

**Budget Institutions and Fiscal Responsibility:  
Parliaments and the Political Economy of the Budget Process in Latin  
America**

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## **Foreword**

As part of its Governance program, the Poverty Reduction and Economic Reform Division of the World Bank Institute (WBIPR) has sought to strengthen parliamentary oversight – especially in relation to the development and execution of the budget.

One of the key questions that this Paper seeks to answer is “Can parliaments make an effective contribution to the budget process while preserving fiscal discipline?” Reforming budget institutions represents a critical task for developing economies seeking to strengthen transparency and curb corruption in the management of public finances. Political institutions and institutional arrangements have a decisive influence on economic performance and fiscal responsibility. Parliaments’ role in the governance of the budget is nevertheless subdued and often dysfunctional, partly as a result of executive predominance, but also because of legislatures’ own deficiencies. Parliaments do possess a wide range of budgetary powers, but often fail to exercise them effectively or responsibly. Legislative oversight of the budget remains inhibited by technical and institutional constraints, both internal and external to legislative organisation. Largely neglected in the first stage of economic reform, legislative budget institutions are now being re-discovered as part of a second wave of reform in governmental financial administration.

The paper explores the contribution of parliaments to the budget process in presidential systems of government with highly centralised budgetary systems. It offers a political economy perspective on the budget process in Latin America and reveals increased legislative budget activism since the restoration of democracy. It assesses the constraints to and conditions for enhancing the role of parliaments in public budgeting in a framework of fiscal responsibility. It underscores the risks of excessive executive discretion, when executive prerogatives are not adequately balanced by mechanisms of internal restraint and external scrutiny. It argues that a more purposeful contribution of parliaments to the oversight of the budget might help countries seeking greater accountability in the management of public finances. Ultimately, the governance of the budget reflects a delicate balance between executive power and legislative oversight. The key challenge of legislative budgeting in Latin American is how to retain the advantages of strong executive authority required to ensure fiscal discipline while providing the institutional checks and balances that guarantee effective accountability.

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## 1 Introduction: Improving governance and fostering accountability

‘Pour qu'on ne puisse abuser du pouvoir, il faut que, par la disposition des choses, le pouvoir arrête le pouvoir.’ Montesquieu, *L'Esprit des Loix* (1748.)

‘We might hope to see the finances of the Union as clear and intelligible as a merchant’s book, so that every member of Congress, and every man of any mind in the Union, should be able to comprehend them, to investigate abuses, and consequently to control them.’ US President Thomas Jefferson writing to his Secretary of the Treasury in 1802, cited in Walker 2004:10.

Can parliaments make an effective contribution to the budget process while preserving fiscal discipline? There is renewed interest in the contribution of parliaments to the governance of the budget and the oversight of public finances, prompted, in part, by calls for greater transparency and accountability in governmental financial management. In the late 1990s, the Asian financial crisis highlighted the risks of opaque and unaccountable management of public finances. The realisation that, when left unchecked, excessive executive discretion in public budgeting tends to create opportunities for corruption is encouraging policymakers to reconsider the contribution of parliaments to the system of checks and balances in fiscal policy.

Concerns for greater transparency and accountability must nevertheless reinforce efforts at promoting budget responsibility and anchoring fiscal discipline. Parliaments do possess a wide range of budgetary powers, but often fail to exercise them effectively or responsibly. In most emerging economies, they tend to lack both the technical capacities and the political incentives to assume a responsible role in public finances (Alesina and Perotti 1995, 1996; Alesina 1999; Stein 1998). The legacy of parliamentary indiscipline and irresponsibility in budgetary matters has convinced policymakers, including legislators themselves, that the centralisation of the budgetary systems within the executive tends to improve economic governance. It is thus feared that a greater role for parliaments in the budget process may endanger attempts at anchoring fiscal discipline.

There exists considerable controversy as to the proper role of parliaments in the budget process. The debate is marked by pendulum logic, oscillating between concerns over how much budgetary power is too much and how much is too much (Schick 2002). The consensual view holds that fiscal discipline and budget responsibility are best achieved and preserved by centralising the budget authority in the executive and, within it, under the tight steering of the finance ministry. Centralisation can be attained either *de jure* by reforming the organic laws governing governmental financial administration, or *de facto* by delegating legislative budget powers to the executive. Economic reformers have come to appreciate the benefits in terms of fiscal responsibility of centralised budgetary systems. Indeed, in the past few decades, economic reform processes have adopted insular strategies isolating key institutions of economic governance from undue political influence, such as central banks, tax agencies and finance ministries (Santiso 2004a, 2003, 2001). The adoption of fiscal rules and hard budget constraints in several countries recent years are partly aimed at reducing further margins for discretion and bargaining.

Against this backdrop, the purpose of this paper is to underscore the benefits that can be derived from a more balanced relationship between the executive and the legislature in budgetary matters. A more effective and responsible contribution of parliaments to the oversight of the budget might help strengthen transparency and accountability in the management of public finance. In democratic systems of government, parliaments perform key accountability functions embedded in their representative, legislative and oversight responsibilities. A more efficacious role of parliaments in the budget process reinforces public scrutiny and open debate on the objectives and performance of government in the management of public funds and, therefore, helps create the conditions for greater government accountability. However, parliaments’ role in public budgeting

is largely subdued and often dysfunctional, partly as a result of executive predominance, but also because of their own deficiencies. Their effectiveness remains inhibited by capacity constraints and structural factors, both internal and external to legislative organisation. *In fine*, institutional arrangements and political economy considerations largely explain why parliaments have not exploited the full scope of their budgetary powers in a purposeful manner.

More fundamentally, the key challenge of the governance of the budget in emerging economies is how to retain the advantages of strong executive authority required to ensure fiscal discipline while providing the institutional checks and balances that guarantee effective accountability. Finding the most adequate balance between executive prerogatives and legislative influence in the budget process represents an intricate dilemma for consolidating democracies seeking to strengthen political accountability while enhancing fiscal responsibility (Wehner 2004, 2001). Strengthening legislative budget oversight is particularly critical in regimes characterised by presidential systems of government and centralised budgetary systems where the distribution of budgetary powers overwhelmingly favours the executive. In this context, the case of Latin America is symptomatic of the challenges of legislative budgeting in political systems characterised by executive discretion and weak accountability. A re-equilibration of budgetary powers is required for achieving more balanced budgetary systems, where government discretion and legislative oversight complement each other to ensure both fiscal discipline and political accountability. This re-equilibration of budgetary powers, in turn, requires parliaments to assume a more effective and responsible role in public budgeting.

Nevertheless, what explains the effectiveness of legislative budgetary institutions in emerging economies remains largely under-investigated. There continues to be great controversy as to what the most appropriate role of parliaments ought to be in public budgeting. The prevailing economic orthodoxy warns against the dysfunctional fiscal effects of unrestrained legislative budgetary powers and, consequently, favours the insulation of economic policymaking in the executive. At the same time, recent experience also demonstrates the risks to public budgeting of excessive executive discretion, when the latter is not adequately balanced with effective mechanisms of internal restraint and external accountability. Ultimately, the governance of the budget reflects a delicate balance between executive and legislative prerogatives in public budgeting. Achieving and maintaining such a balance is a challenging task. It requires understanding the political economy of executive-legislative relations in the different phases of the budget process, as well as the institutional arrangements shaping those interactions.

While the impact of legislative oversight on budgetary outcomes and fiscal discipline is still hard to decipher, the paper reveals increased legislative activism in public budgeting in recent years. However, the contribution of Latin American parliaments to budget policymaking remains inhibited by structural factors related both to the internal organisation of parliamentary work and, external to it, linked to the broader governance context of executive-legislative relations. The political economy of legislative budgeting underscores that political incentives are potent determinants of its effectiveness. The broader governance incentives shaping budgetary performance include, in particular, electoral rules, party systems, parliamentary structures, and the distribution of budgetary power. Adequately understanding the governance of the budget requires identifying the actors involved in the making of budgetary decisions, gauging their interests and incentives and deciphering the formal and informal institutions that shape their interaction.

The paper argues that parliaments have a critical role to play to bridge the accountability gap in public finance management. Legislatures participate in the governance of the budget by approving budget allocations, overseeing budget execution and controlling budget performance. Nevertheless, the balance of budgetary power between the executive and the legislative is not uniform and varies along the different phases of the budgetary process. While increasing attention

is being paid to the role of parliaments in the adoption of the budget, using game-theory models, less attention has been paid to their responsibility in the oversight of the budget.

Henceforth, this paper posits that sound public finance management requires finding an adequate balance between executive and legislative prerogatives along the different phases of the budget cycle. It is argued that parliaments should significantly enhance their role in the *oversight* of budget execution and the *control* of budget performance. While, to ensure fiscal discipline, governments should continue to dominate in the *drafting* and *execution* of the budget, parliaments should more systematically *oversee* and *scrutinise* governments to enforce political accountability. This, in turns, requires parliaments to do a better job at holding governments to account for its fiscal performance. While executive dominance is more likely to ensure fiscal prudence, legislative oversight is critical to provide effective checks and balances and enforce accountability. This institutional solution may help obtaining the benefits of legislative scrutiny of the budget without endangering the prospects for fiscal discipline. It requires, in turn, enhancing significantly parliaments' *technical capacities* for independent budget analysis and legislators' *political incentives* for using them effectively and responsibly.

The evaluation of the role of parliaments in budgeting must nevertheless be put in the broader context of parliaments that are institutionally weak and largely unconsolidated, not only in budgetary matters. Furthermore, parliaments are part of *broader systems of fiscal control* and, therefore, their effectiveness is partly contingent on their ability to forge efficient links with the other institutions part of these systems. The interactions and synergies between the institutions of oversight and accountability are as important as the effectiveness of any single one of them taken in isolation. As Thomas Carothers underscores '[...] treating legislatures as self-contained entities that can be fixed by repairing internal mechanisms is unlikely to get very far' (1999:188).

This paper thus offers an analytical framework to assess the effectiveness of parliaments' role in the budget process and suggests ways in which their contribution could be improved. While focusing on the case of Latin America, its findings are of relevance to other emerging economies characterised by presidential systems of government and centralised budgetary systems. It is structured in four main sections. The first section seeks to better understand the governance of the budget and the delicate balance between fiscal responsibility and political accountability. It reviews the debate on budget institutions and fiscal discipline and underscores both the advantages and risks of centralised budgetary systems. The second section analyses the scope of legislative budget authority in Latin America, evaluating the main features of the legal framework. The third section discusses the internal and external constraints to effective budget oversight, focusing on legislative organisation, technical capacities and political incentives. The fourth and concluding section discussed critical tensions and suggests areas for further research on the politics of public budgeting.

## 2 Budgetary institutions and government accountability

### 2.1 Parliaments as institutions of fiscal governance

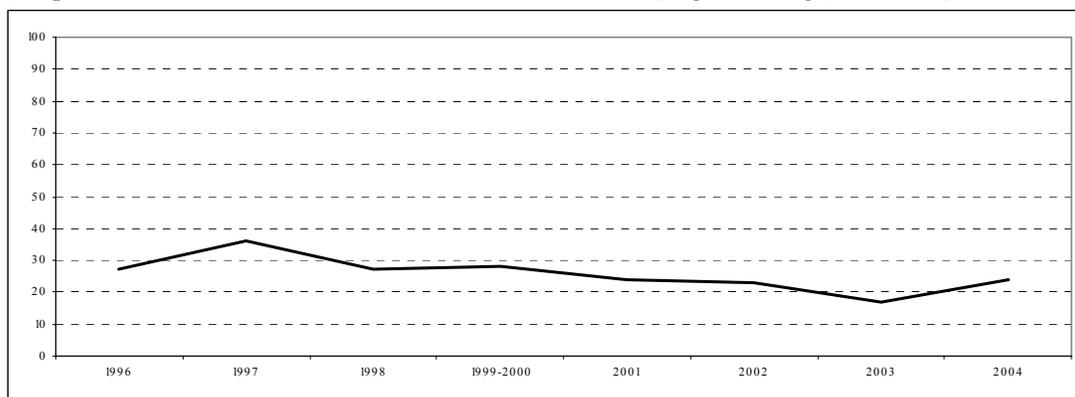
Reforming budgetary institutions is a critical task for emerging economies seeking to strengthen economic governance, enhance government accountability and curb corruption. Recent findings on the political economy of public finance underscore that political institutions and institutional arrangements have a decisive influence on fiscal performance. In their seminal study on *Budget Deficits and Budget Institutions*, Alberto Alesina and Roberto Perotti (1996:i) demonstrate that ‘budget procedures and budget institutions do influence budget outcomes.’ Parliaments play a key role in the governance of the budget process; yet, inquiry into the determinants of their effectiveness remains under-developed, especially in emerging economies.

#### Public budgeting beyond the executive

While our knowledge of the dynamics of public budgeting *within* the executive has considerably improved in recent years, the interaction of budgetary institutions *beyond* the executive has been the subject of little systematic scrutiny. It is increasingly recognised that enforcing the rule of law in the management of public finances requires reinforcing those institutions tasked with overseeing government, in particular in presidential systems of government. In most Latin American countries, the executive dominates the budgetary process and legislatures have largely been perceived as mere ‘rubber-stamps.’

