

Budgeting in Chile

by

Camila Vammalle and Ana Maria Ruiz Rivadeneira*

Chile has achieved outstanding results in terms of fiscal sustainability, economic growth, and reduction of extreme poverty. Chile's strong budget system, was an important element in this success. The economic, social and political environments have however changed greatly in the last decade and Chile's budget system needs to adapt to the new demands this entails.

This review is the result of the collaboration between the OECD and the Directorate of Budget of Chile (DIPRES). It analyses Chile's budgetary practices and procedures in the light of the OECD Recommendation on Budgetary governance, and offers recommendations where improvements could be made.

JEL codes: H500, H610, H830

Keywords: Chile, budget process, DIPRES, fiscal sustainability, CODELCO

* Camila Vammalle is a Senior Economist in the Budgeting and Public Expenditures Division at the OECD; Ana Maria Ruiz Rivadeneira is a policy analyst at the Budgeting and Public Expenditures Division at the OECD.

Foreword

In exchanges of letters between the Chilean Directorate of Budget, DIPRES, and the OECD in 2015, it was agreed that the OECD would prepare a review of the Chilean budgeting process. The report covers the entire budget cycle – preparation, approval and implementation, providing an overview of Chile’s current budgetary institutions and practices as well as offering recommendations where these could be made more effective. A previous budget review was carried out in 2004; main changes and improvements in budgetary practices are highlighted throughout the report.

An OECD mission visited Santiago in November 2015 in preparation for this report. It conducted in-depth interviews with a range of stakeholders in Chile who are in a position to put forward considered views on the subject. The mission accordingly met with a range of institutions including the Directorate of the Budget (DIPRES), the Ministry of Finance, the Ministry of General Secretariat of the Presidency, a number of line ministries, the Undersecretariat of Regional Development, the Central Bank, the Joint Congressional Budget Committee, the Supreme Audit Institution (*Contraloría*) as well as representatives from civil society, think tanks and independent experts. The OECD gratefully acknowledges the expert contributions from all of these stakeholders.

The mission would like to note its special gratitude to Mr. Jorge Rodríguez, Mr. Juan Andres Roeschmann and Mr. Rodrigo Balbontín, Directorate of the Budget (DIPRES), for their continued assistance throughout the drafting of this report.

The views contained in this report are those of the OECD Secretariat and should not be attributed to governments of OECD member countries, or to any organisation or individual consulted for this report.

This report was prepared by Ms. Camila Vammalle, Economist/Policy Analyst, and Ms. Ana María Ruiz Rivadeneira, Consultant, under the supervision of Mr. Jón R. Blöndal, Head of Division, Budgeting and Public Expenditures Division, Directorate for Public Governance and Territorial Development.

Executive summary

Chile’s budget system has contributed to the achievement of outstanding results in terms of fiscal sustainability, economic growth, and reduction of extreme poverty. The system is highly concentrated in DIPRES, which is one of the most highly respected and trusted institutions in Chile. The economic and political environments have however changed greatly in the last decade and Chile’s budget system needs to adapt to the new demands this entails.

On the economic side, after a decade of strong economic growth driven by high commodity prices, the structural GDP growth is expected to stabilise at a lower level than during the period 2004-12. On the political side, Chile has experienced shifts in party power for the first time since the return to democracy in 1990. On the institutional side, several

important reforms have been undertaken, including reducing the presidential mandate from six to four years. In addition, new citizen demands and higher expectations have arisen during this last decade with civil society being much more active in the political arena.

Chile's commitment to fiscal discipline is exemplified by a structural fiscal rule and the operation of a fiscal stabilisation fund whereby surpluses are saved during good economic times and drawn down during more challenging times. Fiscal risks are clearly identified and a detailed report on contingent liabilities is published each year.

However, Chile's fiscal rule does not set a specific balance target, but mandates that each President adopts its own target. While the key parameters for calculating the structural balance are given by two independent committees, the methodology is developed and implemented by DIPRES. In recent years, both the structural budget balance target adopted by the President and the methodology for calculating the structural fiscal balance has been subject to frequent changes.

The strong leadership of DIPRES helps align budgets with the medium-term strategic priorities of the President. Progress has been made in designing operational programmes using the logical framework when submitting requests for new and additional funding. However, the budget document could benefit if its programme structure was more closely aligned with these operational programmes. Medium-term expenditure frameworks (MTEFs) are only used as an internal management tool by DIPRES, and not exploited as a tool for planning.

Chile has a robust evaluation and control system, providing a great amount of performance information. This system is designed to support performance management in general. Evaluations have broad objectives with a heavy emphasis on improvements in policy, process and management. However, this evaluation system is not integrated into budget planning. There is considerable space for improvement in the way this information is used to guide resource allocation, thus enhancing the efficiency and effectiveness of public expenditure.

The Congress has built up some capacity regarding the budget in the last decade with a new Permanent Joint Committee on the Budget and the creation of a Budget Advisory Unit. However, the role of Congress in the budget discussions in Chile is still rather limited. Congress may only decrease expenditure proposed by the executive; it may not increase or reallocate expenditures. During budget execution, its approval is generally not required for reallocations carried out by DIPRES.

Chile established a Fiscal Advisory Council in 2013. However, its institutional independence is weak. For example, the current government replaced all members of the Council upon assuming office.

Chile has made great efforts to increase transparency with a full range of budget reports being published regularly. However, key assumptions and dis-aggregations are often incomplete, which makes independent replications of DIPRES's calculations often difficult to reproduce.

As a legacy of the military rule in Chile, the military receives 10% of the sales of the government-owned copper mining company (CODELCO) to finance defence material and capital goods. These transfers are kept in secret accounts. Since 2003, the information on total expenditure from this account is reported but is otherwise beyond scrutiny.

Chile faces difficulties in attracting qualified civil servants, especially at senior levels. Quality of staff in DIPRES is said to be higher than in line ministries and they are more

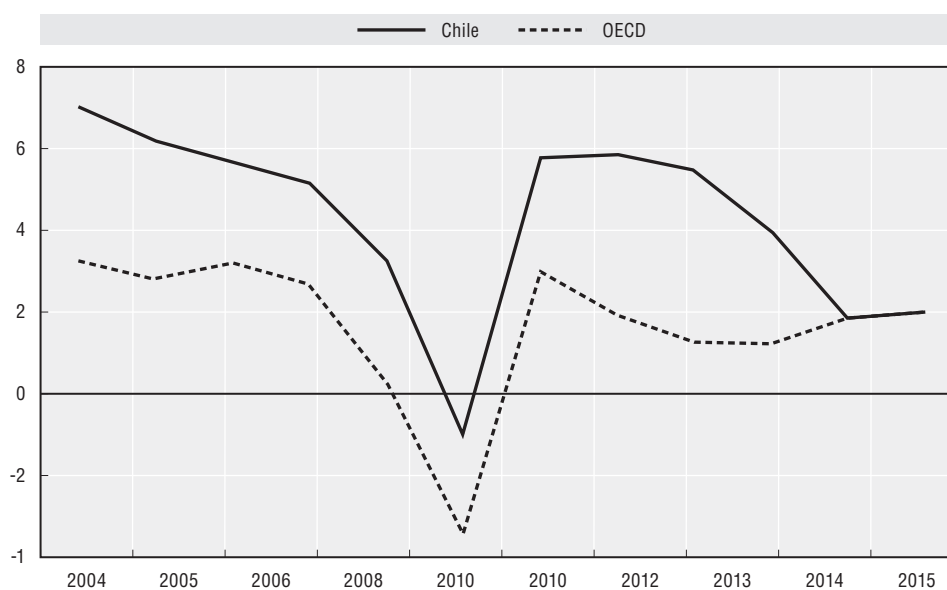
stable at changes of government. This is often used to justify centralisation of decision power in DIPRES. Efforts to transform the senior executive service into a career based one have been made but have not been sufficient to protect senior public managers from political appointments.

1. Economic and social context

1.1. Macroeconomic context: End of boom years

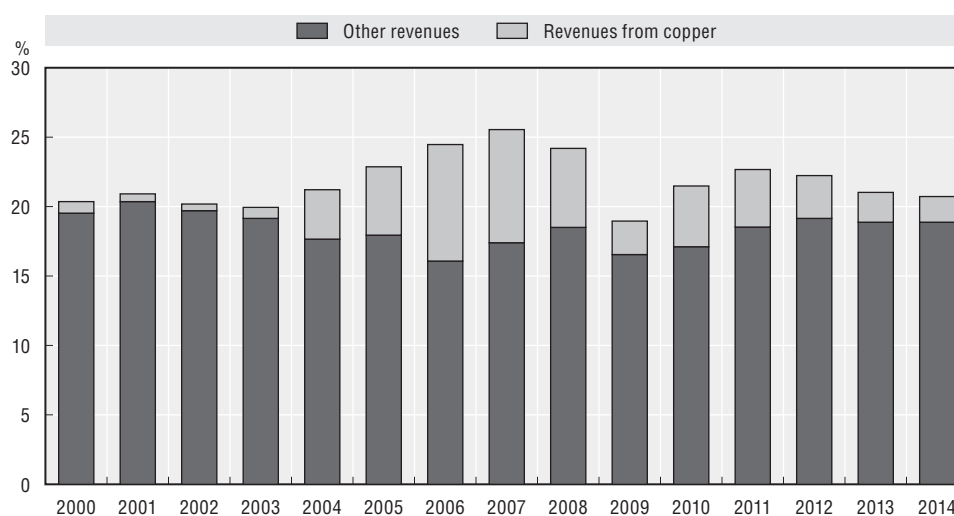
From 2004 to 2012, Chile maintained an outstanding annual growth rate above 5% (Figure 1), only interrupted by the global financial crisis in 2008-09. However, since 2012 this trend changed and growth slowed sharply. Business and household confidence fell, reducing investment and private consumption. The long phase of increasing commodity prices reversed, the national currency depreciated steeply, and productivity growth stagnated. The economy is in the midst of a challenging rebalancing process.

Figure 1. **Total annual growth rate (%) (2004-16)**

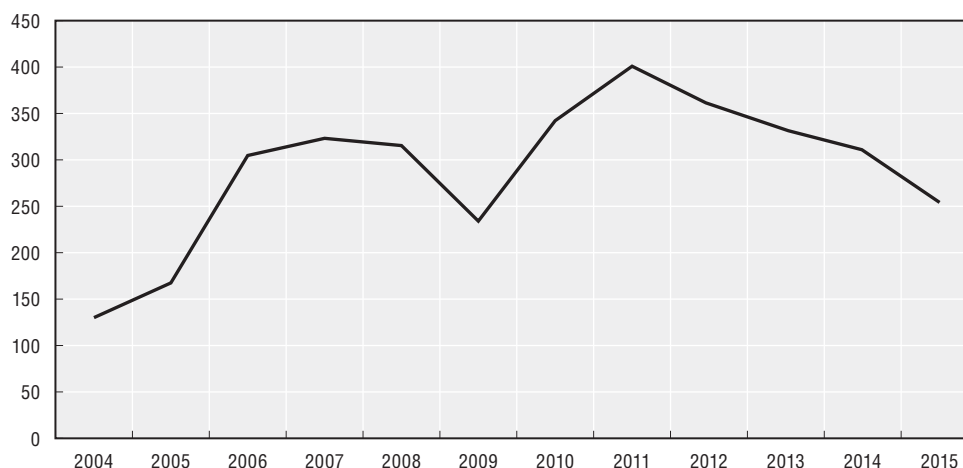


Source: OECD, 2015d (Real GDP forecast indicator) and Central Bank of Chile.

As the largest producer of copper in the world, Chile benefited from the upswing in commodity prices and low international interest rates during the recent commodity super cycle. Revenues from copper have represented as much as a third of total revenues in 2006 and 2007 (Figure 2). However, since 2012 copper prices have deteriorated, and will likely remain at lower levels in the future (Figure 3). The combination of lower copper prices and higher costs has affected mining profitability, sharply reducing investment. Lower terms of trade have also cut household incomes and reigned in private consumption. As a result, output growth expectations and projections have been reduced. The projection of the structural GDP growth for 2015 has decreased from 5% in the 2012 consultation to 3.6% on the 2015 consultation (Figure 4). Similarly, the last public finance report published by DIPRES projects a GDP growth of 2.25% for 2016, far below the projection made in the 2014 report of 3.6%. In response to lower expected growth, the government implemented a strong fiscal impulse in 2015 with public spending increasing by 7.4% as compared to the previous year (DIPRES, 2014b).

Figure 2. **Total revenues and copper revenues (% GDP)**

Source: DIPRES, 2016a (Central government state of operations) and additional data provided by DIPRES.

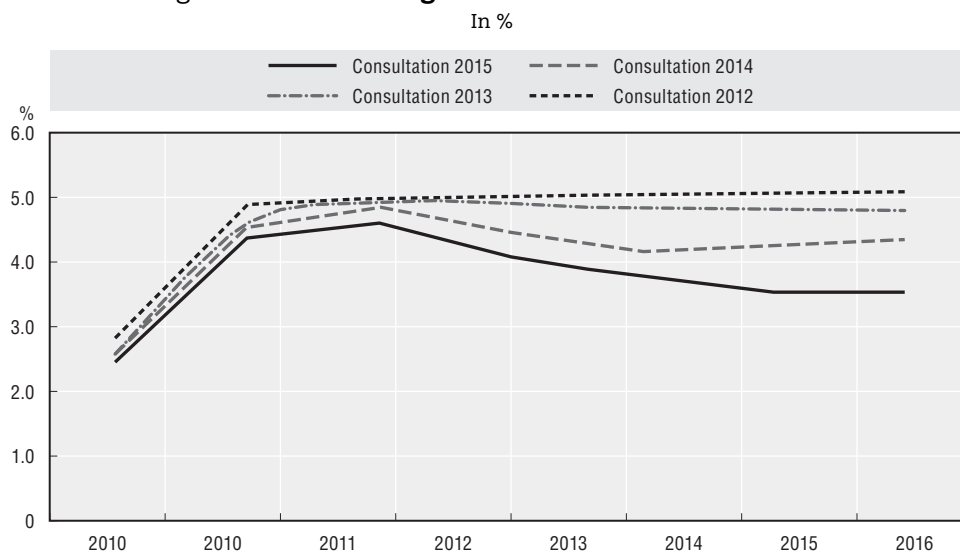
Figure 3. **Copper nominal price (2004-15)**
(USD cents per pound)

Source: Chilean Copper Commission COCHILCO, 2015.

1.2. A sound fiscal position

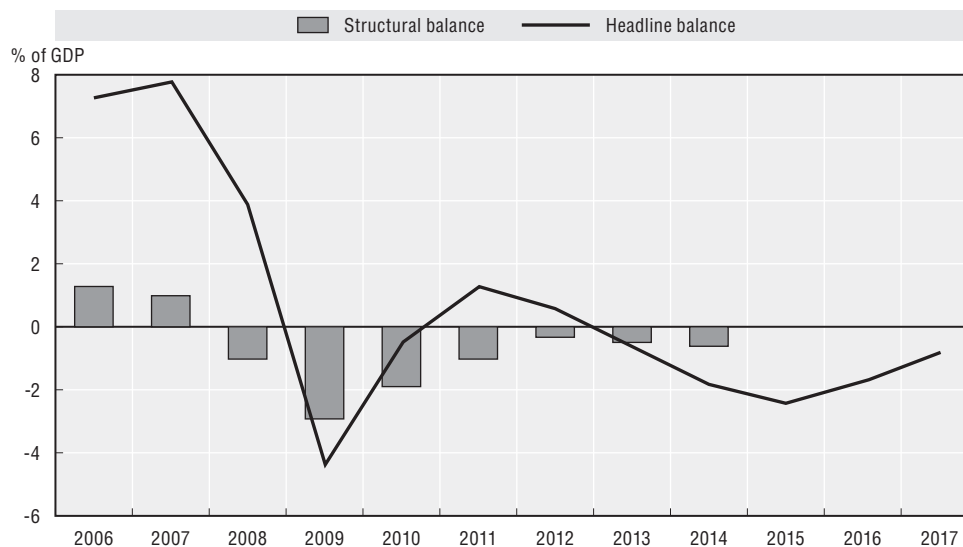
The sound fiscal management in the last decades, helped by a fiscal rule, have allowed Chile to run surpluses during much of the commodity boom (Figure 5). Fiscal surplus rose from 2% in 2004 to over 7% of GDP in 2007, allowing the country to save more than 10% of GDP in its investment funds (see next section). The surplus then moved to deficits as a result of the countercyclical response to the 2009 global financial crisis, reconstruction spending related to the 2010 earthquake and tsunami, and the increase in production costs in mining and the internalisation of what then seemed to be permanently higher commodity prices (OECD, 2015c). Nevertheless, the fiscal situation remains robust, notably by the near absence of net debt (Figure 6), which gave the government some room to carry out a further counter cyclical policy and sustain aggregate demand in response to the 2014 slowdown in activity.

Figure 4. **Trend GDP growth in different calculations**



Source: DIPRES, 2015a (Records of the structural GDP Advisory committee from different years).

Figure 5. **Headline and structural balance**

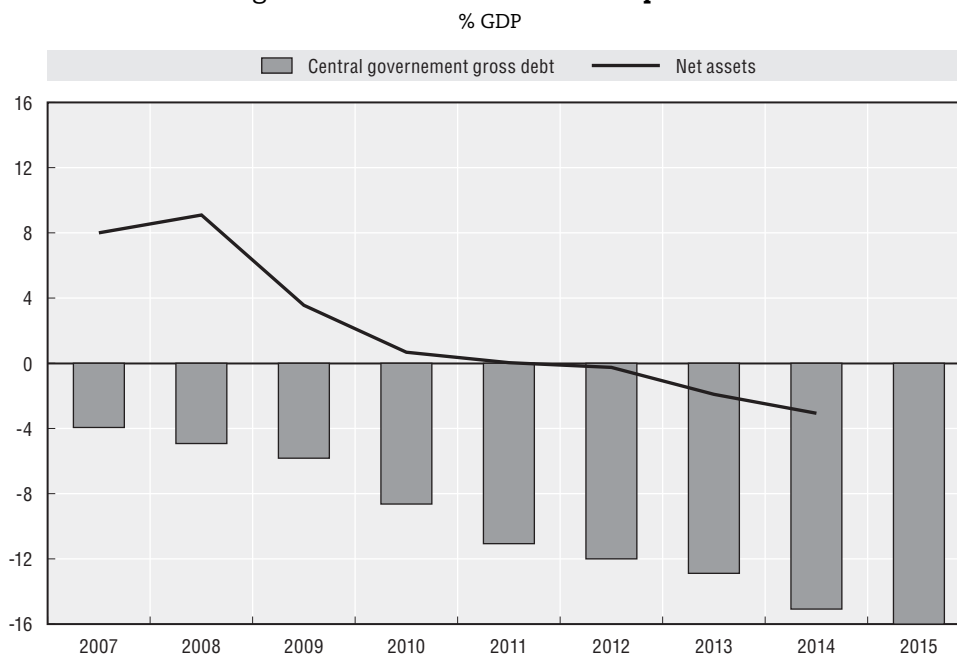


Source: OECD, 2015c (OECD Economic Surveys: Chile 2015).

1.3. Shifts in governments

Chile returned to democracy in 1990 and for the next two decades Chile was governed by successive centre-left governments. They pursued an agenda of great prudence to demonstrate their fiscal responsibility. With democracy maturing, a centre-right government was elected in 2010 and in the 2014 elections a centre-left government was returned back to office. The main goal of the current government is to tackle inequality (Box 1).

Shifts in governments and changes in government priorities represent challenges for the budget process in terms of responsiveness and reallocation capacity. It tests the ability of the budget to adapt in a flexible manner to the needs of the governments with different policy agendas.

Figure 6. **Government financial position**

Source: OECD 2015c, (OECD Economic Surveys: Chile 2015) and Ministry of Finance.

Box 1. **President Bachelet's policy priorities (2014-18)**

Education reform: The education reform aims to improve quality of education, reduce the private vs public education divide, aim for free universal education, and suppress all profit in the education system.

The government presented proposals aiming to build more inclusive schools and reduce skill gaps across socio-economic groups. Recent new legislation ended profits, tuition fees, and selective admission practices in primary and secondary school receiving state subsidies. New bills were sent to Congress to reform early childhood and pre-primary education and improve teacher career paths. To reduce financial constraints faced by students, the government aims to start providing free higher education to students from families that are in the last five deciles of the income distribution in 2016.

Tax reform: A tax reform was proposed to increase government revenues, in order to finance the increase in public expenditures due to the education reform and health care needs, without compromising fiscal stability.

