

**Malta Employers' Association
Proposals for National Budget 2009**

Introduction – A General overview of the economy

In spite of adverse global pressures, the performance of the Maltese economy has shown signs of considerable resilience in facing up to challenging external developments. 2008 has been a year of upheavals and events which are challenging established notions about the stability of western economies and financial markets in general.

On the employment front, Malta has managed to generate substantial full time jobs in the private sector in the past eight months whilst reducing employment in the public sector, and the projected real GDP growth for 2008, at 3% is higher than the EU average, although this figure does not live up to earlier projections. The declining unemployment figure, with fewer than 6000 persons registering for work in September, or approximately 4% of the labour supply, confirms the reports of labour shortages in many sectors of the economy. Yet there has been no improvement in the overall participation rate, which, at 54% means that one of the labour market priorities is to encourage more people to work to achieve sustained economic growth and affordable welfare systems. Many of the 3000 jobs generated in the private sector are in SME's, with 7000 new small businesses being registered during 2006-2008.

The investment in education, particularly in MCAST, is yielding desired results, although there are pockets of qualified graduates that are finding it hard to find employment in their field of specialization. The percentage of school dropouts remains an issue as demand for unskilled labour is on the decline and shifting towards higher value added jobs. 2008 has, thus far also been characterized by stable industrial relations with hardly any man days lost due to industrial actions in the private sector.

Labour market forces are creating widening income disparities between groups of employees in high demand and those in unskilled or declining industries. This factor is contributing towards increased labour mobility. The privatization of the shipyards should release a number of skilled workers which are in short supply in the private sector and serve to partially alleviate the shortages in manpower in some areas of the economy.

The introduction of the EURO went smoothly without any significant shocks to the economy, and there are no indications that the change in currency has, in itself, generated inflationary pressures on the economy. However, the current inflationary trend, with the annual rate standing at 4.42% in August, is a cause of concern to all social partners. Households are feeling the pinch of reduced purchasing power, and employers cannot guarantee adequate compensation without forfeiting profitability and competitiveness. Malta's heavy dependence on volatile international fuel prices is a factor that makes economic planning unpredictable. The experience during 2008 reveals that the fluctuations in oil prices are not determined just by market forces, but equally by international political events which are frequently subject to the whims of leaders in

politically unstable countries. This makes it difficult to predict or to hedge against price hikes. A few months ago most predictions for oil prices pointed towards the \$200 a barrel mark, yet the outcome was a reduction from a high of close to \$150 to current levels approximating \$100 a barrel. In such an unstable environment, and also in view of Lisbon targets with respect to the environment, Malta must invest and educate to reduce this chronic dependence on fossil fuels, although the expectations, given financial and natural constraints, must be realistic and respect the limitations of alternative energy sources.

The tourism sector has taken a boost from the introduction of low cost airlines and the expansion in arrivals of cruise liner passengers, although the latter has seen a slight drop in the first quarter compared to the previous year. This is another volatile sector and subject to the purchasing power of key, markets such as the United Kingdom. The performance for 2008 shows some positive trends over the previous year, but the increase in arrivals has been offset by shorter stays and reduced occupancies in the five star segments.

Malta is enjoying favorable ratings as an investment destination, with FDI retaining the momentum of the previous two years. This is encouraging since new jobs are being created in emerging areas, but one cannot be complacent. The departure of Atlas in the IT sector is evidence that one still has to watch the back door.

Any proposals for the national budget cannot ignore the state of government finances, and the shortfall between revenues and expenditure during 2008 is a major concern which sets serious constraints on the budgetary targets for the coming years. The most worrying aspect is that the deficit of €260 million during the first eight months of this year – an increase of €96m over the same period last year – occurred in spite of an increase in income tax and VAT revenues. The reduction in income tax rates, plus the increase in economic activity have generated increased revenues (income tax revenue increased by 8.4% during Jan – Aug 08, VAT by 9.5% over the same period), but these have been insufficient to meet the increased recurrent expenditure. Expenditure on social security benefits alone shot up by 9.7% (€38m) during 2008. Health costs registered a further increase of €36m over the same period. In spite of the drop in public sector employment, the wage bill has gone up because of the collective agreement increases in the public sector. There is also the question of the financing of the early retirement schemes of the Malta Shipyards, which will also leave a dent in public finances.

In view of the above assessment of the local economy, the Malta Employers' Association is submitting its proposals for the National Budget for 2009. The proposals are based on other position papers that have been presented by the Association recently, and are in line with the document which was sent to the political parties before the last elections, which was based on the principles of Sustainability, Competitiveness and Proactivity.

