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**WHO DECIDES ON
PUBLIC EXPENDITURES?
A POLITICAL ECONOMY ANALYSIS
OF THE BUDGET PROCESS
IN PARAGUAY**

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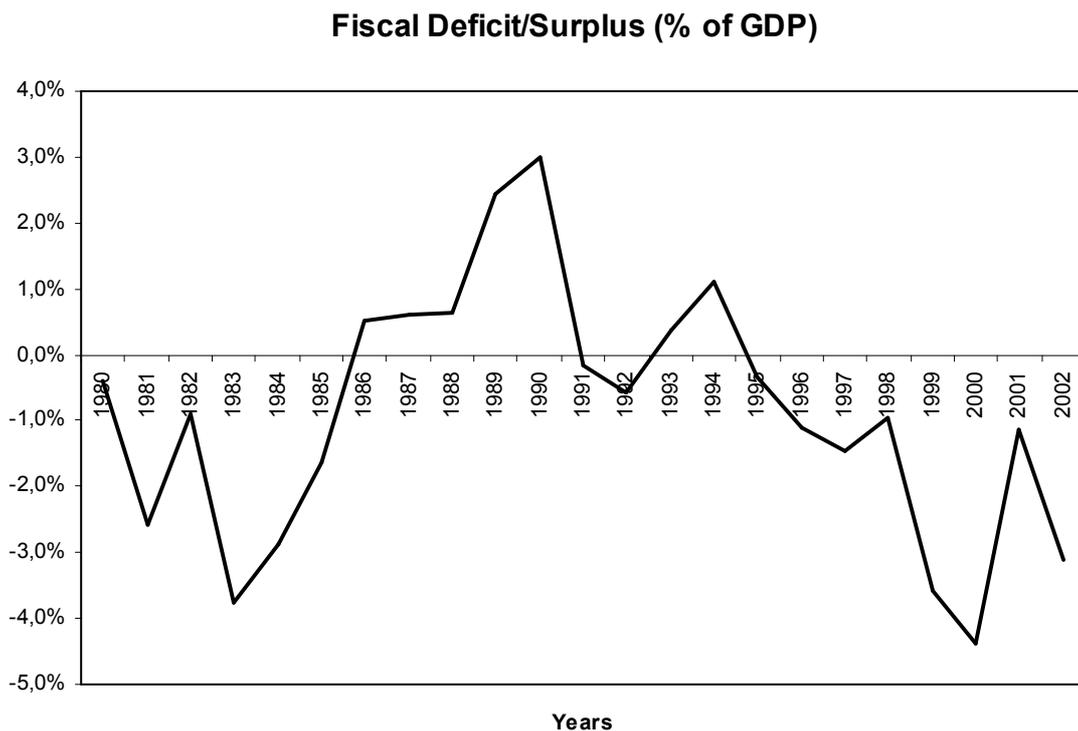
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1. Introduction

By the end of year 2000, as the country recovered from a failed military uprising and the approval rates of the president dwindled, alarming press reports indicated that the Central Bank of Paraguay had recommended the firing of ten thousand public employees (about five percent of the total public workforce). The political context was too sensitive for seasoned politicians to follow such technical advice. Instead, a few weeks later the administration placed bonds for 85 million dollars in order to cover the mandatory end-of-the-year bonuses (aguinaldos) for public employees and retired citizens.

The 2000 Christmas story illustrates a type of situation that has been distinctive of Paraguay since the mid-1990s. Over the last decade, every Paraguayan administration has faced greater political challenges and financial pressures than its predecessor. The result has been a chronic fiscal deficit since 1995. The average budget showed a deficit of one percent of the GDP for the period 1989-2002, and of two percent for the period 1995-2002 (Figure 1).



How can we account for this alarming trend in budget deficits? A recent study of the Paraguayan policymaking process suggests that the new Paraguayan democracy has rapidly expanded the number of formal and informal veto players. A growing number of parties and factions in the legislature has constrained the ability of the Executive to control the budget process, and emerging social movements (in particular, the peasant movement) operate as non-institutional veto players (popular protests, for instance,

forced the cancellation of the privatization program in 2002). The Paraguayan system thus seems to provide relative flexibility for the provision of particularistic benefits but relative rigidity for the control of overall national expenditures (Molinas, Pérez-Liñán, and Saiegh 2004).

In this study we propose to disentangle the budget-making process by studying the key players influencing the budget cycle (preparation, approval, execution, and control), their powers, and their incentives. Section Two introduces our general theoretical framework based on both a transaction cost theory of the policymaking process and the public expenditure management literature. We emphasize the interactions between historical legacies, the overall institutional design, and budgetary procedures as factors that shape politicians' incentives to display cooperative behavior in the elaboration of the budget. In Section Three we describe Paraguay's historical background (marked by the atomization of the ruling Colorado Party since 1989), its current institutional framework (which creates a relatively weak executive and promotes intra-party competition), and the emerging features of the policymaking process (factionalism, the inability of the president to enforce coordination, and the rise of rigid particularistic policies). Section Four addresses the formal and informal rules that guide the budget policy-making process. Our analysis is based not only on the formal instruments (the constitution and related laws) but also on in-depth interviews with several policymakers in the executive branch and in Congress. In Section Five we explore how these procedures interact with the overall political context to create specific incentives for party leaders, public agency managers, the ministry of finance, the president's office, the legislators, the comptroller, and other instances of oversight. In the concluding section we discuss how the generally low incentives for cooperation have created negative conditions for the sustainability of public expenditures, the efficient allocation of resources, and the representative quality of the spending.

2. The Framework

This paper will address Paraguayan budget-making from both a transaction cost theory of the policymaking process (PMP) (Spiller and Tommasi 2003) and the perspective of the public expenditure management literature (Schick 1998). We analyze the "outer features" of the budget policy making process (BPMP) and build on the prior findings of research on the political institutions, policymaking processes, and policy outcomes in Paraguay (Molinas, Perez-liñán and Saiegh (2004)..

At the core of the BPMP lies the ability of political leaders and bureaucrats to coordinate their long-term goals and actions. In the absence of cooperation, public officials are trapped in a common pool problem: multiple agents intend to extract resources from the same Treasury without much concern for the sustainability of the aggregate outcome in the long run. The likely result is thus a tragedy of the commons.

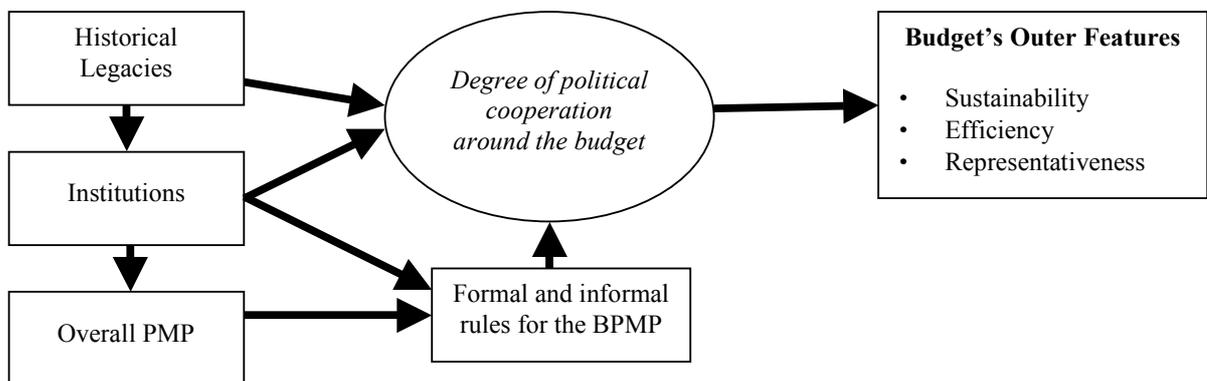
We contend that the incentives for budgetary coordination are created by multiple factors. Historical legacies of prior regimes (and thus prior PMPs) typically shape the goals and

time-horizons of the key players and manifest themselves into the current institutional setting. These institutions in turn shape incentives for cooperation by defining the formal powers of actors (e.g., by creating veto or decisive players) and by providing specific career incentives to politicians. The resulting pattern of interaction among the political players is the policymaking process—with the BPMP being a particular subset of this universe.

The performance of the BPMP ultimately translates into the “outer features” of fiscal policies. Three features deserve careful consideration. First, the **sustainability** of public expenditures indicates to what extent the level of expenditures is consistent with the government’s intertemporal budget constraints (the ability of the government to comply with its obligations in the long run). Second, the **efficiency** of public expenditures reflects the degree to which the allocation of public resources is devoted to the most valuable activities. Third, the **representativeness** of expenditure maps the extent to which the allocation of resources reflects the preferences of the population at large or, alternatively, the preferences of concentrated interest groups (IADB 2004).

The organizing framework for this paper is summarized in Figure 2. The national basic institutions, the overall PMP and history affect the degree of political cooperation around the budget both direct and indirectly. The indirect effect takes place through the rules governing the Budget Policymaking Process. The degree of political cooperation around the budget is assumed to be a major determinant of budget features such as sustainability, efficiency, and representativeness.

Figure 2: The Budget Policymaking Process Framework



Following this scheme, our interpretation of the Paraguayan BPMP can be summarized as follows. One of the main legacies of Stronismo (1954-1989) was an intense internal dispute for the control of the ruling Colorado party after Alfredo Stroessner was removed from office in 1989. Factionalism was in part compounded by the very nature of the democratic transition (which made more difficult for the president or military officers

assert unilateral control over the party) and in part by a series of institutional choices adopted with the 1992 constitutional reform, including the competitive primary elections mandated for all parties. Mandatory primaries washed away the effects of the closed-list proportional representation system: rather than concentrating power in few national party leaders, the electoral system encouraged the formation of political machines under the control of multiple party factions. The performance of these political machines depends on their leaders' access to, and ability to distribute, patronage and pork to their voters. The result has been a policymaking process that emphasizes particularistic policies rather than regulatory statutes or redistributive programs.

The incentives generated by this political context encouraged the emergence of informal procedures that operate in parallel to the formal rules of the BPMP. For instance, although the Minister of Finance is formally in charge of negotiating the approval of the central government's budget with Congress, individual agencies often by-pass the minister and lobby congress members directly. The Ministry of Finance can later use its de-facto control over the disbursement of funds to re-assert its priorities, but bureaucrats and party politicians have responded to this problem by expanding public employment, given that the ministry is highly constrained to tamper with public salaries.

This dynamic has created a serious problem of coordination leading into a common pool dilemma. Multiple veto players want to maximize their share of the public budget without endogenizing the costs of growing public expenditures. To the extent that the ability of the president and the finance minister to enforce cooperation among the players has declined over time, the consequences have been lower levels of budget sustainability (illustrated by the deficit levels displayed in Figure 1) and declining allocative efficiency and representativeness.¹

3. Historical Background, Institutions, and the PMP

Historical Background

The historical period covered by this study has been marked by three major political developments: the dismantling of the Stroessner dictatorship, the internal crisis of the ruling Colorado Party, and the emergence of multiple (but still weak) opposition forces. Between 1954 and 1989, Paraguay was ruled by Gen. Alfredo Stroessner. Stroessner imposed a centralized pattern of policymaking characterized by the support of the armed forces, the government bureaucracy, and the "granitic" Colorado Party. In February of 1989, a coup led by Gen. Andrés Rodríguez ousted Stroessner and ignited the transition to democracy. In the aftermath of the coup (1989-92), the centralized policymaking style continued to operate under aegis of Gen. Rodríguez.

¹ It does not follow from this statement that concentration of power in the Executive branch would be sufficient to solve problems of sustainability, efficiency, and representativeness. An unconstrained president could, for instance, compromise the budget balance in order to reassert his short-term priorities and then happily transfer this legacy to the next administration. As we discuss in the conclusions, problems in the BPMP are not solved by eliminating veto players but rather by "calibrating" their incentives.

Following the conventions of the old regime, Gen. Rodríguez was nominated as the Colorado candidate for the 1989 presidential race and elected with 74 percent of the vote. As part of the transitional plan, the new administration called for the election of a Constitutional Assembly. Fearing that Gen. Rodríguez would try to perpetuate himself in office, the former Stronistas reorganized around the figure of Luis M. Argaña, a seasoned Colorado politician and former Chief Justice. Although the Colorado Party won a majority of the seats in the 1992 Constituent Assembly, the presence of adversarial Colorado factions and the emerging opposition parties weakened the position of the president. The Argaña faction sided with the opposition to impose a constitutional ban on presidential re-election.

Emboldened by his ability to outmaneuver President Rodríguez in the Constitutional Assembly, Argaña aspired to become the nominee for the 1993 presidential election. In late 1992, he confronted businessman Juan Carlos Wasmosy in the first Colorado presidential primary ever. But President Rodríguez's right-hand, General Lino Oviedo, intervened in the vote-counting process to fix the primary and ensure the defeat of Argaña. Wasmosy became the Colorado candidate and was elected president for the 1993-98 term. When President Rodríguez finished his term in 1993, Gen. Oviedo became the new strongman within the armed forces.

The marriage of convenience between President Wasmosy and Gen. Oviedo ended three years later. After several confrontations, in April of 1996 Wasmosy ordered Oviedo's retirement and the general responded with a military insurrection. Wasmosy tricked Oviedo with the promise of appointing him Minister of Defense, lured him away from his cavalry unit, and then forced him into retirement (Ayala Bogarín and Costa 1996). The frustrated general then turned his energies to party politics: he organized an internal faction (the Unión Nacional de Colorados Éticos, Unace), quietly threw his weight behind Wasmosy's enemy Argaña at the election for party officers in 1996, and then defeated Argaña in the presidential primary the following year. In order to prevent Oviedo from becoming the Colorado nominee for 1998, Wasmosy formed a martial court and Oviedo was arrested on charges of sedition (for the 1996 uprising). With the general under arrest, his running mate, businessman Raúl Cubas Grau, was legally placed as the official Colorado candidate for 1998 and Luis M. Argaña, runner-up in the primary, became his vice-president.