In 2014, the government passed an ambitious tax reform to raise revenues (by around 3% of GDP), and improve the level of fairness in the tax code to contribute to reduce inequality. Other measures of the tax reform included modification of several aspects of the corporate tax system to mitigate distortions and opportunities for tax avoidance, and established a General Anti-Avoidance Rule, which forbids aggressive tax avoidance. More than half of the increased revenues are forecasted to come from increased income taxation, mainly from corporate income. Increases in compliance are forecast to increase revenues by 0.5% of GDP (17% of the overall reform revenue goal), while expansions in the VAT base will account for 0.3% of GDP (12% of the overall reform target).

New constitution: A constitutional reform was one of the key campaign promises of President Michelle Bachelet. In spite of multiple reforms, the current political constitution of the Republic of Chile is the one approved under the military dictatorship of Augusto Pinochet.

Box 1. President Bachelet's policy priorities (2014-18) (cont.)

In the beginning of October 2015, and after 15 years since the country returned to democracy, the government started a democratic, institutional and participative process to deliver a new constitution. It is expected that in the beginning of the second semester of 2017, the executive branch of the Government will present a first draft to the Congress. The final version of the document will be submitted to a referendum.

Along these three major reforms, the government launched an ambitious set of legal reforms to implement a “**decentralisation and development agenda**”. The legislative proposals concern three main pillars: i) a constitutional reform allowing the election of the regional intendentes (keeping a gobernador as representative of the central power); ii) the transfer of competences and public services in economic development, social development, infrastructure and housing to the regions; and iii) changes to the law on regional financing and fiscal responsibility, which foresees a greater devolution of resources, to be developed at a later stage.

In 2005, Chile also undertook one of the most important Constitutional reforms since the return to democracy, curbing military power and strengthening democratic institutions. This included reducing the President's term from six to four years. Even though the roles and responsibilities of the executive in the budget formulation were not explicitly altered, shorter presidential terms are perceived as more challenging in terms of implementing a government's policy agenda.

1.4. Higher citizen expectations

Chile has witnessed a rapid increase in citizens' expectations and civil society engagement during the last decade. New social movements have been formed demanding socio-political and economic changes and using public demonstrations as an alternative mechanism for holding political leaders accountable and for them to respond to citizen demands (Meyer, 2014).

In particular, in 2011 a series of large-scale citizen demonstrations took place demanding a variety of social reforms. Initially, the demonstrations focused on the education system, demanding the right to free education and improvements in quality. Later in the year, these protest initiatives were consolidated in a strong popular discontent regarding income distribution and environmental sustainability.

Between 2006 and 2012, protests have been reported in the media for 102 days of the year on average (Fernandez, 2013). This number was as high as 176 days in 2011 (almost half the year). These figures have a special relevance in Chile where citizens were more passive in the policy making process. Nearly all (96%) were non-institutional in nature, i.e. organised through informal channels. This shows a great separation between citizens, political parties and government institutions (Fernandez, 2013).

Under these circumstances, the government faces strong pressure to deliver more and better services. Budgetary practices and procedures have a key role in allowing public administration to achieve these objectives in an effective and efficient manner.

2. Institutional characteristics of Chilean budgeting

2.1. A historically centralised budget process focused on ensuring fiscal sustainability

Chile has a good reputation with regard to its fiscal responsibility, budget surpluses and macroeconomic stability. However, this has not always been the case. Prior to 1986, Chile had recurrent budget deficits. Fiscal sustainability in Chile has been achieved by concentrating the capacity to propose and increase public expenditure in the hands of the President, and reducing the role of the Congress. This was the result of a long process of concentration of fiscal powers in the hands of the executive, which took place from the 1943 Constitution reform which gave the Executive the initiative of new public expenditure, before a 1970 law made proposing new expenditure an exclusive prerogative of the President of the Republic (Box 2).

Box 2. Historical concentration of fiscal powers in the executive

Historically, the Congress enjoyed a very strong role in the budget process in Chile. Starting in the 1830s, the Congress began to exert an ever-greater role, and when the President tried to circumvent the budgetary powers of the Congress in the late 19th century, a civil war ensued. Those allied with the Congress emerged victorious in the Civil War of 1891, and the primacy of the Congress was confirmed in budgetary affairs and in general vis-à-vis the executive. The Congress, however, did not use its powers in a responsible manner, and it is generally believed in Chile that the Congress is always inclined to increase expenditure and budget deficits. A long series of reforms was therefore undertaken to reduce the capacity of the Congress to propose expenditure, concentrating budgetary powers in the hands of the executive, and in particular, of the President.

The role of the Congress diminished steadily, starting with the 1925 Constitution which created a Presidential regime. In 1943, a constitutional reform gave the executive the initiative of new public expenditure. However, this was still considered insufficient, and after several failed attempts, the constitution was again amended in 1970 (i.e. prior to the military government), to give exclusive initiative to the President of the Republic to propose increases to the General Budget Law, and other crucial initiatives for ensuring fiscal sustainability.

Source: Arellano, 2006.

Fiscal Sustainability was further reinforced by the military government in 1975 with the new Financial Administration Law, which concentrates all the power of controlling revenues and expenditures in the Ministry of Finance. These laws also integrated revenues and expenditures of all public agencies into the budget of the state and eliminated nearly all revenue earmarks. Interestingly, the military itself was exempt from the law.

The new Constitution of 1980 confirmed and reinforced these features, giving the President full responsibility and power over the financial administration of the State. This responsibility is delegated by the President to the Ministry of Finance, and in particular to the Budget Office, DIPRES, for its implementation (Box 3).

In particular, the Financial Administration Law stipulates that the Ministry of Finance and the DIPRES are in charge of designing, discussing and executing the budget. The role of DIPRES in the budget process is stronger in Chile than in most other OECD countries. In particular, the balance of power between the sectoral units that shadow respective line ministries and line ministries is in favour of DIPRES, and the ability of DIPRES to reallocate

Box 3. The Budget Office (DIPRES)

The Budget Office is an agency of the Ministry of Finance and is headed by the Budget Director. Although formally reporting to the Minister of Finance, the Budget Director is appointed directly by the President who may dismiss him/her at any time. The position of Budget Director is generally viewed as the equivalent of a senior ministerial position in the Chilean government.

In 2016, the Budget Office staff numbered 432 (including temporary staff). It is divided in a Budget Sub-Directorate (*Subdirección de Presupuestos*), which consists of the classic sectoral divisions shadowing respective spending ministries, a Sub-Directorate for Rationalisation and Public Service (*Racionalización y Función Pública*), in charge of economic studies, statistics and long-term budget studies, and four divisions: Public Management Control (*Control de Gestión Pública*), Public Finances (*Finanzas Públicas*), Internal Administration (*Gestión Interna*), and Information Technologies (*Tecnologías de la información*).

Source: DIPRES.

appropriations during the year is great. The role of Congress is on the contrary quite limited, as Congress cannot increase or reallocate expenditure. All public debt must be authorised by the Ministry of Finance, including for publicly owned enterprises, and municipal debt is prohibited unless specifically authorised by a law.

2.2. A Structural fiscal rule

Chilean fiscal policy has operated on a structural budget balance rule since 2001, aiming to ensure fiscal sustainability while allowing counter-cyclical policy actions. The 2006 Fiscal Responsibility Law defines the target of the structural balance as “the balance that the central government would have achieved if the economy was operating at potential, excluding the effect that the cyclical fluctuations in economic activity, the copper price, and other factors of similar nature, may have on the government revenues and expenditures” (Figure 8).

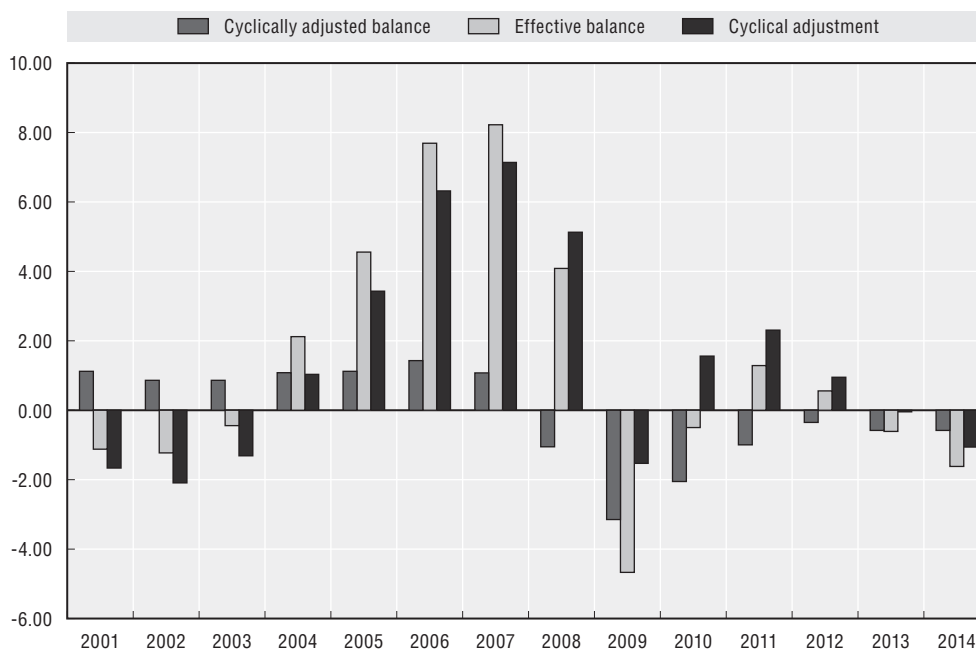
Under the fiscal rule, when the economy is performing above its long-term trend, the government should run a nominal surplus, and when the economy is performing below this trend, the government can allow a nominal deficit. This is conducted through the Economic and Social Stabilisation Fund, described in the next section. As a consequence, public expenditure is not defined taking into account the effective revenue of the government but the structural revenues, also known as cyclically adjusted revenues. The evolution of the fiscal rule and recent evolution of structural balance targets are studied in more detail in Section 3.

Key structural indicators used in the fiscal rule are calculated by two independent panels

Chile designed a mechanism very early on to ensure the independence of the two main inputs used to calculate the structural balance: the trend GDP growth and the evolution of the copper price.

In the first year of implementation (2001), the government created a panel consisting of experts to provide independent, technical inputs to estimate the effect of the economic cycle on tax revenue (the “output gap” panel). A year later (2002), the government created a similar panel to estimate the long-term price of copper (the “copper price” panel). These inputs are then used by DIPRES to calculate the structural GDP and the output gap.

Figure 7. **Cyclically adjusted balance, effective balance and cyclical adjustment (2001-14)**



Note: From 2001 to 2010 figures use 2003 national accounts, from 2011 to 2014 figures use 2008 national accounts.
Source: DIPRES, 2015b.

The “output gap” panel consists of about 15 economists appointed by the Minister of Finance for one year at a time. The same economists are generally re-appointed. The panel members are most often well-known economists from academia and research bodies, and a balance is kept between economists identified with the opposition political parties and with the ruling parties. The panel meets once during the budget season. The panel discusses methodological aspects of the model used. Then, each member of the panel submits a forecast for the various inputs required by the model. Each of the estimates is published anonymously so that each forecaster recognises his/her own. The two extremes on either side are discarded and then a simple average of the remaining forecasts is used. There is no discussion to achieve a consensus among panel members.

The “copper price” panel also consists of about 15 individuals appointed in the same fashion by the Minister of Finance. They are employees of mining companies and related enterprises, as well as academics and researchers. This committee estimates the average long-term (ten-year) price for copper as the reference price. Each panel member submits an estimate which is published anonymously. The two extremes are discarded and a simple average of the remaining forecasts is used. No consensus is sought. In most cases, panel members also send minutes and reports to support their projections.

2.3. Two Investment Funds: The Pension Reserve Fund and the Economic and Social Stabilisation Fund

The Pension Reserve Fund (PRF)

Since 1981, Chile replaced its pay-as-you-go public pension system with a private pension system. This new system aimed to be fully-funded based on individual savings that workers accumulated during their working lives. It is compulsory for all wage and salary

workers and involves the payment of 10% of gross earnings as a mandatory contribution (an additional fee ranging from 0.47% to 1.54% is charged by the pension fund manager). Individuals must select a private pension fund from a number of private companies known as pension fund managers (*Administradoras de Fondos de Pensiones, AFPs*), which are in charge of collecting the contributions and managing them.

This private pension system has been praised for providing a great amount of capital for domestic investment and reducing pressures on the public budget. However, contributions collected were lower than expected and a significant number of citizens were not entitled to receive a pension under the private pension system. The government was therefore obliged to finance poverty prevention programmes that placed pressure on the budget and these would grow significantly over time with demographic changes. The 2006 Fiscal Responsibility Law introduced a fund to finance these. In 2008, poverty prevention programmes were replaced with a new scheme of old-age and disability pensions. Under the new programme, all individuals in the lowest six deciles of income distribution who fulfil the age and residence requirements are entitled to a guaranteed basic pension regardless of their contribution history.

The Pension Reserve Fund was established with an initial contribution of USD 604.5 million. Its objective is to support financing government obligations arising from the government's guarantee to basic old-age and disability solidarity pensions. Accordingly, this fund serves as a supplementary source for the funding of future pension contingencies.

The Pension Reserve Fund's capital increases each year by an amount equivalent to 0.2% of the previous year's gross domestic product (GDP). If the actual fiscal surplus exceeds 0.2% of GDP, the Fund receives a contribution equivalent to said surplus, up to a maximum of 0.5% of GDP. This accumulation rule allows for new resources to be allocated to the fund in any given year regardless of the fiscal situation facing the country each year. The Pension Reserve Fund market value was USD 8.53 billion in March 2016.

The Economic and Social Stabilisation Fund (ESSF)

This fund was established with an initial contribution of USD 2.58 billion, much of which (USD 2.56 billion) was derived from the old Copper Stabilisation Fund that it replaces. The Fund aims to complement the fiscal rule, providing fiscal spending stabilisation. Indeed, it reduces dependency on global business cycles and revenue fluctuations due to copper price volatility by allowing government to draw from the Fund to finance fiscal deficits and amortisation of public debt.

The Fund receives each year the positive balance resulting from the difference between the effective fiscal surplus from the previous year and the contributions to the Pension Reserve Fund and to the Central Bank of Chile, discounting the payment of public debt and advances made the year before (Figure 7).

Since its creation, the ESSF has received contributions in 2007, 2008, 2010, 2012 and 2013. Some partial withdrawals have been made to finance the 2009 fiscal stimulus plan and to finance part of the contributions to the Pension Reserve Fund in 2010 and 2014 (Table 1). The ESSF's market value was USD 14.70 billion in March 2016.

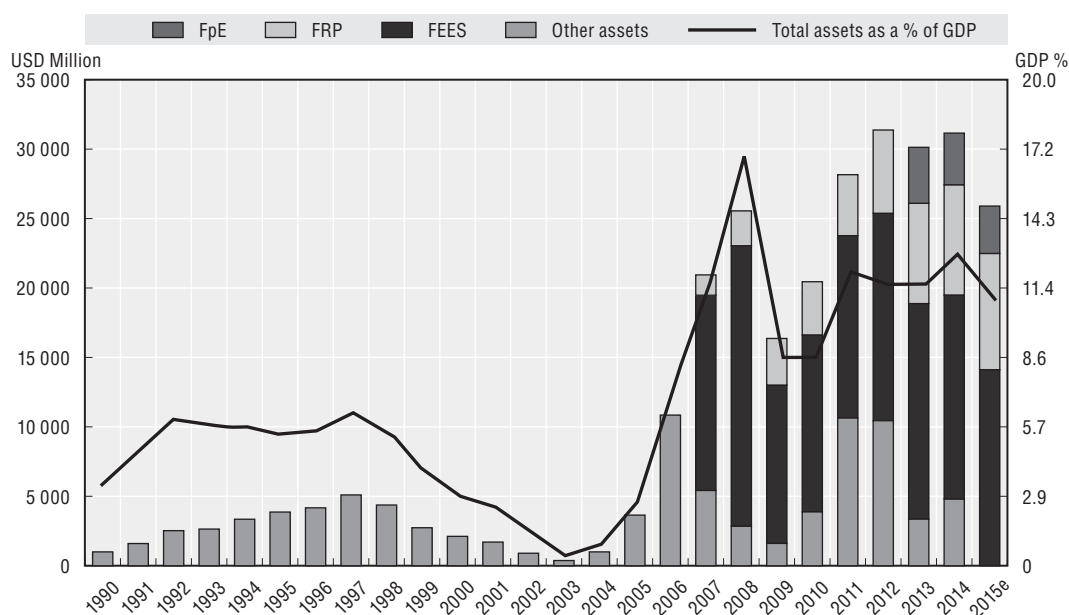
2.4. Actors involved in the budget process

Chile has a strong top-down budgetary process led by the Budget Office of DIPRES (Box 3). Line ministries and some independent councils and committees participate in the

Table 1. **ESSF's Contributions and withdrawals**

USD million		
Year	Contribution	Withdrawals
2007	13 100	–
2008	5 000	–
2009	–	9 278
2010	1 362	150
2011	–	–
2012	1 700	–
2013	603	–
2014	–	499
2015	–	464
Total	21 766	10 391

Source: Chile Ministry of Finance, 2014a (Sovereign Funds Annual Report).

Figure 8. **Public financial assets**

Source: DIPRES, 2015a.

budget cycle but most budgetary responsibilities and tasks are centralised in the Budget Office (Table 2). The power of the sectoral units within DIPRES – which “shadow” individual sectoral ministries is particularly strong, both during the budget formulation and budget implementation. Although the role of the Congress has increased in the last decade, it is still very limited compared with most other OECD member countries.

One particularity of DIPRES compared to most departments in other ministries in Chile is the stability of their staff. While in line ministries, there is a large turnover of staff with changes of government, staff in DIPRES are very stable during changes of government. This further increases the effective power of DIRES vis-à-vis line ministries and is often used as an argument for concentrating decision making power in the hands of DIPRES.

Table 2. **Actors involved in the budget process**

President of the Republic	<ul style="list-style-type: none"> ● Sets fiscal targets ● Presents the budget bill to the Congress
Ministry of the Presidency	<ul style="list-style-type: none"> ● Sets government priorities according to the government programme and fiscal context
Ministry of Finance (other than DIPRES)	<ul style="list-style-type: none"> ● Specifies the calendar for the budget law ● Forecasts tax revenues, tax expenditure, fiscal risks and interest rate, aligned with central bank guidelines (joint work with DIPRES)
DIPRES	<ul style="list-style-type: none"> ● Carries out macroeconomic assumptions for the budget parameters based on information provided by the "copper price panel" and the "output gap panel" ● Forecasts tax revenues, tax expenditure, fiscal risks and Interest rate, aligned with central bank guidelines (joint work with Ministry of Finance) ● Calculates spending limit in line with Presidential fiscal targets and macroeconomic assumptions ● Updates expenditure baselines ● Prepares detailed budget formulation instructions for line ministries ● Discusses sectoral allocations with line ministries ● Drafts budget bill ● Advises the Ministry of Finance during the budget debate carried out in the Congress ● Prepares the public finance report ● Sets annual rules for budget execution ● Proposes a budget execution programme to the Minister of Finance and drafts an expenditure programme defining expenditure levels and priorities ● Carries out programme evaluations supported by external evaluators ● Carries out <i>ex ante</i> evaluations of non-social programmes
Line Ministries	<ul style="list-style-type: none"> ● Prepare the relevant chapters of the budget law, following the precise and detailed instructions of DIPRES ● Discuss sectoral allocations with DIPRES ● Define indicators to monitor performance ● Execute the budget
Ministry of Social Development (MDS)	<ul style="list-style-type: none"> ● Carries out <i>ex ante</i> evaluations of social programmes ● Carries out <i>ex ante</i> evaluations of investment projects which require state funding to determine their social profitability
The "output gap panel"	<ul style="list-style-type: none"> ● Forecast the various inputs required to estimate the output gap
The "copper price panel"	<ul style="list-style-type: none"> ● Estimates the average long-term (ten-year) price for copper as the reference price
Fiscal Advisory Council	<ul style="list-style-type: none"> ● Participates as an observer in the "output gap" and "copper price panels" ● Provides advice to the Ministry of Finance regarding the cyclically adjusted balance rule ● Assesses eventual methodological changes to the rule proposed by the authorities ● Verifies mid-term projections of structural results included in the public finances report
Congress (special mixed commission)	<ul style="list-style-type: none"> ● Approves the budget law ● Follows budget execution
Comptroller-General	<ul style="list-style-type: none"> ● Pre-approves all transactions to ensure legality ● Publishes information on budget execution ● Carries out monitoring and evaluation ● Prepares "citizen friendly" publications on expenditure and programmes.

