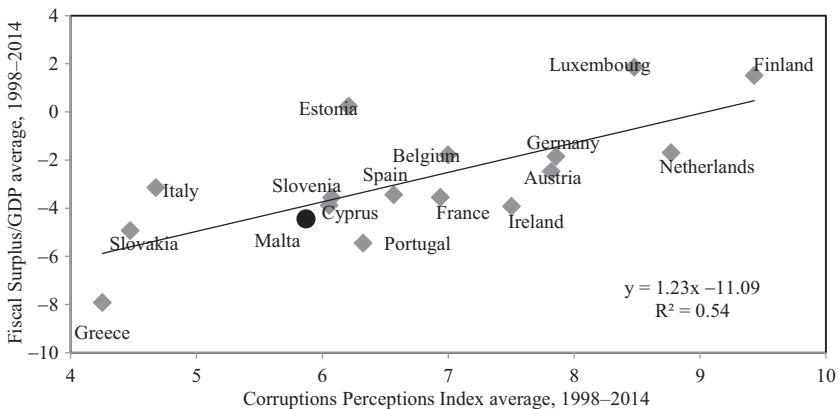


## Final Remarks

### ECONOMIC INSTITUTIONS IN CONTEMPORARY MALTA

The economic liberalization process that started, in earnest, in the early 1990s overhauled many of the country's economic institutions, but the state and its enterprises and agencies still retain a prominent place in the economy. In 2014, the public sector accounted for 26.9 per cent of total employment,<sup>1</sup> compared to 17.7 per cent in the United Kingdom.<sup>2</sup> Growth in public sector employment accounted for 34.7 per cent of the growth in total employment from 2013 to 2014.<sup>3</sup> At the same time, general government consumption as a share of GDP grew from 19.3 per cent to 19.9 per cent.<sup>4</sup> This is 1.9 percentage points higher than the share in 1995,<sup>5</sup> but on average the government's share in the economy has held steady over the past two decades.

The size of the government's share in the economy alone brings all other economic actors into dealings with the state's apparatus. It is, however, the prevalence of both political and bureaucratic corruption—violation of law by public officials for political and private gain—that has made those dealings close and intimate. Typically, corruption takes the shape that it did under colonialism—clientelism and patronage<sup>6</sup>—but sometimes it is also a case of public officials abusing their position for private gain.<sup>7</sup> Government interventions take the form of providing discriminatory benefits for interest groups capable of swaying general elections,<sup>8</sup> awarding preferential access to resources for businessmen and business groups,<sup>9</sup> and



**Fig. 6.1** Fiscal Surplus/GDP ratio and corruption perceptions index in the euro zone, 1998–2014. Notes: Malta is the black circle. This is an updated version of Figure 1 in Achury, C., C. Koulovatianos and J. Tsoukalas (2015), ‘Political Economics of External Sovereign Defaults’, Center for Financial Studies, Frankfurt, Working Paper, No. 508, and SSRN Working Paper No. 2631418. It uses data from 1998 to 2014 rather than from 1996 to 2010. Corruptions Perceptions Index data start in 2003 for Cyprus, 2004 for Malta, and 2002 for Slovenia. The Index ranges from 0 (highest perceptions of corruption) to 10 (lowest). Data from Transparency International, Corruptions Perceptions Index (CPI)—Data Files, Online: <http://data.okfn.org/data/core/corruption-perceptions-index>, Accessed: 8 January 2016. Final three years reordered on 1 to 10 scale. Data for fiscal surplus/GDP ratio from Eurostat, Data—Database—Government Finance Statistics—General Government deficit/surplus—% GDP (tec00127), 2016. The trend line is linear and its equation is in the graph area

providing public sector employment for loyal party supporters and family members.<sup>10</sup>

Figure 6.1 shows evidence of these government interventions on a broad level. The figure shows the correlation between EU members’ fiscal surplus-to-GDP ratio—clientelism and patronage require large fiscal expenditures relative to economic size—and their perceptions of corruption index. The correlation is positive and significant, at 0.74, implying that the more people perceive corruption in their country, the higher the government’s fiscal expenditure (or the lower its surplus). Malta is in the bottom-left quadrant, showing the fourth highest level of corruption perceptions and the fourth-lowest fiscal-surplus-GDP ratio.

