MALTA EMPLOYERS' ASSOCIATION

Proposals for
NATIONAL BUDGET
2021

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Contents

The National Budget for 2021 has to be approached within the context of two major events that will have an impact on Malta during the fourth quarter of this year. These are COVID-19 and the Moneyval Assessment.

1. COVID-19

Firstly, the fiscal performance and projections for 2021 will depend on the extent to which the COVID virus will be contained. Like other economies, Malta was affected by the onset of the pandemic, with mane one which was accompanied by a warning:

'*The effectiveness of this package will depend on the business response to these fiscal injections, and also on* ***the need to strictly enforce public health measures to keep the numbers of infected persons to a minimum and thus prevent a relapse which will be damaging and costly****. Government is urged to maintain contact with the social partners to exchange information so that the situation will be monitored continuously, and further measures that extend beyond September 2020 may be discussed to reflect the prevailing situation'*

This statement reflected the concerns of many business that endorsed the concept of opening the economy whilst reducing the risk of a spike in COVID cases by adopting a prudent approach. Unfortunately, a feeling of overconfidence brought about by successive days of zero to negligible cases, combined with the lobbying of organisers of mass events has clouded government's judgement. The strategy to open up to mass events in lieu of attracting safe and controlled tourism niches has backfired and jeopardised the gains made through so many sacrifices by businesses, employees and the health authorities. This led the Association to state that: '*authorising mass events like parties and feast marches is ridiculous and risks reversing all the gains made against the spread of the Covid virus in Malta*'.

This error of judgment is now having a cascading effect on the economy. Many countries are closing their doors to Malta, hotels are dealing with numerous cancellations, the catering business is depending almost exclusively on domestic business, work places are having issues due to the increase in cases, health services are being stretched and schools may not open in September. Under these circumstances, the budget will be dependent on the extent to which the country can manage to bring down the number of infections in the coming weeks, and the possibility of a vaccine being developed and distributed internationally. If things remain unchanged, government revenues will continue to shrink, and it will be under more pressure to extend its stimulus package to the economy. This could result in a higher deficit than anticipated and a longer recovery time, placing more strain on government finances.

2. Moneyval

Any plans for 2021 will depend on the outcome of the Moneyval assessment. This is a critical factor which will have a strong impact on Malta's reputation as a safe place to invest in sectors like financial services and i-gaming. It is accepted that Malta has suffered extensive reputational damage over the past years, and that actions and reforms are required irrespective of the outcome of Moneyval. The Association has expressed this sentiment in a public statement issued last July: '*The only way in which we can get out of this hole is by acknowledging the gravity of the situation, putting aside tribal differences, and to have a concerted effort to clean up our act by stamping out crime and corruption. We need to restore core values based on entitlement through hard work, solidarity and tolerance, and a business environment based on trust, enterprise and commitment'*.

This has also to be evaluated within the context of MEA's position paper: 'Parliamentary Reform – Towards a More Productive Parliament' which addresses the need to have a more professional parliamentary set-up, better governance and a reform of political party financing. A clearance by Moneyval is a necessary but not a sufficient condition to restore Malta's international standing.

3. The Global Economy

Both the Covid situation and the Moneyval issue exist within the wider backdrop of the international economy, which will slow down in 2021, and will therefore dampen Malta's chances of reaching 2019 levels of economic activity. Yet this also presents an opportunity for restructuring. For years, we have heard about the need of long-term planning, to shift to sustainable economic activities with numerous statements and position papers presented by the social partners. It is about time to look into these ideas concretely in order to shape the economy to provide higher value employment opportunities without the need to depend on an increase in population to sustain growth.