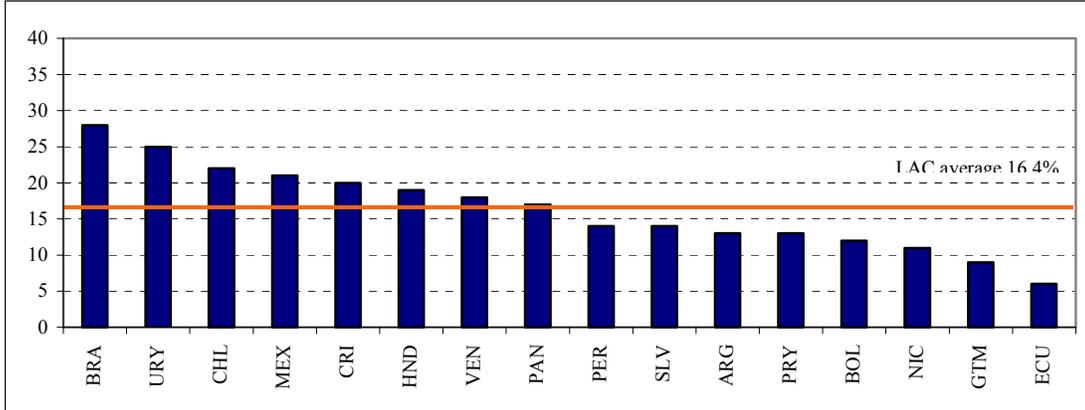
Latin American parliaments are typically characterised by operational, administrative, and resource problems that limit the fulfilment of their legislative, representative, and oversight responsibilities. These structural weaknesses impact their ability to effectively engage with the budget process. Capacity constraints are compounded by political dysfunctions, which severely affect the public credibility of many parliaments in the region. The degree of satisfaction with the functioning of democratic institutions and the performance of national parliaments is dangerously low, scoring better only to trust in political parties, as shown in Graphs 1 and 2.

**Graph 1: Trust in Parliaments in Latin America Over Time (Region average, 1996-2000)**



Source: Latinobarómetro 2004.

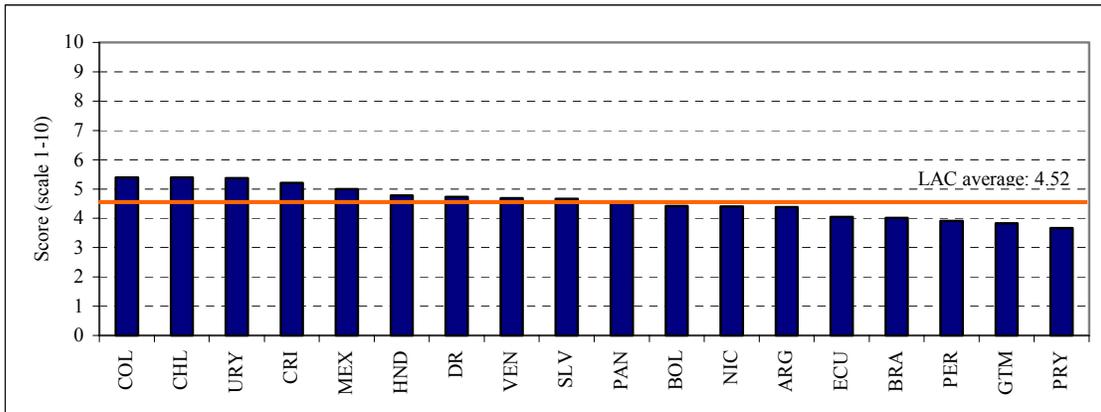
**Graph 2: Trust in Parliaments in Latin America Across Countries (2003)**



Source: Latinobarómetro 2004.

Furthermore, the widespread perception of poor performance of parliaments in further compounded by the weakness of the rule of law, reflected in the low expectation that laws enacted by parliaments, including the budget, will actually be adhered to. Graph 3 illustrates citizen trust in the ability of the state to enforce laws.

**Graph 3: Trust in the Rule of Law in Latin America (2004)**



Source: Latinobarómetro 2004.

### Legislative oversight of fiscal policy

There is heightened awareness of the weaknesses of the mechanisms of government oversight and accountability in presidential systems and the consequent need to enhance the institutions of ‘horizontal accountability’ (O’Donnell 1994, 1998, 1999; Mainwaring and Welna 2003).<sup>1</sup> Indeed, a central thrust of current efforts at reforming the state focuses on the building of robust institutional checks and balances within the state, so that the state can restrain itself (Schedler

<sup>1</sup> ‘Horizontal accountability’ is hereby defined as: ‘The existence of state agencies that are legally enabled and empowered, and factually willing and able, to take actions that span from routine oversight to criminal sanctions or impeachment in relation to actions or omissions by other agents or agencies of the state that may be qualified as unlawful’ (O’Donnell 1999:38; Mainwaring and Welna 2003).

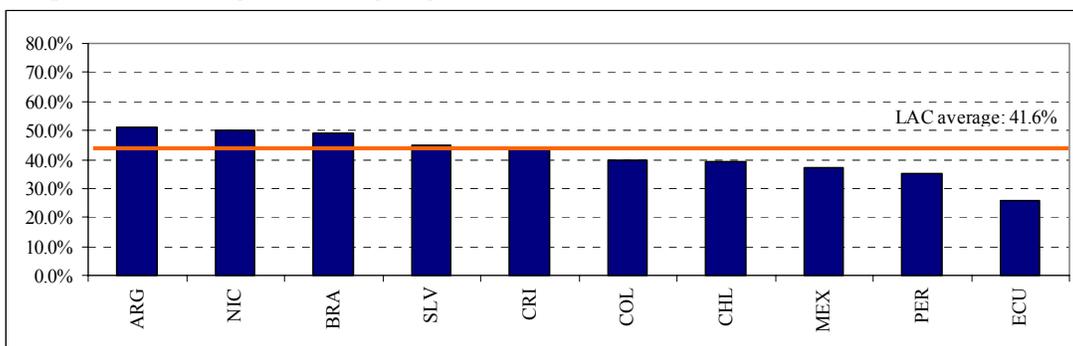
1999). Consequently, the role of parliaments and the contribution of auxiliary institutions such as general audit offices or ombudsman offices to public budgeting are being re-evaluated.<sup>2</sup> Legislative oversight of the budget by critical legislatures and external auditing of public accounts by credible general audit offices constitute key mechanisms of financial accountability.

Parliaments help strengthen government accountability by approving budget allocations, overseeing budget execution and controlling budget performance. The contribution of parliaments in public budgeting can best be assessed along the four main phases of the budget cycle: its formulation, adoption, execution and control. It does not occur only *ex ante* in the formulation and adoption stages, through the scrutiny of the executive's proposal, the discussion of proposed amendments and the adoption of the budget law. It also occurs *concurrently* during the execution stage, as well as *ex post* in the control and auditing stages.

However, analyses of legislative budgeting tend to restrict themselves to the role of parliaments in the initial phases of the budget, often in the framework of game-theory models, focusing on the legislatures' budgetary powers, their amendment prerogatives, the location of the reversion point,<sup>3</sup> or the presidents' agenda setting and veto powers (Saporiti and Streb 2003). Nevertheless, the oversight functions of parliaments during and after the execution of the budget are as important as their contribution to the definition of budget priorities and its authorisation to raise revenue and manage public expenditure.

Paradoxically, while the role of parliaments to the formulation and adoption of the budget is often severely restricted, people think it is essentially adequate, probably reflecting a general distrust in the ability of parliaments to act responsibly. A recent survey of perceptions on the contribution of parliaments to public budgeting reveals that Latin Americans consider the budget powers of parliaments to be adequate, that they have enough time to review the executive's budget proposal and that there is sufficient debate between the executive and the legislature over budget appropriations (Lavielle 2003:14-16). This general perception is captured in the Index of Legislative Budgeting reproduced in Graph 4.

**Graph 4: Index of Legislative Budgeting in Latin America (2003)**



Source: Lavielle et al 2003:15. This perceptions index is made up of three components: (i) a measure of legislative powers to amend the executive's budget proposal; (ii) the time allowed for legislative budget review and (iii) the intensity of legislative debate. It is a sub-index of the Latin America Index of Budget Transparency based on a survey of fiscal transparency practices and procedures.

Enhancing legislative scrutiny of the budget is considered a means to strengthen government accountability and promote greater transparency in the management of public finances (OECD

<sup>2</sup> See, in particular: Santiso forthcoming, 2004c; Stapenhurst 2004a; Schick 2002, 1998; Wehner 2003; OECD 2001b; Manning and Stapenhurst 2002; Krafchik and Wehner 1998; Petrei 1998.

<sup>3</sup> The reversion point refers to the levels of spending and revenues that would occur in the absence of an agreement over the budget, in other words it describes what happens if parliament does not approve the budget on time.

1998, 2001, 2002; IMF 1999; G8 2003). Effective and responsible parliaments can help mitigate the risks of excessive executive budgetary discretion by reinforcing the countervailing mechanisms of government accountability and legislative scrutiny. Recent research on political budget cycles by Alejandro Saporiti and Jorge Streb (2003:3) demonstrates that ‘effective checks and balances in the budgetary process curb political budget cycles. Institutional features of the executive-legislature bargaining game, namely, the actual agenda-setting authority, the status quo location and the degree of legislative oversight and control of the implementation of the budgetary law, play critical roles for the existence and magnitude of electoral cycles in fiscal policy.’

### **Legislative budget institutions and second-generation reforms**

Legislative budget institutions have been neglected in the first stage of economic reform and financial administration modernisation. Legislative budget capacity has been largely ignored in ‘public expenditure management’ manuals (World Bank, 1998). Nor has there been much systematic comparative research into the determinants of legislative budgetary capacity for effective oversight in emerging economies. Legislative budget institutions are now being re-discovered, as part of a second wave of reform in governmental financial administration focusing on the institutions of transparency, oversight and accountability.

In the early 1990s, first-generation economic reforms have focused on improving transparency and efficiency in governmental financial administration *within* the executive branch, targeting finance ministries, tax authorities and central banks. After decades of fiscal mismanagement, the fiscal crisis of the state (Bresser Pereira 1996) forced Latin American governments to re-order their public finances and reform their budgetary systems. In Argentina, for example, the budget as a policy document was basically considered as irrelevant until 1991 (Rodríguez and Bonvecchi 2004). In the course of the 1990s, and partly at the insistence of international financial institutions, Latin American countries have upgraded their financial information, management and accounting systems (Dorotinsky and Matsuda 2002; Asselin 1995; Wesberry 1992). Financial upgrading reforms have been undertaken in Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Paraguay, Peru, Dominican Republic, Uruguay and Venezuela. For example, Argentina re-ordered its public finance management system in 1992, with the adoption of the *Public Sector Financial and Control Systems Act*. In 2001, Chile, with support from the World Bank, introduced an integrated system for government financial administration. Largely led from the executive, these efforts are contributing to transform the budget into a credible tool of macroeconomic management, increasing the reliability of aggregate financial information and budget management systems.

The international financial institutions and donor governments, in particular the United States Agency for International Development (USAID), have supported these efforts through regional initiatives such as SIMAFAL (*Sistema Integrado Modelo de Administración Financiera para América Latina*). Launched in the early 1990s, SIMAFAL’s objective is to integrate financial management systems, joining together the budgetary, treasury, accounting, internal control and external auditing systems. Already in the 1920s and 1930s, the United States government, through the missions of Princeton Professor Edwin Kemmerer, promoted the reform of banking and budgeting systems throughout the region, with significant impact on the reform of financial management systems in the Andean region (Flandreau 2003; Drake 1989). The Kemmerer missions led to the creation, reform or strengthening of key institutions of economic governance, in particular central banks, finance ministries, central budget offices, or general audit offices.

In recent years, however, greater attention has been directed at strengthening the institutions of public finance management *beyond* the executive and improving the mechanisms of oversight and accountability in budget management. In this second stage of reform, the contribution of

legislative budget institutions, such as legislative budget committees, legislative budget offices or general audit offices, to the credibility of the budget as a reliable planning instrument is being re-evaluated. By providing a check on executive discretion, legislative budget oversight ought to enhance the transparency of public accounts and the integrity of public finances. Nevertheless, effective and responsible legislative budgeting is inherently difficult to achieve and maintain (Wildavsky and Caiden 2000). Just as preparing a budget entails trade-offs between competing policy priorities, improving the budget process requires gauging the advantages and disadvantages of alternative institutional arrangements (Schick 1990).

## **2.2 Understanding the governance of the budget**

Despite significant progress in recent years, we continue to lack a robust theory of the budget process in emerging economies. As Carlos Scartascini and Ernesto Stein underscore, ‘understanding the budget process and the incentives of the multiple agents that participate in this process is a key ingredient for any fiscal reform seeking lasting results in terms of improvements in fiscal discipline and efficiency in the use of public resources’ (2004:2).

### **Defining the governance of the budget**

Seminal work by Aaron Wildavsky (Wildavsky 1964, 1992; Wildavsky and Caiden 2000) and Allen Schick (1995, 2002) has provided us with invaluable insights into the politics of the budget process in developed countries. Nevertheless, public budgeting in developing countries is only beginning to be scrutinised. Adequately understanding the political economy of the budget process is critical to grasp the institutional determinants of fiscal performance and the political incentives of fiscal policy. It is also essential to design politically feasible fiscal reforms seeking sustainable impact (Cox and McCubbins 2001; OECD 2003; Santiso 2004b). Sustainable fiscal policies are the result of blending competent technical solutions with political feasibility.

The budget is a pivotal instrument of public policy and a critical arena for political bargaining between the executive and the legislature. It is a reiterative process occurring (in theory) at regular annual intervals. The budget is more than a law; rather, it is a continuous policy process. Indeed, at any point in time, at least three budget cycles overlap: the preparation of next year’s budget, the execution of current year’s budget, and the control of last year’s budget. We therefore use the concept of the *governance of the budget* to capture the dynamic aspect of budgetary cycles, the institutional dimensions of public budgeting and the political economy of public finance management.

The governance of the budget can be defined as encompassing the interests and incentives of individuals and institutions governing the formulation, approval, execution and oversight of the budget. This understanding of the budget process is slightly broader than traditional approaches to budgetary institutions, as it underscores the role of parliamentary institutions in the supervision, oversight and control of the budget *after* it had been approved and executed. Alberto Alesina and Roberto Perotti define budgetary institutions as ‘all the rules and regulations according to which budgets are drafted, approved and implemented’ (1996:3).