In some cases, such extensive government interventions occur due to the absence of adequate market institutions and legislative frameworks, yet Malta, nominally at least, has these institutions.<sup>11</sup> In Malta, extensive government interventions occur because trust in those institutions is weak, which further fuels corruption. A European Commission Eurobarometer survey conducted in 2013 found that 69 per cent of respondents in Malta either ‘totally agree’ or ‘tend to agree’ with the statement that ‘[t]here is corruption in the national public institutions’ in Malta.<sup>12</sup>

Table 6.1 provides some more detail. It compares the percentage of EU-27 and Maltese respondents answering in the affirmative to the question ‘[i]n [our country], do you think that the giving and taking of bribes and the abuse of power for personal gain are widespread among any of the following?’ for the public sector functions in which percentages from Malta are higher or equal to those in the EU-27. For ‘officials awarding public tenders’, the percentages are equal and, at 45 per cent, high. The largest difference is for ‘the courts (tribunals)’, with Malta a full 25 percentage points ahead of the EU-27. In this area, it is not just the difference that is large, but Malta’s absolute level, at 48 per cent. Another Eurobarometer survey—‘Justice in the EU’—shows that only 45 per cent of Maltese citizens ‘tend to trust’ the Maltese justice system.<sup>13</sup> The second largest difference in Table 6.1 is for ‘officials issuing building permits’,

**Table 6.1** Perceptions of corruption in different public services in Malta and the EU, 2013

<i>Widespread corruption in public services?</i>	<i>EU-27</i>	<i>Malta</i>	<i>Difference</i>
	<i>% Affirmative responses</i>		
Officials awarding public tenders	45	45	0
Officials issuing building permits	43	53	10
Police, customs	36	37	1
Officials issuing business permits	33	35	2
Tax authorities	24	30	6
The courts (tribunals)	23	48	25
Public prosecution service	19	20	1
Private companies	38	21	-17

Notes: Answers in the affirmative to the question ‘[i]n [our country], do you think that the giving and taking of bribes and the abuse of power for personal gain are widespread among any of the following?’ From European Commission, Eurobarometer 79.1—Results for Malta, 2013, p. 2, Online [http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_397\\_fact\\_mt\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_397_fact_mt_en.pdf). Accessed: 3 January 2016

with Malta ten percentage points ahead of the EU-27. Third in line is ‘tax authorities’, where Malta is six percentage points ahead. The final row of Table 6.1 shows the answers for ‘private companies’. Here respondents in Malta are a full 17 percentage points below the EU-27. Compared to the EU-27, then, people in Malta have much more trust in private companies than they do in important public sector functions and areas.

This is not to say that corruption has not extended to Malta’s private sector. Illegal acts for profit and mutual advantage play an important part in some of the economy’s business activities.<sup>14</sup> Estimates show that between 1999 and 2014, the size of Malta’s shadow economy went from the equivalent to 27.5 per cent of official GDP to 24 per cent in 2014, varying little in between.<sup>15</sup> This ranks Malta in the same league as Eastern European states like Poland (23.5 per cent) and Slovenia (23.5 per cent), Southern European ones like Cyprus (25.7 per cent) and Greece (23.3 per cent), but considerably above states like the United Kingdom (9.6 per cent), Spain (18.5 per cent), and Sweden (13.6 per cent).<sup>16</sup>

Extensive official constraints that shaped economic activity in the 1970s and 1980s, as we saw in the previous two chapters, provided many opportunities for alliances between state officials, privileged groups, and state functionaries: for example, the dockyards and banking sector. While the economic liberalization programme starting in the 1990s rolled back this extensive state apparatus, individual politicians retained their power to dispense economic benefits to individuals and businesses in return for votes and contributions for their services.<sup>17</sup> These practices continued despite the rhetoric of economic liberalization and EU standards of governance. Before 2015, for example, donations to political parties and electoral campaigns could be made without restriction irrespective of the amount.<sup>18</sup> Party expenditure was unlimited.<sup>19</sup> In 2015, parliament passed a law that empowered the Electoral Commission to regulate party financing. That this law was passed shows the political importance of curbing corrupt practices between political parties, governments, and the private sector, but that the Commission is composed entirely of representatives from the parties that it is meant to regulate highlights the ongoing tension in this area.

