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ECONOMIC AND FISCAL IMPLICATIONS

OF

MALTA'S APPLICATION TO THE E.E.C.

Economic Planning Division
Office of The Prime Minister

24th November, 1969.

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I. INTRODUCTION

On the 4th September, 1967 Malta asked the European Communities that negotiations be opened for the establishment of a relationship between the European Economic Community and Malta in such form and manner as may be considered appropriate; and has suggested that the initial form of relationship could be one of special tariff arrangements leading to full free exchange of trade between the two parties. Malta further proposed that the initial relationship should eventually develop into full participation of Malta in the European Economic Community. (1)

2. The thesis of the Malta delegation during the exploratory talks held with the Commission of the E.E.C. on the 21st/23rd October, 1968 was that Malta would be well on the road to economic viability by the end of the Third Five Year Plan period if it can be assured of an export market free from tariff barriers and quota restrictions and if it is allowed to maintain, for a time, the protection required by Malta's young and vulnerable industries. To this end, Malta proposed a relationship leading to full participation in three stages. The first stage, of five years duration would involve the Community into extending to Malta some of the principles applied to under developed regions within the Six and would reduce

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(1) It is unlikely that the E.E.C. countries could do more than write in the preamble to the agreement some words which would not exclude Malta's eventual membership.

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tariffs to zero on imports from Malta whilst Malta would be allowed a phased reduction of tariffs on imports from Member States to Commonwealth preferential rate levels, and would freeze protection. In the second phase, also of five years duration, Malta would reduce tariffs to zero by stages, would start adopting the common external tariff and would take measures aimed at dismantling by stages her protective commercial policy. The third stage would complete the process of full participation and would be short.

3. The Commission of the European Communities formulated its conclusions and reported to the Council of Ministers on the 26th February, 1969. This report was later elaborated upon in a "Document de Travail" prepared by the Commission for the "Group ad Hoc Malte" on the 21st October, 1969. In synthesis the Commission requested a mandate from the Council of Ministers to start detailed negotiations aimed at achieving a full Customs Union, within a decade, in two stages. The first stage, covering five years, would be a period of adaptation for the Maltese economy with Malta according limited concessions to the Community. In particular, Malta would be allowed to retain the necessary protection for its industrialisation. During this stage Malta will be expected to achieve a phased linear reduction [2] of its general tariff of 35 per cent,

(2) The Commission has recommended to the Council that Malta be asked to reduce its tariffs by 35 per cent as follows:

15 per cent on coming into force of the agreement;
25 per cent by the end of the second year; and
35 per cent by the end of the fourth year.

(except products related to the C.E.C.A.) on the understanding that by the end of the first stage the tariffs against the Community will in no case be less favourable than the commonwealth preferential tariff. (3) The Community, on the other hand, will reduce its tariffs on all Maltese exports, with the exception of the products in Annex 11 of the Treaty of Rome and the products related to the C.E.C.A., by 70 per cent on the day that the proposed Treaty comes into force. The problem of 'diversion of trade' by the rest of the world to E.E.C. markets through Malta in those commodities where the Malta tariff is lower than the common external tariff will be studied during the course of detailed negotiations. Possible solutions could be found in terms of detailed rules of origin, selective lists of exemptions or the adoption in such case of common external tariff rates by Malta. Malta will be allowed during the first stage to retain the present quantitative restrictions for protective purposes but will be asked to abstain from introducing new measures. The Commission has also recommended that Malta be asked for certain special quotas for the Community as regards restricted products. Insofar as the Community is concerned, all restrictions and quotas on Maltese exports will disappear as from the date of the proposed treaty. In so far as the second phase is concerned this would broadly require Malta to reduce her tariffs to zero, to adapt gradually to the common external tariff,

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(3)

There are fifteen tariff classifications, involving £82,000 loss of revenue where the preferential tariff remains below a 35 per cent concession. In these cases the general tariff will have to be lowered between 37 per cent and 82 per cent to bring it in line with the preferential tariff.

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to dismantle gradually the quantitative restrictions, and to harmonize her commercial policies with the European Economic Community. The Community on the other hand would give Maltese industrial products the status of inter community trade. The question of agricultural products has been left open. Negotiations on this second stage will start some 18 months before the end of the first stage. The Commission stated that discussions on the third stage aimed at full membership are premature.

4. The position, therefore, is that the recommendations made by the Commission are less favourable than the requests made by the Maltese delegation. There are two important points of principle, however, which have been accepted: (a) Malta could only make limited concessions to member states during the first stage and (b) Malta could continue to protect her infant industries and would only be asked to dismantle her protection progressively during the second stage. Though the Commission appear to be envisaging a complete dismantlement of protection by the end of the second stage nevertheless they state that 'justifiable exceptions' can be made.

5. The Council of Ministers has not given its decision on the Commission's submissions. Nevertheless it may be important at this stage to analyse the economic effects and the fiscal implications of the recommendations made.

II. ECONOMIC EFFECT OF MALTA'S RELATIONSHIP WITH THE E.E.C.

6. This paper limits itself to an examination of the economic implications of a full customs union phased over ten years. It does not examine the implications of full membership and complete integration with the European Communities. Nevertheless, Malta's proposal that the initial relationship should eventually develop into full participation has been kept in view.

7. As the arrangements leading to full free exchange of trade between Malta and the Community are anticipated to fall within two distinct stages, it is pertinent to analyse the particular problems of each stage.

The First Stage

8. During the first stage Malta will be given two very important concessions on the date of the coming into force of the agreement : (a) the common external tariff on Maltese exports will be reduced by 70 per cent; [4] and (b) all quotas and restrictions on Maltese goods will be removed. Malta's concession will be a progressive reduction of her general tariff, except for products related to the C.E.C.A. of the order of 35 per cent. Malta may also be expected to give a special quota to member states on such imports as are subject to quotas.

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(4) Except for agricultural products listed in Annex II of the Treaty of Rome or to those products which at importation in the E.E.C. are subject to specific regulations resulting from the putting into effect of the common agricultural policy. The products related to the C.E.C.A. would also be excluded from the Agreement.

9. The two concessions which will be made to Malta cannot but be beneficial to Malta's exporters. The removal of quotas will be of particular interest to our textile manufacturers, who are at the moment handicapped by lack of available markets due to the protectionist attitude of most countries to isolate their domestic producers from foriegn competition. A 70 per cent reduction in tariffs should make Malta's products more competitive in member states. Very little, however, is known about the quantitiative effect which such a tariff reduction will have on Malta's exports. Much will depend on the attitudes of exporters : their trade connections, their price structures, their ability to stage sustained sales campaigns in Europe, and their ability to compete in terms of quality. Once the prime aim of a relationship with the European Economic Community is to increase Malta's exports, it is imperative that a comprehensive survey of existing industries be carried out to assess the effects which a 70 per cent tariff reduction will have on Maltese exports.

