

MALTA'S EC APPLICATION: SOME ECONOMIC AND POLITICAL CONSIDERATIONS

Roderick Pace*

Introduction

The Maltese government has announced that it will be applying for membership of the European Community (EC) during 1990.¹ In all probability the application will take place during Italy's six month turn at the rotating presidency of the EC Council of Ministers.² For its part, the Opposition Labour Party has put the whole question under review and decided that it wants an agreement of unlimited duration with the Community. This decision was taken at the end of a General Conference held on March 22nd, 1990.³

The arguments advanced for or against membership have been multi-varied and have touched upon both the political and economic aspects of the question. But some of the issues have changed very little over the past thirty

¹ Prime Minister Fenech Adami announced at a meeting of the European People's Party, held in Palermo on September 6th, 1988, that Malta's application to join the EEC would be made before the end of 1990. For the Nationalist position see also Electoral Manifestos of the Nationalist Party, Independence Press, Malta See [14] point 9.4 and [15] point 10.3.

² The Minister of Justice and Internal Affairs and Deputy Leader of the Nationalist Party, Prof. Guido Demarco, confirmed that Malta would be putting in its application during Italy's turn at the Presidency of the EC, *The Times*, January 22nd, 1990.

³ The *Malta Labour Party* has published short papers on the question of EC membership in February 1990 (see [13]). An MLP extraordinary General Conference was convened in March 1990 to discuss the issue. Details of the decision of the conference appeared in *L-orizzont* of March 23rd, 1990.

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years or so when the political establishment in Malta first became interested in the Community.

In this article I propose to look at some of the economic and political aspects of membership of the European Community beginning first with the history of EC-Malta relations and how this impinged upon Malta's economic development and lastly the various alternatives to membership, their strong and weak points. In concluding it will be shown that the political and economical aspects of the question are really two sides of the same coin.

History of EC-Malta Relations

Too much emphasis on the political aspect of the EC-Malta relationship both past and future, may lead to the economic aspect being ignored or down-graded. I propose to argue that past interest in the EC has always been propelled by Malta's economic self-interest and only afterwards by ideological considerations such as the goal of European unity. However, this is not to say that this was the right perspective or that the political element was always ignored.

In the post war economic thinking it was immediately perceived that Malta's economic development depended on accessibility to a large market. An inward looking policy would attract no investment at all while foreign direct investment was a sine qua non for constructing Malta's industrial and tourist base.

It was Herbert Ganado who as far back as 1961 first argued that Malta should seek ways of entering the European Community which was progressively becoming more prosperous. He also argued that Malta could become a centre for the EC's entrepot trade with North Africa and that our future livelihood would depend on our abilities to export more. The limitation of the U.K. market alone to achieve these aims, quickly became apparent.⁴

With Britain's first application in 1961 to join the Community, it was seen that if it joined with no adequate safeguards being made for Malta which depended solely on its market, Malta could only be negatively effected by her entry in the EC.

Britain had in fact put in an application on Malta's behalf when it asked the Community that should it gain access, special provisions for its colonies,

⁴ See [12]

including Malta, should be made.⁵

At one point it was also felt that before actually becoming independent Malta could negotiate directly with the Community, after obtaining London's go ahead, and conclude a preferential trading arrangement with it. Britain was still constitutionally responsible for Malta, and foreign relations and defence were reserved matters.

Indeed, such negotiating powers were sought and obtained by the Nationalist administration and a Maltese minister travelled to Brussels for exploratory talks in 1962, at the end of which he was told that the Community would be prepared to negotiate a preferential agreement with Malta only after the latter gained independence.⁶

When Britain's application was rejected by the Community, the question of Malta's relations became less urgent as the government busied itself with the first years of independence. However, the whole question was revived in 1967.

In a letter to the Commission⁷ Malta requested to enter into negotiations with the Community, with the specific aim of concluding a preferential agreement that would one day lead to Malta becoming a member of the Community.

Economic concerns were at the back of the mind of the Maltese government of Prime Minister George Borg Olivier, who had promised once that Malta would become independent and join the European Community.⁸

The special defence and financial agreements with Britain were due to come to an end in 1974.⁹ The government was trying to build the economy by developing the tourist and industrial sectors through export-led growth. The need to achieve economic viability and the need to diversify from over dependence on the U.K. market made Malta look towards the EC once again.

