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The Evolution of Budgetary Institutions in Malta Since EU Membership: What Role for the Delegation Approach in the EU's Rules-Based Fiscal Governance Framework?

MOIRA CATANIA

The Evolution of Budgetary Institutions in Malta Since EU Membership: What Role for the Delegation Approach in the EU's Rules-Based Fiscal Governance Framework?

Moira Catania [1]

Abstract

The European Union's (EU) Stability and Growth Pact involves a rules-based, or contracts, approach to achieve fiscal discipline, with limits on the size of the budget deficit and government debt. An alternative approach to fiscal governance is the delegation approach, which emphasises strong procedural rules governing the budgetary process, namely through a finance minister who has strong powers vis-à-vis spending ministers. The characteristics of Malta's political system, with single-party majority governments, as well as the small size of its public administration being a micro state with limited human resources, suggest a delegation form of fiscal governance with centralised budgetary decision-making. Yet, since EU membership, Malta had to adapt to the EU's supra-national fiscal rules and to introduce rules-based institutional reforms. In this context, we examine the evolution of budgetary institutions in Malta since EU membership in 2004, using available delegation and contracts indices, as well as interviews with key stakeholders in Malta's budgetary process and documentary evidence. Our results show that despite initial hesitancy, Malta has considerably strengthened characteristics of the contract approach, particularly through the introduction of national fiscal rules and the set-up of an independent fiscal council, which in some respects went beyond the EU obligations. Nevertheless, the fiscal governance framework remains based on the delegation approach, which was strengthened further during the period under review. Indeed, Malta has adapted the supra-nationally mandated rules-based reforms to its specific circumstances, to strengthen delegation characteristics during budget negotiations and implementation, thus showing complementarity between the two forms of fiscal governance.

Keywords:
Budget institutions, EU membership, fiscal governance, fiscal rules, Malta

Introduction

Upon accession to the European Union (EU), Malta became subject to the budgetary constraints imposed by the Stability and Growth Pact (SGP). But for many years, it faced difficulties to abide by these supra-national fiscal requirements and was subject to an Excessive Deficit Procedure (EDP)

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1 Moira Catania is a Senior Lecturer at the Institute for European Studies, University of Malta.
Contact: moira.catania@um.edu.mt

for most of the years until 2015[2].

The SGP involves a rules-based, or contracts approach to fiscal governance, which requires commitment by budgetary decision-makers to numerical fiscal targets for a multi-year period (von Hagen and Harden 1995; Hallerberg and von Hagen, 1999). The corrective arm of the SGP comprises fiscal rules with limits on the size of the budget deficit and government debt (3% and 60% of the Gross Domestic Product, respectively), enforced through the EDP. On the other hand, the preventive arm emphasises a medium-term budgetary orientation, requiring members of the Euro Area (EA) to present annual Stability Programmes (SP) outlining their fiscal plans to achieve the medium-term budgetary objective (MTO), which for many countries is close to a balanced budget in cyclically adjusted terms[3].

Whilst the EU relies on this rules-based approach to instil fiscal discipline among the member states, there is an alternative – the delegation or hierarchical approach, which focuses on strong procedural rules governing the budgetary process and centralised budgetary decision-making. This involves assigning strong decision-making powers to the finance minister vis-à-vis spending ministers, during budget negotiations and implementation, whilst the executive has strong powers during budget approval, by restricting legislative amendment powers (Alesina and Perotti 1999).

The EU's fiscal governance framework largely ignores this delegation approach. Rather, the rules-based SGP has been strengthened following the EA sovereign debt crisis, through the 'Six-Pack' and 'Two-Pack' legislative packages. In addition, together with the Fiscal Compact[4], these reforms[5] have introduced common rules-based requirements at the national level. In particular, all EA countries were required to introduce national fiscal rules, which reflect the SGP obligations, and to establish independent fiscal institutions (IFIs) with common mandates, including amongst others, to monitor compliance with these fiscal rules. Malta complied with these requirements through the enactment of the Fiscal Responsibility Act (FRA) in 2014, which introduced national fiscal rules and provided for the establishment of the Malta Fiscal Advisory Council (MFAC), which was then set-up in 2015.

In contrast to this thrust towards a homogenous rules-based approach for all EA countries, case studies from European and other countries show that the effectiveness of fiscal governance frameworks to achieve fiscal discipline depends on how well they fit the countries' respective institutional, political, and social context (Kopits 2012; Wyplosz 2012). In particular, according to Hallerberg and von Hagen (1999), a country's ideal form of fiscal governance depends on its type of government. They argued that the delegation approach, with its centralised budgetary decision-making, is more appropriate in countries with a single-party majority government, whereas a contracts approach is more appropriate in countries with coalition governments, especially when there is wide ideological dispersion among the coalition partners (Hallerberg, Strauch and von Hagen 2007, 2009).

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2 Malta was first subject to an EDP during 2004-2007. This was abrogated in time to adopt the Euro in 2008, but Malta was again subject to an EDP during 2009-12 and 2013-15 (European Commission, 2023).

3 Further details on the SGP provisions are available at: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact_en.

4 The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, also known as the Fiscal Compact Treaty, is available at: https://eur-lex.europa.eu/EN/legal-content/summary/treaty-on-stability-coordination-and-governance-in-the-economic-and-monetary-union-also-known-as-the-fiscal-compact.html

5 More information on these reforms is available at: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/history-stability-and-growth-pact_en.

Single-party majority governments are generally characterised by cohesion among the cabinet members and strong leadership from the head of government, who is also the party leader. Thus, members of government are more likely to agree to delegate power to the finance minister, who comes from the same political party and has the backing of the party leader. On the other hand, in a coalition government, members of government would be reluctant to assign strong budgetary decision-making powers to the finance minister, who may be coming from a different political party and thus they would be concerned about whether the different spending preferences of their respective party are being treated fairly in the budget process. In addition, the finance power cannot rely on the backing from the head of government, because they may be coming from different political parties. These characteristics imply that a delegation approach is more appropriate in countries with single-party majority governments than with multi-party coalition governments.

Moreover, agreeing on a fiscal stance is politically more difficult in multi-party coalition governments especially when there are considerable differences in the fiscal preferences of the political parties forming the coalition. Thus, coalition governments tend to negotiate multi-annual fiscal targets or rules at the beginning of the term of office, to avoid having to renegotiate the fiscal stance annually. They also have incentives to abide by these fiscal targets or rules to avoid such budgetary struggles. Thus, the contracts approach is more appropriate for coalition governments. On the other hand, in single-party majority governments, the political cohesion within cabinet makes it easier to renegotiate the fiscal stance annually and there are no effective threats if the government ignores the set fiscal targets or rules when they are no longer considered convenient.

