

## **A SOCIAL PACT FOR MALTA**

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## **WHY A SOCIAL PACT?**

There is no doubt that the Maltese economy is currently facing a number of difficulties. It is our firm view that unless we meet the challenges ahead together we are destined to face more difficult times in the near future. This could have a profoundly negative effect on our ability to continue providing the necessary jobs and creating the necessary wealth to ensure a decent standard of living for the Maltese worker, his family and ultimately the country.

Our economic environment is changing dramatically and at a fast pace. The days of protectionism and monopolies are over. We now have to work within a fully liberalized environment whereby the prerequisite of any success is the achievement of a competitive economy. The competitiveness environment embraces economic and physical infrastructure, labour costs, productivity, innovation, education, training, cost control and a variety of other factors. These factors create the climate for business to invest, expand and flourish. These are all necessary ingredients to stimulate economic activity and employment. If our enterprises are to take on the opportunities of EU membership, they need to be functioning in a competitive economy that will serve as a springboard for success in the wider European and global market.

### **The UHM proposal**

With this in mind the UHM is proposing that a Social Pact between the Unions, Employer bodies and Government is agreed upon whereby each of the participating parties commits itself to the goals listed in the Pact and to fulfilling the measures necessary to reach the desired goals. The idea of a Social Pact whilst somewhat novel for Malta is in itself not a new concept in Europe where a number of European countries have agreed on social pacts spanning over a number of years and covering various issues.

The UHM feels that given the current economic and social environment the time is right to launch this initiative. The UHM is launching this initiative in a sense of full collaboration with all the other social partners and as such should not be seen as a UHM initiative but rather as a national initiative launched in an environment of collaboration.

### **The objective of the Social Pact**

The general objective of the Social Pact itself is to create the necessary framework to bring all social partners to agree on a common set of policies and actions necessary to promote sustainable social and economic growth leading to increased job opportunities and social justice.

The timeframe for which this Social Pact will be binding is that of three years during which all parties will carry out the measures agreed upon.

### **Agreement through Social Dialogue**

Social pacts are an outcome of successful social dialogue. Social dialogue at the national level is dialogue among representatives of governments, employers and workers on issues of common interest relating to economic and social policy. It is through such dialogue that the UHM is proposing that agreement on the final text of a meaningful Social Pact for economic growth is reached. The UHM strongly believes that the enabling conditions for successful social dialogue exist. More specifically these conditions are:

- Strong and independent trade unions and employers' organisations with the necessary technical capacity to meaningfully participate in the required social dialogue
- The political will and commitment of all the political parties to work for a better future for Malta and its citizens
- The appropriate infrastructure, through MCESD, within which the social dialogue should take place.

### **There is also need for a long-term vision**

Whilst presenting a document that puts forward suggestions for a three-year action plan the UHM must emphasise the need for the development of a long-term vision for the country. There is no doubt that immediate action is required to enhance the competitiveness of our economy as well as to maintain and then improve our standard of living. Such immediate action must however be guided by a long-term vision of where we want this country to go. Developing such a vision is beyond the immediate scope of this document however, the UHM feels that work on the elaboration of such a vision which will guide our future actions (both short-term and long-term) should begin immediately. We should also build upon the experiences of other countries and be more imaginative in finding solutions to the new challenges facing our country. In this respect government should consider setting up a 'visionary group' made up of leading Maltese citizens resident both in Malta and abroad.

### **The structure of this document**

The document being presented for discussion is the result of an intense internal debate and takes into account the findings of specific focus groups set up within the UHM itself. It is also the result of discussions with political and business leaders as well as trade unionists. To further compliment this debate and discussion a detailed analysis of the current economic situation has also been carried out. This analysis which is attached to the Social Pact as a supporting document identifies the key challenges currently facing the Maltese economy. With this as a background the Social Pact which is being presented lists 6 areas of top priority where we believe concerted action is needed. Within each priority area we identify the challenges we are faced with and suggest the different measures required for us to successfully meet these challenges. The measures put forward in this document are neither exhaustive nor final. Rather they represent our views on what could realistically be done over the next two to three years. All our proposals are open for discussion by all those parties interested in signing up to a social pact which could mark the beginning of a new era in shared governance.

At the end of each priority area a Measures Matrix is drawn up with all the proposed measures listed. For each of the measures we set out the proposed time frame and indicate who is responsible for the carrying out of each of the measures. The measures are also prioritized. Although each of the measures proposed is important some can be considered to be more crucial than others and thus should be given immediate attention.

### **Invitation to all Social Partners**

The UHM would like to invite all the social partners and political parties to engage in a meaningful discussion through MCESD structures on the document being presented with the ultimate aim being that of agreeing on a common document to which all parties will sign their commitment to its final contents.

## PRIORITY 1 – ENHANCING COMPETITIVENESS

Malta has to become more competitive. According to the 2003 World Economic Forum report Malta ranks 19<sup>th</sup> from 102 countries in the potential growth competitiveness ranking however in the business competitiveness ranking Malta ranks 42<sup>nd</sup> with most of the current and future EU member states ranked above us. This

Business Competitiveness Index Ranking			
Ranking	Country	Ranking	Country
1	Finland	26	Malaysia
2	United States	27	South Africa
3	Sweden	28	Estonia
4	Denmark	29	Latvia
5	Germany	30	Slovenia
6	UK	31	Thailand
7	Switzerland	32	Chile
8	Singapore	33	Tunisia
9	Netherlands	34	Brazil
10	France	35	Czech Republic
11	Australia	36	Portugal
12	Canada	37	India
13	Japan	38	Hungary
14	Iceland	39	Greece
15	Belgium	40	Lithuania
16	Taiwan	41	Jordan
17	Austria	42	<b>Malta</b>
18	New Zealand	43	Slovak Republic
19	Hong Kong	44	Mauritius
20	Israel	45	Costa Rica
21	Ireland	46	China
22	Norway	47	Poland
23	Korea	48	Mexico
24	Italy	49	Morroco
25	Spain	50	Vietnam

means that whilst Malta is considered to have considerable potential for growth it is currently under performing. This is a situation that needs to be rectified.

Given the increasingly globalized nature of the world economy and given Malta's economic integration with the EU, the issue of attaining and enhancing our competitiveness has now become the major challenge for Malta. If we do not attain the necessary level of competitiveness we risk losing out on the opportunities of EU membership and subsequently becoming marginalised in the world economy.

A competitive economy will give us the means to support continued economic growth which will enable us to continue providing jobs for our workers and creating economic wealth.

The UHM believes that enhancing our competitiveness is a top priority which will enable all Maltese citizens to enjoy a high quality of life and to continue to raise his/her standard of living. Now is not the time to be complacent about our continued loss of competitiveness as wages, costs and general public spending accelerate well ahead of what is warranted by long-term stability and progress.

Whilst all improvements in the factors of production and in the business environment lead to enhanced competitiveness the main challenges under this priority are:

- 1) Ensuring an equalisation between work done and rewards received
- 2) Maintaining price stability in the local economy

### **Challenge: Ensuring an equalisation between work done and rewards received**

The cost of labour, amongst other costs, has a direct effect on the competitiveness of the Maltese economy. It is a widely acknowledged fact that Malta cannot build a sustainable competitive edge solely on the basis of low wages. There is however no doubt that the cost of labour does impinge on the overall competitiveness of the country if this is not matched with sufficient levels of production. Given the importance of human resources to the Maltese economy all other efforts to enhance Malta's competitiveness would be undone if due attention is not given to the cost of labour.

In the absence of a reliable measurement of production we are risking that increases in wages outstrip increases in productivity. Such situations would lead to a reduction in the competitiveness of the enterprises / entities involved.

This can be avoided if all the parties concerned (unions, employers and government) agree to a common formula for wage increases over the coming three years. At the same time this agreement to a common formula must be accompanied by a commitment from government to maintain price stability thus protecting both workers and employers from sudden cost increases.

### **Challenge: Maintaining price stability in the local economy**

It is crucial that increases in inflation are curtailed by preventing a wage-price spiral from coming into motion. Whilst the inflation is determined by various factors, some of which are beyond the control of the social partners, the latter should avoid introducing measures which could have a detrimental effect on input and retail prices. Two main factors under the influence of government, in this respect are:

- Direct and indirect taxation
- The cost of services provided by government owned utilities and entities

Both factors impinge on the overall non-labour related costs and hence the competitiveness of Maltese enterprises. The higher the rate of taxation the more entrepreneurial activity is stifled and the return on investment is reduced. Increases in the rates of direct taxation reduce the real disposable income of workers which then must be compensated through increases in wages which once again raises the cost to business thus rendering them less competitive. Similarly, an increase in indirect taxation results in an increase in the overall cost of living, which workers will seek to compensate for by higher wage claims.

Price stability is also affected by the cost of essential services provided by government-owned utilities and entities. Unfortunately we are sometimes exposed to sudden price increases in certain essential services which then have a significant, and sudden effect on Maltese businesses which in turn must take remedial action to safeguard their viability. It would certainly be more beneficial to local enterprises if such increases are first planned and then gradually phased in and adequately communicated to the parties concerned. Such an approach would allow local entrepreneurs to plan ahead taking into account the announced changes. Furthermore by gradually phasing in such changes entrepreneurs are in a position to absorb the additional cost burden in a more gradual manner than if the whole price increase is introduced in one fell swoop.

## What needs to be done

In view of the above, the UHM is proposing the following measures:

- All the social partners should establish and agree upon a cap (limit) on the % of wage increases over the next two years. This means that demands for wage increases should not go above the limit agreed upon. Therefore any wage negotiations should be within the limit agreed. The flexibility to negotiate within the limit established is necessary so that any increases given will reflect the realities of the different sectors and the individual firms.
- The cap (limit) agreed upon should also incorporate any increases in the cost of living. Therefore the cost of living adjustment and any other increases agreed upon by individual employers and unions should be seen as one increase rather than two separate increases.
- Explicitly tied to the setting of a cap on the % of wage increases over the next two years will be a firm commitment by employers to reinvest in the business through the provision of training for their employees and through the purchase of modern technology. The % amount of profits that should be reinvested in their business should be an item open for negotiations. Unions should explicitly tie limitations in demands for wage increases to reinvestment commitments made by employers.
- Wage increases for the third year will be tied to sectoral productivity rates. Thus any wage increases will be reflective of any increase in the cost of living as well as real increases in labour productivity. The concept of one increase to reflect both elements should be maintained in the third consecutive year. An increase in labour productivity usually means that enterprises are in a position to sustain the increase in the cost of their labour because they are being accompanied by increases in turnover and profitability. The validity of this measure will however depend on the establishment of valid productivity measurements. To this end MCESD (through its research arm) should over the next two years establish a sound productivity measurement mechanism whereby benchmarks for the different sectors will be established. In using such benchmarks for wage negotiations it is clear that the realities of the individual enterprises must be taken into account.
- Government will support these measures by undertaking a commitment to not increase both direct and indirect taxation over the coming three years thus continuing to safeguard workers' real disposable income as well as keeping the cost to businesses down.
- Government will also accompany these measures by undertaking (through consultation) a planned and phased approach towards any increases in the price of services provided by government controlled entities (e.g. water and electricity, waste disposal, public transport, Gozo ferry etc).

**Measures Matrix<sup>1</sup>**

<b>Measure</b>	<b>Time Frame</b>	<b>Priority</b>	<b>Government</b>	<b>Unions</b>	<b>Employers</b>
Establish a limit to the % of wage increases given over the next two years. Cost of living and any other increases should be given as one increase	2004 - 2006	★ ★ ★	✓	✓	✓
Linking wage increases to increases in the cost of living and to increases in sectoral productivity. The concept of one increase should be maintained during this third year	2007	★ ★ ★	✓	✓	✓
Productivity benchmarks to be provided by MCESD Research Unit	2004 - 2005	★ ★	✓		
Moratorium on increases in direct and indirect taxation as well as NI	2005-2007	★ ★ ★	✓		
A planned, phased, and consultative approach in the adjustment of prices controlled by government Utilities	2005 - 2007	★ ★	✓		

<sup>1</sup> The higher the number of stars the higher the priority with 3 stars indicating the measure as being a top priority

## **PRIORITY AREA 2 - INCREASING EFFICIENCY OF THE LABOUR MARKET**

Human resources remain one of the country's key assets in the absence of other raw materials. Overall economic growth will largely be determined by the ability to utilise the available human resources in the most productive manner possible. As such Malta must ensure that the labour market operates as efficiently as possible to respond to the changing economic environment. Unproductive individuals must be rendered productive and the productivity of the existing workforce must be enhanced on an ongoing basis.

It has been very evident that Malta's historic competitive advantage of low labour costs has been eroded over time, and will continue to do so as local wage levels increasingly converge with those of the developed countries. Malta's attractiveness as an investment location for labour-intensive industries will therefore continue to be eroded. The future hence lies in attracting higher value adding industries to set-up in Malta which are likely to be increasingly knowledge-based and service oriented industries. The trend towards such industries has already been witnessed over the past decade. Between 1994 and 2002 employment within the services sector increased by 27.7%, whilst employment in direct production declined by 1.7%. This phenomenon, also referred to as de-industrialisation, is consistent with developments in other European countries.

The move towards such higher value-adding industries is imperative if the overall standard of living of the Maltese population is to improve. The process will invariably result in operators in less competitive sectors needing to restructure and possibly even close down. The UHM appreciates that there are cases where the workforce must be downsized and that these are unavoidable. However their impact should be minimised to avoid unnecessary hardship to the individuals concerned and a loss in overall economic output. Appropriate systems, policies and incentives must therefore be devised to ensure that individuals losing their jobs are reintegrated into the productive workforce as quickly and efficiently as possible.

The challenges ahead are hence to:

- Ensure an efficient use of the country's human resources
- Increase the employability of workers

The UHM is aware that the National Action Plan on Employment being prepared at present will seek to address the various issues mentioned below. It believes that consensus between the various partners and rapid implementation is required on the key challenges and measures mentioned under this priority area.

### **Challenge: Ensure efficient use of human resources**

For Malta to prosper economically, it is imperative that the available human resources are utilised as efficiently as possible. A higher employment rate yields higher economic output and hence a higher overall standard of living. Malta's employment rate ranks amongst the lowest of all EU member and applicant states, at 54.5% in 2002. This is partly attributable to the generally low participation rate of females of 34.5%.

A relatively high unemployment rate - fluctuating between 5% and 6% for the past 5 years - is a further contributor towards the lower employment rate. Most of the

unemployed are semi- or unskilled individuals, with slightly over half of the total unemployed population being long term unemployed, i.e. 53 weeks and over. However it is noteworthy that the unemployment rate of the under 25 year-old jobseekers has consistently been higher than the overall unemployment rate. Moreover, the female unemployment rate in this age bracket has been increasing sharply since 2000.

The demographic structure of the Maltese population in conjunction with the proposed increase in the pension age to 65 gives rise to further concerns. Assuming the current employment rate, it is estimated that the overall labour supply will increase by 5,000<sup>2</sup> individuals by 2007 as a consequence of workers remaining in the workforce for longer. This implies that new jobs need to be created not only to replace jobs lost in the restructuring process, but also to create opportunities for new labour market entrants.

### **What needs to be done**

The efficient use of the country's human resources hence requires increasing the employment rate and reducing unemployment. To address these two key issues the UHM proposes the following measures:

#### **Promote female participation in the labour force**

According to a study by the Workers Participation Development Centre at the University of Malta, parenthood and fiscal disincentives remain the primary causes for withdrawal from the workforce amongst females. A significant proportion of individuals surveyed indicated that they would be willing to re-enter the workforce if appropriate work-practices, facilities and fiscal incentives were to be provided. It is therefore proposed that:

- A special emphasis must be placed on the provision of high quality, flexible and affordable childcare. Therefore investment in and provision of affordable childcare facilities should be encouraged. Such investment must be undertaken both by the government and the private sector.
- Specific measures to assist working parents to meet the cost of childcare services should be introduced. These could take the form of a tax relief, and additional measures such as tax allowances and social welfare payments should be targeted at those on low income.
- The concepts of family friendly policies, flexi-hours and promotion of tele / e-working must be accepted and encouraged by both the unions and employers.
- Fiscal disincentives currently associated with part-time work, in particular pertaining to time limits for payment of social security payments and the taxation of females which have opted for joint tax computation with their husband, must be removed / reduced.
- The setting up of temping agencies, which facilitate the temporary placement of individuals within companies should be incentivised by government. This measure must be accompanied by the necessary legislation to safeguard the rights of these temporary workers.

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<sup>2</sup> Estimated by EMCS on the basis of the 2002 demographic data published by the NSO and crude death rate of the respective age cohorts and the current employment rate.

### **Easing of young workers into the labour market**

Reducing youth unemployment requires measures to proactively assist individuals in joining the labour force. This requires:

- More effective career counselling at both the **secondary** and **tertiary** educational institutions to prepare individuals for their career and also assist in the career choice. Career counselling must be closely tied to industry requirements and the overall national industrial policy. In this respect both the employers and unions must provide active support through educational talks and company visits to provide an insight into the opportunities available.
- A review of the current teaching infrastructure should be undertaken to assess whether it is adequate to meet the skill needs of our economy. The review should be the responsibility of the **Ministry of Education** however it should be carried out by independent experts to ensure that an impartial outside view is obtained.
- The use of apprenticeships and internships during academic training must be promoted more actively. This will provide job seekers with a basic level of work experience upon leaving the educational system often sought by employers. When linked to their academic training, such work experience also contributes towards more practical employees and lowers induction costs to employers. In spite of the benefits to the labour market as a whole, internships and apprenticeships are generally avoided by employers due to the cost associated with the training of such individuals for which they would generally not get a return. To encourage such a practice it is hence proposed that:
  - Fiscal incentives be offered to employers to take on interns and apprentices. Such incentives may also be extended to the interns themselves.
  - Unions facilitate the placement and allow the practice of utilising apprentices and interns within enterprises. Apprentices should be seen as complimentary to and not as substitutes of full time employees.
  - Educational entities provide academic recognition for internship period.
  - Investment in the current ETC and MCAST training programmes should continue.