BUDGET PROPOSALS

A general note on budgetary measures and the way they affect employers: before a measure is introduced, the mechanism for its implementation has to be specified. There have been cases where employers are still unsure how to apply these measures. One of them is the 14th week paid maternity leave. Employers do not have a clear direction how to claim the 14th week from the social security contributions.

1. Social security contributions for part timers

The MEA is asking for a change in the legal notice regarding part time work to enable employers to pay the same rate of social security as part time employees who opt to pay the pro rata amount. This will reduce the gap between engaging a part timer who already has a full time job and one whose job is his/her principal employment.

2. COLA increases

The measure taken for the 2008 budget, whereby an enhanced COLA increase was given in anticipation of inflation should definitely not be repeated. Government has also received a recommendation from the IMF to remove the COLA mechanism on grounds that it can lead to wage increases that do not reflect productivity.

COLA increases should only be applicable to employees earning less than €160 per week.

3. Income taxes

The Association has always been prudent in its proposals regarding income taxes. Its position has always been consistent in that income taxes should only be reduced to the point that they do not have an adverse effect on the fiscal deficit.

In its memorandum to political parties prior to the last elections, the Association stated that: 'The management of the fiscal balance should aim at the control of expenditure whilst generating revenue arising from increased economic activity, not added taxation. At the other end, there is also the risk of taking impulsive measures that, although politically convenient, might result in shortfalls that will have to be compensated by other means of taxation to avoid a surge in the fiscal deficit'.

Although it is recommended that Government should not abandon the target for a balanced budget during this legislature, the fact that inflation threatens to eat into people's purchasing power, in spite of the COLA mechanism, cannot be disregarded. Triggering a wage price spiral can result in a deterioration in competitiveness and a reversal of the current positive trends in unemployment figures which can also result in a fall in tax revenues.

It is being recommended to reduce income taxes to the point where the revenue elasticity of reaches zero – i.e. where tax revenue is maximized. The reductions in the previous two years have resulted in increased revenues because:

- more income was declared;
- the increase in disposable income contributed to more spending and increased VAT revenues
- more people were incentivised to work and the economy was sufficiently competitive to generate jobs

However, it is accepted that the multiplier effect of such injections is minimal because of the high propensity to import.

Even if the reduction in tax rates results in a marginal and controlled deterioration in the fiscal deficit, under current circumstances, it would be better option to postpone the balanced budget target by a couple of years than to risk an economic slowdown. At the same time, government should persist with its effort to cut down on public expenditure in specific areas to make up for the expected increase in spending in health and education.

4. Corporate Tax

It is being proposed to reduce the current rate of Corporate tax from 35% to 30%.

5. Family friendly measures

MEA supports family friendly measures that are cost neutral to employers. The diffusion of child care centres and the utilization of school premises after hours for child minding are examples of how such measures can help maintain a better balance between work and family life and increase the female participation rate in the work force.

6. Car Registration Taxes

It is expected that the uncertainty surrounding the revision of vehicle registration taxes will be finally resolved in 2009. Car importers have been suffering from a drop in business because of postponed purchases resulting from anticipated reforms which are frequently based on unfounded rumors. It is of benefit to both consumers and companies to bring this matter to a conclusion.

7. Making work pay: community work schemes

Government needs to use fiscal measures to widen the gap between wages and social benefits, and to persist in its efforts to curb abuse of such benefits. This matter was also highlighted in the report on Flexicurity that was prepared as part of the National Reform Programme. One of the factors that contributes to the low participation rate, and to the black economy, is the welfare system, which is generous when compared to what persons are paid when they take up legitimate employment. Employers constantly report of

persons who are sent for job interviews by the ETC who have no intention to take up any job in the private sector.

One measure that should be put in force is to introduce community work scheme to long term unemployed persons. This will curb abuse, and introduce the principle of giving something back to society when a person is living off taxpayers' funds.

8. Incentivising SME's

It is the experience across Europe that the majority of new jobs are being generated by SME's. In Malta it is estimated that SME's employ in the region of 67,000 persons. Government should stick to the recommendations of the pre-budget document to continue to reduce the administrative and bureaucratic burden of SME's, and also to make it easier for them to get established. The Ta' Maggi industrial park is a step in the right direction and should be followed by others, such as the ones proposed in Mellieha and Xewkija to enable these firms to flourish.

SME's can also be assisted through better sourcing of finance through initiatives with the European Investment Bank.

Incentives to SME's can also be a means to reducing regional unemployment, such as Gozo.

