

BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

MALTA'S GOVERNANCE FRAMEWORK: INSIGHTS FROM INTERNATIONAL GOVERNANCE INDICATORS

BOX 3: MALTA'S GOVERNANCE FRAMEWORK: INSIGHTS FROM INTERNATIONAL GOVERNANCE INDICATORS¹

Introduction

In recent years, Malta's governance framework has been the subject of much debate among both local and foreign stakeholders. This despite the difficulties encountered in properly measuring governance standards not least because quantitative data that could possibly shed light on governance quality is often absent. As a result, assessments are generally based on qualitative data gathered either through surveys or expert judgements.

These assessments are often brought together in indices such as those constructed by the World Bank as part of its Worldwide Governance Indicators (WGI) project. In turn, such indices often inspire evaluations of the quality of governance in a country. Since such indices do not usually comprise an exhaustive list of data sources and elements of governance, their construction may be complemented by other assessments made by credit rating agencies such as Moody's, which passes its judgement on the credit quality effect of sovereigns' environmental, social and governance (ESG) standards.

In the European Union, the European Commission regularly monitors governance standards in the respective countries and makes country-specific recommendations accordingly, with such recommendations often complementing others made by other institutions such as the Council of Europe. Credit rating agencies also use measures of governance when assigning credit ratings to sovereign debt. This further generates a need for policy makers to formulate policies that strengthen the country's governance framework, while at the same time optimising economic performance and growth opportunities.

This analysis uses the WGI and the ESG scores published by Moody's to shed light on Malta's governance framework.²

The Worldwide Governance Indicators

The WGI project assesses governance quality in a country based on six elements of governance, namely (1) voice and accountability; (2) political stability and absence of violence/terrorism; (3) government effectiveness; (4) regulatory quality; (5) rule of law; (6) control of corruption.

A country's performance in each indicator is assessed from data gathered by numerous sources comprising public sector organisations, non-governmental organisations (NGOs), commercial business information providers and surveys of households and firms. These predominantly capture the opinions of households, firms, analysts at multilateral organisations and other respondents with knowledge and experience of the country to be rated. Consequently, the

¹ Prepared by Nathaniel Debono, a Research Economist in the Modelling Office within the Economics and Research Division of the Central Bank of Malta. Helpful comments and suggestions by Governor Edward Scicluna, Deputy Governor Alexander Demarco, Aaron G. Grech and Brian Micallef are gratefully acknowledged. The views expressed in this paper are those of the author and do not necessarily reflect those of the Central Bank of Malta. Any errors are the author's own.

² Further details about the methodology and indicators are available in Debono, N. (2021), [Malta's governance framework: Insights from international governance indicators](#), Central Bank of Malta, *Policy Note*, August 2021.

scores of each indicator and, by extension, assessments of a country's governance framework are largely reliant on respondents' subjective assessments and perceptions.

Under the methodology applied in the WGI project, each country's performance in the respective governance indicators is ranked on a standard normal distribution, with a mean of zero, standard deviation of one and ranging between -2.50 (poor governance level) and +2.50 (best possible governance level). Based on these estimates, countries are further classified on a percentile rank.

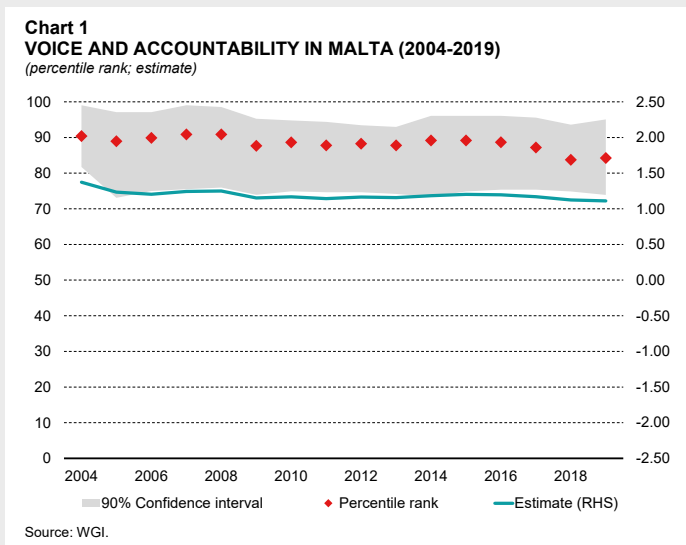
The highest levels of governance recorded in this set of indicators are generally observed in well-developed countries such as New Zealand, Singapore, Finland, Norway, and Sweden. On the other hand, less developed countries are judged to have among the poorest governance frameworks in the world, especially war-torn countries.