By 1998 the key question in Paraguay was not so much whether national elections could be free and fair, but whether the Colorado Party could democratize internally. Immediately after he took office in August of 1998 President Cubas announced his decision to commute Oviedo's prison term for a shorter sentence allowing for his immediate release. This action ignited a new confrontation with the Argaña camp and with the opposition parties in Congress. There was growing speculation that Congress planned to impeach President Cubas and install Argaña as the new chief executive, when the Vice-President was shot in March of 1999. The killing of Argaña triggered a wave of protests that ended with the resignation of Cubas, the exile of Oviedo, and the installation

of the Speaker of the Senate, Colorado leader Luis González Macchi, as interim president.

Over the following three years, the Oviedistas in Congress united with the largest opposition party, the Partido Liberal Radical Auténtico (PLRA) in an attempt to unseat President González Macchi. A failed military coup took place in May of 2000 and, in the midst of several corruption scandals, the Oviedistas and the Liberal Party attempted to impeach González Macchi three times. The impeachment finally took place in early 2003, but the Senate, concerned about the coming presidential race, acquitted the president. In exile and banned from running in the presidential election, Gen. Oviedo broke ranks and ordered the transformation of his faction into a new party under the label Unace for the 2003 race. With this decision, Oviedo virtually closed the dispute for the control of the Colorado Party, formalizing the division. The victor in the Colorado primary for the 2003 election was Nicanor Duarte Frutos, an experienced politician of the Argañista faction who had served as Wasmosy's and González Macchi's Minister of Education.

It is important to notice that none of the three presidents (1993-1998) after the new 1992 Constitution has reached the presidency by their own political weight through the electoral system. This situation has changed with the election of Duarte Frutos to the presidency in 2003 that seemed to take the Colorado Party into a new era. The party recovered cohesion—although never the “granitic” unity of the dictatorial era. Lino Oviedo returned to Paraguay in June of 2004 and went back to prison. (Some pundits interpreted this as the price to regain admission into the Party). More important, for the first time since 1947 the Colorado party failed to capture an absolute majority of the seats in Congress. This new factor has made cross-party coalitions relevant for the policymaking process beyond the ability of the president to form intra-party (cross-factional) Colorado coalitions.

The Institutional Setting

During the age of the Stronismo (1954-89), the **Executive Branch** concentrated formal and informal powers, and the president's acquiescence was necessary and sufficient to alter the status-quo in every major policy area. The convoluted transition to democracy not only eroded the informal powers of the Executive but also its constitutional standing. As explained above, the 1992 Constitution established that the president and vice-president would be elected by plurality for five-year terms with no re-election. In addition, the new charter deprived the president of the power to dissolve congress (present in the 1940 and 1967 charters) and endowed the executive with quite moderate “proactive” and “reactive” powers. The Paraguayan president can enforce policies unilaterally only if congress fails to address an urgent bill within sixty days—but congress can challenge the urgent denomination of a bill with a two-third majority—and has line-item veto—but the veto can be overridden by an absolute majority of congress members. Before 1992 the formal powers of the Paraguayan president were among the strongest in Latin America, but currently these powers are comparatively weak by regional standards (Shugart and Carey 1992, 155; Payne et al. 2002, 202).

The members of **Congress** are elected in concurrent elections every five years and can be reelected indefinitely. The Paraguayan lower house is formed by 80 deputies who are elected from 18 districts (departamentos) for five-year terms. They are elected from closed party lists using proportional representation in relatively small districts (the average district magnitude is 4.4). In theory, the closed-list system creates little incentive to cultivate the “personal vote” (Carey and Shugart 1995; Hallerberg and Marier 2004) but, as we have claimed elsewhere, legally-mandated party primaries and relatively small districts have encouraged particularistic politics in the Chamber. The Senate is composed of 45 members elected from closed party lists in a nation-wide electoral district. The Paraguayan bicameral system is highly congruent—meaning that the partisan composition of the House and the Senate is usually quite similar (Lijphart 1999; Llanos 2002). Although congressional re-election is not banned by the constitution, the electoral context marked by competitive primaries, increasing party factionalism, and new political parties has created greater uncertainty about the political survival of legislators. In 1998, 54 percent of the deputies were reelected; in 2003, only 21 percent of the deputies remained in their seats. The available evidence, which is limited, suggests that there is no high specialization in the committee system. We discuss the specific budgetary incentives created by the electoral system and the declining reelection rates below.

The 1992 Constitution included a broad definition of human rights and established a new framework for the **judiciary**. The Assembly sought to promote judicial independence by mandating that at least three percent of all public expenditures are allocated to the judiciary. In addition, judges were barred from holding any partisan posts, a Jury to prosecute judges (independent from the Supreme Court) was created, and a *Consejo de la Magistratura* to select judges was established. However, many of these dispositions were never fully implemented (or not implemented at all). The result was a somewhat more autonomous but hardly competent judiciary. According to a survey conducted by the World Bank Institute in 1999, the Judiciary’s institutional performance is relatively poor and its officials are perceived as being particularly corrupt (Plan Nacional Anticorrupcion 2000). The judiciary’s institutional performance is ranked below average in different dimensions such as quality of service, quantity of service, cost of provision, and accessibility (Plan Nacional Anticorrupcion 2000, 28). In April of 2004, President Nicanor Duarte convinced congress to remove six of the nine justices in the Supreme Court, in an attempt to reshuffle the judiciary.

Paraguay has not been able to develop an effective, relatively independent, and accountable **bureaucracy**. Political patronage has historically permeated the public administration. With few exceptions, hiring practices are marked by arbitrariness. In the past, party bosses allocated public jobs to their followers and automatically deducted contributions to the Colorado party from their paychecks. In recent years, this practice has been legally banned (EIU 1990, 1:20), but greater electoral competition and internal factionalism have compounded the need for patronage resources. As a result, the Paraguayan bureaucracy is currently plagued by patronage politics even at the lower levels of the pay-scale. We address the implications of this pattern for the budget process later in the paper.

Since the nineteenth-century, two major **political parties** have dominated the local landscape: the Colorados (or National Republican Association, ANR) and the Liberals (Authentic Radical Liberal Party, PLRA). Although the ANR has remained the largest party (winning 67% of the seats in the lower chamber in 1989, 50% in 1993, 56% in 1998, and 46% in 2003), the Liberals were able to capture the vice-presidency in the 2000 election (scheduled to fill-in the vacant position after Vice-President Argaña was killed in 1999). Following the democratization process, smaller middle-class parties (Encuentro Nacional, País Solidario, and Patria Querida) and Gen. Oviedo's Unace have been able to capture several seats in congress. As a result, the effective number of parties in the lower house grew from 1.0 in 1960 to 1.9 in 1989, 2.4 in 1993, 2.3 in 1998, and 3.2 in 2003.² During 2003 and 2004 the ANR was forced to rely on informal coalitions with Patria Querida (on tax reform) and the Liberals (to appoint the ombudsman), and even on a political pact with all legislative parties (to pursue the reform of the Supreme Court) in order to pass its major policy initiatives. At the same time, the historical summary presented above has indicated how the granitic unity of the ANR during the Stroessner era has given way to greater factionalism and internal competition. Primary elections are legally mandated to select all party candidates and to determine the composition of the parties' directive bodies.

The Overall Policymaking Process (PMP)

Historical legacies and institutional conditions shape the overall operation of the policymaking process (PMP) in Paraguay. Molinas, Perez-Liñán and Saiegh (2004) have recently analyzed the overall functioning of this PMP, identifying several characteristics: (a) increasing fragmentation and a multiplication of veto players, (b) dwindling capacity of the executive branch to promote policy change, and (c) an overall capacity to adapt in the realm of particularistic policies but not in nation-wide regulatory or redistributive policy areas. The Budgetary Policymaking Process (BPMP) is a particular subset of the overall PMP and therefore is conditioned by this overall context. We identify the relevance of these general traits for the BPMP below.

Increasing Factionalism. Political fragmentation led to an increase in the number of factional veto players in congress during the 1990s. To assess the magnitude of this problem, we estimated the Rice index of party unity for the Colorado and the Liberal parties in the Chamber of Deputies for all budget-related votes since 1996. The Rice index ranges from zero, when the party is evenly split in a budgetary vote, to one-hundred, when all the members of the party vote together (Rice 1925).³ We identified two categories of budgetary bills: the articles of the annual budget, voted at the end of the previous year, and the amendments to the budget, usually introduced by the Executive branch to correct provisions of the original budget during the course of the year. On average, more than forty bills amending different parts of the budget are introduced in

² The Effective Number of weights parties according to their size (here measured in legislative seats). The formula for the index is $ENP=1/\sum(p^2)$, where p represents the proportion of seats controlled by each party in the lower chamber (Laakso and Taagepera 1979).

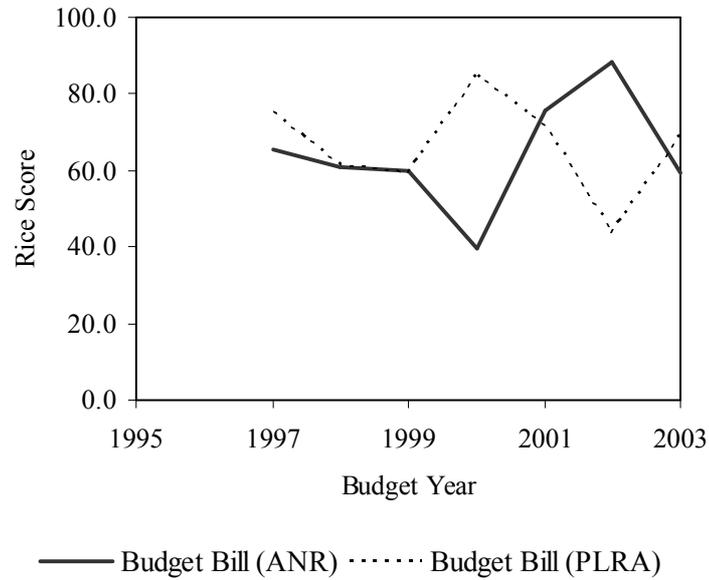
³ The formula for the index is $R=|Ayes-Nays|/(Ayes+Nays)*100$

Congress every year—although not for all of them there is roll-call data. In more than 90 percent of the cases, these bills attempt to transfer or reallocate resources across public agencies.

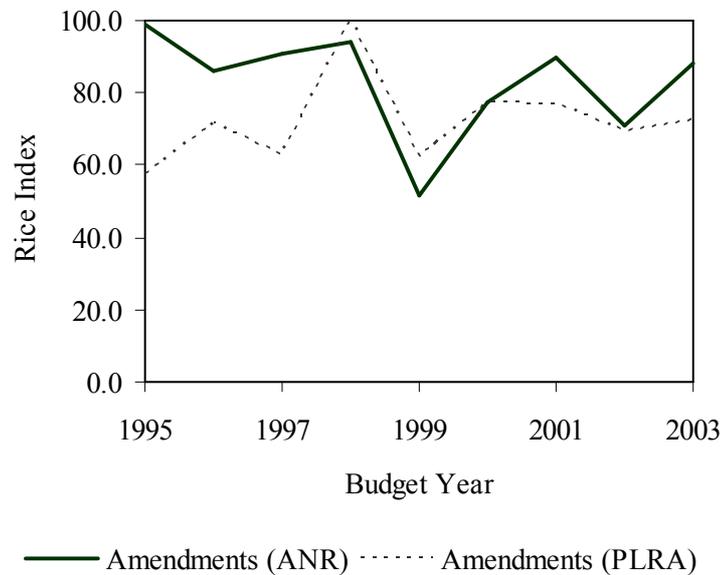
Figure 4 indicates the evolution of party cohesion on budgetary matters over time (roll-call data on the budget bill are available only since late 1996). The figure suggests two conclusions. First, party cohesion tends to be greater when dealing with specific amendments than with the national budget bill. This finding reinforces the idea that the system is more capable of dealing with particularistic decisions than with nation-wide policies, but it may also result from the fact that the president is legally mandated to submit the budget bill to congress, while he can strategically withdraw specific amendments that are expected to fail. Second, and more important, it is clear that internal party crises can directly affect the BPMP. At the peak of the confrontation between Colorado factions (1999, in preparation of the 2000 budget) cohesion dropped drastically and a surprisingly cohesive PLRA stepped in to approve the bill. Party disputes also hindered the party's ability to approve amendments to the current budget during that year.

