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SECTORAL AND CROSS-COUNTRY ESTIMATES OF HOURLY LABOUR COSTS

BOX 6: SECTORAL AND CROSS-COUNTRY ESTIMATES OF HOURLY LABOUR COSTS¹

The labour input plays a key role in the functioning of an economy. For firms, the cost of labour does not only include wages and salaries but also non-wage costs, such as social security contributions paid by the employer. Thus, the total labour cost is an important determinant in a firm's competitiveness, which is also influenced by other factors, namely the cost of capital and non-price elements, such as product quality, branding and after-sale service. For employees, wages or salaries usually represent their main source of income and therefore play an important role in consumption and saving decisions.

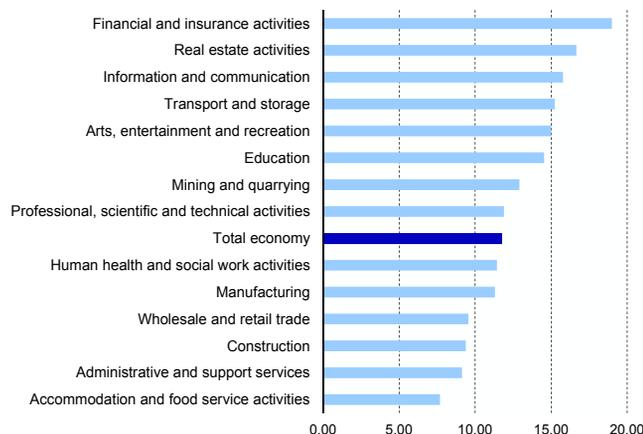
Discussion on competitiveness typically relies on traditional indicators, such as ULCs, defined as the ratio of workers' compensation to their productivity. Such an index, which only looks at cost competitiveness aggregated for the whole economy, should not, however, be interpreted in isolation as it makes no distinction, for instance, between the tradable and non-tradable sectors, or the private and public sector. Indeed, one of the main conclusions from the European Central Bank's (ECB) Competitiveness Research Network is that in-depth assessments of competitiveness should move away from aggregate indicators and focus more on sectoral and firm-level indicators.²

This Box looks at hourly labour cost developments at a sectoral level, using the findings of the Labour Cost Survey 2012, which is carried out every four years. In addition to its sectoral detail, one of the main advantages of this survey is that it allows for a direct comparison between domestic and European hourly labour costs in euro, in addition to changes over time.

Sectoral hourly labour costs in Malta

In 2012 the overall labour costs per hour in Malta, which also include social security contributions, training and other labour-related expenditure, stood at €11.78. As expected, the survey points to significant differences at a sectoral level (see Chart 1). The highest hourly labour costs were recorded in high value added sectors,

Chart 1
HOURLY LABOUR COSTS BY ECONOMIC ACTIVITY IN 2012
(average labour costs per hour in euro)



Source: National Statistics Office.

¹ Prepared by Brian Micallef, Senior Research Economist in the Modelling and Research Department of the Central Bank of Malta. The views expressed are those of the author and do not necessarily reflect the views of the Central Bank of Malta. Any errors are the author's own.

² Di Mauro, F. and Ronchi, M., "Assessing European competitiveness: the contribution of CompNet research", *Working Paper* European Central Bank, June 2015.

such as finance and insurance, real estate activities, information and communication technology, transport and storage, and the remote gaming sector. In these sectors, labour costs exceeded €15.00 per hour, with the highest being registered in the financial and insurance sector, at €18.99. At the other end of the table, labour costs in wholesale & retail, construction, administrative and support services, and the accommodation and food service industry, are, on average, below €10.00 per hour. Hourly labour costs in manufacturing, at €11.30, are slightly lower than the economy's average.

