

Decentralization, Budget Processes, and Feedback Effects

While policymaking processes have a strong impact on policy outcomes, policy outcomes and policy reforms can have a significant impact on the PMP. Thus there are important feedback effects between the PMP and policy outcomes.

Chapters 8, 9, and 10 looked at the impact of the policymaking process (PMP) on policy outcomes in three different sectors: tax policy, public utilities, and education. Each of these sectors has its own specific actors and its own specific sectoral policymaking games. Moreover, each sector has its own challenges, associated with its specific political economy. In each, political and technical considerations interact during the processes of policy design, approval, and implementation. In each, policy outcomes are not independent of the nature of political institutions and policymaking processes.

But the link between policymaking processes and policy outcomes goes both ways. While policymaking processes have a strong impact on policy outcomes, policy outcomes and, in particular, policy reforms can have a significant impact on the PMP. Thus the link between the PMP and policy outcomes is characterized by important feedback effects. This chapter focuses on these feedback effects, illustrating them with a few examples taken from two different policy areas in which these effects can be particularly intense: decentralization and budget processes.

Feedback effects from policy reforms to policymaking processes may vary along a number of dimensions. They can vary in terms of their intensity or their scope. In some policy areas, the feedback effects of reforms tend to be restricted to the policymaking game in the specific policy area subject to reform. In others, feedback effects are broader and can affect the general policymaking process by introducing new actors that play across the board, or by changing the nature of the exchanges that are available to participants.

In addition, feedback effects can be intentional or unintentional. Where they are intentional, the impact of the reform on the PMP is precisely one of the considerations that leads to its adoption. But some reforms can have unwanted or unanticipated effects. A good understanding of the workings of the policymaking process in the countries in question may help limit such unwanted effects.

Chapter 9, on public services, provided a good illustration of feedback effects that are intense but narrow in scope. The process of privatization and regulation generates new actors, such as privatized firms and regulatory agencies, that subsequently change the dynamics of how the policymaking game is played in the public services sector. Yet these new actors are unlikely to have an important impact on the broader policymaking game.

In contrast, in some sectors, policy reforms have the potential to affect the entire PMP. The areas of decentralization and budget processes fall into this category, as well as the area of civil service reform. Not only are the effects of reforms in these areas likely to be broad, but they are also potentially intense.

Political decentralization—such as the introduction of elections for mayors or governors in countries where they were previously appointed—can affect the policy-making process through different channels. It introduces new actors that can play an important role in the national policymaking game, at least in some countries. It may alter the political landscape by encouraging the creation of new parties (often with a regional base of support) and by providing alternative opportunities for politicians to launch and build their political careers, away from the control of the national party leadership.

Fiscal decentralization—in the form of decentralization of revenue, debt, and expenditure responsibilities—may also significantly alter a country's PMP by shifting the balance of power in favor of regional actors, at the expense of others that have a national base of support. Apart from increasing their role in the design and implementation of policies such as health and education, fiscal decentralization provides governors and mayors with a variety of resources (financial resources, government positions, and the like) that can be used to influence the behavior of other actors, such as legislators, who play a key role in the national policymaking process.

Budget reform can also have a significant impact on the broader policymaking game. After all, the budget process is the arena in which the allocation of society's scarce resources is determined. As such, it constitutes a fundamental element of the PMP. Many public policies are decided in this arena. Even those that are agreed upon elsewhere must go through the budget to ensure that the resources will be available to implement them effectively. The budget process is also the arena where many of the exchanges occur that allow certain policies to be implemented.

As is the case with the PMP more generally, the budget process involves a multiplicity of actors with different powers and incentives—the president, the finance minister, legislators, bureaucrats—that interact in the process of fiscal decision making according to certain rules of engagement. Changes in those rules—whether numerical rules that set limits on spending or debt; rules that alter the balance of power among the different actors involved in the budgetary process; or rules that affect the transparency and visibility of the budget—can affect the nature of the exchanges that are feasible, and thus have a substantial impact on the PMP.

