman Rank Correlation Coefficient of 0.95. However one notes the rising importance of the Pharmaceutical industry which quadrupled its exports within one year: from €184million to €779million. Equally strong was the performance of the sector of games/toys which saw exports rise from €70million to €102 in twelve months.

The continuing profitability of such enterprises will be determining to the performance of the manufacturing sector in Malta (National Statistics Office, Malta, 2016f). If such profitability is primarily conditioned by productivity and logistic considerations then the presence of such economic activity in Malta has a stronger base on which to subsist. If, instead, company net profits are also influenced to some extent by tax/subsidies considerations, then the feasibility of such operations may be in doubt. Differential income tax regimes favouring operations run by non-Maltese nationals would have to be reconsidered in the context of an overall assessment of fiscal tools, both taxes and government outlays. Periodical assessments of the fiscal budget assist policy adaptation to emergent socio-economic realities which may not have been addressed effectively in the past. One such important factor is surely 'the deepening of the Economic and Monetary Union' and what it implies. There could be misunderstandings or shades of opinions on what such a vision actually implies for the euro zone, in general, and for the Maltese Islands in particular.

Such an exercise will be also relevant for all types of economic activity involved in the production and

distribution of goods and services. The output of the Services sectors has become the prime currency earner for Malta. While details are available, on a time series basis, for the Manufacturing sector, fewer data are at hand on the Services sub-classification except for the Leisure sector. Thus, for example, the 'Economic Survey 2016' (Ministry for Finance, 2016a) reviews in some details the 'Productive Sector'. The chapter on Services Activities examines the Tourism sector (number of tourists, nationalities, stay, earnings) and then gives "an overview of the regulatory, development and investment promotion activities within the services sector., focusing in particular on the Malta Financial Services Authority, the Malta Gaming Authority and Malta Enterprise (p.71)".

This situation arises from the nature of the economic activities themselves. Data classifications change internationally and new activities may not be categorised separately to ensure data confidentiality especially important in a small economy's data sets. So there may be 'grey areas' referring even to the definition of a 'firm', its location, the origin of its earnings, or parts thereof, and the final beneficiary. If such matters are seen to be somewhat complex for the manufacturing sector, they become even more so for the services industries.

The Tourism sector has been buoyant in recent years following the increase in facilities offered by the entry of several 'low cost' airlines operating from different European destinations. More than 1.78million tourists visited Malta in 2015, up from the 1.34million of 2010. Expenditure by tourists in 2015 is estimated to have been €1.639billion, representing a per capita expenditure of €919. This is roughly the amount per head which has been recorded in the past few years. Average full time employment in the accommodation and food services

activity increased from around 10,000 to 10,700 in 2015 going up to around 11,000 in 2016. The earnings from the tourism sector represented 17% of total earnings from the exports of Services.

One new component of services sector is the Individual Investor Programme (IIP), sometimes known as 'the passport scheme'. Between July 2015 and June 2016 Identity Malta collected €166.6million. This sum rises to €218.7million when one includes property purchases and rent, investments and contributions. Unlike earnings from tourism, such funds are 'one off', pertaining to this particular programme, unless, of course, this scheme is extended. But their relevance to both GDP and foreign exchange earnings cannot be minimised. The gross sum of €218.7million represents 2.3% of GDP (Times of Malta, 11 November 2016). [The way such incomes are accounted for in the Government Consolidated Account has been discussed in Section 3.1.1 above, paragraph (xii).]

Tourism and IIPs are influenced by 'climate'. The former is bound to be conditioned by the climatic changes taking place in the Mediterranean basin; the latter by the perceptions regarding political and country risks. While reviewers tend to focus on this second factor, no attention is allotted to the former. It has been reported that 2015 has been the hottest year on record worldwide, and 2016 could be even hotter still. These climatic phenomena will impact on the distribution of tourists' inflows during the year. Tourists, especially those over a certain age bracket, will refrain from visiting Malta in the hot summer months. Climate change could therefore induce a seasonal diversification of the tourists' flow where the traditional shoulder months may register a higher number, and share, of visitors than hitherto. Climate will not influence schemes like IIPs because these are not directly linked to

climate but to nationality. And actual residence periods are not specifically stipulated at law.

Another sector which would surely be influenced by climate change is that of Agriculture and Fisheries. The performance of the Aquaculture sector has already been described above with reference to the impact foreign exchange movements have on a country's balance of payments. The agricultural sector has seen its relative importance in Malta's GDP decline over time (Delia, 2005). It has been supported over the years on a wide range of activities, from the setting up of sectoral co-operatives, more recently producer organisations, and capital allocations to revamp the various sub-sectors in agriculture, animal husbandry and the administrative organisational set-ups.

But over time its relative contribution kept diminishing, both with the extension and expansion of other alternative economic activities as well as with the ageing of the full time farming population. The sector is being gradually made more dependent on part-time activities, with limited resource commitment from part-times. And yet financial support continues to be allocated to the sector. Factor income averaged €67million annually during 2012-2014, going up to €72million in 2015. Of this, €20million or 30% represented the annual subsidies and they are not related to production. Out of €79.4million in subsidies given to farmers between 2012 and 2015, €74.4million (94%) were not production-tied.

And these subsidies exclude any reference to water consumption. The agricultural sector is the main consumer of underground water. This unrestricted usage of the water supply is having negative impact on water resources in the Maltese Islands and, in the end, is not leading to the sustainability of the sector (Delia, editor,

2007). With rising temperatures this matter assumes even greater relevance for the future.

Annual imports of Agricultural products amount to €500million. Policy makers generally try to maintain some control over the food supply chain, hence the various Agriculture support programmes everywhere, like the Common Agriculture Policy programmes (CAP) in the European Union. But given the ageing farming population, the limited success to date of the restructuring programmes under way for the past fifteen years, and given the excessive use of water resources which are practically not included in the production costs, it is opportune to re-address the feasibility of the sector of agriculture.

A similar observation can be made with reference to the Aquaculture industry. The data presented above referred to variations to factor income arising from exchange rate movements. But the intermediate costs taken into account for the purpose of these computations exclude completely the negative external effects which this industry generates on the surrounding seas where production is located. It turns out that some of this production is not carried out according to the specified health and safety standards. It is causing damage to the adjacent areas to the detriment of the natural marine and coastal environment and also to the recreational space available for locals and visitors alike (Muscat, C., 2016)

So the long-term viability of this industry, one which is properly costed and incorporating also the estimated value of negative external effects, need to be carried out. Otherwise, the declared profitability of the industry will be artificial and the sector will be operating on borrowed time. It has to be admitted, though, that comprehensive evaluations are not quite straight-forward exercises. This

holds especially where industrial development has been sporadic, stretched over a relatively long period and in the absence of a master plan relating geographical areas to economic activities.

3.1.3 Considerations related to Aggregate Demand Factors: Summary

The components that make up Aggregate Demand in the Maltese economy both in the private and public sectors have been buoyant over the past few years. The Government pursued a fiscal strategy which was both financially expansionary, as well as giving space to private sector participation in particular through public-private partnership in several sectors like energy generation, communications and transport, and in the social sector (education, health and care for various sub-groups in the population). The government's fundamental budget structure remained the same over the period. But more funds were injected into the economy, relying on borrowing and net inward fund transfers from various EU programmes. At the same time, government guarantees supported activity which, in part, was undertaken by private sector operators. Indeed both the public debt and government guarantees increased over the period 2010-2015.

Presently, the government's recurrent revenue exceeds the recurrent expenditure. This surplus goes to finance part of the annual public sector capital outlays. But overall, the government's budget is still in deficit. And the 'sum total' of the measures referred to in the draft Budget for 2017, in terms of tax and expenditure changes, is not clear. The Maltese government claims that the deficit will

be reduced while the EU Commission, in its Commission Opinion on the Draft Budgetary Plan for Malta, sustains that the deficit will rise instead (European Commission, 2016). Such statements are based on cash flows based on the Consolidated Account. Real committed outlays and revenues due could present a different impression.

The external account also contributed to the recorded upbeat performance of the Maltese economy. A deficit in the current account of Malta's balance of payments was turned into a surplus for the past few years with the rapid surge in earnings from the Services sectors. The net trade account is still negative, with the payments for imports exceeding the value of goods exported. But income generated from activities falling under the Services Sector, which includes Tourism and Financial Services, exceeds the shortfall in the Trade account. However, such array of economic activities is attracted by Malta's geographical location and by an income tax regime which is considered 'tax efficient' from a beneficiary's perspective. Inward investment in these sectors flourished, included the IIP which exchanged Maltese citizenship for cash, purchase/ rental of property, and participation in Malta Government Stock sales.

Private consumption and investment were also positive. But there remains the quandary of private households' saving rates. The yearly aggregate saving ratio fluctuates rather heavily. Theoretical explanations have been attempted to 'legitimate' the rather rapid movements in this ratio. But these records perhaps are the outcome of shortcomings in the other data bases included in the computation of the aggregate savings statistics. These refer to: household disposable income, total final expenditure including that of visitors to Malta, and household aggregate consumption. Computational

errors (i.e. under- or over-estimation) in any of these will be reflected in the saving statistic data series.

Surveys relating to the expectations of the business community in Malta in the past five years trace the development of the factors referred to above. The annual Economic Surveys carried out by The Malta Chamber of Commerce, Enterprise and Industry on behalf of Eurochambres register the switch over time of the private sector's preoccupations at any one year. In the four years 2010-2014 the business community worried about the 'flatness' if not outright regression of aggregate demand, both in the local sales and in the demand for exports. But in the years 2015 and 2016, businesses focused more on the availability of labour supply at the right price.

Aggregate demand, particularly that segment referring to exports, has been relegated to a lower risk factor. Indeed, the business sector has been claiming that the demand for Malta produced goods and services exists, but there are now difficulties in meeting such a demand. Failure to do so could jeopardise business operations as potential markets could be lost to competitors (Malta Chamber of Commerce, Enterprise and Industry, 2015, 2016).

But such a position does not mean that there are no issues to be attended to in the respective Aggregate Demand components. Indeed, every one of them presents particular characteristics which expect further exploration because they are crucial for effective economic and social policy formulation and implementation.

Reference has already been made to the seeming 'erratic behaviour' of Maltese households when considering their consumption/saving decision making. The data register wide variations annually in the outcome of consumer behaviour. Knowledge about household saving

is indispensable for financial projections of pension schemes, and therefore for future household financial independence. The absence of such independence will render an individual dependent on State support or charitable transfers in cash and kind.

Again, the fiscal analysis is carried out on a government budget based on a cash flow methodology. Government's involvement in the Maltese economy is much wider. So in order to approach the complex subject of public-private relationships and their impact on both the economy and society in the short and the long run, other approaches to data presentation may be more suitable for the purpose. They will complement, not replace completely, the cash flow data sets.

While on the external accounts, one notes the rising importance of the Pharmaceutical industry in Manufacturing and the financial, gaming sectors and aviation industries in Services. There is nothing detrimental in this but a growing reliance on particular sectors could distort not simply the earnings flow but more so the supply of skills and the formation of a 'be constantly-alert' attitude in the labour force.

The search for alternative activities or offshoots of existing operations has to be ongoing. The international tax regime structure may be entering a new phase where personal and corporate taxation on incomes and profits may be given a strong jolt downwards. And differential tax advantages, on which many countries relied to attract Foreign Direct Investment, would be heavily indented as a result. A slowdown in the global rate of economic growth would push countries to re-introduce new subtle barriers to trade while, openly, they will be claiming to support regimes which bolster freer trade environments. The Maltese tax-expenditure relationships will have to

be addressed in this context and, also, in the envisaged evolution of the EMU over the coming decade.

And on top of all this there is climate change. The Mediterranean basin is getting warmer every year. These gradual rises in temperature will affect the Maltese economy and society in various ways. They will induce a greater demand for energy, impact the inflow of visitors to the Islands, and induce the demand for a higher consumption of water resources to keep the shrinking agricultural sector in operation. Similarly, a warmer sea temperature would affect the aquaculture industry. This sector already presents operational challenges under the current climatic and production conditions; higher sea temperatures may compound such issues.

And an elderly population, especially one prone to obesity, heart/blood circulatory problems and dependent on a wide-range of medicinal compounds to remain mobile and active will feel rising temperatures even more. Elderly people are more prone to suffer from heat than the healthier younger cohorts.

There is one constant/restraining factor in whichever economic and social model policy makers adapt as a guide, namely, human resources. People are Malta's main asset. Their skills will either lead to the creation of wealth, and therefore the resources which can enhance the quality of life for all, or, if such skills are lacking, they will act as a drag on future output and its distribution. Skills have to be available in time, at the right numbers and at a competitive price. Mobility of knowhow, personnel and hardware are nowadays the components that together lead to viable operations. The following section, therefore, moves away from aggregate demand components to consider supply issues.

3.2 Supply Considerations

Supply considerations switch analysis from goods and services to human beings. Numbers will matter, but they will no longer refer to volumes, outputs, indices of production or prices but to personal attitudes to work, skill proficiencies, willingness to commit themselves to the tasks undertaken, and propensity to enhance themselves over time. As entrepreneurs and employees they have to adapt to changing trade exchange conditions, arising from global or regional political agreements and domestic legislation and financial/economic policy decisions. While in the preceding section, households were considered as consumers of locally made goods and services and of imports, in this section households are seen as producers of labour services and enterprise.

Once again reference is made to Diagram 1 in Chapter 2 above. The involvement of Labour as input in the production of goods and services emerges from the relationship in Quadrant (IV), where aggregate output is made dependent on the variable supply of labour, in terms of number of employees, their skill composition, and the hours of work committed and carried out per worker. The decision to add to the (given) capital stock is represented by the IS curve in Quadrant (I). The Households and private firms 'save' resources which they may decide to commit again to the formation of new capital stock. The entrepreneurial decision emerges at that point. The mechanics of the 'Labour market', represented by the number of personnel prepared to work (**S**) and the demand for their respective services (**D**) which is derived from the complex set of activities summarised in the aggregate output graph in Quadrant (IV): [$Y=f(L)$], are shown in Quadrant III. The

intersection of the **S** and **D** curves indicates a market-clearing real wage (W/P). This is a 'weighted average' of the many wages and salaries that emerge from the many labour markets operating in every society. **P** stands for the 'average' price level derived from the many prices prevailing in the respective markets.

The labour supply reflects the age distribution of a country's population. In the case of the EU member states, this 'population' is not restricted to one member state but, given the free movement of people, it is extended to include citizens of other states who are prepared to migrate internally within the EU bloc. The principle of free movement of labour had always been fundamental to the development of the EU but at the same time there have always been reservations from practically every single member state for its unconditional, universal application. Member states keep insisting, openly or less-openly, to exercise some form of labour movement control for various reasons ranging from security to the performance of their country's economy at a time.

A country's demographic characteristics are shaped over time. Attitudes towards interpersonal relationships, family set up and size are reflected in the number of births per period. The natural increase of a population emerges from the combination of these births and the number of persons deceased per year. In turn, custom and legislation condition the number and gender of entrepreneurs and employees out of this population stock. Similarly legislation and social acceptance condition the intake and permanency of immigrants, just as in a country with 'surplus labour' (for whatever the reason) people may benefit from emigration. It is the sum of all these forces that is represented in Quadrant III as the Labour Supply

(S) schedule. The Labour Supply schedule is therefore an offshoot of a country's demographic configuration at any one time period.

