

BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

THE EFFECT OF A RISE IN MINIMUM WAGES ON AVERAGE WAGE GROWTH

BOX 1: THE EFFECT OF A RISE IN MINIMUM WAGES ON AVERAGE WAGE GROWTH^{1,2}

The first National Minimum wage legislation in Malta was introduced on December 2, 1974, through the Conditions of Employment Act when a minimum wage of €23.29 per week was set. This wage tended to be increased in a discretionary manner till the cost-of-living adjustment (COLA) mechanism was introduced in 1990. Subsequently, Malta's National Minimum Wage started to rise annually in line with the COLA, at the start of the calendar year. However, in 2017 another social pact was agreed between social partners regarding the establishment of a low wage commission to advise Government every four years on whether there needs to be additional increases to the minimum wage. The pact also stipulated increases in the minimum wage above COLA in 2018 and 2019, and that a person on the minimum wage would get an automatic increase once they complete a full year on this wage, and another increase in the second year.³

In 2023 Malta's weekly National Minimum Wage stood at €192.73 for those aged more than 18 years, which amounted to 28% of the average weekly wage. As announced in Budget 2024, the national minimum wage is set to rise during the period 2024-2026. In 2024, the national minimum wage will increase by €8 over and above the COLA. The latter change integrates the automatic increases specified in the 2017 agreement for those who stay for more than a year on the minimum wage. The €8 will be granted to them immediately, an increase over and above COLA. In the following two years, the national minimum wage is set to rise by €3 over and above the COLA. Considering that the COLA for 2024 has been announced at €12.81, the weekly minimum wage for 2024 is set at €213.54.

This box aims at providing some preliminary quantification of the effects of the rise in Malta's minimum wage for 2024 on average compensation per employee and thus the effect of such a measure on the Bank's wage projections for 2024.

Estimated impact on wages in Malta

Neumark et al. (2000)⁴ show that apart from the direct impact on minimum wage earners, a change in the minimum wage also affects those workers whose wage is close to the minimum wage. Indeed, one of the recurring challenges in such literature is the estimation of the spillover effect from a minimum wage change to higher wage brackets.

In general, literature on spillover effects from minimum wage changes to average wages is mixed. For instance, Neumark et al. (2000) state that those earning higher than the minimum wage are only minimally affected by higher minimum wages in the United States. Also, Stewart (2010)⁵ finds no evidence of minimum wage spillover effects in the United Kingdom.

¹ This box was prepared by Abigail Marie Rapa, Principal Economist within the Economic Projections and Conjunctural Analysis Office.

² This analysis looks at the effects on the National Minimum Wage and does not take in consideration the marginal differences that exist between the national minimum wage and the sector and age-specific minimum wage rates foreseen in Maltese Law.

³ See [National Agreement on the Minimum Wage \(2017\)](#).

⁴ Neumark, D., Schweitzer, M., and Wascher, W. (2000). The effects of minimum wages throughout the wage distribution. *NBER Working Paper Series*, No. 7519.

⁵ Stewart, M. B. (2010). Individual-level Wage Changes and Spillover Effects of Minimum Wage Increases. *University of Warwick*.

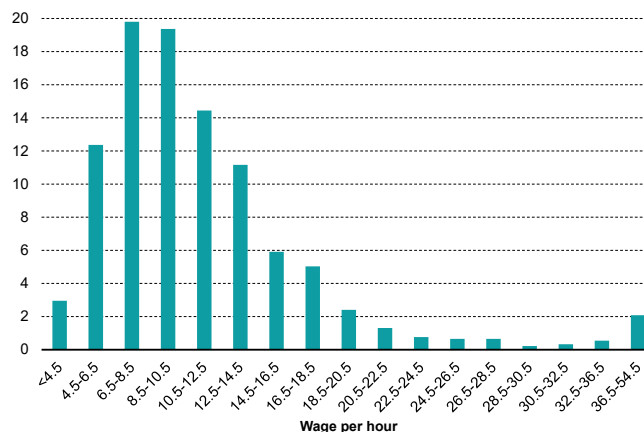
On the other hand, Neumark et al. (2004)⁶ find evidence of substantial spillover effects when they examine effects on individual wage changes directly at various points in the wage distribution.