### **Developing the right skills base**

The availability of sufficient suitable skilled personnel in line with industry requirements must be ensured. Skills shortages result in excessively high salaries, hence reducing labour cost competitiveness, whilst a skills surplus results in a less efficient workforce at best, and high structural unemployment at worst. The development of the right skills base requires knowing the skill requirement of industry supported by measures to ensure that the skills requirements are met.

An on-going assessment of skills requirement by industry is therefore a must. It is proposed that a skills development task force be set up under the auspices of the **Ministry of Education**. The objective of this task force would be to assess the future industry requirements on a regular basis (say annually). The assessment of these skills requirement must be long term, tied to the industrial policy, and should ideally be quantified. The participation of the private sector on the task force is imperative, as is that of the relevant government ministries and parastatal agencies. More active public

dissemination of available labour market information, such as the ETC's "Employment Barometer" is required.

In a second step, suitable incentives for the matching of the skills must be provided within the educational sector. In this respect the current stipend system must be reformed. The UHM believes in investment in human resources. It therefore favours a free educational system. It also believes that individuals should not be disadvantaged from benefiting from further education due to financial reasons. However the current form of the stipend system needs to be redesigned to address the real needs of the country. Stipends should also be linked to performance and should be utilised to support students in those areas of studies where additional manpower is required by industry. It is also proposed that the private sector should be encouraged through appropriate fiscal incentives to sponsor students thereby reducing the overall burden on the public finances. These proposals are addressed at students undertaking tertiary and vocational training.

### **Protect health and safety of human capital**

The investment in the human capital must be safeguarded to minimise the loss in productive output to the economy and reduce the pressure on the welfare and health expenditure. In this respect both the **employers** and the **employees** must ensure that health and safety regulations are adhered to. On the employers side, suitable measures and equipment must be made available, whilst on the employees' side the utilisation of such must be respected. In this respect the **unions** must assist in ensuring that health and safety regulations are adhered to by their members at the respective place of work. On the employers part, a commitment in this respect is also required.

### **Encouraging unemployed to take up self-employment**

A further measure to reduce unemployment is to promote self-employment of the respective individuals. Various incentives already exist in this respect. Awareness about such incentives must however be increased and the necessary support provided with minimal bureaucracy. Moreover, access to finance to prospective start-ups must be facilitated. Given that unemployed do not possess a steady source of income, there is a reluctance by commercial banks to provide them with the necessary finance facilities. It is therefore proposed that a "loans of honour" scheme be introduced, whereby unemployed individuals satisfying a set of predefined criteria will be provided with a **government** guarantee for the respective loan. The loans would be provided by **commercial banks** and should include a repayment moratorium.

## **Challenge: Increasing the employability of workers**

The best protection that can be provided to employment is to ensure that the workforce is skilled, adaptable and creative. The skill levels of employees must be updated in line with the structural shifts and technological developments taking place. Increasing the efficiency of the labour market therefore requires that the process of redeploying human resources within the economy works as efficiently as possible. The level and duration of unemployment must be reduced by implementing measures to increase the employability and flexibility of workers. This is achieved by widening the range of skills that individuals are able to master, by deepening their knowledge of the skills, and by increasing the adaptability of the worker to cope with change. The benefits of such an approach are:

- Employers will be able to redeploy resources more easily within the enterprise to react to changing business conditions, thereby reducing the risk of redundancies

- The level of frictional and structural unemployment will be reduced, as individuals will be able to respond to a wider variety of job opportunities.
- The strain on welfare payments is reduced.

The UHM hence believes that a concerted effort to upgrade the skills-base of workers and changing work processes is essential.

## **What needs to be done**

In view of the above, the UHM proposes that the following measures be adopted:

### **Promoting on the job training**

For most enterprises 'on the job training' is a key element in increasing organisational efficiency and in some cases even a source of competitive advantage. Unfortunately, the short-term costs associated with training in terms of lost production often leads to under-investment in training. This is especially the case in small enterprises which do not have a formal HR department. Participation in EU funded vocational training programmes must hence be promoted more aggressively and exploited by the **private sector**. In this respect the **unions** play a key part in facilitating the process and providing the necessary infrastructure to tap such funds. Moreover, an educational campaign on the benefit of training must be undertaken on the part of the employer bodies amongst their members.

In this respect government too must ensure that it maximises the potential of its own workforce by providing on the job training on a more consistent basis. It should also explore further the possibilities of setting up Private-Public-Partnerships as this could result in a transfer of skills from the private sector to the public sector and vice versa.

### **Improve retraining**

Specialised training courses must be set-up at **ETC**, **MCAST** and **University** for unemployed people. This will enable frictional unemployed to utilise their unemployment period in a constructive manner in furthering their skill or attaining new skills. Crucial for the success of such retraining courses is that the various courses are of a short-term nature and repeated frequently to permit the unemployed to take advantage of the opportunity. In this respect more coordination between ETC, MCAST and University is called for to ensure an efficient deployment of resources.

### **Promoting staff multi-skilling**

Increasing staff multi-skilling requires staff exposure to varied tasks at their place of work and less restrictions on the redeployment of staff within an enterprise. Unions should continue to promote the use of such practices where these are required for training purposes or – in the case of companies in difficulty – for the continued survival of the enterprise.

### **Upgrading the linguistic capabilities of the workforce**

Multiskilling of the labour force also relates to the linguistic capabilities of the workers. This is particularly important for an open trading nation like Malta. A special emphasis must be placed on ensuring an adequate level of literacy of both Maltese and English. Moreover, an increased emphasis has to be placed on foreign languages throughout the educational system. Although there has been some progress in this respect, much still needs to be done in order to strengthen Malta's position within the European

context. As such there is a need to increase the spread of languages being taught, with a special emphasis on European languages, and ensure that there is a higher uptake amongst students. Special emphasis has to be placed on offering courses within the secondary and tertiary educational institutions. In the latter case, the introduction of foreign languages within the academic syllabus should be considered with appropriate recognition provided.

**Measures Matrix**

<b>Measures</b>	<b>Time Frame</b>	<b>Priority</b>	<b>Government</b>	<b>Unions</b>	<b>Employers</b>
<b>Promote female participation in the labour force</b>					
Remove fiscal disincentives for part-time work	2005	★ ★ ★	✓		
Investing and providing affordable child-care facilities	2005 - 2007	★ ★ ★	✓		✓
Tax relief for expenditure on child-care services	2005 - 2007	★ ★	✓		
Promotion of flexi hours and teleworking	2005 - 2007	★ ★ ★	✓	✓	✓
Provide incentives for setting up of temping agencies. This must be accompanied by the relevant legislation	2005 - 2007	★ ★	✓		
<b>Easing of young workers into the labour market</b>					
Promoting apprenticeship / internships within companies	2005 - 2007	★ ★ ★		✓	✓
Improve school / university career counselling	2005 - 2007	★ ★ ★	✓	✓	✓
Continued investment in ETC and MCAST training programmes	2005 - 2007	★ ★ ★	✓		
<b>Minimising impact of redundancies</b>					
Special active immediate assistance to workers being made redundant	2004-2007	★ ★ ★		✓	✓
<b>Developing the right skills base</b>					
On-going assessment of skills requirement by industry and public dissemination	2005-2007	★ ★ ★	✓	✓	✓
Reform of the stipend system	2005	★ ★ ★	✓		✓
<b>Protect health and safety of human capital</b>					
Enforcing health and safety at the work place	2004-2007	★ ★	✓	✓	✓
<b>Encouraging unemployed to take up self employment</b>					
Create awareness of existing incentives	2004-2007	★ ★	✓	✓	
Provide Loans of Honour scheme	2005 - 2007	★ ★	✓		✓
<b>Promoting on the job training</b>					
Promote participation in EU vocational training programmes	2004-2007	★ ★ ★	✓	✓	✓
Educational campaign on benefits of training	2004-2007	★ ★	✓	✓	✓
<b>Improve retraining</b>					
Set-up specialised training courses at ETC, MCAST and University for unemployed	2005-2007	★ ★	✓		
<b>Increasing staff employability</b>					
Promoting the multi-skilling of staff at the work-place	2004-2007	★ ★	✓	✓	✓

<b>Measures</b>	<b>Time Frame</b>	<b>Priority</b>	<b>Government</b>	<b>Unions</b>	<b>Employers</b>
Upgrading the linguistic and literacy capabilities	2004–2007	★ ★ ★	✓		

### PRIORITY 3 – PROMOTING INNOVATION

The EU has recognized the importance of innovation and in 2002 agreed that the overall spending on research and development in the whole of the European Union should be raised to at least 3% of GDP. This has led to the European Commission drawing up the “3% Action Plan” which outlines the measures that are necessary to achieve such a target.

Seeking to enhance our competitiveness solely on the basis of low costs is not a sustainable approach. It is clear that the way forward is through the training of our workers and through the promotion of R&D, both of which ultimately lead to innovation. This will enable Malta to attract FDI in those hi-value areas where R&D plays a major role. If we fail to recognize the importance of this aspect we are likely to face a “de-industrialization” whereby the manufacturing sector declines as the more traditional sectors contract due to intense competition and lack of competitiveness whilst the expansion of the ‘newer’ industries fails to materialize.

#### **Challenge: Promoting research, development and innovation**

Research, development and innovation are critical to enhancing economic growth and assisting Maltese businesses to move up the value-added chain. An environment conducive to greater innovation and research is required. Innovative research forms the basis of the creation of new products and services. Those companies that are able to deliver such new products and services gain first mover advantage on the market and are thus able to gain a competitive edge over their direct competitors.

#### **What needs to be done**

##### **Set up an R&D fund to facilitate access to finance for innovative SMEs**

Carrying out innovative R&D requires both finance and a technical skills base. Given the size of Maltese firms, accessing the required finance to carry out meaningful R&D is a problem. Therefore local enterprises must be put in a position to access the necessary finance. This could be achieved through a pooling of financial resources whereby a national R&D fund is created which allows enterprising SMEs to undertake

<b>Patent applications to the European Patents Office per million inhabitants - 2001</b>	
S	367
FIN	338
DK	310
NL	243
DK	211
L	211
A	174
B	152
F	145
UK	133
IRL	86
I	75
SL	41
E	24
HU	19
CY	14
CZ	11
EE	11
<b>MT</b>	<b>10</b>
EL	8
LV	8
SK	6
P	5
PL	3
BG	2
LT	2
RO	1
TR	1
	<b>Source:- Eurostat</b>

R&D initiatives. The Malta Council for Science and Technology (**MCST**) could be given the responsibility to manage the fund however this should be accompanied by the necessary resources to carry out the function effectively.

The idea of creating a fund is not new and the question of being able to provide the necessary funding for such a fund always remains. What we are suggesting is that a percentage of the income tax on corporate entities collected by **government** is earmarked for such a fund.

In some countries an actual R&D tax is charged to companies however we feel that companies should not face the additional burden of a new tax. Rather, part of the tax amount already being collected should be directly diverted to the creation of the R&D fund. The amount of finance provided by government via this earmarking of taxes collected could be further enhanced through contributions from **leading companies** operating in Malta.

### **Ensure proper administration and communication of the fund**

This is a key issue. All too often positive initiatives are undertaken by the authorities only for such initiatives to fail because they are not communicated well enough to the business community or because they are not administered well. Therefore all efforts must be made to ensure that the fund, its goals and mechanisms are clear and that qualified personnel are put in charge of its administration. **MCST** personnel responsible for the fund should undertake the necessary training to administer and market the fund. The positive experience of IPSE and its restructuring programmes should be referred to and made use of.

### **Assist participation in international research projects**

Participating in international research projects together with other partners provides local enterprises and research bodies with the advantage of having the critical mass necessary to make the carrying out of certain costly research possible. On the other hand SMEs often find it difficult to participate in these projects either because they do not possess the necessary information or else because filling in the necessary paperwork is a lengthy process. MCST already provides a service highlighting research opportunities in the EU 6<sup>th</sup> Framework Programme. This service should be extended to cover other research initiatives. Assistance in dealing with the relevant paperwork should however be provided through the provision of advisory services by non MCST specialised personnel. This is necessary to avoid a conflict with MCST's current role as administrator of the 6<sup>th</sup> Framework Programme.

### **Promotion of existing tax incentives for innovative SMEs**

Fiscal incentives for innovation already exist in the present tax legislation. However, awareness of the possibility of benefiting from the increased tax credits must be further increased for companies to invest more in R&D. To this effect the **constituted bodies** and **government** should undertake to improve communication of these benefits to their members and the business community in general.

### **Encourage further specialization**

Carrying out meaningful R&D requires a specialized skills base. When foreign companies decide to set up in Malta they normally bring along a significant amount of know-how and Maltese workers benefit from the subsequent transfer of knowledge. This however is not enough. For Malta to be an attractive place for the setting up of high-tech industries one of the key elements must be the supply of workers with the

necessary skills base. This clearly means that further specialization at the tertiary level is required.

The importance of this can be seen in the Irish experience. One of the main reasons why Ireland has been successful in attracting high-tech multinational companies has been its ability to provide high quality specialized graduates in those areas demanded by these industries.

In Malta we face a somewhat peculiar situation. Students are given an incentive to undertake tertiary education right up to a first degree via the provision of a stipend. However students wishing to specialize further must do so out of their own pocket or via the sponsorship of a private enterprise. This is resulting in significant numbers undertaking a tertiary education right up to a first degree with a very limited number going on to specialize. The current set up is therefore inadequate and remedial action must be undertaken if the objective of developing high tech sectors is to be achieved.

As suggested in Priority 2 the stipends system needs to be re-evaluated with an emphasis on those sciences likely to be most in demand. This must be clearly linked to our industrial policy. If there is a conscious decision to go for certain sectors such as IT and biotechnology then specialization beyond a first degree in these areas should amongst others be supported by the stipends system.

The change in the stipend system at tertiary level should also be accompanied by efforts to encourage the uptake of science, mathematics and technology related subjects also at secondary level. Particular attention should be paid to the methods employed in teaching these subjects and to the provision of the necessary facilities (school laboratories, equipment etc).

### **Create areas of excellence in specific sectors**

As already indicated above a conscious decision by our policy makers must be taken as to which industries we wish to attract to Malta. We can no longer undertake a haphazard approach towards the attraction of FDI. Given our limited resources it is clear that we must focus on a few key areas and seek to be successful in them. Once these areas are clearly identified and communicated to all the interested players (education authorities, policy makers, employer bodies, unions etc) then all efforts must be directed towards these areas with the goal of creating the centres of excellence.

Creating such centers involves the setting up or usage of existing institutional set ups to promote training and research in these areas. This will continue to contribute towards enhancing the skills base as well as the transfer of knowledge.

### **Encourage the support of the private sector**

The private sector must also be encouraged to participate in this drive towards developing our skills base as well as developing centers of excellence. A tax incentive (e.g. 150% of the cost is deducted from profits) should be provided for those enterprises which undertake to sponsor students undertaking additional specialization in the targeted areas.

## **Challenge: Establishing a firm link between research, education and industry**

While financial support plays an important part, a meaningful collaboration between research, education and industry is necessary if we are to become a knowledge-based economy providing high quality jobs. Unfortunately all too often the link between

research and industry is missing. A lot of valid research and innovation is undertaken at university level as well as at the level of technical institutes. This research is however not adequately transferred to industry and thus very valid work is often not utilized or lost. The challenge therefore is to transfer this research towards industry and to translate it into commercial ideas. We are currently failing in this area as evidenced by the low number of patents per inhabitants in comparison with the rest of Europe. Furthermore, industry should create the demand for research thus ensuring that there is coordination between the research demand and supply.

## **What needs to be done**

### **Establishing a formal link between industry and educational institutions**

A formal platform of dialogue between the private sector and the educational institutions must be created to ensure that resources put into R&D are used efficiently as well as to ensure that our educational institutions are meeting the requirements of local industry. A specific industrial R&D task force containing industrialists and researchers should be created.

Setting up a formal platform is however not enough. It is vital that the results and information obtained through this dialogue are / is disseminated so that policy makers, educational authorities and business leaders can take the right decisions and efforts in this direction.

**Measures matrix**

<b>Measure</b>	<b>Time Frame</b>	<b>Priority</b>	<b>Government</b>	<b>Unions</b>	<b>Employers</b>
<b>Promoting innovative research</b>					
Set up an R&D fund to facilitate access to finance for innovative SMEs	2005	★ ★ ★	✓		✓
Ensure proper administration and communication of the fund	2005 - 2007	★ ★ ★	✓	✓	✓
Assist participation in international research projects	2005 - 2007	★ ★	✓		
Promotion of existing tax incentives for innovative SMEs	2004 - 2007	★ ★	✓		
Encourage further specialisation	2005-2007	★ ★ ★	✓		✓
Encourage the support of the private sector	2005 - 2007	★ ★	✓		
Create areas of excellence in specific sectors	2005 - 2007	★ ★ ★	✓		
<b>Establishing a firm link between research and industry</b>					
Setting up a formal platform of dialogue between industry and educational institutions	2005	★ ★ ★	✓	✓	✓

## **PRIORITY 4 – REDUCING BUREAUCRACY AND CREATING A BUSINESS FRIENDLY REGULATORY ENVIRONMENT**

Excessive bureaucracy often stifles the potential of business. This bureaucracy hits right across the board from the requirements to set up a business right to the carrying out of business on a day-to-day basis. Private enterprise requires an efficient bureaucracy to enable it to generate wealth, raise living standards and create jobs.