3.2.1 Demographic Characteristics and Labour Force Participation in the Maltese Islands

Total population in the Maltese Islands was estimated at 429,344 in December 2014 made up of 214,753 males and 214,607 females (National Statistics Office, Malta, 2016c). Males exceed females by 126; one can say that, gender-wise, the population is equally divided. However, the Maltese population was set at 401,668 of whom 199,381 were males and 201,487 were females. Females exceeded males by 2,106. But this result emerges from the fact that there are almost 7,000 more females than males in the 70+ age brackets. It is this last statistic which may mislead many commentators when commenting on gender representation in the labour market. In the age cohorts relevant for labour market purposes, there are more male participants than female, and this conclusion holds even when one accounts for the presence of registered foreigners on the Islands.

Indeed, such contrasting demographic features are even more highlighted when one compares the two demographic age distributions. Such features have connotations which are crucial for policy formation in the labour market, educational services and general welfare provision. Thus there are more males than females in the 0–59 age bracket: 5,984, almost 6,000. If one considers only the age bracket 20–59, having a strong bearing on the labour supply, the difference between males and females is given at 3,617; 60% of the gender difference is found in

the age segment which is bound to be active in the labour market. These numbers are reinforced by the presence of foreigners on the Islands. There were 13,445 non-Maltese in those age brackets. They augment the stock of potential labour force participants. There were more females than males: 7,993 compared to 5,452 males. But, overall, there are more males than females.

The propensity to work may be gender influenced in many societies. Such cultural inclinations will have to be addressed if Malta's labour force is to remain dynamic in its approach towards a changing competitive EU and global environment. This aspect is taken up below with reference to the first Shift Employment Report for Malta.

Labour force participation has risen steadily over the past few years. Employment as a share of total population aged 15-64, represented by the sum of persons recorded in the Labour Supply and those defined as Inactive, rose from 49.75% in 2013 to 50.43% in 2015 and June 2016. Full time employment increased by around 13,400 posts; it was 162,641 in June 2016. Employees on reduced hours reached a peak of 5,827 in 2014 but fell to 5,104 in 2015. These employees are generally taking care of children or persons in need, and so they are seen computing a dual role: as workers and as 'carers'. The number of part-timers also peaked in 2014, at 24,782 but declined to 23,982 in 2015. Altogether, the number of part-timers and employees on reduced hours went down by 1,870 posts in 2016. But some, or all, of these could have moved to full-time employment (Ministry for Finance, 2016a: p.28-29).

These employment gains were spread over all age brackets except for the Female age cohort 15-24: their participation share fell from 44.4% to 41.7%. The employment rates for the total population aged 15-64

rose from 60.8% to 65.7%, represented by a rise in the Male activity rate from 74.1% to 78.3% and for the Female activity rate from 47% to 52.5%.

Of interest is the rise in the participation rate of persons aged 55-64. For the cohort, the rate increased from 36.2% to 43.5% reflecting the rise in the share of males from 53.8% to 62.9% and females from 18.7% to 24.2%. The impact of legislation ruling pensionable age retirement on employment and output has been the subject of debate for some time. If the participation rates recorded by the present population aged 61 and 62 continues, then the supply of labour could count on further participation by the upcoming workers. Their impact on output, incomes, consumption and saving will depend on where they will be engaged, but such participation would be beneficial to them personally and to society as a whole (Grech, Aaron G., 2016a). To do so, they have to be truly working in profitable activities in a competitive environment otherwise they will be receiving transfer payments (at least in part) disguised as wages.

Measuring the labour supply from absolute numbers or in relation to the demographic age composition is obviously not enough to assess its implication for future economic diversification and growth. Recent surveys have identified shortfalls in skills which are hampering economic activity. The above data refer to the characteristics of the local labour force. They do not account in any way to the trend in the industrial and services sectors vacant posts. Locally based industry is relying more heavily on immigrants to supply the skills it requires. But while expanding the pool of available skills, immigrant labour also induces pressures on such services as housing, health, education and transport. Judging by the way gainful employment is increasing, these pressures on

the social infrastructure would be high, primarily because they were unanticipated (Schembri Orland, Kevin, 2016).

One case suffices to illustrate the fine balance between skill availability, output growth and education. One operator in the security printing industry, with a long-standing presence in Malta, indicated that it wanted to downgrade its activity and discharge 300 workers. Government agencies succeeded to attract another company in the same sector which would have taken up the trained workers. However, the first operator changed its plans and, instead, opted to expand its activities, thereby creating additional demand for workers in the sector. The skill shortfall, consequently, has now been accentuated: the newcomer operator still needs the 300 workers, while the resident one intends to recruit more (Sansone, Kurt, 2016).

This spate of activity, involving two operations, will put additional pressure on the other, smaller firms engaged in the printing sector who would have to compete for the limited personnel with the right technical capabilities, possibly improving the pay package and resorting themselves to import labour. As an offshoot, tertiary education institutes offered to introduce crash-courses to turn out the personnel in demand. But, of course, acquiring and polishing skills is a time consuming exercise. And proficient technical personnel cannot be turned out at will. Especially if the available Maltese that fit the credentials to prepare themselves for such positions are either non-existent or do not come forward. Hence, the comment made by the companies interviewed for the Eurochambres survey, that the labour skills have to be available in the numbers required and 'at the right price'.

The 'numbers required' are influenced by gender. Apart from personnel working on reduced hours, who

are often females, workers who are engaged in shift work tend to be male. One in every five employees works on shift. More than half of them are engaged in public administration, defence, education, human health and social work activities (35%) and the wholesale and retail trade, transportation and storage, accommodation and food service activities (29%). They work full time. Male employees are more likely to work atypical hours - during weekends or weekdays between 8pm and 5am - than females. In fact, almost 70% of all shift workers are male (National Statistics Office, Malta, 2016g). The fact that female workers are also active in these sub-markets could be interpreted that what might have been seen as 'traditionally female caring activities' in Maltese society are now also being carried out, at least in some cases, by men.

Preference for shift work often arises from personal reasons. Shift work allows employees to enjoy more free time during the day; they can accumulate several days off in a row. And so this makes it attractive for this sub-group to join the workforce. Although, it must be pointed out that shift work may induce adverse effects on workers' health due to irregular sleep. Such impact affects the workers; but it could also bear on their concentration at work and, so, on their productivity. In which case, considerations could arise related to the efficiency of the operation and to its profitability. So there are both personal welfare and operational sustainability factors that have to be addressed when assessing labour market conditions.

Employment growth was centred primarily in the various sectors that make up Services. Over the three-year period, 2013-2015, 11,315 new posts were filled. They represent 83% of total new jobs. Services accounted for 96,746 jobs in 2015. Conversely, the sub-sectors that

make up Manufacturing succeeded to hold around 20,000 posts, actually increasing only 265 new vacancies to reach 20,379 in 2015. While the Public Sector – made up of Government Departments, Companies with public sector majority shareholding, and Independent Statutory Bodies – added another 2,033 jobs between 2013 and 2015. The number of engagements was higher than indicated by these numbers – i.e. a total of 13,613 – because these posts exclude from accounting for the number of retirees who were replaced (Ministry for Finance, 2016a: p. 40-46).

Employment in Gozo also registered an increase of 665 jobs over the same period. In 2015, the gainfully occupied population amounted to 10,191 (Ministry for Finance, 2016a: p.44). The difficulties of sustaining employment opportunities in Gozo are well-known. The sister Island is said to suffer from ‘double insularity’, which tends to increase the costs of production and, so, the viability of economic activity. It depends on the availability of reliable and competitive communications, and on the diversity of its products and services.

In the past Gozo registered a comparatively higher emigration outflow, which was for some time stemmed. But it may now be experiencing another form of human ‘loss’ in the form of an exit of its young to Malta for educational and work purpose. This internal outflow will affect not only the social milieu and the quality of life in Gozo, but also the future economic potential of this island. One-fifth (19.97%) of those whose ID cards are registered in Gozo are over 65 years in a population of 30,000. This is 4 percentage points higher than the share of the same age cohorts in Malta (National Statistics Office, 2016c: p.24).

Such concentration tends to render the social environment less attractive for its young as a preparation

for life, in general, and for work, in particular. Besides, the size of the Gozo-born population is less than the 30,000 indicated above. This number includes those Maltese who own property in Gozo and register on the Gozo address to benefit from subsidised ferry fees intended for Gozitans. This demographic feature is an illustration of how tax and subsidy schemes do influence human behaviour in unforeseen ways.

Demographic constraints, coupled to a dynamic economy which aims for growth, are eased through migration. Indeed, foreign workers contributed directly to the Maltese economy's diversification and growth in the past two decades. It is estimated that they have boosted potential annual GDP growth by around 0.5-0.6% since 2009 (Grech, Aaron G., Micallef Brian and Zerafa Sandra in Aaron G. Grech editor, 2016).

And immigration has taken a nature of its own. Nowadays foreign workers provide a wide range of skills. Whereas in 2000 nearly three fourths of foreign workers were managers, professional and technical staff, by 2014 this has fallen to less than half. In absolute terms, however, their numbers increased from 1,400 to 8,400. At the same time, the proportion of foreign workers engaged in elementary occupations and in the clerical and support duties rose from 7.5% to 24%. The inflow of skills – a declining share of higher end and a rising proportion of lower-end occupations – differs from those registered for the Maltese workforce. The relevance of immigration for Malta's future growth is becoming accentuated in all economic sectors (agriculture and fisheries, construction, manufacturing, caring and other services) and in both private and public spheres of activity (Pace, 2016). Therefore the economic and social connotations of such a phenomenon have to be addressed. In particular, the way

in which they are to be assimilated in a more ethnically and culturally diversified Maltese society.

Within this social context one has to refer also to the role exercised at the local level by the members of the clergy and religious organisations. As pointed out in the Introduction to this study, the number of priests and religious are declining. Their mean age is 61 years, much higher than the 41 years recorded for the total Maltese population. This means that the contribution they used to make in the community is being gradually transformed. As numbers decline they will be constrained to downsize their direct involvement in those activities which prepare the upcoming generations in life skills. Social centres may have to be wound down or activities reduced. And, anyway, some parishes already have higher shares of middle-aged and elderly people as residents. Activities related to these sub-groups will have to co-exist with those aimed at the young parishioners. In these contexts the participation of the laity will become more pronounced.

A decades' old organisational parish structure will in the years ahead give way to a new set-up for parish liturgical celebrations and, also, the delivery of individual social support directed to various sub-groups in the community, like the young, the elderly and the sick. Even in these instances a new way of delivering a range of services will have to be devised. And what used to be a voluntary, zero-price amenity may have to be provided at least in part by non-profit or for-profit organisations which will charge for their service. Care of the elderly, sports and cultural activities will be included in such programmes.

In cases like these, to avoid relying solely on voluntary assistance, governments allocate funds for the specific purpose of improving organisational and infrastructural

facilities and enticing private sector investment. This has happened in Malta and Gozo in the past, and this process continues with funds even emanating from various EU social programmes. It will be in the community's interest to devise and implement initiatives that bring together the cultural and social institutions in the locality.

It will be interesting to emphasise the role of the Government fiscal budget, both taxation and expenditure, as an instrument of organisational change rather than simply as a means of stimulating economic demand. In this context, the budget will also focus more than hitherto on the setting up of systems meant to improve human skills and to integrate them in a forward-oriented competitive production set up. Various initiatives were taken in this sense over the years. But, perhaps, this approach has not been emphasised enough except in the context of educational infrastructure. Taxation and government expenditure must be addressed in their totality. They are the means to attain clearly-defined policy objectives – primarily personal development -, to provide the necessary resources to implement them, and to closely monitor their performance.

3.2.2 Fiscal Considerations

As noted in Section 2.1(iii) above, one of the aims expounded in the 2015 Three Presidents' Report is 'ensuring sound and integrated fiscal policies', the so-called Fiscal Union. Such policies refer to the tax regimes – meaning tax schedules and their administration - prevailing in the respective member states, and the disbursement of funds in such a way as to encourage sectoral restructuring, output growth and employment in the European Union and in the single

member states. So far emphasis has also been made on a 'sustaining a social Europe', one where the needs of individuals and families are met up to a specified limit. Industry and welfare support programmes vary from one member state to another, but the principle is the same: nurture wealth creation in the various economic sectors, appropriate an amount of such resources via taxes and charges, and redirect such resources to households (as investors, employees or consumers) in cash and kind.

The convergence of tax regimes in the EMU and the international exchange of cross border financial data with the aim to check tax evaders have to be seen within this general context. Government commitments in a modern democracy are onerous, so revenue collecting and expenditure structures have to be both efficient and effective in reaching 'national/union goals'.

Changes in tax regimes have to be meaningful. Tax systems should ideally be fair, neutral and simple to implement. Fairness implies horizontal equity: all income is taxed regardless of its source or use. It also implies vertical equity: the relative tax treatment of individuals with different levels of economic resources; this is translated as 'progressive taxation'. Tax systems could be integrated with welfare programmes: households considered to be in need would not be taxed on their income. This measure simplifies tax administration.

Tax neutrality implies that taxes should minimise interfering with the economic decision making of producers and consumers operating in relatively efficient markets. And a 'simple tax regime' renders easy the administrative procedures of tax assessments, queries and payments.

Deviations from these general principles, such as differential rates of tax on income by source or nationality

of the tax-payer, or several rates of consumer taxes on different products, or, duties on imports to encourage the consumption of locally produced goods, are very common. And there could be valid reasons for their application. But it always helps to recall the 'ideal' in order to benchmark existing structures and critically assess their relevance, benefits and costs for the community and for regional and world trade. The welfare of other people depends on their ability to exchange goods worldwide.

Adapting such a widespread tax presence in the Maltese economy to the ongoing global debate on taxes on income, capital and trade in goods and services is not easy. It is compounded by the fact that being a member state in the EU and the EMU, Malta operates within an internal free trade area and a customs union vis-à-vis the rest of the world. Besides, there are several taxes on personal income, companies' profits, and production/expenditure processes. Any alignment of tax regimes to a common set of rates in a Union of states has to account on the impact such alignment will have on future output creation, employment, foreign trade and government revenues. The success of public support network depends on the availability of resources to meet ever-higher commitments, at least in the short to medium term, and sustain a productive private sector.

Reference has already been made above to the tendency in many countries to re-think their approach to income taxes, pushing marginal rates downwards. These moves are intended to countervail the heavy outflow of funds from many economies to selected 'havens' where fund-owners pay minimal taxes. However, the timing of such tax changes has to be chosen judiciously so as not to disrupt a country's ability to meet its committed obligations.

Taxes tend to make operators inventive depending

on how the respective tax legislation is drafted. There are always ways of circumventing the statutes, at least for some time. But apart from escaping from paying taxes, operators may devise trade schemes which would be totally alien to any tax legislator. For example, the introduction of Capital Gains Tax (CGT) in Malta in the early nineties had the unwarranted effect of pushing eventually traders to the barter system in the real estate sector. Again, the fact that a company's equity is treated differently from shareholders' loans for inheritance duties purposes encouraged family businesses to inject more shareholders' loans than equity; doing so would reduce future tax burdens. Over time, such tax-induced effects could assume a dimension of their own, and create future problems for the raising of capital from the banking sector or through the stock exchange. They could give rise to under-capitalised firms.