For the purposes of this box, we estimate a range of impacts from minimum wages to average wages in view of the uncertainty exhibited in the literature.

As a first step, we have used Household Finance

and Consumption Survey (HFCS) data to obtain a wage per hour distribution of the Maltese economy. The latest HFCS vintage holds individual-level data of compensation and average hours worked for 2020, which allows us to obtain information about the wage per hour distribution. According to these data, the proportion of those earning the minimum wage in 2020 (€4.48 per hour) stood at slightly below 3% of the total sampled employees (see Chart 1). Moreover, these data showed that around 40% of sampled employees earned between €6.50 and €10.50 per hour.

Chart 1
DISTRIBUTION OF COMPENSATION PER HOUR IN 2020
(percentage of employment)



Sources: HFCS; Central Bank of Malta calculations.

To obtain an estimate for 2023, we extrapolate the wage per hour distribution from 2020 by using COLA increases over the period 2020 to 2023 for the lowest wage bracket, and the average wage per hour growth (obtained from national accounts data) for the rest of the distribution.

To estimate the impact of the recent increase in minimum wages on wage growth in 2024, a baseline wage distribution for 2024 is assumed, whereby an individual receives at least the COLA increase announced in the Budget 2024. This implies that the first 11% of the distribution are assumed to receive an increase in their wage per hour of €0.32. The rest are assumed to receive an increase in their wage per hour consistent with the projected wage per hour growth rate embedded in this forecast publication.

In view of the uncertainty surrounding the expected spillover effects of the rise in minimum wages, a few scenarios were assumed to estimate a range of impacts on the growth in average wages.

To estimate the direct impact of the minimum wage increase, as a first scenario, we assume that only the minimum wage earners are affected by the proposed increase of €8 in their weekly wage over and above the COLA. As mentioned earlier, this will thus effect only

⁶ Neumark, D., Schweitzer, M., and Wascher, W. (2004). Minimum Wage Effects throughout the Wage Distribution. *The Journal of Human Resources*, No. 39, pp. 425-50.

slightly less than 3% of the employed population. According to our estimates, the effect of such a measure on the average wage per hour is 0.04 percentage point and is thus considered to be minimal.

To estimate the spillover effect on other wage brackets, we explore two methods. The first method derives from findings in Neumark et al. (2004). In this study, the elasticity of workers with wages between the minimum wage and 10% above the minimum with respect to the minimum is 0.8, which implies that those earning 10% above the minimum wage per hour would receive 80% of the increase in the minimum wage. This elasticity falls to about 0.4 for those with wages 10-30% above the minimum, and to about 0.25 for those with wages 30-50% above the minimum. Employees whose wage per hour is above 50% of the minimum wage are assumed not to benefit from the rise in the minimum wage. In such an instance, the effect on average wage growth is estimated to be around 0.11 percentage point.

As a third scenario, we account for stronger spillover effects by assuming that the impact from the rise in the minimum wage to other wage brackets depends on where the individual falls within the wage per hour distribution, rather than their relative hourly wage to the minimum wage. In such a scenario, the first 10% of the wage distribution receive the increase in the minimum wage in full. Those who fall in the 10-20% of the wage distribution are assumed to receive an increase of 80% of the minimum wage rise, the next 10% assumed to receive 60%, the following 10% are given 40%, while those falling in the 40-50% of the distribution are given 20% of the minimum wage increase. The rest of the distribution are assumed not to benefit from the minimum wage increase. In such a scenario, the average wage growth is estimated to be 0.69 percentage point higher than the baseline wage per hour.

Implications for the Bank's wage projections

Based on the above assumptions, the impact of minimum wages on average wage growth in 2024 is thus being estimated to fall within the range of 0.04 to 0.69 percentage point. In this projection we take the case of 0.11 percentage point as the most likely impact of the recent increase in the minimum wage on average wage growth in 2024. This is consistent with the methodology derived from estimates in Neumark et al. (2004).

Such estimates are very preliminary, and results may be reviewed as new information becomes available. Furthermore, it is rather challenging at this stage to fully take into account all indirect effects of the minimum wage increase to the rest of the wage distribution, and further analysis and scenarios might be warranted.