ON THE DESIRABILITY AND THE IMPLEMENTATION OF A FACTOR SHARE POLICY FOR MALTA

by E.P. DELIA*

INTRODUCTION

'WHAT is produced is distributed in the process of production' is a simple economic statement implying, as often happens, complex connotations. For, the interrelationship between the production and the distribution of a given output is only crudely understood in economic theory. In addition, ideological conflicts regarding asset ownership, income distribution and wealth accumulation render an understanding of the production – distribution relationship more difficult still to achieve. A recurring socio-political concensus, effected through Government policies, becomes therefore essential for the attainment of a series of partial solutions through time.

The problematic relation between production and distribution could be briefly stated as follows: There exists the necessity, on the one hand, to examine the issue of how a quantity of commodities should be produced; to concentrate upon the optimal resource allocation, including sectoral shifts, devising incentives geared mainly to production, with the aim to produce the highest attainable output. On the other hand, it is necessary to examine how distribution could be managed to exert the greatest influence on production without causing hardships, i.e., how to redistribute the growing national product among those who are active in production and also those who for valid reasons e.g. age or infirmity, are unable to participate in the productive process. Viewed thus distribution becomes an incentive or a brake to economic growth.

If a Growth/Distribution trade-off is unavoidable, cooperation within a society becomes not only desirable but crucial. Political consensus, at least among the majority, is indispensable for socio-economic development, the more so if social changes, considered radical from a community's traditional views, are called for.

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This article applies various elements from several economic theories and models to the gradual transformations experienced by the Maltese economy over the twenty-year period recorded in the official National Accounts data, 1954-1973. Concentration is set upon the functional distribution of income during this period. The main observation rests upon the necessity to determine a relative factor-income distribution policy taking into account the restructuring process continuously operating within the Maltese economy. In order to understand the motive for such a share policy the present structural state of the economy, together with the prevailing social attitudes, must be highlighted; in turn, any future projected schemes and resulting changes in economic and social aspirations would demand to be integrated within the present Maltese socio-economic structure. Although the argument could be very succintly introduced, the actual dimensions of the potential difficulties could only be realistically evaluated after a detailed analysis of the several factors involved is carried out. This paper therefore combines policy with the state of theoretical debates about production and distribution relationship in economics, and with the underlying socio-political situation in Malta at this time period. For this purpose, a theme is developed in every separate section; the observations introduced help elucidate the intricate nature of the problems involved. The discovery and the study of a problem are the primary steps leading to a solution.

An evaluation of the present Functional Income Distribution theoretical debate is submitted first; this is necessary to dispel any possible distorted views about an existing homogeneity of thought about this subject. The ambiguous role of the State in Economics is emphasized, for no social policy can be implemented outside a political framework. The observed factor shares movements and the associated computational difficulties in Malta's Gross National Product (GNP) for the past two decades are then discussed. Finally, selected characteristics and influences observed active in the Maltese economy are analysed in terms of their potential contribution in assisting public policy making upon factor-shares. These include the need to distinguish between the Production and the Commercial profit motive; the linkages between economic growth and factor income distribution; the possibility of alternative employment and its relation to intersector and inter-country labour mobility; and the need to plan capital-labour intensity within production units with the objective of being in a position to meet changing market needs and changing aspirations of investors and workers.

This paper is an introductory work; hopefully it should lead to a series of articles dealing with the personal income distribution, and the impact and repercussions of the Government budget upon household income in Malta. Such work could be rewardingly undertaken when the required data become available.

INCOME DISTRIBUTION AND THE ROLE OF THE STATE IN ECONOMIC THEORY[1]

The distribution of the aggregate output has long been acknowledged by economists as an important element in the mechanism through which market forces function in an economic system. However, despite this awareness, the state of theoretical analysis about this subject remains uneasy. This follows from the lack of a coherent exposition in which distribution is accorded a degree of autonomy. Those analysts who emphasize the social element in distribution without minimizing the power of market forces, insist that people react as collectively conscious groups to the conditions under which the social product is allocated through primary distribution. They emphasize that it is not enough to assume income distribution as an intermediate stage between production and income generation on the one hand, and spending or allocating distributed income to consumption and saving, on the other. If this were so, income distribution can be approached through production (following the neo-marginalist, supply-oriented 'theories') or through effective demand (in accordance with post-Keynesian demand-oriented 'theory') and the debate would be concluded.

Economic thinking, however, appears to be converging upon the need to approach the distribution issue through an eclectic analysis, difficult and problematic as that is. Theories about distribution need not be considered mutually exclusive. A theory could be regarded as attributing predominant influence to a particular process of adjustment in the socio-economic system, and several processes could be in action at the same time and react to one another.[2]

The tenacity with which theorists have defended their selected views and attempt to rebutt the ideas of their academic opponents is understandable. At stake there are personal ideals and social

[1]See (i) Bronfenbrenner M.: 'Income Distribution Theory' (Macmillan 1971)
(ii) Marchal J. and Duclos B. ed. 'The Distribution of National Income – Proceedings of a Conference held by the International Economic Association at Palermo' (Macmillan 1968).

[2]See: Phelps-Brown E.H. 'Pay and Profits' (Manchester University Press 1968) pp. 9-10.

convictions camouflaged as the source that inspires the behavioural reactions and policy targets in the economic models constructed. Besides it sounds practical to integrate an analysis around a single tenet and thereafter concede shortcomings rather than produce eclectic models which, being highly complex and restrictive in the behavioural assumptions introduced, are rendered unsuitable for testing in a real world economy.[3] Theoretical expediency should be integrated with, rather than divorced from, pragmatic policy considerations.

The theory of functional distribution of income concerns the distribution of the social product among the factors of production which combine to produce it. To simplify exposition, productive factors are generally limited to two, Labour and Capital where the latter term is made to represent the non-labour factors of production, namely, capital, land and entrepreneurship.[4] The study of functional distribution reveals the shares accruing to factor labour, but not to the labourer, and to factor capital, but not to money lenders, investors or land owners. The theory of functional distribution is thus by no means a theory of the distribution of incomes among factors of production. The size of the primary income i.e., income before tax deductions and transfer payments from Public sources are allowed for, going to every individual – the personal distribution of income – can be ascertained only when the amounts of la-

[3] See: Krelle W. 'The Laws of Distribution in the Short Run and in the Long Run: An Aggregative Model' (in Marchal/Ducros Ed. op. cit)

[4] It is essential to distinguish between *means* of production and *factors* of production. For the purpose of studying the processes of production and the size of relative shares in the product, it may be convenient to utilise the concept of several factors of production. In a complete theory of the distribution of income, however, there is only *one* factor, namely, labour; the rest are *means* of production.

Reference should also be made to the current economic debate about the term and estimation of 'Capital' and the determination of 'a' profit rate. The debate in capital theory has led to the temporary conclusion that the value of capital cannot be known unless the rate of return or profit is given; this cannot therefore be used in turn to determine the rate of return on 'capital'. Relative bargaining power between owners of productive assets and labour rather than relative market forces determine who gets what in the allocation of the national product.

See: Kregel J.A. 'Rate of Profit, Distribution and Growth: Two views' (Macmillan 1971).

Blaug M.: 'The Cambridge Revolution: Success or Failure' (The Institute of Economic Affairs 1974).

bour and other productive inputs – land, liquid and/or fixed assets and their composition – at the disposal of every individual are known.

Theories are meant to explain and not just describe interrelationships within a system. Unfortunately, income distribution theories describe rather than explain the factor-commodity interrelationships in an economy. Analyses are carried out in 'real' terms within the context of a full-employment situation. The theoretical conclusions thus arrived at are, in turn, applied to interpreting the processes that could be presumed to have evolved in an economy in the attempt to relate observed factor movements with the theoretical results e.g. in terms of the elasticity of substitution in a neo-classical set-up or in terms of a factor's propensity to save in a Kaldorian approach.

In addition, the application of theoretical results to real-world conditions must consider the role of the State in an economy. Therefore, attempts to construct a framework for the derivation of economically optimal situations without accounting for value-judgements involving socio-political set-ups could lead to dead ends when policy prescriptions are sought. The situation becomes confusing when analysis is carried out in compartmentalised steps introducing ambivalent roles to a main factor (in this case, the State) at different stages. This incongruency of the assumed behaviour of the State, and the possibility for a member of society to think unemotionally and disinterestedly are fundamental issues which have not been resolved. Failure to resolve them has meant an incomplete policy-oriented theoretical analysis of the distribution issue.

Practitioners of 'Positive' economics base their approach upon existing political and social structures which they consider as data; their aim is to spell out the optimal social welfare conditions within such a framework, retaining fundamental the freedom of an individual to choose what to sell (labour services or goods) and what to consume. Accepting a given social structure and attempting to maximise welfare within such a constraint implies that the economist would become a propagator of an existing system. For if the analysis could suggest that crucial changes in the social framework itself is necessary for welfare maximisation, the approach adopted need no longer be entirely applicable; and, anyway, by definition, theoretically optimal situations abstain from redistribution consideration. Analyses carried out in 'vacuum' or dated i.e. within the constraints of a particular socio-political framework, are destined to be of limited value to an understanding of the real world; they would lead, as they have actually led, to ambiguous situations. Consider the role attributed to the State in economic theory.

Welfare theory, based upon orthodox abstract microeconomics, starts from the premise that the State should refrain from disturbing the pattern of resource allocation as determined by market relationships, except when the allocation is inconsistent with what it should be under perfect competitive conditions. The State's intervention is a corrective force; it is solely justified for removing the distortions which obstruct the proper functioning of the economic system from attaining the presumed highest possible welfare level (however 'welfare' is defined). Misallocation of resources is attributed to anyone, or a combination of two general categories of distortions, namely, a monopolistic market structure and externalities in production and consumption. These categories could, in reality, prove to be the rule rather than the exception; the concept of externalities is very hard to define rigorously to meet real-world situations. State intervention could generally be recommended upon this tenet. With such an elastic rule, it is doubtful how practical it is to assert that the State should refrain from actively participating in the market economy.

Directly opposite is the attitude of theoreticians towards the State in macrotheory. Macroeconomics considers the State the means whereby output growth is achieved with minimal friction in terms of rising prices or resource unemployment; still, in principle, a corrective force. Once active participation is envisaged for the State, however, it is unrealistic to assume that Government becomes a mere adjusting force that comes and goes without getting itself involved in the economic process. If the State is to be handed over the task of seeing that output growth is promoted with the minimal costs in terms of unemployment and social injustice – for, it must be recognized, that one man's 'equity' need not be another's notion of 'fairness' and, hence, injustice would become a subjective evaluation of events – it becomes difficult to relate this idea with the notion that while influencing the economy through the Public Budget and appropriate legislation – introducing or modifying tax incentive schemes and income subsidies – the State is simultaneously forbidden to acquire productive assets. As the State accumulates assets, the balance of Power within an economy shifts and market structures and policy tools change accordingly. Dispassionate intermediation by State Authorities in the real world is a myth; theorising on the premise of 'no government' become, therefore, a quasi-sterile mental exercise with little positive gains for practical policy making.

