More hierarchical context in terms of fiscal governance can lead to more efficient budgetary outcomes? The Case of Ecuador

A dissertation submitted to King’s College London for the degree of MSc Political Economy of Emerging Markets in the Faculty of Arts and Humanities

2014

Carmen Elena Falconí Vaca
1349660

International Development Institute
TABLE OF CONTENTS

Figures ........................................................................................................................................3
Abstract....................................................................................................................................4
Acknowledgements ..................................................................................................................5
1. INTRODUCTION ..................................................................................................................6
2. LITERATURE REVIEW: FISCAL GOVERNANCE IN A RESOURCE RICH COUNTRY .................................................................9
2.1. Fiscal governance ..............................................................................................................9
2.2. The Budget and the politics of the budget process ............................................................12
2.2.1. Budget ..........................................................................................................................12
2.2.2. Politics of the budget process .......................................................................................15
2.3. Fiscal outcomes as a result of the politics in the budget making process ......................18
2.4. Fiscal outcomes in resource-rich countries ......................................................................20
3. CASE OF STUDY: ECUADOR A RESOURCE RICH COUNTRY ..................................................................................24
3.1. Political and Fiscal changes in Ecuador’s budget process ..................................................24
3.2. How the case fit the research problem? ...........................................................................25
3.3. Research Plan ....................................................................................................................27
4. ECUADOR BUDGET PROCESS, INSTITUTIONAL CHANGES AND FISCAL OUTCOMES ..............................................................................28
4.1. Background .......................................................................................................................28
4.2. The Budget Process in Ecuador .........................................................................................31
4.2.1. Rules for the budget process ......................................................................................31
4.2.2. Budget and the political economy of the Budget Process in Ecuador .......................32
4.3 FISCAL OUTCOMES AFTER THE REFORMS ..................................................................................43
5. CONCLUSIONS ....................................................................................................................48
APPENDIX ................................................................................................................................50
BIBLIOGRAPHY ....................................................................................................................52
LIST OF TABLES AND FIGURES

Tables
Table 1. National Assembly Composition 2007 – 2015........................................37
Table 2. Public Investment Budget Distribution 2007 – 2013............................39
Table 3. Public Investment Budget 2007 – 2013.................................................40
Table 4. Direction of the changes in the budget process.................................40
Table 5. Capacity to negotiate and to spend.....................................................41

Figures
Figure 1. Budget reallocation at different stages of the budget process.............45
Figure 2. Budget reallocation at CLR 2007 – 2013..........................................46
Figure 3. Budget reallocation at CRE 2007- 2013............................................46
Abstract

According to the literature, on fiscal governance a more hierarchical budgetary process can lead to better fiscal outcomes. Several studies had focused on reforms of political and budgetary institutions over the budget process and its effects on the fiscal balance. However, the other dimensions of fiscal governance, especially efficiency have several different approaches and understandings. Therefore, the aim of this paper is analyse if under a similar environment of more hierarchical institutions and players, can the same result obtained by fiscal discipline be expected for efficiency?
Acknowledgements

I would like to express my gratitude to my supervisor, Andres Mejia Acosta, Ph.D., who has guided me through this research and provided endless support and sources of information. I would also like to thank all my colleagues and friends that give me valuable help and advice during this project. Special thanks to my family, for the encouragement and lovely unconditional support.
1. INTRODUCTION

During the last years, the study of fiscal governance and the relation with the budget process has been focused on the political and fiscal institutions that governs it, as well as, the policy making process that implies the budgeting and the reforms applied to improving fiscal outputs.

The budget-making process, as with any other policy-making process, involves a multiplicity of players with different incentives, and its success is possible only under cooperative environments. These interactions affect the distribution of public funds (Scartascini and Stein, 2009).

In terms of fiscal governance, a sound fiscal policy is related to sustainability, efficiency, responsibility, adaptability and transparency. To achieve these outcomes, scholars propose a series of mechanisms derived from the institutional framework, that help to solve the cooperation problems, that comes up from the distribution of public resources and the allocation thereof (regarding most efficient and productive initiatives associated with the national strategic objectives). Hence, the suitable combination of institutional arrangements and mechanisms, with the appropriate balance between restraint and flexibility could lead to better fiscal outcomes.

In this context, the political and budgetary institutional arrangements that influence fiscal discipline and encourage sustainability between others are: a strong executive with prerogatives over the congress, a legislative branch with limited powers in the budget process, incentives to political actors to keep coalitions, fewer number of political parties in the coalition, political affinity between the coalition members, ex-ante fiscal constraints, a more transparent budget making process. (Mejia-Acosta, 1999b).

From this perspective and according to the fiscal governance, countries with more hierarchical institutions, greater centralization of the budget process and rules restraining significant deficits, tend to improve budget discipline (Alesina et al., 1999; Hallerberg and Marier, 2004; Filc and Scartascini, 2006).
Therefore, the question that arises is if under a similar environment of more hierarchical institutions and players, can the same result obtained by fiscal discipline be expected for efficiency?

For the purpose of this paper it is assumed that as fewer reallocations took place, the budget is more efficient (Mejía-Acosta, Albornoz and Araujo, 2009b). This supposing that in a more hierarchical context, there is no need for major reallocations, if: a) the allocation of resources is done almost as proposed by the executive, b) the spending ministers demand resources for efficient projects aligned with the planning and the objectives of the government.

Over the past 16 years, Ecuador has experimented with changes in its legal, economic and political framework, which affected the budget making process. New actors have appeared, and the structure of power has changed. Leading to more hierarchical institutions, with a long-term president with strong agenda-setting powers (the last eight years), fewer veto players and plurality support in the congress. Inside this framework, the purpose of this investigation is to understand how the institutional reforms influenced the budget process and the allocation of resources, and if the results lead to more or less efficient budget outcomes.

Through a qualitative and quantitative analysis, this investigation attempts to explore to which extent the institutional reforms affected the budget process and the fiscal performance in terms of efficiency in Ecuador. Measuring the ratio of changes between each stage of the budget, for the years 2007-2013 focusing on the public investment budget, applying the model proposed by Scartascini and Stein (model that analyse the role of each actor in each stage of the budget process), and by evaluating which actors have more influence, and if the budget execution is close the expected level (Scartascini and Stein, 2009; Mejía-Acosta, Albornoz and Araujo, 2009).

Finally, the paper is organized as follows: It begins with a review of the most relevant information on fiscal governance and the budget process, by explaining the relation between both, and how the policy process and the institutional reforms may assist in achieving the desired outcomes. The next section provides information about the case of study and how it links with the theory, detailing the information that will be analysed. Section 4, describes the Ecuadorian budget process and its fiscal outputs, providing
information on the findings of the investigation. Finally, Section 5 exposes the conclusion of the paper.
2. LITERATURE REVIEW: FISCAL GOVERNANCE IN A RESOURCE RICH COUNTRY

This literature review comprises, in the first place, the main knowledge about fiscal governance and the common pool resource problem that arises from the budget process, followed by the description of the budget and the political making process. Thirdly, it analyses the fiscal outcomes as the result of the budget making process and its variations in a resource rich country.

2.1. Fiscal governance

Fiscal governance can be understood as a group of institutions or the system that sets the environment for the elaboration of fiscal policy and its main instrument: the budget (Hallerberg, Rainer-Strauch, and von Hagen, 2009). As with any policy-making process, the fiscal policy of a country and its outcomes are the results of transactions and bargains that involve multiple actors with different motivations and interests (Scartascini and Stein, 2009).

The attributes with which sound fiscal governance is associated are sustainability, efficiency, representativeness, adaptability and transparency.

- Sustainability is related to the idea of maintaining balanced public finance over time. It is customarily examined by measuring the evolution of deficits, debt, and current accounts (Scartascini and Stein, 2009).

- Efficiency can be seen from diverse perspectives. From an allocation criterion, it implies that the resources are assigned to the most important needs. Technical efficiency is related to a cost–effective use of resources. Efficiency can also be evaluated according to the capacity to reach government goals; degree of execution; and by the ratio of changes between the different stages of the budget process (Scartascini and Stein 2009; Mejía-Acosta, 2009b; Puente et al., 2009).
Adaptability is the capacity to adjust to economic cycles and mitigate impacts over the public spending (Scartascini and Stein, 2009; Puente et al., 2009).

Representativeness refers to the distribution of public resources amongst the population, indicating whether it serves the interests of the inhabitants at large rather than selective elites or private interests (Scartascini and Stein, 2009; Mejía-Acosta, 2009b).

