



Wage Dynamics Report

Malta

This report was commissioned by the Central Bank of Malta and prepared by E-Cubed Consultants Limited on behalf of the Malta Chamber of Commerce, Enterprise and Industry.

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Executive summary

This report investigates the wage setting behaviour of Maltese firms and the extent to which the labour market in Malta exhibits elements of flexibility.

The results presented in this report are based on a survey of 161 firms undertaken as part of the Wage Dynamics Network for reference year 2008. The network is a Eurosystem research network of which the Central Bank of Malta (CBM) is a member. The aim of the survey was to identify the characteristics and sources of labour cost dynamics that are significant for policymakers.

The main findings of the report are:

- **Wage setting and wage changes:** Wage setting in Malta is strongly based on collective bargaining at enterprise level. Indeed, about 31% of firms covered in the sample have a collective agreement. These firms account for 56% of workers in the firms covered by the sample. Changes in wages generally occur on an annual basis with mandatory COLA awarded to all workers.
- **Downward wage rigidity and the adjustment to shocks:** In situations of labour abundance, the majority of respondents, at 31%, indicated that they do not lower wages due to the implicit impact on work effort. Lack of labour market flexibility is also exhibited in situations where the market exhibits a labour shortage. When faced with economic shocks, firms generally prefer to opt for a reduction in costs albeit non-labour costs. In terms of wages, firms generally prefer to opt for a freeze in wages as opposed to a cut in wages.
- **Price setting and price changes:** 40% of firms indicated that they set their price according to costs and a self-determined profit margin. Over 50% of all firms indicated that they would follow competitors if prices are cut. Firms in the manufacturing sector and hotels and restaurants sector exhibited the highest degree of price sensitivity.
- **Reactions to the recent economic downturn:** The effect of the crisis has essentially been evident through a fall in demand for the firm's product as well as difficulties associated in obtaining payments due to liquidity and cash flow. Firms have essentially responded to the crisis through a reduction in costs albeit non-labour costs.

1. Introduction

Economic theory highlights the importance of an efficient and flexible labour market which is conducive towards competitiveness, productivity and employment. In an economic and monetary union, the effectiveness of monetary policy depends on the flexibility of the labour market to serve as an adjustment mechanism when faced with economic shocks. Despite this economic importance, evidence suggests that the labour market is typically inflexible and exhibits, wage rigidity, particularly downwards, resulting in structural rigidities.

This report seeks to present an in depth analysis of the features and sources of wages and labour cost dynamics in Malta with the reference period being 2008. The report is based on the requirements of the Wage Dynamics Network which is a research network consisting of economists from the European Central Bank (ECB) and the national central banks (NCBs) of which the Central Bank of Malta (CBM) is a member.

The objectives of the report are to:

- identify the sources and features of wage and labour cost dynamics and the extent of labour market flexibility in the face of economic shocks
- assess the relationship between wages, labour costs and prices

Given the recent economic downturn, the report also delves into the reactions of firms to the global economic recession.

The results presented in this paper have been elicited from a survey carried out on 161 firms in a number of economic sectors. The survey questionnaire was based on the requirements of the Network, with additional questions being designed by representatives of the CBM, Malta Chamber of Commerce, Enterprise and Industry and local experts.

The report is structured as follows: Section 2 provides the technical background of the survey. Section 3 presents the results from the questions posed on wage setting behaviour in Malta, frequency and causes of wage changes. Section 4 covers obstacles to cuts in base wages and reactions to unexpected shocks to assess the extent of labour market flexibility. Section 5 provides an assessment of price setting and price changes and Section 6 presents firms' reaction to the economic and financial crisis which commenced in 2008. Section 7 provides a conclusion to the report.

2. Wage dynamics survey

In order to elicit the required information, a survey was conducted by the CBM, Malta Chamber and E-Cubed Consultants Ltd.

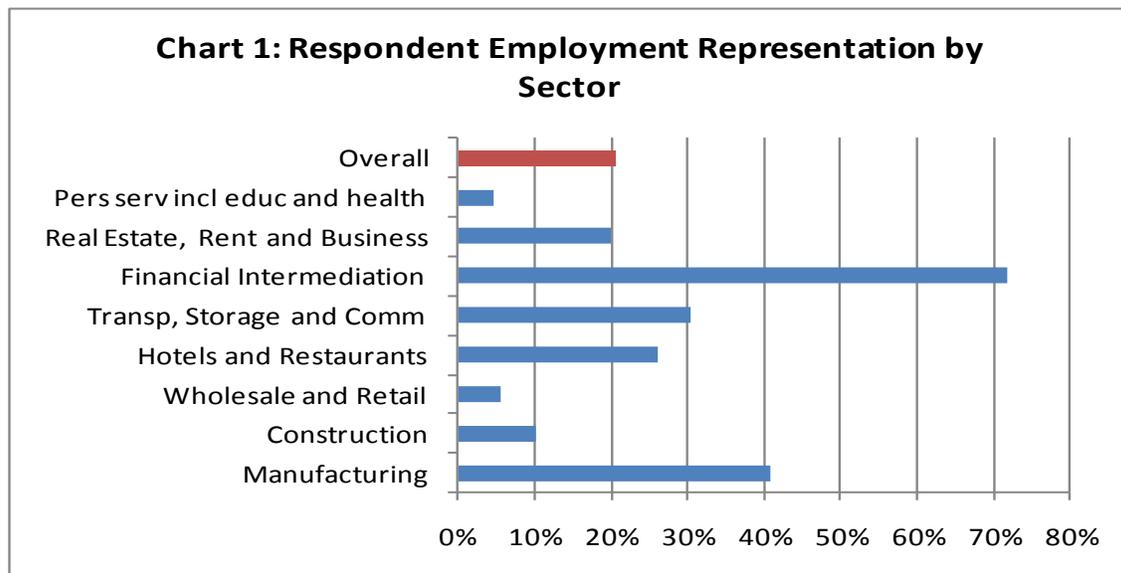
The survey questionnaire was divided into the following five sections:

1. Wage setting and wage changes
2. Downward wage rigidity and the adjustment to shocks
3. Price setting and price changes
4. Reactions to the recent economic downturn
5. Information about the firm

The survey was conducted over a period of six weeks between May and June 2010. A total of 161 private sector respondents answered the survey, conducted through face to face interviews. The respondents were spread across a number of sectors with the sample size based on the employment base of each of the economic sectors. The respondents that took part in the survey employ a total of 25,912 employees representing 21% of the gainfully occupied population in these sectors. Given the different sectoral representation, the report generally follows a sectoral analytical approach. As can be seen from Chart 1, the best represented firms are those in the financial and manufacturing sectors while the under-represented firms are in sectors which are dominated by micro firms and which are statistically difficult to capture such as wholesale and retail and personal services. Technical detail on the metadata is presented in Annex A of the report. The average size of the respondents in terms of employment is relatively high in the manufacturing, transport, storage and communication and financial intermediation sectors whereby the average size of the firms exceeds 200 employees. Labour costs in relation to total costs are highest in the real estate sector and the financial services sector whereby, according to official statistics, the average wage of workers in the financial and services sectors tends to be disproportionately higher than the average wage in the economy.¹

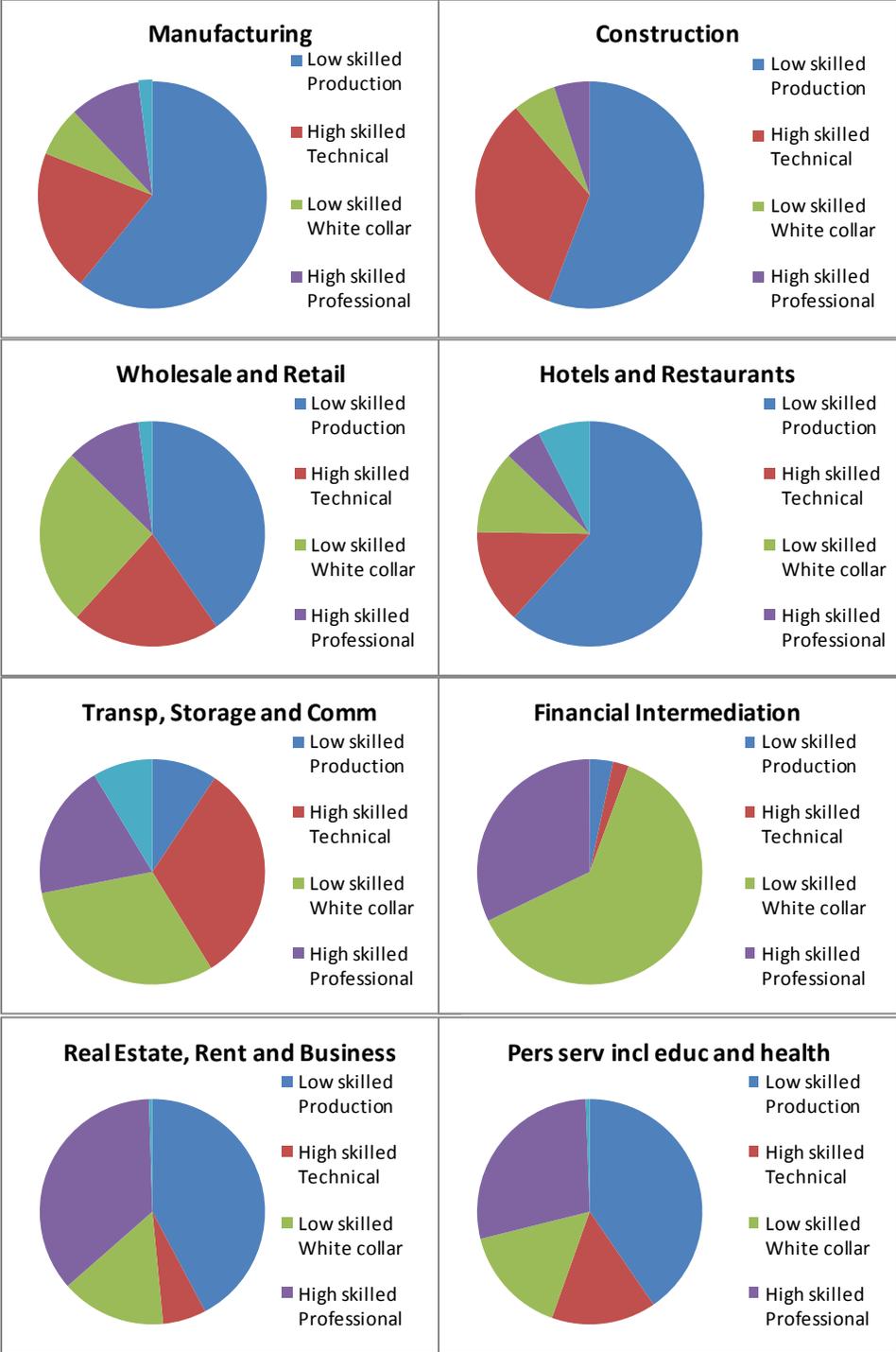
¹ Average wage refers to the ratio of compensation of employees attainable from National Accounts statistics published by the National Statistics office (NSO) and the FTE labour component as published in the Gainfully Occupied press release also published by the NSO.