At the Lisbon European council of March 2000, the creation of a friendly environment for starting up and carrying out business was identified as part of the EU's strategy to become the most competitive and dynamic knowledge-based economy by 2010. During the same summit, European leaders called for further efforts to lower the cost of doing business and remove unnecessary red tape and asked the EU institutions, national governments and regional and local authorities to continue to pay particular attention to regulatory impacts and compliance costs to businesses.

Too much regulation and an unclear delineation of responsibilities lead to delays that all too often result in lost business and lost investment opportunities. The Maltese economy cannot afford the luxury of a having a regulatory environment that does not take account of the needs of our enterprises. Also called into question is the rigid and sometimes uncooperative attitude taken by those people responsible for implementing these rules and regulations. It is vital that these people are made conscious of the vital role they play in enabling businesses to flourish as well as of the counterproductive effects that a too rigid approach can have.

This is now even more important in view of the fact that Malta is joining the EU and will thus be taking on all the rules and regulations of the Union. The UHM is not advocating that these rules and regulations are not respected, what is being advocated is that they are applied in an intelligent manner that contributes towards the flourishing of our enterprises.

### **Challenge:- Better regulation for a stronger business community**

We must aim to foster entrepreneurship and this can be done by creating a good entrepreneurial climate. Malta's regulatory environment should be driven by the desire to make the country more business friendly and attractive to investment. Our regulatory environment needs to be clear, simple and responsive.

All legislation that is introduced should take account of the needs of business to ensure that no unnecessary burdens are put on Maltese enterprises. Where proposed new legislation is found to be of a hindrance to enterprises, this should be reviewed and ways and means of reducing the potential negative effects should be sought. With regards to legislation already in place, a review and a thorough analysis of key legislation deemed to be having an effect on business should be carried out. Our regulatory environment should be one that supports rather than obstructs good business practice. It should also be one which provides certainty to all investors operating or wishing to operate in Malta.

### **What needs to be done**

#### **Setting up of an independent regulatory impact assessment unit**

An independent regulatory impact assessment unit consisting of technical personnel and backed up by an adequate secretariat should be set up. The role of this unit should be that of conducting a critical assessment of all proposed legislation to

evaluate what the impact of this legislation will be on business. This means that not only business legislation should be reviewed but all legislation being proposed irrespective of the area in question. No new legislation should be introduced without a business impact assessment. The process should be further enhanced through a process whereby the input of the constituted bodies is also sought. More specifically the constituted bodies should be asked to provide alternatives within a specified time period to those areas / provisions contained within the reviewed legislation which in their view could harm the interests of the business sector.

This initiative should be undertaken by the **Small Business Efficiency Unit** which however needs to be given fresh impetus. The original aim of the SBU was to improve the legal and administrative environment of business and therefore this initiative should fit within the remit of this unit. It however must be emphasised that although receiving government funding the SBU must be given a large degree of independence to ensure its objectiveness and credibility.

### **An evaluation of the cost of regulation**

An independent evaluation of the cost of regulation to Maltese enterprises should be carried out. In carrying out this evaluation we should seek to identify which are the burdens on SMEs resulting from local legislation, from where they stem, and what the actual cost really is. More specifically this exercise will identify the compliance costs stemming from generic requirements of legislation, the compliance costs stemming from key business legislation and the administrative burdens linked to government formalities and information requirements (red tape). This evaluation should be pushed by government, discussed at MCESD and its findings made public.

This initiative should also be undertaken by the **Small Business Efficiency Unit**.

### **Reduction in disruptions to production processes**

Production and work processes are often significantly disrupted when public / national holidays fall during mid-week. This often results in enterprises incurring significant costs to reset their production processes for a second time during the same week. In order to avoid enterprises incurring this additional unnecessary cost public / national holidays that fall during the week should be shifted to either a Friday or Monday thus avoiding mid-week disruptions. In proposing this due consideration must be given to our religious, cultural and historical heritage.

## **Challenge: Reduction of administrative costs and unnecessary bureaucracy**

Maltese enterprises are faced with government induced costs as well as government induced bureaucracy. These continue to contribute towards the lack of competitiveness of the Maltese economy. For too long we have talked about these issues with not enough being done. Now it is time to take concrete action and obtain visible results.

### **What needs to be done**

#### **Government ministries must undertake concrete annual 'anti bureaucracy' action plans to reduce unnecessary bureaucracy**

Each Government ministry should undertake to present and carry out concrete action plans on how they intend to reduce bureaucracy and introduce business friendly procedures. These action plans should be presented on a yearly basis and they

should be made public so that a transparent evaluation of what has been achieved can be carried out. All Ministers and their respective heads of departments must be held accountable for the results (or lack of) achieved.

### **Challenge: Rationalisation of the cost of government**

The cost of government continues to rise and projected figures of revenue and expenditure are not adhered to. This continues to put an additional strain on government finances. Despite all the pressure on government to control its costs, lack of control and lack of adherence to the appropriate procedures are very often highlighted in the annual Auditor General's Report. A proper management of government spending is required and this should ensure that strategic policy decisions are translated into effective and efficient spending outcomes and the allocation of expenditure as required. It is not only a question of how much is being spent but it is also about what it is being spent on.

### **What needs to be done**

#### **Action on Auditor General report must become institutionalised**

It is an unfortunate reality that the Auditor General report continues to highlight instances where abuses seem to have taken place or controls and procedures were not adhered to. It is also an unfortunate reality that not enough concrete action is seen to be taken following the publication of this very important report. Given this state of affairs it is being proposed that the report by the Auditor General is submitted to **MCESD** for discussion and remedial action to instances of abuse should be sought. All recommendations by MCESD in this regard should be directed towards the Public Accounts Committee which however will be held responsible for undertaking the necessary remedial action.

**Measure matrix**

<b>Measure</b>	<b>Time Frame</b>	<b>Priority</b>	<b>Government</b>	<b>Unions</b>	<b>Employers</b>
<b>Better regulation for a stronger business community</b>					
Setting up of an independent regulatory impact assessment unit	2004	★ ★ ★	✓		
An evaluation of the cost of regulation to SMEs	2005	★ ★	✓	✓	✓
Shifting of all public / national holidays falling during the week to either a Friday or Monday	2005 - 2007	★ ★ ★	✓	✓	✓
<b>Reduction of administrative costs and unnecessary bureaucracy</b>					
Government ministries must undertake concrete annual 'anti-bureaucracy' action plans to reduce unnecessary bureaucracy	2005 - 2007	★ ★ ★	✓		
<b>Rationalisation of the cost of government</b>					
Action on Auditor General report must become institutionalised	2005 - 2007	★ ★ ★	✓	✓	✓

## **PRIORITY 5: A STABLE ECONOMIC FRAMEWORK**

Entrepreneurs require a stable economic framework to inspire the necessary confidence for them to invest. Such stability has, by and large, existed in Malta over the past decade, with EU membership likely to provide an additional boost. However membership, and in particular European Monetary Union, will require Malta to abide by the Stability and Growth Pact rules which stipulate that the size of the Government deficit and public debt should not exceed 3% and 60% of the GDP respectively.

In 2003, Malta did not satisfy both these criteria. One of the key underlying factors being the structural growth of expenditure on welfare programmes and pensions. Like most of the European countries, Malta's demographic structure has resulted in an increased population of ageing individuals. As life expectancy has increased, so has expenditure on pensions and healthcare. Based on current trends, the total number of individuals aged 60 years and over in the overall population will increase from 1 in 6 in 2002 to 1 in 4 by 2020. Radical reforms to the pension, welfare, and healthcare system are hence unavoidable.

The impacts of such reforms will be far-reaching and are likely to affect (i) the overall labour supply if the pension age is increased, (ii) indirect labour costs in the form of increased social security contributions, and (iii) disposable income as individuals will seek private sector pension schemes and health insurance. All these factors will impact on the overall competitiveness of the Maltese economy. Whilst the impact cannot be avoided, a systematic approach to the reforms will reduce uncertainty and thus allow enterprises to prepare for the imminent changes.

### **Challenge: Providing a clear framework for welfare reform**

The UHM believes that one of the key challenges in this respect is to have a clear framework for the welfare reform. The need for reforms to the welfare system has been known and recognised for several years. In fact the welfare reforms commission had originally been set-up in 1999 to review and provide recommendations on the reforms. However successive delays resulted in the final report only being presented at the end of 2003. In the meantime, the pressure on public finances has increased and the temptation to introduce immediate remedial measures is great. The UHM however believes that given the wide-ranging economic and social repercussions such reforms will have, they must not be rushed but must be introduced in a planned and systematic fashion.

### **What needs to be done**

The UHM proposes the following measures to meet this challenge:-

#### **Providing a clear indication of the proposed reforms**

A clear indication of the proposed reforms must be provided to the social partners well in advance of their introduction. The welfare reform must be a coherent and structured reforms package rather than a collection of piecemeal changes over time. It is imperative that the proposed reforms are coherent and implemented only following an exhaustive consultation process with the social partners. The consultations must be genuine, conducted in an open manner by all parties concerned, and with the long-term national interest in mind. The sustainability of the current system is dependent on the carrying out of the necessary reform and in this respect each of the social partners is expected to play an equal part in pushing through this reform.

### **Introduce changes in a phased and orderly approach to minimise disruption to the economy**

To avoid disruption the reforms should be introduced in an orderly and phased approach over a multi-year period. This will allow entrepreneurs to adapt their business strategies in a structured manner to the changing environment thereby avoiding any unexpected changes in input costs and possibly redundancies. The possibility of abuse should of course be eliminated.

#### **Measures Matrix**

<b>Measures</b>	<b>Time Frame</b>	<b>Priority</b>	<b>Government</b>	<b>Unions</b>	<b>Employers</b>
Providing a clear indication of the proposed reforms	2004	★ ★ ★	✓	✓	✓
Introduce changes in a phased and orderly approach to minimise disruption to the economy	2005 - 2007	★ ★ ★	✓	✓	✓

## **PRIORITY 6: ENHANCING OUR TOURISM PRODUCT**

Tourism is one of Malta's most important industries. An estimated 40,000 people are said to be employed directly and indirectly by this industry. Given the importance and potential of this industry the UHM firmly believes that the tourism industry could give the Maltese economy a much-needed boost. There is no doubt that international events such as September 11<sup>th</sup> and SARS have had a very negative effect on global tourism, the effects of which have also been felt by the local tourism industry. Coupled with this is the ever-increasing competition from various destinations within Europe and the Mediterranean.

Notwithstanding this, there is certainly a lot that can be done locally to improve the performance of the industry. Increasing costs and the offering of a poor product continue to see us losing out against our competition. We can no longer take the tourism market for granted. An effort is being made to reposition Malta as a high quality destination as opposed to a Sun and Sea destination. This however requires the collaboration of all sectors directly and indirectly involved with the sector. A serious coherent effort is required to make this very important industry flourish not only in terms of tourist numbers but also in terms of the amount of spending per tourist head and in the return on investment made in the sector.

### **Challenge:- Building an all round culture of service**

The visiting tourist must be given good value for his money. An integral part of this value lies in the quality of service he receives whilst visiting our country. The level of service in many other destinations has improved tremendously and thus the expectations of visiting tourists are now considerably higher than what they were some years ago. There is no denying that the service given by some key elements within the tourist industry leaves much to be desired. It is useless to build five star hotels offering five star services if as soon as the tourist steps outside of his hotel the service given is that of a three star country.

### **What needs to be done**

#### **A concerted effort must be undertaken to improve the provision of essential services**

The authorities, unions and organisations involved with the industry must put pressure on certain providers of essential services to offer a top-notch service to our tourists. It is no secret that tourists using various essential services are sometimes given a very poor service or are serviced with a poor attitude which often leaves a bad impression. This is not to say that all operators within the relevant sectors act accordingly however there is no doubt that the actions of some reflect badly not only on their fellow colleagues but also on the country in general.

The **authorities** and **organisations** responsible for the relevant service sectors must embark on a concerted campaign to stamp out bad behaviour as well as instil a culture of real service amongst the operators. We can no longer afford a lax attitude towards bad service.

### **Continue to invest in the training of our human resources**

Having a trained workforce is essential and even more so in the tourism industry. People providing a service in hotels, restaurants and other tourist related services must be given the right kind of training to be in a position to offer the best possible service. A number of positive initiatives have been undertaken in this sector and investment has been undertaken by both Government and the private sector. It is vital that this investment is continued and bolstered further. More specifically **ITS** should remain the focus of government investment whilst efforts to secure short-term placements abroad should be enhanced. On the other hand **private enterprise** involved in the tourism sector must continue to invest in the training of its people on a regular basis.

### **Challenge:- Improve the presentation of our product**

Irrespective of how much we invest in marketing Malta as a prime tourist destination if the presentation of our product remains poor we will continue to lose market share. There is no doubt that the presentation of Malta as a tourist destination leaves much to be desired. All too often the country looks shabby and little or no consideration is given to the protection of our environment all of which leaves a negative impression with visiting tourists. The challenge ahead is that of enhancing our product to the level expected of a prime European and Mediterranean destination.

### **What needs to be done**

#### **Cleanliness must become a top priority**

The general cleanliness of our country has improved. Efforts by government and local councils have contributed towards this marked improvement however much still needs to be done. Having said that, the UHM wants to make it clear that it believes that the responsibility for the general cleanliness of the country lies with each and every citizen however the authorities certainly have a key role to play and one such role is to enforce the laws related to cleanliness and impose penalties for the breaking of such laws. In this respect government should show the same kind of determination it has shown with the enforcement of traffic regulations through the introduction of wardens. These same wardens should take on a more effective role in the prevention of littering in urban areas. On the other hand **government** is urged to introduce environmental wardens who would be responsible for the safeguarding of our natural environment.

With respect to the general cleanliness of the country the current embellishment of key roundabouts and other roadside areas must be commended and such Private-Public Partnership initiatives should be encouraged. These initiatives must however be accompanied by an element of strict control to ensure that resources are used in as efficient a manner as possible.

#### **Enhance the presentation of our major attractions**

Malta possesses a wealth of attractions which if maintained and presented in the right manner would contribute in no small measure towards the enhancement of Malta as a tourist destination. Attractions such as the historical temples, palaces and Valletta harbour must be given more importance and a greater effort to preserve and enhance the presentation of these priceless assets is required. UHM acknowledges that efforts have been made in this direction however much more needs to be done if we are to exploit their potential.

**Undertake efforts to involve further the private sector and to source 'outside' funds for the maintenance and management of these major attractions**

One of the major difficulties facing the authorities responsible for our historical attractions is the significant cost to maintain and manage these sites. In this respect further fiscal incentives in the form of tax credits should be given as an incentive for the private sector to contribute towards the maintenance of these sites. The involvement of the **private sector** should also be encouraged in the management of these sites. The private sector can very often bring that much needed element of management which is sometimes lacking within the public sector.

The **government** is also urged to make use of EU structural funds for the maintenance and enhancement of our historical sites. Examples of the rehabilitation of historical sites with EU funds abound in current member states. We must make full and efficient use of such funding opportunities.

