



MALTA EMPLOYERS' ASSOCIATION

Proposals for National Budget 2008

JULY 2007

1. Introduction – A General Overview of the Economy

During 2006 and the first quarter of 2007, the economy has shown clear signs of recovery following a period of stagnant real GDP growth. The real GDP growth of 2.9% was the highest for the previous five years, and this momentum seems to be sustained during 2007, given a real GDP performance of 3.5% during the first quarter. This growth has been mainly fuelled by expansion in financial services and high value added manufacturing.

The economy is definitely in a state of rapid restructuring in response to global challenges, as the country is passing through a process of job creation and job destruction. The unprecedented influx of foreign direct investment during 2006, and announcements of major projects by companies like Lufthansa and Smart City, are occurring simultaneously with job losses in declining sectors, with VF, Bortex and others being the latest casualties. These are the necessary pains of shifting economic activities to areas where the country has a competitive advantage. The success of such transition depends on the extent to which the economy can generate new jobs, and also to which these new jobs can be filled by the available labour force.

Prior to the recent spate of redundancies, unemployment, at 4.9% was at its lowest for the past seven years, and the fact that this is accompanied by a fall in public sector employment shows that the private sector is generating sufficient new jobs to keep unemployment in check. The public sector, although still over-manned in some areas, and employing more than 30% of the total labour force, is no longer acting as an employer of last resort.

The low wage differentiation in Malta can, in itself, be a cause of some of the symptoms experienced in the labour market. The high relative cost of our lower skilled segment of the labour force is driving out companies employing mainly unskilled or semi-skilled labour. On the other hand, the relatively low remuneration to highly skilled and professional grades may be driving them out of the country, as is happening with the doctors.

The general feeling among employers is that they are encountering shortages of labour at various levels - professional, technical and also unskilled. This is resulting in an increase in demand for foreign workers. Currently the number of foreign workers in the formal economy is higher than the number of unemployed persons. However, the overall participation in the labour force remains low, with a relatively low average exit age from the labour force, mainly due to a low female participation, early retirements and boarding out.

Government is rightly increasing investment in education. The MCAST project is a welcome investment to increase facilities for an increasing number of students at this institution. A worrying statistic in the educational sector is the number of school dropouts, and those that claim to be illiterate after sixteen years of schooling. It is clear that the availability of unskilled jobs on Malta will decline. The decision to discriminate between the stipends allocated to students following different courses has incentivised students to shift towards more scientifically orientated courses, and the scholarship fund is also a positive initiative to encourage students to follow post graduate courses.

A positive measure of the last budget was the reduction in income tax bands that provided a relief to many households. However, in many cases, the increase in disposable income resulting from this measure has been neutralised by the increase in interest rates that affected many mortgages. On the other hand, the increase in

interest rates was in response to a worrying to a deteriorating current account imbalance, which, in spite of improvement, is still a concern.

Tourism shows signs of a slight turnaround following the introduction of low cost airlines and an increase in cruise liner business, although levels remain lower than 2001 levels. The welcome increase in arrivals up to May this year has, thus far, not upset the emerging trend of shorter stays, which has resulted in fewer bed nights, although expenditure per capita has increased.

There is need for a better-defined strategy, and a stable organisation at the Malta Tourism Authority to improve the performance in this important sector.

Certainly, the fact that Malta has successfully met the criteria for Euro adoption is an indicator of the economy's resilience. The control of inflation, and control of the fiscal deficit to below 3% of GDP seemed to be highly improbable targets a few years ago, given the extent of the deficit at that time, and the unwelcome oil price hikes. The economy needs a stronger growth impetus to be able to sustain this performance, and to reduce the level of national debt that, although declining somewhat, remains well above the 60% threshold.

Industrial relations during 2007 were stable, with few incidents of industrial action in the private sector. The issue of public holidays falling on weekends, although still in force remains unresolved, in spite of efforts by the Employment Relations Board.

The MEA is submitting its proposals for the National Budget 2008 on the basis of this evaluation of the current economic situation.

Budget Proposals

The main thrust of the budget should be to extend the expansionary measures announced for the previous year without falling for the temptation of pre-electoral extravagance.

1. Social Security Contributions for Part Timers

As a result of the measures announced during the budget 2007, part timers have the option to pay the pro rata social security contribution instead of the minimum rate. This was meant to encourage more part timers to work in the formal economy. Employers supported this option, and it was one of MEA's recommendations for the 2007 budget.

A recent legal notice has extended the pro rata benefits to all part timers, irrespective of number of hours worked, thus considerably raising the cost of employing part timers whose job is the principal one. MEA is proposing to extend the option of paying pro rata social security benefits also to employers. In this manner, the gap between the cost of employing a part timer whose job is his principal employment and one whose job is the secondary employment will be reduced. As things stand, the substantial difference in cost (pro rata benefits plus national insurance) is acting against employing people from the unemployment register, or women returners, who are willing to work on a part time basis. It can also result in an expansion of the informal economy.

2. COLA Increases

MEA reiterates that giving COLA increases across the board works against the free operation of the labour market, and is also inflating wages in sensitive sectors. The

principle of wage increases should be as a return on productivity. On the other hand one can appreciate the need to protect those on low incomes from inflationary pressures.

It is being proposed to award COLA only to persons earning less than LM70 per week.

3. Port Reform

The recent revision in port workers tariffs is a positive step towards improving Malta's competitiveness. It is expected that these reductions will result in a reduction on costs to companies.

It is surprising that Malta was the only country to vote against the EU competitiveness council's proposals to introduce measures to simplify customs procedures. If these measures open up competition among stevedores, this should lead to better efficiency at the ports.

