

# GRDA OUTLOOK NOTE



Outlook 2022 - 2024 &  
Budget Proposals for 2023

September 2022



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GOZO REGIONAL DEVELOPMENT AUTHORITY

Innovation Hub, Xewkija - Gozo, Malta

Tel: +356 22156333

[www.grda.mt](http://www.grda.mt)

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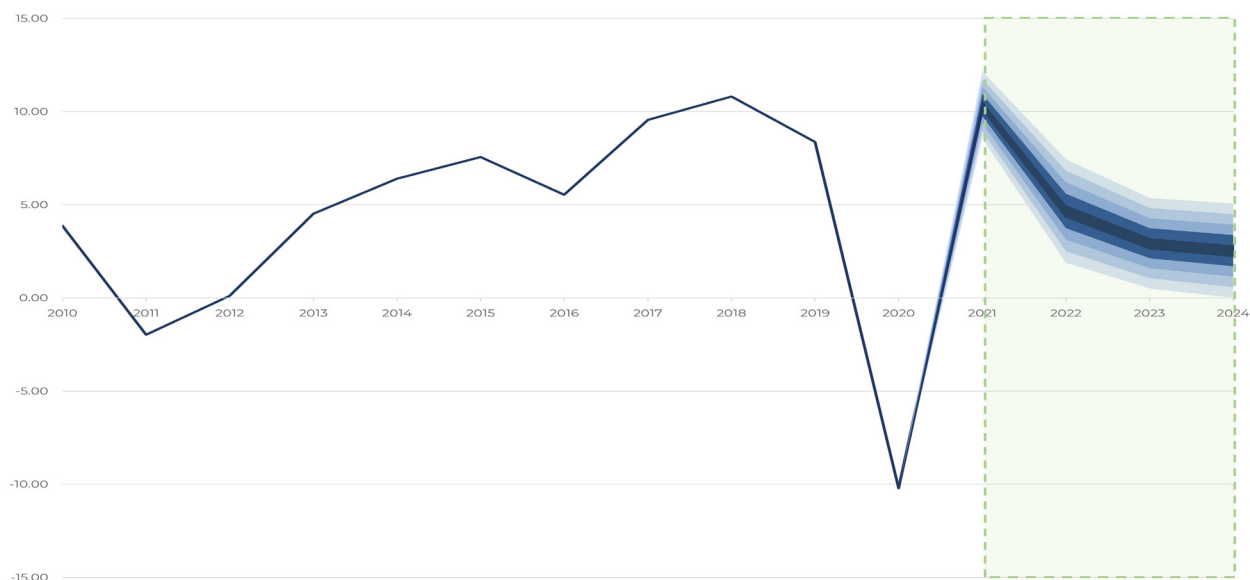
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# Outlook 2022 - 2024

## Macro-Economic

Gozo's economy recovered strongly in 2021, following a 10.2% contraction registered a year earlier.<sup>1</sup> Gozo's real GDP is projected to grow by around 4.0% in 2022 as Gozo's real economic output is set to exceed the levels registered prior to the pandemic.<sup>2</sup> This largely reflects a pickup in tourism related sectors. Beyond 2022, the Gozitan economy is set to continue to grow further on the back of further increase in tourism activities and an envisaged growth in private and public investment. The latter reflects the completion of large infrastructural projects such as the Gozo Museum and the Gozo Aquatic Centre, while the increase in private investment reflects a base effect given that part of planned investment was postponed during the pandemic period.

*Chart 1: Real GDP growth forecast (%)*



Source: Oxford Economics and GRDA calculations

From the output side, growth in 2022 is expected to be broad based with the tourism related sectors being the main drivers of growth. Indeed, the largest contributions are expected to be the accommodation and food services sector and to a lower extent the transportation and storage sector.

Overall, risks to economic activity in Gozo are broadly balanced over the projection horizon. This mainly reflect national and international dynamics and developments. On the negative side, risks mainly emanate from the evolution of the war in Ukraine which in turn can cause further supply chain disruptions including airline connectivity. Moreover, stronger inflationary pressures could lead to a stronger than expected negative impact on private and public consumption. An additional downward risk emanates from lower government capital expenditure due to fiscal consolidation following the unprecedented support offered by the Government to the business

<sup>1</sup> Regional gross domestic product for 2021 has not yet been published by NSO. This is expected to be published in December 2022.