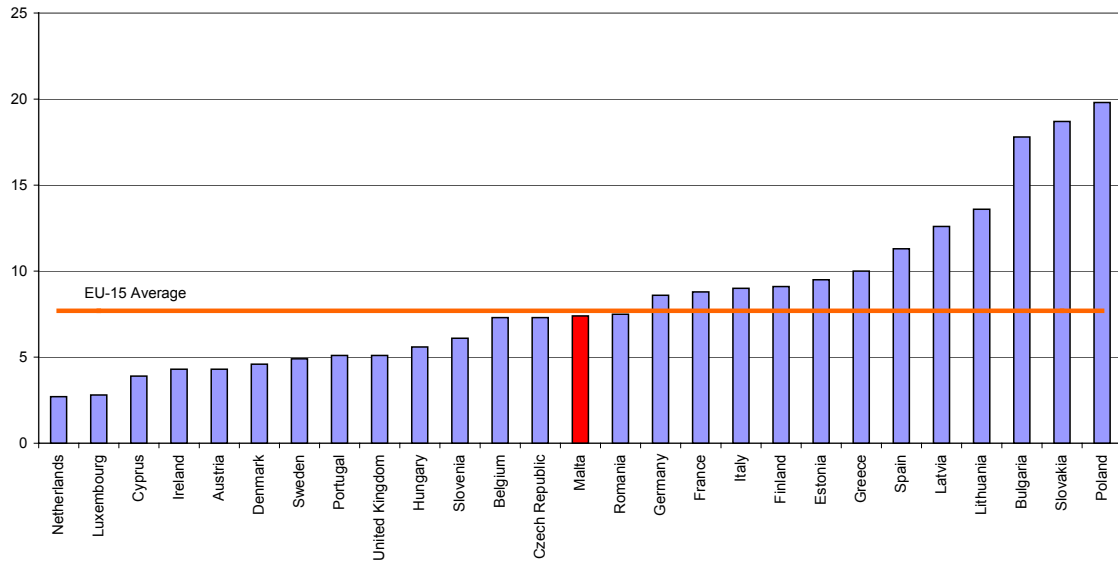
## Measures Matrix

Measure	Time Frame	Priority	Government	Unions	Employers
<b>Building an all round culture of service</b>					
Concerted effort to improve the level of service given in key areas	2004 - 2007	★ ★ ★	✓	✓	✓
Continue to invest in the training of our human resources	2004 - 2007	★ ★ ★	✓	✓	✓
<b>Improve the presentation of our product</b>					
Enforce the law with respect to littering and introduce environmental wardens	2004 - 2007	★ ★ ★	✓		
Enhance the presentation of our major attractions	2005 - 2007	★ ★ ★	✓		
Undertake a coordinated approach to the maintenance and enhancement of these attractions	2005 - 2007	★ ★	✓		
Undertake efforts to involve further the private sector in the maintenance and management of these major attractions	2005 - 2007	★ ★	✓		✓
Make use of EU structural funds to rehabilitate our historical sites	2005 - 2006	★ ★ ★	✓		

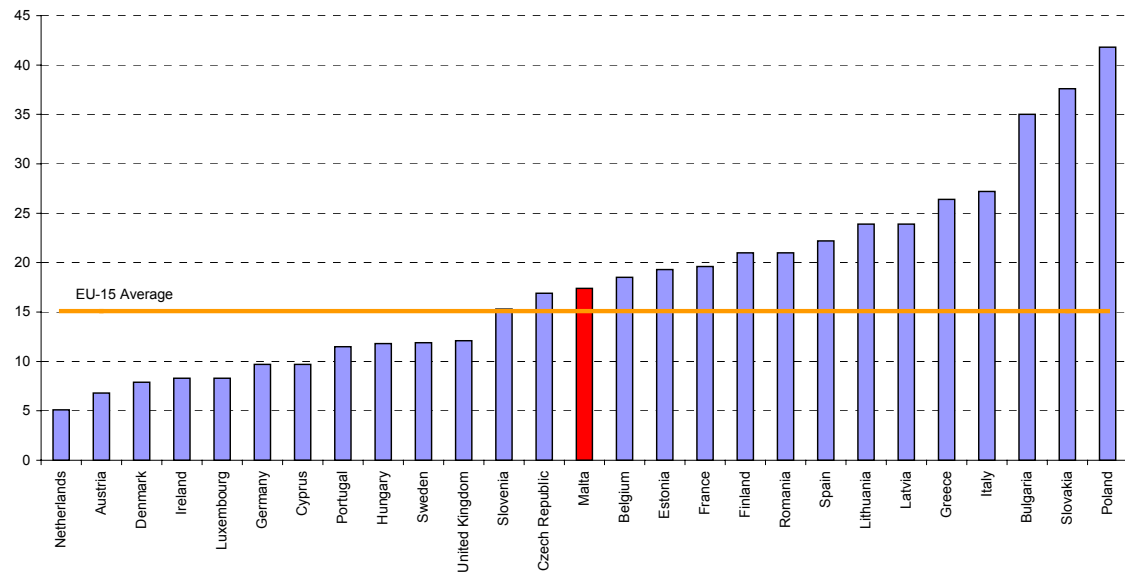
## ANNEX 1 – COMPARATIVE DATA<sup>3</sup>

### Employment

Unemployment Rate  
% of 15 to 74 age group  
2002

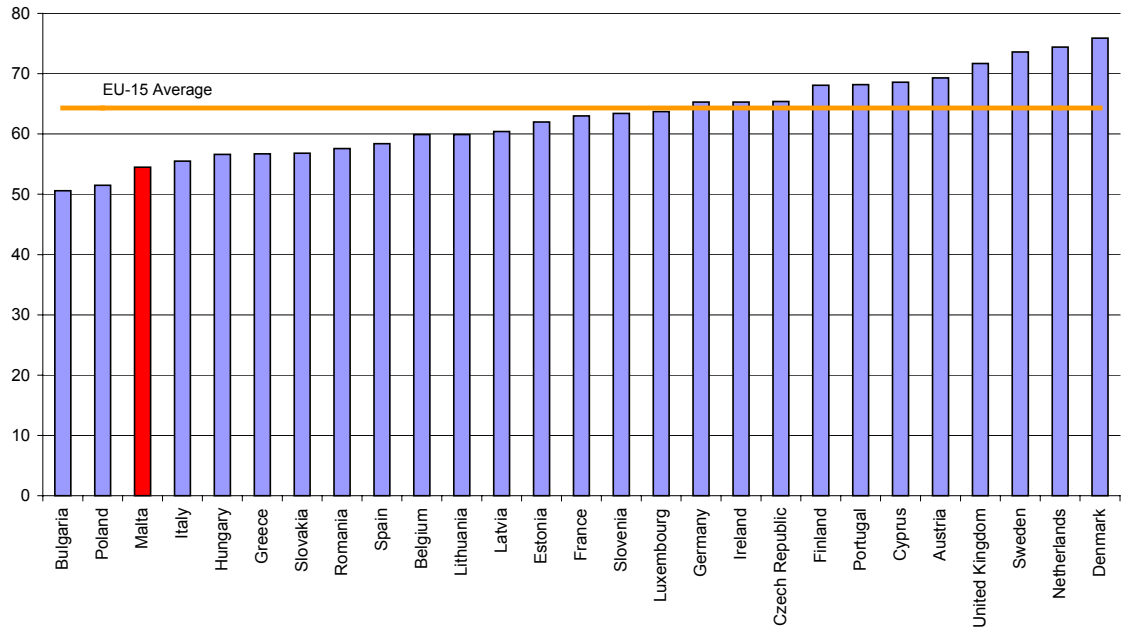


Unemployment rate - Less than 25 yrs

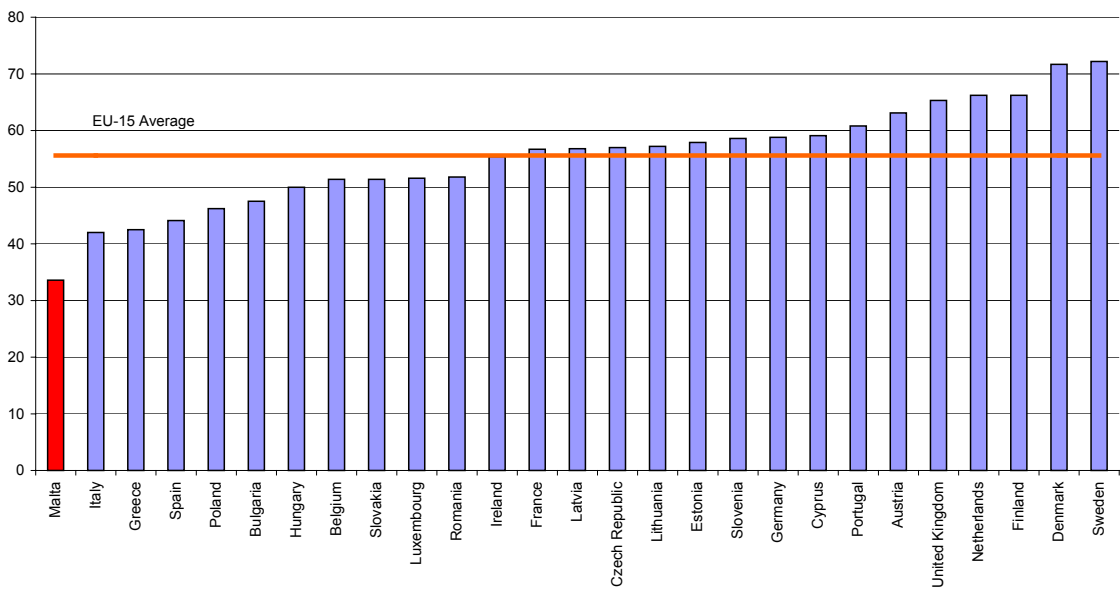


<sup>3</sup> Source: Eurostat

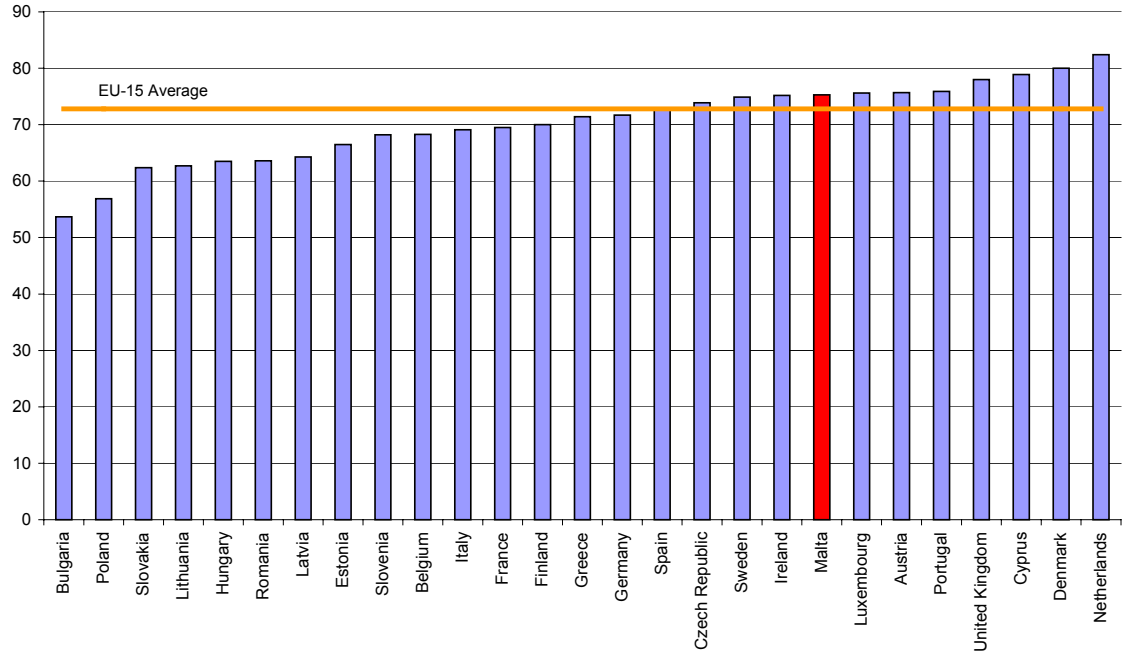
**Employment rate  
% of 15 to 64 age group  
2002**



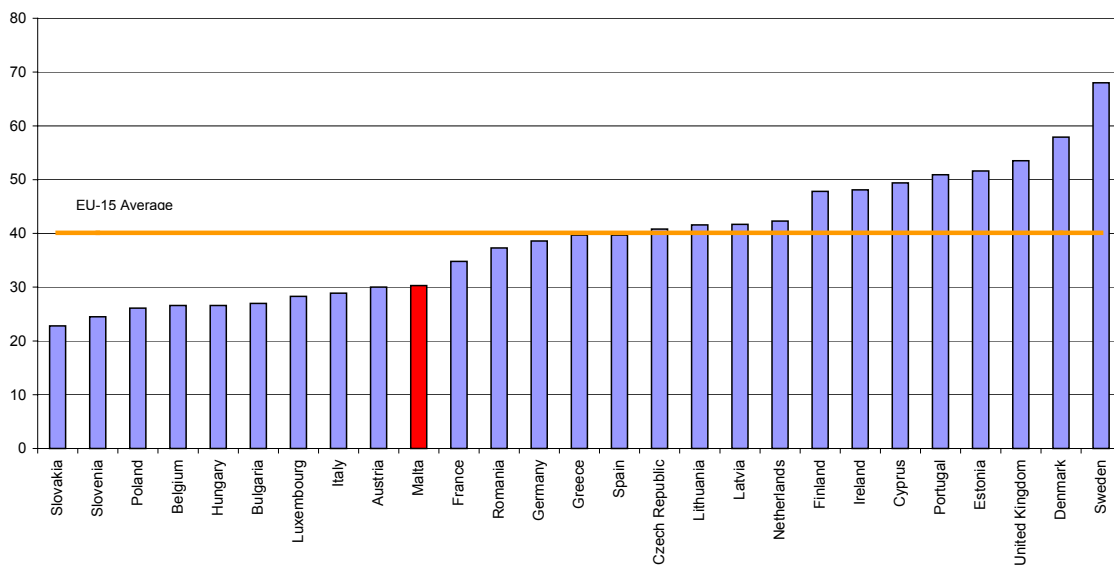
**Female Employment Rate  
2002**



**Male Employment Rate  
2002**

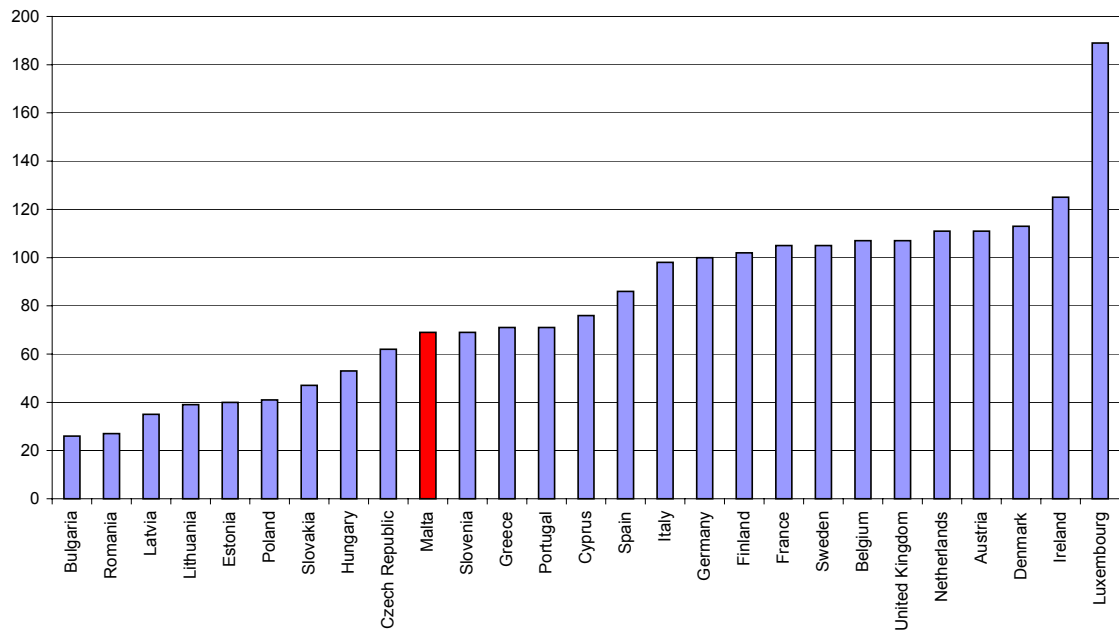


**Employment Rate  
55yrs - 64yrs  
2002**

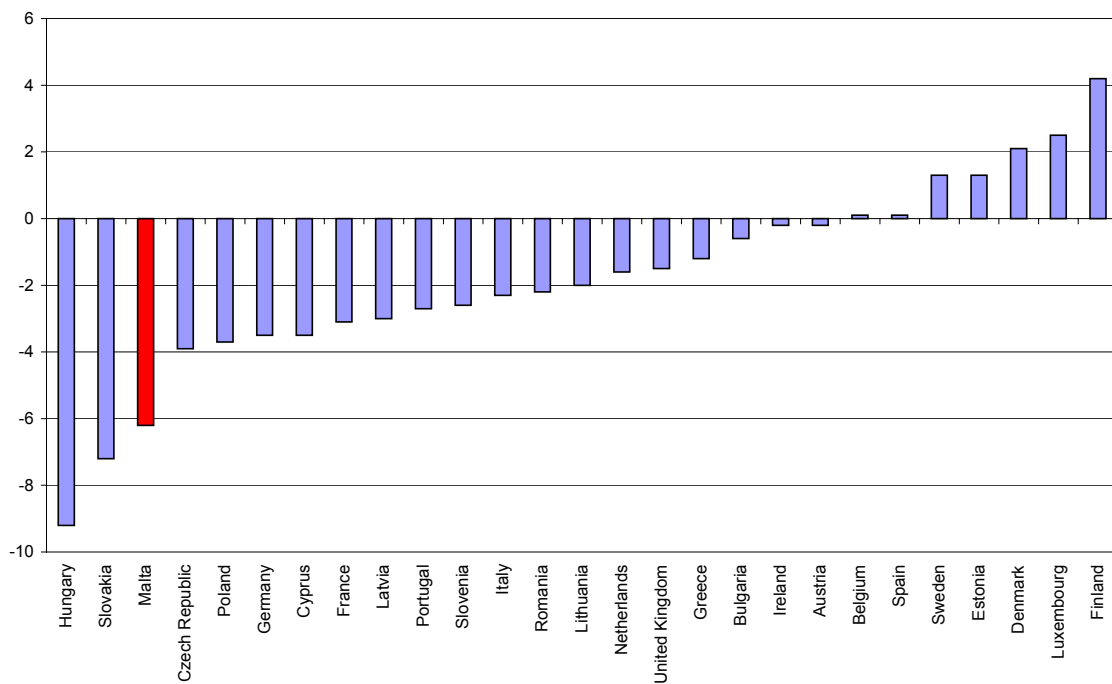


## Economic indicators

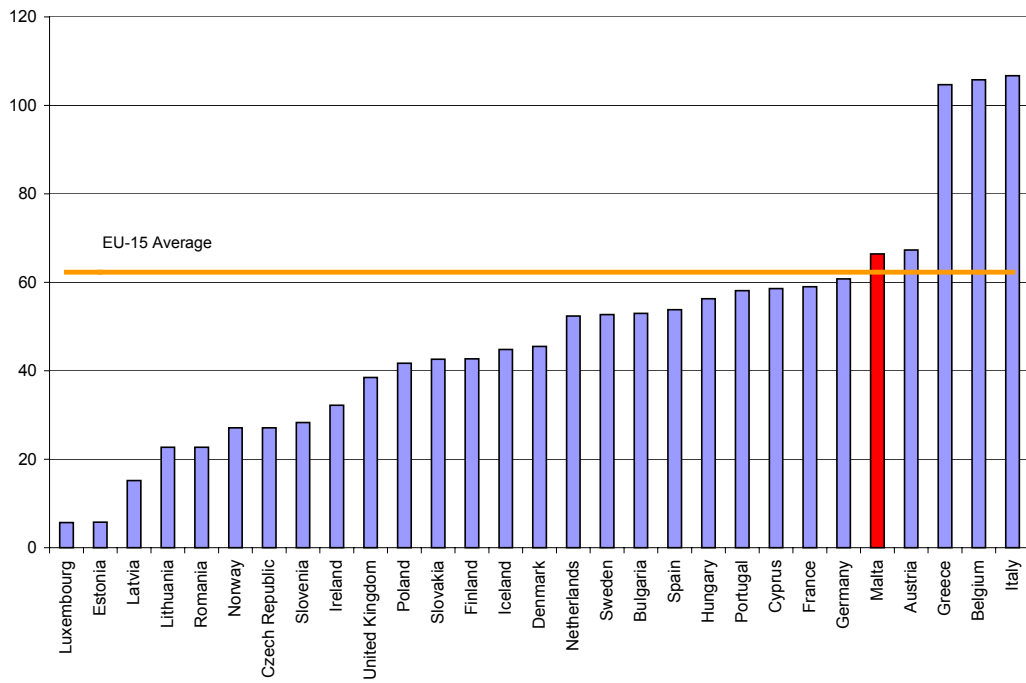
GDP per capita in PPS  
EU (15) = 100  
2002