This is precisely the reason why current economic theory is undergoing an intra-disciplinary ferment. Economic man and social man are one. In time certain ideas become accepted or are forced upon a resistent minority; other ideas are discarded. Though mankind changes very slowly in its basic aspirations, yet in his ways of expression Man can differ over time and places. Production, Distribution, Justice, Sympathy, Greed and Generosity are closely interlinked; the means society implements to achieve social ideals, vaguely defined by its leaders, appear to derive force from the State Authorities that must somehow reflect the social pulse and brain. Consequently a Stateless, mechanical analysis could be deluding rather than illuminating.

Development of theory is not the intent of this paper; rather it is the utilisation of the corpus of ideas in economics to Malta at a transitional stage of economic development. Crude and uneasy as theory is about the subject and related topics, it could be gainfully applied if its shortcomings are correctly and explicitly recognized. So the main contributions of different economic theories and models are briefly explained wherever deemed relevant; these are, in turn, used as a starting-point from which to discuss public policy implications.

The following section submits a 'factual' assessment of relative shares of productive factors in Malta for the twenty year period, 1954-1973.

Movements of Relative Factor Shares in Malta's GNP: 1954-1973

The observed behaviour of the relative factor shares in the Maltese economy is presented, percentagewise, in Table 1; the mean values by category for the four quinquenniums are given. Table 2 submits a different activity classification for the same years. The two tables together enable one to meet certain objections about factor share allocation raised about similar studies for other economies. The discrepancy in terminological usage between concepts in economic theory and their counterpart in National Accounting together with the difficulties met in allocating the proper share to a factor are discussed in notes (5) and (6).

[5] Economic theory defines 'wages' as the payment for human effort exerted in the production process, 'rent' as the return to non-reproducible resources supplied in fixed amounts by nature; 'interest' as the return to non-human, reproducible means of production; and 'profits' as the residual reward to entrepreneurship for risk-bearing, co-ordinating and innovating activity. Factor rewards are, therefore, conceptually homogeneous and distinct.

The conceptual problems indicated in notes (5, 6) render the task of interpreting movements in income shares a heavy one. The observed changes in factor shares could result from measurement bias rather than the outcome of structural economic transformation. These difficulties are recognised as elements tending to weaken the reliability of empirical investigations.

The data in Table 2 suggest a small increment in share accruing to factor labour; a relative increase in Public capital income, mainly in the form of interest and dividends, and a fourfold rise in Un-

In the National Accounts, however, the measures are formed of heterogeneous income elements. Thus, for example, labour income includes indeterminate amount of 'interest' yield on investment in education and training plus 'rent' on unique ability in addition to pure wage income. Also included is entrepreneurial income because the salaries of company executives are added.

[6] Self-Employment ('Mixed Income') has contributed, substantially to the GDP in Malta. The problem of attributing a share to Capital and a share to labour has everywhere proved controversial. At least three positions have been taken regarding its disposition.

According to one view, it is virtually impossible to identify the 'labour' and 'capital' components and, therefore, any separation must be completely arbitrary. It is advocated that analysis should be limited to those sectors of the economy not dominated by unincorporated forms of business enterprises.

A second view argues that proprietors' income is too important to ignore and that it should be assigned to the labour category. Proponents of this view rationalise that a large part of proprietors' income goes to self-employed professionals, e.g. doctors who are engaged predominantly in labour type activity. (Note that in the Maltese National Accounts 'retailers' are included as a separate class).

A third view is opposed to the complete allocation of proprietors' income to labour because such a procedure implies that the property used by the self-employed in their work has a zero yield. Suggested techniques advanced to obtain reasonably accurate disentanglement of the constituent parts of self-employed income include:

(i) dividing the shares in the same ratio as they are divided in the corporate sector; and

(ii) imputing to each self-employed person a labour income equivalent to the market yield on assets similar to those owned by the self-employed.

In Table 2 we consider self-employment income as a separate item. Table 1(b) aggregates wages and salaries and the income for farming, fishing and private services as suggested in the second view above. It was not possible to follow suggestion (ii) of imputing a market value for the capital of the self-employed; statistical data are nonexistant.

Table 1

(a)

MEAN VALUES PER QUINQUENNIUM OF FACTOR SHARES IN MALTA'S GROSS NATIONAL PRODUCT 1954-1973 – PERCENT

ACTIVITY	1954-58	1959-63	1964-68	1969-73
1. Income from Employment	50.59	50.94	50.21	52.04
2. Income from Farming, Fishing and Private Services	7.73	8.54	8.42	8.32
3. Gross Trading Profits	28.04	27.17	27.52	25.42
4. Gross Trading Surplus of Government Enterprises	0.80	0.70	1.04	1.11
5. Income from Property	5.50	4.98	4.85	5.09
6. Net Investment Income from Abroad	7.35	7.68	7.96	8.02
(b)				
FACTOR LABOUR (Items 1 and 2)	58.32	59.48	58.63	60.36
FACTOR CAPITAL (Items 3, 4, 5 and 6	34.34 7.35 41.69	32.85 7.68 40.53	33.41 7.96 42.37	31.62 8.02 39.64

Source: Based on Table 1 National Accounts of the Maltese Islands (C.O.S. Malta.).

distributed Company Profits. The share of Private Capital registered a conspicuous decline in its 1959-63 mean value from that estimated for the preceeding quinquennium, but since then appears to have established itself at about twelve per cent of GNP. Could one interpret the changes in relative factor shares as being indicative of the underlying transformation process in the Maltese economy over the past two decades? Although a definite answer would be hard to obtain, one could attempt to select certain factors that could be presumed to have influenced, or could potentially prove to be basic for socio-economic change.

Table 2

MEAN VALUES PER QUINQUENNIUM OF FACTOR SHARES IN MALTA'S GROSS NATIONAL PRODUCT

1954-1973 – PERCENT

ACTIVITY	1954-58	1959-63	1964-68	1969-74
Labour Incomes	53.22	50.90	50.21	52.02
Mixed Incomes	29.07	29.92	27.17	20.92
Private Capital	13.55	12.37	12.51	13.75
Undistributed				
Company Profit	1.07	2.77	4.72	6.66
Public Capital Income:				
Profits of Govt. Enterprises	0.50	0.50	1.04	1.35
Rents	0.67	0.65	0.60	0.47
Interests and Dividends	2.02	2.45	3.74	4.02
	3.19	3.60	5.38	5.84

Source: Based on Tables 7 (or 6) in the 'National Accounts of the Maltese Islands' (C.O.S. Malta).

Such structural factors affecting the intra- and inter-labour and non-labour shares during the period would include: the decline in the importance of the British Defence Departments; the growth of a manufacturing sector motivated by production-profit; and the relative influence of foreign capital markets and the returns from deposits with bank and non-bank financial institutions. Consider these three items.

The data indicate a fairly stable, or slightly rising, labour's share; this would appear conformable to the much-discussed stability of labour's share in other economies. However there exists the possibility of incongruency in the Malta case. Arguments could be forwarded to back hypothesis that in this period of transition, when corporate enterprise is extended, there should have been registered an *observed* increase in the share of factor capital though this would not necessarily imply an *actual* shift. We explain.

It is noted, for example, that the wages and salaries of Maltese personnel employed with the U.K. Defence Department represented only one item in the expenditure of the Armed Forces in Malta. Whatever capital investment was undertaken at the expense of the British Government (say, the purchasing and installation of radar units or other equipment for the maintenance of the airport) is not accounted for in the Maltese GNP unless Maltese contractors are employed and the installation costs appear under wages or personal profit – if the contractor is not registered as a limited liability company. The Service Departments, as officially estimated, are 100% labour intensive; the subsequent yield on capital invested is nil.

As the British Government reduced Maltese personnel engaged with its Departments, the discharged employees had the choice of emigrating, of turning themselves into self-employed by setting-up small businesses of their own, or of retraining and re-employment in the other sectors of Industry and Tourism or in the Public Civil Service. Consequently, the hypothetical labour intensity for the Maltese economy as suggested in the National Accounts would decrease. For the private sector makes allowance for its capital and assume a rate of return. Capital starts being considered productive; its absolute returns become positive, and, therefore, its relative share should increase compared to its pre-industrialisation value. But such a rise should not imply a shift towards factor capital; rather, it would simply represent the persuit of proper accounting procedures where the non-labour factors are allocated their actual or imputed remuneration.

Similarly, the output of Government Administration as officially recorded is also hundred per cent labour intensive. If Government stabilise the intake and level of recruitment of public employees, thus bringing about a relative decline in the public sector employment to a growing labour force, the overall relative labour-intensity would register an observed fall. The rate at which this partly apparent drop in the aggregate labour/non-labour (L/K) ratio would depend on several factors including the momentum of the industrialisation programme; the average L/K ratios in every sector reflecting the respective L/K intensity in separate units of industry or tourism; the growth of the labour force resulting from changes in school-leaving age, official retirement age, movement in female participation rates, and changes in the length of the working week. The share accruing to corporate capital, whether publicly or privately owned or of mixed ownership, would show the tendency to rise. However, in the cases referred this movement towards an increment in capital's share is due to the omission of allocating a return to capital in the Malta Government and the British Defence Departments. The actual distribution, i.e. one combining a return to capital in these sectors could differ substantially from what the tabulated data suggest. Even within the manufacturing sector itself, if activity proceeds as normally assumed, there exists an inherent element contributing towards an increase in the profit share. In the first years of production, a company could be expected to register negative profits; it aims to break even after two or three years of actity. So, while profits are nil, dividends would not be distributed and it would appear that labour is rewarded at the expense of capital. Once profits are registered the return going to capital becomes positive in turn and the composition of final output of a productive enterprise changes; labour's relative share would indicate a decline. This case would represent another example in accounting techniques, although the cause for such a change in output-sharing is different from the one noted in connection with the Government and the U.K. Defence Departments.

This type of shift in relative shares is important especially since under 'Manufacturing' is included the output of the Malta Drydocks. This industry operated beyond its earning potential since 'commercialised' in 1959; its debts were financed by direct Public subsidies paid out of total Government revenue. Whenever the enterprise turns from a deficit to a surplus, the relative composition of final output could be regarded as the normal distributive share in this unit.

