

BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

LABOUR MARKET SLACK

BOX 2: LABOUR MARKET SLACK¹

The labour market in Malta has experienced a strong recovery in recent years, registering a marked decline in unemployment rates. Moreover, over the past decade, the Maltese labour market passed through a period of significant structural change with increased female participation and a surge in migrant worker flows. In this same period, however, growth in wages remained subdued from a historic perspective, which could indicate that actual slack may be more significant than suggested by conventional measures of labour underutilisation, such as the unemployment rate. Labour market slack is defined as the shortfall between the volume of work offered by workers, and the actual volume of work requested by firms. Economic theory would suggest that wages could be held down by labour market slack. Against this background, this analysis compares developments in a newly estimated measure of slack for Malta to the official unemployment rate and with a similar measure of slack for the euro area.

The estimate for slack presented in this Box extends the labour market analysis in Ellul (2018), which provides only limited insight as the model it employs considers only workers who are in employment and the unemployed – explicitly excluding other labour market characteristics that could indicate slack, such as workers who are inactive or marginally attached to the labour market.²

The attention given to the unemployment rate should not divert policymakers' attention from strengthening the labour market attachment of prospective workers who are inactive, or the underemployed. Focusing solely on the unemployment rate may paint a partial picture which relies on labour demand trends and ignores broader labour supply issues. For example, there may be periods when the number of persons available to take up work but not actually seeking work exceeds the number of short-term unemployed who are seeking work and who feature in official definitions of unemployment. Such periods may provide different challenges to labour market policy design.

Moreover, structural changes to labour demand towards services imply that an increasing proportion of those employed are working on a part-time basis or irregular hours. Some may also prefer to work longer hours than those offered. These may be termed underemployed part-time workers. An economy with an increasing share of these particular forms of employment will have a number of implications on compensation, employment outcomes and welfare on an individual level. It may also affect potential growth, and the economy's output on an aggregate level.

Most economic sectors in Malta have recorded very strong growth in employment according to national accounts data. Total employment rose by 20.7% between 2013 and 2017, with some sectors growing by twice as much, or even more. Overall, the high economic

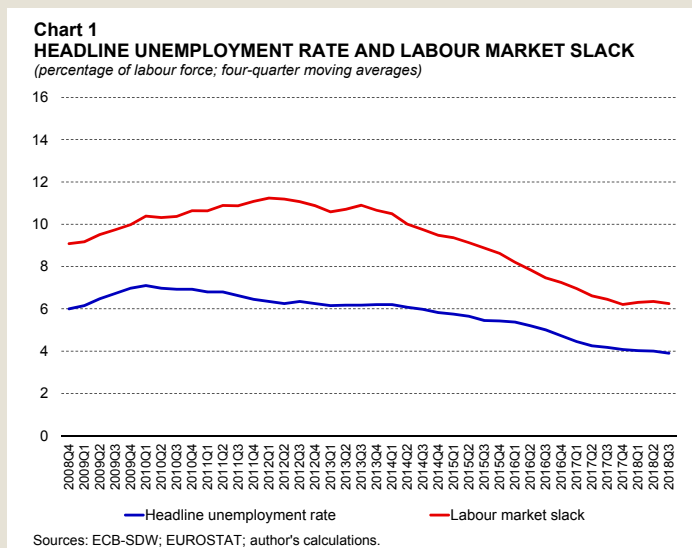
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² Ellul, R. (2018). "Forecasting unemployment rates in Malta: a labour market flows approach," Working Paper WP 03/2018, Central Bank of Malta.

growth rates seen in recent quarters were very employment rich. The number of persons employed rose by over 37,000 since end-2013. Unemployment also fell, with this decline affecting both the short-term and long-term unemployed and, with companies in different industries finding it difficult to employ further workers and increasingly resorting to migrant workers.³

The unemployment rate is seen as a key indicator for labour market performance, which is closely observed by policymakers. However, it does not capture all types of labour market slack. Official unemployment statistics are based on International Labour Organisation (ILO) definitions, which focus on those who are without work, available to start working within a fortnight and seeking work actively. More broad definitions of labour market slack, used by the Organisation for Economic Co-operation and Development (OECD) and the US Bureau of Labor Statistics, include measures of underutilisation of labour resources and the underemployed.