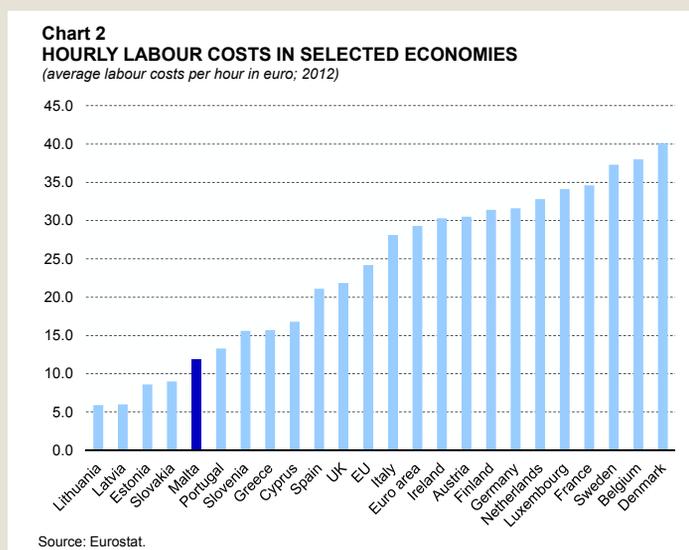
The survey indicates that hourly labour costs are directly proportional to the size of the firm. The lowest costs, at €10.33, were seen in firms employing between 10 and 49 workers, while the highest were in firms with more than 1000 workers, at €15.38. This finding is common in the literature and could be due, for instance, to the fact that larger firms are generally more productive than smaller ones, more capital intensive and have a higher investment in new technologies, thereby raising the demand for skilled labour.³

Cross-country comparisons

Similar to the domestic situation, hourly labour costs in both the European Union and the euro area were the lowest in the accommodation and food service activities sector, and highest in the financial and insurance sector. Again, the survey masks significant differences between countries, with hourly labour costs in Denmark being around 12 times higher than in Bulgaria.

Chart 2 ranks the labour costs per hour in selected EU economies in 2012. With the exception of Bulgaria and Romania, the lowest labour costs per hour were recorded in the Baltic countries and the highest in Scandinavian and core European economies. In the former category, labour costs amount to less than €9.00 per hour while, in the latter group, hourly labour costs stand between €30.00 to slightly higher than €40.00. Average hourly labour costs stood at €24.20 in the European Union and €29.30 in the euro area.

Labour costs in Malta rank at the lower end of the table, being generally higher than in the Baltic and Eastern European countries, but lower than in most other euro area economies. This is also due, to an extent, to the



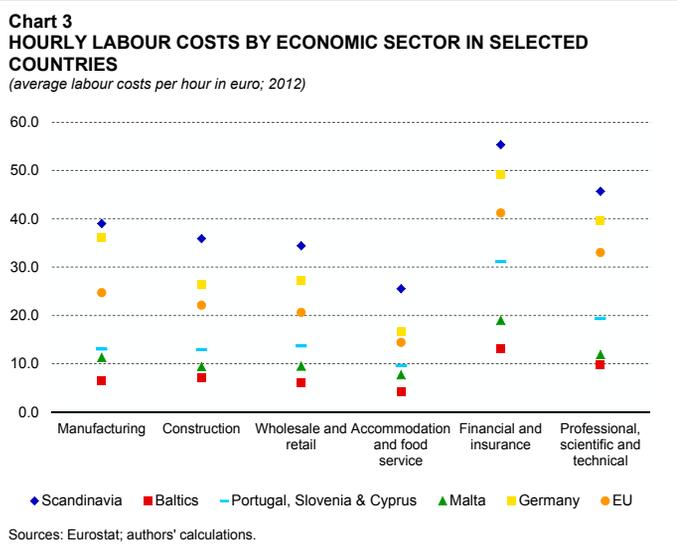
³ Lopez-Garcia, P., di Mauro, F. and CompNet Task Force, "Assessing European competitiveness: the new CompNet micro-based database", *Working Paper 1764*, European Central Bank, March 2015. For a reference in the academic literature, see Idson, T. and Oi, W., "Workers are more productive in larger firms", *American Economic Review* 89(2), 1999.

low share of employers' social security contributions in total labour costs, which, at around 8%, compares favourably with the euro area average of 25.0%. Domestic hourly labour costs are also lower than in other Mediterranean economies, such as Spain, Italy, Slovenia and Cyprus.