<sup>2</sup> The baseline forecasts for Gozo are based on the regional macroeconomic model for Gozo developed by Oxford Economics' European Cities and Regions Service.

during the pandemic and the recent government commitment to keep energy prices stable. On the upside, a stronger recovery in tourism related sectors as well as higher private investment and consumption could lead to a stronger than expected economic recovery.

**Table 1: Risks to the projection**

2022		2023		2024	
1. Inflation	Downside risk	1. Inflation	Strong Downside risk	1. Inflation	Downside risk
2. Tourism	Strong Upside risk	2. Tourism	Strong Upside risk	2. Tourism	Upside risk
3. Private Investment	Upside risk	3. Private Investment	Downside risk	3. Private Investment	Downside risk
4. Interest rates	Downside risk	4. Interest rates	Upside risk	4. Interest rates	Upside risk
5. Geopolitical situation	Downside risk	5. Geopolitical situation	Downside risk	5. Geopolitical situation	Upside risk

Strong Downside risk ■      Downside risk ■      Strong Upside risk ■      Upside risk ■

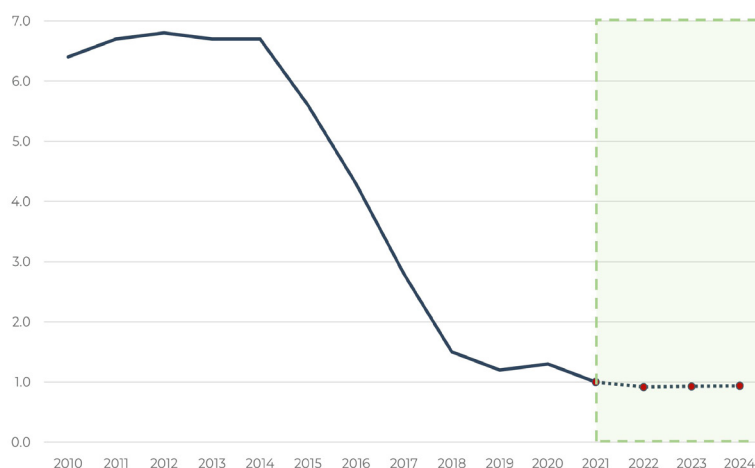
Source: GRDA Workings

## Labour Market

Despite the adverse economic impact of the pandemic, employment in Gozo continued to grow. In 2020 and 2021, employment grew by 3.6% and 1.4% respectively. As a result, as at end December 2021, registered unemployment in Gozo was around 38.0% lower than that recorded prior to the pandemic. These developments reflect the introduction of several government support measures in particular the wage supplement scheme which enabled businesses to maintain their employee headcount. The wage supplement scheme also acted as an incentive to formalise a number of employment which was undeclared, thus increases the headcount (see Chart 2).

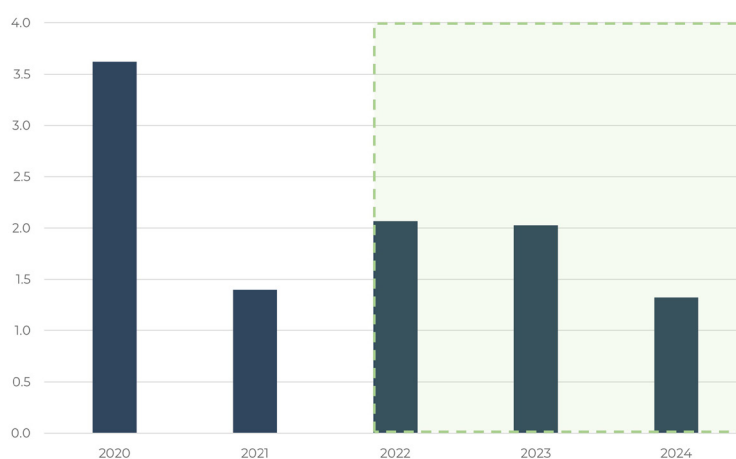
The buoyant labour market environment is expected to persist over the projection horizon as employment is set to grow by an average annual rate of 1.8% over the projection horizon (see Chart 3). In 2022, employment is projected to grow by 2.1% and then

