

UNEMPLOYMENT BENEFITS AND INCENTIVES TO SEEK EMPLOYMENT IN MALTA

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Abstract. The aim of this paper is to analyse unemployment benefit programmes in Malta over the period 1992-2005 and to examine the difference between in-work and out-of-work benefits in order to determine whether the tax-benefit system is financially rewarding. The paper finds that the tax-benefit system did not provide an incentive for particular benefit recipients to seek and accept work. For this reason, it is concluded that a welfare-to-work strategy should be implemented in order to tackle the problem of unemployment benefit dependency among certain groups of benefit recipients.

Introduction

Welfare benefit is a topic of interest to many economic actors, including recipients, policy makers and the public in general. In designing unemployment benefit programmes, policy makers around the world have struggled to attain three main goals, namely: to raise the living standards of unemployed persons, to encourage work and economic self-sufficiency and to keep government costs low. However, policy measures centred on these goals have often resulted in a disincentive to supply labour to the market or to search for work. This is associated with the 'unemployment trap' or the 'poverty trap'. The unemployment trap is created when benefits paid to unemployed persons are high relative to expected earnings derived from employment, in which case benefit recipients have little incentive to find a job. Poverty traps may be experienced if the net income from work after withdrawal of benefits, tax and social security payments, leave no incentive for the individual to seek employment.

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Unemployment Benefit Programmes in Malta

Unemployed persons who have paid or credited 20 contributions (Class One) in the last two consecutive years prior to the year in which the claim for benefit is made, are entitled to receive short-term unemployment benefits. Class Two contributions paid or credited are not taken into account.

Additionally, formerly employed persons must have paid at least 50 contributions from the time that they first entered the labour market. In order to claim such benefits, one must be registering for employment under Part One of the Register kept by the Employment and Training Corporation (ETC). Eligible persons are entitled to short-term benefits up to 156 days and benefit days paid must not exceed the number of contributions paid.

There are two types of short-term benefits in this regard, namely (a) unemployment benefit (UB) and (b) special unemployment benefit (SUB). The difference between the two is that SUB is payable at a higher rate and only a head of household who qualifies for UB and for Social Assistance is entitled for such benefit, subject to certain other conditions.

Unemployment Assistance

When an unemployed person terminates his/her 156 days of receiving benefits s/he will no longer qualify for short-term benefits. In order to re-qualify for such benefits a person must be in insurable employment for a period of thirteen calendar weeks from the last day of his/her entitlement for such benefits. If the entitlement to short-term unemployment benefits is exhausted, claimants can apply for unemployment assistance (UA), which is long-term in nature. UA is also payable to persons who are either unemployed or seeking employment provided that their relative financial means is below that established by the Social Security Act (Chapter 318 of the Laws of Malta). A head of household is entitled for daily social assistance if s/he is registered under Part One of the Register.¹ If there are other members of the household other than the

¹ Part One of the Register kept in accordance with the Employment and Training Services Act includes persons who are available for, capable of, and seeking full-time employment.

head of household and his wife that are in paid employment, the amount that the claimant receives in UA is the difference between the scale rate that would otherwise be applicable if such members were unemployed and the scale rate that is in fact applicable to the household in respect of all the other members of the household. An increase in UA may be received under special circumstances. UA is withdrawn completely if a person finds a job, even on a part-time basis. This also applies if the spouse of the unemployed recipient enters the labour market.

When a person in receipt of any unemployment benefit becomes self-occupied, s/he will continue receiving the benefit during the first twelve weeks of his/her becoming self-occupied as long as s/he is between the ages of 18 and 50 and that during the twelve consecutive months immediately before s/he became self-occupied, s/he had been registered under Part One of the Register. The daily rates paid to unemployed persons receiving UB or SUB are given in Table 1, in terms of Lm, where Lm1 = EUR2.33.

Table 1
Daily Rate of Benefit in (Lm) (2005)

	UB	SUB
A single person or a married person maintaining a spouse who is not employed on a full-time basis	4.13	6.92
Any other person	2.70	4.52

Source: Social Security Act 2006

UA amounted to Lm34.30 per week, for a household of only one eligible member. The weekly rate is increased by Lm3.50 per week in respect of every other eligible member in the household.

Trends in Unemployment Benefits

Short-term Benefit Expenditure and Recipients

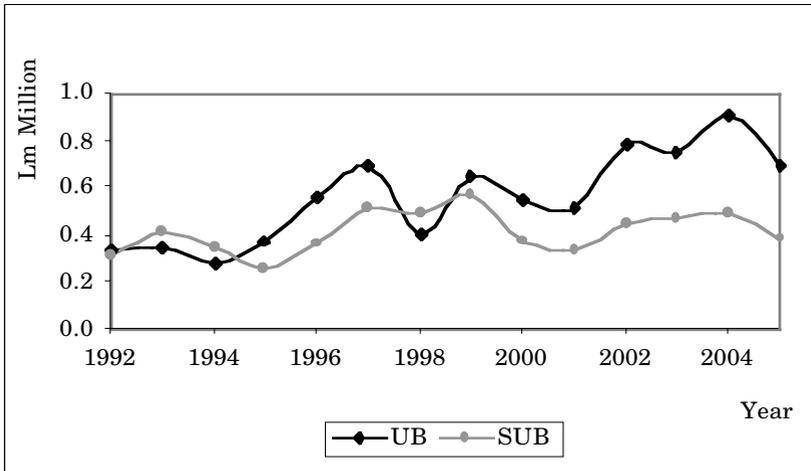
Government expenditure on short-term unemployment benefits followed an upward trend between 1992 and 2005, due to the increase in the

number of unemployed persons receiving UB or SUB over the years (see Figure 1). Government expenditure on UB is generally greater than that on SUB, even though SUB are payable at a higher rate. The reason is that more registered unemployed persons qualify for UB, since SUB are paid to an insured person who is the head of household and qualifies for both UB and Social Assistance (Social Security Department, 2005).