Using data for the EU15 during 1981-94, Hallerberg and von Hagen (1999) presented evidence that the countries had the expected form of fiscal governance, based on their type of government. This was largely confirmed by Hallerberg, Strauch and von Hagen (2007, 2009) in an updated classification for 1985-2004. Yläoutinen (2004) and Hallerberg and Yläoutinen (2010) presented similar findings for the ten central Eastern European countries (CEECs) that joined the EU in 2004 and 2007. Whilst these studies are based on small samples and comprise mainly countries with coalition governments, this empirical evidence, in conjunction with the above discussion, implies that given its strong tradition of single-party majority governments[6], the appropriate fiscal governance framework for Malta should be the delegation approach. Characteristics of small states' public administration, such as scarce human resources, personal contacts, and greater influence of politicians (Randma-Liiv 2002; Sarapu 2010), also facilitate the centralised decision-making, typical of the delegation approach. This suggests a misfit between the rules-based institutional reforms introduced in 2014 and 2015 and the 'ideal' fiscal governance approach for Malta.

Against this background, this paper examines the evolution of budgetary institutions in Malta since EU membership in 2004, distinguishing between characteristics of the delegation and contracts approaches. In particular, we investigate whether the fiscal governance approach in Malta has become predominantly rules-based, or whether there is any complementarity with the delegation approach. We carry out this analysis by using available numerical composite indices to capture the characteristics of the two forms of fiscal governance, together with data generated from interviews with key stakeholders in the budgetary process as well as documentary evidence.

Through its focus on Malta, this study contributes to the literature on budget institutions in the

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6 The two main political parties – the Labour Party and the Nationalist Party, have alternated in government since Malta's independence in 1964 (Organisation for Security and Co-operation in Europe 2022).

country, which is very sparse, and it also expands the literature on the impact of EU membership in this member state to a new area i.e. budget institutions. More generally, this contribution adds to the literature on budget institutions by exploring how the rules-based approach has been applied in a country with an expected delegation approach, as well as through its qualitative methodological approach, which enables an in-depth and contextual analysis of budget institutions.

The results show that since EU membership, Malta has implemented extensive institutional reforms, to comply with the common EA rules-based requirements. In particular, despite initial reluctance, relatively strong fiscal rules have been introduced through the FRA, whilst the MFAC also has considerably broad tasks, going beyond the EU obligations in some respects. Nonetheless, the prevailing approach to fiscal governance in Malta remains a delegation approach, which has been strengthened further during the period under review. Furthermore, the supra-nationally mandated rules-based reforms have been adapted to the specific country circumstances, to reinforce the position of the Finance Ministry vis-a-vis spending ministries during budget negotiations and implementation, thus showing complementarity between the two forms of fiscal governance.

The remainder of the paper is organised as follows. The next section discusses the delegation and contracts indices used in this study, whilst Section 3 describes the interview data and other information sources. Section 4 discusses the evolution of budget institutions in Malta. The following two sections present and analyse the results derived from the numerical indices and the interviews and other sources, respectively. Finally, Section 7 presents overall conclusions.

Delegation and Contracts Indices

Since the early 1990s, several composite numerical indices have been developed to measure the quality of budget institutions. Focusing on those covering European countries, von Hagen (1992) developed an index to measure the overall quality of budget institutions for 12 EU countries. Subsequently, Gleich (2003) and Fabrizio and Mody (2006) produced similar indices for the ten CEECs and Darvas and Kostyleva (2011) for a larger sample of EU and OECD countries. Meanwhile, other indices focus on specific aspects of budget institutions, for instance the European Commission’s (2022) indices for MTBFs, fiscal rules and the scope of tasks discharged by fiscal councils, and the broader fiscal council indices by Debrun and Kumar (2007), Maltritz and Wüste (2015) and Horvath (2018). Separate measures of the quality of the contracts and delegation approaches were produced by Hallerberg, Strauch and von Hagen (2007, 2009) for the EU15, by Yläoutinen (2004) and Hallerberg and Yläoutinen (2010) for ten CEECs and by Catania, Baimbridge and Litsios (2023) for 19 EA countries.

We use the indices by Catania, Baimbridge and Litsios (2023) since this is the only study on delegation and contracts indices that include Malta in their sample. Moreover, being more recent, their indices capture institutional reforms implemented following the EA sovereign debt crisis. In particular, the contracts index includes characteristics of IFIs, which now constitute an important aspect of national budget institutions in the EA. Furthermore, both the contracts and delegation indices provide a comprehensive and detailed description of relevant institutional characteristics.

The contracts index comprises fiscal rules, MTBFs and independent fiscal councils. Their characteristics are measured through the fiscal rules strength index, the index on the quality of

MTBF and the scope index of IFIs, produced by the European Commission (2022)7. These indices are compiled from data generated from questionnaires to national authorities. Both the fiscal rules and MTBF indices have a broad scope and capture various relevant institutional characteristics. Thus, the fiscal rules index captures the number of rules in place, their coverage of the general government sector and their strength, whilst the MTBF index measures the coverage of the targets or ceilings included in the medium-term fiscal plan, its connectedness with the annual budget, the involvement of national Parliament and IFIs in its preparation and its level of detail. On the other hand, the European Commission's IFI index is limited to the mandate of fiscal councils, taking into account whether the tasks are stipulated in the institution's legal remit or carried out on its own initiative, but it does not capture its degree of independence and organisational capacity.

The delegation index comprises three components, relating to the different stages of the budget process. The first measures the strength of the finance minister vis-à-vis spending ministries during budget preparation, including whether budget ceilings are imposed on the initial spending requests by individual ministries, whether negotiations take place bilaterally or within cabinet and the final decision-making power to resolve disputes during budget negotiations. The second refers to the executive's power relative to the legislature during budget approval and other aspects of centralisation during this stage, namely the voting procedure and the structure of the parliamentary committee dealing with the budget. The last and third component captures executive flexibility during budget implementation. Executive discretion to cut spending and to shift funds from one budget item to another can facilitate adjustment to unexpected shocks whilst keeping within the overall fiscal targets, flexibility to increase spending can contribute to slippages from the budgetary target.

Catania, Baimbridge and Litsios (2023) compiled the delegation index from the OECD's 2012 budgeting practices and procedures database and questionnaires to national officials carried out in 2016. Whilst it is acknowledged that using data at two different points in time constitutes a limitation, this is not expected to impact considerably the results since reforms in characteristics related to the delegation approach have been rather limited among EA countries during 2007-2016 (Catania, Baimbridge and Litsios 2023).