Transparency means to ensure access to information related to a) decisions made by public officers or elected representatives; b) the reasons that motivate those decisions; c) their cost; and d) the results (World Bank, 1998).

The core problem of governing public finances is the collective action problem originated by the decision of how to allocate scarce public resources during the budget process (von Hagen, 2006). Achieving agreements in any collective process that involves a diversity of actors with different goals would face common pool resource problems and principal agent problems.

The common pool resources problem arises when the political players involved do not consider the total size of the public fund and want to obtain the maximum amount of resources (Filc and Scartascini, 2006). Each actor or player has incentives to take decisions based on self-interest, meaning that each wants to acquire as much as he or she can of the budget. The collective results of the decisions made by each player may not lead them to achieve this goal (Scartascini and Stein, 2009).

Principal-agent problems are the result of actions taken by agents (elected officials) that prioritize particular goals, and that are not necessarily in the best interest of the principal (voters) (Braun, 2007; Scartascini and Stein 2009).

To mitigate the problems that arise from a collective process, institutions that govern public finance decisions are required. The ability of the players to cooperate between themselves and the validity of the agreement through time, depend on the political and fiscal institutions that regulate it.
Budgetary institutions are the group of rules, procedures and practices that determine how the budget is elaborated, by a) assigning responsibilities and prerogatives to the players; b) regulating the inter and intra branch relations between actors; c) numerical restrictions to fiscal indicators and d) the degree of transparency. All of them affect the size and the distribution of fiscal resources. (Filc and Scartascini, 2006).

Political institutions are the set of rules and procedures of the game. They affect the negotiating processes and thus the incentives of actors that participate in the process, such as electoral systems and party systems (Filc and Scartascini, 2006).

Specifically, the mechanisms proposed to reduce the collective actions problems during the budget-making process in the setting of fiscal and political institutions are:

- Ex ante fiscal rules, which are numerical constraints such as constitutional limits on deficits, or debt spending, or taxes (von Hagen, 2006; Hallerberg, Rainer-Strauch, Hagen, 2009). They serve to encourage various outcomes necessary for sound fiscal governance, such as aggregate fiscal discipline, resource allocation based on strategic priorities, and efficacy and effectiveness of government programs (Shick, 1998). This rule of fiscal performance is related to the sustainability of the economy (Scartascini and Stein, 2009).

- Electoral rules encouraging political accountability and competition, which is the framework for political elections (electoral formula, ballot structure the number of representatives for each district, electoral cycles, etc.) (Von Hagen, 2006).

- Procedural rules of the budget process, which are mechanisms that define how and when decisions are taken, the structure and form of budget estimates, and the scope, participants and the degree of participation during the process (Shick, 1998). Some of them are formal and others are informal depending on the specificity of the laws (flexibility, restraint, participants, transparency), the political system (presidential or parliamentarian) and the legislative composition (one majority party or coalition) (Shick, 1998; World Bank, 1998).
In addition to these rules, the incentives of each agent and other variables such as transparency, and access to reward and punishment instruments are critical factors that contribute to the performance of the mechanisms (Filc and Scartascini, 2006).

Having discussed fiscal governance, the collective process that the budget represents and the principal institutions that shape the fiscal decisions, the following paragraphs now focus on the budget and the political processes involved in its formation.

2.2. The Budget and the politics of the budget process

2.2.1. Budget

The budget allocation process is a game of political bargaining, where political actors with different incentives and constraints interact and decide on the allocation of scarce public resources. A system of formal and informal rules that provides the framework for the formulation of the budget through its four stages: the elaboration of the draft by the executive, the approval of the proposal by the legislature, the implementation of the budget, and the control phase under the shared responsibility of the congress, the executive, the comptroller’s national office and the citizens (Hallerberg, Scartascini, and Stein, 2009).

Preparation of the annual budget

During the preparation of the budget, the executive has the duty to allocate revenues. The first step of this phase is the elaboration and presentation of the guidelines for the budget with a multiyear perspective; followed by the medium term macroeconomic forecasting and the formulation of goals and policies according to the government plan (Jones, 2001; Hallerberg, 2003; Scartascini and Stein, 2004). The key players at this stage are the president, the members of the cabinet and the ministry of finance. The legal attributes of the executive shape the power vis à vis the legislative branch.
Congressional discussion and approval

The legislative approval phase involves the process of amendments to the budget proposal sent by the executive (Scartascini and Stein, 2004). The prerogatives of the legislative branch over the budget vary from country to country. In some cases, the congress can make significant changes to the proposal sent by the executive. For example, the legislative branch may have restrictions to increase the total expenditures or propose new ones. Also, it can have the option to reallocate resources or increase the total amount of the budget, linked to the identification of new sources of financing (Hallerberg, 2003; File and Scartascini, 2006). The principal actors in this phase are the congress with its one or two chambers and the political parties.

Implementation

Once the budgetary bill becomes law, the phase of execution starts. The third stage of the budget changes widely, depending on the established rules. In some cases, the government has the obligation by law to execute the budget without amending it; in other cases the executive can reallocate or make additions to the budget through this phase. This stage offers the executive space for discreitional decisions depending on the existing laws and the degree of rigidity of the budget (Hallerberg, 2003; Abuelafila, Berenztein, Braun, and di Gresia, 2005).

Evaluation and Control

The oversight stage is the process to audit and control the implementation of the budget. (Scartascini and Stein, 2004). It is a significant piece in the overall budget process, as it shapes the incentives of agents in the three previous stages (Cardenas, Mejia and Olivera, 2009).

As aforementioned, the budget process faces a common pool resource problem, which can be reduced by fiscal and political rules. However, the Public Expenditure Management Approach argues that the budget must focus on the outcomes instead of the procedure, with key objectives as aggregate fiscal discipline, allocative efficiency and operational efficiency. Which means the budget must be the set of government strategic priorities pursuing public policies goals, considering the effectiveness of the public programs, and the provision of services at competitive prices. Information, the
interests and behaviour of actors in the fiscal process are complements in this approach (Shick, 1998; World Bank, 1998).

- **Aggregate fiscal discipline** requires a balance between the total revenue and the total spending. The limits of each one must be set independently and before any decision is taken. Reaching and keeping fiscal balance requires institutional arrangements (depending on the type of government and the degree of flexibility or rigidity of the system) as constraints rules, sustainability of public finances over time, and a strong agent that keeps fiscal discipline (Shick, 1998).

- **Allocative efficiency** depends on the ability of the government to reallocate resources from ongoing public programs to more productive ones. The central authority, according to the national priorities and objectives, defines spending limits for sectors or portfolios. The distribution of the resources inside them are entrusted to the sectorial authorities, who must respect the spending ceilings and select the pertinent public initiatives according to the effectiveness of programs, expected outcomes and public policy aims (Shick, 1998).

Defining priorities is a political decision, and must be limited by institutional arrangements, which provide the agent the right incentives to allocate resources in efficient and productive investments. Based on information related to the evaluation of the initiative, its impact and its alignment with the government’s strategic priorities (World Bank, 1998).

Devolving the responsibility of resource allocation to a sectorial authority a) reduces the information demands generated by the central controllers; b) decreases the conflict between the fiscal authority and the responsible ministers; and c) incentivizes ministers to reallocate the resources rather than fight for more. The authority must first analyse the possibility of saving resources inside the portfolio (Shick, 1998).

This criterion assumes that the budget is driven by the behaviour of agents involved in the process. The idea is that each ministry’s request be limited to the
resources that were assigned to it, meaning that efficient and beneficial programs compete for resources (Shick, 1998).

- **Operational efficiency** focuses on the spending control over outputs instead of inputs. The responsibility for the operational management of the resources is shifted to the spending ministers, giving them incentives to use the resources efficiently, based in their discretion, but at the same time; cost, quality and outputs must be permanently accountable to citizens (Shick, 1998).

Summing up, the appropriate restraints with the proper degree of flexibility for managers to take decisions may improve the outcomes. The key is to obtain the correct balance between them, avoiding indiscipline. In addition, strategic decisions should stay at the central level while operational decisions are decentralized (World Bank, 1998).

### 2.2.2. Politics of the budget process

The budget process is part of a larger policymaking process, and the fiscal outcomes are the result of a complex set of interactions between the executive, legislators, economic actors, political actors and civil society. Therefore, bargaining and trade-offs related to other policymaking areas are decided here (Scartascini and Stein, 2009). Reaching political agreements depends on: how far the policy proposed is from the status quo, the willingness of the actors to change the status quo, the number of veto players and the liability of the coalitions (formal or informal). (Mejia-Acosta, 2010).

