PKF Malta

PKF Study

Unemployment and the potential economic implications of the COLA

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Introduction to our firm

PKF Malta is a fast-growing firm specialising in audit, legal and business advisory services. Our firm is a member of PKF International, a network of independent firms of accountant and business advisors with more than 440 offices in over 100 countries. We offer a wide range of services to our local and international clients, including auditing services, corporate services and taxation, remote gaming, law and international relations, services in relation to the Malta citizenship by investment and Malta residence and visa programme as well as economic assessments, and market research and analysis.

Our company has been in operation for the past 25 years, with eighty percent of its client portfolio being local clients doing international business. PKF Malta's business philosophy is based on the harmonisation of our services to provide the most cost effective and efficient business solutions for our clients. Our multi-disciplinary team of professional consultants are skilled in working together to deliver high-quality outputs that meet the requirements of our clients.

Objectives of this study

The rate of unemployment provides policymakers with important information about the labour market. Different metrics are used to measure such rate, hence different figures may be reported over the same period of time. The potential implications of inflation on the labour market are widely studied within the literature. In view of the upcoming Budget speech for 2023, whereby there are speculations that the Cost-of-Living Adjustment (COLA) will be between €8 and €10, this report analyses the potential economic implications of this rise on the labour market. The study also provides recommendations for policies that can mitigate the potential of a wage-price spiral, as a result of the COLA for 2023.

Structure of this report

Following this brief introduction, this report is structured as follows:

Chapter 1: Contextual background;
Chapter 2: Brief literature review;
Chapter 3: The Maltese labour market; and
Chapter 4: Assessing the relationship between unemployment and inflation.

Chapter 1: Contextual background

Introduction

The International Labour Organisation (ILO) defines unemployment as the share of the labour force that is without work but available for and seeking employment[1]. The labour force entails both the employed and unemployed persons aged 15 and over. The rate of unemployment is then calculated by dividing the number of unemployed people by the total number of people in the labour force. Different countries have different appetites for unemployment, mainly due to the trade-off between the unemployment rate and the inflation rate. Notwithstanding, the general consensus is that high levels of unemployment are undesirable as it leads to low standard of living.

Types of unemployment

Understanding the nature of unemployment is critical to ensure that policy makers enact appropriate policies to tackle unemployment. There are four main types of unemployment:

1. **Frictional unemployment**

   Friction unemployment occurs when people transition into and out of the labour force and/or when people move from one job to another. The former refers to people moving from education to seeking employment, while the latter refers to the time period where individuals spend a couple of days or weeks before they enter their next employment. Movements of workers is necessary for a flexible labour market and helps achieve an efficient allocation of (human) resources across the economy. As people change occupations all the time, frictional unemployment will always be present, and is thus a reason as to why unemployment can never be zero. In fact, frictional unemployment is likely to occur at all points of the business cycle and it does not affect wages or inflation[2].

2. **Cyclical unemployment**

   Also referred to as demand-deficient unemployment, this type of unemployment occurs with changes in economic activity over the business cycle. The demand for labour is a derived demand, that is the demand for labour is dependent on the demand for goods and services. During a period of economic expansion, the demand for goods and services increases, such that businesses would need to produce more products to meet the higher demand. Subsequently, the employers' demand for workers increases. Conversely, during periods of economic slowdown and recessions, cyclical unemployment would (ceteris paribus) increase.

[1] Source: "DataBank: Metadata glossary". Available at: https://databank.worldbank.org/metadataglossary/jobs/series/SL.UEM.TOTL.ZS#:~:text=Unemployment%20refers%20to%20the%20share,International%20Labour%20Organization%2C%20ILOSTAT%20database.
[2] Source: "Reserve Bank of Australia: Unemployment". Available at: https://www.rba.gov.au/education/resources/explainers/unemployment-its-measurement-and-types.html#:~:text=There%20are%20three%20main%20types,way%20of%20thinking%20about%20unemployment.

3. Structural unemployment

Structural unemployment occurs when there is a mismatch between vacancies available and the skills of the jobseekers. Workers may become unemployed because their skills are no longer demand, for example typewriters. This type of unemployment tends to take the longest as it can take years for people to develop new skills as required in the market. Structural unemployment may also be influenced by geographical immobility as some people may not want to change where they live to find a region that offers more opportunities.

4. Involuntary unemployment

Keynes disagreed with the conventional notion of wage-price flexibility. First, due to the illusion of money, and second, for institutional reasons, trade unions keep wage rates from falling and will therefore resist any salary reductions. It is assumed that the Keynesian labour supply function depends on the money wage rate. However, this labour supply curve has two parts. The first segment of the labour supply curve is perfectly elastic because of the fixed wage rate. Above this wage rate, comes in the second segment of the labour supply curve which is positively sloped where wages can freely increase.

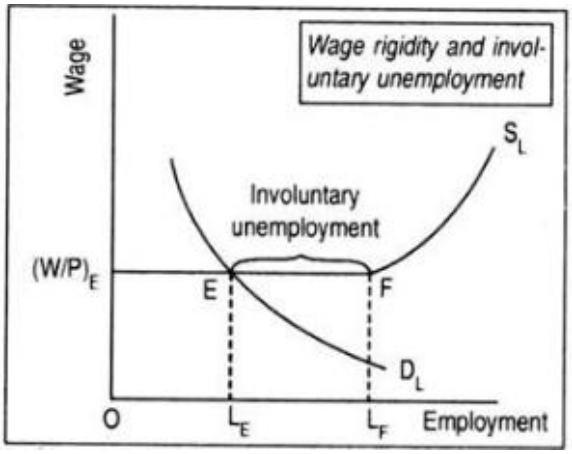


Figure 1: Keynesian Involuntary Unemployment

Equilibrium is reached when the downward-sloping labour demand intersects with the horizontal portion of the labour supply curve. At that wage rate, there is L_F, those people willing to work and L_E, those people employed. Since fewer people are working and more are willing to work, involuntary unemployment is created. Thus, according to Keynes, the cause of involuntary unemployment is wage rigidity[3].

[3] Source: "Keynesian Theory of Involuntary Unemployment (With Diagram)" Available at: https://www.economicsdiscussion.net/employment-theories/keynesian-theory-of-involuntary-unemployment-with-diagram/6209

Chapter 2: Brief literature review

This chapter provides an analysis of the existing literature that relates to this study. This will provide a richer understanding of the topic at hand by assessing the methodologies adopted and results attained by previous studies. Following the evaluation of existing studies, the literature review is divided into the following themes:

1. Different rates to measure unemployment;
2. Relationship between unemployment and inflation
    i. Theoretical Framework: The Phillips Curve
    ii. Empirical Studies on the Phillips Curve
3. The identification of the Phillips Curve in different countries.

Different rates to measure unemployment

The rate of unemployment in Malta is officially measured via two different sources: the Labour Force Survey (LFS) and administrative data from Jobsplus. Given the different methodological definitions between the two data sources, certain discrepancies arise in the two rates[4]. Unemployment in LFS includes all persons who are not working, but are looking for a job and are ready to start working within two weeks of the reference period, irrespective of whether the individuals of are registering for employment with the JobsPlus or not. This makes the LFS definition wider in scope when compared to that of Jobsplus.

Cefai (2020)[5] and Xuereb (2015)[6] utilised the unemployment rate from the LFS which is determined as a percentage of the active population who are within the age cohort of 15 to 74 years. Conversely, Mallia (2003)[7] used unemployment figures from Jobsplus (formerly known as The Employment and Training Corporation), to examine the factors that influence the unemployment rate.

Notwithstanding, the literature highlights the use of other economic tools to measure unemployment. Muscat (2012)[8] uses the disequilibrium labour market model which utilises equations related to the labour demand, the labour supply, the wage adjustment equation and the short side of the market.

[4] Source: "Unemployment Rate: August 2022". Available at: https://nso.gov.mt/en/News_Releases/Documents/2022/09/News2022_171.pdf
[5] Source: "Testing Malta's wage flexibility: a Johansen cointegration approach". Available at: https://www.um.edu.mt/library/oar/handle/123456789/66767
[6] Source: "The role of migration within the context of the Maltese labour market" Available at: https://www.um.edu.mt/library/oar/handle/123456789/66767
[7] Source: "Unemployment in Malta: an analysis of determinants of the current situation and prospects for the next decade" Available at: https://www.um.edu.mt/library/oar/handle/123456789/83565
[8] Source: "An analysis of wage and labour market flexibility in Malta". Available at: https://www.um.edu.mt/library/oar/handle/123456789/4975

Other authors such as Galea (2019)[9] and Agius (2021)[10] obtained the unemployment rate and total unemployed population from Eurostat, whereby the values are attained from the LFS. Alternatively, Dalli (2020)[11] used data from the World Bank, which uses estimates from the ILO as a proportion of the total labour force in each territory.

