

UNICE TASK FORCE ON ENLARGEMENT

**2002 REPORT ON CANDIDATE COUNTRIES' PROGRESS
TOWARDS EU ACCESSION**

MALTA

June 2002

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A. Executive summary

Membership of the EU remains the number one political priority of the current Government, but the stop-start nature of Malta's negotiations with the EU has fuelled uncertainty for business about Malta's accession.

The business community supports EU membership, but it does so from a long-term, strategic standpoint. It takes the view that Malta must modernise, be more outward-looking and acquire the image and credibility which comes from being part of a larger body. It sees EU membership as the way of meeting these aspirations, as well as a way of better 'disciplining' the public sector.

Actions recommended

- A more concerted effort needs to be made to ensure fuller application of the Acquis Communautaire.
- Of Malta's more specific needs in advance of EU membership, reform of the ports monopoly remains by far the most important issue.
- Concerns about inefficiency, red tape and planning delays, customs delays, general bureaucracy and "clientelism" in the public sector have not significantly changed over the past year.
- Other challenges highlighted in the 2001 UNICE Task Force on Enlargement report (namely over-manning in the public service; double-jobbing; effective management of public sector workers; social welfare fraud) also remain applicable. On the other hand, problems identified in the 2001 report with regard to inefficient tax collection are being successfully addressed.
- EU membership will not alter the fundamental problems of the Maltese economy – an overweight and expensive public sector which suffers from action paralysis in regard to necessary reforms. These are internal problems for the Maltese to resolve. EU membership will only increase the urgency to deal with them.
- As negotiations with the EU move ever forward, the most urgent task of Government is to better communicate the benefits of the EU to the hearts and minds of the people in advance of the referendum on membership.

B. Introduction

This submission on the impact of EU accession on the small island state of Malta addresses the adoption, implementation and enforcement of the *Acquis Communautaire*, and highlights problems related to business operations in Malta, from an on-the-ground perspective.

It does not intend to restate the views of the Commission's November 2001 updated Regular Report, but rather to contribute to the debate by outlining and commenting on the views of international and domestic businesses and representative business organisations.

It updates the 2001 UNICE Task Force on Enlargement (UTFE) report on Malta, and constitutes part of the formal UNICE input to the annual UNICE/European Commission meeting on Enlargement, which this year is being held on 6 June. Important observations from the 2001 Report are repeated in the 2002 edition where the issues remain very pertinent, or where action has been deemed marginal.

C. Economic context and developments/investment climate

Political/Social/Economic Background

With particular reference to developments over the past year, the following opinions on various issues were highlighted in feedback from companies:

1. 2001 brought a mixed business climate to Malta. Most companies suffered significant downturns, due in part to international developments. This situation has not been fully reversed to date.
2. To a much greater extent than 12 months ago, there is universal concern amongst companies about rising business costs and the generally poor situation in respect of national competitiveness; in certain instances costs are running well ahead of competitor economies in Central and Eastern Europe, North Africa and the Far East.
3. Unless Government enhances considerably the business environment, internationally owned companies speak of either being forced out of business, or else having to leave Malta. Some companies say that if they were considering coming to Malta for the first time today, they might not locate in the country. While unemployment remains quite low, it has nevertheless risen from 4.6% to over 5% over the past year.
4. There is a very strong feeling of paralysis in the run-up to the next legislative elections - which must be held by January 2004 at the latest. This drift is evidenced in respect of pending privatisations and lack of decision-taking (for example customs and port charges and, up until recently, levies on agriculture and agri-food products).
5. There is also a sense amongst businessmen that any reforms introduced in advance of these elections will be vote-catching, employer-unfriendly measures. The recently published White Paper on Industrial Relations and Employment is an indication of this trend.
6. Employers continue to speak of a strong work ethic in their employees, with a positive and pragmatic approach to flexible working arrangements, and little evidence of strikes or serious labour difficulties in the private sector. This is in contrast to a much more assertive stance by organised labour in the public sector, where pressure is already building up for a new collective agreement. Strikes in this sector (e.g. the customs authorities in early 2002) are totally unacceptable if they paralyse the private sector.

