COMMENTS ON SESSION 3
NEW DEVELOPMENTS: INDEPENDENT AUTHORITIES AND EXPENDITURE RULES

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It is a pleasure for me and my colleagues at Bank of Albania to be able to share our thoughts on two of the papers presented in today's session.

I will first discuss the comprehensive analysis presented by Kopits regarding the idea of reconciliation of fiscal discipline with fiscal sovereignty, both very important topics in a time where fiscal management is very uncertain after the financial crisis.

It is imperative for us economists that to be able to draft adequate policies we must know what are the implications of past events, and knowledge and insights of those interactions ought to be useful for future orientation of our work. Kopits points out early on that loss of fiscal sovereignty usually happens in dire financial times and that, in good times, myopia and short term orientation account for bad policy. To this point, a very revealing question is: can this kind of myopia be a very common rationality failure of the agents? Odds are it will and we believe so as well, but will leave this question opened.

Further on, Kopits mentions that the financial crisis put considerable weight on sovereign bond markets and that expectations of a credible fiscal policy ought to be appropriately anchored. We appreciate this point very much and take the liberty to share with you some of the recommendations that our Governor has made regarding the main criteria that must be satisfied to have a credible working external anchor.

First, a credible fiscal anchor ought to provide motivation to follow sound economic policies in the long run, as well as to fit the final goal of the anchor keeping institution. We believe these are foundational features of the anchor as they provide a back bone to the whole concept.

Second, the anchor must gain validity and urgency by being closely related to some credible threat. If we can envision the peril, we can work to prevent; but otherwise, it is very likely that we will have to cope, and at a very high cost. This relates directly with the preventive and corrective arms of the SGP.

To that same point, anchors should not be put up for negotiations, and governments and central banks should only coordinate the structural benchmarks and policies that condition them. But to keep this process transparent, progress must be really and clearly measured with credible accuracy, which will enable authorities to announce small wins along the way and thus gain validation for future courses of action.

The fifth attribute is goodness of fit of the anchor with the real economy, which is a straight forward criterion, and which relates directly to the point made by Kopits on the need to have home-grown rules for fiscal management. Here we would like to raise a basic but important question: what could have saved the fiscal council in Hungary?

Next, let's go back to the arguments regarding fiscal sovereignty of nations. It is our idea that international fiscal interdependence is unavoidable as long as countries and creditors seek diverse sources of credit for diverse funding challenges. This process has been of a cross-border nature for years and it is only natural to have been so, because there exist different developmental stages of financial intermediation between countries, and Kopits makes sure to mention plenty of examples in his analysis.

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More to this point is the idea of sustainability of fiscal incontinence, which is deliberately stated as an oxymoron, since there can be no sustainable incontinence. However, it seems that nations continue to leave beyond their means, all the while trying to manage fiscal policy with the secondary goal of decreasing borrowing costs so that they can borrow more, and not actually focus on minimizing *the need* to borrow altogether. It seems to us that such an objective would be much more relevant for fiscal rules, and we discussed yesterday the importance of efficiency in public funds management, which we know too well that central governments are not the standard at that. This is not the case, however, for capital investments funding, which given their inter-generational dispersion of benefits, ought to be financed by long term debt.

Next, fiscal sovereignty and international institutions is a topic that hits home, and our idea is that there are still chances to strike a healthy equilibrium between loss of fiscal sovereignty and gain of fiscal guidance in light of emerging, judged, and inexperienced countries. Fiscal guidance for a developing country like Albania, for example, is necessary to build up credibility and creditworthiness because historical inexperience and creditor prejudice put transitory economies at a disadvantage for cross border funding, as was the case for Albania's risk premium on the first Eurobond issue in 2010.

Lastly, we would like to recommend some further steps to complement Kopits measures, in the context of what is said so far and from the viewpoint of our economy.

For countries that aim at a future political and economic integration, it is in their best interest to look out for each other sooner, rather than later, by creating an incentive system for fiscal discipline. We propose to do this by mutual, interest-bearing, debt underwriting, as well as by mutually guaranteeing bond issues. This way we avoid the free rider problem, all the while having given momentum to a cooperative fiscal management process. This is also the case for spreading risk to a much bigger pool, thus decreasing risk per capita, and at the same time increasing the need to behave responsibly under the continuous control of the mutual underwriter. Here we are talking about a kind of checks-and-balance system in fiscal management. The same idea may be applicable between national and sub-national governments acting as mutual underwriters, while not sacrificing political independence between them.

With that said, we move the discussion to the second paper, that of the deviation of *ex post* and first release outcomes, which is a study motivated by the type and timing of information given by first release data as the basis for drafting future budgets, and making decisions about policy.

The paper found that first-release outcomes are overly-optimistic, caused by over-optimism in revenues, and a large amount of this was due to the revision of the previous period's balance in light of new information. Economic factors turned out to have limited role, and political factors no role at all, which is a bit counter intuitive.

To that point, the paper mentions the importance of institutional arrangements, which obviously we concur absolutely. Tighter fiscal rules and higher transparency reduce the degree of optimism at the first release stage. But to this point we have to add that the implementation and enforcement of those rules is vital, and Kopits made a point of this yesterday as well. We can have rules all we want, but no fiscal discipline is achieved until the enforcement system is in place, and political will is important; that is why we also think that externally imposed fiscal rules applied to the measured first-release balances act as good political incentives.

Overall, the paper is revealing of what we have always debated in terms of fiscal data and this debate is much alive in Albania now days. We have discussed these issues from the viewpoint of the credibility lost of the institutions that publish the data, in addition to the problems they create with the empirical analysis. However, we would have liked to have seen further description on the policy implications of the conclusions derived in this analysis, which might be beneficial to include briefly in the final version.

But, other than that, we can't add any more remarks to the analysis presented.