**Figure 4. Rice Index of Party Unity in Budget-Related Votes
(Chamber of Deputies, 1995-2003)**

4.1. Budget Bill (Voted at the End of Previous Year)

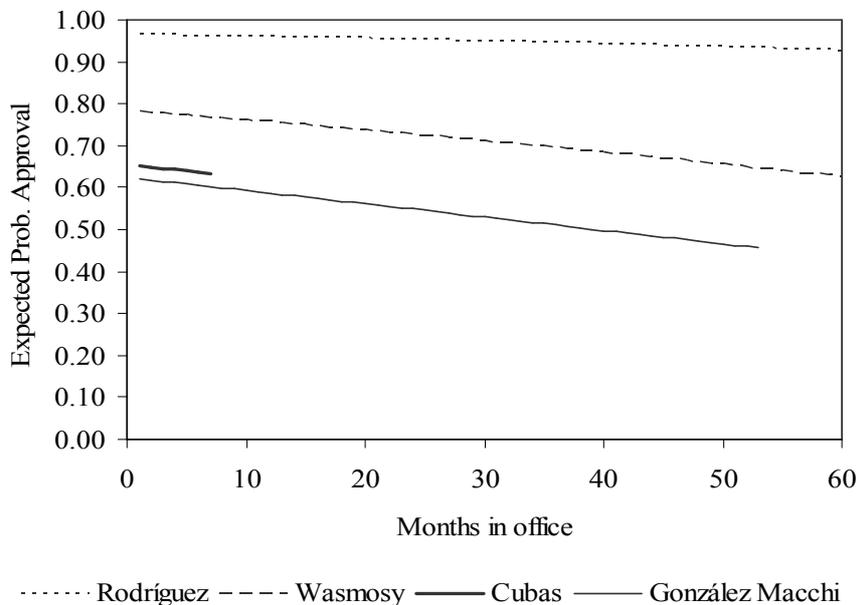


4.2. Current Budget Amendments



Declining Power of the Executive. The erosion of party cohesion, combined with the reduction in formal constitutional powers and with the ban on reelection, has diminished the ability of the president to modify the fiscal status quo. Figure 5 depicts the expected probability of success of a typical nation-wide regulatory bill initiated by four different administrations at different points during their terms. The simulation is based on a logistic regression model that controls for the timing of elections and the nature of the policy area (Molinas, Pérez-Liñán, and Saiegh 2004). The graph suggests that (a) the divisions in the ruling party have left every president since Andrés Rodríguez in a weaker position than his predecessor (although the current situation of Duarte Frutos, not included, is presumably better than the one of Gonzalez Macchi), and (b) given the ban on reelection, the president’s leverage declines as he approaches the end of the term.

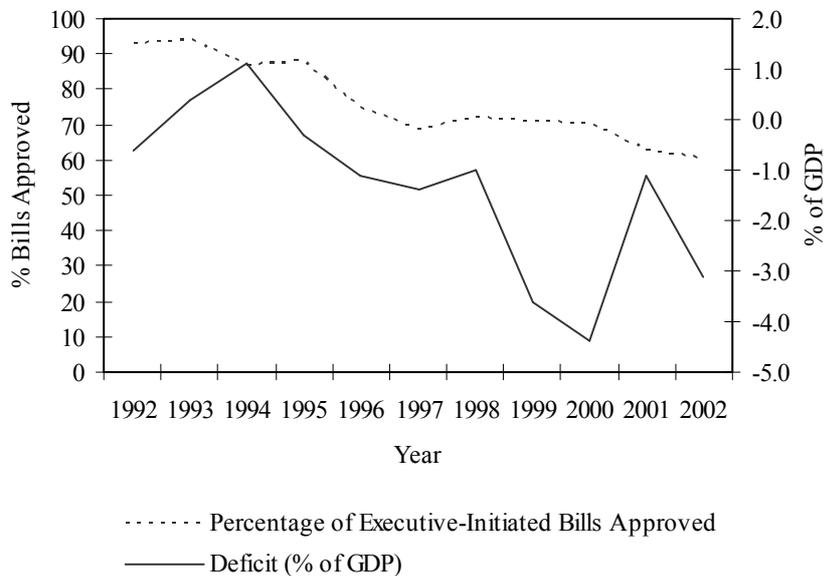
Figure 5. Expected Probability of Success for Administrations (1992-2003)



Source: Molinas, Perez-Linan, and Saiegh (2004)

To what extent is this weakness relevant for the BPMP? Figure 6 below compares the percentage of executive-initiated bills that were approved every year and the fiscal performance figures introduced in Figure 1. The correlation between fiscal deficits and presidential success in congress is .67 (n=11). The inability of the president to mobilize support in congress seems to hinder his capacity to address the common pool problem. Moreover, to the extent that presidents in the late 1990s were focused on political survival in the short-run, questions of long-term sustainability and allocative efficiency were postponed.

Figure 6. Presidential Success and Fiscal Performance



Incentives for Rigid Particularistic Policies. The emergence of an open, more competitive electoral system has presented a challenge for the ruling party and its internal factions. Colorado leaders now confront challenges from the “outside” (the PLRA, Unace, and the middle-class parties) as well as from the “inside” (since legally mandated primaries have opened the way for internal challengers). This political environment has forced party bosses to build factional political machines. Because these machines can be sustained only through the distribution of pork, jobs, and other particularistic benefits, this trend has aggravated the common pool problem in the allocation of public resources.

In this context, the relationship between the Executive and party politicians (whether deputies supporting a bill in congress or local bosses delivering votes in an election) involves a basic problem of credibility. The president may promise (i.e., include in the budget) resources for his allies in exchange for political support, and yet the guardian of the purse (the Minister of Finance) may later refuse to disburse the funds alleging financial strain. Politicians thus have strong incentives to charge for their favors using an account that the Ministry Finance can only refuse to honor at great peril—the public wage bill. We contend that political leaders prefer to trade with appointments and pensions for their constituents rather than with pork and local investment projects.⁴ The very reason that makes this currency more reliable—its rigidity—also constitutes a major problem for the BPMP.

⁴ There is an additional advantage of distributing jobs and pensions as opposed to local infrastructure projects: the former can be targeted at individual constituents, while the latter typically supply geographically narrow public goods.

Two pieces of evidence seem to support this argument. The first one, to be discussed in later sections, is the inordinate expansion of the public wage bill and the low levels of efficiency in those policy areas absorbing the largest workforce (Education and Health). The second one is the composition of the particularistic bills initiated by the legislature. Our prior study showed that particularistic bills (those narrow in scope and distributive in nature) are more likely to be approved by congress than broader regulatory or redistributive bills. A more detailed analysis of those particularistic bills indicates that 60 percent of them are requests for individual pensions.⁵ Pension bills are no more likely to be approved than other particularistic policies, but they are in fact less likely to be rejected once they reach the floor (Table 1).

Table 1. Particularistic Bills in the Paraguayan Congress, 1992-2003

Type	Outcome			Total
	Approved	Rejected	Stalled	
Pensions	607	64	348	1019
%	(59.6)	(6.3)	(34.2)	(100.0)
Others	408	123	160	691
%	(59.0)	(17.8)	(23.2)	(100.0)
Total	1015	187	508	1710
%	(59.4)	(10.9)	(29.7)	(100.0)

Note: Particularistic bills are defined as those targeting individuals or local communities with a distributive intent.

4. Specific Formal and Informal Rules for the BPMP

The specific rules for the budget policymaking process are established in the 1992 Constitution, in the Law 1535 sanctioned in 1999, and in entrenched uses, customs, and informal rules.⁶ In this section, we describe a few general rules of the BPMP and then we discuss the particular rules for the different budget stages.

The elaboration of Nation's General Budget (NGB) rests formally on the following principles: *universality* (it should include all public revenues and expenditures), *legality* (estimated revenues could be exceeded in practice but authorized expenditures represent a maximum ceiling), *unity* (all decisions should be included in a single document), *yearly*

⁵ Most of the remaining 40 percent are bills requiring congressional authorization to sell or donate municipal property. Although these bills qualify as particularistic (since they allow for the transfer of public property to private agents at the local level), public law requires congress to authorize all transfers of municipal property and thus the political implications of these transactions are less clear.

⁶ When a rule has constitutional or legal rank, it will be explicitly noted. Otherwise, it refers to uses and customs. To refer to the Law 1535/99 we will use the acronym L1535 at the end of the paragraph.

periodicity (a new budget must be approved every year), and *balance* (expenditures cannot exceed estimated revenues and financing) (L1535).

Although the annual Law of the NGB may not contain any statement that modifies other laws (L1535, Art. 7.c), the annual budget law may, in practice, contradict the permanent law 1535/99. The Paraguayan legal system does not rank laws and therefore any law can suspend the effect of a previous statute.

The NGB contains the structure of revenue and expenditure (current and capital), the financing arrangements, personnel annex that includes the number, type, name and salary, and the budget of public enterprises, which includes data on cost and performance of goods and services. Expenditure and personnel are presented separately for each public institution (L1535).

Public Employees that generate a misuse of public funds as consequences of their actions or omission against their legal duties will be personally responsible with their assets to repair caused damages (L1535). However, in practice the sanction mechanisms are extremely weak in Paraguay, as we will see below, due to: (i) incomplete legislation, (ii) weak evaluation and control systems, (iii) judicial mis-management, (iv) lack of resources for judicial investigation, (v) lack of inter-institutional coordination, (vi) lack of political will, (vii) strong external pressure over the judicial system.

Preparation

Budget Guidelines. The coordinator of the budget preparation process is the Ministry of Finance. The Law 1535 establishes the following criteria for budget preparation: (i) revenue estimation based on expected economic activity and performance of the tax collection system. The estimation should include seasonality and should specify the performance of each type of revenue. (ii) The expenditure should be a function of objectives and goals. It should be based on performance indicators. (ii) The financing arrangements should be based on government savings estimates and the country's debt capacity (L1535).

Based on the previous criteria, the Executive issue an annual decree within the first four months to establish the guidelines of NGB preparation, according its policy objectives. The Ministry of Finance prepares a draft for the general budget guidelines that are established by a presidential decree (L1535).

Institutional Budget Projects. The institutional budget projects must be consistent with each institution's operating plan. There are differences for institutions comprising the Central Government and those outside the Central Government (L1535). Central Government Institutions must prepare their budget projects subject to the guidelines and total amounts determined by the Executive. The central government is comprised by Executive, Legislative, and Judicial Powers, and the General Comptroller Office (L1535). Institutions outside the Central Government prepare their budget projects based on revenues estimates according their special law and statutes, the treasury and inter-

institutional transfers communicated by the Executive. Institutions outside the Central Government included in the NGB are: The Central Bank, departmental governments, autonomous public institutions, public social security institutions, public enterprises, public financial institutions, national universities, Judge Selection Council, Public Ministry (General Attorney Office), Electoral Justice, and the Ombudsman Office (L1535).

The institutional projects must be presented to the Ministry of Finance within the first semester of each year. In case of delay of any institution, the Ministry of Finance will prepare the delayed institutional project (L1535).

In the budget consolidation process there are some informal negotiations among the Minister of Finance and the other ministers. Indeed, any item that exceeds the general guidelines has to be negotiated between the Minister of Finance and his peers. If the Ministry of Finance deems necessary to significantly cut a ministry's budget proposal, it provides the agency with new specific guidelines to revise its original proposal. In other cases, when the changes are not considered substantial, the Ministry of Finance simply proceeds with the changes. The Ministry of Finance may also increase the budget proposals of the institutions. The consolidated budget may be occasionally discussed in the Council of Ministers. More often, the consolidated budget is presented by the Ministry of Finance directly to Congress as the Executive proposal.

The NGB Project. The Executive consolidated NGB project must be presented to Congress by September 1st. This presentation must be accompanied by an explanation of the fiscal policy, its objectives and goals, the technical foundation and methodology used to estimate revenue and financing arrangements, as well a report of the NGB execution from the previous year and first semester of the current year with a comparison to the present budget project (L1535).

Approval

According to the 1992 Constitution (art. 216), CN 216, the budget must be initiated by the Executive on September 1 every year and must be passed (or rejected) by congress by December 20. If Congress rejects the Executive proposal, the reversionary point is last year's budget. Starting on September 1st, a joint bicameral commission composed by fifteen deputies and fifteen senators studies the budget for 60 days before issuing a non-binding recommendation. On October 30th, the revised proposal moves to the Chamber of Deputies, where it is studied by the House Budget Committee—the largest of the chamber's committees, with 26 members including the ones participating in the joint commission—and must move to a floor vote within two weeks (CN 216).

On November 15, the budget bill moves to the Senate Budget Committee, where it is further revised and must move to a floor vote within two weeks. The Senate can alter any item of the lower chamber's version by simple majority, virtually drafting the "final" version of the budget (CN 207).

Between November 30th and December 10th, the bill moves to the Chamber of Deputies for a second-round vote. At this stage, the lower house can only treat the budget items that have been previously rejected or altered by the Senate (all other items are already fixed) and the deputies confront close rule: they can only reject the Senate's proposals, without modifications, by an absolute majority of the chamber's members. The items modified by the Senate are treated item by item by the deputies. The fallback point is the original deputies' proposal. Between December 10 and December 20, the Senate must vote the whole budget bill up or down (items cannot be treated separately). This treatment provides the incentive to reject the changes introduced by the deputies. The fallback point is the revised Senate proposal. The bill can only be rejected by a two-third majority (CN 207).

As stated in Law 1535, in the approval process, Congress cannot reallocate neither investment resources to finance current expenditures nor resources affected by special laws (L1535).

The Executive-Legislative relations in budget matters will be exclusively maintained through the Ministry of Finance. This Ministry can propose changes to the Executive NGB project after being presented (L1535). However, this formal rule does not apply in practice. All of our interviewees coincide that Ministers and top public managers contact legislators directly to defend their budget proposals.⁷ The Executive has, in principle, constitutional attribution to sanction this type of behavior; however in practice, it seems to be costly to the Executive to change a Minister or top public manager for lobbying Congress for their budget.

Execution

The Ministry of Finance has an active role in the budget execution process. According to (L1535), the Ministry of Finance (MF) will keep the budget equilibrium and will oversee the compliance of the Budget Execution Plan. For such purpose, all public institutions will present to the MF an annual plan of revenue and expenditure installments based on their activity timeframe (L1535).