As a political process, it is conditioned by incentives and constraints imposed on different actors by the political institutions. The rules of the game will shape the bargaining during the budget process depending on a) the type of government: presidential or parliamentarian; b) electoral system: plurality or proportional representation; c) electoral cycles and; d) party systems: fragmented or institutionalized (Filc and Scartascini, 2006).

In addition to political institutions, budgetary institutions and the legal framework will also affect the fiscal results and budget outcomes (Filc and Scartascini, 2006).
All of them shape the incentives that the decisions makers have during the budget-making process according to their preferences. There are two ideal forms of fiscal governance that help to define the appropriate combination of fiscal rules or mechanisms to solve the problems during the policymaking process: delegation and contracts.

**Delegation**
A fiscal entrepreneur is appointed as a central player (most likely to play the role is the finance minister) with considerable decision-making power and authority over public resources. The task of this agent is to ensure that all players choose to cooperate (Von Hagen, 2006; Hallerberg, Rainer-Strauch and von Hagel, 2009).

To be effective on the assigned role, the finance minister must a) have the ability to monitor the other players; b) the support of the president or the prime minister; c) has selective and proper incentives to reward cooperative spending ministers and punish defecting ones by, for example, modifying budget proposals or imposing cash limits, or approving all cash disbursements, or blocking spending during the year (Hallerberg, Rainer-Strauch and von Hagel, 2009).

**Contracts**
A group of agents with similar decision-making rights commits to a set of fiscal targets and negotiates before the start of the budgeting process (Hallerberg, Rainer and Von Hagel, 2009). The bargaining process helps to internalize the common-pool externality and often takes place between the coalitions agreements among the ruling parties. The role of the finance ministry is to evaluate the consistency of each spending unit and that the budgets stay within the limits defined by the fiscal targets (Hallerberg, Rainer-Strauch, and von Hagen, 2009).

The choice between these two models depends on the political system and the electoral rules. At this point, the document focuses solely on presidential systems.
Countries with a single party or coalition governments between parties that are close ideologically choose delegation. While in coalition governments, where the difference in ideology is large, fiscal contracts are a better option (Hallerberg, Rainer-Strauch, and von. Hagen, 2009).

Members of the same party share the same views related to the distribution of funds, and conflicts of interest arise only from the common pool problem. However, in coalition including parties with different ideologies, cabinet members and party members probably are going to have different thoughts about the distribution of resources and the beneficiaries. Consequently, principal-agent problems and common pool problem take place. (Hallerberg, Rainer-Strauch and von Hagel, 2009).

A successful form of delegation requires that the legislative branch delegate its power in the budget process to the central player. This fact guarantees that the proposed bill does not suffer considerable changes without the approval of the executive (Hallerberg, 2003; Hallerberg and Marier, 2004). However, in a coalition government with similar ideologies, the other members of the coalition will not necessarily trust the fiscal entrepreneur with significant powers. Instead, they would desire to keep the capacity to amend the budget if they do not have the suitable incentives to stay in the coalition (Hallerberg, Rainer-Strauch and von Hagel, 2009).

As any policymaking process, the budgetary process is a series of bargains and exchanges between actors, with incentives and constraints that are determined by the aforementioned institutions and exogenous factors such as wars, international crises, etc. The legal and technical capacity attributed to each player by the institutional arrangements will define the negotiations that take place before and during the four stages of the budget process and how fragmented the environment will be.

Consequently, cooperation problems that result from a political process may increase or decrease, depending on the type of government, the size of the cabinets and minority or majoritarian support in the legislative branch. To illustrate this situation, an executive with a smaller cabinet and majority support in the congress will experience fewer
cooperation problems, and the fiscal outcomes reached are better, because the agents can be persuaded to internalize the tax burden. (Scartascini and Stein, 2009).

The decision of the players are also influenced by a) budget institutions; b) informal rules; c) the agreements that the existing coalitions have, imposing restrictions on their actions. (Scartascini and Stein, 2009).

Moreover, the electoral calendar, the constitutional prerogatives of the president, the partisan powers and the ideological affinities has an impact on those decisions.

2.3. Fiscal outcomes as a result of the politics in the budget making process

The budgetary and political institutions influence fiscal governance. Fiscal outcomes are not independent of them. Government and legislatures are not able to obtain the fiscal outcome that they expect, without considering the budget procedures (Alesina et al., 1999).

The institutional framework establishes the boundaries, within which the budget is designed, approved and implemented, and simultaneously imposes restrictions on the actions of its actors. The application of the appropriate set of rules and procedures may contribute to achieving fiscal discipline (Scartascini and Stein 2009).

The arrangements that encourage fiscal discipline are: a) ex-ante constraints on deficits; b) strong prerogatives of the executive over the congress, especially in relation to the capacity of amendment of the budget; c) Strong central agent with agenda setting powers or veto powers, and d) budget transparency (Alesina et al., 1999).

Therefore, two kinds of methods can be discovered in the budget process: hierarchical and collegial. Hierarchical procedures centralize the central player’s decisions with a strong role in the bargaining process; limiting the legislative power to increase the total size of the budget. Furthermore, it is characterized by enhanced discipline and less discretion, while collegial procedures distribute the power between the principal agents involved in the budgetary process (Alesina et al., 1999; Hallerberg and Marier, 2004).
Under these considerations, countries with more hierarchical budget processes, accompanied by rules restraining significant deficits, and more transparent procedures, tend to be more fiscally disciplined than countries with collegial institutions (Alesina et al., 1999; File and Scartascini, 2006).

However, a series of studies discovered that there are other variables that are part of the budget process, associated with hierarchical procedures that can influence the fiscal outcomes. Some of them are:

- Amendments to the budget after the approval stage: if the executive can easily change the budget through the execution without the approval of the legislative branch, the entire budgetary process becomes less meaningful, and in consequence less hierarchical.
- Less fragmented decision-making bodies tend to present fewer cooperation problems and better fiscal outcomes (Scartascini and Stein 2009). To mention a few:
  a. Studies demonstrate a strong positive association between the number of spending ministers and budget deficits (Wehner, 2010).
  b. Numerous parties interacting during the budget process, with different incentives and motivations, affect the size of the budget (File and Scartascini, 2006).
  c. Divided governments: when a party controlling the executive is different from the party that control the congress, higher deficits can appear depending on their ideological affinities (Alesina et al. 1999).
  d. Electoral calendar: deficits may increase in electoral years (Hallerberg and Marier; 2004).

On the whole, the appropriate restraints contribute to better fiscal outcomes; however, it must come together with a degree of flexibility for managers to take decisions and actions to improve the outcomes. The key is to achieve the appropriate balance between both (World Bank, 1998). Budget process and the institutions involved therein affect other dimensions of fiscal outcomes, not only sustainability.
2.4. **Fiscal outcomes in resource-rich countries**

Resource-rich countries dependent on commodity goods face two concerns. The first is related to how much of this non-renewable resource income is spent in the present and how much is saved for the future. The second is related to preventing the fiscal revenue variability considering the unpredictable and volatility of mineral resource prices (Fasano, 2000).

The price swing of non-renewable resources affects the fiscal stability of the country by the gap that is created between the budgets projected revenues and the effective revenues of the country. To solve this problem, policymakers have to apply fiscal adjustment measures with results that spread over the economy. Commodities’ price change rapidly and unpredictably (Davis et al., 2011). Consequently, the fiscal revenue of every country can be very unstable and may require adjustments depending on the boom and bust of resource prices (Dunning, 2005). When a country experiences a boom unexpectedly, managing the additional amount of resources can become a challenge, and cause problems in the balance of payments, instability in income and debt crises (Hill, 1991).

When non-renewable resources are the main source of revenue in a country, this impacts the institutional setting and the policy-making processes, because the agents in these countries do not have the same incentives, preferences and attitudes as the agents in other countries (Puente et al., 2009; Mejía-Acosta, Albornoz and Araujo, 2009). The difference that shapes the budget policy can be explained by fiscal income and spending. Fiscal income in resource-rich countries is not derived, primarily, from taxes. When the rents from natural resources are abundant, the governments tend to tax their populations less heavily. Consequently, the notion of a wealthy state without budget limits is predominant over the idea of scarce public resources. The spending tends to be greater and more inefficient because no one perceives the cost of the increasing spending (Puente et al., 2009).