While the WGI provide useful information about a country's governance standards, sole reliance on aggregate scores as indicators of governance quality has some limitations. Apart from the fact that scores are largely based on subjective assessments by different sources, key information about the background to these scores and the underlying sources is often lacking. Moreover, some data sources do not provide any public justification for certain changes in scores between years. In addition, changes in a country's governance scores provided by a particular source may not necessarily reflect true changes in the country's governance quality but may be due to other methodological changes, such as changes to the criteria on which countries are assessed. In other instances, aggregate ratings may change because certain data sources are dropped as new ones are introduced or because of changes in the weighting procedure.

Voice and accountability

As defined by the World Bank, this indicator captures perceptions of the extent to which a country's citizens are able to participate in selecting their government as well as freedom of expression, freedom of association and a free media.

Chart 1 shows that in recent years, Malta has consistently ranked above the 80th percentile (before confidence intervals are considered) for its voice and accountability. Malta's score in this indicator is derived from information provided by six sources. Assessment of voice and accountability in Malta is currently based on a wide variety of factors including

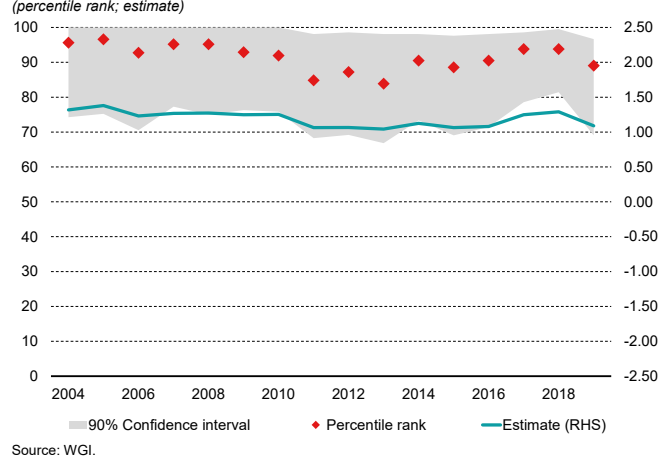


(but not limited to) the extent of political rights, civil liberties, the threat of military involvement in politics, press freedom and surveys about citizens' confidence in the honesty of elections.

Political stability and absence of violence/terrorism

This indicator captures perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism.

Chart 2
POLITICAL STABILITY AND ABSENCE OF VIOLENCE/TERRORISM IN MALTA (2004-2019)
(percentile rank; estimate)



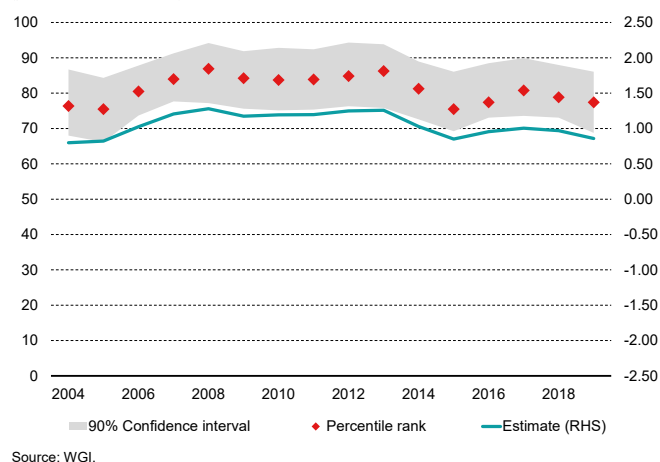
In terms of its political stability and absence of violence/terrorism in the country, Malta is among the best-performing countries in the world, ranking in around the 90th percentile on a consistent basis since at least 2004 (see Chart 2). This reflects the consistently high ratings awarded by the sources that provide the information used to shape assessments of political stability and absence of violence/terrorism in the country. Among others, the factors used to determine the extent of political stability and absence of violence/terrorism in Malta include the risks of protests or riots, terrorism and wars, prevalence of crime, risks of armed conflict, violent demonstrations and internal and external conflicts.