Although short-term unemployment benefit expenditure followed an upward trend, though there were fluctuations leading to built-in cyclical patterns. Unemployment expenditure has decreased for both benefits in 1994, 1998, 2000, 2001 and 2005.

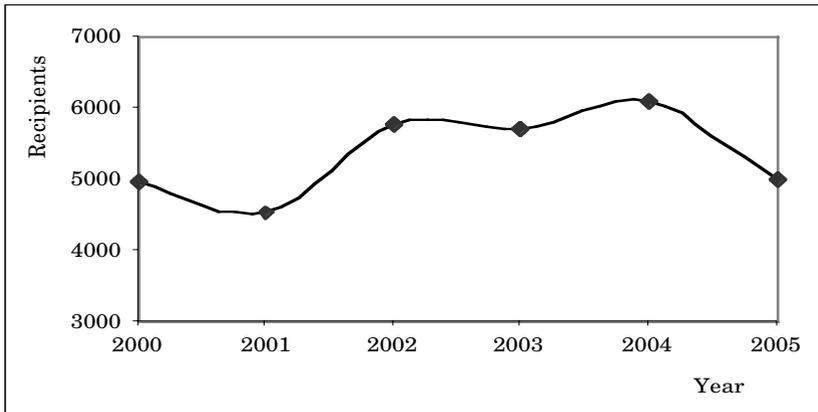
A possible reason for the reductions in 2000 may be that in that year the Employment and Training Centre (ETC) restructured and modernised its strategies and operations. Also as from 2000, the Corporation improved and extended its services schemes. With regard to 2005, the reduction in short-term unemployment benefit expenditure may have resulted from the National Action Plan for Employment in Malta, which was formulated in 2004.

Figure 1
Short-term Unemployment Benefit Expenditure



Source: Social Security Department, 2006

Figure 2
Short-term Unemployment Recipients



Source: Social Security Department, 2006

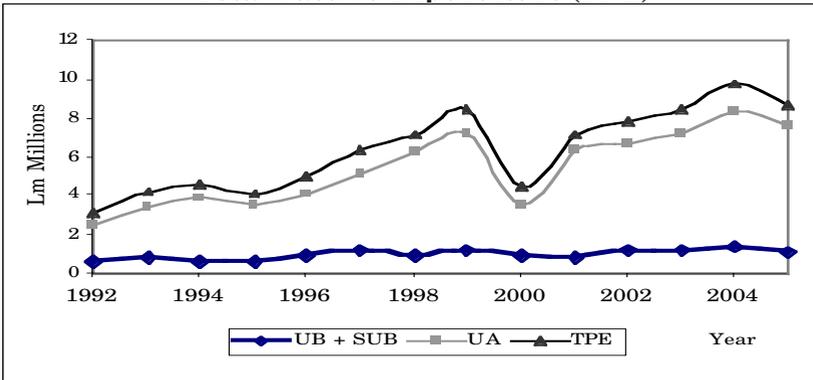
Short-term unemployment benefits expenditure also change with improvements and downturns in employment opportunities, leading to changes in the number of unemployed persons receiving UB and SUB, as shown in Figure 2. For example, the increase in unemployment benefit expenditure between 2003 and 2004, may be the result of the major decrease in employment in the manufacturing sector, particularly in labour-intensive clothing, leather, plastics and rubber manufacturing firms. Further layoffs were reported in the radio, television, telecom and furniture industries (Central Bank of Malta, 2004).

Long-term Unemployment Benefits

Government expenditure on UA, which is long-term in nature, is higher than the expenditure on short-term unemployment benefits and also followed an upward trend between 1992 and 2005, as shown in Figure 3. This was largely due to the increased number of recipients over the years (see Figure 4). Although subject to a means test to prevent abuses of the system, this type of benefit remains a burden on the Maltese economy, indicating that reforms must be carried out in order to reduce long-term dependency and to encourage recipients to enter the labour market.

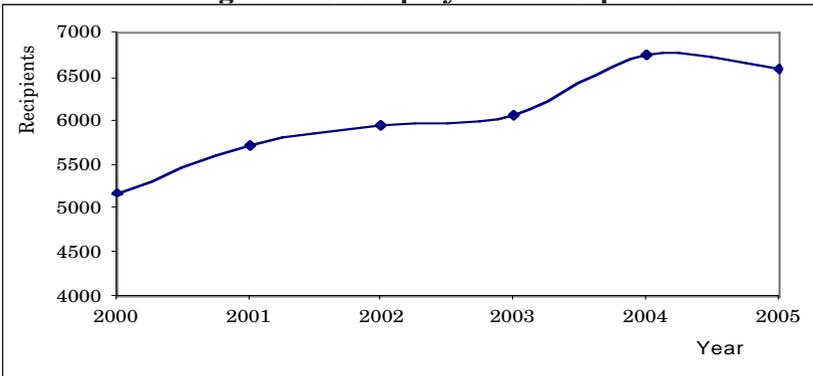
Figure 3 shows clearly that UA takes a much higher proportion of total Government expenditure on passive measures² than on short-term unemployment benefits. This reflects the fact that the number of recipients are mostly the long-run unemployed. In 2005, 57 per cent were UA recipients, while 33 per cent and 10 per cent were UB and SUB recipients respectively.

