A Fit-For-Purpose Single Market: Challenges and Recommendations

A document prepared by the Malta Council for Economic and Social Development (MCESD)

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MCESD
MALTA COUNCIL FOR
ECONOMIC & SOCIAL DEVELOPMENT

ABOUT MCESD

The Malta Council for Economic and Social Development (MCESD) is an advisory council that issues opinions and recommendations to the Maltese government on matters of economic and social relevance. In view of this, the MCESD's vision is one of continuous improvement of Social Dialogue. We consistently strive to be the most effective catalyst between the Social Partners and the Government. Our ultimate aim is that, following consultations held within the Council, sound and concrete recommendations about socioeconomic matters will be heeded by the Government prior to any reforms or measures of relevance.

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BACKGROUND

The year 2023 marked the 30th anniversary of the establishment of the Single Market, the brainchild of then-EU Commission President Jacques Delors, whose recent passing renders an additional poignancy to this anniversary. This document captures the perspectives, recommendations and viewpoints of the Malta Council for Economic and Social Development (MCESD) in relation to the Single Market, the extent to which it has contributed towards Malta's economic prosperity since EU accession in 2004 as well as the path ahead, amidst ongoing geopolitical and economic volatility. It has been prepared as part of MCESD's contribution towards the preparation of an EU-wide report on the future of the Single Market, commissioned to Dr. Enrico Letta, with whom official consultations are scheduled to be held in Malta on Monday 8th January 2024.

This document first provides a contextual description of Malta's participation within the Single Market in recent years, before delving into specific challenges, barriers and opportunities faced by the Maltese Islands as part of the Single Market. These issues have been structured around the four freedoms entailed by the Single Market, with additional cross-cutting themes related to energy, digital union and state aid also included given their relevance to the creation of a fit-for-purpose Single Market in years to come.

CONTEXT

Since its accession to the EU in 2004, Malta has actively participated in the Single Market, with several local businesses seeking to exploit the myriad opportunities created while navigating the inevitable challenges brought about by increased competition. Figure 1 shows the evolution of Maltese exports to the rest of the EU over the period 1995 to 2022, expressed as a proportion of total exports. As seen below, Malta's trading relationship with the rest of the EU has always been strong, accounting for 41% of total exports of goods and services in 2004. Since then, this relationship has only solidified, reaching 47% of total exports in 2022, fuelled by an increasingly diversified array of exports comprising not solely traditional goods like semiconductors but also, increasingly, growth in key service-oriented sectors like financial and insurance activities and gaming.

Similarly, the flow of capital between Malta and the rest of the EU has skyrocketed in recent years, further attesting to the country's growing involvement within the Single Market. Specifically, stocks of Foreign Direct Investment (FDI) present within the Maltese economy expanded from 54% of GDP in 2008 to almost 793% of GDP in 2021[1], fuelled by inward investment in financial services, gaming, ICT and professional services, while outward FDI from Malta to other EU member states also increased from just over 11% of GDP in 2008 to 228% in 2021[2]. In addition, labour mobility has increased significantly since EU accession, with the number of EU nationals employed domestically reaching 33,355 in 2022, compared to only 700 workers in 2005, with much of this growth concentrated over the last 10 years due to favourable local economic conditions and buoyant job creation[3]. Therefore, what these headline statistics underscore is the close ties that exist between the Maltese economy and the rest of the EU across each of the four pillars of the EU's Single Market - goods, services, capital and labour - and which have only grown stronger over time.

[1] Eurostat (2023). European Union Direct Investments. Balance of Payments Statistics, Economy and Finance.

[2] Ibid

[3] JobsPlus (2023). Foreign Nationals Employment Trends. Labour Market Information.

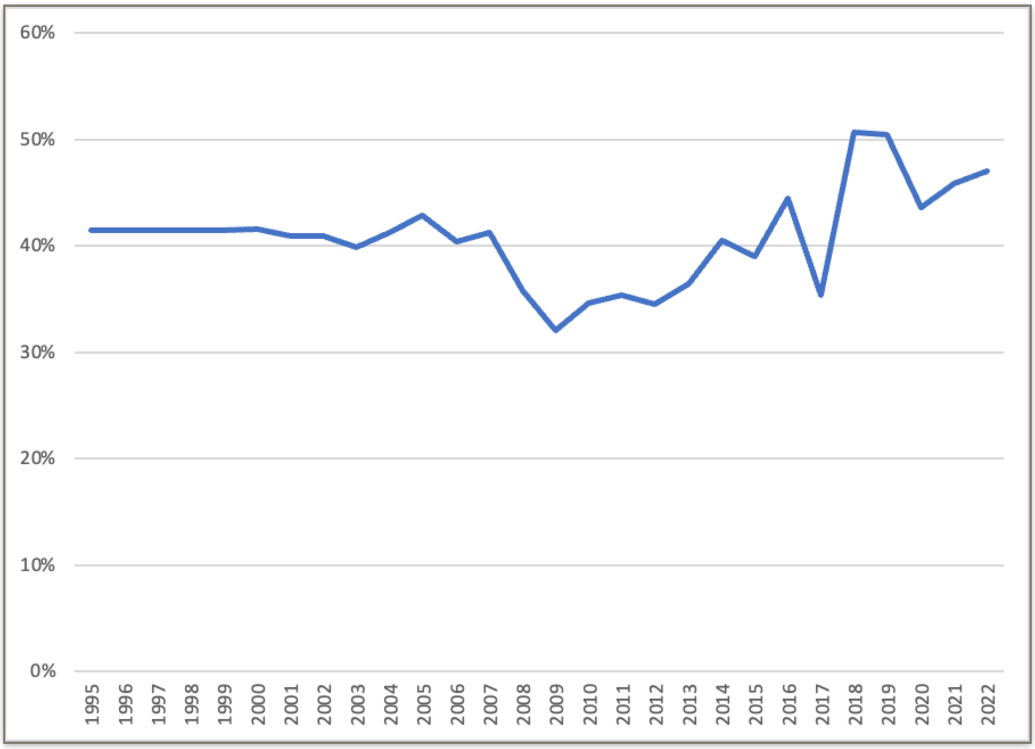


Figure 1: Exports of goods and services to the EU, as a % of GDP (Source: Eurostat, 2023).