Both the delegation and contracts indices are constructed by assigning equal weights to the different components and they are aggregated by using a linear additive approach. Thus, it is assumed that individual characteristics are equally important to achieve fiscal discipline and that they are fully compensable among them. The robustness of the results was tested by using alternative weighting schemes and the different indices are closely correlated to each other (Catania, Baimbridge and Litsios 2023). Further details on these indices are provided in Appendix Tables I and II.

This paper also analyses the overall scores in the delegation and contracts indices at a more disaggregated level, thus providing a detailed analysis of Malta's budget institutions. A cross-sectional analysis is carried out, benchmarking Malta's performance to that of other EA countries. Time series data is available for the contracts index which enables tracking of institutional developments in Malta since EU membership. Due to data constraints, for the delegation approach, this longitudinal analysis is carried out qualitatively, by using the annual Updates of the SP, which report on institutional features of public finances.

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7 Further information on these indices is available at: https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-databases/fiscal-governance-database_en.

Interviews and other data sources

This study also uses data generated from interviews with key stakeholders in Malta's budgetary process, which were carried out by the author in 2016. The main fiscal governance reforms in Malta were implemented through the adoption of the Fiscal Responsibility Act in 2014 and the establishment of the Malta Fiscal Advisory Council in the subsequent year. Thus, the information generated from the interviews captures the implementation of the main budgetary reforms since EU membership and the early years of implementation. The participants included officials directly involved in the budgetary process, namely the Ministry of Finance, Parliament and the MFAC, as well as external stakeholders, namely the Central Bank of Malta and the European Commission. Interviews were also held with current or previous members of Parliament, selected on the basis of their expertise and experience in budgetary matters, with equal representation from the two main political parties. The relatively large sample of 24 participants, from diverse institutions and with at least two participants from each institution (Appendix Table III), reduced the risk of bias and enabled confirmatory data to be obtained for most of the issues of interest from more than one participant.

The interviews comprised semi-structured questions, on the characteristics of the budgetary framework and particularly on the role of fiscal rules and the fiscal council. They were held on a confidential basis, and the length ranged from 20 minutes to one hour and 45 minutes, depending on the degree of involvement of the participants in the budgetary process. The data generated from the interviews was analysed using a manual thematic coding approach. The coding of the data aimed to identify delegation and contracts institutional characteristics and to establish whether there is any complementarity between the two approaches (see Appendix Table IV).

Documentary evidence was also used to complement the data from the indices and the interviews and to fill in missing information gaps. The main documentary sources are fiscal reports and documents published between 2004 and 2022, by Malta's Ministry of Finance, EU institutions and the International Monetary Fund (IMF), together with relevant legislative acts.

Evolution of budget institutions in Malta 2004-22

The early years of EU membership

At the time of EU membership, Malta was one of the few countries (together with Greece and Slovenia) without any national fiscal rules. Furthermore, like most EA member states, it did not have an IFI in place (European Commission 2022). On the other hand, as Malta adapted to the requirements of the SGP's preventive arm, some element of medium-term budgetary orientation was introduced with the preparation of annual Convergence Programmes and after Euro adoption in 2008, Stability Programmes, which set out the government's medium-term fiscal plans. But whilst Malta's budgetary planning is based on three-year business and financial plans prepared by Ministries and government departments, these are roll-on plans (Ministry of Finance 2005, p.59). Indeed, although the Budget Speech sets out the medium-term budgetary targets, Parliament only approves the annual budget (Ministry of Finance 2011, p.67). Furthermore, 'such targets are currently non-binding and subject to subsequent annual budgetary processes' (Ministry of Finance 2013, p.69). Thus, characteristics of the contracts approach were either completely missing (fiscal rules and IFI) or rather weak (MTBF).

On the other hand, centralised budgetary decision-making was very evident in first years of EU membership, with the Prime Minister himself assuming responsibility for the finance portfolio during 2004-08. This reflected the importance of abrogating the excessive deficit procedure in force at the time for Malta to be able to adopt the Euro in 2008.

Delegation characteristics are very evident in the budget preparation stage. Government departments prepare their financial plans and the revenue and expenditure estimates 'within the ambit of a financial package offered by the Ministry of Finance' (Ministry of Finance 2005, p.59). Budget negotiations are held bilaterally between the individual spending ministries and the Ministry of Finance, in two stages, at permanent secretary level and then at Ministerial level (Ministry of Finance 2011, p.67). Although the final approval of the budget preparation is done at the level of the Cabinet of Ministers (Ministry of Finance 2011, p.66), Malta's single-party majority government and the typical strong party cohesion entail a key leadership role for the Prime Minister in Cabinet, and hence also elements of centralised decision-making.

The second stage of the budgetary process starts with the presentation of the Budget Speech by the Minister of Finance in Parliament and ends with the parliamentary approval of the Financial Estimates for the various Ministries (Ministry of Finance 2011, pp. 66-67). Reflecting the polarised two-party majority system, Parliament has weak power relative to the executive (Bulmer 2014) and consequently, the budget approval process is dominated by the executive.

During the budget implementation stage, the Ministry of Finance once again assumes a key role, typical of the delegation approach. During the period leading to Euro adoption, requests by spending ministries for additional funds were 'followed up by a rigorous evaluation process by the Ministry of Finance' (Ministry of Finance 2006, p.67). More generally, the Finance Ministry monitors closely the budgetary performance of Government departments and entities (Ministry of Finance 2007, p.63). This enables it to take corrective measures if there are indications of overspending or revenue shortfalls (Ministry of Finance 2005, p.59).

Pressure to reform Malta's fiscal governance framework

In view of Malta's recurring fiscal imbalances, EU institutions started to put pressure on the Maltese authorities to reform its budget institutions. In its Opinion on the update of the SP for 2008-2011, the Council (2009, C66/14) called on Malta to 'strengthen the medium-term budgetary framework'. This pressure intensified following the EA sovereign debt crisis and the increasing emphasis on the role of budget institutions to improve fiscal discipline, with more specific recommendations calling for a binding MTBF (Council of the EU 2010, 2011, 2012 and 2013). At the same time, common requirements were being introduced for all EA countries to establish national fiscal rules and independent IFIs. Furthermore, the Council Opinions (2010, C1144/4; 2011, C215/12) also called on Malta to strengthen delegation institutional characteristics, namely to 'improve the monitoring of budget execution', in view of repeated expenditure slippages.