Tax reconsideration exercises are definitely not easy tasks. But given the present global and EU tax discussions, it would be worthwhile carrying out various simulations to 'gauge' potential repercussions. Such 'simulations' based on the cash flow fiscal and GDP data could lead to indefinite conclusions. In the case of Malta, we are dealing with relatively small numbers; any one-off transaction in revenue or expenditure will offset gains or losses elsewhere and balance in totality. Understanding the underlying forces at work in the Maltese economy is more challenging than many would like to think. The Opinion of the European Commission on the Draft Budgetary Plan of Malta for fiscal year 2017 (European Commission, 2016) could be taken as an illustration.

The Maltese authorities hold that the measures are in conformity with the rules and the proposed budgetary proposals for some tax changes and expenditure

programmes are consonant with the desired direction. And they quote numbers to support this claim. But the Commission is of the opinion that the Budget Plan is only 'broadly compliant' with the provisions of the Stability and Growth Pact (SGP). And presents its own numbers to explain why. Indeed, the Commission also 'invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2017 budget will be compliant with the SGP.' Besides, 'the Commission is of the opinion that Malta had made no progress with regard to the structural part of the fiscal country-specific recommendations...and invites the authorities to accelerate progress' (p.5).

If it is not quite straightforward interpreting what is actually going on in such a constrained geographical economic space, it is bound to be much harder identifying the impact of a major radical shift in global and EU tax-subsidy regimes. The assumptions one has to make in such a scenario are many, and some of them may cancel out some others (Houlder, 2016).

One fact is certain. Taxes and subsidies change absolute and relative prices of factor inputs and final products. Therefore they have a bearing on the short and long-term viability of many economic activities. In particular, income taxes and social security contributions (SSC) act as a tax-wedge on labour. They reduce take-home pay by the amount of the joint income tax and SSC paid to government. On the cost side, they raise the cost of Labour by the amount of the SSC and by any other work-related benefits such as Cost of Living Allowances and paid leave.

For example, an increase in the Social Security Contribution from the present 10% to say 12% would reduce take-home pay by a further 2 percentage points

and increase the cost of labour by an equal amount. Accounting solely for this measure, there is a gap of 24 percentage points between what a worker receives in wage and what is paid by the employer. Any income tax pay due will reduce further take-home-pay; and paid benefits, such as holidays or sick leave, will top up the labour costs. In turn such measures could influence the degree of competition of a particular sector. Recent data suggest that Malta's competitive position on the international markets was deteriorating. (Vide Section 1.1 (x) above).

Measures aimed at rendering sustainable the pension and health sector would be reflected in social security contributions and hence on the cost of labour. According to the Commission's evaluation, the measures proposed in the 2017 Draft Budgetary Plan to increase pension income and improve the financial sustainability of the healthcare system may not be enough to render these pensions and healthcare programmes sustainable. As yet there are no long-term budgetary projections. And 'Malta's Draft Budget Plan does not include any measure affecting the tax wedge on labour' (page 5, par. 13). This means that the impact which measures aimed at strengthening the provision for retirement and the healthcare programmes will have on the competitive edge of Maltese industry and service providers remains an unknown.

There is a big challenge ahead, indeed.

3.2.3 Supply Considerations: Summary

Supply side considerations focus on the contributions to output by people as entrepreneurial investors and employees. These inputs are conditioned by a society's

culture regarding family formation and culturally-determined gender roles in the home and outside. Legislation ruling Small and Medium sized Enterprises (SMEs) and family businesses in Malta is motivated by this historical framework, and adapted according to emerging social norms with the aim of conserving wealth as a base for future income generation. Company formation, capital sourcing and amount, and statutes regarding inheritance are all somewhat related to the preservation of a 'family's' wealth. From time to time, this model is reconsidered through State direct intervention in the productive process, and the forms adopted for such State or State-Private business co-operation ownership and operation models.

The Supply of labour and enterprise is bound to be conditioned by the gender, age and skill configurations of the population. These three demographic features determine the number of personnel available for work at any one time. Labour Force Surveys have the specific objective of tracking these features, thereby assisting potential labour-seekers to identify skill gaps and seek a remedy for shortfalls.

The Maltese population in 2014 was estimated at 401,668. Overall there are more females than males, but this result is the outcome of a relatively higher number of women in the 70 years plus age bracket. In the cohorts till age 60, there are more men than women. This result is upheld even when one accounts for registered foreigners. Males exceed females in those age brackets relevant for labour market considerations. The total population in the Maltese Islands was given at 429,344 in December 2014.

Labour force participation has increased steadily in the past few years. The share of employment in the total population aged 15-64 is now 65.7%, up from the 60.8%

in 2013. The male activity rate is 78.3% while the female participation rate is 52.5%. Full-time employment recorded a peak of 162,641. Employment gains were spread over all age-brackets, except for the female age-cohort 15-24. Their participation rate fell from 44.4% to 41.7%. Of interest is the increase in the activity rate of the persons aged 55-64: 62.9% of males and 24.2% of females in this age bracket remained active in the labour market. If this behaviour continues, then the local labour supply could be extended further following the projected increases in the coming years in the pensionable retiring age.

The domestic supply of labour was augmented by immigrants. It was their input which facilitated the recorded annual growth rates in the economy in the past decade. Indeed, skill shortages are now considered to be a potential bottle-neck by industry. And the immigrant stock has been transforming itself over time. There has been a declining share of higher end and a rising share of lower-end occupations. The number of Managerial, Professional and Technical Staff increased from 1,400 in 2000 to 8,400; but their relative share declined from three-fourths to less than half. Conversely, the proportion of foreign workers engaged in elementary occupations and in the clerical and support duties rose from 7.5% to 24%. This pattern differs from that registered for the Maltese work force. There is bound to be a series of as-yet unidentified impacts generated by these two contrasting labour force trends on economic activity and social life in the Maltese islands, and especially in Gozo. Gozo has a registered population of around 30,000; one-fifth of them are over 65 years.

Gender, apart from age, also classifies the work force. A survey on shift work reveals particular traits of workers who undertake shift work as a full-time employment.

One in five employees works on shift. Male workers are more prone to select activities which are comparatively better remunerated, offer scope for time flexibility, but may generate adverse effects on workers' health arising from abnormal hours. Understanding who works where and when is a valid starting point for identifying work patterns which have to be addressed effectively in the interest of generating a continuous supply of personnel. There is a wide variety of economic activities which depend on shift work. They range from several sectors in the public administration to the wholesale and retail, transportation and storage, accommodation and food services sectors.

And, in the end, all such activities are influenced by the Government's stand on taxation and expenditure. The importance of this fiscal condition assumes greater weight in the context of the plan to 'deepen the EMU'. Malta may have to adapt to the vision of a greater tax convergence in the EMU and a more stratified way of spending these tax revenues. Like immigration, taxes have a life of their own: they are seen to affect incomes and expenditures in one way, but over time they create their particular side effects on various sectors of the economy. They condition human behaviour in a manner which may have no direct bearing to the original intended effect. Thus, what would have started as a way to reduce Capital Gains Tax would over time lead to the extensive use of barter in the real estate sector. Such behaviour will render incomplete the interpretation of financial data given by the banks on real estate funding. A share of construction development will not be financed directly from bank loans but by barter agreements between the respective operators.

Besides, adapting to tax convergence in the EMU, participating in international exchange of data across

borders, and rendering sustainable Malta's retiring pension schemes and health sector could affect the values of several key economic parameters. These include the absolute and relative size of the government's net budgetary balance, labour cost and Malta's competitive position. They could widen the tax wedge on labour, as the EU Commission pointed out in its Opinion on the Draft Budget for 2017, and induce unforeseen repercussions in various economic sectors as a result. They will condition adversely the life style of many.

Economic analyses are carried out as a means to an end. People produce and consume in order to improve their well-being. The data presented above suggest that the Maltese had generated higher flows of goods and services annually, exported more commodities, consumed goods and services in greater volumes, and considered from a macro-economic standpoint they have been doing relatively fine. Therefore, the next step in the analyses will be to address the personal and social dimension and view the 400,000 Maltese in their interaction with life. Instead of being considered as producers and consumers, they are assessed as individuals in search of life fulfilment.

This exercise is carried out in Chapter Four.

FROM NUMBERS TO INDIVIDUALS IN SEARCH OF MAXIMISING WELL-BEING

So far analysis focused on economic parameters which are grouped together in a model synthesised graphically in Diagram 1 in Chapter Two above. The series of decisions taken by the many persons involved in the multitude of transactions undertaken daily in the markets for goods and services are meant to improve one's life and enhance one's position in society over time. One can think of these transactions as underlying the production possibility frontier depicted in Diagram 2. Such dealings are themselves conditioned by the corpus of legislation under which they take place and by the cultural influences that prevail in the particular markets. They 'determine' the volume of commodities in circulation.

Present legislation reflects the perceptions of society on personal welfare, local production and trade of a past generation of law makers and judges. However such discernments still have important bearing on the future. In Malta's case, present statutes are in part reflective of the views prevailing in the European Union and in the euro-zone. So, the legal background to production, trade and personal relationships is bound to become more responsive than hitherto to influences from outside Malta.

But, in the end, the result is the same: it affects directly the wealth and income generation potential of different socio-economic groups in the Maltese community/economy. Therefore, it also concerns their well-being.

In the process, it is bound to influence, and at the same time be conditioned, by the political decision-making structures in Malta, the so-called 'ballot box' approach to output generation and financing. The political system dealing with resource allocation, personal support and the enhancement of social well-being complements the private market in determining total national output, its composition, distribution and eventual ownership of the resources thus generated.

Viewed in this context, the role of the government's budget assumes another perspective from that of transferring resources from the private sector via taxes and charges and injecting them back again through recurrent and capital expenditures. Besides raising revenues, taxes are regarded as instruments to induce changes in the choice of consumers' preferences for commodities in the many private markets. They also enter into suppliers' decision-making regarding the combination of resources (technology, capital inputs, raw materials, and labour) to compete profitably. In this context, taxation is deliberately meant to be non-neutral by the policymaker. And so are selective subsidies. From a market perspective these policy instruments are used in such a way as to render them market behaviour changers. As a result, the welfare of all those involved in these transactions is modified, either positively or negatively.

And by 'those involved in the transactions' one does not refer solely to the producers and consumers engaged in the exchange but also to the other persons (being consumers or producers) that get directly involved by

the decisions made by other individuals. These effects are referred to as 'externalities', which may be defined as the direct impact on third persons' welfare that arises outside the market system from individual decisions taken on what to buy and consume and on 'what, where and how' to produce a good or service.

Estimating the value of such external effects is a complex matter, and will remain subjective depending on the approach adopted and the data at hand. Their monetary estimate could therefore be conditioned by the analytical proclivities of the assessor. The future efficiency of a country's productive system and the welfare of various sub-groups in a community could thus be put at risk (Delia, 2012). Such valuations are an extension of the measurement of the economic surpluses in demand and supply illustrated in Diagram 3 in Chapter Two above.

The intrinsic value of these surpluses also reflects the set of rules that regulate production and exchange. Policy makers can therefore influence the ultimate financial value of third-party effects by specifying at law the entitlement rights favouring one group of consumers/producers instead of another. In doing so, they transfer the eligibility to pay compensation from one group to another. For example, the Maltese government and parastatal organisations were in the past exempt from paying compensation for harmful third party effects arising from the services sold (e.g. public utilities) or distributed at zero price (like medical treatment) to their citizens. Payments made by government were always considered to be 'ex gratia'. But this position is no longer valid. In fact, the Maltese government and parastatal companies have been found guilty by Maltese Courts of Law and the Human Rights Court in Strasbourg of infringing human rights or of failing to offer the quality

of service expected at law. They had to compensate those persons whose claims were upheld (Delia, 2006a: p. 47-68).

State subsidies could be introduced to encourage the production of commodities which generate positive external effects, like 'clean technology' to produce electricity or the restoration and preservation of cultural sites. Conversely, taxes could be applied to render more expensive the production and consumption of commodities deemed detrimental to a healthy, fulfilling living. Charges imposed on alcoholic drinks, beverages with high sugar content, tobacco products, fuel-guzzling cars and over-congested roads are in part meant to discourage the excessive consumption of such goods or utilities.

And the same two instruments could be used to influence personal behaviour regarding those goods and services which are exchanged through the private markets but whose consumption is socially considered to be inadequate. These commodities are known in economic literature as 'merit goods'. So they are supplemented through the state's budget, some of them in a big way at a price of zero; they are 'free' of charges. These services include social security schemes, health, education, culture and more recently the environment. As pointed out in Section 3.1.1 paragraph (xiii) above, Social protection, Health and Education absorbed around 60% of the annual Maltese government expenditure in recent years.

The 'ideal mix of public-private production and provision' has been a debatable issue world-wide for the past century. There is no one fixed rule to follow; there are several combinations of schemes meant to preserve freedom of choice in deciding on the production/provision of a service, method of financing, and its sustainability.

Different countries tested various approaches to the provision of basic services in social security, health and education apart from such public utilities as transport, water supply and electrical power generation.

But, in the end, what is important is to establish two key facts. Firstly, did past tax-expenditure schemes coupled to private sector commitments generate the necessary capital infrastructure and labour force complement to support a sustainable, competitive economy? And, secondly, did this wealth and income creation mechanism, followed by direct government intervention through the annual budget, induce a more socially-acceptable welfare distribution? In short, referring to the local situation, is today's Malta better off economically and welfare-wise?

Modern societies are being judged in terms of this welfare-efficiency combination criterion. But a particular society's welfare is nowadays more intertwined closely than in the past with that of the rest of the world. And many fail to understand this relationship and dependence. Therefore it could be a cause for political alienation and policy disorientation. Consider the Malta case.

Historically, post-independence, Malta could be selective in its choice of international agreements, legislation, time-frame for implementation and identification of the 'optimal' welfare-maximising policy tools. In certain defined instances this position is no longer tenable. The choice of tax instruments and product-directed subsidies, which may be correlated to a sector's competitive stand, is no longer solely in the hands of the Maltese law makers and public administrators.

Witness the ongoing debate on the future of Malta's national airline, Air Malta, following the stipulated time limit set by the European Commission for government aid to this company. Many Maltese, like others in the EU

member states, fail to appreciate the logic of imposing a time limit for state support. The domain over which the efficiency and employment objectives will be assessed is level-playing in an EMU/EU context. If such a position is considered to go against the interest of a company and its stakeholders, thereby rendering such a course of action politically unacceptable to the present electorate, then this position will be challenged. And with it, EU membership itself will be queried. Indeed, issues like these led the British electorate to the Brexit referendum in June 2016.

Efficiency criteria are generally measured by the series of parameters introduced in Diagrams 1, 2 and 3. Welfare criteria refer to the quality of life in a community. They account for factors which influence the well-being of both the individual and of 'groups', this latter term referring to group formations of different sizes, starting from what is termed 'a household' to bigger formations referring to ethnic groups, institutions, localities, regions, nation states, and 'unions'. The bigger the 'group', the more complex becomes the definition of welfare and the research ability to assess it overall.

Such analyses are carried out in terms of a series of parameters which are grouped together to form an 'index'. There are quite a few indices around, 'describing' a country's position regarding such states as well-being, poverty, gender equality, educational attainment, attraction to investment, and corruption. Reference to the 'Corruption Perception Index', and Malta's placement in such an index ordering, was made in Chapter 1 above. Although the properties synthesised by any one of the above or other indices are often discussed on their own, all of the attributes covered by the respective indices refer to the same group of people at any one time.