Figure 3
Total Passive Expenditure (TPE)



Source: Social Security Department, 2006

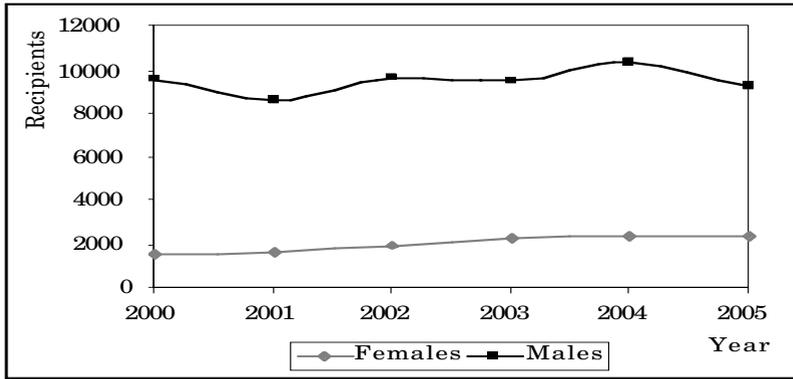
Figure 4
Long-term Unemployment Recipients



Source: Social Security Department, 2006

² Briefly, passive measures refer to social benefits for the unemployed. Active measures are policies designed to improve the access of the unemployed to the labour market

Figure 5
Unemployment Recipients by Gender



Source: Social Security Department, 2006

Employment Benefits by Gender

Figure 5 shows the total number of unemployment recipients in Malta classified by gender. The Figure shows that there are more male recipients than female. This reflects the fact that women's participation in the labour market in Malta is relatively low and since unemployment benefits are payable to those persons who were gainfully occupied prior to becoming unemployed, most women do not qualify for these types of benefits. The number of women receiving unemployment benefits is however increasing, as women increase their share in labour market, albeit at a slow rate.

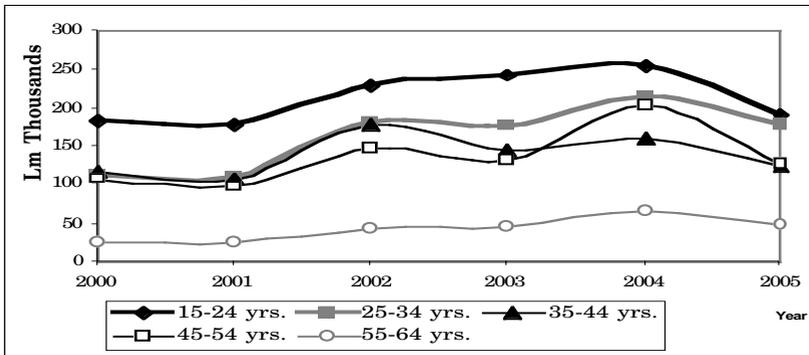
In Malta there is some concern regarding women's participation in the labour force. The Equality for Women and Men Act enacted in 2003 has as one of its purposes the creation of incentives for women to seek and take up work and measures to enable a balance between work and family life (Government of Malta, 2004). Through its Gender Unit Department, the Employment and Training Centre (ETC) is also working in the area of gender and employment to improve the situation of equality between men and women at the place of work. This is done by a combination of research projects, training session, seminars and media campaigns (ETC, 2004).

The Gender Equality Plan drawn up for the years 2005 to 2007 incorporates new training and employment schemes for women and the launching of a manual for employers in order to increase awareness about important issues relating to gender and work. Additionally, a supported employment scheme for single parents is also mentioned in this plan, with the aim of giving off-the-job and on-the-job training to a limited number of single mothers.

Short-term Unemployment Benefits by Age-group

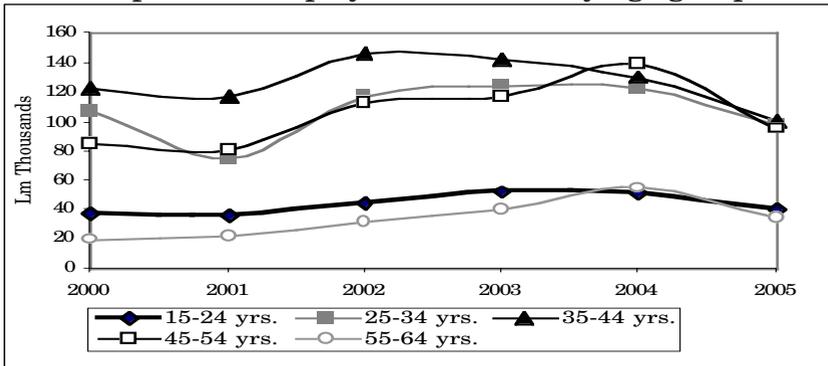
Between 2000 and 2005 the Government’s expenditure on UB was highest for the age-group 15 to 24, as shown in Figure 6, amounting, in 2005, to 48 per cent of the total unemployed. Most probably this is associated with the problem of early school leavers and the difficulties they face in finding a job due to lack of knowledge and experience. In fact, in 2005 it was reported that 69 per cent of the unemployed completed secondary level of education, while only 17 per cent completed post-secondary and tertiary education. This calls for lifelong learning strategies to improve the quality and efficiency of education and training systems. It is acknowledged by the Maltese authorities that individuals must be equipped with the skills required for a modern workforce in a knowledge-based society, to permit their career development and to reduce skills mismatch and bottlenecks in the labour market (Government of Malta, 2004:28).