Intersectoral movements between the self-employed units and factory production in favour of the latter would also reveal a tendency towards an increase in the income share going to profits; once again the observed shift would reflect, in part, the diffusion of proper accounting procedures. Self-employed and owners of small units employing, say, up to four persons, regard the difference between total costs and total revenue as income in the sense of remuneration for their labour efforts. No attempts are made to distinguish between the 'transfer payment' and the 'pure profit' components of the periodic inflow of the funds earned.[7] With the application of proper accounting methods, the self-employed would impute a wage and salary for themselves based upon the value of their

[7]This attitude could have changed with the introduction of Provisional Tax (under the P.A.Y.E. system of tax collecting) introduced in 1973. With unincorporated business the residual between costs and revenue is considered as personal income for income tax purposes. But, apart from Income Tax considerations, the distinction between 'wage income' and 'profits' could have a deeper significance than it appears to in so far as different types of consumption expenditures could be related to different sources of funds, e.g. expenditure upon household durables correlated to accumulated savings.

services in the labour market, estimate the residual and find out the gross return on the funds invested in their business. If the number of self-employed declines, labour moves into corporate enterprise where total output is allocated among the inputs utilised for production; under these conditions capital's share turns positive and, consequently, the apparent overall labour's share falls. It must be emphasized, however, that capital must be obtaining a return, small as it may be, in the one-man self-employed units; only it is not recognised as such by its earners.

Other elements that could be considered to have led to an increase in capital's share are the upward movement in interest rates in Malta and in London where Maltese were habitually investing their savings; and the opportunities in the real-estate market that contributed to the breaking up of the traditional rental ceiling.

The Maltese individual has demonstrated in the period studied a relatively high marginal propensity to save, about twenty five per cent of incremental disposable income. So far, the main choices available for the small savers were: the retention of funds in idle cash balances at home; savings, and time deposits with Maltese or London banks; bonds issued by the British Government in England and since 1959 local stock by the Malta Government; and real estate. High interest rates in recent years could have affected a transformation in psychological attitudes toward deposits with financial institutions; idle cash was transferred into deposits, mainly time deposits, and into Defence or Development bonds where security is guaranteed. As the volume of savings deposited increased and as there occurred simultaneously an upward shift in the structure of rates paid, the annual absolute return in the form of interest earnings rose.

In addition the social conception of the share of housing expenditure in the household's budget is being gradually modified as an effect of a more diffused awareness of costs and of rising standards. The rental issue is highly complex; it involves social and legal considerations in addition to those of a purely economic nature. What is outstanding over the last five years reviewed is the fact that the rentals currently demanded and paid are higher than they were, say, a decade ago; which signifies an increase in the absolute volume of funds earned from house renting.

The above influences were certainly observed over the period discussed. Their effects have been either negligible or counteracted by comparable radical changes in labour incomes or, still, never recorded properly in the National Account Statistics. The third consideration would demand a study for a new approach to meet the transformed socio-economic conditions in Malta; but the first two factors could be elaborated further.

There did occur a radical shift in wages and salaries in the Government sector, following the report of the Wage and Salaries Anomalies Commission in 1969, backdating payments to 1966; wage increases on a minor scale spread to the remaining commercial sectors of the economy through higher expenditure on consumer durables, for example. Such an income rise could have offset the expansion of factory work and service units. Or, it could have happened that since the effects of the British Services run-down fell, in part, upon men nearing legal retirement age, which was lowered from 65 to 61, wage or salaries earners with the Services retired and did not form part of the emerging enterprises where labour and capital factors were allotted their share. Still, those who became unemployed could have either emigrated, or got themselves employed at rates which were comparatively lower than the remuneration with the British Defence Departments; the increase in men employed compensate for the relatively lower financial rewards per head.

The Underdeclaration of personal incomes; the proper distribution between wage income, actual or imputed, and residual or profits in every unit; and the knowledge that actual income per head, as reflected in the domestic standard of living, is greater than the one imputed from National Accounts; these point to one direction: they question the adequacy of the National Accounts data. If the underestimation turn out to be great, one could challenge the usefulness of the present statistics where these are to be compared to those obtained in the future.

Finally, a remark about the share of undistributed company profits (Table 2), which steadily increased. It is assumed that like dividend and profit shares, this item is governed mainly by general business conditions, but undistributed profits tend to fluctuate more than the distributed because companies seem to prefer to maintain their dividend distributions as stable as possible. In the Malta case, this share kept on rising; this could be interpreted as a sign of buoyant activity in several markets. But such an interpretation could be misleading; it is estimated that the marginal propensity to save by Maltese firms is low.[8] This partly reflects the fact that there arises an inducement to distribute rather than retain corporate profits in the existing provisions for tax-free holidays. The increasing relative share and the relatively low corporate

[8] Waldorf, W.H. 'An Econometric model of the Maltese Islands (Office of the Prime Minister 1969) p. 17-18.

propensity to save at the margin, however, could be integrated once it is realised that over the last decade reviewed there occurred an increase in the number of corporate manufacturing and tourist units whose aggregate savings rose relativewise to the GNP. If Waldorf's estimates are accepted, it becomes a matter for speculation what the behaviour of such an item would be when the tax concessionary period expires or if industry is wholly or partly nationalised through the direct participation of the para-statal Malta Development Corporation.

The above comments apply to the past; policy considerations however, look ahead. An attempt is therefore essential to detect factors that would help comprehend a changing society and that would assist in the achievement of economic policy targets. Profit Motives and Entrepreneurial mentality are analysed in the next section while putting forward a case for a share policy.

THE PRODUCTION-PROFIT MOTIVE IN THE MALTESE ECONOMY – NEED FOR A SHARES POLICY?

It is analytically helpful to distinguish between two types of profit: Commercial profit and Production Profit. Such a profit dichotomy identifies the source of profits and thereby suggests entrepreneurial aspirations and probable reactions to different policy measures.

Commercial profit in the wholesale and retail business is based primarily on commissions in the form of a percentage mark-up. It depends, therefore, upon the value of period turnover for its determination. In Malta, this profit is a result of the local consumers' demand for foreign produced goods and services and, consequently, is mirrored in the volume and composition of imports.

Production profit arises from the manufacturing of goods and from the provision of services which are directed either towards the domestic market to substitute imported commodities or to supply foreign demand. This type of profit is consequently affected by the import costs of raw materials and transport, and the export of the finished product.

The wholesale-retail profit relies upon the internal competition among importers and retailers and could be influenced by the availability of funds of a person or a company; such facilities would be reflective of the credit span obtained from the foreign supplier and forwarded to the local distributive outlets. The production profit, on the other hand, depends upon world market conditions in factor costs and product prices, upon marketing knowhow at the pre- and post-production stages, on shipping and air schedules, as well as upon the quality of manufactured goods and delivery time. (This comment does not entirely apply for the sector of Tourism which, being service providing, demands consumption on the spot). The 'importer's profit' arises, like tourism's, out of the rendering of a service, in the tertiary sector; the production profit emanates from the secondary economic sectors.

Gross Trading Profits increased from an estimated £M8.3 million in 1954 to £M27.6 million in 1973; though, the gradual absolute rise in value does not mean an increase relativewise. Averaged over five-year periods, Gross Trading Profits declined by 2.5 percentiles (Vid. Table 1). The production profit in the Maltese economy in the past is conspicuous by its absence. It could be argued, in general terms, that the profit motive as ordinarily understood and implemented in economic theory has been non-existent in the Maltese economy. An impression of the comparative importance of profit-motivated behaviour in the Maltese economic set-up could be formed by classifying the various sectors according to the presence or absence of considerations about the yields on capital invested; importance is judged by the relative labour content of every productive category.

PROFIT MOTIVATION AND ECONOMIC SECTORS IN MALTA 1954 – 1973

	(% OF LABOUR FORCE)	
	1954	1973
I. Profit Motive: Nil		
Public Administration	16.9	18.34 (a)
Defence Departments	26.8	4.54
II. Profit Motive: Indefinite		
Agriculture and Fishing	10.54	6.28
Certain units in retail, construction and private services		
Government Enterprises		
III. Profit Motive: Dominant		
Manufacturing and the Malta Drydocks	10.69	28.56 (b)
Hotels and Restaurants) Insurance, Banking & Real Estate)	7.59	10.38
Wholesale and Retailing	13.01	11.08

(a) excluding Malta Pioneer Corps (which amounted to 4.01% of Total Labour Force)

(b) including Personal Services.

The profit motive is absent in the sectors of Public Administration and the U.K. Defence Departments which, between them, accounted for 43.7% of employment in 1954 and 32.88% in 1973. This implies that the upward shifts in wage and salary structures would not affect the level of employment or the working conditions in these sectors: demand for labour is relatively wage inelastic within remuneration changes normally experienced. The market price mechanism for the services sold tends to be blunted by non-economic considerations.

To these two sectors could be added the Malta Drydocks, formerly under the British Admiralty, but in the sixties converted into a commercial ship-repair yard and since 1969 the responsibility of the Malta Government. When work was commissioned by the British Navy, the accent of production was not so much upon the turnover rate as upon the quality of work. Under the altered conditions, quality *and* time determine, to a great extent, the volume of contracts. Up to 1973 this sector was operating at a loss. So although the profit-motive prevails it is a goal that has yet to be realised. It appears appropriate for the period reviewed to consider this industry with the two sectors in the first category. This would mean that the employment data for 'Manufacturing' for 1973 need to be adjusted accordingly, reduced by 4%.

Profit in the second category is termed 'Indefinite' because there are strong reasons for doubting the true interpretation given to, and the connotation such a concept conveys, in the sectors indicated. It is observed, for example, that in the Agricultural Sector farmers do not distinguish between the components forming the residual resulting from the excess of receipts over costs. With a rising generation of farmers introducing, among other things, the correct accounting methods, a change in attitudes towards capital invested could be expected to occur. The resultant modified views should benefit not solely the persons involved but also the economy in general. Prices would attain their role in the economic system; they would start passing clear messages to producers; resources could be better allocated if ideas about social provisions were to change.

For similar reasons, Government Enterprises were included under the second category; for such services as pasteurised milk could be administered upon profitable lines or, at least, managed with the objective of reducing to a minimum the subsidy per unit (per pint bottle of milk).

Profit appears as the determining factor in the institution and the running of a project and in the employment opportunities and the security attached within the sectors classified under the third category. At the present stage of development these are the sectors that demand careful manipulation and that could generate social friction. These sectors stand in sharp contrast to the rest; the remarks that follow are primarily directed to them.

