

Unclassified

GOV/PGC/SBO(2004)7



Organisation de Coopération et de Développement Economiques  
Organisation for Economic Co-operation and Development

14-May-2004

English - Or. English

**PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE  
PUBLIC GOVERNANCE COMMITTEE**

Cancels & replaces the same document of 01 April 2004

**Working Party of Senior Budget Officials**

**BUDGETING IN CHILE**

**25th Annual Meeting of Senior Budget Officials**

**Madrid, Spain  
9-10 June 2004**

*This budget survey will be peer reviewed at the 25th Annual Meeting of Senior Budget Officials.*

For further information, please contact  
Jon BLONDAL, E-mail: [jon.blondal@oecd.org](mailto:jon.blondal@oecd.org), Tel. +33-1 45 24 76 59 or  
Teresa CURRISTINE, E-mail: [teresa.curristine@oecd.org](mailto:teresa.curristine@oecd.org), Tel. +33-1 45 24 18 52

**JT00164204**

Document complet disponible sur OLIS dans son format d'origine  
Complete document available on OLIS in its original format

GOV/PGC/SBO(2004)7  
Unclassified

English - Or. English

## INTRODUCTION

In June 2003, the Budget Office of the Ministry of Finance of Chile requested the OECD to carry out a review of the Chilean budgeting system in a similar fashion as it does for its Member countries.

The OECD responded positively to this request, recognizing that Chile is an established observer of the OECD Working Party of Senior Budget Officials and the strong interest in the Chilean budgeting system expressed by members of the Working Party.

This report is divided into four parts. *Part I* focuses on the budget formulation process. *Part II* discusses the role of the legislature in the budget process. *Part III* reviews management issues. *Part IV* is devoted to discussing performance and results reforms.

A mission consisting of **Mr. Jon BLONDAL** and **Ms. Teresa CURRISTINE** visited Santiago in June 2003 to carry out the review. During this visit, the mission met with senior officials from the Ministry of Finance, the Budget Office, the Presidential Secretariat Ministry, line ministries and agencies. The mission also met with members of the joint budget committee of Chile's National Congress and with senior officials from the Comptroller-General's Office.

The mission would like to express its gratitude and appreciation for the warm and cordial reception by the Chilean authorities and the uniformly frank and useful discussions with Chilean officials. In particular, the mission would like to express its thanks to **Mr. Mario MARCEL**, the director of the budget, for the generous time he shared with the mission during its stay in Santiago.

Finally, the mission would like to thank **Mr. Jaime CRISPI**, **Mr. Andrés COOPER** and **Mr. Juan Andrés ROESCHMAN** of the Budget Office for organizing the mission's visit and for their help throughout this review. The mission would also like to express its gratitude to **Ms. Marcela GUZMAN** of the Budget Office for her invaluable assistance with this review while she served at OECD Headquarters in Paris on secondment.

The views expressed in this report are those of the OECD Secretariat and should not be attributed to governments of OECD Member countries, or to any organizations or individuals consulted for this review.

This review will be peer reviewed by budget directors of OECD Member countries at the next meeting of the Working Party of Senior Budget Officials.

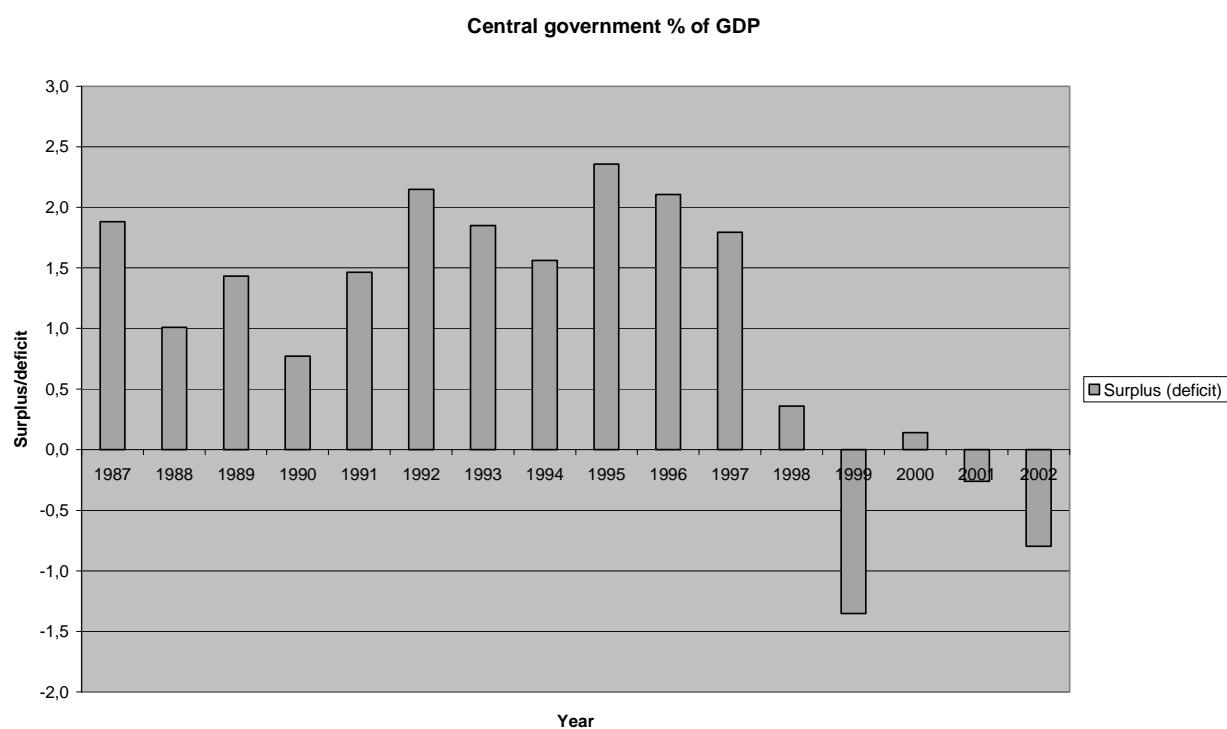
*Chapter I*

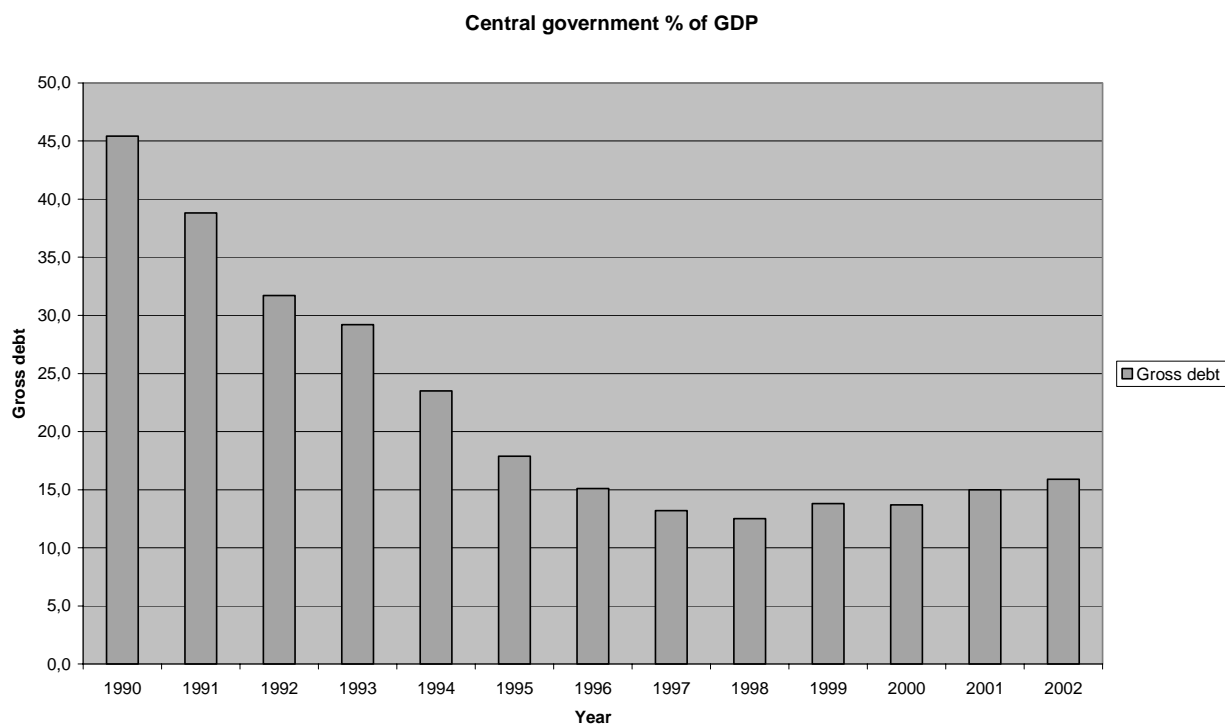
**BUDGET FORMULATION**

**Introduction**

1. One of the most recognized and distinguishing features of Chile is the sound handling of the economy during the past decades, especially the discipline with which public finances have been managed. This is particularly the case following the return to democracy in 1990.

*Graph 1 – Nominal fiscal surplus-deficit 1987-2002*



*Graph 2 – Gross government debt 1990-2002*

2. Why has Chile been able to accomplish this? The answer most likely lies in Chile's tumultuous political and economic history over the past decades.