4. Family Friendly Measures

During the budget speech for 2007, the Prime Minister extended the family friendly measures applicable to the civil service to the entire public sector. This measure was not discussed at any pre-budget meeting at MCESD, and indeed, took the management of many public sector entities completely by surprise.

MEA is in favour of family friendly measures as a means to increase the labour participation rate. However, one cannot apply such measures across the board since companies face different circumstances depending on sector and size. The best way to introduce such measures, which are already practiced by many employers is through collective bargaining. This will ensure that customised solutions are found

for different work places. Employer bodies must be consulted before any national measures are introduced in the private sector.

Any family friendly measures introduced at national level should be cost neutral to employers. Examples are the introduction of child care centres, and the utilisation of school premises after hours, and during holidays to make such premises available for child minding.

MEA supports the initiatives taken thus far, and those which were recently announced, to offer such state run services. The Association also suggests that state assistance should be provided for similar projects on a private public partnership basis, or to set up cooperatives.

5. Income Taxes

As mentioned in the introduction to this document, many families benefited by the revision in income tax bands during 2007, but the increase in interest rates has eroded much of the increased disposable income.

In spite of the revision, revenue from income taxes has increased. It is recommended to introduce further reductions in income tax rates to increase disposable income and stimulate private expenditure up to the point where this does not have a negative effect on the fiscal balance.

6. Protecting Legitimate Business

Government should take measures to protect the interests of legitimate employers.

- ◆ Parallel trading is threatening many established companies in various areas. Although it is acknowledged that parallel trading is not illegal per se, it is unacceptable to have such operators evading VAT and ECO Taxes. Competition is only acceptable as long as there is a level playing field between operators. Some parallel traders are being given an unfair advantage and placing many jobs in jeopardy in other companies.

- ◆ Government should enforce that contractors who are awarded government contracts are complying with the legal conditions of employing persons. There are reports of companies losing business to unprofessional operators who manage to win tenders on cheap prices because they offer conditions of employment inferior to minimum standards. Contractors should also be obliged to respect health and safety standards, and to factor this in their costings.

- ◆ In areas such as training activities, childcare, care for the elderly, Government should direct resources to enable the private sector to provide these services at affordable prices. As is already happening in some sectors, there is an increased role for private public partnerships to provide such services.

7. Enticing the unemployed to seek employment in the formal economy

ETC has been stepping up its efforts to reduce abuse of the unemployment benefit system and there have been a number of strike offs during the past year. Employers constantly complain that unemployed persons who are sent to their enterprises for interviews have no intention of taking up a job.

MEA is proposing compulsory vocational training for the unemployed, particularly for those aged 25 years and under.

Another measure is to second unemployed persons to companies during the period to which the person is entitled to unemployment benefits. Since benefits are being paid anyway it would increase the likelihood of unemployed persons being retained in employment.

8. Redeployment of redundant employees in the Public Sector

One of the action points in the National Reform Program was to conduct an exercise to identify and measure the extent of the redundant personnel in the public sector and to redeploy such human resources by seconding them to the private sector, or through the setting up of public/private partnerships.

MEA proposes for this exercise to be conducted and to implement this measure.

9. Tax Incentives to Businesses

Businesses, particularly SME's can benefit from a number of tax incentives:

- ◆ Tax incentives during start up phase: a tax credit equivalent to each lira that is invested.
- ◆ Tax incentives for employers to train existing employees at risk of redundancy due to skill deficiencies.
- ◆ In cases of spin-offs and mergers, share transfers should become tax exempt.

10. Airport Tax

Government should remove the airport tax. It is an unnecessary tax and a deterrent to travel. It also discriminates against Maltese travellers.

11. Rent Reform

Commercial rents should be liberalised. For decades, property owners from the injustice of fixed rent rates which do not reflect the value of the rented property.

12. University Stipends

The differentiation of stipends between courses appears to be having the desired effect of channelling students to follow courses that are more in demand by industry. This differentiation can be intensified further to direct more students towards such disciplines. The feedback MEA has from employers is that there are a number of graduates from certain courses that are finding it difficult to find employment in their field of studies, and many of them are underemployed in clerical duties.

13. Tourism

MEA had submitted various proposals for a revival in tourism in its document for budget proposals last year. Over the past year, the country has had time to experience the impact of low cost carriers, which the Association had supported. The other recommendations are still valid. The main points that were submitted, and which MEA is again forwarding for consideration are:

- ◆ stricter enforcement of standard of tourist related activities, and the setting up of a task force to enforce such standards
- ◆ increased funding to upgrade of heritage sites
- ◆ a maritime pageant for the harbour area, with construction of replicas of ships from Malta's maritime history
- ◆ investing in health tourism, which could be developed into a significant, high value added segment. Malta has all the necessary qualities to develop this segment.
- ◆ Better coordination between infrastructural works and the tourist season. There have been some improvements but it is still an issue.
- ◆ Developing Malta as a diplomatic centre

With respect to Gozo, MEA is again proposing:

- ◆ Upgrading public transport through the introduction of two intersecting circular routes
- ◆ Introducing a regular shuttle from the airport to Cirkewwa
- ◆ Turning Gozo's agriculture to organic farming, and promoting the island as a venue for agri-tourism, and health tourism.
- ◆ Rehabilitation of forgotten or neglected heritage sites.
- ◆ Further development of pedestrian and country foot- paths

14. Alternative Energy

Incentives to introduce alternative energy and energy saving measures should be strengthened.

Government should also consider MEA's proposal from previous years to intensify the diffusion of solar energy in Malta, even by investing in manufacturing or assembling solar panels and water heaters locally. This could be an opportunity for green job creation in Malta. Malta is still a long way from the 5% target of renewable energy sources by 2010.