Within the third category, the profit motive is dualistic. Though conceptually it could be defined homogeneously, yet its sources are distinctly different and policies could be persued to bear direct effect on one but not on the other. Still, since the Maltese community is numerically relatively small, and considering that the Maltese importer or wholesaler of a certain commercial stature would exert direct influence upon industry and the real estate or tourist business, it could happen that pessimistic psychological inclinations, the results of adverse running of affairs in the import trade, for example, could spread and restrict the momentum of activity in the other sectors. This would not represent the case of the 'average opinion' among industrialists of what their prevailing 'average opinion' about the future in industry and commerce is likely to be. Rather, it would be the impression and attitude of an influential, committed individual the repercussions of whose plans are rapidly diffused and extended over various economic sectors. To avoid adverse and unwanted effects, it becomes essential to clarify the aims and the implementation procedures of whatever public policies are persued.[9]

For planning purposes, shares policy, whether declared explicitly or implied, becomes essential in regulating the movement in the shares accruing to productive units in the industrial and tourist sectors, predominantly, and in the GNP in general. *Ideally,* within a mixed economy, the phases of procedure should be worked out by

[9] It is useful to distinguish between *goals* and *principles* of economic policies. The *principles* determine actions of economic policy, but they are general in scope and mainly qualitative in character. They can be understood as including rules and prescriptions for the shaping of economic life, and in particular the economic order, such as can be found especially in constitutions, laws and also governmental programmes.

Economic policy goals, on the other hand, are defined in a way as to be generally quantifiable. They are taken to mean variables, changes in variables and relationships between variables which relate to matters relevant to the economy as a whole, e.g. the general price level or the size of the GNP. They can be expressed in a cardinal form, e.g. a real growth rate of 5%, or can be set in ordinal form, e.g. a higher degree of involvement in foreign trade. Those economic policy goals which can be expressed in the ordinal form only, lead over to the principles of economic policy.

a constituent body representing the Government, the Labour Movements and the Business Communities; the goal being the channeling of resources where they could be most productive and in ways that would cause the minimum hardship on the sides involved. The restructuring of the economy is currently accorded priority by Public Authorities in Malta; stimulating production along set patterns demands the knowledge of both the benefits and the costs that could be expected to be associated with different programmes. This task is never easily tackled anywhere; it could prove harder still in a country that lacks experience in production planning and in executing schemes directed towards foreign markets in purchasing materials and selling finished goods.

The absolute values of earnings could be established, within limits, through appropriate legislation determining the financial remuneration for the identified economic sectors, the length of the working week, the rates of benefit payments, and private or social insurance contributions. Capital's share, then, depends upon the measures that influence the structures of interest rates, rents and profit. Return in the form of interest is affected by controls over the range of rates stipulated; by the encouragement, or otherwise, of bank cartellisation; and by exchange controls to shield the local market for funds and securities from foreign competition. The rental structure follows from policies regulating controlled or decontrolled residential housing; subsidised public housing programmes; the stimulus to mortgage securities and the introduction of mortgage guarantees or insurance. Rent legislation is tied closely to a set of politically visualized social standards; so policies aimed at interest rate structure (influencing the cost of borrowing funds) and labour wages should contribute towards the degree of success achieved, or to the outright failure of, rent laws' implementation. Profits are directly affected by tax-incentive schemes and depreciation procedures adopted; but they represent the final outcome of a series of forces, namely, education programmes reflected in the quality of labour and of management, local credit facilities and export credit guarantees, a reliable transport network to and from Malta, and harbour and airport management.

Production profit, pre-tax, in a firm is determined by the excess of total revenue over total costs. The latter consist of labour costs; material costs plus other expenditures contracted for the accounting period, including rent, physical asset depreciation (independent of the way estimation is arrived at or whether adequate provision is made), and marketing-costs including transport. Revenue is the outcome of the volume of sales and prices. The wage structure in the manufacturing units, originally devised to encourage investment by widening up the gap favourably to corporate savings, was set up on the absence of a tradition in relatively large factory manufacturing processes. It would therefore be enlightening for policy-making to obtain information about the unit costs and market conditions in the various sectors before plans regulating a sector's nominal or real functional share for a period could be drawn.

Sacrificing corporate savings at this stage would be detrimental to future growth. On the other hand, sacrificing labour could be socially disruptive, economically harmful, and, surely, politically unacceptable. The Maltese economy seeks the ability and willingness of investors, local and foreign, private and governmental, to provide jobs in sufficient number to absorb the envisaged labour supply. Funds are important; but knowhow assumes a crucial character and, unless it is forthcoming, the ability to raise funds may turn out to be sterile vis-a-vis the employment objective.

Cooperation from the private sector, local or foreign, cannot be reduced to secondary importance. For unless foreign governments are prepared to supply temporarily managerial skills, in addition to financial, the Malta Government, aiming at profit-making in the industries it controls, would require collaboration from non-Governmental sources until the time a class of local managers is formed.

A shares policy, then, should be worked out determining the relative shares of labour and capital in industry and tourism based upon feasible projections of growth in every commodity market, account being taken of the overall expansion of the aggregate activity. Such a policy expects the formation of a realistic attitude towards social cooperation founded upon comprehension of the economic needs and the particular problems which the size, natural resources and the social intermixture of Malta give rise to. A shares policy could produce the desired results if it succeeds in minimising friction that usually manifests itself in the form of social unrest.[10]

[10] A shares policy could be drawn up in real and/or nominal terms. One example of the application of such a policy is offered by the wages policy persued by the Netherlands in the post-war period, namely:

	REAL WAGES	WAGES AS SHARE IN GNP
1945-1954	Constant	Decline
1954-1959	Increase	Constant
1959-	Increase with productivity	Movement depended on market influences. e.g. if wages rise

Shared understanding and cooperation among Government, Trade Unions and Business are not obtained effortlessly anywhere; Malta is no exception. Industrial labour in Malta is led by a strong union; unless this organisation is prepared to coordinate its strategy with that of the Public Authorities and Business by temporarily sacrificing certain claims for better work conditions and pay, the setting up of a tri-partite council entrusted with the regulation of shares would be of no avail. Defining incomes may effectively turn out to mean solely wages and salaries, for these constitute the cost components over which local control is feasible; manufacturing profits, being a residual, are controlled in part by international market conditions for raw materials, product prices and transport and no 'National Council', or a similar body, in Malta could ever realistically hope to influencing these forces. Labour, apparently would have to bear the brunt at this transformation stage.

Besides, labour movements are currently bent upon the idea of workers' participation in Industry and tourism. Ideal and deserving encouragement as this goal may be, careful discriminate implementation alone could make it function adequately. If introduced hastily and unconditionally, it could create unforeseen consequences including the loss of trade union control over its members. However, if applied selectively and opportunely it would develop an atmosphere of mutual understanding and participation between the parties involved, and help reduce, if not eliminate completely, future social-industrial unrest.

Restraint and foresight assume critical importance in the export industries where international market forces set the rules. This suggests that whereas wages could move independently of their related labour's productivity in a substantial component of the economy, certain sectoral wage movements would rely exclusively upon the type of industry and the business conditions subject to fluctuations over time. This dual gauge for wage increase could lead to

in excess of productivity and prices remain constant, share of wages would increase.

The Netherlands moved from a policy of virtually direct controls to progressively less restriction. There is reason to believe that the policy aided that nation to achieve a stable reconstruction without seriously eroding its international competitive position. As the recovery proceeded the vital cooperation between economic sectors began to diminish, and the Government's ability to rely on volontary restraint dissipated.

a decline in deference[11] among the local working classes. An aggressive attitude would tend to accentuate itself for two main reasons. First, wages in the profit-motivated enterprises have been comparatively low to those in the other sectors (in terms of both financial and non-financial remunerations); the discrepancy could be reduced following the imposition of a national minimum wage applicable to male and female employees effective for all from April 1976. Secondly, the diversification of education facilities has led to the apparent saturation of those posts formerly reserved for young people with secondary and tertiary education and thus compelled young men and women with equivalent academic or technical qualifications to seek employment in activities deemed, in the not distant past, reserved for unskilled or semi-skilled workers whose education training did not exceed the primary school level. It is difficult for a young man or woman entering the labour market to understand the logic behind income differentials merely in terms of time and demand conditions. Data for the past years indicate the gap among the average sectoral earnings in three main groups, namely Government, U.K. Defence Establishments, and the Private Sector.

Table 3

(a)

AVERAGE WAGE/SALARY (£M)

	1968	1969	1970	1971	1972	1973
Government and Public Utilities	499	639	767	774	764 + 715 *	845 + 705 *
Defence Establishments	626	694	900	1016	1025	1263
Private Sector	352	393	458	496	557	594

(b)

RELATIVITY BETWEEN AVERAGE WAGE/SALARY 1968, 1973

(Private Sector = 100)

	1968	1973
Government and Public Utilities	141.76	142.26 * 118.69 +
Defence Establishment	177.84	212.63
Private Sector	100.00	100.00

* including Malta Pioneer Corps Members. (1495 men in 1972; 4322 in 1973).
+excluding Malta Pioneer Corps Members.

[11] The concept of 'deference' was introduced by political scientists to account for the apparently curious phenomenon that a good proportion of

With the gradual disappearance of the Defence Establishment a head-on clash could arise between the workers in the Government and Public utilities, including the Malta Drydocks, and the labour forces in the industrial and tourist sectors. The rising generation of Maltese consumers dependent at this phase in life solely on wage or salary as the source of income could expect living standards that may not be compatible with the earnings from activity in a profit-motivated enterprise. Whereas employees within the Government or Defence Establishment could eventually exert the necessary pressure to improve their salary scales, similar efforts by workers in the private sector could possibly lead to their unemployment. Government Authorities, with an eye on the inflow of foreign capital participating in development, have continually advertised the relatively abundant labour available with the result that wages in the developing new sectors, especially those for female workers, could possibly have been pegged over the period at an unnecessarily low level.

In a market-oriented economy, an individual's view of oneself depends on success; this leads to investment for one's career. A remuneration-differential enters the expectations of young people. Therefore, the facilities provided by the State in education require intelligent distribution within a small economy. Otherwise oversupply of specialised labour would retain the sectoral wages and salaries at socially unacceptable low levels. Qualified worker participation, though, in production and profits, say, in the form of bonus correlated to preceding year's profits could partly counterbalance this factor.