Figure 6
Unemployment Benefit by Age-group



Source: Social Security Department, 2006

Figure 7
Special Unemployment Benefits by Age-group



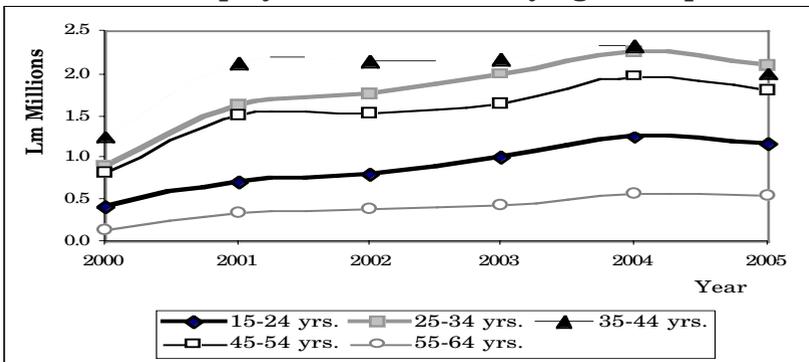
Source: Social Security Department, 2006

In the case of SUB, the highest percentages relates to the 35 to 44 age group, as shown in Figure 7. This problem points to the need for training and better initiatives to this particular age-group.

Unemployment Assistance by Age-group

Between 2000 and 2005, the highest proportion of UA recipients were aged between 35 and 44, as shown in Figure 8.

Figure 8
Unemployment Assistance by Age-Group



Source: Social Security Department, 2006

In Malta unemployed persons find it increasingly difficult to land a job after the age of 44, and the likelihood of employment decreases progressively with age, dropping markedly after the age of 55 in the case of men (Government of Malta, 2004).

Guideline Five of the National Plan for Employment (2004) focuses on increased labour market participation for all age groups. This requires a comprehensive approach covering in particular the availability and attractiveness of jobs, making work pay, raising skills and providing adequate support measures. There is a special concern about the 35-44 age-group.

In 2003 and 2004, the ETC introduced two schemes in order to encourage employers to recruit and retrain older workers.

The first is the Employment Training Placement Scheme which is intended to create incentives for employers to recruit workers over 40, by subsidising half the minimum wage for a specified duration.

The second is the Training and Employment Exposure Scheme which is intended for unemployed persons aged 40 and over. This involves intensive training, work exposure and a monthly allowance exceeding the minimum wage for one year.

By providing aid and assistance to this particular group of unemployed persons, ETC attempts to reduce the risk of these persons remaining unemployed, thereby decreasing Government expenditure on passive measures.

Duration of Job Search

Unemployment duration is longer for men than it is for women, as shown in Table 2. Women are less likely to become long-term unemployed, that is, for over 12 months. An important question in this regard relates to the reason for the shorter search duration of women.

It is not clear whether women move out quickly of the unemployment register because they find a job or because they become discouraged and drop out of the labour force.

Table 2
Duration of Job Search

Duration of job search	2001		2002		2003		2004		2005	
	M	F	M	F	M	F	M	F	M	F
< 5 mths.	1967	1589	2188	2154	2666	2225	1768	1982	2270	2037
6-11 mths.	1722	1042	2098	1085	1358	1071	1212	968	994	785
12 mths.	3152	581	2932	561	3754	1051	4094	1444	3984	1640

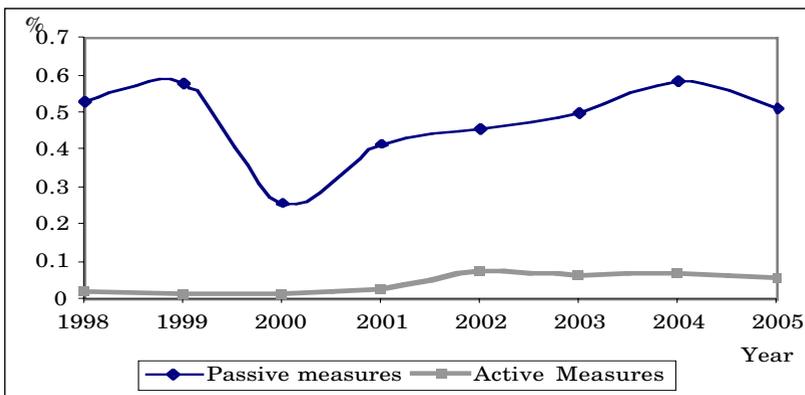
Source: National Statistics Office, Labour Force Survey, 2001-2005

Passive and Active Expenditure

In Malta passive expenditure is much greater than active expenditure as a percentage of GDP (see Figure 9), and as a result income support may be weakening work incentive.

