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LABOUR MARKET RESILIENCE IN MALTA

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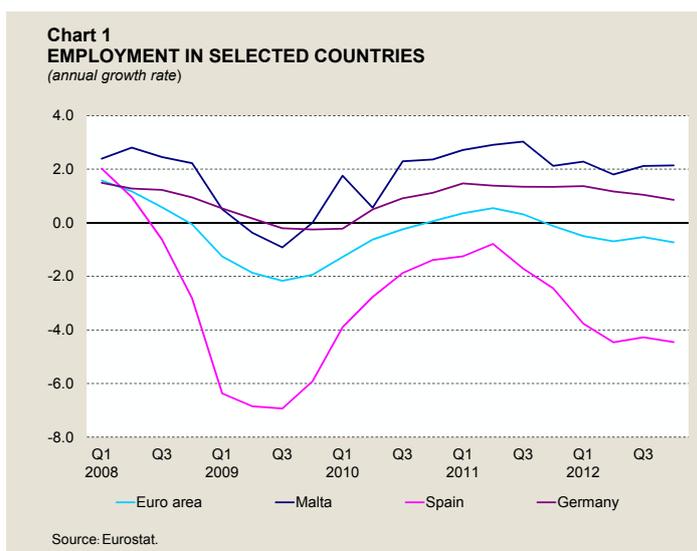
Labour market developments in Europe showed a substantial degree of cross-country heterogeneity since the start of the economic and financial crisis in 2008. This is attributable to a number of factors, such as differences in the severity of the crisis and policy responses adopted by national authorities, the exposure of some countries to sectoral shocks and country-specific institutional features of the labour market. Compared with the euro area, the 2008-2009 recession in Malta was less severe and its impact on the labour market more moderate.

Against this background, this report reviews key labour market developments and the sources of resilience since 2008, and identifies possible bottlenecks, which could hinder the adjustment process in response to future economic shocks.

Employment growth in Malta had already returned to its pre-crisis growth trend in 2010, with job creation in the services sector continuing unabated throughout this period. This performance contrasts with the situation prevailing in the euro area and especially in those countries that were hit hard by the recession, such as Spain, and compares favourably even with Germany (see Chart 1).

Following the collapse of international trade in 2009, the Maltese government provided temporary and targeted assistance directly to companies in difficulties. This approach was deemed more appropriate than a broad-based fiscal stimulus package, which, in a small and open economy, would have mostly leaked abroad through imports.

In part, as a result, the increase in the unemployment rate in Malta was more moderate, from 6% in 2008 to 6.9% in 2009. The rise started to be reversed already by early 2010. This contrasts with the situation prevailing in the euro area, where the increase in the unemployment rate after the 2008-2009 recession persisted and resumed its upward trend following the sovereign debt crisis in 2011 (see Chart 2). Despite the recent increases, the unemployment rate in Malta remains at a low level compared with the euro area, standing at 6.6% in 2013 Q1. According to estimates by the European



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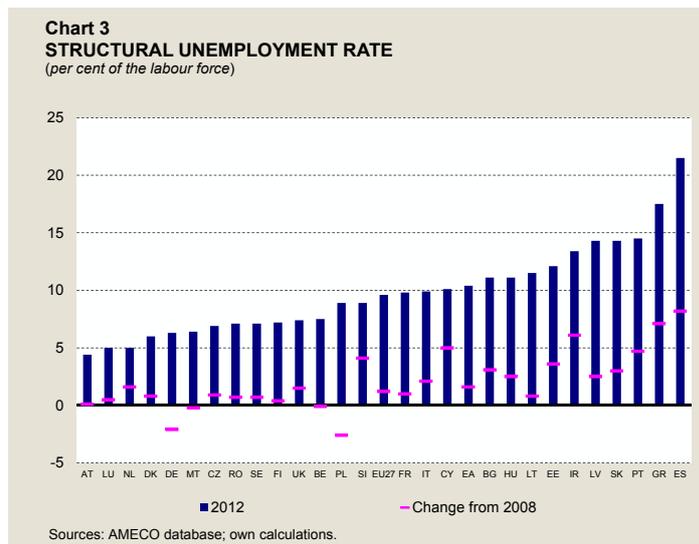
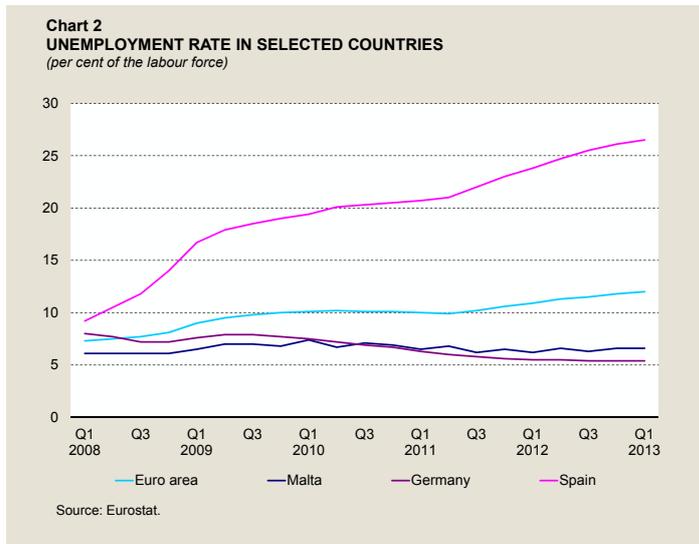
Commission, the impact of the crisis on Malta's structural unemployment rate has been negligible (see Chart 3).²