In this Box, we augment official unemployment data with three other categories of persons relevant for the measurement of market slack apart from the unemployed (i) underemployed part-time workers (ii) persons seeking work but not immediately available and (iii) persons who are available to work but not seeking. Such persons are excluded from the standard labour force, which is the sum of employed and unemployed. These figures derive from the LFS, published in quarterly format by Eurostat.⁴ Summing the estimates of the unemployed and the above three categories indicates that labour market slack in Malta increased substantially in the aftermath of the 2008/9 Financial Crisis, reaching a peak of 11.2% in the first quarter of 2012. By 2017, however, it had decreased to around 6.0% (see Chart 1). By comparison, the unemployment rate averaged 4.0% that year. While the broader measure of slack has consistently exceeded the unemployment rate, the gap between the two narrowed in recent years. Therefore, while there is more labour market slack than the unemployment rate would suggest, the underutilisation of labour is decreasing.⁵



³ Grech, A. G. (2016). "Assessing the economic impact of foreign workers in Malta," *Quarterly Review* 2016(1), Central Bank of Malta.
⁴ The numbers quoted for particular components may be unreliable given the relatively small size of the LFS sample. In that sense, their interpretation ought to be carried out with particular caution.
⁵ The ILO considers labour underutilisation to occur in cases of skills mismatch, relating to workers' placement in roles with lower skill requirements than their educational level. Low earnings may also indicate labour underutilisation to the extent that it arises in full-time employment with low monthly earnings, less than full-time employment with low hourly earnings and those overly employed with low earnings. See: International Labour Organisation (ILO). (2008). *Beyond unemployment: Measurement of other forms of labour underutilisation*. Report of the working group on labour underutilisation for the 18th International Conference of Labour Statisticians, 24 November-5 December 2008, International Labour Office, Geneva.

A striking change can be seen in the development of the components which represent persons who are marginally attached to the labour force (see Chart 2). Underemployed part-time workers halved from a high of 2.7% of the labour force in late 2013 to 1.3% by end-2017. Persons available to take up work but not seeking it fell from around 2.3% of the labour force in 2012 to 0.6% by end-2017. The

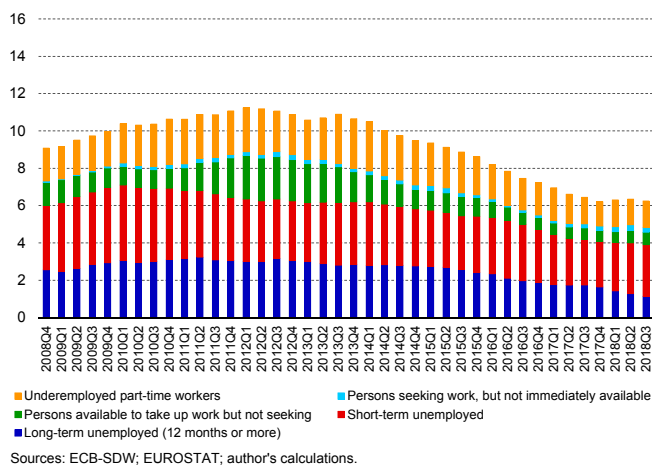
rate of persons seeking work but not immediately available remained broadly constant. These three groups may have been affected by policy initiatives designed to incentivise work, such as the tapering of unemployment benefits, the in-work benefit scheme, and efforts to retrain unskilled workers.

Except for a short period around 2012, underemployment in part-time work appears to be a more important element of labour market slack in Malta than persons available to work but not seeking work (which likely includes discouraged workers).⁶ Those seeking work but not immediately available are the least numerous.

One may doubt whether all the marginally attached workers ought to be considered as additional slack in the labour market, although traditional economic theory suggests they are. This argument is particularly the case when one considers that more flexible forms of work may be due to recent shifts in the labour markets, such as the gig economy, or individual preference for more limited hours of work. One should also recall that the largest element of labour market slack is unemployment in most periods. Unemployment itself has recorded a steady decline, with the level of unemployed workers shrinking on an annual basis in administrative data, as well as in the figures reported by the LFS dataset.