The reform of the civil service also can have profound effects on the general PMP. In particular, in countries in which civil service positions are regularly used as a political resource, a reform that seeks to professionalize the civil service can affect the type of exchanges that political actors engage in to build and maintain political support. It is precisely because political actors are aware of these feedback effects that the reform of the civil service has been such a difficult undertaking.

The rest of the chapter will focus on a few cases that illustrate the feedback effects that reforms can have in the overall policymaking process. The first case, associated with the area of decentralization, focuses on the introduction of elections for governors in Venezuela. This reform, which took place in 1988, activated the federal aspects of the Venezuelan Constitution, which had been latent until then. While the reform had an impact through a variety of channels, probably the most important was its effect on the configuration of the party system. By opening new channels of participation and new opportunities for parties and politicians to enter the political arena, the introduction of elections for governors had a profound (and unintended) impact on the party system. It significantly diminished the power of the national party leaders of the two traditional parties, which had been major players in the policymaking game.

The second case focuses on one particular dimension of budget processes: the discretionality of the president and the executive in allocating budget resources. It compares the cases of Brazil and the Dominican Republic. Rather than focusing on reforms that have actually taken place, the discussion looks at this particular feature of budget processes and the role it plays in the PMP of the two countries. Interestingly, while in Brazil budgetary discretion allows the president to engage in political transactions that are instrumental to his ability to approve and implement his agenda, in the Dominican Republic presidential discretion over the budget seems to be an impediment to cooperation. Thus the same institutional feature has very different consequences, depending on the institutional context in which it plays out. In this way, the comparative cases of Brazil and the Dominican Republic clearly illustrate the need for a general equilibrium view of policymaking processes.

The Introduction of Elections for Governors and Mayors in Venezuela¹

The introduction of elections for governors and mayors in Venezuela is a good example of the impact of political decentralization on the PMP. Prior to decentralization, the policymaking process was characterized by relatively few and stable key players, and was highly cooperative (even collusive) in nature. At the heart of the Venezuelan PMP during the period prior to decentralization (late 1950s to late 1980s) was the *Pacto de Punto Fijo*, signed by

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¹ This case is based on Monaldi and others (2005) and Monaldi (2005).

the two traditional parties, *Acción Democrática* (AD) and *Comité de Organización Política Electoral Independiente* (COPEI), in 1958.² The *Pacto*, which was signed in reaction to the political instability generated by the hegemonic style of rule during the 1950s, involved power sharing and the implementation of common social and economic policies regardless of the results of electoral competition. Oil revenues, which played a key role, were also distributed through key political actors from both parties, regardless of electoral results.

Within this context, political parties, and in particular party leaders, played a very important role. The party system that emerged from the *Pacto*, as well as from the electoral rules in place,³ was characterized by low party fragmentation, high party centralization, and high party discipline. The party leadership controlled the nominations (who gets on the list) and the order of election (who gets elected first). The lack of elections at the regional and local levels did not provide alternative career opportunities for politicians and regional leaders outside the party, making it very costly to defect. The role of parties and party leaders in political and public life was so great that it led one analyst to call Venezuela a “partyarchy.”⁴

The process in the AD for nominating candidates for the legislature is illustrative of the power of central national party leaders. Regional party authorities would propose a list of candidates with three times more names than the number of legislative seats corresponding to the district. The National Executive Council (CEN) reserved the right to pick one-third of the candidates from outside the list and had free rein in establishing the order of the list. In practice, this meant that the CEN decided who could be elected. Other parties had slightly more democratic nomination procedures, but in all parties, the national party leadership had the most prominent role, providing an important incentive for legislators to follow the wishes of party leaders.⁵

The power of the parties and their leaders led to an arrangement where the legislature had a relatively marginal role. Most important decisions were made outside the realm of congress, which to a large extent would rubber-stamp the decisions agreed upon by the president and the party leaders (most of whom were longstanding members of the legislature)—sometimes with the participation of corporatist actors such as the workers’ union, CTV, and the peak business association, FEDECAMARAS.