Labour supply

Contrary to the pro-cyclical behaviour of the participation rate in past recessions, the labour supply in most EU countries remained resilient since the onset of the crisis.³ In Malta the participation rate continued to rise from 58.9% of the working age population in 2008 to 63.1% in 2012, though it still remains lower than the EU average of 71.8%, with both males and females contributing to this increase.

An analysis of the participation rate by educational attainment suggests that the gap between Malta and the European Union is populated mostly by individuals with a low and medium level of education, whereas the participation rate of Maltese persons with a tertiary level of education is higher than in the European Union.

Albeit starting from a low level, the participation rate of females increased by 7.6 percentage points since 2008, by far the largest increase among EU countries, to stand at 47.8% in 2012. During the same period, the participation rate of older workers increased by 4.2 percentage points, to stand at 44.4% in 2012. From a longer-term perspective, however, efforts to retain older workers in the labour market have been less successful in Malta, at least when compared with developments in other EU economies. The pension reform, in conjunction with targeted fiscal measures, should, however, contribute to encourage more



² According to the Commission, structural unemployment refers to the concept of the non-accelerating-wage rate of unemployment (NAWRU), that is, the unemployment rate that is consistent with a constant wage growth. The cyclical component of unemployment in Malta was close to zero in 2012.

³ See European Commission (2012) and ECB (2012) for further details.

older workers to remain active over the coming years.⁴ Statistics on the average exit age from the labour market suggest that Malta is closing the gap with the EU economies.⁵

The increased participation rate of females in the labour force is attributable to a number of initiatives taken since the beginning of the crisis, including back-to-work fiscal incentives, new income tax rules and an increase in maternity and adoption leave. Measures were also aimed at making childcare facilities more available and extending after-school care services in a number of schools to bridge the gap between school days and regular working hours of parents in employment. The possibility of going from full-time employment to full-time reduced hours with the enjoyment of all pro-rata benefits has also helped in this regard.

A related trend in the domestic labour market has been the increasing engagement of part-timers. Statistics from the LFS suggest that part-time employment accounted for more than 40% of the overall increase in employment since 2008, with women accounting for around 60% of that rise during this period.

Immigration also generates an increase in the labour supply and can address structural shortages in the labour market, both in the low and the highly-skilled sectors. This is important not only in view of Malta's ageing population but also because labour shortages in selected sectors can create upward pressure on wages, with adverse effects on price competitiveness. According to the ETC, there were almost 9,000 foreigners with a licence to work in Malta in 2010, with more than half being EU nationals.⁶

Wages, productivity and labour hoarding

The increase in the labour supply was complemented by a period of wage moderation. In the aftermath of the 2008-2009 recession, nominal wage increases in Malta averaged 2.0% per annum, broadly in line with those awarded in the euro area and lower than the historical average wage growth of around 4% before the crisis. Wage moderation was especially pronounced in 2010 and 2011. Econometric estimates presented in Grech *et al* (2013) point towards an important role for wage moderation in sustaining the demand for private sector employment in Malta.

However, with employment by domestic firms rising more strongly than output, labour productivity dropped sharply since 2011. Consequently, unit labour costs increased. Labour hoarding is likely to be one factor behind falling productivity.⁷ In general, businesses resort to labour hoarding if hiring new workers involves substantial search and training costs, namely, if the skills required are very firm-specific and, hence, difficult to find among poten-

⁴ Legislation was introduced in 2008 through which persons of pensionable age under the age of 65 will be able to work without losing their pension entitlements, irrespective of the amount of earnings and of their age. As a result of pension reforms, the retirement age is being gradually raised to 65.

⁵ According to Eurostat, the average exit age in Malta increased from 59.8 years in 2008 to 60.5 in 2010. During the same period, the average exit age in the European Union rose slightly from 61.4 to 61.5 years.

⁶ A large drop in active licences was registered in 2011 since, as from May 2011, EU nationals no longer require an employment licence to work in Malta.

⁷ There could be other explanations for the weakness in productivity, such as the impact that a prolonged period of subdued investment may have on the capital stock, high risk aversion by banks to lend to start-up companies that have the potential to achieve higher productivity and difficulty in measuring real output in emerging sectors of the economy.

tially new workers. In such an environment, firms may opt to vary the utilisation rate of labour during a period of temporary weak demand instead of laying off workers.