Government effectiveness

A country's government effectiveness is determined by the perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation and the credibility of the government's commitment to such policies.

In recent years up to 2019, perceptions of Malta's government effectiveness took a negative turn (see Chart 3). The country's score for this indicator is largely influenced by

Chart 3
GOVERNMENT EFFECTIVENESS IN MALTA (2004-2019)
(percentile rank; estimate)



assessments made by commercial business information providers, namely the Economist Intelligence Unit, IHS Markit World Economic Service, and Political Risk Services. Such assessments are largely based on views of institutional effectiveness and bureaucratic quality, while since 2014, the IHS Markit World Economic Service started considering the adequacy of a country's infrastructure, the risk that the State fails in its responsibilities and the risk of policy instability. Although scores reflecting Malta's performance in each separate measure are not publicly available, the organisation's perceptions of Malta's government effectiveness took a negative turn when the change in assessment criteria came into effect in 2014.

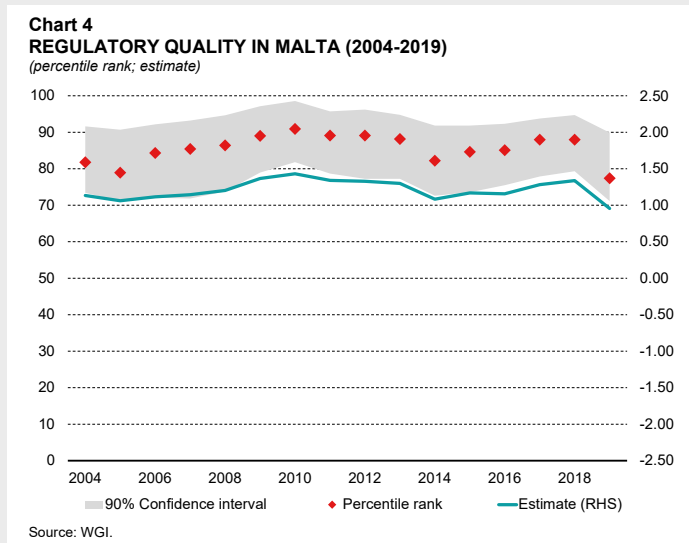
On the other hand, surveys carried out among Maltese households and firms show a more positive outlook. Although road infrastructure in Malta is still deemed to be quite poor, firms surveyed in the World Economic Forum Global Competitiveness Survey have relatively positive views of the country's air transport and seaport efficiency. In fact, Malta ranked 22nd and 27th among 141 countries in these two measures, respectively, in 2019. Moreover, surveys performed by Gallup to capture local households' views of the quality of Malta's education system, roads and highways, and the public transportation system also show increasingly positive perceptions among Maltese households.

Regulatory quality

This indicator captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

Malta's regulatory quality has been deemed to be relatively strong in recent years, but the country's score in this indicator dropped sharply in 2019 (see Chart 4). This drop can be traced to poorer assessments of Malta's investment profile made by staff at the Political Risk Services Group. A country's investment profile is shaped by an assessment of three factors that may impact investment in a country, namely the risks of contract viability or expropriation, profits repatriation and payment delays. No explanation of the decline in Malta's score in 2019 is made available as the group's assessments of Malta's performance in each criterion are only available commercially.

