



## Inequality Dynamics in Malta: Cracks, Blips and Long-Term Trends

Centre for Labour Studies

Presented during a digital conference held on the 22<sup>nd</sup> June 2021

### Rationale and Objectives

Inclusive economic development cannot occur without equity. Besides unfairness, inequality reflects the wastefulness of resources. It lowers social mobility, exacerbates the differences between individuals, distorts market signals and incentives, and shifts the balance of power away from the less affluent members of society. Mitigating the risks and consequences of inequality is key in order to meet society's overall economic and social development objectives. The value of commonly used indicators of inequality are open to interpretation. Some consider inequality to be a "bad" thing, but others value inequality as a reward for education, hard work, and the development of skills. Debates on inequality can easily reach an impasse, as it is difficult to think of such judgements as "correct" or "incorrect". Furthermore, it is not clear to many what inequality is; nor understand its evolution and interlinkages with the factors that drive it.

In view of a dearth of information on the topic, this study analyses changes in income inequality in Malta between 2005 and 2018 and aims to identify factors that may have contributed to such changes. The approach was motivated by the desire to relate inequality trends explicitly to factors without passing value judgements. Indeed, shifting demographics and income differences across gender, occupation, housing tenure and the transition from single-earner to dual-earner households could have contributed to overall inequality trends.

### Data and Methodology

The study employs and analyses data collected between 2005 and 2018 by Malta's National Statistics Office, which conforms with the European Union Survey on Income and Living Conditions (EU-SILC).<sup>1</sup> EU-SILC is a survey that focuses mainly on personal and household income and material deprivation. Data have been collected consistently since 2005, and so it can be considered comparable and reconcilable over time. Around 4,000 households in Malta were interviewed every year for this survey. Respondents were asked to assess their income and living conditions.<sup>2</sup>

### Results

A review of the headline statistics for Malta finds that between 2005 and 2018, the Gini coefficient has increased from 27.0 to 28.7. However, the Gini coefficient remained lower than the EU average of 30.8. A coefficient of 0 means perfect equality where everyone has the same income. In contrast, a coefficient of 100 implies absolute inequality where only one person has all the income. In 2018, the richest 20% received 4.3 times more disposable income than the poorest 20%. This reflects a marginal increase of 0.33 over 2005. In the EU, the ratio of the average disposable income of the 20% richest to the 20% poorest stood at 5.12. Relative to the EU average, Malta's distribution of income is more evenly distributed.

Over the years, the Gini coefficient of equivalised disposable income before social transfers increased by a marginally higher rate relative to the EU average from 40.1 to 44.0. This development shows that inequality over the past thirteen years increased despite social policy. However, social help given by the state attenuated the overall increase in inequality. In the EU, the Gini coefficient before social transfers increased from 49.7 to 51.1. Relative to the EU average, Malta's income distribution is more equal, even before weighing in the positive redistributive effects of social transfers.

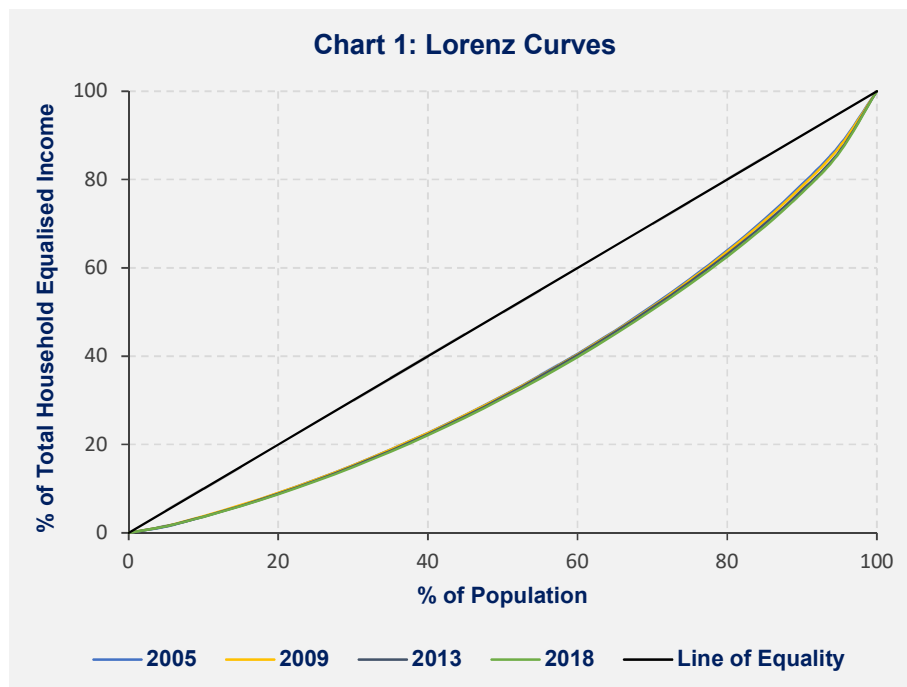
---

<sup>1</sup> This survey is carried out under European Framework Regulation (EC) No 1177/2003.

