

To: Prime Minister  
 From: Economic Mission.

**SECRET**

*For other issues. by the Economic Mission  
 see file OPM 503/63.*

PRELIMINARY MEMORANDUM ON POSSIBLE WAYS OF SOLVING  
 MALTA'S ECONOMIC PROBLEMS

1. THE PROBLEM

Cabinet is of course fully aware of the seriousness of the economic problems confronting Malta. The basic facts of the Maltese situation are the following:

(a) Malta is overpopulated by any standards one wishes to apply. This means that both short-term and long-term solutions to the economic problems of Malta require a reduction in population immediately through emigration and in the longer run through other possible means.

(b) Malta is a small economic unit and thus requires a high foreign trade ratio. At present necessary imports are paid for largely by providing services to the naval base.

(c) The imminent reduction in service spending demands alternative sources of foreign exchange earnings. This implies a drastic change in the Maltese economic structure - from providing military services to exports of goods and other services.

2. THE BASIC AIMS

Consequently one economic-political aim must in the present situation have priority over all others, namely to lay the foundations for a viable productive economy. This is to say that all policy measures should be directed towards this ultimate goal; that no measures are taken in isolation; and that in particular no such politically appealing aims as maintaining employment in a certain

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sector or increasing consumption standards are undertaken unless they contribute to the basic aim of creating a viable and efficient export economy.

(a) The urgency to solve Malta's economic problems springs from the reduction in Service spending. But a policy aiming at political independence would in any case necessitate change in Malta's economic structure. No socially and politically healthy society can be based entirely on the generosity of a foreign power. On the other hand no country can be fully independent, and a small country is in fact entirely dependent on its relations with foreign countries. In a situation of political independence Malta will, however, have the possibility to influence its own future development.

That is, even without the actual Service rundown Malta would have faced the same problem: to create a viable domestic economy, based largely on exports of goods and non-military services.

(b) A very simple definition of a viable economy is that in the long run it must pay for itself and provide for a continuous expansion in production - i.e. in living standards - out of its own resources. This also implies that it must be flexible enough to withstand exogenous shocks. As was said above this means that Malta must create an efficient export industry and also rationalize the whole domestic economy: agriculture, industry, distribution.

At present few exporting industries exist. The manufacturing industries catering for the home market are unable to compete with imported goods despite high import  
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duties. Wages are high, and labour inefficiently utilized. In agriculture no improvements in yields have been made during the past decade. Living standards are artificially high and unemployment is rising.

Obviously drastic measures are required to cope with both the immediate difficulties (unemployment and budget crisis), and the long-term development programme.

### 3. THE NEED TO ACCELERATE EMIGRATION

The immediate economic difficulties of Malta, viz. the unemployment, the Service rundown adding to unemployment and the inefficient utilization of those employed can only be solved by emigration. It is therefore suggested that steps are taken to:

(a) Step up permanent emigration to the maximum possible. During the last quinquennium emigration has averaged some 3,500 per annum, whereas in those years when special efforts were made to encourage emigration (1950 and 1951; 1954 and 1955) the average reached 9,000 (in 1954 11,400). During the coming five year period emigration should be increased to 10,000 and more per annum.

The outflow of labour is no permanent loss to the Maltese economy. It leads to a flow of urgently needed immigrants' remittances (which should become tax free), and could be used to build a market for Maltese exports.

(b) All efforts to step up the outflow of contract labour to European countries should be made. This type of emigration not only alleviates the domestic unemployment but in addition gives foreign exchange (through remittances)

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and creates a skilled Maltese labour force, capable of competing with the most advanced countries.

(c) Finally, the United Kingdom authorities must be persuaded to extend the period of the Defence rundown from five to ten years.

We will prepare a brief in the near future for use by the Prime Minister and Cabinet pointing out

that it is impossible to solve Malta's long run problems unless the Defence rundown is extended over a longer period; that the considerable progress that has already been made in building up export industries will be jeopardized unless the impact of the Defence rundown is somehow softened.

We should like permission to approach the U.K. Commissioner and the Governor directly on these issues.

#### 4. THE MOBILIZATION OF DOMESTIC RESOURCES

The measures described above contribute to the creation of a viable economy only indirectly. In addition it will be necessary to mobilize all available domestic and foreign resources. In the former case largely through directing all efforts on creating efficient export industries and avoiding waste of manpower and capital on unproductive projects, in the latter case largely through maximizing the amount of grants and loans.

(a) The mobilization of domestic resources involves first of all reforms in the Government budgeting system.