Source: DIPRES Website, Decree-Law 1263 (Organic Decree-Law for the Financial Administration of the State), Law 20128 (Fiscal Responsibility Law) and Political Constitution of Chile.

2.5. Budget calendar and process

Budget timeline

The timeline of the Chilean budget process is as follows: Formulation (April to September), discussion/approval (October to December), execution (calendar year) and evaluation (March to May) (Table 3).

Review of previous year's execution and evaluations

The budget formulation process is a top-down process driven by DIPRES. The budget season in Chile starts in April (Table 3). DIPRES then embarks on an internal process of reviewing the execution of the previous year's budget and evaluates the implementation of the budget into the current year. As part of these reviews, DIPRES calls meetings with the

Table 3. **Budget timeline**

April	● Review of previous year's execution and evaluations
April-May	● Baselines update
June	● Maximum amounts for ongoing programmes established ● Instructions sent from DIPRES to line ministries
June/July	● Line ministries prepare relevant chapters of the budget law ● Bilateral meetings between Budget Office and line ministries ● Meetings of panels on economic assumptions ("output gap" and "copper price" panels)
July-August	● The budget sectors (DIPRES) study the drafts sent by line ministries ● Technical commissions composed of officers from DIPRES and representatives from line ministries discuss the draft
End August	● Technical commissions present the budget bill to the Director of DIPRES and to the Finance Minister
August/September	● Copper and GDP panels issue their estimations
Early September	● The Finance Minister discusses the Budget draft with the President
End September	● Final preparation of documentation and pricing
Last day of September	● Budget proposal presented to the Congress
October-November	● Discussion of the budget Bill in the Congress
Last day of November	● Approval
December	● DIPRES prepares the budget execution programme
January	● End of the Budget year (t-1)
March-May	● Budget evaluation (t-1)

Note: Fiscal year = calendar year.

respective line ministries in order to exchange information. These reviews include an assessment based on the information provided by the evaluation process performed during the last phase of the previous budget cycle.

Updating baselines and setting sectoral ceilings

Following these reviews, DIPRES updates the baselines for on-going programmes which then serve as their initial expenditure ceilings. This amount includes a provision for wage settlements (as the negotiations finalise in December after the budget is approved), all expenditures that are mandated by law or contracts and discretionary spending that is judged as continual by its nature. This may include increased expenditures for initiatives that have been established in previous years and are being phased in. The expenditure ceilings are formulated by DIPRES in early June and are then officially communicated to line ministries.

Taking into account the ceilings and the detailed and precise instructions sent by DIPRES, line ministries prepare their submissions and relevant annotations (*glosas*). The use of annotations has increased significantly since the 2004 budget review exercise. This will be further discussed below.

Calculation of the structural (cyclically adjusted) revenues and total expenditure ceiling

Parallel to this process, the independent "output gap" and "copper price" panels meet in June/July to calculate the inputs of the structural budget balance (called cyclically adjusted balance since 2011). In August, this information is made public. Based on their conclusions, DIPRES calculates the structural (or cyclically adjusted) revenues and determines the overall level of resources available for the coming year in August/September. This information is published in October.

Defining sectoral allocations

Between July and August, DIPRES' sectoral units study the drafts presented by line ministries and prepare reports that are later presented to the Director of DIPRES and then to

the Minister of Finance. Extensive discussions will have taken place with the relevant line ministries during this time. After this internal process is concluded (around the first week of September), a draft budget law is presented to the President for his/her approval. The Ministry of Finance then communicates the final presidential decision to line ministries.

Finalising budget bill and submitting it to the Congress

The last step of the budget formulation process is for DIPRES to revise the annotations, finalise the budget documentation and put the budget on the appropriate price level, as all discussions would have taken place on the previous year's budget price levels. DIPRES also produces supplementary documents presenting additional information on performance and results for each of the 26 sectors of the government.

At the latest, the budget bill must be submitted to the Congress on the 30th of September.

2.6. The budget law

The Chilean budget law is divided into 27 portfolios (*partidas*), which correspond to the Ministries and the Treasury. Each portfolio is divided into chapters (*capítulos*), and each chapter is divided into programmes (*programas*) (Box 5). Programmes are usually followed by a large amount of annotations (*glosas*), which specify how the funds are to be spent.

Budget annotations (Glosas)

Chile's budget law has a significant number of annotations (*glosas*), which provide detailed instructions on how the funds are to be spent. Annotations are usually set by DIPRES. In some cases, they have been criticised for being used as a fast track legislative tool to introduce politically sensitive legislations (see more about this in Chapter 4).

Box 4. Characteristics of Chile's 2015 Budget Law

- Published on 6 December 2014.
- Projected total central government revenues: 33 356 904 CLP (21.3% of GDP).
- Projected total central government expenditure: 36 391 119 CLP (23.3% of GDP).
- Almost 800 pages.
- 26 portfolios (*partidas*).
- Almost 200 chapters (*capítulos*).
- More than 500 programmes (*programas*).
- More than 4000 budget lines (*items*).
- More than 2000 annotations (*glosas*).

Source: Law No. 20.798 2014.

3. Ensuring fiscal sustainability

3.1. An evolving structural fiscal rule

Since its introduction in 2001, the fiscal rule has been adjusted in terms of its base, targets, methodology, and institutional framework. Initially, the rule was based on a high-profile political commitment. It was only until 2006, with the adoption of the Fiscal Responsibility Law (FRL), that the implementation of the structural balance rule was supported by legislation.

The Fiscal Responsibility Law does not define a budget balance target. When taking office, the President defines the structural balance target for his/her administration. The President has to adopt, within 90 days of taking office, a “decree defining the fiscal fundamentals of his/her administration and the expected impact on the structural balance”. From 2001 to 2007, the government agreed on a structural surplus of 1% of GDP. The target of 1% surplus was mainly linked to the Central Bank recapitalisation process (Box 5), the exchange rate risk, and the existence of liabilities from concession contracts and the pension system. In 2008, this target was reduced to 0.5%, due to the evolution of these conditions and following the recommendations of an independent study. In 2009, it was reduced to zero to confront the consequences of the international economic crisis.

Box 5. **Capitalisation of the Central Bank**

The Chilean Central Bank suffered a strong deterioration of its capital situation, as a consequence of the 1982 financial crisis and the political decision then taken to rescue the banks, using mechanisms which implied a strong subsidy

To help improve the Central Bank’s financial situation, the Fiscal Responsibility Law stipulates that, for the first five years of application, if the effective surplus is higher than 0.5% of GDP, the government can spend up to 0.5% of GDP for recapitalising the Central Bank. This prerogative was used in 2006, 2007 and 2008. Despite the improvements achieved with this capitalisation measure, the capital balance continues to be negative.

Source: DIPRES (2010) and OECD (2011b).

The Fiscal Responsibility Law not only institutionalised the rule. It also authorised the re-capitalisation of the Central Bank (Box 5). It created two investment funds to manage fiscal surpluses: the Economic and Social Stabilisation Fund (ESSF) and the Pension Reserve Fund (PRF). Finally, it obliges the government to provide information on contingent liabilities and DIPRES must inform annually on the total amount and characteristics of state guarantees. Given the size of contingent liabilities, these are taken into account when calculating the structural balance target.

A “second generation” fiscal rule (2011)

In 2010, the government appointed an independent commission of eminent economists and policy makers, known as the Corbo Commission, to advise on how the fiscal rule could be improved the fiscal rule (Box 6). This process led to several changes in the fiscal rule – which became known as the “second generation” fiscal rule. In particular, the creation by law of an independent Fiscal Advisory Council – which is discussed below, the term “structural balance rule” was also replaced by “cyclically adjusted balance rule”.

Latest reforms of the fiscal rule (2015)

In 2015, the government introduced two additional changes to the cyclically adjusted balance rule. First, it simplified the calculation of the adjusted balance indicator, by eliminating the adjustment for the molybdenum income.¹ Second, it decided to use the inputs calculated by the independent panels to update the cyclically adjusted balance for the current year (before the reform, the inputs of the independent panels were only used to estimate the indicators for the budget of the following fiscal year).

Box 6. Key Recommendations of the Corbo Commission

Based on the recommendations proposed by the Corbo Commission, the Budget Office, DIPRES, presented the main elements of the second generation fiscal rule. The most relevant are:

- The term “structural balance rule” will be changed to the “cyclically adjusted balance rule” to better reflect its purpose. It will only be adjusted for cyclical incomes derived from GDP and from the price of copper and molybdenum.
- Other changes in incomes due to one-off factors will not be adjusted for.
- No cyclical adjustments will be made on interest gains on government assets. No adjustment will be made to “other incomes”.
- The long-term price of molybdenum will be estimated on the basis of a moving average of the actual price for the last seven years.
- The rule will be calculated on the basis of the global balance of the central government.
- Formal mechanisms must be created to ensure an *ex post* compliance of the rule. A section will be incorporated into the annual report on evaluation of the financial performance of the public sector describing the impact of adjustments and deviations from initial projections in the established policy targets.
- An independent fiscal council is to be created aiming to improve the quality of the methodology and the estimates to compute the cyclically adjusted balance.

While this adjustment allows for better comparability between structural balances of different years, it could also increase the variability of the cyclically adjusted balance and the public expenditure for the current year, which could lead to adverse macroeconomic effects.

Recent evolution of structural balance targets

Following the crisis, the government declared its intention to move back to sustainable fiscal settings over the medium term. At the beginning of 2011, President Sebastian Piñera set a medium-term objective of achieving a structural balance by the end of his term in 2014. Taking into account that the initial deficit was larger than expected, this initial target was revised and a new objective was set to achieve a 1% structural deficit by 2014.

In a similar way, at the beginning of her term in 2014, President Michele Bachelet set a target of 0% deficit by 2018. However, given the macroeconomic circumstances, in 2015 the government postponed the objective, with a plan to gradually reduce the structural deficit by approximately 0.25 % of GDP per year, and aiming to achieve a structural deficit of 0.8% by the end of 2018 (DIPRES, 2015a) (Figure 9).

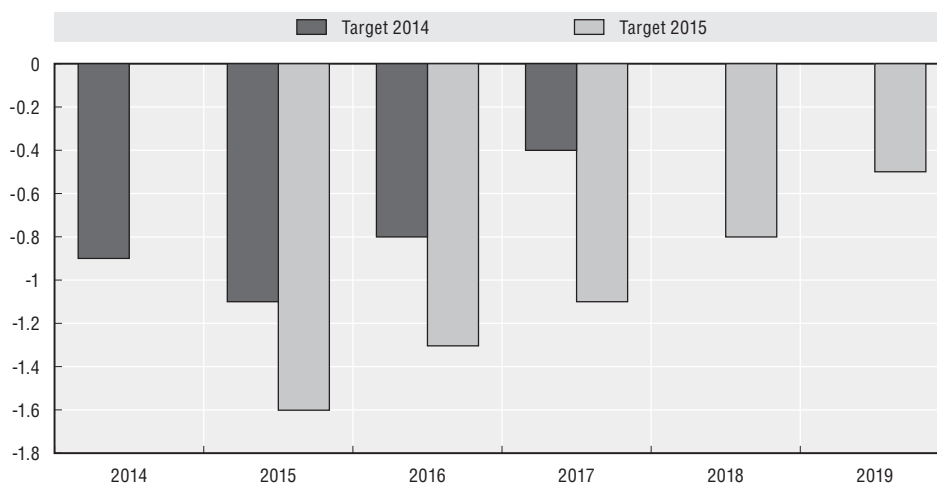
3.2. Fiscal Advisory Council

The Chilean Fiscal Advisory Council was created in 2013, following the recommendation by the Corbo Commission (Box 6). Its main mandate is to discuss, analyse and provide recommendations to the Ministry of Finance and the Budget Office, DIPRES, in matters related to the application of the cyclically-adjusted balance rule to the budget.

Specifically, the Fiscal Advisory Council has the following functions:

- Participate as an observer in the output gap and copper price panels;

Figure 9. **Structural balance target (2014 vs. 2015)**
% of GDP



Source: DIPRES, 2015a and Chile Ministry of Finance, 2014b.

- Verify that the mentioned variables are correctly reflected in the rule and its implementation, and takes position about the estimation of the cyclical adjustment to government revenue and balance prepared by DIPRES;
- Provide advice to the Ministry of Finance on specific aspects regarding the cyclically adjusted balance rule;
- Assess eventual methodological changes to the rule proposed by the authorities; and
- Verify mid-term projections of structural results included in the public finances report. The Fiscal Advisory Council issues minutes and press releases of all meetings and assessments carried out.

The Fiscal Advisory Council is composed of five members appointed by the Minister of Finance for terms of four year. They can however be replaced at any time. Members are typically academics and are not paid. It has no professional staff.

3.3. Other mechanisms for ensuring fiscal sustainability

Strong political commitment to fiscal sustainability

The political commitment towards fiscal sustainability is particularly strong in Chile, and while Presidents are free to set the fiscal target they like, they tend to be rather conservative. In addition, recent history has shown that Presidents (of different political affiliations) have not hesitated to postpone priorities or reduce their scope to accommodate for lower than expected revenues or catastrophic expenditure. For example, newly elected President Piñera changed his government programme to accommodate higher spending needs due to the 2010 earthquake, rather than absorbing this unexpected spending by increasing the deficit. In the same vein, President Bachelet had promised free education for all and is implementing a tax reform to finance this. But given the recent and foreseen structural slowdown in copper prices and economic growth, this promise has been reconsidered to only free education for the poorer 50% of the population.

Costing of new laws by DIPRES

Any new law submitted to Congress and which is expected to require funding must previously be costed by DIPRES, taking into account the medium-term financial implications

of the law. These costings are very influential given Chile's political culture in regard to fiscal responsibility.

Contingency reserve and in-year adjustments

The budget incorporates a contingency reserve. The amount of this reserve has been as high as 7.8% of total expenditures. The purpose of the contingency reserve is to fund legislation that the Congress may enact after the introduction of the budget. In particular, salary increases for government employees are finalised after the enactment of the budget in late December each year.

If financial conditions deteriorate during the year, DIPRES can unilaterally impose spending reductions and/or re-allocate funds between programmes. There is no need for Congressional approval for such in-year adjustments.

Control of Ministry of Finance over public borrowing

All debt issued by a public entity in Chile must be previously approved by the Ministry of Finance. The Ministry of Finance has full control over borrowing by public entities, including state owned enterprises and regional governments. Municipalities have budget autonomy, but need Congressional approval for borrowing, which implies approval by the Ministry of Finance as only the Executive can present laws. Finally, contingent liabilities (state guarantees) must be authorised by the Ministry of Finance. Since 2006, these are gathered in a register of contingent liabilities.

3.4. Recommendations on ensuring fiscal sustainability

The structural fiscal rule has been quite successful in smoothing public expenditure across the cycle, by forcing the government to save revenues due to cyclical upturns (such as high copper prices) Conversely, the government was able to draw from the ESSF Fund to finance a fiscal stimulus plan in 2009. The structural balance rule has also been quite successful in limiting budget deficits during short downswings, with the government taking immediate measures to counterbalance unforeseen reductions in revenues.

However, this strong emphasis on fiscal sustainability may come at the price of flexibility, which would be needed now that Chile is facing what seems to be facing the twin challenge of rising citizens' expectations and a longer-term slowdown in revenues, due to lower economic growth and a strong fall in copper prices. Changes in the fiscal targets and adjustments to the methodology for calculating the structural balance are frequent. For example, adjustments for molybdenum prices were included in the formula in 2005 and removed in 2015, adjustments for specific mining taxes were included in the formula in 2006 and modified in 2007, adjustments for the revenues of fiscal assets were included in the formula in 2008, and adjustments for other revenues were included in the formula in 2009). These changes may reflect the difficulties of calculating a structural balance, and the need of increasing room for manoeuvre to overcome economic slowdowns.

Allow for clear escape clauses rather than modifying the target

In recent years, with the worsening of the economic situation, the fiscal target has been modified to accommodate the desired contra-cyclical policy. In the long term, this may reduce the credibility of the fiscal rule. It may be more desirable to have a stable fiscal target and clear escape clauses during downturns, than to change the fiscal target according to the economic situation. Such escape clauses should clearly specify the conditions under which

they can be triggered and require for the government to submit a plan on how to go back to the fiscal rule. In OECD countries which use such systems, these plans can either take the form of political commitments, or be also enshrined in legislation.

There are different reasons why countries establish fiscal rules. In some countries, which have long traditions of running fiscal deficits (even during good economic times), fiscal rules aim to limit these deficits and increase fiscal credibility. Fiscal rules are very often used in federal countries or monetary unions, to ensure policy co-ordination on public deficits and debts with sub-national governments or member countries (for example, the Maastricht rules in Europe, or the Fiscal Pact in Germany). Other countries implement fiscal rules to secure public savings and unlink public expenditure growth from cyclical variations (for example those due to the price fluctuations of natural resources).

In the case of Chile, one of the main objectives of the structural fiscal rule is to separate public expenditure growth from the cyclical variations of natural resources prices (in particular copper), and ensure that savings are carried out during booms, so that public expenditure does not need to be cut during slowdowns. Allowing for an escape clause during downturns would not threaten this objective and would increase transparency and predictability during downturns. Germany for example allows for limited exceptions to its debt brake rule (Box 7).

Box 7. Germany's Debt Brake rule

Prior to 2009, Germany's fiscal policy course was influenced by a long-standing constitutional requirement that "revenue obtained by borrowing shall not exceed the total of investment expenditures provided for in the budget" subject to exceptions "to prevent a disturbance of the overall economic equilibrium". The rationale for such a "golden rule" was that capital investment should promote economic capacity and thereby increase the serviceability of debt. Over the decades, however, the rule proved ineffective at slowing the build-up of debt or of dampening pro-cyclical fiscal policy.

In 2009, on the basis of groundwork by the Federal Ministry of Finance and a proposal by the Federal Commission, the proposal to replace the golden rule with a debt brake was approved by the German parliament and enshrined in the Constitution. The avowed objectives were to improve the sustainability of the national finances with strengthened fiscal co-ordination among federal and *Länder* levels while providing flexibility to deal with cyclical and demographic challenges. The core elements of the debt brake are as follows:

- **Balanced budgets:** Both the federal and *Länder* governments must balance revenues with expenditures in their budgets, as a fundamental principle. In normal economic circumstances (i.e. when the output gap is closed), "balance" is assumed to be met for the federal government when net borrowing does not exceed 0.35% of GDP. (This is approximately a threefold reduction in the latitude for borrowing, as compared with the former golden rule.) There is no such latitude in normal times for the *Länder*.
- **Symmetrical adjustments over the economic cycle:** Automatic stabilisers will operate freely and fully over the cycle. In other words, cyclical deficits may be run in a downturn, and cyclical surpluses must be run in an upturn. The technical determination of the stage in the economic cycle is handled in line with EU methodologies, and is dealt with (for federal purposes) under an Act and a technical ordinance. The *Länder* make their own implementation arrangements.

Box 7. Germany's Debt Brake rule (cont.)

- **Underlying, not artificial, budget position:** “Financial transactions” within government, such as the sale of an asset yielding one-off revenues, must be netted off from the figures so that the true underlying budget position is used.
- **Control and Correction:** Deviations, either positive or negative, from the permissible borrowing amount that arise during budget implementation are not simply forgotten about: They are booked to a standing “control account” which must be balanced over time. (Deviations arising from unanticipated cyclical changes are not so booked: it is assumed instead that these issues will be covered through re-calculated automatic stabilisers.) Redemption of the control account is required once it reaches 1% of GDP; however, to limit pro-cyclical effects, redemption may be deferred during a downturn, and is in any event capped at 0.35% of GDP even during an upturn.
- **Limited exceptions:** Additional borrowing is allowed to deal with natural disasters and exceptional emergencies beyond state control, and with severe consequences for the public finances. A majority of Bundestag members must ratify any such decision, along with an amortisation plan to repay the borrowings “within an appropriate time period”.
- **Transitional arrangements:** Since the debt brake became effective in 2011, in the midst of the global financial crisis, additional borrowing latitude is allowed, but this must be phased out (i.e. the 0.35% limit for the federal government becomes fully effective) from 2016. For the *Länder*, the ban on structural borrowing will be fully effective from 2020 onwards.

Stabilise the methodology for calculating structural balances, and consider delegating this responsibility to an independent institution

While the projections of trend GDP and the reference (long-term) price of copper are carried out by independent committees, the methodology for calculating the cyclically adjusted GDP and balance is developed, implemented and regularly revised by DIPRES.