Within the EU active measures aimed at the creation of a high-skilled and knowledge-based economy have become the key concept underpinning the European Employment Strategy (Pierre, 1999).

Figure 9
Passive and Active Measures/GDP Ratio (2005)



Source: National Statistics Office, 2006

Member States are called upon to ensure that at an early stage of their unemployment spell, jobseekers benefit from an early identification of their needs and from services such as advice and guidance, job search assistance and personalised action plans. Training, retraining, work practice and other measures must be given to young people before reaching six months of unemployment and twelve months in the case of adults (European Council, 2003).

This is due to the problem, highlighted in the National Action Plan for Employment in Malta (Government of Malta, 2004) that a number of jobseekers are offered work or asked to sit for job interviews but refuse the offer to work. Other areas of concern include:

- a considerable proportion of jobseekers do not benefit from active measures;
- a large number of registered unemployed opt for elementary occupations;
- there is a high illiteracy rate among the registered unemployed;
- a large number of registered jobseekers do not possess sufficient skills and qualifications as demanded by employers for particular occupations.

As an EU member, Malta is expected to take measures to increase its active expenditure to help unemployed persons find employment and thereby reducing passive expenditure. Guideline 1 in the National Action Plan for Employment (*ibid*: 11) states that active measures and preventative measures for the unemployed and the inactive should be designed to reduce inflow into long-term unemployment.

Work Incentive Indicators: METR and NRR

Work incentive indicators are useful to identify any undesirable influences of taxes and unemployment benefits on people's work decisions. These indicators help to identify whether a household member is at risk of the unemployment trap.

These indicators include two which are commonly used in connection with the unemployment trap. These are:

- (i) the marginal effective tax rate on earned income (METR); and
- (ii) the net replacement rate (NRR).

The METR is defined as the rate at which taxes are increased and benefits reduced as a person increases his/her earnings by a small amount (Carone *et al.*, 2004). This indicator quantifies the extent to which the tax-benefit system contributes to the unemployment trap in the case where unemployed persons receive unemployment benefits.

The net replacement rate (NRR) is an indicator of the generosity of a country's unemployment benefit programmes. This indicator is an average concept, linking the average income in and out of work (Disney, 2000).

An METR Indicator for Malta

Let A represent the situation of an unemployed person receiving unemployment benefits and let B represent the situation of an employed person.

Thus, following Carone *et al.* (2004), the change in gross earnings can be defined as:

$$Y_{\text{gross}} = Y_{\text{grossB}} - Y_{\text{grossA}} \quad (1)$$

and the change in net earnings is equal to :

$$\begin{aligned} Y_{\text{net}} &= Y_{\text{netB}} - Y_{\text{netA}} \\ &= (Y_{\text{grossB}} - t_B + b_B) - (Y_{\text{grossA}} - t_A + b_A) \end{aligned} \quad (2)$$

where Y_{gross} is the additional earnings from employment, Y_{net} is the change in net income obtained after deducting taxes and benefits, t is total tax (income tax and social security contribution) and b is total unemployment benefit.

Since in Malta recipients of unemployment benefits do not pay taxes and unemployment benefits are withdrawn completely as soon as a person finds a job, this formula reduces to:

$$Y_{\text{net}} = Y_{\text{netB}} - Y_{\text{netA}} = (Y_{\text{grossB}} - t_B) - b_A \quad (3)$$

Thus, the METR (expressed as a percentage) is calculated by Equation 4 :

$$\text{METR} = [1 - (Y_{\text{net}})/(Y_{\text{gross}})] \times 100 \quad (4)$$

Thus the closer the METR is to 100 per cent, the lesser is the incentive for an unemployed recipient to find a job. A value of the METR higher than 100 per cent signifies that an unemployed recipient will be worse off if employed.

METR for Part-time Workers

Malta has a statutory minimum wage, which in 2005 amounted to Lm3009.76 annually.³

The unemployment trap in Malta is likely to occur as a result of the fact that unemployment benefits or assistance are not taxed. If these were taxed in the same way as labour income is, tax rates or Social Security Contribution (SSC) rates will not affect the difference between net income from unemployment benefits or from work. The unemployment trap is also influenced by the duration of unemployment benefit programmes, since the incentive to remain financially dependent decreases over time as benefits are withdrawn completely after a period of 156 weeks.

The present author (Zerafa, 2006) carried out a study on the METR for part-time workers in Malta to determine whether the minimum SSC paid by these workers leads to disincentive to work. The assumptions made were that an individual is offered a part-time job on a 20-hour basis and that the wage is equal to half the National Minimum Wage. The individual has to decide whether to enter the labour market and thus lose his/her entitlement for benefits or else refuse to take part-time work and continue receiving benefits.

³ Part-time workers are not protected in this regard since there are no regulations to the minimum that these workers must earn. This is likely to discourage unemployment benefit recipients to take on part-time work, since the wage they would earn from work could be less than that received from passive measures.

METR for Single Individuals

The results produced in Zerafa (2006) indicated that, using Equation 4, the METR for a single individual UB recipient was, in 2005, equal to 76 per cent. This relatively high rate means that a UB recipient, who decides to enter the labour market as a part-time worker will earn Lm361.40 above the UB s/he used to earn, amounting to an extra Lm6.95 per week. This might not be enough of an incentive for a person to accept work.