With few exceptions of sources carrying minimal weighting, assessments of Malta's regulatory quality made by the other five sources have consistently been relatively positive in recent years. Among others, the assessed factors include



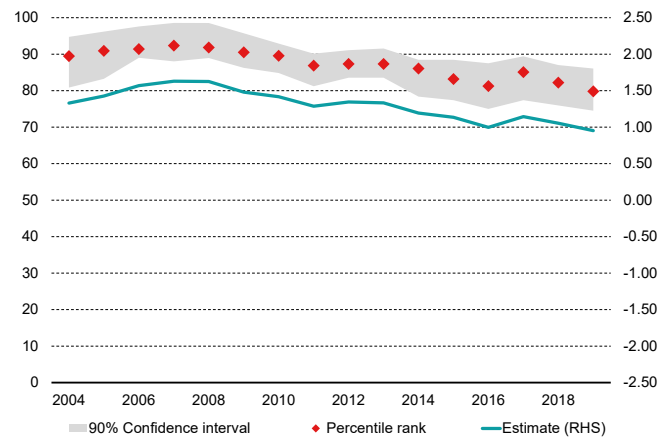
the presence of any unfair competitive practices, the efficiency of tax collection systems, quality of business legislation and burden of government regulation.

Rule of law

Assessments of rule of law are based on perceptions of the extent to which agents have confidence in and abide by the rules of society and in particular, the quality of contract enforcement,

property rights, the police, and the courts as well as the likelihood of crime and violence.

Chart 5
RULE OF LAW IN MALTA (2004-2019)
(percentile rank; estimate)



Source: WGI.

As evidenced in Chart 5, perceptions of Malta’s rule of law have worsened up to 2019. The strength of Malta’s rule of law is based on numerous factors, ranging from public confidence in the police force and the judicial system, to assessments of risks of expropriation, the fairness, speediness and independence of the judicial process, the extent to which property rights are protected and the extent to which crime is a problem for government and businesses. The WGI also consult the ‘Trafficking in Persons Report’ issued by the US State Department, considering sex trafficking and labour trafficking. In this report, Malta is perceived as a country which, while “not fully meet(ing) the minimum standards for the elimination of trafficking fully, it is making significant efforts to do so”.³

Overall, perceptions of commercial business information providers have almost consistently worsened during the past few years up to 2019. On the other hand, a Gallup survey among households shows different trends. The questions considered relate to households’ confidence in the country’s police force and the judicial system and their sense of security in the country, captured through a question asking whether the respondent had ever been assaulted or mugged or whether they had ever fallen victims of stolen money property. Although disaggregated scores are only made commercially available, the citizens’ overall views of these factors seem to have improved considerably over time.

Control of corruption

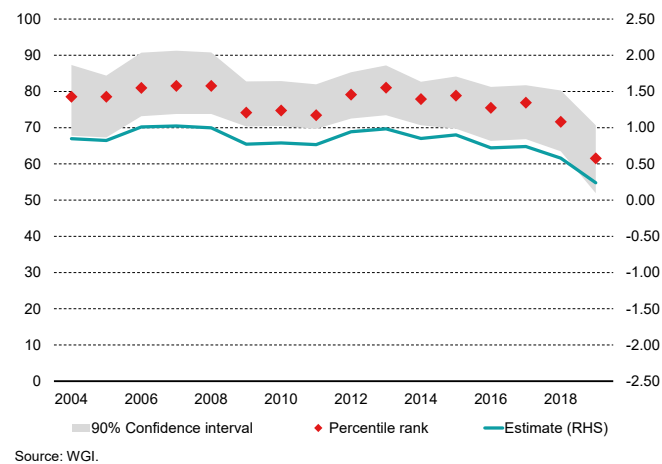
Control of corruption in a country is determined by perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests.

³ U.S. Department of State, ‘2019 Trafficking in Persons Report: Malta’.

Judging by the information available in the WGI, the control of corruption in Malta appears to be the weakest element of the country's governance framework (see Chart 6). Moreover, scores have followed a downward trend up to 2019, reflecting increasingly negative perceptions of Malta's control of corruption. Corruption, as measured by the six data sources providing information about the situation in Malta

includes both financial corruption such as bribery or undocumented extra payments, and corruption in the form of excessive patronage, nepotism, favour-for-favours and close ties between politics and business.