Additionally, citizens have no incentives to demand budgetary transparency and accountability, and institutional weakness can be hidden due the extraordinary level of public expenditure, even if it is not efficient (Puente et al., 2009).
To what extent is fiscal policy affected in a resource rich country? In the first place, fiscal discipline is more challenging with excessive resources. Especially if they are characterized by being extremely volatile, more so if the agents are not forced to internalize the tax burden (Puente et al., 2009; Mejia, Albornoz and Araujo, 2009). Secondly, a rigid budget funded by volatile resources is not able to adapt easily. Consequently, an extra constraint is added to the fiscal balance (Mejia, Albornoz and Araujo, 2009). Thirdly, the allocation of resources does not follow the optimal parameters. Additional resources that come from an increase in the price of a commodity are not necessarily assigned to strategic priorities, agents do not have to reallocate resources thinking about the impact that they have, and they are not constrained by ceilings. Finally, in countries whose public wealth comes from natural resources, funding distribution is based on keeping political stability, most of the time sustained through payoffs and rent-seeking behaviours (Puente et al., 2009; Mejia-Acosta, Albornoz and Araujo, 2009).

Therefore, while resource-rich countries hold non-renewable resources as their principal source of wealth, it remains vulnerable to external shocks and has a limited capacity keeping fiscal sustainability in the future (Mejia-Acosta, Albornoz and Araujo, 2009).

This chapter has reviewed the link between fiscal governance and the budget-making process, as well as fiscal policy outcomes, concluding that more hierarchical contexts in terms of fiscal governance lead to better fiscal outcomes. In other words, fiscal governance predicts that under conditions of single party majorities and a hierarchical president with strong agenda-setting powers, a better and more sustainable fiscal balance is expected.

The influence of the budget process over fiscal governance, especially over sustainability, has been thoroughly studied. However, efficiency is one of the competing facts of fiscal governance that can be analysed from different perspectives, and that deserves a deeper study. Under this consideration and according to the literature, a more hierarchical context improves fiscal governance in terms of fiscal sustainability. Can the same results be expected for efficiency?
For the purposes of this paper, efficiency is going to be understood as a variable that explores the magnitude and the directions of resource modifications during each stage of the budget (formulated-approved-executed) within a year (Mejía-Acosta, 2009b). Moreover, as aforementioned, hierarchical procedures are related to the task of centralizing the decisions of a player with strong agenda-setting powers, who respects the fiscal rules, and where discipline, transparency and less discretion in the decisions are the main characteristics (Alesina et al., 1999; Hallerberg, Marier, 2004).

Consequently, the budget should experience fewer allocations between each stage of the budget making process in a country in which the following assumptions take place:

a. The allocation of resources was according to the strategic priorities of the country.
b. Hierarchical president with one single party majority or a liable and strong coalition.
c. The country has a central authority with total powers over the budget process, whose objective is to keep the fiscal balance in the medium term.
d. Resources are allocated to the different ministers by assigning limits for sectors or portfolios, considering the strategic objectives of the government.
e. The allocation of resources in the budget of each public office is entrusted to sectorial authorities, which select the projects according to their effectiveness and productivity.

The assumption is that a budget processes characterized by significant and continual reallocations of the public resources produce less efficient outputs, which can affect medium term macroeconomic forecasting and generate uncertainty in public institutions. (Mejía-Acosta, 2009b).

Ecuador is a worthy case of study to analyse the hypothesis: Under a more hierarchical context in terms of fiscal governance, the efficiency of budget outputs can be improved? During the last seven years Ecuador has experimented with a series of political, legal and budgetary institutional reforms that led to the thought, that the country has experienced changes in the composition and degree of power of the executive and the
legislative branch. In addition, Ecuador is a resource rich country whose main source of public funding comes from oil.
3. CASE OF STUDY: ECUADOR A RESOURCE RICH COUNTRY

The purpose of this chapter is to overview the evolutions of Ecuador’s budget process as an introduction to explain the reason the country has been used as a case study. Then, it explains in detail the characteristics of data, sources of information, presentation of data and the criteria applied to analyse the information.

3.1. Political and Fiscal changes in Ecuador’s budget process.

Since 1998, the budget-making process in Ecuador and the fiscal and political institutions have been changing, through reforms in the Constitution, the adoption of dollarization in 2000, and the implementation of the Fiscal Responsibility Law in 2002 (Mejía-Acosta, Albornoz and Araujo, 2009).

However, in 2008 another set of reforms was adopted. A new Constitution and the Code of Planning and Public Finance (CPPF) strengthened the president’s agenda-setting powers even more. In addition, the Planning Office (SENPLADES) was included in the elaboration of the bill with strong powers over the Investment Annual Plan. Besides these changes, the following four are the other major alterations to the budget process that should be considered in the study of the proposed research:

- The Ministry of Finance can increase or decrease revenues and expenses by up to 15% of the bill approved by the Assembly without its consent (CPPF, art. 118).
- Each public office (Ministries and Secretariats) could amend the approval budget during its implementation, shifting resources from one item in its budget to others, without the approval of SENPLADES. The consent of SENPLADES is required only if the modification involves: an increase in the total amount of the investment budget of the executing entity, or the inclusion of new programs or projects. There is no limit to the number or amount of resources for these amendments.¹

¹ The procedures and the limits for amendments and reallocations should be defined in the regulation of the Code of Planning and Public Finance. Nevertheless, until today it has not been formulated; consequently, some procedures were informally implemented by the regulatory agencies (SENPLADES and Ministry of Finance).
• Reallocations of resources can be decided by SENPLADES in coordination with the Ministry of Finance if the public office is not spending the funds according to the monthly program of expenditures.²

• The maximum level of public debt is 40% of GDP (CPPF, art. 124).

Other important details to consider are a) the primary source of fiscal revenue of the country is oil. Between 2004 and 2013 oil revenues made up on average 31.2% of nonfinancial public sector revenues and 27.3% of central government revenues, and b) a high level of rigidity characterized the budget. Between the last ten years, the rigidity of the central government budget is on average 49.1% if only wages and payments of interest are considered.

Finally, but not less important, is the fact that during the last eight years, Ecuador has the same president. With a single party majority support in the Congress during 2008 and 2013. From 2009 to 2012 a plurality, with 48% of the total seats in the Assembly, only needing four additional non-aligned votes to obtain majority, instead of having the usual unstable political environment with high levels of fragmentation (Polga-Hecimovich, Basabé-Serrano, and Mejía-Acosta, 2012).

3.2. How the case fit the research problem?

The Budget, as the main tool used to allocate public resources, is the space where collective decisions and the bargaining process take place, involving different political actors, with dissimilar incentives (Scartascini and Stein, 2009). The players in each phase of the budget making process exert various levels of power constrained by a set of formal and informal rules. As a result of this process, there are winners and losers.

The Budget making process as part of fiscal governance, consider dimensions as sustainability, efficiency, equity, adaptability and transparency, to evaluate the final outcomes. These outcomes are not independent of the institutions and procedures that regulate the policy-making process and the behaviour of the agents. (Alesina et al., 1999). Therefore, the appropriate set of institutions considering the country’s environment may lead to a sound fiscal policy.

² IBID
According to the theory and some case of studies, less fragmented decision bodies with hierarchical and transparent procedures accompanied by restrictions on accumulating debt, lead to better fiscal outcomes. (Alesina et al., 1999; Filc and Scartascini, 2006; Scartascini and Stein, 2008)

These facts raise the question if it is possible to expect that a more hierarchical context in terms of fiscal governance has the same effect on other dimensions of public policy, specifically over efficiency?

If budget efficiency refers to fewer reallocations through the different stages of the budget process (Mejía-Acosta, Albornoz and Araujo, 2009) and considering that the ideal management of the budget contemplates:
a) The centralization of the budget process in a central authority with strong powers over the other players;
b) The parameter for allocation of resources is the effectiveness of the projects and the strategic government’s goals; and

c) Each spending minister has a degree of flexibility to decide on the management of resources.

Under a more hierarchical environment with fewer and strong players, the bargaining process will be simple and fewer variations between a) the proposed budget and the approved budget, b) the latter with the real allocations, and c) between allocations and execution, should take place, ensuing in a more efficient budget.

Ecuador offers an excellent option to analyse the research question, because the country fulfils most of the conditions of a hierarchical environment after the institutional reforms that have taken place during the last 16 years. Some of the factors that can demonstrate the more hierarchical fiscal and political institutions in Ecuador are:

- One president in the last eight years (2007 – 2014), in contrast with five presidents during ten years (1997-2006).
- Presidents with strong constitutional prerogatives over the legislative power: budget formulation is a prerogative of the executive, the congress do not have the ability to create new spending lines, and the proposed bill become law if the
assembly does not consider the proposed bill in the following 30 days after the executive sent it (Constitution 2008, art. 295).