Variations in the methodology used to calculate the cyclically adjusted budget have been frequent in recent years, and are decided solely by DIPRES. In 2015, they were also supported by the Fiscal Advisory Council. Given the magnitude of the resulting changes in the structural balance, they have required changing the fiscal target to accommodate the new figures without incurring a severe policy change. For example, methodological changes in tax revenues and others from 2008 to 2009 had a +2.4% GDP effect on the initial year structural revenues (Marcel, 2012).

Having an independent institution responsible for the methodology – or at least, validating it – would increase the credibility of the rule. This function could be attributed to an independent Fiscal Advisory Council.

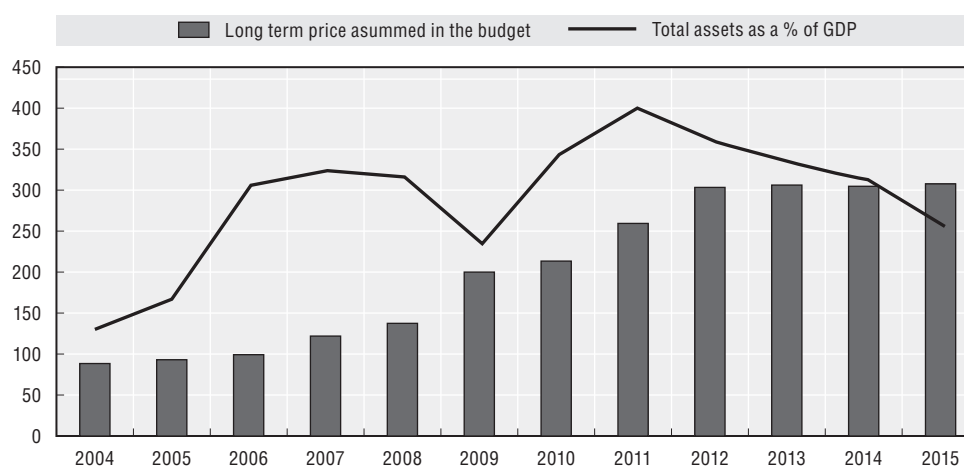
Introduce a control and correction mechanism

Today, there is no mechanism in the fiscal rule to correct for deviations, whether positive or negative, from the permissible deficit/surplus amount. Chile could envisage creating a “control account”, on the same vein as in Germany (Box 7), to keep track of deviations and compensate them in subsequent years.

Reform the Fiscal Advisory Council to ensure its independence

Recent changes in the base and methodology for the calculation of the cyclically adjusted budget balance showed how sensitive the fiscal rule is to the estimates of the structural revenues. In particular, any overestimation of the structural revenues will translate into higher expenditures and a more expansionary fiscal position (Dabán, 2010). Given the formula used to calculate the cyclically adjusted budget, any change in key parameters, such as the estimated long-term copper price (Figure 10), will have a direct effect in the cyclically adjusted balance and in the level of expenditure. Therefore, quality and precision of the estimates, and coherence between the methodology used and the objectives of the fiscal rule are key priorities.

Figure 10. **Nominal copper price vs. long-term price assumed in the budget**
USD Cents per pound



Source: OECD, 2015c (OECD Economic Surveys: Chile 2015).

The implementation of the recommendations of the Corbo Commission, are outstanding steps towards improving the base and calculation of the fiscal rule. However, the still very young Fiscal Advisory Council, which was established by decree, remains weak with limited institutional independence. For example, the current government replaced all members of the Council upon assuming office.

Special efforts are needed to bring the Council in line with the OECD Recommendation of the Council on Principles for Independent Fiscal Institutions (Box 8). A first step would be to establish the Council on a statutory basis. The Council's mandate should be defined in law and could be broadened to include additional tasks, such as analysis of long-term fiscal sustainability, in line with common practice in other OECD countries (see Table 4). The Council should be given sufficient resources commensurate with its mandate, in particular to hire professional staff. Mechanisms should be put in place to encourage appropriate accountability to the legislature, including submission of the Council's reports to the Congress in time to contribute to relevant legislative debate, and council members' participation in parliamentary hearings (see OECD Principles 5.1 and 5.2).

The Fiscal Responsibility Law states that the budget balance target must be set by the President at the beginning of his/her mandate. There is no counterbalancing force to this decision, so the soundness of the fiscal target depends on the soundness of only one

Box 8. OECD Recommendation Principles for Independent Fiscal Institutions

On February 2014, the OECD approved the following twenty-two Principles for Independent Fiscal Institutions (fiscal councils and independent parliamentary budget offices). The most relevant principles for the Chilean case are summarised below:

Local ownership

1. IFIs require broad national ownership, commitment, and consensus across the political spectrum.
2. Local needs and the local institutional environment should determine options for the role and structure of the IFI.

Independence and non-partisanship

3. Non-partisanship and independence are pre-requisites for a successful IFI.
4. The leadership of an IFI should be selected on the basis of merit and technical competence, without reference to political affiliation.
5. Term lengths and the number of terms that the leadership of the IFI may serve should be clearly specified in legislation as should be the criteria and process for dismissal for cause.
6. The position of head of the IFI should be a remunerated and preferably full-time position.
7. The leadership of the IFI should have full freedom to hire and dismiss staff in accordance with applicable labour laws.
8. Staff should be selected through open competition based on merit and technical competence and without reference to political affiliation.

Mandate

9. The mandate of IFIs should be clearly defined in higher-level legislation.
10. IFIs should have the scope to produce reports and analysis at their own initiative, provided that these are consistent with their mandate.
11. Clear links to the budget process should be established within the mandate.

Resources

12. The resources allocated to IFIs must be commensurate with their mandate in order for them to fulfil it in a credible manner.

Relationship with the legislature

13. Legislatures perform critical accountability functions in country budget processes and the budgetary calendar should allow sufficient time for the IFI to carry out analysis necessary for parliamentary work.
14. The role of the IFI vis-à-vis parliament's budget committee (or equivalent), other committees, and individual members in terms of requests for analysis should be clearly established in legislation.

Access to information

15. IFI must have full access to all relevant information in a timely manner, including methodology and assumptions underlying the budget and other fiscal proposals.
16. Any restrictions on access to government information should also be clearly defined in legislation.

Transparency

17. Given that promoting transparency in public finances is a key goal of IFIs, they have a special duty to act as transparently as possible.
18. IFI reports and analysis (including a full account of the underlying data and methodology) should be published and made freely available to all.

Box 8. OECD Recommendation Principles for Independent Fiscal Institutions (cont.)

19. The release dates of major reports and analysis should be formally established, especially in order to co-ordinate them with the release of relevant government reports and analysis.

20. IFIs should release their reports and analysis, on matters relating to their core on-going mandate on economic and fiscal issues, in their own name.

Communications

21. IFIs should develop effective communication channels from the outset, especially with the media, civil society, and other stakeholders.

External evaluation

22. IFIs should develop a mechanism for external evaluation of their work.

Source: OECD (2014), Recommendation of the Council on Principles for Independent Fiscal Institutions.

Table 4. Typical functions of independent fiscal institutions

Country	Organisation	Functions					
		Analysis of long-term fiscal sustainability	Role in macro6 economic forecasts	Role in monitoring compliance with fiscal rules	Directly support legislature in budget analysis	Role in policy costing	Role in costing election platforms
Australia	PBO	●	○	○	●	●	●
Austria	Government Debt Committee	●	▶	●	○	○	○
Belgium	High Council of Finance	●	▶	●	○	○	○
Canada	PBO	●	▶	○	●	●	○
Denmark	Danish Economic Council	●	▶	●	○	○	○
Finland	National Audit Office of Finland	●	▶	●	○	○	○
France	High Council of Public Finance	○	▶	●	○	○	○
Ireland	Irish Fiscal Advisory Council	○	▶	●	○	○	○
Italy	PBO	●	▶	●	○	○	○
Korea	National Assembly Budget Office	●	▶	○	●	●	○
Mexico	Centre for Public Finance Studies	●	▶	○	●	●	○
Netherlands	Netherlands Bureau for Economic Policy Analysis	●	●	○	○	●	●
Portugal	Portuguese Public Finance Council	●	▶	●	○	○	○
Slovak Republic	Council for Budget Responsibility	●	○	●	○	●	○
Spain	AIReF	●	▶	●	●	○	○
Sweden	Swedish Fiscal Policy Council	●	▶	●	●	○	○
UK	Office for Budget Responsibility	●	●	●	○	●	○
US	Congressional Budget Office	●	▶	○	●	●	○
Total countries (no.)		18	18	18	18	18	18
● = Yes		16	2	12	7	8	2
○ = No		2	2	6	11	10	16
▶ = Other		0	14	0	0	0	0
Data not available		0	0	0	0	0	0
Total countries (%)		100%	100%	100%	100%	100%	100%
● = Yes		89%	89%	67%	39%	44%	11%
○ = No		11%	11%	33%	61%	56%	89%
▶ = Other		0%	78%	0%	0%	0%	0%
Data not available		0%	0%	0%	0%	0%	0%

Source: Von Trapp L., I. Lienert and J. Wehner (2016).

person. While setting the fiscal targets is seen as a political decision, they would certainly benefit from recommendations and/or approval from an independent Fiscal Advisory Council.

4. Aligning the budget with the strategic priorities of government

4.1. Including new programmes in the budget

Policy co-ordination

Funding of new programmes is mainly driven by presidential priorities. These are set out in the Presidential Programme. They are updated annually in the *May 21st Presidential Speech to the National Congress*, where the President presents what has been achieved in the past year and outlines the priorities for the coming year.

The General Secretariat of the Presidency (*Secretaría General de la Presidencia*), created in 1989, is in charge of co-ordination between ministries and with the Congress. Its main task consists of ensuring the implementation of the Presidential Programme, and in particular, ensuring the President's priorities are reflected in the budget. It is a key actor for co-ordinating multi-sectoral and multi-annual policies. It works closely with DIPRES and line ministries.

Ex-ante evaluation of new and reformulated programmes

In the year 2000, DIPRES introduced a standard form (*formato estándar*, FE) based on the logical framework, to standardise the information regarding programmes presented by line ministries during the budget process. During 2000-03, this form was made mandatory in order to request funds for new programmes, through a mechanism which was called the competitive fund (*fondo concursable*). Since 2003, the competitive fund is no longer used as such, but new and reformulated programmes must still be presented under this standard form and developed with the logical framework.

In 2008, DIPRES gave new impulse to *ex ante* evaluations of programmes applying for funds, through the creation of a division for providing technical assistance to institutions in formulating their programmes. During the 2008-10 period, the methodology was simplified and a web-based application was designed to provide technical assistance on-line. Objective criteria are established for the *ex ante* evaluation of programmes (diagnosis of problems, definition of the target population, objectives, strategy and use of funds).

In 2011, DIPRES implemented a further innovation: The "open window" *ex-ante* evaluation. This allows institutions to request and receive technical assistance as of April each year (i.e. two months before sending their formal request to DIPRES).

Since 2011, the Ministry of Social Development is responsible for implementing this *ex-ante* evaluation for social programmes, while DIPRES is still responsible for implementing these evaluations for the rest of the programmes. The Ministry of Social Development (MDS) was created in 2011, replacing the Ministry of Planning (MIDEPLAN) (Box 9). The main objective of this reform was to provide an institutional framework that guarantees co-ordination and coherence and hinder duplication of social development policy in government. Apart from strengthening social policy, the reform also aimed to increase evaluative information to allow informed decisions. Indeed, before any new social programme can go forward, it must perform an *ex ante* evaluation. In most OECD member countries, these functions are performed by the budget office.

Box 9. Ministry of Social Development (MDS)

Chile has a long history of planning, in particular in the areas of social development and social protection.

In 1990, Chile created the Ministry for Planning and Cooperation, in charge of designing national development plans, and co-ordinating policies for reducing poverty. In particular, in 2005, it was given the responsibility for creating, co-ordinating and promoting the Social Protection System in the whole country. In parallel, the Ministry of Planning started to carry out evaluations of public policies and programmes, in co-ordination with DIPRES and the Presidency.

In October 2011, the Ministry of Planning became the Ministry of Social Development (*Ministerio de Desarrollo Social*, MDS). The mission of the MDS consists of designing and implementing policies, plans and programmes for social development, with a special focus on eradicating poverty and providing social protection to vulnerable persons and groups, promoting social mobility and integration.

The MDS has two main functions: ensuring co-ordination, consistency and coherence of the policies, plans and programmes in terms of social development, both at national and regional levels; and evaluating investment projects which require state funding to determine their social profitability, and ensuring they respond to the strategies and policies of economic and social development of the country.

The MDS is divided into two sub-secretariats:

- **Sub-secretariat for Social Evaluation**, which is responsible for the design, co-ordination and evaluation of the government's social policies;
- **The Sub-secretariat for Social Services**, which co-ordinates the different social policies of MDS.

Source: Ministerio de Desarrollo Social website.

Ex-ante evaluations for social programmes, developed by the Ministry of Social Development assess three main points:

- The consistency of the programme with the government priorities (President's Programme) and the strategic objectives of the institution that presents it;
- The internal coherence of the design of the programme to achieve its stated objectives (relation between the objectives, the target population, the strategy); and
- Accountability mechanisms in place, such as the indicators which will be used to assess performance.

The Ministry of Social Development also monitors existing social programmes to ensure they comply with their objectives. Non-social programmes are evaluated *ex-ante* and monitored by DIPRES.

The results of the evaluations carried out by the Ministry of Social Development are public, and gathered in the Integrated Database of Social Programmes (*Banco Integrado de Programas Sociales*).

4.2. Medium-term perspective

In 2000, DIPRES started maintaining baseline projections of government revenue and expenditures for the next three years. The aim is to keep these projections constantly up to

date. These are formally reviewed twice a year: In May, when information on the execution of the previous year's budget is available, and in late September, when the budget bill and the official macroeconomic projections are incorporated into the projections for the following year.

However, projections are only presented to the Congress and shared with line ministries at a very aggregate level (Table 5): i) the level of aggregate expenditure permitted by the budget balance rule or (in the present context) target, given projected revenues; and ii) the level of committed expenditure (*gasto comprometido*), which is often referred to in other countries as "baseline" expenditure. The fiscal space is the difference between these two levels.

Table 5. **Medium-term fiscal projections of Central Government (2016-19)**

CLP million 2016 and percentage of GDP

	2016 Draft budget bill	2017 Projection	2018 Projection	2019 Projection
(1) Total actual revenues	34 858 785	37 038 750	39 855 003	42 536 101
(2) Total committed expenditure	40 277 024	42 371 429	44 193 401	45 386 623
(3) Cyclically adjusted revenues	38 138 472	40 347 144	42 707 309	44 962 742
(4) Target cyclically adjusted balance (% of GDP)	-1.3	-1.1	-0.8	-0.5
(5) Expenditure compatible with target	40 277 024	42 164 547	44 055 488	45 880 798
(6) Expenditure difference (fiscal space) (5)-(2)	0	-206 883	-137 912	494 175
(7) Expenditure difference (USD million)	0	-296	-197	706
(8) Expenditure difference (% of GDP)	0	-0.1	-0.1	0.3
(9) Actual plan compatible with target (1)-(5)	-5 418 239	-5 125 797	-4 200 485	-3 344 697
(10) Effective balance compatible with target (% GDP)	-3.2	-3.0	-2.3	-1.8

Source: DIPRES, 2015a and 2016 Budget Bill.

Indeed, DIPRES fears that sharing more disaggregated estimates would create a sense of commitment to the future budgetary funding levels for ministries and institutions concerned. For this same reason, forward estimates are largely prepared within DIPRES, with limited involvement from the spending institutions. However, it is often in the spending institutions that the greatest understanding of expenditure dynamics is to be found. Developing more of a partnership in the preparation of the estimates might therefore be a key means of improving their quality.

The medium-term expenditure projections document is not used as a tool for resource allocation: DIPRES uses it to evaluate the overall trend in public revenue and expenditure to see how the trend is compatible with the over-arching goal of maintaining the structural fiscal rule. As such, the document assists in determining the availability of total resources. The May update provides guidance on resource availability until the independent panels on the structural balance meet in August to finalise the level of resources available. There is no reconciliation between the projections from year to year in the public documents.

4.3. Programme budgeting

Format of budget submissions

In the year 2000, DIPRES designed a standard form based on the logical framework (*metodología de marco lógico*), for submitting requests for funding new programmes or increasing funding for existing programmes. This also separated baseline expenditure (*gastos inerciales*) from new programmes. This has now become a permanent requirement

of the budget formulation process, requiring ministries and agencies to provide key outcome and output information on all new programmes to be financed.

All the funding requests (both for social and non-social programmes) are scrutinized in detail by DIPRES.

Operational programmes vs. budgetary programmes

While the programmes defined through the budget submissions are defined in terms of related outcomes and outputs, the programme classification included in the budget itself is often not. Budgetary programmes pay more attention to organisational criteria than to the objectives of expenditure, and differ considerably from the classification included in the performance management system (see Section 7). These differences reduce the link between government priorities and budget allocations, and undermine the value of the budget as an instrument for expressing allocative choices.

Only a small share of the budget corresponds to programmes as traditionally understood in a programme budgeting context in the sense that these programmes do not necessarily reflect groups of related outputs which share a common outcome. For example

- The programme structure of the budget does not provide a sufficiently detailed classification of expenditure by objective. The budget programmes themselves are generally very high level, and there are no sub-programmes.
- The transparency of the allocation of resources to policy objectives is blurred by the inclusion of large amounts of money in programmes which represent transfers that are paid by the organisational unit concerned to other organisational units, for objectives which are covered by other programmes.
- The programme classification of expenditure in the budget is not accompanied by any statement of the objectives (intended outcomes) or key services (outputs) of the programmes.

The structural differences between the programmes included in the budget and the format of budget submissions have the result of separating the entity's strategic planning from its budgeting function. In a well-designed programme budgeting system, the strategic framework should be integrated with the budget via the budgetary programmes. Concretely, entities should be required to specify the objectives (intended outcomes) of every budgetary programme, and to develop performance indicators for each programme. However, in Chile performance indicators are linked to the strategic products rather than to budget programmes, and the objectives of the budget programmes are not specified.

Reforming the structure of the budget towards programme budgeting is an ambitious undertaking. France for example fundamentally reformed its budget structure, enacting in 2001 a new organic budget law structured along missions, programmes and actions (Box 10).

Box 10. French programme budgeting system

In 2001, France enacted a new organic budget law including a well-defined programme structure, shifting budget classification from nature of expenses to public policy objectives. According to this new approach, the budget must be divided into missions, programmes and actions:

Box 10. French programme budgeting system (cont.)

- A **mission** covers a series of programmes designed to contribute to a specific public policy. A mission can involve a single ministry or several ministries. The Parliament cannot change or adjust the Missions. It has to accept the budget allocations proposed by the executive government and has power only to vary the allocation between programmes.
- A **programme** covers a coherent set of activities of a single ministry targeted to a specific public policy objective. If more than one ministry participates in a large public policy, each of them should have a separate Programme, covering its own responsibility in that matter, and ensuring coordination. Thus a programme corresponds to a centre of responsibility. Accordingly, for every programme, a programme director is appointed. All the resources from the State Budget should be allocated and spent within a Programme. In a similar way, resources allocated by the Parliament to a particular programme cannot be spent by the ministers for another programme.
- An **action** covers a set of operational means to implement the programme. The budget breaks down resources allocated to the actions of each programme; however, this break down is indicative and not committing. There is indeed a high degree of freedom for expenditure choices for ministers, in order to allow the Programme to reach its forecasted performance. However, there is one exception to this increased freedom: Appropriations for personnel are not indicative but binding, in an asymmetrical way: Personnel appropriations can be used for other purposes, but appropriations for other purposes cannot be used for personnel costs.

The Organic Budget Law prescribes an extensive performance reporting process to integrate performance information in the budget system through the following two types of mandatory budget documents: annual performance plans (*projets annuels de performances, PAP*) and annual performance reports (*rapports annuels de performances, RAP*). For a given mission, the PAP provides a detailed description of its purpose, goals, policy targets and performance indicators. As part of the annual budget act, the PAP documents are forward looking and are meant to contribute to the public debate about the costs and benefits of public policy. The RAPs are published in the first quarter along with the budget review act; they focus on performance achievements and provide detailed information on programme implementation and results. The RAPs are thus backward looking and tend to contribute to the public debate on the administration's performance.

Source: Loi organique relative aux lois de finances 2001.

4.4. Use of budget restrictions and annotations (glosas)

The content of the Chilean budget law is very detailed compared to other OECD countries with more than 4 000 line-item appropriations (Table 6), and comprises a large amount of annotations for each budget chapter that further restrict their use.