Table 1: Characteristics of Respondents				
Sector	Number of Respondents	Employment of Respondents	Average Size of Respondents (by employment)	Labour Costs to Total Costs (%)
Manufacturing	38	9317	245	29.1
Construction	11	1044	95	36.1
Wholesale and Retail	18	1244	69	36.2
Hotels and Restaurants	15	2672	178	40.0
Transp, Storage and Comm	16	3414	213	41.7
Financial Intermediation	19	4085	215	49.1
Real Estate, Rent and Business	33	2713	82	58.9
Pers serv incl educ and health	11	1423	129	48.2
Total	161	25912	161	42.4



As expected, the occupational distribution varies across the different sectors. Indeed, low skilled production workers constitute over 50% of workers in the manufacturing, construction and hotels and restaurants sector while low skilled white collar workers represent the largest proportion of workers in the financial sector. On the other hand, skilled workers represent a significant proportion of the workforce in the real estate, renting and business activities, personal services as well as the financial services sectors (see Chart 2).

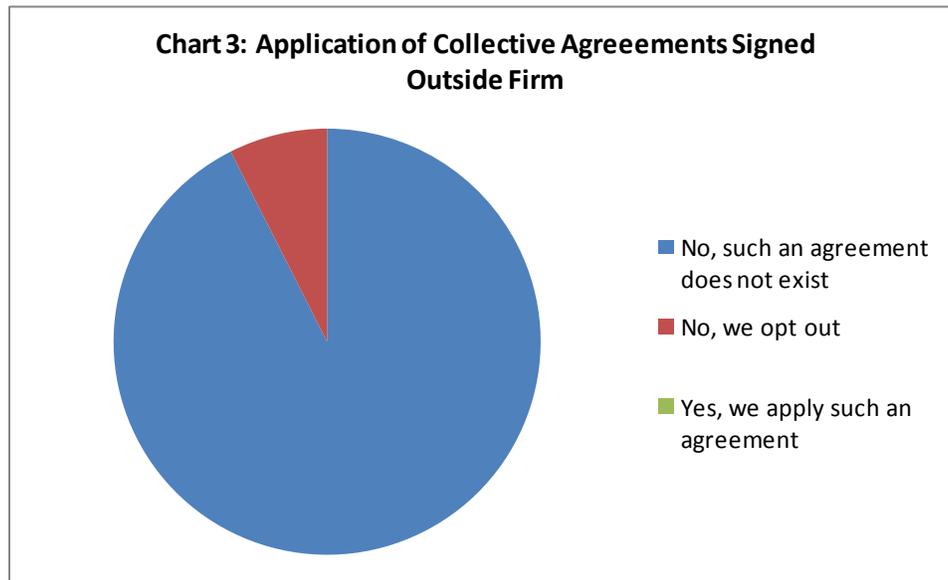
Chart 2: Occupational Distribution in Respondent Firms

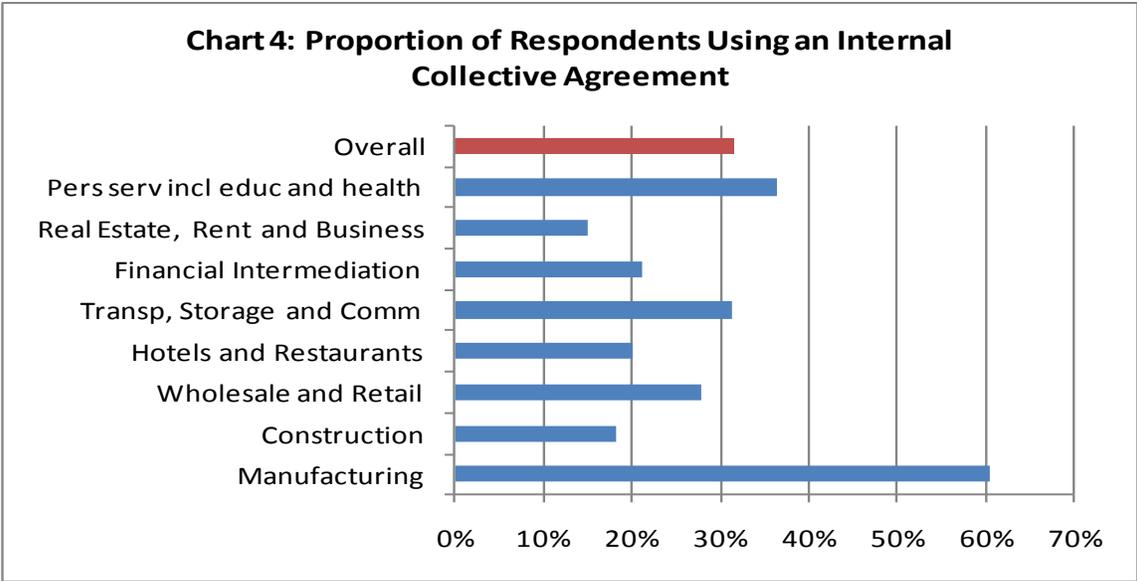


3. Wage setting and wage changes

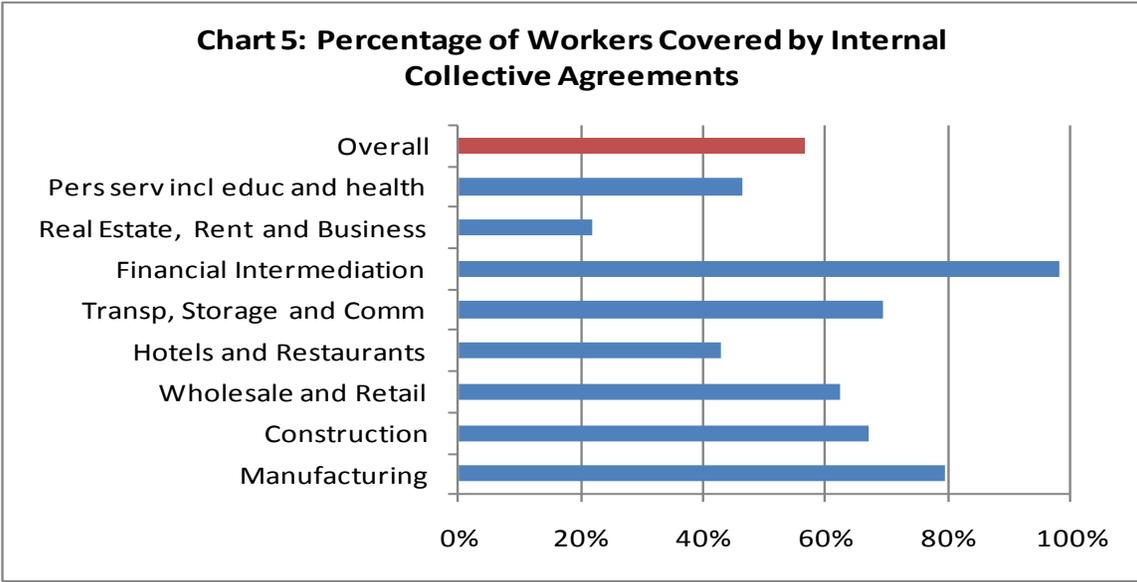
In a bid to assess rigidities in the labour market, the survey delves into issues related to the setting of wages in Malta, the frequency and timing of wage changes as well as on how wages of new workers are set relative to those of existing workers. This section is not to be interpreted within the current economic climate following the recession which began in 2008. Indeed, respondents were asked to consider normal conditions and practices to exclude any extraordinary measures which were taken in response to the crisis.

The wage setting practice in Malta is essentially based on collective bargaining at the enterprise level. This is evident from Chart 3 below which indicates that collective agreements outside firms are highly infrequent in Malta. Indeed, they only apply in the case of public sector arrangements. The norm in Malta is to have internal collective agreements negotiated at an enterprise level. This is applicable to all sectors covered in the survey. It is however important to note that the small proportion of firms which have indicated that they opt out may refer to the case of subsidiary companies which could potentially use collective agreements negotiated at group level, but which rather decided to opt out from such agreements.



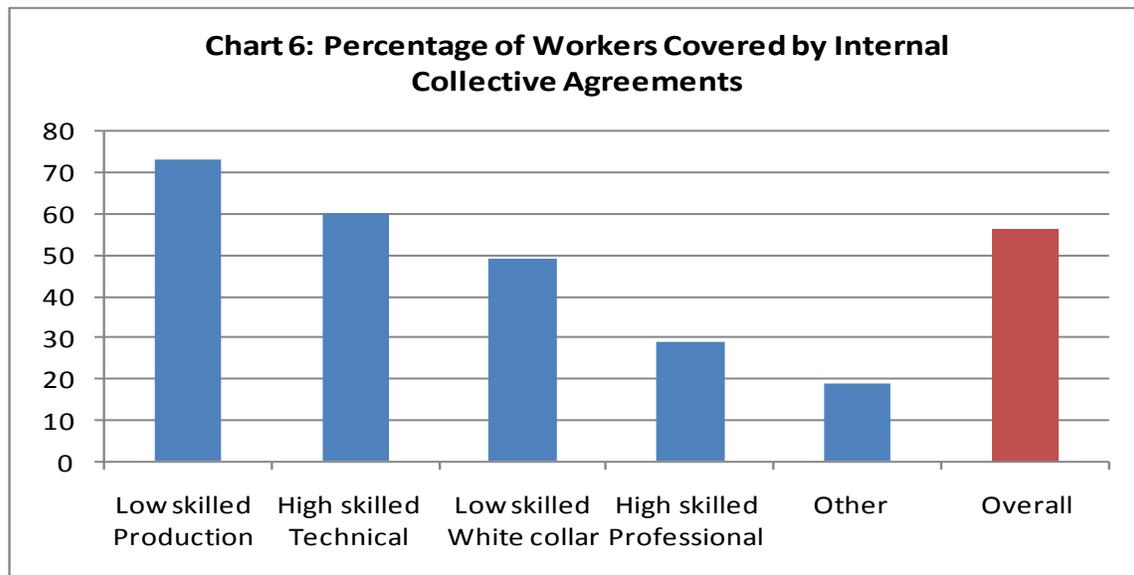


At a sectoral level, the proportion of respondents using an internal collective agreement is highest in the manufacturing sector with 60% of the firms using a collective agreement. When considering the coverage by the number of employees in each of the economic sectors, the financial services sector emerges as a sector with almost full coverage (See Chart 5). Overall as can be seen from Chart 4, 31% of firms are covered by an internal collective agreement. These firms account for 56% of workers in the firms covered by the sample.²



² Data in Chart 4 are weighted by the number of firms covered by collective agreements and data in Chart 5 are weighted by the number of employees covered by arrangements.