The standard indices indicate that favours and interventions run throughout the Maltese economy. The conservative Washington, D.C.-based Heritage Foundation’s *Index of Economic Freedom*, which measures a country’s rule of law, government limits, regulatory efficiency, and market openness,<sup>20</sup> ranks Malta in 58th place out of 178 countries as of

2015, putting the country just above Mexico and just below Romania.<sup>21</sup> Looking only at the ‘Business Freedom’ component, a ‘measure of the ability to start, operate, and close a business that represents the overall burden of regulation as well as the efficiency of government in the regulatory process’,<sup>22</sup> Malta’s rank drops to 106th place. Malta was ranked 43rd out of the 175 countries in the 2014 *Transparency International Corruption Perception Index* of public sector corruption, its index score having dropped in the two previous years.<sup>23</sup> This puts Malta some distance below southern European states like Cyprus (31st place) and Spain (37th place), but above eastern European ones like Hungary (47th place) and the Czech Republic (53rd place).<sup>24</sup> Bureaucratic procedures and a lack of trust in the legal system make Malta seem like a difficult place to do business, according to the World Bank’s *Doing Business Survey*. The 2015 *Survey* ranked Malta in 80th place out of 189 countries.<sup>25</sup> In terms of ‘starting a business’—‘all procedures officially required, or commonly done in practice, for an entrepreneur to start up and formally operate an industrial or commercial business, as well as the time and cost to complete these procedures and the paid-in minimum capital requirement’<sup>26</sup>—Malta’s ranking drops to 132nd, just above Togo and below the Seychelles.<sup>27</sup>

Liberalization reforms of the 1990s were about stimulating economic growth as much as they were about solving the entrenched economic and political problems of the 1970s and 1980s. Politicians seeking to maintain support from socially and politically dominant groups, while also meeting the demands of upwardly mobile groups, complicated this balancing act. The stimulus provided by the economic reforms found a much stronger response among some groups rather than with others. The previous chapter showed us a growing income gap between low- and high-skilled workers, for example, as structural change took Malta way from manufacturing and tourism and towards finance. Meanwhile, the sum of government expenditure on contributory and non-contributory benefits grew, in real terms, by 183 per cent from 1991 to 2014.<sup>28</sup>

Political systems also required adaptation to the new circumstances brought about by liberalization. The persistent ability of government institutions to allocate certain important economic resources—fuel for transport and electricity, for example—has prevented the emergence of effective market mechanisms in the economy.<sup>29</sup> In some areas, liberalization and economic growth have strained the operations of Malta’s public institutions. The Malta Environment and Planning Authority (MEPA), the national agency responsible for land use planning and environmental

regulation, established in 2001, has come under consistent fire for the way in which it allocates land for commercial and residential development; it was singled out in the European Commission's 2014 anti-corruption report on Malta.<sup>30</sup>

In some areas, liberalization provided economic opportunities for previously disadvantaged social groups. The expansion of remote gaming ('iGaming') ever since 2004, when Malta became the first EU-member state to enact comprehensive legislation favouring the industry, particularly in terms of taxation relief, is illustrative. By 2008, Malta registered 500 online gaming licences whose companies' share of revenue from gambling amounted to 7.8 per cent of GDP in that year—11 times higher than the EU average.<sup>31</sup> By 2014, the number of licences companies dropped to 420, but the industry's share of GDP reached 11 per cent and its number of employees hit 7000.<sup>32</sup> The gaming sector demands highly qualified personnel,<sup>33</sup> but also provides many opportunities for low- to medium-skilled workers like customer service agents and live dealers,<sup>34</sup> who had no previous links to the industry.

A broader effect of the increase in private-sector business activity, and the spread of opportunities for new firms and entrepreneurs, is a spirit of aspiration and ambition. With the withdrawal of state agencies from the management of business and allocation decisions, private firms have stepped in to supply a pent-up consumption boom. Malta's gross national savings rate as a percentage of GDP—gross disposable income less final consumption expenditure over GDP—went from 45.7 per cent in 1987 to 21.3 per cent in 2013.<sup>35</sup> The International Monetary Fund projects that the figure will hit 20.6 per cent by 2015.<sup>36</sup> The organizational structure of Maltese firms, particularly in retail and distribution and property businesses,<sup>37</sup> is still one of family firms based on extended kinship. While new organizational structures have emerged, and new expat firms entered the market, family firms with roots in the colonial era persist despite the external stimuli of the past two decades. Family connections in business settings are usually explained as a network of trust that emerges in environments where the formal institutional structures are weak, that is, where property rights are perceived to be weak, where legal process are perceived to be opaque, and where there is limited confidence in institutionalized sanctions and contracts between businesses. Family connections, which tend to reduce transaction costs and informational asymmetries, make for an institutional foundation on which collaborative business relationships can be built. Some of these family-owned

conglomerates have grown large enough to influence public policy, with many of their leaders finding themselves on the boards of prominent public enterprises.<sup>38</sup> It remains to be seen whether the dominance of diversified family groups will persist as an institutional framework for the Maltese corporate sector in an environment of increasingly intense foreign competition.