The MF in coordination with public institutions will propose to the Executive a monthly financial plan of revenue and expenditure for budget execution. The MF will execute the NGB according to the Executive's decision over the financial plan (L1535). The cash plan of the Central Government will be based on the financial plan and subject to availability of resources of the General Treasury (L1535).

Given the monthly cash limits, each ministry decides how to allocate its funds internally. Funds allocated to rigid expenditures (public salaries, external debt service, and pension funds) are managed centrally by the Ministry of Finance.

⁷ The only exception in recent years seems to be the approval process in 2003 with a new administration and congress, and facing an explicit order from the executive to Ministers and top managers not to approach to legislators.

Because the MF has some discretion in the execution of the budget, there is also room for the introduction of political criteria in the release of funds. The degree of political influence in the budget execution process will depend on the characteristics of the President, the Minister of Finance, the other ministries, and the political cycle. Notwithstanding, the minister's leeway in the execution of the budget is severely limited by the high proportion of rigid expenditures.

In the Execution of the budget, the obligated budget establishes the schedule for payments to the institutions. However, throughout the course of the year, some sources of revenue may not be realized, and thus the Ministry of Finance may not be able to make payments as planned. The difference between this obligated budget and the budget actually paid is commonly known as the floating debt.

The budget execution in public institutions presents a considerable degree of discretion by public managers due to the lack of proper definition of a number of key administrative and financial procedures.⁸ There is not a law that regulates public administrative and financial procedures in a consistent manner. The internal norms display significant lacunae. In this line, there is not a procedure that properly sanctions administrative mistakes by top managers. For example, if a middle manager does not comply with the hiring procedures, he will be subject to a disciplinary trial in the institution. However, if the top manager of that institution does not comply with the same procedure, he will not be subject to a disciplinary trial that he is supposed to initiate and execute. There is not a system of fines and penalties that another agency, like the RGC, could apply at low cost. If the mistake is not typified as a crime, the judicial system cannot intervene. Also, it is very unlikely that the Executive would remove a Minister because he did not follow a hiring procedure. In this case, for example, a penalty system applied to the Minister's private assets, not to the institution's assets would be beneficial.

The Executive and the MF will finance any estimated revenue deficit by transfers of credit within an institution or program, and by short term loans from the Central Bank (according to Constitutional Art. 286) (L1535).

If a fiscal deficit of more than 3% of the Central Government Budget occurs at the first quarter, the Executive must present to Congress a project of a Reprogramming Law of the current NGB by June 30th. Congress will treat this project with similar deadlines as any project of NGB laws. Congress cannot affect resources derived from special laws. However, Congress can authorize issuing of Treasury bonds (L1535).

Any remaining funds of public institutions, after being allocated to cancel current debt, will become fiscal revenue for the next fiscal year (L1535). This generates an incentive to

⁸ Both a top member of the RGC and an expert lawyer in administrative law pointed out this situation in interviews carried out for this project. To make the process of interviews easier, we have announced to our interviewees that no mention of their names will be associated with specific statements in the report. We have conducted seven interviews to top ex and/or current officials of the MF, RGC, a former senator, a congressman, and currently top manager of a Public Financial Institution and a legal advisor of several public institutions.

use all funds within the current fiscal year; otherwise, there is no guarantee that funds will be available the following year. Several interviewees emphasized this trend of spending most public funds by the end of the fiscal year. One of them added that in addition many public managers receive “commissions” depending on public expenditures, especially in those institutions with a high proportion of purchases of goods and services.

Budget Modifications

Budget modifications occur in March of every year, during the Execution Phase. Certain rules for budget modifications are:

- 1) Changes in the NGB that increase expenditure must explicitly identify the source for increasing the needed resources (L1535).
- 2) By an Executive Decree, transfers of credit within the same public institution and change of financing source can be made (L1535).
- 3) By a MF resolution, transfers of credit within the same program can be made. Credit transfers cannot re-allocate investment resources to current expenditures (L1535).
- 4) Creation of new public employment and changes in salaries from what has been determined in the NGB can be made only by Law (L1535).

Evaluation

According to the text of the law, the Executive establishes the guidelines for evaluation and control of results from the budget execution (L1535). The budget evaluation measures the results for each program according to the objectives and goals initially established, and it is expected to incorporate an assessment of the results and recommendations for corrective actions (L1535).

However, the formal rules regarding evaluation are not enforced in Paraguay. All interviewees concur regarding this statement, and pointed out that no government institution takes seriously a performance evaluation of the allocation of public funds. On a scale of 1 (not adequate) to 20 (very adequate), the interviewees’ average ranking of the quality of evaluation of results was only 4.5.

Control

The internal and external control of Public Institutions will be handled by the Internal Institutional Audits (IIA), the Executive’s General Auditor Office (EGA), and the Republic General Comptroller Office (RGC) (L1535).

The Internal control comprises the ex-ante control by public managers and the ex-post control by the IIA and the EGA (L1535). The Internal Institutional Audits (IIAs) are

specialized units of controls for each public institution that proceed according to general accepted audit norms. Internal Auditors depend on the highest manager of each institution (L1535). The Executive's General Auditor depends upon the President. It is a unit of internal control of the Executive. The EGA supervise the functioning of the IIAs. The EGA must proceed according to generally accepted audit norms (L1535).

External control is a responsibility of the Republic General Comptroller Office (RGC) (L1535). Also, with Executive authorization, public institutions can hire independent external auditors, according to their special laws and/or international treaties (L1535).

The internal and external control focuses excessively on norms and procedures and not on results. All the interviewees have coincided on this point. Despite the lacunae of the established procedures, the internal and external control places excessive importance on following them at the expense of evaluating results. Moreover, even the control of norms and procedure is only marginally adequate. On a scale of 1 (not adequate) to 20 (very adequate), the interviewees' average ranking of the quality of control of norms and procedures was only 8.5.

Reporting Mechanisms

Within the first 15 days of each month, public institutions must present financial and patrimonial information of the previous month to the MF budget,. The MF could require any additional information for reporting according to the Law 1535. The responsible public employee is personally accountable for complying with this mandate (L1535).

By March 31st, the MF presents to the Executive and Congress a consolidated balance sheet of all Public Institutions from the previous fiscal year (L1535).

Article 282 of the Paraguayan Constitution requires the president to submit a report on the execution of the previous year's budget to the comptroller before the end of April every year.

Within four months after receiving from the Executive, the RGC presents to Congress a report and an assessment on the President Annual Report, based on generally accepted audit norms (Constitutional Art. 282 and L1535). Based on the general comptroller's report, some ministers have been indicted in the past.

To comply with Constitutional Article 282, Senator and Deputies organize a Bicameral Committee comprised by 5 senators and 8 deputies, which take a maximum of 30 days to evaluate the Presidential Report. Each Chamber has 30 days to approve or reject the Presidential Report (L1535).

Congress has always accepted the comptroller's report because there is a clear asymmetry between the audit technical capacity of the comptroller's office and that of congress. The comptroller's office is endowed with a large group of technical auditors who perform their duties through direct inspections of public agencies, requests of information, and the

use of the agencies' electronic information systems. This situation generates an incentive for legislators to accept the general comptroller's report without much questioning, and posits the question of what institution might effectively control the comptroller.

On one hand, these specific BPMP rules are the product of the overall policy-making process, of the basic institutions and the historical moments that are described in the previous sections. On the other hand, the specific BPMP rules affect the incentives of different players to cooperate with each other in generating the public good of efficient, sustainable and representative budget outcomes.

5. The Degree of Political Cooperation: Players, Formal and Informal Incentives Throughout the Different Budget Stages

Political cooperation refers to the solution of coordination problems to generate a management system of public funds that is efficient, representative and sustainable. This management system of public funds has public good features; that is, it is non-subtractable by its use and it is non-excludable from its use. The achievement of political cooperation implies the solution of the prisoner's dilemma-type problems among public agencies and political actors.

The level of political cooperation depends upon, as stated above, the specific rules that govern the players' interaction around the BPMP, the overall PMP, basic institutions and history. The degree of political inter-temporal cooperation is low in Paraguay. In the current political context there has been a multiplication of veto players, as mentioned earlier. This situation has imposed low decisiveness to the PMP.

The current Paraguayan PMP has limited capacity to modify major policies. As a proxy for this process, Molinas, Perez-Liñán and Saiegh (2004) observe that regulatory bills initiated by the executive faced declining rates of success: 87 percent were approved by congress during the last year of the Rodríguez administration, 69 percent during the Wasmosy term, 60 percent during the short Cubas period, and 48 percent during the González Macchi administration. Low decisiveness is the product of a weakened executive coupled with legislators with little interest in policymaking.

Corruption exposés have de-legitimized the policymaking process, thus preventing the emergence of cooperation and blocking substantial policy change. Also, in a context of declining formal and partisan powers, particularistic policy may be one of the few resources left to the executive in order to negotiate with congress. An expansion of pork-barrel politics may be consistent with a strategic attempt by the executive to overcome its increasing weaknesses. In the current context, the president may have limited capacity to adopt new regulatory or redistributive schemes, but he could be even weaker in the absence of distributive policy.

To better understand how the low level of political cooperation around the management system of public funds takes place, we will describe the actors that participate in the

budget process and their incentives, and how they interact in the different budget stages. We will include both formal and informal actors, according to the matrix below.

Figure 7. Formal and Informal Players in the BPMP

Stages Players	Preparation	Approval	Execution	Control
Political Leaders	<i>I</i>	<i>I</i>	<i>I</i>	<i>I</i>
Central Government Institutions	F	<i>I</i>	F	F
Decentralized Public Institutions	F	<i>I</i>	F	F
Ministry of Finance (MF)	F	F	F	F
Executive	F	F	F	F
Congress Bicameral Commission		F		
Chamber of Deputies		F		F
Senate		F		F
Institutional Audits Units				F
Executive's General Auditor				F
The General Comptroller				F
The Judiciary				F

F= Formal (legally mandated), I= Informal (de facto behavior).

Political Leaders

These actors do not have a formal role in the BPMP; however, they informally intervene in all major stages of the BPMP. It is through the political parties that the overall PMP mainly affects directly the level of political cooperation around the budget.

In the preparation stage, Party leaders, local and national, lobby with public managers over public employment for their supporters. Public employment is the main currency of exchange in the transaction between the government and political parties. This practice is not restricted to the different factions of the ANR. It is, rather, a widespread behavior among both ANR and opposition parties.⁹

In the preparation stage, it is common that party leaders approach multiple agents, including top public managers, Ministries, the Executive, and the Minister of Finance. In the approval, execution and control stages, the interaction between party leaders –local and nationally- and legislators is continuous. Moreover, several party leaders are legislators.

⁹ There are, however, honorable exceptions.

The increased political competition has increased the incentives for clientelistic public hiring, since party leaders need to strengthen their leadership. This negatively impact fiscal sustainability in Paraguay. On a scale of 1=No Effect to 20=Very Important Effect, the interviewees average ranking of the impact of clientelistic public hiring on fiscal sustainability was 15.3.

Public Institutions

The Top Management. Within the BPMP, it is important to distinguish two types of public institutions: those from the Central Government and those decentralized public institutions. The main difference is that negotiations with the MF over transfers of funds are more involved for central government institutions.

All types of public institutions must comply with the formal rules of budget preparation established in the Law 1535. However, as mentioned above, public institutions do not comply with the formal rule that the Executive-Legislative relations in budget matters be exclusively maintained through the Ministry of Finance. Ministers and top public managers contact legislators directly to defend their budget proposals. This situation increases the number of players in the game, jeopardizing the prospects of reaching a cooperative outcome between Congress and the MF. The lower perspective of cooperation between Congress and the MF may decrease both efficiency and sustainability in the BPMP.

The relationship of the MF with institutions outside the central government in the approval process can be more complex. These institutions are less dependent on the MF than their centralized counterparts. In several cases, decentralized institutions have their own institutional revenues and do not depend on the MF transfers. For these institutions, the incentive to directly negotiate with Congress is stronger.

Central government institutions have a more difficult path to achieve their desired budget. A successful direct negotiation with Congress during the approval process is only a necessary condition. Then, they have to successfully negotiate with the MF during the execution stage to get the funds released.

Ministers and top public managers must reconcile in their budget proposal both the anticipated expenditure due to clientelistic reasons –i.e. often the public employment due to political patronage that may not coincide with the position requirements—and the necessary expenditure for fulfilling their institutional tasks. Incorporating the clientelistic expenditure may also increase the probability of success of their budget proposal since this creates compatibility of incentives of the political leaders that may lobby for the institution's budget.

During the execution process, the negotiations between the MF and line Ministries can be a very long and frustrating process, as pointed out by several interviewees. The objectives of line Ministries and the MF differ greatly. While line ministries seek resources in order

to carry out needed activities to achieve their institutional objectives, the MF is primarily concerned that the public expenditure does not exceed the treasury's ability to pay the institutions. There is a high transaction cost in the relationship between line ministries and the MF. Line ministries have to obtain the MF support to adjust their budget among different items in the same program or the Executive support to adjust their budget among different programs within the same institution. If resources fall short, line ministries have the option to adjust their objectives or to lobby for more resources with the MF. This lobbying process has at least three stages of negotiation, according to one interviewee. First, there is a negotiation at the Ministers level. If this negotiation is successful, there is another level of negotiation between the Budget Director of the MF and the Administrative Director of the line ministry. The budget director has to be independently persuaded on the merits of the planned expenditure by the line ministry. If it is not persuaded, budget execution is not possible. If the Budget Director of the MF is convinced, there is a third level of negotiation. Once the budget modification is approved and there is authorization to spend, a negotiation over the effective transfer of resources is initiated between the line ministry treasurer and the MF treasurer.