10. The benefits to be derived also depend, in part, from the attitude which the Commission will take during the course of detailed negotiations. The Commission is understandably concerned about the problems of 'diversion of trade' in those items in which the Maltese tariff is lower than the Community's common external tariff. There is an indication that the Commission will tolerate a difference of 3 percentage points but where the difference is higher, one of the three courses of action outlined in paragraph 3 above will have to be resorted to. The Commission have advocated a pragmatic approach on these matters and before detailed discussions are held it is not possible to decide whether such erosions of the original concession are serious or not.

11. Studies are in hand to establish for each item which is the better course of action to take. In general, those items on which the Maltese tariff is low for cost of living purposes could conceivably be subjected to the 'rules of origin' so that we can maintain our low duties. Most of these items are not manufactured by or exported from Malta. The problems are likely to occur in our low or zero tariffs on raw materials. By and large our industries have a low value added and most of them will probably fail to qualify in terms of rules of origin. The alternative is for Malta to increase its tariff on these commodities to the common external tariff level. This would, of course mean that a part of the 70 per cent reduction in community tariffs will be eroded due to the higher cost of raw materials. The choice will have to depend on the special circumstances of each industry and studies have been put in hand to ensure the best negotiating tactics when we are called upon to initiate detailed negotiations with the Commission.

12. The reduction of 35 per cent in Malta's general tariff to the E.E.C. raises a number of economic and budgetary problems. Assuming that no trade diversion will take place from Third countries to the E.E.C., on the 1968 experience it is estimated that the tariff reductions as proposed are likely to result in annual losses of revenue from Customs Duties as follows:

On signing the agreement	£ 800,000
By the end of the second year	£1,334,000
By the end of the fourth year	£1,868,000
By reduction to preferential tariff in those items where a 35 per cent reduction still leaves the general tariff above the preferential tariff	£1,859,000

It is to be appreciated that the actual revenue losses will be much greater due to changes in import prices and volumes. From calculations made the import bill is likely to increase by 35 per cent in real terms between 1968 and 1974.

13. During the present stage of Malta's development it does not appear to be wise to lower sales taxation and to lose the revenues indicated in para. 12 above. Studies and forecasts of likely revenue yields underline the importance of increasing sources of taxation to enable Government to defray the additional expenditure due to public sector involvement in the development exercise. The servicing of loans, together with the increasing costs of new recurrent services, are expected to result in a higher increase in expenditure than in revenue on the basis of the existing tax structure. The reductions in customs tariff must therefore be replaced by some other form of taxation otherwise budget deficits will occur.

14. Forecasts of the workings of the economy during the Third Five Year Plan show that a policy of budget deficits may lead us in serious inflationary situations. Malta is fast approaching the stage of full employment. The experience of mature economies indicates that the threat of inflation is more pronounced when resources are fully employed. We are already experiencing this phenomenon in some sectors of the economy. The inflationary threat cannot be fanned by budget deficits without eroding a substantial part of the gains made through the development exericse. A policy of budgetary surplusses on current account is indicated and alternative sources of revenue, to compensate for the loss resulting from the lowering of the Customs tariff for imports from the E.E.C. group of countries, will have to be found.

15. The lowering of the tariff might also have an adverse effect on our balance of payments. Our import bill has been increasing at an uncomfortable rate over recent years and a lower unitary price for imports might well result in a higher import bill. As no studies have been conducted on price elasticities it is not possible to forecast the increased demand for imports, and the resulting damage to our balance of payments, consequent upon the reduction in prices of imports from E.E.C. countries. Balance of payments considerations, therefore, also dictate the need for an alternative tax.

16. With regard to domestic production for the local market, the reduction of duty on imported commodities, by 35 per cent does not appear to give cause for any grave concern except in the case of a small number of products in respect of which the tariff is higher than the general protective rate of 47 per cent. It is to be pointed out that Malta's protectionist trade policy is largely based on three main elements: (a) high tariffs, (b) import prohibitions and (c) import quotas. The retention of the last two elements should ensure that for the next five years there would be no impellent need for the high cost inefficient producer to close his doors. Then there are local industries which do not enjoy protection by import prohibition or quota restrictions. Hoever, these are generally protected by a tariff rate of 33 per cent on imports from the Commonwealth and 47 per cent on goods from the rest of the world. The lowering of the present rate of duty applicable to E.E.C. goods by 35 per cent as required during the first phase of association, will reduce protection from 47 per cent to 30 per cent which is slightly lower than the Commonwealth Preference rate. The lowering of the general protective tariff slightly below the preferential rate is now likely to affect local industries protected by a 47/33 per cent duty.

Industries which have the benefit of tariff protection only, are normally those which have commanded higher efficiencies and the need has not been felt to extend to them the benefits of very high tariffs, quotas or prohibitions. A reduction of 35 per cent of the present protective tariff phased over five years should enable these industries to plan for adequate productivity increases to retain their competitive ability in spite of the reduced protection. All that would be required is a cumulative increase in productivity of about 2 per cent per annum for five years, which appears manageable.

17. At the time of the general revision of the Customs Tariff it was felt necessary to subject imports of certain commodities to a minimum specific rate in those cases where the 47/33 per cent duty did not afford sufficient shelter to local industries. For example, detergents, toilet paper rolls, socks and stockings (other than nylon and cotton), leather footwear, crown corks, car batteries, knitwear and other wearing apparel such as pyjamas, underpants, ties and brassieres, are charged 47/33 per cent [5] subject to a specific minimum rate in respect of each product. During further negotiations with the Community, Malta should insist on retaining the minimum specific rates on the grounds that if removed the competitiveness of Maltese industries on the local market would be seriously damaged. Such a request appears to be consistent with the Commission's recommendations that Malta could keep its protective measures during the first stage.

18. Furthermore, there are items heavily protected either by a high specific duty or by an 'ad valorem' rate higher than the general 47/33 per cent protective rate. The breeding of oxen

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(5) In the case of footwear the duty is 40/33 per cent

and the production of pasteurised milk, cigarettes, matches and beer are protected by a relatively high specific rate of duty. These pioneer industries still require a good measure of protection and it is adviseable to negotiate that during the first phase of association this specific duty be considered to be the minimum requirement for protective purposes. The reduction of duty of 70 per cent for Maltese exports to the European Economic Community may offer good prospects to the local boat building industry but the soft drink manufacturers and the building steel bars industry mainly cater for the domestic market and on balance they are likely to lose if the import duty were to be reduced by 35 per cent. Therefore, such products could with advantage, be included in the special exemption list comprising products in respect of which the Customs duty will not be reduced by either Malta or member states if the Commission does not accept the thesis that the protective rates should only be dismantled during the second phase. (6)

19. The problem of protection will only become acute during the second stage. During the first stage it is imperative for the Ministry of Trade, Industry and Agriculture and the Development Corporation to work out a detailed five year plan designed at increasing the productivity of those producers who have been accustomed to operate within a protective industrial policy.