Despite falling over recent years, trade union density in Malta, at 59.2%³, is relatively strong. As can be seen from Chart 6, over 70% of low skilled production workers are covered by internal collective agreements, with the majority of these workers working in the manufacturing sector. Other workers included in this category include workers in the hotels and restaurants sector where collective agreement coverage is half of that registered in the manufacturing sector. Highly skilled professional workers are the least covered by collective agreements.

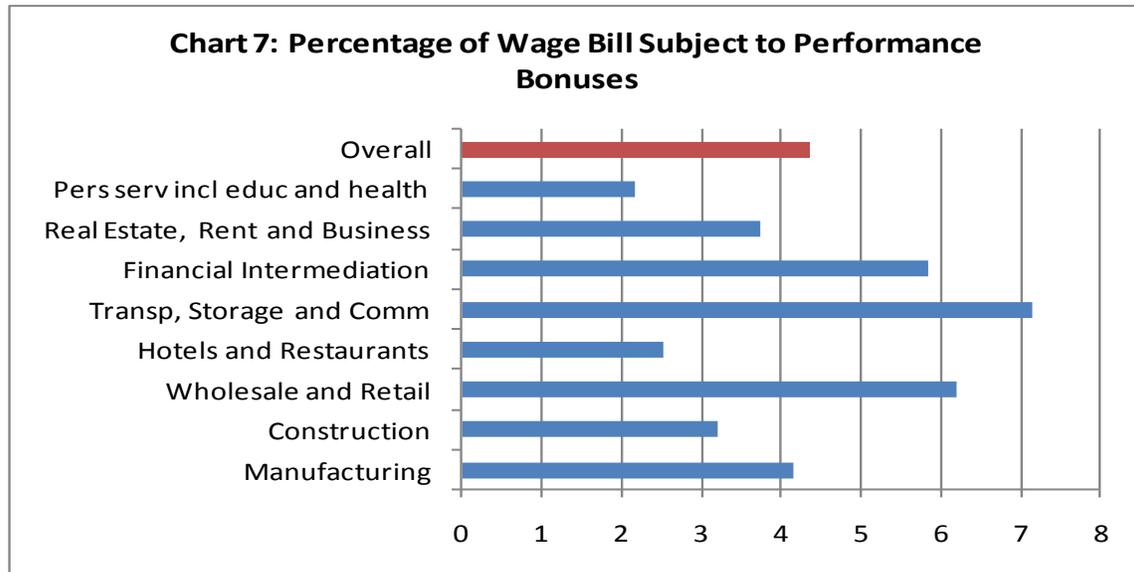


Respondents were also asked to indicate the frequency and types of wage changes. As indicated in Table 2, most of the changes occur on an annual basis most notably due to inflationary pressures channelled through the Cost Of Living Adjustment (COLA) although tenure wage changes are also mainly undertaken on an annual basis.⁴ 88% of respondents indicated that wage increases are concentrated in January, essentially due to the operation of the COLA. With respect to increases outside COLA, 38% indicated that these do not occur in any particular month, while 43% indicated that these wage changes typically occur in January. Only 19% indicated some other month, with no particular month emerging as particularly frequent.

³ NSO Press Release 174/2006.

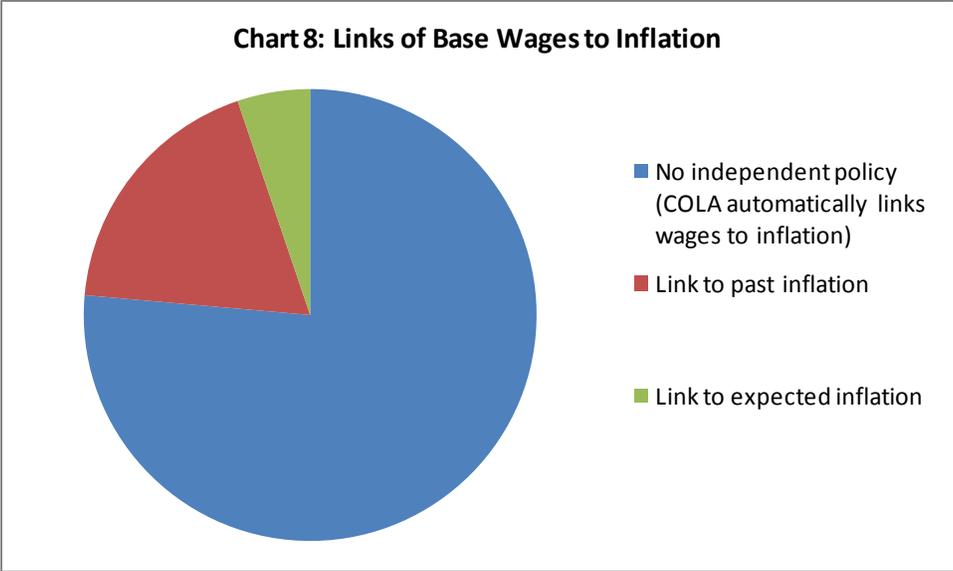
⁴ Firms were asked to comment on the frequency and timing of wage changes, distinguishing between those related to inflation, those related to tenure (i.e. the length of service of the employee) and other factors.

Frequency	<i>proportion of respondents</i>		
	Tenure	Inflation	Other
more than once a year	2%	1%	2%
once a year	42%	85%	47%
once every two years	15%	3%	12%
less frequently	12%	1%	19%
never/ don't know	29%	10%	20%



Firms were also asked on the percentage of the wage bill which is subject to a performance bonus based on the premise that performance bonuses allow for an element of flexibility in wage setting. The proportion of the performance bonus to the total wage bill varies across sectors with the proportion exceeding the overall average in the financial services, transport, storage & communications and wholesale and retail sectors. Overall as can be seen from Chart 7, less than 5% of the wage bill is subject to a performance bonus.

As indicated above, mandatory annual wage changes are also undertaken in Malta through the COLA announced by Government. The adjustment is based on the 12 month moving average inflation rate of the previous year as calculated by the Retail Price Index. All firms are bound to award COLA and the majority of firms do not have an independent policy which is linked to inflation. About 30% of firms, however, did indicate that they have some kind of additional wage indexation system which is linked to past inflation and a small minority of firms also indicated that they have an additional system which is linked to expected inflation (See Chart 8).



Only a small minority of firms have the COLA which is incorporated within the collective agreement (See Chart 9). Of those which have the COLA incorporated within the collective agreement, the majority are within the personal services sector (See Chart 10).

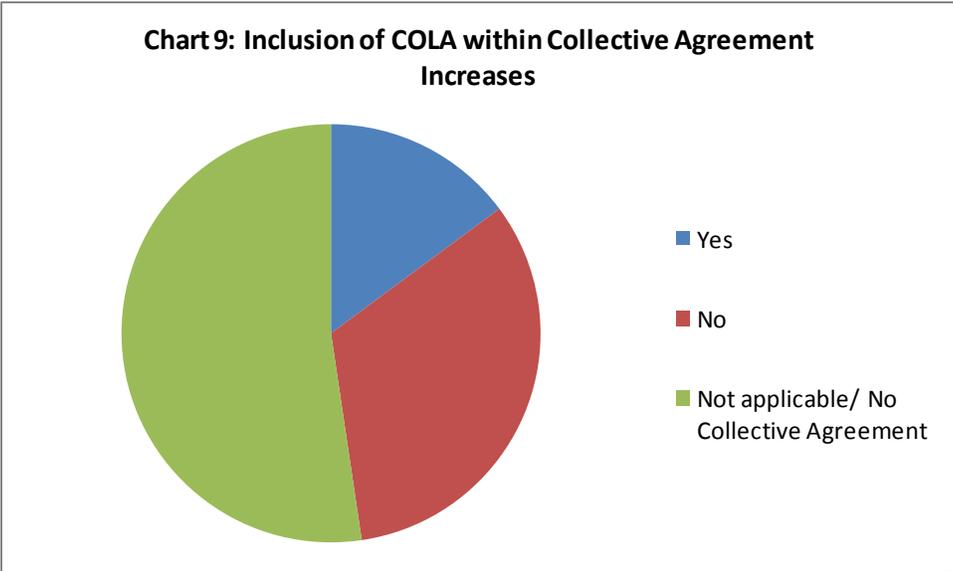
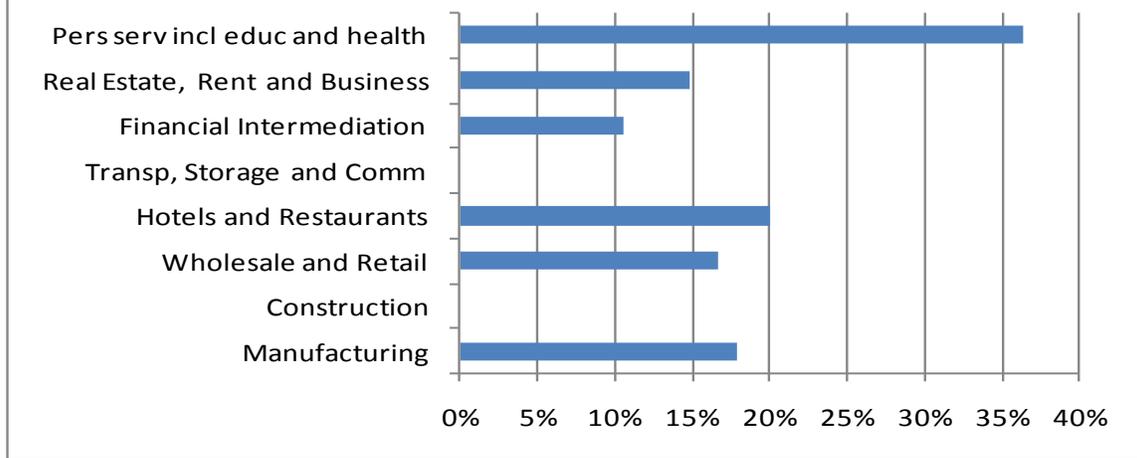
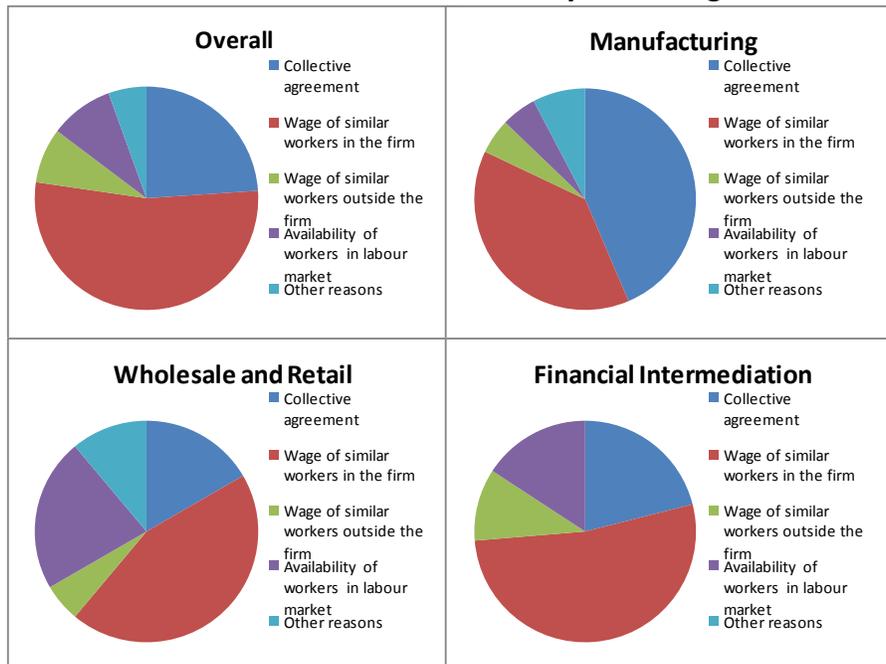