3. In 1970, President Allende was elected president and a comprehensive socialist economic program was introduced. Banks, mines and many other foreign enterprises were nationalized. Workers' "self-management" was introduced in other firms. A general economic malaise followed. Fiscal deficits reached over 15% of GDP; inflation reached an annualized rate of over 500%. In 1973, the military overthrew the democratically elected government. The socialist experiment of President Allende was reversed – and indeed Chile's long tradition of statist economic policies. In 1975, a radical experiment with free market economics was introduced. The economy responded well to these policies and grew at very high rates until the early 1980s. In 1981, the international debt crisis led to severe economic problems in Chile – with high unemployment and the need for the government to bail-out the banking system. In the ensuing years, Chile consolidated its economic reforms and economic growth ensued<sup>1</sup>.

4. Following the return to democracy in 1990, successive elected governments have maintained a strong commitment to sound economic management and fiscal responsibility. In this context, it should be emphasized that the political situation in Chile was quite unstable at this time. The sustainability of democracy was by no means assured and in order to ensure political stability, democratic governments stressed responsible economic policies recognizing that this was one of the main pretexts for the military's take-over in 1973. The country had also witnessed the harsh consequences facing its neighboring countries which had followed less responsible policies immediately following their return from military rule. It

<sup>1</sup> It should be emphasized that the discussion of military rule applies only to their economic policies and no other inferences should be drawn from it. Many of the economic reforms were also refined and made sustainable following the return to democracy.

should also be noted that successive democratic government have been served by very high-caliber economic teams.

5. This chapter reviews the budget formulation process in Chile. The first section discusses the fiscal rule that is the foundation of the budget policy in Chile. The second section discusses the key steps in the annual budget process.

### **Box 1. The Private Provision of Traditional Public Services**

The size of the public sector in Chile is small compared to OECD Member countries. Total general government expenditure is circa 20% of GDP. The private provision of traditional public services is, however, extensive in Chile. When compared to typical public sectors in OECD Member countries, it is estimated that the equivalent of 11% of GDP is provided through the private sector in Chile.

A fully-funded pension system based on individual capital accounts, managed by private companies, replaced the traditional pay-as-you-go regime in the early 1980.<sup>2</sup> Individuals are required to deposit in such accounts an amount equal to 10% of wages, and to make an additional contribution of 2-3% of wages as a premium for disability and term life insurance as well as to cover administrative costs. Employers make no contributions.

A mandatory contribution of 7 per cent of wages and pensions must be used to purchase health care insurance. This system was introduced in 1981. People can either pay this contribution to a government health insurance financing scheme or to private health insurance companies. In addition, about 1/3 of all health care costs in Chile are paid out-of-pocket by the patients, rather than through the insurance schemes. Workplace injury compensation and disability compensation are also covered by compulsory private insurance schemes.

A system of individual unemployment insurance accounts was established in 2002. Employers and employees are required to pay 1.6% and 0.6%, respectively, of wages into an individual account for each worker. These accounts are managed by a private administrator contracted by the government.

Some of these schemes carry with them extensive contingent liabilities for the government. For example, the government guarantees a minimum rate of return for the individual capital accounts – in effect a state guarantee for all the firms that manage those accounts.

### **Structural Budget Surplus Rule**

6. Starting in 2001, Chile adopted the fiscal rule that it would operate each year with a one-percent of GDP structural budget surplus<sup>3</sup>. This is not enshrined in legislation but is rather a political commitment of the current government.

7. A structural budget balance aims to eliminate the effects of cyclical fluctuations of economic activity on the budget balance<sup>4 5</sup>. When the economy is performing above its long-term potential, the government

<sup>2</sup> For further information, see Vial Ruiz-Tagle, J and F. Castro. *The Chilean Pension System*. OECD Journal on Budgeting. Volume 1, N° 1. 2001.

<sup>3</sup> This rule applies to the national government only. It should, however, be noted that the sub-national level of government is small in Chile.

<sup>4</sup> For further information on calculating structural budget balances, see *Structural Budget Balances: A Methodological Note* in OECD Economic Outlook – Sources & Methods.

should return a nominal surplus. When the economy is performing below potential, the government should return a nominal deficit. Over the cycle, these should even each other out.

8. There were several reasons advanced in Chile for the introduction of this rule.

- First, it wanted to formalize the fiscal prudence that has characterized the management of government finances. There was a view that fiscal discipline had depended excessively on the commitment of a relatively small group of actors and this sought to institutionalize it.
- Second, a formal rule served to increase transparency and predictability in the conduct of fiscal policy.
- Third, this allowed Chile to operate a counter-cyclical fiscal policy within an overall framework of fiscal responsibility.

#### **Box 2. Why One Percent?**

The decision to target a 1% of GDP surplus – as opposed to a zero balance – was taken in order to offset a perennial 1% of GDP deficit at the Central Bank of Chile. When the two are consolidated, the public sector has an approximately zero balance.

The Central Bank was the vehicle used to bail out the banking system in the early 1980s and this deficit represents largely the interest rate differential on the debt assumed from the banking system and the loans used to finance them. There are on-going discussions in Chile of recapitalizing the Central Bank.

9. It should be emphasized that calculating structural balances is, at best, an uncertain science and frequent ex post revisions are generally made to their calculations. They should be considered an approximation because of their inherent uncertainty.

10. In Chile, all calculations of the structural balance are performed by adjusting the revenue side of the budget as no expenditures are judged to have a significant automatic cyclical component. These adjustments estimate what the revenues would be if the economy was operating at full potential and copper prices at their long-term average. There are two separate exercises done for this purpose. The first one is to calculate the output gap to measure the effect of the economic cycle on tax revenues. The second is to calculate the long-term price of copper and the effect of deviations from that. (See *Box 3* for further discussion of the role of copper in Chile's economy and fiscal finances.)

11. During the first year of the use of the structural balance rule, these calculations were performed in-house by the Ministry of Finance. There was some skepticism voiced by the opposition and other commentators on this procedure, especially since it was difficult for non-specialists to understand the process.

12. To limit the possibility of irresponsible fiscal behavior through the calculation of these reference levels, and to increase the credibility of the new policy framework, the Ministry of Finance established after the first year two independent panels to carry out the forecasts. As is discussed later in the chapter, this takes place about two months prior to the presentation of the budget proposal to Congress.

<sup>5</sup>

For a technical description of Chile's fiscal rule, see Marcel, M. et al: *Structural Budget Balances: A Methodology and Estimation for the Chilean Central Government* and Report on Fiscal Finance (2003).

13. The “output gap” panel consists of 14 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 twice during the budget season. At the first meeting, the panel discusses methodological aspects of the model used. At the second meeting, each member of the panel submits his forecast for the various inputs required by the model. Each of the 14 estimates is published anonymously so that each forecaster recognizes their own. The two extremes on either side are discarded and then a simple average of the remaining 12 forecasts is used. There is no discussion to achieve a consensus among panel members.

14. The copper price panel also consists of 14 individuals appointed in the same fashion by the Minister of Finance. They are employees of mining companies and related enterprises, as well as financial analysts in this sector. This committee estimates the average long-term (10-year) price for copper as the reference price. Again, the panel meets twice during the budget season. Each panel member submits his estimate which is published anonymously. The two extremes are discarded and a simple average of the 12 remaining forecasts is used. No consensus is sought.

15. The establishment of these independent panels seems to have successfully alleviated fears about the impartiality of the calculations underlying the structural budget surplus.

### **Box 3. Copper Stabilization Fund**

Chile’s fiscal finances are heavily dependent on the volatile price of copper, Chile’s leading export. About 4 percent of total government revenue comes from copper, but copper feeds through the entire economy so economic growth is correlated with the price of copper.

The volatility of the price of copper has had a very negative impact on fiscal finances as expenditures would generally shift upwards when the price was high whereas a downward shift when the price was low did not occur and deficits resulted. In 1987, the Copper Stabilization Fund was established. It was designed to partially isolate the available fiscal revenues from the cyclical fluctuations in the price of copper. When the price of copper goes above a certain target, the extra revenue is deposited in the Fund and is not available to the budget. Similarly, when the price of copper falls below a certain target, the revenue shortfall in the budget is compensated for by making withdrawals from the Fund.

The structural budget surplus rule has effectively superseded the functions of the Fund, and it can now be viewed as redundant to a large degree.

16. The structural budget surplus rule would appear to have performed well since its inception and has definitely served to set a hard budget constraint for the aggregate level of expenditures. In fact, opposition political parties supported the fiscal rule primarily as a vehicle to put a break on spending growth. In this context, it should be noted that it is extremely difficult to secure Congressional approval for increases in taxation in Chile.

17. The fiscal rule requires adjustments within the year in order to keep to the target. The fact that the Chilean government has in fact done so has greatly enhanced its credibility. For example, tariffs were reduced significantly in 2003 following the signing of Free Trade Agreement with the European Union. In order to compensate for the loss of revenue, measures were immediately taken to reduce expenditures within the year<sup>6</sup>. Again, it should be emphasized that this refers to the performance of actual revenue and

<sup>6</sup> In addition, the rate of value-added tax was raised from 18 to 19 percent to compensate for the loss of revenue.

expenditures against the calculated structural balance. Errors in the calculation of the structural balance itself would not be known until well after the fact when more information is available to judge the structural-cyclical components of the budget.