- One single majority party in years 2008 and 2013, 2009 – 2012 plurality representation with 48% of seats in the legislative power, while from 1979 to 2006 the president party in average obtain 26 % of the seats.
- Ministry of Finance can increase the budget up to 15% without the approval of the assembly (CPPF, art. 118).
- Medium term expenditure framework required by law before the elaboration of the budget (Constitution 2008, art. 208; CPPF, art. 74,87,88).
- The budget formulation and execution as the public policies, programs and projects, must be aligned with the National Development Plan (NDP) (Constitution, art. 208).

In addition, the reforms of budget institutions experienced by Ecuador since 1998 has imposed fiscal discipline and strengthened the influence of the executive over the fragmented opposition, giving enough power to eliminated earmarks on oil revenue and centralizing the oil income in the General Government Budget. (Mejía-Acosta, Albornoz, Araujo; 2009).

3.3. Research Plan

The aim of this chapter is to describe the method used in the investigation, detailing sources of the data, and list the variables involved in the research.

The information that supports the dissertation is derived from secondary sources and the research question entails a combination of qualitative and quantities analysis in a mixed method.

The research data related to the budget and other information of the country will be drawn from official sources. In the case of information related to the bill, the sources are the Minister of Finance and SENPLADES through their web pages, www.finanzas.gob.ec and www.planificacion.gob.ec. Macroeconomic information of the country is provided by the Central Bank, www.bce.fin.ec. Data of political institutions and the government mainly are collected from the web pages of the National
The investigation will focus on the years between 2007 and 2013; the period in which the institutional reforms took place, creating the space for hierarchical players in the executive branch with strong agenda-setting powers.

The budget data concentrates on the public investment plan of the central government, selecting information solely of Ministries and National Secretariats. Even if the data is available per year and spending unit, the information is aggregated per year at a sectorial council level. The reasons that motivate the selection of Ministries and Secretariats and the decision to study this effect during the phase of implementation of the budget are as follows:

a) Budget information with the same level of disaggregation is available only from the stage where the Assembly approves the bill. The proposed bill sent by the executive is accessible, but not in the same format and presentation, consequently the data are not always comparable.

b) During the seven years of analysis, the executive created new ministries and secretariats, some disappeared and others merged. With the purpose of avoiding missing information and having a homogeneous base, the public office has been grouped in the sectorial councils.

Finally, the variables that are going to be analysed with the aim of answering the research question are: public investment budget (approved, allocated = approved + amendments and executed), inflation, oil prices, GDP, elections, president

---

3 Ecuador has from 2007 to 2013, 8 Sectorial Councils. Its purpose is to coordinate the sectorial policy of all the Ministers and Secretariats of the same sector, as well as supervise and oversee the plans and programs executed by its members. The Coordinating Ministry of each sector manages the Council.
popularity, number of ministers per year, number of seats in the National Assembly, budget’s rigidity, dollarization, public debt and fiscal balance
4. ECUADOR BUDGET PROCESS, INSTITUTIONAL CHANGES AND FISCAL OUTCOMES

This section discusses the budget-making process in Ecuador. The first part provides a general background on the budget-making process and the institutional reforms between 1998 and 2007. The second part explores the political economy of the budget-making process since 2008, and the last part of this section describes the outcomes of the budget process after the reforms.

4.1. Background

A fragmented environment, with institutional instability and players with few incentives to cooperate, in the long run, characterized the budget process in Ecuador.

The constitutional reform in 1998, the adoption of dollarization in 2000 and the introduction of the Fiscal Responsibility Law (FRL) in 2002 imposed important restrictions over political agents with the objective of ensuring fiscal sustainability and discipline. In spite of this, the high dependency on oil rents affected the budget decision-making process, the actor’s preference and shaped rent-seeking behaviour of the agents (increase of discretionary spending, earmarking allocations) (Mejía-Acosta, Albornoz, Vasquez, 2009).

Moreover, various institutional changes were adopted, such as reduction in the number of legislators from 123 to 100, the approval of the budget was open to the entire congressional floor and re-elections for legislators were allowed (Mejía-Acosta, Albornoz, Vasquez, 2009).

Concurrently, the combination of multiple policy players and an executive with strong constitutional prerogatives generated a conflicting environment to establish and keep coalitions over time (Mejía-Acosta, Albornoz, Vasquez, 2009). Consequently, the presidents delegated the decision-making to a technical bureaucracy the majority of the time, instead of pursuing alternative prerogatives, such as decree power (Mejía-Acosta, Albornoz, Vasquez, 2009). With the Constitution of 1979, the president gained weak agenda-setting powers over the congress with a minority legislative support. While
since 1998 the executive exerted strong influences over the legislative branch, keeping the minority support in the congress (Basabé-Serrano, 2009).

On the other hand, public policy in Ecuador is not known for it stability and continuity, a situation that was deteriorated by the presidential and the cabinet volatility. During 1996 and 2006 no president could complete its term in office, and the cabinet turnover was amongst the highest in Latin America (Mejía-Acosta, 2009b; Polga-Hecimovich, Basabé-Serrano, and Mejía-Acosta, 2012).

Finally, after 2004 with the approval of the Transparency Law citizens are able to oversee the executive actions besides the external control exercised by the General Comptroller’s Office, the Congress, the Ministry of Finance (Mejía-Acosta, Albornoz, Vasquez, 2009) and SENPLADES, each one according to its mandates.

This section has briefly reviewed the facts that characterized the budget-making process of Ecuador in the past. The next part focuses on the institutional reforms since 2008 in Ecuador and the political economy of the budget-making process.

4.2. The Budget Process in Ecuador

This section discusses the formal and informal rules that guide the central government’s budget-making process in Ecuador through its four stages, emphasizing the particularities of the public investment plan and highlighting the changes that the 2008 Constitution and the Planning and Public Finance Code introduced.

4.2.1. Rules for the budget process

A brief description of the formal rules for the budget process is presented in the following paragraphs, based on the 2008 Constitution and the Planning and Public Finance.

The fiscal year in Ecuador coincides with the calendar year. The National Development Plan is the guideline for the elaboration of the budget. Each year the executive has to submit the annual budget and the four-year macroeconomic fiscal framework to the
National Assembly, within the first ninety days of its term of office and, in the following years, sixty days before the start of the subsequent year. In the case of the president’s re-election, the draft budget should be present within 30 days after the declaration of the results.

In terms of fiscal constraints the reforms define three rules: the maximum level of public debt is 40% of GDP, it is restricted to finance public investment in infrastructure or investment projects with financial capacity of repayment; the recurrent revenues can fund recurrent and non-recurrent expenditures, however, non-recurrent revenues cannot finance current expenditures; and exclusively earmarked budget allocations in favour of subnational governments; health sector, the education sector and higher education, science, technology and innovation sector are allowed. The creation of new earmarking is forbidden by the constitution (Constitution 2008, art. 298).

In addition, all the resources of the General State Budget shall be managed through the Single Treasury Account, held in the Central Bank, and administered by the National Treasure Office of the Ministry of Finance.

Clearly the aim of the reforms was to maintain fiscal discipline and strengthen the two central players in the budget process, the Ministry of Finance and the Secretary of Planning and Development.

4.2.2. Budget and the political economy of the Budget Process in Ecuador

Preparation of the Annual Budget

The budget formulation is a prerogative of the executive. The annual budget must be prepared in accordance with the National Development Plan’s priorities and the Medium Term Macroeconomic Forecast.

In this context, the elaboration of the budget begins around April with the forecast of macroeconomic variables. The formulation of the budget takes approximately seven months. The next step, is a meeting between the President, the Finance Minister, the Secretary of Planning and Development, the authorities of the institutions that elaborate
the macroeconomic forecast (Central Bank, Coordinating Ministry of Economic Policy and the Internal Revenue Service). The purpose is to consider the macroeconomic framework; define the ceiling for the investment plan; and define the orientations and priorities for investment, according to the objectives established in the Development Plan and the political and sectorial priorities for each year. The investment orientations from 2007 – 2013 prioritized the generation of capabilities and opportunities in the population, such as nutrition, education, preventive health, housing and basic sanitation infrastructure; and the investment in strategic sectors, such as electricity, telecommunications, transportation, innovation and technology.