ASSESSMENT OF THE SINGLE MARKET

It is amply clear that the Single Market is crucial to the entire European project, as a tool to boost competitiveness and productivity across the bloc while building resilience to economic shocks across individual Member States and boosting living standards. Indeed, several studies have sought to estimate the costs of economic fragmentation within the EU, with one study stating that the benefits of implementing a complete EU Single Market, including public procurement, the digital economy and consumer law, apart from the aforementioned four pillars, at €0.6 - 1.1 trillion per year, equivalent to approximately 5 - 8.6% of EU GDP[4]. Thus, since its inception 30 years ago, it can be argued that the Single Market has emerged as a central feature of the EU's *raison d'être*, driving both its purpose and its long-term objectives, embedded clearly within policy packages like the Green Deal as well as driving centrepiece directives like the Corporate Sustainability Reporting Directive (CSRD).

[4] Pataki (2014). The Cost of Non-Europe in the Single Market. European Parliamentary Research Service.

Therefore, there is no doubt that the Single Market, both from a conceptual and practical perspective, will guide EU strategy and policy for years to come. Indeed, the Single Market envisages a level playing field for EU member states via common rules and standards, to facilitate the flow of people, capital, goods and services across countries which in turn should generate mutual, shared prosperity. Nonetheless, it is imperative to note that the Single Market should not entail a one-size-fits-all approach to rules or policymaking across the EU, but rather a common vision or aim for the EU, with different countries requiring flexibility and a tailored approach to reach these goals, reflecting the diversity of Member States. Otherwise, a one-size-fits-all philosophy may actually go against the precepts of the Single Market and inhibit its development and continued ability to generate wealth and economic growth in an equitable, social manner, exacerbating existing discrepancies across countries and shackling their ability to reach long-term EU goals.

This is the crux of the matter at hand when assessing the Single Market - it must not imply uniformity and rigidity. Indeed, flexibility and nimbleness are key to overcoming existing barriers that have led to fragmentation within the EU, as well as the future development of the Single Market over the next 30 years and beyond. These observations are particularly pertinent for Malta as the EU's smallest Member State; an open, island economy with its own unique set of economic and social realities, opportunities and challenges, having only joined the EU alongside the other so-called New Entrants in 2004, on the periphery of mainland Europe. These issues are exacerbated further in the case of Gozo, given its reliance on maritime transport links with mainland Malta for goods, services and key resources like energy. Although the Maltese Islands fully share the long-term aspirations and goals of the EU in terms of digitalisation and sustainability, and have benefitted from participating in the Single Market, it is evident that their economic characteristics are distinct from those in other EU Member States, meaning that a one-size-fits-all approach would not be well-suited, requiring a more flexible, curated approach at EU level.

In fact, several studies have documented the unique economic challenges faced by small island states relative to larger countries[5], underlining the need for EU institutions to recognise the presence of small states like Malta as key participants within the Single Market, and to envisage a future that fully embraces their presence and contribution without alienating such countries. In fact, the European Parliament adopted a resolution in June 2022 calling for an Islands Pact, which would explicitly assess the unique economic, social and environmental challenges faced by islands in

[5] Briguglio, L. (Ed.). (2016). Small states and the European Union: Economic perspectives. Routledge.

the EU, and devise a strategy around these findings to ensure the full integration of islands in the European project.

The following subsections will document the various challenges and barriers to the Single Market identified by the MCESD as priority areas for Malta, based on an in-depth analysis of the current economic landscape within the country as well as extensive consultations with council members and other key stakeholders.

GOODS AND SERVICES

As a small, open economy fully integrated into the Single Market, Malta is heavily reliant on imports of goods from the EU both for domestic consumption as well as other economic activity like food services and manufacturing. In fact, 32% of total imports of goods and services emanated from the EU in 2022[6]. Imported goods into Malta already incur significant additional costs due to the country's island status, since all goods must either be shipped in or flown in given the lack of road linkages. Therefore, transportation of goods represents a key issue for the Maltese economy, impacting both consumer prices for everyday goods but also the overall competitiveness of several key industries.

Transportation

Predictably, recent directives and measures introduced at EU level have generated significant consternation locally, and reflect the fallacy of one-size-fits-all. For example, the EU's Mobility Package 1 related to the posting of drivers, launched in 2020 in the midst of the COVID-19 pandemic, has been heavily criticised locally and indeed in other countries due to their potential impact on the environment and transportation costs, particularly the requirement that heavy goods vehicles registered in Malta must be driven back to the country every eight weeks. Such rules neglect the geographical realities of islands like Malta, where products sold locally are transported through a lengthy and complex transport chain before they are delivered to the consumer, and are thus heavily reliant on the smooth operation of the

[6] Eurostat (2023). International trade of goods and services. Balance of Payments Statistics, Economy and Finance.

international road haulage sector. Indeed, the Maltese government launched a formal legal challenge to the package, with the Advocate General within the European Court of Justice recently (November 2023) publishing an opinion to annul the 'return of vehicle' rule[7]. Such contradictory policies do little to promote the development and integration of the Single Market, particularly since they seemingly go against the goals set out in the Green Deal by promoting heavier traffic and thus higher transport emissions, while disproportionately impacting peripheral countries like Malta and local road haulage companies, eroding the entire economy's competitiveness due to punitively higher transportation costs.