Historically, slack in Malta appears to be lower than in the euro area (see Chart 3). Between 2009 and 2017, slack in the euro area and in Malta averaged 19.2% and 9.5%, respectively. The positive differential against the euro area averages around 10.0% over this period, but accelerates markedly from 2014 onwards. A recovery in the euro area labour market, however, has narrowed slightly the gap in recent quarters. The differential can mostly be attributed both to higher unemployment in the euro area, as well as to higher proportion of persons available to take up work but not seeking and of underemployed

Chart 2
BROAD MEASURE OF LABOUR MARKET SLACK
(percentage of labour force, four-quarter moving averages)



part-time workers (see Table 1). These three components contributed around 47.0%, 25.0% and 19.0% of the average differential in the overall measure of labour slack between 2009 and 2017, respectively.

When referring to labour market slack in Malta, one has to consider that since EU membership, potential labour supply expanded to include the labour supply in the EU,

or more realistically part of it, as not all EU citizens are willing or able to migrate to Malta. This of course is difficult to quantify, but periods of high labour market slack in the EU may have an impact on wage growth in Malta. Higher slack in neighbouring countries can therefore be another factor, in addition to those identified in this Box, that may explain the behaviour of wage growth – in spite of the very low unemployment rate and the decline in labour market slack identified above.

This wider definition of labour market slack may have the potential to be extended in a framework on a refined measure of the non-accelerating inflation rate of unemployment for Malta, as well as the euro area. This further research may be highly topical as the response to wage growth in recent years was muted, despite the decline in unemployment. An economic explanation of this phenomenon has so far been elusive.

From a longer term perspective, the degree of labour market slack in Malta has declined from the highs seen in 2012, when the broader measure of slack stood at around 11.0%

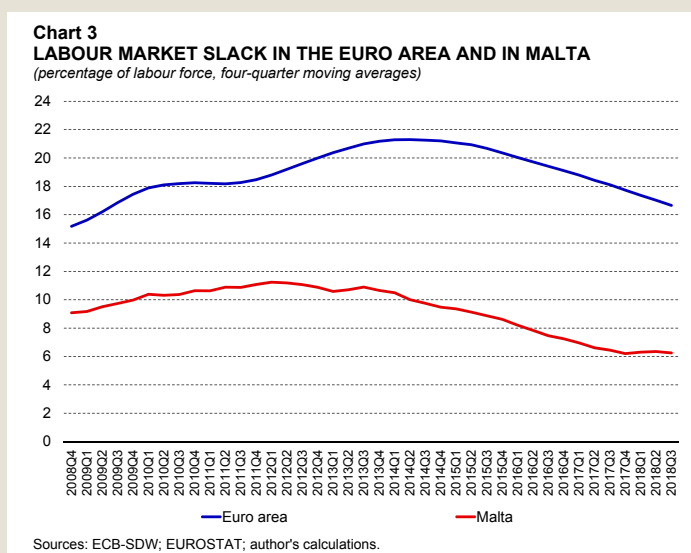


Table 1
LABOUR MARKET SLACK COMPONENTS

Per cent

	Euro area		Malta	
	2008Q3	2018Q3	2008Q3	2018Q3
Persons available to take up work but not seeking	21.6	22.8	17.8	11.2
Persons seeking work, but not immediately available	8.0	6.0	0.3	1.7
Underemployed part-time workers	22.1	21.6	18.4	25.8
Long-term unemployed (12 months or more)	18.4	23.2	23.9	20.6
Short-term unemployed	29.8	26.5	39.6	40.7
Total	100.0	100.0	100.0	100.0

Sources: ECB-SDW; author's calculations.

of the labour force. This was underpinned by improvements in both unemployment numbers as well as a marked decrease in persons available to take up work but not seeking it. By end-2017, slack in the labour market is estimated to have almost halved to stand at around 6.0%, going significantly below the levels seen in the aftermath of the crisis. The small difference between the broader measure of slack and the unemployment rate confirm the existence of underlying tightness in the Maltese labour market. It also suggests that untapped pools of marginally attached Maltese workers appear to have been broadly exhausted; future economic growth may increasingly have to depend on productivity gains by existing employed workers, or further foreign migrant inflows.