The following section brings together a series of data which record various traits identified in the Maltese population in recent years. Such characteristics refer to the following: personal status, financial independence, health, education, well-being, and human rights. Today's generation of Maltese is the 'product' of all decisions taken in the past in the home and in society regarding their vision of life and living, with their ordering of priorities and efforts to attain the objectives as ranked. In the end, the most important consideration is their overall assessment of what they have achieved so far: whether they are satisfied with what they have accomplished and what do they expect from the future.

4.1 Demographic Characteristics and Related Policy Implications

4.1.1 Age, Gender and the role of Grandparents as carers of the young

The age and gender configurations of the present Maltese population have been addressed in Section 3.2.1 above. In brief, overall there are more Maltese females than males in the population of 401,668 recorded for December 2014. But this result reflects the high incidence of females in the 70 years plus age cohort. In the age brackets 0-59 men outnumber women by around 6000. This result holds even when one accounts for the number of foreigners who reside in the Maltese Islands. This gender characteristic has important implication for the labour markets and, in two decades time, will result in a retired, elderly population that will have many more men than hitherto. It is therefore timely to address the impact of such a novel gender phenomenon for services

to the elderly. So far Malta has had to address such an issue with females in mind, together with the life-skills they bring with them. This position has to change. The roles of men and women in the home and in society have been so far distinctly different for persons in these age groups.

It is not just the gender of future retirees that merits consideration by policymakers. There are more subtle social nuances at work which could affect in various ways the development of many individuals, both young and old. These emerge from the evolving role which grandparents, often retirees, are fulfilling in today's society mainly in providing care for their grandchildren.

So far, grandparents have been considered primarily as a resource to support their children with the financial collateral, arising from their savings, to set up home. But gradually they assumed the role of carers for their grandchildren: fee paying childcare centres are insufficient to meet the demand, and, of course, they are considered a cost of rearing a child. Publicly provided caring centres did mitigate somewhat the supply restraint, but the problem still exists. So grandparents fill in reliably a care-service void.

Indeed, it was already evident a decade ago that they may have been bearing more than they could carry effectively: they were being taken for granted by their children who seemed inclined in carrying on with their life and shifted the responsibility of their children's upbringing on the grandparents, all the year round. This attitude was causing undue stress on the grandparents. One writer, a medical practitioner, even claimed that children were 'being dumped' on their grandparents to the detriment of the latter's health and welfare (Mallia, P., 2009; Delia, 2010: p164-169).

This set up could have been a time-and-cost-saver for the parents, especially when two sets of grandparents could be relied upon to support. But it did entail one basic consideration regarding the upbringing of the young: there are cultural differences in the way grandparents evaluate life and methods of approach to it and the manner in which their own children and, even more, their grandchildren chart their expectations and ways of fulfilling them. There might be a 'clash of cultures' taking place steadily every day in the home. This 'clash' may not necessarily generate a healthy personal development. And it may lead to some of the upcoming young being totally unprepared to face effectively tomorrow's world.

Over time, as younger cohorts of grandparents assumed these caring responsibilities, the 'stability' which was meant to be offered by the older retirees could have been indented. As social mores changed over the past few decades, the young ones, especially those coming from households which faced uncertainty from uneasy relationships in their parental homes, could move into similar situations in the homes of their grandparents. Such circumstances would impact on the young, especially those children who are more sensitive to such environments than others. And such situations bring added strain on the grandparents who themselves would have to cope with their own 'unsettled' lives.

But another sub-category of potential grandparents could be emerging. Following the decline in the number of births per couple, with some opting for no children, there are bound to be instances where parents will never become grandparents. Maltese society would have switched from the multi-layered extended family structure to one where parents do not make it to the grandparent state. This may not signify much for many, but it could mean a delusion

to some. Indeed, this state of 'termination' of a family line has been adopted by the Danish government for a publicity campaign to encourage Danish couples to bear more children. This sub-group of retirees could consider such a state as a factor inducing loneliness throughout the rest of their lives.

Solitude has always been a threat to the well-being of the elderly, mainly female in Malta. Recent surveys identified loneliness as a prime condition affecting retirees in Malta today. Thus, in the village of Dingli 'more than half of the elderly interviewed who lived alone had felt the brunt of solitude in recent months. Most of those who suffer from loneliness had mental health problems (Martin, 2016)'. These retirees were the ones who usually cared for others when younger; this was the praxis at the time. But now they were not finding that same level of support being shown to them. This situation alone would be a negative element in the way they would net the balance of their life achievement.

But, as pointed out above, this gender component in the life of retirees is bound to change in the coming two decades with many more males in the 65+ age group. It will be speculative to spell out the reactions of future male retirees; they may enter into new relationships, for example, to extend further their social involvement. After all they are the present 50+ cohort, exposed to the new legislation ruling several types of interpersonal relationships, situations which were unknown to most of the present retirees. But these are scenarios which social policy makers and practitioners have to anticipate thus rendering life meaningful for all.

The Dingli survey also suggests that apart from loneliness, retirees may also experience financial stress. This consideration is developed further below.

4.1.2 At-Risk-of-Poverty, 'Two-Thirds Pension Scheme', 'Minimum Essential Budgets' and Wages

Section 1.1, paragraphs (xi) to (xvi), addressed the characteristics of those sub-groups in the population that are considered at-risk-of-poverty. Such disadvantaged groups include young children, single parent households and the elderly. These last two categories are on the increase.

Exchanges on such results generally include suggestions related to personal or household income generation and increments. In the case of retirees, the case is repeatedly made for the reconsideration of the social security pension, the so-called 'Two-thirds pension scheme'. While in the instance of family measures, the suggestions include the identification of a family's 'minimum essential budget' and relate the national minimum wage to the result thus derived (Caritas, Malta, 2016). Consider these two proposals.

The present retirement pension system was introduced in 1979 to replace the systems prevailing at the time. It supplanted private company pension schemes and the social security scheme with a system which promised to yield future pensioners the equivalent of two-thirds of their income. National insurance contributions were increased accordingly, and they were to be further boosted by another mandatory contribution to finance the health budget. The highest pension was pegged to the salary of the President of the Republic. The scheme was run on a 'Pay As You Go' system.

The project that was actually implemented diverted from these pronounced objectives. First of all, the additional contribution to the health budget was never enacted. Since no additional funds were received by the Treasury to finance the public health budget, surplus funds

in the pension account had to be transferred to the Health account. This movement meant that the accumulated fund which was meant to be created to make good for the increasing number of retirees and their pension bills never materialised. It followed also, that there was no such fund for the health sector to accommodate higher future costs of providing subsidised health services to a greater number of elderly.

Secondly, the contributions and the related benefits were capped. This meant that the initial relationship between personal wage income and retirement pension was broken. Over time, as incomes increased, the gap between wage income and pensions got wider. If the initial maximum pension income – €15,723 – was revised in line with price movements, this would now become €34,000. The correspondent pension equivalent would more than double: from circa €10,400 to €22,450. The mooted second-third tiers pension contributions are meant to boost personal saving today in order to generate higher income in the future, over and above what one is entitled to from participating in the social security system (Delia, 1998; Mallia, C., 2016).

The only class which succeeded to sustain its income-pension relationship is the political group. Maltese parliamentarians and government ministers are entitled to a variable pension related to the respective remuneration tied to a post at any one time. Pension entitlement of EU officials and MEPs are subject to similar conditions. Hence the interest of many Maltese in participating in EU administrative structures; it pays to get such engagements both during the tenure and later on retirement.

It is small wonder that the pension and health/welfare debate is becoming more intrinsically associated with the risk-of-poverty issue and with the competitive positions

of Malta-based industry. As the EU Commission pointed out in its recent appraisal of the Maltese Government's draft budget submission for 2017, one has to address the impact which measures aimed at strengthening the provision for retirement and health care programmes will have on the competitive edge of Maltese industry.

A similar conclusion seems to have been reached in relation to the role which changes in the national minimum wage may have in reducing absolute poverty in Malta. The debate was once again triggered by a publication (Caritas, Malta, 2016) which updated the estimate for what is referred to as 'Minimum Budget for a Decent Living'. The study established three reference values for different households. In a separate exercise, such amounts were compared to various welfare support packages. It was observed that 'households with dependent children or on Social/Unemployment assistance and applicable benefits/allowances do not have an adequate income in relation to the established researched minimum essential baskets' (Ibid: p.9).

Following this conclusion, there was a call by various groups to reconsider the national minimum wage (NMW) and other measures meant to sustain households' real income, such as the COLA, the Cost of Living Adjustment mechanism in place. The subject was debated at the Malta Council for Economic and Social Development and two basic reports submitted for the consideration of the social partners represented on this Council. Employers' representatives advised caution, because changes in a basic wage parameter as the national minimum wage would surely imply additional collateral effects on the rest of the wage vectors prevailing in the various industrial sectors. Other representatives felt that a modest increase in the NMW over a three-year period was sustainable.

Initially, the Government took a cautious approach to this matter, meaning that it was sensing the impact of such measures on Malta's competitive position. As pointed out in Chapter 1 above, data on the Harmonised Competitive Indices showed a deterioration of Malta's competitive position. But once the party in Opposition declared that it would consider following the suggestion of revising the national minimum wage, the Government changed its stand and initiated talks on this subject.

It turns out that the two reports submitted for the consideration of the MCESD posited two contrasting leads: one in favour of increasing the NMW, the other being more wary in its conclusion. So, as usually happens in such national fora, a compromise was found: this compromise actually postpones decisions and calls for other studies before a tentative conclusion on this matter can be reached. In simple terms this means that the report writers have shoved the matter in the domain of the policy maker.

The main conclusions of the findings and recommendations submitted to the MCESD were the following (Micallef, 2016).

"A minimum wage increase would not address absolute poverty but would help in mitigating the effects of relative poverty among those already in employment.

The revised minimum wage should be determined as follows:

*Social partners must first agree on a fixed ratio pegging the minimum wage as a percentage of the average wage

*Once in place, the Cost of Living Adjustment mechanism should be retained

*In cases when the Cola-adjusted minimum wage would still be below the aforementioned fixed ratio, additional wage top-ups would be automatically triggered to bring it in line

The upward minimum wage revision must be accompanied by:

*Measures to safeguard competitiveness

*An evaluation on its fiscal impact

*A long-term future-proof cost of living mechanism

*The setting up of an MCESD committee to focus on low-wage earners”

In short, commission more studies and pass on the buck to someone else. This may seem to be a cynical conclusion. But anyone familiar with labour market economics will know that there is no hard and fast rule to guide policy makers in reaching ‘reasonable, fair, and sustainable’ values of such parameters as wages. In the end it is the organisational structure with its own related costs that matter for a firm’s survival in the markets it competes – of which the rate of exchange, taxation, and cost of capital are generally outside the domain of the firm.

For many producers these parameters are given. So they react by ‘re-inventing’ themselves within the legal constraints to which they are subjected. They may cut hours, bonuses, overtime or perks to mitigate the cost of higher minimum wages. Work places may be ‘fractured’: wage decisions will be replaced by competitive contracting decisions. Such behaviour may explain why real wages remain stagnant for low-skilled workers in the developed world (Weil, 2013; O’Connor, 2016).

In brief, economists do not have a fixed view on the impact of minimum wages on economic activity and family incomes. The goals of the minimum wage are widely accepted as proper: redefine the wage structure politically to achieve a socially preferable distribution of income. Minimum wage laws are usually judged against the criterion of reducing poverty. But their effectiveness in attaining these goals is disputed.

In theory, one can draw a list of the positive claims – enhance living standards of vulnerable groups; motivate workers to work harder and increase the work ethic; stimulate consumption by raising households income; reduce public sector welfare costs in transfers to families – and balance them against negative effects – exclusion of low cost competitors from labour markets, hence they are discriminatory; hurts small business more than large business; reducing overall labour supply; potential cause for inflation; discourage education among the poor by enticing people to enter the job market.

Empirically, the situation is even more uneasy. Disagreement usually takes the form of competing empirical tests of the elasticities of demand and supply in labour markets and the degree to which markets differ from the efficiency that models of perfect competition predict. And, ironically, the human element referring to the personality of the workers or their households disappears amidst data bases and statistical biases (Delia, 2010: p.142-151).

Studies can therefore support either one view or another, depending on the particular market situation and the point in time in which such decisions are to be taken. As observed above, some Maltese analysts concluded that a three-year modest rise in the NMW would not break the system. But the two reports submitted to the MCESD added other considerations that have to be looked into. Since policy makers may themselves have other objectives in mind beside those related to the subject under discussion, one is never certain that the reason for making a particular decision has been based on any one specific study commissioned or on other criteria.

One point is certain: it is not sufficient to identify an issue and try to resolve it on its own. The synthesised

position illustrated in Diagrams 1, 2 and 3 in Chapter 2 above point out at the holistic nature of economic activity and social interaction. Partial analyses and solutions may be of a temporary nature, but they may generate long-term effects on the work and relationship ethics of a people and, accordingly, on the long term sustainability of a 'fair' and competitive production structure.

4.1.3 Marriages, Evolving Family Perceptions and their Outcome

One social institution that stood out in Maltese society was the formation of a family (household) following marriage. The way the Maltese look at marriage has been changing over time, and legislation has come to reflect such views. Divorce and same sex unions are now on the statute bill. And they are bound to be reflected in social statistics.

Official data (National Statistics Office, Malta, 2016c) record an annual fluctuating number of marriages. But, since 2010, they ranged from a low of 2,562 in 2011 to a high of 2,871 in 2014. These data yield a Crude Marriage Rate [CMR] (Number of marriages per 1000 population) ranging between 6.1% and 6.7%.

Over the same period, the number of Civil Marriages increased steadily from 847 in 2010 to 1388 in 2014 (Ibid: Table 5.1, p.83). In 2014, 48% of marriages were contracted under the civil code. However, the number of Maltese who contracted civil marriage is lower: 461 grooms and 366 brides. Still these numbers are higher than they were in 2010 when they amounted to around 300.

However, marriages between Maltese amount to around 60% of the recorded total. Thus, in 2014, Maltese grooms numbered 1,795; they make up 62% of total marriages. While there were 1,720 Maltese brides, representing

59.9% of marriages. So, if one takes the higher number for grooms, 1,795, and relate it to the total Maltese population, the CMR in 2014 falls to 4.5%.

Traditionally, one would have relied on such statistics as representing the factual formation of new household units. But this is no longer the case. Maltese may co-habit and as such they would not be included in the registered marriage records. Such classifications may be attended to in the next Population Census.

One feature is certain: the available data for 2014 indicate that the actual break-up of a marriage could take place at any one time. The number of couples that sought divorce in 2014 – a relatively new legal facility – amounted to 399. 4% of these occurred within less than five years of marriage; 12% between 5 and 9 years; 39% between 10 to 19 years; and 45% for marriages lasting longer than 20 years (Ibid: Table 5.20, p.99). This last number could reflect the fact that divorce was not legally available before, unless one wanted to resort to seeking such a ruling outside Malta.

Data also suggest that marriages occur between persons of different statuses. And this comment applies to both grooms and brides. So a groom who is single may marry a bride who may be herself single, widowed, divorced or whose previous marriage has been annulled (Ibid: Table 5.4, p.86).