Relationship between unemployment and inflation

Theoretical framework: The Phillips Curve

In 1958, Alban William Phillips published a paper which studied the nature of the association between unemployment and the rate of wage growth in the United Kingdom, using data from 1861 until 1957. Phillips found that a robust negative relationship exists between the two variables, over the analysed period. This trade-off is today known as the "Phillips Curve" (PC)[12]. The PC is graphically illustrated in figure 2.

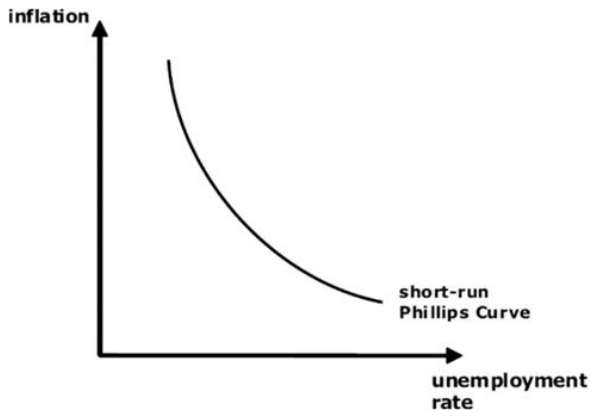


Figure 2: The Phillips Curve

The natural level of unemployment is considered as the level of unemployment where the labour market is in perfect equilibrium, that is, at maximum employment. The PC predicts that the closer is the unemployment rate is to its natural level, the higher is the aggregate demand in an economy, boosting wages, eventually raising prices. Thus, the slope of the PC, measures the speed of adjustment of price changes, with respect to variations in the output gap. This framework suggests that policy makers face a constant trade-off in the short-term, such that higher employment levels tend to lead to increased price levels.

[9] Source: "The macro economic impact of immigration on the Maltese economy: a VAR approach." Available at: https://www.um.edu.mt/library/oar/handle/123456789/57158
[10] Source: "Determinants of youth unemployment in the EU: a panel data analysis" Available at: https://www.um.edu.mt/library/oar/handle/123456789/79728
[11] Source: "An analysis of the determinants influencing labour migration: a gravity model approach: Malta's case" Available at: https://www.um.edu.mt/library/oar/handle/123456789/66730
[12] Source: "Unemployment and Inflation in Malaysia: Evidence from Error Correction Model". Available at: https://jurcon.ums.edu.my/ojums/index.php/mjbe/article/view/111/53

Empirical studies on the Phillips Curve

The notion of the PC was generally validated by empirical studies analysing economies during the post-second world war era. During that time, many economies had reached full employment, and prices had risen quickly. Despite having a strong theoretical base and a wealth of empirical investigations that have supported the PC hypothesis, objections and scepticisms about its validity started to grow, as economies continued to evolve. For instance, renowned economists like Friedman (1968) and Phelps (1967)[13] disputed the existence of a trade-off between unemployment and inflation. They both agreed that there might be a short-run (SR) but not a long-run (LR) negative correlation between unemployment and inflation. They argued that over time, the trade-off between the two variables would vanish, such that the unemployment rate would follow a vertical pattern. A more recent study by Cashell (2004)[14] provided evidence in favour of this claim. According to the study, over the LR, unemployment tends to drift toward an equilibrium level known as the "non-accelerating inflation rate of unemployment" (NAIRU). The NAIRU is the particular level of unemployment within a specific economy that does not raise inflation. In other words, inflation is constant if unemployment is at the NAIRU level in the LR.

Apart from the notion that the PC might not hold in the LR, academics have recently debated the relevance of the PC as a reliable indicator for inflation in modern economies. Inflation and unemployment trends in the 1950s and 1960s did in fact follow a PC-like relationship. However, key development in recent decades have flattened the slope of the PC, implying a weakening in the negative relationship between the two economic indicators. Given that keeping price inflation close to its target and price stability has developed into central bankers' primary objective, data from the latest decades suggests that the PC hypothesis might not be as relevant in today's economy. Back in 2019, the Chair of Federal Reserve, Jerome Powell, had suggested that the connection between laying off workers and economic shocks was much stronger in the past than it is today[15]. Thus, some economists argue that policymakers should not view it as a guiding framework when devising policies, implying that economic growth is always inflationary. Moreover, another instance which contradicts the PC hypothesis is in case of stagflation, which characterised the U.S. economy during the 1970s. Stagflation refers to periods which feature a combination of high inflation and rising unemployment and slow economic growth, thus contradicting PC predictions. In fact, the recent economic turbulence has revived the possibility of enduring stagflation. 2022 has been characterised by high inflation globally, while economic growth slowed down due to clouded economic outlooks, geo-political turbulence and supply chain disruptions.

[13] Source: "Dynamic persistence in the unemployment rate of OECD countries". Available at: https://www.sciencedirect.com/science/article/pii/S0264999310002324?casa_token=mLzKGe_EdcYAAAAA:WNta3fxTtkCNXMl6R13xcT5eTSUSiU0jNsY5dpknbs8ur2eclS_K9B2TJJWYlbvOM6mhXoTgkw
[14] Source: "Inflation and Unemployment: What is the connection?". Available at: https://ecommons.cornell.edu/bitstream/handle/1813/78980/CRS_April_2004_Inflation_and_Unemployment.pdf?sequence=1
[15] Source: "Transcript of Chair Powell's Press Conference December 11, 2019". Available at: https://www.federalreserve.gov/mediacenter/files/fomcpresconf20191211.pdf

Gatt (2018)[16], utilises the Retail Price Index (RPI) and the registered unemployed (from Jobsplus) as a proxy for the inflation rate and unemployment rate respectively, to estimate Malta's PC. Results indicate that the disparity between inflation and unemployment is what caused the slope of the PC to decrease.

The relationship between economic activity and inflation is only present while the economy is growing, which suggests downward price rigidity. However, since the 1980s the main drivers of the flattening of the PC are the increase in openness and the steadier economic growth. Congruent with this, Micallef (2016)[17] found that the flattening of the PC can aid in explaining why the robust GDP growth and the drop in unemployment, did not result in inflationary pressures.

The identification of the Phillips curve in different countries

Various economists studied the relationship between unemployment and inflation to test the empirical implications of the PC. Grodzicki, T., & Jankiewicz, M. (2020)[18] carried out a study for Sweden. In this paper, the Vector Autoregression (VAR) model was used to estimate the relationships between unemployment, inflation and wages in Sweden. Their findings indicate that between 2002 and 2017, the unemployment rate and wages do not adequately explain the trends in Swedish inflation. Additionally, this research demonstrates that there are no significant changes in employment as a result of an increase in the minimum wage, which is consistent with other similar empirical findings.

In contrast, in a paper by Lacker and Weinberg (2007)[19] the authors tried to reproduce the inflation and unemployment relationship of the Phillip's curve baseline period of 1861-1913, they demonstrated a definite negative correlation between higher inflation and reduced unemployment. However, this relationship is said to be influenced by policy changes, and people's behaviour might alter as a result. This suggests that the policymakers may face difficulties due to the role of expectations in the PC.

In another study, P. Ormerod, B. Rosewell & P. Phelps (2013)[20] explore the relationship between inflation and unemployment of three different countries; the United States, the United Kingdom and Germany. The study was carried out in accordance to the PC and utilised the statistical technique of fuzzy clustering. Their findings conclude that the inflation-unemployment relationship occasionally has significant fluctuations that are typically persistent.