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It may also be possible to ask for the retention of these high rates of duty to offset those reductions in tariff in excess of 35 per cent to bring them in line with the preferential tariff.

20. Another important problem is the United Kingdom's attitude to Malta's application. As is well know Britain is by far the largest single market for Maltese exports. Most of our entrepreneurs have hailed from Britain and a large part of our production is in British satellite industries. Indeed if Britain were to retaliate, Malta's exporters will be dealt a very hard blow as it is not easy to find alternative export outlets overnight. It is furthermore to be remembered that the benefit of zero tariffs will not accrue to Malta before the sixth year. It may be reasonably anticipated that so long as Britain expects to become a member of the European Economic Community, it would not retaliate. It is hard, however, to believe that so long as Britain is not admitted as a member state it would tolerate a loss of preference in the Maltese tariff without retaliation. During the first phase a reduction of 35 per cent will in some cases, bring our tariff on E.E.C. goods lower than the preferential tariff. [7] It might be necessary, for Malta, to offer Britain a similar reduction, so that in no case during the first five years will the tariff on E.E.C. imports be less than the tariff on British imports. This will cost the exchequer a loss of a further £1,466,000 in addition to the revenue losses indicated in paragraph 12.

21. To sum Maltese exports tend to gain from a lowering of tariffs in the Community's markets, and from the elimination of restrictions. It is recommended that studies be immediately initiated to quantify the benefit in this respect. The lowering of the Malta

(7) See papers marked BR/C/26/68 dated 13th May, 1969. Out of 44 tariff classifications, 28 will result in rates lower than the preferential tariff.

tariff by 35 per cent would necessitate the tapping of alternative sources of revenue. Though the loss of protection does not appear serious during the first stage, nevertheless it is imperative that a plan should be formulated to enable the domestic producer catering largely for the local market to increase his productivity so that he will be able to meet with confidence the second stage. As regards the Agricultural sector it will probably be wise for Malta to take the stand that the 35 per cent reduction of tariffs should not be extended to the products listed in Annex 11 of the Treaty of Rome.

The Second Stage

22. During the course of the second stage Malta will have to cope with problems arising out of (a) a gradual dismantling of protection and (b) reduction to zero of Customs tariff on E.E.C. products and the acceptance of the Common External Tariff.

23. Loss of protection [8] will pose serious problems. Malta's traditional industrial units are, by and large, small scale undertakings which have managed to survive in a hothouse atmosphere. Hardly any attempt has been made to rationalise such industries and so far very little organisational change has taken place. It is estimated that these small-scale industries provide employment for about 9,800 persons.

24. Removal of the protective umbrella will affect local industry to varying degrees. For example, there are about eleven industries each consisting of one or a few small units, the majority of which

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(8) In a paper entitled "Document de Travail" presented by the Commission on the 21st October, 1969, to the "Group Ad Hoc 'Malte'" it was made clear that by the end of the second stage quantitative import restrictions will have to be eliminated 'sauf exception dument justifiees'. It is of course not possible to anticipate what the E.E.C. would consider as justified exemptions.

adopt primitive production methods and turn out a very limited product range. These industries comprise the production of brooms, buttons, candlesticks, cotton wool and sanitary towels, handbags, nails and screws, collapsible iron gates, remoulded tyres, and steel wool - all protected by prohibition of imports or restrictions, - and the production of travel suitcases and toilet paper rolls - protected by a tariff. These industries, employing just over 100 persons, are not likely to withstand European competition without protection. If they would be compelled to close down, however, no serious economic problems would crop up as the value added locally in the case of each product is not substantial and the economic contribution in terms of import substitution is relatively small.

25. There are also a number of protected industries catering mainly for the local market which, despite the fact that they are relatively well equipped with modern machinery, they are prevented from reaping the benefits of large scale production due to the smallness of the domestic market. Several of the industries falling in this category will have to face stiff competition from Europe but this may in a way urge them to adopt improved production techniques and seek export outlets by using more aggressive marketing strategies. The local producers of mattresses, candles, smokers' pipes, edible oil, soft drinks, wine, cigarettes, matches and gloves are relatively efficient and turn out a product which compares favourably with the imported counterpart at least insofar as price is concerned. Most of these industries are expected to pass the test of operating in a free European market and may be expected to keep their share of the local market. However, the local manufacturers of bacon and sausages, frozen poultry, beer, detergents, and men's shirts, providing employment for about 1,000 persons are likely to have a tougher time. Those producing macaroni, canned peas and tomato

paste can only hope to maintain their present sales on the local market if they improve the quality of their product substantially whilst at the same time leaving their prices competitive with similar E.E.C. products.

26. Then there are quite a number of firms employing about 5,000 persons whose future in an unprotected market is uncertain. These firms produce wicker work, marble works, mirrors, printed matter (jobbing work), shopping bags, ladies' nylon stockings, men's tailoring, floor tiles, paper bags and motor buses which are protected by prohibitions and restrictions, and furniture and other woodwork, footwear, knitwear, building steel bars, crown corks, car batteries, steel furniture and wrought iron work which are protected through the tariff. Whether such industries would be able to survive in a free European market depends primarily on whether during the first five years of Malta's association they can increase their productivity and improve the quality of their final output. A detailed review of the position can only take place after an industrial five year plan aimed at increasing productivity has been drawn up.

27. In strict economic terms the adjustments which will have to take place consequent upon a liberal industrial policy would tend to increase the rate of growth of national income. The targets of the Third Five Year Plan, if achieved, would imply that by the end of the first stage of relationship with the Community Malta would have achieved, for practical purposes, a position of full employment. When that stage has been reached an increase in national income could only be achieved by increased overall productivity. Shifting of resources from high-cost-low-productivity units to low-cost-high productivity units is one way of achieving the desired growth rates. A phased rundown of those units which cannot increase their

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productivities is therefore desirable from an economic view-point, as the elimination of inefficient producers would release under-utilised resources at a time when they could probably be transferred to more efficient use. In practical terms, however, such a rundown is never easy to achieve. There will be both social and political implications which cannot be ascertained without a deeper 'ad hoc' study of the matter.