(i) as shown below ( ) it may be advisable to turn Malta into a Free Port. This implies the abolition of all or most import duties and consequently the revamping of the whole revenue structure. (At present taxes on expenditure account for three-fourths of total Government revenue

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and import duties alone for about one half, whereas income taxes yield only £1.4 million or 13 per cent). We suggest that Government investigate the possibility of levying a turnover tax to replace import duties. We appreciate that it is more difficult to collect turnover taxes from a multitude of wholesalers and retailers than to collect import duties. We submit that this reform is also necessary to enforce good book keeping practices in the distributive trades. We furthermore suggest that in the meantime collection of income taxes be improved. Even without changing present rates it should be possible to collect substantial additional amounts by better collection. We understand that the total declared gross income of taxable people is less than total known savings - a manifest impossibility suggesting substantial under reporting.

We also suggest that the introduction of a property tax be investigated. We understand that public works are held up because of a new constitutional requirement to pay adequate and prompt compensation in full when land is taken over by Government under its right of eminent domain. In other countries such expenditure is recouped fully or in part through increased assessments of the properties benefiting from the public improvements, such as new roads or sewers.

(ii) In view of the tight budgetary situation it seems essential to avoid paying subsidies except in hardship cases. It should be investigated whether the present general subsidies on bread, sugar and paste can be abolished.

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(iii) But still more important is to observe the principle that all services sold by the Government should pay for themselves and should begin to provide for their own expansion on honest accounting as insisted upon by IBRD in connection with the loan to the electricity/water project.

(iv) The suggestions made above to revamp the taxation system are intended to create a healthy budget situation, to remove unnecessary distortions in the wage and cost structure, and to pave the way for an efficient and competitive economy.

Government capital spending must be directed towards projects likely to add to productive resources. In the present situation road building must be given a low priority. Public works should instead be concentrated on projects such as:

- (a) to prepare land for afforestation;
- (b) to prepare land and beaches as tourist sites;
- (c) to create agricultural land through clearing of stones, terracing, bringing in of soil;
- (d) to create some reservoirs.

(v) There is an apparent contradiction between the high savings ratio of the Maltese economy and the scarcity of capital for domestic productive investment, local savings primarily seeking safe investment abroad. All possible efforts should be made to induce savers to invest in domestic enterprises. We think that the best solution, likely to give the quickest results, is a Development

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Corporation - backed by the Government - issuing shares in small denominations and buying stock of local enterprises. (Expand)

#### 5. THE NEED OF FOREIGN ASSISTANCE

Domestic resources will not be sufficient for the necessary adaptation of the Maltese economy. Also foreign resources must be mobilized to the fullest extent.

(i) It may be expected that the United Kingdom Government will continue to help Malta after the expiry of the current five-year Plan and also in the eventuality that Malta becomes independent. It is, however, impossible to give a precise figure for the amount of grants to be received from H.M.G. In our view grants should in the future be used only for such projects which will create productive resources in the wide sense and should therefore carry imputed interest charges.

(ii) When it comes to foreign loans it must be realised that different potential sources of capital have different purposes and will give loans or grants for different kinds of projects. Thus the International Bank for Reconstruction and Development can according to its statute, lend only on viable bankable projects. The IDA on the other hand will not make loans for projects which the Bank feels it can finance. Governments can make loans and grants for purposes for which neither IBRD nor IDA are suitable.

The IBRD is willing to finance the projected water distillation and power projects. By statute it could also help with ports development, possibly with the sewage treatment plant; and the setting up of a development finance corporation.

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We urge Government immediately to accept the IBRD loan. Otherwise additional IBRD funds are unlikely to be forthcoming. Thus even if alternative finance could be found on better conditions it would reduce the total amount of foreign exchange available to the Maltese economy that could be received from friendly sources.

#### 6. CONCLUSION

All the suggestions made above are directed towards the ultimate aim of making Malta selfsupporting, with an efficient, flexible and competitive export industry. It is acknowledged that the transformation of the Maltese economy will take a long time and that it cannot be achieved without foreign grants and loans as well as technical assistance.

Emigration beside eliminating present unemployment helps towards the ultimate goal through relieving the country of redundant labour, which has tended to keep efficiency low. The proposals to change the tax structure aim at keeping labour costs low through keener competition on the domestic market, but in addition they contribute to equity by removing subsidies from those who do not need them while maintaining them in hardship cases.

To a very large extent our suggestions simply repeat the current development plan. But we would like to emphasize that a new sense of urgency should be imparted on the Government departments in charge of industrial development and agricultural development, the port and public works.

22nd January, 1963.