Poor economic performance during the 1980s, partly due to a fall in oil prices but also due to fiscal mismanagement of the oil booms of the 1970s, led to demands to expand the channels of political participation. To a large extent, these demands were a reaction to the dominance of the traditional political parties, which were perceived as being responsible for poor economic and social outcomes. In response to these demands, President Lusinchi created the Commission for the Reform of the State, which proposed significant political reform, including elections of mayors and governors, reform of

² A third party that signed the *Pacto de Punto Fijo*, the *Unión Republicana Democrática* (URD), left the coalition in 1960.

³ In particular, the closed and blocked candidate lists for the legislature, and the concurrency of legislative and presidential elections.

⁴ Coppedge (1994).

⁵ See Crisp (2001).

electoral rules, and democratization of party structures. While the traditional parties resisted these measures, these reforms took center stage during the presidential campaign in 1988, and some of them, including the election (and reelection) of governors and mayors, were approved. The first elections for subnational executive positions took place in 1989.

Subnational elections significantly changed political and party dynamics in Venezuela. The greater number of arenas open to political competition made it more difficult for the national party leaders to keep control of nominations. Because they had to present candidates in more than 20 states and 300 municipalities, they had to rely on local politicians with local or regional appeal in order to select candidates with a greater chance of success. The increase in the number of contests also provided small parties—which had previously had no chance of survival in national elections—with the chance to compete at the regional and local level, initially through the formation of alliances with the national parties. Eventually, several of these parties, such as *Causa R* and *Proyecto Carabobo*, used these regional niches as foundations for building national structures and thus entering national politics.

A number of additional factors also helped enhance the independence of regional political actors. The decentralization of expenditure responsibilities that came with political decentralization and the close relationship with the constituents, together with the fact that regional elections were held separately from the presidential elections, created the means and the incentives for governors and mayors to become more independent from the national parties, and to develop their own political machinery. The introduction of a mixed electoral system in 1993, in which some of the legislators were chosen in districts with only one party nominee, further weakened the control of the party leadership over legislators, and strengthened the bonds between legislators and regional leaders.

All these changes caused an increase in party fragmentation (measured by the effective number of parties) and party volatility, in both presidential and legislative elections (see Table 11.1). The reforms also changed the nature of the policymaking process. Before 1989, bargaining took place among a small number of actors that acted cooperatively in more opaque arenas. In the 1990s, policymaking involved a larger number of actors in more open arenas, and policymaking became more contentious. National party leaders could no longer decide on policies outside the legislature. Not only did they have to deal with more parties, but once they lost control over nominations, they also lost control over their own legislative delegations. Congress became a more important arena, and legislators became more involved in policymaking, as illustrated by the increase in the share of laws initiated by the legislature (as opposed to the executive). Regional actors became more influential, and local/regional policies became a more important token of exchange.

The introduction of elections for governors and mayors in Venezuela very clearly illustrates the feedback effects from policy and institutional reform on the nature of the PMP. The weakening of the national parties and their leaders was an unintended consequence of the reform. These parties, after all, were the ones that had approved the reforms, even if they did so under the pressure of popular demand. The change in the policymaking process also brought about changes in the features of public policies, similar to those dis-

Table 11.1 Party Fragmentation, Party Volatility, and the Role of Congress in Venezuela before and after Decentralization

	Pre-decentralization	Post-decentralization
Effective number of parties in congress	2.65 ^a	4.6 ^b
Party volatility in congress (percent) ^c	18.9 ^d	38.1 ^e
Volatility in the presidential vote (percent) ^f	13.9	52.0
Share of ordinary laws initiated by the legislature (percent)	34.0	64.0

^a Average between 1973 and 1988. See Data Appendix for an explanation of the method for computing the effective number of parties.