As we can see, there are many different levels of approval in the MF for releasing funds. This difficult process generates incentives for "informal" negotiations with MF officials. The currency of exchange at this level could be several, including "favor" exchanges. The transaction costs associated with this informal procedure are huge. First, there is a financial opportunity cost of the delay that is not being considered by the public management. In several cases, private contractors incorporate this shadow price in their pricing for the provision of goods and service to the government. In other cases, it is a transfer from contractors to the government. Second, in many cases *gestores* (people specialized in dealing with specific transactions) have to be hired to do the follow up with the MF.

Public managers are responsible for the ex-ante control and, if they are top managers, for overseeing the function of the internal institutional audits. However, since the perception is a very low level of law enforcement to sanction mismanagement, the incentive to increase efficiency and diligence is not very high.

Also, changes in administration create serious discontinuities in the management of the institution. One interviewee pointed out that "everything is half-started and half-finished in public institutions". It is necessary to have more solid strategic plans by institutions that go beyond current management preferences.

Public managers have incentives to spend independently of their results. An interviewee pointed out that "if an administrator does not execute 90 percent of his budget, he will be told next year that he does not need that money. This situation inhibits the efficient use of resources. For example, if an institution has US\$ 10,000 for computer equipments but the software developed is not yet ready by the end of the year, the budgeted money must be spent before the end of the year even though it would have been better to wait until the software is finished and to buy more modern equipment the following year. However, those funds may not be available for next year". It should be noted that many public

managers have incentives to spend to earn commission on the purchase of goods and services.

We can notice that there are many incentives to pursue particularistic behavior and not as many to search for efficiency and representativeness in public management. These incentives make cooperation around the budget more difficult to achieve.

The Bureaucracy. In spite of democratic formal institutions, Paraguay has not been able to develop an effective, relatively independent, yet accountable, bureaucracy. In 2000, law 1626/00 sought to modernize the public service career by establishing a clearer system of selection, training, promotion and retirement. Among its key measures was the creation of the *Secretaria de la Función Pública* with the rank of a Ministry. This secretary of state was in charge of increasing rationalization, transparency and efficiency in the human resource management. However, the law has been challenged as unconstitutional, substantially delaying its full application (World Bank 2003). Thus, a clear description for public positions, procedures manuals, a consistent scale of public salaries, performance evaluation of public employees, and effective training system do not currently exist in Paraguay (World Bank 2003).

According to Ugo Panizza while the average Latin American public sector employee earns roughly 4 percent more than workers with similar characteristics employed by the private sector, the wage premium for a Paraguayan public employee is around 17 percent. This indicator can be used as a measure of the relative inefficiency of the public sector with respect to the private sector (Panizza 1999). The greatest challenge faced by the Paraguayan bureaucracy, though, has to do with corruption. As Kaufmann et. al. (1999) show, corrupt and dishonest practices are seen by multiple observers as a distinctive feature of the Paraguayan bureaucracy.

Several interviewees stated that the standardized definition of corruption, “the abuse of public position for private benefit,” is not perceived as a wrong thing by the typical public employee in Paraguay. For the typical public employee to receive “an incentive” to accelerate the process is the way of doing things in the public sector. From their standpoint, those payments are for a personalized service that has to be charged separately. Those payments are part of the compensation package of the public employee. For the typical public employee corruption is restricted to direct stealing of public money or government assets. Also, “traffic of influence” is an informal rule in Paraguayan bureaucracy. This is not perceived as wrong but as a manifestation of power, very close to a source of prestige.

Transaction costs within the public sector are too high. An interviewee pointed out that “to get a reimbursement of US\$ 1 for highway tolls, the established procedure requires forms and photocopies valued over 3 US\$. There are too many people that intervene and this makes things slower,” the same person added. Sometimes these delays are explicitly generated to increase the chances of getting tips.

The Ministry of Finance

The role of the Ministry of Finance is central in the BPMP. Its role comprises three fields of activity: economics, public management, and politics. That is, among the ministry's formal duties are designing a macroeconomically sound fiscal policy; coordinating the government's economic team; representing the executive in the negotiation with congress over budget matters; coordinating the use, accounting, and reporting of public funds; and coordinating the tax-collection process.

If we were to characterize the six ministers of Finance in office over the last five years (1999-2004) according to the strongest functions in their profiles, we would find mainly two types of ministers of Finance.¹⁰ The first type displays a stronger profile on management, followed by political and economic capabilities. The second type displays a stronger profile on economics, followed by management and political capabilities. Among the first group are the Cubas' minister Doll and Gonzalez Macchi's ministers Zayas, Oviedo, and Jimenez. Among the second group are Gonzalez Macchi's minister Spalding, and Duarte Frutos's minister Borda.

In the budget preparation process the economic and management dimension of the MF dominates. The MF is the coordinator of the budget preparation process: it drafts the general budget guidelines, receives, revises and prepares (for delaying institutions) the institutional projects that are later consolidated as the Executive proposal to Congress, and drafts the explanation on fiscal policy, its objectives and the technical details of revenue estimation.

During the approval process, the political dimension dominates. The MF faces two strategic fronts of negotiation: one with managers of public institutions and one with Congress. To enhance chances of political cooperation between the Executive and Congress, it would be better to present a consistent Executive, represented by the MF. However, as mentioned before, with the exception of the approval process of the 2004 budget this does not usually happen. Some of the interviewees pointed out that oftentimes, public institutions do not present a technically sound proposal to the MF, deciding beforehand that they will make their highest effort in lobbying directly to Congress. This situation, explains another interviewee, depends upon the profile of public managers, the executive and the minister of finance. If the minister of finance is relatively powerful or it is strongly backed up by the Executive, the incentives to negotiate directly to Congress decrease for public managers. If public managers are relatively powerful and the MF does not have a good working relationship with Congress, the incentives for public managers to negotiate directly with Congress increase.

In the execution stage, transfers of funds to central government agencies are handled by the Ministry of Finance. The Ministry of Finance manages transfers of funds through a monthly cash flow plan that is prepared following a quarterly indicative planning. In practice, however, Finance has some leeway to administer the transfers. Even when

¹⁰ The dimensions compare relatively among each other for each minister. It is not a comparison of the relevant dimensions across ministers.

dealing with rigid expenditures (public salaries, external debt service, and pension funds), the Ministry has some discretionary power in choosing what expenditures will be prioritized in financial hardship. For example, given an acute financial constraint, the previous administration's Minister of Finance James Spalding chose to prioritize external debt service over public salaries. In contrast, its successor, Minister Alcides Jiménez, chose to prioritize public salaries over external debt service. The most rigid expenditures account for approximately 80% of the total budget for the central government. The allocation of the remaining 20% is another source of relative discretionary power for the Minister of Finance because there is no law that establishes the procedure through which the "residual" budget should be allocated. In summary, the Minister of Finance has some limited discretion when allocating funds for both the most rigid items and more discretion with the least rigid ones. The exercise of such discretionary power, of course, is subject to presidential approval. The incentives of the Minister of Finance to make use of his limited discretionary power may vary according to his technical and political profile.

Regarding the control stage, the MF coordinates the reporting mechanisms of the government, consolidating and checking the budget, financial and patrimonial information of public institutions.

The Executive

The 1992 Constitution grants the Executive power exclusive initiation over the budget. If Congress rejects the budget or if the president fails to present a proposal, the status-quo (the current year's budget) becomes the reversionary point (art. 217). The Paraguayan president has limited resources to impose unilateral budget decisions. He lacks proper decree powers (although he may submit "urgent" bills to congress) and as with other policies, his line-item veto of the budget can be overridden by an absolute majority of congress.

In terms of budget coordination at the preparation stage, Paraguay has a relatively hierarchical budget procedure (Alesina et al. 1999, 260) and it has avoided the formation of coalition cabinets. In fact, only five coalition cabinets (in 1874, 1904, 1912, 1946, and 1999) have been formed throughout Paraguay's history (Pangrazio 2000, 324-5). The last one, during the González Macchi administration, crumbled within few months when the Liberal party abandoned the government because the president refused to give the party control over 40% of all political appointments (Paredes 2001).

In practice, the action of the Executive and the MF over the BPMP is very close. The executive oversee the MF in the preparation, approval, execution and control stage. The Executive has also the responsibility to establish the guidelines for evaluation of results that are currently seldom undertaken.

Congress

Paraguay is one of the three countries in Region 1 where the constitution gives congress unrestricted power over the budget process (the others are Argentina and Bolivia). In the

remaining countries, legislators can alter budget items but not raise total expenditures or they are only allowed to cut the budget (Payne et al. 2002, 202).

The unrestricted congressional power over the budget process threatens the aggregate fiscal discipline. As Schick (1998) points out aggregate discipline requires that budget totals are set independently of and before decisions are made on the various part of the budget; otherwise, the spending totals will raise to accommodate demand. Unrestricted congressional power allows them to potentially alter revenue estimates to accommodate demands.

The lack of adequate technical aides and procedures prevents Congress from effectively using programs evaluations in making budget decisions. Congress makes their budget decisions also on a yearly basis with no reference to a medium-term expenditure framework.

For the budget approval process, as explained above, Congress is organized in a Bicameral Committee, the Chamber of Deputies and the Senate. The process starts with the Bicameral committee, composed of 15 deputies and 15 senators, that receives the Executive's proposal and studies it for 60 days before issuing a non-binding recommendation. From Figure 9, we noticed that the bicameral did not significantly change the Executive proposal regarding the wage bill; however, it did regarding non-labor services and consumption goods.

After the Bicameral recommendations, the Chamber of Deputies has two weeks to undertake a floor vote. In recent years, deputies depart themselves from the bicameral recommendations regarding the wage-bill in 3 out of the 4 years analyzed. In two years deputies decreased expenditure over the bicameral recommendation and in one year they increased it. Deputies increased the bicameral recommendations regarding non-labor services and have ambiguous behavior over the recommendations regarding physical investment and consumption goods.

After the Deputies vote, the Senate has two weeks to undertake a floor vote. In recent years, Senators slightly depart themselves from the deputies' first round decision regarding the wage-bill in all 4 years analyzed. In three years the senate increased expenditure over the deputies' decision and in one year they decreased it. Senators increased the deputies' first round decision regarding non-labor services, physical investment and consumption goods.

In the second round interaction, there were few changes over the wage bill in comparison to the senate first round decision in two observed years (2002 and 2003). However, the senate has significantly increased the deputies' second round decision regarding the wage bill in the years 2000 and 2001.¹¹ Regarding non-labor services and physical investment the second interaction between deputies and senators are ambiguous but the final results are not substantially different from the senate's decision in the first round. A similar

¹¹ This situation is quite strange since the Senate can only either approve or reject the second round deputies' decision. This piece of information will be check in a revised version of this paper.

situation is observed for consumption goods in the 2002; however, the result is substantially different from the first-round senate's decision in the year 2003.

In summary, we observe that the Senate is not necessarily more willing to check the budget than Deputies. However, the Senate votes closer to the Executive proposal than Deputies do.

Regarding the control stage, Congress evaluates the Executive report on the execution of previous year budget, based on the Republic General Comptroller report. As mentioned before, the tendency is for Congress to accept the comptroller assessment of the Executive's report.

Internal Controls: Internal Institutional Audit Units and the Executive's General Auditor

Law 1535/99 provides the framework for the internal control. The internal audit is the responsibility of internal institutional audits units (IIA). The Executive's General Auditor (EGA) is responsible for regulation and supervision of the IIAs (World Bank, 2003b). Most of the public agencies do not have an IIA. Internal control quality is poor and inefficient (ibid). The position of the Executive's General Auditor has been filled only by the current administration.

As one interviewee pointed out, "it is necessary to strengthen the IIAs with personal responsibility (*responsabilidad solidaria*) of the internal auditor. The IIAs must be exercised by a technician, not by anyone. Internal auditors have better information on the day by day of the public institutions. Their reports should be sent immediately to the EGA. Through these reports the Executive may monitor outcomes of his ministers".

The same interviewee pointed out that "a good system of internal audits will help both the Republic General Comptroller and the Public Ministry (State General Attorney) to have more adequate information. A well functioning system of internal audits will reduce costs in the control process and will make justice more effective".

External Control: The Republic General Comptroller (RGC)

The execution of the budget at all levels is externally controlled by the Republic General Comptroller (*RGC*). According to the 1992 Constitution (art. 281), the comptroller and his deputy comptroller are nominated by the Senate and appointed by the Chamber of Deputies for five-year terms not concurrent with the electoral cycle. They can be reelected for one period. The incentives to exercise accountability are the potential control by Congress and also the potential judicial suits that their actions may elicit by third parties.

Generally, RGC auditors focus on procedures and expenditure items without paying much attention to outcomes evaluations (World Bank 2003). The effectiveness of the General Comptroller Office is restricted by the very limited financial resources. A large share of their operations refers to fraud and corruption investigation. Even though, the Comptroller's revision should be ex-post, often public agencies asked to perform ex-ante revisions. In this way, the Comptroller is a co-administrator with the executive (*Ibid*). This situation posits a potential conflict of interest with its external audit function, in addition to make the procedures less efficient. These situations do not contribute to attain operational efficiency.

As one interviewee pointed out, "the RGC needs more specialized technical personnel. It has hired people without the technical capacity. However, their personnel are in continuous training. Moreover, the institution needs more legal and environment specialists. They have better accounting and public works auditors. A general deficiency is the personnel ability to write technical reports".

The same interviewee pointed out that "there is a lack of effective coordination among the control institutions. The RGC should work based on the report of the internal institutional audit units (IIA). The RGC should support the technical work of the IIAs. With this support the the RGC would emphasize prevention without undertaking ex-ante control. It is important to avoid to be overwhelmed by acts of corruption". In a scale of 1=not adequate to 20=very adequate, the interviewees' average ranking of the quality of the RGC technical work was 9.2.