In a similar vein, the extension of the EU's flagship Emissions Trading Scheme (ETS) to incorporate maritime transport as from January 2024 will have a disproportionately negative effect on island states like Malta. From the onset, there is no question that there is a pressing need to address climate change and the decarbonisation of the maritime sector. Nonetheless, this policy threatens to derail Malta's entire transhipment industry by effectively placing it at a significant competitive disadvantage relative to other neighbouring non-EU ports who would not fall under

[7] https://www.maltatoday.com.mt/news/national/126034/government_welcomes_ecj_ags_opinion_on_return_of_vehicle_rule_in_eu_mobility_package#.ZZLmUOzML9s

the ETS, given that participation in the ETS is expected to result in a cost differential between EU and non-EU ports of around €34 million per year per route served[8]. Transhipment is a cornerstone of the Maltese economy, linking the country to over 160 ports worldwide and providing significant logistical benefits that belie the country's size, including swift transit times which are crucial for the manufacturing sector, among many others. These additional costs may dissuade large carriers from using Malta as a transhipment hub, instead opting for cheaper alternatives nearby, diverting trade outside the EU to non-EU ports in the process.

Thus, apart from directly impacting the local port and transhipment industry, this will mean that local businesses will face 20-25% higher potential freight costs, longer transit times by as much as 8-10 days and possible issues related to reliability of service, should carriers tranship to neighbouring non-EU ports[9]. The numbers are stark - the cost of shipping a single container to Malta from Genoa is expected to rise by €100[10], while Malta Freeport Terminals stand to lose €138.8 million per year from business diverted to non-EU ports as a result of the ETS scheme[11]. In addition, it is likely that this Directive will result in higher overall global greenhouse gas emissions since carriers would have to reroute to other non-EU ports instead of using EU-based Mediterranean ports like Malta.

Once again, this is a clear case of a policy within the framework of the Single Market that, while commendable in scope, neglects the idiosyncrasies of a small island state like Malta since it threatens to permanently destroy a key economic sector with secondary, deleterious impacts on the rest of the Maltese economy due to higher transportation costs, while also potentially increasing global carbon emissions. Such blanket interventions, despite the urgency of climate action, are somewhat premature considering that the rest of the world has not sought to implement similar measures, thus only serving to erode the EU's external competitiveness while contradicting the EU's stated aim of a *just* green transition that leaves no one behind. Moreover, the introduction of such a significant emissions charge ignores somewhat the current state of technological advancement within the transhipment sector, and should have been accompanied by a reasonable transitory period to allow for carriers to adjust

[8] https://mmf.org.mt/eu-shipping-tax-puts-malta-in-imminent-risk-of-losing-role-as-transhipment-hub-mmf/

[9] https://mmf.org.mt/urgent-implementation-rethink-required-to-ensure-achievement-of-the-commendable-objectives-of-eu-ets-shipping/

[10] https://www.maltabusiness.it/en/malta-maritime-sectors-new-taxes/

[11] Xerri, G., et al (2023). Immediate risks to the Maltese maritime industry & the wider economy pursuant to the EU ETS Directive transhipment rule. Malta Maritime Forum.

accordingly, coupled with significant sectoral support to invest in greener technologies.

Finally, it is essential to look ahead at looming policy interventions that may also hamper Malta's ability to actively and fairly participate in the Single Market. Chief among these is the long-gestating aviation fuel tax under the proposed energy Tax Directive, which is also intended to be a key policy lever in the pursuance of the EU's Green Deal objectives. Once again, the intention behind this policy is unimpeachable given the high reliance on fossil fuels within the aviation sector, and hence its significant contribution to global climate change. However, this tax would once again disproportionately impact small island states like Malta given its geographical realities and lack of road connections to mainland Europe.

In particular, the proposed aviation fuel tax would have significant ramifications for the country's tourism industry, which accounts for approximately 15% of overall economic activity[12], with significant spillover impacts. Indeed, a quantitative assessment of the likely economic impacts from the introduction of an aviation fuel tax in Malta reports that this policy would result in an annual decrease of 0.1 - 0.2% in the country's GDP by 2050, with tourist numbers projected to fall by up to 10% and cargo costs also expected to rise by around 3.3%, quite apart from the rise in airline ticket prices by an average of around €60 per ticket[13]. Thus, for a country so highly dependent on air travel for its economic wellbeing, the imposition of an aviation fuel tax without regard for these realities would have significant implications for the Maltese economy, particularly the tourism industry which has only just recovered from the hammer blow imposed by the COVID-19 pandemic and ensuing travel restrictions.

[12] http://www3.weforum.org/docs/WEF_TTCR_2017_web_0401.pdf

[13] Neiva, R. Et al. (2019). Study on the taxation of the air transport sector. Ricardo report for DG TAXUD.

Market Access and Free Trade

In some cases, limited market access has little to do with poor transportation links, and are more related to the size of the domestic economy. This is the current situation that Malta is facing in relation to perhaps the single most important imported good - medicines. A recent report highlighted how Malta has the lowest level of access to new innovative medicines within the EU, with cancer drugs being particularly scarce[14]. This largely stems from the country's size, which limits its attractiveness to several pharmaceutical companies, who consider the local market to be too small. The European Commission has recognised this issue, and in April 2023 proposed a revision to pharmaceutical legislation to make medicines more accessible, available and affordable across member states, effectively creating a Single Market for medicines to ensure that all patients across the EU have timely and equitable access to medicines.

The issue of market access also leads to a broader discussion regarding free trade across the EU. It is important to learn the lessons from the disruption brought in the

[14] https://www.efpia.eu/media/677291/european-access-hurdles-portal-efpia-cra-report-200423-final.pdf

free movement of goods by the global pandemic and draw up a policy framework to address similar situations in the future. The Single Market Emergency Instrument (SMEI) has been designed to specifically address that through the creation of a list of goods and services of strategic importance to be prioritised as well as monitoring actions to ensure their supply. This framework is designed for extraordinary situations; it is clear on the criteria that would stipulate its application and should not create disproportional burdens to stakeholders such as businesses in its implementation. The sensitive nature of the instrument is evident, and businesses should be assisted as they may not have the necessary resources to fully comply. Nonetheless, businesses, and their representatives, should be given a greater voice within the advisory group that will be established by the European Commission. This is an important element for SMEI to provide direct input on the impact of the crisis.