28. The implications of a complete customs union on our agriculture sector are far from clear. Our protective agricultural policy is based on the principle of seasonal restrictions which will not be affected during the first stage. The Community has a 'common agricultural policy' with three main features (a) common marketing policies (b) common policy for external trade, and (c) common policy to raise productivity and efficiency in farming. In practice the basis of the Common Market for Agriculture has been the setting of common price levels. These levels appear to be much higher than the ruling local prices and therefore acceptance of the common agricultural policy would imply a higher cost of living which will erode, through higher wages, some of the advantages gained by a reduction to zero of Community tariffs on Maltese exports. It has already been agreed that discussions on Malta's adherence to a common agricultural policy be deferred, but even if on a cost of living argument Malta would not want to subscribe to such a policy, nevertheless there may be serious implications on Malta's farming sector. It is a well known fact that farm costs are different among member states and therefore surplusses can be exported at prices substantially lower than the accepted 'common price level'. A good illustration is German and French butter which at the moment is retailed in Malta at a fraction of the price the German and French consumer pays for it.

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Imports of German and French butter into Malta are gradually displacing Australian butter which up to a few years ago practically monopolized the local butter market. This practice may be extended to other products which would tend to displace locally grown agricultural products. It is true that Malta could have recourse to anti-dumping procedures. These may however be very cumbersome. The size and fragmented state of our farm holdings, the soil composition and lack of water all militate against an appreciable increase of productivity in the short space of a decade. Obviously a 'modus vivendi' will have to be found during the second stage of our relationship to ensure that our farmer will not suffer untold hardships.

29. The problems of adjustment which Malta will have to face as a consequence of a liberal commercial policy are outlined above. In addition, Malta would also have to face a drastic adjustment of her fiscal structure. From calculations made (9) it appears that in 1967 the total duty collected from imports from member states was in the region of £2.3 million. It has been calculated that on average the Common External Tariff has a higher incidence of tax than the Maltese tariff. This means that imports from third countries will be dearer due to the adoption of the common external tariff at a time when imports from member states are becoming cheaper due to the elimination of tariffs. This should result in a large scale diversion of trade away from third countries to member states. If the Community is enlarged to include the U.K., Malta would virtually lose all its revenue from Customs. This implies

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(9) Vide Sub-Committee paper marked CPD 1142/68 dated July 25, 1968.

that other ways will have to be found of raising public finance. It is perhaps important to examine the fiscal policy of member states and the present fiscal policy of Malta before analysing the pros and cons of the various alternative fiscal policies that Malta could adopt during the two stages of her relationship leading to a complete Customs Union.

III. TAXATION POLICY OF THE E.E.C.

30. The first exercise which confronted the European Economic Community was the gradual elimination of tariffs on inter community trade and the adoption of a Common External Tariff with the outside world. This degree of harmonisation of consumer taxation was deemed to be compatible only with a Customs Union and not with the degree of economic integration contemplated in the Treaty of Rome. The ultimate aim is the institution of an economic union with all the characteristics of a domestic market. It follows therefore that tax harmonisation will have to go well beyond Customs Tariffs in order to ensure that there will be no distortion in competitive market conditions amongst member states.

31. Most types of taxation, whether direct or indirect, affect economic decisions. To achieve the aim of full economic integration there must be a harmonisation of fiscal structures and the elimination of tax frontiers. This implies that member states must surrender sovereignity in matters of taxation policy and accept a common system of taxation with common rates applicable to all member states. In the opinion of the European Commission the tax revenue of the six E.E.C. countries should be based mainly on three sources: (a) harmonized sales tax (b) harmonized corporation tax and (c) personal income tax whose rate might differ, even in the long run, from one member country to another.

32. At the present stage of development of Common Market thinking priority is being given to the harmonization of sales taxation. This is a logical extension of the ideas which have been tried out successfully during the first phase which has led to a full Customs Union. The use of Customs' machinery to administer members' sales taxes and special excises will have eventually to be dismantled in order to achieve the elimination of tax frontiers at least insofar as exchange of goods and services are concerned. When this is successfully implemented the way will be open for a complete fiscal harmonization.

33. Though priority in terms of tax harmonization is being given to sales taxation the guidelines for harmonizing direct taxation have been announced. In 1967 the European Commission submitted to the Council a memorandum setting out the harmonization programme for direct taxes. The economic and social aims of the programme are: (1) to ensure that the effects of taxation on the cost of production and on the yield on invested capital do not differ too widely between one member country and another; (2) to ensure that capital movements depend on economic rather than fiscal policy; (3) to eliminate tax obstacles to mergers and to the setting up of European companies; (4) to coordinate fiscal policies of member states and bring them into line with the Community's policies. The first step to harmonise taxation on capital has already been taken. The Council of Ministers issued a directive on July, 17, 1969 [10] aimed at abolishing, by January 1, 1972 stamp duty on raising capital. The directive also requires the Commission to make proposals for uniform rates not later than January, 1970.[11]

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(10) See "European Community" September, 1969 page 5

(11) This may well be the death knell of Luxembourg as a tax haven.

34. The choice of a common system of sales taxation had to be conditioned to two important economic criteria: "tax neutrality" and "competitive efficiency". Theoretically the objective of tax neutrality - a tax which is neutral in its effects on the economic organisation of particular productive units - is achieved by a non-cumulative uniform ad valorem tax in all countries and applying to all products whether in the form of goods or of services. The competitive criterion of optimizing production within each country requires that the ratio between marginal costs of production net of tax and marginal values to final purchasers is the same for all products and for all purchases. In theory such a tax would have to be on the broadest possible base - on all goods and services - levied at one single uniform rate. Rate differentiation though compatible with the criterion of social justice - it helps to achieve a progressive tax structure - is incompatible with the economic criterion of competitive efficiency. Though the theoretical guidlines are very rigid, nevertheless in practice the Commission of the European Economic Communities had to be content with a broadly based tax system, as against the ideal of including every economic activity within the scope of the tax; had to allow exemptions both for social and practical purposes, and had to tolerate a small amount of rate differentiation.

35. It is to be remembered that by the mid-sixties every member state employed some form of turnover tax - a tax which is applied to transactions on a <u>wide</u> range of goods (and sometimes services) and which is charged at successive stages of production and distribution. Germany, Belgium, The Netherlands, France, and Italy all had some form of turnover tax levied on the so called 'cascade system'. This was in effect a multiple tax with the taxable

event defined on the basis of transactions. It followed that a producer could lessen his tax liability by verticalisation as in this way he would lower the number of taxable transactions. It was clear that a cascade system of taxation, was incompatible with the criterion of tax neutrality. The concept of a single stage tax had to be adopted to ensure tax neutrality. This was a natural evolution of the tax systems in force, and as it was less onerous than the previous system of multiple taxation it was acceptable.