^b Average between 1989 and 2003.

^c See Data Appendix.

^d Average between 1958 and 1988.

^e Average between 1989 and 2000.

^f See Data Appendix.

Source: Monaldi and others (2005).

cussed in the case of Colombia (see Chapter 7). In line with the increased level of political participation, policies became more public-regarding. But the breakdown of cooperation meant that, at the same time, policies became less stable and less adaptable.

Presidential Budgetary Discretion in Brazil and the Dominican Republic

Like decentralization, the reform of budget procedures may also have profound effects on the PMP. These effects are particularly important, given the role that the budget plays as an arena where policies are funded, where losers can be compensated, and, more generally, where important political transactions can take place. Different dimensions of budget procedures may be subject to reform, and each of them may impact the PMP in a different way.⁶ Since the objective of this chapter is to illustrate the importance of feedback effects with some examples, this section will focus on a particular dimension of budget procedures: the discretion of the executive to modify the allocation of funds during the budget execution stage.

⁶ See Filc and Scartascini (2005).

The discussion will center on a comparison between two countries in which presidents enjoy a substantial amount of budgetary discretion: Brazil and the Dominican Republic. Interestingly, while in Brazil budgetary discretion seems to foster inter-temporal agreements and cooperation, in the Dominican Republic, executive discretion in budgetary matters can make it more difficult to reach agreements. The different role played by budgetary discretion in these two countries can be attributed to differences in the precise nature of the budgetary discretion in each country and, more importantly, to substantial differences in the broader political and institutional context in which this particular feature of budget processes is embedded.

Brazil⁷

According to the Brazilian budget process, the executive branch is quite powerful in relation to the legislature. This difference in relative power is evident in different stages of the budget process. During budget approval, for example, the executive has the ability to veto any amendment proposed by the legislature that it does not favor. Despite this high level of executive control, congress nevertheless systematically proposes and approves a large number of amendments (collective and individual) to the annual budget. Even though the resources involved are small relative to the whole budget, it may seem surprising that the executive would allow its proposal to be moved from its preferred position in such a manner, given the instruments at its disposal.

The reason why the executive allows this to happen is that it still retains a considerable amount of discretion during budget execution. More specifically, the president can impound the funds associated with any of the amendments proposed by the legislators, provided actual revenues fall short of budgeted revenues (which tends to be the case rather frequently). Thus the approval of these amendments provides the opportunity for the president to use his powers of budgetary appropriation to obtain political support for his agenda from the members of the legislature and thus keep the coalition together, even in the context of a highly fragmented party system.

For these political transactions to occur, two things must come together. First, there must be gains to both participants in the transaction. Second, the executive must be credible in its promise to execute the amendments in exchange for the support it receives in congress. Both conditions seem to be present in Brazil.

One of the most important dimensions on which the president is judged is his ability to deliver macroeconomic stability. Macro stability has become an important electoral issue and can greatly affect a president's chances for reelection. To deliver stability, the president needs support for certain reforms, such as pension reform. Legislators also

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⁷ This section is based on Alston and others (2005a, 2005b).

seek reelection. As discussed in Chapter 7, the electoral rules in place (open-list proportional representation) provide incentives for legislators to deliver local investment projects to their jurisdictions. Except when legislators have strong preferences opposing the administration's reform agenda, this combination of factors creates opportunities for gains from trade. Legislators support the executive on crucial votes in the legislature in exchange for the disbursement of funds for local investments (a bridge, a hospital, a school) in their jurisdictions.

It is important to stress that the type of political exchange described here is perfectly legitimate. The president is seeking to further the national public good, and the legislators are acting in line with the preferences of their constituents. Moreover, such an exchange may allow the president to pass his agenda, even if he controls a small share of legislative seats.