<sup>2</sup> The present document has been produced using the EU-SILC 2005-2018 Data - National Statistics Office Malta. The calculations and conclusions with the document are the intellectual product of the present authors.

Although the Gini coefficient is the most widely used indicator of inequality, the Gini coefficient does not depend on how poor the poorer person, or how rich the richer person, is. The Gini coefficient is more sensitive to changes in income in the middle part of the distribution, and assessing inequality necessitates complementing the Gini with other indicators.<sup>3</sup>

The Lorenz Curve shows that in 2018 the bottom 40% of the population earned 22% of the total income, and the bottom 80% of the population got 63% of total incomes (Chart 1). This implies that the remaining 37% of income went to the 20% richest of Malta's population. In general, there were no substantial changes in the Lorenz curves over the past thirteen years. However, there were marginal increases in total income inequality at the upper end of the distribution. After computing four different indices of inequalities each year, this finding is confirmed, each with different sensitivity towards the bottom and top parts of the income distribution. Had there been no direct taxation and social transfers, income inequality would have been more pronounced among the poorest population. This shows that household composition, taxes, and social transfers play an important role in stabilising and redistributing income from the richest to the poorest.

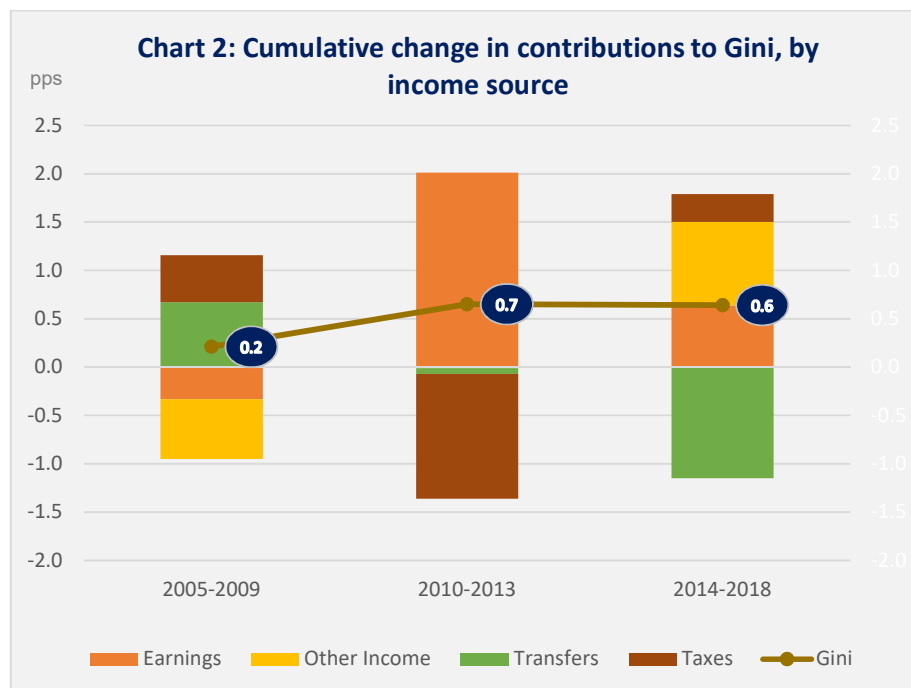


The study examines which income and socio-demographic factors affect inequality and how important they are in Malta. It finds that earnings are a huge contributor, explaining almost three-fourths of inequality. This is expected given that it is an important source of income. Other income (including rental income, interests, and dividends from financial assets) is highly unequally distributed. However, it constitutes a small share of total income. Social transfers and direct taxation have substantial equalising effects on overall inequality.

Chart 2 illustrates the cumulative change in the contribution of each income source to inequality, as measured by the Gini coefficient. A value less than zero indicates that the factor contributes to *lowering* inequality, whereas a value greater than zero means that income source has contributed to *more* inequality. During the first period, earnings marginally contributed to less inequality as the share of earnings to total income declined. Between 2010 and 2018, earnings exerted upward pressure on inequality as more persons participated in the labour market with less evenly distributed market-driven earnings. Had there been no social transfers and taxes, the Gini would have increased by 2.6 between 2010 and 2018 due to market earnings alone. Although other income constitutes a

<sup>3</sup> For ease of comparability, this study follows Eurostat's definition of equalised disposable income. It is calculated as the household disposable income divided by the equivalent household size. Household disposable income is composed of all monetary incomes received from any source by each household member, including income from work, investment and social benefits, plus any other household income. Taxes and social contributions paid are deducted from this sum. The equivalent household size is calculated according to the "modified OECD" equivalence scale.