18. Finally, it is appropriate to note a comment from a leading participant in the Chilean financial market. He stated emphatically that the markets did not pay great attention to the structural fiscal rule. The markets focused on the conventional deficit and viewed a conventional deficit of 1-2% of GDP as acceptable. The structural surplus rule, however, serves to set boundaries for the actual deficit, so the two can be said to work in tandem in that respect.

### **Annual Budget Cycle**

19. The Chilean budget cycle is divided into two very distinct phases. The first one focuses on a critical examination of on-going programs and updating baselines. The second focuses on funding new programs and expansion of on-going programs through a central *Bidding Fund*. This is, however, subject to the availability of resources. For example, there was no second phase at all in the formulation of the 2004 budget.

#### **Box 4. The Budget Office**

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 and he may dismiss him at any time. The position of budget director is generally viewed as the equivalent of a senior ministerial position in the Chilean government. See *Chapter III* for further information on the government's organizational structure.

The budget office has a staff of around 200. In addition to the classic structure of having sectoral divisions shadowing respective spending ministries, the Budget Office has special units dealing with performance and results information, long-term budget studies, and financial management issues.

### **Phase I: Updating Baselines for Existing Programs**

20. The budget season starts in Chile in April following the end of the Southern Hemisphere summer. The Budget Office would then embark on an internal process of reviewing the execution of last year's budget and will also evaluate the implementation of the budget so far during the current year. As part of these reviews, the Budget Office will call meetings with the respective line ministries in order to exchange information.

21. These reviews include a systematic assessment of the performance and results of programs. These assessments are carried out by a special unit within the Budget Office and are discussed in detail in *Chapter IV* of this report.

22. Following these reviews, the Budget Office updates the baselines for on-going programs which then serve as their expenditure ceilings. This amount includes 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. An across-the-board cut ("efficiency dividend") is then deducted from this amount although some programs are exempted from this provision. The review of performance and results may also alter the level of funding for certain programs. The objective is to free up resources for the second phase of the budget formulation process.



23. These expenditure ceilings are formulated by the Budget Office in early June and are then officially communicated to line ministries at the end of June.

24. As is discussed in *Chapter III*, the Chilean government is divided into ministries and agencies. The maximum amounts are set for each ministry and each agency at the same level of detail as the budget. The maximums are, however, sent to the minister responsible and he/she can make any adjustments to them – i.e. reallocate between organizations – before forwarding them on to the agencies. Practices in this field vary across ministries, but in most cases the ministries simply pass the maximums on directly to the agencies without any adjustments.

25. Ministries and agencies can challenge the maximum amounts that they are issued but as this is very rarely successful such challenges are exceptional. This indicates the power of the budget office, and the support it has from the Minister of Finance and the President. It is also important to bear in mind that these maximums only refer to on-going programs, not to new programs.

#### **Box 5. Role of Medium-Term Projections**

In 2000, the Budget Office 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 and they are 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 macro-economic projections are incorporated into the projections for the following year.

This is an internal document of the Budget Office and is only released to the public (or to other ministries) at a very aggregate level. There is no reconciliation between the projections from year to year in the public documents.

The document is not used as a tool for resource allocation. The Budget Office uses it to evaluate the overall trend in public revenue and expenditure to see how it is compatible with the over-reaching goal of maintaining the structural fiscal rule. As such, it 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 finalize the level of resources available.

#### ***Phase II: The Bidding Fund***

26. The second phase of the budget formulation process focuses on the Bidding Fund for new initiatives. As noted, the size of the Fund varies with the economic cycle and there was no Fund used for the 2004 budget. In general however, the Budget Office strives that the Fund be sufficiently large to be relevant in political terms. This has meant a fund that is about 2½ percent of total spending on average in recent years. Again, the Bidding Fund is financed by a critical examination of existing programs in the first phase and the added resources provided by a growing economy. The discussion below refers to the years when the Fund is in operation.

**Box 6. Budget Formulation Timetable**

<b>April-May</b>	Updating baselines. Initial bilateral meeting between budget office and line ministries.
<b>June</b>	Maximum amounts for on-going programs established.
<b>Early August</b>	Bilateral meetings between Budget Office and line ministries.
<b>Early August</b>	Meetings of panels on economic assumptions.
<b>End August / Early September</b>	Line ministries submit proposals to “Bidding Fund”.
<b>2<sup>nd</sup> week of September</b>	Draft budget discussed with President.
<b>3<sup>rd</sup> week of September</b>	Bilateral ministerial meetings between Minister of Finance and line ministers.
<b>4<sup>th</sup> week of September</b>	Final preparation of documentation and pricing.
<b>Last day of September</b>	Budget proposal presented to Congress.

**Fiscal Year = Calendar Year**

27. The launch of the Bidding Fund in 2000 was an effort to improve the quality of budget submissions from line ministries. First, it was designed to counter the incremental nature of the traditional budget process by having line ministries prioritize (rank) their requests for funding new initiatives. Second, it was designed to improve the technical quality of the funding requests which had varied greatly from ministry to ministry and were often lacking. This was accomplished by giving the Ministry of Planning the role of assisting line ministries in completing their bids in accordance with standards set by the Budget Office. This is discussed further in *Chapter IV* of this report. The reason for this arrangement is that the Budget Office found it incompatible with its role to assist line ministries in submitting requests for new funds. It should be emphasized that the Ministry of Planning has no decision-making authority over the bids.

28. This second phase of the budget formulation process starts in the first half of August with bilateral meetings are held between the budget office and line ministries. At these meeting, the submissions to the Bidding Fund are presented and discussed but no decisions are taken. These meetings are led by the relevant sectoral analyst from the Budget Office, and include the under-secretary of the line ministries and the directors-general of the ministry’s agencies together with their finance staff. The length of the meetings varies but they often last two-three days per ministry, depending on the number of agencies it has.

29. At the same time, the independent panels that calculate the structural budget balance meet. Following their conclusions, the Budget Office is in a position to finalize the overall level of resources available for the coming year. This in turn sets the ceiling for the amount of funds available in the Bidding Fund.

30. The Budget Office analyzes the various bids that have been submitted based on two criteria. The first is the technical quality of the bid. The second is the consistency of the bid with the political priorities of the President.

31. The consistency with the political priorities of the President is ensured (promoted) by an explicit system for communicating those priorities. First, the President will communicate these in his annual State of the National address to Congress in each year. Second, the staff of the President (Presidential Secretariat Ministry) will have bilateral meetings with each minister to discuss the President's priorities for the budget. These will first have been discussed thoroughly with the Minister of Finance and the budget director.

32. Based on these two criteria, the Budget Office proposes a list of new initiatives to be funded. The Minister of Finance and the Budget Director will then have one-on-one bilateral meetings with line ministers to discuss the proposals. The Minister of Finance and the budget director then have a meeting with the President to go over the proposal. As the proposals already take account of the President's priorities, the President generally accepts them with minor adjustments only.

33. The last step of the budget formulation process is for the Budget Office to finalize the budget documentation and to put the budget on the appropriate price level as all discussions will have taken place in the previous year's budget price levels. The budget document itself is a streamlined input orientated document. The budget office also produces supplementary documents presenting additional information on performance and results for each of the 18 "sectors" of the government. See *Chapter III* for a discussion of sectors.

#### **Box 7. Budgeting for the Military**

One of the legacies of military rule in Chile is that the military receives 10% of the gross revenue of the government-owned copper mining company (CODELCO) for equipment purchases. This amounts to about 0.4% of GDP. This is treated as an off-budget transaction. In fact, it was only in 2003 that a new law required for the first time the publication of how the military spends this money. The military may also borrow directly in order to finance equipment purchases. The Budget Office limits the amount of borrowing to what can be serviced with the proceeds of the 10% copper revenues. This borrowing is, however, not publicly reported.

### **Conclusions**

34. Chile has an outstanding record of fiscal responsibility and a sophisticated budget formulation process.

35. The structural budget surplus rule appears to function well in Chile's political environment although it is too early to draw any firm conclusions regarding its sustainability. All the early indications are however positive. The independent panels used for calculating it are especially noteworthy, although the inherent uncertainty of such calculations is surprisingly little discussed in Chile.

36. Similarly, the Bidding Fund system appears to perform well. The process for deciding bids is understood well and the explicit linkages with the political priorities of the President are exemplary in operation. Framing discussion on new initiatives in the context of this notional Bidding Fund would appear to have increased the quality of submissions from line ministries.

37. Line ministries do not play a pro-active role in the budget formulation process. Internal reallocations between different components (agencies) of ministries are extremely rare. This is a legacy of a very centralized budgeting system. This is being redressed with the Budget Office now focusing its discussions solely on ministries, rather than talking directly with agencies. The needed culture change in line ministries will likely take an extended time to achieve.

38. Chile does not have a medium-term expenditure framework in the same sense as applied in OECD Member countries. Chile already has the foundation for such a system with the internal documents currently used for macroeconomic purposes. It would be relatively simple to use it more actively for resource allocation purposes. This would greatly aid in the transparency of fiscal finances as well as promoting accountability.

39. Performance and results information is extensively used in the budget formulation process and it would appear to be well integrated with resource allocation decisions. The supplementary budget documentation on each sector presents this information in a very user-friendly manner.

