



Proposals for **NATIONAL BUDGET 2017**

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Introduction

How thick is the Ice?

The major macro-economic indicators for the Maltese economy are positive and clearly above the EU average. Real GDP growth is expected to be in excess of 4.1% this year, unemployment is at a record low of 5.1%, and the labour activity rate has also increased. The growth is spread across all major economic sectors, including manufacturing which has registered an increase in Gross Value Added of 7%. Tourism arrivals have also increased dramatically due to a general improvement of the product and marketing efforts combined with windfall arrivals resulting from instability in other major tourist destinations like Egypt and Turkey. Equally important, government is succeeding in attaining its fiscal targets, with a declining fiscal deficit together with a fall in the debt to GDP ratio. Inflation is also in control at close to 1%.

Malta is passing through a boom period and the major challenges being faced are to keep the economy from over-heating and to manage sustained growth. The main question is: We are skating smoothly on the ice, but how thick is the ice we are skating on? Is this an economy on steroids, or is this level of growth sustainable in the medium to long-term?

The budget needs to project beyond the coming calendar year to address proactively some major fault lines underlying our economy, namely:

- That our economy will probably not be eligible to further EU structural funding post 2020.
- The possibility that the tax incentives which have been critical in attracting our financial services and gaming sectors will be removed or toned down.
- Maintaining positive tourism figures once there is more stability in the Mediterranean region.
- Increasing Malta's economic output capacity.

- Reconciling economic growth with objectives related to environmental constraints and quality of life.
- Ensuring that Malta's reputation of good governance does not deteriorate.
- The drop in national revenue once the gold rush from the sale of Maltese citizenship subsides.
- Ensuring that the Banking Sector continues to be in a position to service international business.

The current positive macro-economic indicators may be hiding these fault lines so increasing expectations from the general population. The heading of the pre-budget document: Prosperity with Social Justice addresses an important concept linked to economic growth – distribution of wealth. This concern is generally being raised due to the following factors:

- The disparity in gross value added between different sectors is leading to widening wage differentials between sectors.
- There are vulnerable groups that may be experiencing a decline in their purchasing power. Two main segments that fall in this category, which have been identified by the Caritas Report, are pensioners and single parent families.
- Rental costs are increasing due to higher demand by foreign workers and residents and are thus eroding the disposable income of persons and families who do not own their own homes.
- Incidences of quick cash payouts that irritate honest working people (e.g. the €80k payment to the Monti hawkers).
- Displays of ostentatious consumption by wealthy foreigners (and some local ones) increases the feeling of relative poverty, especially within the low income segment.
- A two tier labour market: employees in the public sector (including parastatal companies) have guaranteed lifetime employment and guaranteed working conditions, as has happened at Enemalta and will probably occur at Air Malta. Employees in the private sector do not have such luxuries.

The knee jerk reaction to this situation is to intervene with the wage determination mechanism, but government should give due consideration to the fact that a major reason why Malta has managed to successfully weather the brunt of an international recession, and rebound with the current rate of economic growth, has been a strategy of wage moderation and responsible employment practices and job creation by the private sector. Some countries in the EU have higher wages than Malta, but they also have higher unemployment, meaning that a larger section of the working population is deprived of these higher wages, thus making them more emarginated and unable to access the labour market. In principle, the MEA has advocated policies that minimise the number of persons on low wages rather than raising wages artificially. Vulnerable groups, such as pensioners and single parent families should be assisted through focused social interventions. Home ownership and long-term savings should be encouraged and incentivised.

The Malta Employers' Association is in no way advocating a freeze in wages and salaries, but any increases should reflect corresponding changes in productivity and competitiveness of our industries. It will be a mistake on the government's part to meddle with the operation of the labour market and collective bargaining process. There is no question that wage inflation is currently a reality, even in low skilled jobs. This is a result of labour shortages in various sectors of the economy, as well as the creation of more high value added jobs by the private sector.

On the one hand, government has been successful in increasing the supply of labour through a set of active labour market policies and curbing abuse of the welfare system. Yet the increase in public sector employment is also a drain on human resources which would be better employed in the private sector. Many companies report of employees who resign to take up jobs in the public sector, which may not be productive in all cases. For example, employers in manufacturing and tourism sectors in Gozo have been particularly affected by resignations from within their labour force to take up jobs in the public sector.

One factor which is having an impact on the economic and social scenario in Malta is the changing demographic. The increased population resulting from the foreign labour force - estimated to exceed 30k in 2016 – is contributing to domestic demand, but also

exerting pressure in terms of increased rental costs, traffic generation and pressure on educational and health infrastructure, amongst others.