6. The Budget's Life Cycle

In this section we trace the budget's life cycle from its inception to the execution phase using data for 2002 and 2003. In the first part we map the evolution of the budget through the stages of executive preparation and legislative approval. In the second part we analyze the volatility of the budget during the different phases of elaboration and focus on the execution stage (obligations and disbursements).

Absolute Spending Levels: Initiation and Approval

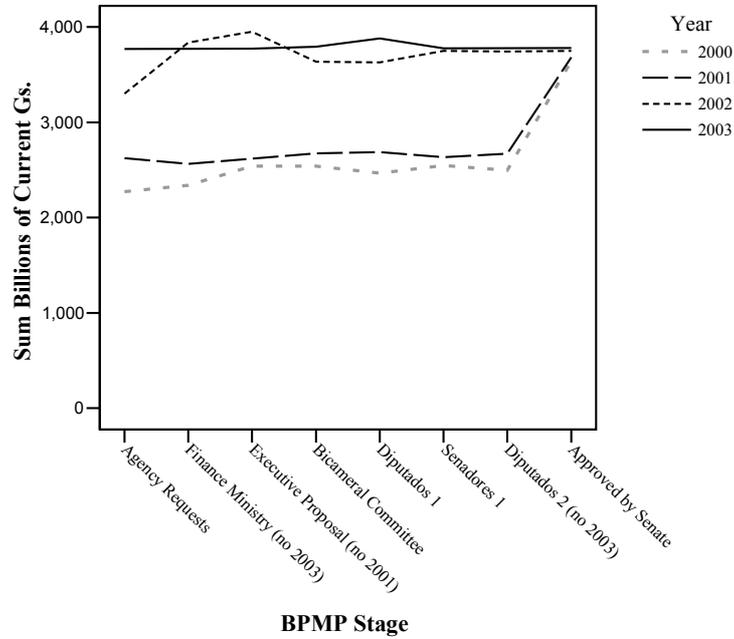
In his analysis of the 2004 budget, Uña (2004, Table 2) identified three items that represent a majority of national expenditures: wages (*servicios personales*, 24% of the 2004 budget); transfers (17% of the budget, mostly devoted to social security); and debt services (13%). Other high-spending categories are physical investment (13% although with a high component of foreign credit) and *bienes de cambio* (16%). In contrast, other categories comprised lower levels of spending, such as non-personnel services (5%) and consumption goods (3%). Our analysis of 2002 and 2003 budgets indicated a similar distribution. In Figure 9 we present the evolution of budget proposals during different stages of the BPMP for two high-spending categories (wages and physical investment) and two low-spending categories (non-personnel services and consumption goods) for 2002 and 2003. In the case of wages we have additional data for 2000 and 2001 that we provide for comparative purposes.

An analysis of the wage bill suggests three conclusions. First, the specific role of the Finance Ministry (MF) in relation to the institutions and the president does not emerge with clarity. In two of the four years (2001 and 2003) there were not significant differences between the institutions, the MF and the Executive proposals. It seems that the MF budget guidelines worked fine, although the consistency across the agencies, the MF, and the Executive proposal are exaggerated by the lack of data for the 2001 Executive proposal and the 2003 MF proposal. However, for the remaining two years (2000 and 2002), the MF *increased* the institutional requests. The expansion was slight in 2000, but substantial in 2002 (from 3.3 to 3.8 trillion guaranies). We have no explanation so far for this fact; it could be that the institutions did not present their proposals on time, and the MF corrected the previous year's budget. In 2000 and 2001, the Executive slightly increased the MF proposal. However, the general perception of our interviewees was that the MF budget proposal is usually the Executive's proposal. This perception is consistent with what we observe in the 2001-2003 period. For this reason, we take the MF and the Executive proposal as interchangeable for comparing with the different Congress chamber behavior.

Second, in three of the four years, the bicameral committee did not substantially modify the Executive's proposal over the public wage bill. In 2002, however, the bicameral commission proposed a substantial reduction in the total wage bill (from 3.9 to 3.6 trillion Gs.), rolling personnel spending back. This episode contrasts with the image of patronage-seeking legislators. But more research is needed to establish whether this was an isolated episode or it is an indication of a more systematic pattern.

Figure 9. Budget Life Cycle: Initiation and Approval

9.1. Total Wages, 2000-2003



9.2. Physical Investment, Total 2002 and 2003

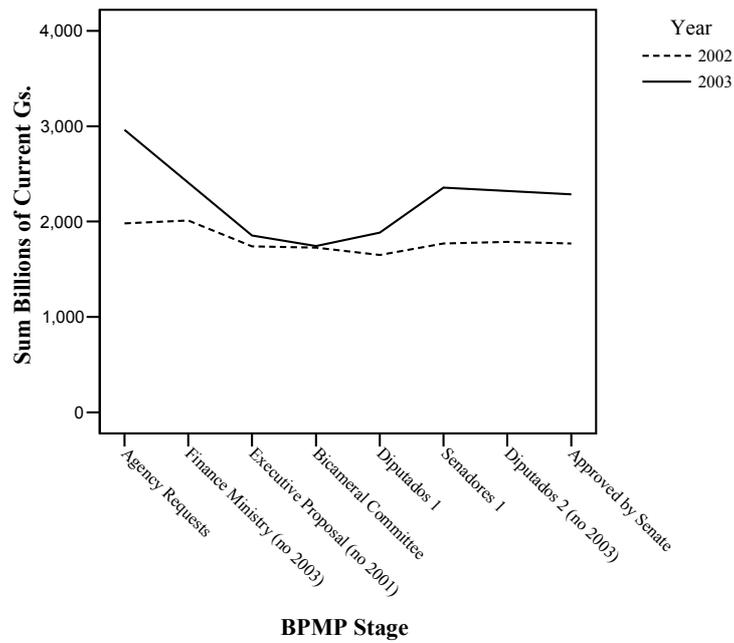
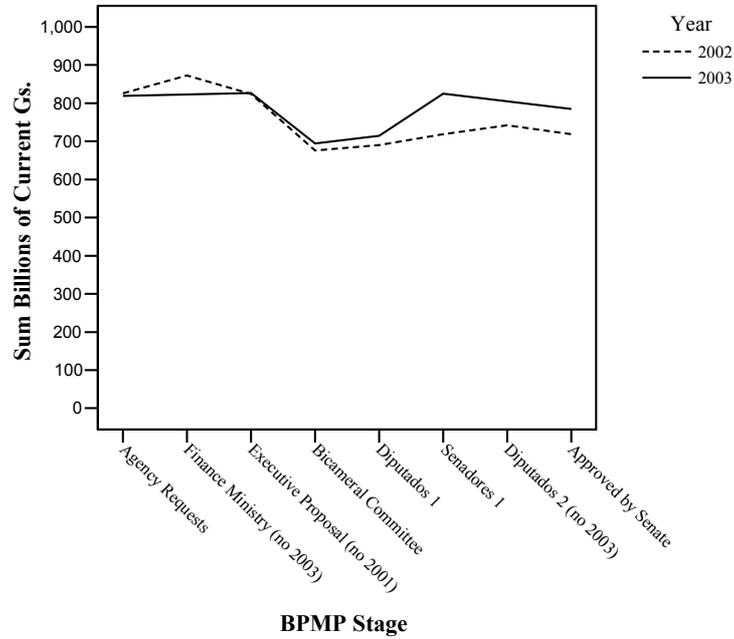
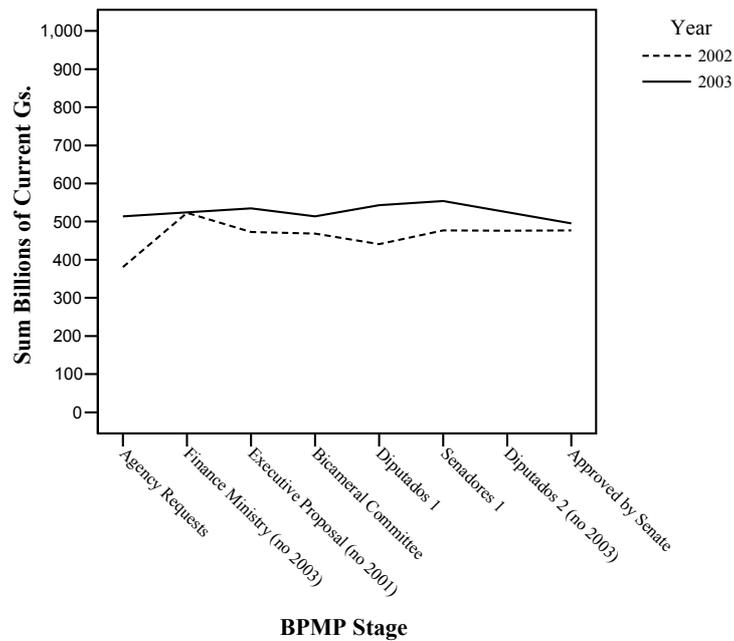


Figure 9. Budget Life Cycle: Initiation and Approval (Continued)

9.3. Non-Personnel Services, Totals 2002 and 2003



9.4. Consumption Goods, Total 2002 and 2003



Third, it seems that the lower house is not a major player in the shaping of high-spending items. Deputies may alter the relative share of the budget for particular items (a topic discussed below), but for the most part it does not challenge the aggregate spending levels set by the bicameral commission. In contrast, the Senate seems to be willing to modify aggregate spending in order to approach the requests of the Finance Ministry. Contradicting theoretical expectations that the MF and the senators (elected in a nationwide district) would be inclined to cut spending, these institutions seemed to struggle with Deputies for greater authorizations. This pattern is confirmed by the Senate's request for physical investment in 2002. The extraordinary increase in personnel spending in the last phase of the legislative process in 2000 and 2001, however, is probably not a unilateral decision of Senate—since senators are not allowed to tamper with specific items at this stage. This last-minute expansion of the wage bill deserves further research.

The unexpected willingness of the bicameral commission to cut spending and of the Senate to raise aggregate budget levels to match the requests of the Finance Ministry is also verified in low-spending categories, like non-personnel services (2003). In summary, in the preparation and approval stage, we notice that while the MF and the Executive do not cut the total wage-bill from the institutional proposals, it seems that they do cut on other items like physical investment. That is, the Executive is not as strict with public employment but it tries to compensate with other types of expenditures. We also notice that the Senate behavior is much closer to the MF and Executive proposals than are Deputies. The Executive finds in the Senate a friendlier partner than in the Chamber.

Relative Spending Levels: Volatility and Execution

How stable is the composition of the budget from one phase to the next? To what extent is the Ministry of Finance able to reassert its priorities during the execution phase? In order to address these questions, we estimated the degree volatility of the budget proposal at different stages following Abuelafia, Berensztein, Braun, and Di Gresia (Abuelafia et al. 2005, 38). Given a number of government agencies, N , the coefficient of volatility for the budget at the t -th stage of elaboration equals

$$C_t = 0.5 * \sum_{i=1}^N \left| \frac{S_{i,t}}{\sum_{i=1}^N S_{i,t}} - \frac{S_{i,t-1}}{\sum_{i=1}^N S_{i,t-1}} \right|$$

Where C_t is the coefficient for budget phase t and S_i is the proposed spending for the i -th agency. The estimation of C is akin to the estimation of electoral volatility coefficients in the analysis of party systems (e.g., Pedersen 1983). It captures the total share of the budget that is transferred from “loser” agencies to “winning” agencies from one phase of the BPMP to the next.¹² Because the share of the budget lost by one agency is transferred

¹² In this estimation, agencies are winners or losers in relative, not absolute terms. All agencies may lose part of their budgets if, for instance, congress consistently cuts their requests in the budget bill. But if congress preserves the relative size of their budgets (e.g., by cutting a uniform ten percent for all agencies), the volatility coefficient is zero.

to others in the next version of the budget, the absolute aggregate change is divided by two.

We assess five phases in the BPMP: (A) the agencies' initial requests; (B) the Executive's proposal; (C) the budget approved by congress (at the second vote in the Senate); (D) the operating budget (after amendments are introduced during the year); (E) the obligations contracted by the government; and (F) the executed budget. In the following analysis we use those capital letters to identify the phases, so for instance A-B denotes the coefficient (C_B) for the volatility of the budget observed between the initial requests and the executive proposal submitted to congress.

Table 2 presents the values of C for the different phases of the BPMP between 2002 and 2004 (data for the initial phases of the 2004 budget are not available). The values reflect the evolution of the total budget (in the top panel); of central government spending; of the decentralized institutions; and of the social sector spending (a subset of central government spending comprised by health and education). Figures in bold indicate levels of budget volatility above the 10 percent mark.

The evidence suggests that some "wrestling" takes between the agencies, the minister of Finance, and the López Palace during the preparation phase prior to September 1. This process seems to be more acute in decentralized institutions. At the same time, Finance seems to use obligations as an instrument to reassert its priorities. In 2004, the volatility between the budget bill and the obligations amounted to more than 40 percent of the total budget. At the same time, volatility in the social sector budget seems to be consistently lower, what suggests two alternative (but not exclusive) interpretations: (a) that social policy is seen as a priority by all players; and (b) that spending in health and education is politically sensitive (and thus respected by all players) not only because of its social impact, but also because of its capacity to generate sources of patronage.