[16] Source: "Time variation, asymmetry and threshold effects in Malta's Phillips curve" Available at: https://www.um.edu.mt/library/oar/handle/123456789/40740
[17] Source: "Drivers of Low Inflation in Malta after the Crises. Theoretical and Practical Research in Economic Field" Available at: https://www.um.edu.mt/library/oar/handle/123456789/33662
[18] Source: "Forecasting the level of unemployment, inflation and wages: the case of Sweden" Available at: https://www.um.edu.mt/library/oar/handle/123456789/78017
[19] Source: "Inflation and Unemployment: A Layperson's Guide to the Phillips Curve" Available at: https://ejournals.um.edu.mt/login?url=https://www.proquest.com/scholarly-journals/inflation-unemployment-laypersons-guide-phillips/docview/204877676/se-2.
[20] Source: "Inflation/unemployment regimes and the instability of the Phillips curve" Available at: https://doi.org/10.1080/00036846.2011.628299

Notwithstanding the significant fluctuations in the trade-off between inflation and unemployment, there is still substantial evidence of instability, especially in the short-run. Hence, policymakers must use caution when making decisions based on the trade-off between inflation and unemployment in the short-run.

Zayed et.al, (2018)[21] attempted to test the PC for the Philippines. The study uses the inflation rate, the unemployment rate, the wage rate and also the GDP, to determine whether the PC holds. Findings show that there is a long-run relationship between the variables and that the variables are positively correlated with inflation, except for GDP. The positive correlation between unemployment and inflation rate is not consistent with the PC. This implies that the Philippines' PC, for the period between 1950 and 2017, is not identified, as the PC states that the inflation rate and unemployment rate are inversely related.

Academic studies of the PC hypothesis in relation to the Maltese economy are still lacking. The Central Bank of Malta (CBM) has recently attempted to estimate an econometric model for the PC in the Maltese economy. The results provide evidence of a weakening in the slope of the PC in Malta, for the period ranging from 1980 to 2015. International studies also suggest that the flattening of the PC, or else the reduction in inflation responsiveness with respect to unemployment changes, has occurred in various other economies over the same time period. In theory, during recessionary periods, employment is less demanded by firms and thus wages and general price levels could remain stagnant or else fall. However, in practice, this has not been the case in Malta as no particular reduction in wages was observed during bad times. Furthermore, findings from the CBM estimates also highlight the fact that the labour market has gone through structural changes in Malta. A fall in unionisation rates accompanied with the consistent availability of foreign labour, has calmed wage demands in recent times[22]. Due to the significant political and economic ramifications stemming from the PC, and the present inflationary periods which global economies are experiencing, this report focuses on Malta as a case study to examine the relationship between unemployment and inflation.

[21] Source: "TESTING PHILLIPS CURVE TO EXAMINE THE INFLATION RATE REGARDING UNEMPLOYMENT RATE, ANNUAL WAGE RATE AND GDP OF PHILIPPINES: 1950-2017" Available at: https://ejournals.um.edu.mt/login?url=https://www.proquest.com/scholarly-journals/testing-phillips-curve-examine-inflation-rate/docview/2133346216/se-2.

[22] Source: "The Phillips Curve in the Maltese Economy". Available at: https://www.centralbankmalta.org/file.aspx?f=11292

Chapter 3: The Maltese labour Market

How does the labour market in Malta compare to that of the EU?

The Maltese labour market has undergone substantial transformation over the past 10 years, whereby strong economic growth has led to historic low unemployment levels. The working world remains a critical yet challenging one. The world is facing a unique challenge as a confluence of different forces are acting together and can bring fundamental and disruptive changes in our economies and the world of work. New forces, accelerated by the pandemic, are transforming the world of work as we speak and continue in the near future.

Malta's unemployment had been steadily falling prior to 2019. In light of pandemic disruptions to the labour market, the actual number of registered unemployed increased from 1,642 in 2019 to 2,765 in 2020. However, with economic activity gradually picking up again throughout 2021, the number of registered unemployed fell to an all-time low of 1,352 persons by September 2021, of which 45.8% are 45 years and over, 36.1% are aged 25-44 and the remaining 18.1% fall within the 15-24 age cohort.

On the back of strong labour market conditions and dropping unemployment levels, long-term unemployment, measured by the number of people that have been unemployed for more than 12 months, has also improved significantly over the past years. By the end of 2021, the number of long-term unemployed registered at Jobsplus dropped to just 363 persons, of which the majority are male, with the number of female unemployed for more than 12 months amounting to 103 or an equivalent 28.1% of the total number of long-term unemployed.

Meanwhile, the rate of youths aged between 15-24 not in employment, education, or training (NEET) which had plateaued at 7.3% in 2018, started increasing again, very much in line with the EU average, to reach 9.8% of the total population aged 15-24 by quarter three in 2021. This amounts to roughly 5,000 youths (LFS), of which 3,000 are unemployed and the remaining 2,000 believed to be inactive. On the other hand, there were only 230 registered unemployed aged between 15-24, at Jobsplus, as at September 2021.

According to the latest CBM outlook for the Maltese economy 2021-2024, employment growth in 2022 is expected to reach 2.6%, from 1.4% in 2021. The pick-up in employment growth comes on the back of stronger demand conditions and is supported by an assumed gradual normalisation in net migration flows, beginning in 2022. The latter should start to gradually alleviate the broad-based labour shortages that were experienced in many sectors during 2021. That said, however, employment is set to grow slower than GDP during the whole projection horizon, as firms seek to regain some of the productivity losses experienced during the pandemic. The unemployment rate is projected to continue hovering around 3.5% over the duration of this outlook.

The LFS categorises the unemployed into the short-term unemployed and the long-term unemployed. The former refers to persons who have been unemployed for less than a year, whereas the latter refers to persons who have been unemployed for more than one year. The policy note published by the CBM in 2021 states that a number of characteristics have an impact on the duration of one's unemployment period. More specifically the Bank argues that in Malta, males tend to remain unemployed for longer periods than females, people who are single take less time looking for a job, and that older cohorts tend to have higher job search durations than younger cohorts[23].

On a national level, Malta's economy remains resilient together with our labour market. Unemployment remains at record lows and well below European averages. Challenges remain. Shortages of staff are still a daily issue for firms and matching the right talent for the jobs required is also a challenge. Within this environment, Jobsplus remains committed to supporting and enabling Malta's labour market.

Malta's economic performance has been particularly strong when compared to the EU's average, and although the business downturns highlighted key vulnerabilities, growth rebounded right after. The strong economic performance was reflected in a buoyant labour market. The impact of the crisis on the labour market was successfully countered by Government support measures. As at 2021, Eurostat figures show that the unemployment rate in Malta stood at 3.5% (compared to the EU's average of 6.4%), being the third lowest rate reported following Czechia (2.8%) and Poland (3.4%)[24]. Except for 2020, Malta has been registering a decrease in the unemployment rate recorded. In fact, looking at the past decade, the rate of unemployment in Malta has declined from 6.9% in 2009 to 3.5% in 2021, that is a decrease of 3.4 percentage points. Figure 3 shows Malta's performance against the EU average (which includes 27 countries).

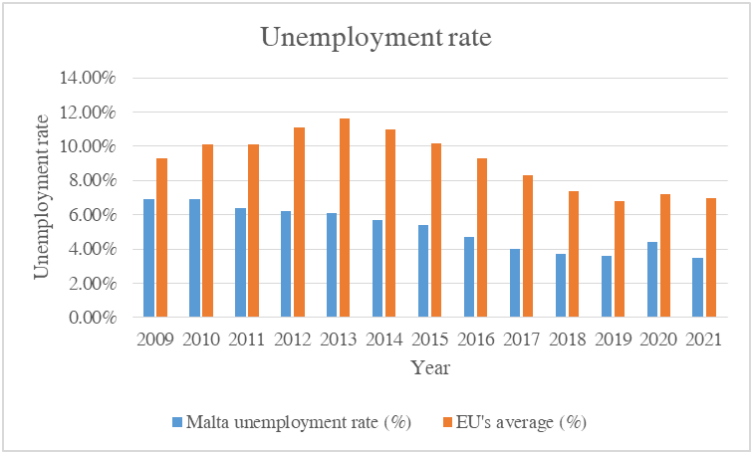


Figure 3: Unemployment rate in Malta and EU over time. Source: Eurostat

[23] iBid
[24] Source: "Eurostat: Unemployment by sex and age". Available at: https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=une_rt_a&lang=en

Although the economic recovery from the effects of COVID-19 will continue to take centre stage, Malta is expected to recover quickly and robustly from the pandemic. Labour market policies, underpinned by the recently launched National Employment Policy 2021-2030, are set to prioritise upskilling and reskilling programs focusing on improving educational achievement, raising student retention rates, and increasing participation in lifelong and adult learning. The observed decline in unemployment in Malta was predominantly brought about due to labour market policies (LMP) undertaken by the government.