The urgency of hammering out an agreement with the Community grew when, after a series of Sterling crises and balance of payments problems, the

⁵ Felice Giovanni, Minister for Industrial Development and Tourism, *Debates of the House of Representatives*, Sitting No. 40, February 6th, 1963, pp 4053 ff.

⁶ Felice in [11] pp 28-29, explained the powers given to the Government by the Constitution to negotiate an agreement with the EC. Details of exploratory talks held in Brussels were made by Dr. Giovanni Felice in a Parliamentary Statement, referred to earlier *ibid*, Parliamentary Sitting No. 40 of 1963, pp 4053 ff. About the visit to Brussels, see also *Ir-Review* VIIth Year, No. 175 of June 20, 1962.

⁷ Letter was sent on September 7th, 1967. See DOI [2].

⁸ See [3].

⁹ See DOI [5] on (i) Mutual Defence Assistance, and (ii) Financial Assistance.

U.K. imposed import restrictions and exchange controls. The former negatively affected Malta's young industry, the latter made Malta one of the few vacation spots British tourists could afford and this boosted the development of the local tourist industry.

For Malta, the problem was compounded when in line with a decision to cut global military commitments, the U.K. government announced cuts in the British military establishments in Malta.

This brought about the ominous prospects of discharges of Maltese personnel employed with the British services in Malta. Malta was then faced with a situation in which it had only a short span of time to effect the leap forward that was needed. The European Community offered such a possibility.

However, after Malta's 1967 letter to the Commission, negotiations dragged on for nearly three years before an Association Agreement was finally signed in Valletta, on December 5th, 1970.¹⁰ Although this agreement did not specify eventual membership of the EC for Malta, Prime Minister Borg Olivier said that the government saw it as an important step towards membership.¹¹

The agreement was criticized by the Opposition for lacking an agricultural portfolio. The government replied that although this had been requested by Malta, the EC had not given any concessions, because Maltese agricultural goods were considered to be "sensitive" by the Community. Besides, agricultural exports were doing well in the Community market despite the fact that they were not accorded preferential access. The government also said that concessions could be obtained by future negotiations and that whatever the outcome, free access would be achieved when Malta and the EC eventually formed a customs union as envisaged in the second stage of the agreement.

The Post 1971 Period

With the change of government in 1971, Malta negotiated and obtained further concessions on the basis of the 1970 agreement. These concessions took the form of protocols which were weaved into the original agreement. In

¹⁰ See [8].

¹¹ Borg Olivier George, speech on the occasion of the signing of the Association Agreement between Malta and the EC, in [4].

this way the first stage of the agreement was extended to 1977 and subsequently to the end of 1980, modifications were made to the rules of origin, some concessions were made on Maltese agricultural exports and a financial protocol, similar to the ones the EC had concluded with other Mediterranean non-member states round about that time, was signed.

The period in which the agreement became effective is characterised by strong economic growth propelled forward by large annual increases in exports. Although there is some discussion regarding the extent to which this growth can be attributed to the effects of the Association Agreement, a survey of industry carried out in the late seventies showed that foreign direct investment decisions were influenced by the existence of the agreement guaranteeing free access into the Community market.¹²

One important feature of the Association Agreement, by no means unique to Malta, was the allocation of financial aid by the EC through the financial protocol. The Maltese government however, refused to use the loan element in the protocol on the grounds that a Maltese law (which the Labour Government itself had enacted) prevented it from borrowing at rates of interest higher than three per cent.

Malta tried to turn this loan into a straight grant, but this was opposed by some EC member states on the ground that it would create a precedent for the other Community partners. The Commission did at one point propose to Council that Malta should be given a special gift, however, this was repeatedly blocked on the grounds of the precedent it would create for the EC's other partners and as a result of the human rights situation in Malta the European Parliament repeatedly approved resolutions condemning the Maltese government and at times calling upon the EC to halt all financial aid.