40. The military is a special case in Chile's budget formulation system. The current state of affairs is highly inappropriate from a budgetary point of view. This is recognized in Chile and is slowly being rectified. This is, however, a very sensitive area.

## *Chapter II*

### **ROLE OF THE LEGISLATURE**

#### **Introduction**

41. Historically, 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 19<sup>th</sup> 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 a general state of malaise ensued. Its role diminished steadily, starting with the 1925 Constitution. Today, the Congress enjoys very limited powers in the budget process. It simply appears to be accepted across the political spectrum that Congress would act irresponsibly in the budget arena if it were given any substantive power.

42. Congress was completely closed during the military take-over in 1973 and did not re-open until 1990 with the return to democracy. All accountability mechanisms were suspended during this time and no comprehensive budgetary information was made publicly available. The current government has made improved accountability to the Congress a priority. For example, a formal agreement was signed in 2002 between the executive and the Congress for the government to conform to the *OECD Best Practices for Budget Transparency*.

43. This chapter reviews the current congressional budget process. It concludes by discussing possible avenues for the future development of the role of Congress in the budget process.

### **Box 8. The National Congress**

Chile's *National Congress*, located not in the capital Santiago but in the coastal town of Valparaíso, is a bicameral institution with a Chamber of Deputies and a Senate

The Chamber of Deputies has 120 members. They are elected from 60 two-member electoral districts and serve a four-year term. The Senate has 38 elected members. They are elected from 19 two-member electoral districts and serve an eight-year term. Half of the Senate's electoral districts are up for elections at each election to the Chamber of Deputies.

In addition to the elected members, the Constitution provides for former presidents to serve in the Senate for life after they leave 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.

Chile's congressional elections are governed by a unique binomial system that rewards coalition slates. Each coalition can have two candidates for the two Senate seats and the two Chamber of Deputies seats in each electoral district. Typically, the two largest coalitions split the seats in a district. Only if the leading coalition ticket out-polls the second-place coalition by a margin of more than 2-to-1 does the winning coalition take both seats.

### **Current Congressional Budget Process**

44. The budget is presented to Congress on the last day of September. This is not an important moment in the political calendar in Chile. In fact, the Budget Office has purchased advertisements in newspapers in order to provide information on the contents of the budget proposal.

45. There is no discussion of the budget in plenary session of either chamber of the Congress upon its introduction. The budget is automatically referred to the Budget Committee. The Budget Committee is unique in that it is a joint committee of both chambers of the Congress. 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. Effective in 2003, the Budget Committee has become institutionalised as one of the permanent committees of the Congress and will therefore operate year-round. The Budget Committee consists of 26 members, drawn equally from the Senate and the Chamber of Deputies.

**Box 9. Constitutional Restrictions on the Role of Congress**

The Congress may only decrease expenditures for any program the government proposes. It may not increase expenditures, and it may not reallocate expenditures between programs.

The Congress cannot amend the economic assumptions or the revenue forecasts used in the budget proposal.

If the Congress does not approve a budget (either the original proposal from the government or one amended by Congress) by 30 November, the original government proposal becomes law.

The Congress may not scrutinize arms purchases by the military. This applies to the 10% of the gross revenue of the government-owned copper mining company (CODELCO) which must be transferred to the military.

The President sets the agenda of the Congress by giving priority status to bills that he desires and gives Congress a given number of days to consider them.

46. As noted, the budget is referred automatically to this committee without prior action in either house in plenary session. 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. Each of these meetings lasts for approximately a half-day with members of the Committee asking the minister and the budget director questions following their presentations. The budget director will also have had meetings with the budget committee and informal meetings with each political party represented in Congress to provide information ahead of the introduction of the budget.

47. After receiving the minister of finance and the budget director in plenary session, the Budget Committee divides into five sub-committees each focusing on a different set of ministries. Each committee has five members (except one that has six). The scrutiny of the budget proposal takes place in these sub-committees. Each ministry and agency is examined during a four-week period. The length of examinations differs, but generally take two or three days for each ministry. The sectoral minister and the heads of every agency that he's responsible for attend the examination.

48. 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.

49. The budget is then referred to both the Chamber of Deputies and the Senate where it is discussed very briefly and then approved in a series of ministry-by-ministry votes. Numerous amendments are still proposed at this stage by members of Congress, but some are dismissed as out of order (inelligible) 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 would make a proposal which must be voted without amendment in both chambers. The budget is generally passed in late November. It would appear to be a matter of pride for the Budget Committee to have enacted the budget in as short a period of time as possible.

**Box 10. Congressional budget timetable**

<b>Last day of September</b>	Budget presented to Congress Budget referred automatically to the Budget Committee
<b>First week of October</b>	Minister of Finance makes policy address to Budget Committee
<b>First week of October</b>	Director of the Budget makes technical address to Budget Committee
<b>October-November</b>	Budget Committee forms five sectoral subcommittees to scrutinize the budget proposal
<b>Mid-November</b>	Budget committee finalizes report on the budget proposal
<b>Mid-November</b>	Budget approved by Congress
<b>November</b>	Protocol signed between Budget Committee and Budget Office
<b>1 January</b>	Start of fiscal year.

50. As noted above, even if the government's budget proposal (or one amended in accordance with the restrictions noted above) was not approved by 30 November, the government's original proposal would nonetheless become law according to the Constitution. This has, however, never happened and would appear today 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 made their vote on unrelated legislation – the Free Trade Agreements were cited as an outstanding example – conditional upon desired changes in the budget. The frequency of such behind-the-scenes interventions is, however, said to be rare.

51. 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 demonstrates the will of Congress. These are, however, also rare. (These restrictions are further discussed in *Chapter III*.)

52. The Budget Committee is assisted by a secretary, who is mainly responsible for ensuring that the rules of procedure in the Congress are adhered to in the discussion of the budget. An embryonic budget research office has also recently been established with a professional staff of three analysts. It should also be noted that think-tanks associated with political parties are very active in policy research and that each member of Congress gets a stipend to purchase technical assistance.

53. Since 1997, the Budget Committee and the Budget Office have agreed on a "protocol" at the end of each budgetary cycle. This is not legislated but is rather a signed and formalised political document between the legislative and executive branches. These protocols have become more elaborate in each year and are commitments by the executive to provide information to Congress on budget-related matters throughout the year. For example, a recent protocol commits the government to conform to the *OECD Best Practices for Budget Transparency*.

54. In formal terms, Congress can be described as having very limited impact on the budget policy of the government. The current budget process is designed for Congress to swiftly approve the government's proposal with no changes. The influence of Congress in informal terms would also appear to be small, despite the instances mentioned above. The introduction of the structural budget surplus rule was, for example, not even discussed with Congress before being introduced. Whether this passive role for Congress is sustainable – or desirable – is certainly open to debate. The role of the legislature in OECD Member countries is certainly greater, and increasing in many cases.



### Box 11. Audit

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 and his term of office is until he reaches 75 years of age. He can only be removed before then by being impeached for gross misappropriations of duties. He sets his own budget, level of staff, and salary in consultation with the President and the Senate.

It is a most unusual body in that it acts not only as an audit office but also pre-approves all expenditures and staff actions in order to ensure their legality. The case for modernizing this office and re-launching it as a modern auditor-general body appears appealing. As an office of the legislature, it would also assist the legislature with its oversight duties in holding the government accountable. In such a reformed model, the pre-approval of expenditures and staff actions would no longer be performed by the body.

### Conclusion

55. As noted in the introduction, Chile's *National Congress* had once a strong role in the budget process. Although there appears to be general satisfaction with the very limited role of Congress at present, it is worthwhile to consider that this may change in the future and that the Congress would take a more active role in the budget process. Despite their rarity, the behind-the-scenes negotiations on the budget and the restrictions placed by Congress on individual appropriations point in this direction.

56. Congress at present has a limited institutional capacity to consider the budget, as shown by the fact that a permanent budget commission is only being established this year. By not further developing its institutional capacity, the long-term risk may be that Congress would regain a stronger role in the budget process but without the institutional features to promote fiscal discipline and responsibility in its use.

57. The efforts to provide improved budgetary information to Congress are commendable, including the commitment to conform to the OECD Best Practices for Budget Transparency. Accountability of the government to the legislature could also be improved by re-launching the *Comptroller-General of the Republic* as a modern audit office and as an office of parliament.

### Box 12. The Swedish Parliamentary Budget Process<sup>7</sup>

During 1996 and 1997, fundamental changes were made to the manner in which the Swedish Parliament approves the budget. There are no restrictions on parliament's ability to amend the budget but a rigorous institutional process has been put in place to promote budget discipline. It is one of the most modern parliamentary budget processes in OECD Member countries.