Action(s) undertaken to mitigate unemployment

Public employment services (PES) are government entities delegated to assist in managing the labour market by connecting job seekers with employers. These institutions are mandated to provide employment-related services such as job placement, roll out active labour market policies, and disseminate labour market information[25]. In other words, PES are expected to offer integrated employment services to ease labour market frictions and guide jobseekers to employment opportunities. Other labour-related services such as labour migration policies and administration of unemployment benefits are also offered by PES in a number of countries, particularly within the European Union[26].

The leading Public Employment Service in Malta is Jobsplus, which seeks to keep a register of job seekers and by engaging in the matching of job vacancies with job seekers; a register of persons in employment is also kept to supply data on Malta's gainfully occupied population. Jobsplus implements training programmes and scheme to assist job seekers as well as offer training to upskill employees.

Over the longer-term horizon, the availability of skilled workers will continue to be a major bottleneck for the Maltese labour market, and skill gaps with other European economies are projected to widen. Labour market policies, underpinned by the recently launched National Employment Policy 2021-2030, will therefore prioritise upskilling and reskilling programs focusing on improving educational achievement, raising student retention rates, and increasing participation in lifelong and adult learning. The labour market policies introduced in Malta took the form of two main types of policies; work-first oriented schemes and human-capital oriented schemes. The former type of policies aims to incentive the unemployed to re-renter the labour market and subsequently help prevent them from falling back into unemployment after a period of time. These include the free childcare scheme, the In-Work benefit scheme and the tapering of benefits scheme. To support working parents there is the breakfast club and the Klabb 3-16, where such services occur before and after school hours respectively.

[25] Source: "OECD: Local Economic and Employment Development" Available at https://www.oecd-ilibrary.org/docserver/9789264251854-en.pdf?expires=1664268215&id=id&accname=guest&checksum=3F1C3E41F0AEAD63626C54BD960A80E6
[26] Ibid

In addition, mothers returning to the labour market are entitled to one year of tax exemption or a maximum of €2000 in tax credit, while self-employed women who re-enter the labour market are entitled to a tax credit of €5000[27]. On the other hand, the human-capital oriented schemes are intended to make the unemployed more attractive to potential employers. These include the youth guarantee scheme, the training pays scheme and the work programme initiative[28].

The government's spending on LMPs increased from circa 5% in 2006 to 14% in 2016, mainly due to the introduction of a number of new policies in 2014. In line with 'a priori' expectations, the spending on LMPs as a percentage of GDP has declined since 2016 to around 8% in 2019. This is because as the level of unemployment declined, the need to spend more on labour market policies diminished as well[29].

To be in line with the newly launched National Employment Policy, the Corporation will be working on its renewed strategic action plan to ensure that Jobsplus will remain a catalyst of a renewed and resilient labour market. As of 2022, Malta will start to benefit from the new multiannual financial package of the European Union. Jobsplus will ensure its readiness and preparedness to leverage such funds and to leverage them for the best interest of Malta's labour market.

Main shortcomings in the current labour force

Challenges exist in relation to a lack of participation within specific age cohorts and a greater drive towards gender equality in work, best explained by the gender pay gap which is defined as the difference between the average gross hourly earnings of men and women expressed as a percentage of the average gross hourly earnings of men. In 2020, the gender pay gap in Malta stood at 10% as opposed to the EU 27 average of 13%. Although this figure compares more favourably to the EU's average, the persistence of this gap remains a pressing concern especially considering unprecedented female participation levels in the labour force.

In the second quarter of 2022, the activity rate of females in the population stood at 72.3%, which increased by 3.9 percentage points from last year's second quarter.[30] However, given the increase in the activity rate of females, the gender pay gap is still a concern for women in the labour market. Also, eradicating this inequality has increasingly been defined as a priority in Malta and beyond, primarily since it is an obvious manifestation of gender inequality, as well as a contributing factor to poverty risk.

[27] Source: "Thinking of going back to work?" Available at: https://jobsplus.gov.mt/resources/publication-statistics-mt-mt-en-gb/policies/fileprovider.aspx?fileId=1262
[28] Source: "Central Bank of Malta: The characteristics associated with the short and long term unemployed in the Maltese labour market". Available at: https://www.centralbankmalta.org/site/Reports-Articles/2021/policy-note-unemployment-duration.pdf?revcount=9728
[29] iBid
[30] Source: "Labour Force Survey:Q2/2022" Available at: https://nso.gov.mt/en/News_Releases/Documents/2022/09/News2022_164.pdf

In addition, a recent NSO study revealed that Malta's labour market lacks effectiveness in job matching. Findings show that more than half of workers are in jobs that do not match their level of skills or education. In 2021, 40% of the female workers were over-educated while 32% of male employees were over-qualified for their job. Over-educated workers were those who possessed a level of education which is higher than that required to perform their job. Overall, 43% of Maltese workers are over-educated, while only 32% of foreign workers resulted be over-qualified. In terms of occupation, the most matched job category was that of clerical support workers, while technicians and associate professionals was the most over-educated category. Meanwhile, the most matched economic activity was found to be the agriculture, forestry and fishing economic segment, while the public administration, defence, education, human health and social work activities were the economic activity which most employed over-educated workers[31]. This finding confirms that by limiting public sector employment, more workers would be participating in the private sector.

In fact, another main challenge in the Maltese labour market relates to the bloated public sector employment. Since 2013, the employment within the public sector have been significantly increasing over time. This is evident in Figure 4 below, as the public sector employment has grown by 22.5% over the last nine years.

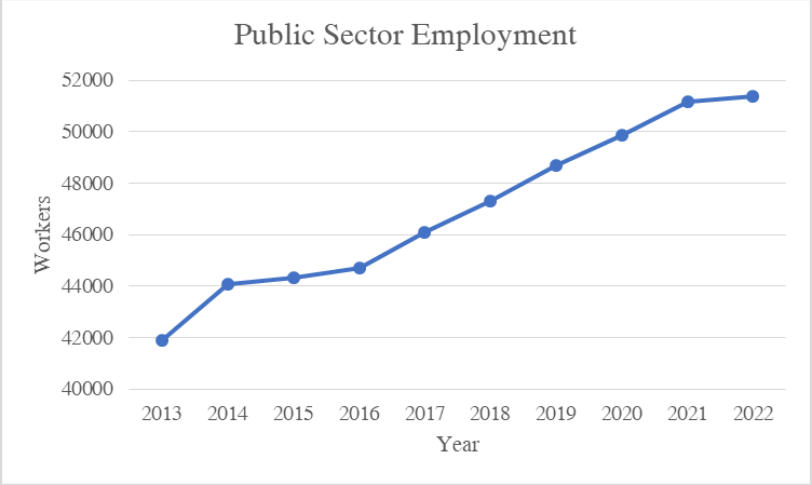


Figure 4: Public Sector Employment (2013-2021). Source: NSO

In the meantime, the GDP has also been growing, partially suggesting that the growth in employment was not unjustified. However, the rate of growth in public sector employment was not totally consistent with the GDP's rate of growth. This could account for the fact that public sector employment was excessive and not used effectively.

[31] Source: "Malta Skills Survey". Available at: https://skillsnso.gov.mt/vertical-mismatch/#

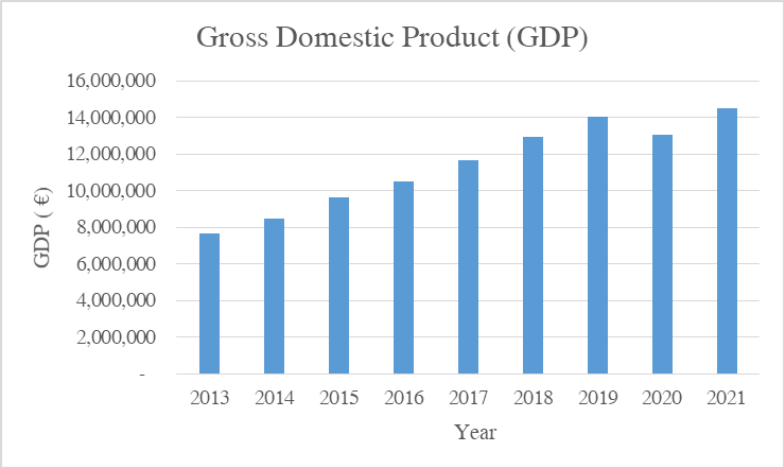


Figure 5: Gross Domestic Product (2013-2021). Source: NSO

The president of the Chamber of Commerce, Marisa Xuereb, specified that the bloatness in public sector employment is causing problems in the labour market and that the cutting down on certain employment in the public sector will free up human resources to be used in the private sector. In the public sector, there are areas of employment where individuals are employed for political reasons, where there is an overstaffing in government departments and entities. However, these do not include the health sector, education sector or the police force because those professions still require labour. To tackle the excessive employment in the public sector, Xuereb put forward two proposals. Firstly, to carry out an independent audit exercise to evaluate the skills and output of the human resources currently employed within the government so that the surplus employees would then be transferred to the private sector. Secondly, in order to promote economic recovery and the long-term sustainability of public finances, it is advisable to avoid hiring people who are already employed full-time and at a competitive salary in the private sector.