Similarly, the IMF, in its Article IV missions, was also recommending both rules-based reforms, to reinforce the medium-term orientation in the budgetary strategy (IMF 2008, 2009) and to introduce 'a strong fiscal rule' (IMF 2010, p.2), as well as to strengthen the delegation approach through increased 'budget execution discipline' (IMF 2009, p.2).

The Ministry of Finance initially resisted the common EA requirements, arguing against a one-size-fits-all approach: 'the desirable characteristics of national fiscal rules and institutions depend on domestic circumstances, such as the institutional and political setting and the nature of fiscal problems' (Ministry of Finance 2006, p.68). It argued that political commitment to the fiscal targets and appropriate monitoring and enforcement systems could be as effective as fiscal rules and similarly argued against the need for 'special status of fiscal institutions' (Ministry of Finance 2006, pp. 67-8). It was particularly hesitant to set up an IFI, highlighting 'the need for lean institutional structures in the public administration of a small state' and 'avoidance of unnecessary duplication in institutions' oversight and competence' (Ministry of Finance 2011, p.65). Eventually it had to comply to align 'Malta's fiscal architecture with the legal obligations in the Fiscal Compact and the relevant EU Regulations and Directives on economic governance' (Ministry of Finance 2014, p.63). But it is clear that these reforms were supra-nationally mandated, and the Maltese authorities insisted on a flexible interpretation of the fiscal rules (Ministry of Finance 2013, p.68).

The Fiscal Responsibility Act

The institutional reforms required to comply with the 'Six-Pack' and 'Two-Pack' legislative packages and the Fiscal Compact Treaty were introduced in Malta through the FRA, which was enacted by Parliament in 2014 (Ministry of Finance 2015, p.63). The FRA introduced national fiscal rules targeting the budget balance and the government debt ratio, whilst allowing for some flexibility through escape clauses, during 'exceptional circumstances'. It also provided for the establishment of an independent IFI - the MFAC, with responsibility amongst other tasks, to assess the macroeconomic and fiscal forecasts prepared by the Ministry of Finance and to assess whether the fiscal stance is compliant with the fiscal rules and the obligations emanating from the SGP. The MFAC was set up and became operational in 2015 (MFAC n.d).

The FRA also provided for the formal establishment of a medium-term fiscal plan and a draft budgetary plan, to comply with the relevant SGP provisions. Whilst the medium-term fiscal plans were strengthened by requiring political endorsement by the Prime Minister and the Minister for Finance, they remained non-binding with three-year rolling fiscal targets (Ministry of Finance 2015, p.63).

In some respects, the FRA went beyond the EU obligations. Whilst EA member states are only required to have their macroeconomic forecasts endorsed by an independent institution (Regulation (EU) No 473/2013 Article 4(4)), the MFAC is required to endorse also the fiscal forecasts (FRA Article 13(3)(a)). Furthermore, the FRA also included nationally-driven, institutional reforms pertaining to the delegation approach. In particular, the FRA provided more power to the Ministry of Finance during budget negotiations with spending ministries and more control over public expenditures during budget implementation. In-year budget monitoring was also improved through the preparation and publication of half-yearly and annual reports by the Ministry of Finance (FRA Articles 39 (7-10) and 41, respectively), which are also required to be assessed by the fiscal council (FRA Article 13(e)).

Results from the contracts and delegation indices

Contracts approach index

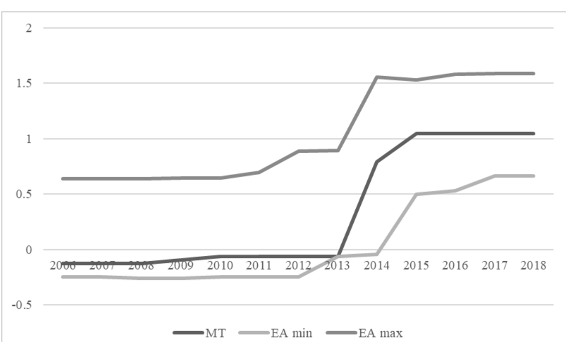
From among the weakest performing EA countries, Malta's score in the contracts index increased considerably, first with the introduction of national fiscal rules in 2014 and then with the establishment of the MFAC in the subsequent year (Figure 1). Whilst similar improvements are noted across the EA, as countries introduced similar reforms to comply with the EA common requirements, Malta's ranking improved considerably, from very close to the bottom (between 16-19) up to 2013 to sixth place as from 2015 (Figure 2). This shows that notwithstanding its hesitancy, Malta implemented deep contracts-based reforms, particularly as regards fiscal rules and IFI.

Indeed, Malta's score in the European Commission's fiscal rules strength index improved considerably in 2014 (Figure 3) and as a result, its ranking rose from 18th or 19th up to 2013 to multiple fiscal rules obtain higher scores. In fact, individually, Malta's balanced budget and debt rules have the highest scores among the same type of rules in EA countries, with strong features across most of the different characteristics considered, including its legal statutory base, monitoring by an independent body (the MFAC), correction mechanism and escape clauses.

Malta also scores relatively highly in the European Commission's IFI mandate index, ranking fourth among the EA member states during 2021[8] (Figure 5). In particular, Malta's IFI compares well in relation to monitoring of compliance with fiscal rules and assessment of budgetary forecasts. On the other hand, its performance is not as strong regarding macroeconomic forecasting, as it does not produce its own forecasts and there is no reconciliation procedure in place in case of diverging views with the Finance Ministry. Malta's IFI is also not engaged in quantitative policy costing and long-run sustainability analysis.

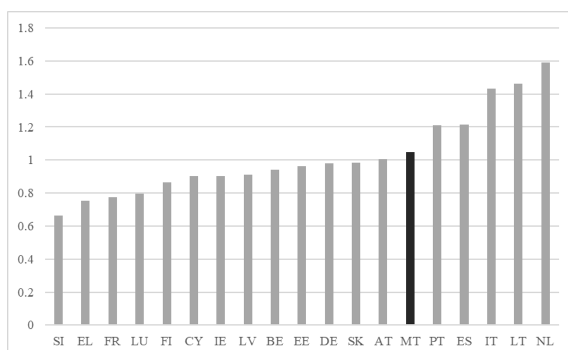
As regards the remaining component of the contracts approach index, referring to the MTBF, institutional reforms have been somewhat more muted. Malta improved its score around the time of Euro adoption (Figure 6), as it complied with the SGP obligations to set and achieve an MTO and to report progress towards attaining this objective in annual updates of the SP. Subsequently, the FRA only formalised this medium-term fiscal strategy. In contrast, other EA countries, especially the weaker performers, strengthened their MTBF around 2014, so that Malta's ranking slipped from around sixth in 2014 and 2015 to 10th by the end of the period under review (Figure 7). Strong features of Malta's MTBF include the involvement of the IFI and the level of detail included in the fiscal plans. On the other hand, weak aspects mainly concern the fact that the medium-term fiscal targets are not binding and lack of involvement of Parliament[9].