### **Fiscal governance and the centralisation of budgetary systems**

It is now well established that political institutions influence budgetary processes and fiscal outcomes (Alesina and Perotti 1996 and 1995; Acosta and Coppedge 2001). Research by Ernesto Stein et al (1998) and Alberto Alesina et al (1999) has significantly increased our understanding of the influence of budget institutions on fiscal discipline. It underscores that budget institutions contribute to explaining cross-country variance in fiscal experiences in Latin America. Lisa Baldez

and John Carey (1999) demonstrate that budgetary restraint and fiscal discipline in Chile is largely attributable to the institutional arrangements of budget policymaking. Similarly, David Samuels (2002) and Jeffrey Weldon (2002) underscore the negative impact legislative politics has on the dysfunctional fiscal policy and budgetary processes in Brazil and Mexico, respectively.

However, there continues to be great controversy as to what the most appropriate role of parliaments ought to be in budget policymaking. In theory, increased legislative budget powers ought to enhance transparency, accountability and integrity in public expenditure management. There nevertheless exist risks, as effective legislative budgeting requires the capacity to discharge budgetary functions in an effective and responsible manner (Wehner 2001, 2004; Krafchick and Wehner 1998). Immature legislatures and unstable party systems are often the source of dysfunctional economic governance, budget deficits and fiscal imbalances. At the same time, however, unconstrained executives and autocratic presidents tend to abuse their constitutional authority and delegated powers, left largely unchecked by amenable parliaments. The use, misuse and abuse of executive discretion in public budgeting have often lead to serious economic mismanagement, pervasive corruption and state capture.

The prevailing orthodoxy warns against the dysfunctional fiscal effects of unrestrained legislative budgetary powers and consequently favours the insulation of economic policymaking within the executive branch. It posits that excessive legislative prerogatives in public budgeting tend to lead to fiscal disequilibria, greater budget deficits and public debt; overspending and under-taxation are likely results (Alesina and Perotti 1995, 1996; Alesina et al 1999; Stein et al 1998). Consequently, it is argued, greater concentration of budgetary powers within the executive is ‘more likely to enforce fiscal restraint, avoid large and persistent deficits and implement fiscal adjustments more promptly’ (Alesina and Perotti 1996:7).

The core of the argument linking institutional arrangements to fiscal performance resides in the ‘common pool’ dilemma of public budgeting: while the costs are borne by the general fund, benefits go to specific groups, sectors, or localities (Weingast et al 1981). This problem can be minimised by assigning control over the budget to agents with incentives to internalise the costs of the programs the state finances. The introduction of procedural and numerical budget constraints and the strengthening of transparency and integrity mechanisms help mitigate those risks. By voluntarily delegating much of their budgetary powers to the executive, parliaments too have contributed to restrict and restrain themselves. As Allen Schick aptly notes (2002:16), ‘the legislature voluntarily yielded budgetary power to the executive because it accepted the view that parliamentarians cannot constrain their political inclination to tax less and spend more. Legislatures entrusted budgetary authority to the government because they could not trust themselves to make responsible financial decisions.’

Consequently, budget institutionalists argue that greater centralisation of budgetary powers and procedures in the executive leads to greater fiscal discipline (Von Hagen 1992; Alesina and Perotti 1995, 1996; Hallerberg and Von Hagen 1999). They convincingly demonstrate that that ‘hierarchical’ or centralised budget systems that ‘concentrate power in the finance minister, vis-à-vis other ministers, and in the executive vis-à-vis congress’ (Stein et al 1998:3) provide stronger procedural incentives for promoting fiscal prudence. Typically enshrined in the countries’ constitutions or organic budget law, hierarchical budget institutions centralise the budgetary process in the executive branch and, within it, in the finance ministry’s budget office.<sup>4</sup> They confer

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<sup>4</sup> Hierarchical budget institutions refer to those procedural and organisational arrangements that ‘limit the role of the legislature in expanding the size of the budget and the deficit, and attribute a strong role to a single individual, typically the treasury minister, in the budget negotiations within the government, limiting the prerogatives of the spending ministries’ (Alesina et al 1999:255).

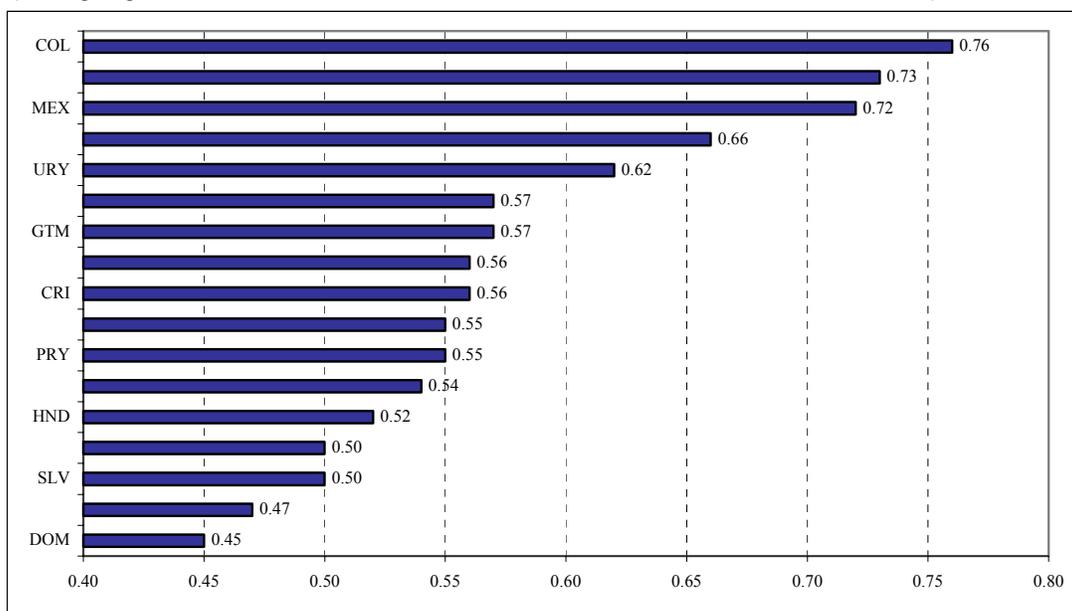
greater budgetary powers to the executive than the legislature, and, within the executive, they strengthen the position of the finance ministry vis-à-vis line ministries. Under those institutional arrangements, the central budget office of the finance ministry becomes the guardian of budgetary rectitude and fiscal discipline.

Alesina et al (1999:256-257) identify three main institutional arrangements that are more conducive to fiscal discipline: (i) laws which establish ex ante constraints on deficits; (ii) top-bottom or hierarchical procedural rules; and (iii) transparent procedures. They show that ‘procedures which include constraints on the deficit and are more hierarchical and transparent lead to lower primary deficits’ (255). Such hierarchical institutions limit the capacity of the legislature to amend the budget proposed by the executive. For example, the executive veto on legislative amendment proposals tends to neutralise, or at least diminish the amendment powers of parliament. Other institutional reforms are also believed to promote fiscal discipline, such as two-stage budgeting with prior setting of deficit targets, restrictions on amendments of spending proposals, and constitutional limits on deficit spending, debt ceilings or fiscal targets (Persson and Tabellini 2000, 1999).

Following Alesina et al (1996), Stein et al (1998) have developed an index of budgetary institutions capturing the nature of budgetary institutions in Latin America during the period 1990-1995 reproduced in Graph 5. Budgetary institutions include numerical constraints on budget deficits, procedural rules governing the budget making process, and the transparency of budgetary and fiscal information.

**Graph 5: Index of Budgetary Institutions in Latin America**

(Average figures for 1990-1995 on a scale from 0 to 1, from the least to the most centralised)



Source: Stein et al (1998).

Such views have greatly influenced economic policies in Latin America in the 1990s. As for budgetary institutions, policy prescriptions derived from the Washington Consensus counselled giving greater independence to the institutions of economic governance, in particular central banks, tax authorities and regulatory agencies (Santiso 2004a, 2004b).

The case of Chile, which has one of the most centralised budgetary systems in the region, is instructive. Chile has a long legacy of a centralised budgeting system pre-dating the wave of reforms in the 1990s (OECD 2004; Marcel and Tokeman 2002; Vial 2001). The Chilean budgetary system is the result of a long historical process marked by recurrent conflicts between the government and parliament over the budget. Executive-legislative conflict over the budget became particularly intense during the liberal republic (1861-1891) and the parliamentary regime (1891-1925). Indeed, the Revolution of 1891 originated in a deadlock over the budget. In January 1891, as the Chilean parliament refused to approve the budget proposed by the government, President José Manuel Balmaceda decreed that the previous year's budget would remain in effect, thus openly violating constitutional provisions. Parliament proceeded to impeach him and the revolution broke out. Those allied with the parliament emerged victorious but executive-legislative tensions continued during the parliamentary period. The role of parliament diminished steadily thereafter and the Constitution of 1925 and related reforms opted for strengthening the budgetary powers of the president. These institutional arrangements were ratified in the 1975 *Organic Law of Financial Administration of the State* and the 1980 Constitution.

After the fiscal crisis of the state in the 1980s, many Latin American countries have rationalised their public finance management systems. They have upgraded finance ministries, increased the independence of central banks and strengthened the autonomy of tax agencies. The move towards more hierarchical budgetary institutions was particularly swift in Argentina under Carlos Menem (1989-1999) and in Peru under Alberto Fujimori (1990-2000) (Stein 1999). In Argentina changes in the budget process were formalised in the 1992 *Law of Financial Administration*. They involved the adoption of quantitative spending limits for different ministries at the beginning of the process and the restriction of parliament to propose amendments that would increase budget deficits. The laws of fiscal responsibility adopted in 1999 in Argentina and Peru, in 2000 in Brazil, in 2002 in Ecuador, and in 2003 in Colombia and Panama have established numerical and procedural budget constraints, albeit not always rigorously adhered to. Chile introduced fiscal numerical rules in 2001 to enhance further the credibility of its procedural constraints. Interestingly, through the introduction of fiscal responsibility legislation, parliaments tie their own hands, as much as the governments'.

### **2.3 Fiscal responsibility and political accountability**

#### **Risks of hierarchical budgetary arrangements**

There are nonetheless important risks associated with hierarchical budgetary arrangements. Five main risks can be identified. *First*, 'hierarchical' budget institutions tend to allow for excessive executive discretion in public budgeting, especially in presidential systems, and thus impede the consolidation of institutions of accountability in governmental financial management. Unfettered executive discretion does not only hinder the consolidation of mechanisms of self-restraint, but also tends to circumvent or neutralise those that exist. Such trends make public finances particularly vulnerable to corruption and capture (Accosta and Coppedge 2001). Indeed, the restoration of democracy in the region has often been accompanied with a strengthening of parliaments' budgetary powers. In Brazil, where parliament was not dissolved during the military dictatorship, restoring the powers of parliament in public budgeting was considered an integral part of the restoration of democracy during the debates of the constituent assembly in the mid-1980s. Reflecting a compromise between executive and legislative prerogatives, the 1988 Brazilian Constitution gave parliament great powers in public budgeting and limited the discretionary prerogatives of the executive (OECD 2003).

*Second*, unconstrained and unchecked executive discretion in public budgeting tends to undermine the credibility of the budget as an instrument of policy-making and strategic planning. The instability of budgetary institutions and fiscal rules has hampered the consolidation of credible budget processes with predictable procedures and enduring structures. Frequent alternations of authoritarian and democratic regimes have been particularly detrimental to the institutionalisation of parliamentary processes and the emergence of stable legislative budget institutions providing the necessary checks on executive discretion. Parliaments themselves remain largely unconsolidated. Furthermore, until recently, parliaments have been dominated by majorities belonging to or associated with the president's ruling party. The combination of presidents' constitutional powers, the authority delegated to governments by parliaments, and the political configuration of legislatures has reinforced vertical patterns of power relations.

*Third*, centralised and insulated budgetary systems tend to be less transparent. Lack of transparency makes fiscal discipline and expenditure control harder to achieve, in particular considering the quasi-monopoly of the executive on public financial information. Budgets present the facts orienting decisions on public spending. However, not all governments are equally transparent in the way in which they present those facts. Alesina et al recognise that 'even the most stringent fiscal laws can be circumvented if non transparent procedures make budget documents unintelligible and unrelated to the real fiscal situation [...] Politicians often do not have incentives to produce the most transparent budget' (1999:6). The introduction of automated and integrated governmental financial information systems partly responds to the need for greater transparency and more effective management of financial information (Dorotinsky and Matsuda 2002; Asselin 1995). Proponents of hierarchical budget institutions acknowledge the value of transparent processes to ensure fiscal prudence, although they do not necessarily link it to a strengthening of legislative oversight.

*Fourth*, while it allows for greater flexibility and decisiveness, especially in times of economic crises, executive discretion in public budgeting tends to undermine the resoluteness of fiscal policy and budgetary management (Haggard and McCubbins 2001). Parliamentary involvement in the budget process helps strengthen both the credibility and the legitimacy of the budget and ensure that budget priorities adequately reflect policy priorities. As noted earlier, excessive executive discretion in budget management, combined with erratic swings in public policies and legislative delegation of budgetary powers, tend to undermine the credibility and predictability of the budget.