36. As is well known, the European Economic Community has decided to harmonize sales taxation on the basis of a single stage tax, payable by instalments at each stage of the production process, and refundable on exportation. The tax has been labelled the Value Added Tax (12) because the liability of each producer is limited to the payment of an ad valorem rate on the value added which is roughly equivalent to the profits and wages created during the process of manufacture.

37. Member states appear to be threading very cautiously along the path of harmonization on the basis of a Value Added Tax. Full harmonization is to be achieved in two stages. The first stage will concern itself with the adoption of a common system of value

(12) The tax is commonly referred to on the continent as T.V.A. - an abbreviation of its French name "Tax sur la valeur ajoutee". The British insist on calling it V.A.T. - value added tax. To complete the confusion some authors are now calling it A.V.T. - added value tax.

added tax, whilst full harmonisation and the adoption of common tax rates has been deferred to a later period. The problem of 'special excises' has not yet been tackled, and it appears that the term "elimination of tax frontiers" on the movement of goods does not include "special excises". The first stage - the adoption of a common system - has been scheduled to start by January, 1970. (13) No time schedule has been set for the second stage.

Harmonization of Turnover Taxation

(a) The First Stage

38. On April 11, 1967, the Council of Ministers issued two directives aimed at instituting a common turnover tax system based on the value added principle of taxation. When all six community members have switched over to the common system of value added tax, the system of cumulative cascade taxes will be abolished and comparable products in each E.E.C. country will be subject to the same system of turnover tax (even if rates applied vary). The directives, whilst imposing a common system, have not insisted on uniformity of legislative provisions byt only on substantial equality

(13) Belgium has recently announced its decision to postpone the introduction of the value added tax by a year whilst Italy has applied for a postponement of two years.

of treatment. With the common system each member country will decide its own tax rates and tax exemptions. The tax will be collected on the 'country of destination principle'. This means that the tax is imposed in the country where the good is consumed. Therefore, exports are exempted from the value added tax (tax already paid on such goods in the exporting country is refunded), and all imports in member states are subjected to the value added tax in the same way as similar domestic products. In the case of imports from third countries the value added tax is levied on the C.I.F. price plus the import duty imposed under the Common External Tariff.

39. The common system as defined in the Council's two directives is a general tax on the consumption of goods and services, imposed on deliveries of goods and the rendering of services. Deliveries of goods are defined to include the sale of electricity, gas and similar commodities even if their production is undertaken by the State. In terms of the 'directives' a service is taxable if it raises the price of a good or of another service significantly.[14] The tax is directly proportional to the price of the goods and services irrespective of the number of transactions during the production and distribution process preceding the stage at which the tax is imposed. It is a single stage tax in the sense that the total tax liability is always equal to the 'ad valorem' rate on the price on which the commodity (or the service) is disposed of to the final consumer. The tax is paid by instalments (the French call it fractional payments) at each transaction. Broadly when a delivery is effected, or when a service is rendered, the producer will have to pay the total tax due on his sales price. The Treasury then credits the producer with all tax paid on the inputs that have gone into the productive process.

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(14) The services which are compulsorily included under the value added tax are itemised in Annex B to the Second Directive.

Thus the actual liability is equivalent to the tax on the difference between the selling price of the commodity and the value of all inputs (excluding labour inputs) that have gone into the manufacture of that particular commodity.(15) The total tax liability is also abated by the tax paid on investment goods purchased.

40. The two directives prescribe that the common system is to be applied at all stages of production and distribution including the retail stage. During the transitional period, which is of unspecified duration, member states have been allowed the option to exclude retail trade transactions, agricultural products, and the production of small enterprises from the tax, but each member state will have to take special action, tax wise, in these fields. These are sensitive topics and no clear thinking has yet emerged to provide the basis of an acceptible solution for the conclusion of these sectors under a common system of value added tax.

(b) The Second Stage

41. Whilst the first stage, originally scheduled to start in January, 1970 consists in the alignment of tax structures by the adoption of a common system of value added tax, the second stage

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(15) In practice the taxpayer, defined as the seller of the good or services, sends monthly returns to the tax authorities giving his sales for the month and his total liability as well as a return of tax paid by previous taxpayers on his purchases. If his tax liability exceeds his tax deductions he has to settle the amount within a specified period of time. If tax liability is less than deductions he is allowed to carry forward a tax credit for the following month. Trade losses are eligible for tax credit.

will concern itself with the elimination of tax frontiers and the adoption of common rates. The imposition of common rates to equalise competitive advantage is a final and probably most difficult obstacle in the path of attaining complete harmony of turnover tax structures amongst member states.

42. The introduction of common tax rates during the second stage (for which no time table has yet been set) will open up enormous practical and conceptual difficulties. The practical difficulties revolve around the common standard rate which will finally be adopted, whilst the conceptual difficulties include the changeover from the present procedure of collecting the tax in the country of destination (where the good or service is consumed) to the country of origin (where the good or service is produced).

43. It is probable that the common rate will be worked out on nothing more sophisticated than the average of the rates adopted by member states during the first stage. Mr. Jansen, Head of the Taxation Division of the Commission of the European Communities has been quoted [16] as indicating that the common rate is likely to be in the region of 15 per cent. In that case, introducing a common rate would increase the burden of turnover tax in Germany, the Netherlands, Luxembourg and Italy and reduce it in France and Belgiu. The first three countries could therefore

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See "Community Topics: 29" - European Community Information Service, July, 1967.

lower direct taxes while France and Belgium would need to raise them. Italy would be able to abolish many of its special taxes on production and consumption. From a Community point of view this would constitute an important step towards bringing into line the ratio between direct and indirect taxation in the six member countries and would bring the community one stage nearer to the realization of the aim of equal conditions of competition. Acceptance of a common rate, however, will entail that member countries will have to surrender virtually all their sovereignity in turnover taxation. The opportunity to use turnover taxes for purely national economic and social aims will then be minimal. All this indicates that intensive studies are still necessary and a 'modus vivendi' has still to be found.