The dispute over the first financial protocol dragged on until the time had arrived for a second financial protocol to be negotiated. The majority of the member countries, excepting Italy, did not wish to discuss the proposal for special aid to Malta outside the framework of the second financial protocol. While Cyprus got a financial package of around 44 million ECUs in 1983, Council could not even agree on a compromise figure, suggested by the German presidency, of around 28 million ECUs for Malta.

Two years later, a marginally improved package was agreed to by Council and Malta was allocated 29.5 million ECUs in loans and grants which it accepted. Taking account of inflation, this package amounted to around half the total of the first financial package in real terms.

¹² See [16].

What irritated the Community, besides Malta's negotiating tactics¹³ was the fact that while it was always asking for more, Malta failed to utilise the allocated funds both in the first and second financial protocol. In fact it was only in 1988, that the funds of these protocols were finally committed to specific projects.

The Economic Aspect of Membership

Membership of the EC entails that Malta will have to gradually dismantle, over an agreed time frame, all trade barriers with the Community, liberalise capital, adopt the Common Customs Tariff and introduce Value Added Tax in place of the existing duties system.

This would entail that the Maltese economy becomes more open than it already is. Sectors which enjoy high protection will have to restructure and adjust to the new competitive environment or simply die. Theoretically, membership of the Community should result in net welfare gains for Malta because of the opportunities it offers to accenuate export led growth, because of the increase in direct foreign investment that membership of the community could attract, because of the transfer payments from the Community that should help Malta overcome infrastructural deficiencies and as a result of access to the various research and development programmes that should buttress Malta's efforts to acquire a scientific basis for its industry and the transfer of technology.

Of course if the opportunities open to Malta by membership of the Community, are not complemented by the right set of domestic policies such as those which would encourage more private sector involvement in the economy, an educational system which is responsive to modern economic needs and the removal of bureaucratic obstacles, to mention but a few, all the opportunities could be squandered.

The Rome Treaty establishing the European Community, specified that one of the aims of the Community is to strengthen the unity of the economies of the member states and **"ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions"**.¹⁴

¹³ See [20], p. 58, "Her (Malta's) negotiating tactics arouse ill-feeling in Brussels".

¹⁴ See [9]

This means that Malta will be entitled to and will receive considerable financial transfers from the Community structural funds that would help its development efforts, such as improving its economic infrastructure, retraining schemes for workers to encourage labour mobility and funds to restructure certain problem industries such as shipbuilding to make them more competitive or help them diversify their products.

Malta's port facilities could be developed into one of the Community's transshipment centres in the Mediterranean. This will not however be achieved simply by gaining accession to the Community but as a result of facing up to the cut throat competition in the sector.

Through membership of the Community, Malta will gain unrestricted access to a market of more than 320 million. If we add to this those countries with whom the Community enjoys a free trading arrangement such as the EFTA countries or those which have granted reverse preferences to the EC, the market will be much larger. While stating this however, it must be kept in mind that these same countries will also eventually gain full access to the Maltese market. This will occur at the end of a transitional period which should give the domestic oriented manufacturers ample time for adjustments.

Firms manufacturing solely for the local market will be the most "negatively" hit by this development, unless they start their adjustment early, ie during the application and negotiating phase and then during the transition period. Those firms which are constrained to become more efficient and to seek foreign outlets for their goods as a result of greater competition on their domestic terrain, will represent net gains for the Maltese economy as a whole. However, opening the small domestic market to the winds of competition will certainly induce quality and economic efficiency, which are a net gain to the economy.

The benefits that can accrue to a small country from applying protectionist measures are too small in the short and long run to make them a policy tool to hang on to at all costs, although they do come in handy at times. A small economy such as Malta, with a stake in an open world trading system, should not be caught negotiating for greater market access and insisting on the removal of the safeguard clause on the one hand while at the same time arguing against membership of the Community because this will not allow it to protect some of its industries.

The main advantage from membership is however that Malta, a small economy which needs a large market in its hinterland in order to follow an export-led growth, would have finally secured its future. The dangers of staying out are too numerous. Take for example the application of the safe-

guard clause in the EEC-Malta Association Agreement. This empowers the Community to stop or restrict imports from Malta when these threaten to disrupt its market.¹⁵ When the European Community takes global protective measures against all third countries in response to such a perceived threat or when the less likely happens and Maltese exports of a product threaten it with market disruption, it will invoke the clause to restrain or stop imports.