Financial Services

The Single Market, as mentioned earlier, touches upon every single facet of the Maltese economy. One sector that has benefitted most in terms of its access to the various opportunities presented by the Single Market is Malta's financial services sector. Since the early 2000s this sector has gone from strength to strength with an increasingly international outlook, and today accounts for around 8.8% of Malta's annual Gross Value Added (GVA)[15], as well as over 85% of inward FDI into the country[16]. Nonetheless, since the 2008 global financial crisis, the regulatory burdens imposed on financial services operators globally, and particularly within the EU, have grown exponentially. A recent study on the compliance costs across different EU financial legislation estimated the total one-off costs to be equal to €55.6 million for banks and conglomerates and €151 million for investment banks, with ongoing costs expected to reach €42.8 million and €128 million respectively[17]. EU-wide directives like the Markets in Financial Instruments Directive (MiFID II), as well as the 4th Anti-Money Laundering Directive, entailed significant investment in compliance personnel, risk management, technology and training.

[15] NSO (2023) Gross Domestic Product, 2022.

[16] NSO (2023). Direct Investment in Malta and Abroad: January-June 2022

[17] ICF, Centre for European Policy Studies (2019). A study on the costs of compliance for the financial sector. FISMA.

The Maltese financial services sector, as well as government, are committed towards good governance and best practices within the financial services sector, as attested by the speed with which the country was removed from the Financial Action Task Force (FATF)'s grey list of jurisdictions. However, it is also true that such directives, as well as the frequency, scope and complexity of new updates, have created notable compliance costs for Maltese financial services operators, with the burden being particularly heavy for the multitude of SMEs operating within this sector, which collectively account for over 15.7% of all SMEs in existence within the Maltese Islands[18]. Such regulatory burdens may act as a barrier to new innovative entrants into the market within FinTech and other emerging segments, and may even tie up resources that would have been better deployed in more productive uses. It is also worth noting that these rules, particularly those in relation to anti-money laundering and Know Your Customer (KYC) have significant direct and trickle-down effects on other important economic sectors like professional services, real estate and gaming. Thus, it is incumbent upon the Commission to ensure that new rules and standards are introduced in an efficient manner with as little red tape as possible, cognisant of these compliance costs across the financial sector and beyond.

[18] Grech, A.G. (2018). SMEs' contribution to the Maltese economy and future prospects. Central Bank of Malta Policy Note, October 2018.

On the flip side, there is a sense that while the EU has been overzealous in its approach to regulating certain aspects of the financial sector, it has been reactive and ponderous in its approach to regulating new emerging sectors like crypto assets, decentralised finance (DeFi) and the broader topic of digital finance. This lacuna has recently been addressed somewhat with the Digital Finance Package and the Markets in Crypto Assets Regulation (MiCA). In the latter case, several member states including Malta have long had regulatory frameworks in place to account for crypto assets and their increased prevalence across investment markets, and the EU's reactivity has to some extent contributed to greater fragmentation across member states in relation to the treatment of such assets.

Matters are perhaps even more pressing when it comes to DeFi, with a recent working paper by the European Central Bank (ECB) arguing that technology in this field has outpaced regulation[19], with the European Securities and Markets Authority (ESMA) cautioning that despite being in its infancy, DeFi poses serious risks to investor protection due to the highly speculative nature of many DeFi arrangements, coupled with important operational and security vulnerabilities, and the lack of a clearly identified responsible party[20]. The Digital Finance Package is broader, and can be seen as the EU's somewhat belated attempt at leveraging the growing influence and processing power of the latest digital technologies to tackle existing fragmentation in the Digital Single Market for financial services by enabling European cross-border consumer access (via digital identity solutions) and assisting European financial firms to scale up their digital operations.

Gaming

Over the last 15 years, the gaming sector in Malta has evolved from a burgeoning new niche to a pillar of the economy, supporting thousands of high skilled jobs and attracting major global companies to set up shop locally. Today, the sector accounts for approximately 9.5% of Malta's GVA[21], with several induced impacts on other sectors like legal and accounting services and real estate.

[19] https://www.ecb.europa.eu/pub/financial-stability/macroprudential-bulletin/focus/2022/html/ecb.mpbu202207_focus1.en.html

[20] Chone, A. (2023). Decentralised Finance in the EU: Developments and risks. ESMA TRV Risk Analysis.

[21] Malta Gaming Authority (2023). Interim Report 2023.

The general expansion of the gaming industry has also been in line with trends in other countries like Germany, Sweden and Austria, creating a highly competitive, technology driven European industry, one of the largest and most sophisticated globally. The numbers speak for themselves - in 2022, the online gambling sector generated €38.2 billion in revenue in Europe, an 8% year on year growth, and is projected to reach €54.3 billion by 2027[22]. However, despite its obvious emergence and growth potential, there is no single, EU wide policy package or standard with regards to the licensing of gaming companies across member states.

As a result, the gaming industry within the EU is characterised by fragmentation, unilateral licensing regimes and in many instances protectionist policies. Malta in particular has borne the brunt of such tactics by other larger member states, creating a disproportionately one-sided situation that acts as a notable barrier to the development of the Maltese gaming sector. Therefore, in this case the Single Market is conspicuous by its blatant absence. A coordinated, unified approach to licensing within the European gaming industry would significantly alleviate matters, not only for Malta but for the entire industry, promoting fair internal competition and market access while boosting efficiency and ultimately external competitiveness. Furthermore, a strong EU-wide licensing system would result in a safer and stronger gaming industry and work towards the removal of the many illegal operators which continue to put consumers at risk. The current system of national licensing is failing in this regard.

In the context of the online gambling sector, it is important to note that the unit within the EU Commission (under the DG for Internal Market), that used to monitor and assess the functioning of Single Market principles, and which assessed how ECJ rulings in this sector were applied by the Member States, was disbanded a few years ago. It is clear that such a unit should be reinstated, in order to allow the Commission to have the necessary oversight in ensuring that its Treaty Guardianship role can be effectively fulfilled, while providing it with market intelligence, and concurrently to reinstate a forum whereby Member States can discuss upcoming technical and regulatory matters that may affect the functioning of the Single Market. The absence of such a unit has resulted in the imposition by a few Member States of unjustified restrictions to the functioning of the Single Market for regulated Business to Business (B2B) gambling operators through a mandatory, jurisdiction based license requirement. Thus, the re-establishment of the online gambling unit would serve to

[22] https://www.egba.eu/eu-market/

reinforce the importance of the EU Treaty in the context of the online gambling industry, particularly for the B2B sector.