*Fifth*, 'hierarchical' budget institutions and the Washington Consensus policy prescriptions, when combined, tend to overemphasise aggregate fiscal discipline over the other goals of public budgeting, constraining the ability of governments to pursue counter-cyclical fiscal policies in bad times. As the World Bank acknowledges, 'the pursuit of aggregate fiscal discipline is often done in such a way as to undermine [allocative and operative] performance – arbitrarily reordering priorities and devastating service delivery and operational performance more generally. Similarly, a lack of discipline and budget realism in making strategic policy choices leads to a mismatch between policies and resources, with the result being inadequate funding for operations.'<sup>5</sup> As described by Shick (1998), the three main objectives against which the performance of public finance management systems are to be evaluated are: (i) aggregate fiscal discipline, (ii) allocative efficiency; and (iii) operational efficiency (Table 1). An adequate balance between the multiple objectives of public budgeting must be found recognising such equilibrium is bound to be unstable and contested.

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<sup>5</sup> World Bank, *Introduction to Public Expenditure Management*, which can be accessed at: <http://www1.worldbank.org/publicsector/pe/pem1subthemes.htm>

**Table 1: Objectives of public expenditure management**

Aggregate fiscal discipline	Budget totals should be the result of explicit, enforced decisions; they should not merely accommodate spending demands. These totals should be set before individual spending decisions are made, and should be sustainable over the medium-term and beyond.
Allocative efficiency	Expenditure allocations should be based on strategic priorities and on effectiveness of public programs. The budget system should spur reallocation from lesser to higher priorities and from less to more effective programs.
Operational efficiency	Agencies should produce goods and services at a cost that achieves ongoing efficiency gains and (to the extent appropriate) is competitive with market prices. This should lead to a more efficient and effective use of resources in the implementation of strategic priorities.

Source: Adapted from Schick, 1998 and Dorotinsky and Matsuda 2002:3.

### **Accountability functions of parliaments in the budget process**

Echoing George Tsebelis' rational choice theory on 'veto points' and 'nested games' in public policymaking (Tsebelis 2002, 2000, 1995), political economy analyses of fiscal policy emphasise the accountability functions of parliaments in the budget process. A new strand of comparative research revisits traditional assumptions on the contribution of parliaments to fiscal governance in presidential systems (Morgenstern and Nacif 2002; Mainwaring and Welna 2003). It challenges and amends the prevailing view of executive-legislative relations in Latin America, which has tended to emphasise the reactive role of parliaments and the proactive role of presidents (Cox and Morgenstern 2002). Even in symptomatic cases of 'delegative democracy' (O'Donnell 1994), legislatures influence economic policy and public budgeting, often more than originally thought. For example, Argentine legislators have had more influence on fiscal policymaking (Jones 2001) and taxation reform (Eaton 2002) than it was originally assumed, mainly using indirect means of influencing budget outcomes. The oversight functions of the Argentine legislature, while still weak, are gradually being strengthened (Morgenstern and Manzetti 2003).

Parliaments have a key role to play to improve budget transparency. The problem of lack of transparency can be dealt with either by setting standards to be followed, such as procedural fiscal rules and hard budget constraints, or 'to have independent agencies which provide a check on the accuracy of the budget' (Alesina and Perotti 1996:8), in particular general audit offices and legislative budget institutions. By increasing the scrutiny of the budget, legislative oversight help redress the information asymmetries between the state and society, opening up the budget to public debate and social control. Legislative scrutiny of the budget promotes greater debate on the facts and analysis underlying policy choices and budgetary allocations.

This, in turn, requires that parliaments have both the technical capacities to generate their own independent budget analysis and the political incentives to use them effectively. As Allen Schick (2002:29) underscores, 'responsible and effective legislative action on the budget depends on adequate information concerning the activities financed with public funds and the results ensuing from government programs.' As most Latin American parliaments lack institutional capacity for independent budget analysis, greater fiscal transparency can lower the costs and improve the performance of legislative oversight of the budget.

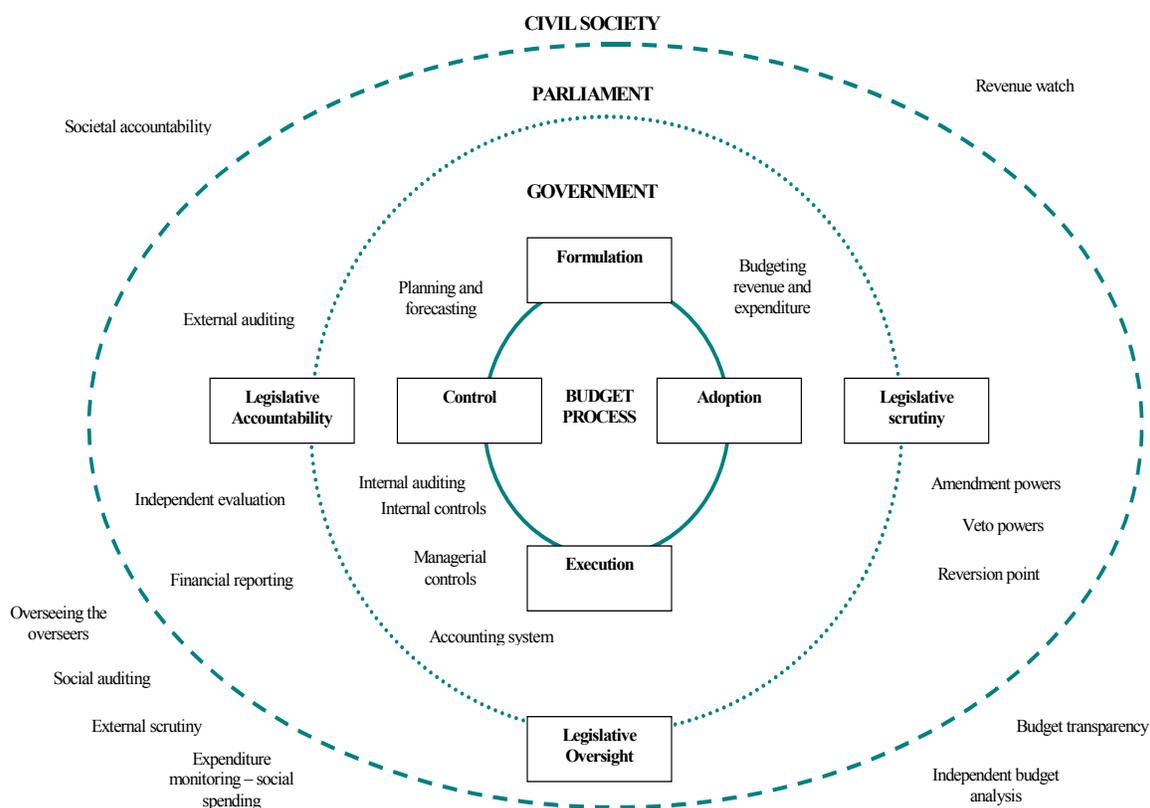
Legislative oversight also helps enforce political accountability. Together with other external oversight agencies such as general audit offices, parliaments help ensure that the government is

held to account for the manner in which it administers public finances (Pelizzo and Stapenhurst 2004). Parliaments help enforce government accountability along the different phases of the budget cycle. Graph 6 depicts the accountability cycle of the budget process and illustrates the contribution of parliaments to fiscal oversight and financial accountability. It underscores the fact that parliaments are a key part of broader systems of fiscal control.

Therefore, strengthening the institutions of legislative budget oversight contributes to foster the three main dimensions of accountability:

- (i) *Ex ante accountability*, ensuring that budget allocations adequately reflect policy priorities;
- (ii) *Concurrent accountability*, improving the oversight of the execution of the budget by the executive; and
- (iii) *Ex post accountability*, holding government to account for performance and results.

**Graph 6: Accountability cycle of the budget process**



Admittedly, legislatures often fail to responsibly use their budgetary powers and adequately perform their accountability functions. The Latin American paradox remains that, while endowed with limited budgetary powers, legislatures in the region fail to effectively use those that they do have. For example, the 1988 Brazilian Constitution ‘provides an extensive array of oversight mechanisms and an adequate legal apparatus to sanction government [...] These favourable institutional conditions, however, are not sufficient for effective oversight. Congress’s legal ability to take on oversight initiatives is much greater than its capacity to achieve actual results’ (Argelina Figueiredo 2003:172).

What then explains the disjuncture between the legal provisions for legislative budgeting and parliaments' actual role? The following section delves into the legal framework of legislative budget authority and underscores the constraints posed by legal provisions and institutional arrangements.

### **3 Legislative budget authority: Legal framework**

In Latin America, as elsewhere, there exists an important gap between the *formal powers* and *actual role* of parliaments in public budgeting. Budgetary processes are indeed governed both by formal institutions and informal processes. Thus, the legal framework can only partly explain the actual performance of legislatures. The constitution, the organic budget law and parliaments' internal rules define the legal framework for legislative budgeting. Legislative budgeting can be defined by the scope of budget authority and the effectiveness of budget oversight.

#### **3.1 Overview of legislative budget powers**

The role of parliaments in public budgeting varies along the four main phases of the budget cycle. The four main phases of the budget process are (i) its formulation, (ii) its adoption, (iii) its execution, and (iv) its control.

While parliaments are usually devoid of powers in the formulation of the budget, which is the exclusive prerogative of the executive, they are entrusted with its adoption for the budget to become law. Henceforth, their power to influence the budget largely rests on the scope of their amendment powers and the executive's agenda-setting and veto powers. Similarly, while the executive is responsible for implementing the budget, parliaments are tasked with overseeing its execution. Legislative oversight of budget execution is contingent on the institutional capacities and political incentives of parliaments to do so. Parliaments are also responsible for ensuring that governments are held to account for their compliance with the authorised budget and the performance of public expenditure programmes.

Four sets of variables condition the ability of parliaments to effectively engage with the budget process: (i) whether parliament is *legally empowered* to intervene in budgeting; (ii) whether it is endowed with the required *technical capacities*, (iii) whether it possesses the *necessary political incentives*, and (iv) whether the *governance environment* is favourable. Roy Meyers (2000) identifies five key institutional features determining the effectiveness of legislative involvement in budgeting: the extent of legislative involvement in fiscal planning; the timing and duration of the budget adoption process; the extent of legislative direction in the budget and the means of legislative oversight of budget implementation; the expansion of budgetary expertise within the parliament; and the internal coordination of legislative budgeting between committees.

In Latin America, legislative budgetary powers are severely limited by the prerogatives of the executive in the budget process. Constitutional provisions endow presidents with uncommon powers, both in absolute and relative terms, although important variations exist between countries. Assessing the budgetary powers of the executive in 23 presidential systems, Mathew Shugart and Stephan Haggard (2001) find that in seven of them presidents enjoy exclusive power over spending legislation and legislatures confront severe constraints on amending presidential proposals. Legislative budgetary powers nevertheless exist along the different phases of the budget cycle. Table 2 captures the main constitutional restrictions on the budgetary powers of seventeen Latin America countries.

**Table 2: Executive Legislative Budget Relations in Latin America**

	Initiative	Legislative amendment powers		Executive veto	Legislative over-ride	Reversion point				Budget reallocation authority		
		Unrestricted	Restricted (cannot increase deficit or spending)			Budget of previous year	Executive budget proposal	New proposal has to be presented	Deadlock (no expenditure can be incurred)	Executive with legislative approval	Executive without legislative approval	Legislature
Argentina	✓	✓ (3)	✓ (4)	✓	✓	✓					✓	
Bolivia	✓	✓		✓	✓		✓					✓
Brazil	✓		✓	✓	✓			✓				✓
Chile	✓		✓	✓	✓	(9)	✓				✓	
Colombia	✓		✓	✓	✓		✓				✓	
Costa Rica	✓	✓		(2)	(2)		✓				✓	
Ecuador	✓		✓	(1)	(1)		✓				✓	
Guatemala	✓	✓		✓	✓	✓						✓
Honduras	✓	✓		(2)	(2)			✓			✓	
Mexico	✓		✓ (4)	✓	✓				✓ (8)		✓	
Panama	✓		✓	✓	✓	✓					✓	
Paraguay	✓	✓		✓	✓		✓					✓
Peru	✓	✓ (5)	✓ (6)	✓	✓		✓					✓
Dominican Republic	✓		✓	✓	✓	✓					✓	
El Salvador	✓		✓	✓	✓			✓			✓	
Uruguay	✓		✓	✓	✓	✓					✓	
Venezuela	✓		✓ (7)	✓	✓	✓					✓	

Source: Alesina et al 1999; World Bank 2001; Casar Pérez 2001; Payne et al 2003; Rodríguez and Bonvecchi 2004.

Notes: (1): The president has no veto power; (2): Veto powers do not apply to the budget; (3): Until 1992; (4): Since 1992; (5): Until 1991; (6): since 1993; (7): Cannot increase spending; (8): The location of the reversion point in Mexico is subject to controversy; (9): The budget of the previous year would apply only if the executive did not present its proposal on time, otherwise the executive's proposal would apply.

## 3.2 Legislative powers along the budget cycle

### Budget formulation and drafting

The executive has a predominant role in the formulation of the budget and the drafting of the budget bill presented to parliament for review and adoption. In all seventeen countries under review in Table 2, it has the exclusive right to initiate the budget process and draft the budget bill. It is also the only branch of government that possesses the required technical capacity and information base for doing so. The central budget offices of the finance ministries are responsible for coordinating the budget drafting process within the executive and overseeing its execution by spending agencies. Access to and control over governmental financial information gives them an undisputed advantage both over the legislature and the other ministries and executing agencies within government.

### Budget review and approval

Once agreed within government, the draft budget bill is submitted to parliament for consideration, review and approval. As for any other piece of legislation, the executive's budget proposal must be approved parliament to become law. The budget approval process is influenced by the distribution of budgetary powers between the executive and parliament. Five key institutional variables frame executive-legislative relations in the budget approval stage: (i) the amendment powers of parliament, (ii) the veto powers of the president (package and line item veto powers), (iii) the override powers of parliament; (iv) the location of the reversion point, and (v) legislative process and structures, which include internal rules and legislative capacities, and especially the timing and sequencing of the budgetary process.