Figure 1: The contracts index (2006-2018)



Source: Catania, Baimbridge and Litsios (2023)

Figure 2: The contracts index (2018)

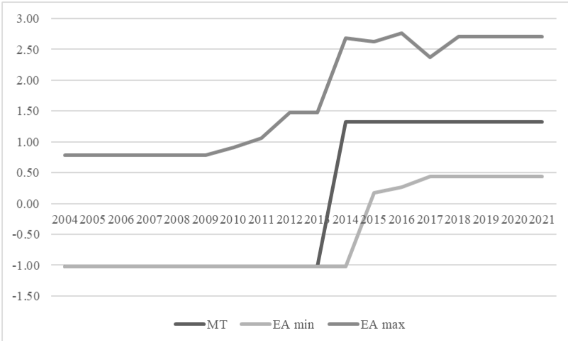


Source: Catania, Baimbridge and Litsios (2023)

8 A comparison of Malta's performance prior to the establishment of the MFAC is not possible since the European Commission's IFI mandate index is only available from 2015. However, most EA member states have set up their IFIs since 2010, with only Austria, Belgium and the Netherlands having longer established institutions (IMF 2023).

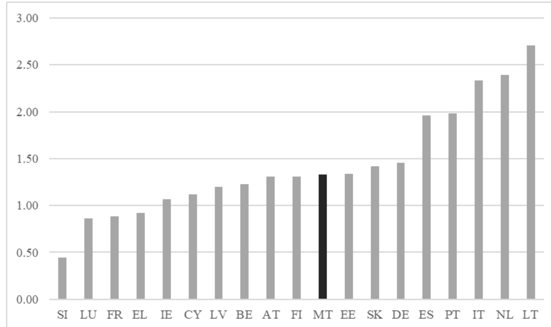
9 The medium-term fiscal strategy is tabled in Parliament, as required by Article 15(1) of the FRA, but there is neither a parliamentary discussion nor a vote.

Figure 3: Fiscal rules strength index (2004-2021)



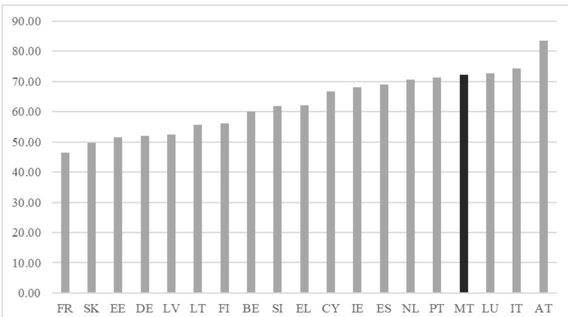
Source: European Commission (2022)

Figure 4: Fiscal rules strength index (2021)



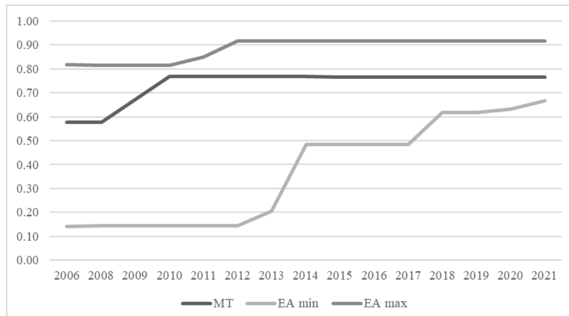
Source: European Commission (2022)

Figure 5: IFI mandate index (2021)



Source: European Commission (2022)

Figure 6: MTBF index (2006-2021)



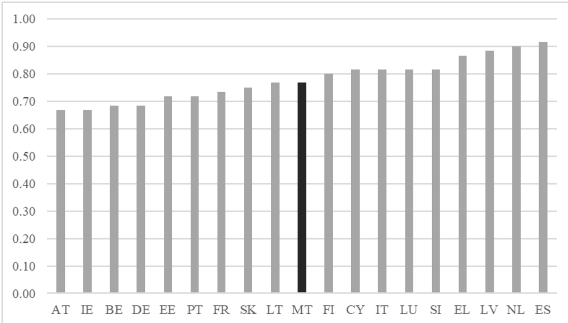
Source: European Commission (2022)

Delegation approach index

Whilst its political characteristics and small size suggest a delegation approach to fiscal governance, overall Malta ranks low in the overall delegation index - 16th among the EA19 (Figure 8).

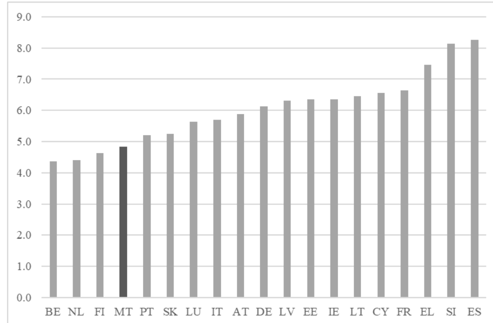
However, an analysis at a more disaggregated level shows a diverging performance in the different stages of the budgetary process. Malta has relatively strong delegation characteristics during budget negotiations, ranking 6th, together with three other countries (Figure 9). This mainly reflects the bilateral nature of budget negotiations between the Finance Ministry and spending ministries, as well as the imposition of budget ceilings on initial spending requests of individual line ministries. On the other hand, Malta has a relatively lower rank (12th) in the budget implementation stage (Figure 10). Whilst it has strong executive flexibility to cut or cancel spending and especially to reallocate funds, which can help to adjust to unexpected shocks and developments, it also has considerable flexibility to increase spending, including through supplementary budgets, which facilitates expenditure slippages. Finally, it has the lowest score during budget approval (Figure 11), reflecting the lack of formal restrictions on legislative powers to amend the draft budget by the executive, as well as the lack of a top-down budgetary voting procedure and of a centralised parliamentary committee structure dealing with the budget.