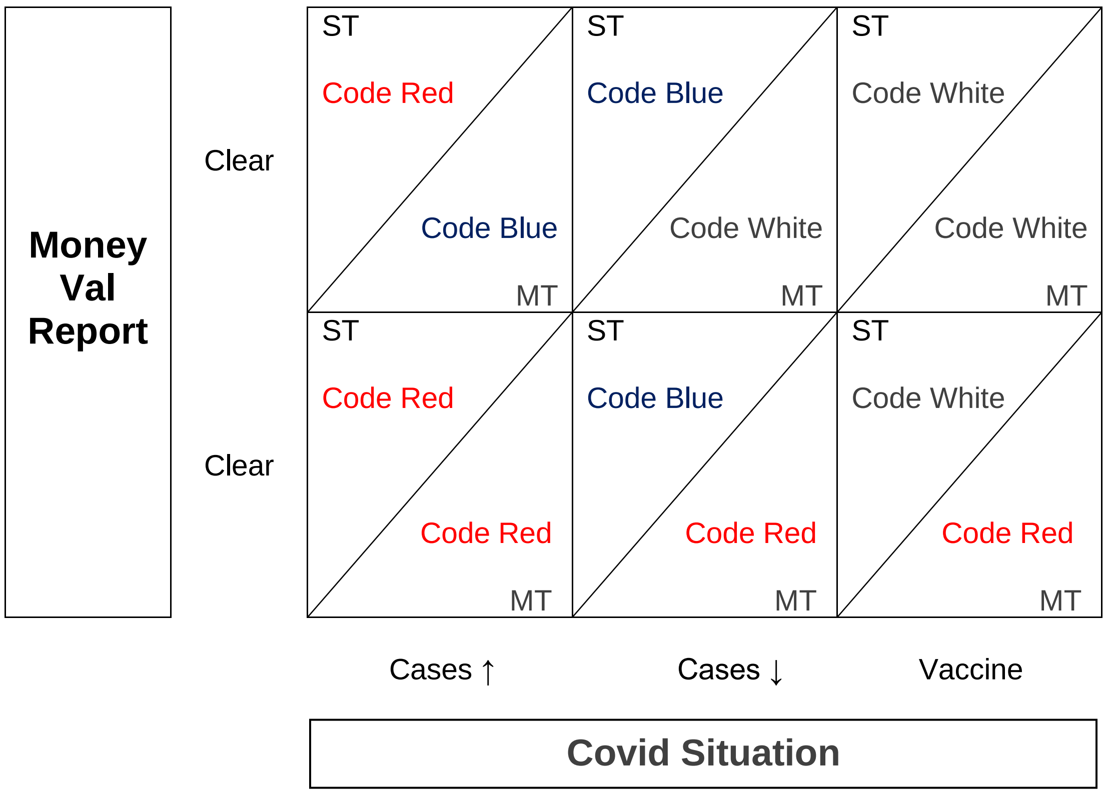
4. Outcomes

In all these scenarios, the likely outcomes are:

- Low or negative economic growth
- Higher unemployment
- A fiscal deficit that will persist in 2020 and 2021
- Recovery in some sectors – tourism in particular - will be slow and may extend to 2023.

The severity of these outcomes depends on the scenarios explained below.

5. Scenarios



The Figure above plots different outcomes for the Moneyval and Covid issues. The options for Moneyval are: Greylisting or No Greylisting, and the ones for Covid are: Increased cases, Decreased cases, and Vaccine. The interaction of these possible eventualities is graded according to their short term (ST) and medium term (MT) negative impact: Code Red = High impact; Code Blue = Medium impact; Code White = Minimum/positive impact.

The possibilities range in impact. The worst eventuality is: High number of COVID cases together with a Moneyval greylisting, with predicted negative economic consequences both in the short and medium term. This outcome will result in major challenges for government finances, investment and employment. Recovery will take more than 3 years for most sectors, with major economic sectors: tourism, financial services, i-gaming and possibly construction being the most heavily affected.

At the other end, the introduction of a vaccine by the end of the fourth quarter, together with a positive Moneyval evaluation could place the economy on a fast track to recovery in 2021.

The other areas are based on permutations between the two events. For example, a positive Moneyval outcome with a drop in cases will result in a Code Blue in the short term but a Code White in the medium term. This is because the impact of Covid will still be with us in the final quarter, albeit in control, and the medium term threat to the financial services sector will also be minimal, subject to constructive follow-up.

Any fiscal projections will depend on these outcomes, coupled with the impact of the international situation. In all probability, government will have to extend the stimulus package which expires in September to at least another quarter, especially if the number of Covid cases remains high. Some businesses who have waited for the outcome of the Summer months before taking decisions concerning employment levels might take action to downsize, leading to an increase in unemployment.

As the economy contracts, government may also find the cost of a bloated public sector more difficult to sustain and will be constrained to reduce manpower in areas where it has idle persons.

Conclusion

From the above, one can conclude that:

- the recommendations submitted to Government for the June mini-budget still stand and are attached.
- the stimulus package which expires in September 2020 will have to be extended for the final quarter of 2020.