The time allocated for budget review greater varies across countries. On average, Latin American parliaments dispose of 90 days to review and approve the executive's budget proposal. As Table 3 shows, the time allocated to debate in the budget committee and plenary varies between 30 days in Mexico to 120 days in Honduras. In Peru, for example, the executive must submit the draft budget bill by 30 August and parliament must approve it by 30 November, while in Mexico the federal government must submit its proposal by 15 November and parliament has until 31 December to approve the final budget. In Argentina, the executive must submit the budget proposal by 15 September and parliament has until its recess on 30 November to approve it before the beginning of the fiscal year. Bicameral systems, where both chamber need to approve the budget, are not necessarily given more time to consider the budget.

The situation in Latin American compares favourably to that in the majority of countries, including those of the Organisation for Economic Cooperation and Development (OECD). According to the OECD World Bank Budget Database, a survey of budget practices and procedures,<sup>6</sup> the executive presents its budget proposal to the legislature up to two months before the beginning of fiscal year in 28.2 percent of the cases, and between two to four months is 56.4 percent.<sup>7</sup>

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<sup>6</sup> In 2003, in cooperation with the World Bank, the OECD carried out comparative research on budget practices and procedures, including the role of legislatures in the budget process. The results of the first OECD budget survey completed in 2003 cover forty-four countries, including six Latin American countries (Argentina, Bolivia, Chile, Colombia, Mexico, and Uruguay). See: <http://ocde.dyndns.org>.

<sup>7</sup> OECD World Bank Budget Database (2003), Question 2.7.b.

**Table 3: Time for Budget Review in Latin America**

<b>Country</b>	<b>Parliamentary structure</b>	<b>Days allowed for reviewing budget proposal</b>
Argentina	Bicameral	75
Bolivia	Bicameral	60
Brazil	Bicameral	100
Colombia	Bicameral	90
Chile	Bicameral	60
Paraguay	Bicameral	90
Dominican Republic	Bicameral	90
Uruguay	Bicameral	45
Venezuela	Bicameral	n.a.
Mexico	Bicameral	30
Costa Rica	Unicameral	90
Ecuador	Unicameral	90
El Salvador	Unicameral	90
Guatemala	Unicameral	120
Honduras	Unicameral	105-120
Nicaragua	Unicameral	60
Panama	Unicameral	90
Peru	Unicameral	90

Source: Based on Gutiérrez 2001: Chapter III; World Bank 2004 for Nicaragua; and 1992 organic budget law for Argentina.

The ability of parliament to modify the executive's budget proposal is critically determined by the scope of legislative amendment powers. Parliaments in Argentina (until 1992), Bolivia, Costa Rica, Guatemala, Honduras, Paraguay and Peru (until 1992) have unrestricted powers to amend the budget, while in Argentina (since 1992), Brazil, Chile, Colombia, Ecuador, Mexico, Panama, Peru (since 1993), Dominican Republic, El Salvador, Uruguay and Venezuela legislative amendment powers are restricted. Parliaments cannot propose amendments that would increase the deficit or spending, except as it pertains to their own budget. For example, since 1992, the Argentinean parliament can increase spending only if it also increased revenues.

In that regard, the budgetary powers of Latin American parliaments are more limited than those of OECD parliaments, where a majority of them (55.5 percent) has no restriction to modify the executive's budget proposal. Most countries, however, put some form of restriction to legislative amendment powers (56.0 percent worldwide).<sup>8</sup> These restrictions are contained in constitutional provisions in a great majority of cases (52.1 percent, including Chile, Colombia or Uruguay), in organic budget legislation (21.7 percent, including Argentina or Mexico) or in the internal working rules of parliaments in a few cases.<sup>9</sup>

The rules and procedures governing the amendment process constitute another set of determining factors of amendment outcomes. Within parliament, the budget and finance committee plays a key role in the legislative budget process. It is the main forum in which the budget bill and its amendments are discussed, negotiated and ultimately agreed. The capacity of parliament to effectively engage with the parliament thus often depends on the internal organisation, technical

<sup>8</sup> Ibid, Questions 2.7.d and 2.7.e.

<sup>9</sup> Ibid, Question 2.7.f.

capacities and political incentives of the budget and finance committee. Low re-election rates amongst legislators and high rotation rates amongst those legislators sitting in those committees tend to weaken the committee's capacity to effectively engage with the budget process (Morgenstern and Nacif 2002).

Legislative amendment powers, restricted or not, are nevertheless further limited by the executive ability to veto them, fully or partially. The executive has package and line item veto powers in a majority of the Latin American countries. Only in Ecuador the executive does not possess veto powers, while these do not apply to the budget in Costa Rica and Honduras. Where executive veto powers do exist, the legislature has nevertheless the possibility to insist in its amendment and override the executive's veto, if it can muster the necessary qualified majority.

Lastly, the parameters of the budget game between the executive and the legislative is conditioned by the location of the reversion point, that is what happens if the budget is not approved on time by the legislature. There exist four alternative scenarios: (i) the budget of the previous fiscal year remains in effect, which is the case of Argentina, the Dominican Republic, Ecuador, Guatemala, Paraguay, Uruguay or Venezuela; (ii) the executive must present a new budget proposal, as in the case in Brazil, El Salvador or Honduras; (iii) the executive's proposal automatically becomes law, such as in Bolivia, Chile, Colombia, Costa Rica, Panama, or Peru; or (iv) there is a deadlock and government cannot incur any expenditure, such as in the case of Mexico (although there exists controversy in that respect). The situation of Latin America diverges from that of the rest of the world, especially in OECD countries where interim arrangements take effect in 65.1% of the cases until the budget deadlock is resolved.<sup>10</sup>

In Latin America, clauses relating to the location of the reversion point give the executive extraordinary leverage over the legislature, as legislative inaction does not preclude the executive proposal from being adopted. They *de facto* neutralise legislative obstruction and significantly diminish the leverage of legislatures in the budget bargaining process, as legislatures have no veto power over the executive's budget proposal. While they help avoid deadlock over the budget, these provisions create a set of incentives that is not conducive to effective scrutiny and oversight. Only in Brazil (Samuel 2002; Figueiredo 2003) and in Mexico (Casar Pérez 2001; Díaz Cayeros and Magaloni 1998; Guerrero Amparán and López Ortega 2001; Sour et al 2003, 2004), the inability of the executive and the legislature to reach agreement over the budget can lead to deadlock.

### **Budget oversight and control**

Constitutions give parliaments an important role in the oversight of the execution of the budget, the scrutiny of budget re-allocations, and the ex post review of public accounts. In practice, however, legislative oversight of budget execution is still embryonic, undermining its contribution to concurrent budget accountability. Legislatures exercise only a limited monitoring of the government's compliance with formal budget rules and procedures as set in the budget law. They are even more ill-equipped to monitor the performance of public spending and enforce results-based budgeting.

In Latin American presidential systems, the combination of an extensive use of executive decrees to reallocate budget appropriations and the delegation of legislative budget authority has allowed the executive to *de facto* expand its legal prerogatives. In Argentina, for example, since 1996, parliament has delegated its budgetary powers to the executive, which is able to change the budget during its execution by re-allocating appropriations almost at will using emergency decrees (Rodríguez and Bonvecchi 2004). In theory these decrees are subject to parliamentary revision.

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<sup>10</sup> Ibid, Question 2.7.c.

However, the bi-cameral committee tasked with overseeing and empowered to overrule such decrees has yet to be established. The executive can thus modify the budget largely unchecked.

In Brazil, the budget is permissive, rather than mandatory, and the executive makes adjustments during the execution of the budget through decrees to ensure that the fiscal responsibility law's targets are met. In particular, the execution of capital expenditure appropriations and legislative amendments requires another authoritative decision by the executive (Pereira and Muller 2002, 2004). These within year adjustments explain the differences between budget allocations and budget execution. While increasing the 'costs of governing', this arrangement has nevertheless allowed the Brazilian federal government to muster coalitions of support for specific legislation at a relatively cost-effective price.

Parliament possess another potentially powerful instrument to control budget execution and enforce *ex post* accountability: the annual certification of public accounts. However, it has seldom used this tool effectively. Institutional and technical constraints partly explain the ineffectiveness of the legislative review of public accounts, in most cases performed by a specialised legislative committee (the public accounts committee) or a sub-committee of the budget and finance committee. Based on the audit of public accounts performed by the general audit office, the public accounts committee emits an opinion to the plenary, which decides whether to discharge government for having purposefully accomplished the mandate contained in the approved budget. In practice, unless if allegations of fraud and corruption are sufficiently strong to warrant the establishment of a special commission of inquiry, Latin American public accounts committees have seldom refused to discharge governments, or threatened to do so. Furthermore, the likely consequences of doing so are often unclear. Often, significant delays in the certification process affect its ultimate effectiveness as a mechanism of accountability. More fundamentally, the political incentives of legislators is to bargain over the terms of the following year's budget in order to obtain benefits for their constituency, rather than assess the performance of past years' budgets.

Legislative certification powers are often constrained by the ambiguity of constitutional provisions regulating the certification process. For instance, in Argentina, the likely consequences of the legislature refusing to discharge government are unclear. This has led to a paralysis of the certification process in the joint public accounts committee, when the budgets and public accounts clearly were a fiction, such as in 1995 following the Mexican 'tequila crisis' of 1994. Indeed, in 2002, parliament was still examining the public accounts of 1996. In other countries, the process may be denaturalised by 'hierarchical institutional arrangements.' In Peru, a constitutional provision stipulates that if parliament fails to act on the public accounts reports within the imparted time, the opinion of the public accounts committee is transmitted to the executive for adoption by legislative decree. This constitutional clause, while providing for continuity in the budget process in the event of legislative inaction, does nevertheless neutralise the oversight prerogatives of parliament in the certification of public accounts and the discharge of government.

Whether nominally linked to parliament or not, general audit offices provide critical support to parliaments' oversight functions. In a great majority of the cases (in almost 84 percent of the countries surveyed by the OECD and the World Bank and 88 percent of OECD countries), the general audit office is independent of the executive, audits government accounts and reports to the legislature.<sup>11</sup> Relations between general audit offices and parliamentary public accounts committees vary according to the institutional arrangements for external auditing. General audit offices must be independent from the executive to ensure their credibility and effectiveness. They must also develop effective functional and institutional relations with other branches of

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<sup>11</sup> Ibid, Question 4.5.e.

government, in particular parliament. Their independence from the executive is enshrined either in the constitution or in their organic law. The general audit office's independence from the executive is enshrined in the constitution or established by law. In Latin America, there exist three broad institutional models of general audit offices, each entailed a distinctive linkage to parliament institutional models: (i) that of an autonomous state institution, such as the Chilean and Peruvian *Contralorías Generales de la República* (CGR); (ii) that of an advisory body to parliament, such as the Argentinean *Auditoría General de la Nación* (AGN) (Despouy 2003); and (iii) that of independent institution with quasi-judicial powers, such as the Brazilian *Tribunal de Contas da União* (TCU) (Speck 2000).

#### 4 Legislative budget oversight: Actual performance

There exists an important gap between the *legal framework* for legislative budgeting and parliament's *actual performance*, mirroring a disjuncture between the *formal powers* and *actual role* of parliaments in public budgeting. In emerging economies, the role of parliaments in budgeting remains subdued and is often dysfunctional, partly as a result of executive dominance, but also because of legislatures' own deficiencies. Parliament's role in budget oversight remains inhibited by structural factors related both to the *internal organisation* of parliamentary work and the broader *external governance context* of executive-legislative relations.

Research on budget transparency reveals the gap between the quality of the legal framework for public budgeting and adherence to it (IBP 2003). According to the survey data reproduced in Table 4, while the quality of the legal framework for public budgeting in Argentina, Brazil, Chile, Mexico and Peru is generally sound, perceptions of budget transparency are poor. The gap between the legal framework and expert perceptions is particularly acute in Argentina and Peru. Table 5 disaggregates the quality of budget transparency along the different phases of the budgetary process. It interestingly reveals that legislative oversight and external auditing are perceived as particularly deficient. These are precisely the phases of the budget in which the parliament ought to be most assertive. Table 5 also underscores that, in general, the quality of fiscal information is believed to be sufficient, an indication that seems to suggest that it is action on existing information by budget oversight institutions that is lagging. Fiscal information is therefore available, but not necessarily acted upon.

**Table 4: Budget Transparency in Latin America (Aggregate Index)**

Country	Assessment of Legal Framework	Perceptions Index	Aggregate Index (un-weighted)
Argentina	7.0	5.1	6.1
Brazil	6.4	5.1	5.8
Chile	7.3	5.9	6.6
Mexico	5.1	5.0	5.1
Peru	6.0	3.7	4.9

Source: IBP 2003:5. Note: The index of perceptions is an average on a scale of 1 to 10, of not transparent to transparent.

**Table 5: Budget Transparency in Latin America (Disaggregate Index)**

<b>Phases of the budget (scale 1-5)</b>					
	Most transparent				Least transparent
Formulation	Chile	Mexico	Argentina	Peru	Brazil
Average	3.36	2.67	2.57	2.47	2.47
Approval	Chile	Argentina	Brazil	Mexico	Peru
Average	2.80	2.79	2.63	2.44	2.39
Execution	Chile	Argentina	Brazil	Peru	Mexico
Average	3.16	2.71	2.40	2.38	2.36
Oversight and auditing	Chile	Brazil	Mexico	Argentina	Peru
Average	3.07	2.31	2.27	2.19	1.89
Economic Information	Chile	Argentina	Brazil	Mexico	Peru
Average	3.53	3.15	3.15	2.75	2.66

Source: Based on IBP 2003:3.