Chart 3 compares hourly labour costs by economic sector across different country groupings. A similar pattern is observed in most Member States, with the highest hourly labour costs in 2012 observed in the financial and insurance sector, and the lowest in the accommodation and food industry. There are, however, wide differences across countries, with labour costs per hour always being the highest in Nordic countries and the lowest in the Baltic States. In all sectors, hourly labour costs in Malta are lower than those not only in the European Union but also in other comparable small and open economies, such as Portugal, Slovenia and Cyprus.

In general, hourly labour costs in Malta were slightly less than half in the European Union in 2012. At sectoral level, the gap between hourly costs in Malta and the European average varied. In the accommodation and food service industry, costs stood at 53.0%, reflecting the lowest gap in costs, while professional, scientific and technical services recorded costs at 36.0% of the European average, signifying the largest variance in labour costs. In the latter sectors, the relatively low domestic hourly labour costs compared with the European average have persisted, despite the significant shift towards services observed in Malta in recent years.⁴

Hourly labour costs in Germany, commonly considered as one of the most competitive economies in the euro area, are higher than the European Union average and in Mediterranean countries, although lower than in Nordic economies. In the export-oriented manufacturing sector, hourly labour costs in Germany are more than three times in Malta. Despite relatively higher hourly labour costs, Germany has been successful in maintaining the competitive edge of its manufacturing industry, with its share in gross value added remaining broadly unchanged over the past decade, at slightly higher than 22%. On the contrary, manufacturing in Malta has been on a



⁴ Grech, A. G. and Zerafa, S., "Structural changes in the Maltese economy", *Annual Report*, Central Bank of Malta, 2014, pp. 72-76. These authors find that the gross value added in professional services, and information and communication services increased from 75.0% in 2006 to 115.0% in 2013 of the domestic manufacturing sector.

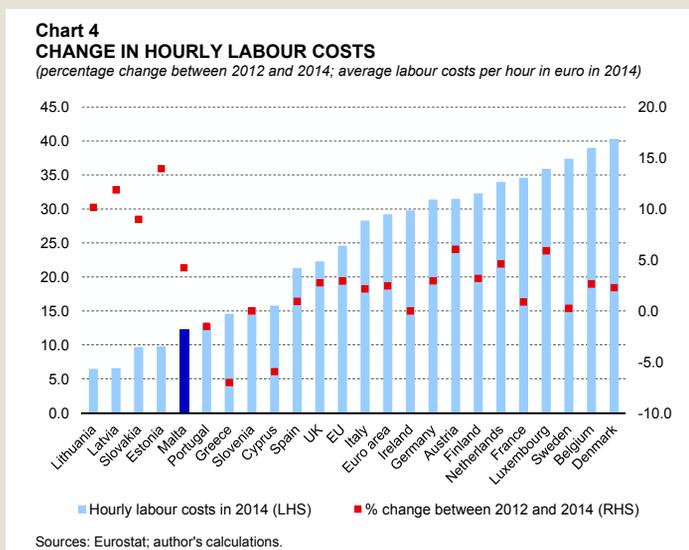
declining trend, falling from 21.4% in 2000 to 10.2% in 2014. These findings confirm that competitiveness involves both price and non-price elements. The competitiveness of the German manufacturing sector is not due to low wages but rather to the quality of its exports, including the development of new technologies and its ability to drive innovation owing to a highly skilled workforce that, in turn, demands higher labour rates.

Turning to more recent developments, Chart 4 plots the percentage change in hourly labour costs between 2012 and 2014, together with ranking of labour costs in 2014. These figures are based on a less comprehensive annual update of the four-yearly survey. In particular, the yearly updates are more limited in their sectoral coverage, narrowing the analysis to four aggregate sectors, namely industry, construction, business services and other services (such as education, health, arts, entertainment and recreation activities).