The key reform focused on introducing a top-down budgetary process where aggregate levels of expenditure are approved before individual appropriations. This operates on several cascading levels. A Spring Fiscal Policy Bill is presented to parliament in April, five months before the budget is submitted to parliament. The Bill proposes limits on the aggregate level of government expenditures and government revenues. Parliament debates these aggregate limits and enacts them into law in early June. Again, there are no restrictions on parliament's ability to amend the government's proposal. The Bill has created a vehicle whereby debate in Parliament can focus on the appropriate size

<sup>7</sup> For a description of such a system in operation, see Blöndal, J.: *Budgeting in Sweden*, OECD Journal on Budgeting. Volume 1, N° 1, Paris. 2001.

of the public sector and the economic impact of various combinations of aggregate revenues and aggregate expenditures. The Budget – which is presented in September - must be in conformity with the aggregate level of revenue and expenditures as approved in the Spring Fiscal Policy Bill. The Budget as presented to parliament is divided into 27 Expenditure Areas. Parliament debates and approves by late November the level of aggregate expenditure for each of the 27 Expenditure Areas. Again, there are no restrictions on changes as long as the total voted in the Spring Fiscal Policy Bill is respected. Finally, parliament decides in late December on the level of individual appropriations within each of the 27 Expenditure Areas. Parliament can make any changes to individual appropriations within the aggregate level of expenditure for each of the 27 Expenditure Areas.

A strong division of labor among the committees of parliament accompanied these reforms. The Finance Committee is concerned mainly with the aggregate level of expenditures and revenue as contained in the Spring Fiscal Policy Bill and in the level of total expenditure for each of the 27 Expenditure Areas. It has essentially been given the role of ‘policeman’ of the parliamentary budget process. Individual appropriations within an Expenditure Area are the concern of the relevant sectoral committee of parliament. For example, the health committee would recommend the allocation within the relevant Expenditure Area for health. (The 27 Expenditure Areas reflect the committee structure of parliament.) Involving the sectoral committees like this also supports the use of performance information by parliament.

Chile may wish to consider aspects of the Swedish system as it strengthens the institutional framework for the congressional treatment of the budget.

### *Chapter III*

## **MANAGEMENT**

### **Introduction**

58. Management practices in Chile are presently being modernized at a very rapid pace.

59. This chapter reviews reforms undertaken in the area of organizational structures, human resource management, and financial management. A special emphasis is placed on managerial flexibility in Chile.

### **Ministries and Agencies**

60. Chile has a presidential system of government with executive power radiating from the presidency to ministers. In addition to ministries, Chile has a long history of other types of organizations – known collectively as *services*. This organizational model dates back to the early 1800s. Currently, there are 18 ministries and 165 *services*. Both the ministries and services vary greatly in staff size.

61. In legal terms, all of the services report directly to the minister as equals. The fact that the President appointed the heads of the services in the same manner as ministers, and he could dismiss them at any time, has however served to muddle this relationship. In fact, the relationship between ministries and services in general has been unclear in many instances.

62. Reforms to re-launch this organizational structure as a modern ministry-agency structure along the lines of the Scandinavian countries are being implemented. The term *agencies* will be used hereafter to refer to the various services.

63. First, the notion of *sectors* was introduced. This entails formalizing the groupings of organizations around a minister into a ministry and agencies. There are 18 sectors, matching the number of ministries. This was largely a presentational issue but the implication was clear. Ministries were to be responsible for policy-making and coordination, whereas the agencies would be responsible for policy implementation. The results of this reform vary greatly between sectors as they depend on how the minister himself has decided to operationalize it.

64. Second, the Ministry of Finance has used the budget process to promote the ministry-and-agencies system. This is done by the Ministry of Finance communicating with the ministry as representing all the agencies in the sector – and not communicating with the agencies directly. The Ministry of Finance also encourages ministries to reallocate resources between agencies in the sector. Although the actual level of reallocations is low, the operation of the budget process has greatly aided in the “culture shift” in the sectors and the role of ministries as coordinators for the whole sector.

65. Third, and most recently, it was recognized that some of the agencies were actually policy-making in nature, rather than simply engaged in policy implementation. This resulted in 25 agencies being classified as policy making (or “centralized”) and 140 agencies as policy implementators (or “decentralized”). The former category includes the budget office, the latter category includes general service delivery, enforcement activities, and regulatory commissions. By recognizing the 25 agencies as being special, it

will relieve tensions from the overall system and allow for the remaining 140 agencies to fit better into the modern ministry-and-agency structure being developed in Chile.

66. The management of all agencies is vested in a director-general<sup>8</sup>. Previously, all directors-general were selected by the President. Now, the president will only nominate the directors-general of the 25 policy-making agencies. For other directors-general, the positions will be advertised and an elaborate nominating process will operate. This reform is effective 2004.

67. A special nominations committee for directors-general will be created. It will consist of the head of a new human resource management agency and four other members who are appointed by the President upon confirmation by a 4/7 vote of the Senate. This nominations committee must present a list of no less than 3 and no more than 5 qualified people for all vacant positions of directors-general of agencies. The President may only appoint persons from that list; he can also reject them all and the whole process will start again. The President also enjoys the right to dismiss a director-general at any time. The appointments are for three years. They can be extended without advertisement twice for a total of nine years. After that, the competitive process must be opened again.

68. As part of this new reform, directors-general will sign contracts with their ministers concerning the goals of the agencies. This is discussed further in the *Chapter IV*.

### **Managerial Flexibility**

69. There are two aspects to managerial flexibility. The first is the legal detail of budget appropriations. The second is the various central management rules on implementing the budget, notably in the field of human resource management. This section will review Chile's position in these areas.

### ***Budget Appropriations***

70. For operating expenditures, each ministry and agency in Chile receives one appropriation for human resource and one appropriation for the purchase of goods and services. These are global amounts with no subdivisions among individual items of expenditures. The appropriations are considered maximums, i.e. there is not an obligation to spend appropriated funds. Some large organizations with a nationwide network have their appropriations divided among several regions, i.e. each region is treated as a separate agency.

71. In addition, there are a number of *restrictions* for each account. There are two types of restrictions. The first are common to all accounts and includes a maximum amount that can be spent on four items of expenditure: overtime, travel, training and on consultants. The amount of the restrictions originates with the Ministry of Finance 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.

72. The second type is restrictions for specific appropriations. These generally earmark parts of a larger appropriation for specific projects. This can be viewed as simply a pragmatic approach to program budgeting. These restrictions generally originate in the Ministry of Finance as well. In other cases, they originate in Congress. As detailed in *Chapter II*, Congress cannot increase spending for any program, but they can use their power to reduce spending to force agreement with the Executive to mandate that a certain amount within a larger appropriation be spent on a certain project using this form of restrictions. It should be noted that these are relatively few at present.

---

<sup>8</sup> In exceptional circumstances, the management of an agency vested with a collegium, or in a board of directors.

73. A noteworthy feature of the Chilean system is that the all expenditures -- each and every transactions -- must be pre-approved by the *Comptroller-General of the Republic* in order to ensure their “legality.” Certain other administrative acts must also be approved similarly. Even though the Comptroller-General has the authority to waive this procedure to whole categories of operations, for those not benefiting from such waivers, this can be a very cumbersome and time-consuming procedure.

74. As a general statement, however, the level of detail of appropriations allows quite wide managerial flexibility.

### **Box 13. The Contingency Reserve**

The budget contains a contingency reserve. The amount of this reserve has been as high as 7.8% of total expenditures, but is now equivalent to 1.8% of total expenditures. The purpose of the contingency reserve is to fund legislation that Congress may enact after the introduction of the budget. The outstanding example of this is that the Congress approves salary increases for government employees in a special legislation in late December each year.

### **Human Resource Management**

75. Chile has two types of human resource management systems operating side by side. The traditional system, known as *planta*, is highly inflexible. About sixty per cent of government workers are in this system. The remaining 40% are hired on contracts, the *contrata* system, which is flexible. The formal system is concentrated with older workers. Over 50% of public employees have less than 10 years experience and most of these are contract employees. It should be noted that the numerical ceilings on staff (posts) apply for both the traditional and contractual workers.

76. The employees in the traditional system are hired for life. They are classified into one of 28 pay categories and progression from one pay category to the next based on seniority only. There is also a fixed number of people in each category. By contrast, contract employees are hired on one year contracts, which are renewable. In fact, they are generally renewed and it is common for employees to spend their entire career in the government on such renewable contracts. They can be placed in the equivalent of any of the 28 pay categories, i.e. a person who would be classified into pay category 4 in the traditional system could be paid the equivalent of category 15 as contract employees. The contract system is generally used in Chile’s private sector. Contract employees in the private sector receive one month’s severance payment for each year worked (up to a maximum). Contract employees in the public sector, however, receive no such payments.

77. Similar to the reformed process for appointing directors-general, the government is introducing reforms to the hiring and promotion of staff in the *planta* system. Promotions are to be competitive with positions being advertised and an independent panel reviewing the candidates. If no suitable persons are available within the organization, the position may be re-advertised and opened to persons from outside the organization. At the same time, the government launched an incentive package for the early retirement of older employees. This applies to the *planta* system. The government intends that a reformed *planta* system will reduce the reliance on the *contrata* system.

78. There is a further category of employees, which can be termed “consultants.” They give an invoice for their services and are paid with no reference to the 28 pay categories at all. These positions were traditionally used for special ministerial advisers and persons with exceptional skills for a certain project on a short-term basis. However, this system began to be used in order to pay higher salaries to people in

occupations of high demand, such as computer specialists. This system was also abused and as a result has been reformed. A ministry or agency (through its ministry) can apply to the Ministry of Finance to have certain positions designated as “critical.” Such designations can allow an increase in salary of up to 100% to be paid on an on-going basis. At the same time, the restrictions in the budget on the total amount that can be paid to consultants was introduced as noted above.