- Government must have contingencies in place to bear the brunt of any negative outcomes mentioned in this paper. It might be advisable to prepare an interim budget for Q4 and a budget for 2021 after the situation regarding Covid and Moneyval is more clear towards the end of the year.

Appendix 1 – Proposals for National Budget June 2020

1. A Budget within a Context

The eruption of COVID -19 in the last quarter of 2019 sent a worldwide tsunami that dealt a heavy blow to the global economy. Malta has not been spared. The impact on public health has been addressed through well-managed interventions by the Public health Authorities, and, since March 2020, Government decisions have been constrained to thread a fine line between safeguarding public health priorities and keeping the economy from coming at a standstill.

Although jobs have been lost, unemployment has thus far not increased dramatically for a number of reasons:

- A resilient and diversified economy, whereby the relatively strong performance in some sectors has compensated for a slowdown or outright cessation of activity in others.
- Social dialogue has led to the design and implementation of numerous government schemes that have to some extent incentivised companies to retain their labour force. Research carried out in April by MEA revealed that just 9% of companies surveyed resorted to redundancies as a measure to counter the impact of the crisis, even though the reception to the schemes was not very positive.
- Many foreign employees, third country nationals in particular, did not have their contracts renewed, with thousands being repatriated and therefore not showing up on the unemployment register.
- As has occurred in past crisis, employers in Malta have shown that they are less likely to shed labour when things turn south. In many other countries, unemployment has increased at a much faster rate than Malta, in spite of government schemes and incentives that are similar to those that have been implemented locally.

The number of registered cases is on a steep decline, both in Malta and many European countries, but the economic side effects will be drawn out, even in the absence of a second wave. The negative impact has not been the same in all sectors, with travel related companies being the worst affected. Expectations in those sectors are that recovery will be slow and may take between 2-3 years to reach pre-COVID levels of activity.

What many affected firms are deciding at this stage is whether to downsize, and the extent to which they can postpone downsizing if business does not pick up. This will depend on:

- The duration of the outbreak
- Domestic demand
- External demand
- The extension of government assistance

These factors could also serve as a basis for Government actions. The decision to have a budget at this stage is a commendable one. The current situation is a classic Keynesian scenario, with fiscal policy taking the fore to stimulate demand through government expenditure, thus kick starting the economy and steer it towards pre-COVID levels of activity. Under these circumstances, a budget deficit is not evil, it is necessary. The Maltese economy has the required fiscal manoeuvrability that allows government to engage in focused short to medium term spending to shore up business activity and generate aggregate demand. At EU level, the Commission has endorsed a handsome financial package to minimise unemployment, to provide guarantee funds for loans to companies, and supporting member states (through the European Stability Mechanism). Malta should benefit from these measures.

The challenges here are:

- Extending assistance schemes will stretch government resources
- One of the causes of a fall in domestic demand is fall in local population brought about by the drop in tourism and repatriation of TCNs. On average there are approximately 75k fewer persons/consumers living in Malta (including tourists

and TCNs) than there were in June 2019. As trends over the past five years pointed towards an expansion in total population, businesses catering for the domestic market – catering, retailing, rentals etc. - increased their capacity accordingly.

- Domestic demand has also decreased because many employees have suffered a drop in income -through loss of overtime, a reduced hour week etc. - even if they have been retained in employment.
- The openness of the economy implies that many businesses' performance is not dependent on domestic demand. (e.g. language schools).
- External demand is governed by variables over which government has little to no control.

One characteristic of the crisis is the extent that different economic sectors have been affected. At the extremes, the accommodation sector has contracted by 18% in the first quarter. Construction, on the other hand, has expanded by 14%, real estate by 9% and real estate by 5%. Such figures underscore the need for a targeted approach to assist businesses. It is also an indication of an economy that is relying more heavily on construction activity, which is a volatile sector itself and comes at a cost to Malta's natural resources which in themselves are a source of income to other sectors, tourism amongst them.

Although the budget is addressing what is essentially a force majeure situation, it should also act as a catalyst for discussion and planning to shape the economy to move towards higher value added activities which place quality over quantity. The crisis has also had some positive side effects, especially with respect to the environment. We should be proactive and start thinking now about how to address air and noise pollution, which have been reduced during the past three months, to improve people's quality of life. Other environmental matters, such as food security and the transition to green technology should also move up in the hierarchical ladder of national priorities. It would be a lost opportunity if these issues are not addressed.