Public Balance 2002

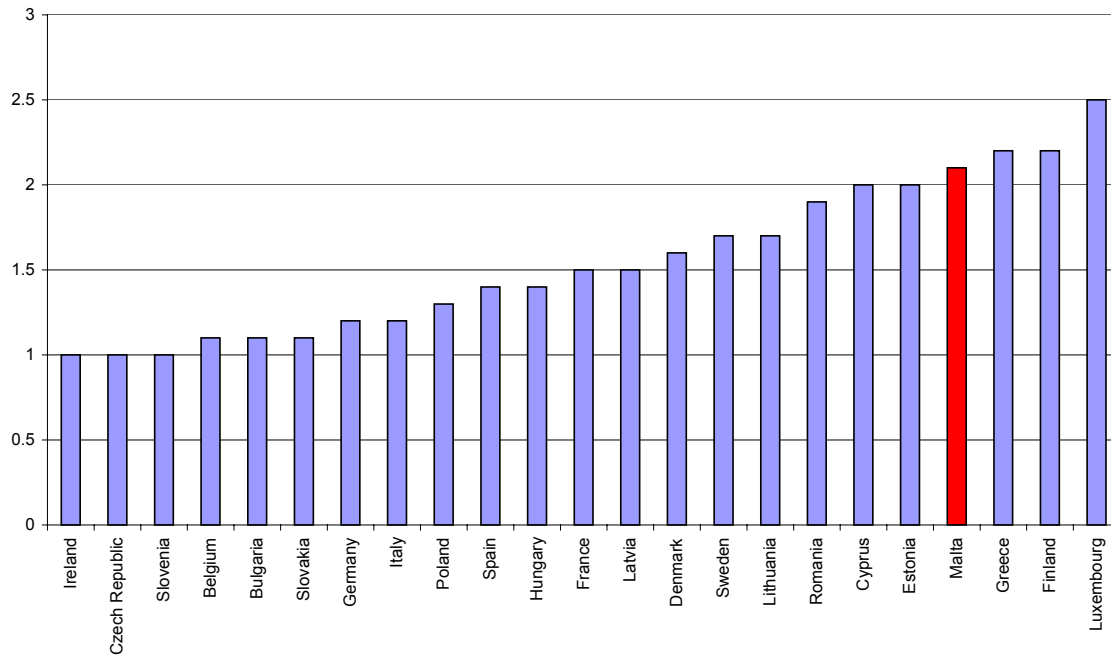


**General Government Debt  
2002**

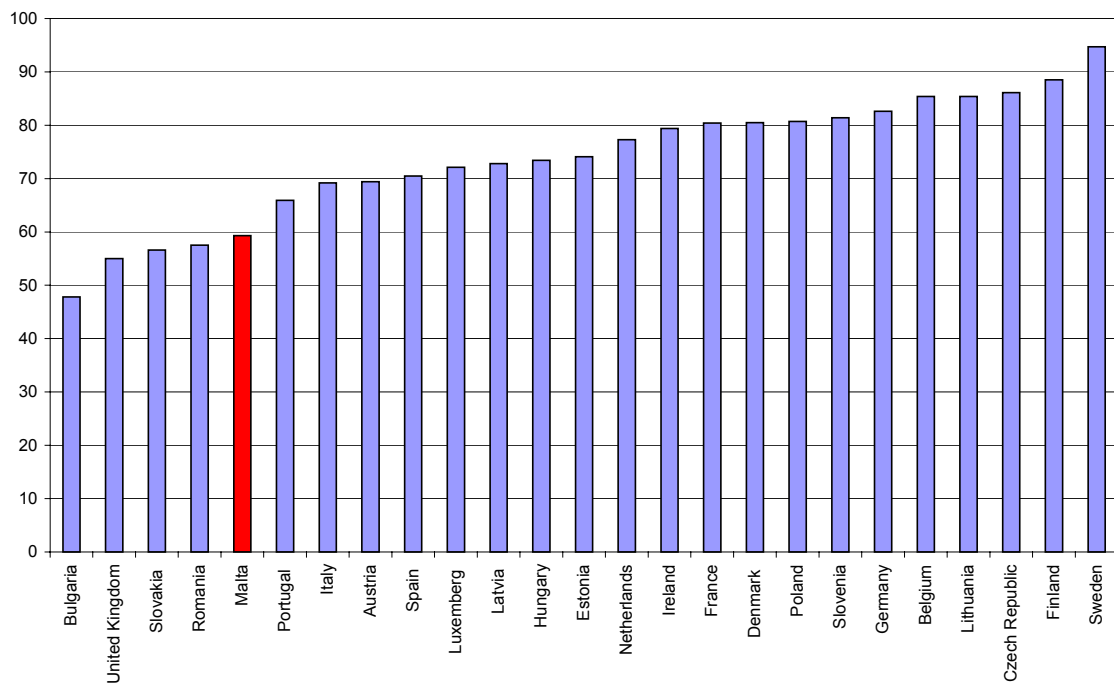


## Education

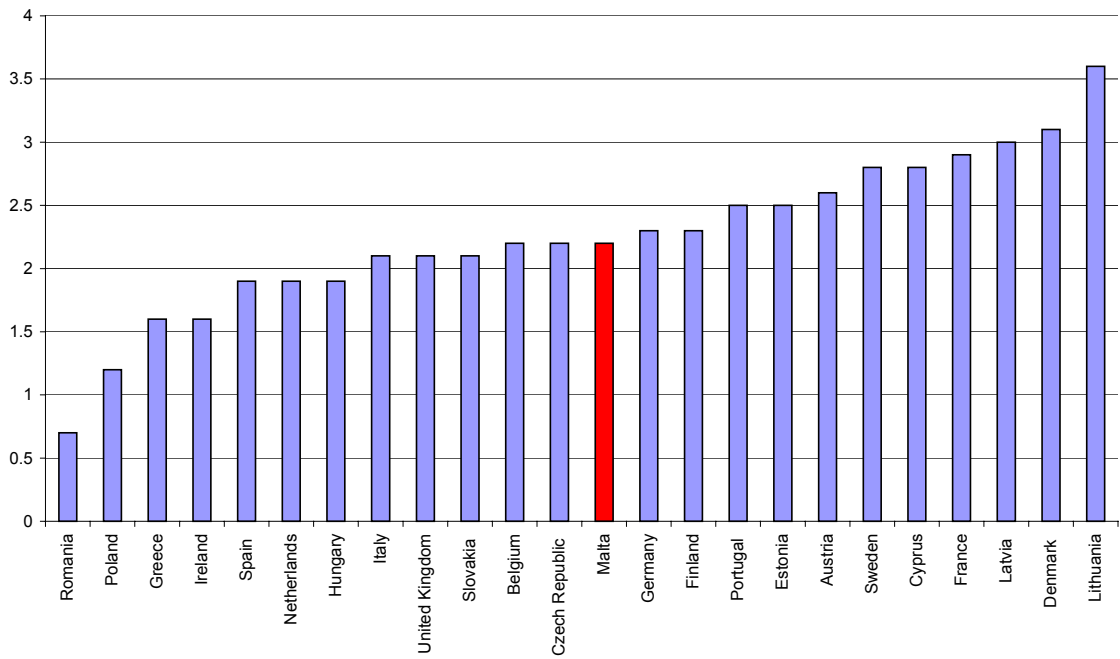
Foreign languages learnt per pupil  
Secondary Level



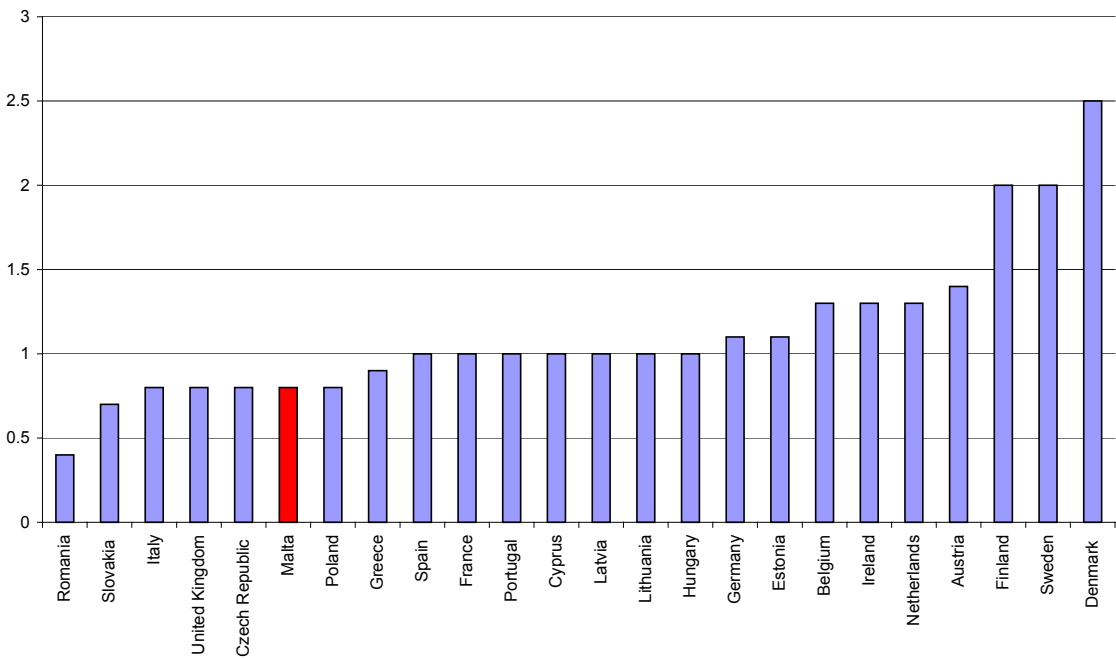
18-year-olds in education



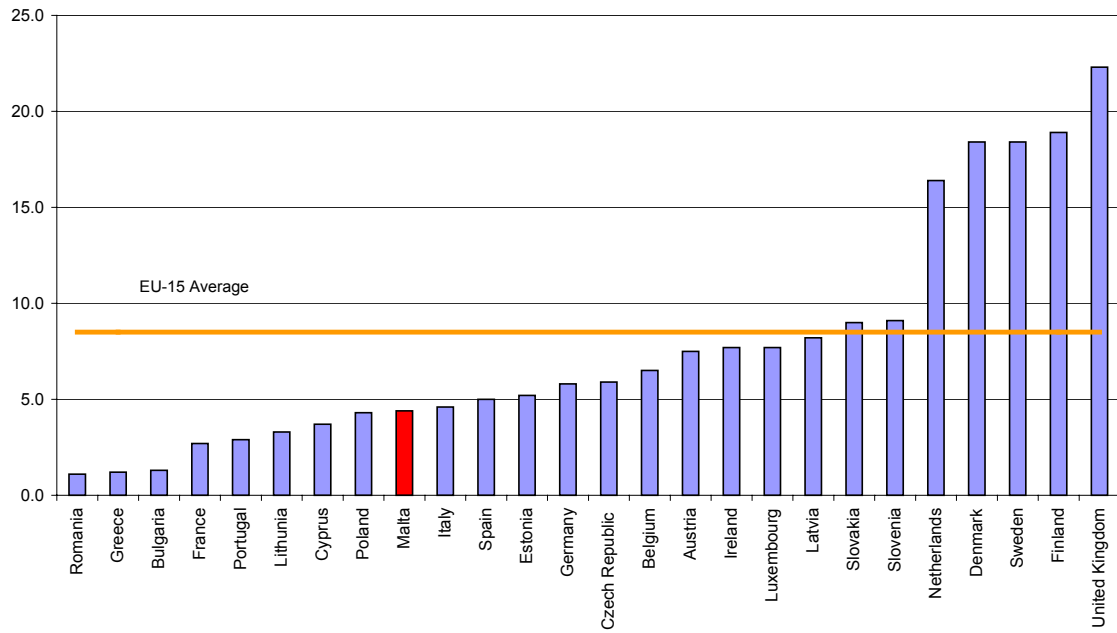
**Public expenditure on secondary education  
2000**



**Public expenditure on Tertiary education  
2000**

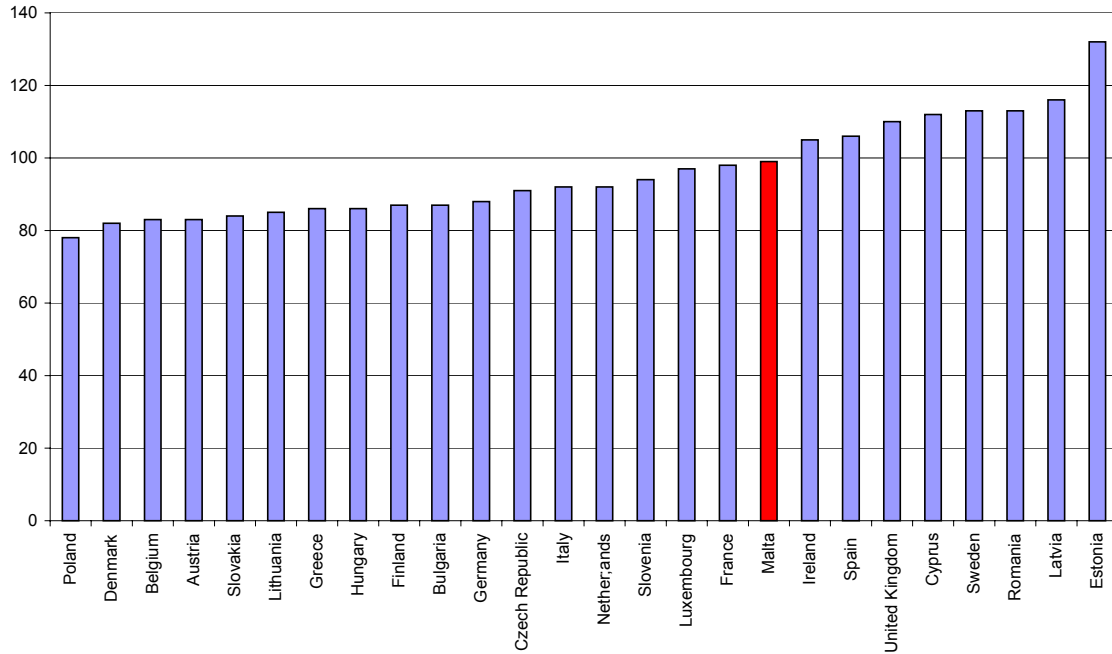


**Life-long learning**  
**% of adult (25-64) population participating**  
**2002**

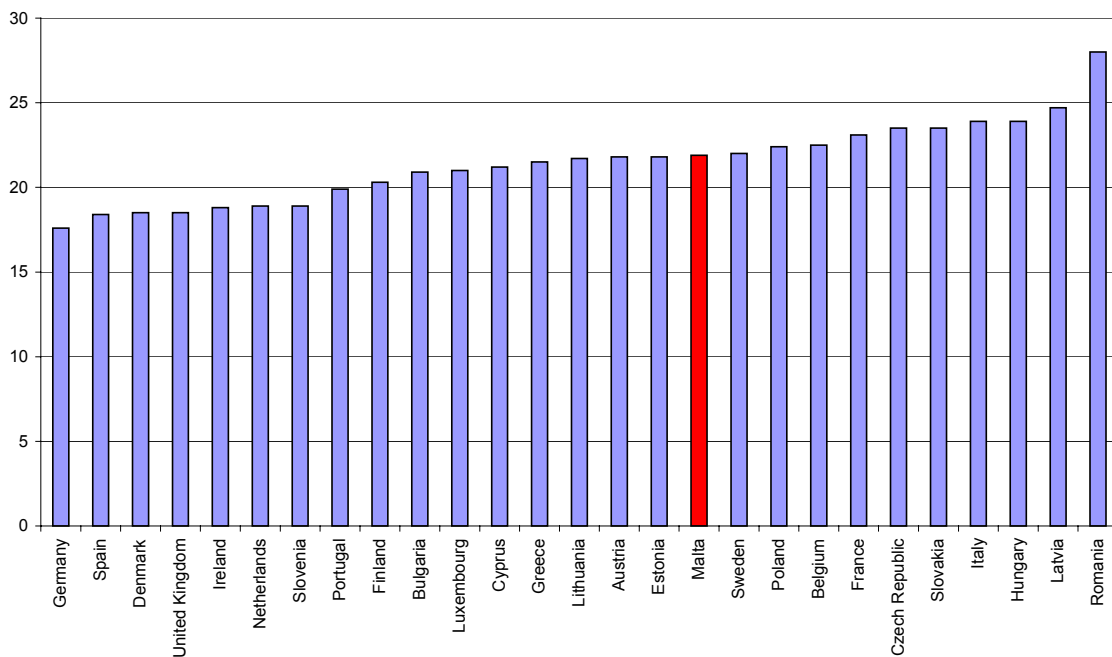


## People in the labour market

Serious accidents at work  
2001



Hours worked per week of part-time employment  
2002



## **ANNEX 2 - THE STATE OF THE MALTESE ECONOMY AND THE CHALLENGES AHEAD**

This document was prepared as a support document for the Social Pact as proposed by the UHM. The document presents the main findings of a detailed economic analysis carried out by the authors which aims to provide a concise overview of the current state of the Maltese economy highlighting the key challenges that Malta faces over the coming years.