**Chart 2: Unemployment rate (%)**



Source: Oxford Economics

**Chart 3: Employment growth (%)**

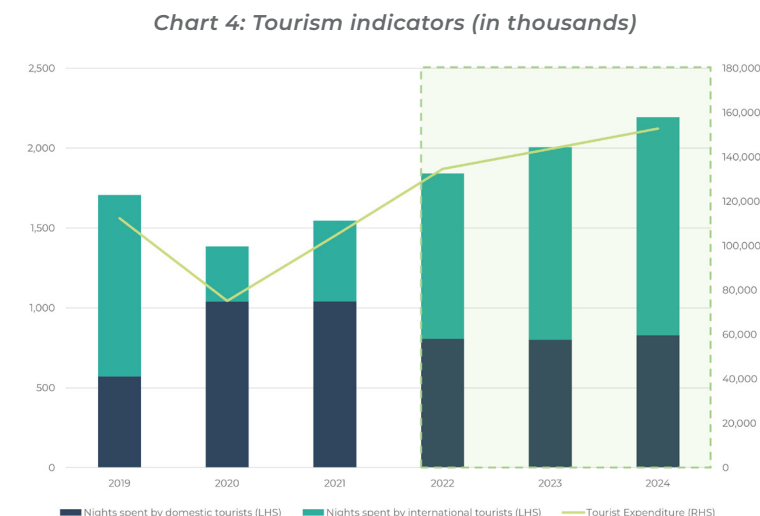


Source: Oxford Economics

gradually tapers off by the end of the projection horizon. This reflects tight labour market conditions, with the private sector often noting shortage of workers especially unskilled and semi-skilled.

## Tourism

Tourism activity improved in 2021 after declining in 2020 as a result of the pandemic. In level terms, the number of overnight stays increased by 161,395 when compared to a year earlier. These developments largely reflect the registered increase in international tourism. Nonetheless, activity indicators for the sector remained below pre-pandemic levels (see Chart 4).



Source: Oxford Economics

Tourism activity is projected to grow markedly this year and marginally exceed the levels registered prior to the pandemic with international tourists more than making up for the decline in domestic arrivals.<sup>3</sup> Going forward, tourism activity is set to continue to rise between 2023 and 2024 with a stable domestic tourism while international tourists being the main driver to growth.

## Social and Demographic Developments

According to the results of the most recent State of the Nation survey, which was released earlier this year, living conditions for Gozitan residents have improved since last year.<sup>4</sup> In fact, 77.1% of Gozitans said they were happy with their current personal situation, which is higher than the 66.7% recorded in 2021 and in line with the national average. The expectations for next year indicate that 24.6% of Gozitan residents anticipate an improvement in their living conditions, while 19.6% expect a decline, partly reflecting inflation concerns and consequently lower household confidence.

Population in Gozo reached 39,287 individuals as at end of 2021. This is an increase of 25.2% when compared to the 31,375 recorded in the previous census carried out in 2011.<sup>5</sup> This rise outpaced the increase in other regions in Malta which on average grew by 24.4%.

The rise was evident across all localities in Gozo. The localities with the highest rise in population were in Żebbuġ (which includes Marsalforn) and Munxar (which includes Xlendi) as they

<sup>3</sup> Tourism forecasts were computed by Oxford Economics. The model framework used combines historical tourism data from the National Statistics Office with economic indicators from Oxford Economics' Global Economic Model.

<sup>4</sup> An extract of the State of the National survey results for Gozo are available in: <https://grda.mt/wp-content/uploads/2022/07/GRDA-Report-Stat-tan-Nazzjon-2022.pdf>.

<sup>5</sup> For more information see: <https://nso.gov.mt/en/nso/Media/Salient-Points-of-Publications/Documents/2022/Census%20of%20Population%20and%20Housing%20Preliminary%20Report/Census%20of%20population%202021.pdf>.

<sup>6</sup> For more information of foreign employment developments in Gozo see: <https://grda.mt/wp-content/uploads/2021/11/Foreign-nationals-employed-in-Gozo-09.11.21.pdf>.

increased by 79.4% and 59.8% respectively. The smallest increase was registered in the locality of Kerċem which increased by 9.5%.

The number of males living in Gozo exceed those of females as their share in total population reached 52.0%. This development mainly reflects the influx of foreign workers, particularly in the construction sector, which as a result led to higher share of men, a phenomenon which occurred for the first-time in decades.<sup>6</sup>

On a general level, it is plausible to state that the local community and the migrants' communities co-exist rather distinctively from each other. Instants of tension do emerge occasionally, however, until now they cannot be considered as a structural issue. However, moving forward this new reality needs to be addressed and managed carefully. If left unmanaged it risks giving rise to social tension. Additionally, consideration must be given to a relatively recent trend where people facing social accommodation issues are being directed to Gozo. This is partly being underpinned by relatively cheaper accommodation in Gozo and by the availability of units being offered to the Housing Authority for its schemes. An unmanaged inflow, without proper consideration of the socio-economic implications risk increasing the likelihood of pressure on the social fabric and infrastructure.