The measures proposed in this document are based on the above considerations.

2. Proposed Measures

2.1 Sustaining employment

- The current COVID Wage Supplement Schemes should be extended until then end of September.
- Annex B of these schemes should be removed and leave only the benefits falling under Annex A to which any company affected by the COVID crisis will be eligible, in line with the actual loss in business. Although companies falling under more NACE codes will be eligible, the actual number of companies will decline as the economy picks up.
- Companies whose business will be zero will continue to receive the benefits falling under Annex A. for a period of six months. In such extreme cases, National Insurance contributions will be waived and the period will be accredited to the employees for pension eligibility. This will make the cost of employment neutral and employees will remain on the books and receive the wage supplement.
- Government should launch a scheme to subsidise commercial rents for a period of six months, particularly those managed by the Malta Industrial Parks.
- The Teleworking Scheme should be extended indefinitely to encourage a better take-up and implementation of remote working systems. Government should actually give grants to teleworkers, gaining the benefit in less traffic and commuting.
- Commercial Energy rates will be reduced.
- The conditions for returning to work are too confusing and are subject to mixed messages and interpretation, especially to employees. More concise, clear guidelines are expected.

- Child Care and Summer schools should be in a position to accommodate all students. Many parents are reluctant to return to work, saying that their children will still be at home during the summer months. The situation will worsen if schools do not open normally in September. Some companies are experiencing disruption not because of the loss of work caused by the virus, but because the employees are not turning up for work.
- Government should introduce re-training schemes and employment support programmes for persons who lost their job.
- Identity Malta needs to expedite extension of work permits of TCNs who are still in employment when they expire. In spite of the crisis, there is still a demand for foreign labour in areas where no Maltese employees are available.
- Company tax rate will be reduced to 30% for a period of a year, based on 2019 profits.
- Incentivise businesses to re-launch economy by introducing a number of extraordinary tax incentives for those companies which make investment post Covid in the coming 12 months, with enhanced incentives channelled towards green economic activities, agriculture and innovation. This can be supported and sustained by EU funds.
- Government should incentivise the upgrade of the tourism product to attract higher quality tourism which can compensate for lower numbers in the coming years.
- Resources should be channelled in the public and private health sectors to make up for the backlog of patients whose healthcare has been put on hold.

2.2 Stimulating domestic demand

- Although many of the restrictions have been relaxed, and many businesses are open, people may still be reluctant to visit outlets due to the fear factor. A re-assurance campaign, combined with strict enforcement of regulations, will help to change attitudes.

- Government should issue vouchers to be used exclusively in retail and catering outlets. Recipient owners will be able to cash vouchers. Under the circumstances, this will be better than a cash bonus as the funds will be pumped directly in the economy.
- VAT rates can be temporarily reduced to lower prices. Germany shall be reducing its VAT rates from 19 to 16%, and that on hospitality from 7% to 5%. It is proposed to reduce VAT to 15% and 5% for hospitality.
- A reduction in household utility bills will increase disposable income.
- Introduce a rental subsidy scheme to households suffering from unemployment or a loss in household income of more than 30% as a result of the Corona crisis.

2.3 Addressing External demand

- The opening up of airport routes has to be accompanied with a reassurance campaign to promote Malta as a safe travel destination.
- There should be an intensive marketing campaign to promote Malta and redevelop routes. This can be done with Air Malta.
- Government could issue direct incentives to inbound tourists in the coming six months: i.e. one free night accommodation to visitors spending more than six nights in collective accommodation. Incoming flights could also be subsidised for a limited period.

2.4 Greening the Economy

- Government should set up a special fund to address national food security and promote local agricultural products.

- A national noise reduction strategy is required: this can involve a revision of flight paths to minimise impact in heavily populated areas; strictly enforcing the use noise reducing equipment and measures in industrial and entertainment areas; slapping fines on noisy vehicles.
- Stronger incentives to switch to electric vehicles.
- A specific fund should be set up to address climate change, increase innovation and incentivise digitisation.

2.5 Transparency of Incentives

Ultimately, all incentives and measures introduced by Government will be carried by the taxpayers, current and future. Companies that make use of these incentives need to be held accountable for the incentives received and there needs to be a transparent procedure on the manner in which the incentives are granted. Transparency is also achieved through an objective compilation and analysis of where these funds have been spent which is communicated to the authorities.