44. The elimination of tax frontiers will logically imply that the 'destination principle' of tax collection be abandoned for the 'origin principle'. (17) This means that each state will collect tax on the value added generated by its factors of production. It is only in this way that a movement of a taxable commodity or service does not get involved in the tax machinery of the receiving state. This change will have radical repercussions on the national fiscal patterns and on the burden requiring further adjustments and further

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(17) Both the "Tinbergen Committee" (Report on the problems raised by the different turnover tax systems applied within the Common Market - 1953) and the "Neumark Committee" (E.E.C. Reports on Tax Harmonization - Internation Bureau of Fiscal Documentation - Amsterdam 1963) recommended levying the Value Added Tax in the country of origin for trade within the E.E.C. and in the country of destination for E.E.C. trade with third countries and for excise.

changes to the national ratios between direct and indirect taxation to the ones induced by the acceptance of a common rate. In general, countries whose total importation constitutes a high proportion of domestic consumption will necessarily find their current revenues seriously curtailed and unless a system is introduced whereby the country of origin which has levied the tax will pay some part of it to the country of destination where the goods are sold, such countries may be driven to increase their in cidence of direct payable taxation to such a level as to create serious disincentives to effort.

Conclusion

45. The path towards complete harmonization of turnover taxes and corporate profit taxes is strewn with difficulties and progress will inevitably be very slow. Even the first stage limited to a common system of sales taxation has taken years of study and public debate. The principle of a common system of value added tax has been accepted by the countries of the European Economic Community, but even at the eleventh hour it appears as if the target date of implementation - January 1970 - will not be achieved. The Commission of the European Communities has proposed the postponement of the final date following announcements by the Italian and Belgian Governments that they will not be able to meet the present deadline. The Italians, who are in the midst of other major fiscal reforms in addition to the value added tax, have said that they will need two extra years before the new system can be introduced. The Belgians have aksed for a postponement of the deadline by a

year because their economy is booming and they cannot afford to feed the inflationary process by the additional pressures on prices which a changeover to a value added tax will bring. (18)

46. In spite of these set-backs, and in spite of the administrative difficulties involved in the changeover, all E.E.C. countries have drafted their value added tax legislations. Outside the E.E.C., Denmark and Sweden have already adopted a value added tax while Greece, Turkey and Finland have introduced limited systems. The introduction of a value added tax in Britain has been rejected in the past, but a renewed debate has now arisen in the light of developments in the E.E.C. and in certain of Britain's E.F.T.A. partners.

47. Harmonization of direct tax regimes has not progressed beyond the stage of enunciation of general principles, and some indicative thinking on taxation on raising capital. The problem of harmonization of "Special Excises" is still unresolved and the aim of abolishing tax frontiers on consumer taxation is still without a date line.

IV. MALTA'S TAXATION POLICY

48. The Maltese tax structure is on the whole fairly progressive (i.e. it tends to reduce pre-tax inequalities of income). In addition, a number of tax measures have been introduced designed to assist economic growth and very slowly a sophisticated fiscal policy is being formulated aimed at assisting economic development and furthering social justice.

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(18) In fact the Commission has proposed that the entry into force of the value added tax should be postponed by one year and that at the same time a timetable for the harmonization of rates should be adopted.

49. The prime feature of Malta's tax structure is the relatively low yield of direct taxes. In Malta taxes on household income [19] account for about a tenth of the total tax yield as against an average of a fifth in E.E.C. countries and a third in Britain. Malta does not have a Corporation Tax but corporate profits are taxed at source and offset against personal tax assessment. In other words the incidence of corporate taxation is on undistributed profits and on profits accruing to persons who are not Maltese taxpayers. Social service contributions (5 per cent of total tax yield) are very low when compared with the United Kingdom (15 per cent) and E.E.C. countries (33 per cent).

50. There is an under-emphasis of direct tax proceeds, as opposed to indirect, partly because of the distorting effect of arrears of assessment and collection and partly because large sectors of the economy are non-profit making enterprises. The tax base has also been eroded in the interest of overall development by awarding ten-year income tax holidays as an inducement to investors. The yield of income tax, despite relatively high rates, is proportionally low because it is derived from a population with low per capita incomes. On average, personal income taxes are lighter in the E.E.C. than they are in Malta. [20] The process of development and the continual increase of money incomes will gradually increase the ratio even on present tax rates. The introduction of a betterment levy, and a gains tax in respect of land will also help to achieve a higher ratio of direct to indirect taxes.

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(19) Excluding Social Service contributions.

(20) Vide Final Report by Mr. Pepper - page 140

51. In Malta there are no local tax rates and in their place revenue is derived from fees, licences, etc. Most of this revenue is collected on the basis of outdated rates and no effort has been made to update the rates and to take into account present market conditions.

52. The basis of indirect taxation in Malta has been the Customs tariff which was extensively remodelled in August, 1964 and turned into an important and flexible economic and social instrument. The tariff imposes differentiated rates both to effect a measure of personal rate progression, and to allow manipulation of rates for purposes of controlling output and use. The tariff is broadly divided into four parts: (a) high rates to protect local manufacturers, (b) zero tariffs on raw materials, machinery and equipment required by industry; (c) low to zero tariffs for necessities, and (d) medium to high rates for luxury articles. The bulk of taxation on consumers' outlays is derived from the Customs tariff, and special exises are limited to local production of beer and tobacco.

53. The concept of taxation on consumers' expenditure in Malta has not been extended to domestic production (apart from beer and tobacco products) partly due to the smallness of the domestic productive sector which could make such a tax unrewarding and partly to protect the local manufacturing sector and accelerate the process of import substitution. The domestic sector produced about a third of retained imports in 1960 and about three eights in 1967, indicating that the need to tap this source for revenue purposes has not been pressing. Development and rising real incomes have resulted in a high level of demand for imports. In spite of import substitution the increased import bill yielded a high and steady increase in revenue from customs duty.

54. The present position therefore is one in which taxation on consumers' outlays is nearly exclusively based on import taxation. The tariff, by taxing luxury goods at higher rates than necessities has introduced an element of progressivity in the tax structure as a whole. The complete absence of turnover taxation coupled with a carefully designed customs tariff has given the local producer a preferred status on the domestic market. Neither his inputs of raw materials and machinery nor his outputs are subject to indirect taxation. Furthermore the tariff can be used as a major instrument in regulating imports if balance of payments considerations makes it necessary. Tariff rates can be manipulated selectively to penalise those particular imports which are causing concern.

Alternative Taxation Policy on association with E.E.C.

55. It has already been argued that as during the first stage of our arrangements leading to a full Customs Union the loss of revenue will amount to about two million per annum after the fifth year, both for budgetary and balance of payments considerations Malta would have to start adapting her fiscal structure at an early date. Though it is accepted that the adaptation will have to be phased, this paper only analyses the aims and direction of fiscal policies, leaving the detailed phasing to be worked out later, if the general concepts sketched below are acceptable.

56. In theory, an economy which relies very heavily on indirect taxation is regarded as having a regressive tax structure. An indirect tax cannot function like an income tax with progressive rates according to the capacities of individual tax payers but, on the contrary, the small consumer who has of necessity to spend

all his earnings will be paying tax on all his earnings while the richer consumer who is in a position to save some of his income will end up with a part of his income untaxed. On these grounds it may be argued that it is desirable to substitute a part of the tax on consumers' outlays by direct taxation in the interest of social justice.