Hourly labour costs in Malta increased to €12.30 in 2014, or by 4.2% compared with 2012. This rise was higher than that registered in the euro area and the European Union during the same period, although the ratio of hourly labour costs in Malta compared with both economic areas still remained between 40% and 50% in 2014. Large differences were observed between countries in the euro area. The largest increases were registered in the Baltic countries, whose labour costs are still relatively low and are thus in the process of converging to the higher EU average. In contrast, hourly labour costs declined in stressed countries, such as Greece, Cyprus and Portugal, and remained broadly unchanged in Ireland and Slovenia. Despite these developments, hourly labour costs in Malta still remain more competitive compared with the latter countries.

The limited sectoral composition suggests that the higher hourly labour costs in Malta compared with the euro area since 2012 were mainly driven by the services sector. On the contrary, the increase in hourly labour costs in domestic manufacturing, at 1.7%, was considerably lower than in the euro area and Germany, at 3.9% and 5.4%, respectively. This bodes well for the cost competitiveness of the domestic manufacturing base. Hourly labour costs in construction, at around 2%, were broadly in line with the European average.

Overall, the findings from this Labour Force Survey are broadly consistent with other sources that point to a period of wage moderation in Malta in recent years.⁵ The increase in the labour



⁵ Micallef, B., "Labour market resilience in Malta", *Quarterly Review* 2013:1, Central Bank of Malta, 2013, pp. 41-46.

supply, driven by reforms targeted to raise the participation rate of females, as well as a higher share of foreign workers in the workforce, has also eased labour shortages in selected sectors and helped to keep wage pressures contained.⁶ These factors, together with prudent economic policies and labour market institutions, such as wage bargaining at firm level, have improved the resilience and increased the flexibility of the Maltese labour market, as evidenced by continued job creation and low levels of unemployment.⁷

Conclusion

Survey information on hourly labour costs by sector suggests that the Maltese economy is quite competitive in terms of costs, compared with other euro area countries, and has maintained its cost competitiveness despite the reduction in labour costs in stressed countries since the financial crisis. In 2014 hourly labour costs in Malta remain less than half those in the euro area. In the export-oriented manufacturing sector, domestic labour costs are less than a third of those prevailing in Germany and have become even more competitive in recent years.

Since joining the European Union in 2004, the Maltese economy has gradually diversified its economic base, moving away from traditional sectors towards high value added ones, which pay better. The increase in overall wages since 2012 is a continuation of this process, driven by the shift towards more labour intensive professional services. Hence, the convergence of wages towards those prevailing in the euro area is not associated with a deterioration in price competitiveness, especially considering that domestic labour costs are still more attractive than those in stressed economies, but rather as a natural result of a maturing economy.

Going forward, however, the Maltese economy cannot compete on costs alone, especially with Eastern and emerging countries. As in the German business model, the economy's competitive advantage has to come from a combination of price and cost competitiveness, together with further specialisation in high value added activities. To this end, policy makers must continue to pursue structural reforms that lead to productivity gains that enable sustained increases in real wages and, ultimately, higher living standards. This can only be achieved by further raising the workforce's skill base through investment in education to improve the quality of human capital and to strengthen active labour market policies. The latter include lifelong learning and adequate incentives for both employers and employees to promote development of job-specific skills. Improvements in productivity must also be supported by a reduction in red tape, more flexible management practices and adequate investment in supporting the physical and technological infrastructure of the country.

⁶ According to ETC statistics, the share of foreigners in Malta's workforce increased from 5.1% in 2010 to 10.8% in 2014. While the influx of foreign workers is spread across the board, it is unevenly distributed towards certain sectors, such as the remote gaming industry, where the share of foreigners is around a third of the workforce. The share of foreigners exceeds 10% of the workforce also in administrative & support service activities, accommodation and food services, and professional, scientific and technical activities. Further details on the share of foreigners working in the Maltese economy is available from the National Employment Policy, available on: <http://education.gov.mt/employment/Documents/EMPLOYMENT%20POLICY%20DOC%20sml.pdf>

⁷ For an analysis of the evolution of the Maltese labour market after the crisis, see Micallef, B. and Caruana, K., "Wage Dynamics Network Survey", *Annual Report*, Central Bank of Malta, 2014, pp. 56-61.