Figure 7: MTBF index (2021)



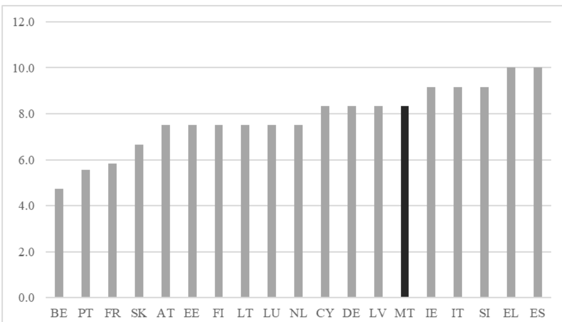
Source: European Commission (2022)

Figure 8: The delegation index[10]



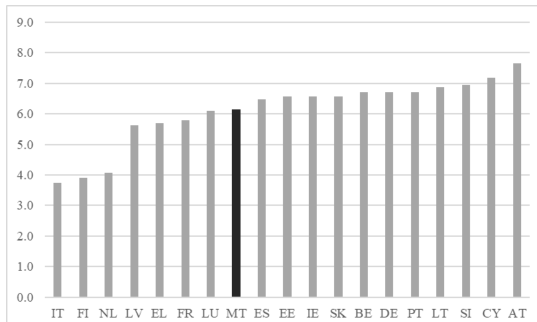
Source: Adapted from Catania, Baimbridge and Litsios (2023)

Figure 9: Delegation approach - budget negotiations sub-index



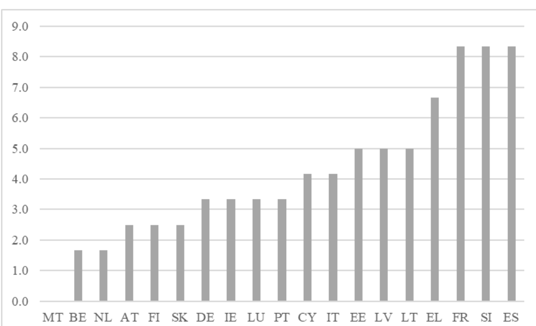
Source: Adapted from Catania, Baimbridge and Litsios (2023)

Figure 10: Delegation approach - budget implementation sub-index



Source: Adapted from Catania, Baimbridge and Litsios (2023)

Figure 11: Delegation approach - budget approval sub-index



Source: Adapted from Catania, Baimbridge and Litsios (2023)

10 For Figures 8-11, data refers to 2016 for Malta, Latvia, Lithuania and Cyprus and to 2016 for the remaining countries.

Results from interviews and other data sources

Budget preparation stage

The national fiscal rules and MFAC influence budget preparation, mainly through the processes of generating the budgetary forecasts and setting of the fiscal targets.

Malta is one of the few EA countries that requires, not only the endorsement of the macroeconomic forecasts, but also of the fiscal forecasts (EXT16 2016, pers. comm., 20 October). Reflecting this legal obligation, the Ministry of Finance asserted that: 'we cannot afford that our forecasts are not endorsed' (MFIN2 2016, pers. comm., 2 September) and another participant explained that the Ministry is open to the MFAC's feedback and in some instances, revised the forecasts following discussions with the council (MFIN3 2016, pers. comm, 6 September). Most participants agreed that the MFAC's assessments have resulted in a more prudent approach by the Ministry when generating both its macroeconomic as well as its fiscal forecasts: 'when you are being scrutinised, you are more cautious, ensure that the assumptions are realistic' (MFIN2, 2016, pers. comm., 2 September). But there was also a deliberate more cautious stance adopted by the new Labour government elected in 2013, emphasising the need that the 'projected rate of growth be both realistic and cautious' (Minister for Finance 2013, p.16). So far, the MFAC has endorsed all the macroeconomic and fiscal projections prepared by the Ministry of Finance, whilst outlining any relevant risk factors[11].

The influence of the MFAC is enhanced through interaction with other institutions, which produce their independent forecasts, namely the European Commission, the IMF during its Article IV missions as well as credit rating agencies. These take note of the reports published by the fiscal council and also hold meetings with it during their missions to Malta (MFAC4 2016, pers. comm., 7 September). At the same time, the MFAC also faces limitations in its influence, being a young and relatively small institution[12]. In particular, it does not generate its own forecasts, but only carries out a qualitative assessment (MFAC4 2016, pers. comm., 7 September; EXT7 2016, pers. comm., 26 September) and it also has low media visibility (MFAC6 2016, pers. comm., 20 September).

Moving on to budget negotiations, the interview participants confirmed the typical delegation scenario, with the spending ministries pushing for higher spending whilst the Ministry of Finance is concerned about fiscal discipline implications. Nonetheless, the SGP obligations, as also reflected in the national fiscal rules, constitute the main consideration for setting the budgetary targets. The Ministry of Finance then derives the total expenditure ceiling, from the revenue projections, conditional on the macroeconomic forecasts (MFIN1 2016, pers. comm., 25 August). This aggregate expenditure ceiling constitutes the basis for the bilateral budgetary negotiations between the Ministry of Finance and the line ministries. Importantly, the Ministry of Finance considers the fiscal rules as a form of 'external anchor' which strengthens its position vis-a-vis spending ministries (MFIN1 2016, pers. comm., 25 August).

The MFAC assesses whether the budgetary targets set by the government are compliant with the fiscal rules, but here the MFAC only has an advisory role (FRA, Article 13(6))[13]. Indeed, there is no

11 The MFAC's reports can be accessed at: https://mfac.org.mt/publications/reports/.

12 The Council is composed of a Chairperson and two members. Its staff comprises five economists and an administrator (MFAC n.d.).

13 The only exception is in the case of a significant deviation from the adjustment path towards the MTO, where the government is obliged to submit a corrective plan to Parliament within two months, if it does not accept the assessment by the MFAC (FRA Article 13(7)). Such a situation has not occurred up to now (2024).

legal comply and explain requirement, as clearly pointed out by the Minister of Finance during the hearing of the MFAC in Parliament's Public Accounts Committee in 2016: 'the recommendations are made, but then it is up to the government to decide whether to implement them or not' (Parliament of Malta 2016, p.12).

Budget approval stage

Although there are no legal restrictions on Parliament's budget amendment powers, by convention, a vote on the budget, like all money bills, is considered as a vote of confidence in the government (PARL10 2016, pers. comm., 3 October; PARL12 2016, pers. comm., 13 October). Given these implications and the strong party cohesion in Malta's two-party political system, members of Parliament vote strictly along party lines, and the draft budget proposed by the executive is approved without any amendments[14]: 'what the government decides in the budget, it will pass through without any problems' (POL11 2016, pers. comm., 4 October).