The most important institutional issue in Malta's future economic development is whether economic growth will be 'inclusive'.<sup>39</sup> That is, whether the continued liberalization programme will provide opportunity to all Maltese citizens rather than only those with social and political clout and those who entered the reform era ready with a strong basis for success. Both Nationalist and Labour Party government policies have over the past few years stressed social and economic upward mobility and equality of opportunity rather than redistribution. This has made it increasingly important to address deep-rooted structural issues raised in the previous chapter, like education and human capital formation, and those raised in this conclusion, like trust in public institutions, clientelism, and perceptions of corruption. Inclusive development requires a social and cultural commitment, and not just public sector reform and economic liberalization.

## NOTES

1. Calculated from figures in Central Bank of Malta, Annual Report 2014, Table 3.8, p. 54. Online: <http://www.centralbankmalta.org/file.aspx?f=11185>.
2. United Kingdom Office of National Statistics, Labour Market, People in Work, Employment, Employment Type, Public Sector Employment, Data, Table 5: <http://www.ons.gov.uk/ons/rel/pse/public-sector-employment/q3-2015/rft-table-1.xls>.
3. Calculated from figures in Central Bank of Malta, Annual Report 2014, Table 3.8, p. 54. Online: <http://www.centralbankmalta.org/file.aspx?f=11185>.
4. Central Bank of Malta, Real Economy Indicators, Gross Domestic Product, Gross National Income and Expenditure Components (at current market prices): [http://www.centralbankmalta.org/site/excel/statistics/gdp\\_current\\_2000.xls?20130910091950&rcvcount=7931](http://www.centralbankmalta.org/site/excel/statistics/gdp_current_2000.xls?20130910091950&rcvcount=7931).

5. Central Bank of Malta, Real Economy Indicators, Gross Domestic Product, Gross National Income and Expenditure Components (at current market prices): [http://www.centralbankmalta.org/site/excel/statistics/gdp\\_current\\_2000.xls?20130910091950&rcount=7931](http://www.centralbankmalta.org/site/excel/statistics/gdp_current_2000.xls?20130910091950&rcount=7931).
6. Among others, Baldacchino writes that in Malta since 2004 ‘Patronage, favouritism and clientelism are widely but discretely practised’ in Baldacchino, G., Pangs of nascent nationalism from the nationless state? Euro coins and undocumented migrants in Malta since 2004, *Nations and Nationalism* 15(1), 2009, p. 153. See also: Mitchell, J., Corruption and Clientelism in a ‘Systemless System’: The Europeanization of Maltese Political Culture, *South European Society and Politics* 7(1), 2002, pp. 43–62. For the colonial period, see Pirotta, G., *The Maltese Public Service 1800–1940: The Administrative Politics of a Micro-State*, Malta: Mireva, 1996.
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9. Staff writer, Government to rent public land to American University of Malta on the cheap, *The Malta Independent* on Sunday, 30 August 2015; Staff writer, Luqa Lidl: Previous owner was not allowed to develop site due to aircraft danger, *The Malta Independent*, 13 September 2014.
10. Borg, J. The 18-year-old director of new government security company is nephew of Chris Cardona’s chief of staff, *The Malta Independent*, 25 June 2015; Camilleri, I., Labour hands out 64 jobs on ‘position of trust’ basis—Dog handler among the political appointments made since the election, *The Times of Malta*, 11 March 2015; Vella, M., Public Sector Jobs: where is the increase?, *MaltaToday*, November 17, 2014.