relatively small share to total income, it was the main contributor to the increase in inequality between 2014 and 2018. As expected, such income is unequally distributed and reported by families with higher incomes. Turning to social transfers, the first period was characterised by marginally lower redistributive elements, followed by a neutral period in the post-financial crisis years. However, the positive redistributive effect of social transfers was boosted between 2014 and 2018. This helped almost to cancel out all the inequality pressures exerted by the market forces. Indeed, such a period was characterised by an arsenal of social measures, such as the introduction of the in-work benefit and tapering of social benefits and more generous means-tested benefit rates. On the other hand, the reported changes in direct taxation reflect both the share of taxes to total income as well as how evenly distributed taxes were among households. Taxes contributed to more inequality between 2005 and 2009, reflecting changes in tax parameters between 2007 and 2009, and then reversed in the following period. Indeed, during the latter period, taxes regained grounds both in terms of their relative importance and redistributive shares. The contribution of taxes to overall inequality trended upward during the final period. This coincides with the widening of the tax bands for the middle- to upper-income class between 2013 and 2015.



The study finds that the educational attainment of the head-of-household is the most important factor for explaining inequality among households, and its importance has become more pronounced over time. Whereas education explained almost 15% of inequality between households during 2005-2009, the rate increased to 25% between 2014-2018. The study confirms that the income of individuals with tertiary education relative to head of households with primary, secondary and upper-secondary education has been racing away.

Household employment structure is another factor contributing to inequality. Households with more than one income earner have become commonplace in Malta and are generally considered more financially secure than single-earner households. Much of the transition away from predominantly single-income households is attributed to evolving perspectives about the role of each partner in the household. Concurrently, the number of Maltese individuals who live in their parental home until their 30s appears to be rising, as are the number of women engaged in part-time or full-time external employment. One may argue that multi-earner households are at an advantage compared to single-earner households. Access to higher income brings about greater purchasing power, more consumer choice, economies of scale, and value to leisure time. Perhaps that is why the household employment structure explained almost 31% of income inequality between 2005-2009. However, between 2010 and 2018, this factor lost some of its explanatory power and reached 22% during 2014-2018. Indeed, the data confirm that when adjusting for household size, the relative income of multi-earner households has been converging to single-earner households. It is hard to say what has caused multi-earner households to have relatively less equalised income than before. However, it indicates that participation in the labour market on its own may not guarantee financial security.

Examining the difference between full-time/part-time employees, self-employed, unemployed, and inactive persons below and above retirement age, similarly reveals that labour status and work intensity are key determinants of income inequality. In the context of the increasing number of active persons between 2005 and 2018, this has helped to hold back inequality growth. However, in the process, the relative income of persons who remained inactive or unemployed fell behind. Such finding has twofold interpretations. On the one hand, the widening gap between employees and inactive persons can be seen as arising from work rewards. On the other hand, if individuals remained inactive because of unequal access to the labour market, such as financial exclusion, material deprivation or social exclusion, it is harmful to the wellbeing of the society.

On the effect of occupations, the findings indicate that market earnings between occupations explains almost 20% of inequality. This reflects the main findings in the literature that occupations play an important role in income dynamics in a context of a more globalised and digitalised world. Furthermore, the share of demographic transition is becoming more pronounced in explaining the share of inequality. This transition has increased the proportion of the elderly relative to the working-age population. As expected, the youngest and oldest cohorts were the groups with the most unequal earnings. It is important to point out that the effect of demographic transition can work indirectly through other factors, such as occupation and education. This result is congruent with that found in the literature, in that a population with a higher relative number of older adults widens income differentials between older and younger workers.

## Conclusion

This study demonstrated that in isolation, an income inequality indicator hides the complexity of income distribution. The current analysis identified several factors affecting income inequality, including education, labour market status, and occupation. On the other hand, the welfare system appears to limit or reduces inequality.

While the Gini coefficient remained relatively stable between 2005 and 2018, the Lorenz curve moved further away from the line of equality at the upper end of the income distribution. This shows modest inequality increasing during this period. By benchmarking the most recent time period under review against the 2005-2009 period, Government intervention, through social transfers but not through taxes, has had a mildly neutralising effect upon inequality,. Social transfers provided a greater safety net to citizens than they did during the 2005-2009 period, whereas the tax reforms during the years have abraded some of the tax progressivity.

The study also found that inequality was mostly attributed to differences in the individual's qualifications, hours worked, occupations, and household employment structure and size. In general, this accords with the theoretical insights that the productivity of workers plays a significant role in the labour market. Without policy intervention, the imperfectness of the labour market can result in further inequality. Thus, an important implication for policy is to reduce further barriers to economic inclusion as the benefits of growth can easily become battered by its downsides, especially due to the roles of globalisation, technology and market forces.

*This research was conducted under the auspices of the Centre for Labour Studies (CLS), University of Malta. The project was initiated by former CLS director Dr Anna Borg, then taken forward under the directorship of Dr Luke Anthony Fiorini. The research was carried out in 2020 and is the first of two studies on income inequality and poverty in Malta. Funding for this research was made possible by the Centre for Labour Studies.*

**Authors: Melchior Vella and Gilmour Camilleri**