Line-item appropriations are the most detailed level of spending mandated by the legislature. Depending on the country, the level of line-items may be as specific as financial inputs (e.g. travel), or more aggregated at the programme or agency level. The existence of many line-items often constrains managerial flexibility by detailing the specific inputs that can be used for specific areas. Relaxing central input controls can not only increase the effective use of resources, but with concomitant management reforms can foster accountability for results.

Table 6. **Number of line-item appropriations contained in the budget**

Below 300 line items	Between 300 and 1000 line items	Between 1000 and 2000	More than 2000
Austria	Australia	Denmark	Chile (> 4 000)
Canada	Czech Republic	Estonia	Spain (16 700)
France	Greece	Norway	Japan (23 000)
Italy	Finland	USA	Turkey (> 40 000)
Korea	Hungary		Portugal (> 40 000)
Netherlands	Ireland*		
Poland	Israel		
Slovak Republic	New Zealand		
United Kingdom	Slovenia		
	Sweden		
	Switzerland		

* The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD, 2014.

Chile's budget is divided in 26 portfolios (*partidas*), which correspond to line ministries, the Presidency, Congress, Judicial power and Supreme Audit Institution. Each portfolio is divided into chapters (*capítulos*: Almost 200 in total) which correspond to sub-secretariats. Some large organisations with a nationwide network divide their appropriations among several regions, i.e. each region is treated as a separate chapter. Each chapter contains one to ten programmes (*programas*). Finally, each account is divided into revenues (budgetary revenues and fees or transfers received) and expenditure. Expenditures are classified into personnel expenditure, purchase of goods and services, current transfers (subdivided into all the different recipients), purchase of non-financial assets (subdivided into vehicles, machines and equipment, computer equipment and software), capital transfers (subdivided into all the different recipients), debt service and liquidity. All these add up to more than 4 000 budget lines.

Restrictions on budget appropriations

Appropriations are considered maximums, i.e. there is no obligation to spend all appropriated funds. There are a number of restrictions for each account. These are common to all accounts and include a maximum amount that can be spent on four items of expenditure: Overtime, travel, training and consultants. The amount of the restriction originates with DIPRES in the budget proposal presented to Congress. The budget also contains a ceiling on the number of staff (posts) and the number of vehicles that each ministry and agency may have.

Budget annotations

In addition to the above mentioned restrictions, Chile's budget law has an important number of annotations (*glosas*). These are restrictions for specific appropriations. They generally earmark part of a larger appropriation for specific projects. These annotations are discussed with line ministries, but usually originate in DIPRES. They refer to a broad group of subjects and include very detailed instructions on how the resources should be spent (e.g. particular information and reporting requirements, type of expenses that are covered, limit to the number of goods or services that can be purchased, and specific procurement conditions). In some cases, they also contain more substantive provisions about the characteristics and targets of the programmes (e.g. definition of recipients and type of benefits).

These annotations serve as a tool to follow up and monitor expenditure for programmes of particular relevance. They can be viewed as a pragmatic approach to the lack of true “programme budgeting” (i.e. lack of correspondence between the operational programmes and the budgetary programmes), as they describe how these resources are to be used. But even then, these annotations do not specify the causal chain between the actions and the planned results, nor provide indicators on the situation it aims to address or the targets of the policy.

The use of these annotations has increased in recent years, and it is often criticised that the budget is used as a fast track legislative tool to introduce legislations which are of particular interest to the President, minimising the possibilities of debate in the Congress. This was for example the case for the new free higher education policy: An annotation in the 2016 Budget Law determines that higher education would be free for the 50% of the population with lower income, studying in specific type of institutions (for example non-profit institutions). This trend to broaden the scope of the budget law to substantive legislation for parliamentary reasons is shared – and often criticised – in other OECD countries.

4.5. Recommendations on aligning budget with medium-term strategic priorities

Make better use of the medium-term expenditure framework (MTEF) as a tool to identify fiscal space

Political decisions on spending priorities are taken by the President, and the strong centralisation of the budget process in the hands of DIPRES facilitates the alignment of the budget with these priorities. The Ministry of the Presidency plays a key role in co-ordinating presidential priorities, and has extensive working relations with DIPRES. DIPRES maintains a comprehensive MTEF that is updated in real-time. However, it is only an internal document.

MTEFs can strengthen the budget office’s ability to plan and enforce a fiscal path. They also help offset the annual focus of budgets, which tends to impede effective expenditure management decisions on resource allocation covering a number of years. Many policies require an extended time horizon, such as large capital projects, new programmes and organisational restructuring. The forward estimates of spending beyond the budget year make clear the medium-term implications of budget decisions. Most OECD countries have introduced MTEFs into the annual budget preparation process.

In a fiscal consolidation context, if the forward estimates show a spending increase in excess of the fiscal objectives, compensating reductions can be introduced into the forward estimates and clearly communicated to the line ministries.

While DIPRES fears that sharing the MTEF with line ministries may be understood as a commitment for future funding, in a downsizing environment, it could on the contrary be a tool for preparing line ministries to a slower growth in their budgets. This would put agency managers in a better position to plan their operations, as they have some indicative level of funding beyond the next budget. This would require a significant change in culture given Chile’s historically centralised budget process.

With the prospect of slower economic growth, the challenge is now to create sufficient fiscal space to finance new priorities. This requires making better use of existing information on performance and evaluation of programmes to phase out previous priorities or inefficient programmes.

Gradually move towards a more comprehensive programme structure of the budget

Over the years, the budget has become a long and cumbersome technical document, which is difficult for parliamentarians and citizens to understand. Moving towards a programme budgeting system, with clear targets, would help giving clarity to the budget. It would also allow reducing the number of budget lines, giving more room for manoeuvre to managers in line ministries while holding them accountable for achieving the targets rather than complying with input mix.

In moving towards programme budgeting, special consideration should be given to:

- Budget programmes should be designed to be as useful as possible as a tool for expenditure prioritisation and for the integration of budgeting and strategic planning.
- Giving priority to programmes that have particular political goals;
- Ensuring the programme structure provides a detailed classification of expenditure by objective, by i) breaking up certain highly aggregate programmes into two or more programmes, and ii) by introducing sub-programmes;
- Reviewing programmes to ensure that they are defined as groups of outputs with common outcomes;
- Identifying more clearly the specific objective (intermediate outcome) of each programme;
- Linking relevant outcome and output indicators to each programme and sub-programme.

Some line ministries in Chile have successfully experimented moving towards programme budgeting, and this small scale experimentation could be used as a starting point to scale up the experience. In 2014, for example, the Ministry of National Assets (*Ministerio de Bienes Nacionales*) identified three main lines of action: Property regulation, management of public assets and land registry. It therefore created four programmes: One for each of the above mentioned activities and one for fixed and non-attributable costs. This practice can still be improved by attributing all costs to operational programmes.

Define what subjects can be regulated in the budget law, and what subjects should be in permanent legislation

While annotations are useful tools to compensate the mismatch between the programme structure of the budget and operational budgets, their use for more substantive policy making may be criticised. Chile should define what could be ruled by annotations in the budget law, and what issues should be have a separate discussion in Congress, and be included in permanent legislation.

5. Budget discussion, approval and transparency

5.1. Parliamentary discussion and budget approval process

Legislatures are constitutionally mandated to hold governments to account. However, the role of the legislature in the budget process, and in particular its amendment powers, varies across OECD countries (Box 11).

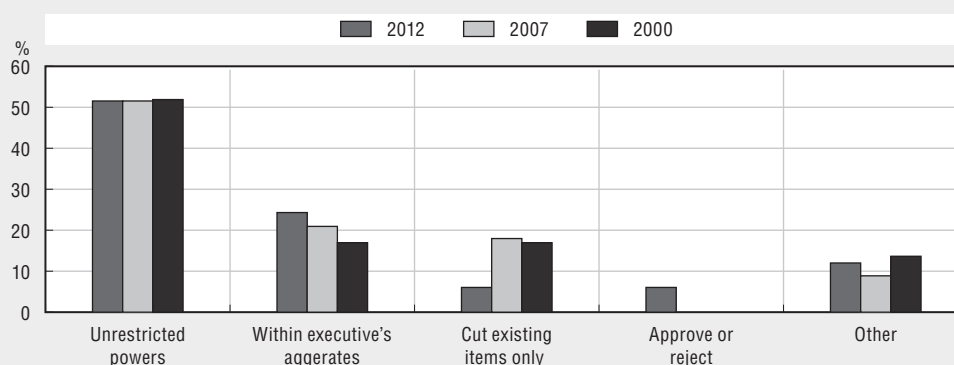
Limited amendment powers

The role of the Chilean Congress during budgetary discussion and approval is very limited despite recent reforms (Box 12). As discussed earlier, the Chilean Constitution imposes strict limits on Congress in regards to budgetary matters. The Congress only has the right to decrease expenditures proposed by the executive, and which are not determined

Box 11. Legislature's budget amendment powers in OECD countries

The legislature's formal amendment powers may be defined as unrestricted, restricted or prohibited.

- **Unrestricted:** The legislature may increase or decrease the level of revenues and/or expenditures without the consent of the executive.
- **Restricted:** The legislature is only able to make budget amendments insofar as the budget balance (surplus or deficit) of the executive's budget proposal is unchanged; or, alternatively, the legislature may only amend downwards any aggregates, often requiring overall reductions in expenditure.
- **Prohibited:** The legislature may not make any amendments to the executive's budget proposal, and must either approve or reject the budget in its entirety (Wehner, 2006).



Note: Percentage of participating OECD countries (33 in 2012, 33 in 2007 and 29 in 2000).

Source: OECD (2014).

It is important to distinguish between formal powers of amendment, such as those outlined in primary and secondary law, and actual practice, reflecting customs and conventions. While legislatures may have formal legal powers to amend the government's draft budget, their actual use may be curbed for reasons including fiscal rules and mandatory spending. Consultation and bargaining during the budget formulation stage may also reduce the size of the legislature's actual amendments during the approval stage. Conversely, This can also serve to increase the legislature's *de facto* amendment power. And some countries, particularly those with Westminster based systems, are effectively restrained from using amendment powers as votes on the budget are considered as a vote of no confidence in the government.

in permanent legislation. It may not increase expenditures, and it may not reallocate expenditures between programmes. Similarly, the Congress cannot amend the economic assumptions or the revenue forecasts employed in the budget proposal. The lack of an independent fiscal institution or internal body for calculating key parameters would not allow it to do so.

Budget annotations (*glosas*) can be discussed in Congress, but can only be amended with the consent of the government. The Congress can only add an "information annotation", requiring the government to report periodically on how specific appropriations are being used and progress towards any targets.

Box 12. **Chilean National Congress**

Chile's National Congress is located in the coastal town of Valparaiso. It is a bicameral institution composed of a Chamber of Deputies and a Senate.

Until 2005, the Constitution provided for former Presidents to serve in the Senate for life after they left office, as well as for nine other members to be appointed to the Senate for eight-year terms on an "institutional" basis, including four nominated by the military. Since 2005, all members of the Congress are elected by popular vote following a binomial system (i.e. two members represent each constituency), and can be re-elected. At present, the Chamber of Deputies has 120 members serving a four-year term, and the senate has 38 members serving an eight-year term.

A 2015 electoral reform increased the number of members to 155 deputies and 50 senators, and changed the voting mechanism from binomial to proportional. The reform will start implementation in the 2017 election.

Limited consultation on reallocations by DIPRES during budget implementation

Budget reallocations within ministries during the implementation phase are frequent, and in most cases do not require Congressional approval. Despite certain limitations imposed by law, the Ministry of Finance has great autonomy to make reallocations within line ministries, compared to other OECD countries. There are examples of individual budget appropriations being doubled during the implementation phase without consultation with Congress. This serves to undermine the role of parliament in the actual allocation of public funds.

A Permanent Joint Committee on Budget and five sub-committees

The President presents the budget bill to the Chamber of Deputies before the end of September each year. There is no discussion of the budget in plenary session of either chamber of the Congress. The bill is automatically referred to the Permanent Joint Committee on Budget (a joint committee of both chambers of the Congress) (*Comisión Especial Mixta de Presupuesto*) composed of 13 Senators and 13 Congressmen. In the past, this committee was a temporary *ad hoc* committee formed each year and operating only for a short period of time immediately following the introduction of the government's budget proposal. In 2003, the Budget Committee was institutionalised as one of the permanent committees of the Congress and operates year-round since.

During the first week of October, the Minister of Finance introduces the budget by making an address to the Budget Committee highlighting the state of the economy and major policy decisions contained in the budget. The following day the budget director makes an address to the Budget Committee highlighting the various technical aspects of the budget. After these introductory presentations, the Budget Committee divides into five sub-committees, each focusing on a different set of ministries. The scrutiny of the budget proposal takes place in these sub-committees. Each ministry and agency is examined during a four-week period. The sectoral minister and the heads of every agency under his/her responsibility attend the examinations. Following these examinations in sub-committees, the Committee reconvenes in plenary session and the conclusions of each sub-committee are discussed. As a rule, the Committee endorses the findings of the sub-committees.

Approval process

The budget is first referred to the Chamber of Deputies where it is discussed and then approved in a series of ministry-by-ministry votes, and then to the Senate. Traditionally, only a few topics were debated in Congress and the approval was rather fast. Today, discussions in Congress are much more extensive, and the budget is subject to significantly more negotiations than ten years ago. Numerous amendments are proposed at this stage by members of the Congress, some are dismissed as out of order and others are voted down by the government's majority. If the votes from both chambers do not coincide, a special committee of both houses is formed. This special committee will make a proposal which must be voted without amendment in both chambers.

The entire discussion and approval process cannot exceed 60 days (Table 7). If the Congress does not approve a budget by 30 November, the original government proposal becomes law. However, this has never occurred and would appear to be considered politically unacceptable. This opens the way to behind-the-scenes negotiations whereby the government itself decides to introduce amendments to the budget that are desired by Congress. Similarly, members of Congress have conditioned their vote on unrelated legislation upon desired changes in the budget, or threatened to reduce to one thousand pesos appropriations that are particularly sensitive for the government. The frequency of such behind-the-scenes interventions is, however, said to be rare. The Congress can also place restrictions on individual appropriations, for example by mandating that a certain part of the total appropriation be spent on a specified activity. This respects the constitutional provision that the total appropriation not be increased and at the same time demonstrates the will of the Congress. These restrictions are, however, also rare.

Table 7. Congressional budget timeline

Last day of September	Budget proposal presented to the Congress Budget referred automatically to the Permanent Joint Committee on Budget
First week of October	Minister of Finance makes policy address to the Budget Committee Budget director makes technical address to the Budget Committee
October-November	Budget Committee forms five sectoral sub-committees to scrutinise the budget proposal
Mid-November	Budget protocol signed between Budget Committee and DIPRES
1st January	Start of Fiscal year

Budget “protocols”

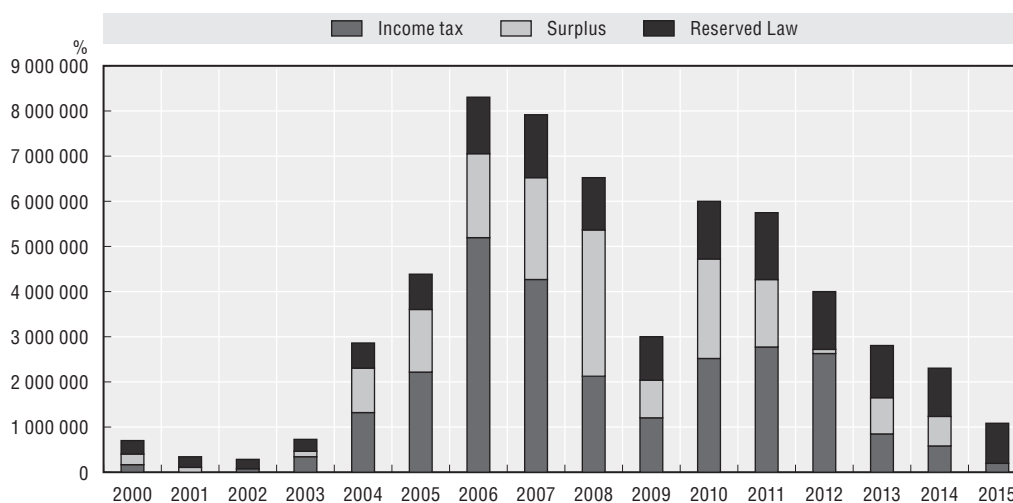
Since 1997, the Budget Committee and DIPRES have agreed on a Memorandum of Understanding (*Protocolo*) at the end of each budget approval cycle. This is not legislated but is rather a signed and formalised political document between the Congress and the government. The 2015 *Protocolo* is six pages in length and includes actions to be undertaken by the Ministry of Finance/DIPRES and specific line ministries. For example, it states that the Ministry of Finance will complement the resources available to finance investment projects for health through budgetary reallocations, and that the Ministry of Defence will present a bill to strengthen civil defence institutions. Other actions include studies, evaluations and reports to be undertaken by line ministries.

These budget protocols are not binding and cannot be enforced by the Congress. However, they are a key negotiating instrument to reach agreement during the budget approval process. The government (DIPRES and line ministries) does not carry out all the commitments included in the protocol, but a large proportion of them are implemented in order to increase support for other presidential initiatives that need Congressional approval.

5.2. Budgeting for the military

One of the legacies of military rule in Chile is that the military receives 10% of the sales of the government-owned copper mining company (CODELCO) to finance defence material and capital goods. These resources are transferred in similar shares to the army, the navy and the air force, in separate and secret special accounts. There is a minimum-revenue guaranteed by the Reserved Copper Law (*Ley Reservada del Cobre*): If resources do not reach this minimum, a budgetary appropriation must be made to cover the difference. However, there is no ceiling or maximum amount to be transferred to the secret accounts. This resulted in very significant transfers to the military during the boom years for copper prices (Figure 11).

Figure 11. **Total transfers from copper extraction to the central government (2000-15, USD thousand)**



Source: Data provided by DIPRES, 2016b.

These special characteristics of the off-budget earmarked funds for the military lead to inefficiencies and suboptimal allocation of resources. There is an arbitrary, permanent and invariable distribution of resources, which are not discussed or approved by Congress, and which does not take into account the real needs of the national defence sector. In addition, its rigid design does not allow effective prioritisation within the military sector and with the other sectors of the administration. There is also a complete absence of regular and objective evaluation and reviews, and there is almost no oversight or accountability for the use of these earmarked funds. In addition, resources are not managed in a transparent manner and documents are not accessible. Reserved Copper Law expenditure information is reported (aggregated in one general line item) only since 2003.

Conscious of the great limitations of the current system, the Chilean Government has attempted several times to abolish the Reserved Copper Law. In particular, the last two Presidents presented specific bills to the Congress in this regard. However, none of them were successful in their objective.

5.3. Parliamentary support and citizen engagement

The Budget Advisory Unit

One of the main obstacles for congressional involvement in the budget process is often the lack of capacity of members of parliament to understand and analyse the budget,

which is a very technical and long document. It is therefore important for legislatures to rely on experienced staff and expertise to exercise their oversight functions properly.

In 2003, together with the creation of the Permanent Joint Committee on Budget, the Senate and the House of Representatives joined forces and hired five experts specialised in budget issues to support the work of the Permanent Joint Committee on Budget.

The functions of this Budget Advisory Unit consist of providing technical support to the Permanent Joint Committee on Budget and its sub-committees, including analysing the budget proposal and related documents submitted by the government. All the reports produced by the Budget Advisory Unit are publicly available.

The work of the Budget Advisory Unit is however hampered by restrictions on access to some key assumptions and some data, especially at disaggregated levels. In addition, the Budget Advisory Unit lacks sufficient capacity, which leads to a limited scope and depth of analysis, and to some extent, a dispersion of the topics analysed.

Civil society participation in the budget discussions

As discussed earlier, the role of civil society has increased in the last decade, and many more stakeholders participate in political debates. Civil society organisations have flourished, analysing presidential programmes and monitoring their implementation. They only focus on the budgetary issues to a very limited and secondary degree. They find the budget information “too technical,” and thus difficult to use. They call for a more digestible “citizen’s budget”.

5.4. Transparency and reporting

Chile has made great progress in increasing transparency. Since 2002 Chile committed to following OECD best practices in transparency. Documents and databases related to the costing of new initiatives and laws, the cyclically adjusted GDP and balance, the budget proposal, budget implementation, *ex post* evaluations and performance indicators are now available (Table 8).

However, key assumptions and disaggregated data are not made available in certain instances, which then make independent replication of DIPRES’s calculations difficult for external analysts.