Chart 10: Proportion of Respondents with COLA Increases included within Collective Agreement Increases



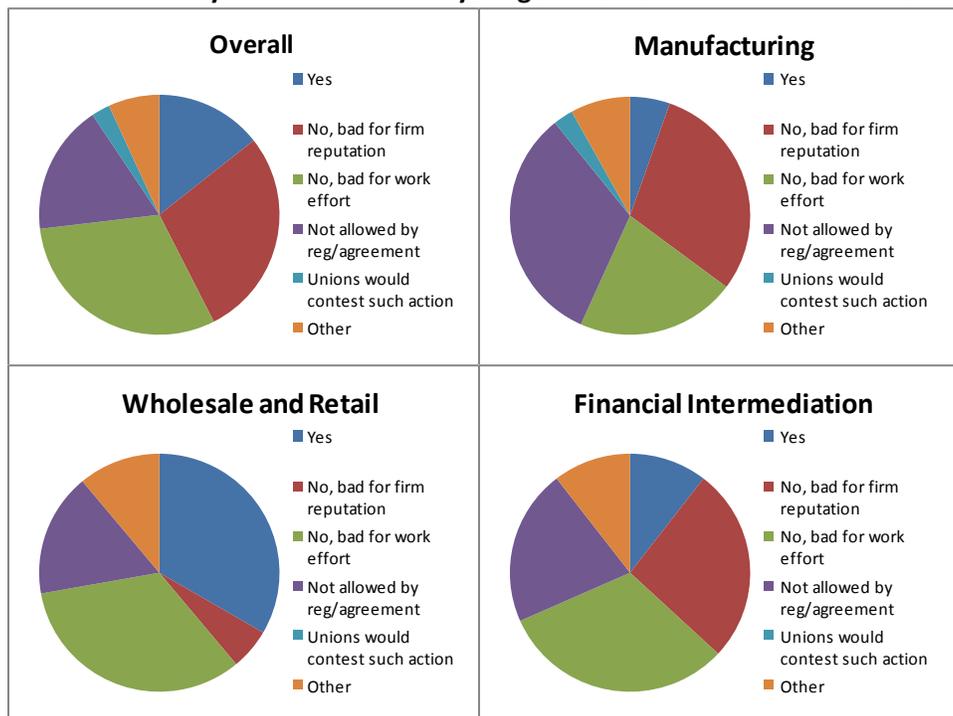
Firms were also surveyed on the entry level of wages. Overall in the economy, the determinant factor depends on the wages of similar workers within the firm. This is also evident at a sectoral level namely in the wholesale and retail and financial intermediation sectors as shown in Chart 11. It is however to be noted that in the manufacturing sector, where there is a predominance of workers unionized and covered by collective agreements, the determining factor of entry level wages is the collective agreement.

Chart 11: Determinants of Entry Level Wages



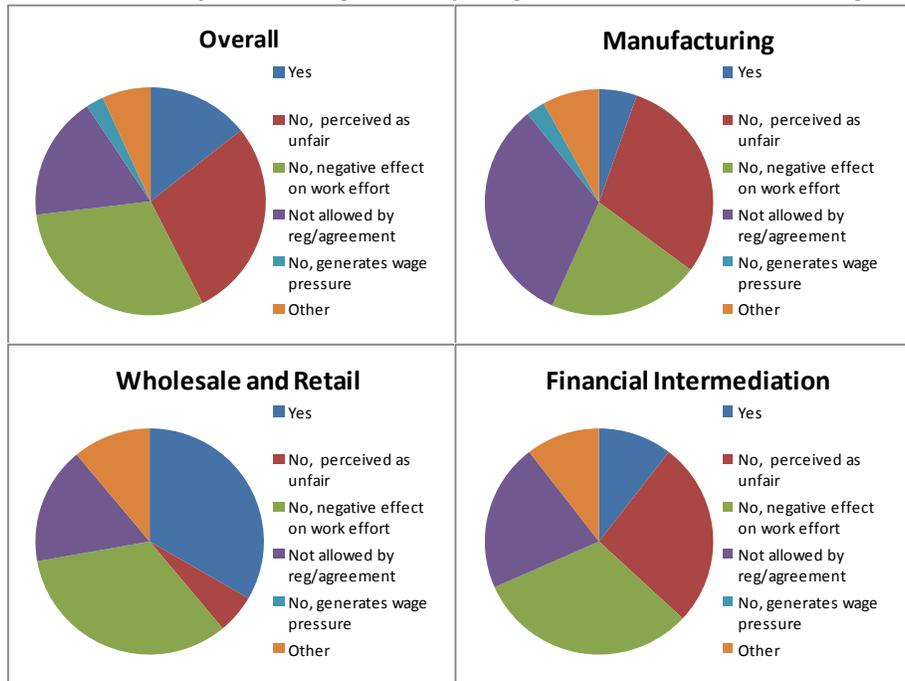
In a bid to assess the extent of labour market flexibility, respondents were also asked about the level of wages in situations when there is excess demand or excess supply in the labour market. Overall, in situations of labour abundance, the majority of respondents, at 31%, indicated that they do not lower wages due to the implicit impact on work effort followed by the negative reputation which the firm may acquire following a drop in wages. At a sectoral level, in the manufacturing sector, wages are not lowered essentially due to the fact that it is not permitted by the collective agreement. It is however interesting to note that in the wholesale and retail sector, 33% of the respondents indicated that wages are lowered when there is an overabundance of workers reflecting the fact that this sector is market driven (See Chart 12). This sector, as shown in Section 5 of this report, has also recorded the highest proportion of firms that set prices as mark up over costs. This possibly implies that firms within this sector prefer to opt for a reduction in costs as opposed to a reduction in profit margin when faced with competitive pressures.

Chart 12: Payment of Lower Entry Wages in Case of Labour Abundance



Lack of labour market flexibility is also exhibited in situations where the market exhibits a labour shortage. Entry level wages are not increased as it is considered unfair to hire workers at a higher wage and it may also have a negative impact on the work effort of the existing workforce. At a sectoral level, 32% of the firms in the manufacturing sector indicated that wage increases for only some of the workers are not permitted by the collective agreement.

Chart 13: Payment of Higher Entry Wages in Case of Labour Shortage



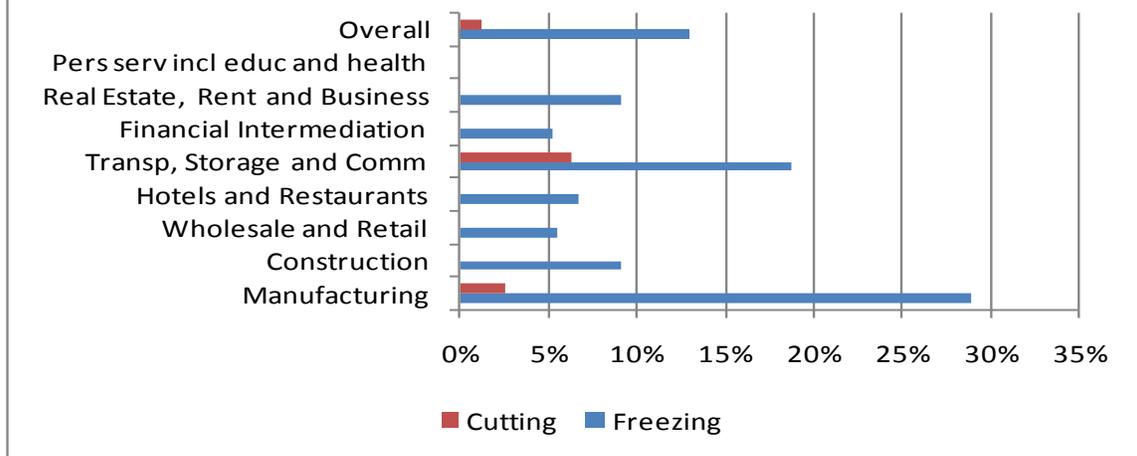
4. Downward wage rigidity and the adjustment to shocks

This section of the report focuses on the presence of potential obstacles to downward wage adjustments and the adjustment of the labour market to economic shocks.

Overall, as can be seen from Chart 14, firms prefer to opt for a freeze in wages as opposed to a cut in wages. The underlying reason for opting for a freeze on wages is due to a decline in economic activity and profitability.