Chart 6
CONTROL OF CORRUPTION IN MALTA (2004-2019)
(percentile rank, estimate)



Moody's environmental, social and governance standards

The credit rating agency Moody's issues another set of scores, reflecting its assessments of sovereigns' ESG standards and how these affect a country's credit quality. Moody's consults country information from public sources and provides its expert judgement to assess the extent to which countries are exposed to ESG risks.

A sovereign's environmental risk is based on assessments of a country's physical climate, water management, waste and pollution, carbon transition and natural capital. Assessments of social risks are based on consideration of risks associated with demographics, labour and income inequalities, access to quality education, housing, health and safety concerns and access to basic services. Moody's assessment of a sovereign's governance risk is based on four aspects, namely institutional structure, policy credibility and effectiveness, transparency and disclosure, and budget management. Based on these respective assessments, countries are awarded an overall credit impact score (CIS), reflecting the impact of ESG factors on credit quality.

Overall, Malta's ESG risks are deemed to have a 'moderately negative' impact on Malta's credit quality. The country's CIS score is largely driven by assessments of 'moderately negative' exposure to environmental and social risks. On the other hand, Malta is considered to be a country that actually benefits from having a strong governance framework. However, the overall impact of ESG factors on credit quality for Malta seems to be mostly affected by the 'moderately negative' exposure to environmental and social risks.

Exposure to environmental risks

Moody's assessment of a 'moderately negative' exposure to environmental risks are largely driven by the agency's assessment that Malta suffers 'moderately negative' risks associated with its physical climate and water management. On the other hand, the country's susceptibility to risks associated with carbon transition, depletion of natural capital, and waste and pollution is deemed to be 'neutral-to-low'.

Exposure to social risks

Malta is judged to have 'highly negative' risks associated with its demographics, possibly due to the country's ageing population, persistence of gender inequalities and rapid immigration, all of which are viewed by Moody's as potential leads to social risks. Furthermore, Malta is considered to be suffering 'moderately negative' risks associated with labour and income inequalities, whereas risks related to education, housing, health and safety, and access to basic services in Malta are assessed to be 'neutral-to-low'. Overall, Malta's exposure to social risks is assessed to be 'moderately negative'.

Exposure to governance risks

Overall, Malta is judged to have very strong governance standards. The country's overall score is largely due to 'positive' perceptions of Malta's budget management, transparency and disclosure, and policy credibility and effectiveness. The quality of the country's institutions are deemed to pose a 'neutral-to-low' risk but they seem to have had no impact on the overall perceptions of the extent of governance risks facing Malta.

Conclusion

Despite the emphasis being placed on governance in recent years, difficulties persist in uniformly defining and measuring countries' governance standards. This study attempted to shed some light on the Maltese governance framework using two sources of data: the WGI and the ESG standards issued by the credit rating agency Moody's.

Among the WGI, 'political stability and absence of violence/terrorism' and 'voice and accountability' appear to be Malta's best elements of governance. Perceptions of 'government effectiveness', 'regulatory quality', 'rule of law', and 'control of corruption' in Malta have become less favourable in recent years up to 2019, with the latter standing out as the weakest element in the country's governance framework. Delving into the data sources behind Malta's score in the respective indicators, it appears that for the most part, the decline in many indicators results from changes in assessments made by a small number of commercial and non-governmental organisations whereas surveys among local households do not tend to show similar trends. As also pointed out by the producers of these indicators, this highlights the need to supplement these indices with other country-specific information in the designation of policies aimed at improving governance standards.

One such other source of information is provided by Moody's who assess Malta's ESG risks to have an overall 'moderately negative' impact on the country's credit quality. This overall score is largely driven by the agency's assessment of a 'moderately negative' exposure to environmental and social risks. Although Malta's quality of institutions is judged

to pose a 'neutral-to-low' risk for the country, Malta is considered to benefit from having a strong governance framework, predominantly thanks to its budget management, transparency and disclosure, and policy credibility and effectiveness.

The lack of quantitative data means that the quality of governance as assessed by these sources is often based on qualitative data gathered either through surveys or expert assessments. This makes the determination of the quality of governance in a country largely dependent on subjective assessments, which may not always be accurate. While this represents a potential caveat, these sources of information are particularly useful in light of the increasing pressure on countries to have robust standards of governance.