The success of a share distribution policy depends upon this mechanism based on restraint in rapid upward shifts in consumption patterns to enable the formation of an industrial sector sufficiently sound to repay the workers for the deprivation endured at a point in time. Workers would be investing in wage restraint hoping to be compensated at a compound rate at a future date. The time horizon and the rate of return would be the issue which, after detailed statistical information and several projections, one could attempt to determine. Relative share participation could be computed

working class voted for a Party which did not represent their interest. The explanation given is that these workers hold deferential attitudes, ie. they feel they are inferior to well-educated middle class people: that it is the business of such people to govern society; and therefore they ought to vote for them as their natural leaders. Applied to the economic field, the effect of a decline in deference means that workers are less and less prepared to accept that they should be paid less than 'middle-class' people.

upon different basic assumptions regarding commodity and labour prices together with probable social change.

A shares policy is inherently dynamic; economic growth considerations, therefore, cannot be abstained from if a flexible plan is to be drawn as a policy guide. A synoptic exposition of the present inconclusive theory delineating the relationship between growth and distribution is useful not only for what it suggest but also for what it does *not* suggest. The next section introduces the main features of one theory of this complex issue and proceeds to infer indications for policy formulation.

GROWTH AND THE DISTRIBUTION OF INCOME IN ECONOMIC THEORY: A GUIDE TO POLICY MAKING.

There is no universal agreement about the possibility of formulating a general theory of economic growth; differences in socio-polical conditions render every growth process specific. It is harder still to incorporate the distributional effects of different growth processes upon different income groups.[12] However, economic growth is commonly explained by these factors: abundant resources, with high elasticity of labour supply to start with; capital accumulation; more efficient allocation of resources i.e. the transformation of the productive structure and the redistribution of resources among the different sectors; economies of scale; and qualitative improvement of resources (the application of new or higher technologies with respect to natural resources, and education in the use of human resources).

The effective economic growth rate depends upon the rapidity with which the socio-economic system transforms itself. This transformation rate is supposedly at a maximum level in an 'intermediate' phase of the growth process when both the elasticity of the labour supply and exceptional opportunities for the reallocation of resources and economies of scale are found together. The flexibility of an economic system may become accentuated by characteristics of the investment process and technical progress during this phase which can lead to continuous transfers of resources from low productivity sectors to those with a high level of productivity.

Unfortunately, growth theory, in spite of the complex models[13] in

[12] Vid. Chenery et al: 'Redistribution with Growth' (Oxford University Press 1974).

[13] It must be pointed out that a model does not constitute a theory. The latter is concerned with providing reasons for activity: it is interested in causes. A model, on the other hand, traces the effects of a given change upon a set of variables. It accepts a cause as a datum.

which it is expounded, and in spite of its practical motivations, has become concerned with rather esoteric issues. Its link with public policy is often very remote. Accordingly, it would be highly misleading to draw any theoretical conclusions relevant for policy considerations from the models presented.[14] Despite these limitations, reference is here made to the neo-Keynesian model of distribution to derive the implications that it could be interpreted to suggest. Kaldor's model,[15] departing from the basic assumption that Investment is a variable behaving independently of an economy's saving, would suggest that to achieve a positive growth rate, the distribution of factor income would have to be shifted in favour of capital (non-labour factor). The argument can be briefly stated as follows: the profit (capital's) share could be shown to depend upon the investment share in aggregate output; with positive growth rate, if the investment share increases, the profit share would have to increase to bring about the Saving-Investment equality and attain equilibrium. Besides, emphasis in other models based upon Keynesian thinking elucidate the existence of a two-way relationship between the rate of profit and the rate of investment, such that the latter will be the major determinant of the former but the former, through expectations, would affect the value the latter obtains.

Kaldor's model is developed in terms of a closed economy. If foreign trade is accounted for, as it should be if concrete policy implications are to be derived, the model could become worthless as soon as exports play a major part in the economy;[16] if we assume in addition a high price elasticity of both imports and exports, the close relation between aggregate demand – prices – profits would no longer automatically hold.

Moreover, investment raises income but it increases productive capacity as well. The distribution of income could change in the short run, favouring non-labour factors, but there exists also the potentiality of a higher output. The increased output could be distributed according to a Kaldorian mechanism i.e. in terms of saving propensities. Yet the outcome would be uncertain if capital is not considered a limitational factor and the wage bill increases as a response to an increase in the demand for labour. Once again, the

[14] Vid. Eltis W.A., 'Growth and Distribution' (Macmillan 1973) ch. 14.

[15] Kaldor, N. 'Alternative theories of Distribution' (Review of Economic Studies 1955) and Kregel J. op. cit Ch. 9

[16] Vid. Falise M. 'The Distribution of National Income in Belgium 1953-62' in Marchal/Ducros ed. op. cit pp. 149-170.

consequences for the distribution under such conditions cannot be analysed within the framework of the widow's cruise theory. Investment would not be solely a function of profit and capacity but also of another factor, say, the firm's struggle for domination in a particular market.

Of course, it is very difficult to elicit practical specific conclusions for the Maltese economy from such general observations. The local economy is both outward looking and growing; diversification of production units and of the ownership of productive assets, so important from the above model's point of view, are objectives currently actively persued by the Malta Government. Besides, although preferential treatment is given to capital investment and profits assuming implicitly a 'standard' propensity to invest, one can distinguish, at least, five marginal propensies to save, namely of labour, of the domestic entrepreneur, of the foreign private investor, of a foreign government as an investor in Malta, and of the Malta Government. These could range from 0.25 for labour to nil for the Malta Government. Hence the two-owner model would fail to indicate a solution for a five-factor situation where behavioural reactions are certainly different. But, assume, that in principle there potentially exists an 'equilibrium' solution and that whatever solution evolves it is socially acceptable.

For policy purposes, considerations should focus upon the volume of capital required to stimulate growth from local and foreign sources, and the trend in wage rates over a period starting from a basic low initial level to the potentially highest over a given time horizon. Local wage-bill increases could mean either a resulting rise in exported commodity prices and a possible loss of a foreign market; or a reduction in profits; or, under the pressure of inflationary situation in the economy where commodities are sold, no effect whatsoever on factors' shares within the unit of production in Malta.

The relevant approaches to encourage *private* capital to move into Malta together with the probabilities of applying the funds thus attracted are insisted upon in Government economic plans. Yet a misguiding attitude is often implied regarding investment exclusively as an income-propagating force. Apart from the relatively high leakage element that reduces considerably the short-run multiplier effect within the Maltese economy of a unit of autonomous investment, (the lags being unknown), investment outlays, as already observed, add to the productive capacity as well. The infrastructural pattern relevant to assist or directly produce output once constructed would influence activity for a long time. Increased effective demand, mainly achieved through exports of goods and services for consumption, has to meet the demands of the profit-oriented newly-instituted production units (factories and hotels). The preoccupation with unemployed labour, regarded a national concern, could detract attention from the considerations that should be given to idle technical capital or idle liquid funds generally thought of as being the responsibility of private industrial concerns or of the banks. Apart from the fact that the Public sector is gradually extending its control over a wider area of economic activity, and, as a consequence, the national interest could, in time, directly assimilate itself with the interests of many productive units; the small size of the Maltese economy, and the commercial-industrial capital-ownership considerations introduced in the previous section, do not permit such a dichotomy in social attitudes. Fixed capital needs to be fully active as much as labour, and liquid savings should be provided with the potential for outlets where they could be profitably absorbed.

In addition, the physical size of the Island discourages the setting up of very large manufacturing concerns whose commodities are subjected to regular demand fluctuations abroad. If scale economies and the realisation of ancillary industries could be profitably envisaged, the type of enterprise relevant need to be carefully selected. The hope for future expansion following entries into new markets should be given priority in feasibility studies. However, caution should also be demonstrated in not relying heavily upon single, comparatively 'giant' enterprises. The Maltese economy probably would not be sufficiently resilient to absorb a fairly large number of workers once the development momentum declines, unless a coincidental rise in aggregate activity could temporarily assist in damping down the undesirable effects of sectoral unemployment. This point will be discussed further in a subsequent section.

Idle capacity, unless judged of a transitory character, would discourage scarce, quick-profit seeking foreign capital and the essential expertise that it carries with it. The problem facing economic planners could therefore be briefly stated as the constant search for the type of product (or products) that could not only compete on the world markets but that could also generate confidence in non-related enterprises and act as an 'emulating guide' to their managers.

Now, given the product prices, the costs of raw materials, capital equipment and transport, it follows that, within a unit, wages' and capital's shares are determined by the degree of capital intensity. Given this capital/labour (and capital/output) ratio an increase in non-labour's share implies a decline in that of wages; or stated differently, a rise in product prices not complemented by increments in costs, could be reaped entirely in the form of profit.

If: π = profits per unit (a residual)

P = price per unit

C_n = cost per unit other than labour's

C_w = wages and salaries

Then $\pi = P - (C_n + C_w)$

Given P and C_n, changes in C_w affects π; if π is to rise then C_w must be set at a level sufficiently low (thus establishing the static upper limit of wages) in order to obtain the desirable profit per unit. If production units do not allow flexibility between different capital/labour relations, and account is taken of the basic fact that non-labour costs and product prices are determined under international market dispositions, wages might have to be kept unexpectedly low to attract foreign private capital in Malta. This state of affairs could be socially acceptable for a few years, but it is bound to be reflected in the supply of labour offering its services, as will be discussed in the next sections, and could create labour unrest rendering a Shares Policy impracticable.

The tertiary or service sectors could perhaps be encouraged to a greater extent than at first would appear desirable. In these sectors, where adaptation would be relatively costly and uncertain, the notion of the Capital/labour relationship affecting shares tends to lose its lucidity. Fixed investment in tertiary units may bear no close relationship to the working capital necessary for the provision of a service; still the investment funds spent on construction would offer the sole scope for the ancillary developments that follow. For example, a dock or a first-class hotel. The heavy investment outlay expended in the carving up of a dock would be a resource waste unless the location is utilised for the specific purpose for which it was constructed; and, at the same time, those funds could hardly be included in estimating the Capital/labour ratio in the ship-building/repair industry. Even though it is felt that its inclusion is justified, it is only with hesitation that the result is compared with technological changes as normally understood, when comparisons between techniques in production are made.

Once it becomes difficult to allocate the relevant capital actually contributing to the production and sales of a service, it follows that it turns out harder still determining the share going to the said factor. Deliberate shifts in share movements could, consequently, be determined only within projected limits.

Foreign investment implies repatriation of profits; fund outflow depends partly upon reinvestment in expansionary projects and partly on tax schedules. Mr. Waldorf estimates a 'marginal propensity to repatriate profits' equal to .41; besides his equation indicates that the importance of profits due abroad relative to total profits tends to grow unless there are changes in assets ownership in the future.