Whilst this reflects the dominance of the executive during the budget approval process, other aspects of centralised decision-making are lacking. In contrast to most other EA countries, Malta does not have a parliamentary budget committee in place. Other committees have a different mandate: the Public Accounts Committee is an audit committee with an oversight (ex-post) function (Article 120E of the Standing Orders of the House of Representatives) and since its set-up in 2013, the Economic and Financial Affairs Committee has not shown interest in discussing budgetary matters (POL15 2016, pers. comm., 19 October). Furthermore, the voting procedure does not follow a top-down approach. Rather, the adoption of the budget law –the Appropriation Act– which sets maximum ceilings for aggregate expenditure from the Consolidated Fund and for each Ministry and vote item, is approved by Parliament at the same time (PARL9 2016, pers. comm., 3 October).

Moreover, there has hardly been any influence on the budget approval process from the rules-based institutional reforms. Even though Article 57 of the FRA provides for the possibility of hearings of the MFAC by Parliament's Public Accounts Committee, only two such meetings have been held (Meetings Nos. 96 and 101 of 28 June 2016 and 30 January 2017, respectively), with no subsequent developments.

Budget implementation phase

During budget implementation, the Ministry of Finance faces pressure for new and additional expenditure (MFIN1 2016, pers. comm., 25 August). The FRA introduced provisions which aim to facilitate monitoring of fiscal developments. In particular, the Ministry of Finance considers the half-yearly report as 'a good tool that would help us' by putting more pressure on Ministries that are over-spending (MFIN17 2016, pers. comm., 27 October).

Similarly to the budget negotiations stage, the fiscal rules also strengthen the position of the Finance Ministry during budget execution, and this is further enhanced by the MFAC's assessments

14 The only recent exception was when a member of Parliament from the government side voted against a budgetary motion related to the financial estimates for 2013 (Plenary sitting No. 536, 10 December 2012). The government lost its one-seat parliamentary majority and this led to early general elections in March 2013.

of compliance with the fiscal rules (FRA Article 13)[15]. Caught between the obligations of the fiscal rules on the one hand and pressure from spending ministries on the other hand, the Ministry of Finance relies on flexibility in budget execution to abide by its budgetary targets. In fact, whilst the Ministry generally sticks to the budget balance target, there are considerable revisions in individual components (MFIN1 2016, pers. comm, 25 August; EXT72016, pers. comm., 26 September). The budgetary legal framework provides considerable flexibility. The Appropriation Act involves a maximum ceiling for expenditure, rather than committed expenditure and thus the Ministry of Finance can cut, cancel, or postpone spending without requiring parliamentary approval (PARL10 2016, pers. comm., 3 October). Furthermore, Article 24 of the Financial Administration and Audit Act (Cap. 174) allows the Minister of Finance (or his delegate) to carry out virements between line items within votes. Articles 23 and 24 of the FRA reinforced such flexibility by requiring that new or additional expenditures made during the budget year are financed through re-allocation of expenditure either within or across Ministries.

At the same time, the executive also has considerable power to increase spending during budget implementation. Article 103 of the Constitution of Malta and Article 25 of the Financial Administration and Audit Act (Cap. 174) provide for Supplementary Estimates, which allow the Ministry of Finance to exceed the appropriations approved by Parliament, both at a Ministry vote level as well at an aggregate level. The provisions concerning the reasons for such additional expenditures are very broad and moreover, although the Supplementary Estimates are approved by Parliament, the procedure applied, taking place immediately after the long process of voting and approval of the budget for the following year, discourages any discussion (PARL10 2016, pers. comm., 3 October). The possibility of Supplementary Estimates not only facilitates expenditure slippages, but also weakens the binding nature of the fiscal targets (MFIN2 2016, pers. comm., 2 September). It is notable that the FRA did not bring any specific changes in this regard.

Conclusion

The analysis based on composite numerical indices, interviews with key stakeholders and documentary evidence shows that since EU membership, Malta's budget institutions were subject to extensive reforms.

Upon accession, Malta's budgetary framework involved, almost completely, a delegation approach, reflecting its political context and small public administration. Characteristics of the contracts approach were either non-existent (fiscal rules and IFIs) or weak (MTBF). Given the persistent budget deficits, EU institutions, and the IMF, put increasing pressure on Malta to reform both the contracts approach (strengthen its MTBF) as well as the delegation approach (budget execution discipline). Furthermore, the introduction of common EA rules-based requirements required the establishment of national fiscal rules and IFIs by all member states.

Malta complied with these obligations in 2014 through the enactment of the FRA, which introduced national fiscal budget balance and government debt rules, reflecting the SGP obligations, and provided for the set-up of the MFAC, which started operating in the subsequent year. Despite its initial hesitancy towards these contracts approach requirements, Malta's institutional reforms

15 Up to now, the MFAC has always assessed positively the government's fiscal policy vis-a-vis the fiscal rules and obligations of the SGP, whilst highlighting any risks surrounding the attainment of the fiscal targets. The MFAC's reports are available at: https://mfac.org.mt/publications/reports/.

went beyond the EU obligations. In particular, whilst it only has two fiscal rules in place, they have very strong features compared to the same type of rules in the other EA member states, whilst the MFAC's mandate requires the endorsement of both the macroeconomic as well as the budgetary forecasts. On the other hand, the MTBF compares slightly below the EA average, mainly due to its non-binding nature and limited involvement of national Parliament.

Besides these rules-based reform, the FRA also strengthened characteristics of the delegation approach, namely the power of the Finance Ministry during budget negotiations and implementation. Malta ranks slightly better than the EA average in budget negotiations, but its performance in budget implementation is weakened by considerable executive flexibility to increase spending during budget execution. Finally, delegation characteristics during the budget approval stage are very weak, mainly due to the lack of a top-down voting procedure and of a centralised parliamentary committee structure dealing with the budget.

The rules-based institutional reforms introduced by the FRA have mainly influenced the budget preparation and implementation stages. Whilst these remain characterised by a typical delegation scenario, the introduction of fiscal rules, by constituting an 'external anchor,' has strengthened the position of the Finance Ministry. The Ministry sets the budgetary targets so as to comply with the obligations of the fiscal rules. These determine the expenditure ceilings which constitute the basis for budget negotiations with spending ministries. Similarly, the fiscal rules put pressure on the Finance Ministry during budget execution to achieve the budgetary targets. The Finance Ministry generally sticks to the budget balance targets but uses considerable flexibility on the expenditure side of the budget.

Meanwhile, the main influence of the MFAC on the budgetary process is through its assessment of the macroeconomic and fiscal forecasts. Being a legal obligation, this is considered as critical by the Ministry of Finance and has contributed to a more prudent approach in the forecasting exercise. On the other hand, the MFAC's influence when assessing government's fiscal stance and compliance with the fiscal rules, is rather limited, reflecting its advisory role and being a young and small institution, with limited media visibility.