According to the Chamber of SMEs, businesses are also having a difficult time competing with the government. This is due to the fact that businesses are unable to offer the same benefits as the government and because there is lack of human resources. In order to boost productivity and encourage employment in the private sector, the Chamber of SMEs recommended implementing an attractive secondment plan with the private sector. The purpose is to have the government cover the wages for the first few years of the secondment to the private sector, which will pay off in the medium- to long-term. There is no particular suggestion for the tightening of fiscal morality because it gains credibility when the government demonstrates a commitment to maximising resource usage, both in terms of employment in the public sector as well as public procurement.

However, fiscal morality can be addressed by issuance of direct commands and more diligence on the issue of public tenders. Additionally, through increased digital innovation initiatives, better use of human resources in the public sector could be attained.

A proposal put forward by the Malta Chamber of Commerce to address the issue of employment in public service is the removal of summer half-days. These are harmful for business such as the Customs department[32]. Additionally, without the half-days, the government no longer has an advantage on the private sector since shorter hours usually attracted more employees.

Why do some unemployed people opt not to register for work?

Over the past years, there has been an increase in the number of unemployed who do not register with Jobsplus but who result to be unemployed when using the LFS criteria. Recent developments led to an increasing gap between the two different unemployment rates. This suggests that less persons are resorting to Jobsplus in their job search. Workers could be searching for full-time employment without the need of registering with the Jobsplus, due to the rise of effective online platforms which bring job seekers and employers together, such as Linkedin, Keepmeposted, and JobsinMalta. Latest unemployment trends could highlight that when looking for employment, new entrants to the labour market are using online recruitment platforms rather than referring to Jobsplus. If this is the case, Jobsplus unemployment figures would be misrepresenting the true state of the market. Thus, policymakers should not base its employment strategies solely on one unemployment rate, but they should keep in mind the reasons behind the varying unemployment rates available in the Maltese labour market.

A few months ago, workers participating in the Community Workers Scheme (CWS), formed a union to fight for guaranteed jobs and equal pay. The CWS was originally launched in 2009 and then reformed in 2016 by the current Finance Minister Clyde Caruana. The CWS aims to help job seekers in their transition into employment. Initially, the scheme was intended to be temporary and recruit not more than 600 long-term unemployed individuals, putting them on State payroll on a full-time basis, until they are ready to find alternative gainful employment in the private sector. However, original plans were not abided by in practice as the scheme has expanded significantly, such that recent figures show that the scheme holds around 1,200 people, costing taxpayers around €20 million a year. Workers are paid the minimum wage for their 40-hour per week output. The CWS is popular in Gozo, such that around half of the scheme's members are from Gozo[33].

[32] Source: "Recommendations for the 2023 National Budget, Malta Chamber of Commerce" Available at: e81e91c0e72e142e56c6f88aa7de2934baca8525.pdf (timesofmalta.com)
[33] Source: "Placements on governments 'jobs-for-votes' scheme doubles. Available at: https://theshiftnews.com/2022/05/17/placements-on-government-jobs-for-votes-scheme-doubles/

The General Workers Union (GWU) manages this scheme after being awarded a public tender which was issued for the management of the scheme. Government reports shows that the GWU, won the tender with €980 per month per worker. This fee covers the minimum wage of the worker and the management, operational and training cost of the individuals[34].

Critics have argued that the CWS provides the government with an advantage as the individuals participating in the scheme are classified as private sector employees (GWU), even though they are being paid by taxpayer money. Thus, data on employment levels and unemployment rates could be misleading, if the participants in the CWS keep on increasing[35]. Furthermore, not only is the CWS misleadingly underestimating the unemployment rates, but its misuse is removing participants from an already tight private sector labour market into complacent public employment. In this manner, participants within the CWS are not listed on Jobsplus unemployment databases, even though they are not full-time employed, potentially undervaluing the actual unemployment figures. In fact, back in 2021, lead representatives of the MEA have claimed that there are no reasons for the CWS to have over 1,000 participants. MEA representative Joseph Farrugia claimed that even though the scheme is intended to aid unprofessional and unskilled workers, it tends to be influenced by political motives.

Latest data published by the NSO indicate that as of the second quarter of 2022, 8,446 people were unemployed in Malta[36]. Notwithstanding, similar to the trends observed overseas, Malta is currently experiencing a shortage of employees. During 2021, a survey was administered by Jobsplus among a sample of employers to identify those occupations for which there was a shortage or a surplus, which skills were lacking, and how employers in Malta tackled these issues. Findings indicate that almost one third of employers experienced a shortage of employees and/or skills. The hardest to fill vacancies in 2020 were for delivery persons and heavy truck and lorry drivers. The hardest to fill vacancies were mostly found within the Wholesale and Retail Trade and Repair of Motor Vehicles and Motorcycle sector. These findings corroborate other information which Jobsplus has at its disposal. In addition, even though hundreds of professionals such as accountants, lawyers and teachers graduate every year from the university, they are still hard to find and thus this creates a gap within the labour market.

In the same year, Jobsplus prepared and launched the Employers' Satisfaction Survey to measure the level of employers' satisfaction with Jobsplus' services. Results were not yet available by end of year.

[34] Source: "Community Work Scheme Fact Sheet". Available at: https://education.gov.mt/en/Pages/Community-Work-Scheme-Fact-Sheet.aspx
[35] Source: "Jobless scheme members form union to fight for guaranteed jobs and equal pay". Available at: https://theshiftnews.com/2022/08/12/jobless-scheme-members-form-union-to-fight-for-guaranteed-jobs-and-equal-pay/
[36] Source: "NSO: Labour force survey: Q2/2022". Available at: https://nso.gov.mt/en/News_Releases/Documents/2022/09/News2022_164.pdf

In addition, Jobsplus analysed the employment prospects of persons completing Jobsplus' schemes and courses, as well as of the number of persons lapsing from the jobseeker register and the reasons leading up to this. The use of Jobsplus' services by the registered long-term unemployed and youths was also examined as required by multiple Council Recommendations on the Integration of the Long term Unemployed into the Labour Market and Youth Guarantee. Analytical data was also compiled to update the Labour Market Policy.

Public Employment Services (PES) reduce information asymmetry by matching job seekers' abilities with employers' demands. However, several studies have found that informal search channels such as personal contacts, direct applications, and/or responses to job advertisements are used more frequently and effectively[37]. This is mainly due to selection bias. Typically, those looking for work through PES belong to groups that are underrepresented in the labour market, such as people who lack personal networks, had a history of unemployment, or face other work impediments[38]. In addition, jobs offered by PES are often low-end jobs and therefore less attractive for higher qualified workers. This then creates stigma among employers that applicants searching employment via PES are less qualified or suited for a job.[39] Aside from the potential selection bias and stigma associated with these institutions, variations in registration rates among PES in different countries can also be attributed to institutional factors such as PES service quality and appeal, unemployment and social benefit levels, duration, and eligibility, as well as the conditions and sanctions associated with these benefits[40].

The European Network of Public Employment Services Assessment Report provides an overview of the main trends in the development of PES across Europe and presents the aspects of each PES capacity and the client services they offer. The assessment report has identified 12 categories of labour services, to which each PES must reply with information about whether the service is being provided. The report indicates that Jobsplus offers only five services: three services with full responsibilities and two services with partial responsibilities. Conversely, the report highlights that the Maltese PES does not administer the following functions: unemployment benefits, licensing and supervising private employment agencies, apprenticeship places, social allowances, disability benefits, approval of layoffs made by employers, and career advice and guidance for young people still in education[41]. In addition, Jobsplus offers fewer services than the other 25 (out of 31) registered entities in Europe[42] [43].