Synchronously, SENPLADES submitted the request to each Executing Unit (EUs) (Ministries, Secretariats, Agencies, Institutes) for the registration of their public investment requests through the depository of investment projects for the next four years. The requirements should be consistent with the guidelines of the budget established by the Ministry of Finance and SENPLADES. Only the programs and projects that have been approved by the correspondent Coordinating Ministry and SENPLADES can demand resources. Once the EUs submitted their needs, the Coordinating Ministries evaluates the request and prioritizes them considering the resource limits given for each sectorial council. SENPLADES provides to each sectorial council three scenarios with spending limits. Often the requests of the public agencies exceed the financial possibilities.

In a second step, the Planning Office analyses the proposal of each sectorial council and elaborates a draft, taking into account the technical criteria and the recommendation of the Coordinating Ministry. Once the first draft is done, the proposal is discussed with the Coordinating Ministry of each sector. If the request of the global sectorial council exceeds the ceilings or there is no agreement, review sessions are held with the sectorial ministers with the participation of the Ministry of Finance, only regarding allocations for multiannual investments or initiatives that are a national priority.

After the consolidation of the draft, the President arranges a final appointment with the Finance Ministry, SENPLADES and the Coordinating Ministries, to approve the proposal budget and resolve any conflicts between the central agencies and the spending ministries. The spending ministers are eligible to attend this meeting, depending on the
willingness of the Coordinating Minister, and on the informal power of each spending minister. Key ministers that manage a sensible political area can influence budget allocations easily. The head of each coordinating ministry leads the bargaining process with the President. Usually, an agreement is achieved before this session, due to the incentives that spending ministers have to defend a planning budget with allocative efficiency and technical parameters. Before the president call for the final meeting, who receives information from SENPLADES related with: the original request, the agreements and disagreements during the review sessions, and the technical criteria for approving only certain initiatives and amounts of resources.

Moreover, the formulation of the current expenditure budget follows the same parameters that request each public office pursues. However, the central agent with veto powers is the Finance Minister. Unrealistic requests for additional resources are uncommon in these types of expenditures, and the margin for bargaining is limited.

The integral draft of the budget is verified and consolidated by the Ministry of Finance before November 1st, the date on which the proposal budget is sent to the National Assembly.

Finally, the budget formulation stage with the institutional reforms shows the delegation of the bargaining process from the President to the Ministry of Finance and SENPLADES, empowering the latter with absolute control over the public investment projects. Furthermore, the coordinating ministers acquire strong influences over the line ministers with selected exceptions; in this context the number of players with veto powers in the bargaining process are fewer, meaning that the line ministers have lost power during this last years. Nevertheless, the President maintains absolute control over the budget. It is imperative to mention that even if a marginal increase is authorized for a specific sector, the budget totals set at the first meeting are not affected.

Approval

This stage commences the first week of November; the Assembly is tasked with approving the General Governments Budget and the four years Macroeconomic Fiscal Framework (Constitution 2008, art. 295).
The president of the congress according to article 103 of the Organic Law of the Legislative Branch, should send the executive’s proposed budget to the pertinent committee, after the approval of the Managerial Council of the Legislative Branch, which is made up of the president and the two vice-presidents of the National Assembly plus four members, who are elected according to party shares in the Chamber.

In 2007 and 2008 the bill was sent to the Committee of Tributary, Fiscal and Banking. After the approval of the 2008 Constitution, from 2009 to 2013 the proposal of the executive was submitted to the Committee of Economic Regime and of Tributary, except in 2012, the year in which the bill was analysed by the Committee of Economic and Productive Development. Since 2009, in each of the committees where the bill was sent, the government party led the presidency.

The Committee has ten days to analyse and report, with recommendations to the Plenary, the budget proposal and the macroeconomic fiscal framework. If the committee requires technical support, the public offices involved in the budget process, may be called on to the Committee, to explain the information exposed in the budget proposal. Since 2007, the Finance Minister and Secretary of Planning and Development have been requested to assist to the Committees.

The Assembly has thirty days to approve or object the budget in a single debate (including the ten days allowed to the Committee for deliberation). If the legislative body do not pass or reject the draft, the proposal becomes law. In the years in which the president takes office, the former initial budget remains until the new one is approved. The Bill can be observed by income and expenditure sectors, without increasing the total budget, and the creation of budget items is not allowed for any assemblymen.

As an informal practice, the Finance Ministry and SENPLADES presented the proposed budget to the government’s party assemblymen (Alianza País) before the bill was debated. The President of the Assembly can request that both ministers explain and present the draft to the entire Chamber. The bills of the last seven years (2007-2013) have been approved without major observations.
As explained earlier, the legislative branch is a key actor in a democracy; one of its main responsibilities is supervising the executive’s actions and maintaining honesty (Hallerberg, Scartascini and Stein, 2009). The approval stage of the budget should be the space where the parties that have seats in the congress maximize the profits of their constituencies (Mejía-Acosta, Albornoz and Araujo, 2009). However, as in any policy-making process, cooperation problems arise between the different actors. To solve the common pool resource problem and to reach an agreement between the actors, in this case: the executive, the legislators and the parties, the rules that govern the relation between the actors, and the incentives and the constraints that each agent faces are key factors.

Presidents who have the legislative support of a discipline and majoritarian or plural party in the congress faced fewer problems to achieve policy success. In addition, the cooperation between both branches occurs more easily when the ideologies of the parties are similar. Nevertheless, building a coalition, its liability, and the type of coalition depends on several other factors such as, the incentives, the electoral calendar, the party unity, the number of members of the coalition, the payoffs between others (Mejía-Acosta, 2009a).

Additionally, the bargaining process during the approval of the budget can differ considerably according to the rules of the game, the political system and the legislative composition. According to the literature, settings where the decision bodies are less fragmented experienced fewer cooperation problems and better outcomes. (Scartascini and Stein, 2009).

In this context, the legislative agenda-setting powers in Ecuador have changed considerably as well as the incentives of the legislators and its composition. Until 2007 the congress was known for been highly fragmented, the presidents do not enjoy a single party majority support and coalitions always require the need for the executive. Table 1 illustrated that in 2007, three political parties control 65% of the seats in the congress, while from 2008 to 2013 one single party, control 62% and 48% of the seats. Since 1998, no one of the four presidents has majority or plurality in the congress, and two of the four traditional and powerful parties of the country have the major number of seats in the congress (between 20% and 28% of the seats) (Mejía-Acosta, 2009b).
Moreover to the almost hegemonic control of the Assembly and the party discipline, the loss of bargaining space and the lack of technical capabilities to perform a verifiable analysis of the budget, diminish the role and the power of the legislative branch.

**Implementation**

The Ministry of Finance is responsible for the elaboration of the normative that guides the execution, amendments and payments of the public funds. To avoid concerns about cash flows at the beginning of each year, usually during the first 15 days of January each EU submits the annual indicative program to the Ministry of Finance, detailing the amount of resources that are going to be spent quarterly each year by spending items. Concurrently, each EU should send a monthly execution plan to SENPLADES, detailing the amount to be spent on each investment project. This document must have
the approval of the Coordinating Ministry, and is the guideline to evaluate the spending capability of the EUs.

The Budget can be amended during the implementation phase for three reasons. The first is when revenues run below or over the projected flows, a modification of up to 15% of the approved budget does not require the consent of the National Assembly. However, the legislative branch should be informed of these changes. The second type is intra or inters EU transferal modifications. According to the Code of Planning and Public Finance each EU can amend the approval investment plan, by shifting resources from one item to another without the approval of SENPLADES, if the modification does not involve an increase in the total amount of the investment budget of the EU or the addition of new investment projects. The reallocation of resources between entities should first have the approval of the Coordinating Ministries - the aim is to verify the pertinence of the modification - before the authorization of SENPLADES. The third reallocation is based on spending capabilities. Every four months SENPLADES analyses if the EUs spend the investment resources as planned, if the spending levels are not the expected within a margin of +/- 5% of the expected amount and there is not a solid justification for it, together with the Coordinating Ministry the resources are reassigned. Education, Health and Security are EUs outside the criterion of reallocation for under execution. Most of these procedures are informal practices.