Contingent liabilities

Since 2007, DIPRES publishes a report on contingent liabilities yearly. The law does not specify a calendar. In practice, DIPRES requests information to the relevant agencies in September and the report is published in December. This report carries out sensitivity analysis on minimum income guarantee on concessions, state guarantee on debt of state owned enterprises, guarantee of higher education loans, state deposit guarantee, Chilean Economic Development Agency (CORFO) hedge fund risk and small business guarantee fund, and guarantees of the pension system.

Budget reports

A monthly report is prepared on the revenues and expenditures of the government. This is audited and is available 45 days from the close of each month (Table 8). The report specifies revenues and expenditures at a highly aggregated level. For example, expenditures are not classified by government organisations which are only published on a quarterly basis.

Table 8. **Public finances reporting**

Type of report	Content	Frequency
Budget execution monthly report	Total central government revenues and expenditures (economic classification), balance sheet	Monthly
Budget execution quarterly report	Total central government revenues and expenditures (economic classification), balance sheet, adjusted balance, tax expenditure, additional information on revenues, changes and balances of FEPP, FRP and FEES, gross public debt	Quarterly
State owned enterprises financial report	Assets and liabilities balance, by enterprise; income statement by enterprise, consolidated	Quarterly
Public finances statistics	Including municipalities, state owned enterprises and net public debt	Annually (July/August)
Public finances report	Draft budget law, public sector financial projections, central government assets and liabilities, improvements in quality of expenditures, tax expenditure	Annual (first week of October)
Contingent liabilities report	Current situation and projections, management of contingent liabilities, fiscal position analysis	Annual (December)
Central government debt	Current situation and previous years, total amounts; detail by maturity, currency, creditor; medium-term projections	Quarterly
Evaluation of the financial management of the public sector, updating of projections	Evaluation of previous year's financial management of the public sector, updating of fiscal projections current year	Annual (June/July)
Public debt report	Gross and net debt of the public sector; gross and net debt of Central Bank; explanatory notes and additional information	Quarterly
Report on financial assets of Public Treasury		Monthly
Monthly execution report on Pensions Reserve Fund		Monthly
Monthly execution report of the Economic and Social Stabilisation Fund		Monthly
Quarterly report on Pensions reserve fund		Quarterly
Quarterly report on Economic and Social Stabilisation Fund		Quarterly
Cyclically adjusted balance indicator	Methodological aspects; results of the calculation of the cyclically adjusted balance (previous year); conclusions and challenges	Annual (first quarter after reference year)

Source: DIPRES (2015a).

Additional summary information on the government's financial assets and liabilities is also presented on a quarterly basis. These reports are publicly available. An annual financial statement is prepared and is available one month following the close of the fiscal year. As it is based on the audited monthly reports, this document is not specifically audited by the supreme audit institution. The annual report is publicly available.

5.5. Recommendations on budget discussion, approval and transparency

Capacity of Congress on budgetary issues could be reinforced, in particular by strengthening the role of the permanent budget committee.

While still modest, the Congress has gained influence in the budget process. Debates are more comprehensive, as they now cover all aspects of the budget. For example, the legislature has begun to scrutinize the economic assumptions, asking DIPRES to provide more detailed explanations or its projections and underlying methodology.

Congress now has a permanent budget committee and budget advisory unit, but its analytical capacity and access to information should be reinforced, to better support parliament.

Legislative oversight of the budget is critical to promoting fiscal transparency and accountability. There may be concerns however as to the impact of a strong legislature on

fiscal discipline. A growing number of OECD countries have addressed these concerns by giving the legislature new influence in setting and approving overall budgetary targets while ensuring that subsequent legislative decisions adhere to those constraints.

Consider clearly defining the boundaries of the budget law

Several important pieces of substantive legislation are typically introduced in Congress as part of the budget. Transparency and democratic debate could be enhanced by clearly defining the boundaries of the budget. Other legislation should be the object of a separate legislative process, allowing for proper debate and scrutiny by the corresponding parliamentary commissions.

Improve alignment of budgetary programmes with operational programmes to increase readability of the budget document

Congress and citizens have a difficult time linking budget allocations to specific policies and targets, which reduces their capacity to deliberate them in a meaningful manner. This is due to the fact that budgetary programmes do not correspond to operational programmes. Moving towards programme budgeting and improving the alignment of budgetary programmes with operational programmes would facilitate comprehension of the budget by Congress and citizens. This would help hold the government to account. Such a reform could be carried out progressively, starting with the more reform oriented ministries for example, and gradually incorporating more areas into the new budget structure.

Fully disclose key assumptions and disaggregated data

DIPRES consistently publishes reports and the results of *ex post* evaluations, but could improve in the disclosure of underlying data, assumptions and methodologies used to carry out certain evaluations.

Integrate the budget for the military in the regular budget process

The Reserved Copper Law on the military budget was enacted during a particular moment of Chile's history. With a quarter century of democratic rule now in place, it may be appropriate for Chile to reassess this law and the special treatment given to the military budget. In addition to the lack of transparency of this process, linking the military budget to the price of copper instead of actual needs is not an efficient way of allocating resources.

6. Budget execution: Flexibility, human resource management, cash management and accounting

6.1. Budget flexibility

The budget law is effective from the 1 January to 31 December. During this period, disbursements are made to each institution, as well as monitoring, re-allocations, and reporting on budget implementation.

Budget implementation act

Each year, DIPRES publishes a book of "Instruction for the execution of the public budget" (*Instrucciones para la ejecución de la ley de presupuestos del sector público*). This brings together all decrees and guidelines for budget execution for the current year. It is a very detailed and extensive document including specific authorizations, budget classification, and other relevant regulations (e.g. human resources, public procurement, public

investment, management, and capital markets). The book also includes budget flexibility rules (*normas de flexibilidad presupuestaria*), defining the competences to modify the budget during the budget year.

Pre-approval by Comptroller-General

A noteworthy feature of the Chilean system is that all expenditure – each and every transaction – must be pre-approved by the Comptroller-General of the Republic (Box 13) in order to ensure their “legality”. This pre-approval, which is quite unusual in OECD countries nowadays, is justified by the lack of trust that line ministries would spend the money in a manner consistent with the enacted budget, and the lack of sufficient *ex-post* accountability mechanisms to ensure that line ministries have incentives not to misuse the funds. Chile could consider modernising this practice by moving towards more *ex post* monitoring of results rather than *ex-ante* legalistic controls.

Box 13. The Comptroller-General of the Republic of Chile

The Comptroller-General of the Republic is Chile’s supreme audit institution. In constitutional terms, it is not an office of the legislature, but is rather considered a co-equal branch of government. The Comptroller-General is nominated by the President and confirmed by the Senate for a period of eight years with no possibility of renewal. The Comptroller-General must be less than 75 years of age. He/she can only be removed before then by being impeached for gross misappropriations of duties.

The Comptroller-General is also very active in publishing information on budgets and budget executions, and preparing “citizen friendly” publications on expenditure and programmes in certain areas.

Budget reallocations

Budget reallocations within year are frequent, and mainly driven and approved by DIPRES. While increasing total expenditure or reallocating funds from one ministry to another requires parliamentary approval, reallocation within ministries, reducing or cancelling spending or carrying over unused funds into the next budget year only require a decree by the Ministry of Finance. The only restrictions are that overspending, borrowing from future appropriations or reallocating funds from investment to current expenditure are not allowed.

If fiscal objectives so require, DIPRES can also impose reductions in budget allocations. While this reinforces budget sustainability, it reduces the capacity of line ministries and programme managers to anticipate their level of funding, and may not lead to the most efficient reductions.

6.2. Human resource management

DIPRES staff is generally viewed as one of the most qualified in the government, which is one of the main arguments used to justify the high level of centralisation of decision making power in DIPRES. This section provides a short discussion of human resource management issues, types of contracts and attempts at creating a professional public service to shed a light on the difficulties line ministries have in hiring and retaining qualified staff.

Two types of contracts: *Planta* and *contrata*

Chile's human resources management system offers two main types of contracts. The traditional contracts, known as *planta*, are highly inflexible. Employees under these contracts are hired for life. The other category is the *contrata* contracts. Under this more flexible framework, employees are hired on one-year renewable contracts, and external staff can be recruited at higher levels of hierarchy. These contracts are generally renewed, and it is common for employees to spend their entire career in the government in such renewable contracts.

The traditional *planta* contracts involve mainly older workers. Most public employees hired in the last 20 years are *contrata* employees. In 2005, about 55% of government workers were under the *planta* system and 45% under the more flexible *contrata* system. Today, these shares have inverted, with about 60% of employees under the *contrata* system, and 37% under the traditional *planta* system (Table 9).

Table 9. **Central Government employees by type of contract**

Type of contract	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Planta	90 316	89 454	87 119	86 069	86 352	85 547	84 387	85 024	84 819	85 085
Contrata	73 938	79 954	88 366	97 430	106 473	113 823	119 043	125 528	131 705	138 672
Código del trabajo	2 835	2 545	2 607	3 529	3 747	3 714	4 005	4 190	4 196	4 103
Consultants (<i>honorarios</i>)	64	64	37	24	14	9	11	13	14	9

Source: DIPRES (2015c), Estadísticas de recursos humanos del sector público (2005-2015).

The Chilean budget sets numerical ceilings for public employees. These refer both to *contrata* and *planta*.

This system is criticised in Chile and the need to reform it recognised.

Difficulties in attracting qualified staff

Chile faces difficulties attracting qualified staff, especially at senior levels. There are indications that the combination of low remunerations for technically complex jobs and a politicised working environment tends to deter well-educated and skilled people from applying. The introduction of the *contrata* represented a response to this. Another response has been the development of consultants (*honorarios*), for hiring highly qualified staff for short-term (less than a year) projects, at higher salaries. However, the higher salaries of the consultants are also associated with weaker labour rights than under the *planta* and *contrata* contracts, and their number remains marginal.

Public sector wage negotiations

Public sector wage negotiations follow usual labor market practices and are not regulated specifically in law. The negotiations are carried out by, on the one side, a public sector panel (*mesa del sector público*) representing all the sectors, and 15 unions (*Central Unitaria Trabajadores*, CUT); and on the other side, the government, represented by the Finance Minister, the Labor Minister, and the sub-Director of rationalisation from DIPRES.

Wages are negotiated for all sectors (e.g. municipal employees, universities, doctors, etc.), and only apply to *planta* and *contrata* employees. Results of wage negotiations are ratified by Congress at the end of December of each year.

Professionalising higher management

In 2003, following a political agreement between the government, the opposition and other relevant partners the Senior Public Management System (*Sistema de Alta Dirección Pública*, ADP) was created. This aims to create a more professional senior civil service, with compensations based on responsibilities, and a meritocratic framework. It implied a cultural change, from a system where senior public managers were nominated based on quotas per political party.

The National Civil Service Directorate (DNSC) is responsible for the management of the Senior Executive System, with a Senior Executive Council (*Consejo de Alta Dirección Pública*) in charge of guaranteeing the transparency, confidentiality and absence of discrimination during the selection process. It is chaired by the director of the National Civil Service Directorate and composed of four members nominated by the President and confirmed by the Senate. The selection process, which takes around four months, begins with the publication of the vacancy in the media. A specialised firm commissioned by the Council assesses the applications and prepares a shortlist for the Council or a designated selection committee (under the supervision of the Council). Professional competence, integrity and probity are some of the criteria used in the selection process. The Council then interviews the best candidates and prepares a final shortlist for the final appointment. Senior managers selected through the senior public management system are appointed for a three-year term, and can be renewed twice for the same period.

While this system has been successful in increasing the professional standard of senior public managers, it has not succeeded in creating a cadre of professional senior executives, protected from political turnover. Indeed, these managers remain in a position of “trust of the President”, so large turnovers of senior managers are still frequent with changes of government. In addition, the system has an “escape clause”: when a position is vacant, the President can nominate a substitute, which can stay in place up to one year, until a new formal recruitment process takes place. Proposals for reforming this are under study. In addition, this system only targets higher management and does not focus in creating a professional civil servant career path.

DIPRES is an exception to this high turnover of senior public managers, with only the Budget Director and a negligible number of senior managers traditionally being replaced by a new government. Pays are higher in DIPRES than in other ministries which, helps in attracting talent. In addition, the level of expertise needed and acquired in DIPRES is considered in Chile as higher than in line ministries, making it more difficult to replace staff. Heads of sectoral budget units (which mirror line ministries) in particular, which tend to be in their positions for many years and are much more stable than their counterparts in line ministries, are seen as particularly difficult to replace.

6.3. Cash Management

All government ministries, agencies and regional offices maintain their own bank account in a government-owned commercial bank, usually the *Banco del Estado*. There are 180 accounts, subdivided into about 5,000 sub-accounts, as separate sub-accounts are opened for each programme. Each entity makes its own payments from their sub-accounts. There is no central payment system.

The Treasury transfers money from its Single Fiscal Account (*Cuenta Única Fiscal*) main account to the 180 accounts in accordance with an official monthly schedule of revenues

and expenditures (apportionment) for each government ministry and agency. This schedule is prepared in January. It is then revised each month to adjust to the execution of programmes. The schedule is not publicly available.

The balances of these accounts represented 2.3% of GDP on the 31 December 2015. A notable improvement since the last budget review was carried out in 2004 is that DIPRES now has access to the information on these balances. It receives a daily report from the banks with the balances of each of the accounts.

6.4. Accrual reporting and accounting

There have been major improvements in Chile's accounting system during the last decade – moving from a cash basis system to a fully accrual basis system of financial reporting.

In 2010, Chile formally started a process to prepare the adoption of International Public Sector Accounting Standards (IPSAS). The objective was to implement IPSAS gradually and in phases. The first phase was putting in place a legislative framework that called for accrual basis reporting; the second phase was the development of a strategy and timeline for the transition; the third phase was the official adoption of IPSAS and the performance of an analysis of the gap between current practice and IPSAS requirements; the final phase refers to IPSAS implementation, preparing the accounts for different layers of government. During the last five years, Chile has implemented the first three phases. The last phase will start in 2016, aiming to fully apply IPSAS by 2019.

6.5. Recommendations on budget execution

Improve capacity of line ministries and ensure adequate development of managerial capacities and competences

While the trend in OECD countries consists of increasing managerial flexibility and devolving decision power to line ministries during the budget execution phase, this is not the case in Chile where DIPRES plays a primary role. The Chilean system places strong emphasis on inputs and legalistic controls, due to a lack of trust in spending entities, and insufficient accountability and enforcement mechanisms. However, the weak roll of line ministries, both in the formulation and in the execution phases of the budget may reduce allocative efficiency. Line ministries are responsible for defending and implementing public policies in their sector. As such, they can use their technical capacities and information to perform a better programme prioritisation and expenditure allocation. Lack of capacity of line ministries is often cited for justifying centralisation of budgetary decision making in DIPRES. But little is being done today to correct this situation; DIPRES would appear not ready to devolve these responsibilities.

As a first step towards creating the necessary conditions to decentralise some decision power to line ministries, the senior executive service should be reinforced.

Move from ex ante input control to ex post monitoring of results and accountability, enabling and empowering managers “to manage”

Devolving power over budget execution to line ministries requires moving from ex ante input controls to ex post monitoring and accountability mechanisms. Delegating some managerial authority to line managers over the use of budget funds and human resource management would contribute to a more dynamic management of the public service.

Delegation of budget and human resource management authority is critical to empower public managers and enable them to meet organisational goals.

Chile could start designing such mechanisms, and could consider small scale experimentation of delegating more decision making authority to those ministries and institutions which prove the most capable and reliable. This could generate an incentive for capacity building in line ministries, and a virtuous circle whereby line ministries would have incentives to comply with the rules and reach their targets, in order to receive further responsibilities. Accountability frameworks and capacity in line ministries can be built, but would require improving medium-term strategic design. However, this also requires a cultural change for DIPRES, especially in the sectoral units that mirror line ministries, to accept this new role and share power.

Create a single treasury account

Cash management should be reformed, unifying all public money in a single treasury account, not only for revenues, but also for expenditure. Line ministries would then authorise payments, and Treasury would execute these. This would generate important savings in bank fees, as well as earning interest from funds overnight.

7. Using evaluation and performance to improve resource allocation

7.1. Multiple types of evaluations

DIPRES has a well-developed but complex system for obtaining information on the performance of agencies and programmes, which combines performance measurement with evaluations. DIPRES began experimenting with performance indicators in the budget process in 1994. After more than 20 years, Chile has an advanced, robust and well established system for obtaining information on agency and programme performance known as the Evaluation and Management Control System (*Sistema de Evaluación y Control de la Gestión SECG*). The system's objective is to provide performance information and improve the quality of public expenditure in particular, resource allocation, execution and transparency.

The coverage of evaluations has progressively increased over time. The programmes and organisations to be evaluated are selected by a designated interministerial committee consisting of DIPRES, the Ministry of the General Secretary of the Presidency, and the Ministry of Social Development, in consultation with the Congress. Evaluations are then carried out by external evaluators (consultants or research institutions) contracted by DIPRES, who also provides the terms of reference and methodological guidelines. The unit in DIPRES running the evaluations is the Public Management Control Division (*División de Control de Gestión*), which reports directly to the Budget Director.

All final evaluation reports are made available to the Congress and the public, and their summaries are included in the budget information papers in the form of "executive minutes". DIPRES and the relevant ministry discuss the recommendations of the evaluations and agree on the specific actions (commitments) which should be taken in response to evaluation recommendations. This then becomes the subject of a formal agreement, the implementation of which is monitored in subsequent years by DIPRES.

The system's performance management and evaluation tools can be grouped in the following categories:

Monitoring and follow-up

This programme was initially launched in 1994 on a volunteer basis. By the 2013 budget, 154 agencies were participating and produced a total of 1 035 performance indicators.

Indicators and targets are proposed by the agencies, and reviewed by DIPRES, who assesses their technical standards and ensures that targets and goals are consistent with budget appropriations. Then the Budget Office and the relevant ministry discuss the performance indicators and targets that will be included in the supporting budget documentation. The selected performance indicators and goals are incorporated in the information reports which accompany the Budget Bill presented to the Congress. These indicators seek to evaluate performance on different dimensions including economy, efficiency, and effectiveness. They include process, output, intermediate outcomes, and outcome indicators. However, around 90% of the indicators are process and output indicators (2015).

Evaluations

There are three main types of evaluation currently in place:

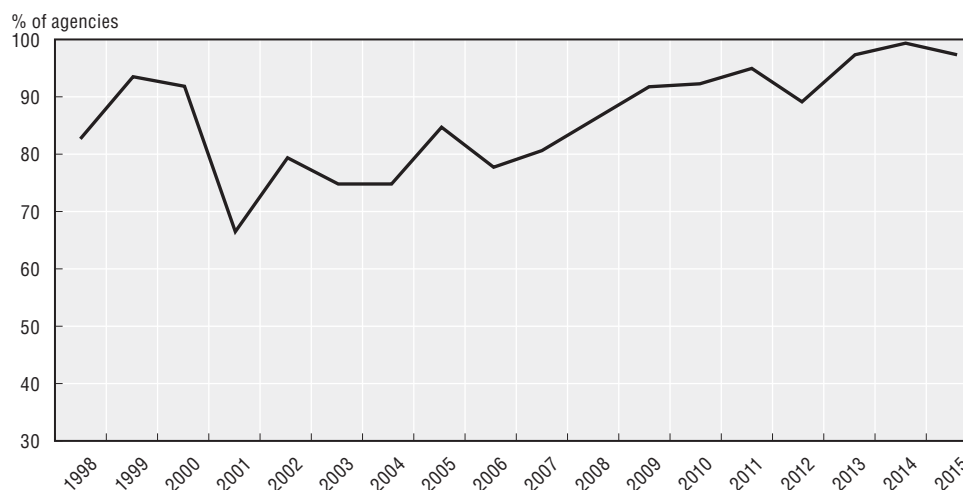
- **Evaluations of government programmes (since 1997):** The main element of these evaluations is the analysis of what has sometimes been called the “intervention logic” or causal chain of programmes. However, as will be further discussed below, the “programmes” which are evaluated are not the same as the programmes in the budget. These evaluations analyse the programmes in terms of design, processes, resource use, levels of production and short and middle term results.
- **Impact evaluations (since 2001):** The main focus of these evaluations is whether programmes have achieved their intended outcomes. This line of evaluation is strongly based on econometric methodologies (counterfactual groups) and uses primary information for this purpose (field work). **Institutional evaluations (since 2002):** which are often called “comprehensive expenditure evaluations” or “institutional expenditure evaluations” (*Evaluaciones Comprehensivas de Gasto o Evaluaciones del Gasto Institucional*). These evaluations look at specific institutions or sectoral groups of institutions. They examine a range of issues including the consistency of institutional and sectoral objectives, organisational structures, production and management processes, resource use, and service-delivery performance.