## **Selected Sector: The Property Market Outlook**

Over the last few years, construction and real estate activities contributed significantly to the economic activity in Gozo. In fact, over the last decade these two sectors respectively grew by an average annual rate of 9.6% and 4.6%. However, the construction sector imposes high externalities both environmental as well as social.

A survey commissioned by the GRDA in 2022 indicates that the majority of Gozo residents considers overdevelopment as a concern.<sup>7</sup> In this survey, participants were also asked on what kind of development bothers them, with around 42.0% pointing towards large-scale construction projects that consists of numerous units. The reasons could be multi-faceted but common themes that frequently emerge include density, parking problems and the loss of the Gozitan village identity and its vernacular heritage.

Despite the fact that overdevelopment is viewed as a major concern, demand for real estate in Gozo is still robust. This is reflected from the National Statistics Office data on residential property transactions with more deeds and promises of sale signed in 2021 when compared to a year earlier.

Despite the unprecedented increase in the supply of property put on the market over the last years, property prices continue to increase. This partly reflects the excessive demand for this asset type. Reasons could be various, and these are well captured in a paper by Borg & Duca (2022) published in the GRDA journal *Perspettivi*.<sup>8</sup> This rise in price of property in Gozo is evident from the quarterly housing market assessment of Djar Malta.<sup>9</sup> According to the latest quarterly report,

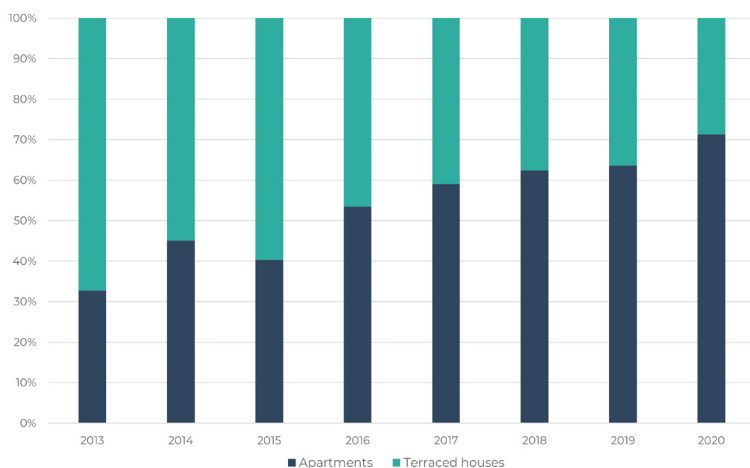
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<sup>7</sup> <https://grda.mt/wp-content/uploads/2022/02/Extract-2-of-3.pdf>.

<sup>8</sup> [https://grda.mt/wp-content/uploads/2022/04/Perspettivi\\_Issue-1.pdf](https://grda.mt/wp-content/uploads/2022/04/Perspettivi_Issue-1.pdf).

<sup>9</sup> For more information see: <https://djar.com/>.

**Chart 5: Apartments and terraced houses permits (share to total)**



Source: PQ 20714 Legislature XIII, PQ 19565 Legislature XIII

The high level of demand is not only leading to higher prices but also on the type of property built. Due to the lack of available land, large-scale apartment developments and high-rise construction projects are frequently the outcome of efforts to meet this demand, with share of apartment permits to total permits increasing over the years (see Chart 5).

property prices in Gozo registered a year-on-year increase of 1.7% during the third quarter of 2021. On the other hand, property prices in other Maltese regions fell marginally when compared to the same period a year earlier. This was also evident in the previous report published by Djar Malta in June. According to this report prices in Gozo increased by 1.9% in the first quarter of 2021 when compared to the corresponding period a year earlier, while those in Malta remained relatively stable.

## GRDA Budget 2023 Proposals

The Gozo Regional Development Authority (GRDA) serves to address an important gap in the socio-economic development of Gozo by streamlining regional policies and their implementation. This ensures that Gozo's significant and unique economic, social and environment characteristics are reflected in national strategies and policies.