Table 2. Volatility Index for Total Spending, 2002-2004

Total Budget					
	A-B	B-C	C-D	D-E	E-F
2002	.069	.045	.020	.063	.049
2003	.083	.055	.065	.084	.043
2004	n.a.	n.a.	.061	.204	.026
Central Government					
2002	.056	.038	.021	.035	.029
2003	.078	.078	.094	.083	.046
2004	n.a.	n.a.	.065	.063	.023
Decentralized Institutions					
2002	.106	.054	.022	.091	.013
2003	.034	.034	.028	.074	.010
2004	n.a.	n.a.	.057	.417	.018
Social Sector (Education and Health)					
2002	.026	.038	.000	.029	.031
2003	.006	.006	.009	.054	.043
2004	n.a.	n.a.	.002	.028	.032

Key:

A-B Agency Requests – Executive’s Proposal

B-C Executive - Senators II (Budget approved by congress)

C-D Senators II - Operating Budget

D-E Operating Budget - Obligated

E-F Obligated - Executed

We looked at the volatility rates for one particular type of spending: the wage bill. Information for personnel services is available between 2000 and 2004. The evidence presented in Table 3 suggests that: (a) congress is more likely to modify the president’s requests in this field than in others; (b) the Finance Ministry is willing to use obligations aggressively as an instrument for budget control (and this is also true for decentralized institutions); and (c) the public wage bill in the social sector remains relatively uncontroversial. It is tempting to interpret the data as proof that congress intends to expand patronage politics beyond the social sector while the Finance ministry contains this expansion. But the evidence is very inconclusive. In fact, Figure 9.1 indicates that in 2002 congress was willing to cut on personnel spending, and thus the direction of the observed volatility may go against simple assumptions.

Table 3. Volatility Index for Personnel Services, 2000-2004

Total Budget					
	A-B	B-C	C-D	D-E	E-F
2000	.005	.092	.018	.121	.114
2001	.015	.336	.031	.347	.144
2002	.019	.041	.006	.015	.026
2003	.027	.023	.015	.018	.014
2004	n.a.	n.a.	.039	.099	.014
Central Government					
2000	.042	.440	.061	.440	.060
2001	.018	.089	.015	.011	.019
2002	.011	.017	.005	.008	.022
2003	.029	.016	.012	.009	.018
2004	n.a.	n.a.	.015	.009	.016
Decentralized Institutions					
2000	.009	.091	.011	.304	.469
2001	.008	.076	.025	.045	.409
2002	.032	.109	.009	.023	.013
2003	.025	.041	.023	.031	.001
2004	n.a.	n.a.	.104	.293	.006
Social Sector (Education and Health)					
2000	.003	.075	.002	.004	.008
2001	.000	.071	.001	.007	.005
2002	.009	.009	.002	.003	.021
2003	.003	.003	.002	.001	.031
2004	.079	.074	.001	.001	.024

Key:

A-B Agency Requests – Executive’s Proposal

B-C Executive - Senators II (Budget approved by congress)

C-D Senators II - Operating Budget

D-E Operating Budget - Obligated

E-F Obligated - Executed

7. The BPMP Outer Features

1. Sustainability

The increased rigidity of public policies is reflected in the budget, which also present a high degree of rigid expenditures. The lack of capacity to take advantage that the context presents (low policy adaptability), jeopardize policy innovation and growth. The combined effect of high rigid expenditures with the opportunity cost of lack of policy innovation and growth threatens the sustainability of public finance. In fact, there have been chronic fiscal deficits in Paraguay since 1995. Since the democratization process started in 1989, each administration has confronted greater financial difficulties (Table

4). Whereas the Rodriguez administration achieved in average a fiscal surplus of 1% of the GDP, the Gonzalez Macchi administration faced an average fiscal deficit of 3% of the GDP. This situation occurred despite both an increase in tax revenues as proportion of GDP and an increase in non-tax revenues (arising mainly from royalties of the bi-national electric dams).

Table 4. Key Budget Data, 1980-2002

Collected Revenues and Allocated Expenditure as Percentage of GDP				
	Administration:			
	Stroessner	Rodriguez	Wasmosy	Gonzalez Macchi
	1980-1988	1989-1993	1994-98	1999-2002
Fiscal Deficit (-)/ Surplus (+)	-1.2	1.0	-0.5	-3.0
Tax Revenue	7.2	8.7	10.5	10.0
Non Tax Revenue	1.0	3.6	4.6	6.4
Revenue from Itaipú – Yacyretá	0.0	2.0	2.5	4.0
Public Expenditure	9.6	11.5	16.1	20.1
Current Expenditure	7.3	9.6	12.6	15.6
Public wage bill	3.0	4.4	7.1	8.6
Goods and services	1.2	1.2	1.4	1.2
Public Investment	2.3	2.0	3.5	4.5
Source: Authors' calculations based on financial reports of the Ministry of Finance (1980-2002)				

The driving force behind the increasing fiscal deficit is the steady increase in public expenditures, especially current expenditures. In turn, the main factor behind the rise of current expenditures is the expansion of the public wage bill. The public wage bill, as a proportion of GDP, almost doubled in the Gonzalez Macchi administration with respect to the Rodriguez administration. At the same time, expenditures on goods and services have remained rather fixed as a share of the GDP. This situation might create imbalances that will erode public employees' productivity since they do not have access to non-labor complementary inputs to perform their duties.

2. Efficiency

Efficiency considerations in public finance refer to the ability to reallocate resources from lesser to higher priorities and from less to more effective programs (*allocative efficiency*), as well as the ability to operate efficiently, to be competitive with market prices (*operational efficiency*).

Regarding allocative efficiency, we could observe that after 1989 the policy preferences of the Stroessner and the Rodriguez administrations proved divergent. This can be seen from the significant change in budget allocation that took place since 1989. In fact, we

contend that the significant increase in the public wage bill was propelled by the interaction of three factors: a) the need to strengthen key institutions after the demise of the dictatorship in 1989; b) the new social priorities of the democratic period, and c) the increased number of political veto players demanding pork for their constituencies.

a) Table 5 illustrates that new institutions put in place with the 1992 constitution, as an enlarged congress and a renewed judiciary, naturally demanded more resources. The percent of the budget allocated to Congress doubled as a proportion of the central government expenditure in the 1992-2002 period. The participation of the Judiciary more than tripled during the same period.

Table 5. Congress, Judiciary and Executive Expenditures
(%Total Central Government Expenditure)

	% Share in 1988	% Share in 1992	% Share in 2002
<i>Congress</i>	0.3	0.6	1.2
<i>Judiciary</i>	1.1	1.6	5.4
<i>Executive</i>	56.8	73.1	58.3
Source: Financial reports of the Ministry of Finance (1980-2002)			

b) The new priorities in social spending following the demise of the Stroessner regime also help explain the growth in the public wage bill. Expenditures in education and health significantly increased in the 1992-2002 period. In fact, the combined budgets of the Ministries of Education and Health rose from 30% to 46% of the Executive's total budget in 1992-2002 (Table 6).

Table 6. Executive Expenditures by Ministries
(%Total Expenditure by the Executive)

	% Share in 1988	% Share in 1992	% Share in 2002
Presidency	1	2	3
Ministry of Interior	14	10	11
Ministry of Foreign Affairs	2	3	4
Ministry of Defense	22	16	7
Ministry of Finance	4	12	3
Ministry of Education	20	21	34
Ministry of Health	8	9	12
Ministry of Justice and Labor	2	2	2
Ministry of Agriculture	6	8	5
Ministry of Industry	1	1	1
Ministry of Public Works	20	16	18
TOTAL	100	100	100
Source: Financial reports of the Ministry of Finance (1980-2002)			

c) The transition to democracy also prompted the multiplication of veto players. The effective number of parties in the lower house grew from 1.0 in 1960 to 1.9 in 1989, 2.4 in 1993, 2.3 in 1998, and 3.2 in 2003.¹³ In addition, the ruling Colorado party has been increasingly divided; factional disputes led to the collapse of the Cubas Grau administration in 1999 and permanently threatened the survival of the González Macchi administration. In this context, the transaction costs of legislative policymaking rose substantially. Because in Paraguay most pork-barrel takes the form of patronage, these costs were mostly funneled through the creation of positions in the public sector.

We hypothesize that the increased demand for pork, combined with a legitimized agenda for social expenditures, produced an inefficient allocation of public jobs in the social sector. This will affect the operational efficiency of the social sector. In contrast to other bureaucratic domains, the education and health systems have a nationwide employee network, and positions in this network may be a precious token of exchange with deputies and local party leaders at the local level. As an example of the operational inefficiencies created by the politics of social policy employments, consider the case of teachers' salaries presented in Box 1.

Box 1. The Teacher's Salaries Case

The emergence of the social agenda, combined with the political pressures to accommodate demands for pork across the nation, may explain the significant increase in the social sector budget. Following this hypothesis, we would expect to see inefficiencies in the allocation of social expenditures for human resources.

In this line, a background study for a World Bank loan to the education sector has pointed out that a more efficient allocation of teachers and students across schools could potentially generate significant savings in the Paraguayan education system. In the first two cycles of the basic education system, the average number of students per section is only 18. In the third cycle of basic education, this average increases to 29 students per section. In the three-year cycle of secondary education, the average number of students per section is 25. Simulations done with a supply-and-demand model for education show that in Paraguay the total expenditures for teachers' salaries are quite sensitive to the average number of students per section. The model used to run the simulations has its technical coefficients calibrated to actual data for the year 2000. These simulations tell us that by increasing the average number of students per section to 28 in the first two cycles of basic education, and to 30 in the third cycle of basic education and in secondary education, the potential total savings would be equivalent to 11.7% of the total budget of the Ministry of Education and Culture (MEC) in the year 2000. Considering the 2000 budget of the MEC, the total savings in teachers' salaries could reach US\$44.8 million in one year.

Source: World Bank

¹³ The Effective Number of Parties is an index akin to the Hirschman-Herfindahl index of market concentration (HHI) applied to the distribution of legislative seats among political parties. The formula for the index is $ENP=1/\sum(p^2)$, where p represents the proportion of seats controlled by each party in the lower chamber.

3. Representativeness

In a context of low public regard, the budget representativeness is expected to be also low. As mentioned above, the current PMP displays a very low level of public regard. In Congress, for example, controversy over bills (and thus a greater role of veto players) is expected to concentrate on comprehensive (nation-wide, region-wide, or sector-wide) policies of regulatory or redistributive intent. In contrast, particularistic policies (distributive bills with a local focus) of low visibility and low marginal cost will be less likely to generate frictions within the legislature or in executive-legislative relations. It is possible that the Paraguayan system may provide relative flexibility for the provision of particularistic (privately-regarded) policies, but relative rigidity for the provision of comprehensive regulatory or redistributive policies.

It is more difficult for a set of particularistic policies to reflect the preferences of the population at large. It might be the case that the low representativeness of the budget jeopardizes the equity of public expenditure.

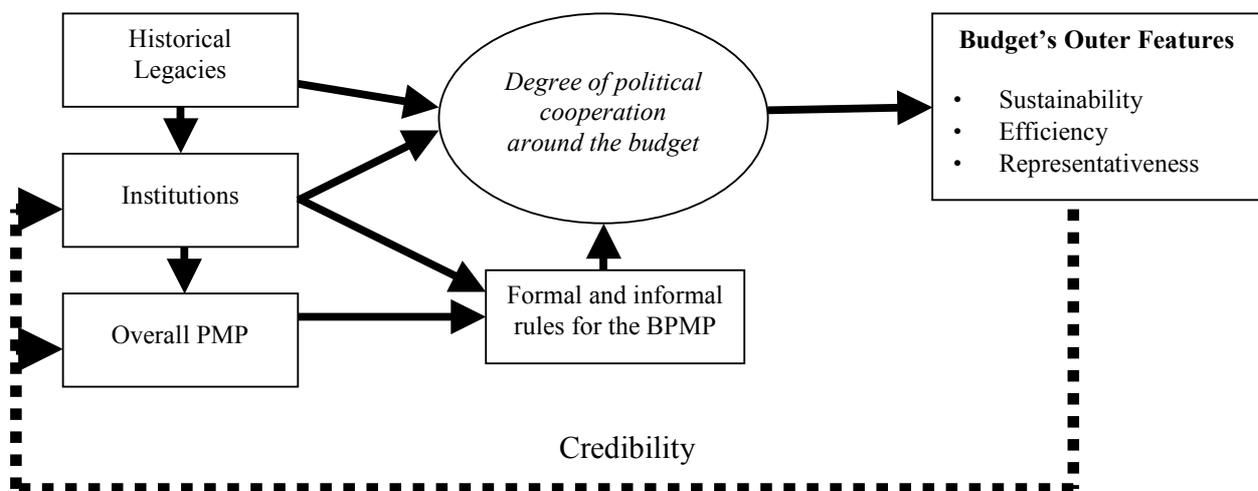
8. Conclusions and Policy Recommendations

In order to identify policy recommendations, we return to the conceptual framework presented in Figure 2. The degree of political cooperation around the budget is a major determinant of budget features such as sustainability, efficiency and representativeness. However, the degree of political cooperation depends upon the rules (formal and informal) of the budget policymaking process (BPMP), the overall PMP, the incentives created by the broader institutional framework, and other historical legacies.

Because some of these parameters (e.g., the historical legacies) must be treated for practical purposes as exogenous and “fixed,” our recommendations focus on adjustments to the formal and informal rules of the BPMP. Changes in the BPMP rules may solve problems of collective action and increase the levels of cooperation among political actors, allowing them to achieve more sustainable, efficient, and representative public expenditures. However, we should consider that (i) the impact of the BPMP on the desirable features of public expenditure is indirect (mediated by the degree of political cooperation); (ii) any change in the BPMP has to be carefully analyzed in the context of current practices of the overall PMP and institutions; and (iii) exogenous shocks can alter the conditions for sustainability independently of the BPMP, while patterns of efficiency and representativeness are more directly under the control of policymakers.

