MALTA EMPLOYERS' ASSOCIATION
35/1, South Street, Valletta VLT 1100, Malta.
Tel: (+356) 21 237585, 21 222992
Fax: (+356) 21 230227
E-mail: admin@maltaemployers.com
Web Site: http://www.maltaemployers.com

9th July 2009

Talking Point

Automatic Destabilisation

As an open economy, Malta is very much exposed to the effects of global developments and most companies are being affected by the contraction of the global economy resulting from the international recession. In such circumstances, governments worldwide are designing stimulus packages which include discretionary fiscal policy measures intended to mitigate the negative impact of the recession. These discretionary measures are intended to complement existing automatic stabilisers that act to smoothen the shocks of sudden changes in economic activity and thus protect the economy from strong cyclical fluctuations. In effect, the automatic stabilisers (e.g. transfer payments, progressive income taxes) act as the shock absorbers of the economy. During times of recession or excessive heating of the economy, Governments resort to discretionary measures when automatic stabilisers on their own are insufficient to stabilise the economy to a desired level of activity.

The Maltese economy has a well developed system of automatic stabilisation, which, given current circumstances, needs to be enhanced by further Government intervention to prevent as much as possible a slowdown of the economy and loss of jobs resulting from the recession. The fact that, thus far, Government has opted for intervention at enterprise level rather than going for a national stimulus package satisfies the major conditions for such interventions in the sense that they are timely, targeted and temporary. There is no doubt that, for many companies, such timely and focused assistance by the government task force has saved hundreds, if not thousands of jobs in the private sector.

It is a pity that the fruits of all this effort can be wasted because of the COLA mechanism. Compared to its major trading partners and competing countries, Malta has experienced a relatively high level of inflation in the past twelve months. The reasons for this can be many, but certainly a major cause has been the hike in energy tariffs. These inflationary pressures in themselves are affecting our competitiveness. However, the negative effects of inflation are being compounded because Malta is one of the few countries with an automatic indexation between wages and inflation. Indeed, even the IMF has cautioned the government about this flawed mechanism which threatens to erode the competitiveness of many companies, particularly in manufacturing and tourism.

Current indications point towards a COLA increase of €7 per week for 2010, and it is evident that many enterprises will not afford to absorb the costs of COLA in the midst of an international recession, especially if such companies are also committed to collective agreement increases for 2010. One needs to point out that other countries are looking at longer working hours, and even wage cuts to combat the recession. In Ireland, for example it is being considered to slash children's allowances.

Since other countries have lower inflation than us, and do not have a similar mechanism to our COLA, the result of imposing a weekly €7 increase on employers will be a deterioration in competitiveness at a very critical time. In effect, the COLA will demolish the accomplishments of the targeted discretionary measures that were so successfully implemented.

This is a time when the social partners should put their heads together to prevent this economic suicide. The last thing we want in 2010 is to have a surge in the unemployment figures through a recession of our own making. There are many options to solve this problem. Government may decide to award COLA only to minimum wage earners. Alternatively, COLA will not be given to those who already have a collective agreement increase in their package for 2010. The best route will be to think long term and accept that COLA, is in effect, an automatic destabiliser and should be replaced by an alternative mechanism that links wages to productivity indexes, rather than prices. This is a matter for the social partners to treat with urgency and should be central to any pre-budget discussions that will take place in the coming months.

Joseph Farrugia
Joseph Farrugia is the Director General of the Malta Employers' Association.