For the first time since its establishment, the GRDA is publishing specific proposals in preparation for the forthcoming Budget. The submissions draw on research, consultations with and feedback from stakeholders which the GRDA carries out on an ongoing basis. Importantly, the submissions are complimentary with and in addition to the measures in the GRDA's Regional Development Strategy that will be published in the coming months.

### Proposal 1: Better targeting and alignment of the stamp duty reduction on residential property with Gozo's socio-economic and environmental needs

The 2017 Budget Speech introduced a scheme for the reduction of stamp duty from the standard 5% to 2% of a property's value payable by buyers of residential immovable property in Gozo. The scheme was originally introduced for the duration of one year but has since been extended each year.

Eligibility is open to all types of dwellings irrespective of price and, unlike other property incentives, this scheme does not distinguish between first-time, second-time or other buyers. Since the implementation of this scheme, there has been an annual increase in the number of deeds signed for property in Gozo (see Chart 6). The pandemic caused a decline in the

number of deeds signed, yet it was still higher than what had been observed before the introduction of this initiative.

The indiscriminate nature of the scheme renders the policy objective it was intended to achieve unclear, other than to boost the quantity of property units. The latter conflicts with GRDA's vision for Gozo of attaining sustainable development by making optimal use of the island's limited space. GRDA believes that Gozo requires a balanced approach

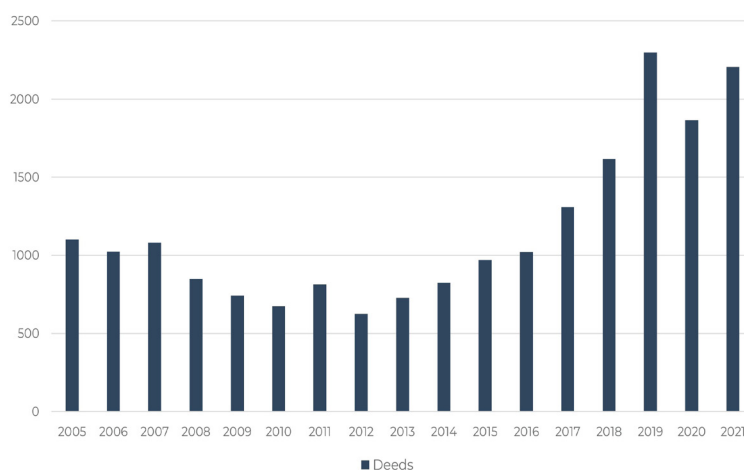
by ensuring a constant close alignment of land use planning and sectorial policies thereby avoiding situations which could compromise its long-term potential.

As it stands, this scheme has the potential of generating unintended adverse consequences with the benefits accruing to society from a reduction in the stamp duty falling way short of the costs that it could inflict. It is not readily apparent that the scheme could be justified on social grounds since eligibility is not tied to the buyer being established in Gozo. Therefore, the scheme could be distorting the market by subsidising and encouraging haphazard and excessive holiday or buy-to-rent property development with possible repercussions to Gozo' delicate environment and long-term economic consequences in terms of attractiveness that this may have, if not managed in a sustainable manner.

Moreover, although in the short run the scheme could have provided partial relief to residential buyers in terms of lower transaction costs, in the longer run it may contribute to adverse second round effects in terms of housing price dynamics with implications on affordability. The impact on prices depends on market expectations about whether the reduction in stamp duty is permanent or temporary and the relative bargaining power of buyers and sellers. Given that, at least within a particular price range, buyers are more price-inelastic than sellers, property vendors may capitalise the reduced stamp duty into house prices. That is, house ask prices will increase at least by the amount of the reduction in stamp duty. If this happens, then the benefit from reduced taxes would accrue mostly, if not entirely, to vendors, while the benefit to buyers would be negligible, if at all. Unless the original policy objective of the scheme was indifferent about the incidence of the incentive's benefit as long as real estate activity is stimulated, this points to an undesirable outcome from a society point of view. Moreover, prices of property not eligible to benefit from the incentive also tend to increase as vendors attempt to restore relative prices that existed prior to the introduction of the scheme, thereby further adversely affecting affordability.