11. This is a major issue in India, for example: Tomlinson, B., *The Economy of Modern India: From 1860 to the Twenty-First Century*, Cambridge: Cambridge University Press, 2013, pp. 223–225.
12. Question: ‘Please tell me whether you agree or disagree with each of the following?’ Answers: ‘Totally agree’ (23 per cent) and ‘Tend to agree’ (46 per cent). From European Commission, Eurobarometer 79.1—Results for Malta, 2013, p. 1, Accessed: 3 January 2016: [http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_397\\_fact\\_mt\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_397_fact_mt_en.pdf).
13. European Commission, Flash Eurobarometer 385—Justice in the EU, Report, 2013, p. 14. Accessed 26 June 2016: [http://ec.europa.eu/public\\_opinion/flash/fl\\_385\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_385_en.pdf).
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16. Estimates for 2014, provided by Schneider, F., Raczkowski, K., Mroz, B., *Shadow Economy and tax evasion in the EU*, *Journal of Money Laundering Control* 18(1), p. 45.
17. European Commission, Annex 18—Malta—to the EU Anti-Corruption Report, Brussels, 3.2.2014, COM(2014) 38 final. In 2015, the Maltese media reported that one of the country’s largest developers, Sandro Chetcuti, who is also the president of the Malta Developers Association, was a volunteer for the party voted into government in 2013, and that ‘he has helped [the party] out in fund-raising activities’. In 2015, he was reported to have said ‘Without being partisan, I must admit that this administration understood clearly the need and the importance of the building industry’. First quote: Dalli, M., ‘Sandro Chetcuti is Labour volunteer’, says party CEO, *MaltaToday*, 27 January 2014. Second quote: Staff writer, *Make hay while the sun shines—MDA* [Malta

- Developers Association] president tells developers, *The Times of Malta*, 2 November 2015.
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  19. European Commission, Annex 18—Malta—to the EU Anti-Corruption Report, Brussels, 3.2.2014, COM(2014) 38 final, pp. 4–5.
  20. The index is based on ten quantitative and qualitative factors, grouped into four categories: Rule of Law, Limited Government, Regulatory Efficiency, and Open Markets. See: <http://www.heritage.org/index/about>.
  21. This is the ‘World Rank’: [http://www.heritage.org/index/excel/2015/index2015\\_data.xls](http://www.heritage.org/index/excel/2015/index2015_data.xls).
  22. See: <http://www.heritage.org/index/regulatory-efficiency>.
  23. Transparency International Corruption Perception Index, data: <http://www.transparency.org/cpi2014/results#myAnchor1>.
  24. Transparency International Corruption Perception Index, data: <http://www.transparency.org/cpi2014/results#myAnchor1>.
  25. World Bank Ease of Doing Business 2015 Survey: <http://www.doingbusiness.org/rankings>.
  26. World Bank Ease of Doing Business: <http://www.doingbusiness.org/methodology/starting-a-business>.
  27. World Bank Ease of Doing Business 2015 Survey: <http://www.doingbusiness.org/rankings>.
  28. Government expenditure on social security: sum of contributory benefits (pensions, industrial injury benefits, unemployment, sickness, maternity, orphan benefits) and non-contributory benefits (child allowance, old age pension, family bonus, parental allowance). Both series from the National Statistics Office Stat DB: <http://nso.gov.mt/statdb/start>. Deflated using annual Retail Price Index with 1946 base year: [https://nso.gov.mt/en/nso/Selected\\_Indicators/Retail\\_Price\\_Index/Pages/Index-of-Inflation.aspx](https://nso.gov.mt/en/nso/Selected_Indicators/Retail_Price_Index/Pages/Index-of-Inflation.aspx).
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35. The International Monetary Fund, World Economic Outlook Database, October 2015 update, series: Gross national savings.
36. The International Monetary Fund, World Economic Outlook Database, October 2015 update, series: Gross national savings.
37. For example, the highly-diversified Mizzi Organisation, Alf Gera & Sons (pharmaceutical distribution), the Gasan Group (automotive, insurance and finance), and the Tumas [Fenech] Group (property).
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39. The World Bank defines inclusive growth as ‘growth that is high and sustained (a crucial condition for poverty reduction); broad-based across sectors and inclusive of a large part of the country’s labor force (issues of structural transformation and economic diversification thus take center-stage); and characterized by equality of opportunity in terms of access to markets and resources’. See: International Monetary Fund, Jobs and Growth: Analytical and Operational Considerations for the Fund, March 14, 2013, Washington, D.C., U.S.A, pp. 24–31.