The above data refer to a single year, 2014. But it is evident that Maltese society has surely modified the 'traditional household formation model regarding marriage and related rights and responsibilities' with other forms of life-sharing units. In turn, these new unions are bound to re-inforce selective strands of perceptions regarding personal behaviour, attitudes towards relationships and mutual comprehension and support. They are definitely

bound to influence the views of the present generations, but perhaps more so, those of the upcoming young ones.

The role of the legislator cannot be emphasised enough in such a critical transition period in the life of a community. Future policies referring to the upbringing of the young, education, health, provisioning for retirement including asset ownership as collateral savings, will have to account critically for these social developments. The future of many individuals depends on such considerations. Similar statements have been made in the past. Yet it is now evident from the emerging data that the incisive actions needed to countervail these social forces and rebalance 'personal and social equilibrium' were either absent or less effective than expected by the policy makers.

Researchers in the nineties on the family in Maltese society emphasised that the family was 'strong' and provided support and formation to the individual. They pointed out that two out three families were satisfied with their home life (Tabone, 1993). But enhanced living standards, faster means of communication and transportation, increased social mobility especially among the upcoming generation, the financial independence of women, and the erosion of religious values: such factors had a critical bearing on the formation of new family cells and intra-family relationships.

Within a decade a substantial number of Maltese stopped identifying themselves with the Catholic Church, and adjusted their views on family-related matters. Data for 1984 indicate that 94% of respondents to a survey on values considered themselves religious; this figure fell to 55% in 1995. Moreover, the share of those who claimed to be 'non-religious' increased from 4% in 1984 to 46% in 1995 (Abela, A., 1995). The result of the consultative

referendum on divorce and the enactment of several statutes regulating marriage and cohabitation post-2010 have their roots in the changes in social perceptions and mores of the 1980/1990's.

For these studies did suggest a growing uneasiness with the 'traditional' family set up and an urge to break loose. The research results indicated that one in three respondents had marital problems. Only 6 out of 10 respondents felt secure in their marriage. And the number of Maltese who claimed to be 'completely satisfied with their home life' declined from 76% to 60% between 1991 and 1995, a difference that was statistically significant. Moreover, only 65% of respondents would get married again if they had to start afresh; 23% would not remarry while 12% were doubtful (Tabone, 1993).

A sense of disillusion with the family may be a direct outcome of the shift away from conformity to traditional values – such as religious beliefs, children and interests in common – to the more intrinsic values of self-fulfilment, mutual respect and a happy sexual relationship. At the same time there has been shift in culture concerning the role of women in the family: as years go by fewer women feel the need to become mothers or to stay at home to be fulfilled (Abela, 1995).

It seems that from the perspective of adaptation to such role changes in the home, at work, and in society in general there is still a lot to be done. There cannot be a generic application of 'educational approaches' to such an issue because research suggests that there are life-skills deficiencies which impair personal relationships at home and at the place of work, and there are also regional discrepancies in life-styles and welfare.

There are no short cuts to attaining changes in personal attitudes of respect for, and co-operation with, one another.

It is perhaps significant that the co-operative model of organisation has not really been successful in Malta despite all the attempts made by Governments to encourage such an organisational structure (Delia, E.P., editor, 2006b). Similarly, voluntary work is gradually giving way to paid services and cases of corrupt practices are now perceived by the Maltese to prevail in all sectors, including trade and industry, sports and charity. Anecdotal evidence is on the increase which goes to support such perceptions. These distinct indicators possibly emanate from the same source: a society in transition which may be struggling to identify clearly the objectives it wants to attain resulting in weak social networks.

Although hard evidence on family life may not be readily collated, because many victims of domestic violence tend to suffer in silence, data by locality suggest that the incidence of such actions may be reduced through stronger social networks (Callus, 2016). The number of cases of domestic violence reported at police stations increased from 228 in 2005 to 1,393 in 2015. They refer to both female and male victims.

And families are not solely the providers of positive thinking and support; they may also promote crime. In a recent study assessing intergenerational continuity in offending, it is claimed that Malta's prison population is 'flooded with criminal families that ply the trade of their parents and/or other members of the family' (Formosa Pace, Janis, 2015; Dalli, K., 2015; Azzopardi, A., 2016).

Such scenarios indicate the precarious situation that children find themselves in. They are always the losers unless their interests are cared for in time and effectively by their family or by the community at large represented by public and private voluntary institutions. Such caring starts pre-birth and continues thereafter. As pointed out in

section 4.1.2 above, they are considered a disadvantaged group prone to fall within the risk-of-poverty category.

Intervention on behalf of the child's interest takes place because of societal belief in the intrinsic value of life. Besides, there are additional external benefits that accrue to the community at large from a person's contribution to economic and social activities. Communities support child development through tax financed health, housing and educational programmes. Children benefit from such projects. Governments also complement families' incomes through various cash transfers and income tax credits so as to bolster households' capacity to provide for children's upbringing.

So when many are seen suffering for one reason or other - whether they are children, elderly people, single parents, the unemployed, employees under stress especially low real-wage earners, or entrepreneurs whose business is in serious difficulties as a result of various policy measures undertaken – then it is reasonable to assess the validity of the political, economic and social strategies adopted to date.

The Maltese government's commitment to such programmes has been described in section 3.1.1 above. This is not being queried. It is rather the effectiveness of such outlays to attain the stated goals of the specific programmes which is under scrutiny.

For policy makers and administrators cannot ensure that these schemes produce the desired results. Judging from the observed traits of behaviour within Maltese families, this is definitely not always the case. Indeed, the data discussed so far already indicate that there is still a long way ahead before it can be claimed that the resources being allocated for the welfare of the community are reaching effectively their goal: the enhancement

and sustainability of personal welfare. When further consideration is made of the health and educational profiles of Maltese, such impressions are reinforced even more. Hence the need to re-assess the way in which goods and services have been produced and/or provided by the public and private sectors in order to maximise the effectiveness of the respective single programmes.

Education in its general form – imparting life skills, cultural involvement and technical knowhow – is proposed as a vehicle to prepare an individual for life. It has its informal and formal dimensions. It starts in the ‘home’, continues in the ‘streets’ (‘the university of life’) and is reinforced and/or adapted in educational institutions. But one has to distinguish between imparting behaviour or knowledge and acting on such information and guidelines. One example suffices to show the difference between imparting knowhow and applying it.

In a survey on the effectiveness of an EU-sponsored programme promoting healthy eating in Maltese schools, the following behavioural pattern emerged. 80% of parents know that the regular consumption of fruit and vegetables leads to a healthy life. 20% did not know this, despite the on-going information campaigns to impart such a message. However, only 60% of parents consume regularly fruit and vegetables themselves. And, this percentage falls to 40% when asked whether they give their children fruit and vegetables.

The moral: the message conveyed by the healthy eating programme – advertising campaigns, seminars, and regular distribution of packages of fruit and vegetable in schools – is estimated to have reached around 80% of Maltese parents. Yet, these parents for various reasons did not follow up the message themselves – only 60% did so. And still, what is even more important when referring

to the upcoming generation, only 40% strove to impart healthy eating habits to their children. Knowledge alone does not necessarily lead to the desired action especially when one is referring to inter-generational transmission of lifestyles and values.

This behavioural pattern may be observed in the sectors of education and health. There are presently contrasting indicators in both sectors which may be the result of one common factor. Over time, reports have indicated specific lines of actions: they identified the main issues, proposed action programmes, and indicated the key players to pursue them. Every report starts anew and follows the three-step sequence just described. By now it should be evident that the key limiting factor rests with the units entrusted with the implementation of the programme – the regulators and the administrations. In Chapter 1 above, we referred to regulatory ‘mirages’: these organisations exist but they are not exercising effectively the tasks for which they have been set up. Unless their shortcomings are attended to, the desired enhancement of people and their welfare will remain an evasive objective.

4.1.4 Education and Health in the Maltese Islands: Services and Results

Education

The demand for State educational services, and therefore the supply of such facilities, has been marked by a radical change over the past two decades. In part this reflects the emergent demographic profile of the 0-15 age brackets. The number of births has been falling over time, compensated in part by an increasing number of foreigner workers and their families who settled in Malta

in the past decade. In part, it reflects a small shift towards fee-paying independent schools and the state-financed Church schools.

Indeed, state primary schools saw their pupil population drop from 21,311 in 2000/01 to 13,740 in 2014/15. State secondary schools also registered fewer students over the same period: from 18,572 to 11,495. There were 14,648 fewer students in state schools. Church schools increased the number of pupils in primary schools; there were 7,585 students last year. But they had fewer students in their secondary schools, 7,027. The independent schools registered 3,000 pupils in the primary grades and 2,745 in the secondary.

The situation in the tertiary educational sector is different. Enrolled students increased; there were 10,000 in 2009/2010 and 13,216 in academic year 2014/15, of which 12,397 were Maltese and 819 foreigners. Female students numbered 7,388 and males 5,828. Both in terms of numbers and gender distribution, the attraction of tertiary education seems to have become entrenched in the Maltese psyche. In fact, the percentage of 'early school leavers', defined as persons aged 18-24 who have achieved lower secondary level or less and who are not in further education, has fallen to around 20%.

These data highlight two aspects related to the labour market and culture. Firstly, since more young people are pursuing higher academic studies, they expect to be eventually remunerated for their additional commitment. But such reward does not depend solely on academic training but, more so, on the demand for skills in the respective labour markets. If supply continues to grow without a corresponding increase in demand, then such expectations may not be fulfilled. Graduates would then have to decide on working in positions which they did

not consider in the first place or move to other countries where they can command a higher return.

Secondly, there are more female graduates than in the past. But they are still concentrated in the field of education (80 % of students in this area of study), health and welfare (67.5%) and social sciences, journalism and information (62.2%). In a sense, they have kept to areas that seem somehow more compatible with a home-work balance. Education, health and welfare posts offer more possibilities – through shift work, part-time employment and holidays – to combine the role of employee and motherhood. Whether such ‘balance’ is attained is another matter. That depends on the support of the partner and, as explained in section 4.1.1 above, on family relatives to care for children.

Male graduates have a stronger presence in the fields of information and communications technologies; engineering, manufacturing and construction; agriculture, forestry, fisheries and veterinary (National Statistics Office, Malta, 2016i). Such academic studies may focus more on technical competences and less on life skills. It is the latter which play a key role in family relations. If these skills are missing, irrespective of the academic preparation, then relationships could be strained. The emerging data on marital relations in Malta refer to such situations. What may be an asset in monetary terms related to a post could be a liability in terms of human relations and personal well-being.

A recent ‘evaluation’ in terms of ‘value for money’ from spending in the educational system was made through the ‘Program for International Student Assessment (PISA)’ coordinated by the Organisation for Economic Cooperation and Development (OECD) (OECD, 2015). Countries which did well per unit of currency spent were

those who 'made teaching more prestigious and selective, directed more resources to children in most need, enrolled most children to high quality pre-schools, and applied rigorous, consistent standards across all classrooms. Meanwhile, school systems which prioritised after-school learning – such as homework, additional instruction or private study – tended to perform less well.'

The manner in which resources for education are allocated is just as important as the amount of resources available, with no firm link between increased public spending and better results. Data suggest that Maltese school children are underperforming in science, maths and reading relative to the amount of resources allocated to their education. On average, the OECD high-income countries, Malta included, spend €82,000 per student. Malta spends €107,000 per student aged 6 and 15. Yet it does not score favourably in the three disciplines (Vide: OECD, 2015: Tables M1, R1 and S1, and Leone-Ganado, 2016).

Besides, data for the local matriculation examinations for the years 2011-2016 suggest that the upcoming generation of students is losing interest in the main foreign languages taught in Maltese schools, namely, Italian, French, German and Spanish. More than 30% chose not to sit for the Ordinary Level exam in these subjects in the past four years. Indeed, in 2012, the number reached 40%. Besides, between 11% and 25% of students who applied did not turn up for the exam. And of those who did between 12% to 16% failed (Schembri, 2017).

The younger generation, meaning those aged 25 or under, is not being exposed to a third language and so struggles with learning foreign languages. Contrary to what was expected, new technology (in this case, the introduction of satellite and cable TV) has wiped out the

exposure of the Maltese to a third language, like Italian. Young people are not exercising effectively this wider range of choice. They are limiting themselves to tune to English language channels. As a result they do not become proficient in speaking in a third language, beside Maltese and English. A skill is being gradually lost.

Other data indicate that school absenteeism still exists, though it seems to have been contained in the past few years. But it is still considered high among the 16 year olds, with male students recording the higher levels of absenteeism (National Statistics Office, Malta, 2016j). Indeed, this kind of behaviour has been leading to the 'drop out' phenomenon which records the number of students who 'disappear' from the school and employment records. 300 such cases occurred in 2016 (Martin, 2017). These cases do not fall under the classification of 'early school leavers' which records the performance of youth aged 18-25, referred to above.

However, the government's attempt to fine parents who do not send their children to school has not found the backing of the teacher's union. Teachers believe the problem lies in parental skills which are missing in many households. Since young people spend more time at home than at school, the corrective guidance that formal institutions can give is proving to be insufficient to countervail the mores informally taught at home (Schembri Orland, 2016; Malta Union of Teachers, 2016).

Such data may be judged disturbing not just in terms of eventual labour market and output considerations. But, it is upsetting primarily because the well-being of these individuals is being affected, possibly negatively, for life. The Maltese society, via government, has allocated resources for their personal development. However, such enhancement did not occur. And they themselves

and society will have to allocate other resources either to remedy this position and train them or allocate resources over time to contain any harm they may commit to themselves or/and to other members of society.

Besides, the Teachers' Union is also claiming that not enough is being done to support the educational sector with the adequate complement of teaching staff. The MUT maintains that primary schools would report a shortage of 200 teachers unless immediate action was taken. It is being claimed that the present teaching staff will not be in a position to make up for the missing staff component (Martin, 2017a). If this situation reflects the true position in the primary school sector, then it is not only a question of 'quality of teaching and approach' that is at stake but also one regarding staff resources.

A similar conclusion, although in a different context, emerges from the health profile of the present Maltese community. This is briefly described in the following section.

Health

A series of reports has highlighted the urgent need to address the twin issues of obesity/overweight and diabetes in which the Maltese seem to excel. According to the World Health Organisation, Malta currently has the worst obesity and overweight rates in the EU and ranks third in the whole of Europe. Unless such situation is attended to successfully, Malta will have to commit large resources in the future on treatment of diabetes, heart disease and cancer. The WHO concluded that children in Malta 'are the most obese and overweight in more than 40 countries'. In May 2016, a study collecting information on the Body Mass Index (BMI) of students in schools in Malta indicated that 10,850 children are obese,

almost 6,000 of them in primary schools, with the rest in secondary schools. 15% of children are overweight; for girls in secondary schools the share is 17% (Cassar, 2016).

Obesity, unhealthy diet and physical inactivity – apart from smoking and poor blood pressure control – are associated with increased risk of developing diabetes. In a Consultation Document on ‘Diabetes: A National Public Health Priority 2015-2020’, the Maltese government proposed a five-year programme to promote knowledge about this condition, its potential causes and preventive measures for those types which are preventable, and ways of adaptation by those patients who are affected by it. Diabetes is associated with a variety of other conditions affecting health, and hence personal well-being.

A 2010 pilot study on the prevalence of diabetes in Malta suggests that 9.8% of the population aged 18 and over had diabetes. Based on this and other related information the document estimates that ‘the annual excess cost for hospital, primary care and specialist visits for persons with diabetes versus those without diabetes... is at least €9 million, the bulk of which is due to more frequent and longer inpatient stays’ (p.13).