At a sectoral level only a small proportion of firms in the transport and communication sector and the manufacturing sector have opted for a cut in wages. In the manufacturing sector almost 30% of the respondents indicated that they have opted for a freeze in wages in the past five years with the freeze in wage applied to all employees irrespective of occupational grouping. In most cases, the freeze applied to enterprise negotiated wage agreements with the national COLA element nevertheless being awarded thereby increasing the wage levels in the country.

Chart 14: Proportion of Firms Cutting/Freezing Wages in Past Five Years



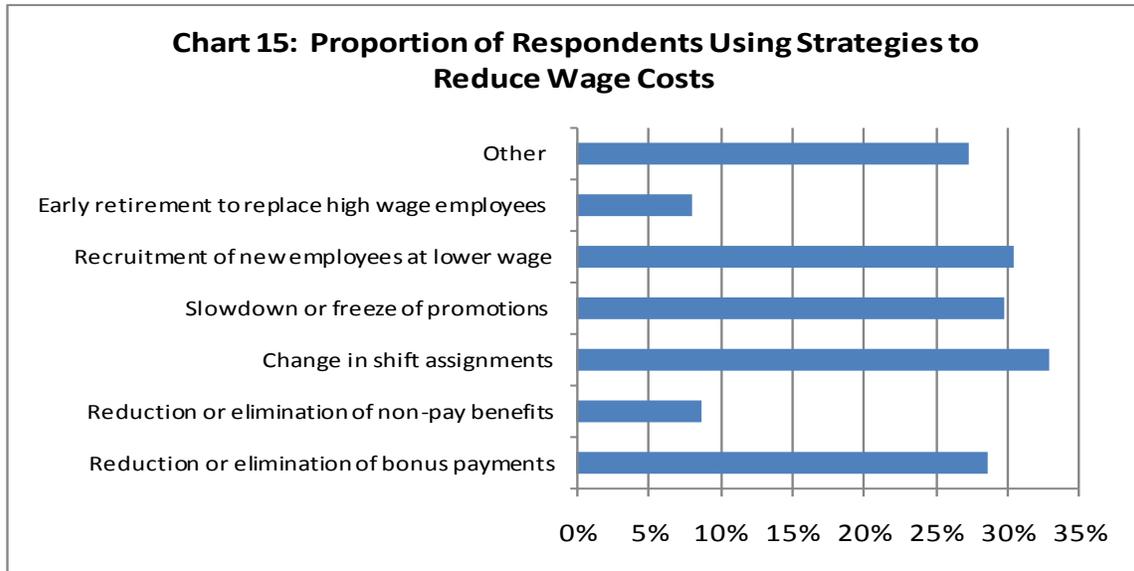
There are a multitude of obstacles which result in downwards wage rigidity. This is highlighted in Table 3 which ranks the obstacles to base wage cuts. Overall most of the respondents indicated that all variables are relevant with issues such as productive workers leaving firms following a wage cut and a reduction in morale and effort by the existing labour force cited as the most relevant obstacles. A sectoral assessment is also presented for a limited number of sectors which represent the most relevant information. In this respect, another important variable which is highlighted by firms operating in the financial services sector is the cost of hiring and training workers.

Table 3: Obstacles to Base Wage Cuts

	<i>1=not relevant, 4=very relevant</i>			
	Overall	Manufacturing	Whole and Ret	Financial
Regulation/Agreements	2.1	2.8	1.7	2.3
Reduction in effort	3.3	3.4	3.2	3.2
Reduction in morale	3.4	3.4	3.3	3.6
Reputation damage	3.1	2.9	2.7	3.1
Productive workers leaving firm	3.4	3.6	3.3	3.3
Cost of hiring and training	3.2	3.1	3.2	3.5
Difficulties to attract workers	3.0	2.9	2.6	3.1
Cyclical stabilisation	2.2	1.9	1.6	2.9
Comparability with other firms	3.0	2.8	2.8	3.2

Respondents were also asked to indicate which strategies have been adopted to reduce labour costs as depicted in Chart 15 below. The responses were relatively homogenous across sectors with over 30% of respondents indicating that they undertake a change in shift assignments where this is applicable. 30% of the respondents also indicated that they opt for recruitment of new employees at a lower wage and almost 30% referred to a slowdown or freeze of

promotions. It is to be noted that respondents referred to multiple strategies to reduce wage costs.

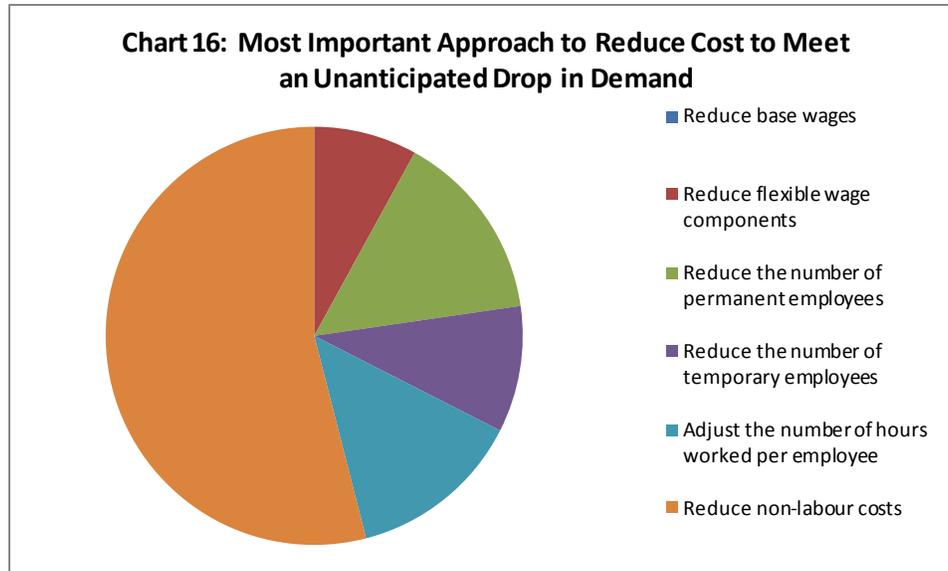


Flexibility in the labour market is also gauged through a firm’s ability to deal with unexpected shocks particularly negative ones. As a result, respondents were also asked how firms adjust wages, prices, total costs, employment and margins to economic shocks. Overall, in a bid to meet an unanticipated slowdown in demand, firms essentially opt for a reduction in costs (See Table 4). Part of the respondents in the wholesale and retail sector, however, also consider a reduction in margins to be a relevant strategy. This to an extent reflects the sensitivity of the sector to price changes. A further breakdown of these costs is presented in Chart 16 whereby 54% of the respondents indicated that they seek a reduction through costs which are not related to labour.

Table 4: Strategies to Meet an Unanticipated Slowdown in Demand *

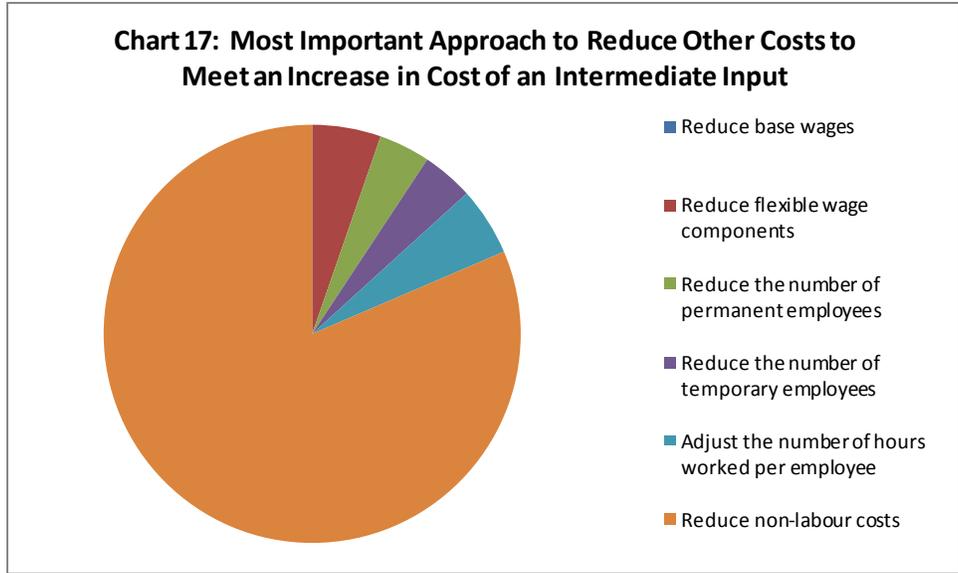
1=not relevant, 4=very relevant

	Overall	Manufacturing	Whole and Ret	Financial
Reduce prices	2.4	2.1	2.9	1.8
Reduce margins	2.8	2.8	3.2	2.5
Reduce output	1.9	2.9	2.3	1.2
Reduce costs	3.4	3.6	3.2	3.3
* Values refer to average				



Respondents were also asked which of the strategies they consider to be the most relevant in the face of an unanticipated increase in the cost of an intermediate input. Overall, a reduction in other costs is again considered to be the most relevant strategy as opposed to changes in prices, margins or outputs implying that respondents seek cost efficiency gains. A further breakdown of the costs indicates that the reduction in costs is sought through a reduction in non-labour cost (See Chart 17).

	<i>1=not relevant, 4=very relevant</i>			
	Overall	Manufacturing	Whole and Ret	Financial
Increase prices	2.2	2.1	2.8	1.4
Reduce margins	2.6	2.8	3.1	1.9
Reduce output	1.2	1.3	1.7	1.1
Reduce other costs	3.2	3.6	3.1	3.1

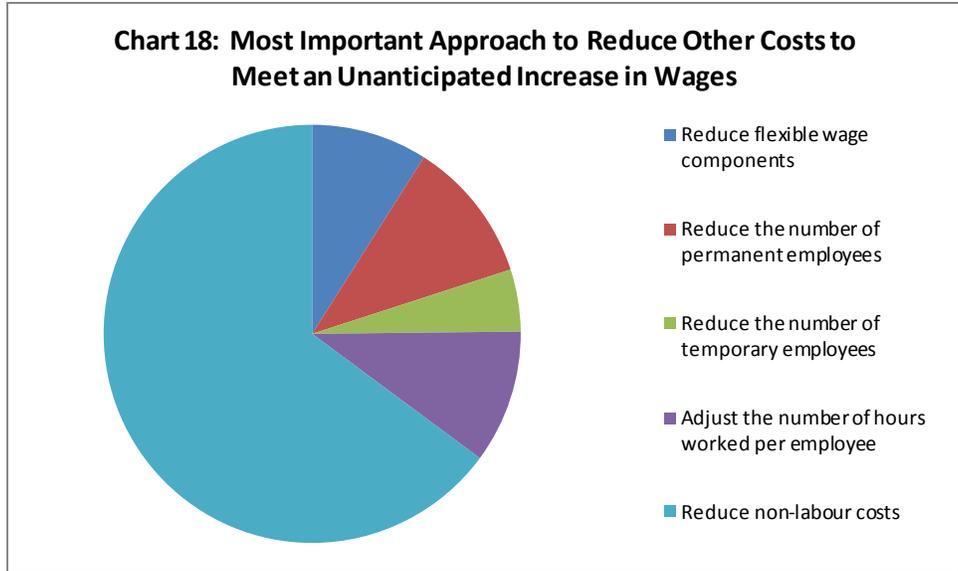


Finally, respondents were also asked which of the strategies is considered the most relevant when dealing with an unexpected permanent increase in wages as shown in Table 6 below. Once again the reduction in other costs is met through a reduction in non-labour costs reflecting the lack of labour market flexibility (See Chart 18).