The Maltese economy is facing challenging times. The boom years of the early 1990's have long gone, economic growth has slowed, and international competition has steadily increased. Malta is not alone in this respect. Most of the developed economies have experienced a severe downturn in economic growth over the past 3 years. However this fact should not be used as an excuse.

As this document will highlight, Malta still has a lot of untapped potential, in particular with respect to its human resources, which is not being exploited in the most efficient manner. Moreover the country has been experiencing relative price stability over the past few years and has benefited from a relatively low unemployment rate (by international standards).

That said, there are various factors which need to be addressed if economic growth is to be reinvigorated. One of the most pressing challenges is the need to increase the overall competitiveness of the country. Competitiveness in this respect encompassed a variety of issues, including labour cost, indirect government induced, the efficiency of the public sector, and the overall macro economic conditions.

The second challenge is to render the state of the public finances sustainable. This requires first and foremost the reform of the current welfare programmes and the pension scheme. Given the demographic structure of the Maltese population, the current programmes are already straining recurrent expenditure. The strain will only increase will over time if left unaddressed, making reforms more difficult and burdensome.

Moreover, there is a need to ensure that revenue collection is improved. Tax evasion unfortunately remains pervasive in Malta despite efforts and some success in curbing it. As a result the tax burden is not carried equally amongst the various members of society, with law abiding tax payers having to foot the bill of the increasing expenditure.

That said, there is also a need to further increase efficiency within the public sector to provide value for money. It is clear from the National Auditors Report that there are various shortcomings within the public sector that clearly lead to wastage. There must clearly be greater accountability on the part of the civil service and entities that are financed by public funds in the way these public funds are being spent. This also applies to the civil servants who have to ensure that they deliver their wages worth in time of productive time. The public sector currently accounts for close to one-third of the total gainfully employed. It stands to reason that if the productivity of one third of the gainfully occupied population is increased, then the overall economic output will increase as well.

Other issues that need to be addressed include:

- Diversifying the manufacturing base to reduce the reliance on a limited large enterprises;
- Accelerating the job creation process in particular in higher value industries; and
- Utilising the available human resources more efficiently.

All this has to be seen within the context of the imminent accession to the EU, which will provide both opportunities and challenges that need to be proactively managed to ensure that the domestic economy regains the growth momentum it had already exhibited in the early 1990s.

## ECONOMIC GROWTH – PERFORMANCE

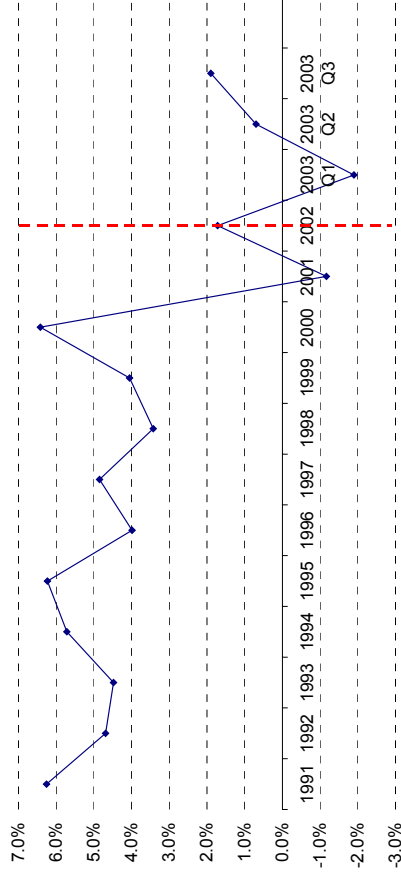
Malta experienced relatively strong economic growth during the most of the 1990's with real GDP growth consistently exceeding 3% until 2000. A slight reduction on growth occurred on account of political uncertainty due to the general elections in 1996 and 1998, however these were short-lived. These growth rates have however not been sustained over the past 3 years. The general slowdown in world economic growth during the second half of 2001, combined with the adverse impact of the September 11<sup>th</sup> attacks in the US, contributed towards a contraction in GDP growth in 2001. Whilst there has been a slight recovery since, the overall growth rate remained subdued, at slightly over 1% since 2001. The recent downturn highlights the high dependence of the Maltese economy on the external sector, most notably the tourism and the export-oriented manufacturing sector, both of which were adversely affected by the international developments and are only recovering slowly.

Two key trends are of relevance to overall economic growth. Firstly economic growth is principally driven by the external sector, i.e. in the form of the export oriented manufacturing sector and the tourism sector. Secondly, the importance of the services oriented industry as a generator for growth has been increasing.

### Domestic exports are as key determinant of growth

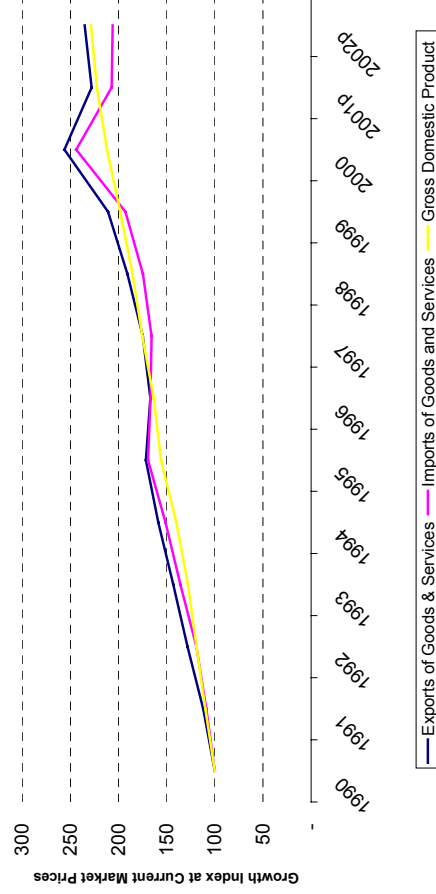
The importance of the external sector is amply highlighted by the extent to which the trade of goods and services affect the overall Gross domestic Product. Imports and exports of goods and services as a percentage of GDP amounted to 89.1% and 87.7% in 2002. Trade growth has been strong in nominal terms over the past decade. Imports and exports of goods and services increased by 235 % and 206 % between 1990 and 2002. Underlying factors affecting the overall growth rate being a strengthening in domestic demand, a consistent trade liberalisation programme during the 1990's which was subsequently intensified in the run-up to EU membership, and the relatively strong growth in the tourism sector during the course of the 1990s.

Growth in Real GDP



Source: National Statistics Office

Growth in GDP and Trade in Goods and Services at Current Market Prices



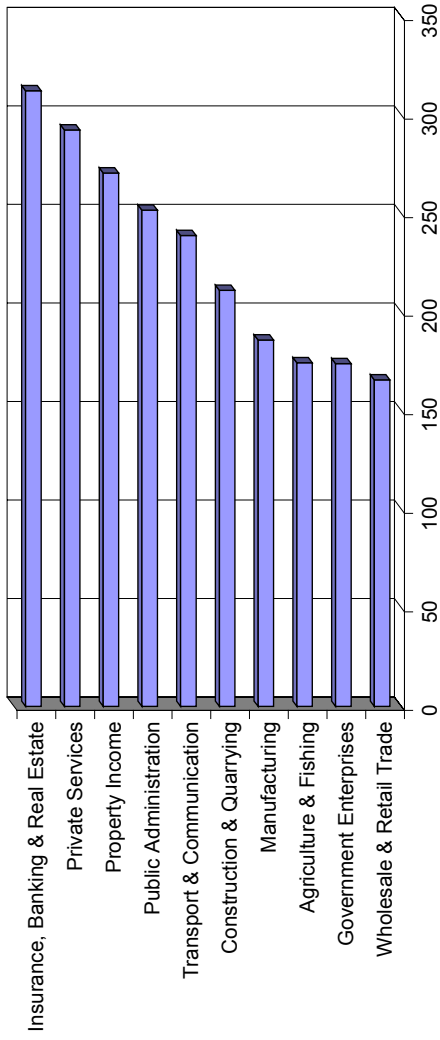
Source: NSO, Base 1990 = 100

**Service oriented industries are the fastest growing sectors**

In terms of the overall economic structure, the size of the services industry has increased in importance over time both in terms of contribution towards GDP and in terms of employment. In total private market services, combined with the financial services sector and the real estate sector account for 21.2% of total economic output, slightly lower than the manufacturing sector which accounts for 23% of the total GDP in 2002. The public administration and government enterprises on the other hand accounts for a 23% of total GDP.

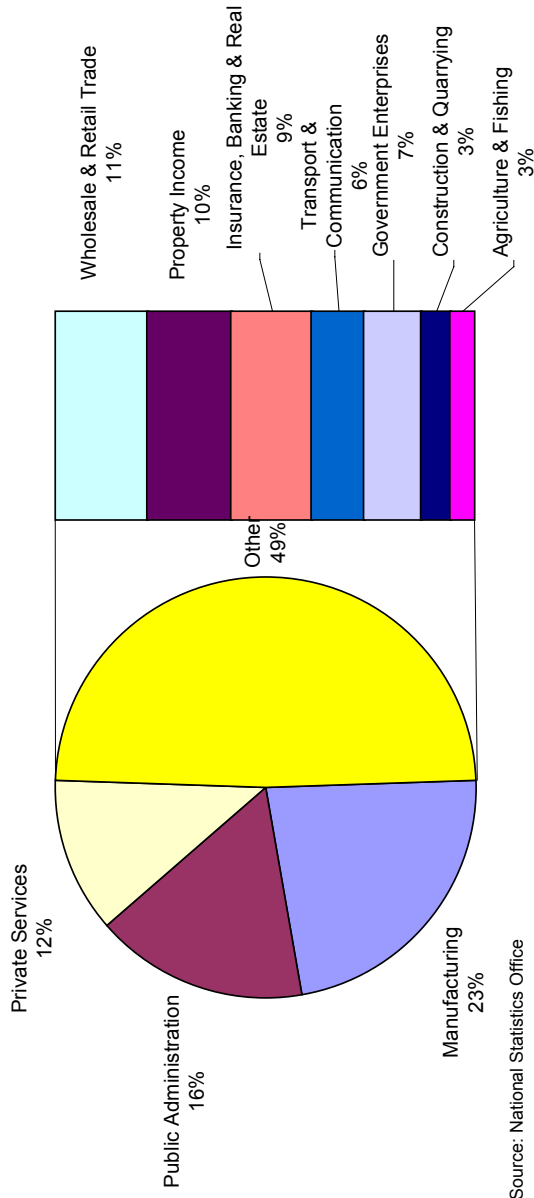
During the past decade growth was most significant in the services oriented industries, with the highest growth being registered in the financial services and the private services sector. Since 1990 these sectors have grown by over two and a half times in terms of their contribution to GDP. That said, the public sector also increased by close to 250% during the period on account of increases in wages and salaries in the sector. In contrast, weaker growth was registered within the manufacturing sector, including the agriculture and fisheries sector, government enterprises and the distributive trade.

**Sectoral Growth in GDP at Factor Costs**



Source: NSO, 1992 data. Base 1990 = 100

**Composition of GDP at Factor Costs 2002**



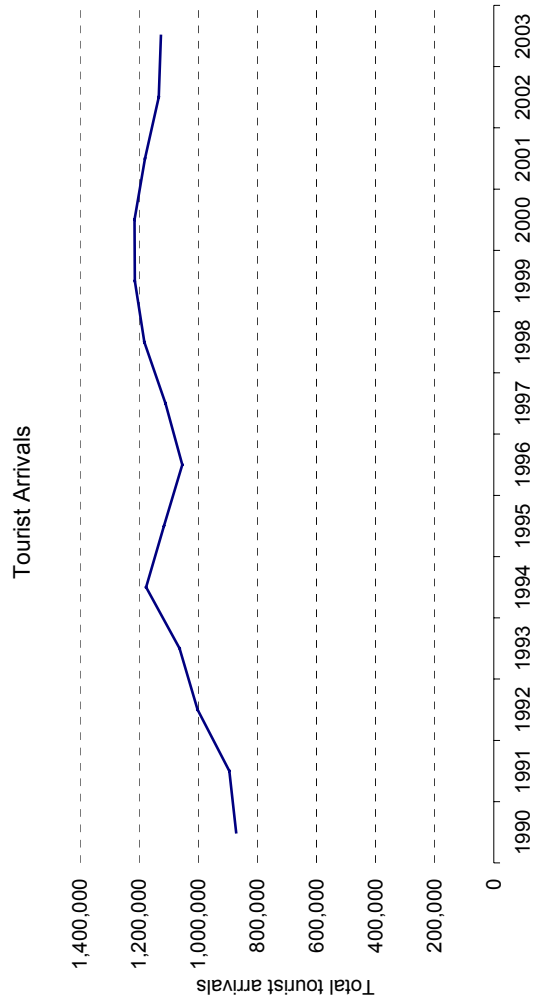
Source: National Statistics Office

### Tourism is a key economic sector

Although the tourism sector is not a specific sector per se in the national accounts data, the overall impact of the industry on the various other sectors of the economy cannot be overlooked. A study conducted by the Malta Tourism Authority in 2000, estimates that tourism accounted for 10.5% of the GNP directly and 24.3% of the GNP indirectly if the various industries benefiting from the tourism industry are taken into consideration. The impact is even greater when the overall employment effect is taken into account. The study estimates that the tourism industry accounts for 12.8% of full-time equivalent employed, and 27.4% of the full-time equivalent employed if the indirect spin-offs in related industries are considered.

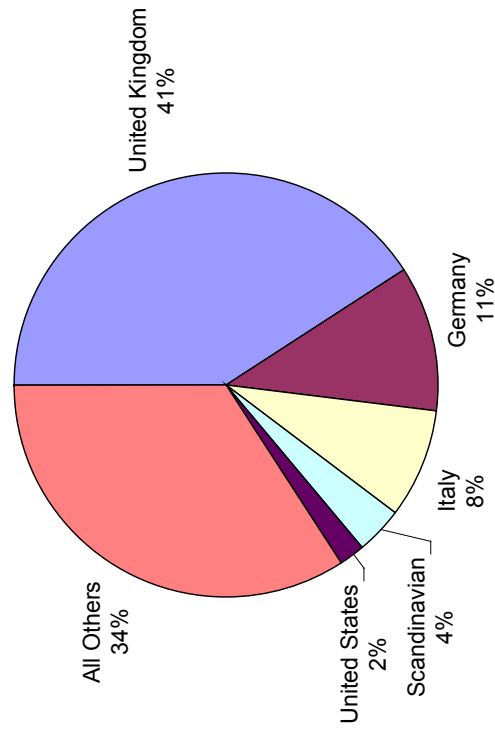
The importance of tourism to the economy is reflected by the fact that the performance of the industry based on overall tourist arrivals effectively mirrors the overall performance of the economy. Overall tourist arrivals to Malta had generally increased during most of the 1990's with the exception of 1996, when Malta was adversely affected by intense competition from other Mediterranean destinations. Tourist arrival number recovered rapidly and subsequently stabilised slightly over 1.2 million in 2000. The adverse impact of the September 11<sup>th</sup> attacks combined with a subsequent slowdown economic growth in Malta's principal tourist markets, and SARS have adversely impacted overall tourist arrivals. Since 2000, total tourist arrivals have fallen slightly to 1.1 million in 2003.

Malta's principal tourist markets have largely remained the same over the past decade, with the UK remaining the primary market followed by Germany, Italy and France which in 2003 collectively accounted for 60% of total arrivals. However, weak economic growth within these key markets and a general strengthening of the EU has resulted in declines in the both the German and Italian markets which in 2003 were down by 11.5% and 6.6% respectively over 2002. Fortunately the UK market has managed to compensate for some of the loss in these markets. Earnings from tourism have largely followed the tourist arrival trends, although it is worth noting that in 2003, despite a slight fall in overall arrivals, earnings from tourism actually increased by 6%.