7. In social/community terms, Malta is a relatively cohesive and successful society, a cohesiveness that is not of course reflected in its politics. In a business assessment of Malta's readiness for EU membership, politics should not normally form a large part of the picture. Unfortunately, in Malta politics is so enmeshed with the economy that its influence cannot be ignored.
8. Politics in independent Malta is, and always has been, polarised and confrontational. The two parties (currently Christian Democrats in government, Socialists in opposition) conduct a continuous altercation in public and in the media, in mutually hostile and accusatory tones. Incessant divisiveness is seen by business as the worst sickness affecting the Maltese polity.
9. The explanation given for this situation is that the core support for the two main parties is very evenly balanced. Election successes turn on a small number of swing votes; the parties therefore fight for every stray voter.
10. The effect of this situation is that there is no sign of political consensus on issues, and little sense of a concept such as "the national interest". This is a very unfortunate situation for a small island nation faced with a large decision. The issue of EU membership is the major casualty of this political polarisation. This means that the difference in support for the No and Yes camps regarding Malta's EU accession is as knife-edged as the rest of Maltese politics.
11. Factual information about EU membership and its effects is seriously affected by this confrontation between the political parties. The Opposition conducts an actively negative campaign. Very biased - and not always factual or complete - information about the EU and its estimated impact on Maltese society circulates widely in Malta.
12. There are strong views on the Government's strategy in communicating the European Union to the Maltese population.
13. While the Government-sponsored Malta-EU Information Centre (MIC) is diffusing a lot of very useful information on the implications for Malta stemming from closure of specific chapters, there is nevertheless no clear and focused campaign by Government on what the real benefits of EU membership actually are.
14. This means that the social partners are currently carrying most of the burden of communicating a positive message on the European Union. Government's stated policy is to wait to sell the package as a whole once the negotiations with Brussels are completed. Such a strategy may well cost the Government the EU Referendum, as anti-EU politicians are enjoying free rein in the meantime to pre-dominate the national debate.

Attitudes of companies to Accession

1. A significant part of the manufacturing sector produces wholly or largely for export, and a large part of this in turn is foreign-owned (e.g. 60 German companies).
2. In a very representative business survey amongst companies, recently commissioned by the Chamber of Commerce, 42% of respondents who had assessed the effects of EU membership on their business indicated that the result of their assessment was positive, 20% claimed the contrary and 38% said the result was neutral.

3. The attitudes of export-oriented companies to EU accession are however quite finely balanced, largely because they already enjoy advantages close to those of full membership. They have some apprehensions about potential negatives to full EU membership, such as:
 - loss of, limitation of, future tax holidays
 - tariff costs on purchase of materials from third countries
 - increased costs from the application of the *Acquis*, which could be social (48 hour week, health and safety requirements), environmental (tighter waste or pollution controls, higher taxes due to higher standards required from e.g. water supply) or other.
4. Manufacturing companies serving mainly the local Malta market have other problems. EU membership inevitably means loss of protection (e.g. in the agri-food sector) and most expect some loss of market share. Import levies are already coming down, so that the process of adjustment is under way. Some sectors thus continue to feel they are being sacrificed on the altar of EU membership.
5. In general, larger companies have a good understanding of the risks and opportunities of EU membership, of competitive threats and of the need for cost improvement, re-structuring, export development, etc.; most are pro-active in preparing for accession.
6. Smaller companies – those covered by the State agency IPSE and normally Maltese-owned – by and large remain more apprehensive of EU membership than larger companies. In practice, the kind of “service manufacturing” in which most such companies are engaged, is likely to be much less affected by EU membership.
7. There is frustration amongst some business leaders at the lack of any significant EU pre-accession funding for Malta. For example, Malta has not been eligible for environment and infrastructure funding (ISPA) or agriculture and rural development funding (SAPARD). Many feel that if Malta were given the opportunity to benefit from such funding, or indeed from any other funding, it would greatly assist vis-à-vis public opinion.
8. Other specific concerns that were voiced included registration of medicines, VAT on food and medicines, and levies on agricultural products. The debate on the future competitiveness of the agri-food sector in a post-EU membership scenario is just unfolding as a Special Programme of support measures has recently been discussed with stakeholders. It is however early days to ascertain whether what is being proposed will actually be secured by Government in the negotiations with the EU.

Relations between the European Union and Malta

1. Membership of the EU remains the number one political priority of the current Government.
2. There is a view amongst some companies that the two decisions (forthcoming elections and EU referendum) could be voted on at the same time, although recent indications from Government suggest that this will not be the case.
3. The stop-start nature of Malta’s negotiations with the EU has fuelled uncertainty for business about Malta’s ultimate EU vocation; this lack of clarity gives rise to uncertainty amongst potential foreign direct investors. Indeed, the Opposition has stated that, should it enter into Government following a general election held after a Yes vote in a referendum, it would not respect the outcome. [A referendum on EU membership in

Malta is actually neither legally necessary nor legally binding on Government; however, the current Government promised, in its 1998 electoral manifesto, to hold a referendum].