If designed correctly, changes in the rules for the BPMP could trigger a virtuous circle of political cooperation and development. That is, if appropriate changes in the rules foster political cooperation, more desirable features of public expenditure could eventually catalyze improvement in the functioning of institutions and the overall PMP. For example, in case of a major improvement of efficiency and representativeness of public expenditures, it would be plausible to expect an increase in the government’s credibility that would in turn facilitate improvement in the overall PMP and in the functioning of public institutions. This situation is illustrated in Figure 10.

Figure 10: The Budget Policymaking Process Framework



In order to identify potential areas for improvement in the BPMP rules, we summarize the formal and informal rules in Table 7.

TABLE 7

FORMAL RULES	INFORMAL RULES
Within the annual Law of NGB, there will be no statement that modifies other permanent laws.	The Paraguayan legal system does not rank laws. Any law could suspend the effect of a previous one.
Public Employees that generate a misuse of public funds will personally be responsible with their assets to repair damages.	The sanction mechanisms are extremely weak in Paraguay, due to: (i) incomplete legislation, (ii) weak evaluation and control systems, and (iii) judicial mismanagement, among others.
PREPARATION	
Revenue estimation based on technical assessment.	Congress modifies revenues at will.
The expenditure should be a function of objectives and goals. It should be based on performance indicators.	Often it replicates the previous year's.
The Executive-Legislative relations in budget matters will be exclusively maintained through the Ministry of Finance.	Ministers and top public managers contact legislators directly to defend their budget proposals.
EXECUTION	
The Ministry of Finance (MF) will keep the budget balanced	The minister's scope in the execution of the budget is severely limited by the high proportion of rigid expenditures.
	High degree of discretion by public managers in budget execution due to the lack of proper definition of procedures.
	Public managers have incentives to spend independently of their results. What it is not spent, it is lost.
EVALUATION AND CONTROL	
The Executive will establish the guidelines for evaluation and control of results.	No government institution takes seriously a performance evaluation of the allocation of public funds.
The Internal Institutional Audits (IIAs) are specialized units of controls for each public institution	IIAs are technically weak. They do not have incentives to "disagree" with top managers.
	The internal and external control focuses excessively on norms and procedures and not on results.
	Even though, the Comptroller's revision should be ex-post, often public agencies asked to perform ex-ante revisions. Potential conflicts of interest.

Although changing some of the rules described in Table 7 would require a constitutional reform, many other rules can be altered through administrative procedures. We concentrate our discussion in the latter cases. Given the low degree of political cooperation in Paraguay, political actors may require clear signals of commitment to reforms from the executive before cooperating in more ambitious reforms of the legal system. Thus, successful administrative reforms will make future legal and constitutional reforms easier.

Administrative Changes to Improve the BPMP Rules

Given that under the current PMP implementing any major change represents a challenge, we focus on five administrative measures that are expected to effectively improve the BPMP rules. The following recommendations are based on ideas collected during the qualitative interviews with policymakers and framed by our understanding of the budgetary policymaking process (as presented in the previous sections). If the feedback summarized in Figure 10 takes place, success in these administrative measures will increase the government's credibility, making other reforms that would require constitutional reforms—briefly discussed in the last point—easier to implement.

Our recommendations in this area involve two basic components: a set of changes in administrative procedures and a set of proposals to collect and disseminate budgetary information. The changes in administrative procedures involve not only modifications in formal regulations, but mainly informal adjustments in the executive's strategy to deal with the budget. The question is how to design strategies that (a) are feasible given the institutional constraints of the executive branch, and (b) are realistic given the incentives created by the overall PMP. We believe that calls for formal institutional change intended to fix institutional constraints and incentives often fail to consider the resilient incentives created by informal institutions and entrenched political practices. Our emphasis on the adoption of new budgetary practices rather than formal rules seeks to address this problem. The related proposals to collect and disseminate information seek to make budgetary decisions more transparent, and thus to re-calibrate the political incentives of politicians and public agencies.

1. Strengthening the Relationship between Public Resource Allocation and Clearly Defined Policy Priorities

Our study suggests that public employment and other particularistic policies are essential for the survival of competitive factions; these instruments have therefore become the main currency to build coalitions for the executive. In this context, funds are likely to be attracted by powerful politicians in the government (key ministers) rather than by agencies addressing policy priorities (key ministries).

One way for the executive to counteract this tendency is to signal a credible commitment with respect to certain policy priorities. Our proposal has four components. First, early during the term the president should announce a medium-term (e.g., four-year) spending

plan. The plan would indicate the main programs that constitute the president's agenda. (Priorities should be stated in terms of specific programs and outcomes, rather than broad spending categories such as "education" or "health"). Second, those priorities would be translated into a scoring system to assign "points" to requests for new funding from public agencies. Third, during the preparation phase, the executive (that is, the *equipo económico nacional* and the cabinet) would rank agency requests based on these criteria. Fourth, the ratings and the justification for the allocation would be released together with the presentation of the budget proposal to Congress by September 1st every year. The document explaining the decisions about allocations (including the scoring of requests) would be presented to the press, in order to reinforce the commitment of the administration to its agenda.

This proposal would serve as an informal equivalent of the multi-year budget plan discussed at the end of this section. We contend that this approach would improve the representativeness of the budget by making the preparation phase more systematic and transparent, and by increasing the levels of public debate and accountability even before the congressional phase. It would also promote sustainability by giving the executive an instrument to fence off the demands of powerful players within and outside the administration—unless they can frame those requests in terms of the president's public agenda.

2. Strengthening the Relationship between Public Resource Allocation and Agency Performance.

The policymakers interviewed emphasized the need to link public expenditures with performance indicators. The adoption of performance indicators should be a key component of the preparation phase, and performance evaluations could be incorporated as part of the scoring system for agency requests suggested in the previous section.

Our second proposal has two components. First, the public administration system should move towards an Activity Based Costing (ABC) accounting system. The adoption of the new accounting system would be followed by rules intended to facilitate public access to this information. In this way, both the government control agencies and the organized civil society would be able to assess the efficiency levels of different government units. The disclosure of timely and disaggregated data on programs would increase the demands for accountability of public managers and would work as a deterrence mechanism for the creation of inefficient public positions.

Second, the budget guidelines issued by the Ministry of Finance should require every agency to establish the criteria for measuring the agency's performance during the following year. In this way, every agency would adopt explicit indicators to assess future outcomes as part of the request for new funds. Using those indicators, agencies would set targets for the following year regarding their levels of output (quantitative criteria), policy outcomes (qualitative criteria), and time frames. Those commitments would be used as a benchmark to score requests the following year.

The latter point would require the creation of task forces to prepare, monitor, and evaluate programs in every public agency. Every team should issue an initial report, analyze the later implementation process, and present a report on program outcomes in preparation for next year's budget. The reports would become public information after two years.

3. Strengthening the Public Service Career System.

At the core of this paper is the argument that public employment is a major resource to build political support—support that flows from voters to factional leaders, and from those leaders to the executive. As explained in Section 5, a law passed in 2000 attempted to modernize the public service by establishing a clear system of selection, training, promotion, and retirement. The law, however, was challenged on constitutional grounds, failing in the end to establish a consistent scale of public salaries, an effective training system, and a procedure for performance evaluation of public employees.

This question cannot be analyzed in isolation, ignoring the broader conditions imposed by the historical legacies, the institutional framework, and the general rules that govern the PMP. The Paraguayan executive confronts a tradeoff between the demands of coalition-building and the requirements of greater bureaucratic efficiency. While the articulation of broad coalitions requires a flexible use of political appointments and patronage as political currency, the organization of a strong bureaucracy demands the establishment of selective criteria for hiring, regular training and evaluation, and well-structured administrative careers. Paradoxically, the type of bureaucracy that facilitates the approval of the president's initiatives is the same one that hinders their efficient implementation.

Legal attempts to solve this paradox often compound the problem by providing job security for public employees in a context of patronage politics. Rather than creating a structured career system with strong internal markets and advancement opportunities for public officials, those systems often accumulate successive layers of frustrated bureaucrats and poorly paid political appointees.

The solution to this problem must avoid “type I” error (the rejection of patronage politics at the cost of political stalemate) as well as “type II” error (the acceptance of inefficient administration as the “price of peace”). Based on the suggestion of a policymaker, we propose the adoption of a tenure system for the public administration. Under this system, public officials would not acquire job stability during their first two years in the civil service. After this period, they would be evaluated by the *Secretaría de la Función Pública* and would be confirmed in their posts or dismissed. The system would perform three functions: (a) it would retain public employees with valuable skills, promoting the professionalization of the civil service in the long run; (b) it would free vacancies in the public administration with certain regularity, allowing politicians to re-negotiate political pacts; and (c) it would provide a distinct policy instrument for the *Secretaría de la Función Pública*, an agency with the rank of ministry created recently to increase rationalization, transparency, and efficiency in the human resource management.

4. Strengthening the Anti-Corruption Systems Through Better Public Management.

Rather than presenting anti-corruption as a moral crusade, we propose a re-calibration of the incentives for public managers throughout the system. First, all public institutions should undertake a reliable risk map, identifying procedures lacunae, potential weakness of the control systems and adopt anti-corruption preventive measures. Special care should be put in strengthening technically the Internal Institutional Audit units (IIAs). The General Comptroller Office should retrain itself in performing ex-ante revisions.

Second, we encourage the adoption of procedural manuals to guide the preparation of the budget requests by the agencies and the ensuing decision-making process by the executive (the cabinet and the *equipo económico nacional*). From the point of view of the agencies, the manuals should establish not only the spending caps (determined by the Ministry of Finance), but also the main policy lines (determined by the president's guidelines discussed in the first recommendation), and the criteria to adopt annual indicators of performance (discussed in our second recommendation). From the point of view of the cabinet, the manuals should establish procedures to reward public managers that met the performance commitments adopted the previous year and to reduce the budget of agencies that displayed poor performance. This mechanism could be given greater leverage through the adoption of new rules to require regularly updated (e.g., quarterly) information on the status of the agency's programs and on the allocation of the budget.

Third, civil society organizations should be encouraged (and allowed) to monitor efficiency and the proper use of public resources. This could be done through the compilation of public and timely databases that registered: (a) the quarterly reports of agency programs discussed in the previous paragraph; (b) the administrative irregularities detected by both the IIAs and the Comptroller's Office, and the following treatment that those cases received in the different stages of control or sanctioning procedures.

In order to increase the levels of societal monitoring, our interviewees also suggested two related policies: (a) the use of university teams to analyze the allocation of budget resources in particular programs and to study medium-run trends in these policy areas, and (b) the organization of public forums with representatives of the social sectors that constitute the main stakeholders in particular policy areas.

5. Strengthening the Negotiation Position of the Ministry of Finance to Deal with Congress.

Under the current BPMP, a typical sequence identified in Table 7 takes place: although executive-legislative relations in budget matters should take place only through the Ministry of Finance, powerful ministers and public managers contact legislators directly and lobby them to protect their budget proposals. In turn, the Ministry of Finance uses its control over transfers to re-assert policy priorities, although this practice is often constrained by the rigidity of public wages and of social policy spending.

On the other hand, the specific agencies are highly dependent on low-level Finance officials because Law 1535 of 1999 established that internal transfers of funds within an agency require the approval of the Finance Ministry. We suspect that this administrative hassle can create an opportunity for restructuring the coordination of budget negotiations. Finance could adopt a simple administrative procedure to “certify” public agencies. Agencies in this category would be granted discretion to manage their own internal budgets—approval from the Finance Ministry would be automatic. Agencies outside of this category, in contrast, would be subject to the regular approval procedure. Agencies would disqualify for certification if they failed to meet the expected benchmarks of performance, if they displayed administrative irregularities during the past year, or if they by-passed Finance to lobby congress directly.

This solution would both de-centralize key administrative decisions that should be made at the agency level, and centralize the power to coordinate negotiations of the budget process during the approval phase in Congress.

Suggested Changes to Improve the BPMP Requiring a Constitutional Reform.

The adoption of the preceding recommendations would address some of the most pressing problems identified in Table 7. In turn, successful results would probably facilitate the approval of more difficult constitutional reforms. We summarize two proposals for this second stage: the creation of a multi-year budget and the establishment of a legal hierarchy for statutes.

A formal multi-year budget system would encourage basic agreements on major policy issues and would facilitate inter-temporal coordination. Although part of those advantages would be achieved through the commitment device proposed in our first recommendation, a constitutionally sanctioned multi-year budget would project in the medium-run the high level of political cooperation obtained by every new administration. It may, however, introduce rigidities in the BPMP if the system is exposed to exogenous shocks.

The adoption of a legal hierarchy would address the possible contradictions between the annual budget and the rest of the legal architecture of the Paraguayan state. It is necessary to have a binding general law that provides a clear set of criteria to formulate periodic budget laws. This requires a ranking system of laws currently missing in the Paraguayan legal order. Only within such legal hierarchy, the mandate of Law 1535 (within the annual Law of National General Budget there will be no statement that modifies other permanent laws) would be credible.

Although Paraguay is one of the few countries in Region 1 where the constitution gives congress unrestricted power over the budget process, we do not advocate constitutional budget caps during the approval phase. It would be tempting to propose a constitutional reform allowing the executive to set expenditure limits and preventing Congress from modifying revenue estimations at will. But the evidence presented above suggests that

under some circumstances Congress is willing to cut spending below the requirements of the Executive. This final point suggests that further research is necessary to pinpoint the precise *incentives* that drive public spending before a clear reallocation of *powers* across institutions is advocated.

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