Malta has already had a taste of this as a result of the EC's protectionist measures in the clothing and textile sectors in the second phase of the Multi Fibre Arrangement (MFA II). After following quite liberal policies towards third world imports of MFA goods during the first phase of the MFA, the industrialized countries became significantly less liberal in the second phase. This was in response to economic developments in Europe which was in the grips of a recession characterised chiefly by rising unemployment and inflation.

By 1977 the EC had signed agreements regulating textile and clothing imports with more than 20 countries under the auspices of MFA II. The EC's main difficulties lay in the way that it had to tackle countries with a preferential arrangement with it. Clearly such controls were seen as going contrary to the spirit of the agreements by the partners concerned. The ACP countries, linked to the EC by the Lome Convention, posed no serious challenges because the textile and clothing industry in these countries were negligible in export terms. The main threat for the Community came from the Mediterranean basin countries especially Turkey and Egypt.

In 1978, the United Kingdom had asked the Community to impose restrictions on Maltese textile and clothing imports, invoking the **safeguard clause**. Malta pleaded at the time that exports of these goods towards Britain were so small as to be ineffectual in causing harm to the British textile and clothing industry. The British insisted that controls be imposed so that Malta's case will not serve as a precedent in dealings with other partners.

In 1979, the EC imposed ceilings on some eight categories of textile and clothing goods exported from Malta. These quotas remained significantly under utilised in the first phase of the agreement, as a result of which, with successive renewals, ceilings were gradually removed so that by the 1988-90 extension only one category of clothing, namely trousers, was subjected to a

¹⁵ The safeguard clause in the Malta-EC agreement of 1970, article 10.

ceiling and this was so large as to make it ineffectual.¹⁶

That Malta failed to utilise the ceilings could be attributed to two main reasons: on the one hand, in line with its policies towards smaller suppliers with preferential arrangements with it¹⁷, the Community did not really wish to restrict Maltese exports of these goods and had imposed them to look as if it was being even handed with all partners. Most vocal insistence for controls on Maltese exports of these goods came from the British side, which no doubt was due to the fact that the British Labour Government facing rising unemployment and a fastly approaching election, came under considerable pressure from trade unions representing the sector to curtail imports.

The other reason was home-grown. Rising labour costs and a hardening Lira arrested the further growth of the sector in Malta. Infact, after 1979, the local economic scene was characterised by a number of negative economic developments. First, there was a massive increase in labour costs due to a sharp increase in wages which was followed by a gradual hardening of the lira. The result of these two developments was that they accelerated the loss in comparative advantage in the sector, giving local policy makers little time to ponder over, let alone effect, structural adjustments.¹⁸

The outcome of all this is that we cannot really quantify how deadly the effect of the "safeguard clause" really is because the lack of fulfilment of the ceilings de facto nullified its formal application. The test would come if we were faced with a clear situation in which its application becomes the real obstacle to increasing our exports.

The danger of future disruption of Malta's exports by resort, on the Community side, to this clause is so real that it prompted the previous Maltese government to include the removal of the clause as one of the conditions for the new **special relationship** it proposed with the Community.¹⁹

¹⁶ Malta and the EC signed a Memorandum of Understanding to regulate Maltese exports of certain clothing and textile goods in 1979, to cover the period 1979-81. It was subsequently renewed in 1982, 1984, 1985, and 1987. The agreements have never been published, however, details have been supplied by the Malta government in the House of Representatives and the ceilings agreed upon with the EC have also been published. Information regarding quota utilization is available from the Malta government and the Commission.

¹⁷ Pomfret [17], "The brunt of EC protectionism was, however, borne by the non-Mediterranean low-cost suppliers who were induced to agree to a more restrictive MFA renewal under threat of unilateral EC Action The EC's imports from Mediterranean countries increased by both value and volume, mainly at the expense of the big low-wage exporters....."

¹⁸ This point is discussed at some length in [1], pp. 55-56.

¹⁹ See [6].

Membership of the Community has other economic advantages. When coupled with political stability at home and Malta's proximity to the Community, it can induce further direct foreign investment from companies wishing to export to the EC market using Malta as a base. In the past Malta was one of the few countries close to the Community which could be developed as off-shore industrial bases of the Community.