The allocation of public investment resources across the different EUs between 2007 and 2008 portrays that 86.5% of the total investment budget was absorbed by Strategic Sectors, Social Development and Security (Table 2). The trend has not changed after the amendments to the budget; the three same sectors absorbed the 89.2% of the real allocated budget (budget law + modifications) (Table 2).
Table 2. Public Investment Budget distribution

2007 – 2013

<table>
<thead>
<tr>
<th>SECTORIAL COUNCILS</th>
<th>BUDGET LAW</th>
<th>REAL ALLOCATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>STRATEGIC SECTORS</td>
<td>45,0%</td>
<td>48,2%</td>
</tr>
<tr>
<td>SOCIAL DEVELOPMENT</td>
<td>31,9%</td>
<td>30,3%</td>
</tr>
<tr>
<td>SECURITY</td>
<td>9,6%</td>
<td>10,7%</td>
</tr>
<tr>
<td>PRODUCTIVITY</td>
<td>6,5%</td>
<td>5,5%</td>
</tr>
<tr>
<td>OTHERS</td>
<td>3,1%</td>
<td>2,4%</td>
</tr>
<tr>
<td>CULTURAL HERITAGE</td>
<td>1,9%</td>
<td>1,5%</td>
</tr>
<tr>
<td>KNOWLEDGE AND HUMAN TALENT</td>
<td>1,6%</td>
<td>1,2%</td>
</tr>
<tr>
<td>POLITICAL AFFAIRES</td>
<td>0,3%</td>
<td>0,1%</td>
</tr>
<tr>
<td>ECONOMIC POLICY</td>
<td>0,2%</td>
<td>0,1%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Authors’ calculation.

The reallocation of resources shows that during the last seven years, Security, Strategic Sectors and Social Development are the areas with the positive modifications. The other six sectors had suffered negative reallocations in relation to the distribution of the budget. With this analysis, it is not possible to identify the reason of the reallocation. In none of the seven years were the allocations more than the 15% of the total budget approved by the Assembly.

Strategic Sectors, Social Development and Security are areas where the government did the most important investments.

The modifications between the approved budget and the real allocations show an increase in the amount of public funds, in other words additional resources were available for investment in almost all the years. At the same time, the level of public spending was higher the years in which the income increased. Thus, it can be inferred that modifications did not occur only because of inter and intra transferal or under spending of the EUs (Table 3).
Another way to analyse the gap between the approved budget and the real allocation and between the real allocation and the executed is characterizing each ministry by its capacity to bargain and by its capacity of execute the resources. The methodology consists in define the direction of the changes in each stage (+ or -) and with this information compare the public offices (Mejia-Acosta, 2009b).

Table 4. Direction of the changes in the budget process

<table>
<thead>
<tr>
<th>STRATEGIC SECTORS</th>
<th>CRL</th>
<th>SOCIAL DEVELOPMENT</th>
<th>CRL</th>
<th>SECURITY</th>
<th>CRL</th>
<th>PRODUCTIVITY</th>
<th>CRL</th>
<th>OTHERS</th>
<th>CRL</th>
<th>CULTURAL HERITAGE</th>
<th>CRL</th>
<th>KNOWLEDGE AND HUMAN TALENT</th>
<th>CRL</th>
<th>POLITICAL AFFAIRS</th>
<th>CRL</th>
<th>ECONOMIC POLICY</th>
<th>CRL</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td></td>
<td>-</td>
<td></td>
<td>+</td>
<td></td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

Note: CRL= Real Allocation – Law  
CER= Executed – Real Allocated  
Source: Authors calculation.
From the relation between the real allocation and the budget law, it can be infer the ability of each office to bargain, becoming good lobbyists, if the result of the negotiation is the allocation of additional resources. While the capacity to spend the resources effectively given is measure by obtaining the difference between the executed and the real allocated.

Table 5. Capacity to negotiate and to spend

<table>
<thead>
<tr>
<th>CER</th>
<th>+</th>
<th>-</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>-</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Authors´ elaboration.

From this information, Strategic Sectors can be defined as a lobbyists sector with important capacities to execute the resources allocated. Another sector that seems to have enough influence to increase its budget is Security. However it is not known for having a great capacity to spend the resources. This testing illustrates that key factors in the variation of the bill and the real allocations is the political power of the head of the office and the incentives that he or she has. Nevertheless, in addition to the technical capacity of the teams of each public office, numerous factors can affect the levels of execution, for example, the real availability of the resources, the type of investment, among others.
Several variables can be the cause of the important changes in the approved budget and the real allocated budget. In an environment of a hierarchical executive, where the allocation of resources is according to the strategic priorities and entrusted to sectorial authorities, and a central authority has absolute power over the budget process, it is supposed that better fiscal outcomes can be reached. On the other hand, as the literature states, excessive flexibility of the executive to amend the approved budget, a high number of spending ministers, and electoral calendar can influence the fiscal outcomes. In the case of study, even if the majority of the conditions to improve fiscal governance in a context of more hierarchical players has been accomplish by the country, factors that can influence over fiscal outcomes are present, such as elections and referendums during 5 of the 7 years, an increase in the number of ministers during these seven years from 24 to 42, and the absolute power of the executive to amend the budget. In addition, the permanent rise of oil prices, the main income of the country; and the popularity of the president may be additional facts that influence the budget process and that may explain the variation of the budget during its different stages.

Evaluation and Control

The evaluation and control of the budgetary execution are prerogatives of the executive through the Ministry of Finance, SENPLADES, Executive Units, the National Assembly and the General Comptroller’s Office. The Office of the Comptroller monitors ex post the use of fiscal resources and the achieving of the goals of the public offices (Mejía-Acosta, Albornoz y Araujo, 2009). The Assembly must oversee the execution of the budget. As an input for the constitutional obligation of following up the execution, the Ministry of Finance submits a report of the budget’s execution every six months.

Each EU should retain internal control over the use of the resources and the achievement of goals (Mejía-Acosta, Albornoz y Araujo, 2009). SENPLADES is the
responsible institution for coordinating with each EU, in overseeing the achievement of the NDP goals. Additionally the Planning Office has to evaluate the public investment projects.

Moreover, with the enactment of the Transparency Law, citizens can oversee the executive’s actions.

4.3 FISCAL OUTCOMES AFTER THE REFORMS

Fiscal governance theory supports the idea that countries with more hierarchical budgetary institutions and less fragmented decision bodies face fewer cooperation problems and tend to have ameliorated fiscal outcomes.

The impact of the institutional change in the efficiency of the fiscal outcomes is measured through the variations of the budget during two stage of the process. Here the magnitude of the total change in the composition of the budget is measured for the period 2007-2013, considering the dates of the institutional reform. Following the methodology presented by Scartascini and Stein (Scartascini and Stein, 2009); the relative magnitude of the changes in spending composition is calculated through different stages of the budget process.

In the case of study only 2 stages are analysed:

a) CLR: Changes between budget law and real allocated

\[ CLR = \frac{\sum_{i=1}^{a} |L_i - R_i|}{2}, \text{ for each year} \]

b) CRE: Changes between real allocated and executed

\[ CRE = \frac{\sum_{i=1}^{a} |R_i - E_i|}{2}, \text{ for each year} \]

Where,

\( L_i \) = participation of item i in total spending approved in the budget Law

\( R_i \) = participation of item i in total real allocation

\( E_i \) = participation of item i in the total of executed expenditure
Each indicator identifies where the changes take place and which actors have more influence over the budget. In the first stage, it is the executive who has more discretionality. The politically strongest ministers or the lobbyists ones should have the best option for obtaining more resources. The second stage measures the capacity of the spending ministry to execute the planned expenditures.

Figure 2 shows that after the institutional reform the extent of the changes during both stages is exactly the same. After the endorsement of the Code of Planning and Public Finance, the magnitude of the total changes between the approved budget and the real budget and between the budget law and the execution reduces, except for 2013. From the results and the information described in this paper, a possible assumption can be that the Constitutional Reform appears to set the environment for a more hierarchical context in the country. However, the specific rules that lead the budgetary institution to achieve better budgetary outcomes are defined in the Code of Planning and Public Finance.

The reasons that could explain that the path was not follow in 2013 are diverse, based on what the literature portrayed; the proximity of elections, new players in the cabinet, popularity rate of the president, and the volatility of the oil prices and the errors in the macroeconomic forecasting (Appendix 2) could explain it.
An attempt to compare the results with other variables that helps to explain the variations in the magnitudes of the changes in each stage is done (Figures 2; 3). However, the logical inference for one year does not apply to another. To illustrate this, in 2008, 2009, 2011 and 2013 elections and referendum occurred, in 2013 the increase of the coefficients CLR and CRE should be explained by the desire of the executive to win the next election, nevertheless this variable does not apply to explain the decrease in both coefficients in 2011. For both analysis, there are two possible reasons for the rise in the magnitude in 2013. The first one is related to the increase in the popularity of the president. The second one is that in 2009 and 2013, the data available is not the real approved budget by the legislative branch - in the years in which the president takes office, the former initial budget remains until the new one is approved- in consequence, the variation in the magnitude will be higher.⁴

⁴ The relationship observed only by comparing similarities on the trends is not the most appropriate way to explore a relationship between two variables. Therefore, econometric analysis should be made before arriving at any conclusion.
Figure 2. Budget Reallocations at CLR
2007 – 2013

Source: Authors’ elaboration.