79. The public sector is heavily unionized in Chile. There is, however, no formal collective bargaining permitted and salaries are set by an act of Congress each year. Since the return to democratic rule, however, the government and trade unions have regularly carried out informal negotiations over salaries and working conditions in the public sector.

80. A new Personnel Agency is being created in the Ministry of Finance. Its primary role is to assist the nominations committee for directors-general of agencies and the selection panels for positions within organizations. However, its mandate is quite wide for implementing human resource management policy in general. Previously, this had been a function of a unit within the Budget Office.

### **Financial Management**

81. A number of reforms are underway to improve financial management in the Chilean government.

82. At present, all government accounts are maintained in a government-owned commercial bank, the *Banco del Estado*. Taxes to the government can be paid in any commercial bank which then has 3 days to forward it to the government’s account with the *Banco del Estado*. All government ministries, agencies and regional offices maintain their own bank accounts at the *Banco del Estado*. There are some 5,000 accounts in all as separate accounts are often opened for individual projects. Each entity makes its own payments from this account following approval from the *Comptroller-General of the Republic*. There is no central payment system. A daily statement is prepared by the *Banco del Estado* showing the revenues deposited and payments disbursed each day. This statement is not made publicly available.

83. The balances of these accounts are not swept overnight and invested by the government. The Bank invests these balances overnight for its own gain. Regardless of the fact that the bank is government-owned, this is highly inappropriate and reforms to this practice are under discussion.

84. Significantly, the Ministry of Finance does not have access to information on the balances in the accounts. Other ministries and agencies delay their responses to such questions and the *Banco del Estado* claims that bank secrecy laws prevent it from giving the information to the Ministry of Finance.

85. The Ministry of Finance transfers money from its main account to the 5,000 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, but is revised frequently in response to the development of fiscal revenues and the timing of capital projects. It is not publicly available.

86. 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. The report specifies revenues and expenditures at a highly aggregated level. For example, expenditures are not classified by government organizations which are only published on a semi-annual basis. On a quarterly basis, additional summary information on the government’s financial assets and liabilities is presented. These reports are publicly available.

87. An annual financial report is prepared and is available 3 months 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 Institute. It is publicly available.

88. A capital charging system is being implemented in three phases. In phase 1, a comprehensive asset register is being assembled. Phase 2 will see the valuations of those assets and Phase 3 will see the levying of a capital charge. This is expected to be implemented in 2005-2006.

89. The government's budgeting and financial reporting system are presently on cash basis. Chile is adopting *GFS / Government Finance Statistics* as the basis for its budgeting and financial reporting which is on accrual basis. This is, however, a statistical framework and not an accounting framework and poses important conceptual challenges<sup>9</sup>.

## Conclusion

90. It is clear that Chile is undertaking a large number of initiatives in order to modernize the management of the public sector.

91. Chile is very well placed to re-launch the government's organizational structure as a modern ministry-and-agencies model. Managers enjoy a high degree of flexibility in the operation of their institutions and this flexibility would appear to be exercised in a responsible manner.

92. The depoliticisation of the appointments for directors-general of agencies and the move to a merit based system -- rather than a seniority based system - for the promotion and hiring of officials are reforms of huge importance. The government's apparent objective of increasing the reliance on the *planta* system -- at the expense of the *contrata* system -- need however to be implemented with caution. The *contrata* system has served the government well and is a very established part of the Chilean government. A more urgent reform would appear to be the need to improve the conditions of contract employees if their contracts are not renewed, i.e. by giving them severance payments in line with private sector practices.

93. The financial management reform agenda is especially ambitious. The reform to the cash management system -- especially the activities of the *Banco del Estado* -- are urgent. The introduction of a capital charging system will improve asset management as well.

94. Chile needs to be careful in relying on a statistical framework, rather than an accounting framework, as the basis for its budgeting and financial management. Although international efforts to harmonize them are underway, there are at present large conceptual gaps between the two.

95. Finally, the role of the *Comptroller-General of the Republic* in pre-approving all expenditures should be reviewed. Effective internal controls and audit should be sufficient to assure the legality of transactions.

---

<sup>9</sup> See *Catalogue of Issues – Comparisons of GFS, IPSAS and ESA* for a detailed listing of these differences [GOV/PGC/SBO(2004)1].

*Chapter IV***ACCOUNTABILITY FOR PERFORMANCE****Introduction**

96. This chapter examines the development and use of performance information in the budget process. It is divided into four sections: 1) describes the four different approaches used by the Ministry of Finance to assess the performance of agencies and programs, 2) examines the integration and use of performance information in the budget process, 3) assess the methods for reporting on performance and 4) discusses the mechanisms used to report on performance to the legislature.

**1. Performance Programs of the Ministry of Finance**

97. The Ministry of Finance has a highly developed albeit complex system for obtaining information on agencies' and programs' performance, which combines performance measurement with evaluations. It first began experimenting with performance indicators in the budget process in 1994. A decade later, there are five different tools used by the Ministry to focus its public sector on performance. A special unit called the Management and Control Division within the Budget Office of the Ministry of Finance works on designing and implementing performance systems and on the subsequent monitoring of line ministries' results. The table below sets out the different performance information tools and their date of introduction. Each of these tools will be discussed in more detail.

**Table 1. Performance Information Tools**

<b>Name of Tools</b>	<b>Year</b>
Performance Indicators	1994
Evaluations	1997
Comprehensive Management reports	1997 <sup>10</sup>
Management Improvement Programs	1998
Bidding Fund	2001

***Performance Indicators***

98. This program was initially launched in 1994 on a volunteer basis. Line ministries that participated in the program developed performance goals or targets and indicators that were included in the budget process. In 1998, the program was removed from the budget process. The main reason for this change was the introduction of the Management Improvement Programs (MIPs) which incorporated indicators and targets linked to salary bonuses without relating these to the budget. However, MIPs encountered problems

<sup>10</sup> This tool will be discussed in Section 3.



the agreed targets were low and the results difficult to verify. In 2001, as a result of these difficulties, MIPs were reformulated and performance indicators were removed from this program and re-introduced into the budget process.

99. Initially after this re-introduction into the budget process, agencies prepared the performance indicators, goals and targets and presented them along with their budget proposal to the Ministry of Finance. Since 2002, the Ministry of Finance has sent proposals for performance indicators to the agencies, which they can alter before submitting them to the Ministry of Finance.

100. The Budget Office reviews these submitted indicators and goals to evaluate technical standards and to ensure 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 Congress.

101. The number of agencies taking part in this program has gradually increased. By the 2004 budget 132 agencies were participating and they produced a total of 1684 performance indicators (averaging 12.8 per agency). See Table 2 below for details on the total number of performance indicators produced between 2001-2004.

**Table 2. Number of Performance Indicators: 2001-2004<sup>11</sup>**

Functions	2001		2002		2003		2004	
	N°	%	N°	%	N°	%	N°	%
General	53	19%	82	15%	215	21%	318	19%
Social	113	41%	266	50%	500	48%	803	48%
Economic	109	40%	189	35%	324	31%	563	33%
<b>Total indicators</b>	<b>275</b>	<b>100%</b>	<b>537</b>	<b>100%</b>	<b>1039</b>	<b>100%</b>	<b>1684</b>	<b>100%</b>
<b>N° agencies</b>	<b>72</b>		<b>109</b>			<b>111</b>		<b>132</b>

102. These measures seek too evaluate performance on different dimensions include economy, efficiency, and effectiveness. They include process, output, intermediate outcomes, and outcome indicators. However, the vast majority of indicators are processes and outputs measures. (See Tables 3 and 4 below for details).

<sup>11</sup> Classified according to the Functional classification of Expenditure, Estadísticas de las Finanzas Públicas, Dirección de Presupuestos, Ministerio de Hacienda.

Table 3. Performance Indicators 2004: Function and Evaluation Dimensions<sup>12</sup>

Functions	Effectiveness	Efficiency	Economy	Service Quality	Total	(%)
General	170	45	56	47	318	19 %
Social	405	118	123	157	803	48 %
Economic	273	70	96	124	563	33 %
<b>TOTAL N°</b>	<b>848</b>	<b>233</b>	<b>275</b>	<b>328</b>	<b>1684</b>	
<b>%</b>	<b>50%</b>	<b>14%</b>	<b>16%</b>	<b>20%</b>	<b>100%</b>	<b>100 %</b>

Functions	Process	Output	Result			Total
			Intermediate	outcome	Total	
General	116	124	48	30	78	318
Social	224	394	122	63	185	803
Economic	173	261	117	12	129	563
<b>Total</b>	<b>513</b>	<b>779</b>	<b>287</b>	<b>105</b>	<b>392</b>	<b>1684</b>
	<b>30%</b>	<b>46%</b>	<b>17%</b>	<b>6%</b>	<b>23%</b>	<b>100%</b>

Table 4. Types of Performance Indicators in 2004

103. The 2002 budget included 537 performance indicators; these were reported on in the first quarter of 2003. In this second round of evaluating performance results the agencies reported on 73% of them, with a 69% compliance rate within a range of 95%-100% (See Tables 5 and 6).

<sup>12</sup>

Ibid.