Table 6: Strategies to Meet an Unanticipated Permanent Increase in Wages

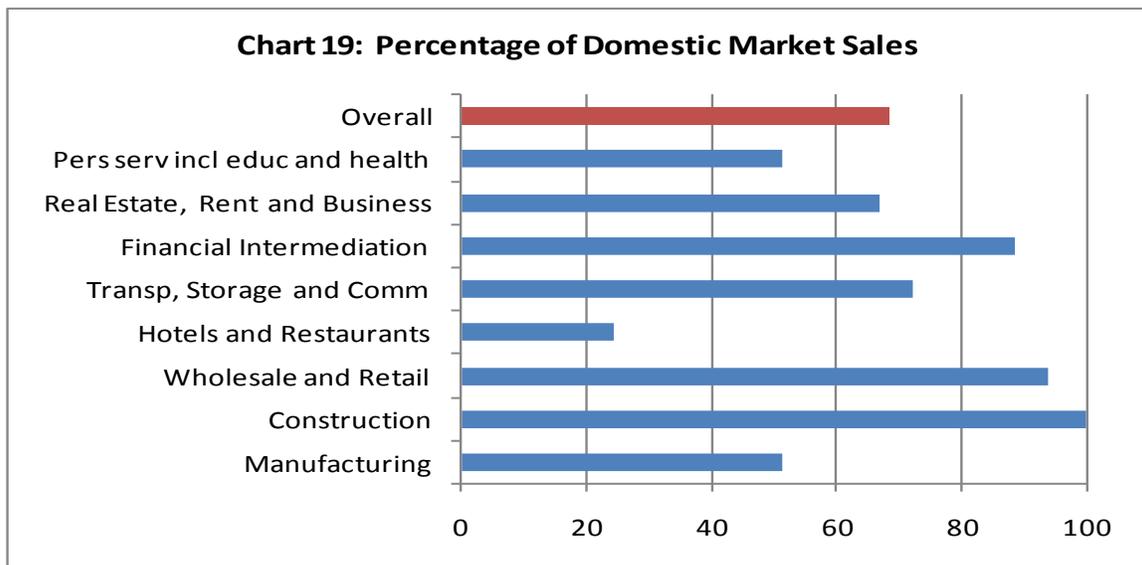
1=not relevant, 4=very relevant

	Overall	Manufacturing	Whole and Ret	Financial
Increase prices	2.2	1.9	2.1	1.5
Reduce margins	2.5	2.7	3.2	1.5
Reduce output	1.1	1.2	1.4	1.0
Reduce other costs	3.1	3.5	3.1	2.6



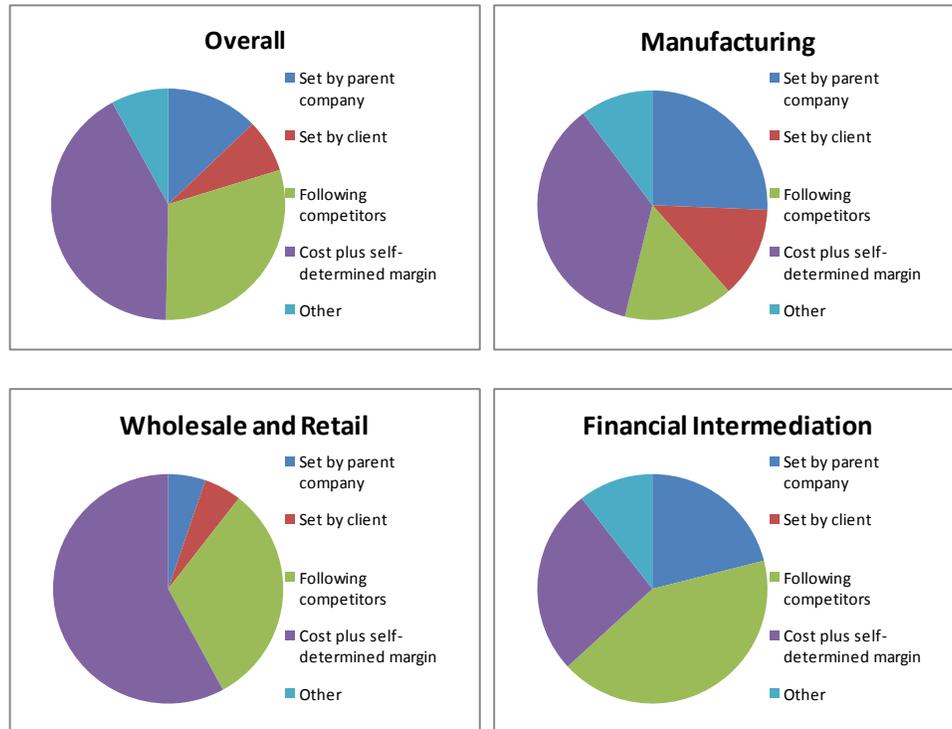
5. Price setting and price changes

The share of revenue generated by domestic market sales by all firms covered in the sample amounts to 68%. As expected, the percentage of domestic market sales amounted to 100% in the construction sector. High percentages of domestic market sales were recorded for wholesale and retail and financial intermediation at 94% and 88% respectively, whilst a low percentage was recorded for the hotels and restaurants sector at 24% given that the sector essentially caters for foreign tourists.

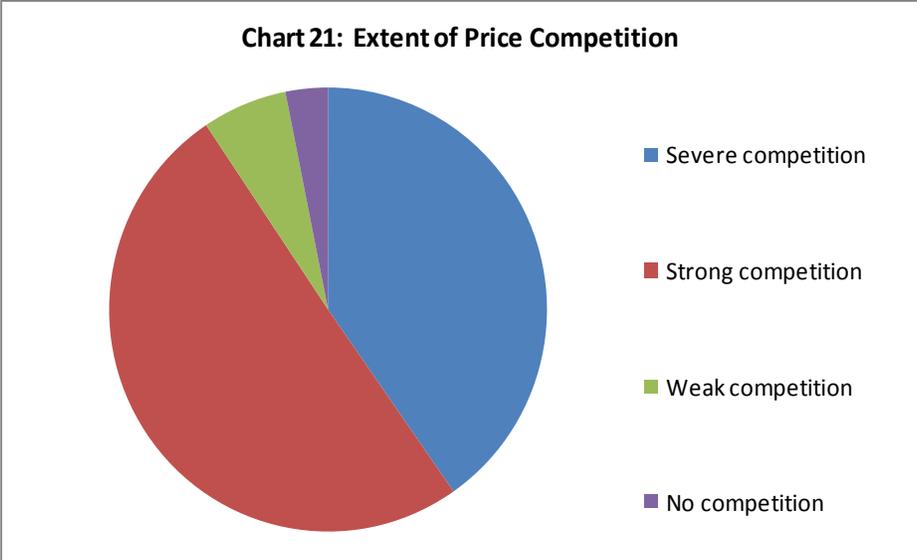


42% of firms in all sectors set the price according to costs and a self-determined profit margin reflecting a degree of market power. On a sectoral level, these variables play the strongest role in wholesale and retail. Competitive pressures are also considered an important variable with 30% of firms setting the price following their main competitors. The setting of the price by the parent company plays a stronger role in manufacturing and financial services. Overall, there is a limited role for price setting by the firms' main customer.