Government should also bear in mind that SME's are not exclusively manufacturing orientated, but operate across the whole spectrum of economic activities, including tourism and financial services.

9. Protecting legitimate business

Many importers face an unfair disadvantage from operators who are managing top import products and bypass the obligations to pay VAT and Eco Tax. This is resulting in loss of revenue to the local exchequer, and also placing numerous jobs in danger. These operators often employ workers with conditions of employment that are much inferior to those in legitimate business.

MEA is satisfied to note that the Minister for Social Policy will be insisting that tendering contracts will include decent work obligations to ensure a level playing field between tendering companies. It is important to enforce these clauses to protect the interests of companies who abide by the laws and respect health and safety standards.

10. Rent reform

The Rent Reforms should be actioned during 2009. Government should fine tune the recommendations for commercial rentals to reflect the complexities of this segment.

11. University stipends

As mentioned in the introduction of this paper, there are pockets of graduates that are finding it difficult to find suitable employment because their discipline is not in demand. Many of these are ending up underemployed. Government can further differentiate between the stipends given to different courses to channel students to take up more relevant careers. Tertiary institutions should also improve their counseling services for prospective students to have a better indication of career prospects offered by different courses.

12. Alternative Energy Measures

The experience of 2008 should definitely set the alarm bells ringing to have a national strategy for the diffusion of alternative energy measures in Malta.

- Government should increase the incentives to consumers and industry to adopt alternative energy. The rates for feeding electricity into the grid from solar panels should be revised upwards to reduce the payback period of installing such technologies.
- Standards should be set for the construction industry to make buildings more energy efficient.
- Government should take measures so that the water from the waste recycling plants is stored and used for agricultural purposes. This will reduce the problem of illegal boreholes that are posing a serious threat to Malta's natural water table.
- Solar panels should be installed in public buildings to make institutions such as schools more energy efficient.
- Intensive education campaigns should be launched to make people aware that subsidies are not the solution to energy issues.
- The surcharge system should be transformed into a revised tariff system, with subsidies being conditional to the introduction of energy saving technology in homes and companies.
- Subsidisation should be shifted from consumption of energy to the purchase of energy saving equipment.
- Incentives should be introduced for the purchase of electric vehicles, particularly for operators in the distributive trades.
- MEA has been proposing the setting up of a manufacturing plant through a public private partnership to assemble and install solar technology in households, public buildings and companies.
- Government should investigate the benefits of joining with the electricity grid, rather than invest in power stations to increase electricity supply.

These measures were presented by MEA in a paper that was discussed at the MCESD. There is a need for a national strategy that would tackle such a sensitive matter from both a micro and a macro perspective. Macro measures like the wind farms entail heavy capital expenditure and take longer to yield results. Micro measures distribute part of the burden among society in general and produce more immediate effects. The national

strategy would also include provisions for investment in research and technology in alternative energy sources.

13. Port Charges

Many companies have expressed disappointment at the outcome of the port reforms, and claim that the reduction in costs was marginal at best. Government should investigate how port charges can be reduced to improve competitiveness.

14. Tourism

There are a number of positive measures being undertaken to upgrade the tourism product in Malta, and the allocation of EU funds to this purpose is yielding results. MEA will reiterate its proposals for an upgraded tourism product:

- Stricter enforcement of standard of tourism related activities
- Increased funding for the upgrading of heritage sites
- Better coordination between infrastructural works and the high tourist season
- Audiovisual should be charged 5% VAT same as other heritage attractions. Some of them are still being charged at 15%.
- Government should adopt a national strategy on developing and promoting health and medical tourism. Although there are private initiatives in this direction that are yielding results, these are sporadic and a national coordinated effort is required to realize the full potential of this sector. Malta has all the qualities of developing this sector into a major lucrative segment.
- Another area that can be developed is that of boarding schools. With the increased number of foreign employees working in Malta there will be a corresponding increase in the demand for boarding schools. Government should provide incentives and assistance to institutions who are willing to provide this service that carries great tourism potential for Malta.
- MEA would also reiterate its proposal for the construction of replica ships from different era's of Malta's maritime history to serve as unique attractions in our harbour.

MEA has also made numerous proposals to develop tourism in Gozo:

- The upgrading of public transport by having two interconnected circular routes, using electric vehicles. This will solve accessibility problems which are a big problem in Gozo.
- Converting Gozo into an organic farming centre and promoting the island as a centre for agri and health tourism
- The rehabilitation of neglected heritage sites
- Further development of pedestrian and country footpaths surrounding the villages.
- Gozo can also be a hotspot for internet services. This will provide added value to the upper segment of the tourist market.