The pursuit of the Incentive package programme in the form of grants, non-interest bearing loans, tax concessions or generous depreciation terms, allied to the growth of export market by the manufacturing industries would not only tend to increase the profit share in this sector but also represent a permanent benefit.[17] The package mix of financial aid and concessionary terms has to be drawn up in a way that would stimulate investment but not at a permanent 'cost' to labour. The policy of raising company tax rate and granting a tax-concession period for specified investments has the double effect of enabling the firm to recoup quicker the original capital, i.e. it shortens the payback period, assuming sales of goods occur, while permitting the Public Treasury to collect more revenue than otherwise if profits are realised after the tax holiday period elapses.

If foreign capital from private sources is not forthcoming private enterprise would have to represent the share of non-public ownership of productive units. This could be crucial to the determination of the scope and the role of productive factors predominantly in terms of the Person-State relationships. So long as corporate private enterprise prevails, one could talk of different ownerships and conjecture various social groups. If socialisation of the national product occurs, the problem of allocating the respective shares would remain, but within a modified State-Individual relationship the friction that would be expected to arise between the shares accruing to 'profits' and those going to wages, would either tend to be subdued completely or assume a greater dimension in the form of passive resistance. Social ownership would justify attitudes that under a different socio-political framework would be regarded intolerable. The withdrawal or outright exclusion of private capital

[17] It is sometimes held that the treatment of depreciation in the tax legislation only influences the distribution of income over time. Disregarding the effects of progressive taxation, a liberal policy is often claimed to mean a short-term gain for profits (net of taxes), but when the capital has been fully depreciated while it still generates income the punishment is inevitable. This may be correct under stationary conditions; assuming growth, however, the gain becomes permanent.

sources could create problems in terms of managerial skills. Management not only influences sectoral transformations, but also determines the long-term rate of economic growth, imposes the limit of sectoral maximum absolute output level and the composition of the GNP and, as a result, influences functional share allocation.

Economic theory seems to imply that there has to be a real, observed shift towards the share of non-labour factors, mainly in the form of profits from production and tourism. Pragmatism, however, has to rule decision making; dynamic projections based upon different hypothetically, changing socio-economic conditions, rather than short-run considerations, would provide the measure against which projects are assessed. The economy should be enabled to diversify its resources in such a way as to generate opportunities in the future for reinvestment parallel to the demands of technology and the markets served.

Assuming mixed-enterprises, decisions about industrial projects feasibility, incentive schemes, and, also wage structures, could be reached after evaluating the following factors:

(i) the economic feasibility of setting up an enterprise in Malta;

(ii) the structural balance between manufacturing and the other sectors (primary and tertiary) as the U.K. Defence Department is tapered out;

(iii) the wage ranges estimated acceptable and profit-yielding under changing market conditions;

(iv) the ability of the Malta Government to enter into joint ownership with private foreign companies; they supply expertise in production and marketing in addition to funds for investment;

(v) the success of the Malta Government to raise funds from foreign Government sources and invest them in industry on their own or on inter-Government joint-ventures; there would still arise the need for the managerial personnel to run business with success;

(vi) the behaviour of the labour unions vis-a-vis workers' cooperation and participation in a production unit. Labour movements in corporate sectors could participate from profits (as distinct from share ownership) by obtaining a percentage share of annual profits which funds would be allocated for the benefits of union members, say for the setting up of pension funds or social benefit schemes. (Note that the employees in the tourist industry are in a different situation from those in the manufacturing enterprises; schemes in these units do not reflect the pay packet of the workers. Wages, denoting the functional share of labour in the firm's books, are augmented by tips. To a certain extent the increment in the form of tips could be regarded as a function of the class of hotel or restaurant, the income bracket of the tourists, and of the activity level within a set period. There is implied, indirectly, a relationship between the original investment in fixed capital – the hotel or restaurant – and the tippage value.)

(vii) the social aspirations, the result of investment in human beings, that have to be met if the timely supply of specialised and general labour is to be forthcoming. This aspect is discussed in the following section.

The result of the several forces bearing upon a scheduled distribution sharing of the GNP could be that, despite its recently acquired political independence, Malta would still have to preserve, in an altered form, its traditional characteristic of a 'region' forming part of a vast complex. Past statistics for functional income shares indicate that factor capital was not adequately accounted for. The Maltese GNP was mainly based upon wages and salaries subsidized from imported funds not aiming to earn a profit. Such a situation could be partly extended, in the form of income from royalties from oil production just as at the moment it is assisted through the renting of defence facilities to Britain and its N.A.T.O. allies.

Labour Supply Elasticity and Functional Shares

This section considers a hypothesis that, the functional distribution of income is affected not only by the market structure but also by the elasticity of supply and demand for labour irrespective of the market form. E. Preiser[18] concludes that the greater the elasticity of the labour supply schedule, reflecting the preferences of the working force in terms of work and remuneration rates deriving support from capital ownership, the lower is the share going to non-labour factors.

The greater the supply elasticity of labour the lower would be the level of employment and the higher the wage rate, given the labour demand schedule (based upon technical properties, product prices and market structures, and costs). Employment is lower not

[18] Preiser E. 'Property and Power in the Theory of Distribution' (International Economic Papers – 2. 1952) Preiser implements a static two factor model: labour and land where the latter term stands for all the material factors of production, i.e. what in this paper is defined as 'capital'.

Government's power and initiative are, however, omitted from Preiser's analysis.

as a result of an artificially raised wage rate, i.e. of a wage rate that does not correctly represent the scarcity of labour. Rather the lower degree of employment corresponds to the essential facts of of the case, for supply is lower. It is, in a sense, voluntary unemployment. Labour refuses to offer its services at the rates prevailing or under the conditions offered. In any economy the quantities of labour and non-labour resources are available for their owners; but this means that they are not *awaiting* disposal, only that first they have to be placed at the disposal of production. Behind the elasticity of supply lies the power embodied in 'property'. Where labour is completely divorced from ownership of 'land' (or other forms of income yielding sources except man's mental or physical capacities) the supply of labour is rigid; wherever the worker owns a certain amount of 'land', the labour supply is elastic and the wage rate higher quite irrespective of the market form. Capital ownership is a foundation much more stable than, say, a collective monopoly of workers which could limit the supply of labour in a market economy only by artificial means, and, by its very nature only temporarily.

This idea could be applied to the Maltese labour supply, in general, and to local agricultural land, in particular. No attempts at quantitative testing are made: interest is set upon the qualitative content of the argument and its policy implications.

Labour supply elasticity in the Maltese economy could be expected to be influenced by a series of factors including the academic or technical training and the social esteem associated with a task; the close family relationships enabling a household to financially support a young man or woman – this could be a function of a family's size and wealth; the possibility of continuing family trade and turning oneself self-employed; the trends in female participation rates; and the prospects of emigration. Other factors would be social security benefit schemes; assistance under the National insurance plan; and temporary employment in para-statal bodies, such as the Pioneer Labour Corps.

These factors could operate simultaneously, or individually, for particular cases, but their net effect would determine the dated location and the shape of the aggregate labour supply schedule, although they would represent varying degrees of importance when applied to selected economic sectors.

In the immediate post-war period, employment in Malta centred upon primary industries (agriculture, fishing, stone quarrying); the U.K. Defence Establishment and the Public Service Departments; and a diversified complex of self-employed or very small units.

The mentality behind job acceptance was work stability and personal freedom in time allocation. This attitude persists; the Maltese worker, generally speaking, appears to be selective as regards job conditions, remuneration and timing of accepting or refusing employment.

Over the nineteensixties, opposing influences could be discerned in operation tending both to change the then-established labour-supply schedule and to affect its shape or elasticity by determining the response of labour to money income changes. Three factors, Female Activity Rates, Self-Employment and Emigration are selected from those enumerated above and their relative influence upon labour's supply elasticity analysed. The first factor tends to reduce elasticity; the other two tend to increase it. The final outcome per time period depends upon the relative strength of every factor. The three elements chosen could be considered to have a wider application in the Maltese economy than the rest which tend to influence decision making of a restricted number of labour units.

Table 4 classifies the productive sectors in the Gross Domestic Product (GDP) in terms of the mean periodic percentage composition going to Wages and Salaries and income accruing to self-employment.

Table 4

INCOME FROM SELF-EMPLOYMENT BY SECTORS IN THE GROSS DOMESTIC PRODUCT

(Period Averages: Percent)

SECTOR	1955-58	1959-63	1964-68	1968-73
Agriculture and Fishing	92.19	94.35	92.86	94.16
Wholesale and Retail	92.96	89.68	90.07	87.90
Insurance, Banking and Real Estate	66.67	79.15	78.02	69.79
Construction and Quarrying	12.15	15.18	18.23	19.88
Manufacturing	56.80	32.64	36.57	32.58
Private Services	56.49	51.14	43.05	35.51
Public Administration	NIL			
Military Services	NIL			

Source: Based on Table 11 'National Accounts of the Maltese Islands'.

The first category represents the traditional household businesses and self-employed units, where emphasis lies upon liquid funds rather than mechanisation (physical capital), namely agriculture, fishing and commerce. The incremental observation in construction and quarrying (though low percentagewise in self-activity) indicates the changes in this sector's employment status over the sixties. Private services and manufacturing registered a decline as the relatively large industrial and tourist units, demanding comparatively heavy investment and employing large numbers of workers, assumed a dominant role in this category. Self employment is nil in the fourth group.

The influence upon the elasticity of labour supply could be illustrated from Agriculture. It is observed that the number of wholetime farmers experienced a steady decline over the twenty-year period, 1950-1970. The work conditions and the financial compensations are not sufficiently rewarding to retain the rising generation born in agricultural families. Ideas about a fixed work-week and a regular wage-payment have been endorsed by this social group, depleting the agricultural population. Moreover, as educational opportunities were extended, young people became more selective in their choice of work. The result was that farmers-to-be emigrated or transferred their labour-services to the other sectors, those unskilled mainly into the construction and quarrying industries.

However, once the economic sectors, in which new employment was found, underwent a decline in activity, it is observed that the labour movement out of the agricultural group is arrested and a slight increase even registered.[19] If this pattern repeats itself, with marginal changes in the numbers of farmers tending to move inversely with the level of activity in the rest of the economy, one could forward the hypothesis that unskilled or semi-skilled workers whose families work land and, therefore, could provide an immediate buffer activity yielding a return, feel they have the option to decide when to leave the trade, at what price and where to move. Wages need be above stipulated minimums, varying among individuals but still valid to apply in relevant quantities for the economy; working conditions must be attractive enough to make men leave the family's trade and become wage-earners. As the manpower directly engaged in agriculture declines and the remaining labour units are utilised better, the return per unit of labour could be expected to rise. Specific courses in agricultural technique improvement and a better organised marketing network, could raise further

[19] See Agricultural Census Reports for 1972, 1973.

this sector's average yield and act as a constraint upon the outflow of labour.