Table 5. **Performance Indicators Reported on and Fulfilled in 2002**

Functions	Number of Indicators				(%)	
	Reported	Agreed Not reported	Total	Fulfilled	Reported/total	Fulfilled/Reported
General	52	27	79	37	66%	71%
Social	187	79	266	134	70%	72%
Economic	155	37	192	99	81%	64%
<b>Total</b>	<b>394</b>	<b>143</b>	<b>537</b>	<b>270</b>	<b>73%</b>	<b>69%</b>

Table 6. **Degree of Compliance, by Functions Classification 2002**

Degree of Compliance	Economic	General	Social	Total	%
95% - 100%	99	37	134	270	69
90% - 94%	14	6	16	36	9
89% - 80%	15	3	12	30	8
< 80%	27	6	25	58	15
<b>Total</b>	<b>155</b>	<b>52</b>	<b>187</b>	<b>394</b>	<b>100%</b>
<b>Percentage</b>	<b>39%</b>	<b>13%</b>	<b>47%</b>	<b>100%</b>	

### *Evaluations*

104. The Budget Office makes use of evaluations as an important tool for stimulating performance and assisting in resource allocation. Currently there are three types of evaluations, desk evaluations, impact evaluations, and comprehensive spending reviews. Since the establishment of the program in 1997, a total of 151 evaluations have been conducted, 145 desk evaluations and 10 impact evaluations. The annual public expenditure of programs that have been evaluated is approximately 27% of total governing spending. In addition, three Comprehensive Expenditure Reviews have been completed. The annual spending of these agencies is 4.5% of total governing expenditure.

105. An inter-ministerial committee oversees all evaluations. The members of this committee include representatives from the Ministries of the Presidency, Planning, and Finance. The National Budget Office is accountable for the execution of all evaluations.

106. The following process is used to conduct desk evaluations. The Ministry of Finance submits a proposal to Congress with the names of the programs and agencies it wishes to evaluate in the coming year. After the programs have been agreed with Congress, external consultants are chosen to conduct the evaluations through a process of public bidding. The consultants carry out evaluations based on a logical framework methodology and procedural guidelines established by the Management and Control Division. The evaluation reports contain results and recommendations which can vary from advice to eliminate the program to requests to introduce minor changes. Since the establishment of the program in 1997 the

agencies being evaluated have participate in the process by commenting on the intermediate and final reports, including the recommendations. Additionally, since 2000 the relevant agency and the Budget Office have officially agreed commitments to improve performance based on these recommendations.

107. The process is similar for impact evaluations with two notable differences. Another methodological approach is used and these evaluations are contracted out either to research institutions or universities rather than external consultancies. Since it involves more field research and data collection this type of evaluation is expensive and time consuming. Given these cost implications it tends to be used for programs which represent a large amount of public spending that have not been evaluated or for programs where previous desk evaluations have failed to reach conclusions on outcomes.

108. A comprehensive spending review evaluates a ministry or agency. This evaluation examines, the structure, functions, mission statement, objectives and strategic management and planning framework of the relevant ministry. It also examines if the ministry used resources in an economic, efficient, and effective manner.

109. All final evaluation reports are sent to Congress, publicized on the internet site and available in the Budget Office. The recommendations of the evaluations are discussed with the relevant ministry. The ministry agrees with the Budget Office commitments to implement these recommendations. These commitments are then incorporated into a formal agreement between the Ministry of Finance and the relevant ministry. They are monitored in subsequent years to ensure that they have been implemented.

110. The recommendations from the 71 programs evaluated between 2000-2003 have resulted in 25% of these programs introducing a major redesign of their programs or institutional changes, 38% underwent substantial design modifications to some components and/or internal management procedures and 26% have had to improve their information systems and make minor changes to management processes. In addition 11% of these programs were eliminated in the light of their results and/or because their objectives no longer responded to new requirements (see Table 7 for more details).

Table 7. Implementation of Evaluation Recommendations 2000-2003

Categories	Percentage of programs
<i>Minors Modifications</i> Programs requiring minor adjustments such as improvements of information, follow up and monitoring systems, fine-tuning some aspects of design and or internal management process.	26%
<i>Design Modifications of Some Components and/or Internal Management Procedures</i> Programs needing mainly design modifications to some components or activities and/or internal management processes. Among the most important are: review of focalisation criteria or methodological tools; improvements of information, follow up and monitoring systems; improvements of internal and external coordination among staff and/or agencies involved; improvements of management procedures in relation to financial transfers within the different level of responsibility with respect to the execution.	38%
<i>Major Program Reformulations and/or Institutional Re-location</i> Programs needing substantial reformulation or deep changes in design, internal management processes and/or re-location to other agencies, with the aim of adapting to new elements of diagnostic and or ensuring more coherence and better integration among lines of action.	25%
<i>Program Cuts</i> Programs which have finished their execution period, previously defined, or whose results no longer justify their budget allocation.	11%
<b>Total</b>	100%

111. In addition to the evaluation programs discussed above, the Ministry of Planning is responsible for Capital Projects Evaluations, formally known as the National Investment System. Since 1988 it has been a mandatory requirement that all investment projects must have an ex-ante evaluation. The Ministry involved in the investment project must submit an evaluation report to the Ministry of Planning for technical examination. Only if the evaluation is technically approved by the Ministry of Planning can the project be introduced into the budget proposal in the formulation stage.

#### ***Management Improvement Program (MIP)***

112. This program started in 1998 from an agreement with the public sector unions. It establishes a reward system for central government employees in which bonuses are determined by organizational performance. The program is similar to ISO in that it 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 their wider objectives and targets.

113. In 2001, when performance indicators were removed from the MIP and re-introduction into the budget, the MIP changed to focus on assessing progress in managerial systems. By 2004 these managerial systems included Human Resources, Quality of Customer Services, Planning, Control and Territorial Management, Financial Management, and Gender Focus. Each of these areas is divided into systems and progress against every system is measured in stages 1 through 4 or 1 through 6. By 2004, MIP functioned in 88 centralized agencies and 89 decentralized agencies.

114. This program operates in the following way: the Ministry of Finance prepares a general framework program including areas, systems and stages. This is discussed and approved by the inter-ministerial committee. This is sent to each agency who prepare their proposal according to the framework program, stating the overall stage in each system they wish to achieve by the end of the year. These proposed systems are submitted to the Ministry of Finance, where they are reviewed by a specialist network. The systems are then sent to the Inter-Ministerial Committee for approval. This committee consists of members from the Ministry of Interior, Presidency, and Finance. If the proposal is approved by the committee, agencies will issue a decree that sets out their new commitments for the coming year. This decree is issued by the relevant Ministry and approved by the committee.

115. In the following year, agencies produce an MIP report detailing their progress against management objectives. The report is certified by a specialist network and each agency's internal auditors check the results and. In 2002, 79% of agencies achieved 90-100% compliance with MIP objectives and total compliance with objectives reached 93%. When the agency meets 90-100% of its organizational objectives staff will receive 3% salary increase for the following year and achieving 75%-89% of objectives results in a 1.5% salary increase for the following year.

### ***Bidding Fund***

116. As discussed in Chapter 1, the bidding fund is a pool of unallocated resources to which ministries can submit bids either for new programs or to substantially extend or reformulate existing programs. Essentially the fund is a device for allocating new funds however, it is designed in a way that provides incentives for agencies to introduce formal performance indicators and targets.

117. Ministries submit bids in a standard format, which is based on a logical framework matrix. It incorporates the program's objective, main components, performance indicators, targets, target population, expected results, spending request, and its contribution to the relevant agency's overall strategic goals and outputs. The Ministry of Planning provides technical assistance to agencies in developing their matrix.

118. These bids are sent to the Ministry of Planning where they are reviewed and graded. They are then included in the relevant ministry's formal budget proposal. The Ministry of Finance makes a short list of programs taking into account the technical criteria and most importantly their relevance to government priorities. This list is sent to the President and it is part of the discussion on the total budget proposal. The President makes the final decision on which programs will receive funding. This process is described in more detail in Chapter I.

119. In the 2002 budget, 138 million US dollars was allocated to 126 programs. In 2003 budget, 116 programs received funding amounting to a total of 130.4 million US dollar, 90% of these resources were allocated to existing programs. Since the fund has been established, the number of new programs decreased from 61% in 2001 to 27% in 2003. This trend is explained by the fact that 2001 was the first budget of the new government who introduced its program priorities in this period. In all years more than 50% of resources were allocated to social functions.

120. Once programs have been selected, the Management and Control Division enters into discussions with the relevant agencies to decide which of the performance indicators and targets contained in their logical framework will be included in the information reports that accompany the budget bill. If the performance indicators are not of high enough standard to be included, the agency is required to work on developing satisfactory indicators during the course of the year.

121. In the subsequent financial years, if a program remains a high priority and performs well in terms of achieving results and developing relevant new indicators it will generally be included in the agency's baseline. As discussed in Chapter I, there was no bidding fund for the 2004 budget due to lack of resources. In terms of performance, the bidding fund helped to motivate agencies to introduce indicators for new programs, to extend indicators to existing programs, and when indicators already existed to attempt to improve them.

## **2. Performance Information in the Budget Process**

122. If performance information is to improve accountability and performance it is important that it be integrated into the budget process and used in decision making. This provides the opportunity to hold agencies accountable for results and to push them to achieve improvements in performance. In Chile, performance information is integrated into two stages of the budget cycle, the internal evaluation stage and the preparation stage.