According to information collected in 2010 and presented in the *Wage Dynamics Report*, more than half the surveyed firms indicated that, when faced with economic shocks, they prefer to cut non-labour costs and overtime rather than shedding jobs.⁸ Statistics from the LFS confirm that the trend in hours worked per employee, both for full-timers and part-timers, has remained below the pre-crisis levels.

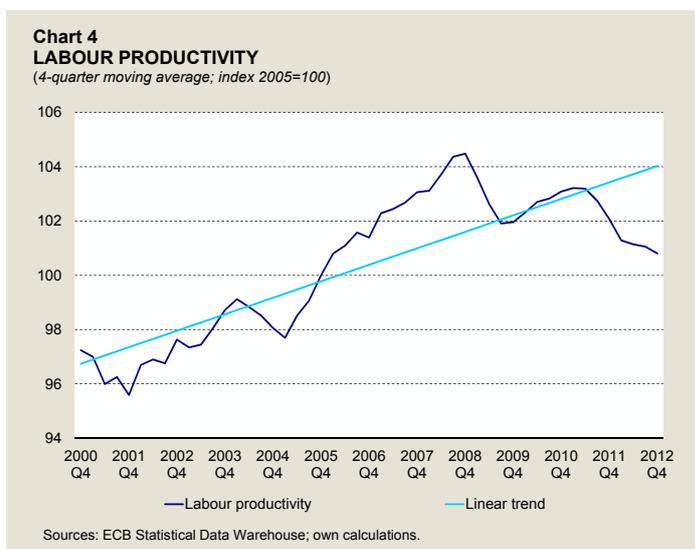


Chart 4 uses the difference between labour productivity and its long-term trend as a proxy for labour utilisation.⁹ The chart plots an index of labour productivity and a fitted linear trend. Data points below the trend line represent an underutilisation of the workforce, implying an increase in labour hoarding, and vice-versa. The chart points to a drop in labour utilisation in 2009, bringing it back to its long-term trend. Since the end of 2011, however, this indicator implies an increasing degree of labour hoarding as labour productivity fell further below its long-term trend.

Skill mismatches

The relatively low unemployment rate in Malta masks important differences in the profile of the unemployed. According to the LFS, slightly less than half of the unemployed in 2012 were searching for a job for more than a year, thereby being classified as long-term unemployed. Such structural unemployment may be the result of a mismatch between the skills offered by the unemployed and those required by today's industries.

Further indications of possible skill mismatches can be gauged by the occupations sought by persons on the ETC unemployment register. In 2012 more than 60% of registrants were looking for low skilled jobs that do not warrant a higher level of education, such as elementary occupations, plant and machine operators, sales workers and clerks.¹⁰ In addition, more than 40% of those on the unemployment register are over 45 years of age, an

⁸ For details of the *Wage Dynamics Report*, see Central Bank of Malta (2011).

⁹ A similar approach was proposed by Felices (2003). Since labour productivity is measured as output per headcount employment, such a measure should be interpreted with caution in light of the increasing use of part-time workers. In addition, the absence of price deflators at the sectoral level for Malta prevents an in-depth analysis of sectoral productivity dynamics.

¹⁰ The figures include both Part 1 and Part 2 of the unemployment register.

indication of an added challenge that may be encountered in the upgrading of skills and qualifications.

In recent years, efforts were directed to increase the employability of the long-term unemployed by introducing schemes to undertake work in the community. Such programmes are also intended to tackle the problem of undeclared work.

Main policy implications

The Maltese labour market performed relatively well since the economic and financial crisis of 2008, at a time when labour market performance in a number of other European countries deteriorated drastically. This resilience is the result of a combination of prudent economic policies and labour market institutions, such as wage-bargaining at firm level, which helped to keep wage pressures contained and employment growing.

Going forward, measures to increase the supply of labour, primarily by attracting more females and older workers to the labour market, should remain high on the policy agenda. Incentives should continue to be directed to address bottlenecks for these target groups by providing tax incentives on income from work, making childcare more available and extending after-school facilities. The introduction of more flexible work arrangements, such as flexitime and teleworking, could help reconcile work and family life. Recourse to early retirement schemes should be limited, instead opting for measures to support the employment and retention of older workers in the labour market by emphasising the value of work experience.

The education system in Malta should remain adaptable and flexible to ensure that the diversification of the economy's production structure does not lead to shortages in the high-skilled segment of the labour market. Initiatives that strengthen the collaboration between academia and the business community should be encouraged to bridge the gap between the skills of new graduates and the requirements of today's industries.

Finally, despite Malta having one of the lowest youth unemployment rates in the European Union, additional efforts are needed to reduce early school dropouts, improve vocational education and extend apprenticeships schemes. Efforts should continue to be directed towards labour market policies that facilitate the return to work of less-skilled individuals, in particular by providing appropriate training to improve the employability of job seekers and tackle the mismatch between the supply and demand of labour skills.

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