There exist a number of structural factors that constrain legislative budget oversight. *First*, the rigidity and inertia of the budget itself limits the scope for exercising legislative budget powers. In Brazil, 90 percent of the budget is considered rigid, as a result of constitutionally mandated expenditures, earmarking of tax revenues and mandatory expenditures. As the OECD (2003:4) notes, the ‘effect is to insulate a very large proportion of the budget from effective scrutiny each year.’ Hence, the type of public spending on which parliament could potentially have the greatest influence, capital expenditure, represents only a small fraction of public expenditures, albeit of strategic importance for building ad hoc political coalitions, as in the case of the Brazilian system for executing budget appropriations (OECD 2003). *Second*, the gap between the approved and executed budgets further hinders legislative oversight. Optimistic assumptions on revenues, weak execution capacity of sector ministries and ad hoc changes in appropriations partly explain this gap.

The resulting instability of budgetary institutions and fiscal rules hampers the consolidation of credible budget processes with predictable procedures and enduring structures. Capacity constraints and skewed incentives further hamper effective budget oversight. Factors explaining constraining legislative budget oversight in emerging economies can be regrouped in two broad categories: (i) one consisting of factors *internal* to legislative organisation; and (ii) another one consisting of *external* factors linked to the governance context in which Latin American legislatures operate.

#### **4.1 Internal factors**

A first set of constraining factors is *internal* to the legislatures, related to deficiencies in the structures and processes of legislative budgeting. They essentially relate to organisation, resources and capacity. Redressing these shortcomings may help parliaments to acquire a more effective and responsible role in public budgeting. Three legislative budget institutions are particularly important: (i) the organisation of legislative committee work; (ii) the extent of legislative technical advisory capacity; and (iii) the extent of legislative budget research capacity.

## Legislative committee organisation

Strengthening the organisation and functioning of key legislative committees, in particular the budget, finance and public accounts committees, would undoubtedly enhance legislative budget oversight. Strong and capable parliamentary committees enable legislatures to develop their expertise and fulfil their accountability and oversight functions in public budgeting (Wehner 2003, McGee, 2002; SIGMA 2002).

In Latin America, as in most countries, a single legislative committee, the budget and finance committee, generally deal with the executive's budget proposal. This committee is probably one of the single most important legislative committee. Sectoral committees formally or informally participate in the budget negotiations, such as in Argentina, Brazil or Mexico. In contrast, however, public accounts committees are generally weak, especially if they function as stand-alone committees separated from the budget and finance committee. In bicameral systems, joint legislative budget committees are not always permanent structures. Hence, the organisation of committee work often lacks the kind of institutionalisation that would allow specialised committees to effectively contribute to the budgetary process in all its stages. The organisation of legislative standing committees has an important impact on the incentives for inter-committee coordination and coherence.

In Chile, the Political Agreements for the Modernization of the State reached in January 2003 made the Special Joint Budget Committee a permanent parliamentary committee. The committee has 26 members, with an equal number of senators and deputies and has traditionally been chaired by the president of the Senate Finance Committee. The executive's budget proposal is reviewed by five sectoral sub-committees, which are the only ones able to propose amendments. In Brazil, the Joint Committee on Plans, Public Budgets and Auditing (*Comissão Mista de Planos, Orçamentos Públicos e Fiscalização* CMPOF) has a dominant role in examining the executive's proposal. It consists of 84 members from both houses of parliament (21 senators and 63 deputies). Its chairman is elected each year, alternatively from the Senate and the Chamber of Deputies. Nevertheless, the committee's role in providing consolidated response to the executive's budget proposal is limited by the ability of sectoral committees to also directly propose changes to the budget, and by the existence of a separate taxation committee, which examines budget revenue issues (IMF 2001c; World Bank 2002).

A more rational division of responsibilities between the different committees dealing with different facets of public finance (taxation, budgeting, oversight and control) would also help enhance the coherence of parliament's impact on the budgetary process. In most Latin American parliaments, the committee system remains unconsolidated and has fluctuated over time. These shortcomings are particularly detrimental to budgetary work, given its increasing complexity and technical specificity. For example, while in Peru three distinct parliamentary committees oversee public finances, in Venezuela these structures are sub-committees of the finance committee of the unicameral National Assembly. In Brazil, the Senate of Financial Control and Audit (*Comissão de Fiscalização Financeira e Controle* CFFC) established in 1995 is tasked with overseeing the execution of the budget and certifying public accounts. This committee first emerged in 1936 in the internal rules of parliament, which created 14 committees amongst which the public accounts committee. Probably, a single finance committee with specialised sub-committees for the economy, the budget and public accounts is likely to enhance the coherence and impact of parliament in budgeting.

Furthermore, the internal composition of committees tends to lessen the incentives for legislative oversight of government. In the majority of the cases, the composition of parliamentary budget

committees is proportional to that of parliaments. Therefore, in conditions of unified government, the ruling party controls these key legislative committees, which tends to lessen the incentives for effective oversight and control (Messick 2002). Legislative committees are most often chaired by the legislative majority, which sets their agendas. In contrast, in several parliamentary systems, the main opposition party chairs public accounts committees (McGee 2002).

### Legislative technical advisory capacity

Improving the quantity and quality of technical advice available to legislative budget and public accounts committees and their members is likely to enhance their oversight capacity. In Latin America, as elsewhere, the quality of technical advisory capacity is largely inadequate to allow legislatures to effectively engage in increasingly complex budgetary processes. Budget and public accounts committees are assigned only a limited number of permanent technical advisers. However, this is not an unusual situation, as most legislative budget committees are staffed by two to five advisers, as Table 6 shows. Chile, Colombia and Mexico stand out, as their committees are more adequately staffed, with over five permanent advisers.<sup>12</sup>

**Table 6: Staff levels of budget-related legislative committees**

	Total	Percentage for all countries	Percentage for OECD countries	Latin America
< 2	2	5.1 %	3.8 %	Uruguay
2-5	17	43.5 %	46.1 %	Argentina, Bolivia
6-10	9	23.0 %	15.3 %	Mexico, Chile
> 10	11	28.2 %	34.6 %	Colombia

Source: OECD World Bank Budget Database (2003), Question 2.10.d

In fact, the political advisers of the legislators sitting in the budget and public accounts committees carry out most of the advisory work, although these advisers might not always be budget experts or solely dedicated to budgetary issues. Advisers to political parties also provide budget analysis. Tables 7 to 9 illustrate the extent of budgetary advice provided by partisan structures, which, although limited, exists.

**Table 7: Members of parliament with professional staff dealing with budgetary issues**

	Total	Percentage for all countries	Percentage for OECD countries	Latin America
Yes	3	7.5 %	3.8 %	Colombia
Yes, but only those who belong to budget, finance or other related committees	14	35.0 %	30.7 %	Argentina, Bolivia, Uruguay
No	23	57.5 %	65.3 %	Chile, Mexico

Source: OECD World Bank Budget Database (2003), Question 2.10.h.

**Table 8: Political parties in the legislature with advisory capacity dealing with budgetary issues**

	Total	Percentage for all countries	Percentage for OECD countries	Latin America
Yes, supported by parliament budget	10	27.0 %	20.0 %	Bolivia, Chile
Yes, supported by party funds	5	13.5 %	16.0 %	Mexico, Argentina
No	22	59.4 %	64.0 %	Colombia, Uruguay

Source: OECD World Bank Budget Database (2003), Question 2.10.f.

<sup>12</sup> Ibid, Question 2.10.d.

**Table 9: Number of technical advisory staff serving political parties and dealing with budget issues**

	<b>Total</b>	<b>Percentage for all countries</b>	<b>Percentage for OECD countries</b>	<b>Latin America</b>
None	8	25.0 %	19.0 %	Colombia
<10	19	59.3 %	66.6 %	Argentina, Bolivia, Uruguay
10 to 25	4	12.5 %	9.5 %	Chile
25 >	1	3.1 %	4.7 %	Mexico

Source: OECD World Bank Budget Database (2003), Question 2.10.g.

### Legislative budget research capacity

As a result, technical input in the budget review process tends to lack the technical substantiation required for impartial evaluation. The absence of a tenure-track parliamentary staff in many Latin American countries is accentuated by the weaknesses of civil services. Parliaments can only rely on the limited research and advisory services that are available to them through incipient legislative research offices and ill-equipped parliamentary libraries, which exist or have been recently established in Brazil, Chile, Colombia and Peru.

The budget research capacity of Latin American parliaments remains largely deficient, except in a few cases. However, as Table 10 shows, the situation of Latin American legislatures is not unique, as over 70 percent of the legislatures surveyed by the OECD and the World Bank do not possess specialised budget offices.

**Table 10: Legislative budget offices**

	<b>Total</b>	<b>Percentage for all countries</b>	<b>Percentage for OECD countries</b>	<b>Latin America</b>
Yes (<10 professional staff)	7	17.9 %	12.0 %	Chile
Yes (10-15 professional staff)	1	2.5 %	4.0 %	
Yes (>16 professional staff)	3	7.6 %	12.0 %	Mexico
No	28	71.7 %	72.0 %	Argentina, Bolivia, Colombia, Uruguay

Source: OECD World Bank Budget Database (2003), Question 2.10.e.

Increasing the research capacities of parliaments for budget analysis is likely to enhance their oversight capacity and allow them to acquire a more informed role in budgeting. This can be achieved either directly by creating or strengthening legislative budget offices, or indirectly by mobilising the support of policy think-tanks and civil society organisations. Capable professional staff and institutionalised technical expertise within parliament itself are necessary conditions for legislatures to be able to exercise their budget oversight functions effectively and responsibly. It is indeed noticeable that a major impediment to legislative budgeting often resides in parliaments' incapacity to engage constructively with the budget process, rather than the restraints put on their budgetary powers.

Access to independent budget analysis helps parliaments redress the asymmetries of budgetary information with governments. Legislative committees rely almost exclusively on the information that government agencies provide, which significantly constrains their ability to carry out independent budget reviews and adequately oversee budget execution. The quality and availability of the financial information produced by the executive thus becomes critical. While financial constraints partly explain the deficiencies in budget research capacity, there also exist political reasons explaining why parliaments have generally not purposefully sought to build these

capacities. Timely access to budget information is strategic in the sense that the opposition has the greatest incentives for independent budget analysis.

This is gradually changing, however, as the contribution of legislative budget offices to effective budget oversight is increasingly being recognised. Although not as powerful as the US Congressional Budget Office (CBO), legislative budget offices are gradually emerging or being strengthened, as in Venezuela, Mexico or Chile. In Brazil, the Congress' Joint Committee on Plans, Public Budgets, and Auditing is assisted by a research office consisting of about 35 professionals, which is not, however, exclusively focused on providing services to the committee. Nevertheless, one needs to be mindful that the establishment of a legislative budget office does not, *per se*, guarantee the supply of impartial budget analysis to parliament as a whole. Impartiality and non-partisanship must characterise the work of this office for it to be credible and effective. This requires broad-based, multiparty commitment (Anderson 2004).

In Chile, an embryonic budget research office was established in 2003 with professional staff of three analysts (OECD 2004), as part of broader institutional reforms aimed at enhancing the role of parliament in the budget process. In Mexico, parliament's research and advisory capacities for independent budget analysis have been significantly enhanced with the establishment, in 1998, of a Centre for the Study of Public Finances (*Centro de Estudios en Finanzas Públicas*, CEFP) in the lower chamber of parliament. The Mexican parliament's general research capacities were already relatively important before, as there existed the Research and Analysis Services (*Servicio de Investigación y Análisis*, SIA) of the parliamentary library and the Institute for Legislative Research of the upper chamber of parliament (*Instituto de Investigaciones Legislativas del Senado de la República*, IILSEN), established in 1985 to provide general technical advice to the Senate.

Similarly, in Venezuela, an Economic and Financial Advisory Office (*Oficina de Asesoría Económica y Financiera de la Asamblea Nacional*, OAEF) was created in 1997 within the National Assembly, with support from the Inter-American Development Bank (IDB), to enhance the technical advisory services of parliament in public finance. This new parliamentary structure was able to draw on the existing sources of legislative research and analysis, such as the Autonomous Service of Legislative Information (*Servicio Autónomo de Información Legislativa*, SAIL) created in 1994. Nevertheless, increasing tensions between the executive and the legislature since President Hugo Chávez took office have undermined the functioning of this office. OAEF was closed in February 2000 to be subsequently reopened in June of the same year, as part of the reactivation of the suspended loan by the IDB. In 2002-03, the office was under renewed pressure (Rojas and Zavarce 2004).

## **4.2 External factors**

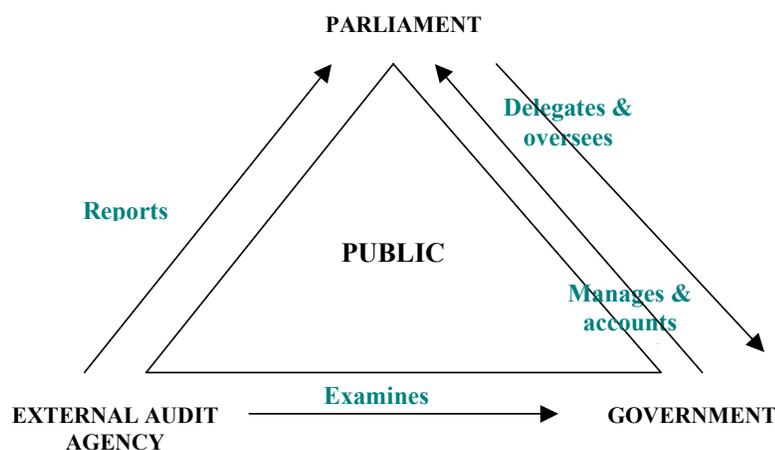
A second set of factors is *external* to the legislature, linked to the formal and informal rules shaping executive-legislative relations. Such factors include: (i) the presidential nature of the political system, (ii) the over-reliance of executive decree authority, (iii) skewed electoral incentives, and (iv) a fragmented political party system.