Today that advantage has relatively declined partly as a result of the second enlargement of the Community with the entry of Spain, Greece and Portugal with regions offering similar or better advantages than Malta, as well as the benefit of actually being Community territory, with all the advantages that it implies.

Membership also means joining a zone of monetary stability, especially if the goals of a European Monetary Union are eventually achieved. This sort of stability will not be looked at with disdain by any of the Maltese economic sectors.

Of course exchange controls will have to be removed eventually and free movement of capital introduced. Interest rates will probably increase to the average European level, although experience shows that they need not do so. The dreaded flight of capital and savings may not occur if interest rates rise, however local borrowers, accustomed to lower rates, would be negatively effected. Such an upward shift in interest rates could effect investments and consumption unless mitigating action is taken.

Regarding the flight of savings and capital following the removal of exchange controls, the experience of other countries shows that this may not result in a net loss.

One must also consider the psychological effect. If people's minds are put at rest by economic decisions that inspire confidence and by the fact that they can take their money in and out of the country at will, coupled with a more realistic interest rate policy, the result may not be the financial haemorrhage that some seem to regard as inevitable.

The economy would on the other hand benefit from the availability of wider and more competitive financial services while Small and Medium Sized Enterprises (SMEs) will benefit from the Community aid earmarked for them.

For Maltese industry there is also great potential available from the scheme of the European Interest Grouping and from Malta's participation in Community scientific and research and development programmes.

Some other economic aspects that have been aired in the debate regard the effects of the introduction of Value Added Tax (VAT) on the cost of

living.²⁰ VAT need not be inflationary. Its base could be wider than that of the taxes it replaces. However, it can be "zero rated" for essential goods and could in effect be lower than the tax it replaces for some goods. The outcome of the introduction of VAT, judging from the experience of other countries, could either be a once and for all increase in the general price level or a no increase at all, but it is unlikely to be inflationary.²¹

The International Context of Membership

Malta's membership of the EC cannot be viewed in a vacuum. It has an international context. It must be considered in relation to what is happening in the EC itself, in Europe and in the Mediterranean.

Some consider that the 1992 internal market process hardly effects us. However, we must consider that Maltese firms are having to face an increasingly competitive environment and that new actors are appearing on the scene competing where hitherto they have been unable to compete.

Moreover, Community based firms enjoy the services of information and EC programmes designed to help them, Maltese firms do not.

The second development that must be considered springs from the political upheavels in Eastern Europe. The EC's attention will be turned eastwards for a good number of years to come. Helping the East European economies does not only entail providing them with finance and investments, but also opening the Community's market to them. To this effect, a number of cooperation agreements have already been finalized with these countries.

The East European countries will be Malta's direct competitors for investments and in the EC market.

Moreover, their political importance will continue to strain the EC's limited resources that can be dished out to its partners. With the ACP countries, the Mediterranean non-member countries and the East Europeans all clamouring for more, the EC will finally share the cake along geopolitical considerations. In this scenario then, the Mediterranean is in danger of becoming once again of secondary importance to the Community.

²⁰ Reference to VAT has frequently been made in the debate on the EC, and its introduction has often been depicted as being inflationary. The MLP made reference to VAT in the papers published in *Il-Helsien* of February 23rd, 1990.

²¹ See [19], pp. 38-43.

For Malta it is important that it becomes attached as early as possible to the heart of Europe. With most North African states forging a sort of regional union among themselves, the worst place for Malta to be at the moment is standing alone in the middle.

The Maghreb countries could bargain together with the Community, but who would Malta join to bargain with the Community?

The Options

The alternatives to membership of the Community are numerous but not as viable. Malta could decide not to join and continue to develop its relations along the present Association Agreement, eventually forming a Customs Union with the Community. In this respect a number of questions will have to be provided with an answer: Maltese agricultural products will fall under the Common Agricultural Policy (CAP) but will Malta be able to benefit from the relevant Community funds that go in the CAP? The EC has a number of preferential agreements with third countries, all allowing for the free circulation of industrial goods in the Community. Will they also circulate freely in Malta?

