

ISLAND MENTALITY

Malta has experienced 30% growth in its financial sector for the last four years, since it joined the EU in 2004. **Tonio Fenech**, minister of finance for the economy and investment, speaks to Michael Jones about the republic's enticing blend of offshore fiscal policy and EU regulation.

Future Banking It has been an extraordinary past few months for the financial sector. How has it affected the market in Malta?

Tonio Fenech We are a small, open economy, very much dependent on external demand. We can support more industry but the international situation will mean less demand for manufacturing products for some time. So we are taking measures to support business but there is a limit to what we can do. We are upgrading our economy and infrastructure. This will create activity that would be less forthcoming from the private sector in a world recession. We have aimed for a budget that will create a strong long term environment and in the short term spending by the government will have a positive impact on the economy.

- Malta's financial sector is growing at a rate of 30% annually and is predicted to grow 2% in 2009, even in a downturn.

FB What steps can you take to improve the situation?

TF We need to instill confidence back into economies because of the impact of the collapse of the financial markets and the impact that this is having on stock markets and on every-day life. We have the necessary flexibility to address our economy and to keep our country moving. Even within the economic downturn that is being felt in the world, the European Commission projection for Malta in 2009 is 2% growth.

We are forecasting 2.5% in growth – the Commission is always a bit more conservative – but it is also important to

know that the Commission has forecast growth in jobs for Malta, whereas in other countries there is a negative employment rate. In an international mood of pessimism I think it would be detrimental to our economic growth prospects if we had been more austere with our budget.

Clearly Malta cannot influence world demand; we are too small in economic terms. But we can take initiatives to make sure that we create the necessary internal demand – linked to investments, not just linked to consumption.

FB The European Commission is expecting Malta to come out of troubled economic times quicker than the majority of other EU member countries – why is that?

TF The fundamentals are good. We have proved to have a very solid and sound

financial system so, while the huge storm swelled in other markets, our institutions were not affected. We have a very solid banking system – our banks are very liquid and safe in terms of the types of deposits they hold and they don't possess toxic assets. Obviously they held assets in what were very highly credited financial institutions, like Lehman Brothers, but nobody really expected that to happen so I can't really say that they have made bad judgements.

FB To what factors do you owe this sound financial standing?

TF The economy has passed through a solid phase of good times and there are still signs of growth in a number of areas, namely the service economies of the ICT and financial services sectors. Our economy is becoming more dependent on these areas rather than traditional manufacturing and tourism, which are much more prone to cyclical downturns on an international level.

In terms of the financial services market, even with the downturn, there is a lot of interest in Malta. Our regulator is highly respected and our fiscal structure provides a number of advantages, as does quality of our professionals.

FB It strikes me that Malta is blessed with very well educated people, ideal for this sector.

TF Usually when international companies come to Malta they start small and are attracted, particularly in the financial services sector, by our tax structure. But when they really start to operate they realise that they can find people with the level of skill that they require; people with a strong work ethic. The English language use in Malta is an advantage too.

FB How is financial markets regulation in Malta becoming more harmonised?

TF All financial services will be regulated by the Malta Financial Services Authority (MFSA). This gives us the ability to look at the market from a wider perspective, but also to be more responsive. Legislation is passed quickly.

FB How do you nurture market confidence?

TF Malta is a financial centre that cherishes its reputation. We conduct business that is good for that reputation and this is bearing fruit. Now that we have cleared our tax structure with the Code of Conduct Group within the EU, this has put us in a completely different league, with a very well regulated system. This gives certainty to operators in Malta and within the European Union.

We have seen the financial services contribution to the economy grow 30% annually since 2004. We have seen a number of new financial institutions opening up. In

problem that they were facing they didn't realise that they were creating an uneven playing field. Other financial institutions that were not in the same markets, were much more prudent and are now being hit worse than the US players who were not operating properly. This has created a lot of confusion at the European level.

FB Governments, regulators and other authorities need to be reminded that financial services are there to support world business with credit and risk management products. How can that confidence be restored?

'I can't really say that we are feeling the impact of a credit crunch locally.'

the year until September we had 34 financial institutions receiving licenses in Malta and 384 captive insurers have registered.

FB Are you concerned that tighter regulation in response to recent events will squeeze financial innovation?

TF It is a concern. As always happens, the good guys get dragged down with the bad guys. You'll find countries where the financial regulators were being too relaxed and too trusting that professionals were doing the right thing, then discovering that there were toxic assets in the market and nobody was supervising them. Clearly that needs to be addressed. The tightening of regulation could mean suffocation of certain initiatives but nobody really knows how this landscape will change because the crisis has been so huge.

FB What solutions can you foresee coming into operation?

TF Everybody is talking about the need for reform of financial regulation and the platform on which we operate. It will be a very interesting debate, but having a super-regulator may not provide the best solutions. Because the regulators in the US wanted to address the

TF At a local level the appetite by banks to lend has not really been affected. That doesn't mean that a bit more caution hasn't come in but the operators and the banks have not altered their policy in terms of credit. I can't really say that we are feeling the impact of a credit crunch locally. Clearly internationally it is there and therefore that will create problems in terms of growth. What will restore the confidence? It's a very difficult question to answer. Governments decided to get into banks not just to bail them out but because of banks' reluctance to trust the system and to start providing the credit. This was the real concern – the feeling that institutions were not really operating any more as banks but just protecting their

interests; not taking any risks and not trusting each other in terms of liquidity. That really needs to be addressed. FBA



TONIO FENECH

Tonio Fenech is a fellow of the Institute of Accountants and a public practice warrant holder. In March 2004, he was appointed parliamentary secretary in the Ministry of Finance by prime minister and minister of finance Lawrence Gonzi.