123. Since 2001, performance information has been incorporated into the internal evaluation stage of the budget cycle. During this stage of the budget process, within the Ministry of Finance, the Budget Director, staffs from the Management Control Division and the relevant Budget Sector division, meet to assess each agency's annual progress. For each agency they discuss all financial and also performance information including progress against targets, results of evaluations, and the MIP. These meetings set the foundation and framework for the next stage of the budget cycle.

124. There are also separate meetings within the Ministry of Finance to discuss the results of evaluations. If the results and recommendations of these evaluations have consequences for allocation; decisions are taken in these meetings and discussed with agency heads at the preparation stage of the budget. If there are no implications for allocation, the results and recommendations are discussed with agencies after the Budget Bill has been sent to Congress. These discussions aim to develop a formal agreement on how the agency will implement the recommendations.

125. The preparation stage of the budget process, takes places after ministries have received their baseline and submitted their proposals to the Ministry of Finance. At this stage one on one technical committee bilateral meetings are held with the ministerial under-secretary, the head of each agency and relevant Budget sectoral division and staff from Management Control Division also participate. In each meeting, the relevant agency's budget proposal is discussed along with its past performance, proposed performance goals, and targets. There are several smaller meetings to examine the details of goals and targets.

126. The Ministry of Finance has developed a system, which integrates the results of evaluations and performance measures into the budget process. However, OECD experience demonstrates that the integration of the performance information into the budget cycle does not guarantee that it will be used in decision-making. It is a necessary rather than a sufficient condition for improving accountability for results and performance. In some OECD countries, this information has simply been ignored when it came to making decision about allocations.

127. The Chilean system of performance budgeting does not automatically and directly link performance to appropriations. It does not mechanically cut funding to programs that fail to meet targets or increase the

funding of programs that achieve results. The Ministry of Finance has in fact sought to avoid the mechanical association of budget allocations to performance measures.

128. Rather performance information is used in the budget cycle along with financial and other information as a starting point for discussions with agencies. Resulting from these discussions performance data has been used to confirm existing allocations or when results were poor various actions have been taken to push agencies to improve performance. These include new performance conditions being established and incorporated into the Budget law and/or agencies agreeing to modifications in their programs. These promises are reviewed in subsequent years to see if performance has been improved. Furthermore, in some cases funding to programs has been reduced due to continuous failure to achieve improvements and in a few instances programs have been eliminated.

129. In our view the Chilean approach to performance budgeting is a sensible one. It recognizes that it is often not possible to routinely reward good performance through the budget allocation process, but performance motivation is achieved through a carrot and stick incentive structures. The carrot comes from the MIP system discussed in section one it provides pay incentives for employees and teams to improve processes which will assist in achieving goals.

130. The stick comes from the view, expressed by line ministries interviewed for this study that the Ministry of Finance would reduce funding or even possibly eliminate programs if performance did not improve. In practice the elimination of programs is a rare course of action. However, the fact that this has happened in a few cases and that the Ministry of Finance has both the power and the willingness to take this action or to reduce funding, serves as an incentive for ministries to improve performance.

131. The Ministry of Finance has developed a high-quality system for integrating performance information into the budget process and successfully combined this with a realistic use of this information in decision-making.

### **3. Reporting on Performance to the Ministry of Finance**

132. The main mechanism used by line ministries to report to the Ministry of Finance on their performance is the Comprehensive Management Report. The 1997 Budget Law requires all agencies in central government to present information on their objectives, management targets, and results. This information is provided through the Comprehensive Management Reports, which all agencies are obligated to produce each year for presentation to Congress.

133. These reports are very wide-ranging and encompass the major activities and functions of the relevant agency. Each report includes the following items: a letter from the agency head, the laws and regulations that govern the agency, information on the agency's financial and human resources, and a detailed presentation of agency's performance results, this includes among others achievements against performance indicators, results of MIP goals and progress in implementing evaluation recommendations. Agencies' progress in implementing evaluation recommendations are reported on twice a year; in the Comprehensive Management report and also in July of each year.

134. The Comprehensive Management Report is produced in the first quarter of every year. The Management and Control Division, designs and sends to each ministry a standard format and structure for the report along with instructions. These instructions are produced by the Budget Office and the Ministry of the Presidency. Each ministry produces its report and sends it to the Budget Office, where it is reviewed and analyzed. The Ministry of the Presidency also reviews sections of these reports, which are relevant to its goals and priorities.



135. These results are analyzed, verified, and audited. Meetings are held with the Budget Office and the agencies for verification of the data and review of performance measures. Also the information databases and systems within ministries are audited by the Government General Internal Audit Committee. These audits are conducted on programs/agencies with a high public profile or on a random basis.

136. Since the re-introduction of performance indicators into the budget process there have only been two rounds of reviewing performance against targets. There are positive signs of improvement; however, there still are concerns about the quality of information provided, the linking of outputs to strategic goals, the provision of data against targets, and the timely provision of data. Given that agencies compete against their own past performance record it will take time to gather the necessary historical data to be able to gauge if the goals set are too high or too low and to monitor progress overtime.

137. There are also concerns about the technical capacities of individual ministries to develop performance indicators especially outcome measures and to monitoring progress against targets. Each ministry has to monitor and collect information from at least three if not four different performance programs and additionally provide information to the Ministry of the President on progress against goals. This gives rise to concerns about the ability of the ministries to co-ordinate the information from these different programs and to obtain and maintain the necessary data systems. Furthermore, it is unclear if managers and/or agencies use this performance information internally in making decisions on their programs or if it is just a reporting mechanism to the Ministry of Finance.

138. In the end the bounded nature of ministerial and managerial attention sets strict limits on the volume and complexity of performance information that will be properly utilized in decision-making. Having launched the performance reform, Chile like many OECD countries, will have to wrestle with how to select and prioritise the performance indicators and targets that most matter.

139. These issues are prevalent in OECD countries, where concerns have been expressed that performance management and budgeting runs the risk of becoming nothing more than a paper exercise. The Budget Office has sought to address some of these problems by including the development of management and planning system as one of the areas in the MIP program. It remains to be seen how this will progress.

140. It is too soon to predict if this revised system of performance indicators will prove effective however, despite the above issues the early signs are positive. The combination of evaluations and performance measurement provides strong mechanisms that enable the Ministry of Finance to hold agencies accountable for results, and provide instruments to motivate agencies to improve performance.

#### **4. Reporting on Performance to the Legislature**

141. The legislature receives information on the performance of agencies and programs from the Ministry of Finance in three different forms, the Comprehensive Management Reports, information on performance indicators, and reports from program evaluations.

142. Annually the Ministry of Finance sends a Comprehensive Management Report on each agency to the Budget Committee in Congress and relevant sub-committees. Performance indicators, targets, and goals are incorporated into the information reports sent with the Budget Bill to Congress. Progress against these targets and goals are included in the Comprehensive Management Report. The Budget Committee also receives final program and agency evaluation reports.

143. If the provision of this information is to improve accountability to the legislature it is important that Congress use it to hold the executive to account. The presentation of these reports is scheduled to ensure that the information is provided on time to be included in congressional debates on the budget.

144. Nevertheless, Congress has proven largely uninterested in examining performance information and using it in decision-making. It has demonstrated some limited interest in specific program evaluations. This is partly because Congress plays a role in the selection of programs to be evaluated. However, even in this area the attention given to the reports is sporadic and dependent on the political and media interest in the program evaluated.

145. Parliamentarians' lack of interest in performance information is common in OECD countries. The information executives consider important for management, is not necessarily the same that parliamentarians want for oversight control.

146. However, in the Chilean context this problem of lack of interest has been compounded by two factors. First, up until recently the Budget Committee was only in session for two months in the year and therefore, had little time to examine this information. Second the dominance of the Executive limits the ability of Congress to make decisions and to play any significant role in the budget process.

147. The first issue has been partly addressed, since July 2003 the Budget Committee has been running throughout the year. This provides more time to examine performance information and during interviews for this study the Budget Committee expressed an interest in doing this. The second factor reflects constitutional features, which are difficult to alter, although some internal process adjustments may prove useful.

## **Conclusion**

148. The Chilean Ministry of Finance has a highly advanced system for obtaining information on agency and program performance. Over a ten-year period, this system has been developed and adjusted to take account of lessons learned and changing demands. The Ministry has adapted performance systems to address problems, many of which are common within OECD countries and do not have easy or obvious solutions. Most importantly, the Ministry has proven willing to take a long time approach and to persist with performance programs.

149. Overall the Chilean performance system compares favorably with OECD countries especially in terms of the attention and priority given to performance information in the budget process. This system has combined the integration of performance information in the budget process with the sensible use of this information in decision-making.

150. If there is a weakness in the Chilean system, compared with the best of OECD systems, it is that the performance system is so heavily centralized. As a long term aim it would be desirable for agencies capacity to be built up so that they are a more equal partner in the decisions on indicators and measures.

151. Nevertheless, to date this is a success story. The key factor is the attention given by the Budget Director to performance information. This is reflected in his establishment of a separate unit, the Management and Control Division, the priority given to the use of performance information in the budget process, and the variety of different instruments reinforcing the performance idea. This strong role reflects the relatively unchallenged power of the Executive in the Chilean budget process. In an OECD context where, legislatures generally have a more powerful role, such a centrally directed process would not be feasible.