The same calculations were carried out for recipients of SUB. The METR for single individuals receiving SUB was calculated to be 114 per cent. This means that if a person who was entitled to SUB accepted to take part-time work, s/he would have lost Lm206.44 per annum. This leads to the conclusion that a single individual who is receiving SUB was worse off if s/he decided to work part-time, since the annual income from unemployment benefits was higher than the wage being offered.

The METR for a single individuals receiving UA amounted to 139 per cent. Therefore, if a UA recipient decides to enter the labour market, s/he would have lost Lm579.80. For this reason, unemployed recipients of UA were not likely to consider working part-time.

It should be noted that the SSC rates in Malta are rendering the system regressive in nature, due to the fact that they are more burdensome on low-income earners than on high-income ones. Thus, SSC on part-time work provide a disincentive for unemployed workers to engage in formal work, as these result in high METRs.

METR for Married Individuals

The same analysis was carried out for married persons receiving UB, SUB and UA respectively. The METR for married UB recipients was found to amount to 106 per cent, implying that a married person receiving UB has no incentive to take on part-time work since the income from work would be lower than that received from benefits. This also affects spouses, since benefits are withdrawn completely, if any of the partners enter the labour market.

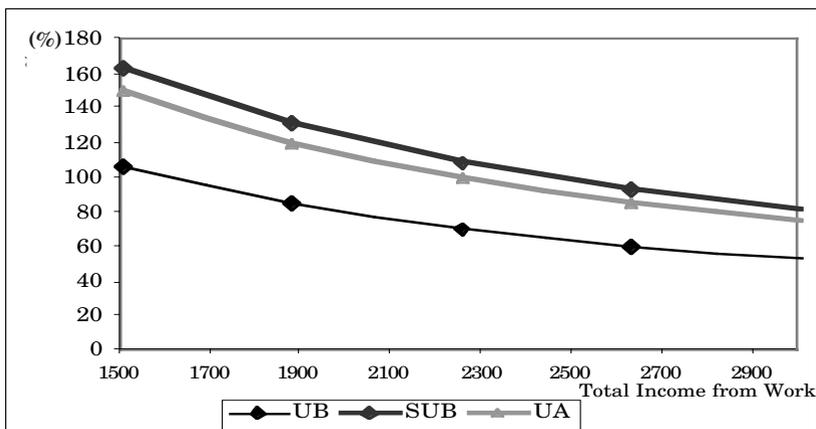
The METR for married individuals receiving SUB amounted to 163 per

cent, implying that these persons would have lost Lm955.24 annually had they decided to take part-time work.

Married recipients of UA faced an METR of 151 per cent, which although less than that for recipients of SUB, still did not give any incentive for long-term unemployed recipients to seek a part-time job.

Figure 10 shows the METR for an unemployed benefit recipient of UB, SUB and UA respectively, who decided to enter the labour market as a part-time worker. The Figure shows different results as the recipient works additional hours until s/he ends up working full-time. As can be seen in this Figure, the METR was as high as 106 per cent when a UB recipient decided to accept part-time work for 20 hours (half the minimum wage). The METR diminished with increased hours of work, until the person concerned decided to be a full-time worker where the net effective tax rate was equal to 53 per cent, which was still considerably high especially for persons who prefer leisure to work. This reality may have encouraged recipients to participate in informal activities clandestinely, and still receive UB while earning their undeclared wages.

Figure 10
Marginal Effective Tax Rates (UB, SUB, UA) (2005)



Source: Calculations by the author

The METR for a person receiving SUB is higher than that for a recipient entitled to receive UB. Starting from as high as 163 per cent for a recipient who decided to work for 20 hours per week, it decreased to 82 per cent for a person who decided to accept full-time work. Therefore, in this case, it was much more discouraging for persons receiving SUB to accept part-time work since they would have earned less from work than from benefits.

The METR for recipients of UA was higher than that for recipients of UB, however it is less than that for recipients who are entitled to SUB. The METR was as high as 151 per cent as an individual decided to work for 20 hours, however it diminishes to 75 per cent as an individual decided to work full-time.

The NRR Indicator

Following Disney (2000) the net replacement rates for Malta can be computed as shown in Equation 5:

$$\text{NRR} = b(1 - t_b)/w(1 - t_w - c) \quad (5)$$

where b = the level of benefit, t = tax rate, c = social security contribution and w = income from employment.

Since in Malta, unemployment benefit recipients are exempted from paying taxes, this formula reduces to (in percentage terms):

$$\text{NRR} = b / [w(1 - t_w - c)] \times 100 \quad (6)$$

Equation 6 shows that the lower the percentage NRR the higher is the disparity between the benefits and net income from employment, implying that a person with high income from employment will find it harder to depend on unemployment benefits than a person with low net income from employment.

It should be noted that this analysis takes into consideration unemployment benefits only—other benefits, such as medical assistance and subsidised services, are not taken into account.