Emigration constitutes a more influential factor. Table 5 presents data for 1957-1973 period of migrants aged 15 to 16, i.e. those who form part of the labour force.[20] Emigrating individuals or households have to face, and overcome, two social barriers: language and a way-of-life based upon very restricted geographical dimensions. Young people, academically trained and/or guided by relatives and voluntary or State organisations, find emigration less discouraging. With inter-country mobility possible, and with changes in personal outlooks, labour supply elasticity could, in principle, reach any value. A worker's strength in bargaining, shown in the choice of the country of work and the related rate of payment within a sector, is increased; the possibility of an altemative employment increases supply elasticity.

Table 5

EMIGRATION DATA (EMIGRANTS AGED 15-60) AND THE UNEMPLOYMENT RATE 1957 – 1973

EMIGRATION				% OF LABOUR FORCE		UNEMPLOYMENT
YEAR	MALE	FEMALE	TOTAL	MALE	FEMALE	% OF LABOUR FORCE
1957	1584	857	2441	1.792	0.969	3.714
1958	1435	871	2306	1.554	0.943	3.719
1959	1516	828	2344	1.666	0.910	3.541
1960	1738	1033	2771	1.879	1.118	4.079
1961	1739	941	2680	1.858	1.006	4.667
1962	1647	1138	2885	1.768	0.869	6.823
1963	2737	1908	2643	2.927	2.039	7.501
1964	4208	2460	6668	4.468	4.170	8.117
1965	3389	2338	5727	3.531	3.867	8.189
1966	1802	1376	3178	1.851	1.414	8.072
1967	1674	1232	2906	1.696	1.277	5.463
1968	1369	959	2328	1.369	0.959	4.199
1969	1276	827	2103	1.223	0.793	3.659
1970	1290	826	2116	1.216	0.779	4.677
1971	1356	858	2214	1.21	0.76	5.44
1972	1466	1029	2495	1.34	2.28	5.96
1973	1889	1272	3161	1.75	1.18	4.54

[20]Note that the denominator representing the labour force has not been adjusted; ratios are based upon data for the end of December of every year. Still the statistics should enable us to formulate a general impression about the potential annual unemployment 'disguised' in migration outflow.

The unemployment equivalent of *female* emigrants should not be interpreted at the above rates. The statistics should be adjusted to allow for certain social factors, such as those married women who would probably have remained in the home and would not have sought outside work. Still, it is observed that the *male* emigration rate annually amounted to about one half of the total unemployed rate until 1966, the year that marked the first signs of the construction boom with its sectoral employment multiplier effects. Emigration, though socially and economically disruptive, could become a regulating force that establishes the level of wages acceptable in industry by male labour. The absolute wage level set by labour groups would determine, in turn, the feasible range of production techniques, given the other costs, and thereby influence the type of enterprises instituted.

Normally, the interpretation given to the association between emigration and wages is not the one suggested. Reasoning usually links insufficient employment outlets with the movement of individuals out of the island. This relation is a strong one, of course; but the element now emphasized in the decision of a man to emigrate is that since his aspirations of wage and work conditions can not be adequately fulfilled in a locality, it would be personally welfare increasing to move elsewhere once such possibility exists. Such decisions would influence the Maltese labour force, by reducing the number of those seeking work – thus depressing social anxiety preoccupied with providing short-run employment outlets – and, more important, influence production techniques by permitting the installation of relatively more capital intensive industries – given local borrowing costs, and so guarantee higher labour remuneration rates. In time, following a decline in the birth rate, thus reducing the rate of increase of the labour force, and following an expansion of domestic productive units, the outflow of migrants would be reduced.

A rising female activity rate, on the other hand, tends to reduce labour force supply elasticity. The working horizon of the Maltese female outside the home has been generally short. The young woman plans to get herself employed for a few years before marriage; what has mattered for the young woman has been the need to save money in order to reduce the financial burden on her family when she takes up the married status. (The desire to be free from parental control would constitute another strong motive; but this urge is not considered here.) Her planned 'employment span' would depend upon her educational training, her social class, and the financial assistance she expects to obtain from her family. If the employment opportunities available are not as remunerating as she hopes for, and even if they offer no promotion outlets, she would not opt for emigration but would probably undertake to benefit from them. Whereas the young man would be reluctant to accept a job upon a permanent basis unless wage exceeds a minimum or unless he could count upon the possibility of future promotion or upon the opportunity of taking up an additional job outside work, the young woman planning her work career on a shorter time horizon, would accept the job. Female participation rate has maintained an upward trend – 17.9% in 1959 and 29.5% in 1973 (planned to rise to 35.5% by 1979).

The availability of labour determines the wages offered, given demand. To the extent, therefore, that supply is relatively elastic for male workers but inelastic for female workers, wages in those sectors operated by male labour would register higher wages than otherwise. Higher wages could reduce employment in a unit (though it need not do so if the profit margin in time is wide enough to act as a buffer against reasonable increase in the wage bill.) But they could act as an incentive to an efficient running of a firm; disguised unemployment is reduced to a minimum if not entirely eliminated. Those sectors employing exclusively female operators could offer lower wages than economically warranted and still recruit personnel; wages in such sectors could be raised through the activity of labour organisations. In those sectors in which the worker's sex is unimportant, wages are set at a level initially indicated by management, probably at a lower level than economically feasible; intervention through industrial action or Wages Council would raise the rates paid. If the assumption of an initial under-valued payment is correct, wage increases, up to a level differing among industries and intra-industry plants, would not damage the competitiveness of an enterprise; workers would be being paid what, in a private enterprise system, would be computed their contribution to the production of a commodity. The introduction of a national minimum wage in 1974, and equality of pay for work, irrespective of sex, by 1976, help establish the minimum wages that could be paid in industry and tourism, but not, of course, an upper limit.

The above application of Preiser's idea may directly affect functional shares in part because emigration does not entitle a labour unit to a share in the Maltese GNP. But self-employment would: a man becomes a wage-earner (imputed) and an owner of property. In addition, Preiser's conclusion could be forwarded as an argument for labour participation in management and profits. The important issue becomes the achievement of a degree of equity without stifling growth. It could be that the optimal solution would be to offer a group of workers a share not in their product but in the product of others; workers would participate in the management of the enterprise in which they are employed while they would be given the opportunity, as individuals or as corporate entities, to own shares in other business units.

It should be emphasized that the ownership of capital, apart from influencing the personal income distribution, could affect the functional shares by turning workers into units partly independent from their labour source of earnings thus enabling them to resist the terms offered and raise their wages and/or better their work conditions. This is bound to produce an impact upon the internal distribution of a firm's product, given the price of final output as is the case confronting the Maltese firm.

Given the market conditions and the profit considerations evaluated in the previous section, trade unions could demand participation in profits through a firm's annual contributions reflecting productivity and sales; this, as suggested already, could take the form of an agreed percentage of disposable profits which would go to benefit an insurance or investment fund for the workers. If the weekly pay-packet is sufficient to retain the workers cooperative, the future benefits could be interpreted as investment (savings) for the employees. The value of the appropriated profits could be included in the workers' share similar to the social insurance contributions by employers. The measured effect upon functional distribution would depend upon the interpretation given to these funds by the firm: whether they are regarded as costs prior to estimating net profit, or, what seems logical, to consider them as profit's shares. Functional distribution could remain unaltered; but personal distribution, more important from a social angle, would be modified in favour of the workers.

The interrelationship between the elasticity of factor supply and relative shares could be also applied to the utilisation of arable land. Land is leased to individuals, normally at a low nominal fee, especially in those areas not considered suitable for dwellings construction and development. Though the payments are regularly paid by the tenants – full-time or part-time farmers or game hunters – yet areas left uncultivated, season after season, are fairly common. The low rental is not burden-some upon an individual; the tenant has no incentive to terminate the lease. Effort is not produced although land is available. The gradual efficient organisation of the agricultural sector, demanding investment in irrigation systems and tenancy consolidation, would raise the yield on agricultural investment and increase the opportunity costs of leaving cultivable land idle. An increase in output would induce extensive as well as intensive cultivation of land. The *observed* shares accruing to factor labour – hired and imputed in the case of self-employed – and to factor capital – profits and rentals – would depend upon the price of products and upon the accounting technique adopted. Reorganisation within this sector should activate idle land, thus eliciting work effort leading to increased output and higher absolute returns to both labour and non-labour factors.

Capital/Labour Intensities and Dynamic Planning

Maltese Public Authorities have propagated the idea among foreign investors that local factor labour is abundant and relatively intra-sectorally immobile, in an attempt to accelerate nascent productive investment and ease the social pressure of unemployment. Time and emigration constituted a pressing element for the Government though not necessarily for the outward-looking individual or household. The incentive scheme assistance during the sixties was positively correlated to the amount of labour units employed by a firm, unwarrantedly creating the temptation for investors to inflate the projected manpower required to assist in production output. Inflated labour projections meant a higher financial grant, a reduction in own-capital outlay and an automatic rise in the effective rate of return.[21] Preferential treatment was given to those pro-

[21] The effective rate of return can be illustrated by a simple hypothetical example which stressed the importance of distinguishing between 'private' and 'social' rates of return.

Factory Construction cost + land	=	£M 40
Cost of machinery & equipment	=	100
		£M140

Assume the firm is given £M30 in grants.

So: Firm's Investment from own sources: £M70 (£M100 – 30)
Government's investment 70 (40 + 30)

Suppose that the end of the first year profit amount to £M28. This figure gives a yield equal to 20% on Total Investment (i.e. £M140). and 40% on the firm's investment (£M70).

So while the nominal rate is 20%, the effective rate for the firm (private rate of return) is double that value. If profits persist at that rate and are withdrawn the payback period would be reduced to 2½ years as against 5 years if total investment – machinery plus factor construction – were considered. Projects may be profitable from the short-term firm's point of view but could possibly be rejected if evaluated from a social, long-term angle.

jects which utilised a lower capital/labour (K/L) ratio for given output.

As noted already, an economy in transition must innovate. Entrepreneurs are faced with a series of innovations of which they are assumed to select the optimal, given the actual (present) and the expected (future) economic conditions, and apply it to a particular industry. Innovations generally fall into two classes: product-innovations and process-innovations. The terms are self-explanatory. Though distinction is fairly easy in principle, yet it is difficult to hold in the real world for the introduction of a cost-reducing process is sometimes accompanied by a change in the product mix.[22]

In setting up a production process, firms follow experience. The competitive firm cannot rationally decide upon a particular level of production without some estimate of future product and factor prices. It is not sufficient to have 'primary information' about technical production possibilities, consumers' preferences and current input prices. To determine the profitability of investment, firms must also be acquainted with 'secondary information' which enables them to form expectations of future sales and prices realistically, i.e. facilitates the dynamic projection of future costs and revenues. This type of information takes the form of known restraints on rival behaviour which makes it possible to estimate the range of competing supply at a future date. To survive the innovator must adapt production processes to relative factor scarcities, and *should be prepared to adjust,* so far as indivisibilities of capital allow, production to changes in factor scarcities.