And the Maltese Parliament enacted in 2016 ‘The Healthy Lifestyle Promotion and Care of Non-Communicable Diseases Act’. This Act aims to establish and ensure a lifelong approach favouring physical education, balanced diets and a healthy lifestyle, thus reducing the level of non-communicable diseases throughout all age groups’. Its positive approach should be an encouraging start to an issue which has been talked about for many years but which is evidently not properly attended to.

It has already been pointed out above that knowledge, by itself, is not enough to promote a healthy lifestyle. Parents may, or may not, appreciate the benefits of

healthy diets and physical activity. But even if they do, it does not follow automatically that they are going to abide by this knowledge themselves or, equally important, to instil the correct attitude to diet and exercise in the children under their care. Knowledge is necessary but not sufficient to guarantee a successful transformation of what may be 'deeply entrenched' personal attitudes and social habits.

This has to be stated because similar remarks were made on this same important subject in 1992 in an official document presenting the Malta case at the FAO/WHO International Conference on Nutrition (Bellizzi, Agius Muscat, and Galea, 1992). This report practically anticipated what is being written at present on this subject; it went further as it integrated economic considerations regarding food availability and the application of fiscal tools (taxation and subsidies) to encourage changes in households' dietary approach and in their consumption expenditure patterns (Ibid: Chapters 4 and 5).

Recent research on health and diets in Malta indicate that we are still at the compilation stage of data bases with the specific intention of evaluating them and continue updating them from time to time. And in the meantime, all those individuals who were hit by the non-communicable diseases had to undergo the discomfort associated with these respective illnesses and induce further negative impact on the well-being of those who are close to them.

Although progress in the medical sector had been achieved following the massive investment in state hospitals and private clinics, and associated health insurance products, yet many continued to suffer personal setbacks as a result of daily practices which lead eventually to ill-health and discomfort. One fact stands out: the incidence of obesity is highest among girls in

secondary schools. This is occurring at the same time that this age cohort is being constantly reminded by marketing firms to be physically active and sportive, be trim and take care of one's image.

Once again we are led to conclude that selling positive messages may be a relatively facile exercise. But ensuring that such communications are being effectively understood and followed up is a much harder task. And it is the success of the latter which in the end impinges on personal and community welfare.

The sum total of these 'failed messages' could mean acts of despair for some, leading even to considering and actually committing suicide. Suicide is a complex problem worldwide. Suicide rates vary from one country to another and over time. Data compilation tends to be conditioned by the religious beliefs and cultural milieu in which statistics are recorded. Thus, Mediterranean countries generally register lower suicidal mortality than the other countries in Europe.

But data suggest there are similar trends across countries. The population adjusted suicide rates in many countries tended to rise, but thereafter decline for both males and females. In the case of Malta, the recorded increase in the rates came later, during the 1980s. But unlike the other countries, the rates did not decline in the 1990s and 2000s. On the contrary, the overall low level of suicides in Malta in the past was replaced by an increase in suicide rates since those years, especially in the case of males (Helema, Holopainen and Partonen, 2014). The highest number of suicides recorded was in 2015, with 36 cases (Schembri Orland, 2016c).

In sum, there are many Maltese who have to cope with certain life disadvantages related to health, lifestyles, culture and income/wealth generation which are the

direct outcome of decisions taken by many others earlier on in their lives. For various reasons, many may have been exposed in the home, in society and in learning institutions to nutritional, educational and cultural habits which are now proving to be detrimental to their personal development and social interaction at home, place of work and at leisure. They have to deal with such disadvantages for the rest of their lives.

At the same time, many would have benefitted from others' actions. There are many instances of these. But one tends to focus more on what detracts in life because often it may be very difficult, if not impossible, to rectify certain conditions. Such direct effects of a person's action on the welfare of others are referred to in economic literature as 'externalities'. They may be remedied in whole or in part by appropriate policies and implementation programmes which could include compensation. Legislation can influence these inter-personal relationships. Statutes are generally inspired by fundamental human rights criteria which aim for a holistic development of the person. This issue is developed further in section 4.1.5 below.

4.1.5 Rights, Compensation and Knowledge Thereof in Maltese Society

There is a hierarchy of rights. The ranking represents a community's basic values. The right to life is fundamental as it refers to the very existence of a person. It precedes, say, the right to develop one's leisure interest. Personal rights are therefore not symmetrically equal from an equity perspective. Therefore a community will delineate as clearly as possible what falls in the 'pure' private domain and the manner in which inter-personal conflicting interests will be resolved. 'Purely private goods' do not really exist; all personal actions carry

with them unintended direct effects on other people's welfare.

The way statutes are written and interpreted by the courts of law will define the ordinal ranking of rights and, as a consequence, the eligibility to receive compensation in case of harm endured (or the obligation to pay compensation in case of direct benefits received). Over time, such rules will condition behaviour of both consumers and producers in a society. And all citizens are either one or the other at any one point in time.

The fact that persons have rights, acknowledged even at law, does not render them automatically immune in relation to others. A child has the right to live happily and reasonably well. Whether this condition is actually satisfied will depend on various conditions, primarily on the willingness and ability of parents or guardians to care for the young in what may be termed an 'appropriate manner'. When the child-guardian 'rights' are in conflict, third parties - including state agencies - intervene to protect the rights of the child who is always the weaker person in the relationship. Child fostering and adoption laws regulate such situations.

Similar reasoning applies in other areas. The right to live in a clean physical environment, which improves the quality of life, precedes the 'right to smoke' or the 'right to dump factory waste into a river'. Over time, civilised societies devised arrangements to enable the respective players in a 'market' to internalise these direct effects into the production/exchange mechanism. Zoning and compensation are two such operational instruments used in these situations.

Besides, as explained above in the introduction to this chapter, governments tend to subsidise those commodities which are believed to generate positive external effects on

society. Education, health, cultural activities and clean environment measures are thought to produce such impact on a community. They are therefore subsidised from public funds to encourage people to 'consume' them in larger quantities than they would otherwise have done from their own resources.

Conversely, governments aim to discourage the consumption or production of commodities which generate negative direct effects. They prohibit their free exchange – as is the case with drug distribution in Malta – or tax them in order to render them more expensive, possibly discouraging their consumption in the process. This has been the position *vis-à-vis* cigarettes and alcohol. But this reasoning could be applied to raising charges on sugary drinks and foods, certain types of fuels, or products which harm the environment.

Whether governments actually believe that these measures are taken to enhance the quality of life is another matter. They may raise taxes on such products because they want to raise revenue, and so admit that within the price range implemented the demand for that commodity remains price inelastic.

Similar arguments could be applied to the implementation of zoning or the protection of 'cultural heritage buildings' in regional planning. The way physical development actually evolved over the years indicates gaps in long-term infrastructural and transport planning which should have preceded urban development. Traffic congestion with its negative external effects – waste of time and fuel, higher pollution, rising tempers with their related health effects, especially as average temperatures keep rising slowly but steadily over time – could prove to be very difficult to address with reasonable success. The resource costs to remedy this situation could be high.

The same could be said about the preservation of sites and buildings which are considered important from the cultural perspective of the Maltese community. Such decisions are never easy. But they have to be taken after due consideration is made of the various issues involved. Preserving heritage means safeguarding the rights of future generations. But, just like children who are in a weak position in front of their guardians, so are future generations frail when confronted with the present. The voting power lies with today's electorate who has to be sensitive to certain arguments in order to preserve the national patrimony for the future. Their personal interests may prevail.

A self-centred, consumption-driven group of voters may find it difficult to understand why they should act in one way rather than another. This would be especially so if they grew up in a social environment that was not community-centric. They consider the 'collective' as a means to be exploited to their own advantage. This is after all what the meaning of 'corruption', as defined in Chapter 1 above, stands for.

In section 4.1.3 above, it is suggested that a rather radical shift occurred in social attitudes in the 1980s-1990s in the wake of rising incomes, more work opportunities outside the home, and wider contact with the rest of the world. It seems that the relevance and implications for social cohesion of these changes were underestimated, with the result that very little may have been done to 'channel' them in a structured manner. In a democratic society open to social media policy makers cannot 'control' the speed with which society adapts itself to non-traditional ideas. But it pays to prepare society for such adaptations.

This harnessing of personal and social potential has not been undertaken in Malta. The above results observed

from data on the jobs sector, intra-family relationships, achievements in education and personal health are indicative of this. Every individual was left to find his or her place in a rapidly transformed society, especially after Malta's membership of the EU, without even being well informed on the merits of basic nutritional habits, emerging labour market demands and inter-personal communication skills. It is therefore small wonder that the pressure to cope within such an environment was rather heavy for many.

It may be symptomatic of this uneasy process relating the individual to society that two issues being debated / referred to at present in Malta are euthanasia and abortion (Borg, 2017; Times of Malta, 2017). One has to do with the beginning of life, the other with its termination. And 'what happens in between' is restricted mainly to civil unions / marriages. But there are other areas which are also related to human rights and collective obligations which demand consideration. And these are not limited solely to the Maltese Islands but also to the entire European Union. If many Maltese fail to follow that which is directly of interest to them in the personal and Maltese social context, they will find it even harder to comprehend and react effectively to the demands of EU membership, even more so to those of the Economic and Monetary Union.

Indeed, in the views of Vincent de Gaetano, Chief Justice Emeritus and Judge sitting in the European Court of Human Rights, the Maltese public at large may not even be 'aware of what is meant by fundamental human rights, by the protection provided by the European Convention of Human Rights and the European Court of Human Rights and how to identify incipient signs of human rights problems in our society' (Xuerab, 2017). And that is so on the 50th anniversary since Malta ratified

the European Convention of Human Rights. This is yet another gap in the framework of basic knowledge and appreciation which every Maltese should have mastered over the years.

4.2 Summary

Modern democratic societies are judged in terms of efficiency-welfare criteria. 'Efficiency' refers to their success in re-inventing themselves over time in order to remain competitively productive, create employment, and exchange goods and services internationally. In the process, they generate incomes, accumulate resources, and yield satisfaction to all those involved in the production and exchange.

'Welfare' refers primarily to the state of well-being enjoyed by those involved in the 'efficiency' process. But it also considers the way in which a society organises itself in order to support all of its members, both those who work and those who cannot for a variety of reasons. Children, retirees and disadvantaged people fall under this category. All have basic human rights which a community attends to, thereby affecting the state of personal and overall well-being in the community.

This 'state of well-being' may be interpreted from selected data referring to the characteristics of various subgroups in the Maltese population. Malta's future is heavily dependent on its population age, gender and skill characteristics. They condition Malta's ability to accept economic and social change and successfully adapt to it. It is noted that every single sub-group is itself undergoing transformation in its traditional social role, creating opportunities for resource generation by the group itself and by other groups related to it. But such transformations create challenges in their own right which need to be

identified, understood and integrated in the social and economic networks.

Maltese society has gradually changed from having a majority of females to one where there are more males in the 0-59 brackets. Females are heavily represented in the 70+ age classes. These data have a bearing on the present labour supply and on future services for the elderly retirees. The labour market has to cater for more jobs which have been historically associated with male workers. Gaps in supply will imply immigration or resort to more capital-technology intensive systems of production. After-retirement services – like those related to home help and food preparation - ‘assumed’ a predominantly female population with the gender-related attitudes and skills associated with them in the ‘traditional’ Maltese family. This approach will have to adapt to the emerging demographic reality.

Besides, grandparents have been caring for their grandchildren while the latter’s parents were both at work. In the process, they tended to pass on the cultural and moral values to the young generation. This had its positive effects in providing a sheltered stable environment perhaps in the greater part reflecting what they find in their own home. But there are also ‘negative’ effects. Some grandparents would find it difficult upgrading their vision of life and the means to meet the ever-rising consumer habits. An age-gap situation will arise in this case.

However, the changes that the Maltese family underwent in the past two decades meant that in some cases the relative ‘stability’ which the grandparents’ home offered the young may not necessarily be forthcoming. Grandparents may have relationship difficulties of their own, a state which may render the care of the young

heavy on their part. They want to support but they may feel inadequate.

And, in the wake of the reduction in the number of births per family, some parents may not reach the state of 'grandparenthood'. Their children will represent the 'end of the line' since they do not have children. Governments in other European countries are already facing similar situations. This could be a possible scenario for Malta and Gozo. In such cases, solitude, which is often associated with the elderly, would be reinforced. More elderly will feel lonely as a result of this new social reality. Loneliness is detrimental to the elderly's health and well-being.

Retirees may also experience financial stress as do some other sub-groups, like single mothers. Their welfare is bound to suffer as a result. Discussion of the issue of 'risk-of-poverty' in the Maltese Islands has taken a two-way prong: the present performance and suitability of the social security, pay-as-you-go, retirement pension system and the validity of the national minimum wage mechanism in 'eliminating' absolute poverty. The existing social security pension has deviated from its original declared objective of remaining equal to two-thirds of the worker's income. Instead, both the contributions and, so, the pension have been capped at their initial values. Besides, since the intended additional contribution to finance the health sector did not materialise, the surplus funds in the pension account have been transferred to the health account. This means that there are no savings to make good for the expense in the pension and health sectors to cover the additional costs of supporting a higher number of retirees.

Regarding the 'wage-minimum family budget requirement' consideration, the debate so far has remained, as expected, 'inconclusive'. Some analysts

claim that a modest, three year increase in the national minimum wage will help reduce the incidence of absolute poverty in Malta; others insist that there are further considerations to be accounted for, such as the impact on the wage concertina and the induced impact on the firms' competitive position. The policy maker will have to decide on such a parameter without the 'comfort' of definitive reports on such position.

In its comment on the Maltese government's draft budget for 2017, the EU Commission noted precisely these two shortcomings and referred to Malta's competitive stand in international trade following envisaged increases in labour costs arising from pension and health budgets considerations.

Personal welfare is being also influenced by the modified social perception of family life and marriage. The 1980s and 1990s witnessed a radical break with traditional views on the family which were not complemented by ancillary education to impart on Maltese society the meaning and implications of what was going on. The end result is a higher recorded family break up especially following changes in family law over the past few decades and the willingness of Maltese society to adopt more liberal attitudes in personal interrelationships.

The 'positive values' which Maltese families were said to convey need not have been as diffused as one would like to imagine; this is what the few surveys on Values seem to suggest. And families may transmit even negative inter-generation influence as new research on crime in Malta implies. And one cannot rely solely on 'education' to convey certain views. People may capture the message, but they need not necessarily follow it for reasons of their own.

Besides, education and health statistics suggest that Maltese society may be benefitting from the public and

private sector services on offer in these two fields. But when it comes to individual gains there is still a lot to be achieved. This conclusion emerges from the data which show that Malta may not be getting value for money in the way funds are allocated for the education of its young. Many still leave school unprepared for life and for the labour market.

And, even though there had been progress made in public health, with major improvements in life expectancy and 'life quality', yet when it comes to prevention of future health problems Malta lags behind. Malta is high on the list of those countries who suffer from overweight and obesity, which eventually lead to avoidable non-communicable diseases such as diabetes, heart problems and cancer. Apart from making life miserable for those who are afflicted by such ailments, their care adds excessively to health costs, resources which could be wiser spent on preventive measures rather than remedial ones.