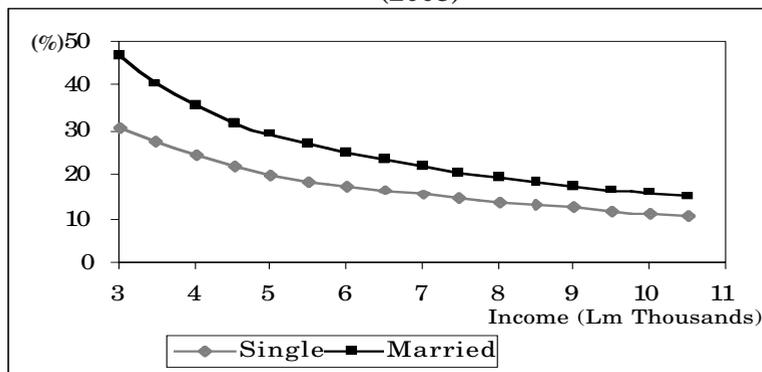
Computing the Net Replacement Rate for Malta

Figure 11 shows the NRRs for single individuals who in 2005 were entitled to UB, considering income from employment. As can be seen from the Figure, the NRR amounted to 31.1 per cent for those persons who were earning the minimum wage, and continued to decrease as the level of income increased. Therefore, people who were paid the minimum wage rate benefited from higher replacement rates. This may imply that people that for example used to earn above Lm8000 before becoming unemployed will find it hard to depend on unemployment benefits since they were accustomed to a higher standard of living. Therefore, these people were more likely to put more effort in order to find work than low-skilled workers who face higher replacement rates.

Figure 11 also shows the NRRs for married persons. As can be seen, married persons faced higher replacement rates than single persons. However if we consider a person on minimum wage, the NRR amounted to only 47.6 per cent of his/her previous income which is still quite low.

One can conclude, therefore, that contrary to what was found in the case of part-time employment, it is not worthwhile for an individual to depend on UB if s/he is seeking full-time employment.

Figure 11
Net Replacement Rates for Single and Married Individuals
(2005)



Source: Calculations by the author

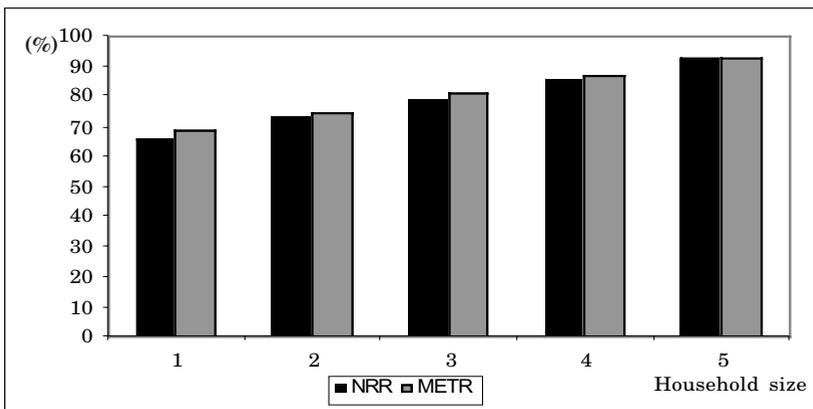
METR, NRR and Household Size

This section will take a closer look at full-time workers earning the minimum wage and recipients of UA. The analysis will be carried out with regard to different household sizes. It is assumed that if the size of the household is equal to two, this constitutes a married couple. If the household size is greater than two, then the household is assumed to consist of a married couple with children. In order to simplify tax computations, another assumption is that only the breadwinner of the household is employed and earns a wage.

Figure 12 shows that as benefits are increased as the household size increases, both the NRR and the METR increased with the size of the household, so that a household consisting of five members would have had an NRR and an METR as high as 93 per cent.

Thus, it is clear that as household size increases the incentive to work is reduced. It should also be kept in mind that recipients of UA are entitled to other benefits, such as full children's allowance, no surcharge on water and electricity and free medical assistance.

Figure 12
METR, NRR for a Minimum-Wage Earner
by Household Size (2005)



Source: Calculations by the author

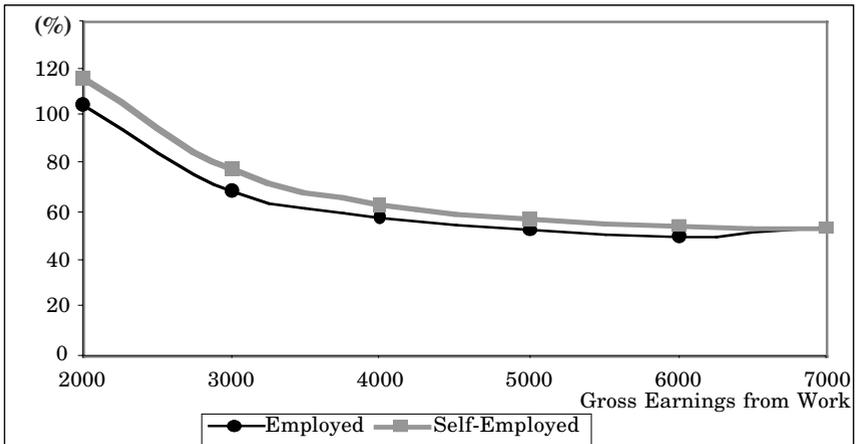
Work Incentives for Self-Employed Individuals

The tax-benefit system in Malta may also discourage unemployed individuals to start their own business as self-employed. The first disincentive is that unemployed persons who decide to open their own business must pay SSC; however if their business fails, self-employed individuals are not entitled to any UB or SUB.