[37] Source: Broschinski, Sven, and Marie-Luise Assmann. "The relevance of public employment services for the labour market integration of low-qualified young people–a cross-European perspective." *European societies* 23, no. 1 (2021): 46-70
[38] Ibid.
[39] Ibid
[40] Source: "European Commission: European Semester Thematic Factsheet Public Employment Service" Available at https://ec.europa.eu/info/sites/default/files/european-semester_thematic-factsheet_public-employment-services_en_0.pdf
[41] Source: "European Commission: Assessment Report on PES capacity" Available at https://op.europa.eu/en/publication-detail/-/publication/d81111c5-a8ca-11ec-83e1-01aa75ed71a1
[42] *Belgium has three registered PES*
[43] Ibid

Although the duties among PES in Europe do not differ significantly, the provision of certain services can significantly affect the registration rate in these agencies. One example is the unemployment benefits which are mostly handled by the PES across Europe; while in the case of Malta, this is being managed by the social security office[44]. This can influence the incentives of unemployed individuals to seek assistance from Jobsplus to inquire about their unemployment benefits and eventually, be demotivated in looking for work via the agency. Therefore, the lack of centralisation of services by one organisation could be a demotivating factor for the unemployed to seek assistance, when required.

The management of private employment agencies being outside the remit of Jobsplus can also be a significant factor. There are currently over 170 private employment agencies, many of which have a major role in hiring migrant workers in Malta[45]. Given the number of agencies and the management of these entities being outside of Jobsplus' function, Jobsplus may have difficulty ensuring that all hired labour is properly registered.

Employment in the informal sector or shadow economy can also be a key factor why unemployed individuals may not be registered with public employment services like Jobsplus. Shadow or informal economy are activities that are productive and legal but are deliberately hidden from authorities to avoid taxation or meet regulatory standards. In the case of Malta, the underground economy is estimated to be at 21% of its GDP in 2019, making the sector a significant contributor to providing work opportunities[46]. Individuals who have long been employed in this sector may opt to not register with Jobsplus during their unemployment spells due to the fear of being taxed heavily or being subject to regulations that can affect their income.

[44] Source: "Government of Malta: Registering as a Jobseeker" Available at https://www.gov.mt/en/Life%20Events/Pages/Looking%20for%20a%20Job/Registering-as-a-Jobseeker.aspx
[45] Source: "Malta Department of Employment and Industrial Relations: List of Employment Agencies" Available at https://dier.gov.mt/en/Industrial%20Relations/Employment%20Agencies/Documents/EA%20List%20as%20at%2005.08.2022.pdf
[46] Source: Gauci, Tiziana Marie, and Noel Rapa. *An analysis of the shadow economy in Malta: A currency demand and MIMIC model approach*. No. WP/02/2020. CBM Working Papers, 2020.

Chapter 4: Assessing the relationship between unemployment and inflation

This section of the report primarily presents an explanation of the inflation and unemployment rates, in the context of the Maltese economy. In addition, the practical implications of the relationship between inflation rates and unemployment for the Maltese economy are also explained.

Overview

Inflation and unemployment rates are two of the most meaningful metrics within an economy. In broad terms, inflation is defined as the rate at which prices increase over a specific time period. As a result, the rate of inflation is often considered to be a metric for the general rise in a nation's cost of living. On the other hand, deflationary periods are often undesirable since a deflation rate represents periods where price indices decline from one period to another, generally signalling an economic slowdown.

In contrast, unemployment rates are a gauge of how effectively an economy's available labour resources are being utilised. Although no single figure can fully represent the state of the labour market, unemployment rates measure the percentage of workers in the labour force who do not currently have a job but are actively seeking one.

The situation in Malta: Recent developments

Over the past decades, the Maltese economy has been through periods which have seen huge economic transformations. From becoming a member of the European Union (EU) in 2004, to adopting the Euro as the single currency in 2008, and then enjoying periods of exponential economic growth during the majority of the 2010s. As a result, the labour market as well as the market for goods and services have both sustained significant transitions during the same period under consideration.

Figure 6 plots the seasonally adjusted monthly unemployment rate published by the National Statistics Office (NSO) and the Retail Price Index (RPI) which is an inflation index published by the NSO, on the same graph.

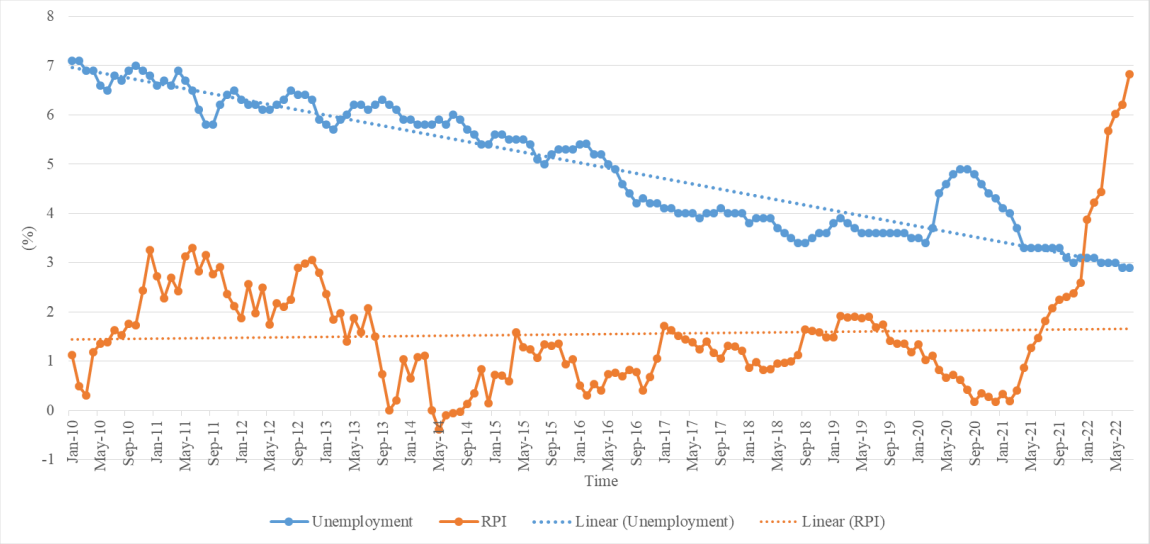


Figure 6: Trends in Monthly Unemployment and Inflation rates (2010-2022). Source: NSO

Graphical trends show that from 2010 onwards, the unemployment rate kept declining, edging closer to its natural rate. In the meantime, price levels remained positive and overall stable, with the only significant increase occurring in early 2022 due to unforeseen economic turbulence.

Practical implications

As can be observed in Figure 6, during some periods, a partially inverse relationship does exist between the inflation and unemployment rates in the Maltese economy. In other words, in the SR, periods of positive inflation rates tend to be accompanied by higher-than-average unemployment rates. However, the PC hypothesis predicts that periods of high employment should cause increasing inflation, which was not the case for Malta. As the unemployment rate was declining from 2010 until the pre-pandemic period, price growth was gradually but not excessively rising. Thus, one can conclude that in the case of the Maltese economy, the SR PC hypothesis did in fact hold for the period under consideration, but with a flattening slope. More specifically, even though inflation was on the rise while employment was increasing, it should be noted that the rate of growth in inflation was lower than that of employment. This could be attributed to the consistent large influx of foreign workers in Malta which have kept a consistent labour supply. In turn, the fact that the labour supply has matched the increasing job opportunities which were generated over the past decades could have been crucial in ensuring a stable price growth and modest wage demands by local workers. In fact, from the end of 2010 until the end of 2021, the sum of foreign nationals working in Malta increased exponentially from 10,687 to 77,825[47] over eleven years.

[47] Source: "Foreign Nationals Employment Trends". Available at: https://jobsplus.gov.mt/resources/publication-statistics-mt-mt-en-gb/labour-market-information/foreigners-data

Figure 7 better illustrates the PC trade-off for the Maltese economy, as the inflation rate is plotted against the unemployment rate.