These situations beg the question: Are the Maltese aware of their rights? It seems that they are not 50 years after Malta ratified the European Convention of Human Rights. There is still confusion in the mind of many of the existence of a hierarchy of rights, the determination of such a ranking, and how to relate legal statutes and their interpretation by Courts of Law to reflect the importance of several basic guiding principles in the life of a society.

Just like Poverty, Wages and Competitive Trade, and the Single Currency 'Basic Human Rights' are listed in the category of 'poorly known' subjects by the Maltese population.

COMPLEX SYSTEMS, CLARITY
OF OBJECTIVES AND EFFECTIVE
OPERATIVE INSTITUTIONS

Three themes dominate the expositions presented in the first four chapters of this study. First, modern economies and societies are actually made up of many complex systems which interrelate one with the other. Although one tends to compartmentalise discussions under various headings, like politics, economics, sociology, psychology, technology or the various branches of the physical sciences, yet one is truly assessing one main system. Second, though seemingly complex, such systems often operate on simple rules which condition personal behaviour and are transmitted from one domain to the others. Third, the challenge for policy makers lies in identifying the delineation of the systems and the rules that guide them. In doing so, they may appreciate more the implications of the policy decisions they take and be better prepared to critically assess their outcome.

One may refer to the work carried out by specialists from various disciplines trying to 'understand' the underlying mysteries of the universe: massive, expanding, seemingly chaotic but propelled by some as-yet-unidentified energies, operating on 'rules' that may be described overall as 'simple', resulting in the end in an ordered

grand design. There is one main difference between the universe and societies: human beings constitute communities and they are free to change their minds. Hence, to remain efficient and survive societies need guidance: the objectives they are striving to attain must be clear to all; trade-offs between any two of these objectives must be ascertained and evaluated; and the institutions with the remit to identify the objectives, evaluate the trade-offs, chart courses of action and implement them have to be effective over time.

The preceding analyses followed three main thrusts: the macro-EU/EMU context; the main aggregate demand components and the labour supply resources which configure the Maltese economy; and socio-economic characteristics which describe personal welfare and life satisfaction of the Maltese. It turns out that the three areas have one element in common: although many speak of 'Europe', or 'Malta's economy and society', or 'personal well-being', yet no one really defines clearly what these terms stand for, how the three are inter-related, and address the performance to date of these interrelationships.

This means that in the absence of such clarifications, there cannot be a clearly defined objective which is common to all 'Europeans and the European Economy'. Therefore there cannot be a 'European society' because all 'Europeans' think 'nationally' (Maltese, French, Italian, Hungarian..). Economic and financial measures adopted are introduced with the 'nation state' in mind. And, as a consequence, the objective of maximising individual welfare is caught in a vision warp leading to policy shortcomings.

In turn, this tendency will be also reflected at the national level, where inadequate organisations are expected to implement sets of policies that are not put

together in a holistic manner. Thinking thus becomes permanently fragmented and partial. Undesirable effects will emerge gradually. By the time they are evident to many the social or economic sub-systems which induced them would have already taken over. Reconditioning such an environment may be possible but always at a cost to the generations that have to bear it.

A 'hazy' vision of a people's future leads to uncoordinated policy formation. It does not contribute to a sound ranking of objectives and to a structured programme of action. The long-term orientation for a sustainable economy will be put at risk since policy measures will generally be implemented in a fractured manner and often independently of one another. In this context consider a working definition of the 'European Vision'.

'..(A) common vision for Europe. It is a vision of equity, of unity and, most importantly, the inclusive participation of all people to build peace within and across our societies...To achieve this European vision, I believe the economic strengthening of our Union must be equalled by more attention to inclusive strategies that improve people's daily lives. The growing gap between the Union and its people needs to be bridged. Our vision must be one of respectful connection, reaching beyond the fears and doubts that constrain us. We must be brave. Our vision must be outward looking, upward going and forward moving. The European Union must combine its goals for continued economic growth with the need to safeguard everybody's prosperity, both within and outside the labour force.....' (President Marie-Louise Coleiro Preca, on the occasion of the opening of Malta's presidency of the Council of the European Union, January 2017).

In simple terms, the 'European vision' represents the Production-Distribution Trade-off explained in Section

2.2 above at the 'European level'. But which one: the single market and customs union of the EU or within the countries which additionally share a single currency, the EMU? The rules of generating income and wealth, the tools available, and the freedom for policy makers to operate are different under the two regimes. If that basic question is not addressed, then the rest of the discussion will not follow. Indeed, this is what is meant by 'clarity of vision' which enables the formulation of multiple integrated policies spanning various political, economic and social dimensions in prescribed geo-political areas.

It is precisely such 'orientation objective' (or, rather, its absence) which seems to unite the analyses presented in Chapters 2, 3 and 4 above. The 'European Union' means various things to many people, Maltese included. Policies are therefore envisaged in a selective manner. Again, charting the way ahead for the Maltese economy has been rendered more complex given the demographic shift towards the 60 year plus cohorts. This has resulted in a radical change in the perspective of many of their expectation from life, work and retirement. And, thirdly, at the personal level the major switch from the traditional to more intrinsic values of self-fulfilment in the 1980s and 1990s, with their related behavioural changes in family relationships in Malta, has resulted in a disorientation of life focus for many. The data are now revealing the outcome of such conditions.

Before highlighting the key observations presented above, it is relevant to point out three analytical reminders. First, economic and social analyses rely on 'numbers'. Yet it is the people behind those numbers who are of interest to researchers and policy makers. They are considered under various roles throughout their life, and it is their welfare that ultimately matters.

Secondly, it is these people's judgements and actions that make up the object of analyses. They are consumers, producers, voters, tax payers and benefit recipients, family members, friends and allies or competitors. They are the same group considered from different perspectives. That is why in the end it is their personal satisfaction, or otherwise, that counts. Depending on their judgement regarding this last criterion, they will plan their way forward in life.

From an analytical viewpoint, reports evaluating particular schemes need to be as comprehensive as possible. It is not enough to present proposals to support a particular economic sector or group of potential beneficiaries, for example, without specifying the cost of such an initiative and the source of financing. Resources have to be identified before supportive programmes can be implemented. Failure to do so could mean that the proposed project will remain under-funded and will fail to attain its stated objectives.

Besides, people are conditioned by power and powerlessness. If power tends to corrupt, so does powerlessness. If people are hemmed in by rules and feel over-dominated, then they tend to get even by over-controlling their own domain. They vent frustrations on others who are more powerless. The powerless retaliate through subtle sabotage, especially when there is scarcity: the less there is around, the more the infighting is over the crumbs. Gender relations and the role of voluntary organisations in Maltese society may be usefully addressed in this context.

Thirdly, if something cannot go on for ever, it will stop even when nothing is done about it. This holds for economic and monetary unions 'in progress', economic growth relying heavily on real estate or financial bubbles,

and policy options that fail to adjust to the evolving aspirations of a community. It is helpful to record such a caveat when identifying potential courses for future action, both at the personal and society's level.

This presentation did not aim to offer solutions to the various sets of issues taken up. Rather, it introduced several other perspectives to those generally addressed in official documents in assessments of Malta's economy and society. Such considerations are deemed critical for a proper evaluation of the policy objectives and tools in terms of reaching effectively the dual objectives of sustainable income generation and maximising personal welfare of all. Paramount in the assessment is the identification of the unit whose 'income generation' is to be sustained (whether it is Malta, the EMU or the EU) and as a follow up who represents 'all' in the welfare equation: the citizens of Malta, or of the EU member states, or of the EMU zone. The answers one is after will depend on the units identified.

The main results of the analyses are presented below. They refer to the performance of the Maltese economy and key trends observed emerging in Maltese society. But the EU and the EMU, Malta's economy and the Maltese population may be considered for analytical purposes to be 'works in progress'. The evolution of the EU and the EMU will definitely condition the development pattern of Malta's economy, its income generation and employment, and so the welfare of all those who live on these Islands, irrespective of their nationality.

5.1 Macroeconomic Performance and Socio-economic Indicators

Overall, the Maltese economy registered positive growth rates throughout the past six years, notwithstanding the economic slowdown registered in many other countries. Indeed, recent revisions to the GDP data suggest that the performance was even better than initially recorded. Employment has also increased with inroads made in the participation of female workers in the labour market. And Malta's balance of payments turned positive, boosted by earnings from the services sector, mainly, tourism, financial services and e-gaming.

Such encouraging results are tempered by several features: i) The value of economic activity in the underground economy is estimated to have remained in the 20-30% region, meaning that the real worth of income and wealth generation and their distribution remain actually an unknown. (ii) The public sector is still registering an annual deficit, and the national debt continues rising. This is taking place while the Maltese government is relying more than ever on public-private ventures, with government acting as guarantor even to some private sector initiatives. If one includes such guarantee considerations, the share of the 'national debt plus guarantees/GDP' is much higher than recorded by the debt/GDP ratio: in 2014 it was close to 95% instead of the 68% recorded for the debt/GDP ratio. (iii) And assets which in the past were owned by Maltese parastatal companies are now in part controlled by foreign companies, some of which are foreign governments' parastatal firms. (iv) Malta's Gross National Income is less than its Gross Domestic Product. This means that the net external income out-payments exceed the in-payments:

repatriated earnings and profits outside Malta exceed the similar amounts received by Maltese companies or households. This is happening at a time when Malta is still a net beneficiary from EU funds. If Malta's position in this regard were to change, then the gap between GDP and GNI could widen.

Trade competitive indices suggest that production in Malta may be under strain, especially due to relatively high administrative and labour costs. The relative shortage of skilled personnel is exercising pressure on wages. Immigrant workers are filling the gap, but they introduce with them other considerations than those pertaining to the labour market. Housing, commercial enterprises and rents; education of their children and school plant and equipment; health services and leisure networks and infrastructure; and the maintenance of law and order: these services sectors are all inter-related with immigrant labour especially when numbers keep rising.

And the share of the population at-risk-of-poverty has not been contained. There were around 66,000 Maltese, representing 15.9% of the population who were considered to be at-risk-of-poverty in 2014. This is 6000 more than in 2008, when they made up 15% of population. Children, single-parent households, and the elderly are more prone to be represented in this category.

Policies regarding wages, retirement pensions and household income support schemes have to combine considerations which relate to the economic and labour features summarised above.

5.2 The Meaning of a 'Deeper Economic and Monetary Union'

Malta is a member of the European Union and of the Economic and Monetary Union. Malta is also a member of the British Commonwealth and entered into bilateral agreements in various areas with other governments. This is a common feature for member countries in the EU.

The EMU is evolving. Two main documents prepared by the European Commission spell out a plan to establish a banking, capital and fiscal union in the years ahead leading ultimately, around the year 2025, to a political union. Such a vision and plan of action is meant to be endorsed and implemented by all member states.

Under the EMU, member countries gave up their own currency and adopted the euro. In the process they lost the rate of exchange as a policy tool and some degree of control over the interest rates charged in an as-yet-imperfect single market in monetary and financial services. In this scenario, these countries may compete within the EMU via real wages, labour and capital productivity, and fiscal measures which are circumscribed by rules emanating from industrial competition and tax agreements among the EMU signatories.

But recent events in various EU member states, but primarily in the United Kingdom following the June 2016 consultative referendum on EU membership, are casting doubts on the feasibility of this declared vision to move to a political union in the EMU within a decade. Even Maltese policy makers have stated that Malta does not back up such a direction. They are not in favour of further integration in the Union.

It is the prerogative of every people to chart its destiny. But whatever that may be has to be declared clearly so

that the requisite changes in the way a society organises itself may be undertaken in time. If there is no general agreement among the EU/EMU member states on what status are they aiming for, then the planning of future organisational structures has to be postponed. What happens in the meantime, given the present multilateral freedom of operation, is any one's guess. In principle, every member state can develop its political and economic strategies in such a way as to maximise its own economic rate of growth irrespective of the impact this may have on fellow member states.

A competitive tax-wage regime could be created to attract the production of goods and the provision of services from a particular location. Judged from the perspective of a Union, such a scenario could lead to the misallocation of resources in the long term. The identified economic sectors may not be fully compatible with the convergence of those policy measures in tune with a fully-fledged single market operating on a single currency. And the costs to rectify such a state of affairs and render it compatible with the single currency regime may be high. As a consequence, the proposed 'deeper economic and monetary union' will not materialise.

Viewed within this context, the transaction costs of reaching agreements even on a set of limited objectives would remain high in the EMU/EU. In addition, the priority of targets will not be set in terms of the entire Union but will remain focused on the 'nation-state'. The long-term economic and social development of any one particular region will be determined internally, with policy makers seeking support for their programmes of action only from local voters. The overall long-term economic and political vision will continue to be primarily focused on matters related to that particular country.

In which case 'Project Europe' will not actually take off as is being suggested. But national policy makers cannot be expected to continue relying on such ill-defined programmes indefinitely. At some stage the project itself would have to be questioned. Such queries have been already made in Greece, the UK, Hungary and Austria. The outcome of the UK's result, calling for that country's exit from the EU, is perhaps demonstrating the lack of preparation on a wide front in considering in advance certain uneasy situations. This lesson could be an eye-opener for all.

Under these circumstances 'Vision Europe' cannot be deemed to really exist.

5.3 Sectoral Economic Considerations, Labour Supply Issues and Fiscal Measures

An expansionary fiscal thrust, financed partly by EU funding, and the deliberate greater involvement of private sector participation, both local and foreign, in economic projects boosted output, incomes and employment. The government's basic budget structure remained unaltered, but more resources were injected per head of activity. Overall, the government's budget remains in deficit, but in the past few years recurrent revenue exceeded recurrent expenditure generating a small surplus which goes to finance in part the capital budget. This latter has reflected the inflow of resources from EU project-tied sources. Indeed, as these sources were taken up, government's capital projects undertaken declined.

The external account also contributed to the upbeat performance of the Maltese economy. Incomes generated from the industries that make up the Services Sector

turned a negative balance of trade position into an overall external balance positive result. This took place while private sector consumption continued expanding. However, the data bases referring to aggregate income and consumption expenditure may not be recording correctly the monetary values of households' earnings and consumption outlays. As a result, the data for aggregate households' saving registers a high degree of volatility, which becomes difficult to explain.

Recent surveys on local industrial performance have shifted focus from deficiencies in aggregate demand components (local sales and exports) to the availability of skilled personnel at the right price. Skill shortages could prove to be detrimental to the sustainability of an economic activity because buyers, even regular ones, may switch their orders elsewhere triggering others to exit from the Maltese market.

Over-reliance on particular industrial operations (say, pharmaceuticals) or services initiatives (registration of gaming companies or tourists coming predominantly from one particular country) could put the future of economic output at risk. Similar positions would develop in the case of economic activities which rely relatively heavily on soft tax regimes. Additional regulatory and competition conditions in various economic sectors coupled to fiscal convergence within the EMU area would stress test to the limit the profitable production of such goods and services in Malta.

A new factor which is working itself gradually in the consideration of entrepreneurial activity in Malta is global climate change, but more specifically rising temperatures and more volatile climatic conditions in the Mediterranean basin. Such phenomena would influence negatively the preservation of natural resources, like

water, plants, vegetation and fish stocks. They also condition the consumption of energy which is also related to the production of the potable water supply in Malta. Consequently, the cost configurations in several sectors of production, including those of Agriculture and Fisheries and the Hospitality industry, will be adversely affected. Climate change impacts also households' expenditure budget outlays on cooling or heating homes. And it conditions directly the health, hence the well-being, of the elderly and the young.