Manufacturing

The manufacturing sector in Malta has undergone something of a metamorphosis since EU accession, with the lifting of trade barriers having a significant impact on domestic manufacturing activities, resulting in a period of relative stagnation. Over the last decade, however, the sector has bounced back, buoyed by new domestic and foreign investment and a shift towards higher value-added production, which has boosted sectoral research and development and productivity[23]. Many of the key challenges cited earlier for transportation have a direct impact on manufacturing by increasing operators' costs, which threatens to derail the sector's competitiveness.

However, beyond these issues, there is also a broader discussion that must place with regards to European manufacturing as a whole, and the pressing need for a new European Industrial Policy, which would serve as a blueprint to reclaim the EU's manufacturing potency within the global economy. In light of recent global supply chain issues that have been exposed following both the COVID-19 pandemic and the Russian aggression in the Ukraine, as well as growing demands for greener manufacturing, the need for bold action in this regard could not be any more apparent.

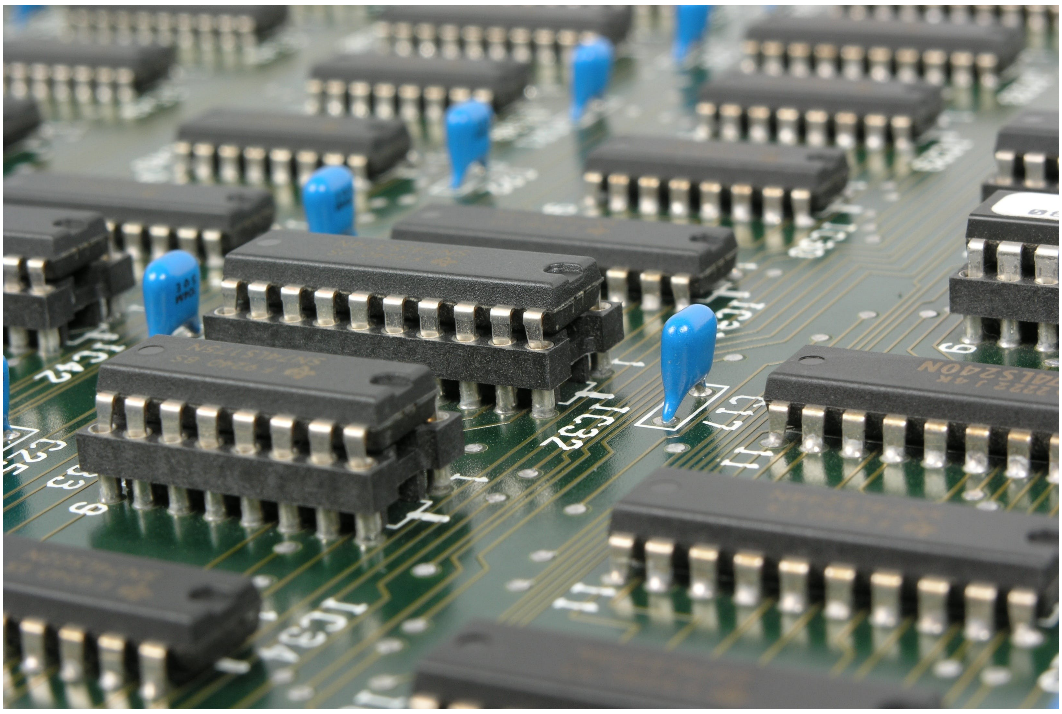
Indeed, the first inclinations towards such a bold policy have already been evidenced by the European Chips Act[24], which seeks to reinforce the semiconductor ecosystem in the EU, ensure the resilience of supply chains and reduce external dependencies. One of Malta's leading manufacturing companies, ST Microelectronics, has in fact already benefitted from this approach, to the tune of in excess of €20 million in approved state aid to upgrade its production lines and invest in R&D and automation[25]. Similarly, the Critical Raw Materials Act is also a strong step in the right direction, given the importance of these materials across various sectors of European

[23] MCESD (2023). National Productivity Board Report 2022.

[24] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2023.229.01.0001.01.ENG

[25] https://timesofmalta.com/articles/view/stmicroelectronics-get-injection-euapproved-state-aid.1036511

manufacturing, as well as their central role in the digital and green transition, coupled with existing supply chain disruption risks due to the EU's heavy reliance on imported materials.



However, there is a sense that the European manufacturing industry is already at a competitive disadvantage relative to the rest of the world, notably the U.S., South Korea and Japan. These result from a variety of factors, including excessive bureaucratic measures for manufacturers stemming from the steady stream of new rules or standards, skills shortages, less attractive incentive packages relative to other territories (e.g., the U.S.'s Inflation Reduction Act), laggard innovation performance in emerging technologies, high energy prices and, as mentioned earlier, heavy reliance on imported critical raw materials.

Thus, a European Industrial Policy must address all of these issues in a holistic, coordinated manner, supporting innovative industries as well as legacy sectors in their transition towards a greener, digital future. Otherwise, a fragmented approach to improving manufacturing competitiveness will persist, since apart from the fiscal implications of such spending, the issue of State Aid could rear its head and the disproportionate spending capabilities of larger member states relative to small countries like Malta, which would create internal competitiveness and fairness issues; once again highlighting the need for a European Industrial Policy.