Institutional Wage Incentives Mechanisms

The Management Improvement Programme (*programas de mejoramiento de la gestión*, PMG) started in 1998 from an agreement with the public sector unions. It established a reward system for central government employees, in which bonuses are determined by organisational performance. The programme focuses on improving management processes within agencies, against a pre-established benchmark. It seeks to contribute to enhancing performance by improving the internal management processes of ministries, thus assisting agencies to achieve wider objectives and targets. In 2001, performance indicators were removed from the management improvement programme, which changed focus to assessing progress in managerial systems. These include for example: Human resources, quality of customer service, planning, control and territorial management, financial management, gender focus. Each of these areas is divided into systems, and progress in every system is measured in stages 1 to 4 or 1 to 6.

Today, about 95% of agencies achieve their goals, and receive 100% of the bonus (Figure 12). Such high achievement rates suggest that the targets are not useful and do not serve their intended purpose any longer. However, these bonuses often make an important share of civil servants' wages, (up to 8% of annual salary), and are now considered as entitlements. Reforming this would thus require creating a task group to re-think the system, without hurting civil servants' revenues.

Figure 12. **Compliance statistics**



Source: DIPRES.

7.2. Mismatch between budget programme structure and programme evaluation

Despite the well-developed evaluation and management control system, Chile still faces challenges to use the output of these evaluations to improve resource allocation and efficiency. Evaluations are mainly used to modify programme design and management, rather than for budget allocation purposes. A 2010 study shows that 37% of evaluations led to design or process modifications, 25% to “substantial” programme redesign, 24% to “minor” changes, and 7% to institutional reassignment of the programme² (Arenas and Berner, 2010). On the other hand, in the 2011 OECD Performance Budgeting Survey, Chile reported that budgetary consequences (budget increase or decrease, elimination of programme or budget freezes) when performance targets are not met are rare. In fact, in some cases, failing to meet the targets does not have any consequence at all.

Programme evaluation and budget formulation in Chile tend to be two separate arenas with little space for integration. Indeed, first, during the budget formulation process, little discussion takes place between budget sector analysts and line ministries about this subject. In most cases, political and technical reasons do not allow to eliminate programmes or to reallocate resources in response to programme performance. In addition, as identified in Section 4, the operational programmes that are evaluated do not correspond to the budgetary programmes. This undermines the value of evaluations as an instrument for supporting allocative choices. Moving towards a design of the budget where budgetary programmes correspond to operational programmes would allow improving the value and use of evaluations for allocation decisions.

7.3. Recommendations on evaluation and performance

Chile has a robust evaluation and control system, providing a great amount of performance information. This system is designed to support performance management in general. Evaluations which are carried out have broad objectives, with a heavy emphasis on improvements in policy, process and management. However, this evaluation system is not predominantly focused on serving the budget, and there is space for improvement in the way this information is used to guide resource allocation, having a positive impact on the efficiency and effectiveness of public expenditure.

Gradually move towards a more comprehensive programme structure of the budget

Section 4 analysed the misalignment between the operational programmes and the budgetary programmes, and the impact this has on the clarity of the budget document and the link between the annual budget and the longer term strategic objectives. This section showed that the mismatch between operational programmes and budgetary programmes also reduces the effectiveness of the evaluation system. Indeed, the conclusions of the evaluations are difficult to translate in budgetary choices. As mentioned in Section 4, moving towards a more comprehensive programme structure of the budget would also have positive impact on evaluation and performance.

Make better use of existing evaluations for budget allocations, and in particular, to identify saving options

Partly because of the misalignment between the evaluated programmes and the budget accounts, and partly because of a lack of culture for doing so, evaluations are not used in the day-to-day budget formulation process, and performance evaluations are not always used to identify saving options.

Spending reviews could be a powerful tool to strengthen the link between evaluation systems and budget allocation

Spending reviews are often used in OECD countries as a tool to give the government enhanced control over the level of aggregate expenditure, find fiscal space for new spending priorities, and improve expenditure prioritisation. Given the tight fiscal context that Chile has been facing during the last couple of years and the conservative forecasts for the years to come, such a tool could be a useful instrument to improve the efficiency and effectiveness of public expenditure. Furthermore, spending reviews could be a powerful tool to strengthen the link between evaluation systems and budget allocation, especially if it becomes a permanent feature of the budget process. In particular, it could have the following benefits:

1. Improve expenditure prioritisation (allocative efficiency). Spending review processes expressly recognise that substantial room for new priorities – while keeping aggregate public expenditure under control – can only be found through the willingness to prune back waste and cut ineffective, outdated or otherwise low priority services.
2. Improve control over the level of aggregate expenditure. Spending reviews are a tool specially designed to identify options and implement cuts on baseline expenditure, bringing the growth of baseline expenditure under control. A systematic spending review process could help Chile in the objective of finding adequate fiscal space for high priority new spending, such as education, while keeping control over aggregate expenditure.

3. Evaluation decentralisation and capacity building for the line ministries. DIPRES has a long experience in carrying out evaluations, but line ministries have a more precise knowledge of day-to-day activities and are in a better place to identify allocative efficiencies. A spending review, carried out by joint teams with staff from DIPRES and the reviewed ministry could help line ministries learn from DIPRES' long tradition with evaluations, and for DIPRES to build on the ministries' specific knowledge of the sector.

Even though there is no one-size-fits-all methodology for spending reviews, previous international experiences point out a common set of factors that are crucial when designing and implementing a spending review exercise (Box 14).

Box 14. Key factors for implementing a successful spending review process in Chile

1. Spending review should be a regular and ongoing feature of the budget process. Simultaneous consideration makes it possible for governments to adopt other high priority new spending proposals without increasing aggregate expenditure, by selecting additional savings options sufficient to fund the extra new spending. In other words, both allocative efficiency and aggregate expenditure restraint benefit from simultaneous consideration of new spending proposals and savings options. In addition, implementing a spending review as an ongoing feature of the budget process ensures that the scale of the spending review effort is calibrated to the government's budgetary objectives for aggregate expenditure (Robinson, 2014).
2. Clear definition of the scope of the spending review. There is not a unique way to implement spending reviews; they can be focused on efficiency and/or strategic savings; they can be selective (limited to a specific list of review topics) or comprehensive; and they can examine specific programmes, business processes used in the production of government services, or organisations (ministries and agencies). There is not one type of review that is *a priori* better than the other ones; they serve different purposes and have different strengths and limitations. However, a proper alignment between the objective of the government and the type of review implemented is a key success factor for the spending review exercise.
3. Political oversight and direction of the spending review process. Spending review is not a purely technical function; it should be under the direction of politically-appointed officials who are sensitive to the priorities of the Presidency. The overall management of the spending review process at the bureaucratic level by DIPRES – together, where relevant, other central agencies which play an important role in the budget process – is essential for its success.
4. Clear definition of roles in the spending review process. Taking into account the clearly centralised evaluation process currently in place, Chile could benefit from a joint spending review exercise, where line ministers can contribute with their particular knowledge of the sector and DIPRES can support and orient the process due to its long tradition with the evaluation and control system.
5. Ensure line ministries buy in. Increase efforts to promote the evaluation function within spending institutions could be a good strategy to increase engagement and support from line ministers. External evaluations are undoubtedly an essential part of the system; however, a limitation of external evaluation is that the institution being evaluated may not “own” the evaluation. Rather, it may regard the evaluation as an external imposition and, as a consequence, fail to make full use of its recommendations.

Box 14. Key factors for implementing a successful spending review process in Chile (cont.)

6. Develop standard terms of reference. Setting standard terms of reference to be followed by the spending review teams, including a defined set of questions or criteria to be applied in the search for strategic savings and whether there will be pre-set savings targets, are well known strategies to support the spending review implementation process.
7. Have a system of outcome evaluation (using existing relevant performance indicators) and efficiency analysis already in place. Chilean evaluation and control system is a strong base to build a spending review process, however improvements must be done to make this information more focused on providing information that is useful in the budget preparation process, as opposed to evaluations which are primarily focused on recommending policy and management improvements. A great emphasis is then needed on efficiency reviews to ensure their relevance for budget preparation.
8. Have a well-defined programme budgeting (see Section 4). A successful spending review depends in large extent on the MoF knowing exactly which programmes are being delivered by each spending ministry and how much is being spent on each, making the programme classification of the budget particularly relevant to programme review, and to the search for strategic savings (Robinson, 2014).
9. Implement the review at the right moment in the political cycle. Because cuts to existing programmes usually create some political resistance, the best time to carry out an in-depth spending review may be at the start of each presidential term of office. The best approach to the conduct of spending review may therefore be to carry out an in-depth spending review in the first year of each presidential term of office, plus more limited spending reviews in other years.

Source: Robinson (2014), OECD (2015a).

Improve the way efficiency issues are managed in the evaluation system

DIPRES could improve the way efficiency issues are handled in the evaluation system. Besides identifying inefficient practices and recommend steps to reform them, DIPRES could estimate the magnitude of the savings that could be achieved through improved efficiency. In a similar way, efficiency reviews should include transversal issues (efficiency issues that affect several government agencies, such as the organisation of support services or procurement practices).

Reform the management improvement programme (PMG)

This programme is now applied in all government entities, and the financial rewards constitute an important share of civil servant's annual wages. The targets are set by institution, and all public employees within an institution get the same level of reward. However, today, in spite of a complex and costly management system, most agencies achieve all their targets, and employees expect to get the full rewards, which do not act as incentives anymore. It is therefore a costly system, with very limited impact. Since these rewards have become an institutionalised part of salaries, it should be recognised for what it is.

Notes

1. As copper, molybdenum is a mineral whose price has increased considerably in the last decade, and constitutes an important share of Chile's public revenues.
2. The study did not provide any estimate of the extent to which evaluations led over time to budget savings through efficiency enhancements.

Bibliography

- Arellano, J.P. (2006), *Del déficit al superávit fiscal: razones para una transformación estructural en Chile*, Estudios Públicos, 101.
- Arenas, A. and H. Berner (2010), *Presupuesto por Resultados y la Consolidación del Sistema de Evaluación y Control de Gestión del Gobierno Central*, Dirección de Presupuestos, Ministerio de Hacienda, Santiago de Chile.
- Bachelet (2013), *Programa de Gobierno 2014-2018*, <http://michellebachelet.cl/programa/> (accessed on 22 December 2015).
- Blöchliger, H. and C. Vammalle (2012), *Reforming Fiscal Federalism and Local Government: Beyond the Zero-Sum Game*, OECD Fiscal Federalism Studies, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264119970-en>.
- Blöchliger, H., C. Charbit, J.-M. Piñero Campos and C. Vammalle (2010), "Sub-central Governments and the Economic Crisis: Impact and Policy Responses", *OECD Economics Department Working Papers* No. 752, 18 February, OECD Publishing, Paris, <http://dx.doi.org/10.1787/5kml6xg5bgwc-en>.
- Blöndal, J. and Curristine, T. (2004), "Budgeting in Chile", *OECD Journal on Budgeting*, Vol. 4/2, OECD Publishing, Paris, <http://dx.doi.org/10.1787/budget-v4-art8-en>.
- COCHILCO (2015), *Cobre Nominal-Real Anual*, BML, COMEX, 1935-2015, www.cochilco.cl/estadisticas/precio-metales.asp.
- Cumplido, F. (2006), *Reforma constitucional en Chile*, Biblioteca Jurídica Virtual del Instituto de investigaciones Jurídicas de la UNAM, www.juridicas.unam.mx/publica/librev/rev/dconstla/cont/2006.1/pr/pr6.pdf.
- Chile Ministry of Finance (2014a), *Sobering Funds Annual Report*, www.dipres.gob.cl/594/articles-144320_doc.pdf (accessed on 15 April 2016).
- Chile Ministry of Finance (2014b), *Estado de la Hacienda Pública 2014*, www.senado.cl/prontus_senado/site/artic/20141007/asocfile/20141007100158/estadohaciendapublica2014.pdf (accessed on 15 April 2016).
- Chile Ministry of Finance (2015), *Estado de la Hacienda Pública 2015*, www.hacienda.cl/documentos/estado-de-la-hacienda-publica/estado-de-la-hacienda-publica-2015/estado-de-la-hacienda-publica-2015.html (accessed on 15 April 2016).
- Chilean Ministry of Finance, *Fondo de Estabilización Económica y Social*, www.hacienda.cl/fondos-soberanos/fondo-de-estabilizacion-economica-y.html (accessed on 15 April 2016).
- Dabán Sánchez, T. (2011), "Strengthening Chile's rule-based fiscal framework", *IMF Working Papers*, 1-26, Washington, DC.
- Díaz, J. (2009), *La reforma constitucional del año 2005: contexto, impacto y tópicos pendientes*, *Revista actualidad jurídica* No. 20 – Tomo I, Universidad del Desarrollo.
- DIPRES (2005), *Gobierno envía al Congreso Proyecto de Ley de Responsabilidad Fiscal*, www.dipres.gob.cl/594/articles-21088_recurso_1.pdf (accessed on 22 April 2015).
- DIPRES (2010), *Política Fiscal de Balance Estructural en Chile: Lecciones tras 10 años de Aplicación*, www.cepal.org/ilpes/noticias/paginas/5/39245/jorge_r_cabello_Balance_Estructural.pdf (accessed on 15 April 2016).
- DIPRES (2014a), *Instrucciones para la ejecución del presupuesto del año 2015*.
- DIPRES (2014b), *Prioridades del presupuesto 2015*, www.hacienda.cl/especiales/presupuesto/presupuesto-2015/prioridades-de-ley-de-presupuestos-2015.html.
- DIPRES (2015a), *Informe de Finanzas Públicas 2016*, www.dipres.gob.cl/594/w3-propertyvalue-22939.html.
- DIPRES (2015b), *Notas Indicador del Balance Cíclicamente Ajustado Metodología y resultados 2014*.
- DIPRES (2015c), *Estadísticas de recursos humanos del sector público (2005-2015)*.

- DIPRES (2016a), *Estado de Operaciones del Gobierno Central Total 1990-2014*, www.dipres.gob.cl/594/w3-propertyvalue-15494.html (accessed on 18 April 2016).
- DIPRES (2016b), *Minuta Antecedentes Ley Reservada CODELCO*.
- DIPRES website, www.dipres.gob.cl/594/w3-channel.html (accessed on 22 December 2015).
- Fernández, J. (2013), *La Protesta Social en Chile (2006-2011): conflicto social y repertorios de acción en torno a los movimientos estudiantil, mapuche y ambiental*, GIGAPP Estudios/Working Papers.
- Hawkesworth, I., O. Huerta Melchor and M. Robinson (2013), "Selected budgeting issues in Chile: Performance budgeting, medium term budgeting, budget flexibility", *OECD Journal on Budgeting*, OECD Publishing, Paris, Vol.12/3, <http://dx.doi.org/10.1787/budget-12-5k44tpx5bl48>.
- Kraan, D. (2007), *Programme Budgeting in OECD Countries*. OECD Journal on budgeting Volume 7 – No. 4, OECD Publishing, Paris, <http://dx.doi.org/10.1787/budget-v7-art18-en>.
- Marcel, M. (2012), *Límites institucionales al gasto público: La regla fiscal de balance estructural en Chile*, OECD, Madrid, www.fedea.net/limites-constitucionales/MarioMarcel.pdf (accessed on 19 April 2016).
- Marcel, M. and R. Engl (2009), *¿Es posible derogar la ley reservada del cobre? Alternativas para el financiamiento de las adquisiciones militares en Chile*, CIEPLAN – Documento de Trabajo.
- Meyer, P. (2014), *Chile: political and economic conditions and US relations*, Congressional Research Service.
- Ministerio de Desarrollo Social website, www.ministeriodesarrollosocial.gob.cl/conocenos/historia/ (accessed on 22 December 2015).
- OECD (2002), *OECD Best Practices for Budget Transparency*, OECD Publishing, Paris, www.oecd.org/gov/budgeting/Best%20Practices%20Budget%20Transparency%20-%20complete%20with%20cover%20page.pdf.
- OECD (2011a), *Chile review of the private pension system*, OECD Publishing, Paris, www.oecd.org/finance/private-pensions/49497472.pdf.
- OECD (2011b), *Chile Review of the Financial System*, OECD Publishing, Paris, www.oecd.org/finance/financial-markets/49497488.pdf.
- OECD (2013), *Working Party of Senior Budget Officials, 3th Annual meeting of OECD Senior Budget Officials Spending Reviews*, OECD, Paris.
- OECD (2015a), *Background note: Spending Reviews*, unpublished.
- OECD (2015c), *OECD Economic Surveys: Chile 2015*, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-chl-2015-en.
- OECD (2015d), *Real GDP forecast (indicator)*, <http://dx.doi.org/10.1787/1f84150b-en>, <https://data.oecd.org/gdp/real-gdp-forecast.htm> (accessed on 22 December 2015).
- OECD (2014), *Budgeting Practices and Procedures in OECD Countries*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264059696-en>.
- OECD (2015b), "Budget Review: Germany", *OECD Journal on Budgeting*, Vol. 14/2, OECD Publishing, Paris, <http://dx.doi.org/10.1787/budget-14-5jrw4sxb32q4>.
- Robinson, M. (2014), "Spending reviews", *OECD Journal on Budgeting*, Vol. 13/2. <http://dx.doi.org/10.1787/budget-13-5jz14bz8p2hd>.
- Schmidt-Hebbel, K. (2014), *Chile's Fiscal Policy Rule*, Sixth Annual Meeting of OECD Parliamentary Budget Officials and Independent Fiscal Institutions. Jerusalem, http://knesset.gov.il/mmm/oecd/Session_5_Klaus_SCHMIDT_HEBBE.pdf.
- Vammalle, C. and C. Charbit (2010), *Fiscal Federalism: Recent developments and Future Trends*, in: *Local public sector in transition: A Nordic perspective*, Antti Moisio (Ed.), Government Institute for Economic Research (VATT), Helsinki, Finland.
- Vammalle, C. and C. Hulbert (2013), "Sub-national Finances and Fiscal Consolidation: Walking on Thin Ice", *OECD Regional Development Working Papers* (2013/02), OECD Publishing.
- Vammalle, C. and C. Hulbert (unpublished), *Ensuring fiscal sustainability of sub-national government debts recent trends, Monitoring Practices and Challenges in OECD Countries*.
- Vandierendonck, C. (2014), *Public Spending Reviews: design, conduct, implementation*, European Economy, Economic Papers 525, European Commission, Brussels.

- Villarroel, A. (2012), "El protocolo de acuerdos de la Ley de presupuestos del sector público", *Revista de Derecho de la Pontificia Universidad Católica de Valparaíso*, No. 38, Valparaíso, pp. 617-657.
- Von Trapp L., I. Lienert and J. Wehner (2016), "Principles for independent fiscal institutions and case studies", *OECD Journal on Budgeting*, Vol. 15/2, <http://dx.doi.org/10.1787/budget-15-5jm2795tv625>.
- World Bank (2008), *Chile estudio de evaluación en profundidad del programa de mejoramiento de la gestión (PMG)*, Volumen I, Washington, DC.

ANNEX A

International practices on decentralisation reform

A.1. Today's Chile's decentralisation reform

Chile is amongst the most centralised OECD countries. It is composed of 15 regions and 54 provinces. Regions are headed by superintendents (*intendentes*) and provinces by governors (*gobernadores*), both appointed by the President. In the 2014 Presidential Programme, President Bachelet introduced a “decentralisation and development agenda”, around three pillars:

1. A constitutional reform allowing the election of the regional superintendents (keeping a governor as representative of the central power);
2. The transfer of competences and public services in land use, economic, social and cultural development; and
3. Changes to the law on regional financing and fiscal responsibility.

This implies profound institutional and cultural changes, and experience of other OECD countries in decentralisation and the governance of intergovernmental fiscal relations could be useful for Chile when designing its new system.

An in-depth study of the decentralisation reform is currently being carried out by the OECD, where the specificities of the Chilean case will be analysed. This section only aims to provide some international benchmarks and experience which could be useful to policy makers for preparing this decentralisation reform.

A.2. Experience of OECD countries in decentralisation and design of intergovernmental fiscal relation frameworks

A.2.1. Impact of decentralisation on equity, efficiency and macroeconomic stability

There has been a trend in OECD countries in the last decade before the 2008-10 global financial crisis towards a greater devolution of spending and revenue raising capacities to sub-national governments. This followed the principle that decentralisation of spending responsibilities can improve efficiency in the allocation of resources and welfare. Indeed, local governments should have better information about local needs and preferences, and could therefore provide a composition, quantity and quality of public goods closer to the preferences of their beneficiaries.