In addition, both single and married self-employed individuals in 2005 faced higher METRs and NRRs than hired employees, as shown in Figure 13 and Figure 14.

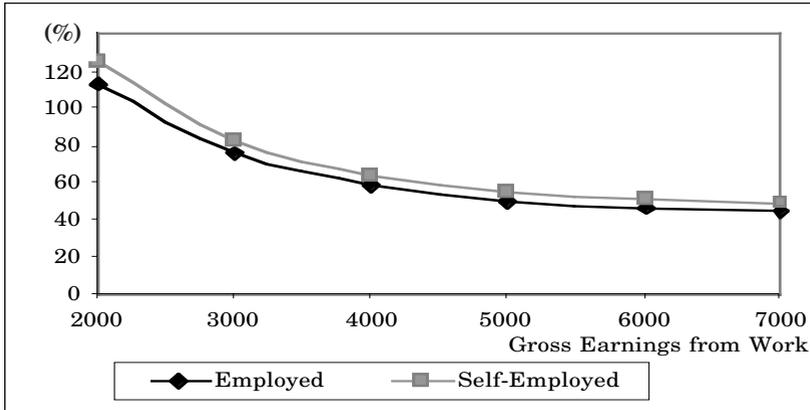
The computed METRs and NRRs for persons earning Lm2000 or Lm3000 annually were very high, particularly for self-employed persons who earned Lm2000, with an NRR of 121 per cent and METR of 116 per cent for single persons and 134 per cent and 125 per cent for married persons. For these reasons, the incentive for an unemployed person to work as self-employed was low for both single and married persons.

Figure 13
METR for Single Employed and Self-employed Individuals (2005)



Source: Calculations by the author

Figure 14
METR for Married Employed and Self-employed Individuals
(2005)



Source: Calculations by the author

Conclusions and Policy Recommendations

The main objective of this paper was to find out whether or not the system of unemployment benefits in Malta disincentivises a person from seeking employment. Using appropriate indicators, the paper examined whether the tax-benefit system is financially rewarding.

The empirical evidence suggests that the system is not very conducive to encourage an unemployed low-income earner to seek employment. The paper produced evidence that:

- Social Security Contributions on part-time work provide a disincentive for unemployed benefit recipients to engage in formal work, due to high METRs. This disincentive is greatest for recipients of SUB.
- Low-income earners have higher NRRs when compared to high-income earners. Therefore, low-income earners who become unemployed have a lower incentive to find work.
- Married persons have higher NRRs than single persons, again suggesting that married persons have less incentive to find work.
- As household size increases, low-income earners will have less incentive to find work, since these households benefit from very high NRRs and METRs.

- Self-employed individuals face higher METRs and NRRs than employed individuals. For this reason, they may be more tempted to participate in the informal economy while receiving unemployment benefits.

It can therefore be concluded that the tax and benefit systems should be reviewed and, where appropriate, reformed with a view to encouraging unemployed persons to benefit markedly from seeking employment. The focal point of policy design for Malta should be to increase net benefits from work.

The Government has various options in this regard, on its own or jointly with the private sector. These options include:

- Reform social security systems by reducing benefits.
- Increase the minimum wage.
- Reduce tax rates and/or SSC rates.
- Strengthen financial incentives through in-work benefits (IWBs).

The first option would seem to be the simplest one to tackle the unemployment trap. However, the social costs associated with this option may be unacceptably high. Although lowering out-of-work benefits might improve the gap between income from employment and unemployment benefits, this could result in increased risk of poverty for non-employed individuals. For this reason, the present author does not recommend that the Government reduces the amount paid in benefits as a policy tool.

The second option, namely an increase in the minimum wage, could also reduce the unemployment trap. However this could have serious repercussions on Malta's competitiveness and could also lead to increased unemployment.

For these reasons, Government should resort to one of the other two options or a combination of both. Zerafa (2006) proposed a system aimed towards achieving a significant reduction in high marginal effective tax rates and in reducing the tax burden on low paid workers, as follows:

- Remove the minimum payment that an individual earning below the minimum wage must pay for social security, and introduce a proportional social security payment of ten per cent of gross earnings.⁴

⁴ Such a scheme was actually introduced by the Government as from January 2007.

- Merge the Social Security Department with the Employment and Training Corporation for better screening and monitoring. This will make it easier to combine stricter controls over benefit programmes and to reduce benefit dependency in order to incentivise unemployed persons to seek employment. The merging of these organisations is required to increase both the cost-effectiveness and the effectiveness of labour market policies.
- Impose stricter rules and introduce stricter penalties, such as head of households and single individuals should be penalised through a reduction of their benefits, if it is found that an unemployed person has not made sufficient effort to find a job or to be involved in training.
- Introduce and implement a Jobseeker Screening Instrument in order to identify those unemployed individuals who are at risk of becoming long-term unemployed and a Motivation Screening Instrument for those remaining unemployed for six months or more, to instil motivation, self-esteem, literacy or numeracy skills.

With regard to financial incentives, Zerafa (2006) proposed the introduction of:

- In-work benefits for a full year to long-term unemployed recipients and SUB recipients who find work within the first six months of receiving such benefits.
- In-work benefits for a full-year to unemployed recipients who decide to start their own business.

These recommendations will contribute towards achieving a significant reduction in METRs and incentivising unemployed persons to seek work.

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