Box 1 - Key Insights Relevant to Goods and Services

- Malta's geographical realities pose significant challenges for the transportation of goods.
- ETS for the maritime sector will increase freight charges locally by 20-25%, create additional 8-10 day delays in shipments and divert trade away from the EU (€138.8 million per year in Malta alone).
- An aviation fuel tax would result in a €60 increase per airline ticket, with an annual decrease of 0.1 - 0.2% in Malta's GDP by 2050.
- The EU must immediately tackle disparities in market access, notably Malta's low access to medicines.
- Compliance costs within financial services have risen drastically due to growing regulatory requirements, while the EU has been slow to react to new developments like crypto assets and decentralised finance.
- Licensing for gaming companies in Europe is highly fragmented, leading to unilateral restrictions which hinder the sector's overall growth and competitiveness.
- A European Industrial Policy is required to overcome various challenges that hinder the development of the EU's manufacturing sector.

PEOPLE

Workers and ordinary citizens are the lifeblood of the European Single Market. Thus, any attempts at cultivating the Single Market over the coming years must ensure that the protection of workers' rights remains sacrosanct, backed up by robust institutions and active social dialogue, without ignoring the need for flexibility in labour markets across the EU given rising difficulties and costs involved in recruitment.

Labour Markets

Amidst calls to assess newly proposed directives or rules via a competitiveness test, it is imperative that this does not come at the expense of individual workers or social goals. Such considerations must not be taken for granted. The Single Market must not be considered in isolation, but must relate to a strong social dimension, based on a robust common set of rules to ensure fairness. The Single Market should guarantee social progress, quality jobs and upward social and wage convergence and promote collective bargaining and social dialogue while raising living standards for all, in pursuance of the European Pillar of Social Rights.

Among the various instruments at its disposal, the Single Market must strive for a uniform, ambitious transposition of the Directive on Adequate Minimum Wages, and of the Directive on Gender Pay Transparency, with stronger action at EU level required to eliminate the gender pay gap. Furthermore, the future Single Market should guarantee the right to all access to high quality training without costs for workers, during working time. It is also of paramount importance to ensure robust social protection systems; universal, effective and adequate, able to provide a decent standard of living for people encountering social risks such as old age, sickness, disability and unemployment. Moreover, it is essential that the Single Market ensures the full respect of social dialogue and workers' rights, including the universal right to organise, union access to workplaces, the right to bargain collectively, and the right to strike.

Skills Mobility

Although labour mobility is one of the key pillars of the Single Market, various obstacles still exist which hinder the free movement of workers across member states[26]. One important obstacle is the cross-country recognition of skills, training and qualifications. This is a notable barrier, which limits the efficiency of the Single Market to deploy human resources in more productive uses, thus hindering overall competitiveness and creating unnecessary labour market frictions.

Perhaps it is time to revisit the proposal made by Mario Monti in his seminal report on the Single Market, wherein a recommendation was put forward to reform the systems

[26] https://www.eurofound.europa.eu/en/labour-mobility-eu-recent-trends-and-policies

for the recognition of professional qualifications in order to facilitate the mobility of workers and adapt training to current labour market requirements, raising the possibility of introducing a European professional card[27]. Since then, this proposal to enable workers' qualifications to be recognised across the EU was only introduced for six professions in 2016, including nursing and mountain guides. The time is ripe to reassess the merits of this proposal and expand the scope of the EU professional card to include other professions, particularly in those sectors that are critical to the green and digital transformation of the European economy. This would not only benefit EU workers seeking new avenues for employment, but would also assist in attracting talented TCN workers to the EU, since they would be assured that any skills or qualifications obtained in one member state would also be recognised elsewhere within the EU, thus expanding their potential employment prospects.

[27] Monti, M. (2010). Towards a Single Market Act: For a highly competitive social market economy. COM (2010) 608.

Brain Drain

The inclusion of concerns related to brain drain may at a glance seem contradictory given the previous point on skills mobility and the fact that free movement of labour is a key feature of the Single Market. Nonetheless, brain drain and the loss of domestic talent is a growing concern across several EU member states, including Italy, Romania and Portugal[28], especially in light of global labour shortages in several high-skilled fields and the costly nature of free education to government coffers. This issue could be a serious barrier to growth and competitiveness, particularly in a small economy like Malta which already has a limited pool of talent, meaning that any outward movement of talent has an immediate impact on the labour market and the economy in general.

The issue of brain drain is extremely complex, touching upon economic, social and institutional factors. A well-functioning Single Market should naturally include labour mobility across countries, but crucially should also allow citizens the freedom of choice in terms of staying versus leaving the country, with domestic opportunities and work/life pursuits comparable to those in other EU member states. Hence, the issue of brain drain ultimately relates to economic and social disparities across countries, and over the coming years a concerted effort is required to reduce these discrepancies. The EU Cohesion Fund is one such tool that could be used to alleviate economic and social conditions in vulnerable regions. Other potential actions include understanding the needs and profile of skilled workers, creating mechanisms for cooperation between government, businesses and universities, and removing structural barriers which inhibit the country's attractiveness to international talent[29].

Box 2 - Key Insights Relevant to People

- Single Market must be rooted in protection of workers' rights and social dialogue.
- Cross-country recognition of skills is a must, aided by the widening of EU professional skills cards.
- Brain drain is a significant issue across the EU - the Single Market must tackle economic and social disparities.

[28] https://aer.eu/brain-drain/

[29] https://cor.europa.eu/en/engage/studies/Documents/addressing-brain-drain/addressing-brain-drain.pdf

CAPITAL

Despite the present challenging global geopolitical and economic environment, banks have continued to show remarkable resilience and play a major role as a source of finance. Thanks to a sound capital and liquidity base, as well as a strong risk culture, European banks are continuing to contribute to the European economy by supporting their clients and financing businesses and households – as even the worst times of the pandemic demonstrated.

However, recent crises have also highlighted Europe's vulnerabilities in defence, security, energy, and supply chains, accelerating its competitive decline against regions like the US and Asia. This is a very important source of concern as competitiveness fosters growth, indispensable for the well-being of Europe and its citizens. It is also essential for servicing the debt of states and companies, financing the green transition, investing in digital innovation and (cyber)security, and supporting an aging population. These require trillions of Euro a year and will be paramount for Europe's continued prosperity and strategic sovereignty in the coming decades.