These findings show that, whilst considerable rules-based characteristics have been introduced in Malta's budgetary institutional framework, these have not replaced delegation characteristics. Rather, in contrast to their portrayal in the literature on budget institutions as alternative forms of fiscal governance, depending on a country's type of government, Malta's experience shows that they can be complementary. Indeed, the rules-based institutional reforms have strengthened the role of the Finance Ministry during budget negotiations and implementation.

Thus, the supra-nationally mandated rules-based requirements were adapted to Malta's specific country circumstances. This highlights the importance of context-dependent research. In this regard, case studies on the adaptation of budget institutions to the common EA rules-based requirements in other EA countries constitutes an area for further research.

Finally, in view of the new EU economic governance framework, which will be applied as of 2025, and its emphasis on medium-term expenditure targets, it is recommended that the authorities take this opportunity to introduce institutional reforms which strengthen the binding nature of its medium-term budgetary framework, as well as introduce further monitoring and control measures, typical of the delegation approach, during budget implementation so as to reduce the possibility of expenditure slippages.

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Appendix

Table I. The contracts approach index

Sub-indices	Variables	Weight		Data sources
Fiscal Rules		0.33		
	Legal base		0.2	European Commission fiscal rules database
	Binding character		0.2	
	Bodies monitoring compliance and the correction mechanism		0.2	
	Correction mechanisms in case of deviation from the rule		0.2	
	Resilience to shocks		0.2	
Medium-term budgetary framework		0.33		
	Coverage of the targets/ceilings included in the national medium-term fiscal plans		0.2	European Commission MTBF database
	Connectedness between the targets/ceilings included in the national medium-term fiscal plans and the annual budgets		0.2	
	Involvement of national Parliament in the preparation of the national medium-term fiscal plans		0.2	
	Involvement of independent fiscal institutions in the preparation of the national medium-term fiscal plans		0.2	
	Level of detail included in the national medium-term fiscal plans		0.2	
Scope of Independent Fiscal Institutions		0.33		
	Tasks - Monitoring compliance with fiscal rules - Macroeconomic forecasting - Budgetary forecasting and policy costing - Analysis of long-run sustainability of public finances - Promotion of fiscal transparency - Normative recommendations on fiscal policy		 0.30 0.25 0.20 0.10 0.05 0.10	European Commission fiscal institutions database
	Legal force coefficient - Tasks stipulated in legal remit of IFI - Own-initiative tasks with proven and regular output - Own-initiative tasks with sporadic output			

Source: Catania, Baimbridge and Litsios (2023)

Table II. The delegation approach index

Sub-indices	Variables	Weight		Data sources
Budget negotiations		0.33		
	Place where negotiations take place		0.33	Questionnaire to all EA countries
	Imposition of budget ceilings on the initial spending requests of each line ministry		0.33	OECD EA countries - OECD Budget Practices and Procedures Survey Questionnaire to non-OECD EA countries
	Final/ultimate decision-making power to resolve/ settle disputes during the budget negotiation process		0.33	
Budget approval		0.33		
	Formal powers of the legislature to amend the budget proposed by the executive		0.33	OECD EA countries - OECD Budget Practices and Procedures Survey Questionnaire to non-OECD EA countries
	Sequence of voting procedure		0.33	
	Type of committee structures for dealing with the budget		0.33	

Budget implementation		0.33		
Executive authority to cut/cancel/ rescind spending	Whether executive can cut/cancel/rescind spending once the budget has been approved by the legislature Whether executive has authority to cut/cancel/ rescind all types of spending Whether there are any thresholds that apply to the executive's authority to cut/cancel/rescind spending Whether approval is required for the executive to cut/cancel/rescind spending		0.25	OECD EA countries - OECD Budget Practices and Procedures Survey Questionnaire to non-OECD EA countries
Power of line ministries to re-allocate funds within their budget envelope	Whether line ministers can re-allocate funds within their own budget envelope Whether there are any thresholds that apply to line ministers' re-allocation of funds within their own budget envelope Whether approval is required for line ministers to re-allocate funds within their own budget envelope		0.25	
Restrictions on executive authority to increase spending	Whether executive can increase spending once the budget has been approved by the legislature Whether executive has authority to increase all types of spending Whether there are any thresholds that apply to the executive's authority to increase spending Whether approval is required for the executive to increase spending		0.25	
Supplementary budgets	Top reason(s) why the supplementary budget/s were necessary		0.25	

Source: Catania, Baimbridge and Litsios (2023)

Table III. Interview participants

Institution	Number of participants	Identifying code for interviews[1]
Ministry of Finance - Budget Office - Economic Policy Department - Permanent Secretary's Office	6	MFIN1, MFIN2, MFIN3, MFIN17[2] , MFIN19
Parliament officials - Office of the Speaker - Office of the Clerk of the House	6	PARL9, PARL10, PARL12[3], PARL22
Malta Fiscal Advisory Council	2	MFAC4, MFAC6
Central Bank of Malta[4] - Economics and Research Department	2	EXT5, EXT7, EXT13[5], EXT14, EXT16
European Commission - European Commission Representation in Malta - Directorate General for Economic and Financial Affairs	4	
Politicians - Two ex-members of Parliament - Two members of Parliament (in 2016) (two from the Labour Party, two from the Nationalist Party)	4	POL8, POL11, POL15, POL21
Total number of participants	24	

Notes:

[1] Participants are identified on the basis of their institution. The number in the code refers to the order in which participants (including ones that refused participation) were contacted.

[2] Joint interview with two participants.

[3] Joint interview with three participants.

[4] The participants from the Central Bank of Malta requested that their responses are not identified as originating from the Bank and hence were grouped with the participants from the European Commission, as external stakeholders.

[5] Joint interview with two participants.

Table IV. Thematic coding analysis of the interview data – main themes

Delegation approach	Contracts approach
Budget preparation stage	
Bilateral budget negotiations between finance ministry and spending ministries	Fiscal council's legal obligation to endorse macroeconomic and fiscal forecasts
Fiscal rules as 'external anchor' for finance ministry	Prudent forecasts Interaction between fiscal council and other institutions
	Young and relatively small institution with low media visibility
	Advisory role of fiscal council
	Fiscal rules and setting of budgetary targets
Budget approval stage	
Strong executive power in parliament	Weak interaction between fiscal council and parliament
No parliamentary budget committee	
Lack of centralisation in voting procedure	
Budget implementation stage	
Spending requests by line ministries	Fiscal rules and compliance with budgetary targets
Fiscal rules as 'external anchor' for finance ministry	Advisory role of fiscal council
Flexibility in budget execution	