So far the Community has concluded only one customs union agreement with a third country, which is Cyprus.²² The experience is then very recent and premature to be anything by which to go by.

The Malta Labour Party's proposal for a "Special Relationship" as outlined by the then Prime Minister Mintoff in 1981 is equally unacceptable to the Community. This can be seen from the fact that after launching the proposal, negotiations on the issue with the Commission ran into stalemate for six whole years.

For the "special relationship", Malta had requested that it be given access to the structural funds, that agricultural goods be allowed free entry into the Community as is the case with industrial goods, that the safeguard clause be nullified and that Malta would not be constrained to adopt the common customs tariff.

None of these demands are acceptable to the Community for they amount to the privileges of membership, without the accompanying burdens and duties. The removal of the safeguard clause, access to the structural funds and free circulation of agricultural goods can be had only with membership

²² See [10].

of the Community.

Some milder form of "special relationship" could be the one suggested by Mr Derek Prag²³ whereby Malta would become a member of the EC in all matters but would not have the powers of veto in some of the decisions at the level of European Political Cooperation. This again amounts to a second class membership. Membership should imply full participation in all the Community institutions and a lesser status is in effect an undermining of the very concept of European integration on the basis of equality.

The other alternative could be that of joining the European Free Trade Area (EFTA) and using this organization as a Trojan Horse to enter the Community. EFTA is the EC's biggest trading partner, its members have a free trade agreement with the Community, they cooperate with it in the fields of standards, research and development as well as the environment. Following the Luxembourg Declaration²⁴ the two sides are committed to the creation of the single European Economic Space, characterized by the four freedoms of capital, goods, people and services. However President of the Commission of the European Community, Jacques Delors, said that no matter how far this relationship develops, it will never amount to the same privileges as membership of the Community.

EFTA also happens to be the club of the European neutral countries and may thus appeal to some on the strength of having the closest affinities to Malta.

We must however consider that as a result of the changing situation in Europe and the transformation of the military alliances into political ones, the value of neutrality is changing and in future the European neutrals may not find it at all offensive to join in the project of European Political Union.

Another consideration is the fact that EFTA itself is changing in nature. It has had to establish EFTA organizations so that it could negotiate with the Community with one voice. Its "functionalist" philosophical basis as a model for European union is thus being questioned. Besides, it is clear that the post-war tussle of what Europe should look like when fully integrated, has clearly been won by the federalists.

EFTA's future is bleak from another angle. One of its members, Austria, has applied to join the Community. Norway only just missed the boat in 1972 when the people decided in a referendum by a narrow margin to stay out of

²³ See [18].

²⁴ Luxembourg Declaration between EFTA and EEC, April 9th, 1984, EFTA Press Release 3/84/F.

the Community after successfully completing the negotiations. All the other EFTA countries want to move closer to the EC.

The Approach to Europe

In our approach to Europe we must banish from our minds the thought that membership of the Community is a cure all, that all we have to do is sit it out and our economy moves up the development ladder on its own.

The benefits of membership could easily be squandered by the adoption of the wrong set of domestic policies.

Secondly we have to accept the Community as it is, not only because the formal acceptance by Malta of the *acquis communautaire* is a condition for membership, but because any approach to the Community is of our own free choice. Hence such skirmishes with the EC as the one on the first financial protocol, when we demanded that Community practices should conform to Maltese standards, and not vice versa, have to be avoided.

Thirdly, contractual obligations have to be tightly adhered to. In this regard precedents have been very negative in EEC-Malta relations. In December 1980, the first stage of the Association Agreement had lapsed without agreement on the second stage. The EC continued to renew unilaterally the trade provisions of the agreement, pending the successful outcome of negotiations. In the end it was only in 1988 that agreement was reached to extend it once more to the end of 1990.

The same can be said about Malta's delay in concluding adaptation protocols for its Association agreement, after the entry of Greece, Spain and Portugal in the Community.

When all is said and done, it is only in unity that all Europeans can grow in prosperity and with them their trading partners. But to achieve unity, there must be the political will. And this is where the political and economical considerations finally join hands, for one cannot exist without the other. Malta's place is in a united Europe. Economics dictate it. Politically we have to find a way of achieving it.

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