Source: NSO

### Composition of Tourist Arrivals 2003



Source: National Statistics Office

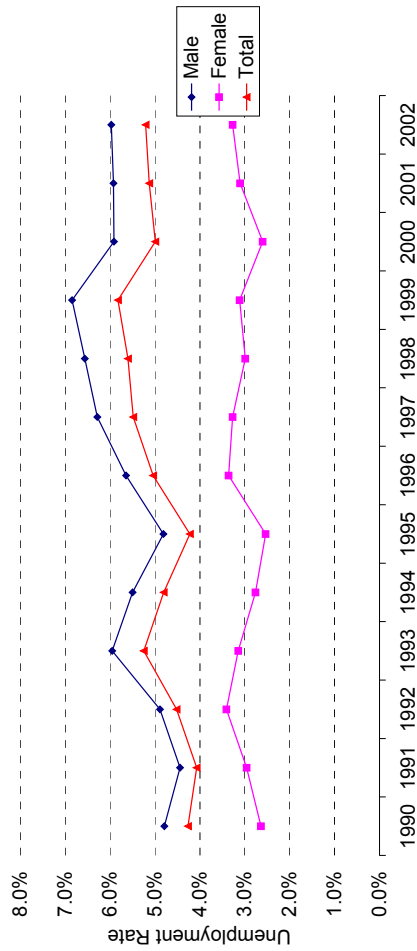
## THE LABOUR MARKET

Given Malta's general lack of raw materials, the county's labour force is the principal source of economic wealth creation. The effective utilisation of the available human resource and improving their productivity is hence key to continued economic growth. To date unemployment hasn't been a major problem for the country. Based on the number of registered unemployed, Malta's unemployment rate has increased slightly since the early 1990's when it fluctuated between 4% and 5% to slightly over 5% since the mid 1990's. It has since remained steady between 5% and 6% since 1996. The actual unemployment rate is however estimated to be slightly higher than the above figures given that not all unemployed individuals actually register with the ETC. The labour forces survey, which is based on a sample of the working population actually indicates that in December 2002 the estimated unemployment rate stood at 6.8% compared to the unemployment rate as computed by the number of registered unemployed which stood at 5.2%. Whilst these levels are still relatively low when compared to other EU member states, the inability to reduce the unemployment rate remains of concern.

An analysis of the composition of the unemployed suggest however that here is a core of long-term unemployed, much of which is structural in nature. Slightly over half of the total unemployed population is in fact long term-unemployed, i.e. 53 weeks and over. Moreover most of the individuals are semi- or unskilled individuals. Male unemployment has consistently been higher than female unemployment which fluctuated between 2.5% and 3.5% over the course of the past decade. Moreover, the over 70% of the unemployed are aged 30 years and over, a trend which has remained unchanged over the course of the past 7 years.

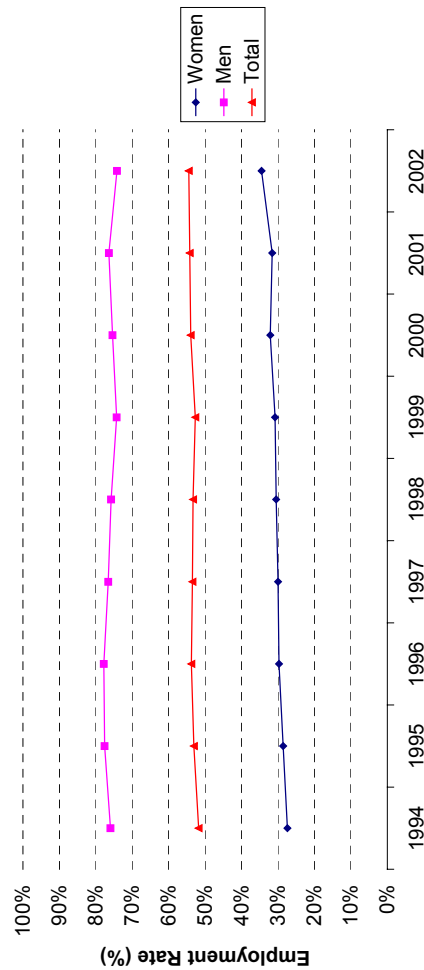
The utilisation of the overall available human resources remains low. Malta's employment rate, which at the end of 2002 stood at 58.5%, remains one of the lowest compared to the other EU member and accession states. This implies that there is still significant potential for growth if a greater portion of the available population were to join the available work force. This is particularly the case with respect to female participation.

Unemployment Rate (based on Registered Unemployed)



Source: National Statistics Office.

Employment Rate



Source: Employment and Training Corporation, NSO

### New job creation is not growing fast enough

The overall labour supply increased by 6.1% between 1994 and 2003. However, Over the past 3 years it has however remained close to static. The increase in the labour supply has been principally on account of a rise in the female participation rate during the period. In fact male labour supply growth during the corresponding period has only been 2.9%.

During the comparable period, the number of gainfully employed individuals increased by 4.9%, this suggests that the employment generation process has been slower than the growth in the overall labour supply, thus contributing towards the slight increase in the overall unemployment rate.

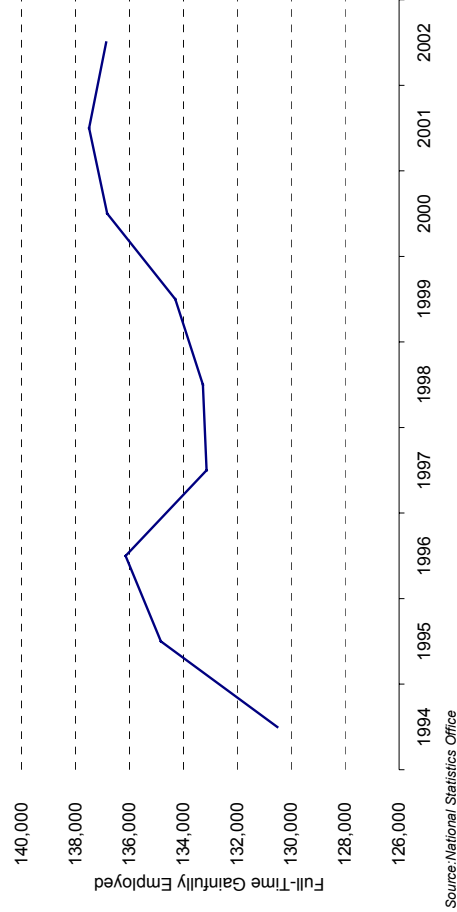
The principal driver of new job creation over the past decade has been the services sector. Between 1994 and 2002 employment within the private services sector rose by 33.6% effectively moving away from other sectors such as agriculture, industry and non-market services. As a result the services industry grew to the single largest employer accounting for 41.9% of total gainfully employed in 2002 followed by manufacturing, the Quarrying and construction sector, and agriculture which accounted for 21.0%, 5.0% and 1.6% of total employment respectively.

### Labour Market - Key Issues

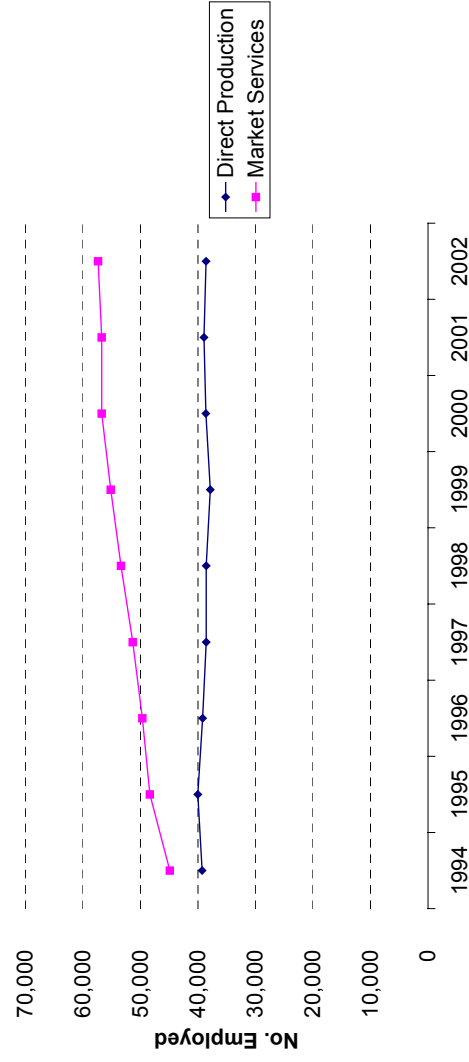
In the context of the next few years, a number of key issues pertaining the labour market are of relevance. These include:

- The demographic distribution of population will result in an increasingly aged population, many of which will leave productive employment;
- The female participation rate in Malta remains very low suggesting that there is potential for further increasing labour supply if appropriate incentives are provided;
- Young job seekers are finding it more difficult to find a job;
- The public sector continues to tie up significant human resource

Gainfully Employed



Gainfully Employed in Direct Production and Market Services



### Demographic growth patterns

The current demographic distribution of the Maltese population has resulted in an relatively large portion of the population approaching the pension age with a smaller number of younger individuals joining the labour force. Whilst the longer term impact of these trends have been highlighted by the welfare reform commission, the nearer term consequences, in particular with respect to the overall labour supply in Malta has not been fully investigated. Based on the latest demographic data published by the NSO, the authors projected the estimated population distribution in 2007. Based on the findings, the following conclusions were reached:

- No significant change in the overall working population would occur at the current pension age is maintained at 60.
- If the pension age were to be increased to 65, the overall labour supply could increase by at least 5,000 individuals based on the assumption of the current employment rate.
- Overall the number of new job entrants, i.e. between the age of 15 and 25, are expected to decrease from the current levels.

Age Group	2002	2007	Change
15 - 65	264,170	273,845	9,675
15 - 60	248,139	247,152	-987
15 - 25	57,513	55,903	-1,610

Source: Estimates based on 2002 Demographic structure projected at crude mortality rate for 2002 and 2001

Depending on the nature of the current pension reforms, any alteration in the pension age will hence have an impact on the overall labour supply. If the proposed actions will result in a higher pension age and therefore a greater labour supply, this implies that the overall new job creation will need to be accelerated if the unemployment rate is not to deteriorate.

### The female participation rate remains low

The female participation rate in Malta is the lowest amongst the current EU member states and accession countries. Moreover at 32.1% it is also significantly lower than that of males which stood at 75.4% in 2002. The reasons for the relatively low participation rate are varied and include amongst other social factor, especially related to paternal duties. Economic factors, in the form of fiscal disincentives in the current income tax regime and national insurance contribution have also been found to be contributory factors. That said some progress has been registered over the past decade. These include various initiatives to address some of the factors inhibiting female participation, with the latest changes being incorporated in the new employment legislation. The impact of these changes have contributed towards increasing the participation rate from 27.4% in 1994.

A further increase in the overall participation rate is to be expected in particular given that the number of females participating in higher education has significantly increased over the past decade. In fact with the female participation rate in tertiary education, which stood at 54.8% in 2001 actually slightly exceeds the EU average.

Further measures to increase the female participation rate are expected to be introduced in the National Action Plan for Employment over the course of the next years, which in turn is expected to contribute towards increasing the overall labour supply.

### A skills mismatch exists

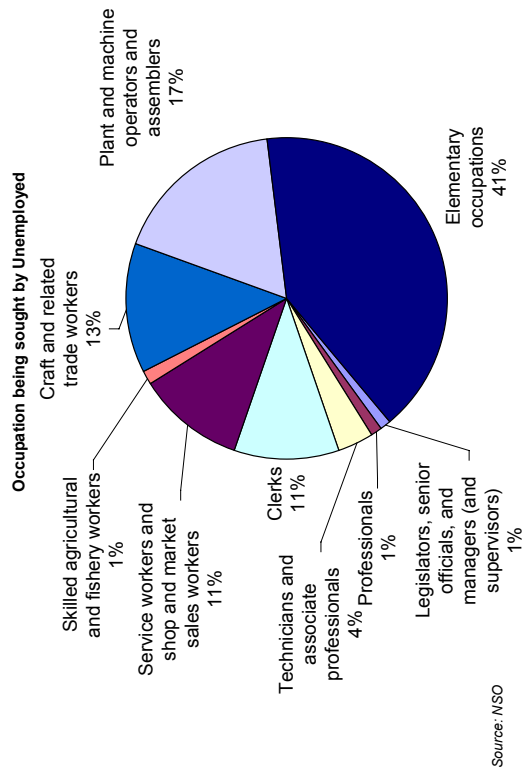
There is however a skills mismatch within the economy. Whilst reliable statistics on the degree of this mismatch are not readily available, anecdotal evidence to this effect is provided by the composition of occupations sought by unemployed. Based on the findings labour force surveys conducted, during the past years there is a consistent trend in that the majority of unemployed seek manual and clerical jobs which are less required in the increasingly knowledge based industries which exhibit the higher growth rates. Moreover, the employment barometer prepared by the ETC indicated that there are shortages in particular in the technical and engineering fields.

### Youth unemployment remains high

The integration of new entrants into the workforce is also proving to be a challenge. Over the past 5 years the unemployment rate of the under 25 year-old jobseekers has consistently been higher than the overall unemployment rate. In December 2002 the youth unemployment rate stood at 7.2% compared to the overall unemployment rate of 5.5% . Similar to the general trend in unemployment in Malta, the youth unemployment rate differs between genders, with the unemployment rate of males within the age cohort being higher than that of females. That said, it is pertinent to point out that the female unemployment in this age bracket has been increasing sharply since 2000.

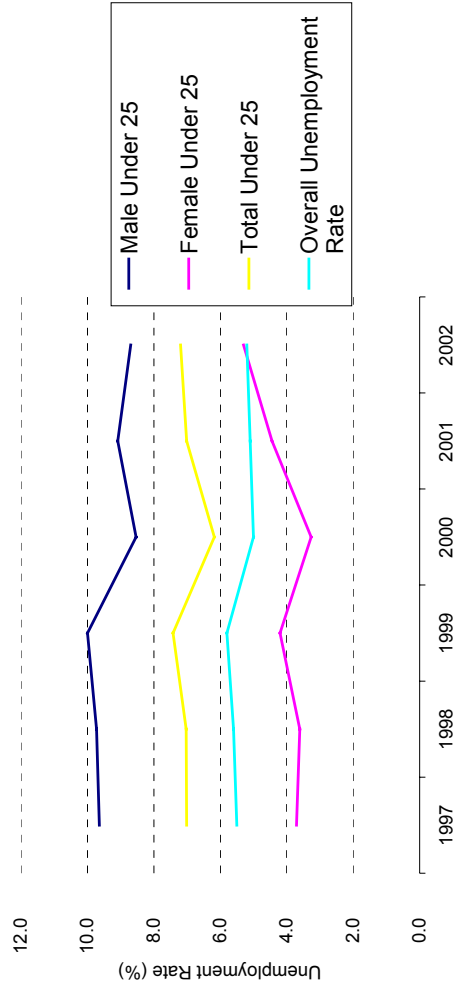
### The public and parastatal sector continues to absorb substantial resources

The public sector employs a significant part of the overall human resources in Malta. In 2002 public and parastatal sector employment accounted for 34.7% of total gainfully employed it did however only accounts for 22.9% of GDP. The overall size of the public sector has however reduced over the course of the past decade, with overall employment down by 8.2% since 1994. Overall productivity in the sector has also improved over the period.



Source: NSO

Youth Unemployment Rate (Under 25 years)



Source: National Statistics Office. Based on registered unemployed

## FISCAL POLICY

### Persistent fiscal deficit for the past decade

The state of the public finances remains a key problem for the country. For the past decade the government's fiscal stance has been expansionary consistently running a fiscal deficit. During most of the 1990's the annual fiscal deficit fluctuated between 4%-12% of GDP. Up to the mid 1990's the deficit was principally attributable to high infrastructural investment during the period which included the Freeport and the new airport. The difference between recurrent income and expenditure during the period was generally in surplus. However, since 1996 the growth in the fiscal deficit has principally been driven by an imbalance in the recurrent income and expenditure. In particular the expenditure has exhibited in-built structural growth over the years, partly on account of the wages rises to the relatively large public sector, but principally on account of automatic increases on the various social welfare programmes and pensions which are driven by the demographic structure of the Maltese population.

Consolidating the state of the public finances has been one of the key priorities of the Administration. A detailed programme seeking to reduce the size of

public deficit and thereby also curtailing the growth in the public debt was presented by the Minister of Finance in 1998. The objective of the exercise was to ensure that the size of both parameters were in line with the Stability and Growth Pact criteria of 3% and 60% of GDP respectively by 2004. This has not been achieved to date.

Financing the deficit has resulted in a rapid growth in the public debt and associated debt servicing. A programme of privatisation initiated in 1999 in order to assist in a systematic consolidation of the public finances has failed to generate the targeted revenue and efficiency gains set out in the original plan.