There are plausible indications that point to the possibility that this might have occurred over the past years. A recent study<sup>10</sup> shows that a similar scheme introduced in 2013 allowing a partial

*Chart 6: Deeds for property in Gozo*



Source: NSO

<sup>10</sup> Cilia, D. (2021). An Analysis of the First-time Buyers' Scheme Impact on First-time Buyers in Malta.



stamp duty exemption rate to first-time property buyers led to higher property prices in both Malta and Gozo. It would be reasonable to assume that similar dynamics may have occurred as a result of the reduced stamp duty on residential property in Gozo.

In terms of value for money, as with any incentive or tax holiday, there is a distinct possibility that this scheme gives rise to economic inefficiencies and so-called deadweight social losses - in this case, property transactions that would have occurred anyway even without the relief. In addition, as evident from Figure 6 above, the effectiveness of the scheme in supporting demand for property in Gozo seems to have diminished in recent quarters, rendering its value-for-money in public policy terms doubtful.

In light of the above, GRDA recommends that the scheme is transformed into targeted incentives that are aligned with the achievement of policy objectives, namely: (i) encourage more upmarket property development in Gozo; (ii) limit eligibility of the scheme to low-end, dilapidated and vacant property which is repurposed into medium- to higher-end real estate in selected development zones; (iii) at the same time, subject small units to either higher stamp duty and/or additional fees to disincentivise the construction of small, low-end units; and (iv) promote green and efficient buildings.

## **Proposal 2: Ringfencing of revenue from the tourism eco-contribution to Gozo**

In 2016, the Government introduced an environmental contribution or occupancy tax, on stays in accommodation.<sup>11</sup> The main objective of this contribution was to improve quality along the tourism value chain. All revenue generated from this initiative is earmarked to upgrade and embellish the local infrastructure in touristic areas. The eco-contribution, amounts to €0.50c per person (18 years or older) per night up to a maximum of €5 for each continuous stay. This applies to local and foreign guests staying at any type of accommodation including hotels, guesthouses, farmhouses, villas, hostels, self-catering apartments, b&b, host families etc.

The revenue collected from the occupancy tax is directed to a fund managed by the Foundation for Tourism Zone Development set up in 2017 which is also tasked with carrying out tourism-related embellishment and maintenance project works. The revenue collected from the occupancy tax since its introduction is shown in Table 2. There are no indications that suggest that the occupation tax has harmed tourist arrivals to the Maltese Islands. Indeed, the fact that it was introduced during a time of strong European and international travel demand and increasing tourist arrivals in Malta and Gozo may have contributed to neutralise any potential adverse impact of the tax.

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<sup>11</sup> L.N. 174 of 2016 - Eco-Contribution Act (Amendment to the Second Schedule) Regulations, 2016 and L.N. 175 of 2016 - Eco-Contribution Act (Amendment to the Third Schedule) Regulations, 2016.

**Table 2: Revenue collected from Environmental Contribution Tax - (Eur millions, 2016 - 2021)**

	Total
<b>Total Revenue</b>	€16.5
<i>of which:</i>	
Revenue from accommodation establishment in Gozo <sup>(1)</sup>	€1.7

<sup>(1)</sup> Estimate based on the number of overnight visits in Gozo as a share of total overnight visits.

Source: PQ 15908 Legislature XIII and GRDA calculations.

The GRDA supports market-based measures in which the user pays, at least partially, for the costs of providing public services since this favours a more efficient allocation of resources. The tourism industry generates a substantial flow of visitors each year which impose additional costs on infrastructure and the local population. The presence of a large number of tourists is likely to be related to substantial external costs such as congestion and pollution that may be uncompensated. To the extent that these costs remain uncompensated, local citizens who do not participate in the tourism industry have a legitimate concern about the increasing cost of government services and may legitimately feel that they are subsidising the operators. Therefore, the eco-contribution provides a means of ensuring that the tourist industry shares in covering for the costs relating to tourist activity.

Moreover, in line with the broad agreement that exists among tourism industry stakeholders around the policy objectives of the eco-contribution, the GRDA is in favour of the notion that the revenue generated should remain earmarked to upgrade the tourism product since it provides a signal and protects this priority industry which is crucial to Gozo's continued prosperity. Ensuring that the revenue collected is reinvested in the economic activity that has been singled out to be taxed ensures legitimacy and acceptance by the operators.

To ensure that this legitimacy and acceptance is strengthened further, GRDA recommends that apart from activity earmarking, the money collected from the eco-contribution is also geographically ring-fenced. While there is validity in the principle that taxes should be levied and funds spent where value is generated, there is a case to make in favour of broader considerations that go beyond the number of guest nights when determining the method for the allocation of the money ring-fenced to Gozo.