These exchanges also require an important element of credibility. Empirical research suggests that the executive delivers on its promise: the execution of budget amendments proposed by individual legislators is highly correlated with the share of votes in which the legislator voted in favor of the administration's position.⁸ Moreover, the research shows that the execution of legislators' amendments significantly increases their probability of electoral success and political survival.

Dominican Republic

As in Brazil, the president of the Dominican Republic also has a high degree of budgetary discretion, although the extent of this discretion has declined in recent years. Yet while this element contributes to facilitating political transactions in Brazil, the impact is quite the opposite in the Dominican Republic. The contrast between these cases clearly shows that the consequences of discretionary power depend on how budgetary rules operate in conjunction with the remaining features of the PMP.

Historically, the executive has had discretion over a large portion of the budget because of the combination of various rules that have limited the prerogatives of the legislature. Congress cannot propose budget increases, modify any expenses, or move allocations between budgetary items in different budget chapters without having a two-thirds majority of the total membership in each chamber.⁹ When congress is not in session, the president can freely move resources between budget chapters by decree. Most importantly, until fairly recently the president controlled the "1401 Account" and had discretionary control over its distribution. The funds in this account had two origins: 75 percent of any revenues above and beyond budget estimations, and 100 percent of any "unutilized" funds by any executing unit. It was not unusual for the executive to underestimate revenues and control expenditures through cash management in order to have more control over the distribution of budget expenditures.¹⁰ Primarily through the

⁸ Alston and others (2005a).

⁹ In effect, it is more demanding to introduce or modify expenses in the national budget than to reform the constitution.

¹⁰ It is important to point out that the rules regarding the use of the 1401 Account changed in 2002. As a result, the discretion of the president in distributing resources has been significantly reduced.

use of this account, the Office of the President executed more than half (50 percent) of the budget every year between 1986 and 1996.¹¹

In the context of the Dominican PMP, the executive's discretionary powers over budget matters seem to increase the cost of passing reforms and approving legislation. The difference can be traced to the two elements that are necessary for efficient transactions to occur: gains from trade and credibility. In Brazil, the gains from trade are clear. In the Dominican Republic, the opportunities for trade are less clear, in the context of a clientelistic party system. The reason is that both presidents and legislators tend to be judged according to their ability to deliver public goods and transfers to specific groups of voters. In this regard, they are competing for the distribution of the same pool of resources.

Credibility has also been lacking in the Dominican Republic, for a simple reason: credibility suffers when the bargaining chip one holds is costly to sacrifice. Unlike in Brazil, where the executive can decide whether or not to execute an amendment (without the power to change the destination of the funds), until recently the budget process in the Dominican Republic allowed the president to gain control of the funds by limiting budget execution on any item. In effect, a president seeking political support to pass legislation through congress would be subject to what the literature refers to as a *time-consistency* problem. He could promise to deliver budget resources in order to build a coalition to pass key legislation—but he would not be able to credibly commit to deliver.

In the presence of time-consistency problems, the “market” for political exchanges breaks down. In this case, the result was difficulty for the president in passing key legislation or economic reform, and a contentious relationship between the executive and congress. Given the relative lack of party discipline in the Dominican political system, this difficulty persisted even during periods in which the government's party controlled a majority of the legislative seats. Examples of legislation that was severely delayed or blocked in congress include the monetary and financial code, which took almost a decade to clear congress,¹² and various attempts to increase tax revenues, which were repeatedly blocked.¹³

The contrasting cases of Brazil and the Dominican Republic illustrate how particular features of the PMP may have different effects when they are embedded in different institutional contexts. Examination of such contrasting cases highlights the need for a nuanced view of policymaking processes that takes into account a multiplicity of institutional dimensions and their interactions.

¹¹ Central Bank of the Dominican Republic (2005).

¹² Some observers believe its earlier approval could have prevented the financial crisis that took place in the country in 2003.

¹³ Interestingly, attempts to lower taxes are typically approved without much complication.