Political criteria

1. Malta's Judiciary remains independent of political influence and free of concerns about corruption. However, the judicial system is still seriously overloaded and therefore very slow. This is a worry for business needing enforcement on matters of commercial law.

Economic criteria

1. Business is concerned that future efforts at reducing the deficit should not focus on further increasing the level of the tax burden. In addition, business is insisting that Government restrain further expenditure growth.
2. Malta needs to renew efforts in the areas of structural reform and deregulation. The November 1999 White Paper on Privatisation on achieving the privatisation programme by December 2005 has been effectively stalled over the past 24 months, although there are indicators that some entities might be privatised over the coming months.

D. Progress in adoption, implementation and enforcement of acquis

Free movement of goods

- The Government needs to speed up its review of the current import licensing procedures, and there is widespread frustration over lengthy customs procedures.
- A satisfactory plan exists for the removal of protective levies before or by 1 January 2003 on imports of goods of EU origin (except in the agriculture and agri-food sector).
- The Malta Standards Authority is performing a good role and Institution building in the area of market surveillance and conformity assessment, is proceeding in a satisfactory manner.

Transport

- As outlined in detail in this report last year, the ports regime is the most serious case of inefficiency and diseconomy on a national scale.
- In the context of potential EU membership, reform of the ports system remains vital and urgent. Without a competitive and efficient ports system, Maltese exporters will suffer extra costs against EU competitors and Malta will present extra cost disadvantages to potential EU investors. For a peripheral island economy, it is hard to think of any economic issue of more importance than the minimising of freight and handling costs.
- Any time derogation that is eventually agreed between the Government and the EU on this issue should be minimal.

Competition policy/state aid

- There are strong expectations amongst internationally owned businesses that fiscal state aid can be maintained as far ahead as 2020 and that the 2001 Business Promotion Act provides legal security for this.
- Companies indicate that the viability of many FDI operations is predicated upon continuance of such a regime. Concern was nevertheless expressed by some industrialists about the full EU compatibility of the BPA.
- Legitimate expectations of companies constitute a key issue in the ongoing negotiations on this chapter.

Economic and Monetary Union

- The country does not yet fully meet the criteria that would allow for the smooth transition to the single currency. Sustained effort and vigilance on the part of the Government should however allow Malta to meet the criteria within the coming 5-7 years.
- The general budget situation of the Government continues to improve slightly (general Government deficit is now approx. 5% of GDP).
- However, companies feel that inflation is gradually running out of control (currently 3.5% and rising), though the Central Bank is confident that the trend will soon be reversed.

Taxation

- With regard to VAT, the question of zero-rated and exempted products is still being negotiated. It is noted that the UK and Ireland benefit from such arrangements.

Energy

- In general, there is annoyance across the private sector over inefficient parastatals.
- Privatising some functions of the parastatal EneMalta Corporation should be explored.
- A Regulator has now been put in place, but it is too early to evaluate its role in the energy and minerals sector.

Employment and social affairs

- Flexible work arrangements in the private sector remain a plus to industry in Malta. Notwithstanding transition periods that have been secured, EU Directives on issues such as Working Time are considered by some companies to pose a threat when they eventually have to be implemented in full, as will compliance costs in the environmental and H&S fields.
- The participation rate of women in the labour force – at 34% - is below the current EU average, and far below the target set by the EU of 60% by 2010.

Regional policy and cohesion

- The demands of Gozo to be given a special status (for Structural Funds) different from the rest of the country are considered an unjustified distraction from more urgent issues that need to be addressed in respect of regional policy, such as the finalisation by the authorities of a National Development Plan, and a clear programming and monitoring mechanism to absorb all the resources which will be made available to Malta between 2004-2006.

Environment

- Malta is the only candidate country amongst the leading block of ten not to have completed provisional closure on this chapter.
- Environment is still a major barrier to the successful Maltese alignment with the EU *Acquis*, and action still remains limited in terms of preparing for the challenges in this field. Massive investment will be needed to comply with the EU's rules on *inter alia*, waste management, air quality, water and noise pollution.

Statistics

- The production of national statistics in real-time will need to be addressed as a matter of urgency (e.g. figures for Sept. 2001 were published in March 2002). Indeed, there are a lot of data in various sectors not yet available for the first quarter of 2002, or even overall public finance data for 2001.