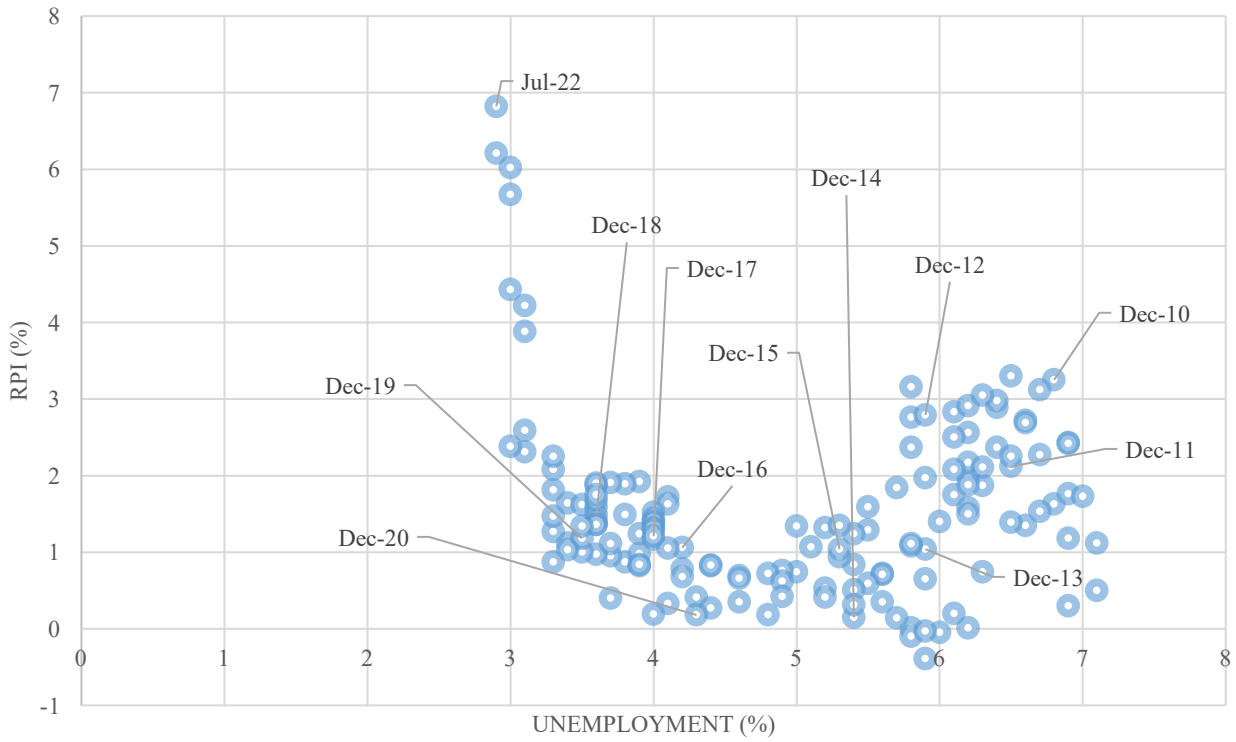


Figure 7: Monthly inflation rates against unemployment rates for Malta (2010-2022). Source: NSO

Figure 7 is a scatter plot which illustrates the monthly inflation and unemployment rates from 2010 until the latest available data for 2022 (July). In order to avoid confusion, labels for only end-of-year points were included for 2010-2021 data, and for 2022, the July data point is labelled, given that it is the latest month with available data.

Therefore, even though a negative slope is observed in Figure 7, one cannot simply conclude that a strong a PC-like relationship can be observed in Malta. Due to labour market policies formulated over the past few years, an inflation rate close to its target (2%) was maintained during periods of very low unemployment rates, contradicting PC predictions. In practice, this implies that policies targeted at boosting employment have to be formulated, implemented and subsequently monitored with caution as they impact the rate of price growth, which impacts daily spending decision for Maltese households. In other terms, the evidence from the Maltese economy suggests that the developments in the labour market do influence fluctuations in the markets for goods and services to some extent, and vice-versa.

The Cost-of-Living Adjustment (COLA)

In light of the upcoming 2023 Budget speech, it is noteworthy to mention the COLA mechanism. The Maltese government attempts to account for annual price changes through the use of the COLA.

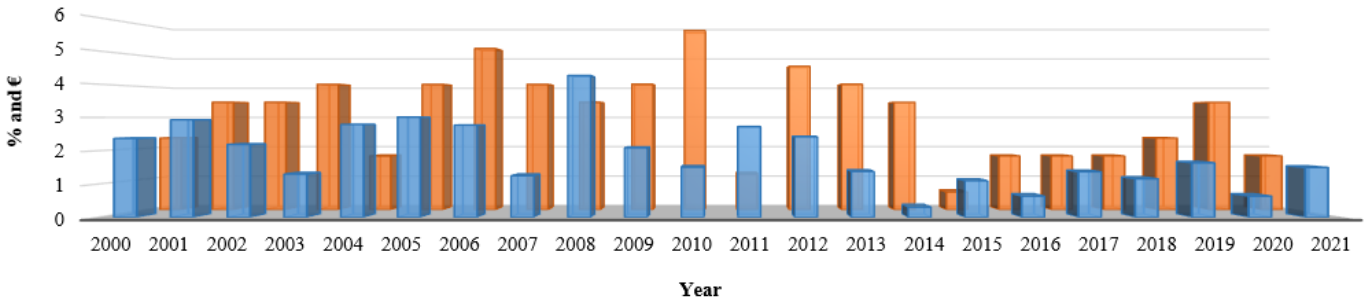
The COLA agreement dates back to 1991, where several social partners together with the Malta Council for Economic and Social Development (MCESD) had agreed that consumers' purchasing power should be protected on annual basis, aiming to mitigate inflationary pressures. The evaluation of the COLA is independent of the general government as it is estimated using a standardised formula which accounts for several economic factors, such as: the rate of inflation over the past twelve months[48]. Ultimately, this mechanism intends to account for annual cost of living changes by protecting peoples' purchasing power and thus their overall well-being.

In order obtain a better understanding of how the mechanism works in practice, Figure 8 compares the COLA adjustment from 2000 until 2021 with the annual RPI inflation rates of the same period. The data shows annual inflation rates for RPI. Meanwhile, COLA figures correspond to the year in which they were affected. In other words, the €1.75 2021 COLA figure corresponds to the 2021 Budget which was announced in 2020, such that a €1.75 increase in weekly basic wage was affected throughout the entirety of 2021 full-time employees' wages.

The cost-of-living increase is usually announced annually in the Budget speech by the Ministry of Finance, as it obliges employers to add the COLA grant to the wages of all its employees. A full-time worker gets the full increase while a part-time employee is entitled to part of the cost-of-living increase in proportion to the hours worked. Additionally, the COLA is received in full by pensioners with two-thirds of the increase being directly added to the pension rate and the remaining one-third being provided through a cost-of-living bonus.

As can be noted from Figure 8, periods of high inflation rates are generally followed by higher-than-average increases in the COLA mechanism. In other words, inflationary periods tend to impact the cost-of-living instrument with a time-lag. For instance, in 2008, the RPI was 4.3%, which is higher than the 3.1% RPI average over the period under consideration. As a result, even though inflation was tamed down after 2008, weekly COLA adjustments in 2009 and in 2010 remained higher than the €3.10 average, as it stood at €4.10 and €5.80 respectively. On the other hand, as inflation rates was relatively low from 2014 until 2016, the COLA mechanism fell significantly below its average from 2015 until 2017. Thus, due to the formula utilised in the calculation of the COLA, the higher the inflation over the previous twelve months, the higher would be the COLA in the present period, and vice-versa.

[48] Source: "Ministry for Finance – COLA issue explained". Available at: https://finance.gov.mt/en/videos/pages/videoblog65.aspx



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
RPI (%)	2.37	2.93	2.19	1.30	2.79	3.01	2.77	1.25	4.26	2.09	1.51	2.72	2.42	1.38	0.31	1.10	0.64	1.37	1.16	1.64	0.64	1.50
Weekly COLA (€)	2.33	3.49	3.49	4.08	1.75	4.08	5.24	4.08	3.49	4.08	5.82	1.16	4.66	4.08	3.49	0.58	1.75	1.75	1.75	2.33	3.49	1.75

Average RPI (%) 2000 – 2021	1.9
Average Weekly COLA (€) 2000 – 2021	3.1

Figure 8: Annual inflation rates versus COLA in Malta (2000-2021). Source: NSO and Gemma

As explained earlier, in the derivation of the value of the COLA mechanism, the trailing twelve months inflation rate is included as one of the numerous economic variables. Nonetheless, latest economic developments have generated inflationary pressures from both the demand and the supply sides in the Maltese economy, leading to the inevitable increase in the cost of living. As a result, in the 2023 Budget and those immediately after it, the COLA is expected to be higher than the average (circa €9), putting more pressure on the already rising price levels.