Malta's main asset remains its population, which was estimated at 401,668 in December 2014. When account is taken of foreign nationals residing in Malta, the total population was 429,344. The labour supply is structured by the gender, age and skill configuration of this population. There are more males than females up to age 60, that is, in those age brackets which are mainly relevant for labour market considerations. But females at present outnumber males in the age cohort 70 plus, which result yields a small overall female majority in the entire population.

Labour force participation for both genders improved in the past few years, particularly for females. The male activity rate is 79% while the female rate approached the 53% level. Of social and economic interest is the rise in the activity rate registered by persons aged 55-64. If such behaviour continues in future, the local labour supply would benefit from the projected increase in the pensionable retiring age in the coming years. The same holds for aggregate output and incomes – they will be higher as a result.

Gender may be a determinant in the search for employment. Thus, one in five workers is employed on shift activity as a full-time job. And most of them are males. Females tend to select posts which are related to

the 'caring professions', namely, education, health and social welfare.

And immigration will remain a means to expand the labour supply and countervail the observed bottlenecks in skills. But even this sub-group in the local labour force has been passing through a transformation process. There has been a declining share of higher end occupations and a rising share of lower-end jobs. This pattern differs from that registered for the Maltese work force. Such trends reflect the dynamism with which modern competitive economies keep regenerating themselves in order to sustain market shares and their profitability.

Production nowadays tends to follow not only skills but also fiscal attractions. Both entrepreneurs, who commit their capital to production, and labour, whose remuneration depend on their input, follow incentives globally. Such inducements have been around for quite some time now; and Malta has historically implemented incentive schemes for both investors and employees to operate from these Islands. But the EMU project contemplates fiscal convergence in the future, an aspiration which is not openly shared by all member states. This convergence refers to both taxes and support for industry: it therefore bears on both the revenue and the expenditure side of a government's budget.

Apart from conditioning the present performance of an economy, in terms of income, output, allocation of resources, employment, and personal well-being, such a network of fiscal measures will impinge even more strongly on the direction that an economy may take. Production cannot be sustained indefinitely in an economic and financial environment where the liabilities associated with a line of production are not known in advance with relative certainty. This holds for taxation

ruling location, production and distribution, profits and negative externalities. It holds also for charges associated with welfare and retirement - like the social security contributions, private pension funds and health insurance – and to their transferability from one company to another.

The ‘deepening of the EMU’ entails all of this. The manner in which this process is undertaken will therefore affect heavily the overall economic development of the Maltese Islands, the presence of foreign investment and personnel on these islands, and the welfare of all those involved in these operations.

5.4 The Well-Being of the Maltese: Perceptions and Actual Results

The state of well-being of the Maltese may be assessed from data referring to the life-styles of various sub-groups in the population. These sub-groups are going through transformations in their traditional social role in the process altering the perceptions of the respective individuals on life, work fulfilment, and overall satisfaction with life-family-work inter-relationships and ‘balance’.

Gender-wise, as noted above, Maltese society presently incorporates more males than females in the age brackets 0-59. The male perception and implementation of the life-family-work has traditionally been different from those experienced by females. So a culture which strives to sustain the equality of rights and responsibilities will have to induce a transformation of these embedded expectations which tend to be based on gender and related cultural roles in the home, at work and elsewhere.

These changes will be even reflected in the way future retirees will behave: their involvement in the home and society in general, the need for supplementary assistance and its induced complementary costs, and health care requirements and their financing.

One such role which is registering an evolutionary pattern is that of 'grandparenthood'. Grandparents have been supporting their children in a variety of ways, including financial transfers and care for the young. But it seems that this second role could become somewhat heavy on them, primarily because of a culture-gap in the way grandparents and grandchildren perceive life and values related to it. But, still, grandparents' homes were considered as a reliable and cost-effective place where the young could be looked after.

However, two other states are emerging. Some grandparents have personal relationships problems themselves. They have to cope with their own life difficulties and at the same time try to continue offering a healthy environment to their grandchildren. Society does not provide enough placements to cater for the demand for child care, even against payment. There is also another category which may be extending itself: some parents may never reach grandparenthood because their children do not bear children. When such a state is happening on a relatively wide scale it could be personally and socially depressing, particularly when a demographic group is going through such an experience for the first time.

Personal welfare is therefore also reflecting the modified perceptions of family life and marriage. The last thirty years witnessed a radical break with the traditional views on the family which were not complemented by any basic educational preparation for such a radical change. The end result has been a higher number of recorded family

break-ups especially evident following the enactment of new statutes on marriage, divorce and civil unions. But, probably, the 'deeply entrenched positive family values' which the Maltese society was accredited with have not been there in the first place on the scale claimed. Only, the mechanism to reveal them was not available at the time. Signs of family stress had already been registered in the surveys on Values carried out in the 1980's and 1990's.

Resort to 'education' alone will not ensure a change in deeply-entrenched customs. People may not understand the message being conveyed; or they may grasp its content but, for various reasons, decide to ignore it or to apply it selectively. The number of behavioural computations could be high. And, as always, the impact will be entirely positive or less so depending on the individuals themselves and on the environment in which they are operating. Many will have to bear the costs of inattention or neglect, even if such a stand would not be taken deliberately.

And data suggest that formal education is more successful among women, if one judges by exam results and academic achievements throughout the various stages of the educational curricula. They record more positive achievements than male students. Given the higher incidence of males in the school age brackets, this fact implies that the rate of relatively 'low academic performance' is increasing. The loss of potential skills is accordingly growing over time. And it seems that official statistics are 'losing track' annually of a number of potential job seekers. At a time of scarce labour supply and the need to implement selective immigration programmes to match demand for skills, such a loss of manpower resources cannot bode well for the Maltese economy and society. Indeed, it seems that some young

people tend to be inclined to remain operative in the 'grey economy' as a preferred way of life and income earning.

Again, a higher number of academically-successful young women mean a larger number of persons who have to adapt to a social background which is not yet totally sympathetic to their active participation in the world of work. As indicated above, the support young families need to rear up a family and be engaged in the labour market is still inadequate. It is not enough to talk of 'life balance' (which truly could be an 'empty' phrase and nothing more). Both genders have to be clearly instructed in the meaning of sharing of responsibilities; this represents another element, a co-operative mentality, which has been glaringly missing in Malta. The history of the co-operative movement suffices to illustrate this fact.

Health wise, there are also certain disturbing traits in the population which warrant urgent considerations. There is a relatively high incidence of non-communicable diseases which emanate from overweight and obesity: heart and respiratory complications, diabetes, and cancer. These do not only affect negatively the lifestyle of the persons who suffer from them, and those close to them, but they impact directly on their ability to create wealth, be financially independent, and contribute to the welfare of other members of society. Instead, they absorb scarce resources to remedy a condition which, possibly, could have been attended to if treated earlier. Again, personal and social welfare are worse off as a result.

Inadequate educational achievements and relatively poor health conditions combine to raise the numbers of those who are at risk-of-poverty. Furthermore, if these conditions are added to the changing lifestyles within the family set up, the number of stress-inducing factors tends to rise. In all these circumstances, personal satisfaction

with life will suffer as a result. Focusing on a factor like wages will not be enough to address the real determinants of poverty. Much more is at stake.

In this context, it is pertinent to query the sensitivity of the Maltese to the way society considers its own treatment of basic personal human rights. Experience suggests that they may not even be aware of what is meant by fundamental human rights, let alone able to identify incipient signs of human rights problems in Maltese society.

In short, there are several areas which influence personal welfare positively and render life worth living, irrespective of the occasional unsavoury episode. Yet there are institutional structures which are failing to achieve their aim in informing the Maltese of their fundamental human rights and contributing to their personal development through effective family-oriented supportive measures, including those related to education and health.

5.5 Concluding Remarks

This study sought to widen the considerations that are generally introduced in assessments of Malta's economy and society. There is a group of people, numbering around 430,000 who live on these islands, of whom 400,000 are of Maltese nationality. This community keeps transforming itself every day, in small numbers but continuously. This means that what one may term the 'overall guiding principles on inter-personal relationships' based on the aspirations for a better future of every Maltese keeps adapting themselves to ideas that need not necessarily be compatible with 'tradition'. When such views proliferate themselves sufficiently throughout society they condition

the policy debates and their outcomes. It is perhaps only at that point in time that many realise what has been going on in the various population sub-groups and in the economy's sub-sectors.

The Maltese economy has performed a full circle in terms of migration. In the post-war years the Maltese population was young. But work opportunities were restricted to the traditional trades which could not absorb the new entrants to the labour market. So, for three decades – 1948 until the mid-1970s - its income and wealth creation was heavily supported by a massive outflow of subsidised migration. This movement eased pressure on the creation of new employment in the restructured Maltese economy as global and European trade expanded and the political world divides that dominated the post-war period gave way to a more conciliatory stance and co-operation based on freer trade, capital and labour movements.

Malta is now resorting to immigration to support its economic growth. And the inflow of labour is taking place in various economic sectors, ranging from financial and e-gaming services to the hospitality sector and health and home support. Indeed, this movement itself has been gaining a momentum of its own as relative shortage of skills is becoming every day more apparent. In part this is a reflection of the fact that the Maltese population has aged. The population pyramid today represents an inversion of the one registered in 1948.

There is no short term solution to this phenomenon. Maltese families have over time decided to have fewer children in the absence of any incentives to do so. Their decision was freely taken and implemented. Moreover, their perception on the traditional family unit has changed, whether irrevocably or not only time will tell. But as things stand, an increment in Malta's annual

output and income will continue to depend on attracting the optimal mix of skills, capital investment, and market diversification that together render such growth possible.

Throughout these years, Maltese governments based their plans for diversifying the economy, generate exports and create employment on an economic model that used fiscal incentives to attract investment and knowhow. They also allocated resources for the education of the upcoming generations and the re-training of those already in the labour market. And, it may be claimed that this approach proved to be successful by enabling the Maltese economy to re-invent itself over the years.

This position held even after Malta's membership of the European Union in 2004 and the adoption of the euro in 2008. But two factors which are coming to the fore may challenge this feature. One is a change of attitude in many countries towards competitive fiscal incentives which may be considered to favour one destination instead of others. Governments are constrained to raise resources to support ageing populations world-wide and to upgrade their social infrastructure. They do not look positively on other countries which they consider to be depriving them of tax revenues or income-generating operations.

The second factor refers to the Economic and Monetary Union. Recent reports from top-level officials in the EMU suggest that this union has to move ahead with its banking, fiscal and political integration. Besides, the operations of the Single Market will be extended further to those areas which are at present partially excluded. Such moves may not be congenial with the way in which Malta's development economic model has been implemented so far.

Moreover, the future of the EU project itself is being queried more loudly following the referendum result in

the UK regarding EU membership. A country, especially a small island like Malta, cannot chart its future if it is constantly faced by such uncertainties and unknowns. Hence the evolution of the EMU has to be plotted in definite terms so that member countries may plan concretely their own contribution to this greater unit. Alternatively, member countries may reconsider critically their involvement in this project and draw their own conclusions.

Central to such exercises are the institutions – both the supra-national EU units, like the Commission and the ECB, and those responsible for policy making, regulation, and implementation at the national level. The perceived ‘growing gap between the Union and its people’ – to quote Malta’s President Coleiro Preca – could perhaps be attributed to the failure of both classes of institutions to convey correctly and clearly the issues at stake and to deliver their mandates in a timely and effective manner

We limit observations to the local regulatory and administrative organisations. In Chapter 1 above it was pointed out that public institutions were becoming a ‘mirage’: they exist at law, supposedly monitoring and regulating events occurring in the economy and society but they were failing in their duties. They were not assessing critically what was going on and, at best, they would re-act with a lag instead of pre-empting events so as to lead an economic sector or a population sub-group to a pre-determined objective.

This is not solely a Maltese phenomenon. Indeed, the term ‘sophisticated state failure’ has been coined to refer to such situations. In these contexts, the result is very little which is really valid for long-term economic restructuring, social ordering and political accountability actually gets done. And the gap gets wider between what people

believe is being done and what ought to be committed in an evolving political and economic context.

A case in point is the utilisation of the EU funding programme to assist the upgrading of Malta's communications infrastructure, cultural heritage and sectoral/industrial upgrading with the aim of becoming profitably competitive in the single market environment. Millions of euros were spent in report writing and consultation, familiarity and exchange visits, and actual capital projects. But the main query remains: have these resources and projects truly addressed the issue of competitive production and sectoral re-structuring? If they did not achieve this result, then the funds only served to generate short term economic activity and incomes leaving vulnerable producers exposed to uncompetitive practices and market threats.

Assessing the future of the EMU in such contexts becomes doubly difficult: production units may be still weak in competitive terms and the funds which were meant to re-shape their production-distribution configuration have already been allocated. The survival of these units would depend on the injection of additional resources.

So it seems logical to address the role of the regulatory organisations in Malta and the way they are inter-relating with their EU/EMU counterparts. They are meant to anticipate emerging issues for the units under their jurisdiction so that together they can face them positively. If such an exercise fails in this objective an entire economic sector will be overtaken by events which generally start from factors external to it.

It follows that the success or otherwise of such regulatory interventions will impinge directly on the persons involved in the respective sectors. Hence it is

related to the personal welfare of many. Multiply this to several sectors related to production of goods and to the provision of services - the latter to include education, health, leisure, personal welfare support, law and order – and the relevance of efficient institutions becomes a matter of paramount importance.

The data summarised in Chapters 3 and 4 attest to this. These refer not only to economic considerations but also to personal aspirations expressing themselves in an ageing community and smaller family units. It was pointed out that this ageing phenomenon and fall in birth rate is reflecting itself in a parallel way in the number of men and women who dedicate themselves to the priesthood and religious life. They are ageing as well, but at a faster rate than that recorded for the Maltese population. This is primarily the result of a sharp fall in the number of vocations.

The existing organisational church-voluntary work set up was drafted when the number of vocations was still relatively high. Such a network cannot be supported by the envisaged number of personnel in future. So the way society organises itself at the village level, utilising the inputs of both lay and religious persons, will have to be re-addressed. The relation between 'Church and State' will have to take a different meaning in the towns and villages of Malta and Gozo. Such direct, personalised and rapid support to families and individuals in a locality will complement any service being given centrally on a national level.

Of course, such networking will involve the political system in Malta. Local councils are an offshoot of the main political party structure that rules policy decision making in Malta. Politics is seen prevailing everywhere. Since parties rely on voter allegiance, their actions

are inextricably intertwined with the fiscal operations of Malta's government, including the allocation and administration of EU funds.

Such a close relationship in a small community of 430,000 people will inevitably lead to the perception of pervasive political interference in the everyday life of the Maltese. This may explain the popular sensitivity to 'widespread corruption in Malta', meaning the attempt made by many to benefit personally in various ways at the expense of the collective. And this would hold in all types of activity or relationships, whether these are based on market transactions or on voluntary work. Intrinsically such behaviour is also bound to condition personal and social well-being.

The future is truly testing. But people often rise with determination to a demanding objective. The future of the EU, the continuous re-invention of the Maltese economy, and the revival of personal aspirations for a better life in a supportive social context: these are taxing objectives. But they are definitely worth pursuing under one proviso.

Those 400,000 Maltese must not underestimate the challenges ahead or their own limitations.

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