### **Legislative oversight and external auditing**

Strengthening legislative budget oversight necessarily requires improving the links between parliamentary committees and supporting oversight institutions, in particular between the budget, finance and public accounts committees and the general audit office. General audit offices are one of the established means for strengthening fiscal oversight and financial accountability. They oversee the management of public funds and lend credibility to government financial statements. They provide critical information and advisory services to parliaments, directly or indirectly (Dye

and Stapenhurst 1998). As Figure 2 shows, general audit offices assist parliaments in the fulfilment of their accountability functions through the independent auditing of public accounts. They also perform audits at the request of members of parliament. The availability of timely and reliable information on budget performance is key to the effectiveness of legislative oversight.

**Figure 2: Accountability relationships in public finance**



Source: Adapted from Stapenhurst (2004b).

Strengthening the capacity of general audit offices and improving their functional linkages with public accounts committees can help enhance legislative budget oversight. In turn, securing the political independence of general audit offices, which have been significantly undermined by executive interference and political meddling, is critical to guarantee effective external auditing of government finances (INTOSAI 2001). Issues such as criteria guiding the nomination and removal of auditors general and the length of their term in office, as well as the procedures regulating recruitment, promotion and dismissal of professional staff are critical to the effective independence of general audit offices. Predictable financial resources are also necessary, yet not sufficient for institutionalising general audit offices and insulating them from political interference.

Nevertheless, relations between general audit offices and parliamentary public committees remain largely dysfunctional. There is limited publicity of audit reports, which have often failed to be adequately followed-up. Those institutions that ought to act upon audit findings largely ignore them. These considerations, in turn, question the capacity and willingness of parliamentary public accounts committees to effectively supervise the work of general audit offices and act upon the recommendations of the audits they perform. Reversing these trends will prove particularly challenging. An important consequence of these dysfunctions is the resulting general unavailability of timely information on budget performance, which hampers effective oversight of government finance and limits effective budget oversight by the legislature.

For example, in Brazil, the federal general audit office (*Tribunal de Contas da União TCU*) emits a preliminary opinion on the financial statements of the federal government, which are part of the annual report of the president to parliament, the General Balance of the Union (*Balance Geral da União*). Once received by parliament by 15 April, the public accounts report is referred to the TCU, which is required to report back to parliament within 60 days. The TCU issues a preliminary

opinion to guide the discussion in parliament, which appoints an individual parliamentarian to review the statements and the TCU opinion and to recommend that parliament either approves or disapproves the government financial statements. However, this process suffers important dysfunctions (World Bank 2002). For example, its opinion on the 1998 public accounts was not issued until 2000. In 1996 and 1997, the member of parliament designated to review the TCU opinion and submit a recommendation has not completed the process. More importantly, since 1995, parliament has made no final decision of approval or otherwise of the government financial statements. The World Bank thus concludes that the process of parliamentary review of public accounts 'does not appear to be functioning [and that] there also appears to be some lack of interest by Congress in reviewing past events, and correspondingly greater interest in issues of budget construction' (2002:47).

Ex post accountability is also constrained by the timing and sequencing of legislative scrutiny. There are important time lags and inconsistencies that adversely affect the accountability cycle of the budget process. In particular, the review of public accounts and the evaluation of the auditor general's report often take place at a time that does not always allow them to adequately feed back into the budget process. There is only limited opportunity for the external audit report of the execution of the previous year's budget to inform the review of the draft budget bill of the following year, which in practice does not occur. In Peru, for example, parliament receives the reports on the previous year's public accounts by 15 November and must approve the following year's budget by 30 November. During that short period of fifteen days, the budget debate takes place in plenary, which further limits technical input into the process. The review and certification of public accounts by parliament take a further four months. In effect, the parliament's review of the government's budget proposal is largely disassociated from its control of the budget executed in previous periods, significantly weakening the accountability functions of legislative oversight.

Acknowledging these shortcomings, Latin American countries are seeking to strengthen their external auditing functions, with the support of international financial institutions (Santiso 2004c). Important reforms have been introduced in recent years. In Mexico, for example, a general audit office, the *Auditoría Superior de la Federación* (ASF), was reformed in 1999 as an advisory body to the lower chamber of parliament, to assist the latter in the oversight of federal public finances and the review of federal public accounts (Solares Mendiola 2004). Shortly thereafter, in 2000, parliament approved the law on external accountability (*Ley Superior de Fiscalización de la Federación*). In Chile, the 2003 Political Agreements for the Modernization of the State confirmed the political consensus on the need to continue strengthening the general audit office, with the financial backing of the IDB.

### **Economic governance and budget execution**

Beyond the constraints imposed by institutional frameworks for legislative budget oversight, the presidential nature of political systems, coupled with an over-reliance on executive decrees, has been detrimental to the strengthening of the institutions of government accountability in public budgeting. In most Latin American presidential systems, the use of executive decrees in public budgeting is impressive both in absolute and relative terms in countries, such as Argentina, Brazil or Peru. Legislatures exercise little oversight on presidential decrees (Carey and Shugart 1998). Moreover, the frequent use of urgency decrees to change budget appropriations and approve supplements adversely affects the quality of budget management.

In Peru, for example, between January 1994 and March 2001, parliament passed 1,152 laws or legislative resolutions, while the president issued 870 decrees, 86 percent of which were urgency decrees. Of those 748 urgency decrees, 27 percent directly amended the budget and a further 41 percent had clear effect on the budget or public finances (World Bank 2001:60-62). Furthermore,

the frequent and early use of executive decrees to re-allocate budget appropriations not only undermines the legislative oversight, but also weakens the credibility of the budget as an instrument of economic governance and strategic planning (Santiso and García Belgrano 2004; Mostajo 2002). As Table 11 illustrates in the case of Peru between 1998 and 2001, reallocation decrees are issued as early as late January, less than a month after the budget had been adopted. In Argentina, over-reliance on executive decrees to reallocation budget items is compounded by the systematic request of delegation of legislative budgetary powers. Jesús Rodríguez and Alejandro Bonvecchi (2004) argue that these features of the Argentinean budgetary process are intrinsically linked to the institutional arrangements, the political context and the economic circumstances.

**Table 11: Changes in Budget Execution in Peru (1998-2001)**

<b>Fiscal year</b>	<b>Changes in the budget *</b>	<b>Date of first change</b>	<b>Number of secret emergency decrees **</b>
1998	29	19 February	2
1999	34	25 January	2
2000	38	16 February	1
2001 (first semester)	19	13 January	0

Source: Mostajo (2002:19).

\*: Essentially supplementary credits and transfers.

\*\*: Between 1995 and 2000, there have been 20 such secret emergency decrees.

The over-reliance on executive decrees is symptomatic of the insulation of economic policymaking within the executive branch. A defining characteristic of first-generation market reforms implemented in the early 1990s has been their emphasis on insulating economic policymaking from political meddling (Santiso 2004b). Indeed, the insulation of economic policymaking and the building of hierarchical budget institutions were largely complementary processes reflecting the prevailing consensus in the early 1990s on how radical reforms ought to be implemented and how economic policy ought to be managed. Nevertheless, the manner in which first-generation economic reforms were implemented has often undermined the mechanisms of political accountability, external scrutiny and legislative oversight in public finance, sometimes unintentionally, but often purposefully (Santiso 2004a and 2003). The neutralisation of ‘veto points’, such as legislative oversight or judicial review, did indeed facilitate the implementation of market reforms.

Over time, however, the institutions of economic governance became vulnerable precisely because they were isolated, ultimately leading to dramatic cases of state capture. Clearly, government by executive decree, while an asset in the initial phase of economic reform, progressively becomes a liability in the second phase of reform. The institution of urgency decrees is a double-edged sword, as there exists an inherent trade-off between decisiveness and resoluteness in economic policymaking (Haggard and McCubbins 2001): when political systems allow for more decisiveness in economic governance by insulating economic policymaking and extending the use of executive decrees, decisions can be as easily reversed as they can be adopted. Such institutional arrangements tend to generate erratic patterns of policymaking. The cases of Peru under Alberto Fujimori, Brazil under Fernando Collor, and Argentina under Carlos Menem are symptomatic of the dysfunctional effects of abusing executive decree authority.

### **Political governance and legislative budgeting**

Improving legislative budget oversight hinges not only on strengthening parliaments’ technical capacities. It also requires understanding and improving the political incentives of individual legislators. Electoral rules that improve party consolidation, cohesion and coherence are likely to increase the political incentives of legislators to effectively oversee the execution of the budget.

The efficacy of the institutions of ‘horizontal accountability’ critically hinges upon the quality of the mechanisms of ‘vertical accountability,’ in particular the nature of political regime, the dynamics of executive-legislative relations, the coherence of the party system and the incentives provided by electoral rules.

Legislative behaviour and executive-legislative relations in public budgeting are necessarily intermediated by political parties and electoral rules. Recent research on the politics of budgeting in Brazil shows that participation by the legislative branch in the budget process can only be understood when the political parties and electoral rules are taken into account (Mainwaring and Welna 2003; Morgenstern and Manzetti 2003; Figueiredo 2002, 2003). A major finding of the research into the political economy of the budgetary process is the recognition of the critical role of political and institutional variables in explaining fiscal performance. Stein et al. (1998) have uncovered a statistically significant relationship between electoral systems and fiscal performance. Electoral systems characterised by a large degree of proportionality (i.e. large district magnitude) and political fragmentation (i.e. number of effective parties represented in parliament) tend to have larger governments, larger deficits and a more pro-cyclical response to the business cycle. However, Stein et al ‘find no evidence that centralised budgetary arrangements neutralise the potentially adverse impact on fiscal deficits of a large degree of proportionality of the electoral system’ (1998:17). Similarly, Torsten Persson and Guido Tabellini (1999) show that large deficits and debts have been more common in countries with proportional rather than majoritarian electoral systems, coalition governments and frequent government turnover, and lenient rather than stringent government budget processes.

Furthermore, the fragmentation and volatility of political party systems has been detrimental to the effective exercise of legislative budget oversight, significantly shortening the time horizons of individual legislators. In many countries in the region, parties lack the sort of internal coherence, cohesion and discipline that would allow them to act purposefully and consistently within parliament. Alesina and Perotti (1996) find that key political-institutional variables are the role of electoral systems, party structure, government fragmentation and political polarization, as well as the incentives shaping legislators’ behaviour, such as career paths, partisan links, personal vote, term limits and re-election constraints. Indeed, in many Latin American countries, term-limits and low re-election rates mean that the career paths of parliamentarians critically hinge on their links with the governing party (Morgenstern and Nacif 2002).

Recent research by Mark Hallerberg and Patrik Marier using a data set of Latin American countries for the period 1988-1997, finds that the relationship between budget institutions and fiscal discipline is intermediated by the nature of the electoral system. Consequently, changes to electoral systems are likely to have broader implications to the governance of the budget. This research indicates that ‘executive power in the budget process is most effective in reducing budget deficits when electoral incentives for the personal vote is high in the legislature, while strengthening the president (or prime minister) in countries where the personal vote is low in the legislature has no effect’ (2004:571). The ‘common pool’ resource problem in the legislature depends on the type of electoral system: if states have open list proportional representation systems favouring the personal vote, such as Brazil, then increases in the district magnitude tend to increase the problem, while under closed list systems, such as in Argentina, increases in the district magnitude tends to decrease the problem.

### **Parliamentary opposition and government accountability**

The strength and coherence of parliamentary opposition is a key factor explaining the efficacy of legislative oversight. As the executive dominates budget formulation and execution, partisan participation in the budget process depends on the parties’ relations with the executive (Pereira and

Mueller 2002). The electoral connection between the executive and the legislature depends on the nature of the political regime.

In presidential systems, the separation of powers tends to provide parliament with significant oversight powers, while semi-presidential and pure parliamentary systems are generally found to provide fewer opportunities for oversight (Dubrow 2002). What matters is the degree of congruence between the legislative majority and the ruling party in government. When the ruling coalition holds a disciplined majority position in parliament, such as in parliamentary systems and presidential systems with unified government, there exists a possibility of control dilution. Indeed, presidential systems marked by fused executive and legislative majorities tend to have inoperative systems for enforcing government accountability. As Richard Messick underscores, 'When the interests of a legislative majority and the executive branch coincide, the majority has little incentive to oversee the executive' (2002:2) and, as a result, legislative oversight is often weak. The behaviour of members of parliament is itself shaped by the incentives to which they respond. In presidential systems, situations of divided government are likely to provide further incentives to parliament to effectively exercise its oversight powers.

Interestingly, in Mexico, the emergence of an effective parliamentary opposition has provided strong incentives for enhancing legislative budget oversight and increasing parliament's capacities for independent budget review. It has also revealed the flaws, obsolescence and inadequacy of the formal budget process. The budgetary powers of the legislature are determined by its own constitutional and legal budgetary prerogatives, as well as the legislative and partisan powers of the executive. Conflict over the budget has emerged since 1997, often threatening deadlock and leading to standoff (Economist 2004). The emergence of a parliamentary opposition following the 1997 elections, when the long-time ruling party lost its legislative hegemony in the lower chamber of parliament, the Chamber of Deputies, has led to a surge in parliament's budget activism (Weldon 2002; Gutiérrez et al 2001). In 2000, the opposition won the presidential election for the first time in 71 years, leading to the first alternation of power under the terms of the 1917 Constitution.