In a country with limited resources and output capacity, we will have to make choices as a society, as some activities may interfere or even disrupt others. A classic case is the threat to sea cleanliness posed by the pollution being generated by fish farms. Will we have to choose between fish farms or quality tourism, or can there be a happy coexistence between the two activities? The same can be said about Malta's carrying capacity as a tourist destination in terms of available accommodation, flight capacity, and environmental sustainability. The major future challenge may well be one not of utilising existing resources to full capacity, but rather of how to establish the best mix of economic activities to maximise sustainable economic performance together with environmental and quality of life considerations. In the same way that ten years ago we had to restructure the economy because of circumstances which were forced upon us, namely the outsourcing of our low end manufacturing sector to low cost destinations, we will have to take important decisions which can well mean the deliberate phasing out or reduction of activities which yield a low return or which have an adverse effect on our society's quality of life.

Proposals

1. IIP Reform

Following extensive consultation with its members, the MEA has issued a set of recommendations for a more efficient processing of VISAs for foreign employees. Although some progress has been registered, there needs to be a greater effort to expedite applications to meet demand for labour. The recent measure to fast process applications for waiters in the catering industry is only a stop gap measure as companies are experiencing shortages in all sectors. The MEA's report on work Visas with recommendations can be accessed by following this link: <http://www.maltaemployers.com/loadfile/cd5a503e-09ed-42ee-9a01-7fd82463d559>

2. A Level playing Field

Competition is a healthy aspect of business and has always been encouraged by the Association, as long as all participants play by the same rules. This is not the case in the retailing sector. Many supermarket owners report that they are surviving on the merit of an increased population due to the many foreign workers in Malta and Gozo, and that they are losing market share to a retail chain that is gaining a market dominant position due to tax incentives from which they do not benefit. This state of affairs is also affecting manufacturers who produce for the domestic market as, to reach consumers, they face a serious barrier to entry.

The constant flow of unchecked imports from Sicily by catamaran also needs to be addressed, as this is being detrimental to local producers and importers who face a serious competitive disadvantage as they pay VAT and other taxes on their output while the products brought over from Sicily pass through unchecked. Products and produce coming from Sicily by catamaran should be subject to customs checks and regulations same as any other imports.

3. Public sector Collective Agreement

The public sector collective agreement will expire shortly and will be open to fresh negotiations. In its memorandum to political parties before the last election, the MEA had proposed that no negotiations in the public sector should take place in the six months before a general election. Government's bargaining position will grow progressively weaker the closer the election gets and will thus be prone to bow to unrealistic demands by unions.

The private sector is also a stakeholder in the public sector collective agreement, as excessive increases in the working conditions will affect relativity with those in the private sector.

4. Pegging of Wages in the Public Sector to those of the Private Sector

Pegging wages of employees in the private sector to those in the public sector has been a mistake which has to be rectified. Improvements in working conditions should be left open to collective bargaining or a possible tweaking of the Wage Regulation Orders, and not become automatically linked to wages in the public sector. Companies who provide services to the public sector and who are also engaged in B2B with other companies in the private sector face an anomalous situation whereby groups of employees doing similar jobs are being paid different rates. This has created a dangerous precedent. If public sector wages are going to be applied to the private sector, then the private sector should be involved in the negotiations of the public sector collective agreement.

5. The Minimum Wage

The minimum wage should only be adjusted through the COLA mechanism. However, every effort should be made to minimise the number of employees actually living off the minimum wage. The minimum wage in Malta is certainly not the lowest in Europe,

and the percentage of employees earning the minimum wage is very low. The operation of the labour market mechanism, combined with a relatively high incidence of unionised employees in Malta provides more opportunity for employees to improve their conditions of employment, particularly during times of low unemployment.

6. The Rental Market

Government should conduct an audit of its housing stock to determine whether the occupants are in need of social housing. There might be beneficiaries who would have benefitted from schemes when they were relatively poor but are not in the same situation today. This can release properties to be allocated to more needy families.

7. Consultants in the Public sector

All consultants engaged with public entities and who have not been employed through a recruitment process should be subject to a periodic audit by an independent board to justify their position. As with any private sector company, they will report on time spent, activities and results achieved.

8. Consultation and Implementation

There should be adequate consultation on any measures that affect employers well before implementation. No measures should come in force before the full administrative process becomes in place. The negative experiences of the employment of persons with disability and the Maternity Leave trust fund should not be repeated. To date, no company has received any re-imbursement from the maternity leave fund even though employer have been contributing to this fund since July 2015.

9. Energy prices

In spite of reductions, energy prices for Maltese enterprises remain higher than the EU average, partly because, for decades, the commercial rates have been subsidising the residential rates. Benefits arising from lower prices of fuel and efficiencies in energy generation should be passed on to enterprises to make them more competitive.

10. Alternative Energy

It would be of long term benefit to the economy to transfer part of the savings on fuel prices to incentivise a stronger diffusion of alternative energy. Fuel prices may not stay low indefinitely, and a stronger infrastructure in alternative energy will hedge the economy against the volatility of energy prices.