### The social welfare services including pensions and health services

Expenditure on social welfare services including pensions and the health services is one of the key factors contributing to the overall growth in recurrent expenditure. A underlying driver in this respect being the demographic pattern of the Maltese population. Like most of the European countries, Malta's demographic structure has resulted in an increased population of ageing individuals. As life expectancy has increased, so has expenditure on pensions and healthcare. Based on current trends, the total number of individuals aged 60 years and over in the overall population will increase from 1 in 6 in 2002 to 1

### Public Finances 1990 - 2002 as Percentage of GDP

% of GDP	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Ordinary Revenue	44.4%	43.3%	39.0%	41.2%	39.2%	40.9%	37.2%	39.1%	37.0%	38.1%	39.8%	41.0%	41.0%
Recurrent Expenditure	37.2%	37.4%	37.7%	39.2%	39.9%	39.5%	42.1%	41.8%	41.8%	40.2%	39.6%	42.2%	42.9%
<b>Primary Surplus / (Deficit)</b>	<b>7.1%</b>	<b>5.9%</b>	<b>1.3%</b>	<b>2.0%</b>	<b>-0.7%</b>	<b>1.4%</b>	<b>-4.8%</b>	<b>-2.6%</b>	<b>-4.8%</b>	<b>-2.1%</b>	<b>0.2%</b>	<b>-1.2%</b>	<b>-1.9%</b>
Capital Expenditure	14.7%	14.3%	6.6%	6.3%	6.1%	6.1%	6.1%	8.0%	7.1%	7.3%	6.3%	5.0%	5.8%
<b>Total Borrowing Requirement</b>	<b>-7.6%</b>	<b>-8.4%</b>	<b>-5.3%</b>	<b>-4.3%</b>	<b>-6.7%</b>	<b>-4.8%</b>	<b>-10.9%</b>	<b>-10.7%</b>	<b>-11.9%</b>	<b>-9.3%</b>	<b>-6.1%</b>	<b>-6.1%</b>	<b>-7.7%</b>
Grants	1.0%	2.0%	1.9%	0.9%	1.2%	0.4%	1.7%	0.8%	0.7%	0.7%	0.6%	0.1%	0.2%
Local Loans	4.7%	3.8%	4.1%	3.1%	2.8%	2.8%	5.8%	13.0%	8.1%	5.8%	0.0%	7.5%	2.4%
Foreign Loans	1.9%	1.1%	0.1%	0.3%	1.1%	0.1%	0.3%	0.2%	0.0%	0.0%	0.0%	0.4%	0.6%
Receipts from sale of shares	0.5%	0.8%	0.1%	0.1%	1.2%	1.3%	0.0%	0.0%	0.0%	5.0%	0.8%	0.0%	1.6%
<b>Total Financing</b>	<b>8.1%</b>	<b>7.7%</b>	<b>6.1%</b>	<b>4.3%</b>	<b>6.4%</b>	<b>4.6%</b>	<b>7.8%</b>	<b>14.0%</b>	<b>11.4%</b>	<b>11.5%</b>	<b>1.4%</b>	<b>8.0%</b>	<b>4.8%</b>
<b>Net movement in consolidated fund</b>	<b>0.5%</b>	<b>-0.7%</b>	<b>0.8%</b>	<b>0.0%</b>	<b>-0.4%</b>	<b>-0.2%</b>	<b>-3.1%</b>	<b>3.3%</b>	<b>-0.5%</b>	<b>2.1%</b>	<b>-4.7%</b>	<b>1.9%</b>	<b>-2.9%</b>

Source: Central Bank of Malta

in 4 by 2020.

The impact of this change has resulted in a widening of the welfare gap, i.e. the shortfall between social security contributions and social security expenditure, to grow from Lm 60.4 million in 1995 to Lm 94.2 Million in 2002. This increase occurred notwithstanding modifications to an increase in the social security contribution rate on the part of the employee during the period.

The sharp change in the demographic structure over the next 15 years, is expected to significantly exacerbate the problem, in particular with respect to the pensions payments and healthcare expenditure.

### The overall public sector employment

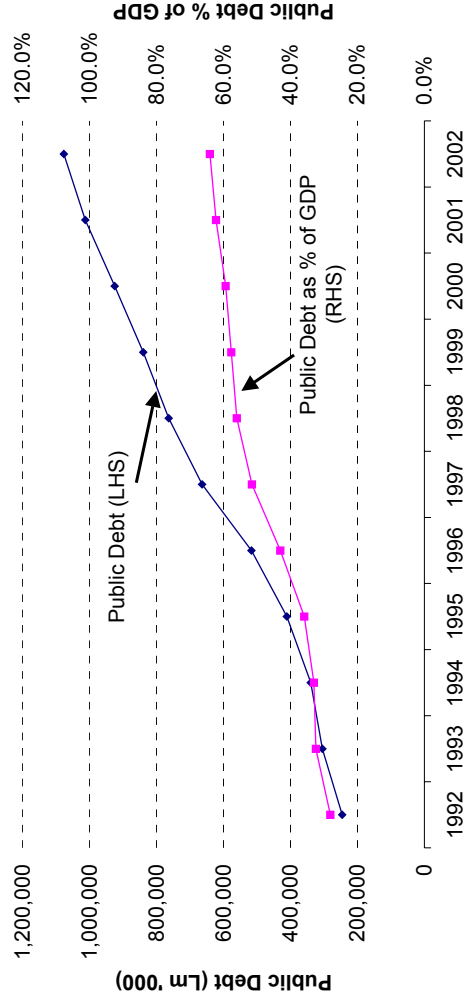
A second contributor towards the overall growth in the personnel emoluments of the public sector. Although there has been a slight downsizing in public sector headcount over the past decade, wage increases have contributed towards increasing the overall government payroll from Lm 92.1 million in 1990 to an estimated Lm 199.6 million in 2004. In fact, the latest statistics by the NSO indicate that the average salary within the public sector actually exceeds that obtained in the private sector.

### The Public Debt Continues to Grow

The financing of the shortfall in revenue has to date been predominantly been through domestic borrowing. The public debt has hence grown considerably from Lm 245.8 million in 1992 to an estimated Lm 1,077.0 million at the end of 2002 or 64.1 % of GDP. The associated cost of financing the public debt has risen accordingly and in 2002 accounted for 58% of the overall public deficit.

Taking advantage of the lower interest rate scenario over the past two years, the administration has resorted to short-term financing through the issuing of treasury bills more recently. The composition of the public debt as at the end of 2003 was 75.5% Government Stocks, 20.3% Treasury Bills, and 4.2% Foreign loans. However the size of public sector borrowing during the period has led to a certain degree of crowding out of private investment.

### Growth of the Public Debt



Source: Central Bank of Malta

### Privatisation has not generated the planned revenue

The privatisation programme launched during the 1999 Budget speech aimed to generate an estimated Lm 220 million in revenue until 2004 in order to reduce the public sector borrowing. To date however only Lm 112.6 Million has materialised through the privatisation of Mid-Med Bank, the Malta International Airport, and the public lotto department.

## MONETARY POLICY

### Price stability has generally been maintained

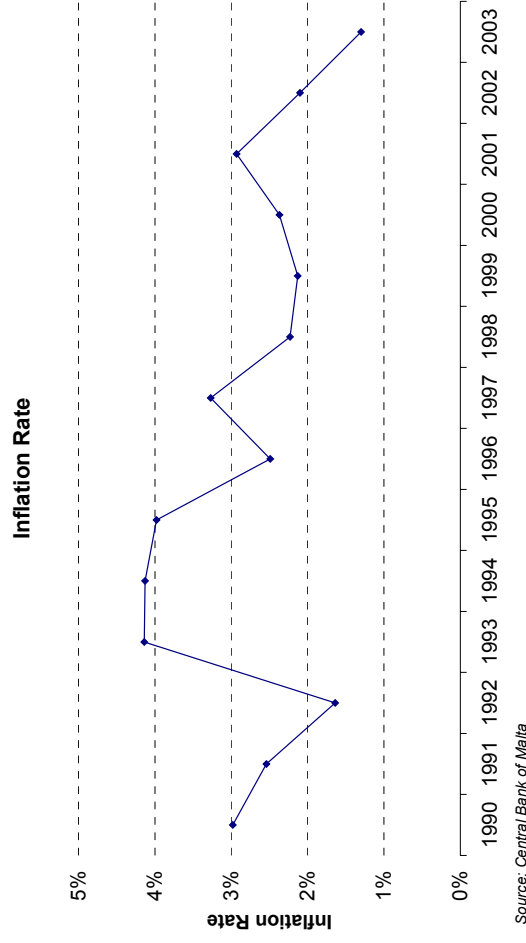
The central bank's primary objective has since been changed to maintaining price stability following the amendments of the Central Bank of Malta Act in September 2002. This objective has been pursued implicitly over the past decades through the use of the trade weighted currency basket whereby the Maltese lira has been pegged to the currencies of the main trading partners, namely the ECU/ euro, US dollar, and Pound Sterling. This effectively linked the domestic inflation rate to the inflation rate in Malta's main trading partners, whose relative strength, has by and large aided in maintaining a relatively low domestic inflation rate. The success of the peg is exemplified by the fact that the domestic inflation rate has been below 5% since 1990.

Over the course of the second half of the 1990's the central bank used open market operations to tighten the stance of monetary policy. This was in response to rapid credit expansion to both the government and the public sector, which exerted strains on external revenue, as a result of higher imports. This stance has subsequently been eased several times since 1999 on account of a slowing domestic demand as well as a looser monetary policy by both the Federal Reserve and the ECB. The discount and intervention rate has thus been reduced to the current 3% level from 5.5% in 1998.

The reduction of interest rates has however only had limited success as commercial banks tightened their lending policies. As a result the banking sector has experienced excess liquidity, which in turn have exerted further downward pressure on interest rates in the money market.

The central banks' ability to pursue a largely autonomous domestic monetary policy during the latter half of the 1990's has principally been due to the still rigid exchange controls at the time, which restricted the excessive outflow of capital in response to diverging domestic interest rates.

However, with the abolishment of exchange rate controls, which have hitherto prevented excessive pressure on the external reserves, the central bank is



bound to significantly reduce its manoeuvrability in influencing the domestic interest rate. Given the government's and Central Bank's commitment to keeping the current exchange rate strategy until eventually joining ERM II, any divergence in the domestic interest rate and synthetic interest rate (Comprising the weighted average interest rates of the composing currencies) would result in a net in/outflow of capital, thereby impacting the external reserves.

The gradual loss in autonomy is already evident over the past 2-3 years, whereby the Central Banks' Monetary Policy Council decision on the domestic discount and intervention rate have had to take into consideration the monetary policy pursued by the ECB and US Federal Reserve. With the eventual total removal controls of short-term capital movements upon accession, the latter is likely to become the prime determinate of domestic monetary policy.

Once Malta fully joins the EMU and adopts the EURO, interest rates will be set centrally by the ECB. Whilst the Central Bank of Malta will be a member of the ECB and thus have an influence on the overall direction of interest rates, the circumstances within the wider EURO zone will be the principal determinants of the overall monetary policy.

## INTERNATIONAL TRADE – PERFORMANCE

As a small open economy, international merchandise trade remains a key component of economic activity. Over the past decade, Malta has experienced persistent balance of trade deficit for the past decade, which in 2003 stood at 349.9 million. The size of the trade deficit has largely been on account of rising consumer and government expenditure during the course of the first half of the 1990's, a trend which has persisted to the current day. Lacking most raw materials, Malta is forced to import most of the inputs for its manufacturing sector, rendering industrial supplies as the largest component of overall imports.

### Trade integration with the EU has always been high

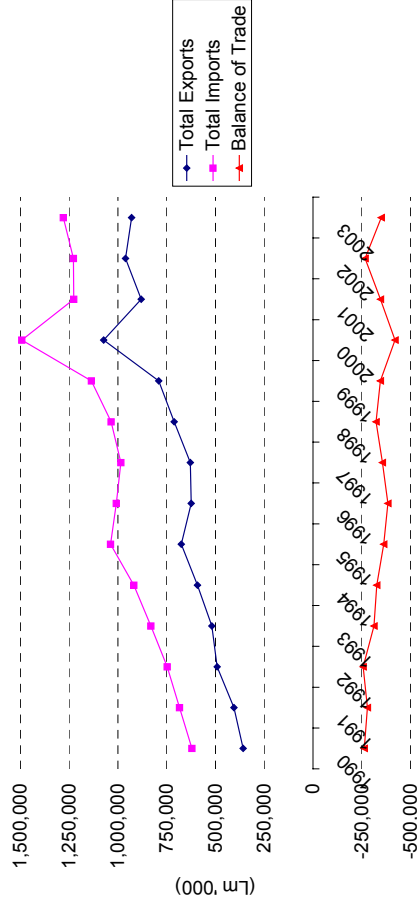
The EU remains Malta's principal trading partner in terms of both imports and exports, accounting for 47.8 % and 44.3% respectively in 2003. Noteworthy in this respect however is the fact that over the past decade the composition of exports to the EU and the high degree of imports is of particular relevance in view of the recent weakening of the US dollar.

Domestic exports continue to be a significant driver of economic growth, accounting for 47.4% of the overall GDP in 2002. Exports have grown steadily over the course of the 1990's. Reduced international demand post 2000, has however resulted in a sharp decline in exports, which are now recovering gradually. The latter has been principally on account for the demand for electronic goods.

### Export performance is dependent on few large firms

One of the key concerns on the international trade remains the high importance of the machinery and transport equipment sector accounting for 67.2% of total domestic export in 2003. The output of this particularly is also highly concentrated amongst only a few large foreign owned operators. In 2003 this particular sector accounted for 140 % of the total export growth effectively compensating for the fall in export in other sectors of the economy. Given this high degree of dependence on this particular sector, the export performance of

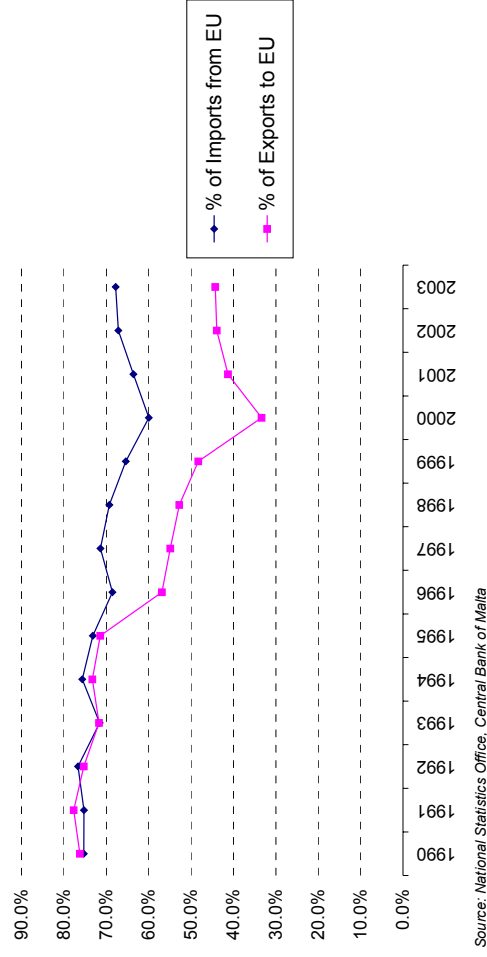
Terms of Trade



Source: National Statistics Office

the country is hence closely linked international demand for a limited number of products, with the associated risk of this dependence being clearly highlighted

Percentage of Total Exports and Imports to/from the EU



Source: National Statistics Office, Central Bank of Malta

by the recent slow down in exports .

It should be noted that the process of trade liberalisation pursued over the past decade has been a major contributory factor towards boosting overall trade activity. This includes the reduction / removals in tariffs and other trade barriers as well as an increased reliance on indirect taxation with the introduction of VAT. Further liberalisation with the complete removal of all remaining protective levies of agro-products at the beginning of May 2004 is expected to further boost importation over the next 12 – 24 months as the prices of imported products are expected to be reduced.

Trade liberalisation, in particular the removal of the protective levies, has resulted in hitherto protected enterprises being exposed to increased price competition from imported products. Invariably the increased price competition will force less competitive operators to restructure or exit the industry. As part of this restructuring there will be increased pressure to changes work practices and there is an increased possibility of redundancies. That said, the phased removal of levies has provided domestic manufacturers with the opportunity to utilise the period since 2000 to undertake the necessary changes to improve their productivity and enhance their chance of survival.

## THE IMPACT OF EU MEMBERSHIP

The impact of EU membership will have a far reaching economic impact on Malta. In the most basic terms, however, and for the purpose of the preparation of the social pact, it is crucial to review the impact of the four freedoms on which the economic union is based. These being the freedom of movement of capital, labour, goods, and services.

### Freedom of movement of Capital

One of the basic premises of the EU is that capital can move freely between all the member states of the EU. Hence all restrictions on the investment by individuals and corporate individuals will be removed both inwards and outwards. Hence, capital is free to be allocated where it will obtain the highest return. This will of course have serious implications for Malta. To date inbound investments, whether in the form of Foreign Direct Investment or through international banking institutions has on the whole faced little restrictions. Attracting new FDI will indeed be one of the primary challenges for the Maltese economy upon joining the EU. But Malta will be facing serious competition from all the other accession countries, many of which offer lower labour costs and are not disadvantaged by their geographic locations. This implies that Malta will need to ensure that it is sufficiently attractive, from an economic perspective, for foreign investors to opt for Malta as an investment location. The overall competitiveness of the country has hence to be enhanced.

Often overlooked in this respect is the need to prevent Maltese capital from leaving the domestic economy and being invested overseas. This has been controlled to date through the exchange control regime. Although the latter has been gradually relaxed and is expected to be completely abolished in due course, the extent of domestic capital outflow hasn't been excessive. On accession this may well gradually change, if the domestic economy is able to provide investors with a sufficiently high return to render investing these funds in Malta a viable option.

### Labour

The freedom of movement of labour within the European union will also have a significant impact on the domestic economy. Although intra-state migration of labour has been found to be relatively small, the fact that Maltese will be able to work in other member states and EU Nationals will be able to take up employment in Malta will have an impact on the domestic economy. Whilst concerns have been raised about an influx of foreign workers into Malta, the possibility of an outflow of talented Maltese individuals to other EU states cannot be ignored. Such a "brain drain" could potentially undermine the future economic growth. As such it is imperative that job opportunities are created with commensurate pay to keep talented individuals. Moreover, the freedom of movement of labour also provides Maltese enterprises with the opportunity to attract additional resources which may be in short-supply in Malta without having to endure the current bureaucratic procedures in the employment of expatriate staff.

### Goods & Services

The impact of the freedom of goods and services is the most visible in view of the open nature of the Maltese economy. However, given that most of the trade restrictions and protective levies have already been gradually removed, the overall impact is likely to be relatively limited when it comes to goods. In the case of services there is bound to be a greater service offering to the Maltese consumer and hence there will be more intense competition for domestic service providers, requiring the latter to enhance their respective offering. That's said, the abolishment of restriction on the movement of goods and services will also provide local operators with a new growth opportunity.