But decentralisation also has its drawbacks, aggravating regional differences and undermining distributional equity. In addition, decentralisation makes macroeconomic management more delicate. The global financial crisis for example has shown that

sub-national governments' actions can go against central government's macroeconomic objectives and co-ordination between levels of government becomes necessary (Blöchliger et al., 2010; Vammalle and Hulbert, 2013).

A.2.2. Importance of a well-designed intergovernmental relations framework

In decentralised environments, the framework for fiscal relations across levels of government is crucial. The design of intergovernmental fiscal relations bears multiple – possibly conflicting – objectives: Macroeconomic stability, efficiency of spending and redistribution concerns. The main instruments to achieve these goals are fiscal rules, taxes and grants. To achieve its three objectives, the design of fiscal relations across levels of government has three main policy tools: 1) the share, composition and autonomy of sub-national governments' expenditures, 2) the share, composition and autonomy of sub-national governments' revenues, and 3) fiscal rules.

A.2.3. Optimising allocation efficiency

Allocation efficiency concerns are mainly addressed in the assignment of spending responsibilities. The general rule is that to increase efficiency in the allocation of resources, the responsibility for each type of public expenditure should be assigned to the level of government that most closely represents the beneficiaries of these services. Therefore, in general terms, the more spending autonomy is given to sub-national governments, the greater the allocation efficiency.

However, the efficiency benefits from spending delegation must be balanced with possible negative impacts of spending decentralisation on other objectives, such as equity (as poorer regions will not be able to provide the same level of public goods than more developed regions) and macroeconomic stability (as the addition of all sub-national governments spending might lead to over-spending on a global level). Besides, as some locally provided public goods and services might have externalities which will not be taken into account by sub-national governments; the aggregate level of public goods provided might not be optimal. An example of such goods is education or basic health care, which affect the overall stock of human capital, and therefore the potential for growth at national level.

A.2.4. Equity and the need for equalisation mechanisms

Equity (income redistribution) concerns are one of the key elements in the allocation of revenues. The main sources of financing for sub-national governments are own taxes, and inter-governmental transfers (tax-sharing and grants). The larger the reliance of sub-national governments on own taxes, the larger the potential discrepancies between poorer and richer regions. Inter-governmental transfers are thus needed to increase distributional equalisation. These can take the form of tax-sharing, where the coefficients are calculated on redistribution criteria, such as population, regional income per capita, indicators of backwardness, etc., or they can take the form of grants.

The drawback of equalisation is that if incentives are not designed properly, it might lead to moral hazard issues, where sub-national governments will not be encouraged to increase tax pressure, as their lower revenues are compensated by intergovernmental transfers.

A.2.5. Ensuring macroeconomic stability

Decentralising expenditure capacity to lower levels of government can have positive effects on efficiency, as local governments are more aware of local needs and tastes than

central governments. But this can also undermine global macroeconomic stability, as SCGs do not always take into account the effect of their fiscal decisions on the rest of the country on the one hand, and might even have incentives to overspend on the other hand.

In 2013, sub-national governments debts represented on average 13% of GDP and 17% of total public debt in OECD countries. While the sub-national government debt to GDP ratio may be low, the ratio of sub-national government debt to their revenues, which proxies their capacity to repay, is much higher: 80% of revenues on average, but up to 200% of yearly revenues in Canada or Japan (Vammalle, Hulbert, unpublished).

Fiscal stability (macroeconomic management) issues are mainly addressed through fiscal rules such as golden rules, balanced budget rules or borrowing rules (Box A1). These fiscal rules should allow sub-national governments to provide the most efficient level of public goods, while making sure that sub-national governments' policies are consistent with national macroeconomic objectives.

Box A1. Different types of fiscal rules for sub-national governments

Four types of rules can be used to support fiscal sustainability and short-term stability:

- **Balanced budget requirements** in OECD countries vary according to whether they are applied to the current budget and/or the capital account (balanced budget requirement applied only to the current budget, thus allowing borrowing to finance net investments is usually referred to as the “golden rule” of public finance); whether they are set annually or multi-annually; and whether they are imposed from above or self-imposed. Most commonly, balanced budget requirements are applied to current and capital budgets, are set annually, and are imposed from above.
- **Borrowing constraints** are widely used in OECD countries, but with a substantial variation in terms of restrictiveness. They range from total prohibition (Denmark and Korea) to no restriction at all. In most cases, sub-national government borrowing requires prior approval by higher levels of government, and is often restricted to certain purposes (such as investment).
- **Tax and expenditure limits.** Overall limits on tax rates or reliefs are widely used in OECD countries, and usually take the form of an explicit limit on tax autonomy set by central government. Expenditure increase limits are usually linked to income, inflation or population growth. But explicit, binding, expenditure limits are rather rare (they exist only in Germany, Korea, Portugal and Turkey). In some countries such as Japan, the Netherlands, Poland and Spain, expenditure limits are not imposed by central government, but self-imposed.
- **Process rules** that govern implementation will determine the degree of commitment of sub-national governments to the set of rules described above (indeed, without a proper commitment mechanism, sub-national governments could either ignore, or change the rules binding their autonomy). Process rules include the obligation to produce financial accounts (transparency), monitoring and reporting, and eventual sanctions in case of non-compliance. But process rules should also allow for flexibility of response, as breaking the fiscal rules might be the appropriate response to an unanticipated shock such as large revenue shocks, downturns in the local economy, the impact of natural or other disaster, etc. This is why many countries incorporate escape clauses that allow sub-national governments to breach the rule in case of certain predetermined events.

Source: Vammalle, Charbit (2010).

A.3. Decentralisation reforms: Big bang vs. gradual processes

Decentralisation reforms may have different drivers, and it has not always been possible for countries to implement them in a gradual way. However, granting new responsibilities to sub-national governments implies the need to build the capacities to carry these out. Building such capacities takes time, and often requires cultural changes. In some regions, it may be difficult to attract and retain qualified staff. Gradual decentralisation reforms are usually a better option than big bang processes, as the cases of Indonesia and Spain illustrate (Boxes A2 and A3).

Box A2. Decentralisation in Indonesia: A Big Bang reform

Since the fall of Suharto in 1998, Indonesia switched from being one of the most centralised countries, to the implementation since 2001 of very ambitious decentralisation programmes. “Big bang” decentralisation began in 2001, with the transfer of 1.7 million civil servants to sub-national governments and the granting of enhanced autonomy to the two provinces.

Decentralisation had both fiscal and political components:

- **Fiscal:** Provincial, and particularly district, governments were endowed with wide ranging autonomy over public service provision. Provincial governments now provide inter-district services, provincial infrastructure, roads, etc.; and districts/municipalities are responsible for primary and secondary education, health services, local roads, etc.
- **Political:** In 2004, in response to widespread concerns over corruption and money politics, responsibility for the selection of district level heads was transferred from local legislatures to the district population.

A second big bang reform in 2006 increased transfers to sub-national governments by almost 50%. Transfers to sub-national governments represented about 34% of central government revenues during the 2001-10 period, and account for about 87% of municipal and 55% of provincial revenues during 2008-10. Transfers to sub-national governments have not decreased during the crisis, in spite of a reduction in central government revenues.

Challenges raised by decentralisation are numerous, and go beyond fiscal challenges:

- **Vertical fiscal imbalances** exist such that sub-national governments are responsible for most public services but remain highly depending on central government transfers.
- **The proliferation of districts**, largely due to the formula of central transfers has led to local government fragmentation (191 new regional autonomies were established between 1999 and 2008) with potentially negative impacts on regional development. President Yudhoyono has called for a moratorium on the proliferation of new districts.
- **Limited human and organisational capacity of sub-national governments** inhibits their ability to fully exercise their new competencies. This raises particular challenges for local public service delivery and regional development. The central government is still reluctant to release assets to the lower levels of governments, most notably state-owned corporations, arguing that most local governments are not properly prepared to manage assets.
- **Despite important institutional progress corruption remains rife**, and money politics still play an important role in local elections. As a result de facto accountability remains a concern.

Box A2. Decentralisation in Indonesia: A Big Bang reform (cont.)

- **Strategic planning for public investment presents a particular challenge.** The political decentralization has shifted the focus of spending from long-term investment needs to more popular and visible spending, leading to a change in budget compositions both across sectors (a greater focus on social spending at the expense of infrastructure) and toward highly visible spending (road building over road maintenance).
- **Co-ordination across jurisdictions is a concern.** This is particularly true in relation to investment in infrastructure. Districts are responsible for 51% of road expenditures, and often fail to internalise the benefit of adequate roads that accrues at the provincial level. Furthermore, access to revenues bears little relationship to district spending needs as central government transfers are distributed largely on the basis of the salary bill of the civil service, leaving poorer regions with inadequate resources for roads expenditure.

Box A3. Fiscal decentralisation in Spain: A gradual reform

After the transition to democracy, the Spanish Constitution of 1978 created a regionalised state, shifting from a highly centralised system to a highly decentralised one. The Constitution created the autonomous communities, and stipulated that they should have financial autonomy to carry out their competences.

However, in practice, the process of devolving political and fiscal power to the Autonomous Communities has been gradual over a 30 year period. This slow trend is reflected in the evolution of the share of autonomous communities in total public expenditure, which rose from 21.5% in 1995 to 35.6% in 2009 and 43% in 2014. The share of public revenues by autonomous communities also increased from 6.6% in 1995 to 24.1% in 2009 and 27% in 2014 (OECD Fiscal Decentralisation Database).

In addition, decentralisation also had to respect the constitutional principle of co-ordination with the central government, and the principle of solidarity between all Spanish citizens, guaranteed by the central government. More specifically, the solidarity principle implies the guarantee of access to basic public services in the whole territory, and the lower of income disparities between regions.

Each autonomous community established its “Statute of Autonomy”, which is equivalent to a regional constitution. Both the central government and the autonomous communities have legislative powers, and their laws have the same status (in the event of a conflict, the central government laws do not prevail over that of the autonomous communities), even though each level of government can only issue laws on matters that are under its competences.

Source: Blöchliger, Vammalle (2010).

A.4. Recommendations on decentralisation reform in Chile

National fiscal arrangements between levels of government vary widely, as they necessarily incorporate local economic, but also political, social and cultural factors. However, there are some elements that must be addressed in any decentralised environment. In addition, experience of countries implementing decentralisation reform could be useful to Chile, for choosing the pace and scope of the forthcoming reform.

A.4.1. Decentralisation process

- Gradual decentralisation processes allow more time for building local capacities, and are preferable to “big bang” decentralisation processes.
- Experimentation and asymmetric decentralisation can be good tools to give incentives to sub-national governments to build up their capacities, and allow for a gradual and pragmatic decentralisation process.
- Clearly define the roles and responsibilities of each level of government, avoiding overlaps.
- Ensure that sub-national governments’ revenues are sufficient to carry out their responsibilities. Given that the cost of providing public goods and services may differ from one region to another, this is by no means an easy task.

A.4.2. Multi-level governance

Decentralising responsibilities inevitably creates asymmetries of information and co-ordination needs. Therefore, it is important to design a multi-level fiscal governance framework together with the devolution of responsibilities to other levels of government.

A.4.3. Ensuring fiscal sustainability

The pros and cons of granting sub-national governments the faculty to issue debt, and the specific conditions under which this could be allowed should be carefully studied. On the one hand, allowing sub-national governments to issue debt to finance productive infrastructure could have positive development effects. However, the cost of issuing the debt and interest rates paid would be higher for smaller scale issues.

If sub-national governments are granted the right to issue debt, it is important to design mechanisms in order to ensure their fiscal sustainability. There are three main mechanisms for monitoring sub-national government debts and ensuring their fiscal sustainability. Monitoring mechanisms range from pure reliance on market discipline, with no control from central governments, to direct control by higher levels of government of the amount and purpose of debt issued by SNGs. Fiscal rules lie somewhere between these two extremes, as they set the limits and conditions for SNG spending, but do not call for an *ad hoc* examination of each loan request by SNGs.

There is a great diversity of practices in monitoring sub-national government debts across OECD countries, ranging from a pure reliance on market mechanisms to sophisticated systems of fiscal rules (Box A4). Pure reliance on market mechanisms is rarely successful, and should not be privileged in Chile if regions are granted the right to issue debt. Direct controls are only effective if they are not automatically granted, and require a large amount of information for the central government to evaluate the requests submitted. Fiscal rules are probably a better option. These should be sufficiently simple to avoid gaming, and to be easily enforceable, and should encompass a control and correction mechanism in case a sub-national government infringes the rule.

A.4.4. Lessons from OECD countries

- Ensure that all sub-national governments use the same budgeting and accounting processes and standards.
- Make sure sub-national governments regularly publish all relevant financial information. In particular, if sub-national governments own public enterprises, these should be

Box A4. Ensuring fiscal sustainability of sub-national governments

- In federal and quasi-federal countries, states/regions tend to rely more on market discipline or self-imposed fiscal rules than sub-national governments in unitary countries.
- There has been an increase in the control of sub-national government debts by central governments since the beginning of the decade, with fiscal rules being introduced or reinforced in a number of OECD countries. Fiscal pacts in particular, where different levels of government negotiate and agree on debt limits, have been signed in several countries (mainly federal and quasi-federal).
- There has been a move towards structural rules rather than simple rules. However, simple rules may be preferable where sub-national government revenues have a relatively low cyclicity, are not too exposed to unexpected shocks, or when sub-national governments lack capacity for implementing sophisticated rules. Applying and monitoring fiscal rules generates administrative burden and compliance costs. Sophisticated rules (for example structural budget balance rules) may be less pro-cyclical than a simple rule, but also more difficult to implement and more prone to gaming and political manipulation. Multi-year balanced budget rules may be an appropriate substitute for structural rules when sub-national government capacity is limited.
- Most countries specify fiscal targets for sub-national governments individually, rather than for sub-national governments in aggregate. Escape clauses and *ad hoc* transfers from the central government are useful tools to address the impact of significant asymmetric shocks on revenues and/or expenditures.
- Enforcement mechanisms and sanctions for non-compliance with the rules have been tightened since the early 2010's.

Source: Vammalle and Hulbert, unpublished.

consolidated with those of sub-national governments for setting (and monitoring compliance with) numerical targets.

- Sound public investment management principles would help to ensure SNGs will not face unforeseen negative consequences on future budgets (such as high operating and maintenance costs), and that the investments carried out have the greatest impact on future SNG growth. OECD forthcoming principles for effective public investment could be a useful guide.
- Direct controls are effective only if authorisation for issuing debt is not systematically and automatically granted.
- The impact of fiscal rules depends on the ability of SNGs to circumvent them and the credibility of enforcement and sanction mechanisms. If SNGs feel there are no consequences when infringing fiscal rules, these may not be respected. Automatic correction requirements (debt brake-type provisions) may be a solution for promoting sustainable sub-national fiscal behaviours. However public investment (defined in a detailed way so that it is not used to circumvent the rule) could be excluded, to protect SNG growth from the long-term effects of wide investment cuts.
- Early correction mechanisms for SNGs facing financial difficulties are useful to reduce the risk of defaults and recurring to bankruptcy or bailout. However, benefitting from such mechanisms should imply a cost to the SNG, in particular to the management team, in order to reduce moral hazard and soft budget constraints.

ANNEX B

Chile's budget system in light of the OECD Recommendation on Budgetary Governance

The OECD *Recommendation of the Council on Budgetary Governance* (C(2015)1) sets out ten principles of effective modern budgeting, based upon the experience and insights of the Senior Budget Officials and with inputs from the global community of PFM practitioners and experts. The table below provides a concise summary assessment of Chile's budget system by reference to the ten budget principles, based upon the analysis set out in this Budget Review. Chapter/section references are provided in each case.

Budget Principle	Chile's budget system	Reference
1. Clear fiscal limits	<p>Chile has a structural budget balance rule since 2001. Until 2006, the target was 1% structural fiscal surplus. In 2006, the new Fiscal Responsibility Law indicated that each President must specify a target at the beginning of his/her mandate. Structural fiscal balance is calculated by DIPRES, based on inputs of structural GDP growth and long-term copper price provided by two independent panels.</p> <p>This rule has been quite successful in smoothing out the peak of revenues generated by the rise of the price of copper during the 2000s. However, it seems less efficient for coping with the current downturn: it has no escape clauses and accommodating a counter-cyclical policy requires changing the cyclically-adjusted balance target. Chile's structural fiscal balance has been negative since 2008, and the target date to return to a balanced position has been postponed repeatedly.</p>	Section 3.2
2. Medium-term strategic alignment	<p>The strong centralisation of the budget process in the hands of DIPRES facilitates the alignment of the budget with the President's priorities. However, the mismatch between operational programmes and budgetary programmes makes it somewhat difficult to link government priorities to budget allocations.</p> <p>DIPRES maintains detailed and continually-updated baseline projections of government revenue and expenditures for the next three years. This is an internal document, and projections are only presented to the Congress and shared with line ministries at a highly aggregate level.</p>	Section 4
3. Capital budgeting framework	<p>Chile's capital budgeting framework is characterised by strong and transparent institutions and regulations. The strict centralised budget process ensures fiscal sustainability and affordability. Chile's National Investment System has a number of well-institutionalised processes that promote value for money and transparency of the public sector, but formal criteria for investment framing choices, such as PPPs are missing.</p> <p>Chile misses a clear alignment of the budget and appraisal mechanisms with the medium-term strategic priorities of government to meet the national development needs. Furthermore, coordination of investment planning and execution within and across levels of governments is weak, and capacities on sub-national level are missing.</p>	OECD (forthcoming), Review of Gaps and Governance Standards of Public Infrastructure in Chile

Budget Principle	Chile's budget system	Reference
4. Open, transparent and accessible budget documents and data	Chile has been committed since 2002 to following OECD best practices in budget transparency. Documents and databases are available relating to the costing of new initiatives and laws, the cyclically-adjusted GDP and balance, the budget proposal, budget implementation, <i>ex post</i> evaluations and performance indicators. However, some key assumptions and dis-aggregations are sometimes incomplete, which makes DIPRES's calculations difficult to replicate by independent analysts. The military still receives 10% of the sales revenues of the government-owned copper mining company (CODELCO), and these funds are maintained off-budget.	Section 5.4
5. Inclusive, participative and realistic budgetary debate	The Congress has built up some capacity regarding the budget in the last decade, with a new Permanent Joint Committee on the Budget, and the creation of a Budget Advisory Unit. However, the role of Congress in the budget discussions is still rather limited. Congress can only decrease expenditure proposed by the executive. It may not increase or reallocate expenditures.	Section 5
6. Comprehensive, accurate and reliable accounting	Chile has recently moved from a cash basis to a fully accrual basis system for financial reporting. In 2010, Chile formally started a process to prepare for the adoption of International Public Sector Accounting Standards (IPSAS). IPSAS should be fully operational by 2019.	Section 6.3
7. Active planning, management and monitoring of budget execution	Budget execution in Chile heavily relies on <i>ex ante</i> input control, rather than <i>ex post</i> monitoring. For example, every transaction must be pre-approved by the Comptroller-General of the Republic to ensure their "legality". Turnover of higher civil public managers is very high in line ministries. Higher management should be professionalised and a professional civil servant career path could be reinforced. This would improve managerial capacities of line ministries, thus creating the necessary conditions for later decentralising some decision power to line ministries.	Section 6
8. Performance, evaluation and value-for-money	Chile has a robust evaluation and control system, providing a great amount of performance information. However, as the operational programmes evaluated do not correspond to the budgetary programmes, the results of these evaluations are difficult to use for resource allocation purposes.	Section 7
9. Fiscal risks and long-term sustainability	Since 2007, DIPRES publishes an annual report on contingent liabilities, clearly identifying fiscal risks.	Section 5.4
10. Quality, integrity and independent audit	Chile created a Fiscal Advisory Council in 2013, with a mandate mainly centred upon the cyclically-adjusted fiscal rule. Its members are appointed by the Minister of Finance and can be removed at any time. The independence of the Fiscal Advisory Council could be reinforced, and its mandate expanded to include analysis of fiscal and long-term sustainability risks.	Section 3.2



From:
OECD Journal on Budgeting

Access the journal at:
<https://doi.org/10.1787/16812336>

Please cite this article as:

Vammalle, Camila and Ana Maria Ruiz Rivadeneira (2017), "Budgeting in Chile", *OECD Journal on Budgeting*, Vol. 16/3.

DOI: <https://doi.org/10.1787/budget-16-5jfw22b3c0r3>

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to rights@oecd.org. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at info@copyright.com or the Centre français d'exploitation du droit de copie (CFC) at contact@cfcopies.com.