Figure 3. Budget Reallocations at CRE
2007 – 2013

Source: Authors’ elaboration.

As aforementioned, the explanations for this situation can be innumerable. According to
the literature, more flexibility to execute amendments after the budget is approved, and
the dependency on oil resources - that affect the incentives of the agents- both can undermine the entire budgetary outcome (Alesina et al., 1998). Having access to more revenues than the expected, means that the allocation of those resources will not necessarily follow the regular parameters, this investments commonly are not planned to be executed in that particular period and the ex-ante fiscal limits established for the budget are not real.

Assuming that in 2013 factors as the popularity of the president and the initial budget is not the approved by the assembly, the data of the analysis seems to support the hypothesis that after the reforms that led to more hierarchical budget institutions, the budget suffered slighter reallocations and, as a result, the budget outcomes are more efficient. However further research and analysis for a long period, supported by econometric evidence should be made before arriving at a definite conclusion.
5. CONCLUSIONS

This paper has described the actual budget process in Ecuador, after the adoption of the political and budgetary institutional reforms. Since 2007, the country has had a long-term president with strong popular support and significant agenda-setting powers, with almost hegemonic control of the legislative branch. In the legislative arena, the congress is a weak player without agenda setting powers and under the hegemonic control of the executive.

Within this context, the main findings of the investigation are the following:

The implementation of mechanisms such as aggregate fiscal discipline and allocative efficiency, in addition to fewer veto players in the budget making process, has helped to keep discipline in the formulation of the budget process and to prioritize the strategic goals of the government.

Secondly, the discussion and approval of the budget seems to be cooperative due to the discipline support of the government party and the absolute leadership of the president. As a result, the bill is approved without many significant bargaining. However, all political actors need incentives to follow the orders given by the party leader or to keep in the coalition, as a consequence the form and space of the negotiations should have change. A deeper investigation of this success is needed to understand in which phase the bargaining occurs.

Thirdly, the implementation is the stage of the budget characterized for its flexibility in the reallocations. The last seven years, the budget average growth rate from the approval stage to the real allocation stage is 40%, and 29% of those resources comes from no expected or underestimate revenues. In average, 82% of the resources that are reallocated were executed.

On the other hand, the magnitudes of the changes between the approved budget and the real allocated budget, and between the real allocated and the execution are smaller after the enactment of the Code of Planning and Public Finance. However the information is not enough to confirm the finding, it can be support by assuming that factors such as
additional resources, political decisions or electoral calendars have an impact over the trend.

Consequently, the investigation reveals that within a context of a strong president with almost hegemonic support of the congress, and political and fiscal institutions clearly defined, the magnitude of the reallocations between the different stages of the budget diminished, and more efficient outcomes may be achieved; assuming that the investment should be spending as planned and that the prioritization criteria of the projects still over initiative less productive. However, other variables can affect the outcomes even with hierarchical institutions.

Finally, a hierarchical budgetary process accompanied by a volatile income implies a risk for the country in terms of fiscal outcomes, if restrictions on how to reallocate the additional revenues or compensate the shortage of the income are not defined. The data shows that during the last seven years on average the income generate by the rise in oil prices has been reallocated and that the executive has had the capacity to spend it. Nevertheless, being able to spend not expected resources not necessarily means that the outcomes are the desirable ones and that the entire budget process is not undermine.
## APPENDIX

### Appendix 1. Sectorial Council

<table>
<thead>
<tr>
<th>SECTORIAL COUNCIL</th>
<th>INSTITUTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOCIAL DEVELOPMENT</td>
<td>MINISTRY OF COORDINATION OF SOCIAL DEVELOPMENT</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF EDUCATION</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF LABOR RELATIONS</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF PUBLIC HEALTH</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF SOCIAL INCLUSION</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF URBAN DEVELOPMENT AND HOUSING</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT FOR MIGRANTS</td>
</tr>
<tr>
<td>PRODUCTIVITY</td>
<td>MINISTRY OF AGRICULTURE, CATTLE, AQUACULTURE AND FISHING</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF COORDINATION OF PRODUCTIVITY, EMPLOYMENT AND COMPETITIVITY</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF ENVIRONMENT</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF INDUSTRIES AND COMPETITIVITY</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF TOURISM</td>
</tr>
<tr>
<td>CULTURAL HERITAGE</td>
<td>MINISTRY OF COORDINATION FOR CULTURAL HERITAGE</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF CULTURE</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF SPORTS</td>
</tr>
<tr>
<td>POLITICAL AFFAIRS</td>
<td>MINISTRY OF COORDINATION OF POLITICAL AFFAIRS</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT OF POLITICAL MANAGEMENT</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT FOR POPULATION, SOCIAL MOVEMENTS AND CITIZEN</td>
</tr>
<tr>
<td>ECONOMIC POLICY</td>
<td>MINISTRY OF COORDINATION OF ECONOMIC POLICY</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF FINANCE</td>
</tr>
<tr>
<td>STRATEGIC SECTORS</td>
<td>MINISTRY OF COORDINATION OF THE STRATEGIC SECTORS</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF ELECTRICITY AND RENEWABLE ENERGY</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF NO RENEWABLE NATURAL RESOURCES</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF TELECOMMUNICATIONS</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF TRANSPORTATION AND PUBLIC WORKS</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT FOR WATER</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT OR HYDROCARBONS</td>
</tr>
<tr>
<td>SECURITY</td>
<td>MINISTRY OF COAST</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF COORDINATION OF SECURITY</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF FOREIGN AFFAIRS</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF GOVERNMENT AND POLICE</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF JUSTICE AND HUMAN AFFAIRS</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF NATIONAL DEFENSE</td>
</tr>
<tr>
<td></td>
<td>MINISTRY OF PUBLIC AFFAIRS</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT FOR TRANSPARENT MANAGEMENT</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT OF NATIONAL INTELLIGENCE</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT OF RISKS MANAGEMENT</td>
</tr>
<tr>
<td>KNOWLEDGE AND HUMAN TALENT</td>
<td>MINISTRY OF COORDINATION OF KNOWLEDGE AND HUMAN TALEST</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT FOR HIGHER EDUCATION, SCIENCE AND TECHNOLOGY</td>
</tr>
<tr>
<td>SIN CONSEJO</td>
<td>OFFICE FOR PUBLIC CONSTRUCTIONS</td>
</tr>
<tr>
<td></td>
<td>PRESIDENCY AND GENERAL SECRETARIAN OF PUBLIC ADMINISTRATION</td>
</tr>
<tr>
<td></td>
<td>SECRETARIAT OF PLANNING</td>
</tr>
<tr>
<td></td>
<td>VICEPRESIDENCY</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance, 2014
## Appendix 2. Oil Prices 2007 – 2012

<table>
<thead>
<tr>
<th>Year</th>
<th>ESTIMATE OIL PRICE US$ (1)</th>
<th>OIL PRICE US$ (2)</th>
<th>ESTIMATE OIL PRICE-OIL PRICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>35,00</td>
<td>60,23</td>
<td>25,23</td>
</tr>
<tr>
<td>2008</td>
<td>39,53</td>
<td>73,24</td>
<td>33,72</td>
</tr>
<tr>
<td>2009</td>
<td>74,52</td>
<td>46,62</td>
<td>-27,90</td>
</tr>
<tr>
<td>2010</td>
<td>60,90</td>
<td>58,35</td>
<td>-2,55</td>
</tr>
<tr>
<td>2011</td>
<td>55,94</td>
<td>74,54</td>
<td>18,60</td>
</tr>
<tr>
<td>2012</td>
<td>71,84</td>
<td>72,06</td>
<td>0,22</td>
</tr>
<tr>
<td>2013</td>
<td>60,64</td>
<td>68,48</td>
<td>7,84</td>
</tr>
</tbody>
</table>

Source:  
(1) Central Bank  
(2) Ministry of Finance
BIBLIOGRAPHY


• Asamblea Nacional, 2014. Resoluciones de proforma presupuestaria. (online). Available at: www.asamblea.gob.ec


• Mejía-Acosta, A. (2009 b). Por el Ojo de una Aguja: la formulación de Políticas Públicas en el Ecuador, Quito. Flacso, Sede Ecuador.


• SENPLADES, 2014. Plan Nacional de Desarrollo. (online). Available at: [http://www.buenvivir.gob.ec](http://www.buenvivir.gob.ec)