Currently, banks in Europe are the primary source of investment funding. In this context, it is obviously essential not to limit the banks' financing capabilities, especially through disproportionate regulatory and capital constraints. On the contrary, it is necessary to support the development of a robust, resilient, profitable and competitive banking sector within a dramatically changing environment. It is crucial for the progress of Europe because banks will continue to finance the lion's share at least for the next years to come.

But banks alone will not be able to finance all the needs, nor will governments, especially considering their state of indebtedness - a more significant portion needs to come from private capital. Consequently, Europe must create conditions to attract long-term private capital to a much greater extent. Unfortunately, the figures tend to show that the EU's share of global capital markets activity has nearly halved over the past fifteen years - despite the political will to advance the Capital Markets Union - and is significantly smaller than its share of global GDP[30]. To retain and restore its competitiveness, Europe needs to boost its financing capabilities while, in a world increasingly marked by conflict and the formation of blocs, focusing on financial autonomy. While remaining open to third countries, Europe needs to continue

[30] https://www.consilium.europa.eu/en/policies/future-of-eu-capital-markets/

developing its financial sector, including a capable and effective banking industry and a significant deepening of capital markets backed by a more flexible and future-proof regulatory framework. Failing to do so, Europe risks not being able to finance its sustainable transformation and keep up with technological advancement.

The European securitisation market must also be strengthened, since it is a simple instrument for facilitating more lending - even to companies that do not have access to the capital market. The volume of securitisation is growing significantly in many regions but not in the EU, leaving considerable potential untapped here. The reasons for this are various: the regulatory framework is far too complicated; the processes take too long and are too expensive. To establish a Capital Markets Union, several critical reforms to remove cross-border obstacles remain to be launched or completed, making it important to build consensus around a prioritisation and sequencing of the next-generation reforms.

A deeper, stronger Capital Markets Union will undoubtedly create several new opportunities for Malta, particularly given both its size limitations as well as the limited activity of domestic equity markets. Indeed, access to a fully-functioning, integrated European capital market would unlock new sources of finance for promising innovative start-ups, business expansions, FDI, as well as new investment in green and digital technologies, all of which are leading priorities for the local economy in line with the rest of the EU. A streamlined capital markets union would also assist in boosting investment in R&D and innovation in Malta, with a recent study highlighting a lack of available financing options as a key barrier to the uptake of innovative projects within the private sector, and which would assist in bridging the research divide that currently exists between Malta and the rest of the EU[31].

Furthermore, this would also provide Maltese savers and investors with new investment opportunities within the EU, thus enabling them to diversify away from typical local investments which usual comprise of immovable property and government bonds, with recent data pointing towards some €24 billion held in local bank deposits[32]. Indeed, this unlocking of dormant capital across Europe could propel the EU's economy forward in terms of its digital and green ambitions towards a more innovative, research-driven path, a boost that is long overdue since the EU is currently lagging behind the rest of the world, notably the U.S. and China, when it comes to innovative technologies like genomics, AI and quantum computing[33].

Box 3- Key Insights Relevant to Capital

- A well-functioning capital union is key to unlocking finance for innovative projects as well as the EU's green and digital transformation.
- Capital union would also provide new investment opportunities for savers and investors alike, especially in small countries like Malta.

[31] MCESD (2023). National Productivity Board Report 2022.

[32] https://www.maltabankers.org/banks-continue-to-support-the-financing-of-the-maltese-economy/

[33] https://www.mckinsey.com/~/media/mckinsey/featured%20insights/innovation/reviving%20innovation%20in%20europe/mgi-innovation-in-europe-discussion-paper-oct2019-vf.ashx

ENERGY

The need for a coordinated, streamlined Single Market for energy across the EU has assumed even greater relevancy over the last few years in light of the significant impact of the conflict in the Ukraine on both the availability of energy as well as prices across Europe. Strengthening the Single Market for energy is also crucial to successfully address the EU's long-term decarbonisation goals as part of the Green Deal. The current fragmentation and country-by-country approach on support schemes (e.g., for biofuels or hydrogen[34]), including unprecedented state aid expenditure in certain member states, threaten the overall EU cohesiveness and the implementation of cleaner, greener energy across the bloc.

By contrast, a true Energy Union would yield significant benefits to the EU as a whole, including improved energy independence and lower electricity costs, which in turn would boost internal economic activity and elevate competitiveness levels. A coordinated Energy Union would also enable the EU to benefit from higher economies of scale in relation to the generation of green energy like hydrogen by pooling together expertise, resources and capacity, further accelerating the EU's decarbonisation and leading to a greater proliferation of clean energy, while minimising potential negative side-effects from this transition like temporarily higher energy costs. Needless to say, a small country like Malta would benefit immensely from such a union, given its limited market size and scope for economies of scale which inhibit the development and deployment of new green energy technologies.

Box 4- Key Insights Relevant to Energy

- A Single Energy Market would help combat rising energy prices and reduce exposure to geopolitical volatility.
- Energy union would also hasten the decarbonisation of the sector across the EU via greater economies of scale.

[34] https://www.politico.eu/article/olaf-scholz-germany-ukraine-gaps-eu-single-market-plugged-economy/

DIGITAL UNION AND DATA

The increasingly digitised world that we inhabit has invariably shone a light on the need for the Single Market to incorporate digital technologies and, in fact, leverage their capabilities to further promote unification. Indeed, the Digital Single Market has long been discussed and promoted by the EU, with the launch of the EU's Digital Strategy further placing it on the European agenda. A digital union would encompass much more than simply enhanced e-commerce trade across member states, but rather would include the development of high-speed digital networks and infrastructure, the proliferation of AI, and the creation of digital value chains that span the length and breadth of the EU, among other activities. The economic potential of this union are massive - in fact, estimates suggest that the removal of existing barriers to a digital union would generate an additional €415 billion in GDP across the EU[35].