This is because Gozo faces a number of peculiarities and disadvantages. Despite an increase in recent years, compared to the mainland, Gozo still suffers from a lower number of guests that stay in collective accommodation. According to NSO data, the share of guests staying in collective accommodation in Gozo accounted for just 7.1% of the total guests with the majority (over 90%) being domestic travellers. And although Gozo boasts of a significant stock of self-catering establishments representing the majority of the bed supply, the growing trend of Maltese purchasing a holiday home in Gozo is denting the potential of revenue that could be collected from the eco-contribution. Indeed, total nights spent by domestic tourists is split almost equally between rented and non-rented accommodation. At the same time, day trippers constitute some 87% of annual total visitors to Gozo. While same-day visitors and guests staying in non-rented accommodation do not fall within the scope of the eco-contribution, they nonetheless exert pressure on infrastructure and public services.

Therefore, the formula to apportion the funds between the two islands should also take into consideration the above realities. It is being proposed that the formula should consist of an element that reflects the proportion of person nights which is topped up by a compensating factor that reflects the disadvantages in terms of same-day visitors and non-rented accommodation guests mentioned above.

Lastly, since budgets are fungible, it should be ensured that ringfencing does not result in offsets through cuts in other sources that are mobilised for the purpose of upgrading and maintaining the tourism sector.

### **Proposal 3: Regional input-output tables for Gozo**

High-quality statistics are an essential and necessary input used to inform evidence-based policymaking and which, together with valid research methodologies, provide accurate and reliable information on which decisions can be based. Possessing such an information capacity, in turn, sustains strategic objectives and the underlying policies and supporting instruments.

Over the years, the National Statistics Office has made substantial efforts to strengthen, in terms of both quality and quantity, the production and dissemination of data. An important development has been the publication of a growing number of regional statistics. Since national data alone cannot always reveal the full picture, subnational statistics are an important tool to better understand the specific characteristics of regions. In this context, regional level data also allow for more meaningful comparisons and analysis of socio-economic and environmental performance with other regions. Lastly, sound regional statistics are critical in preparing proposals and policy interventions for EU funding purposes.

While acknowledging these achievements, it is important to build and consolidate further the national statistical system by ensuring that more regional level statistics and indicators are made available. Specifically, the GRDA recommends that NSO embarks on an exercise to produce and disseminate supply-use (S-U) and input-output (I-O) tables together with the related multipliers for Gozo. S-U tables provide a picture of the annual flow of goods and services in an economy by describing how products are brought into an economy (either domestically-produced or imported) and how those same products (intermediate consumption, household and government final consumption, capital and exports) are used. S-U tables also serve as a basis for deriving I-O tables which depict the connection between final and intermediate uses of goods and services defined according to outputs.

Besides their importance for compiling statistics, in particular the calculation of gross domestic product, S-U and I-O tables are useful for analytical purposes. For instance, they show the interaction between producers and consumers and provide the basis for structural analysis, including measuring an economy's productivity performance as well as environmental effects in the context of sustainable development. Indeed, the scope for their exploitation is diversified, including for the purposes of policy formulation and evaluation.

While acknowledging that S-U and I-O tables are more challenging to compile and more complex than most other statistics especially given the data limitations at a subnational level,

the benefits that would accrue from producing this data are large in many ways since their properties allow for a much wider set of analyses that would lead to a more detailed portrait of Gozo's economy and better understanding of its specific socio-economic characteristics. In case data limitations impede the generation of survey-based S-U and I-O tables, a second-best option is to use regionalisation methods of national input-output tables to generate regional I-O relations. These methods apply non-survey techniques to estimate regional tables (using national ones as a starting point) which could, at a second stage, be graduated to a hybrid approach, as more information and experience is gathered.

The GRDA considers the availability of timely and high-quality statistics, including the S-U and I-O tables for Gozo, to be an important support to achieve its tasks. Regional S-U and I-O tables would allow policy- and decision-makers as well as researchers to form a more comprehensive view of Gozo's distinctive characteristics, which together with the ability of stress testing the region's response to positive or negative shocks, will lead to the anticipation and formulation of more effective policies to improve growth.



**GOZO REGIONAL**  
DEVELOPMENT AUTHORITY

Tel: +356 22156333

Email: [info@grda.mt](mailto:info@grda.mt)

[www.grda.mt](http://www.grda.mt)