The budget should include funds to re-activate incentives for the installation of photovoltaic panels by enterprises. There was a good take-up with previous schemes by businesses. Additional incentives should be introduced for the diffusion of electric vehicles and the setting up of solar farms.

11. Air Malta

The situation at Air Malta needs to be resolved as early as possible. The country needs a cost effective, self-sustaining airline. Employment levels should reflect the size of the airline.

12. Freeport

The Association has issued a public statement concerning the future of the Freeport. It is important to seek ways to allow this company to reach its full potential as a major logistical hub in the Mediterranean while minimising the possible negative impact on

the locality. There should be a reasoned discussion which excludes partisan political agendas.

13. Education

- In spite of improvements over the past ten years, and an expenditure on education which, in terms of percentage of GDP, is higher than the EU average, the results on particular aspects of education such as NEETS, leave a lot to be desired. Government should investigate to determine whether increased expenditure leads to better results, or whether there could be a more streamlined educational system which is more efficient and yields better outcomes. The reasons for low achievement might not lie within the educational system itself, but may be attributed to exogenous factors.
- In the tertiary sector, while it is commendable that MCAST offers a wider range of courses, these should not overlap with courses offered at University, and the main thrust of the institution should remain vocational courses focused on MQF levels 1 to 5.
- The issue of truancy is still a problem in government schools. This is contributing to a deteriorating work ethic in the private sector at a later stage in the students' lives. There should be enforcement to ensure that doctors who certify healthy children as sick will risk losing their warrant.

14. Care of Elderly Parents

Family friendly measures are normally associated with child care. However, with an ageing population more families are pooling resources to cater for the needs of parents, through private homes for the elderly or even engaging care workers at home. It is being proposed to grant tax incentives for working persons who are paying for private services in elderly care. Such initiatives can relieve government institutions from carrying the full burden of caring for an increasing number of elderly persons, and also help in retaining people – mostly women - in the labour force.

15. Child Care

The measure to introduce free child care has yielded positive results in terms of an increase in female participation. The service can be improved by considering the needs of an increasing number of families who are on shift work. These can be accommodated through an expansion of the hours during which child care is available, and through the setting up of more child care centres around Malta and Gozo.

16. Set-off between Government Departments

It is common for companies to be owed money from one Government department whilst having outstanding payments themselves with other Government departments. This causes a strain on the cash flow of many companies who are, in some instances, charged interest and penalties on outstanding payments, and at times even face criminal proceedings. It is proposed to establish a system under which set-offs can be arranged. This will be a big relief for many businesses as it improves their liquidity situation.

17. Assistance to Start-ups and SMEs

Government could be instrumental in creating a culture of good corporate governance by setting up a Body of Approved Non-Executive Directors to sit on start-up companies, offering advice to new entrepreneurs as well as mentoring the executive directors/owners of these new businesses. These non-execs would be financed by Government to assist start-ups in making it into the business world, as well as creating the correct platform and set-up of company boards and good governance. These companies could also be looked up more favourably by banks, Malta Enterprise, and any other organisations that would normally assist such start-ups.

Additional proposals for SMEs:

- urgent publishing of ERDF schemes – to include grant schemes for SMEs
- the need of a holistic comprehensive and exclusive SME website to facilitate information
- the need of a business clinic – to support SMEs in difficulties
- the establishment of an SMEs commissioner who will be acting as a small business envoy amongst others
- the need of another incubation centre for start-ups in artisan trades, innovative creations, and traditional icons
- The support for entrepreneurs developing a niche for local (villages and towns in Malta) branding

18. Traffic

The traffic situation is getting progressively worse. With increased traffic, patching the system through attempts to improve the bus system can only lead to temporary short term improvements. What is clearly required is a re-thinking of public transport to include long-term investment involving sea transport, more efficient traffic management, and possibly a metro system through the utilisation of EU infrastructural funds. In the short run, government should explore incentives for better use of school transport and where possible, transport organised by the company.

The deteriorating traffic congestion is costly for businesses. Distribution is slower and more expensive, employees are finding it more difficult to report to work on time, and considerable productive hours are simply being wasted stuck in traffic.

19. Revision of VAT Thresholds

The VAT thresholds for exempt without credit supplies of goods and services have remained unchanged since the introduction of VAT in 1995. It is being proposed to revise these thresholds to reflect current values.

20. EU Funds

There is an urgent need to issue the calls for projects to utilise EU funds. Companies are waiting for such calls to propose projects which will further contribute to economic growth.

21. NI Contributions by Employers

In cases where employees working part-time or reduced hours pay less than the minimum flat rate of National Insurance, the employer should not be obliged to pay the minimum rate. The employer should pay the equivalent of that paid by the employee.

22. Tax on Health Insurance

Removing the tax on health insurance as a fringe benefit will incentivise health insurance which in itself relieves the state of the expense of a free public health sector.