Between 1928 and 1999, the institutional framework regulating the budget process in Mexico was ignored, neutralised by the 'meta-constitutional' powers of the president (Weldon 2002). Parliament used to approve the budget sent by the president without major amendments, usually under 0.1 percent (Wilkie 1967). Indeed, as Jeffrey Weldon aptly remarks, a striking feature of legislative politics in Mexico until recently has been 'the disuse of Congress' power to oversee the executive budget' (2002:119). Many legislators recognised that significant steps ought to be taken to allow parliament to fully exercise its constitutional powers in the budgetary process. Among those steps were ensuring that the Chamber of Deputies (the only chamber dealing with budgetary issues) had access to the information necessary to review the executive's budget proposal and monitor its execution. This recognition led to the establishment of a legislative budget office in 1998 and a structural reform of government auditing functions in 2000, bringing external auditing within the purview of parliament. Since 1997, the Chamber of Deputies has more forcefully intervened in the budget, slightly decreasing it between 1998 and 2000, and increasing it by 1.66 percent in 2001, 3.73 percent in 2002, and 1.54 percent in 2003 (Sour et al 2003.)

The case of Mexico demonstrates two important issues. First, the emergence of a credible parliamentary opposition significantly increases the incentives of parliaments to oversee the budget, which, in turn, leads to the strengthening of legislative capacities (Carbonell 2002; Weldon 2002). Second, legislatures do possess important budgetary powers, but often fail to exercise them effectively until political incentives are 'right.' The Mexican parliament does indeed possess unusually extended *de jure* budgetary powers, having the authority to not only oversee but to supervise and control the budget. Its authority to approve, modify or reject both the income and

expenditures pieces of the budget gives it much more authority than most of its Latin American counterparts. The exercise of its *de jure* budgetary powers, in turn, depends on the configuration of political power.

There exist nevertheless many grey areas in the legislation regulating the budget process. The 'meta-constitutional powers' that his legislative hegemony gave the president rendered these unnecessary in the past. Unified government, party discipline and the recognition of the president as the party leader gave the latter unusual *de facto* budgetary powers. Under this institutional arrangement, which lasted over seven decades, the president had been *de facto* delegated enormous discretion over public expenditure. Budget authorisation rarely corresponded to the actual expenditures. Clarification of the 'rules of the game' of executive-legislative budget relations is now warranted under divided government (Carrillo and Lujambio 1998). For example, constitutional provisions do not provide for a reversion point in the event that parliament does not approve the budget on time (Casar Pérez 2001). Similarly, the Mexican 1917 Constitution and the organic budget law of 1976 do not clearly establish whether the president can veto the budget bill, either by using an item veto on specific articles of the draft budget bill, or a package veto on its entirety (Sour et al 2003). There thus exists scope for interpretation.

This lack of clarity of legal provisions did not represent a problem in the previous context of unified government, characterised by the fusion of executive and legislature power. It does now under divided government, which led President Vicente Fox to propose amending the constitution in 2001. In December 2004, conflict over the extend of the president's veto powers has led to a stand-off in over the 2005 budget when President Fox vetoed the amendments made by parliament and threatened to take the dispute to the Supreme Court. Previously, the president's 'meta-constitutional powers' allowed him to circumvent the formal restraints put on executive power.

The case of Mexico illustrates an important point concerning the effectiveness of legislative budget institutions, such as the previously mentioned legislative budget offices. While the existence of an effective parliamentary opposition partly explains the political incentives that led to the strengthening of legislative budget capacities and the establishment of a strong legislative budget office, the credibility of legislative budget analysis requires ensuring its impartiality and independence. The latter is a function of the balance of powers within the parliament itself. In other words, while the establishment of legislative budget offices responds to the dynamics of executive-legislative relations, its sustainability depends on the dynamics of legislative politics.

Ultimately, effective and responsible legislative oversight requires the existence of a sufficiently effective parliamentary opposition and the strengthening of the legislative capacities for independent budget analysis. In Brazil, parliament has traditionally been the privileged arena for pork-barrel politics over budget appropriations and amendments (Samuels 2002). Even in Argentina, a country characterised by relatively disciplined parties, public budgeting has been the subject of more conflict and bargaining than previously thought (Eaton 2002; Jones 2001), through informal processes as well as the formalised process (Rodríguez and Bonvecchi 2004).

## **5 Concluding remarks: Politics of public budgeting**

Parliaments can make an important contribution towards improving transparency and accountability in the management of public finances, provided that they have the necessary institutional capacities and political incentives to do so. The politics of public budgeting constitute a determining factor of the efficacy of legislative budget oversight. Ultimately, the fundamental question is how much legislative budgetary power is enough and how much is too much. The pendulum is likely to continue to swing before it stabilises. Four main conclusions can be derived from the analysis of the effectiveness parliaments' role in the budgetary process.

### **5.1 Technical capacities and institutional incentives**

A first key question of strategy resides in ascertaining whether parliaments' technical capacities or political incentives should be enhanced first; whether legislative capacity should be build first, or whether it should emerge as a result of increased legislative activism. For instance, redressing the information asymmetries that characterise executive-legislative budget relations is a political issues inasmuch as a technical one. As Thomas Carothers underscores, 'to build effective legislatures, mobilising political power is more important than increasing technical skill' (1999:181).

The political economy of the budget process reveals that technical capacities and political incentives interact in determining the effectiveness of legislative budget oversight along the different phases of the budget cycle. Parliaments do possess important budgetary powers. However, they seldom use them effectively or responsibly. While capacity constraints partly explain why parliaments do not exercise their budgetary powers effectively, governance constraints explain why they sometimes do not exercise them responsibly. Therefore, parliaments' ability to establish their credibility as institutions of economic governance is contingent both on the strengthening of their technical and advisory capacities to perform their budgetary functions, as well as on the existence of an enabling governance environment that allows these to be exercised effectively and responsibly.

The study of legislative budgeting in Latin America demonstrates that capacities and incentives ought to be addressed simultaneously. Increasing technical capacity and enhancing analytical capabilities through building legislative research services or improving investigation techniques in audit institutions are likely to remain ineffectual as long as there does not exist enough political space for them to be exercised effectively. Technical improvements can easily be neutralised or emasculated by adverse political constraints. The key question is whether endowing oversight institutions with more technical capacity can strengthen them, or whether increased independence and assertiveness would lead these institutions to create and utilise more technical capacity. Technical fixes are likely to have limited impact unless they also address institutional incentives.

### **5.2 Legislative hierarchical budget institutions**

A second core challenge of legislative budgeting in Latin America is to adequately combine increased legislative oversight with the furtherance of fiscal discipline. Allen Schick aptly summarises this critical tension to be resolved: 'as legislatures enhance their budget role, one of the challenges facing budget architects will be to balance the impulse for independence with the need to be fiscally responsible. The future of legislative-governmental relations will be strongly influenced by the manner in which this balance is maintained' (2003:14).

Nevertheless, as Joachim Wehner underscores, ‘certain institutional devices can help legislatures reconcile budgetary activism with fiscal prudence’ (2004:14). Strengthening parliaments’ fiscal capacities and budgetary responsibilities would certainly help parliaments enhance their role and influence in the budgetary process in a fiscally responsible way, including streamlining legislative procedures, reforming the committee system, strengthening party caucuses, or reinforcing advisory and research capacities. It could indeed be argued that what is needed to enhance the role of parliaments in public budgeting is to strengthen ‘hierarchical’ budgetary institutions *within* parliaments.

In Brazil, for example, the legislative amendment process has recently been reformed and rationalised (IMF 2001c; World Bank 2002; OECD 2003). Numerical and procedural constraints have been introduced to centralise the amendment process within the Joint Committee on Plans, Public Budgets and Auditing tasked. Numerical rules now include limits of the number and size of proposed individual and collective amendments that can be proposed by individual members of parliament, political groupings, sectorial committees, and state representatives. These limits correct the previous situation where individual members of parliament could propose several thousand amendments. For example, in 1993, 76,114 changes were proposed, of which 18,994 were actually approved by parliament (World Bank 2002:32). Procedural constraints have also been reviewed to strengthen the figure of general rapporteur of the Joint Committee on Plans, Public Budgets and Auditing.

### **5.3 Parliaments and systems of fiscal control**

A third lesson of the review of the role of parliaments in budgeting is that the effectiveness of legislative budget institutions cannot be assessed in isolation from the wider context system of fiscal governance. Improving transparency and accountability in public finances necessarily requires focusing on the *process* of fiscal control, as much as on the *institutions* of budget oversight. Parliaments are a component of the national systems of fiscal control, albeit a key one. The quality of inter-institutional cooperation is determinant to the effectiveness of public finance accountability. Therefore, legislative budget oversight is also likely to be enhanced by strengthening those other institutions that are part of the system and improving the functional linkages between those and parliaments.

The links between parliaments’ public accounts committees and general audit offices are critical. On the one hand, legislative oversight of government finances critically depends on the availability of credible financial information and independent budget analysis provided by general audit offices in a timely manner, which in turn depends on the quality of the government’s accounting system. On the other hand, The audit reports of general audit offices are largely ineffectual if their recommendations are not followed through and not acted on by other institutions part of the system of control, in particular the public administration itself (administrative accountability), the judiciary (criminal accountability) and parliament (political accountability), as well as institutions of external scrutiny such as the media and civil society organisations (societal accountability) (Smulovitz and Peruzzotti 2003).

Furthermore, the institutions of fiscal self-restraint within the state are likely to be more effective if they are supported by external oversight mechanisms, as suggested by Figure 1. The role of civil society in the budgetary process is both direct and indirect. Civil society can help improve *ex ante accountability*, undertaking independent analyses of the budget, influencing the formulation of the budget, promoting greater and more open debate on the budget and advocating that budget allocations adequately reflect policy priorities. It can contribute to strengthen *concurrent accountability*, overseeing the execution of the budget and in particular social sectors spending. It can enhance *ex post accountability*, undertaking independent budget reviews, monitoring

predetermined indicators of budgetary performance, ensuring that budget objectives have been adequately met and promoting performance-based budgeting. Experiences of participatory budgeting in Brazil and Peru are examples of the institutionalisation of participatory processes of budget policy-making and oversight. Civil society can also have an indirect impact on the budgetary process assisting and overseeing those state institutions tasked with overseeing public finance management, such as parliaments themselves as well as general audit offices or central budget offices (Krafchik 2003). Civil society can thus contribute indirectly to improving budgetary accountability by ‘overseeing the overseers’

More recently, civil society organisations have started to monitor revenue and taxation policies, especially in natural-rich countries. ‘Revenue Watch’ initiatives such as those of the Open Society Institute (OSI) appears promising endeavours which insert themselves in broader processes aimed at promoting greater transparency and accountability in the revenues generated by extractive industries. Since 2002, the United Kingdom promotes an initiative aimed at promoting greater transparency and responsibility in the management of revenues from extractive industries, the Extractive Industries Transparency Initiative (EITI). Following the conclusion of the review of its lending policy in the oil, gas and mining sectors, the Extractive Industries Review (EIR) in 2004, the World Bank has also increased its attention to the governance dimensions of natural resource management. In late 2005, the IMF has drafted guidelines to better gauge and assess fiscal transparency in resource revenue management, especially in those countries that derive a significant share of revenues from natural resources (IMF 2005).

The growth of civil society budget work is undoubtedly a promising avenue to increase transparency and accountability in public finance management. More systematic research is also required to better understand the direct and indirect ways through which civil society can oversee the budget and reinforce ‘societal accountability’ (Smulovitz and Peruzzotti 2003). Civil society budget work is indeed an increasing field of activity with significant potential to enhance external scrutiny of the budget. In 1997, the International Budget Project of the Centre (IBP) on Budget and Policy Priorities (CBPP) was launched as an international initiative to promote and improve the role of civil society organisations in the budget process.

#### **5.4 How much is enough? How much is too much?**

The fourth and more fundamental challenge of legislative budgeting resides in finding the right balance between executive prerogatives and legislative oversight in public budgeting. These should not be seen as exclusive, but rather as mutually reinforcing. First, the strength of legislative budget institutions is a continuous variable, not a dichotomous one. It varies over time and across countries depending on the nature of governance systems and the specific circumstances under which these operate. Finding the most adequate balance between executive and legislative budgetary powers is therefore a continuous process of re-equilibration and reform. The question is not whether budgetary institutions should or should not be ‘hierarchical,’ but rather how ‘hierarchical’ they should be, given the specific circumstances of each country.

Second, one ought to differentiate the contribution of legislatures in the different phases of the budget. It may be argued that, while executive dominance in the formulation and management of the budget is more likely to ensure fiscal prudence, legislative oversight is critical to enforce accountability in the execution and control of the budget. While the management of public expenditures ought to firmly remain within the purview of the executive, the role of the legislature is critical to ensure that government is held to account for the manner in which it allocates and executes public spending. Furthermore, by strengthening the mechanisms of accountability in public budgeting, legislative budget oversight is likely to enhance, over time, the credibility of the budget and provide effective restraints on executive discretion.

Achieving these qualitative changes would require transforming institutional attitudes and executive-legislative budgetary relations, from a predominantly confrontational and adversarial relationship to a more cooperative and constructive approach. As Schick (2002:17) underscores, 'the legislature's new role in budgeting cannot come from government's weakness [...] the legislature's role must be defined more in terms of policy, accountability, and performance, and less in terms of control and restriction.' Indeed, 'legislative budget work has as much to do with making policy as with controlling government action' (32), by reviewing executive proposals, devising feasible alternatives and reviewing executive performance. Building legislative fiscal capacity is not only about restraining government, lengthening budget execution or sanctioning financial mismanagement. It is also about improving financial management, stimulating efficiency reforms, and promoting fiscal discipline.

Ultimately, as Schick notes (2002:31,) 'resourcing the legislature does not itself ensure that it will assume a larger or more active role. The legislature must also define how it fits into overall governance.' Further research is undoubtedly required to better understand the political economy of public budgeting and the interactions between individuals, interests, institutions and incentives along the different stages of the budget process, as well as assessing the influence of formal political institutions and informal power relations. Strengthening the institutions of legislative budget oversight and the agencies of public finance integrity is undoubtedly a structural challenge for Latin American emerging economies. It is nevertheless a critical one.

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