57. It has already been shown that Malta's tax structure on consumers' outlays is fairly progressive. The zero tariffs on necessities of life and the very high tariffs on luxury imports are meant precisely to correct the imbalances normally created by the varying proportions of total income devoted to consumer outlays by the different socio-economic groups. If redistribution of income had to be the sole criterion for taxation policy, then every economy should be geared only to progressive direct taxation. There is no country in the world, however, which pursues such a type of fiscal policy. There are other criteria to be kept in mind not least the effect of direct taxation on effort.

58. It has already been shown that tax rates on personal incomes in Malta are not unduly low. Experts have suggested that on an average these rates are higher than they are in the E.E.C. It will probably not be good policy to legislate for rates which are appreciably higher than those obtaining for the regions with which Malta aims at integrating. International investment is very sensitive to direct tax rates and a disparity with the rest of the world might act as an important disincentive to foreign entrepreneurs who might wish to invest in Malta. The question of tax yield, which effects the direct:indirect tax proportion must not be confused with the question of tax rates. A country might have much higher rates than another and at the same time, because of differences in the level of money wages, the proportionate yield would be much smaller. It appears that Malta is in such a position and the apparent discrepancy will

be corrected in time when money wages are raised to the European levels, when the present tax holidays expire, and when we have achieved a higher efficiency in tax assessment and collection.

59. This does not mean that direct taxation is limited only to taxation on personal incomes. It has already been suggested that an important milestone in direct tax history has recently been announced in the form of a betterment levy and a gains tax in respect of land. It is too early to forecast the economic and social effectiveness of such a tax as its yield is highly correled with the economic conditions of estate business. Another possibility is to tax corporate profits. At the present point in time there is very little scope for such a tax because large profits of new undertakings are enjoying a ten year holiday. In addition the system of a tax at source [21] is less likely to deter the Maltese investor. The foreign investor, if he is not enjoying a tax holiday, will pay the full tax of 25 per cent in Malta and would probably have to pay income tax on distributed income in the country in which he resides. This is an important incentive to Maltese investors which should not be foregone.

60. There are two further considerations militating against a complete reorientation of our tax structure in favour of direct taxation. In the first place if Malta would eventually achieve full membership in terms of the Treaty of Rome, she would have to conform to E.E.C. rules governing indirect taxation. It is inadvisable,

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It is understood that the Commission of the European Communities has recently sent a memorandum to the Council of Ministers asking that the practice of the "tax at source" be eliminated.

therefore, at this stage to reorientate the fiscal structure towards direct taxation when in ten years time Malta might have to undergo another exercise in a different direction. Secondly, the tax harmonization requirements consequent upon regional integration have introduced a new school of thought which is giving greater prominence to indirect taxation with a broad base supplemented with liberal social security benefits to achieve a desired level of progressivity. A report on the value added tax by NEDO [22] hints very strongly at such a course of action for the United Kingdom.

61. The above leads to the suggestion that it is desirable to replace the Customs tariff by another form of taxation on consumers' outlay. It is to be emphasised that this could be done by stages, starting with low rates or on a very narrow base and increasing the rates or base in inverse proportion to the reductions which Malta will have to make in its tariffs over the next ten years.

62. Of the possible alternative systems of sales taxation two stand out very prominently: the value added tax and the purchase tax. Other forms of consumer taxation such as the cascade system of turnover taxation have been proved inadequate in other countries and need not be considered as a possible alternative. Malta is under no compulsion to harmonize her taxation on consumption with the E.E.C. during the course of the two stages leading to a full customs union. Though economic integration and eventual tax harmonization remain as the ultimate aim, nevertheless it is not axiomatic that it is in Malta's best interest to introduce a value added tax before we reach the membership stage.

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[22] VAT - a report by NEDO H.M.S.O. 1969.

Introducing a value added tax in Malta

63. The case in favour of the introduction of a value added tax has been argued largely in terms of replacing a 'sales tax' based primarily on the principle of multiple taxation by a form of single stage purchase tax, payable by instalments, refined to exclude payments of tax on investment goods and rebatable on exportation. The case against has been largely argued by the British on the assumption that a value added tax would replace the British purchase tax and the British Corporate Profits tax.

64. It must be made clear that there is no tax which in itself is liable to induce a higher rate of growth in an economy. It is scarcely possible to consider in isolation the effects of the introduction of a new tax. If the new tax is designed to replace another tax, it is possible to analyse the economic efficiency of the two alternatives with a view to adopting that alternative which appears the more suitable to the particular economic circumstances which a country finds itself in. If the new tax is an additional one, this would normally imply either additional Government expenditure or reduced Government borrowing - the economic results are those of the circumstances as a whole and not those of the new tax alone.

65. It has been claimed by those who support the value added tax that this tax encourages exports, efficiency and consequently economic growth. These claims can only be upheld within the context of a value added tax in substitution of a cascade system of turnover taxation. The value added tax taken in isolation, will not induce either efficiency or economic growth. The Richardson Committee (23) pointed out that "there is no logic behind the suggestion

(23) Report of the Committee on turnover taxation - CMND 2300

that it is better to pay a tax and later have it refunded than never to pay it at all". Viewed from the point of view of an entrepreneur the tax is paid on the value of sales less the value of all purchases. It follows that the tax is paid on 'value added' which is equivalent to wages plus profits. Furthermore any value added tax paid on investment goods is deducted from the total tax liability. In theory therefore, the tax system induces the entrepreneur to invest more and become more capital intensive in order to lower his tax burden. Once it is generally accepted that the most obvious and effective way of increasing the productivity of labour is through capital intensity a tax system which gives a tax incentive to capital investment is normally to be preferred to a tax which does not give such an incentive. In highly industrialised countries with a perpetual shortage of manpower this makes sense but in economies with labour surpluses, a virtual tax on labour and profits may render the transitional stage more difficult than it would otherwise have been with a different fiscal structure.

66. The case in favour, is therefore largely based on the fact that with a tax on wages and profits the entrepreneur would reduce his tax burden by substituting capital for labour on the assumption that a highly capitalised industry is more efficient than a labour intensive industry.

67. In the case of Malta the value added tax must be compared with the Customs tariff it replaces, bearing in mind that the tariff has stood the test of time and such a switch would never have occured had it not been imposed on Malta to achieve the benefits of a Customs Union.