Chart 20: Setting of Price of Main Product

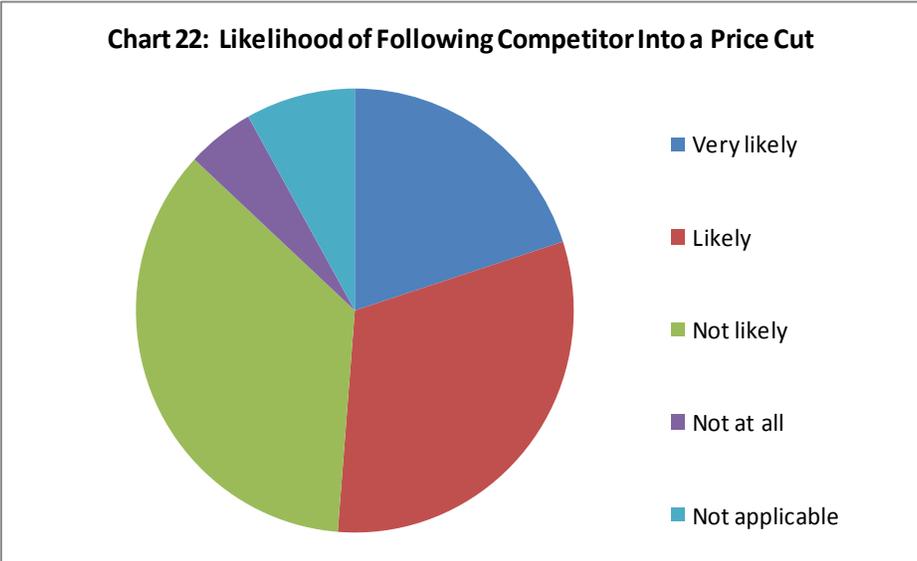


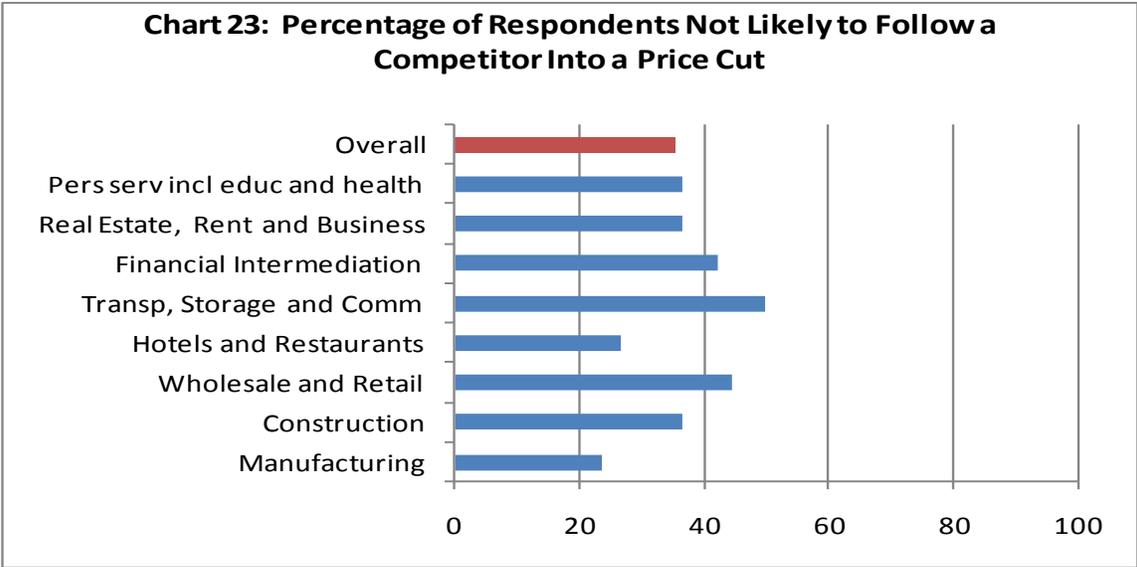
90% of firms across all sectors indicated that they experience some degree of price competition. 50% of all firms experience strong competition whilst 40% experience severe competition. Few firms face minimal or no price competition at 7% and 3% of all firms, respectively. Answers were uniform across the different sectors.



Just over 50% of all firms would follow competitors if prices are cut. Nevertheless, 36% of all firms indicated that they are not likely to follow competitors. Responses were similar across the different sectors (See Chart 22).

At a sectoral level, manufacturing and hotels and restaurants are the sectors which are the most sensitive to price competitiveness with firms in these sectors indicating that they need to cut prices to meet the reduced prices of their competitors (See Chart 23).





Most firms indicated that there is no defined pattern with regards to the timing of price changes. This indicates vulnerability to competition and costs and the inexistence of pre-planned marketing mechanisms with respect to pricing.

70% of respondents indicated that there is no particular month when price changes occur while 19% indicated that they change their prices mainly in January. The rest of the respondents were divided between other months throughout the year (See Chart 24).

Chart 25 depicts the relationship between wages and prices with 65% of firms indicating that there is no link between the timing of price changes with that of wage changes. This supports earlier findings that most firms have no defined pattern with regards to the frequency of price changes. On the other hand, 19% of firms specified that there is a link between the timing of price changes with that of wage changes although no particular pattern is highlighted. This result is consistent across all sectors.

Chart 24: Frequency of Price Changes

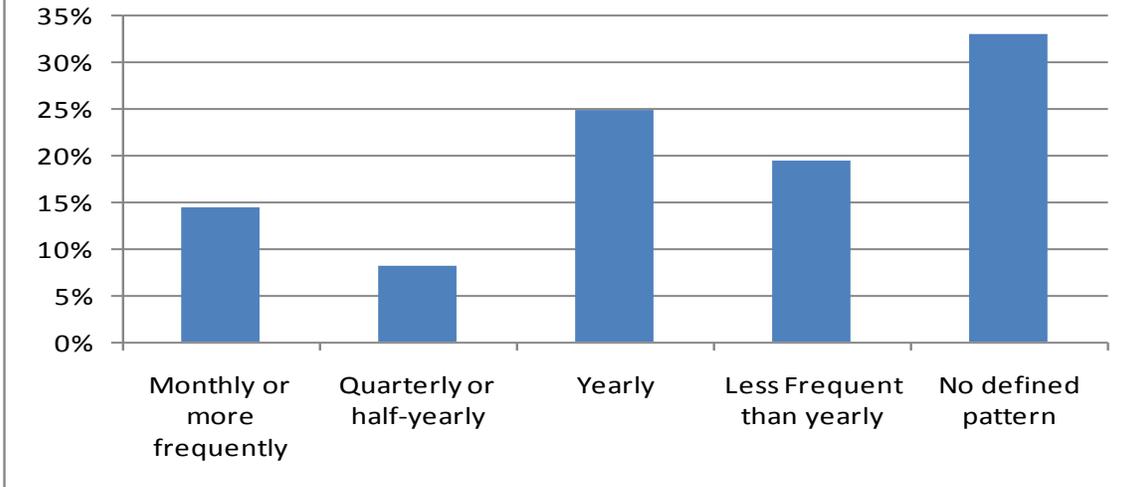
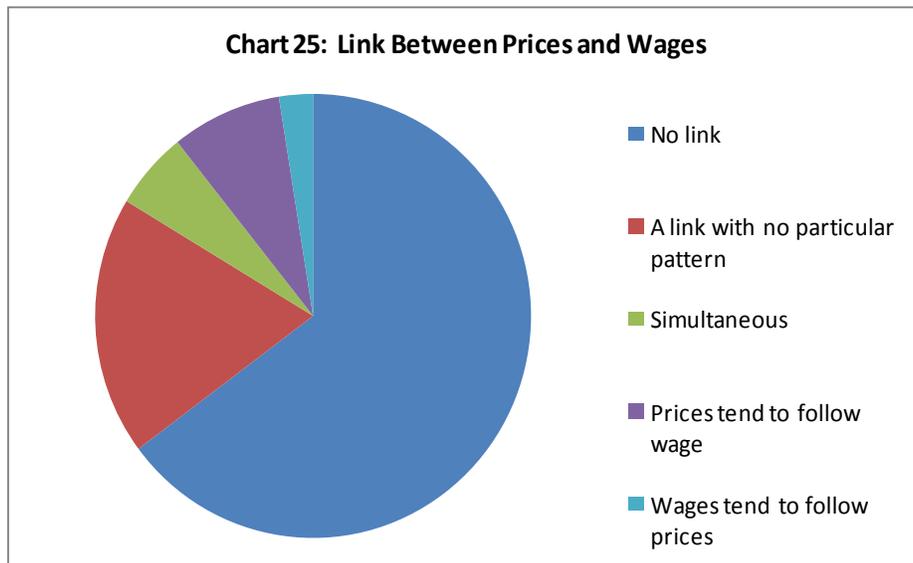


Chart 25: Link Between Prices and Wages

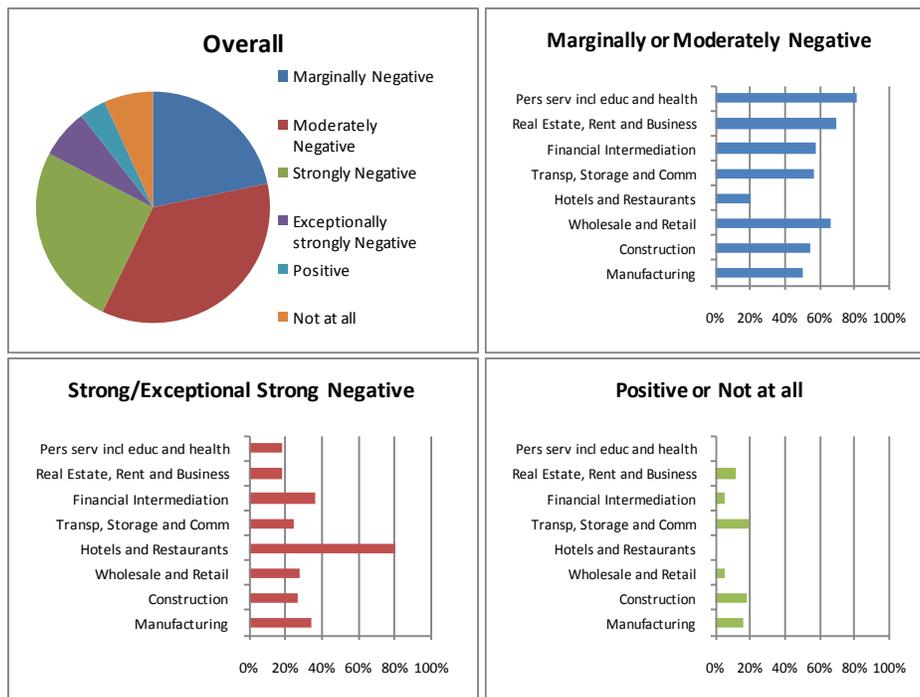


6. The reaction to the recent economic downturn

This section of the report focuses on the reaction of firms to the recent economic downturn. It is to be noted that, according to official statistics, in Malta the brunt of the recession was borne by corporate profits which declined in 2009 compared to 2008. On the other hand, wages continued to increase in spite of the recession.⁵

This is corroborated by the responses made by firms in the survey whereby overall the effect of the crisis is considered strongly to moderately negative. 80% of firms in the personal services sector indicated that they were marginally or negatively affected while 80% of firms in the hotels and restaurants sector indicated they were strongly affected. It is interesting to note that about 11% of all firms indicated that were positively affected or not affected at all by the crisis.

Chart 26: Effects of Recent Crisis



The effect of the crisis is essentially evident through a fall in demand for the firm's product as well as difficulties associated with being paid. Bank funding and supply sourcing were not considered an issue. Results are consistent across all sectors.

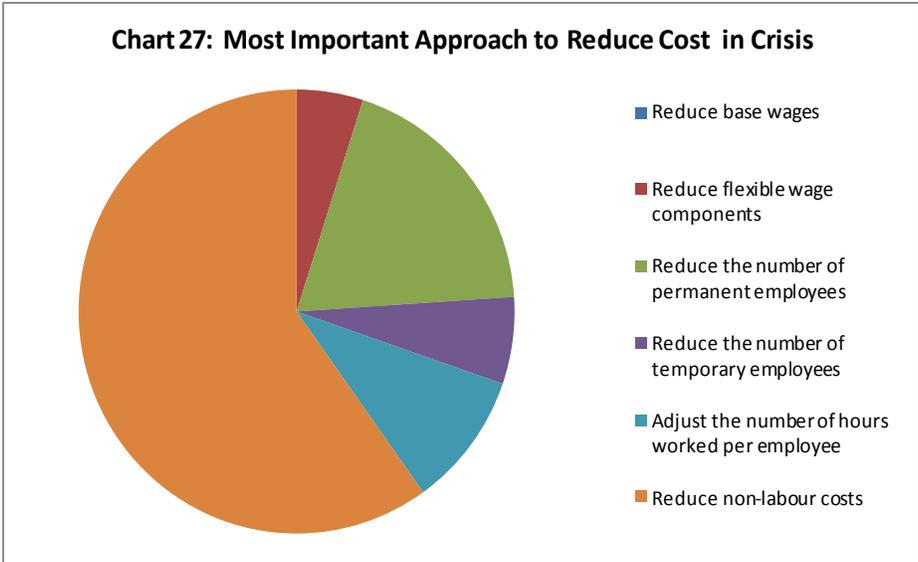
⁵ NSO Press Release 106/2010.