Another exciting avenue for growth that could be unleashed as part of the Single Digital Market the development of an EU-wide data economy wherein data collected from businesses across different member states can be bought and sold in a secure manner that protects personal data, with businesses increasingly relying on Big Data and the Internet of Things (IoT) to tailor product and promotional offerings to specific demographics and discerning clients. Indeed, this new economy is the subject of the recently-announced Data Act which aims to boost the EU's data economy by unlocking industrial data, optimising its accessibility and use, and fostering a competitive and reliable European cloud market. Once again, the potential benefits are huge, from improved market intelligence and competitiveness to higher innovation, with the European Commission estimating that data sharing could generate €1 trillion by 2030[36].

The EU is in a uniquely privileged position to be able to benefit from the data economy via the Single Market, with the collection, storage and processing of data already governed by the General Data Protection Regulation (GDPR), which not only helps to protect personal data, but in effect creates a common standard for data collection which in turn facilitates the sharing of data in a secure manner, cultivating a greater sense of trust. Within this context, the Digital Union would create significant

[35] https://www.businesseurope.eu/policies/digital-economy/eu-digital-single-market

[36] https://digital-strategy.ec.europa.eu/en/library/results-new-european-data-market-study-2021-2023

opportunities for Maltese businesses, by expanding their potential pool of customers, enhancing export opportunities within the sphere of digital services, increasing the potential for collaborations with other value chain partners across the EU, and in participating in the data economy. In other words, a Digital Single Market is viewed extremely positively in Malta, especially in view of the fact that it is an area which is not impacted by the country's geographical peripheral position and indeed allows local businesses to reap the potential of the EU Single Market.

Two important considerations are worth noting in relation to the Digital Union, and which must be prioritised as this union deepens. The first relates to the concept of digital sovereignty, which relates to the extent to which the EU can act independently and autonomously in the digital sphere, amidst growing concerns over the economic and social influence of non-EU technology companies, which threatens EU citizens' control over their personal data, and constrains both the growth of EU high-technology companies and the ability of national and EU rule-makers to enforce their laws. The second, related point concerns cyber security, which is an immense potential concern for individuals, businesses and countries alike. Once again, a joint effort is required at EU level to tackle cyber security, as envisaged in the EU's Cyber Security Strategy, with particular assistance afforded to smaller member states who may be more vulnerable to cyber attacks.

Box 5- Key Insights Relevant to the Digital Union

- A well-functioning capital union is key to unlocking finance for innovative projects as well as the EU's green and digital transformation.
- Capital union would also provide new investment opportunities for savers and investors alike, especially in small countries like Malta.

STATE AID

The issue of state aid, which was already alluded to earlier, merits its own separate section given the enormous implications that it has for the functioning of the Single Market. EU state aid rules should be rethought to promote the international competitiveness of the EU and to ensure that peripheral locations that are disadvantaged in accessing the Single Market are adequately supported to be able to do so at par with mainland locations. At present, however, the state aid landscape across the EU directly contradicts these aims, distorting competition which is a basic prerequisite for the Single Market to function properly.

In the wake of the COVID-19 pandemic, state aid rules were understandably relaxed, with state aid shooting up from €135 billion in 2019 to €320 billion in 2020[37] as countries grappled with the economic, social and health impacts of the pandemic and ensuing containment measures. However, the issue is that as the pandemic dissipated, state aid spending across the EU has remained at an all time high, creating a highly distorted situation since larger economies are able to afford significantly higher state subsidies relative to smaller countries like Malta. By way of example, in 2022 around €356 billion of state aid were approved for Germany alone, accounting for 53% of all state aid approved within the EU, with another €162 billion approved for France (24% of the total)[38]. This unprecedented leap in state aid comes on the back of the Commission's decision to tweak state aid rules in March 2022 to account for the economic fallout from Russia's war in Ukraine. It is not just a question of absolute amounts either - Germany's state aid expenditure for 2022 is equivalent to almost 10%

[37] https://competition-policy.ec.europa.eu/system/files/2022-09/state_aid_scoreboard_note_2021.pdf

[38] www.politico.eu/wp-content/uploads/2023/01/16/Letter_EVP_Vestager_to_Ministers__Economic_and_Financial_Affairs_Council__Competitiveness_Council_aressv398731.pdf

of their annual GDP, whereas Malta's approved expenditure is approximately 0.75% of GDP[39]. Unless state aid rules are tightened, it is clear that many member states will continue to indulge in widespread state aid spending to prop up their flagging economic fortunes, further distorting free competition within the EU and effectively destroying the Single Market.

Another important consideration on state aid relates to the disbursement of EU funds for projects. Maltese enterprises are disproportionately impacted by the EU's State Aid regulations, which govern the extent to which Member States can grant financial support to individual beneficiaries due to potential market distortions and uncompetitive practices. This is given the predominance of micro and small enterprises domestically and the size of the local market, which is not conducive to economies of scale. In fact, in October 2022 the European Commission adopted a revised State Aid framework for research, development and innovation, including revisions to the definition of RDI activities and enabling public support for experimentation and testing of new technologies that facilitate the digital and green transformation. It also simplified certain rules to alleviate administrative burdens on grant holders. Similarly, in November 2022 the Commission launched a consultation on a proposed revision to the *de minimis* regulations which would raise the ceiling for the total amount granted by a Member State to a single beneficiary over a three-year period, amidst growing inflationary pressures. In fact, the new *de minimis* regulations increased the threshold for aid from €200,000 to €300,000 over a period of three years, with the threshold for *de minimis* aid for Services of General Economic Interest rising from €500,000 to €750,000. Nonetheless, the maximum aid intensities for co-financing RDI projects have been maintained, and these may pose issues for SMEs with limited access to external sources of funding or cashflow.

Box 6- Key Insights Relevant to State Aid

- State aid constitutes a significant threat to the Single Market, with state subsidies from large countries far outstripping those approved for small countries like Malta.
- Rules related to *de minimis* thresholds impact small economies like Malta more acutely due to the absence of economies of scale and predominance of micro enterprises.

[39] https://www.eliamep.gr/en/publication/in-focus

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