Potential economic implication of the COLA on the labour market: Wage-Price Spiral

The Maltese labour market has recently been operating at nearly full employment, giving workers more negotiating power over their earnings. Meanwhile, the Maltese economy's high exposure to external shocks accompanied with the continuously increasing cost of raw commodities, have threatened business owners' profit margins. The interaction of a volatile aggregate supply with constant revisions in inflationary expectations has generated the possibility of a wage-price spiral. The latter term refers to a vicious cycle where workers demand frequent upward wage reviews due to increasing inflation, such that employers continue to offset higher labour costs by raising their prices. Such a series of events would lead to a negative feedback loop, adding to the existing uncertainty and tension in the economy.

Maltese producers and business owners are therefore currently facing a very critical situation. Inflation in the past months has led to speculation that the COLA will be between €8 and €10 in the upcoming budget. The Malta Employers Association (MEA) carried out a survey among businesses, finding that 55% of respondents feel that the COLA rise will affect their competitiveness. In addition, the president of the Malta Chamber of Commerce (MCC), Marisa Xuereb, has argued that a relatively high COLA increase would lead to more inflation.

She stated that the allowance would be more effective if specifically targeted to low-income groups and to those employees who have not received wage raises during this inflationary environment[49]. In fact, in a recent joint statement, Malta's trade union groups have proposed a new alternative cost of living mechanism to the government, warning that a COLA increase of €10 per week could drive employers out of business. The proposed instrument would see the COLA range from a weekly minimum of €2.50 to a maximum of €6, starting from Budget 2024 until that of 2028[50]. Concurrently, the president of the Malta Chamber of Small and Mid-size Enterprises (SMEs), Paul Abela, claimed that businesses are willing to accept the COLA, even amid concerns it could be as high as €10[51].

Chamber representatives claimed that a survey carried out recently highlighted that the biggest challenge was a shortage of labour with employers only finding low-skilled workers. The chamber suggested a series of measures to help mitigate the impact of a high COLA, such as lower tax, wider of income tax brackets, limiting public sector employment, ensuring an efficient Third Country Nationals (TCN) recruitment system, and the removal audit requirements on micros with under €500,000 turnover. In response to the aforementioned COLA proposals, the Minister for the Economy, Silvio Schembri claimed that the government would be open to a change in the mechanism, if a unanimous agreement is reached between all stakeholders involved[52]. Ultimately, in light of the surge in COLA, policymakers need to bear in mind the repercussions of forced wage increase on the long-term external competitiveness of the private sector.

Mitigating the wage-spiral affect – recommendations

In mitigating inflation and inflationary expectations, policy makers can resort to either fiscal or monetary policies. Given that the central bank is an independent institution in an economy, monetary policy refers to the actions taken by the central bank in an attempt to influence economic activity. Monetary policy can be either conventional or unconventional, where the former refers to tools such as interest rate adjustment, money supply growth, and open market operations, and the latter involves quantitative easing. Generally, monetary policy balances between three main objectives; price stability, full employment, and economic growth.

[49] Source: "Granting COLA increase to everyone will lead to widespread increase in prices – Chamber president. Available at: https://www.independent.com.mt/articles/2022-08-21/local-news/Granting-COLA-increase-to-everyone-will-lead-to-widespread-increase-in-prices-Chamber-president-6736245308

[50] Source: "Unions, in rare joint statement, seek meeting with government on COLA". Available at: https://timesofmalta.com/articles/view/unions-rare-joint-statement-seek-meeting-government-cola.981902

[51] Source: "Chamber of SMEs ready to accept cost of living adjustment". Available at: https://timesofmalta.com/articles/view/chamber-smes-ready-accept-cost-living-adjustment.981923

[52] Source: "COLA mechanisms will change if all stakeholders agree – Minister for Economy". Available at: https://www.independent.com.mt/articles/2022-09-14/local-news/COLA-mechanisms-will-change-if-all-stakeholders-agree-Minister-for-Economy-6736245907

Conversely, governmental decisions relating to; fiscal spending, fiscal deficits, and taxation, are referred to as fiscal policy. During times of economic overheating, contractionary fiscal and monetary policies tend to be implemented in order to reduce economic speculation and to avoid unsustainable levels of inflation. In turn, during recessionary periods, expansionary fiscal and monetary policies are generally formulated with the aim of reviving economic activity.

Furthermore, in times of abnormal inflation and rising price levels, fiscal and monetary policies generally depend on the nature and cause of inflation. Inflation can be cost-push or demand-pull. The former refers to cases where higher production costs are levied on consumers, while the latter involves an overheated aggregate demand, leading to increasing price levels, pushing up the average prices for goods and services economy-wide. Policies implemented during inflationary periods are optimised when they are targeted at tackling the underlying cause of the rising price levels. The root of the 2022 inflationary environment can be attributed to a combination of the significant increase in money supply growth during the pandemic, the unforeseen rise in raw material costs for producers, and the economic uncertainty caused by geo-political turbulence. A booming economy coupled with supply-chain issues which made it more difficult to acquire goods, putting pressure on prices. Thus, the crucial question that arises is how policymakers should tackle current inflation while minimising the damage to employment and the labour market.

In terms of monetary policy, central banks worldwide have already been increasing the cost of borrowing in financial markets in order to reduce the availability of credit, aiming to push inflation back to its target. Meanwhile, due to the large increase in public debt during the pandemic period, governments are limited in their spending capacities, such that they could only influence the economy by adjusting taxation rates. In fact, the newly elected U.K. Prime Minister, Liz Truss, had initially planned a tax cut for high-income earners as part of the proposed growth package for the English economy, prior to abolishing such a proposal.

In Malta, the demand-side of the economy has been very strong as revenge spending after the pandemic led to maintained aggregate demand. The recent increase in interest rates announced by the ECB, should serve as a contractionary monetary policy, cooling down investment while reducing speculation in the housing and stock markets. On the other hand, the supply-side of the economy seems to be the major factor behind the sustained price levels that are being observed both locally and globally. Therefore, policymakers should formulate fiscal and monetary policies that reform the current aggregate supply.

Some relevant policies to offset inflation include:

- controlling energy bills via subsidies or alternative energy sources;
- offering lump-sum cash rebates to households or discounted water and electricity bills, as a proportion of households' net income, to avoid over-subsidisation. In this manner, poorer families would be relatively more supplemented than high-income earning households, ultimately balancing the benefits of the fiscal measure;
- raising the overall productivity of labour resources such that higher costs would not be totally levied on consumers;
- incentivising the provision of capital-intensive goods and services in order to mitigate exposure to external economic shocks and
- reducing fiscal spending.

Apart from fiscal spending, governments can use taxation as a tool to influence economic activity. In fact, as a response of the expected abnormal increase in the COLA during the upcoming budget, various stakeholders have proposed tax changes. For instance, the MCC has proposed a VAT reduction from 18% to 7% for restaurants, given that most of the recent inflation has been led by higher prices in the food industry. In providing a set of 2023 Budget Recommendations, the MCC claimed that the increasing costs related to imports accompanied with higher wage demands by workers, have led to substantial restaurant prices, damaging overall affordability for low-income earning households.

In a nutshell, policies implemented during inflationary periods are generally targeted at calming down the economy, potentially reducing employment in the short-term in order to revert inflation back to its target. In the meantime, given that rising unemployment is undesirable, any governmental intervention during the current inflationary environment has to attempt to minimise the damage on employment. The most recent economic changes present brand-new difficulties for monetary policy. Fiscal and monetary policies will need to be put into place at both the European and national levels in order to achieve the required economic transition and address issues of competitiveness and long-term sustainability.

Recommendations for further research

In conclusion, further studies on the topic in question should delve into the dynamics influencing the discrepancy between the Jobsplus unemployment rate and that reported by the LFS. Unemployment rates should be treated with caution, and in this regard, further studies should attempt to identify the main reasons for the growing discrepancy between the two main unemployment rates evaluated in Malta. It could be the case that the unemployment rates evaluated may need to be updated, in order to better reflect the dynamics of the rapidly changing Maltese labour market.

In addition, it is recommended that future studies relating to unemployment and inflation rates evaluate the relevance of the PC in the Maltese economy, as there seems to be a literature void on the topic. Such studies could apply econometric frameworks in the form of regression functions, ultimately identifying the overall significance of the relationship between price growth and changes in the unemployment rates.

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