Table 7: Effects of Crisis				
	<i>1=not at all, 4=exceptionally strong</i>			
	Overall	Manufacturing	Whole and Ret	Financial
Fall in demand	2.3	2.4	2.4	1.9
Difficulty in obtaining funding	1.5	1.5	1.1	1.5
Difficulty in obtaining payment	2.3	1.9	2.4	2.1
Difficulty in sourcing supplies	1.3	1.4	1.6	1.1

Respondents were also asked about the strategy adopted following a slowdown in demand due to the crisis. Most of the respondents indicated that the most relevant strategy is cost reduction. A reduction in profit margins is also considered relevant albeit to a lesser extent whilst the reduction in prices and output is considered even less relevant. This indicates that firms essentially seek efficiency in order to compensate for the slowdown in demand. This strategy is consistent with that of cost reduction in the case of a slowdown in demand not caused by the crisis as presented in Section 4 of the report.

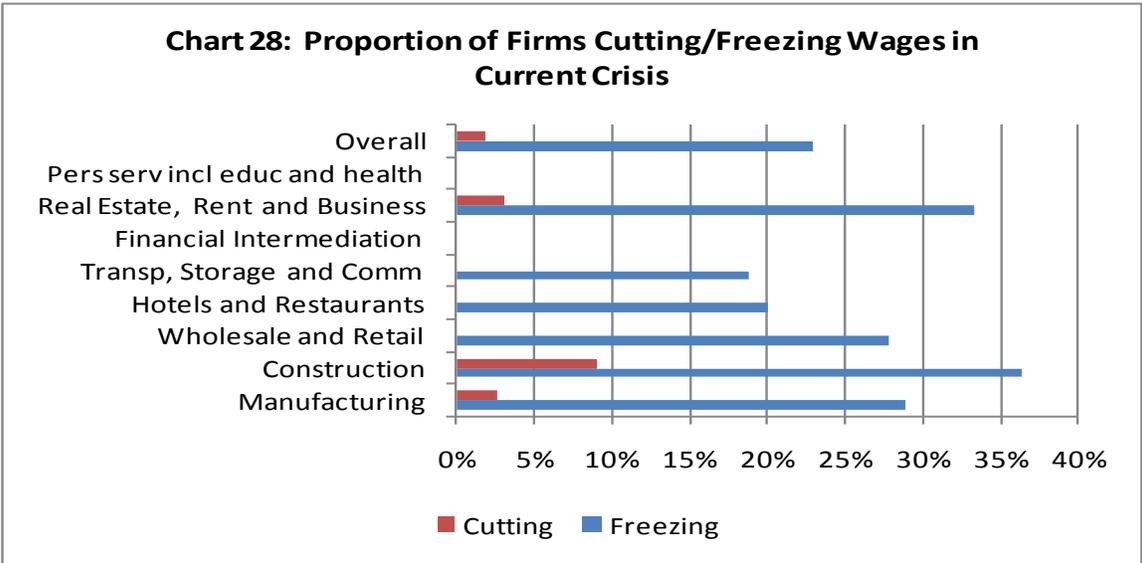
Table 8: Strategies to Meet a Drop in Demand in Recent Crisis				
	<i>1=not relevant, 4=very relevant</i>			
	Overall	Manufacturing	Whole and Ret	Financial
Reduce prices	2.1	2.0	2.1	1.7
Reduce margins	2.5	2.7	2.8	1.9
Reduce output	1.7	2.5	2.4	1.0
Reduce costs	3.2	3.3	3.3	3.1

Chart 27 indicates that due to the crisis, the majority of firms reduce costs through the reduction of non-labour costs. As indicated above, this indicates that firms opt for efficiency gains by lowering other costs as opposed to those related directly to workers. This may be due to the fact that human resources are considered an essential element of the firms' input and that the loss of workers or a reduction in their working conditions may be detrimental to the firms' survival. This result is uniform across all sectors and is consistent with the responses presented in Section 4 of the report.



Firms were also asked on the adoption of a wage freeze or wage cut in the recent crisis. 23% of firms indicated that they froze wages or were considering a freeze in wages during the crisis. It is to be noted that the proportion of respondents to this strategy is double the amount of the number of firms who indicated that they would opt for a similar strategy though not during the crisis. The proportion of firms opting for a wage freeze is higher in the real estate, rent and business, hotels and restaurants, wholesale and retail and construction sectors.

A cut in wages is considered by a relatively minor proportion of firms in the construction, manufacturing and real estate sectors.



In total, 13% of firms were/are benefiting from Government measures aimed at avoiding loss of workers or wage cuts. Half of these firms are in the manufacturing sector which has exhibited a significant element of vulnerability to the crisis.

Firms that oppose base wage cuts in the current crisis mostly fear that the most productive workers leave the firm and workers' morale is lowered. These results are congruent with those presented in Section 4 of the report which outlines the obstacles to wage cuts though not during the economic crisis.

Table 9: Obstacles to Base Wage Cuts in Current Crisis

1=not relevant, 4=very relevant

	Overall	Manufacturing	Whole and Ret	Financial
Regulation/Agreements	2.1	2.7	1.6	2.0
Reduction in effort	3.1	3.3	3.2	2.9
Reduction in morale	3.3	3.4	3.3	3.1
Reputation damage	3.0	3.0	2.7	2.8
Productive workers leaving firm	3.3	3.5	3.2	3.4
Cost of hiring and training	3.0	2.9	3.1	3.0
Difficulties to attract workers	2.7	2.7	2.5	2.9
Cyclical stabilisation	2.2	1.8	1.7	2.8
Comparability with other firms	2.8	2.8	2.8	2.9

7. Conclusion

The economy's competitiveness depends on the efficiency and effectiveness of the labour market. Indeed, wages account for a significant proportion of total production costs and are strongly linked to prices, both of which are components which determine the level of inflation in the economy. As a result obtaining a better understanding of what determines wages is important for policymakers particularly in the design and monitoring of monetary policy.

The results presented in this report are based on a survey of Maltese firms undertaken as part of the ESCB's Wage Dynamics Network. Wage setting in Malta is strongly based on collective bargaining at enterprise level. Indeed, about 31% of firms covered in the sample have a collective agreement. These firms account for 56% of workers in the firms covered by the sample. Changes in wages generally occur on an annual basis with mandatory COLA awarded to all workers. The entry level of wages essentially depends on the wages of similar workers within the firm.

In a bid to assess the extent of labour market flexibility, respondents were also asked about the level of wages in situations when there is excess demand or excess supply in the labour market. Overall, in situations of labour abundance, the majority of respondents, at 31%, indicated that

they do not lower wages due to the implicit impact on work effort. Lack of labour market flexibility is also exhibited in situations where the market exhibits a labour shortage.

In terms of wage rigidity and adjustment to shocks firms generally prefer to opt for a freeze in wages as opposed to a cut in wages. When asked about which strategies firms adopt to reduce labour costs, over 30% of the respondents indicated that they undertake a change in shift assignments and recruitment of new employees at lower wages. In a bid to meet unexpected economic shocks, firms generally indicated that they opt for a reduction in costs, essentially non-labour costs.

Firms were also asked about their pricing policies with over 40% of firms indicating that they set the price according to costs and a self-determined profit margin. 90% of firms across all sectors indicated that they experience strong or severe price competition with just over 50% of all firms indicating that they would follow competitors if prices are cut. Firms in the manufacturing sector and hotels and restaurants sector exhibited the highest degree of price sensitivity. In terms of the link between prices and wages, 65% of firms indicated that there is no link between the timing of price changes with that of wage changes.

Finally, firms were also asked about their reaction to the recent economic downturn, whereby the overall effect of the crisis is considered strongly to moderately negative. The effect of the crisis has essentially been evident through a fall in demand as well as difficulties associated in obtaining payments. Firms have essentially responded to the crisis through a reduction in costs, particularly non-labour costs.

Annex A – Sources and methods for the sampling process

From the National Statistics Office’s (NSO) business register 300 private companies were chosen from the manufacturing, construction, wholesale and retail trade, tourism (hotels and restaurants) and the services sectors. As shown in Table 1 below, each sector was sorted by full-time equivalent employees (based on gainfully occupied population data as published by the NSO Press Release 224/2009 issued on 15 December 2009) and by size of firm in terms of employees in the following employment brackets: 0-9, 10-49, 50-249 and over 250 employees. Companies employing less than 10 employees were discarded, while those firms falling within the top decile of each sector, totalling approximately 50 companies, were included on the basis that these firms reflect the main developments in the labour market. The rest of the companies were randomly selected from the remaining 250 companies, ensuring a stratified representation from each sector and size brackets in terms of employment. Table 2 shows the number of firms in the sample by sector. The face-to-face interview stage started at the beginning of May 2010 and ended in mid-June 2010. In all 161 companies participated in the interview stage. This represents a response rate of 53%. Weighting, where applicable, was carried out on the basis of employment data.

Table 1: Private Sector Full-time Employment (Annual Average 2008)

Economic Activity	Private Employment (Annual Average 2008)
Agriculture, hunting and forestry	1,631
Fishing	538
Mining and quarrying	477
Manufacturing	21,221
Electricity, gas and water supply	8
Construction	8,790
Wholesale and retail trade, repairs	21,824
Hotels and restaurants	10,030
Transport, storage and communication	8,961
Financial intermediation	5,093
Real estate, renting and business activities	12,299
Public administration and defence; compulsory social security	1
Education	3,286
Health and social work	1,744
Other community, social and personal service activities	6,662
Activities of household as employers of domestic staff	0
Extra-territorial organizations and bodies	163

Table 2: Number of firms in each economic sector

Economic Activity	Private Employment (2008)	Percentage	Number of Firms
Manufacturing	21,221	21.24%	64
Construction	8,790	8.80%	26
Wholesale & Retail Trade	21,824	21.84%	66
Tourism	10,030	10.04%	30
Services	38,046	38.08%	114
	99,911	100.00%	300