When real investment is cheap relative to labour, standards of obsolescence could be assumed to be stringent and the spread bet-

[22]Economic theory classifies innovations as 'labour saving' and 'capital saving' on the assumption of two production factors. Following the Hicks-Robinson definition a 'labour saving' innovation is one which raises the marginal productivity of capital relative to that of labour at a given capital-labour ratio employed in producing a given output; and conversely for a 'capital saving' innovation. Note that neo-classical distribution models interpret changes in relative factor shares following growth or innovations in terms of the elasticity of substitution with the value of unity (in non-vintage growth models) as the condition for constant relative shares. Kaldor N. introduced the concept of a 'technical progress function' as a substitute for the aggregate production function and for the concepts of 'capital (Labour) saving'.

See: Blaug M: 'A Survey of the Theory of Process Innovation' (Economica – February 1963).

Kregel J.: op. cit Ch.9

ween the best and the average technique is narrow. A fall in interest rate or in equipment prices lowers the capital costs of adopting the best-practice technique, while a rise in the wage rate increases the operating costs of averaged priced techniques; both tend to induce the scrapping of old machines. On the other hand when real investment is dear relative to labour, the capital structure of an industry would consist largely of outmoded equipment.

The absorption of innovatory techniques relies upon the degree of technical dynamism of an economy, i.e. on the flow of new ideas and the readiness of the system to integrate them. Producers in Malta, at this stage of development, have to import ideas and know-how. Originality in commodity presentation could be easier to create in the sector of tourism; but this industry pertains to a genre of its own. To the extent that products manufactured in Malta are 'unique', favourably planned, produced and directed to specific markets, ideas could originate in the island. These, however, require the appearance of a new generation of Maltese producers reared up in a 'manufacturing and marketing' environment and conversant with the investor's and the saleman's language, style and approach. On the other hand, to the extent that exports retain the characteristics of a high elastic demand, and are geared to meet commodity-supply gaps in foreign markets, conditions of productions are dictated abroad and have to be scrupulously followed. The following observations are directed towards this second type of products, to Tourism and to ship repairing facilities.

The incentive scheme operated to encourage investment was purposely heavily biased towards grants and tax-exemption. This meant that the original corporate private investment, but not total outlay – could be recovered in a shorter time span, i.e. the payback period for the invested funds is reduced in inverse proportion to the ratio of grants, plus the cost of factory construction not incurred, to the total initial outlay. The higher this ratio the shorter the payback period, given annual revenue. The profitability of an investment in Malta would be higher and unrealistically promising if the yield is estimated upon the funds invested by the firm rather than calculated upon the aggregate commitment. In an attempt to recoup quickly its original share, a firm might withdraw funds in excess of what would be desirable to allow for reinvestment purposes, if any reinvestment plans exist in the first place.

The investment incentive schemes operated were inherently inconsistent. The lowering of capital costs through grants and interest-free loan should lead to the application of a labour saving technique, i.e. to a production method that raises the productivity of capital in terms of a hypothetical K/L ratio in the instance of a newly established local unit. However, financial assistance was correlated to the number of jobs provided by the enterprise. It follows that techniques considered optimal in the absence of 'labour clauses' would be substituted by a process of a less technically advanced nature. The advantages that could have been gained from the reduction of capital costs would, as a consequence, fail to materialize. Labour employment would turn out to be in excess of the optimal process requirements when dynamic considerations are accounted for. Work stability would be threatened from the beginning and labour's share within a unit would perhaps be lower than it otherwise could have been. For, in order to anticipate future wage increases, the rates initially offered would be purposely set at an economically-unwarranted low level; such level would simultaneously guarantee a very short payback period of own-invested funds.

If this argument is valid, the investment-incentive scheme could be considered a means of creating and sustaining temporarily disguised unemployment. A fixed technical relationship would be modified on purpose by the projected engagement of superfluous labour when a firm applies for assistance; the promised target, if implemented, would undermine the stability of the enterprise. Given the labour supply elasticity conditions described above, a rise in wages in those industries employing male labour could lead to the streamlining of production, reduce employment (or the rate of increase of labour intake following firm's expansion) but raise labour's share to what it should have been in the first place. Labour's share in those units operated by female workers could be affected under supply rigidity, only if the supply curve shifts inwards, denoting lower employment, (or a lower growth rate of female employment in terms of demand) at higher wage rates.

In the absence of a capital-goods sector in the Maltese economy, analysis is restricted solely to the consumption-goods producing units. Intersectoral factor mobility and changes in factor prices do not behave as two-sector economic models postulate. The variable element that could be controlled with some success is the cost of labour dynamically estimated, i.e. growing at a rate per time period. The cost of physical capital goods is determined outside the Maltese economic system; this would also be true for local savings (liquid assets) in the absence of exchange restrictions. With exchange controls, the cost of local borrowing could also be regulated at a cost to the financial institution and depositors, and at a gain to foreign investors.

It is agreed, then, that industries established should reflect the factor supply conditions based upon current and future cost and revenue estimates. Prices, however, may not reflect the true factor market conditions for the price system may be inoperative. It has been repeatedly stated that labour-oriented industry should represent the optimal units for Malta. Labour-intensity cannot, however, be evaluated without including the financial outlay on fixed capital: thus we may get two 'equally' labour intensive industries in terms of running costs with completely different fixed asset structure, for example, ship repair and textiles. Surely one cannot compare the initial costs of building a dock and workshops in a naval yard with the costs of setting up a textile factory even though the wage and salary content in the operation of both firms may be considered labour intensive.

Still, the Maltese labour supply cannot be dynamically described as abundant; emigration and a decline in birth rate would regulate the natural growth of the labour force. It is true that over the sixties and seventies the labour supply for private industry has been augmented by the rise in female participation rate and the closure of the Defence Establishment, i.e. through structural unemployment superimposed on a post-war 'baby boom' and an altered conception of the social role of the woman. But such phenomena are intrinsically of a temporary nature.

Neither could labour in Malta be classified as 'cheap' once due consideration is given to the duality in profit-motivation existing in the local economy and the relative importance of the sectors in which workers are freed from worries of competition in output and fluctuations in demand for their services. The latter's earnings are bound to structure the wage demands and the expectations of labour in industry. The K/L ratio deemed feasible in another developing economy becomes socially unacceptable when critically studied in the Malta context. Production processes involving a higher K/L ratio than those artificially made to prevail under static conditions and probably improving labour's rate and share appear desireable even at the socially unwanted cost of a higher trade-off in terms of emigration, or unemployment, or the creation of parastatal corps to absorb the unemployed and reduce the emigration flow.

The introduction of equal pay for equal work and the establishing of a national minimum wage, coupled to the less attractive incentive programme (for the adventurous entrepreneur) introduced since 1971 should encourage reorganisation in the industrial units already established and instigate improved production techniques in those projects still at the planning stage. Such modifications would affect both the functional shares and help improve the personal incomes of industrial labour.

Conclusion

The real objective of public policy should be man's welfare; therefore, the *personal* distribution of income should be the main end of government activities. However, transitional policies must be concerned, as a first step, with the *functional* distribution of income. Such policies, thought of macroeconomically, would indicate the allocation plans of a market system within a socio-political framework; public policies are meant to depart from a value based factor shares allocation and proceed to achieve the personal income-wealth-welfare distribution desirable. Such a task cannot be simple; it is inherently complex and dynamic. And, although income or wealth distributions may be tuned to the planned patterns, there always remains the difficulty of correctly evaluating personal and social welfare.

This paper introduced certain elements that can only be ignored at a cost. A factor share policy whether in nominal or in real terms could be omitted from the explicit considerations of public planners; but it is inevitably implied as the net outcome of several forces that, in the absence of deliberate thinking about the subject, could be cancelling out the positive contribution every one of them has to make.

A functional share policy for Malta should take into account the following considerations:

(i) the realisation of the demand for novel initiative undertakings arising out of the production profit motive, and the time and the means required to enable a native entrepreneurial community to mature in terms of export-oriented competitive markets.

(ii) the social implications in terms of asset-ownership arising out of the theoretical economic conclusion that growth favours a shift of resources towards factor capital. The adaptation and the implementation of an Aids to Industries Scheme together with the role of Government's direct participation in commodity producing would be regulated within the value judgements implied by different asset-ownership distribution criteria.

(iii) the effects arising out of power in personal decision making vis-a-vis work, its reward and conditions following the ability of the Maltese worker to move between industries and between countries. Having an alternative at hand strengthens an individual's bargaining position; self-employment and emigration possibilities enable a man to resist offers for financial and non-financial rewards in work. Conversely, the limitation of self-employment outlets and control over migration outflow reduces the bargaining strength of labour enabling a shift towards factor capital and, possibly, reinvestment and economic growth. This idea should be judged in connection with the previous observation about asset ownership.

(iv) the capital-labour intensities in the secondary and tertiary sectors envisaged dynamically, i.e. in terms of expected changes in wages and other costs, and the rate of change in product prices. An investment decision, once taken, would control activity for a relatively long time; the small size of the Maltese economy does not allow enough scope for radical changes in production techniques. The structure of enterprises' set-up are bound to determine sectoral activity and, through it, the fulfilment, or otherwise, of labour employed. Social stability and order demand that labour's aspirations, the desires of the majority, are adequately met.

The problem is not as simple or as of secondary importance as it might casually appear to be. In a rapidly changing world short-term policies, taken ad hoc, are essential: but an overall medium run view must never be lost out of sight. Economics is at its best when long run considerations are made; however, short-run policies are essential as everyday experience shows and it is within the short-run frame that an interdisciplinary approach to a socio-economic problem becomes a necessity. Economics on its own would fail to achieve what it could attain with the assistance of other disciplines. So, politicians should not be relegated to a minor role for they are the men responsible for short-run adjustments; but neither can economic considerations be completely omitted, for scarce-resource-allocation and its effects would certainly make themselves felt over the long run.

Co-operation and mutual comprehension between active economic groups and public policy-makers are crucial for the organisation of a social economy in transition: an often repeated statement but unfortunately one whose real implications are hardly ever critically assessed. Failure to do so would make *all* the difference between socio-economic stability and socio-economic unrest.