68. The value added tax is very different from a Customs Tariff both in its incidence and in its economic effects. This tax has been adopted because it is neutral in its economic effects and is acceptable to those countries who have subscribed to the fundamental concepts of the Treaty of Rome. The value added tax cannot be used to correct fundamental defects in the balance of payments nor can it be used to influence the use of resources to achieve a desired output. The inexorable market forces are given full play with no fiscal intervention. The practice of stimulating certain sectors of production by altering the tax incidence is not possible with a value added tax. When eventually the Community will agree to adopt common rates member states can only compete if their productivities are the same. Those particular member states whose productivities are lagging behind will have no option but to devalue in order to become competitive. With the adoption of common rates member states will probably have to abandon the post-war policy of pegged rates of exchange and will have to adopt a policy of flexible exchange rates.

69. Whilst import taxation allows a wide freedom of choice as to the range of consumers' expenditure which is to be subjected to taxation a value added tax is designed to hit nearly all types of consumer expenditure, though the E.E.C. directives have given member states the option to determine exemptions as they consider necessary. [24] The substitution of import duties by

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(24) This is only true of the first stage of the introduction of a harmonized system of value added tax.

a value added tax would render our fiscal structure regressive, and it will be difficult to make politically palatable the fact that exemptions or low rates are granted mainly for economic reasons rather than for equity reasons as has been the case with our tariff.

70. The value added tax has a broader base than import taxation and is levied at a more or less uniform rate. Differential rates of consumer taxation turn a tax into a highly selective economic tool. Countries which are in the process of development cannot afford to deprive themselves of selective economic tools. It is only the mature economies that can hope that the full rigours of competition would stimulate entrepreneurs through constant research, innovation and the adoption of cost reducing techniques, to become more productive and therefore more competitive. It is perhaps not out of place to state that the major European powers who are now in the process of consolidating the European Market into one whole, have passed through a century and a half of strict protectionist policy to enable their economies to built up the necessary productive process. It was only Britain that advocated a policy of "laissez faire" at a time when it clearly had technical superiority. Malta, with its precarious balance of payments position and with an emergent industrial sector does not appear to be in a position to replace its selective fiscal regime by a neutral tax.

71. The value added tax with its system of fractional payments implies that tax becomes due at every stage of production and not simply when the goods pass into the hands of the final consumers. This will have the effect of requiring a higher working capital and, with current high rates of interest, this may be translated into

higher costs.[25] More research is required into this subject to establish what additional costs would devolve on industry if a value added tax is adopted. Insofar as export industries are concerned it is possible to adopt the "suspension of tax rules" whereby value added tax is not actually paid by those industries which cater mainly for export. The tax will automatically become a "single stage tax" for those commodities sold on the domestic market. In this respect, therefore, the introduction of a value added tax should not affect our export industries

72. The substitution of import duties by a value added tax will certainly effect the general price level. Once the value added tax has a broader base than the tariff, assuming an identical revenue yield, it follows that certain commodities which are now untaxed or taxed at low rates will have to be raised and the tax on certain luxury articles will have to be lowered. It is not possible to say whether the retail price index would show an increase or not without detailed studies based on a sound household budgetary survey. Once luxury articles normally carry a low weight in the index the probability is that the general price level will rise though this will be somewhat mitigated by leaving necessities of life outside the scope of the value added tax. Clearly, however, unless rates are worked out it would not be possible to forecast the price effect.

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Insofar as imported raw materials are concerned the value added tax will have the same effect as a higher import duty. The raw material imported from outside the six will be subjected to the common external tariff plus the value added tax.

73. From a purely practical point of view it is manifest that a value added tax is more complicated and more costly than the present system of collecting tax on consumption through the customs machinery. Furthermore in the case of Customs taxation the 'taxable event' is defined as the date on which the goods are released from Customs' shed. On the assumption that the tax yield will remain unchanged, tax levied on value added would accrue to the exchequer at a much later date than it would have accrued if it were raised in terms of Customs Taxation.

74. From the foregoing analyses it appears that the structural changeover to a value added tax European style would reduce the progressiveness of the entire tax system with serious implications on the redistribution of income. Furthermore in Malta's case, incentive provisions have been a feature of our development exercise and it does not appear prudent to renounce to the differential rate structure of taxing consumer expenditure, and to adopt a tax which has been designed in such a way as to be neutral in its effect. Though Malta would undoubtedly have to conform to a harmonized fiscal structure when full membership is achieved, it is submitted that the decision should be deferred, and the acceptance of value added tax be recognised as the price that Malta will have to pay in order to achieve full membership.

<u>Purchase Tax</u>

75. The above considerations lead to the suggestion that ideally the Customs tariff should be substituted by a single stage tax for ease of collection and should have differentiated rates. Insofar as certain commodities are concerned (e.g.tobacco, alcoholic spirits, beer and minerals) it should not be difficult to subject them

to special excises payable on importation. Insofar as other commodities are concerned probably the introduction of a Purchase Tax (a single stage tax with differerentiated rates) levied on importation for imported commodities and 'ex factory' for domestic production is the nearest we can get to a Customs tariff.

76. The purchase tax, unlike a value added tax, can be as narrowly based as is desired. In this respect as Malta starts reducing its customs tariff the purchase tax can start on a narrow base, with the base becoming progressively wider as time goes on. The purchase tax will retain the essential economic characteristics of the customs tariff as its rates can be manipulated to stimulate some industries relative to others. The cost of collection, while probably higher than import duty collection, is nevertheless much lower than a value added tax.

77. In fact the purchase tax as a system of consumer taxation is not very different from a value added tax. A purchase tax may be regarded as a version of value added tax with a suspension of tax at earlier stages. The introduction of a single stage purchase tax at a modest rate is the most advantageous course of action as it would not affect prices and the cost of living unduly, it would not make heavy administrative demands, it would continue to provide Government with the necessary economic and social device, and it could gradually be modified to conform with E.E.C. requirements if Malta desires to attain member status, though the main hurdle of a tax which is economically neutral, will have to be met when the changeover becomes necessary.

V. CONCLUSION

78. It is the conclusion of this paper that:

(a) during the first stage of relationship with the European Economic Community Malta would tend on balance to gain out of the proposed relationship. Precise indications of the gain cannot be given without a proper survey. The gain will, in part, depend on an adequate solution to the problem of "trade diversion";

(b) during the second stage there will be serious problems condequent upon the loss of protection. Much depends on the feasibility of a plan aimed specifically at increasing the productivity of the high cost low efficiency units which cannot hope to compete under present conditions on the local market with E.E.C. products imported free of Customs Duty; and

(c) it is essential to introduce a Purchase Tax early during Malta's first stage of association both for budgetary as well as for economic purposes. The tax could at first be narrowly based and gradually broadened to replace the Customs tariff.