Administrative capacity to apply the *Acquis*

- The small size of the country and therefore the inevitably small size of the administration it can afford inevitably give rise to challenges. Adding the extensive weight of the *Acquis*

to existing legislation represents a large extra burden of implementation and enforcement on a small administration.

- The second difficulty is the relatively poor record of Government in the implementation and enforcement of ordinary law. This needs to be urgently addressed if the Maltese economy is to function smoothly in the EU's internal market.
- Many businessmen continue to consider there is a lack of capacity and possibly a lack of ability in Government to implement and enforce much of the *Acquis*.

Administrative structures

Whilst capacity building in the Government Departments which deal with enlargement matters remains an issue, the situation has nevertheless improved considerably over the past year; the Environment and Agriculture Ministries have the most catching up to do.

Concerns, Constraints – Government and Public Sector

1. There are serious weaknesses in the State sector (Government and State agencies) which impact adversely on the Maltese economy and which will cause additional problems in the event of EU membership.
2. The effects of these factors on the economy in general, and the business sector in particular, include higher direct costs (e.g. ports), higher taxes to pay for excessive Government expenditure, and costs and delays in enforcement of commercial law.
3. Concerns about inefficiency, red-tape and planning delays, customs delays, general bureaucracy and clientelism in the public sector have not significantly changed over the past year, and in some instances, the situation may have even deteriorated.
4. Challenges highlighted in the 2001 UNICE report (namely over-manning in the public service; double-jobbing; effective management of public sector workers; social welfare fraud) also remain applicable. On the other hand, problems identified in the 2001 report with regard to inefficient tax collection are being successfully addressed, with the Inland Revenue Department now very efficient.
5. Overall, Government in Malta is too big: it accounts for 34% of the workforce, higher than in any EU Member State. Business leaders express the view that the State needs to be 'rolled back'.
6. In addition to being an unacceptable drain on public resources, it also has a distorting effect on the Maltese labour market, as the draw of a reasonably well-paid public sector job constitutes a brain drain from the private sector. The indicators unfortunately point towards this process of 'crowding out' being set to continue, not least because of the transposition of the EU *Acquis*.

E. Conclusions and recommendations

1. A more concerted effort needs to be made to ensure fuller application of the *Acquis Communautaire*.
2. The business community supports EU membership, but it does so from a long-term, strategic standpoint. It takes the view that Malta must modernise, be more outward-looking and acquire the image and credibility which comes from being part of a larger body. It sees EU membership as the way of meeting these aspirations, as well as a way of better 'disciplining' the public sector.
3. While there are many clear advantages, and arguably some disadvantages, of EU membership: in either scenario the competitiveness imperative remains urgent.
4. As regards FDI, as mentioned in the UNICE report last year, the small size of the island and high transaction costs are significant negative factors in attracting FDI. Nevertheless, there is significant scope for new FDI for SMEs and eventually privatised parastatal companies.
5. Of Malta's more specific needs in advance of EU membership, the reform of the ports monopoly remains by far the most important issue.
6. EU membership will not alter the fundamental problems of the Maltese economy – an overweight and expensive public sector which suffers from action paralysis with regard to necessary reforms. These are internal problems for the Maltese to resolve. EU membership will only increase the urgency to deal with them.
7. As negotiations with the EU are now moving ever forward (though it is noticeable that Malta is lagging behind the other nine front runners, with Bulgaria currently catching up), the most urgent task of the Government is to prepare the groundwork in a more concerted way than heretofore, by actually starting to better communicate the benefits of the EU to the hearts and minds of the people well in advance of an eventual referendum on membership.

List of Rapporteurs of the UNICE Task Force on Enlargement 2002

Mr Erkki **Auvinen**, Partek Corporation

Mr Michael **Carbine**, International Computers Limited

Mr Werner **Freilinger**, MIBA Sintermetall AG

Mr Janis **Grins**, Freja

Mr Edi **Kraus**, Yulon d.d.

Mr Uwe **Krüger**, HOCHTIEF AG

Mr Willem-Jan **Laan**, UNILEVER NV

Mr Dominique **Meillassoux**, Mossley Group

Mrs Lucy **Neville-Rolfe**, Tesco

Mr Vincent **O'Doherty**, Superquinn

Mr Michael **Persson**, DANISCO A/S

Mr Andreas **Polycarpou**, Ideal Group

Mrs Bertrand **Vanden Abeele**, Suez